PROJECT FINANCE AND PRIVATIZATION: THE BOLIVIAN EXAMPLE

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I. INTRODUCTION

In recent years, many countries in the Third World and the former Eastern Bloc have moved from state ownership of various industries and natural resources to private ownership.[1] This move towards privatization, with the encouragement of foreign investment capital, is a dominant trend in the global economy.[2] In previous years, foreign involvement in natural resource development in statist economies came primarily in the form of loans granted to state-owned corporations.[3] Now those nations that once

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1. *See* J. William Gibson, *Trade Secrets: Industries and Business Seem to Cycle Naturally Between Government and Private Control,* DALLAS MORNING NEWS, Feb. 22, 1998, at 8J.

2. *See* Thomas Waelde, *International Energy Investment*, 17 ENERGY L.J. 191, 191–92 (1996), *available in* WESTLAW, Engy Database. In contrast to the nationalization of the energy sector in the 1970s, "ex-socialist countries are rushing into foreign investment as a panacea for their woes, and strongly entrenched state enterprises are being restructured and move towards privatisation." *Id.* at 191–92.

3. *See id.* at 191.

looked upon foreign ownership and development of their natural resources with disfavor have decided, because of a mix of economic need and a shift in political ideology, to allow foreign investment in their economies.[4] The national governments of these nations have redefined their role in the national economy from that of ownership and control to that of regulator and guarantor of a market framework, particularly in the oil and gas industry.[5]

One of the nations that has begun to move from statism to a free market framework is Bolivia.[6] Bolivia has chosen to embark upon a unique form of privatization, an ambitious program of "capitalization" that will be detailed in this Article.[7] This Article explores the economic and political backdrop of Bolivia's capitalization plans, discusses some specific players and events in this new economic order, and analyzes the present and future prospects for this system.

In this Article, the terms "privatization" and "capitalization" are used interchangeably when referring to the economic reforms in Bolivia. However, the terms are not exactly synonymous, particularly in comparison with privatization in other nations. The terms "liberal" and "liberalization" in the context of this Article refer not only to a move towards market economics, but also a move towards greater political freedom.

II. BACKGROUND

Bolivia is a landlocked country in central South America, southwest of Brazil.[8] Its land area is approximately 1,084,390 square kilometers, which is "slightly less than three times the size of Montana."[9] Bolivia's population is approximately 7,669,868 people, with an estimated growth rate of 2.04% per year and a labor force of 2.3 million people.[10] The country has four major ethnic groups: the *Quechua* (30%), the *Aymara* (25%), mestizo (mixed white and Amerindian ancestry, 25–30%), and white (5–15%).[11]

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4. *See id.* at 191–92.
5. *See id.* at 192.
6. *See* Jonathan Friedland, *Bolivian General's Election Comeback Unsettles Investors*, WALL ST. J., June 3, 1997, at A18.
7. *See id.*
8. *See CIA World Factbook* (visited Apr. 6, 1998) <http://www.odci.gov/cia/publications/factbook/bl.html>.
9. *Id.*
10. *See id.*
11. *See id.*

Bolivia has a republican form of government,[12] with democratic rule firmly established, and an essentially stable political system.[13] Bolivia, like many Latin American countries, was once plagued by military coups, but this instability ceased in the early 1980s.[14] The consistency between the policies of the previous elected governments and peaceful transfers of power added much to the stability and business climate of Bolivia, given Bolivia's previously turbulent history. Democracy was returned to Bolivia in 1982 under President Hernan Siles Suazo, one of the few Latin American leaders committed to liberalization at that time.[15] Austerity programs started by President Paz Estenssoro in 1985 and tax reforms based upon a cut in income taxes and introduction of a value-added tax are credited as helping to increase prosperity and economic stability.[16]

The current president, Hugo Banzer, governed Bolivia during the 1970s as a military ruler.[17] This fact, coupled with his populist political platform, concerned many foreign observers during his presidential campaign.[18] However, it appears that those concerns were exaggerated, and that President Banzer will not create radical changes that will disrupt the economic and political reforms implemented by previous administrations.[19] President Banzer states that he will not revise the contracts made with foreign investors, but will merely review them[20] to make sure that these firms have not created monopolies, which are forbidden under the Bolivian Constitution.[21]

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12. *See id.*

13. *See* Friedland, *supra* note 6.

14. *See Bolivia Lays the Groundwork to Become a Consumer Market,* MARKET LATIN AM., Nov. 1, 1996, *available in* 1996 WL 8913120 [hereinafter *Consumer*]; Friedland, *supra* note 6 (noting that Bolivia has had 190 government changes in its 188-year history).

15. *See Consumer, supra* note 14.

16. *See id.*

17. *See* Lally Weymouth, *Dictator Turned Democrat,* WASH. POST, Oct. 22, 1997, at A21; Friedland, *supra* note 6.

18. *See* Weymouth, *supra* note 17; Friedland, *supra* note 6. In addition, President Banzer irritated U.S. government leaders through his association with the Revolutionary Leftist Movement (MIR). *See id.* However, President Banzer responded to this criticism by stating that the MIR is no longer a leftist organization. *See id.*

19. *See* Friedland, *supra* note 6.

20. *See id.*

21. *See* Weymouth, *supra* note 17. In fact, President Banzer has stated that he, not former President Sanchez de Lozada, is the true father of Bolivian economic reform. *See id.* President Banzer points out that it was he who helped hire Harvard economist Jeffrey Sachs to help plan a way out of Bolivia's

There is good reason for optimism regarding this new administration. President Banzer is considered a "good democrat" in the eyes of the Bolivian people.[22] During his first 100 days in office, he called for a national dialogue to be conducted by all segments of Bolivian society to prepare Bolivia for the challenges of the next century.[23] In a nation such as Bolivia, which has a history of authoritarian governments that have often shown contempt for the views of the people, this was an important symbolic gesture. President Banzer has also formed a coalition government with various parties on the left.[24] If anything, the concern among Bolivian political observers is not that President Banzer will embark on risky political changes, but that he will not embark on new ambitious programs.[25] Despite this criticism, President Banzer has high ratings at this time in Bolivian opinion polls.[26] Also, these critiques of his policies miss an important point—President Banzer's conservative policies may be what is currently needed to consolidate the rapid changes and advancements that have occurred recently in Bolivia. This conservatism is far from a type of inaction. Instead, it is a wise policy that strengthens the foundations of the institutions necessary for long term economic and political liberalization.

While Bolivia is not an economic powerhouse,[27] its economic situation is improving.[28] Bolivia's gross domestic product (GDP) has grown at an annual rate of approximately

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inflation problems, that he merely wants to conduct privatization in a manner more favorable to the needs of the poor, and that he does not wish to re-nationalize industries or drive away foreign investment. *See id.*

22. Juan Carlos Rocha, *Bolivia-Politics: Banzer's 100 Days of Democracy*, Inter Press Serv., Nov. 18, 1997, *available in* 1997 WL 13257705.

23. *See id.*

24. *See id.*; Weymouth, *supra* note 17.

25. *See* Rocha, *supra* note 22.

26. *See id.*

27. *See CIA World Factbook*, *supra* note 8 (noting that Bolivia is one of the "poorest and least developed Latin American countries").

28. *See Blueprint for a "New Bolivia,"* LATINFINANCE, May 1, 1997, at S1, *available in* WESTLAW, Allnews Database. "Bolivia's key economic indicators are all headed in the right direction. Inflation has fallen, growth is rising and significant progress is being made over its debt burden." *Id.* The Bolivian investment climate has been described as "'excellent'" by Bolivian-American Chamber of Commerce President Charles Bruce. *See USA Still Bolivia's Best Customer*, SOUTH AM. REP., Mar. 1998, at 6, 7. "'You can have 100% ownership, and the Ministry of Foreign Trade and Investment will bend over backwards to help you. They're very understanding of investor needs.'" *Id. But see Big Economic Challenges Ahead*, SOUTH AM. REP., Mar. 1998, at 7, 7 (noting that Bolivia's trade deficit has grown and per capita GDP has shown only minimal increases).

4% in recent years.[29] Bolivia's 1996 inflation rate and public sector deficit were the lowest in at least twenty years, at 7.95% and 2.1% respectively.[30] International reserves, private bank deposits, bank portfolios, and goods and services production have experienced steady growth in the 1990s.[31] Foreign direct investment in 1996 was approximately US$540 million, compared to US$35 million in the late 1980s; Bolivia's 1996 ratio of foreign direct investment to GDP was higher than that of any other Latin American country.[32]

Bolivia's energy situation is as follows. Bolivia has proven oil reserves of 131.9 million barrels, and its oil production in 1995 was 38,000 barrels per day.[33] Oil consumption in 1995 was 31,000 barrels per day, and Bolivia's crude oil refining capacity at the beginning of 1996 was 45,000 barrels per day.[34] Bolivia's natural gas reserves are estimated at 4.5 trillion cubic feet, with natural gas production in 1995 at 113.4 billion cubic feet.[35] Domestic natural gas consumption in the same year was 43.4 billion cubic feet.[36] As the previous statistics show, Bolivia has rich energy resources that have not been completely tapped.

The state oil and gas company, Yacimientos Petroliferos Fiscales Bolivianos (YPFB), was the largest of Bolivia's state

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29. *See Bolivia: Americas Review 1998*, AMER. REV. WORLD INFO., Mar.1, 1998, at 14, *available in* WESTLAW, Allnews Database. It is estimated that approximately 3.1% of Bolivia's 1996 GDP came from the drug trade. *See* Juan Carlos Rocha, *Drugs—Bolivia: Countdown to the End of Coca Plantations*, Inter Press Serv., Jan. 23, 1998, *available in* WESTLAW, Allnews Database. Bolivia is the world's second-largest producer of coca leaf, and the cocaine trade is a major source of income to many peasants. *See id.*; *CIA World Factbook, supra* note 8. Cocaine production is legal when the leaves are used for traditional purposes (tea, chewing), but not "surplus uses"—namely the production and transportation of coca to create illegal narcotics for export. *See* Melanie R. Hallums, *Bolivia and Coca: Law, Policy, and Drug Control*, 30 VAND. J. TRANSNAT'L L. 817, 822–27 (1997). U.S.-backed eradication projects have led to increased anti-American sentiment in the cocaine producing areas. *See id.* at 861. However, the drug trade has not dissuaded foreign investment. *See, e.g.*, *Blueprint for a "New Bolivia," supra* note 28 (noting that Bolivia has a higher foreign investment-GDP ratio than any other Latin American nation).

30. *See Blueprint for a "New Bolivia," supra* note 28.

31. *See id.*

32. *See id.*

33. *See Bolivia*, U.S. ENERGY INFO. ADMIN. (last modified Sept. 19, 1997) <http://www.eia.doe.gov/emeu/cabs/bolivia.html>.

34. *See id.*

35. *See id.*

36. *See id.*

monopolies.[37] Bolivia's capitalization of YPFB has catapulted Bolivia to the forefront of Latin American privatization in recent years.[38] It is widely believed that Bolivia has huge untapped potential as an energy producer and transportation hub; this fueled foreign interest in YPFB's privatization.[39] It is also believed that Latin America's natural gas market is likely to grow at a tremendous rate and that Bolivia's location near the geographic center of South America places it in an excellent position to benefit from this expanding market.[40] David Nagel, a senior vice president of Amoco Corporation, has estimated that natural gas demand in South America is likely to at least double by 2010, with a commensurate expansion of pipeline networks.[41] Given Bolivia's natural resources and strategic location, changes in its energy industry have ramifications throughout South America, and are of great interest to foreign investors and nations.

III. PRIVATIZATION IN BOLIVIA AND ELSEWHERE

Often the term "privatization" refers to the outright sale of state-owned industries to private owners.[42] This is done for various reasons: to raise revenue for the government (particularly if the government is running a high budget deficit), to increase efficiency by exposing the industry to market discipline, and to reduce the government's role in the national economy.[43] Governments also privatize industries to provide for a wider share of ownership, to introduce greater competition, and to raise investment capital.[44]

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37. *See* Sally Bowen, *Sally Bowen Charts the Progress of an Alternative Privatisation Programme Now at Its Half-Way Stage: Bolivia Wins Applause for Its Capital Idea*, FIN. TIMES, Nov. 15, 1995, at 8, *available in* WESTLAW, Allnews Database.

38. *See* Ricardo Hausmann, *Latin America Reaping Rewards of Privatization*, HOUS. CHRON., Dec. 17, 1996, at A23. Bolivia became the regional leader in privatization in just one year. *See id.*

39. *See* James v. Derrick, Jr. & Robert H. Walls, Jr., *Natural Gas and Electric Markets in South America, in* ENERGY LAW AND TRANSACTIONS, 164-2, 164-19, 164-21 (1997).

40. *See Expanding Natural Gas Markets Top Industry Agenda in Latin America*, OIL & GAS J., Nov. 13, 1995, at 25, *available in* 1995 WL 13457362.

41. *See id.* at 27–28.

42. *See* Andrei Baev, *Is There a Niche For the State in Corporate Governance? Securitization of State-Owned Enterprises and New Forms of State Ownership*, 18 HOUS. J. INT'L L. 1, 10 (1995); Waelde, *supra* note 2, at 196.

43. *See* Diane Preston, *Privatization of Energy in Argentina and Brazil: A Roadmap for Developing Countries*, 48 ADMIN. L. REV. 645, 647, 652 (1996).

44. *See Privatization and Globalization of Energy Markets* (visited May 28, 1998) <http://www.eia.doe.gov/emeu/pgem>; *cf.* Preston, *supra* note 43, at 652 (noting that the impetus behind the Argentinean privatization of the gas

These reasons for privatization are particularly salient in the Latin American energy context. The history of state-owned Latin American energy companies was not always one of failure.[45] Originally, state-owned companies helped stabilize and safeguard the general economic and energy needs of their respective nations, and were a large source of funds for the state, both from energy sales and as a conduit for loans from multilateral organizations and banks.[46] The debt and inflation crises of the 1980s destroyed this framework, and inefficiencies within the firms and high fiscal deficits led to a push towards privatization.[47] Shifts in the ideology of the political leadership and the realization that the state did not have an advantage in information as compared to the private markets (in fact, the state's access to information might be worse), also contributed to the privatization push.[48]

There are many different types of privatization, which lie on a continuum from outright sale and divestiture of nationalized industries to simple deregulation and outsourcing of certain tasks to the private sector.[49] Sale and divestiture deals can be done either via public sale or private placement of shares, or through total or partial sale of shares or assets.[50] The extent that foreign investors are allowed to participate in the privatization process, and the extent that the government of the host country retains some degree of control of the privatized industry, also varies from place to place.[51] The retention of certain powers and controls by the state, particularly the ability to outvote or veto all other

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industry was to increase efficiency, encourage private capital contributions, determine the government's role in the industry, and guarantee that benefits were passed to consumers).

45. *See* Preston, *supra* note 43, at 645.

46. *See id.* at 646.

47. *See id.*

48. *See id.* at 647.

49. *See id.* at 649–51 (noting factors in selecting privatization methods); Baev, *supra* note 42 (noting the most common methods of privatization).

50. *See* Baev, *supra* note 42, at 8.

51. *See, e.g.,* Preston, *supra* note 43, at 649–51 (describing government motivations behind privatization strategies). For example, Argentina, rather than transferring power, decreased its power in public enterprises through the execution of leases, licenses, joint ventures, or private contracts. *See id.* at 650. However, in the oil and gas industry, Bolivia contracted out previously public entities to private ones. *See id.* Governments circumvent full transfers of power to avoid prohibitions against sale, allow efficiency increases without interrupting business operations, and gain support when privatizations are not favored in that country. *See id.* at 651.

shareholders, a scheme termed the "Golden Share,"[52] is a matter of particular concern to strategic investors.

Golden Shares tend to be created when the privatized industry is one that is considered a strategic industry, such as energy.[53] Veto power tends to scare off investors; therefore, Golden Shares are uncommon in privatization deals.[54] Bolivia has no Golden Share in the capitalization arrangement to be discussed.

It is no small feat to structure privatization deals. Too low of a sale price can lead to complaints that the government is giving away national assets to foreigners.[55] Also, creation of the proper post privatization regulatory regime is key for the government to achieve its goals, such as increased competition. For example, trading a public monopoly for a private one can undermine efficiency goals.[56]

Individual private power projects in developing nations typically take one of two forms. The project may be conducted on a Build-Own-Operate basis, in which the developer builds the plant, owns the plant, and sells the energy to the nation's public utility.[57] Another method is the Build-Own-Operate-Transfer method, in which the developer builds, owns, and operates the project, but eventually transfers ownership of the plant to the public utility.[58]

In any private power project, the central contract is called the power purchase agreement (PPA).[59] The PPA creates the revenue stream upon which investment returns are realized and financing is obtained.[60] While the details of PPAs vary, generally a pricing system is set up, pegged to the production capacity of the project, and the structure of payment is designed to protect all parties from large fluctuations in cost and price.[61] The developer is normally responsible for obtaining financing.

Bolivia's capitalization system entails the following. Capitalization is a form of privatization in which the sale

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52. Baev, *supra* note 42, at 20.
53. *See id.* at 32.
54. *See* Telephone Interview with Mario Yzaguirre, President of Enron Mexico Corporation (Feb. 26, 1997).
55. *See* Preston, *supra* note 43, at 648.
56. *See id.* at 649–50.
57. *See* William M. Stelwagon, *Financing Private Energy Projects in the Third World*, 37 CATH. LAW. 45, 49 (1996).
58. *See id.* at 49–50.
59. *See id.*
60. *See id.*
61. *See id.*

proceeds stay with the company to finance future investment.[62] For example, if the previously nationalized industry has a market value of US$100 million, an investor would pay US$100 million into the company, making it worth US$200 million.[63] This payment provides working capital for the capitalized firm, and the government shares in the capitalized company will be distributed to the Bolivian people in the form of shares in a government pension fund.[64] Doing so helps solve the shortage of working capital that sometimes afflicts privatized firms, and helps allay popular fears and resentment of privatization.[65]

The step-by-step series of events in Bolivian capitalization is as follows. The legal status of the nationalized industry is changed into a mixed capital company that allows private sector investment.[66] Then the employees are allowed an opportunity to obtain some of the shares of the company.[67] Next, the government carries out an international bidding process for 50% of the shares in the new company.[68] The winner of the bidding obtains management control of the company, and uses the bid amount to capitalize the new company.[69] The full bid amount must be invested in the new company, without allowing the owner access to this money, via dividends, for seven years.[70] The remaining 49% of the shares are distributed over this period to the Bolivian people in the form of privately managed pension funds.[71] Once the shares are transferred, the company reverts to a joint-stock company under the control of the private investor.[72]

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62. *See* Andrew Ewing & Susan Goldmark, *Privatization by Capitalization*, PUBLIC POLICY FOR THE PRIVATE SECTOR (last modified Nov. 1994) <http://www.worldbank.org/html/fpd/notes/31/Ewing31.html>.

63. *See id.*

64. *See id.*; Derrick & Walls, *supra* note 39, at 164-16–17.

65. *See id.*

66. *See id.* at 164-16.

67. *See id.* (noting that the maximum value of shares an employee can obtain equals the value of their accrued employee social benefits).

68. *See id.*

69. *See id.*

70. *See id.* at 164-16–17.

71. *See id.* at 164-17 (stating that the capitalization program is "designed to create a retirement system for the Bolivian people and to encourage long-term private investment in Bolivia," rather than increase state spending).

72. *See id.* Present and future Bolivians will not have access to government capitalization funds or pensions. *See id.* The plan is designed to foster "long-term investment of private capital and management skills." *Id.* It has been perceived as an example for future privatizations in South American countries and elsewhere. *See id.*

As Gonzalo Sanchez de Lozada was preparing for his presidential campaign for Bolivia's 1993 elections, he was confronted with popular pressure for faster tangible results.[73] Although the economy was stable, it was not growing. Privatization appeared an obvious answer.[74] But Sanchez noticed the problems plaguing other privatizations.[75] For example, East Germany's leveraged buyout based privatization left little working capital for the enterprise.[76] With this problem and the local suspicions of privatization in mind, he created his capitalization policy and made it a centerpiece of his victorious presidential campaign under the slogan *Plan de Todos*, which means "plan for everyone."[77] Capitalization under the *Plan de Todos* is not limited to the energy sector.[78] Telecommunications, electricity, railways, airlines, and some mining activities have been or will be capitalized.[79]

The focus of this Article, the capitalization of YPFB (specifically, the transportation unit of YPFB), is the largest of the capitalizations and the most politically volatile.[80] YPFB is to be divided into three units: an upstream exploration and production unit, a transportation unit, and a refining and marketing unit.[81] Each unit will consist of one or more companies, of which 50% of the capital of the new companies will be purchased by private entities from other countries.[82] The post-capitalization Bolivian energy industry will be governed by the new Hydrocarbons Law, which will be the new regulatory structure for the oil and gas industry.[83] The

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73. *See* Ewing & Goldmark, *supra* note 62.
74. *See id.*
75. *See id.*
76. *See id.*
77. *See id.*
78. *See id.*
79. *See id.* Capitalization is not the first move Bolivia has made towards economic reform. Bolivia has allowed joint venture and concession projects in recent years. For example, Exxon has completed exploratory seismic studies, and Enron entered into a joint venture with YPFB to build the Bolivian section of a Bolivia-to-Brazil natural gas pipeline. *See Privatization and Globalization of Energy Markets, supra* note 44; *infra* Part V.
80. *See* Derrick & Walls, *supra* note 39, at 164-20.
81. *See id.*
82. *See id.* For example, a consortium of YPF S.A., Perez Companc S.A., and Pluspetrol S.A. paid approximately US$264 million for 50% of one of the exploration and production companies, Empresa Petrolera Andina S.A. *See id.* The other exploration and production company, Empresa Petrolera Chaco S.A. was purchased by Amoco Bolivia Petroleum Company, which paid approximately US$307 million for their 50% interest. *See id.*
83. *See id.*

overall regulatory system, governing electricity, oil and gas, and other infrastructure related markets, called the Sectorial Regulatory System (SIRESE), will be an entity within the executive branch of the Bolivian Government.[84]

The Bolivian capitalization plan differs from the privatization methods of other nations.[85] For example, Argentina has also embarked on a policy of privatization, one that is considered a leader in Latin America.[86] While there had always been a small amount of private sector participation in the Argentine energy industry,[87] the state traditionally was at the center of oil and gas exploration and production, via the state-owned oil company, Yacimientos Petroliferos Fiscales (YPF) and the gas company, Gas del Estado (GdE).[88] Argentina began its first steps toward comprehensive privatization of its energy industries in the mid-1980s.[89] In 1985 the Argentine government initiated the "Houston Plan," in which private firms were allowed to bid for rights to explore and develop energy resources in Argentina under a system of development concessions and joint ventures.[90]

The Houston Plan was a success, and, as a result, by May of 1992, US$330 million had been invested in Argentine oil and gas properties.[91] Argentina moved towards increased deregulation and more joint venture projects during the late 1980s and early 1990s.[92] This progression from exploration and development concessions to joint ventures and production associations to the outright sale of formerly state-

84. *See id.* at 164-19.

85. *See id.* at 164-16 (contrasting Bolivia's capitalization to the privitizations of Argentina and Brazil).

86. *See id.* at 164-11.

87. *See* Daniel A. Bianchi, *Privatization of the Oil and Gas Industry in Argentina - A Model For Latin America?,* 39 ROCKY MTN. MIN. L. INST. 17-1, 17-12 (1993).

88. *See* Rogelio N. Maciel, *Argentina: Privatisation of the Natural Gas Industry*, J. ENERGY & NAT. RESOURCES L. 371, 371–72 (1992); Bianchi, *supra* note 87.

89. *See* Maciel, *supra* note 88, at 372.

90. *See* Bianchi, *supra* note 87, 17-14–15. Privatization was accomplished via "service contracts" that included "take-or-pay commitments and tax stabilisation clauses." Maciel, *supra* note 88, at 372. There were 76 of these contracts from 1985–1990, prior to the announcement of a more comprehensive privatization plan passed by the Menem administration in 1991. *See id.*

91. *See* Bianchi, *supra* note 87, at 17-14.

92. *See id.* at 17-14–15.

owned properties has been a boon to Argentina's energy sector, increasing both investment and production.[93]

Argentina's new system of privatization and deregulation has moved away from the protectionist system of its past[94] to one in which there is largely open access and nondiscriminatory treatment of producers and transporters of energy, regardless of their nationality.[95] In particular, YPF transferred most of its oil reserves to the provincial governments, auctioned many other assets, and reorganized its marketing, operating, and services procedures.[96] YPF then sold approximately 50% of its equity in the world's financial markets, raising US$3 billion.[97] As a result of these restructurings, YPF has become an international player in the energy industry, as evidenced by its acquisition of the U.S. company, Maxus Energy, for US$743 million.[98] YPF expects natural gas production to rise by 150% between 1994 and 2004, and plans to undertake further expansions.[99]

As the Argentine example shows, privatization and deregulation can be beneficial both in terms of investment and expansion. However, it differs from the Bolivian model. Argentina had a more advanced and established energy industry,[100] tended to move slowly in its reforms, and did not take on an experimental plan, such as the Bolivian capitalization. Argentina also used regional decentralization as part of its privatization,[101] while Bolivia has chosen to divide the industries into component parts and sell them off.[102] Also, Bolivia has used privatization as a method to fund future social programs,[103] while Argentina allocated the

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93. *See id.* at 17-10–20.

94. *See id.* at 17-12.

95. *See* Derrick & Walls, *supra* note 39, at 164-7.

96. *See id.* at 164-8.

97. *See id.*

98. *See id.*

99. *See id.* at 164-9. Companies in the Argentinean market are ideally situated to undertake further expansions in Argentina and other South American countries because Argentina had a well-developed oil and gas market prior to privatization. *See id.* There are approximately 100 companies in the upstream and downstream oil and gas markets. *See id.*

100. *See id.* at 164-9.

101. *See id.* at 164-8.

102. *See id.* at 164-20 (noting the split of YPFB into exploration and production, marketing and refining, and transportation units, and the sale of 50% ownership to private entities).

103. *See id.* at 164-17.

funds for government use.[104] Argentina is more of a classic privatization, and while its example is instructive, it should not be assumed that its successes (or failures) will be matched by Bolivia, given the differences.

IV. PROJECT FINANCING AND DEVELOPMENT

The stakes in energy privatization, particularly in Bolivia, are high. Millions, if not billions, of dollars can ride on a single deal. The scramble for corporate dominance has been described as a 1990s version of Rudyard Kipling's *Great Game*, with energy corporations, rather than imperial powers, jockeying for position.[105] The access routes between oil and gas fields and major cities in Latin America are key points for long term positioning and advantage.[106] Barry Adams, President of British Gas's Brazilian operation, says that "[p]ipelines mean position, position for the next [forty] years."[107] The fact that energy companies in recent years have become much more integrated and international has accelerated change: companies that were once exclusively oil and gas firms have entered into electricity, and companies that were once regional players have become international, thereby increasing the number and sophistication of possible players in the new economic order.[108]

Given the stakes and long term ramifications involved, strategic investors, particularly foreign ones, have certain key concerns that must be dealt with to have a successful project financing and development plan. Various factors must be considered in a wise bidding strategy and long term operational plan.

First, the strategic investor must carefully evaluate how much the local government is asking for ownership or development rights in the project, and then compare this with the degree that outside parties value the project. Legal concerns such as local tax policies are also important in setting the proper valuation.[109] Unfortunately for investors,

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104. *See id.* at 164–5 (noting the purpose of privatization was to reduce the public debt and improve public services).

105. *See* Jonathan Friedland, *In This "Great Game" No Holds Are Barred*, WALL ST. J., Aug. 14, 1996, at A7.

106. *See id.*

107. *Id.*

108. *See Privatization and Globalization of Energy Markets, supra* note 44.

109. *See* Larry Luxner, *Privatization Fever Sweeps Latin America*, AREA DEV., Nov. 1995, at 83, 85; *see also* Waelde, *supra* note 2, at 201 (noting that the imposition of new taxes may interfere with contract provisions in production sharing agreements, contrary to contractually-stipulated stabilization clauses).

national tax policies, which have a great impact on energy development projects, are generally structured towards maximizing the host government's share relative to the investor, rather than maximizing the total income and productivity of energy extraction.[110]

Another legal and regulatory issue of increasing importance is environmental protection. While the debate between environmental protection and energy production in developing nations is generally won by energy production, there is a growing view that environmental protection is a relevant commodity that must enter any calculation.[111] Environmental consciousness can manifest itself in both local opposition to development and pressure on companies from their own governments and investors.[112] As a result, covenants regarding environmental issues have become part of the boilerplate and substantive provisions of development contracts.[113]

According to one commentator, when it comes to regulatory issues like taxes and environmental law, unless something is set a particular way in the host nation's constitution, anything is conceivably negotiable.[114] During negotiations, tax waivers and subsidies can be agreed to, and while "getting to yes" is no easy feat, the general legal regime

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110. *See* Waelde, *supra* note 2, at 194.
111. *See id.* at 203–04.
112. *See id.* at 203–06.
113. *See id.* at 205–06. Environmental clauses often contain the following clauses:

> (1) Restriction of off- and onshore oil exploration to areas not used for touristic purposes;
> (2) Obligation to submit a separate environmental impact statement using recognized independent environmental expertise;
> (3) Setting-up of environmental responsibilities within the operator's internal organization;
> (4) Obligation to submit bonds/guarantees for environmental liability (in particular offshore oil spillage) and to include limited environmental liability in mandatory insurance coverage;
> (5) Obligation to carry out periodic environmental audits or to allow the government agency to arrange for an independent environmental audit evaluating compliance with environmental obligations, best environmental practices and standards, identify major environmental risk and the "at any time" most effective/efficient risk mitigation and disaster management programmes[; and]
> (6) Obligations to restore areas used for exploration and extraction to a safe state, in particular to comply with international guidelines for abandonment of offshore installations.

Id.

114. *See* Yzaguirre, *supra* note 54.

often acts as more of a default rule than an iron-clad system that cannot be changed for the purposes of the particular deal.[115] These government assurances are pivotal in providing comfort for lenders and investors in the project.[116] However, the degree to which things are negotiable depends on the size of the project and the importance of the project to the host country's government. Not every issue can be waived or negotiated away,[117] particularly in the case of smaller projects.[118] It appears that while much is negotiable, the extent to which that actually occurs depends on the leverage of the parties in a given situation.

Further, the degree of control exercised over the project by the investor is an issue of concern. This not only involves Golden Share situations, in which the host government retains a veto bloc of shares, but also the general regulatory and political environment. In a related matter, the restrictions (or lack thereof) on the use of the investor's funds by the new company is another issue the investor would want answered.[119]

An investor must also consider cultural issues. Nationalist passions may be inflamed by foreign investment, particularly if the investors are American. Also, particularly in regard to infrastructure or energy projects, many state-owned industries were historically run for political ends, and kept costs artificially low.[120] Investors must be willing to take some criticism regarding "sticker shock" if prices rise and the local populace becomes upset.[121]

Investors must also consider commercial and political risks in the calculation. Commercial risk factors include the

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115. *Id.*

116. *See id.*; *cf.* Waelde, *supra* note 2, at 207–08 (noting that in the United States, Middle East, Far East, and parts of Africa, contracting between the government and companies "helps to insulate the conditions agreed upon from the reach and interferences of subsequent legislation, and mobilized the 'sanctity of contract' to protect foreign resource investment in international arbitral tribunals").

117. *See* Waelde, *supra* note 2, at 208. It is not uncommon to encounter "coerced, renegotiation and cancellation of contracts" by the government. *Id.* However, in most cases the government uses its legislative powers sparingly and regularly consults with the industry. *See id.* Therefore, the contract may provide more "psychological than legal comfort." *Id.*

118. *See* Telephone interview with John Novak, Partner, Gibson Dunn & Crutcher, L.L.P. (Mar. 16, 1997).

119. *See* Ewing & Goldmark, *supra* note 62.

120. *See id.*

121. *Cf.* John Ale, *Capital for the Emerging World*, HOUS. BUS. REV. 93, 93–94 (1996) (noting that governments often cover the resultant real costs of privatization by raising utility prices).

size and growth of the customer base and the degree of competition.[122] Another factor is how and when the project is to pay for itself.[123] There are other questions that a strategic investor would want answered, such as whether the revenues will be paid in American or local currency.[124] If local currency is to be used, strategic investors will want to know whether the currency is convertible, and which party will set the rate of exchange.[125] One must calculate evaluation risks, which are harder to shift to political risk insurers than other problems.[126]

Force majeure risk, while a matter of concern with any business deal, takes on a particular significance in less developed countries. Terrorism and civil unrest are often more common in developing countries than in developed countries, and the stoppage of production by "political force majeure" is a major issue in political risk analysis.[127] Force majeure protections can be "the biggest heartache" in structuring a deal, especially in a nation that sees unrest as an ever present possibility and does not want to force itself into a contractual box if unrest occurs.[128] However, force majeure provisions must be spelled out with appropriate detail, lest investors and lenders be frightened off by the level of risk.[129]

Last but certainly not least, strategic investors would want to know the danger of expropriation and re-nationalization of the project property.[130] The extent that trustworthy guarantees against such expropriation can be offered to lenders and investors affects the willingness of parties to enter into the business arrangement. In practice, change of law protections are negotiated for and written into the contract to deal with changes such as expropriation, or

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122. *See* Stelwagon, *supra* note 57, at 51. Other factors include the acquisition costs of project locations and services, the ease of obtaining licenses and permits from the relevant country, currency convertability and exchange controls, and the ability to obtain commercial and political risk insurance. *See id.*

123. *See* Ale, *supra* note 121, at 97.

124. *See id.*

125. *See id.*

126. *See* Stelwagon, *supra* note 57, at 57.

127. *Id.* at 62. Force majeure risks include war, terrorism, and natural and technical disasters. *See id.* This risk can be countered through insurance covering asset loss, business interferences, and the construction and operations phases of the project. *See id.*

128. *See* Yzaguirre, *supra* note 54.

129. *See id.*

130. *See* Ale, *supra* note 121, at 97.

less radical changes, such as shifts in tax law. These protections are necessary for any deal and are a major sticking point in the typical negotiation.[131]

Aside from the factors in the host nation itself, a strategic investor must weigh financing options. As stated, the sums of money required to successfully finance and develop a large scale energy privatization are huge. While some companies can finance the transaction with their own funds, choice or necessity often brings in outside financing.

Project finance has become a major field in law and business as a response to these needs for funding, and the possibilities for risk spreading by bringing in many parties (including lenders and multilateral institutions) have further encouraged the development of project finance.[132] The internationalization of energy markets and firms, and the global privatization trend, has encouraged many lenders and investors that previously stayed away from international energy development deals to enter the game.[133] Project financing is generally nonrecourse, which means that investors can only secure against the assets of the project itself, and the return on investments comes from the cash flows of the project.[134] This situation further creates the need for proper mitigation and allocation of risk.[135]

There are many possible outside sources of debt and equity for financing. Multilateral agencies and export credit banks provide funding for projects in some cases.[136] The most important multilateral is the World Bank Group, which consists of the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA).[137] The IBRD is the section commonly referred to as the World Bank. Aside from funds, the various subdivisions of the World Bank Group provide technical assistance, policy

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131. *See* Yzaguirre, *supra* note 54.

132. *See* John P. Cogan, Jr., *Case Study: Upstream Oil & Gas Projects*, *in* PROJECT FINANCING IN EMERGING MARKETS 1996, at 229, 231–32 (PLI Commercial Law and Practice Course Handbook Series Order No. A4-4511, 1996).

133. *See id.*

134. *See* Stelwagon, *supra* note 57, at 47–48.

135. *See id.* at 48.

136. *See* Ale, *supra* note 121, at 94.

137. *See* Thomas A. Duvall, III, *World Bank Support for Private Sector Projects*, *in* PROJECT FINANCING IN EMERGING MARKETS 1996, at 243, 245–46 (PLI Commercial Law and Practice Course Handbook Series Order No. A4-4511, 1996).

consultation, and policy analysis for member nations.[138] These institutions often will take risks that private actors will not take because they are chartered to help develop the economies of emerging nations and promote international trade.[139]

The goals of multilaterals give them different perspectives and risk concerns than private actors that seek short term profits. Multilaterals can act directly as lenders or they can guarantee debt advanced by private lenders.[140] The problem is that these institutions can be difficult to negotiate with, place tight constraints on the project owners, and have limited funds.[141]

Similarly, various governments set up export-import banks and other bilateral organizations to spread risk and to encourage lending for domestic and foreign policy objectives as well as profit. The Overseas Private Investment Corporation (OPIC) and the U.S. Export-Import Bank are two

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138. *See id.* at 48. This assistance includes providing specialists in the areas of survey development, fiscal and economic problems, planning development programs, project appraisal, and asset and liability management techniques. *See id.*

139. *See id.* at 51–52.

> The basic purpose of the World Bank is to promote economic and social progress in developing nations by helping raise productivity so that their people may live a better and fuller life. The purposes of IBRD as stated in its Articles of Agreement include:
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> (i) to assist in the development of territories of members by facilitating the investment of capital for "productive purposes";
> (ii) to promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources; and
> (iii) to promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.
>
> IDA has a similar development mandate under its Articles of Agreement, but focuses its assistance on relatively poorer nations that do not qualify for IBRD loans.

Id.

140. *See* Ale, *supra* note 121, at 95.

141. *See id.*

institutions of great importance to American firms.[142] OPIC is an independent U.S. government-owned corporation, which provides insurance and financing for U.S. firms seeking to invest in developing nations.[143]

OPIC was founded (under a different name) during the Marshall Plan as an arm of the State Department.[144] OPIC was formed as an independent agency in 1971.[145] OPIC provides insurance covering currency inconvertibility and financial transfer, expropriation, and political violence risks.[146] OPIC's purpose is to promote and facilitate investment of U.S. capital and skills in developing nations.[147] It is not a concessionary agency, and does not give cut-rate loans or subsidies to U.S. companies.[148]

OPIC is self-sustaining, and operates both as an insurance company and a bank for loans.[149] OPIC must make a profit to survive, and it does not receive any money from the U.S. treasury.[150] It earns income by charging insurance premiums, interest on its direct loans, and guaranty fees on OPIC-guaranteed loans.[151] Its government backing comes from the fact that the U.S. government gives full faith and credit to OPIC's obligations.[152]

OPIC has accumulated reserves of at least US$2.4 billion.[153] George Muñoz, President and CEO of OPIC, states that OPIC is conservative and market-driven in its strategy, and while occasionally a loan or insurance agreement will not go as planned, OPIC has never been in the red.[154] The U.S. Export-Import Bank provides similar support to insure the

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142. *See* Stelwagon, *supra* note 57, at 66–67.
143. *See id.* at 66.
144. *See* Ana-Mita Betancourt, *OPIC Political Risk Insurance for Infrastructure Projects in Emerging Markets*, *in* PROJECT FINANCING IN EMERGING MARKETS 1996, at 179, 182 (PLI Commercial Law and Practice Course Handbook Series Order No. A4-4511, 1996).
145. *See id.* at 183.
146. *See id.* at 182.
147. *See id.* at 181.
148. *See* Telephone interview with George Muñoz, President and CEO of OPIC (Dec. 27, 1997); *see also* Maura B. Perry, *A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation*, 36 VA. J. INT'L L. 511, 514 (1996).
149. *See* Betancourt, *supra* note 144, at 181, 182.
150. *See id.* at 181
151. *See id.* at 182.
152. *See id.* at 181.
153. *See id.*
154. *See* Muñoz, *supra* note 148; Perry, *supra* note 148, at 514.

sale of U.S. goods to foreign parties, and can cover foreign lenders ineligible for OPIC programs.[155]

Aside from its economic activities, OPIC is also an arm of U.S. foreign policy.[156] OPIC requires human and labor rights contractual agreements from the investors it deals with, as well as certain environmental protections.[157] OPIC only operates in countries that have established a bilateral agreement with the United States as to the operations of OPIC.[158] OPIC makes agreements with individual nations, and requires that OPIC not be treated like a typical bank or insurance company (*i.e.*, OPIC is not subject to local host country banking or insurance regulations); that OPIC has a right to oversee projects; that international arbitration be used to settle any disputes; and that OPIC not be taxed.[159] If a nation breaks the agreement, OPIC may suspend operations, but all of the existing insurance and financing remain in place.[160]

Multilateral and bilateral organizations have an important role in project finance and lesser developed nations.[161] Multilaterals and bilaterals have an "appetite for political risk" that commercial banks generally do not have, and multilaterals (particularly the World Bank) can pressure debtors because of their political leverage and status as a repeat player.[162] The participation of the International Finance Corporation, a multilateral institution, helps bring in private lenders.[163] The IFC either provides commercial loans to companies investing within nations that are members of

155. *See* Stelwagon, *supra* note 57, at 66–67. The Export-Import Bank similarly provides inconvertibility, transfer, and expropriation risk insurance. *See id.*

156. *See* Muñoz, *supra* note 148; Perry, *supra* note 148, at 513 n.5.

157. *See* Betancourt, *supra* note 144, at 185.

158. *See id.* at 183–84; Perry, *supra* note 148, at 554.

159. *See* Betancourt, *supra* note 144, at 183–84; Perry, *supra* note 148, at 554.

160. *See* Perry, *supra* note 148, at 554. When a nation breaks an agreement with OPIC, the United States steps in as guarantor. *See id.* The U.S. Department of State can then use its full powers to enforce the agreement. *See id.*

161. *See* Telephone interview with Douglas S. Bland, Partner, Vinson & Elkins, L.L.P. (Mar. 11, 1997).

162. *Id.*

163. *See id.; see also* Hossein Razavi, FINANCING ENERGY PROJECTS IN EMERGING ECONOMIES 45–46 (1996). The IFC, established as an affiliate of the World Bank in 1956, lends money to private companies. *See id.* at 45. It also seeks partners for joint ventures and encourages lenders to participate in its financial projects. *See id.* at 46. In the first half of the 1990s, for every dollar provided by the IFC, six were provided by other sources. *See id.* at 47.

the World Bank or acts as a structuring agent for lending.[164] In these structuring relationships, the IFC is the lender of record, and commercial banks funnel their money through the IFC, which administers the loans and collects borrower payments.[165] Through these methods, multilaterals and bilaterals are involved in at least a large plurality of financings in the developing world.[166]

As stated, commercial banks are another possible source of financing, and many large international banks are experienced in project financing and development. Aside from involvement with multilaterals, a club of banks led by a structuring agent bank can spread the loans out through a large web of institutions, and the agent bank will often take the lead in monitoring the loan once it is made.[167] However, similar to multilateral agencies, the banks can place strict restrictions on borrowers, and the loan terms from commercial banks are often comparatively short.[168]

The capital markets are another source of funding, either via a broad offering on the public markets, or to "qualified institutional buyers," such as pension plans, mutual funds, and insurance companies.[169] The rise of institutional investors to prominence in the U.S. economy, partially caused by demographic shifts such as the aging of the Baby Boomer generation, has created a new, large source of capital.[170] The European and Asian exchanges are also

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164. *See* Bland, *supra* note 161; *see also* Razavi, *supra* note 163, at 46 (noting that the IFC aids in financing projects in developing countries through the syndication of commercial bank loans).

165. *See* Razavi, *supra* note 163, at 46–47.

166. *See* Bland, *supra* note 161 (noting that multilaterals play a pivotal role in project financing and listing the various multilateral agencies involved in project financing).

167. *See* Ale, *supra* note 121, at 95 ("An agent bank often takes the lead in negotiating the original deal and monitoring the loan once made, streamlining the process of amendments and waivers when needed.").

168. *See id.* ("Banks typically lend at floating rates, requiring the borrower to absorb the risk of interest-rate increases, something project economics may not support, or incur the cost of an interest-rate swap to hedge against this possibility.").

169. *Id.*

170. *See* Edward A. Fallone, *Latin American Laws Regulating Foreign Investment*, *in* GOING INTERNATIONAL: FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS, 323, 327–28 (ALI-ABA Course of Study, July 8–12, 1996), *available in* WESTLAW, SB04 ALI-ABA 323.

> A demographic shift in the United States population, caused by the aging of the Baby Boomers, has led to record inflows into mutual funds and retirement savings accounts. Institutional investors have put this money to work and, because domestic financial markets have proven

possible places to list the offering.[171] Capital markets, foreign and domestic, offer more relaxed controls and covenants, as compared to banks and multilateral agencies, as well as longer maturities.[172] Financings for capital markets offerings also have shorter execution times.[173] However, these deals require more oversight because of their complexity, which makes them more difficult to place.[174] Also, the borrower must pay interest on funds received, even if they will not use the funds until later (offerings are generally up-front and one-shot deals), which makes this method of financing prohibitive.[175]

Unfortunately, in recent years the U.S. capital markets have not been as promising a source of funds as originally hoped.[176] The recent financial crisis in Mexico made Latin America less desirable to many American investors and lenders, a reaction commonly called the "Tequila Effect."[177] Also, most mutual funds and pension plans are conservative in their investment planning, and are wary of entering into Third World development deals.[178]

Most funding for energy development in the developing world comes from debt, not equity.[179] Typically, 60–80% of funding (on a global scale, not in individual deals) comes from debt, via institutional investors, international commercial banks, multilaterals and bilaterals, international bond markets, local banks and bond markets, suppliers' credit, special energy funds, and the IFC and regional development banks.[180] Equity constitutes 20–40% of the cost of funding.[181] Sources of equity include the producer's own cash, subordinated loans, multilaterals, capital from international and local markets, certain energy equity funds,

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> incapable of providing sufficient investment opportunities, some of this tremendous inflow has found its way to Latin America.

Id. at 327–28.

171. *See* Ale, *supra* note 121, at 95.

172. *See id.*

173. *See id.*

174. *See id.* at 95–96.

175. *See id.*

176. *See* Bland, *supra* note 161.

177. Jonathan N. Axelrod, *Quarterly Mutual Funds Review: Risky Bond Funds Thrived in Weak Quarter*, WALL ST. J., July 3, 1996, at R4.

178. *See* Bland, *supra* note 161; Telephone Interview with Richard McGee, Partner, Vinson & Elkins, L.L.P. (Mar. 14, 1997).

179. *See* Razavi, *supra* note 163, at 7, 9 (noting that equity for energy projects ranges from 20–40%).

180. *See id.* at 9.

181. *See id.* at 7, 9.

and government investment.[182] As the previous passages show, a company wishing to enter into a project finance and development deal has many options for raising capital, and generally, such companies use multiple sources of capital because of financial convenience and institutional necessity. Part V addresses some of the activities of specific players in Bolivian capitalization deals.

V. SPECIFIC ACTORS AND EXAMPLES

Enron Development and Shell International Gas, Inc. have joined as strategic partners, spending US$263.5 million for Bolivian Transportation Co.[183] This is part of a controversial US$1.5 billion pipeline deal that would create a natural gas pipeline from Bolivia to Brazil.[184] Enron originally had the "right of first refusal on any other pipeline that touches Bolivian soil on its way to Brazil," regardless of where the pipeline started.[185] This did not please other energy companies in the region, and as potential bidders for capitalized firms, these firms warned the Bolivian government that such a deal might lower the value of the capitalized firms.[186] The deal had to be renegotiated and Enron lost its privileged position.[187]

The pipeline was uniquely financed. The Bolivian side of the pipeline was financed on the debt side by Petrobras.[188] Petrobras contributed US$280 million toward the total US$350 million construction cost in Bolivia, and structured the arrangement as an advance payment for later consumption and transport of natural gas.[189] This arrangement was done to speed along construction of the pipeline, and is "absolutely not standard" for international pipeline deals.[190] The balance of construction costs on the

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182. *See id.* at 7–9.

183. *See Bolivia Awards Stakes in State Oil Company to 6 Energy Concerns*, WALL ST. J., Dec. 9, 1996, at C14.

184. *See* Friedland, *supra* note 105.

185. *Id.*

186. *See id.* ("[P]otential bidders for Bolivia's oil-and-gas company ganged up on Enron . . . . The bidders grew alarmed that the deal would give Enron control of access to the only market for Bolivia's gas, and warned La Paz that its oil-and-gas company would be worthless when auctioned.").

187. *See id.* ("A vigorous fax campaign by the bidders and a week of filibustering by opposition politicians led to a renegotiation of the deal. Enron lost the right of first refusal on other pipelines and a guarantee of a high rate of return on its investment.").

188. *See* Yzaguirre, *supra* note 54.

189. *See id.*

190. *Id.*

Bolivian side are to be paid by the sponsors.[191] Argentinian natural gas will flow through this pipeline only until additional Bolivian natural gas is found and produced.[192] This is intended as a first major step in positioning Bolivia as the "natural gas hub" of southern South America.[193] Petrobras has the turnkey contract for construction of the Bolivian side of the pipeline, and will act as construction manager on the Brazilian side.[194] Enron will operate the Bolivian side of the pipeline, and other key participants in the construction will be Brown & Root and Murphy Brothers.[195]

Enron and Shell won the bidding war for capitalization of the transportation section of YPFB.[196] Shell entered into the arrangement to help allay suspicions that Enron would monopolize gas production.[197] Both firms jointly acquired a 50% stake in the transportation assets of YPFB, including ownership of the Bolivia-to-Brazil pipeline.[198] The remaining 50% is owned by the Bolivian pension fund system.[199] The bid for this project was US$263.5 million,[200] and will be paid out of the funds of the sponsors, not from loans or financing.[201] This was required by the bidding rules set up by the Bolivian government for the capitalization to ensure that large, healthy corporations would be involved and the project would not be debt laden from the beginning.[202]

The capitalization of YPFB has forced a restructuring of the ownership and control of the Bolivian part of the Bolivia-to-Brazil pipeline. In the old arrangement, YPFB owned 60% of the line, and Enron owned 40%.[203] Because YPFB is out as an owner and Shell and the Bolivian pension funds are in, a new ownership arrangement has been created. YPFB's interest in all of its former transportation sector has been

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191. *See id.*
192. *See* Jeff Share, *Massive Pipeline to Carry Bolivian Gas into Brazil,* PIPELINE & GAS J., Aug. 1, 1997, at 34, 35.
193. *Id.*
194. *See id.* at 36.
195. *See id.*
196. *See Enron, Shell, Amoco, Argentine Firms Are Winners in YPFB Capitalization*, LATIN AM. ENERGY ALERT, Dec 15, 1996, *available in* WESTLAW, Latnews Database [hereinafter *Winners*].
197. *See id.*
198. *See id.*; *see also Enron Finalizes YPFB Stake*, OIL DAILY, May 29, 1997, at 5, 5 [hereinafter *Enron Finalizes*].
199. *See Winners, supra* note 196; *Enron Finalizes, supra* note 198.
200. *See Winners, supra* note 196; *Enron Finalizes, supra* note 198.
201. *See* Yzaguirre, *supra* note 54.
202. *See id.*
203. *See id.*

transferred to a new corporation called Transredes, which is 50% owned by the pension funds and 50% jointly owned by Shell and Enron.[204] Since YPFB owned 60% of the pipeline under the original deal, the basic distribution of ownership of the Bolivian side of the pipeline has been reorganized. Pipeline ownership is divided approximately as follows: Enron and Shell own 29% each in the Bolivian portion, and Enron, Shell, and the Bolivian pension funds (34% owned by Transredes), own 1/3 of the overall project.[205]

This was one of several large capitalization bids announced in December of 1996, in addition to the Enron-Shell capitalization of the transportation section of YPFB. A consortium of Argentine companies, including YPF, won the bidding contest for the Empresa Petrolera Andina upstream unit with a bid of $264.8 million.[206] The Empresa Petrolera Chaco upstream unit went to U.S.-based Amoco for US$306.7 million.[207]

The above sales totaled US$834 million, and were the most important step to date in the Bolivian government's privatization policy.[208] The buyers stand to gain given their advantageous position in the expanding Brazilian natural gas market.[209] Previously, the pace of privatization had been delayed because of a combination of delays in the reorganization of YPFB, slow movement by the Bolivian Congress in approval of the necessary new regulatory structures, and political opposition in some quarters.[210]

VI. FUTURE TRENDS AND RISKS

While Bolivia is largely stable and unlikely to face large-scale political change (such as a socialist revolution or a military coup), there is a backlash against privatization that must be considered. The capitalization system is based on deferred gratification, with the money injected into the capitalized company covering operating expenses in return

204. *See Enron Finalizes, supra* note 198.

205. *See* Jeff Share, *Massive Pipeline to Carry Bolivian Gas Into Brazil*, PIPELINE & GAS J., Aug. 1, 1997, at 34, *available in* WESTLAW, Allnews Database.

206. *See Winners*, *supra* note 196.

207. *See id.*

208. *See* Friedland, *supra* note 105.

209. *See id.*

210. *See Bolivia Delays YPFB Privatization Yet Again As It Releases Valuation,* LATIN AM. ENERGY ALERT, Sept. 20, 1996, *available in* WESTLAW, Latnews Database.

for control and 50% of the shares, and the other 50% of the shares going into the pension system.[211]

In addition to those who might feel an intense ideological or personal aversion to privatization, the new system will not appease those in Bolivia that believe Bolivia needs direct aid now. The fact that the pension system calls for a retirement age of 65 when the average life expectancy in Bolivia is 60 adds to the dissent.[212]

Nationalist feelings have been inflamed by what is perceived as a foreign takeover of many industries, particularly the Chilean takeover of the Bolivian railroads.[213] Chile has been viewed with some degree of hostility in Bolivia since Bolivia lost access to the sea in a war with Chile in the late 1800s.[214] Nationalist feelings and concerns about the capitalization plan helped elect President Banzer, and partially explains why President Banzer has not included the party of former President Sanchez de Lozada, the Nationalist Revolutionary Movement (MNR), in his ruling coalition.[215] Given the new political order, it is likely that more funds from capitalization will be funneled into immediate social welfare programs than long term pension plans.[216]

This backlash against privatization is not unique to Bolivia; it includes resurgent left-wing extremist groups like the "Shining Path" in Peru or the Zapatista rebels in Mexico, and populist-nationalist parties on the right, all of whom are capitalizing on the discontent with reform for their own purposes.[217] While there have been massive improvements on the macro level in Latin America in recent years, they have yet to trickle down to the masses, and the overly messianic

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211. *See* Jonathan Friedland, *Money Transfer: Bolivia Is Selling Off State Firms to Fund Its Citizens' Future*, WALL ST. J., Aug. 15, 1995, at A1.

212. *See* Bill Hinchberger, *Bolivia Embraces 'Capitalism,'* INST. INVESTOR, Mar. 1, 1997, at 179, *available in* 1997 WL 9673494. However, life expectancy figures may be skewed because of Bolivia's high infant mortality rate. *See id.* Government statisticians claim that "[i]f a Bolivian reaches 20, he or she can plan on living to 70." *Id.*

213. *See Fair Shares For All in Bolivian Capitalisation*, PRIVATISATION INT'L, Jan. 1, 1996, *available in* WESTLAW, Allnews Database.

214. *See* Fabio Castro, *Andean Community Presidents Meet to Work on Common Regional Policies,* Agence France-Presse, Apr. 5, 1998, *available in* WESTLAW, Allnews Database.

215. *See* Lally Weymouth, *Dictator Turned Democrat*, WASH. POST, Oct. 22, 1997, at A21.

216. *Cf. id.* (noting that Banzer intends to focus on education and healthcare reform, and that seven out of ten Bolivians live in poverty).

217. *See The Backlash in Latin America*, ECONOMIST, Nov. 30, 1996, at 19, 20 [hereinafter *Backlash*] (noting that guerrilla violence, while not as frequent as in the 1960s and 1970s, is part of a higher escalation of violence).

rhetoric that accompanied liberalization set expectations that were too high.[218]

This backlash has led to some slowing in reform across the region.[219] The hard left is unlikely to win control of Bolivia or any other Latin American country anytime soon.[220] However, their terrorist actions can and do disturb the mainstream order,[221] and responding to them takes time and resources from other activities.[222] The populists have been more politically successful than the radical left, though they have not seriously reversed the reformist course when they have taken office in any nation.[223]

Reform also faces the problem of a lack of deep historical roots. One author calls the historical forces of populism, caudillism (concentration of power in the hands of a strongman, or *caudillo*), militarism, and chauvinism the "four horsemen of the Latin American apocalypse," and notes that these forces have stymied reform in the past.[224] Enrique Krauze points out that these Four Horsemen display themselves on the left and right, and always must be

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218. *See id.* at 19–20 (noting that voters only felt the benefits of reform for short "spurts of growth" fueled by the return to stability).

219. *See id.*

> What seems to be happening is that middle-class folk are joining the backlash of the poor. A remarkable revolt took place at a recent assembly of Mexico's ever-ruling Institutional Revolutionary Party (PRI). Furious that unpopular market reforms had resulted in electoral defeats, hardliners rebelled. "Down with neo-liberalism!" rang the cries as they voted to stop privatisation and ban technocrats from high office. The public cheered the rebellion.

Id. at 20.

220. *See id.* ("In more pluralistic countries, the backlash is no more likely to lead to leftward policy shifts. By and large, the Latin left has failed in opposition. . . . Leftist leaders have not come up with any coherent alternative to the prevailing free-market agenda.").

221. *See id.* at 19 ("From the rugged sierras outside the Mexican resort of Acapulco, the People's Revolutionary Army (EPR) has been running a vicious bombing campaign in half a dozen states.").

222. *See id.* at 21. "[T]he region spends an astonishing 13–15% of GDP on security expenses (both private and public). That is more than total welfare spending. It represents a crippling burden on the economy." *Id.*

223. *See id.* at 20 (noting that in Venezuela and Ecuador economic reformist presidents were replaced with old-style populists that eventually returned to some form of economic reforms).

224. *See* Enrique Krauze, *Eva Peron: A Biography*, NEW REPUBLIC, Feb. 10, 1997, at 36 ("They are the four horsemen of the Latin American apocalypse, the wounds that have blocked the continent's access to the modern world, the true origin of the depression and the despair that afflicts this weak point of the Western world.").

considered as part of the backdrop in Latin American politics.[225]

In addition to the nationalist and leftist critiques of liberalization, some Latin American liberals have expressed dissent with the reform movements in Latin America.[226] The liberal critique, as stated by Alvaro Vargas Llosa, is that piecemeal reforms that focus on macroeconomic management without a commitment to private property for the people, real market competition, and a commitment to creation and support for democratic institutions, lead to a mercantilist system that benefits few.[227] Llosa believes reformers are confusing mercantilist private enterprise with free market capitalism, and the failures of the former will be blamed on the latter.[228] He states that many countries are merely shifting control of monopolies via privatization, and that when the people see the problems of these monopolies (and that the profits from these changes go to the already existing upper class), capitalism and liberalism will be blamed for the failures of a system that is neither truly capitalist nor liberal.[229] He argues that this economic failure, coupled with a lack of true liberal democracy, is fueling a

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225. *See id.* For example:

> During the most recent Argentine military dictatorship, many of these "left-Peronist" guerrillas (as well as thousands of men, women and children who had never lifted a finger in violence) would die, often by being thrown, still barely alive, from airplanes into the Atlantic Ocean, after weeks and months of unspeakable torture at the hands of, among others, "Peronists of the Right."

Id.

226. *See* Alvaro Vargas Llosa, *Give Latins Real Reform, Start with Property Titles*, WALL ST. J. EUR., Jan. 6, 1997, at 6.

227. *See id.*

228. *See id.*

229. *See id.*

> Private ownership is not a panacea for an economy. Ill-conceived privatizations have replaced public monopolies with private monopolies, transferring ownership while still protecting markets and scandalously fueling corruption. One example is telecommunications. Throughout Latin America, users are suffering high rates and poor service because telephone companies have been sold as private monopolies. This is especially obvious in Peru, Mexico and Argentina. Users then wrongly deduce that capitalism, not a lack of it, is the cause of this abuse. They fail to understand that this is what happens when you transfer a closed market from public to private control.

Id.

backlash, which anti-liberals of the left and right gladly feed on and benefit from.[230]

Fareed Zakaria has pointed to a related problem facing new democracies worldwide, and Latin America in particular: illiberal democracies.[231] Zakaria writes that while democracy has been spreading, liberalism[232] has not spread as quickly, and is not a part of many new democracies.[233] Indeed, many new democracies resemble de Tocqueville's warnings of the perils of "the tyranny of the majority," rather than a liberal constitutional republic.[234]

While Bolivia is not a democratic tyranny of the sort described in Zakaria's article, the danger of such a political order still exists because of the lack of deep historical roots for democracy in Bolivia.[235] However, President Banzer appears to be serious about political and economic reform, and his policies tend to be aimed at stabilizing Bolivia's economic and political situation,[236] a move that is wise given the rapid changes Bolivia has recently experienced.

Other commentators believe that dangers to a new liberal democratic order in Latin America exist because of a weak institutional base for a true rule of law, namely corrupt police and weak judicial institutions incapable of protecting rights or punishing the guilty.[237] Violence and the fear of agitation for an authoritarian response to social problems are the motivations for the "Santiago Consensus," which consists of the following elements.[238]

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230. *See generally id.* (noting that despite numerous reform and privatization measures in Latin America, the majority of the population remains poor).

231. *See* Fareed Zakaria, *The Rise of Illiberal Democracy*, FOR. AFFAIRS, Nov. 21, 1997, at 22, *available in* 1997 WL 9287610. In the West, democracy is equated with liberal democracy. *See id.* In the rest of the world, the two are not equated together; democracy is flourishing while constitutional liberalism is not. *See id.*

232. *See id.*

233. *See id.* As of 1997, 118 of the world's 193 countries were democratic. Of those democratic countries, 35% of democratizing countries were illiberal compared to 22% seven years earlier. *See id.* It is very rare for an illiberal democracy to mature into a liberal one. *See id.*

234. *Id.*

235. *See* Eduardo Gallardo, *Bolivian Election Won't Alter Economics*, NEW ORLEANS TIMES PICAYUNE, June 1, 1997, at A16 (stating that prior to the return of democracy to Bolivia in 1982, the country endured 17 years of harsh military rule).

236. *See* Juan Carlos Rocha, *Bolivia-Politics: Banzer's 100 Days of Democracy*, Inter Press Serv., Nov. 18, 1997, *available in* WESTLAW, Allnews Database.

237. *See Backlash, supra* note 217, at 21.

238. *Id.*

First, while decentralization is necessary, the national state should remain strong, because an overly rapid devolution of central power can simply transfer power to local oligarchs who may in turn derail reforms.[239] This recommendation for the need to walk the fine line between sensible decentralization and anarchic deconstruction of the state is echoed by Robert Kaplan.[240] Kaplan describes the present situation in Mexico as being situated at a crossroad between these two divergent paths, owing to a mixture of political realities and the geographic distribution of population and wealth in the country.[241] All over Latin America, the difficult task of navigating between decentralization and destabilization is a key concern of the reformist state.[242] Second, supervision of new business enterprises must be set up to prevent corruption.[243] Institutions along the lines of the American Securities and Exchange Commission, or independent central banks, would be useful.[244] Third, other institutions, namely the judiciary and police, must be bolstered and reformed to ensure the rule of law.[245] Finally, social spending should be targeted toward education, infrastructure, and public health,[246] rather than patronage and pork-barrel corporatist projects.[247] These measures would ensure liberalization and stability in Latin nations.[248]

> John Williamson, formerly of the Institute for International Economics, muses that a powerful president may be best for governability and growth. That is remarkable coming from the father of the Washington consensus, whose followers have tried to get the state out of almost everything. He now says: "Policy needs to shift from cutting back a state that had become bloated to strengthening a number of key state institutions whose efficient functioning is important for rapid and/or equitable growth." Call this policy shift the Santiago consensus . . . .

Id.

239. *See id.*

240. *See* Robert D. Kaplan, *Foreign Affairs: History Moving North,* ATLANTIC MONTHLY, Feb. 1997, at 21, 22.

241. *See id.* at 21–22.

242. *See generally Backlash, supra* note 217, at 19–21 (noting resistance to economic reforms).

243. *See id.* at 21.

244. *See id.*

245. *See id.*

246. *See id.*

247. *Cf. id.* (noting that "social spending is run by centralised bureaucracies which are corrupt" and that "local governments and non-governmental agencies should be permitted to provide social services").

248. *See id.*

Applying the Santiago Consensus, Bolivia appears to be headed on the right track. Bolivia has transformed from an unstable nation plagued with military coups to a republic.[249] President Banzer, a man who previously governed Bolivia as a military ruler, seems committed to liberalization, though at a slower pace than his predecessor.[250] This change in attitude is not a small issue to be dismissed, and given the great changes that Bolivia has recently undergone, this tactic of conservatism seems prudent. Also, Bolivia has already applied the Santiago Consensus. The capitalization system itself is one in which social programs are created to provide a basic safety net for the people, and the structure of capitalization places the national government at the center of oversight and responsibility, thereby preventing the type of chaotic decentralization critiqued earlier in this paper.

Bolivia is moving to clean up its judicial and executive branches,[251] a necessary part of the Santiago Consensus.[252] Judicial reform is key for the creation and consolidation of a liberal political order that respects individual rights.[253] The government recently passed measures for judicial reform.[254] As part of this reform, two supreme court justices were impeached for corrupt activities, an unprecedented move in Bolivia.[255] As Fareed Zakaria has written, "The 'Western Model' is best symbolized not by the mass plebiscite but the impartial judge."[256] Further, the government has sought to root out corruption in its executive branch and has decentralized political decision-making to local governments and community groups.[257] In addition, the creation of

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249. *See* Gallardo, *supra* note 235.

250. *Cf.* Raul Burgoa, *Former Bolivian Dictator to Take Over as President*, Agence France-Presse, Aug. 8, 1997, *available in* WESTLAW, Allnews Database (noting that Banzer intends to continue previous open market reforms, but also intends to help those adversely affected by those reforms).

251. *See Vice President Quiroga Is the Man to Watch,* LAGNIAPPE LETTER, Jan. 9, 1998, *available in* WESTLAW, Allnews Database [hereinafter *Quiroga*].

252. *See Backlash, supra* note 217, at 21.

253. *See* Krauze, *supra* note 224 (noting that important facets of constitutional liberalism include the rule of law, private property rights, separated powers, and free speech and assembly).

254. *See Quiroga, supra* note 251.

255. *See* David C. Scott, *Latin American Citizens Counter Corruption*, CHRISTIAN SCI. MONITOR, Mar. 2, 1994, at 12.

256. Zakaria, *supra* note 231, at 27.

257. *See Blueprint for New Bolivia*, LATINFINANCE, May 1, 1997, at S1, *available in* WESTLAW, Allnews Database; Jonathan Friedland, *Steppingstones: City Hall Is Becoming a New Power Center All Over Latin America*, WALL ST. J., Aug. 28, 1997, at A1; Robin Wright, *For Democracy, the Next Revolution Is Devolution Politics: Central Governments Yield Cash, Control to States and*

SIRESE to monitor and regulate the new post capitalization economic order is just the type of necessary regulatory step suggested by many observers.[258]

Also, it would be unfair to imply that all of the possibilities for a slowing in international project finance and development in general (and Bolivia in particular) come from a backlash against liberalization in Latin America. The United States has its share of problems as well, namely a re-emergent isolationist trend present on both the right and left wings of the political spectrum.[259] American isolationists tend to oppose the multilateral and bilateral groups that help to provide insurance and comfort for international investment and trade.[260] These groups claim U.S. support for multilaterals somehow undermines U.S. global influence and sovereignty.[261] However, U.S. global influence and reach is increased by support for these groups, which support the spread of capitalism in general and the influence of U.S. companies in particular.[262] As George Muñoz, President of OPIC, says, "if you believe democracy and capitalism are good for the [United States], then such foreign investment is good [for the United States]."[263]

Those that attack U.S. government support for groups like OPIC and the U.S. Export-Import Bank often do so without regard for the fact that much investment is encouraged by those groups, and may not occur otherwise.[264] For example, it is estimated that OPIC-supported investments have helped generate 200 thousand jobs in the United States and US$43 billion in the sale and manufacture

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Towns. Working Out Details Can Be Troublesome, L.A. TIMES, Feb 19, 1997, at A1.

258. *See* Jonathan Friedland, *Bolivia's Regulatory Agency Frustrated by Politics*, WALL ST. J. EUR., Dec. 3, 1997, at 4 (noting that Bolivia's regulatory system includes SIRESE, and the Financial Regulatory System, or SIREFI).

259. *See* Joseph S. Tulchin, *Hemispheric Relations in the 21st Century*, J. INTERAMER. STUD. & WORLD AFF., Mar. 22, 1997, at 33, *available in* WESTLAW, Allnews Database.

260. *See id.*

261. *Cf. id.* (noting that U.S. isolationist tendencies run counter to pressures to participate in multilateral agencies such as the United Nations, Organization of American States, World Bank, and Inter-American Development Bank).

262. *Cf.* Kenneth Lay, *OPIC: Does the Nation Still Need It; Investment Agency Helps US Companies*, J. COM., Sept. 11, 1996, 6A, *available in* WESTLAW, JOC Database (noting that OPIC has "been an essential ingredient in financing [U.S.] projects in India, the Philippines and Turkey," and that absent OPIC financing, the United States will lose future private investment opportunities to other countries that can provide long-term guarantees).

263. Muñoz, *supra* note 148.

264. *See* Lay, *supra* note 262.

of U.S. goods.[265] Further, some 40% of U.S. exports are exported to U.S. foreign investments, not foreign consumers, thereby intertwining foreign and domestic production by U.S. firms.[266]

Multilaterals are under fire from various groups in furtherance of their respective ideological and personal agendas.[267] However, it is a mistake to lump organizations such as OPIC with the sort of wasteful programs that are rightfully criticized and cut, and the end result of an attack on bilateral and multilateral organizations by U.S. political interests poses its own risk to both lesser developed economies and American job growth.

Bolivia has a long way toward modernization, but this might actually work in its favor. The mixture of reformist policies and the tremendous amount of work necessary to create a fully modernized economy leaves great room for growth. While there is some dissent about the proper road to modernization, the general argument seems to have settled in favor of reform. As stated, the extremists of the right and left are not likely to seize power, and the new government seems to want only to slow the pace of reform, rather than stop it. Even if the political will to stop the reforms and re-nationalize YPFB and other industries existed, the aforementioned disciplining mechanisms of multilaterals like the World Bank and the necessities of the global marketplace would stifle a move to turn back the clock.

Others are optimistic about Bolivia's future as well. One example is Lionel Zupanich of Eaglecrest Industries, who says that "[t]he business climate is incomparable to any First World country since the chances of survival and success here are so much greater, given the limited competition to be dealt with. Bolivia continues to be a land of opportunity."[268] Others share Zupanich's optimism. Bolivia has great resources and is the key to the Southern Cone of South America. Bolivia's future is bright, and this will become apparent very quickly, once the projects presently in construction are completed.[269] Opportunities for long term growth seem strong, and the new political administration appears committed to encouraging

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265. *See id.*
266. *See* Muñoz, *supra* note 148.
267. *See* Mark Suzman, *The Americas*, FIN. TIMES, March 6, 1997, at 3.
268. *Consumer, supra* note 14.
269. *See* Yzaguirre, *supra* note 54.

foreign investment and economic growth.[270] There does not seem to be any major sense of concern among foreign investors that the reforms in Bolivia will be reversed, and Bolivia's location in the Southern Cone of South America will be advantageous for further energy transport and development projects.[271]

Bolivia's resources and location put it in an excellent position, and its leadership is at present devoted to reform. There still exist anti-reform elements in the nation, and as the Russian example shows, those elements can be troublesome;[272] however, they are not likely to stop or reverse the flow of foreign capital into Bolivia. The future seems bright, not only for Bolivia, but also for the project finance field in general. The tremendous need for infrastructure of all types in the developing world will keep project finance and development going strong for years to come, both in Bolivia and in other developing nations. The economic benefits from project finance and development in the developing world are vast, and the political threats to further investment, both in the United States and abroad, while worth noting, do not appear strong enough to successfully stand athwart the tide of history.

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270. *See* Telephone Interview with Mark Brazzil, Partner, Vinson & Elkins, L.L.P. (Dec. 17, 1997).

271. *See id.*

272. *See* Preston, *supra* note 43 (noting that privatization in Russia has been delayed because of obstacles to passing legislation and the possible reinstatement of Communism).