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One Year After the Foul Expropriation of YPF: Argentina's Road to Ruin

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It is one year ago since the Argentinian President, Cristina Fernández de Kirchner, introduced the bill that allowed the government to expropriate the 51-percent share in YPF, an energy company, held by the Spanish Repsol Group. The asset grab, done without any compensation to the owner, was sold to the public as a move to boost energy production, and more generally to improve the authority the government command over its deteriorating macroeconomic performance. Predictably, it has nothing but reinforced the spiralling downward trend of Argentina's economy.

The "anniversary" of Argentina's expropriation of Repsol's share in YPF marks an historic event, even by the standards of Argentina's policy on investment protection. It is far from the first time in Argentina's post-crisis era that the government has resorted to foul expropriation of assets in order to boost its own standing. Argentina remains one of the most frequent respondents in cases of investor-state dispute settlement in the World Bank's International Centre for Settlement in Investment Disputes (ICSID). Investment protection in Argentina is ranked low in the World Bank's Index on doing business; last year it continued to fall and the country is now in the same place as Russia and Syria, countries hardly known for their hospitable investment policies. Generally, the Wall Street Journal Index on economic freedom now considers Argentina to be a "repressed" economy.

Yet the expropriation stands out for a number of reasons. First, the value involved is very big. The government grabbed assets that, using stock-market valuations before rumours of the pending expropriation started, were worth more than 10 billion US dollars. Second, no compensation was offered to the owner – assets were simply confiscated. Third, the expropriation concerned a critical part of the country's production. Unlike most other investment disputes that Argentina has with foreign owners, this one does not concern the country's sovereign default in the early 2000s but an important part of the real economy. Fourth, the government claimed it was a necessary move to boost Argentina's oil production, but as it came only two months after Repsol YPF had significantly increased the estimated reserves in the shale oil finding it did in 2010 in Vaca Muerta, it is quite obvious that the government wanted to seize an oil reserve that could generate significant revenues. Had Repsol YPF already started production in Vaca Muerta, the value of the assets held by the Repsol Group at the time of the expropriation would have been valued higher than 10 billion US dollars.

There are other factors that help to explain President Fernández' action. Argentina's political leadership is increasingly moving the country back to its past of economic populism. Steeped in the Peronist political tradition, the government has recently radically increased state intervention in the economy. Late last year, Bloomberg's Ian succinctly summarized Fernández' policy: "In a desperate gambit to save local jobs and central bank reserves, the government has since 2010 implemented a series of economic regulations that seem to mix purposeful self-delusion -- akin to closing the window shade and claiming it's nighttime -- with discredited economic theories last taken seriously during the era of black-and-white television."

Furthermore, Argentina's macroeconomic conditions have weakened considerably in the past years. The post-crisis recovery in 2010 and 2011 has ended. Inflation has shot up and is now a seriously weighing down real economic growth. Government authorities claim inflation to be under control and the statistical agency, INDEC, has reported monthly inflation rates during the first quarter of 2013 that suggest the annualised rate to be just north of 10 percent. However, no independent observer of Argentina trusts the official rates. The International Monetary Fund has been shut off from the country in the past years and has censored Argentina for its absent reporting of inflation statistics. A group of opposition members in Argentina's Lower House has for some time now released inflation estimates from independent economists, and their latest estimate suggest annualised inflation to have edged closer to 30 percent. Yet it could be even higher. Estimating inflation on the basis of purchasing power parity, annualised inflation based on the past three months could well be in the region of 100 percent.

The government has responded to the return of high inflation with a raft of market and trade restrictions like price controls, export restrictions, import-substitution measures, and a wide use of local-content requirements. Yet this medicine is now making the patient even worse. President Fernández' expropriation of Repsol's controlling stake in YPF is a case in point. The government claimed at the time of the expropriation that it would boost oil production and turn its trade deficit in oil and gas into a surplus, which would help to generate much-needed foreign currency to the country. It said that the previous owner had pursued a strategy depleting the company of capital to invest in new oil production and forcing it to court other international partners for production in the new shale reserves.

However, the Argentinian government has been proven wrong on all these claims. Argentina's total oil production declined in 2012, once one factor in the effects of the oil strikes in 2011. Oil production by YPF fell by 8 percent in the fourth quarter in 2012, according to Argentina's Department of Energy. After the expropriation, the government's strategy for how to expand production has collapsed. It has been forced to acknowledge that YPF need international partners for production in Vaca Muerta; a big oil reserve like Vaca Muerta simply require several investors as the amounts involved are very big. Yet the government has not been able to sign up any foreign partners for this endeavour, apart from a Memorandum of Understanding with one potential partner. Likewise, the government has also reversed its position on some price controls, like raising the artificially depressed wellhead gas prices, which undermine the economic case for investing in new production.

The expropriation has put Argentina's government in a difficult position. Given the need to access foreign sources of capital to invest in new oil production – which is important for Argentina's economy – it is difficult to see how the government could engineer a solution that would be more favourable to the Argentinian government, let alone the Argentinian economy, than when YPF was controlled by Repsol. In the worst-case scenario, YPF will not be able to start production in critical new fields because it cannot fund new investments. In a best-case scenario, investors will demand much higher yields in return for investing capital in a very unpredictable investment environment, plagued by the recent expropriation and, among other things, regulations and foreign exchange restrictions making it difficult to repatriate capital. Naturally, investors are wary of putting their money into countries and companies with records like Argentina and YPF. If they at all are going to consider it, the return on investment has to be far above normal yields.

This expropriation has defeated its purpose. The only way for Argentina to enable its energy sector to grow at its potential is by welcoming foreign investors. Yet that will not happen until Argentina overhauls its international economic policy – and pays the former owners of YPF a fair price for what it confiscated.