Argentina – Energy Nationalism

State and private oil firms relations

Abstract

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1 Motivation

The motivation of this presentation and of this abstract is to analyse the evolution of the relations between the Argentine government and the private oil companies throughout the 20th century.

The study is made between 1907, year in which petroleum was found in the city of Comodoro Rivadavia, in the Patagonia, and the end of 2008. The case of Argentina is quite particular, because it was one of the first countries in South-America to implement a national oil policy through the creation of a state-owned oil company and also the only one that completely deregulated the energy sector in the 90’s, decade during which deregulation policies expanded throughout the continent. When the firm was created in 1927, it was the second state-owned vertically-integrated oil company in the world, having been the first the one owned by the USSR. Despite the fact that the company was among the 150 most profitable companies of the world and the biggest asset the state owned, it could not escape the series of privatizations that took place at the beginning of the 90s.

An analysis of how and why these relations changed so much and so often throughout the century is presented together with the relevant historic and political events that caused these changes.

2 Methodology

It is impossible to explain the development of the relations between the oil sector and the Argentine state without presenting a brief summary of the political events that took place at each moment. The presentation analyzes diverse statistical data (oil produced, oil imported and state-company market share among others) and relevant national and international events will be clearly marked on the graphics in order to analyze the influence of these.

Although the changes of governments and the application of new policies did not always yield as result an instant change in the key indicators, they did indeed in many cases.

The extend up to which, how and why new policies were able to increase the oil production rates is a very complex topic over which several books have been written and it is not the purpose of this presentation to go into depth. Hence, only the most relevant events will be presented (presidency changes, military coups and relevant international events) and its related tendencies, when evident, will be exposed and analyzed.
3 Outcome

3.1 1907-1946 – Oil discovery and YPF creation

At the beginning of the century, the situation of the country was really different to its actual situation. The population in 1897 was 4,000,000. Although it had gained its independence from Spain in 1816, the country was from the economical point of view a pseudo-colony of Great Britain. British capitals controlled almost every relevant aspect of the economy, including transport and public services. The country was mainly a producer of grains and cattle, and the UK was the country’s biggest buyer. Grains and bovine products (flesh and leather) were exported to Europe by British-owned companies, mainly installed in the capital, Buenos Aires. In exchange, almost all industrialized products, coal, gas and fuels were imported also from Great Britain. At that moment, the country was governed by an oligarchy which only defended the interest of the privileged sectors. Although the country was a theoretically democracy, the elections were controlled with fraud by the most important political party, the P.A.N. or Partido Autonomista Nacional. (1)

Regarding the energetic situation, oil represented only 5% of the energy matrix, being coal and wood the two main sources of energy. Gas was not widely used and was produced as coal-gas. Although oil had already been discovered in some other areas, the production rates were really low and the projects bankrupted after some years. The fuel and the petrochemicals consumed in the country were imported by foreign firms, mainly by the West Indian Oil Company, a subsidiary of the American Standard Oil Company.

The situation changed in 1907, when in the remote town of Comodoro Rivadavia, located in the Patagonia aprox. 1500 km away from Buenos Aires, oil was accidentally discovered while drilling for water. At that time, the Patagonia was almost inhabited. Although at the beginning the government ignored the discovery, it took action some years later as they realized that oil was becoming a very important strategic resource. This is why in 1911 the government created the GPEDCR, General Petroleum Exploitation Direction of Comodoro Rivadavia (Dirección General de Explotación del Petróleo de Comodoro Rivadavia), in order to start exploiting the area. (2)

During its first years, the office had a really tight budget and the production did not progress significantly. The distance and the adverse climate conditions made things worse. In 1916, five years later, some exploitation permits were granted to private companies, which started extracting oil in areas nearby. In the following years, the productivity rate of the private companies exceeded by far that of the state-owned company. This is why in 1922 the government of H. Irigoyen, the first president not belonging to the P.A.N. in several decades and belonging to the U.C.R. (Unión Cívica Radical), restructures the GPEDCR into the DGYPF or General Direction of Fiscal Oilfields (Dirección
**General de Yacimientos Petrolíferos Fiscales**, known as YPF. A nationalist military, Gen. Mosconi, was appointed as director of the new company. The goal of the company was to vertically integrate all the process, from extraction until marketing, and it was the second state-owned vertically-integrated oil company to be created in the world, being the first one the oil company of the USSR.

Although during the first years the Congress approved a limited budget to fund the company’s operations b, YPF increased its productivity considerably. Between the years 1922 and 1930, the company electrified the extraction facilities, revamped the existing seaport of Comodoro Rivadavia and bought new ships to make transport to the capital more efficient, constructed its first refinery near the city of La Plata and explored and found new oilfields in several regions. The company expanded from a mere oil extractor to a vertically-integrated firm. During these years, YPF production increased considerably. Nevertheless, in 1930 the first military coup took place and Gen. Mosconi resigned to his office, based on political differences.\(^3\)\(^4\)

During the next 13 years, a series of military and elected through fraud governments succeeded each other in what is known as the “Infamous Decade”. During this period, opposed interests existed in the ruling sector: some nationalistic sectors were in favour of giving YPF more funds and power and saw oil as a strategic resource which should be exclusively controlled by the state, while other more conservative sectors thought that expanding too much the state-owned company could tense foreign relations and decrease foreign investments, in particular those from the U.S.A. and the United Kingdom.\(^5\)\(^6\)

During these years both YPF and the private sector experienced an increase in the production rates. Another factor that characterized this period was the negative economic influence of the “Great Depression” which broke out in 1929 and the increased level of corruption that existed in almost all the layers of the governing sectors.\(^7\)

After the break out of WWII in 1939, the availability of fuel decreased drastically. The government answered by increasing the national production, both in the state-controlled YPF and through the granting of exploitation contracts to the private sector, in order to compensate this decrease in importable gasoline, oils and fuels.\(^7\)

### 3.2 1946-1990 – Rise and fall of energy Nationalism

In 1946 elections took place and Gen. J.D. Perón won and assumed office. In 1949 a constitutional reform took place. The main objective of the reform was to allow re-election, but among other changes, all oil and gas reserves were nationalized and declared property of the federal government and YPF was designated as the organ to administrate all oilfields located within the national territory. The existing natural gas distributors were also nationalized in 1946 and the state-
owned gas company *Gas del Estado S.E.* was established. Nevertheless, the existing private oil companies continued operating in the country under a special legal frame.

During his first presidency, Perón implemented a strong industrialization plan. This plan brought as an immediate consequence a strong increase in the demand of gasoline, fuels and oil-related products. Since the relations with the private companies were not in an optimum situation and since YPF was lacking public funds and know-how, the national production stagnated and imports started increasing again. By the year 1955, oil imports represented almost one third of total imports and Perón signs a contract with the *Standard Oil of California* to develop new oilfields. The measure was heavily criticized by many sectors, including sectors from within his party, which regarded the measure as “anti-perorist”. Some weeks later he was overthrown by a coup d’état. The constitutional signed in 1949 was derogated and the contract with the *SOCAL* was suspended.  

Between 1955 and 1958 three military presidents ruled the country and in 1958 elections took place, being Perón's political party banned. A. Frondizi, belonging to the U.C.R. wins and assumes presidency.

In 1958, Frondizi declares the so-called Oil Battle (*Batalla por el petróleo*) having as paramount objective the self-sufficiency. Once again but through a law and not through a constitutional reform, all oil reserves were declared national property. Nevertheless, existing contracts were respected and private companies were allowed to explore and extract oil en new areas as “operators”: they are to extract the oil but sell it to YPF. During the following four years, new exploitation contracts, in several areas hitherto not explored, were granted. The state shared the investment risks with the private companies and private investment boosted. After four years, self-sufficiency was achieved, the production was triplicated and the reserves increased from 390.000.000 to 590.000.000 tons.  

In 1962, Frondizi was overthrown by a new coup d’état. The military called for elections one year later and A. Illia assumed presidency. As he had promised on his presidential campaign, he cancelled all contracts signed with private oil companies by Frondizi. He thought that these contracts were providing the companies too much power over the control of a sensitive resource and thus declared them unconstitutional. Huge compensations had to be paid to the companies and YPF was the only company allowed to extract oil. Private companies were also allowed to commercialize gasoline, fuels and petrochemicals but by refining oil bought from YPF. In 1965 Illia faced the same problem that Perón did before: production stagnated and imports were increasing too fast. He then restored some of “Frondizi's-contracts” but with some modifications, especially regarding the duration of them.
In 1966 a new coup d’état took place and a series of military governments ruled the country between that year and 1973. During the first government, the nationalization law passed by Illia was revoked and the private firms recovered the operation rights of several oilfields. The production of these oilfields, as well as that of YPF, increased considerably, especially after 1968. Some new concession contracts were signed but the private production did not increase significantly in this period. Regarding oil imports, they increased and decreased alternatively, showing no clear tendency.\(^{(7)}\)

In 1973 Perón was elected for a third time as president. He assumes and dies after only nine months in office. His vice-president and wife E. de Perón assumes office. During the period 1973-1976 the country suffered severe social turmoil and was at the border of a civil war between left-wing guerrillas and paramilitary right-wing commandos. The economic situation was worsening, with inflation growing at alarming rates. During this period energy policies were not a priority and no relevant measures were taken.

In 1976 and amidst the terrible turmoil that was installed in the country, a new military Junta overthrew Perón’s widow. This Junta would rule the country between 1976 and 1983 and carried out the so-called “National Reorganization Process” (Proceso de Reorganización Nacional), a series of measures which were to stabilize politically and economically the country. This process turned out to be a complete failure: a non-declared war between guerrillas and the military (the “dirty war”) took place, with guerrilla attacks taking place everywhere and with thousands of persons being kidnapped, murdered and “disappeared” by the military without any trial or judiciary process. Regarding the economy, a series of reforms were introduced, all of them aiming to deregulate the economy. Although the company would continue to exist until 1990, the events that had as a final consequence the privatization of it took place in this turbulent period of the Argentine history.\(^{(10)}\)

Inflation increased considerably and the economy stagnated, e.g. in 1976 the GNP decreased 0.8% and the inflation rate reached 182%. Since all the state owned companies were intervened by the military, the government started taking loans on international banks through these companies. YPF’s debt increased between 1976 and 1983 between 17 and 20 times. This money was not invested at all into infrastructure or exploration required by the company; instead these dollars were injected into the foreign exchange market, in order to control inflation, and also used for funding other public sectors.\(^{(11)}(12)\)

In 1983, after having lost a war against the United Kingdom for the Malvinas Islands (Falkland Islands) and having very low levels of popularity, the military Junta called for elections, which R. Alfonsín won. The same year he assumed as president. During the six years he was in office, the
government fought constantly against hyperinflation, which reached historical records, e.g. the inflation rate of 1988 reached ca. 5,000%. Since the government found YPF in a terrible financial situation, and also due to the economic crisis taking place, YPF production decreased in this period. Nevertheless, the oilfields operated by contracted firms experienced a slight increase in production. Three laws were passed in order to encourage private exploration in new oilfields but they did not throw positive results. \(^{(12)}\)

In 1989 Alfonsín left office six months before the end of his term and was succeeded by recently elected C. Menem, belonging to the Peronist Party. He implemented the so-called “State Reform” (“Reforma del Estado”), privatizing all state-owned companies, including YPF. This was a slow process and was done through a series of laws passed by the parliament and of presidential decrees. In 1990 the company’s entity is changed from “State Corporation” (S.E. for “Sociedad del Estado”) to “Public Limited Corporation” (S.A. for “Sociedad Anónima”), keeping the state 51% of the shares and a privileged “gold” share. The reasons alleged at the time in favour of the privatization were that the company was unprofitable, that the state could not afford the investments needed for exploration and that if turned into a mixed-company, its efficiency would increase and the prices would thus decrease. Also, the money originating from the sale would be used to pay owed pensions. The whole operation was heavily suspected of corruption and it is suspected that huge bribes were paid to several public servants in order to pass the law. A huge media campaign took place the months before to turn the public opinion in favour of the privatization. Although it was true that the company had serious efficiency issues, it was still a profitable firm. Besides, the critical financial situation of the company was exclusively product of the terrible and unnecessary debts acquired during the military government. Furthermore, the state absorbed all the debts of the company and the price at which it was sold was between 10 and 15 times smaller than the price fixed at that time by several private consultants. After several laws the company was completely privatized in 1999, year in which the Spanish Repsol acquired 98% of the stocks and renamed the company Repsol YPF. Argentina was one of the few countries that deregulated completely its energy sector. The company is heavily criticized by many sectors for not investing the necessary in exploration, only exporting as much as possible from oilfields discovered previously by YPF. In fact, the exploratory wells drilled, an indicator of the exploratory investment, decreased from an average 110 wells per year between 1983 and 1989 to an average of 32 between 2000 and 2007. \(^{(7)(11)(12)}\)

In the year 2004, three years after the country experienced an economical and social crisis in December 2001, President N. Kirchner established by presidential decree ENARSA (Energía Argentina S.A.), a mixed-company, having the state 51% of the shares. The aim of this company is trying to recover some capacity of increasing the country’s oil reserves, which have been dropping
dramatically in the last years. Anyway, the real power of the company is limited since it lacks equipment and technical staff, and its only assets are some exploitation permits for several offshore oilfields. Nowadays the company is carrying out exploration tasks in a joint-venture with Petrobras (from Brasil) and PDVSA (from Venezuela).

4 Gist

The irregular relations between the State and private oil firms were influenced mainly by the following factors:

- **Ideology of the sector in power**: the government of the country experienced many changes throughout the 20\(^{th}\) century. Conservative presidents were usually reluctant to give the state-owned companies a very strong role, since they thought that this could deteriorate relations with other countries, mainly the U.S.A. and the U.K. Military presidents also shared this point of view but the influence of strong nationalist ideas regarding oil, a “strategic resource” was also present. Although Perón was a strong supporter of nationalizing almost all public services, which indeed he achieved, but had no choice but to pragmatically call private capitals due to the lack of public funds and know-how required to increase the reserves. The last Military Junta (1976-1983) had a strong liberalist economic ideology and the nationalist influences were not present as in previous military governments. The two “radical” governments (“radical” makes reference to the name of the political party U.C.R., not to the ideology) had different attitudes, being Frondizi’s period friendly towards joint-ventures and being Illia’s government reluctant towards it. Finally, the Peronist government of Menem, going completely against the Peronist doctrine, completely deregulated the sector.

- **Financial situation**: the availability of public funds to be invested into YPF was also a deciding factor. As an example, Alfonsin’s series of measures to stimulate private investment and joint ventures were probably taken not on ideology grounds but because the state was suffering a serious budget deficit and had no funds to be spent on YPF.

- **Balance of trade**: the strong increase of oil imported forced Perón and later Frondizi and Illia to negotiate with private companies in order to be able to satisfy the demand.
• **Pressure of companies and governments:** the action of “loobies” was a decisive factor in the decision of finally selling YPF and deregulating the energy sector.

As a final conclusion regarding the process that took place in the 90’s, although the privatization of YPF was able to increase its productivity, it brought a huge amount of drawbacks, such as the lost of a profitable company and the lost of real control over reserves. The regime used between 1922 and 1990 was very effective in, first, achieving self-sufficiency, and later, in carrying out a rational exploitation of the resource and of making the country’s internal prices independent of international crises, without the use of any maximum prices policy and by controlling indirectly the end-user prices through an accessible price fixing by YPF, which had the biggest market share. Being YPF a state company, its only purpose was not to maximize profits. The granting of the special exploitation contracts similar to those granted during Frondizi’s presidency would have been an excellent alternative to solve the problems that the country faced at the beginning of the 90’s, without the need of selling the company. It is also important to remember that this privatization process was not transparent and that funded suspicions of corruption exist.

The leeway of the actual government is limited. The recently established company ENARSA lacks real infrastructure and the solution to the reserves depletion problem will for sure be present in the political agenda of the next years.
5 References


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