



## Shortcomings of Energy Policy in the Western Hemisphere

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Under the auspices of CSIS, the Simon Chair has just completed two years of research on oil, natural gas, and electricity policy in 11 oil and gas producing countries in the Western Hemisphere, from Canada in the north to Argentina in the south.<sup>1</sup> The focus in the research was on the political-economic-social context for making policy in each of the countries. However, the examination included material on infrastructure, the environment, comparative regulatory frameworks, and the roles of China and India in energy issues in the hemisphere. The research will be published in February by the CSIS Press (in a book entitled *Energy Cooperation in the Western Hemisphere: Benefits and Impediments*).

The main conclusion of the study is that, all in all, hemispheric countries have made more of a hash of energy policy than a success. In case after case, the political impediments to working together have overwhelmed cooperative endeavors. By cooperation we had in mind such things as providing accurate information on oil and gas reserve levels, coordinating oil and gas pipeline construction, vetting changes in regulations with other countries before adopting them, collaborating when planning liquefaction of natural gas (to make liquefied natural gas [LNG]) and regasification facilities in importing countries, and giving attention to limiting environmental degradation in producing oil, gas, and electricity. A recommendation is to replicate to the extent feasible what is done in international trade—to set rules for the conduct of trade while facilitating competition in the actual trading of goods and services.

The comments that follow illustrate the extent of noncooperation that prevails.

Hugo Chávez, president of Venezuela, regularly voices harsh anti-U.S. pronouncements. Perhaps his most vitriolic speech was given at the September 2006 opening of the United Nations General Assembly, when he compared President George W. Bush to Satan. Venezuela's actual energy and foreign policies are more nuanced, even as they gradually are becoming more nationalistic. Most of the oil that Venezuela's exports is still shipped to the United States, where the refining capacity exists for the country's heavy oil, and U.S. companies still provide the

bulk of Venezuela's imports of goods and services. Contract terms with foreign oil companies have been altered to increase Venezuela's tax take. Only this month, on January 6, President Chávez deepened what he called "twenty-first century socialism" when he said he would nationalize Venezuela's telephone company and change the terms of foreign holdings in the country's Orinoco belt of heavy crude oil, where the quantities of unconventional oil for future exploitation are enormous.

Among the large hydrocarbon producers in the LAC region, President Evo Morales of Bolivia is closest in philosophy to Chávez. Bolivia has large reserves of natural gas and its main export markets are Brazil and Argentina. Morales altered natural gas contracts to give the Bolivian treasury a larger tax take; and more significantly, he forcibly seized properties of foreign gas companies and gave the owners 180 days to comply with his demands or leave the country. The largest companies involved were Petrobrás, Brazil's national oil company, and Repsol-YPF, a Spanish-Argentine company. Morales then had to backtrack somewhat when the companies threatened litigation; and equally, if not more importantly, he discovered that Bolivia's national oil company lacked the expertise to run the seized operations. Both Brazil and Argentina now need the Bolivian gas, which is being sold at an even higher price than before, but this can change over time as Brazil develops significant new gas finds and Argentina, perhaps one day, removes the disincentives it has for investment in gas exploration. The final chapter on Bolivia's actions must still be written, and this could take many years if Bolivia's neighbors are able to replace part of the gas imports now purchased from Bolivia.

Under the Morales government, Bolivia continues to refuse to ship natural gas to Chile because of the ill feeling stemming from the loss of its outlet to the sea, resulting from its defeat to Chile almost 125 years ago in the War of the Pacific. Bolivia even refused to send natural gas to a port in Chile, the most convenient location, for liquefaction and shipment of LNG to Mexico and the United States.

The Argentine government, under President Néstor Kirchner, used price controls on natural gas to keep consumer costs low, and this resulted in a drastic drop in new exploration investment. There has been some easing of these controls since

<sup>1</sup> The full list of countries is Argentina, Bolivia, Brazil, Canada, Colombia, Ecuador, Mexico, Peru, Trinidad & Tobago, the United States, and Venezuela.

2002, but the lack of new investment largely explains Argentina's need to import large amounts of natural gas from Bolivia at prices higher than Argentine producers are allowed to charge. These gas shortages have also led to the termination of a contract for Argentine shipments of natural gas to Chile.

Chile is thus unable to buy needed gas from either Bolivia or Argentina. Peru, which in recent years has been developing its own natural gas resources, is reluctant to sell its gas to Chile, in part because of resentment from Peru's defeat in the War of the Pacific, and in part because of domestic needs and promises to send LNG to Mexico and the United States. The lack of cooperation in the Southern Cone of South America has prompted Chile to plan a regasification facility to receive LNG from as far away as Asia. To state the situation succinctly, Chile does not have friendly neighbors when it comes to obtaining natural gas.

Ecuador has the third-largest reserves of oil in South America, and it also has a history of conflict with foreign oil companies. The assets of Occidental Petroleum (Oxy) were seized in May 2006, and the company was forced to leave the country. Ecuador's president-elect, Rafael Correa, who will take office this month, has stated that, among other actions, he intends to renegotiate contracts with foreign oil companies. Some of his other statements were that he intends to rewrite the country's constitution, and that Ecuador must renegotiate its foreign debt. Potential foreign investors are waiting to see what actually happens when he is in office.

Mexico, the second-most-important oil exporter to the United States after Canada in recent years, is not politically obstreperous in its energy policy, but its future reliability as an oil exporter is not high. This is because its national oil company, Pemex, is taxed so heavily to finance about one-third of federal government expenditures that it has been unable over the years to devote enough funds to exploration, especially in promising deep waters of the Gulf of Mexico. Indeed, Pemex runs at a loss each year, even as the federal government's revenue has risen because of recent high world oil prices. At current rates of oil production and reserve replacement, Mexico's proven reserves will last only about 11–12 years longer. There are three ways that this problem can be resolved: collect more taxes; borrow more to carry out exploration; or accept private equity investment for joint ventures with Pemex, as most national oil companies in the hemisphere and elsewhere do. None is immediately feasible: successive administrations have failed in efforts to collect more taxes, and the new government under Felipe Calderón is unlikely to make higher tax collections a priority with a Congress in which Calderón's political party does not enjoy a majority; Pemex is already all borrowed up; and acceptance of private equity investment would require a constitutional amendment that would meet with little public favor. Mexico might luck out and make an important new discovery. But it may take an electricity crisis for Mexico to change its energy policy. This is normal practice for many governments: crisis first, correction later.

Brazil is caught up in the actions of other countries such as the nationalization of Petrobrás's gas operations in Bolivia and the announcement by President Chávez that he will alter the terms on foreign holdings of heavy oil in Venezuela's Orinoco belt. Chávez also proposed a megapipeline to bring gas from Venezuela, through sensitive terrain in the Brazilian Amazon, to Argentina, with pipeline spurs to Brazil and Uruguay. Petrobrás reacted positively to this, as did Argentina, but the general consensus among energy experts is that the pipeline is a political and not a practical project, because the gas would be more costly in Brazil and Argentina than facilities to receive LNG. LNG regasification would also inflict less environmental damage. Indeed, Venezuela now lacks the gas to make large shipments to Argentina. Petrobrás is an efficient national oil company that has many joint ventures with private investors. Unlike Pemex in Mexico, Petrobrás has developed great skills in deepwater exploration and the production of oil and gas.

The major problems facing Canada in its further development of the oil sands in the Western Canada Sedimentary Basin are environmental, including immense usage of fresh water and large emissions of greenhouse gases. Peru's Camisea gas reserves are in a delicate region of the country and key environmental problems remain to be resolved. Trinidad & Tobago is the most important exporter of LNG to the United States, but the country must deal with the environmental degradation caused by its oil, gas, and related production. Colombia must still deal with guerrilla activities interrupting oil flow through its pipelines.

Sales to the United States dominate the oil and gas scene in the Americas. However, U.S. foreign policy pays little heed to the hemisphere, even as it seeks cooperation on energy issues; and this is a serious discrepancy. Technical issues must always be addressed to produce oil and natural gas. The issue that has been highlighted here is that hemispheric countries must also resolve political problems to derive maximum economic benefit from the exploitation of their hydrocarbon resources. There is no simple answer as to which problem is more difficult. However, I think I can say with confidence that once it is established that oil and natural gas resources are available, failures of cooperation within and across countries are due more to political conflicts than to technical problems.

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