A Latin American Opportunity in World Energy Woes

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The outlook for U.S. energy security is unclear at best and troubling at worst. Two-dollar-per-gallon prices for gasoline are just the most obvious and direct sign. In the view of energy industry analysts and policymakers, there is a host of short and long-term worries that make reliable oil supplies and pricing uncertain.

Herein lies an opportunity to boost Latin American economies and enhance U.S. relations with the region. The more Latin America develops its oil and natural gas sectors, the more important the region becomes to U.S. interests. This, too, brings the added benefit of enriching the region's own treasuries and catalyzing the broader social and economic gains envisioned by the Washington Consensus, which has sought to broadly improve living standards in every corner of the hemisphere.

Some of the day's energy inflation is simply driven by supply and demand. After all, the U.S. economy is expanding at its fastest rate in 20 years, and 2003 and 2004 are the first years since the mid-1980s that the U.S., European, and Japanese economies have grown simultaneously. China's booming economy has made it the world's second largest oil consumer. Demand for oil is proving to be stronger than expected in Brazil and India.

Yet global supply has no cushion left with non-OPEC nations, which have zero extra capacity, and only the United Arab Emirates and Saudi Arabia sit on any surplus production.

But a more significant factor, and one which is harder to quantify, is what

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some observers have called a "terror premium"—a cluster of flash points that account for perhaps nearly 25 percent of current prices, near $50 a barrel, and that show no indication that stabilizing even one of them will bring lower prices or ease worldwide oil anxieties.

Saudi Arabia. The Big Kahuna of oil production, Saudi Arabia exports eight million barrels every day, or about 10 percent of the world's consumption. But there is a growing crisis of confidence in Riyadh's ability to keep its oil flowing. Al-Qaeda attacks have foreign oil industry workers terrorized and doubtful of the government's ability to protect them: Saudi security forces have been penetrated by anti-Western militants, and even the House of Saud is turning increasingly to non-Saudis for its own safety. If Saudi oil production were to shut down for just a few days, the reverberations, especially for the U.S. economy and stock market, would be massive.

Iran. War in neighboring Iraq continues to reverberate throughout Iran, which would like to extend its influence in the Persian Gulf, even as it finds itself at odds with U.S. strategic interests. Iran's three million barrels a day of production are key to world oil prices. In addition, its increasingly aggressive stance in the Gulf risks pushing oil prices even higher, if Iranian warships threaten tankers in the narrow Straits of Hormuz.

Iraq. Supposedly the world's next great oil source, the country has yet to match its prewar 2.8 million barrels of daily production. Regular terror attacks on pipelines and infrastructure make Iraq unlikely to pick up its own slack on production any time soon.

Adding to the pressure on energy prices are other ongoing developments, such as tribal violence and threats of civil war in oil-exporting Nigeria, as well as production disruptions in the Gulf of Mexico during a brutal hurricane season.

It is a situation that has led T. Boone Pickens, the legendary oilman and energy entrepreneur, to speculate about gasoline rising above $3 a gallon in the United States. In his view, the global oil industry is "pretty close to peaking on what [it] can produce. We're dealing with decline curves on some big oil fields. All the refineries around the world are running at full capacity. Demand is going up. OPEC is basically maxed out."

Latin American leaders, policymakers, and energy ministers should take advantage of this crisis. While the United States and other industrialized economies focus on and fret about events in the volatile Middle East, Latin America has oil and natural gas resources that, if developed strategically and with long-term perspective, can do much to address growing global demand and economic uncertainty.

Venezuela, as the possessor of some of the region's largest oil reserves, is an obvious place to begin. Called "another Saudi Arabia"[1] for its huge deposits of crude oil, it also faces great obstacles to increasing the region's energy production.

In fact, former U.S. State Department energy policy official, Edward Morse, and a Saudi Arabian government advisor, Nawaf Obaid, have suggested in *The New York Times* that the jump in world oil prices and Venezuela's attendant roiling of global financial markets has its roots in the 2002-2003 strike by workers at state-owned Petróleos de Venezuela (PDVSA). The strike removed some 200 million barrels of crude oil and gasoline from world supplies.[2]

Venezuela has not assumed a hemispheric energy leadership role since the strike. President Hugo Chávez has become a hawkish voice on keeping production tight and prices high. He has also floated the idea of a Latin American energy conglomerate, which has been called Petroamérica. It would knit together various state oil companies into a hemispheric OPEC.

PDVSA's production capacity has continued to decline since the strike—down 19 percent in 2003 from 2002 and still declining in the first quarter of 2004, according to some reports—so higher oil prices are the country's easiest way to boost revenues. There are privately owned or operated oil projects that could increase production if conditions—financial and regulatory—were right. However, in the end, if political calm took root in Venezuela and the necessary legal and tax reforms followed, private investment could flow to Caracas and a broadly revived energy sector would be possible.

The April announcement that PDVSA and unnamed foreign partners would invest $37 billion over the next five years—$27 billion from the state-owned company and $10 billion from foreign companies—to raise Venezuela's total oil production to 5 million barrels per day by 2009 from the current 2.6 million is encouraging, if it is true. Given that Venezuela sits on 78 billion barrels of proven oil reserves and 4 trillion cubic feet of natural gas, there is potential for this money to be well spent in raising the country's energy production and revenues. But Venezuela lacks its own capital to put this planned production increase into play, and foreign investors will not be running to Caracas until political stability and a professional, rather than political, PDVSA are assured.

Mexico, too, has the potential to boost both hemispheric energy production and global oil supply. Already the second largest oil exporter to the United States, Mexico potentially sits on some of the largest undeveloped reserves in the world.

Here is the rub: while government-run Petróleos Mexicanos (PEMEX) is the sector's dominant player, Mexico's constitution makes investment difficult for foreign companies. As a result, the exploration, technology, pipelines, infrastructure, and capital needed to further develop Mexico's oil sector can be tough to come by.

Even so, American and other international investors are ready to work in Mexico, and energy cooperation between the United States and Mexico is partly underway. Mexican President Vicente Fox and the recently retired PEMEX General Director Raúl Muñoz Leos have made energy development with the United States a priority. During the 2001 California energy crisis, Mexico provided electricity to the state to light 50,000 homes at a time when brownouts and rolling blackouts were everyday occurrences. Now President Fox has offered the Bush administration broader energy development as part of a plan to align more closely both nations and to add other key issues, like migration reform and homeland security, to the well-established agenda of drug interdiction, water, and trade.

But U.S.-Mexico energy cooperation is far from fulfilling its potential. From the American side, only high-level, sustained discussions—not the episodic, on-again-off-again relationship of the past four years—will build momentum. Constitutional changes in Mexico for foreign direct investment in the energy sector are essential for the country to leverage its oil resources, to replenish dwindling reserves, and to fuel far-reaching development through the country's economy.

There are a host of other energy opportunities in South America. Many will be surprised to learn that oil reserves in Ecuador are equal to those of Angola, which has been a hotspot for oil exploration. But companies are lining up in Africa, not the Andes, because the latter region's decision makers at times stand in their own way. There are ongoing questions about the government's respect for signed contracts, the rule of law, and international arbitration—the clarification of which would help international investment.

Today, ChevronTexaco, Duke Energy, Occidental Petroleum, and other international firms are locked in disputes with the Ecuadorian government. But President Lucio Gutiérrez has come to understand that businesses need stability and reliability to operate in foreign markets, the absence of which is handicapping his nation's competitiveness while also risking its free trade talks with the United States. The fact that only three percent of Ecuador's oil is now tapped means the country could be an important producer in the world if it gets its energy house in order and continues to highlight responsible economic development instead of political brinksmanship with foreign investors.

Colombia is the tenth-largest exporter to the United States, shipping more oil than heavyweight producers Russia, Oman, Algeria, and the United Arab Emirates. Moreover, it is also one of the great overlooked resources for the hemispheric economy. A country mostly known for its war against narcoterrorists, Colombia and its oil industry usually gained notice only when its Cano Limon pipeline was attacked, which cost the nation $400 million in 2002 alone. Now that the pipeline, with U.S. help, is well defended, increased oil revenue could redefine Colombia's profile and boost the country's economic ties to the world.

Some 8 trillion cubic feet of natural gas sit beneath the ground and off the shores of Latin America, awaiting development and full commercialization. Right now, Peru, Bolivia, Argentina, Brazil, and Trinidad and Tobago are poised to join the energy producer club. Latin America could reshape world energy markets if—and this is a big if—the natural gas it sits on can be efficiently moved as a viable, mass-market resource.

U.S. Federal Reserve Chairman Alan Greenspan—arguably the most trusted economic voice in the United States—sought to put natural gas squarely on the national energy front burner in early 2004, when he encouraged companies to begin expanding their natural gas infrastructure so imports could be boosted in the coming five to seven years. With proximity to the United States, the aforementioned countries, along with Venezuela, have the potential to become mainstay natural gas suppliers, ahead of competitors Australia, Indonesia, Russia, Libya, Algeria, and others. But this can occur only after they commit to smart, innovative development and begin to attract investment.

Currently, only Trinidad and Tobago is widely accepted as having advanced commercial development of its natural gas reserves. The nation is working within the Caribbean Community (CARICOM) to sort out how to integrate its resources into the island region's energy market. But Venezuela is considered to be 25 years behind schedule with the building of its natural gas capacity, which began in the late 1970s. Bolivia's fierce rivalry with neighboring Chile and intense nationalism have all but undone plans to build the $7.5 billion Pacific liquefied natural gas project, which would have extended exports all the way to terminals in Mexico.

Energy development has an extremely long lead time. It took Detroit seven years to get fuel-efficient cars to market after the 1979 Iranian Revolution, which sent energy prices to the equivalent of $60 per barrel in today's dollars. The last new major oil refinery to produce gasoline went on line in the United States. in 1976, after years of legal, environmental, political, and financial wrestling. For Latin American nations to commoditize their energy resources, they will require an international effort combining technology, investment, transportation, construction, and diplomacy. Furthermore, there will be risks to Latin American treasuries and communities, and to U.S. consumers and world markets, which are now too dependent on the increasingly dangerous and unpredictable Middle East.

U.S. energy and foreign policymakers should remember that each $10-per-barrel increase in crude oil prices yields $70 billion in higher costs to American consumers through inflation; in effect, the price increase constitutes a tax on many elements of the U.S. economy. If the real costs are not alarming enough, there is the competition as well: state-owned Brazilian oil company Petrobras has signed a $7 billion agreement to find, produce, and refine oil primarily in Latin America with Sinopec of China. Both Chinese and Indian state-owned oil companies are active in Ecuador, led by India's ONGC Videsh, Ltd., which is exploring a $1.5 billion investment.

Continuing to fiddle while the Middle East literally and figuratively burns is a missed opportunity for economic development and national security. People and communities in Venezuela, Bolivia, Colombia, and elsewhere, for whom energy is an unrealized birthright—as well as by the rest of the world, in need of energy, economic, and political stability—pay the price.

The difficult conditions necessary to elevate Latin America to the status of a global energy player have been attained: the resources are known, the need is established, demand is growing, and technology is off the shelf from U.S. and European energy firms. What awaits is the political and business leadership, the investment, and the vision to create a partnership between Latin America and the United States. to reshape global energy realities. ■

NOTES

1 "Big Oil and a Revolution," *The Economist*, September 9, 2004, <http://www.economist.com> (accessed November 3, 2004).

2 Edward L. Morse and Nawad Obaid, "The $40-a-Barrel Mistake," *The New York Times*, May 25, 2004 <http://www.nytimes.com/2004/05/25/opinion/25MORS.html> (accessed November 6, 2004).