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How Does the Current Surge in Oil prices Compare to 2008?

Inter-American Dialogue's Latin American Energy Advisor

Q and A: How Does the Current Surge in Oil Prices Compare to 2008?

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With ongoing tensions in the Middle East, oil prices have soared to heights not seen since before the economic crisis. What is the impact of the surge in oil prices on Latin American countries? Which countries and industries stand to benefit? Which stand to lose? How does the situation compare to the last time prices reached $100 per barrel in 2008?

A: William (Hunt) Buckley and Larry B. Pascal, attorneys with Haynes and Boone in Mexico City and Dallas:

"Some of the effects attributed to soaring oil prices are already being felt in Latin America. At first glance, it would seem that countries with significant oil resources can only benefit from higher prices. Net exporters, such as Mexico and Venezuela, are generally expected to report a positive impact on their public finances and appreciation in their currencies due to oil price increases. Other Latin American countries with oil production, such as Brazil and Colombia, are also expected to reap the benefit of increased prices, especially within the oil and related industries. In Mexico's case, oil price increases may also make Pemex's new contract model more attractive, because Pemex's limit on payment is tied in part to oil prices. However, unless offset by factors such as increased efficiencies, inflation caused by high oil prices can potentially reduce the benefits and could introduce destabilizing political factors. Countries that provide subsidies or enforce price limits on staple products, transportation and energy may have to confront some politically unpopular choices. They may have to phase out or eliminate subsidies, increase prices, or, to support subsidies, borrow or tax more or dip into oil-generated surpluses. Some may simply defer politically unpalatable decisions to the next government. For net importers, the situation is exacerbated because, without oil-generated support, their choices are more limited. Any action taken will likely trigger some level of political disaffection and uncertainty. Moreover, the world economy is arguably in a more tenuous condition, due to the lingering effects of the global financial crisis, lack of confidence in many developed markets to meet their sovereign debt commitments and sustained unemployment. Finally, currency appreciation makes one's exports more expensive and hence less competitive and both Brazil and Mexico are fighting the effects of this situation."

A: Paul Isbell, visiting senior fellow at the Inter-American Dialogue:

"The price of Brent crude was already approaching $100 per barrel when the 'Jasmine Revolutions' of Tunisia and Egypt bloomed at the beginning of 2011.When the price shot up by 20 percent in just two months, it seemed reasonable to ask whether the unrest in the Arab world might provoke a spike in oil prices with negative consequences for the global economy. A week ago one might have quickly answered the question with relation to Latin America: a severe price spike would help the region's large, yet struggling oil exporters, like Venezuela and Mexico—at least in the short-run—bolstering their indebted NOCs and buoying national finances. However, a truly significant and sustained price rise would destroy demand, choke off the world's incipient recovery and send oil into longterm decline. Only true energy policy reform would be able to translate higher prices into longer term stability and prosperity in such clumsy producer states. Central America and the Caribbean would be the most vulnerable to a price spike, sustained or not, given the subregion's near complete dependence on imported oil. Perhaps Petrocaribe could alleviate the pain, but in an increasingly unstable economic and political environment, no one is going to bet on Venezuela remaining or becoming their white knight. Meanwhile, net exporters (like Colombia and Ecuador) would have something to gain in the short run and net importers (like Chile) would suffer, at least in relative terms. Brazil might have the most to gain, as higher prices supported both its biofuels and subsalt bids, and as the resulting instabilities provided an increasingly interesting diplomatic stage on which Brazil might operate. But ultimately Latin America—better off now than ever before—would remain vulnerable if higher oil prices halted Chinese economic growth. But the world is a very different place than it was a week ago. Japan is facing a triple calamity and the world's negative consequences for the global economy. A week ago one might have quickly answered the question with relation to Latin America: a severe price spike would help the region's large, yet struggling oil exporters, like Venezuela and Mexico—at least in the short-run—bolstering their indebted NOCs and buoying national finances. However, a truly significant and sustained price rise would destroy demand, choke off the world's incipient recovery and send oil into longterm decline. Only true energy policy reform would be able to translate higher prices into longer term stability and prosperity in such clumsy producer states. Central America and the Caribbean would be the most vulnerable to a price spike, sustained or not, given the subregion's near complete dependence on imported oil. Perhaps Petrocaribe could alleviate the pain, but in an increasingly unstable economic and political environment, no one is going to bet on Venezuela remaining or becoming their white knight. Meanwhile, net exporters (like Colombia and Ecuador) would have something to gain in the short run and net importers (like Chile) would suffer, at least in relative terms. Brazil might have the most to gain, as higher prices supported both its biofuels and subsalt bids, and as the resulting instabilities provided an increasingly interesting diplomatic stage on which Brazil might operate. But ultimately Latin America—better off now than ever before—would remain vulnerable if higher oil prices halted Chinese economic growth. But the world is a very different place than it was a week ago. Japan is facing a triple calamity and the world's markets have responded with swift retreat. Oil prices are falling again, not only from the increase in Saudi production and the sense that Gaddafi will soon manage to revive Libyan production, but most seriously from the spreading gloom cast across the global economy by the disaster in Japan."

A: Gianna Bern, president of Brookshire Advisory and Research in Flossmoor, Ill.:

"Undoubtedly, the dramatic increase in oil prices will benefit the larger oil producing nations in Latin America such as Brazil and Mexico. Certainly, major oil producers such as

Petrobras and Pemex will benefit as Brent and WTI crude oil prices top $115 and $100 per barrel, respectively. Industries hardest hit will be the large commercial users of fuels such as airlines, agribusiness and other transport sectors. Sustained increases in Brent crude prices beyond $125 per barrel have the propensity to slow economic growth in many countries, including Latin America. The recent increases in crude oil prices differ substantially from that of 2008 when crude oil prices reached $147 per barrel. Brookshire research revealed a fundamental crude oil shortfall of approximately 1.5 million barrels of crude when compared to global crude oil demand in 2008. This differs dramatically to recent price increases, which are driven primarily by geopolitical risk and potential production disruption concerns. For lack of a better term, there is a fear factor in today's crude prices. Middle East unrest is a market shock not experienced in the energy markets since the 1990s."

A: Francisco Ebeling Barros, member of the board of Economics and Energy Policy of the Brazilian Institute of Oil, Gas and Biofuels in Rio de Janeiro:

"In recent years, commodity speculation has risen considerably as other assets became less attractive. This led to higher prices, especially in the foods market, which meant, for many countries, higher inflation rates. This was also true for oil prices, although not reaching the same levels of prices observed around mid 2008. In this context of recovering prices, with the ongoing tensions in the Middle East, there is a trend of even higher prices, especially if they are able to destabilize Saudi Arabia, the core of the OPEC cartel. For Latin America, this crisis has a different meaning than for developed countries such as the United States and, for instance, China. Unlike those countries, which depend on foreign oil and have to worry about whether or not they can count on Middle Eastern oil, most countries in Latin America have an oil surplus or consume small amounts. Therefore, Latin American oil exporting countries tend to become increasingly attractive oil markets. In this sense, in the next few years, Chinese and American E&P investments will skyrocket, as those leading countries see Brazil as a reliable partner in the oil business. This is also true for Venezuela, which manages to maintain stable oil exchange flows with the United States despite Chaves' antiimperialistic rhetoric. China has also great interest in Venezuelan oil. Furthermore, higher prices should not have a relevant negative macroeconomic impact in Latin America. On the contrary, higher oil prices will mean higher oil revenue for oil exporting countries such as Brazil, Mexico, Colombia and Venezuela, which will positively impact their payment balances. Cuba, for instance, has favorable oil importing conditions due to its close ideological ties with Venezuela. And countries such as Uruguay or Chile are not very big consumers. In one word, there are not many significant losers. The 2008 price downturn taught oil companies not to use high prices as guiding parameters for new projects, knowing that, in the long run, prices will rise but never as abruptly as is happening now. Thus, higher oil prices should not make them invest even more."

A: Matt Hartwig, director of public affairs at the Renewable Fuels Association:

"The recent surge in U.S. exports of ethanol is good news for U.S. producers struggling with a capped domestic market and tight margins. But these increased exports raise two critical questions: Should the United States be maximizing its use of domestic renewable fuels like ethanol to displace oil imports? Or, should the United States continue to look to overseas markets to help its balance of trade? The answer to both is yes, but all in due time. The U.S. ethanol industry has been built as a tool to address the nation's dependence on imported oil. Yet, artificial caps are placed on the amount of ethanol the United States can blend into a gallon of gasoline.

The Obama administration should lift that cap to at least 15 percent ethanol in each gallon, as a current waiver from the ethanol industry requests, for all vehicles on American roads. Such a move, together with investments in ethanol infrastructure and new technologies would ensure the United States is maximizing the benefits of domestic ethanol production and use. Only after the United States has realized these benefits should it actively look to overseas markets for its ethanol. A global trade in ethanol should and will develop. In the meantime, each nation should be allowed to realize its own potential without interference from other nations."

A: Gal Luft, executive director of the Institute for the Analysis of Global Security in Washing-ton:

"The United States has vast potential to increase its ethanol production capacity, but the ability of its domestic market to absorb the fuel has maxed out. The reason: in the United States, ethanol is used as a fuel additive and Environmental Protection Agency (EPA) regulations allow cars to burn fuel that contains as much as 10 percent ethanol. Once the industry reached this blend wall it can only grow by exporting its product. This is why its main lobbying priority is to raise the blend wall to 15 percent. The EPA's ruling on whether or not to do so is due this month. Should the EPA rule in favor of the industry, the domestic market will expand and the industry is likely to shelve its plans to export product. Should the Obama administration decline to raise the blend wall, we can expect the U.S. ethanol industry to divert growing parts of its yield to foreign markets while fighting hard to maintain the 54-cent-per-gallon tariff on imported ethanol. This does not necessarily mean a loss of market share for Brazilian ethanol. Brazil's sugar industry has experienced a bumper crop this year and the country's ethanol production is expected to rise 19 percent. But Brazil is also on the verge of opening a vast new market for its ethanol: Iran, which faces sanctions on imported gasoline. Brazil's ethanol would allow Iran to replace as much as 20 percent of its gasoline requirement hence neutering the sanctions. Oil prices are expected to rebound, sanctions on Iran passed this week and global demand for ethanol will increase. Neither Brazilians nor Americans should worry. There will be sufficient market for ethanol for everyone to profit."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at kuleta@thedialogue.org with comments.*