7-25-2011

Can Latin America Capitalize on Oil Wealth in the Long Term?

Inter-American Dialogue's Latin American Energy Advisor

INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ ENERGY

Q and A: Can Latin America Capitalize on Oil Wealth in the Long Term?

Citation: Inter-American Dialogue's Latin American Energy Advisor July 25-29, 2011; pp. 1, 3, 6. Also online at **www.thedialogue.org**.

Venezuela holds some 85 percent of Latin America's crude oil reserves, and the region overall has the world's second-largest oil reserves after the Middle East, according to figures presented by the Latin American Energy Organization (OLADE) at a two-day seminar earlier this month in Quito. Looking ahead 20 years, what are the geopolitical implications of Latin America's vast hydrocarbon resources? What energy trends will shape the economies of Latin America and the Caribbean in the long term, and how can the countries of Latin America best capitalize on energy wealth in the global environment moving ahead? Can Latin America avoid the political turmoil and other "oil curse" hazards that have long plagued nations of the Middle East? How?

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

"OLADE's reserves estimate is very optimistic with respect to the ultimate viability of the Orinoco's vast, super-heavy oil reserves, and quite pessimistic with regard to the eventual exploitation of Brazil's potentially massive subsalt reserves. One should not assume that being dominant on OLADE paper makes one the dominant oil power of Latin America. While Brazil's internationally-recognized proven reserves currently stand at around 15 billion barrels, a range of official and independent estimates put Brazil's eventual level of proven reserves anywhere between 50 billion and 200 billion barrels, potentially taking its share of Latin American oil reserves from 5.6 percent to somewhere between 18 percent and 46 percent. The geopolitics of this very different picture offers an historic opportunity for Brazil, but it will have to avoid falling into the trap of the oil curse. If Brazil can create and manage a countercyclical state oil fund to counteract the effects of Dutch disease, and continue to tack a moderate and counter-cyclical energy policy direction, maintaining sufficient space and incentive for IOCs to invest in Brazil's subsalt and calibrating the state's take to rise and fall with oil prices (something that would both feed the oil fund and encourage investment at times of lower prices), then it might be able to follow in Norway's footsteps rather than Venezuela's in this regard. Oil will certainly affect the future geopolitical balance in the Atlantic Basin in favor of Brazil, but shale gas—an unconventional gas resource now in the midst of an expanding but controversial revolution—could easily be the big game changer in Latin America over the long run. Argentina possesses the world's third largest reserves of shale gas, behind China and the United States. Of course, to avoid the resource curse, Argentina would need significant internal change, but its shale gas might also stimulate an expansion of gas-to-liquids technology (GTL)–of which South Africa is the global pioneer. A shale gas-GTL dynamic would allow potentially huge new shale gas reserves to not only displace coal, nuclear and even hydropower in the region's electricity mixes, but also potentially large amounts of petroleum-based fuels used in transportation."

A: Nelson Altamirano, associate professor of economics at the School of Business and Management at National University:

"Venezuela holds the largest reserves of crude oil in the region, but natural gas is more evenly distributed between Venezuela, Colombia, Ecuador, Peru, Bolivia, Argentina and Brazil. The re-confirmation that Venezuela holds 85 percent of Latin America's crude oil reserves poses a challenge to Venezuela more than the other countries in the region because it is the country where economists agree the mechanisms and predictions of the Dutch disease and resource curse apply undoubtedly. There is an open discussion when applying these explanations to the other Latin American countries, but not for Venezuela. Venezuelan policymakers should learn from the Chilean copper experience. To avoid the distortions of huge revenue fluctuations due to the ups and downs of international prices, Chileans have a copper stabilization fund. This fund creates the conditions for stable sustainable fiscal policy. Of course, a national copper company is at the center of the copper policy. Codelco, like PDVSA, is the largest corporation in the country, but is efficient and a leader in the industry in terms of technology, management practices and market price maker. Codelco operates independently from short-run political interests, but it is fully accountable to the government and public in general. If there is a firm that is followed in the press every day, it is Codelco. Finally, the industry is open to foreign competition and the northern region is not only the largest copper hub in the world, but it is a region that is to the copper industry what Silicon Valley is to the software industry."

A: Roger Tissot, independent energy economist:

"According to OPEC, Venezuela's proven reserves are 296 billion barrels, higher than Saudi Arabia (264 billion). The key difference between both OPEC countries has been in their capabilities to increase production—or 'excess capacity.' Saudi Arabia has had that capability, while Venezuela has not. Thus, the Arab country has been able to impose some sort of discipline based on the threat a flooding market would hurt other OPEC members more than the Saudis. In recent years, the surge in demand reduced the Saudi's 'excess capabilities,' resulting in increased price volatility. Now, Venezuela is not only set to increase its reserves but also its production with the assistance of foreign oil companies, particularly Chinese NOCs. In the medium- to long-term, Latin America should become an even more relevant player in the oil market, since Brazil's output and reserves are also expected to continue their fast-growing trend. Any additional energy reform in Mexico could also unleash vast reserves from deep offshore waters in that country. Sadly, it is unlikely the region can capitalize from 'energy wealth' if it continues with its traditional 'rentier' strategy. In fact, the 'oil curse' is something the region has experienced already too often, including the Mexican crisis—when the government overextended its spending believing that the vast Cantarell oil field and high oil prices were a golden goose that would last forever. Venezuela's oil boom during the first Carlos Andrés Pérez administration lead to a steady decline and eventual collapse of the economy and the political structure of that country, and eventually the rise of Hugo Chávez. Ecuador and Colombia have also not been exempt from the oil curse: heightened social conflict, increased corruption, over-valued currencies, Dutch disease, inflation, etc. However, contrary to the Middle East, Latin American countries' democratic institutions have strengthened in the last two decades, allowing perhaps for some cautious optimism. But again, the most challenging case is Venezuela, where the future is increasingly uncertain due to the 'caudillo's' health problems and growing economic imbalances. In a way, Venezuela resembles more a Middle Eastern country than a Latin American one."

A: Gustavo Roosen, president of the board of Instituto de Estudios Superiores de Administración in Caracas:

"As the supply-demand balance of oil becomes more precarious due to increasing supply constraints, the vast oil resources in Latin America will gain importance. Latin America has different levels of resources, Venezuela being by far the most prolific. The state of maturity of industry and their potential to tap those resources into production to market is also different. The development of the Orinoco Belt and the Brazilian and Mexican deep offshore reservoirs will call for innovative ways of balancing private foreign capital participation and the resource nationalism of the region. Traditionally, the more resources a country has, the more restrictive the access to it becomes. To tackle this Gordian Knot is one of the biggest challenges. China's recent resource hunting is an indication of the geopolitical importance of those resources. It has added complication for governments to choose between partners that are politically expedient but do not possess the best technology. The Dutch disease effects will also need to be tackled. The abundance of oil provides opportunities to those countries, but also limits the need for economic diversification and competitiveness which must generate social opportunities and sustainable employment to a young population. On the demand side, the region will be very dynamic. However, Central American and Caribbean countries are victims of high energy prices. A solution that does not smell of 'energy colonialism' needs to be implemented if these countries are not to be left behind. Latin America is in a strong position for economic growth with availability of natural resources, including a diversified ecosystem. If only the region could develop the necessary institutional framework to be able to transform that potential into a sustainable reality, the sky should be the limit."

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