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Argentina's Energy Pricing Challenges

Pablo Fenández-Lamela

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Energy Challenges in the Americas

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Cover Image:

Ribeirao das Lajes dike with its forest bordering the reservoir, an example of Light S.A.'s reforestation program. Light, a subsidiary in Brazil of the French company EDF (Électricité de France), distributes electricity to 80% of the State of Rio de Janeiro and implements environmental protection programs. ANTONIO SCORZA/AFP/Getty Images.

Argentina's Energy Pricing Challenges

By Pablo Fernández-Lamela

Argentina's most immediate energy challenge is pricing—a situation it has in common to varying degrees with many other Latin American countries. Since 2002, the Argentine government has capped the price of oil, gas and electricity substantially below market levels. The result has been a sharp drop in energy investments, rising consumer demand and growing subsidies. The government has taken some measures to address the situation but the central problem persists: To attract investment, reduce wasteful consumption and increase hydrocarbon reserves, Argentina needs to let markets determine most energy prices.

For the past two decades, Argentina has been a net energy exporter, but low prices, declining production and rising domestic demand have brought the country close to becoming a net energy importer. Oil output decreased by 27% between 1998 and 2010, and gas production has declined by 10% since 2004. Oil exports dropped by 64% from 2001 to 2009; gas exports plummeted by 88% from 2004 to 2009. Proven reserves of oil declined 22% in the last 10 years and gas reserves have fallen by 55%.

In the 1990s, Argentina shifted its heavily state-managed energy sector to private ownership and introduced a series of other energy-related reforms. State oil, gas and electricity companies were mostly



privatized and new policies and regulations promoted foreign investment in energy companies. Production of oil, gas and electricity went up, while costs per unit came down. Argentina became an energy exporter.

Since the country's 2001-2002 economic collapse, the Argentine government has kept energy prices artificially low. The price of oil is 70% of its international reference price. Gas and electricity prices have fared worse at only 20% and 30% of international references. Sustaining low consumer prices (which leads to inefficiently high use) requires the government to subsidize imports during months of elevated demand, with major fiscal consequences. During the first three quarters of 2010, the Argentine government spent approximately \$4.5 billion on energy subsidies, or about 1.3% of GDP. From 2002 to 2009, oil and gas subsidies cost

the Argentine government \$55 billion. Energy subsidies have also been a source of friction in Argentina's external relations; for example, high domestic usage allowed the Argentine government to halt exports of natural gas to its neighbor, Chile.

Raising energy prices is an extraordinarily sensitive political matter in Argentina, as it is in many other Latin American countries, but it is essential for the health of the energy sector and for the country's longer-term development. Without higher prices, neither foreign nor domestic investment will be available for energy exploration or production, and subsidies will continue to drain Argentina's fiscal resources. ■

Pablo Fernández-Lamela is a Master of Public Administration candidate at Harvard University's John F. Kennedy School of Government.