

Energy and Development in South America: Conflict and Cooperation

*Edited by Cynthia J. Arnson, Claudio Fuentes,
and Francisco Rojas Aravena
With Jessica Varat*

First South American Energy Summit © Eduardo Morales/epa/Corbis
Front Row L-R- Colombian President Álvaro Uribe, Chilean President Michelle Bachelet,
Bolivian President Evo Morales, Venezuelan President Hugo Chávez,
Brazilian President Luiz Inácio Lula da Silva

Back Row L-R- Uruguayan Vice-President Rodolfo Nin Novoa,
Ecuadorian President Rafael Correa, Guyanan Prime Minister Samuel Hinds

Oil Rig in Stormy Sea © Steve Bloom/Getty

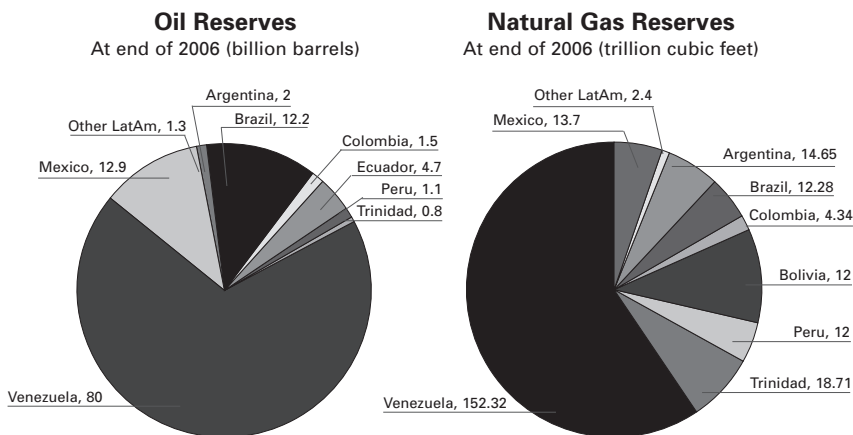
Contents

- 1 Introduction**
Cynthia J. Arnson and Jessica Varat, Latin American Program, Woodrow Wilson Center
- 9 Energy and Development in South America**
José Miguel Insulza, Secretary General, Organization of American States
- 13 Energy Integration in Latin America: Limits and Possibilities**
Francisco Rojas Aravena, Secretary-General, Facultad Latinoamericana de Ciencias Sociales (FLACSO)
- 19 The Crisis in the Argentine Energy Sector and its Regional Impact**
Thomas A. O’Keefe, Mercosur Consulting Group
- 27 Chile’s Choices: Securing Supplies and Maintaining Growth**
Oscar Landerretche, Universidad Técnica Federico Santa María
- 35 Venezuela: Energy, the Tool of Choice**
RoseAnne Franco, PFC Energy
- 41 Diversifying the Energy Matrix: The Case of Brazil**
Sergio Trindade, SE2T International

- 49** **Energy and Bad Luck in Bolivia**
Humberto Vacaflor, *Siglo 21*
- 55** **Oil and the Transformation
of the Ecuadorian State**
Walter Spurrier Baquerizo, Grupo Spurrier
- 61** **Energy, Development,
and Regional Integration**
David Mares, University of California, San Diego
- 73** **Author Biographies**

Venezuela: Energy, the Tool of Choice

RoseAnne Franco



It is impossible to discuss energy in Latin America without addressing Venezuela. The country houses the largest hydrocarbon reserves in the region, registering some 80 billion barrels of proven oil reserves and 152 trillion cubic feet (tcf) of natural gas. So it is not surprising that the administration of President Hugo Chávez has decided to tap these vast hydrocarbon assets to move his ambitious regional energy integration and social development agendas forward.

On the energy front, Chávez's vision has both domestic and international aspects. First, the Venezuelan president is eager to assert Venezuela's national sovereignty within the domestic energy industry, which was evident in the promulgation of the 2001 Hydrocarbon Law.¹ Second, he has tasked *Petróleos de Venezuela (PdVSA)* with social and industrial development initiatives at home and abroad. Moreover, Chávez is committed to reducing Venezuela's economic dependence on the United States and diversifying *PdVSA's* client base.

Finally, Chávez seeks to facilitate energy integration in the Caribbean and Central and South America and to engage with other regional powers (e.g., Russia) to counterbalance U.S. global influence.

With respect to the government's energy agenda, the activist regional role being pursued by Caracas is nothing new. Historically, Venezuela appears to assume a leading role following periods of high oil prices, which create windfalls. For example, in 1980 Venezuela, along with Mexico, signed the San José Accord, which continues to provide crude oil and refined products to eleven Central American and Caribbean nations on favorable terms. The cooperative agreement was reached shortly after oil prices had reached record levels triggered by tensions between the United States and Iran. In other words, Caracas assumes a more activist role on the continent whenever it can afford to do so.

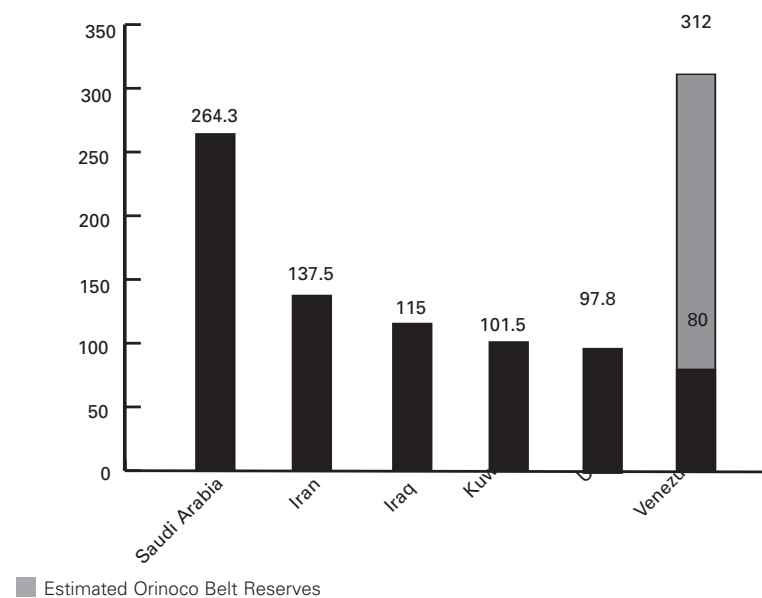
Therefore, it is consistent with the behavior of previous Venezuelan governments that Chávez has been pursuing a new wave of regional energy efforts since 2002, fueled by steadily rising oil prices. Among the government's high profile projects are PetroCaribe, PetroAndina, and PetroSur. To varying degrees, these energy agreements seek to integrate Latin American countries' energy sectors and, in particular, to foster cooperation between PdVSA and other National Oil Companies (NOCs). Another important component of Chávez's regional energy integration strategy is the development of the Orinoco Oil Belt. While its reserves are still undergoing certification, the area is estimated to hold some 233 billion barrels, which when coupled with existing oil assets, would place Venezuela ahead of Saudi Arabia in terms of overall petroleum reserves. Accordingly, Chávez would like the Orinoco Belt Reserves to be viewed as a reliable energy source for the continent. To mitigate the technical difficulties and costs related to refining Orinoco's extra heavy crude, Chávez has proposed the expansion and upgrading of numerous existing refineries around Latin America. The development of the Orinoco Belt provides an opportunity for regional NOC-NOC cooperation. It is divided into 27 blocks and five Latin American NOCs—Brazil's Petrobrás, Argentina's Energía Argentina S.A. (ENARSA), Uruguay's Administración Nacional de Combustibles, Alcohol y Portland (ANCAP), Ecuador's Petroecuador, and Chile's Empresa Nacional de Petróleo (ENAP)—have committed to work alongside PdVSA in the development of the acreage. An additional nine NOCs, including Russia's Lukoil and India's Oil and Natural Gas Company, Ltd. (ONGC), have also signed on to the project.

Nonetheless, there are clear challenges to Chávez's ambitious energy integration efforts. His PetroAmérica plan yields a mixed bag as PetroCaribe is the most advanced of the energy arrangements, while PetroAndina is the least developed. The energy needs of partner countries and their political sympathies (or lack

thereof) with President Chávez tend to influence the level of integration. With regard to Chávez's downstream commitments to reconfigure and expand the region's refineries, he appears to have overcommitted, as a number of his refining projects have yet to move beyond the planning stages. Another challenge to Caracas' regional integration efforts is its reliance on NOCs. All state oil companies are not alike and yet the Venezuelan government has made the NOC its partner of choice, with little regard for the individual companies' technical and organizational competencies or financial capacity. It is unlikely that these NOCs—many of which are fledgling—can meet the increasing technological challenges and capital needs of Venezuela's energy sector.

OIL RESERVES

At end of 2006 (billion barrels)



A closer look at Chávez's numerous energy project proposals calls their viability into question. Those that have come to fruition tend to meet the risk criteria established for private sector energy projects of the same size. In other words, ideology aside, those projects that move forward must meet certain thresholds with regard to political support, geology, economics, environment, and security. For example, it is not surprising that one of Chávez's most ambitious energy proposals—the 'Gas Pipeline of the South'—has stalled. While the project faces no political opposition and little security risk, there are concerns

about the size of Venezuela's natural gas reserves relative to the project's export needs, the economical viability of the project, and the extent of the proposal's environmental costs due to the pipeline's projected proximity to the Brazilian rainforest. On the other hand, the Venezuela-Colombia natural gas pipeline, completed in May 2007, successfully meets much of the project risk criteria. It benefits from active political support from the countries' respective governments, lower environmental impacts, and greater economic feasibility; in addition, the Colombian government has developed targeted security plans to mitigate the project's greatest above-ground risk—facility and personnel violence.

Hand in hand with regional energy integration, Chávez is also using his country's energy wealth as a vehicle to promote social development. When Chávez entered office in 1999, some 43 percent of all Venezuelan households were living below the poverty line. To address the nation's social needs and in an effort to bring Venezuela's NOC closer to 'the people,' the Chávez government explicitly tasked PdVSA with providing funding and fostering social development. As a result, PdVSA's social spending increased from \$249 million in 2003 to \$13.26 billion in 2006, with the government channeling revenues to the Economic and Social Development Fund (Fondespa) and the National Development Fund (Fonden) and neighborhood-based *misiones* (missions) becoming the most visible example of Chávez's social welfare plan. Today some twenty-two social missions provide targeted care to local communities. To foment more economic development Chávez has also proposed co-ops (Social Production Companies—EPS's) to 'democratize' access to business opportunities within Venezuela's oil industry and strengthen the domestic oil services sector. Nonetheless, like Chávez's regional integration agenda, energy as a mechanism for social development has its limits. The EPS program has been hampered by limited local expertise and allegations of corruption. While the government's missions provide fast and targeted delivery of social services, they have also been criticized for their lack of transparency and poor accountability, their negative impact on existing social programs and institutions, and the degree to which they make social welfare programs directly vulnerable to oil price fluctuations. All this is in addition to the growing concern that PdVSA's social development funding is coming at the expense of much needed investment in oil exploration and production.

Other segments of the hydrocarbon industry that Chávez has tasked with development initiatives are natural gas and refining. The CIGMA industrial complex is designed to use local natural gas for petrochemicals and stimulate local industrialization. Implicit in Venezuela's gas policy is a priority on domes-

tic consumption, which increasingly takes liquefied natural gas (LNG) exports off the table. The construction of new refineries also has socioeconomic and strategic functions, as Chávez has determined refinery locations so as to generate new employment and encourage migration to less populated parts of the country. In particular, Chávez seeks to support industrial activity and better integrate the center and southern regions of the country, also known as the Orinoco-Apure Axis. Historically, Venezuela has prioritized the economic development of coastal/north areas in response to the U.S. Gulf coast market.

Not surprisingly, regional energy integration and social development were the foci of the first South American Energy Summit, convened by Chávez in April 2007. However, despite its good intentions, the summit yielded few concrete measures and Venezuela's energy agenda fell flat. Chávez's opposition to bio-fuels in response to recent U.S.-Brazil cooperation on ethanol and his proposed Gas OPEC ('Oppegasur') failed to gain much traction. The summit also did not revive momentum for construction of the Pipeline of the South. The lone initiative that appears to have survived, albeit barely, is the Bank of the South, which has been proposed as a regional alternative to existing multilateral banks. Perhaps more telling, the summit revealed that any regional energy agenda must take into account the interests of the continent's other major energy producer—Brazil. On the whole, energy has proven to be an uneven tool for regional integration and social development for Venezuela. The government's energy goals are quite ambitious, and while social development projects at home may continue to move forward, they divert resources from investment in the upkeep and modernization of the energy sector itself. In addition, regional energy integration efforts are long-term in nature and thus subject to more scrutiny, halting the advancement of all but the most pragmatic of his proposals.

NOTES

1. The law increased royalty rates to 30 percent and mandated majority state participation in all upstream oil projects. Initially unaffected, operating service agreements were forced to migrate to the new law in 2005 and the Orinoco Belt heavy oil strategic associations followed suit in 2007.