Istituto Affari Internazionali

Turmoil in South America and the Impact on Energy Markets

by Lisa Viscidi

ABSTRACT

2019 has been marked by widespread uprisings throughout Latin America. In the last few months, protests have erupted in Bolivia, Ecuador, and Colombia, while Argentina elected a new leader, Bolivia's president resigned following growing tensions with his political opponents and the military, and Peru's leader is facing a political crisis. Largely fuelled by anger over graft, economic disparity, and the rising cost of living, the resulting social unrest has led to uncertainty over the energy sector outlook. Continued political and social turbulence will likely contribute to stagnant oil and gas production growth in these countries. Conversely, Brazil and Guyana are on track to become the region's largest oil producers. In Brazil, pre-salt reserves have been attracting foreign investment, although further market-friendly reforms will need to be made to sustain development. Guyana, for its part, is in line to become the region's newest petrostate and will see explosive economic growth in the coming years. Despite its large reserves, Venezuela is excluded from this study because the country's political and economic turmoil, coupled with US sanctions, make any increase in investment highly unlikely in the short term.

Argentina | Bolivia | Brazil | Colombia | Ecuador | Guyana | Peru | Domestic policy | Energy | Oil | Natural gas

keywords

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Turmoil in South America and the Impact on Energy Markets

by Lisa Viscidi*

Introduction

2019 has been a tumultuous year for South America. In recent months, mass protests have swept across several countries, including major oil and gas producers Bolivia, Ecuador, Peru and Colombia. Protesters in these countries are disillusioned with corruption, anti-democratic practices, inequality and the rising cost of living.

In Argentina, facing deteriorating standards of living, voters rejected the business-friendly incumbent Mauricio Macri in favour of Peronist Alberto Fernández and his running mate and former president, Cristina Fernández de Kirchner, whose interventionist economic policies led to massive fiscal deficits and rampant inflation. The return of the Peronists in Argentina exemplifies another ongoing trend in the region: constant oscillation between a state-led development model and economic policies that seek a greater role for the private sector.

Political turmoil, social unrest and alternating economic models lead to a worrying lack of clarity over energy policy. In Argentina, it is unclear whether Fernández will revive previous economic policies of the Peronist party, known for its tendency to intervene heavily in the economy. There is significant risk of a return to the capital controls, export restrictions and subsidies that deterred foreign investment and shut Argentina out of international capital markets, preventing it from developing the vast Vaca Muerta shale oil and gas reserves.

In other South American countries, political and social turbulence generate tremendous uncertainty over the energy sector outlook. In Bolivia, Evo Morales, president from 2006 to 2019, nationalised the oil and gas sector upon taking office, though he had recently provided some investment incentives in an effort to stem the decline in gas reserves. But in November, Morales resigned when the military pulled its support for him amid evidence of electoral fraud, and now it is unclear

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who will be the next Bolivian president and how the new leadership will affect the energy sector. Ecuador and Colombia, in turn, had introduced policies to incentivise energy sector investment. And while it's unlikely that their presidents will resign in the face of protests, both leaders have seen their popularity and credibility severely eroded, reducing their ability to further reform the energy sector. In many South American countries, particularly Colombia and Peru, there is also deep public scepticism of the oil and gas industry and its social and environmental impact on local communities. All of these factors suggest that oil and gas production will remain largely stagnant in these countries.

In contrast, Brazil and Guyana are likely to become among the world's top sources of oil supply growth over the coming years. Brazil discovered the massive offshore pre-salt oil reserves over a decade ago. However, production growth was retarded by nationalist oil policies that overburdened state oil company Petrobras and sidelined major international oil companies. The current government has carried out policies that have brought substantial foreign investment to the oil sector. Although the country needs to implement further reforms to introduce market competition, Brazil is on track for major increases in oil and gas output. Guyana, for its part, is poised to become the region's newest petrostate. The country has been slow to develop the institutions and laws needed to govern the new oil industry, and a recent political crisis has further delayed that process. Nonetheless, Guyana is set to become one of the region's top oil producers.

Despite its large reserves, Venezuela is excluded from this study because the country's political and economic turmoil, coupled with US sanctions, make any increase in investment highly unlikely in the short term.

1. Resource nationalism and political upheaval cloud the oil and gas investment horizon

In recent decades, resource nationalism – when governments assert control over their nation's natural resources – has ebbed and flowed, often in line with movements in global oil prices. In the 1990s, historically low oil prices created room for privatisation in many of South America's oil industries. When oil prices rose again in the early 2000s, the pendulum swung back toward state control in Brazil, Argentina, Bolivia and Ecuador, which were all likely inspired to some degree by Hugo Chavez's Venezuela (Colombia and Peru were the main exceptions). As global oil prices collapsed after 2014, South American countries like Brazil, Argentina and Ecuador started to offer more favourable terms to international investors. Today, the swings in oil policy are colliding with new challenges: mass street protests, severe political instability and fervent opposition to oil projects encroaching on local communities. This upheaval is affecting even countries with traditionally more consistent energy policy such as Colombia and Peru, as well as Bolivia and Ecuador.

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1.1 Argentina

Fears abound over a potential return to interventionist economic policies following the election on 27 October of Alberto Fernández of the Peronist Party and his running mate, former president Cristina Fernández de Kirchner, who beat the pro-business incumbent Mauricio Macri in the first round. These concerns derive from the legacy of Fernández de Kirchner's rule (2007–15), which was marked by capital controls that made it difficult for foreign investors to repatriate profits, export taxes and soaring interest rates, as well as price freezes and subsidies for fuel and electricity. The state oil company, part-owned by Spanish firm Repsol, was nationalised. Macri reversed many of these policies in an effort to attract foreign investment. However, after introducing mostly gradual reforms, he was unable to stave off an economic spiral: per-capita income fell almost 10 per cent,[1] inflation spiked and the peso lost 71 per cent in the second half of his term. As his inauguration on 10 December 2019 drew closer, Alberto Fernández had not given clear signals about his planned economic or energy policies. Nonetheless, the factors that will likely shape his decisions can be gleaned from his party's history, his public comments and the local and international context in which he will govern.

On the one hand, Fernández has signalled publicly that he wants to support further development of the gas-rich Vaca Muerta shale play, which is key to meeting Argentina's target of doubling gas output to 260 million cubic meters per day (MMcm/d) between 2018 and 2023.[2] He appointed Guillermo Nielsen, a former finance minister who has called for special incentives for shale development, as president of the Argentinian energy company YPF. The oil and gas sector is one of the greatest potential sources of immediate flows of foreign investment and export dollars, which would help stabilise the economy by bringing in foreign currency to boost the peso's value and contain inflation. Today's lower commodities prices and weaker public finances would also make it much more difficult for Fernández to implement state-led growth. Even under the Fernández de Kirchner administration, energy policies were generally favourable to the industry – a 2014 hydrocarbons reform, for example, provided investors with offshore exploration opportunities, longer contract periods, tax exemptions and other incentives.[3] But Argentina's broader macroeconomic policies under her government deterred investment. The new president's economic team is discussing a draft bill that would shield investors

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[1] Federico Sturzenegger, "Yes, Macri Failed on the Economy. But It Wasn't All for Naught", in *Americas Quarterly*, 31 October 2019, https://www.americasquarterly.org/content/yes-macri-failed-economy-it-wasnt-all-naught.

[2] Charles Newbery, "Argentina Delays Vaca Muerta Gas Pipeline Project Due to Financial Crisis", in *S&P Global Platts*, 6 November 2019, https://www.spglobal.com/platts/en/market-insights/latest-news/natural-gas/110619-argentina-delays-vaca-muerta-gas-pipeline-project-on-financial-crisis.

[3] Ignacio J. Randle and John P. Cogan Jr., "Argentina", in Philip Thomson and Julia Derrick (eds), *The International Comparative Legal Guide to: Oil & Gas Regulation 2019*, London, Global Legal Group, January 2019, p. 44-46, https://iclg.com/practice-areas/oil-and-gas-laws-and-regulations/argentina.

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from capital controls, provide stable fiscal terms and suspend export taxes for liquefied natural gas (LNG). His advisors have also floated the idea of lowering taxes for the oil and gas sector.

On the other hand, as a member of the traditionally populist Peronist party inheriting power at a time of deep dissatisfaction among Argentines, Fernández will likely want to enact policies that are politically popular – which are often those that involve state intervention that is unfavourable to investment. Even under Macri, less market-friendly measures were reintroduced in the final months of his term as it became clear his re-election prospects were slipping. In the run-up to the election, as markets reacted negatively to a potential Fernández victory, the Central Bank re-instituted capital controls to fight inflation. In April, Macri also attempted to appease voters by fixing food and gasoline prices.[4] The freeze on diesel and gasoline prices cut the domestic price of crude to 49.50 dollars per barrel (compared to 60 dollars per barrel for international oil benchmark Brent) while the break-even price in Vaca Muerta is about 40 dollars per barrel.[5]

As the public is demanding relief from declining real wages and increased electricity bills, Fernández has promised to tame inflation, boost salaries and benefits and renegotiate terms of a deal with the International Monetary Fund (IMF) signed by Macri.[6] He may maintain capital controls in an attempt to preserve international reserves and prop up the peso and raise taxes.[7] He will face tremendous pressure to re-establish subsidies for electricity and fuel prices. His advisors have asked him to freeze natural gas and power tariffs and fix petroleum product prices to the peso rather than the dollar, presumably with companies covering the gap.[8]

Given all the uncertainty, most oil companies are waiting for clearer signals from the new government before increasing investment. The number of frac stages declined 54 per cent from 676 in August to 312 in October.[9] The Energy Secretariat delayed bids for an 800 million dollar pipeline project in Vaca Muerta

[4] Patrick Gillespie and Jorgelina Do Rosario, “Argentina Freezes Prices as Macri Seeks to Appease Voters”, in *Bloomberg*, 17 April 2019, https://www.bloomberg.com/news/articles/2019-04-17/argentina-freezes-food-prices-as-macri-tries-to-appease-voters.

[5] Charles Newbery, “In Argentina, Politics Threatens Oil Production Growth Again: Fuel for Thought”, in *S&P Global Platts*, 7 October 2019, https://www.spglobal.com/en/research-insights/articles/in-argentina-politics-threatens-oil-production-growth-again-fuel-for-thought.

[6] Natalie Alcoba, “Facing Economic Crisis, Argentina Picks Fernandez As President”, in *Al Jazeera*, 28 October 2019, https://www.aljazeera.com/news/2019/10/argentina-rejects-austerity-elect-alberto-fernandez-president-191028004353278.html.

[7] Eliana Raszewski, “Factbox: Argentina’s Fernandez Could Review IMF Deal, Impose Capital Controls”, in *Reuters*, 13 August 2019, https://reut.rs/2YFx9Iy.

[8] “Argentina: Oil Industry Fearful of Tariffs’ Freezing As Suggested by Alberto Fernandez Advisors”, in *MercoPress*, 11 October 2019, https://en.mercopress.com/2019/10/11/argentina-oil-industry-fearful-of-tariffs-freezing-as-suggested-by-alberto-fernandez-advisors.

[9] Charles Newbery, “Argentina Authorizes 5% Hike in Diesel, Gasoline Prices”, in *S&P Global Platts*, 1 November 2019, https://www.spglobal.com/platts/en/market-insights/latest-news/oil/110119-argentina-authorizes-5-hike-in-diesel-gasoline-prices.

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until March 2020 due to the country's financial crisis, which has made it difficult to finance a new section of the pipeline that was recently added to the project.[10] This infrastructure is essential to overcoming bottlenecks in production and exports. Until Fernández announces specific policy plans, it appears energy companies will put investment decisions on hold.

1.2 Bolivia

A political crisis and the resignation of longtime president Morales have created tremendous uncertainty for investors in Bolivia's natural gas sector. Regardless of the political outcome, the next president will face waning economic growth, dwindling natural gas production and reserves and the country's main markets – Brazil and Argentina – replacing Bolivian imports with domestic supply of natural gas.

Morales candidacy at Bolivia's Presidential elections (held on 20 October 2019) for the Movimiento al Socialismo (Movement for Socialism) party was already controversial as he was running for his fourth term despite an earlier referendum in which a majority voted against removing term limits – a result a friendly supreme court would later declare illegal in a controversial ruling. As preliminary results showed Morales with insufficient support to avoid a runoff, the Supreme Electoral Tribunal inexplicably stopped reporting the vote tally late election night. When it was resumed on Monday, Morales was just far enough ahead to escape a runoff. Protests and violence erupted around the country, forcing Morales to resign on 10 November along with his vice-president and two heads of congress. After Morales fled to Mexico, Senator Jeanine Añez from the opposition proclaimed herself interim president.

Whichever party retains the presidency will face a difficult economic situation, due in large part to declining natural gas exports, a legacy of nationalist energy policies under Morales and challenging external market factors. Export revenues have fallen since the 2014 decline in oil prices, as Bolivia's gas contracts are oil-indexed. There have been no significant new discoveries since 2004, before Morales first won the presidency. Proven reserves are at 254 billion cubic metres (bcm)[11] and, at current production rates, will last for just around ten years. Unfavourable tax regimes, heavy reliance on the inefficient and over-extended state company and regulatory uncertainty following Bolivia's history of expropriation early in Morales's presidency have dissuaded private investment.

Natural gas export market options are also drying up as Brazil and Argentina, Bolivia's main buyers, are increasing their own gas production. Petrobras expects to replace some Bolivian gas with associated gas from its prolific deepwater pre-

[10] Charles Newbery, "Argentina Delays Vaca Muerta Gas Pipeline Project Due to Financial Crisis", cit.

[11] "Bolivian Gas Production and Exports in Figures", in *Interfax Global Energy*, 13 December 2019, https://interfaxenergy.com/article/34877/bolivian-gas-production-and-exports-in-figures.

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salt oil fields. As Bolivia enters into negotiations with Brazil over extending its contract into 2024, Brazil's imports of Bolivian gas have been shrinking amid lower demand.[12] As Argentina ramps up output from its Vaca Muerta shale deposits, it has also arranged to cut back imports from Bolivia.[13] Tapping alternative markets would take time as new pipeline infrastructure would have to be built to reach the coast of a third country, as land-locked Bolivia cannot directly export LNG to global markets.

In this context of uncertainty, Interim President Áñez has named new heads to the Energy Ministry and Yacimientos Petrolíferos Fiscales Bolivianos (the state-owned oil and gas company) as an attempt to stabilise the sector, but it remains to be seen whether Bolivia's political leadership will be eventually able to boost natural gas exploration and production (E&P).

1.3 Ecuador

Ecuadorean President Lenín Moreno has shifted the country toward more market-friendly energy policies, seeking to break with his the nationalist approach of his predecessor Rafael Correa, which had contributed to declining investment. However, his government has recently faced widespread social unrest as Ecuador's citizens reacted to austerity measures imposed as part of an IMF loan deal, generating a cloud of political uncertainty that creates risks for Ecuador's oil sector.

In a bid to boost oil production – Ecuador is aiming to increase crude oil production to 700,000 b/d, from 545,000 b/d currently[14] – Moreno reversed some of the signature policies of his predecessor. He eliminated the service contracts introduced under Correa, restoring the production sharing contract (PSC) model, which is more favourable to international oil companies because it allows them to retain a share of crude and book reserves for financial reporting purposes. The service contracts had contributed to a reduction in upstream investment from 500 million dollars in 2010 to 282 million dollars in 2017, though oil output rose by 12 per cent over the period (any reduction in exploration investment would not immediately impact oil production as it take years to find oil).[15] Moreno first introduced PSCs for the onshore Intracampos bid round in the oil-rich Oriente region, awarding seven of eight exploration blocks on offer with expected investment of over 1 billion US dollars.[16]

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[12] "Bolivia's Morales Set for Run-off, Gas Boom Fades", in *Argus Media*, 21 October 2019, https://www.argusmedia.com/en/news/1999367-bolivias-morales-set-for-runoff-gas-boom-fades.

[13] "Bolivia Considering Exporting Natural Gas from Liquefaction Terminals in Argentina", in *MercoPress*, 23 April 2019, https://en.mercopress.com/2019/04/23/bolivia-considering-exporting-natural-gas-from-liquefaction-terminals-in-argentina.

[14] Alexandra Valencia, "UPDATE 1 – Ecuador to Leave OPEC in 2020 Due to Fiscal Problems – Ministry", in *CNBC*, 1 October 2019, https://cnb.cx/2r4KkDi.

[15] "Ecuador Tests Return of Production-Sharing Model", in *Argus Media*, 6 September 2018, https://www.argusmedia.com/en/news/1749385-ecuador-tests-return-of-productionsharing-model.

[16] Ernst & Young, "Recent Developments in the Oil & Gas industry in Latin America: Ecuador,

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However, the government has faced many challenges related to its energy policy. In February 2019, Moreno accepted a 4.2 billion dollar loan from the IMF to help reduce the country's large fiscal deficit and massive external debt, and as part of the broader austerity measures agreed with the Fund, Moreno ended government subsidies that had kept fuel costs low for decades. As a result, the price of diesel skyrocketed from 1.04 to 2.27 dollars per gallon, sparking mass protests and leading Moreno to declare a state of emergency.[17] After almost two weeks of violent protests, Moreno agreed to scrap the decree, although it is not clear when new regulations governing fuel prices will go into effect or what they will look like.[18] In addition to this, the protests of Indigenous communities against drilling activities in the environmentally sensitive Yasuni National Park contribute to rising tension in the country. The environment ministry recently approved drilling for the last field of the so-called ITT project which holds 20 per cent of the country's reserves. The field is home to two uncontacted indigenous tribes.

In an effort to quell social unrest, Moreno said he will reconsider the economic policies that sparked the protests and agreed to meet with the opposition. However, he will likely struggle to reach consensus on a fiscal plan that satisfies his constituents and the IMF. Without IMF funds, which are contingent on financial reform, the government will struggle to boost the economy. Further economic deterioration, in turn, could hurt Moreno and his party in the looming 2021 elections. The decision to develop the ITT will boost by production by 90,000 b/d but will remain highly controversial. The fierce reaction to the fuel subsidy withdrawal suggests Moreno is still on shaky ground.

1.4 Peru

Peru has experienced upheaval over the past year, as four former presidents and the main opposition leader have become entangled in massive corruption investigations. The current president, Martín Vizcarra -formerly the vice-president who took power when Pedro Pablo Kuczynski resigned amid corruption allegations – plans to hold early elections. Thus far, the political turbulence has not impacted the natural gas outlook. The Vizcarra government has proposed reforms to the regulatory and fiscal regimes to attract investors while strengthening social and environmental protections. However, the looming 2020 elections introduce greater uncertainty, since Vizcarra does not plan to run.

Argentina, Brazil, Mexico and Colombia", in *EY Energy Alert*, 14 May 2019, http://bit.ly/2Hi1baT.

[17] Economist, "Bello - An Equatorial Earthquake", in *The Economist*, Vol. 433, No. 9165 (19 October 2019), p. 36.

[18] "Ecuador's Moreno Announces Tax Reform After Rolling Back Fuel Price Hike", in *Reuters*, 19 October 2019, https://reut.rs/2MYw71s.

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Vizcarra remains popular thanks to his anti-graft reforms. Many voters also support his proposal to hold presidential and congressional elections before the scheduled date in 2021 in order to end his stalemate with the opposition-controlled congress After lawmakers rejected his initial proposal for early elections, he called a vote of confidence, which is used as a last resort to solve disputes between Congress and the president. Congress chose to vote no for the second time during Vizcarra's term, constitutionally allowing him to dissolve the legislative body and trigger new elections. Outraged by his decision, the congress called for his impeachment, and attempted to swear in Vice-President Mercedes Aráoz as a replacement. The Constitutional Tribunal will ultimately settle the dispute, but until then Vizcarra's legitimacy hangs in the balance.

Peru is a major gas producer, with output of more than 33 MMcm/d, and South America's largest LNG exporter, while crude production has declined to 41,000 b/d, forcing the country to heavily rely on imports. In this context, Vizcarra has focused on promoting investment to increase hydrocarbon production. In June 2019 the president proposed an amendment to the hydrocarbons law to provide incentives for oil exploration and strengthen the environmental and social licensing process.[19] The amendment would extend contract terms from 30 to 40 years with longer exploration periods, introduce more flexible fiscal terms and strengthen the ability of oil regulator Perúpetro to negotiate and execute contracts. The amendment would also reorganise the community consultation process requiring the government to secure consent before offering the area for drilling contracts. Protests against oil and gas projects throughout Peru have occurred for decades. It also obliges leaseholders to reforest lands and contribute to an environmental remediation fund.

While Vizcarra's proposed reforms are promising, he may have little time left to implement them. Given the discrediting of the major parties and Vizcarra's promise not to run, candidates outside of the country's two traditional parties may have a greater chance of gaining power. This would introduce significant uncertainty, as any newcomer's stance on energy policy could diverge significantly from that of previous establishment leaders.

1.5 Colombia

In Colombia, investor interest in the oil and gas sector has increased, as President Iván Duque has sought to auction off new areas for exploration and production, particularly in the gas-rich offshore Caribbean. His government signed at least sixteen new E&P contracts in 2019, after almost five years during which not a single E&P contract was signed under the previous government. However, Duque has been unable to resolve the main impediment to oil and gas production: local opposition to extractive industries, particularly fracking.

[19] Beatriz De La Vega et al. (eds), *Peru's Oil & Gas Investment Guide: 2019/2020*, Ernst & Young, May 2019, p. 147, https://www.gob.pe/es/i/275862.

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The basic regulatory framework for unconventional oil and gas development in Colombia was created in 2008 and has since been updated to reflect new practices, regulations and local studies. However, there has been fierce opposition to fracking from a variety of local communities, politicians and judges, with many municipalities vetoing fracking in local referendums. Several bills have also been proposed in Congress to ban fracking, and a coalition of lawyers and activists has filed a suit against the energy ministry to halt potential use of the technique. In 2018, Colombia's High Court temporarily suspended the previous rules used to regulate fracking due to concerns over its environmental and health impacts.

Upon taking office in August 2018, Duque proclaimed a desire to advance with shale development, driven by concerns over depleting conventional oil resources. Colombia's oil reserves will only last another 6 years at current production rates, but exploiting shale potential could almost triple oil and gas reserves, according to government figures. In this context, in December 2018 Duque appointed a committee to evaluate the methods and risks of fracking, which recommended starting with three pilot projects under strict monitoring standards.

However, the committee was criticised by environmental groups, which said it had numerous conflicts of interest, including previous employment in the oil industry and open pro-fracking stances. The High Court then stepped in, appointing a new committee from the National University in Bogotá to again re-evaluate the environmental impacts of fracking. The new committee concluded that Colombia lacks sufficient information to decide whether to allow fracking, which led the High Court to reinstate the moratorium on fracking although it said pilot projects would be allowed to proceed.

Fracking is the most high-profile focus of opposition to oil and mining projects in Colombia. However, the country has also witnessed protests, strikes and road blockages by workers demanding more benefits from the oil industry, which have also impeded oil production. More recently, broader social turmoil has engulfed the country. In late November, mass protests around the country, which sometimes turned violent, demonstrated widespread dissatisfaction with the government of Duque, who has an abysmal 26 per cent approval rating.[20] The opposition from local communities to some oil projects, combined with Duque's unpopularity, suggest that the country's oil production will rise at a sluggish pace.

[20] Merrit Kennedy, "Amid Protests, Colombia's Capital Placed Under Curfew", in *NPR*, 23 November 2019, https://www.npr.org/2019/11/23/782279678.

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2. Large resources and favourable contract terms: Brazil and Guyana on track for spikes despite regulatory challenges

In spite of the volatile environment currently plaguing South America Brazil and Guyana are on track to see a surge in oil production. In Brazil, development of the oil-rich pre-salt reserves is forecast to increase output to around seven million b/d by 2030 thanks to investment-friendly policies and the country's huge resource base. Guyana's nascent oil sector will witness explosive growth because of favourable contract terms and a major oil find. In both countries, governments are counting on oil revenue to fill state coffers and boost economic growth.

2.1 Brazil

Revitalising Brazil's energy sector is among President Jair Bolsonaro's top economic priorities. The president and his team are implementing measures that have helped open the oil and gas sector to privatisation after years of resource nationalism under the governments of Presidents Luiz Inácio Lula da Silva (2003–10) and Dilma Rousseff (2011–16) that led Brazilian oil output to stagnate. Thanks largely to these recent steps, oil production is expected to grow 200,000 b/d in 2019,[21] making Brazil one of the top sources of supply growth outside of the Organisation of Petroleum Exporting Countries (OPEC), the world's leading oil cartel. However, further adjustments will be required for Brazil to meet its full potential in oil production, as recent auction results demonstrate. Beyond crude production, deep reforms are needed also in areas like natural gas transportation and refining, which remain concentrated in the hands of state oil giant Petrobras.

Under the presidency of Michel Temer (2016–18), Brazil had started to reverse nationalist policies that had slowed oil production and introduced measures to bring in the foreign capital required to develop the country's massive pre-salt reserves. The government resumed oil auctions open to private companies in the pre-salt area, eliminated the requirement for Petrobras to be operator in all pre-salt fields (although it retains a right of first refusal and minimum 30 per cent stake), and eased local content regulations. Bolsonaro, who took office in January 2019, has kept these reforms on track.

However, the president has also faced some hiccups. In November, Brazil held two highly anticipated pre-salt auctions where Petrobras offered the sole bids in all the blocks awarded, and no majors won acreage. The only company participation other than Petrobras came from two Chinese firms, China National Offshore Oil Corporation and a subsidiary of China National Petroleum Corporation, which took minor stakes in blocks alongside Petrobras. The first auction raised 17 billion dollars, well below the 26 billion dollars the government had forecast.

[21] OPEC, *Monthly Oil Market Report*, November 2019, p. 55, https://www.opec.org/opec_web/en/publications/5392.htm.

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The disappointing results show that Brazil needs to make further adjustments to maximise investment and production potential. The government requested steep signing bonuses that made the fiscal terms uncompetitive. Brazil's PSCs and Petrobras' right of first refusal in the pre-salt may also have dissuaded some companies. In addition, many of the majors already have significant acreage in Brazil from previous pre-salt auction rounds and may not want to take on further investments. A more attractive regulatory and fiscal regime could entice interest from majors in future auctions, and in this context government officials have already expressed support for ending Petrobras' right of first refusal and switching from PSCs (in which the government retains a share of the oil) to concession contracts (in which private companies own all of the oil and only pay taxes and royalties to the government) in the pre-salt.

In the natural gas sector, Bolsonaro is also eyeing reforms. Brazil has among the highest industrial natural gas prices in the world, in part because of Petrobras's control over pipeline access, which deters producers from increasing gas output. The administration, in response, announced plans to liberalise access to Brazil's natural gas pipeline capacity, while Petrobras is expected to sell stakes in gas transport and distribution.[22] These reforms are needed to enable multiple players to market natural gas and allow private companies producing associated gas from pre-salt oil to sell to the domestic market for power generation and industrial use.

Brazil's refining and fuel markets also need to be opened to more competition. Petrobras owns 98 per cent of the country's refining capacity and thus is able to control fuel prices for all of Brazil. Under previous governments, Petrobras was forced to sell fuel below market prices, generating losses that contributed to unsustainable debt levels. Under Bolsonaro, the state company is selling eight refineries to strengthen its finances and focus on its core oil exploration and production business.

Despite the need for further reforms, Brazil is already expected to quickly ramp up production over the medium to long-term. OPEC's World Oil Outlook predicts a rise in total liquids production of 1.4 million b/d by 2024 from 3.3 million b/d currently.[23] As a result, the oil sector will make up a growing share of Brazil's economy.

2.2 Guyana

A tiny country with a population of around 800,000, Guyana is poised to become the world's newest petrostate. In 2015, US energy giant ExxonMobil successfully drilled its first well in the Straboek exploration block off the Guyanese coast. Since

[22] "Brazil Approves Pro-Market Gas Regulations", in *Argus Media*, 25 June 2019, https://www.argusmedia.com/en/news/1928024-brazil-approves-promarket-gas-regulations.

[23] James Griffin (ed.), *2019 World Oil Outlook 2040*, Vienna, OPEC Secretariat, 2019, p. 135, https://www.opec.org/opec_web/en/publications/340.htm.

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then, the company has made over a dozen other offshore discoveries. By the mid-2020s, Guyana will likely produce more crude per citizen than any other country.[24] However, the country is ill-equipped to handle this influx of oil revenue, with a lack of key institutions and laws governing the oil sector. Moreover, political turmoil has hindered progress on establishing the framework needed to regulate the oil sector and manage the expected revenues.

In December 2018, President David Granger's ruling coalition received a no-confidence vote after one member voted in favour of the opposition party, the People's Progressive Party. The vote of no-confidence constitutionally triggers the dissolution of Congress and a new election within three months. The current date, after several appeals and delays, is set for March 2020, soon after the time oil production is expected to start.

Oil production is set to ramp up quickly in the next few years. Since May 2015, ExxonMobil has made fourteen discoveries,[25] which are estimated to contain over six billion barrels of oil equivalent in recoverable resources.[26] Crude oil output could increase to 750,000 b/d, making Guyana one of the largest oil producers in the region.[27] The Granger government began a number of initiatives to help the country prepare for the growing oil industry. It drafted local content rules and proposed legislation for a Petroleum Commission, although both have been delayed due to the political impasse. The government also announced plans to create a local content compliance unit to be led by the director of Guyana's Department of Energy. A sovereign wealth fund approved by law in January 2019, is expected to take in 5 billion dollars in oil revenue per year by 2025.[28] The World Bank is providing technical assistance for a Petroleum Resources Governance and Management Project to establish a legal framework, revenue and project management, and institution building for the industry.

However, Guyana has been slow to create institutions for the oil sector, and the political situation has further distracted from those efforts. The Department of Energy has a tiny 2 million dollar budget. The oil and gas regulator has not yet been formed. And the government has not put forth a high-level plan for how to distribute the oil revenues.

[24] Kevin Crowley, "The World's Newest Petrostate Isn't Ready for a Tsunami of Cash", in *Bloomberg*, 13 August 2019, https://www.bloomberg.com/news/features/2019-08-13/guyana-isn-t-ready-for-its-pending-oil-riches-but-exxon-is.

[25] ExxonMobil, *Guyana Project Overview*, 13 November 2019, https://corporate.exxonmobil.com/Locations/Guyana/Guyana-project-overview.

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[27] Neil Marks, "Guyana Government to Challenge No-Confidence Vote in Court", in *Reuters*, 3 January 2019, https://reut.rs/2VsWm3N.

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Conclusion

Political and regulatory instability has been one of the greatest impediments to development of the oil and gas sector in South America. The tension between resource nationalism and privatisation has existed for decades and continues to generate uncertainty. Many resource-dependent countries in the region swing back and forth between left-wing governments that tend to favour state control of natural resource development and right-wing or centre-right governments that seek a greater role for the private sector. For the most part, the state-led development model for the oil sector has led to stagnant or declining production in South America, including in Bolivia, Argentina and Brazil. Government efforts in these countries to increase state control over the oil sector and boost the role of national oil companies has generally led to a reduction in the capital investments and expertise needed to develop these resources. Guyana will only start producing its first commercial quantities of oil in 2020, and it remains to be seen whether the country can build solid institutions and shield energy policy from political instability.

More recently, governments looking to develop oil resources are confronting new challenges from the public: street protests, political instability and opposition to oil projects encroaching on local communities. 2019 in particular has seen tremendous political turmoil amid deep dissatisfaction with the ruling class in various countries, which has led to governments being overturned or lacking a strong mandate to govern and implement needed reforms. The public is also voicing concern over the impacts of extractive industries, which poses further challenges for both companies and governments.

Looking ahead, the trend toward unstable political regimes and flip-flopping economic models is likely to continue. As traditional political parties have been discredited by corruption scandals, an inability to deliver broad economic gains, and other failures, and as political polarisation has deepened, presidents cannot retain power for long and thus energy policies will inevitably become more unpredictable. For investors, these challenges require gaining an in-depth understanding of political, social and regulatory risk and preparing for various scenarios. Governments, for their part, must attempt to enact regulations that can be insulated from political turbulence while creating a more inclusive policymaking process.

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