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POLICY BRIEF

RECOMMENDATIONS FOR THE NEW ADMINISTRATION

U.S. Policy Toward the Hydrocarbon Industry in Latin America

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OVERVIEW

Latin America holds the largest concentration of hydrocarbon reserves outside of the Middle East. The region's official proved oil reserve figure was 340 billion barrels (20% of the world's total) in 2015, second only to the Middle East with 803 billion (47%), and more than the U.S. and Canada, with a combined total of 227 billion barrels (13%).[1] Latin America also has one of the world's largest estimated endowments of shale and other unconventional resources. Its natural gas endowment is not as relatively abundant, but still the region has proved reserves of 280 trillion cubic feet, compared to a combined 440 tcf in Canada and the U.S.[2]

This very favorable natural endowment contrasts with the poor performance of the sector in the region. While the U.S. and Canada together increased oil production by 73% in 2005–2015 from 9.9 million barrels/day to 17.1 mb/d, Latin America decreased production in the same period by 7%, from 11.1 mb/d to 10.3 mb/d. This underperformance is particularly striking since it occurred during a decade of very high oil prices. Resource nationalism is largely to blame for this wasted opportunity. The region has experienced a wave of expropriations and nationalizations, and some national oil companies largely mismanaged the opportunity given by the windfall.

The general underperformance of the sector hides the divergent production trajectories within the region. Venezuela, Mexico, and Argentina experienced the worst declines in production due to significant policy obstacles to private investment, while Brazil and Colombia did take advantage of the price boom, but even in these successful cases, some regulatory impediments increased. The recent oil bust has hit the Latin American oil industry very hard; both investment and production have been falling rapidly. Production declines in 2016 could reach as high as 400–500 thousand barrels a day, a dramatic drop of 4–5% in just one year, with Venezuela and Mexico again having the steepest declines in output.

LOOKING AHEAD

This critical situation has strengthened a trend that was already in the making: the re-liberalization of the oil industry throughout the region. Countries are starting to compete to offer the best conditions to foreign investors. This new opening cycle offers a significant opportunity for sector development and for foreign capital to flow into the region. If lessons from the past are learned, this could herald a new awakening in Latin America, but it could also end in failure if the institutional frameworks that support it are not strong enough.

Energy trade with Latin America will continue to grow. Latin America, a major importer of oil products from the U.S., represents close to one-half of U.S. product exports (or about 2 mb/d). As product demand peaks in the U.S., Latin America will continue to demand refined products from

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This policy brief is part of a series of recommendations from the Baker Institute for the incoming president's administration.

the U.S. Mexico's imports of U.S. natural gas have tripled in the past decade, to above 1 tcf per year. Latin America has also become a major importer of LNG from around the world, and this will likely continue. After the U.S. lifted its oil export ban, Latin America became a key destination for U.S. light crude exports. Since in Colombia, Mexico, and Venezuela production is increasingly of heavier crudes, it is likely that exports of light oil from the U.S. will be increasingly used to blend with these types of crudes to make them marketable. In turn, some of these blends will be re-exported to the U.S., where they can be processed domestically in its complex refining infrastructure.

RECOMMENDATIONS

U.S. policy should be geared toward facilitating and supporting investment in Latin America's oil and gas sectors. From a national security perspective, the expansion of production in the region contributes to energy security by providing a more diversified supply portfolio in a geographical area close to the U.S., thereby reducing the concentration of production from the Middle East. It also serves as a tool of economic integration with Mexico and the rest of Latin America. The growth of Latin America's hydrocarbon industry would generate economic opportunities and promote regional stability, which in turn would help support efforts to combat drug trafficking and the spread of terrorism.

- The end of the U.S. oil export ban was a good step toward energy integration that will promote efficiency and trade.
- LNG exports to Latin America should be facilitated, given that it is one of the most geographically attractive markets for the U.S.
- Mexico's energy reforms offer a tremendous opportunity to expand energy trade with Mexico and develop markets for the U.S. oil supply chain and to integrate them with Mexico's. U.S. foreign and commercial policy should aim to support the reforms and the integration of the two countries' energy sectors. The U.S. could, for instance, offer technical assistance and facilitate the deployment of investments to help achieve integration through shared pipelines and appropriate transportation infrastructure for supply chain expansion.
- The incorporation of the energy sector in the investment arbitration mechanisms of trade and investment treaties could help strengthen the property rights of U.S. investors and bring stability to the sector.[3]
- The U.S. should support World Bank and Inter-American Development Bank technical assistance programs to Latin American countries. These programs should be aimed at strengthening the region's institutions and legal frameworks for energy investment, promoting long-term policy stability. Colombia, and more recently Mexico, offer some interesting policy options for the rest of the region.
- Cuba has significant oil and gas potential in the deep waters of the Gulf of Mexico. It is in the U.S. interest that these resources are developed in an environmentally sustainable manner in concert with the U.S. energy industry.

ENDNOTES

1. See the BP Statistical Review of World Energy 2016. If we use alternative measures of reserves from more conservative unofficial sources, the region still has a resource potential exceeded only by the Middle East and rivaling the U.S. and Canada.

2. Latin America has been much less explored than the northern part of the Hemisphere and there are strong reasons to believe that the potential resources yet to be discovered are significant. The region has been underexplored largely due to institutional and political factors.

3. The Center for Energy Studies, the Mexico Center, and the Latin America Initiative at the Baker Institute have published research on these topics. See: www.bakerinstitute.org/center-for-energy-studies and www.bakerinstitute.org/energy.

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