Defining the Business of Politics

The Politics of Oil in Latin America

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Key macro questions about Latin American and its energy investment climate

1. Does the rise of Leftist governments in Latin America pose a risk to investors?

2. How do domestic politics affect a country's energy sector and its investment climate?

3. What are the principal domestic/international risks to energy sector investment?

Our answers up front

1. Does the rise of Leftist governments in Latin America pose a risk to investors?

Not always. Leftist governments vary dramatically in their anti-investment tendencies.

2. How do domestic politics affect a country's energy sector and its investment climate?

Domestic politics affect the current and future structure, policies, and attitudes governing a country's energy sector.

3. What are the domestic/international risks to energy sector investment?

Building fiscal pressures on the hydrocarbons sector could lead to arbitrary changes in the rules of the game.

Geopolitical tensions and deteriorating international economic conditions threaten to restrict investment and essential oil revenues.

There is no regional anti-investment trend in Latin America

		Government ideological origin	
		Leftist	Rightist
Energy investment climate (upstream)	Most restrictive		Mexico
	Moderately restrictive	Bolivia Ecuador Venezuela	Trin&Tob
	Less restrictive	Argentina Brazil	Colombia Peru

Variation in energy sector openness (upstream)

Country	State oil company	Product-sharing or risk service contracts	Concessions
Argentina	Privatized (YPF)	N/A	Yes
Bolivia	Partially priv. (YPFB)	Yes	No
Brazil	Partially priv. (Petrobras)	Yes	Yes
Colombia	State-owned	Yes	No new
Ecuador	State-owned	Yes	No
Mexico	State-owned	No	No
Peru	Partially priv. (Petroperu)	N/A	Yes
Trin & Tob	State-owned	Yes	No
Venezuela	State-owned	Yes	No

Leftist Latin American governments have taken their open energy sectors in different directions

What they inherited			
Less open	**Relatively open**	**Open**	**Very open**
	Venezuela	**Brazil**	**Argentina** **Bolivia**

What they became			
Less open	**Relatively open**	**Open**	**Very open**
Venezuela **Bolivia**		**Brazil**	**Argentina**

Political and market constraints on policymakers

1. Market constraints

    a. Reliant on oil revenue
    b. Commodity exporters
    c. Fiscal vulnerability that requires international financing
    d. Regional Trade Agreements

2. Political institutional constraints

    a. Independent judiciary
    b. Consolidated political parties
    c. Heterogeneous civil society organizations
    d. State and municipal governments

Voter demand for populism and nationalism

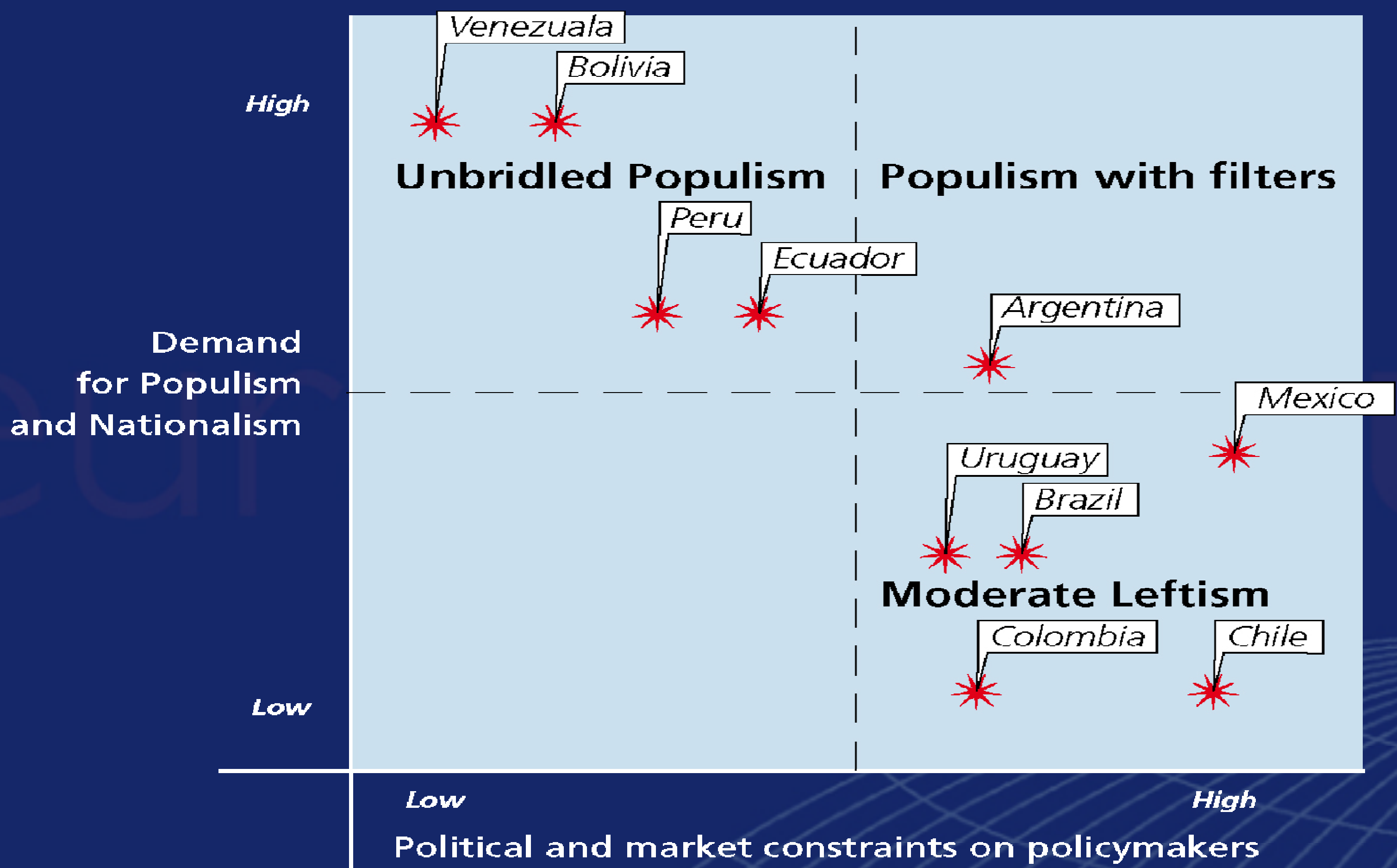
1. Willingness of voters to accept more inflation in order to generate higher growth

    a. Which segments of the electorate are hurt by inflation?
    b. Does tolerance to inflation decrease over time in a stable economy?

2. Extent to which voters are alienated form the political system

    a. Segments of the electorate excluded from economic gains
    b. Exclusion from political representation
    c. Heterogeneity of voter preferences

Constraints vs. Demands



Mexico: Domestic politics restrict energy investment

The status of the energy sector

- State oil monopoly Pemex conducts all upstream oil/gas activities
- The Mexican Constitution restricts upstream private investment
- Constitutional reform is difficult to pass
- Other legislation allowing private investment risks constitutional challenges

Domestic politics impedes energy reform

- Three parties dominate politics: PRD (left) - PRI (left-center-right) - PAN (right)
- The PAN supports reform, but doesn’t have enough votes to pass it
- The PRD opposes constitutional change
- The PRI is pivotal but is divided on reform for electoral/ideological reasons

Risks to the energy sector: the 2006 presidential elections

- A PRD president – the likely winner – is unlikely to push reform reform
- A PAN president – a possible winner – will have trouble passing reform
- A PRI president – an unlikely winner – is well positioned to pass reform

Brazil:
Leftist government supports open energy sector

The status of the energy sector

- **Open for private participation, regulation conducted by National Oil Agency (ANP)**
- **Petrobras is a dominant player in the market**
- **Gas remains unregulated**

PT's posture toward regulated sectors has been ambivalent

- **Lula administration began threatening autonomy of ANP**
- **Over the course of two years government has matured (regulatory agency reform)**
- **Congress has acted as a constraint on Lula administration**
- **Ministry of Mines and Energy working on gas regulation reform**

Risks to the energy sector: the 2006 presidential elections

- **PT victory – the likely winner – gas reform likely**
- **PSDB victory – a possible winner – regulatory environment will improve**

Venezuela:
Chavez tightens his grip on energy

The status of the energy sector

- One quarter of Venezuela's GDP is generated by oil sales
- Oil accounts for around half of Venezuela's total government income
- Venezuela's state oil company (PDVSA) produces around 60% of total production
- PDVSA shortfalls could create a heavier dependence on private production

Chavez's aggressive, nationalist agenda undermines this sector's attractiveness

- New law imposes tougher fiscal terms and grants PDVSA a majority share
- Operating agreements with private sector forced to migrate to the new law
- Back tax claims threaten to increase the private sector's fiscal burden

Risks to the energy sector: Electoral fiscal pressures threaten to squeeze production

- Venezuela's fiscal burden will rise in a packed electoral year
- PDVSA and private partners will be relied on to make up that shortfall
- Investment budgets could shrink and threaten production recovery efforts

Bolivia: Domestic politics undermine the energy investment climate

The status of the energy sector

- The new Hydrocarbons Law reverses the investor-friendly investment climate
- The new law requires all contracts to migrate to the new terms
- It significantly raises taxes/royalties, nationalizes hydrocarbons at the wellhead, requires indigenous consultation, restructures the pricing regime and exploration and production practices

Domestic politics turns against energy sector investors

- A rise in populist/nationalistic sentiment among voters
- Some politicians capitalized on Leftist sentiments and targets hydrocarbons
- The Leftist shift was reinforced politically by a change in electoral laws
- And even traditional parties/politicians have moved to the left to survive

Risks to the energy sector: Rising Leftism and Constituent Assembly elections

- Many social, civic, and political groups have raised populist/nationalistic petitions, risking political and policy stability regarding hydrocarbons
- Pending Constituent Assembly elections may undo even the new energy regime, raising uncertainty about the future energy investment climate

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