“Energy Insecurities in the Western Hemisphere”

Submitted Testimony for the Record

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Chairman Lugar, distinguished Members of the Committee:

Thank you for inviting me to submit testimony on this important subject—energy security in Latin America. Your hearing comes at a time when rising gasoline prices have opened our eyes to the vulnerabilities of supplies worldwide, especially those in our own neighborhood.

Speaking at The Heritage Foundation on March 31, 2006, Assistant Secretary of Energy for Policy and International Affairs Karen Harbert said that a secure and prosperous Western Hemisphere is vital for our national interest. Integrated energy markets, interconnected infrastructure, development of a broad range of resources, and efficient use will benefit the United States and the populations of neighboring countries.

However, there are significant roadblocks to achieving those goals. Differing philosophies about resource ownership, exploitation, and distribution within the Americas hamper the establishment of a free energy market. Weak or inconsistent governance plagues some states, thereby limiting investment and cooperation. Dwindling reserves and rising consumption generally threaten energy security where further exploration and research into fresh technologies is absent.

Keys to overcoming these impediments are more active hemispheric diplomacy, urging neighboring countries to embrace open markets not cartels, more support for improvements in democratic governance, and a commitment to diversify energy supplies.

Staggering Statistics

Energy sources can be broken down by fossil fuels, electricity generated from renewable sources, and nuclear energy. By far, fossil fuels are the mainstay of transportation systems and electrical powerplants—our major concern.

On average, the Western Hemisphere consumes about 30 million barrels of oil per day, of which the United States uses more than 20 million barrels, two-thirds of it imported.[1] In 2005, net imports accounted for 58 percent of U.S. total petroleum consumption. According to the Department of Energy, 13 states in our hemisphere provided 49 percent of the United States' gross imports of crude oil and petroleum products. Top suppliers included Canada, Mexico and Venezuela. These three countries accounted for 39 percent of U.S. gross imports in 2005, with Ecuador, Colombia, Brazil, Trinidad and Tobago, and Argentina following close behind.[2]

As economies expand worldwide, car ownership is rising and new factories require more energy. As an example of the relationship between energy consumption and growth, China's petroleum use increased by 15 percent in 2004, outpacing its 9 percent economic growth rate.[3] Without significant discoveries of new reserves or technological advances, the world will face an energy crunch.

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[1] U.S. Department of Energy, Energy Information Administration, International Energy Annual 2003, June 28, 2005, Table 1.2, at *www.eia.doe.gov/pub/international/iealf/table12.xls* (February 10, 2006).

[2] Karen A. Harbert, "Western Hemisphere Energy Security," testimony before the House Subcommittee on Western Hemisphere Affairs, March 2, 2006.

[3] Jason Bush, "China and India: A Rage for Oil," Business Week, August 25, 2005, at *www.businessweek.com/bwdaily/dnflash/aug2005/nf20050825_4692_db016.htm?chan=gb* (February 7, 2006).

The United States has estimated reserves of 21 billion barrels of oil (in decline since the 1970s) and 192 trillion cubic feet of natural gas. Canada has 178 billion barrels of oil and 56 trillion cubic feet of gas, making it potentially the largest petroleum supplier. Mexico has only 15 billion barrels of oil and about 16 trillion cubic feet of gas.[4] Venezuela has an estimated 77 billion barrels of oil (supplying about 7 percent of U.S. needs) and about 149 trillion cubic feet of gas.[5] These, plus other known global reserves might last for 30 years or more, barring no new discoveries.[6]

Obstacles to Cooperation and Security

Countries throughout the Americas hold differing concepts of property rights and the purpose of government that impact resource use and the stability of markets. Consequently, they have sharply divergent capacities to exploit resources and pursue technological advancement.

Apples and oranges. In colonial times, Britain's weak rule permitted the growth of community governments and free commerce in the north. As a result, North Americans developed a system of property rights that protected that which was granted to, bought, or invented by an individual. Spain's military expeditions imposed centralized government and monopolies in the south. If not so stated in national charters of resulting independent nations, the right to own property was considered a concession of the state. Whereas individual citizens and private enterprises could stake claims to underground treasure in the United States and Canada, almost all Latin American constitutions made subsurface resources the property of the state.

Today, property rights may be stronger in some Latin American countries than others, but minerals, petroleum, and gas are controlled by those in power. Governments predominantly own fields, pipelines, and refineries, subjecting them to political influences. Where economies are not big or free enough to support enterprises that can explore, extract, and market resources, the state offers concessions to foreign operators in exchange for part of the revenues.

These arrangements can remain stable for years. But if market prices rise, politicians may desire a bigger cut of the profits or suddenly think they have the capacity operate such industries on their own. Ecuador's May 2006 takeover of Occidental Petroleum's concessions is an example of the latter. In Venezuela, deputy oil minister Bernard Mommer recently told foreign oil companies, "The government can promise you whatever they want—it is not binding."[7] Such caprice is an outgrowth of centuries-old personalistic rule and traditions of impunity.

Squandering profits. For years, the revenue transfer from Pemex (Petróleos Mexicanos) to the Mexican state was the epitome of industry serving a single-party state. By the time Mexico's first opposition president Vicente Fox came into office, Pemex was turning over more than half its revenues to the government, amounting to half the federal budget. At the same time,

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[4]Based on estimates from U.S. Department of Energy, "World Proved Reserves of Oil and Natural Gas."
[5]*Ibid.*
[6] The United States produces almost 90 percent of the hemisphere's coal and has significant reserves—but there are limits to how it can be used.
[7] Thomas Catan and Andy Webb-Vidal, "Caracas warns oil companies of more tax increases," *The Financial Times*, April 11, 2006, p. 11.

executives claimed it was losing about $1 billion annually to internal corruption.[8] Since then, Petróleos de Venezuela (PDVSA) has surpassed Pemex as an example of industry supporting a misguided state, but also funding the malicious agenda of an authoritarian leader.

On December 2, 2002, business and labor leaders called a national work stoppage, hoping to pressure Venezuelan President Hugo Chávez into resigning. Some 35,000 PDVSA workers walked out, temporarily slowing production. Chávez fired nearly half of them, then put the semi-autonomous oil giant under his direct control. Petroleum income now appears to support his Bolivarian social programs, foreign debt purchases, campaign contributions to leftist candidates in neighboring countries, and a worrisome arms build-up. Democratic, market-oriented Trinidad and Tobago could be a target of intimidation should Chávez decide to seize some of its adjacent offshore gas fields.

Throughout the region, Chávez plays petro-politics. In September 2003, he accused the Dominican Republic of harboring former President Carlos Andrés Pérez, a political foe. He then stopped oil deliveries, triggering a temporary energy crisis while Dominican authorities scrambled for new suppliers. Such turmoil helps lift prices giving him the ability to offer discounted fuel to cooperative admirers in foreign countries, including the United States, where he can influence politic discourse and public opinion. In May 2006, he donated fertilizer and oil to Sandinista mayors in Nicaragua. Presidential elections will take place there in November.

President Evo Morales of Bolivia is headed in a similar direction, announcing the partial nationalization of gas fields in May 2006. He has so far followed Chávez's playbook in politics, announcing a constituent assembly to rewrite the constitution, inviting Cuban advisors to help run the police, and devising a scheme to redistribute land. Bolivia's pygmy economy generates about the same activity annually as Springfield, Illinois and higher rents from the hydrocarbon industry could help Morales consolidate power as long as mismanagement does not put him out of business.

Markets versus monopolies. Outside of the taxes, salaries, and dividends to stockholders, private energy companies use profits to modernize equipment, service fields and mines, and conduct research in such areas as renewable energy supplies. In contrast, Mexico's Pemex still supports the state to such an extent that field maintenance and further exploration has become a minor prioprity leading to stagnating output. Foreign investment could help, but Mexican elites fear such an opening could lead to loss of financial control, while pliant politicians have convinced the public that national patrimony is at risk. Sadly, Mexico now imports natural gas from the United States, even though it has some 15 trillion cubic feet of reserves.

Further South, Venezuela's Chávez announced an extravagant $20 billion, 5,000-mile gas pipeline from Venezuela to Argentina that will probably never materialize.[9] More realistically, he is starting to unite state hydrocarbon industries into a cartel under his control. Petrocaribe, Petrocentro, Petroandina, and Petrosur are entities he invented under an umbrella organization called Petroamérica. Ecuador's statist oil and Bolivia's hydrocarbon industries are good

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[8] Tim Weiner, "Corruption and Waste Bleed Mexico's Oil Lifeline," *The New York Times*, January 21, 2003, p. 1.

[9] The gas pipeline will be more expensive to build and operate than liquefying and shipping gas. "The Explosive Nature of Gas," *The Economist*, February 11, 2006, p. 36.

candidates for membership. Argentina, Uruguay, Central America, and many Caribbean states with few or no resources could make up the client base. High prices outside the cooperative would support subsidies within. But attendant corruption, mismanagement, and lost foreign investment could also provoke collapse.

Energy-hungry China, the world's fourth largest economy, is another power player on the state industry side of the ledger. China has pursued petroleum partnerships with Venezuela, Ecuador, Colombia, Argentina, Brazil, Mexico, and most recently Cuba where it could soon be drilling in the Florida Straits, 50 miles from U.S. shores. China's state-to-state business deals reinforce the region's tradition of centralized decisionmaking and anti-competitive practices.

Jumping the Hurdles

Rising global consumption and the emergence of powerful new economies mean that timely adoption of effective energy strategies is crucial. The best way to assure sufficient resources is to foster competition and let markets respond to needs. And while prospects for much of the region seem grim based on prevailing anti-market policies in neighboring countries, the United States has reliable energy partners in market-oriented Canada, Trinidad and Tobago, and even statist Mexico, Colombia, and Peru. Brazil could become an important associate in developing new supplies of ethanol, a product that involves more private enterprise than government monopoly. To move the ball forward, the United States should:

- **Embrace regional energy diplomacy.** Right now Venezuela's Chávez has seized the initiative by developing monopolistic arrangements in Latin America. As suggested by the proposed Energy Diplomacy and Security Act (S. 2435), the U.S. Departments of State and Energy could promote a hemispheric energy security forum to encourage collaboration among willing states on competitive energy markets, attracting investors, replacing monopolies with regulatory authorities, and sharing information and research—as some Latin American countries have attempted to do before without much success. The U.S. Congress should support those and existing multilateral diplomatic efforts with adequate funds for travel and dedicated personnel.

- **Urge neighboring countries to embrace free markets not cartels.** Eventual adoption of stronger property rights and competitive enterprise is the key to spreading prosperity through jobs and ownership. One way to make state energy monopolies truly public is to distribute company shares among the country's voting population. The government's role then converts to regulation. U.S. public diplomacy could help Latin American publics understand such concepts.

- **Consistently support improvements in democratic governance.** Since elections took place in the majority of Latin American nations in the 1990s, U.S. support for checks and balances, constituent representation, transparency, and rule of law has been spotty. Development funds have been shifted to serve other regions of the globe while big dollar environmental and health programs have dominated Latin American assistance efforts. The U.S. Secretary of State should ensure that development programs in Latin America help consolidate of deeper democratic traditions—to bring voters of all classes and income closer to their governments and diminish the appeal of authoritarian populists.

- **Promote diverse energy supplies.** At home, the U.S. Congress should end the 54-cent per gallon tariff on sugar cane-based ethanol meant to protect U.S. corn farmers. There are other uses for corn besides making ethanol. The United States, Caribbean and Central American allies, and Brazil could then collaborate in developing ethanol markets to free each other from Hugo Chávez's extorsionist petro-politics. American lawmakers should ease complicated regulations that limit refinery expansion and mandate complicated regional recipes for gasoline that have made it difficult for existing refiners to meet growing demands. By equal measure they should make further exploration possible for responsible extraction of fossil resources.

Conclusion
According to the U.S. Department of Energy, Latin America will require nearly $1.3 trillion in energy sector investment between now and 2030. Unfortunately, high oil prices have resulted in a resurgence of government control over industries and the rise of populist, authoritarian leaders in Venezuela and Bolivia. Outside of the hemisphere's market economies, needed investment will probably not occur. While the United States cannot rescue every neighbor from bad decisions, it can encourage cooperation among allies in making ones that will help sustain growth and broaden prosperity.

As responsible neighbors, we must agree on policies that allow market forces to shape demand, guide energy users in changing consumption habits, and promote the development of new technologies such as fuel cells and hydrogen power. Considering the emergence of powerful global economies and expanding populations in our own hemisphere, there is little time to lose.

Again, I appreciate the chance to provide testimony on this important topic and commend the Committee for its work.