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FEATURED Q&A

What Will the End of Fuel Price Pegging Mean for Petrobras?

Brazilian state-owned oil company Petrobras said it would end its policy of pegging the cost of fuel to international prices. // File Photo: Agência Brasil.

Q Brazilian state-owned oil company Petrobras said May 16 it would end its policy of pegging the cost of fuel to international prices. President Luiz Inácio Lula da Silva had previously argued the government should shield the country from the volatility of international fuel prices, and in his previous terms he used Petrobras to tackle inflation by forcing it to sell fuel below cost. The policy cost approximately $30 billion and turned Petrobras into the most indebted oil company in the world. How will the change affect fuel prices, and the company's reserves? How well can such a measure tackle the country's inflation and stimulate its economy? What additional changes can be expected at the state-owned company?

A Mário Braga, senior analyst for Brazil at Control Risks: "The new pricing policy is in line with President Luiz Inácio Lula da Silva's campaign promise to make domestic fuel prices less vulnerable to international drivers and underscores how the current administration will resort to political influence to use state-owned enterprises as policymaking tools. Ultimately, Lula's goal is to limit inflation and boost his popularity. Since Brazil relies on roads to transport two-thirds of the goods it produces and consumes, limiting fuel costs will likely have a short-term trickle-down effect on the economy. The risks such a strategy entail revolve around its long-term sustainability and the broader impacts on Petrobras and the fuel distribution market. Price mismatches can affect diesel importers' operations and increase the risks of occasional fuel shortages, for instance. Petrobras CEO Jean Paul Prates

Continued on page 3

TOP NEWS

OIL & GAS

Ecopetrol Reaches Deal With Seven Labor Unions

Colombian state-owned oil company Ecopetrol said Monday that it reached a four-year contract with seven labor unions. The agreement includes pay increases and social investment plans.

Page 2

OIL AND GAS

Argentina Asks Oil Companies to Finance Imports

Argentina's government has asked oil companies to finance their imports for 90 days because of a national shortage of foreign currency.

Page 2

CLIMATE CHANGE

Britain Helping to Fund Research Project in Amazon

Britain announced that it will provide 7.3 million pounds ($9.2 million) in funding for an environmental research project in the Amazon rain forest. Foreign Secretary James Cleverly visited the project's site, located north of the city of Manaus.

Page 3

Cleverly // File Photo: U.K. Government.

OIL & GAS NEWS

Argentina Asks Oil Companies to Finance Imports

Argentina's government has requested that oil companies finance their imports for the next 90 days because of a national shortage of foreign currency, a source familiar with the matter said on Wednesday, Reuters reported. The move followed another request from the government that asked companies to secure finances through international banks or parent companies to avoid drawing on U.S. dollars from the exchange market. The South American country is reeling from a recent drought, battling triple-digit inflation and seeing a fall in foreign reserves that is threatening its ability to meet its payments. Argentina needs the funds to cover trade costs and future debt repayments, as well as to reach the economic goals set by its $44 billion loan program with the International Monetary Fund. Argentina's oil sector could more readily access the exchange market to bolster energy imports and assist the development of its hydrocarbons production, notably in the Vaca Muerta shale formation, the world's second-largest shale gas reserve, Reuters reported. The formation produces 47 percent of the country's total oil output and 41 percent of its gas. Argentina's energy trade balance could reach break-even this year, according to government estimates, following a $4.5 billion deficit in 2022. Last week, the largest union in the country went on strike to demand better labor conditions after a series of incidents at the Vaca Muerta shale formation injured workers, Reuters reported.

Colombia's Ecopetrol Reaches Four-Year Contract With Unions

Colombian state-owned oil company Ecopetrol agreed to a four-year contract with seven unions, the company said on Monday, Reuters reported. The agreement with Petroleum Industry Workers' Union (USO) and smaller workers' groups, including Asintrahc and Asopetrogas, lays out pay increases for workers and social investment plans for local communities. It will be in force until Dec. 31, 2026, Ecopetrol said in a statement. Workers will be granted an annual pay rise adjusted for inflation plus 1.5 percent this year and inflation plus 1.6 percent over the next three years. Colombia's consumer prices rose 13.12 percent in 2022, and the country's central bank predicted an inflation rate of 9.5 percent for this year. "The deals include improvements in the labor conditions of workers, the commitment to continue to promote diversity, equity and inclusion with a focus on gender," Ecopetrol said. Some 79 percent of the oil company, or 9,500 workers, will benefit from the deal, Reuters reported. The USO praised the agreement and the associated price hikes as well as community investments in a posting on Twitter. "Ecopetrol's investment plan reflects the development of a new corporate vision, which began in 2018, and today is contained in the 2040 Strategy 'Energy that Transforms.' " Inés Elvira Vesga, partner at Holland & Knight, told the Energy Advisor in a **Q&A** published Jan. 6. "The pillars of this plan include competitiveness in the core business, decarbonization, clean energy, digitalization, sustainability strategies and community relations," she added.

Exxon Mobil Appeals Guyana Court Ruling on Oil Spill Insurance

U.S.-based oil major Exxon Mobil on May 19 said it appealed a Guyanese court ruling that it must have insurance for "unlimited liability" in the event of an oil spill off the coast of the South American country, the Associated Press reported. In the ruling two weeks ago, the court ordered the local environmental agency to obtain independent liability insurance from Exxon's subsidiary Esso Exploration and Production Limited. It also sought additional insurance from its parent company to protect against catastrophic oil spills, the AP reported.

NEWS BRIEFS

U.S. Renews License for Oil Service Companies to Preserve Venezuela Assets

The United States on Tuesday renewed a license for six months authorizing U.S. oil service companies to preserve their assets in Venezuela, Reuters reported. Restrictions preventing them from drilling, processing or handling Venezuela-origin oil are still in place. The license, issued by the U.S. Treasury Department, was first granted in 2019 by the Trump administration to a group of companies, including Halliburton and Chevron.

Thirteen Injured in Separate Incidents Involving Mexico's Pemex

A fire at a refinery of Mexican state-owned oil company Pemex and a separate explosion injured a total of 13 people, the company said in statements on Wednesday, Reuters reported. Four people were injured in the fire at Lázaro Cárdenas refinery, in the eastern city of Minatitlán. Production at the refinery continued uninterrupted, Pemex said. In the State of Mexico, nine people were injured, including three Pemex workers, after an illegal tap caused a pipeline to explode. The oil company said it would investigate both incidents.

Argentina's YPF Signs Deal for Exploratory Well in Shale Formation

Argentine state oil company YPF said on Monday it signed a deal with Compañía General de Combustibles to drill the first exploratory well in the Palermo Aike shale formation, Reuters reported. The shale formation, located in the Patagonian province of Santa Cruz, is expected to hold reserves of some 10 billion barrels of oil. It is the second largest deposit of its kind in the country. The companies did not disclose budget data or a time frame for the project.

Exxon Mobil said the court failed to consider that the company, along with its consortium partners Hess Corp. and China National Overseas Offshore Corp. had the "undoubted ability" to meet their financial obligation in the event of a spill. The consortium is operating the offshore Stabroek Block. The company said the dispute over oil-spill insurance in Guyana could halt production, cutting revenue by some $350 million per month, Reuters reported. Guyana could incur a loss of up to $88 million in earnings from its share in production. Guyanese High Court Justice Sandil Kissoon said in his ruling that Exxon "engaged in a disingenuous attempt" to circumvent its obligations under its environmental permit. Kissoon gave the company until June 10 to provide Guyanese authorities with a liability agreement from an insurance company, Reuters reported.

CLIMATE CHANGE NEWS

Britain Helping to Fund Brazil Amazon Research Project

Britain on Tuesday announced new funding for a project in Brazil's Amazon rain forest that seeks to measure the effects of rising carbon dioxide levels on trees, the British Embassy said, Reuters reported. Foreign Secretary James Cleverly visited the site north of the city of Manaus, where scientists are working on towers that will inject the canopy with carbon dioxide and monitor how it is absorbed. The experiment, named AmazonFACE or Free-Air CO2 Enrichment, could help scientists understand how the rain forest might respond to rising carbon dioxide levels in the atmosphere. It could also signal how resilient the rain forest will be to climate change in the coming decades, Reuters reported. It is a combined project between scientists from the National Institute for Amazonian Research, the University of Campinas in Brazil and the British Met Office. Results will become available starting next year and will be made available to the scientific community around the world. Britain is contributing 7.3 million pounds ($9.2 million), or 45 million reais to the research, adding to 32 million reais in Brazilian funds. Earlier this month, British Prime Minister Rishi Sunak told Brazilian President Luiz Inácio Lula da Silva during a meeting in London that Britain would contribute to the Amazon Fund, an initiative designed to fight deforestation, Reuters reported. "I'm delighted to announce we will be investing in your Amazon Fund and I pay tribute to your leadership in this initiative," Sunak said. Lula thanked Sunak for the contribution, the amount of which was not announced. Lula added that "much more can be done in terms of trade" between the two countries. Launched in 2009, the Amazon Fund seeks to fight deforestation and foster sustainable development. Lula's predecessor, Jair Bolsonaro, froze the fund, but Lula

FEATURED Q&A / Continued from page 1

affirmed that the company will not resort to below-cost prices, and it is unlikely that it will lose its autonomy entirely. However, the announcement fits Lula's and his Workers' Party (PT) belief that the state should have an increased role in the economy and indicates that further interference in strategic decisions is likely. These will include scrapping Petrobras' divestment plans, limiting dividend distributions and reinvesting profits in an attempt to create jobs and boost the economy."

> **Ultimately, Lula's goal is to limit inflation and boost his popularity."**
> **— Mário Braga**

A **Daniel Hellinger, professor emeritus of international relations at Webster University:** Too often, we classify oil-producing countries by their reserves, production or share of the global export market. None of these make a lot of sense for Brazil, because more than 80 percent of its production is slated for domestic consumption. According to the United States' International Trade Administration, Brazil is the eighth-largest oil producer but also the eighth-largest consumer. Petrobras accounts for about 73 percent of production. A recent Bloomberg report called Brazil a 'powerhouse' because production is expected to exceed 3.4 million barrels per day (bpd) this year and to reach 4.6 million bpd by 2030, 96 percent from offshore 'pre-salt' concessions off the Atlantic coast. The break-even production cost for Petrobras is about $40 per barrel. Global oil prices today are around $70. That price level will provide Petrobras with sufficient capital to maintain production levels for consumption and not have to resort to imports, as it did after the financial crisis of 2010. A 20 percent return on operating income would leave an extraordinary surplus of $22. Lula has imposed a temporary 9.2 percent royalty ('export tax') on export prices. That bite will take about $6 out of this surplus, assuming it's extended. What can Lula do with the remaining $16? Even after collecting the roughly 35 percent tax on corporate profits, there is plenty for Petrobras and the state to share. Lula can dedicate his share to carbon emissions or anti-poverty programs. Or, he can lower domestic prices below international levels. The choice is more political than economic."

A **Anabel Teixeira, associate at the Brazil and Southern Cone practice at McLarty Associates:** "Petrobras recently announced the end of its import parity policy, which was implemented during the Temer administration in 2016. The new policy adopted by the state-owned oil company will define fuel prices based on competitors and the 'marginal value' of Petrobras. During his campaign, President Lula had promised to make fuel cheaper for Brazilians, and the policy is expected to drastically lower prices for consumers (by 13 percent for

Continued on page 6

restarted it after he took office earlier this year. Last month, U.S. President Joe Biden vowed to contribute $500 million to the Amazon Fund, an amount that would make the United States among the fund's largest contributors, CNN reported. [Editor's note: See related Q&A in the March 3 issue of the Energy Advisor.]

POLITICAL NEWS

Ecuador's Electoral Council Schedules Election for Aug. 20

Ecuador's National Electoral Council on Tuesday said it was scheduling early presidential and legislative elections for Aug. 20, the Associated Press reported. If there is no outright winner for the presidency, a runoff would be held in October. The snap elections were scheduled after President Guillermo Lasso last week dissolved the National Assembly in a move that also shortened his own term. He took the action after the assembly started impeachment hearings against him and was poised to remove him from office. Lasso was accused of corruption for not stopping a contract between the state-owned oil transportation company and a private tanker firm. He denies wrongdoing. The winners of this year's elections will fill the remainder of the terms of the original elected officials. Lasso is eligible to run for president again. On Tuesday, Ecuador's minister of government said Lasso was still considering whether to run, Reuters reported. Until the elections, Lasso can rule by decree, with the oversight of the Constitutional Court, for as long as six months. Last Thursday, the court rejected several legal challenges that sought to invalidate Lasso's decree that dissolved the assembly. In the vote, Ecuadoreans could elect Andrés Arauz, the "proxy candidate" of former President Rafael Correa, to the presidency, Eileen Gavin, principal analyst for global markets and the Americas at Verisk Maplecroft, told the daily Latin America Advisor in a Q&A published May 18. "Local business groups suggest that Arauz is more of a moderate, consensual figure than the highly polarizing Correa–and less likely to adopt Correa's interventionist and dogmatically anti-private sector stance," said Gavin. However, "the prospect of a new leftist government will set off alarm bells" on the part of domestic and foreign companies with assets in Ecuador as well as bondholders. Also on Tuesday, Lasso issued a decree to establish areas with special tax and foreign-trade rules as well as tax exemptions, in an effort to attract private investment and create jobs in the country.

ADVISOR Q&A

Will Chile's Second Attempt at a New Constitution Succeed?

Q **Right-wing parties on May 7 won a majority as Chileans voted for a 50-member commission that will draft a new constitution. The outcome marks a shift from the previous commission, which was dominated by independent and left-wing parties and that oversaw the first attempt at drafting a new constitution. Chileans rejected that proposed constitution in a September 2022 plebiscite. What does the result mean in terms of the direction the new draft constitution will take? How will the second attempt differ from the first, and how likely is it to succeed?**

A **Mariano Machado, Americas principal analyst at Verisk Maplecroft:** "Chile's second-attempt constitution has entered uncharted waters, with no guarantee of a successful resolution by the end of 2023, when a new draft will be put to a public vote in another referendum. This second drafting process will take a more conservative direction. The election for the commission has resulted in further political fracturing and polarization at the cost of the traditional centrist forces. It has also promoted the revival of an ultraconservative right, in an apparent response to the radical leftist movement surrounding President Gabriel Boric. But even though this second attempt will swap who is in the driver's seat–the left drove in the first initiative–there are strong similarities between both processes that could outperform differences. These include having a body that appears (again) ill-suited to deliver a consensus text and a weak ruling coalition (again) observing the process from the sidelines. Hence, how José Antonio Kast's Republicanos balance their previous contempt for constitutional change with their newly found incentives to deliver the new charter will be the critical variable steering the process. Delivering a new constitution could strengthen Kast's presidential aspirations; obstructing it could have significant consequences–especially if he were elected to La Moneda in 2025. However, the political class does not have control over the dominant risk for the process. With a society explicitly disenchanted with progress thus far, potentially having to elect between the current constitution and, perhaps, a more conservative one, the risk that a second text will be rejected remains substantially high."

EDITOR'S NOTE: More commentary on this topic appears in the Q&A of Tuesday's issue of the daily Latin America Advisor.

Mexico's López Obrador Orders Railway Line Seizure

Mexican President Andrés Manuel López Obrador on May 19 ordered the seizure of a portion of a private railway line near the oil port of Coatzacoalcos in Veracruz state, The Wall

NEWS BRIEFS

Trial Begins Against Former Panamanian President Martinelli

Former Panamanian President Ricardo Martinelli, along with some 20 other people, were put on trial on Tuesday over money laundering allegations, the Associated Press reported. The case, known as "New Business" dates back to 2017 and involves lucrative government contracts awarded under Martinelli's term, that were then funneled into a publishing company. The former president denies any wrongdoing. Martinelli, who served as president from 2009 to 2014, is expected to seek re-election next year.

Chile's Economy Grows 0.8% in First Quarter

Chile's economy grew 0.8 percent in the first quarter as compared to last year's fourth quarter, the central bank announced May 18, Reuters reported. The first-quarter growth was lower than expected by analysts in a Reuters poll, who had predicted a 1 percent increase. In the fourth quarter, the economy grew 0.1 percent as compared to the third. Chile recovered quickly from the Covid-19 downturn but faced a slowdown last year.

Brazil's Supreme Court Convicts Former President Collor de Mello

Brazil's Supreme Court on May 18 convicted former President Fernando Collor de Mello on corruption and money laundering charges, Reuters reported. Six of the 10 judges voted in favor of the conviction. Collor was impeached in 1992 on corruption allegations. The prosecutor's office accused him of receiving some 30 million reais ($6 million) in bribes from a subsidiary of state-run oil company Petrobras in connection with the widespread 'Car Wash' probe that has led to the imprisonment of dozens of politicians and business leaders.

Street Journal reported. Mexico's government said it transferred possession of the part of the railway line from its owner, Ferrosur, a subsidiary of Grupo México, to a government entity that the armed forces will operate, the newspaper reported. Grupo México said in a statement that armed members of Mexico's navy conducted a "surprise and unusual seizure of facilities" on Friday at 6 a.m. Grupo México's chairman, billionaire Germán Larrea, is among Mexico's richest people. Grupo México said it would continue to serve customers on the seized portion of the railway, though under the supervision of the military. Trains were running "with surveillance of the armed forces" on the roughly 60-mile stretch of the seized line, Grupo México said, the Associated Press reported. Mexico's government said it would compensate the railway's owners for what it called a "temporary occupation." The stretch of railway is a main component of the Inter-Oceanic Corridor of the Isthmus of Tehuantepec, said the decree ordering the seizure, The Wall Street Journal reported. López Obrador is seeking to modernize the rail link between Mexico's coasts in order to create a transportation route that could potentially compete with the Panama Canal, the newspaper reported. The decree justified the seizure by calling it a matter of national security and saying that the railway line is a "public utility." The takeover happened a day after the Mexican Supreme Court rejected a government order that classified national infrastructure projects as matters of national security. Hours after the ruling, López Obrador issued a new decree declaring infrastructure projects to be in the realm of national security, a measure that was seen as a challenge to the court. The move also followed López Obrador's seizure in March of a Caribbean coast seaport owned by U.S.-based construction materials producer Vulcan Materials, the AP reported. Mexican authorities then used the seaport, located near Playa del Carmen, to unload cargo from Mexican cement company Cemex. On Wednesday, President Andrés Manuel López Obrador said compensation to Grupo México for the partial railway seizure will not include cash, Reuters reported. "Not money. What we are looking at is compensation. That is to say, let's see, we are going to restructure the concession," López Obrador told reporters.

ECONOMIC NEWS

Brazil's Chamber of Deputies Approves Fiscal Framework Bill

The lower house of Brazil's Congress on Wednesday approved fiscal framework legislation that would replace the country's current spending cap, a victory for the administration of President Luiz Inácio Lula da Silva, Reuters reported. The bill, which now goes to the Senate, would keep government expenditures from rising more than 70 percent of any revenue increase, with spending growth also limited to 0.6 percent to 2.5 percent annually above the rate of inflation. If those restrictions are not met, spending growth would be capped at 50 percent of revenue increases as a penalty. "This measure will allow for sustainable growth combining social and fiscal responsibility," the government's institutional relations minister, Alexandre Padilha said after the vote. "It was an important victory for the country," he added.

Russian Officials, Business Leaders Sign Deals With Cuba

Russian government officials and business leaders signed several deals last week with counterparts in Cuba during a gathering in Havana, Reuters reported May 19. Among the agreements were deals to work together on increasing production of Cuban sugar and rum and also ensuring supplies of Russian crude oil and wheat to Cuba, the wire service reported. "[The agreements] constitute a milestone in the history of our bilateral and business ties," Cuban Trade Minister Ricardo Cabrisas said in a speech marking the end of the meetings. Also among the agreements is a contract for Russian company Prodintorg to provide wheat to Cuban state-owned company Alimport in an effort at "guaranteeing the stability" of the commodity to Cubans, Reuters reported, citing a document from the Cuban-Russian Business Committee.

FEATURED Q&A / Continued from page 3

gasoline and diesel and by 21 percent for liquified petroleum gas, used for heating and cooking). The overall reduction in prices will contribute to lowering inflation, while the administration hopes this will help convince the central bank to reduce interest rates. Petrobras will also reduce the frequency of price adjustments to once or twice a year to shield consumers from volatility and in the hopes that the longer periods without price adjustments will cause price drops or hikes to even out over time. Although some analysts said the new policy lacks transparency, markets were generally relieved with the announcement as they expected the policy to be more interventionist, and it even caused some economic analysts to reduce their year-end inflation forecasts for Brazil. Petrobras shares surprisingly rose after the announcement, and the state-owned enterprise has stated that the new policy will not affect profitability. Reactions were better than expected, but uncertainty about the implementation of this policy does remain, particularly in circumstances where international prices are especially high. Additionally, the lower gas prices may be short-lived, as fuel taxes are set to resume in July."

A **Edmilson dos Santos, associate professor in the Institute for Energy and Environment at the University of São Paulo:** "Brazilian state-owned oil company Petrobras said on May 16 it would end its policy of pegging domestic prices of fuels to international prices on a short-term basis. President Luiz Inácio Lula da Silva had previously argued that the government should shield the country from the volatility of international fuel prices, which brings Petrobras' pricing policy back to practices that the government adopted from the late 1990s to early 2000s, including during President Lula's previous terms. The domestic fuel prices were then linked to international prices in less volatile, long-term adjustment curves. But after 2011, under President Dilma Rousseff, Petrobras was increasingly used to tackle inflation by forcing it to systematically sell imported fuels below import costs. The policy cost approximately $30 billion and helped to turn Petrobras into the most indebted oil company in the world, just when the Brazilian state-owned company was moving forward in its intense investment program to develop its newly discovered large oil reserves in the pre-salt offshore frontiers."

A **Paulo Valois Pires, partner at Schmidt, Valois, Miranda, Ferreira & Agel Advogados in Rio de Janeiro:** "It is still unclear what the new Petrobras policy will be toward the oil byproducts price. The markets are still awaiting the details, although I believe this government and Petrobras' upper management will not commit the same mistake of arbitrarily pricing down oil byproducts to the detriment of the company's financial statements. I expect some lessons will be learned from the past when Petrobras was heavily indebted due to a mismatch of the international prices and the prices determined by the company in the domestic market. We know that fuel prices are among Brazil's most essential inflation items. Therefore, any reduction will have a positive effect on the economy and society at large. In the upcoming months, it will be paramount to find a way to balance the country's economic needs and the financial health of Petrobras."

The Energy Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta.

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