

# Energy Diplomacy and the Crossroads in South American Unification

By Eduardo Gudynas | July 24, 2007

It's possible to postulate that these days the integration of the countries of South America finds itself at a crossroads. Different strategies have converged to the point where the large trade blocs find themselves at a standstill and turn into political forums. The new attempts are centered on energy, and from there new proposals arise. Brazil has sought to lead by consensus but has not been willing to pay the economic and political price of this position, while Venezuela is exploring another avenue by sharing energy projects and resources with other countries.

The large blocs of South American unification, the Andean Community of Nations (CAN) and the Southern Common Market (MERCOSUR) have had different histories but today they find themselves in similar situations. Trade problems persist and governments seem to accept that many of these difficulties will not be resolved in the near future, so these blocs continue to exist more and more as political forums. There exist some areas where advances seem possible and among them energy stands out as a central axis for new attempts at integration. But from here new avenues are opening where there are at least two perspectives: one is represented by Brazil's position illustrated by the role of its state oil company Petrobras, and the other by Venezuela and the joint agreements articulated around PDVSA, the Venezuelan state oil company. They are demonstrating two distinct integration proposals, that in some ways conflict.

## Energy Diplomacy

Since the beginning of 2007 a series of meetings and presidential summits have taken place at a dizzying rate and in many cases energy has played a central role.

Let's begin by recalling that in March the president of the United States, George W. Bush, visited Brazil, Uruguay, Colombia, Guatemala, and Mexico on the trip called "the ethanol tour." His presence fed the idea of a major partnership between Brasilia and Washington, especially due to trade in biofuels. Bush reinforced this idea still more by inviting Brazilian president Luiz Inácio Lula da Silva to visit him on the grounds of Camp David a few weeks later. As a reaction to these meetings, first of all the president of Venezuela, Hugo Chávez, launched a "counter-tour" in opposition to Bush, and later, joined by Fidel Castro, began to critique the role that biofuels will play.

In this context, on April 16-17 the South American heads of state held a meeting on the island of Margarita (Venezuela), with the presence of Chávez of Venezuela, along with Nestor Kirchner of Argentina, Lula de Silva of Brazil, the Bolivian Evo Morales, Nicanor Duarte of Paraguay, Rafael Correa of Ecuador, the Chilean President Michelle Bachelet, Alvaro Uribe of Colombia, Vice President of Uruguay Rodolfo Nin Novoa, Prime Minister of Guyana Sam Hinds, and Prime Minister Delegate of Surinam Gregory Rusland.

The energy summit presented objectives that all would share, such as that energy integration, "should be utilized as an important tool to promote social and economic development and the eradication of poverty," or to "involve as principal actors the State, society, and industry businesses" without omitting the classic calls for "technical cooperation." But this type of generic agreement has been a recurring theme in presidential declarations for many years.

The most concrete agreements were the creation of the Energy Council of South America made up of the energy ministers of each country. This council must develop a continental energy strategy, an action plan, and a proposal for a South American Energy Treaty. The presidents again recognized the importance of joint undertakings, mentioning specifically the Venezuelan plan *Petroamerica*. But it also needs to be recognized that the Margarita Declaration does not include any concrete measures toward other energy integration in the sense of sharing these resources beyond interconnections or the buying and selling of oil or gas.

On other issues disagreements between the countries also recurred. There were no agreements in support of the idea of an international organization of countries that



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export natural gas. Nor did they agree to support the great Gas Pipeline of the South as a collective undertaking, and for now its progress continues in the hands of Venezuela, Brazil, and Argentina. Biofuels were the object of long discussions between the delegations, especially because of Brazil's self-defense, until ultimately the final declaration accepts them as a mark of the diversity of energy sources (Bolivia maintained its disagreement on this point). Nor did they reach an agreement to launch the Bank of the South, especially promoted by Venezuela, Argentina, and Ecuador. Brazil resisted this proposal and made it a condition for its incorporation that all the points be discussed again. The other countries acceded and new discussions are currently taking place.

The Venezuelan proposal to call the South American Community of Nations the "Union of South American Nations" (UNASUR) was accepted. This union will have its headquarters in Quito and the creation of a council was announced. Although this decision was surrounded by optimism, no plan of action was agreed upon. Remember that this is the third name given to the attempts at South American integration, which began in Brasilia in 2000 as a continental free trade region, and in 2004 in Cuzco (Peru) was named the South American Community of Nations.

An overall evaluation of these decisions shows that many presidents really are seeking mechanisms for regional unification, and that they have ceased to be mere promoters of exports to the global markets. It is also evident that energy has become a central issue, and that based on that, they are seeking bilateral or regional agreements. But, on the other hand, it again lapses into the publicity arena when they launch the idea of the "South American Union" in spite of the serious internal problems inside the Andean Community and MERCOSUR, and while the South American Community of Nations has barely taken its first steps.

Therefore, while it's true that the opportunity for discussion continues—and it is correct to recognize progress on some points—they should admit the difficulties in order to arrive at concrete agreements in many aspects related to the economic and productive articulation between countries, despite clear discrepancies that persist on various issues. That's how these meetings end up as political forums.

A few days later on April 27-28 the fifth presidential meetings of the countries participating in ALBA (Bolivarian Alternative for the Americas) took place, and in this case Chávez, Morales, Daniel Ortega of Nicaragua,

and Cuban Vice President Carlos Lage, as well as observers from Haiti and Ecuador among others, attended. There they signed a series of agreements, including an "ALBA Energy Treaty," with important innovations like shared access to an area of oil exploitation in the Orinoco River basin that assures the other countries of access to these reserves for the next 25 years. They announced the creation of joint ventures for the utilization of natural gas and they will aim to increase each member's refinery capacity. Even though these are still generic goals, an ALBA Energy Council made up of the ministers of each country was created to put them into effect.

But the most outstanding aspect was the presentation of the concept of the "great national" company (as an alternative to the transnational companies). In the energy agreement they announced a "great national" energy company that will encompass wide sectors such as oil, gas, refining, petrochemicals, infrastructure development for storage and transportation, electrical energy, and alternative energies. The treaty establishes that the new "great national" company will be composed of the State-run companies.

## **Brazil and Bolivia Say Goodbye**

Shortly after these presidential meetings what appears to be the final solution was reached in the disputes between the Bolivian government, Petrobras, and the Brazilian government. These disputes are a clear example of the true distance between the declarations of the summits and the concrete relations between the countries. Since in May 2006 Morales initiated state actions to control the extraction and sale of hydrocarbons, there have been disputes with the Brazilian petroleum company. For Brazil, Bolivian natural gas is a key contributor to its energy matrix, and for many long months they disputed its price. Immediately afterwards they added to the negotiations the transfer of Petrobras' refineries to the Bolivian state petroleum company YPF. An outside observer might be surprised to find conflicts between two governments that define themselves as leftist, but the truth is that they were defending commercial interests and national political goals without being able to agree on true energy unification.

The many arguments at play cannot be summarized in a single article, but two facts can be mentioned as an example of their complexity. First, one must recognize that Petrobras did not keep its promises to process hydrocarbons inside Bolivia, and therefore, there was no

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real contribution to Bolivian development beyond the sale of gas. This is an example of energy interconnection without productive integration.

Secondly, it is also important to recognize that Lula's government managed to counteract the strong internal pressures of the conservative and business sectors that wanted to practically crush the Bolivian nationalization of its hydrocarbons. These groups presented the dispute as the "Gas War," alternating wounded nationalism with claims of retaliation.

Lula's government sought a solution to the conflict for various reasons, ranging from the need to end the internal debate within Brazil, to avoiding future accusations of causing the destabilization of Morales. Finally Petrobras accepted US\$112 million for its refineries in Bolivia. The Bolivian government celebrated this arrangement, although it is a very big gamble given the limitations that it faces and taking into account the technical capacity and resources needed to manage the new facilities. In some way, Brazil has abandoned Bolivia to its own fate, with a clear distancing between the two presidents. Petrobras will maintain its contracts to buy natural gas until they end in 2019, and it announced that as of that date it will buy no more Bolivian gas.

While Brazil takes its leave of Bolivia, Morales' government sought support in other countries. The clearest examples are the agreements with Venezuela, including technical assistance from PDVSA, as well as new oil explorations in the northern part of the country. Also it procured a long-term agreement for the sale of natural gas to Argentina in order to reduce its dependence on Brazilian sales.

These disagreements between Brazil and Bolivia are possibly the most well known, but others exist that are very similar and less publicized. For example, Paraguay is demanding changes in the old contracts for the sale of electrical energy to Brazil from the Itaipú dam that the two nations share; and Argentina has re-initiated the intermittent suspensions of gas exportation to Chile, in spite of the contracts and agreements between the two countries.

## **The Shadow of Corruption**

Another real problem that is becoming evident in the energy sector is the return of the shadow of corruption, in both the private and public sectors.

The most alarming case is unfolding in Argentina, where after repeated accusations, irregularities in the payment of taxes by the Swedish company Skanska, in charge of natural gas transportation projects, were confirmed. As the investigation continued, evidence showed a scheme of overcharging more than US\$5 million for the work ordered by the Argentinean government.

The case has some shocking aspects, such as the accusation that the plan to overcharge came from high government officials, who themselves set up the mechanism the funds came from. The projects were financed by an enormous Argentinean governmental trust set up to finance works of infrastructure, and exists without parliamentary control. Contributions to this fund come from both the Argentinean treasury and the Brazilian National Bank for Economic and Social Development (BNDES). The progress of the investigation caused President Kirchner to remove from office various high officials, including the manager of the state trust as well as the president of the recently created national gas company. The investigations have expanded to other companies (Techint and Odebrecht), and to undertakings in other countries on the continent (like Peru).

Almost simultaneously, in Brazil, a political investigation discovered a bribery scheme established by construction companies that involved top figures in both federal and state governments, legislators, and business people. The case resulted in the resignation of the energy minister, Silas Rondeau.

All these are bitter blows to the attempts to achieve a greater presence of the State sector, whether by means of State companies or by means of greater regulation of private companies. Many of the energy integration agreements are turning into juicy deals, very difficult to control, that require new processes for transparency.

## **Interconnections and Integration: Two Distinct Concepts**

Even though energy appears time and time again to be the axis of the new efforts at integration, it is necessary to point out that in many cases what is called "integration" is really "interconnections," such as gas pipelines, oil pipelines, or electrical networks. These undertakings are important, but they are only connections that permit the commercialization of energy. A large part of the optimism comes from considering the agreements for interconnection as advances in unification, but in reality they are not synonymous since there is still a need to agree

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on common strategies regarding access to resources and the ways that they will be used.

This distinction between “interconnection” and “integration” allows us to understand how two countries as interconnected as Bolivia and Brazil still don’t make progress in the process of energy integration. The same situation applies in the case of the problems between Paraguay and Brazil, or Argentina and Chile, already mentioned.

In the same way, the difference between “interconnection” and “integration” also explains the progress in the energy negotiations between Colombia and Venezuela, in spite of the ideological differences between the two governments. Indeed, these countries have carried out projects like the Ballenas-Maracaibo binational gas pipeline, that carries Colombian gas to Venezuela and includes a possible expansion to Panama and the rest of Central America, as well as the Venezuelan investments in Colombia for such works as the construction of a fertilizer plant in Cartagena. Uribe and Chávez do good business, but they don’t build common energy policies; it is an example of business without integration between two politically distinct regimes. In the same way, in the Southern Cone, there exists an intricate network of electrical and gas interconnections between Argentina, Bolivia, Brazil, Chile, and Uruguay, but they have not achieved a common energy platform within MERCOSUR.

In the last few years, the confusion about infrastructural interconnections, both in highways and waterways and in energy, has been one of the pillars of defense of an optimistic version of the progress of linking South American countries. Nevertheless, these connections in almost every case still depend on conventional commercial interests anchored in the import and export of energy and guided on some occasions by business goals of making a profit and on others by classic nationalistic postures. Since they are business ventures, whether they are private or public, the shadow of corruption enters in. Meanwhile, in the presidential summits, like the one in Cartagena, they try to find a common energy strategy, but they still haven’t found effective actions that will lead to real integration.

## **Perspectives at Play**

Today we can distinguish two principal perspectives in the proposals for energy linkage. The first one can be described as a strategy based on classic commercial agreements for the buying and selling of energy, dependent on market demands, where the businesses involved

(whether public or private) seek to maximize their profits and their benefits in these sales. It’s in this way that the conventional international agreements have functioned and that the transnational companies in the Northern hemisphere operate.

Recently various countries have acted in this way (like the pacts to buy and sell gas between Argentina and Chile, and Bolivia with Brazil), and so have regional companies (the clearest example is Petrobras). This posture is not opposed to the promotion of energy interconnections since these connections are indispensable in order to permit the commercialization of the products. But energy integration, in the sense of having common energy resources, elaborating joint undertakings, and helping shared productive initiatives, does not exist.

The second strategy is much more recent and still in the initial stages. It also includes commercial agreements and promotes interconnections, but it offers the novel idea of trying to share energy resources and to link them to joint productive projects. This stance is promoted by the Venezuelan government, whose principal agent is the state petroleum company PDVSA. It operates by means of joint projects or joint ventures between PDVSA and a local partner, usually a governmental company. But at the same time it permits this local partner to participate in oil enterprises inside Venezuela. Thus, there are monetary payments, but they can also resort to other procedures such as payment in local products that they export to Venezuela. In many cases, there is an obvious imbalance in the prices, and Venezuela is contributing more than it receives.

From the first perspective, joint projects of this type are not carried out, and countries do not share their hydrocarbon deposits in this way, instead keeping them for direct exploitation or concessions under classic trade rules. A good example has been the role of Brazil and Petrobras, since the controversies with this company have not only taken place in Bolivia, but also in Ecuador, Peru, and Argentina. In all these cases, the Brazilian company has acted like any other transnational corporation, seeking to maximize its earnings without promoting local development and with a poor social and environmental performance.

In the meantime, the Venezuelan enterprise PDVSA has spun a web of agreements in many other countries. For example, it has signed agreements with the state companies of Ecuador (Petroecuador), Colombia (Ecopetro), Paraguay (Petropar), Uruguay (Ancap), YPF (Bolivia), among others, and even with Petrobras itself.

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The agreements are of different types; some involve Venezuelan investments in national refineries to adapt them to the extra-heavy crude oils of that country (for example, in Paraguay and Uruguay); in others there is shared access to oil fields (for example, Venezuela permits Ecuador's co-participation in the Orinoco Belt, while Ecuador gives Venezuela priority to access the large oil reserves of Ishpingo-Tambococha-Tiputini). They reach agreements in which Venezuela agrees to receive products as compensation (for example, the agreement with Uruguay's ANCAP grants participation in Venezuelan oil fields, but Venezuelan crude must be processed in Uruguay and they accept as payment Portland cement and other Uruguayan products under advantageous conditions), while in other cases there are also important components of direct support, such as what we see in Bolivia.

Although Brazil presents itself as a regional leader, one must admit that it has not followed this type of path and has not been willing to cover the costs of agreements that promote productive enterprises between neighbors. Furthermore, its state companies, not just Petrobras, but others like Odebrecht, have acted unilaterally in neighboring countries. This is not a problem exclusive to Brazil, since similar things have taken place between other important countries in the region, such as Argentina and Chile, who have not tried to promote further regional unification either, and whose state companies have repeated business practices and entrepreneurial traditions. The difference stems from Brazil's attempt to position itself as a regional leader whereas other nations do not seek this position.

## **At a Crossroads**

The series of cases and examples presented throughout this article permit us to offer an analysis of the current trends. It is possible to state that in the last few years there have existed two types of linking processes between South American nations.

The European model of unification, based on a common market that develops parallel to a political structure, was represented by MERCOSUR. This effort clashed with the impossibility of taking the necessary step to supernationalization, and Brazil in particular would not accept this measure. Because it is also the largest economy in the region, it could have attempted a substitute or palliative measure to permit certain levels of asymmetrical trade that would benefit the smaller neighboring countries. But Brazil was not willing to pay that price either, and on the

contrary, its conduct in Bolivia did not manage to change the entrepreneurial logic of maximizing competitive advantages and profits. The only substantive concession was granted to Argentina, accepting a commercial agreement with protection of vulnerable sectors, reducing friction with Argentina at the cost of increasing the disenchantment of Paraguay and Uruguay. In the situation, MERCOSUR advances and retreats regarding trade problems that it cannot resolve since it lacks a supernational normative framework, and, therefore, continues to stagnate under a very incomplete customs union. This explains why the block operates mostly as a political forum. Currently the relevant fact is that there appears to be an acceptance (mixed with weariness) of this situation among the partners of MERCOSUR.

Another model was based on an important opening to international markets, both those of neighboring countries as well as those on other continents. It is an extreme form of "open regionalism" that was followed by Chile, and more recently by Colombia and Peru. These countries have not been able to articulate a more in-depth unification process within CAN, since their goal is the opening of trade and they did not expect to reach other agreements, such as, for example, common productive policies. Contrary to what happened with MERCOSUR, where they still maintain certain levels of trade protections, in the CAN they opt for a strong liberalization; but at the same time, the Andeans abandoned attempts at supernationality and even those at having a customs union. Therefore, the CAN also wound up being a political forum, although for different reasons and by a different route than MERCOSUR.

We find ourselves facing two different paths that for different reasons now meet at a crossroads in a similar situation, where the commercial and economic aspects are stagnated and the blocks continue as political forums. This explains in large measure the reasons why the attempt at South American unity, whether under the name of Community or Union, also expresses itself as a political forum.

In this situation, the role of Brazil is key. In recent years, it has maintained a more or less defined idea of a regional unification project. Its proposal, initiated in the year 2000 under the F.H. Cardoso administration, was adapted by Lula da Silvas's government, keeping the central nucleus and giving it some nuances of its own. Its position is that of exercising regional leadership by consensus, or a benevolent leadership, where it seeks to promote a certain amount of regional unification, but is not

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willing to assume the cost of this leadership, whether in the economic or the political realm.

Furthermore, Brazil has announced that it will carry out negotiations separately from the rest of MERCOSUR by means of a strategic agreement with the European Union, while it keeps alive the idea of joining the OECD (Organization for Economic Cooperation and Development, the organization of industrialized countries). Although it is considered different from a trade agreement, this distinction may be a mere difference in terminology since it will involve mutual commitments and concessions. That step will be a hard blow for MERCOSUR, and will be invoked by Paraguay and Uruguay to seek in turn an agreement with the United States. Accordingly, the business lobbies inside Brazil that promote free trade agreements will be strengthened.

In this way, in Brazil there exists a strong tension between the desire for regional integration and the costs and obligations that this task requires. This type of tension is not present on the path of open regionalism nor in the positions taken by Chile, since its essential goal is trade liberalization.

The most relevant recent change is Venezuela's stepping forth with a different idea on regional unification. Its position points to a closer relationship between South American nations and a more active disconnection from globalization in order to gain greater autonomy. These ideas, contrary to the Brazilian perspective, are currently much more diffuse—in some cases imprecise, at times contradictory, and they are under construction.

Under some circumstances, the government of Caracas seems to opt for strengthening regional unification but in others it would seem that it obstructs it: it abandoned the

CAN and requested admission to MERCOSUR, and although it is taking its first steps there, Chávez has already said that this block is not working in its current state. Then it opts for the South American Community of Nations and then proposes to rename it Union of Nations, but immediately reinforces its own program under ALBA.

This makes the Venezuelan stance seem at times contradictory and it generates a lot of controversy. But beyond these arguments, one must recognize that it offers a key difference in opposition to the previous proposals: Venezuela is willing to assume for now the political and economic costs of its integration proposal. This is based not only on the great availability of funds owing to the oil profits, but also reflects another political stance with regard to neighboring countries. In this case there are no tensions with regard to a supranational goal or wounded sovereignties, since a shortcut based on joint ventures with the participation of various countries has been reached. Joint projects of state companies, especially the co-participation in the Venezuelan oil reserves, have indubitable economic importance, but they also form a network of help and support to try out another integration process.

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