

Gas and Power in Brazil – Disruption in a Disruptive Setting



Brazil's offshore Pre-Salt production has been well publicized and Brazil has overtaken Venezuela as the region's largest oil producer. The natural gas sector, on the other hand, has not received as much attention. It represents perhaps not a new resource for Brazil's energy matrix, but rather a new approach to the country's energy sector and Brazil's growing role in the global energy market. Indeed, "disruptors" both globally and domestically with regards to natural gas and the electric sector from deregulation and the rapidly-changing model for production and consumption of electricity are being grappled with in Brazil.

Natural gas as a disruptor links closely to oil production in Brazil's offshore fields. Officials are increasingly recognizing the need for more market friendly policies in line with the international oil industry. In essence, the policy direction is to open the fields to international investment requirements, promote competition and reduce state intervention. Petrobras, the national oil company, will continue to participate and own production. But Brazil's oil and gas sector will increasingly be seeking private participation for the exploration, production and distribution of gas and oil. This shift has attracted attention to the renewed rounds of oil and gas field auctions.

These issues were at the center of vigorous debate and discussion at the Institute of the Americas' Roundtable in Rio de Janeiro in early November both in the formal sessions and sidebar conversations among the attendees from across industry, government and civil society.

Decio Oddone, Director General of Brazil's Petroleum Regula-

tory Agency (ANP), summarized the current state of gas production from the Pre-Salt formation. Almost 80 percent of the 114 million cubic meters of gas produced a day comes from off-shore wells. Currently, a substantial percentage of this production is reinjected, burned off or not used due to insufficient pipelines and infrastructure to bring the gas to the market.

The objective of the "Gas for Growth" program being developed and submitted to Congress is to radically change this scenario by making the product available at a competitive price. According to ANP, Brazil has over 600 billion cubic meters of gas in proven reserves with probably over twice as much in as-yet-to-be explored fields. Brazil has abundant energy, which can be used effectively in the midterm given sufficient investment and adequate management.

The production and market challenges include ramping up production to reduce unit costs, improving delivery infrastructure and reducing the marketing strictures. Currently Bolivia is Brazil's main source of natural gas with sporadic imports from other countries on the spot market. James Story, the United State Consul General in Rio, noted in his presentation that the US has exported LNG to Brazil six times during the past year.

Brazil expects to develop a new gas market through a step-by-step process that has already started. It should be completed within the next 4 to 5 years.

Melissa Mathias of ANP listed these major steps:

- 1) Implementation of best international practices
- 2) Attract investors
- 3) Recruit a wider range of participants and agents
- 4) Promote access to information and a dynamic investment environment
- 5) Participate with those now in the sector
- 6) Promote and open up competition in the supply of natural gas
- 7) Adhere to contracts

What was abundantly clear during the discussions at the Roundtable is the trend to move away from the state monopoly held by Petrobras. Petrobras has overseen production, transportation, distribution and price regulation for the wholesale market. Brazil's oil and gas industry will eventually provide access to other companies at all levels from production to delivery to the end user.

The proposed liberalization represents a major shift in the ongoing evolution of Petrobras and Brazil's strategy. Presently, there are only 3 LNG terminals located in Pecem (north/northeast), Salvador (northeast) and Sao Paulo (southeast). Some 9409 kilometers of gas pipelines are currently tightly regulated by ANP and Petrobras. The new proposal would open this system of storage and transportation and attract investment funds for new infrastructure. Companies would compete in a more transparent market. This will certainly include major building of infrastructure for production, storage, transportation and end user delivery with an increasing focus on electricity from gas.

"Gas by wire" is becoming more important for electricity generation. As is well known, Brazil's power costs are among the highest in the world even though hydroelectric plants generate more than 70% of the nation's electricity. However, droughts, changing weather patterns, increasing demand and frequent fluctuations in hydroelectric supply open an immense field for gas and other alternative forms of energy generation and consumption.

Additionally, there is consensus among all productive sectors that "Custo Brasil" has created an unacceptable drag on economic growth. Thus, "Gas for Growth" should help Brazil recoup industrial production and advance in the global market, through deregulation, opening and making competitive an underused energy source.

Several speakers were also optimistic about the enthusiastic participation of major oil producing companies in the recent rounds of auctions. Exxon Mobil, Shell, Total, Sinopec and others paid significant premiums for exploration rights.

On the other hand, several speakers brought a dose of moderation to the proceedings. Concerns included the need to view gas as closely tied to oil production. There has long been a standing nationalistic view that Petrobras to safeguard Brazil's oil. This "oil is ours" (O petróleo é nosso) mentality could thwart efforts to open up Brazil's oil and gas sectors to others. There is also concern about exactly how Brazil will proceed on the path to a liberalized natural gas market as well as modifications of the framework for the electric sector. Brazil is notorious for promoting policies that later get bogged down in execution. Much of this is due to preexisting laws and regulations that inhibit the movement of enterprise and the factors of production. For example, even as ANP has promoted the opening and competition of these sectors, it has also controlled and intervened, possibly defeating its own best intentions.

Mauro Storino from FitchRatings spoke of an important topic for financial markets. Brazil's fiscal crisis has led to the loss of investment grade status. Further downgrades could come if Brazil fails to implement major spending reforms. Given that 2018 brings a presidential and general election, politicians are wont to give up their strong hold on Brazil's pork barrel projects. This likely will make international financing for the gas sector more competitive and harder to achieve.

Despite the chaotic political backdrop, most if not all speakers were positive about Brazil's economic and energy outlook and focused on the upside the disruption of global energy markets could mean for Brazil.

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