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FEATURED Q&A

Are Major Oil-Sector Reforms Coming to Ecuador?



Ecuadorian Oil Minister Carlos Pérez has been lauded for his efforts to make the oil sector more transparent in the months since taking the position. // File Photo: Ecuadorian Government.

Q Ecuadorian President Lenín Moreno's administration in late August said it is commissioning a foreign auditing firm to look over the technical and financial terms for five oil-sector projects that have had serious operational failures despite large investments. What are the likely root issues causing the operational problems? Will these problems amount to big setbacks for the country's oil sector? Is the oil sector being properly managed under Moreno's government? Is the Moreno administration likely to bring forward any major oil-sector reforms as a result of the audit?

A Santiago Mosquera, professor at USFQ Business School: "News in the oil sector is positive. From the appointment of Hydrocarbons Minister Carlos Pérez to the most recent results of a bidding process for small oil fields, there is plenty of evidence that the sector is likely to improve under the administration of President Lenín Moreno. Minister Pérez, who has a long experience at top-ranking positions in multinational companies both locally and abroad, has made a complete assessment of the oil industry in less than three months, improving transparency on the real financial situation, which is clearly weaker than originally expected. After years in complete obscurity, the government has made public the existing credit oil facilities with Chinese companies and Thailand's PTT, while the foreign auditing will provide an external opinion on the technical situation of key public assets. Some service-providing contracts, which have affected state-owned Petroamazonas' liquidity position and triggered the accumulation of debts at the hydrocarbons ministry, are under revision, thus improving

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TOP NEWS

OIL & GAS

Venezuela Invites More Producers to Join OPEC Cuts

Venezuelan Oil Minister Eulogio Del Pino said he has invited as many as 12 more oil-producing countries to collaborate with OPEC in cutting oil output in order to bolster global oil prices.

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RENEWABLES

Norway's Statoil Enters Brazil Solar Market

Norwegian energy company Statoil announced it had signed an agreement to acquire 40 percent in the Apodi solar asset in Brazil, marking the company's entrance into the solar market.

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OIL & GAS

Mexico's Pemex Finds Partners for Onshore Fields

The Mexican state oil company secured partnerships to help increase its oil production at mature onshore oil fields in southern Mexico, which Pemex CEO José Antonio González Anaya said was favorable for the company.

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González Anaya // File Photo: Mexican Government.

OIL & GAS SECTOR NEWS

Mexico's Pemex Secures Partnerships for Onshore Fields

Mexican state oil company Pemex on Wednesday secured partnerships to help increase its oil production at mature onshore oil fields in southern Mexico, The Wall Street Journal reported. On the same day, an auction to form partnerships with private companies under production-sharing contracts for two offshore oil fields received no bids. Egyptian oil company Cheiron Holdings won a contract to co-develop with Pemex the Cárdenas and Mora fields in the southern Tabasco State. German oil company DEA Deutsche Erdoel won the tender for the Ogarrio field, also in Tabasco State. Both offered maximum royalties to the Mexican government as well as additional cash payments in exchange for owning 50 percent stakes in the projects. "At the end of the day, the result is favorable for Pemex, which will receive cash payments for more than \$500 million," said Pemex CEO José Antonio González Anaya. The Mexican state-owned company's oil output has steadily declined since 2004, and it is expected to produce an average of 1.94 million barrels per day this year. Lower output, combined with the global drop in oil prices, has put pressure on Pemex's budget. The company sees the farmouts as a means of sharing both the investment burden and the risks, while harnessing partners' technological capabilities.

Venezuela Invites More Oil Producers to Join OPEC Cuts

Venezuelan Oil Minister Eulogio Del Pino on Wednesday said he has invited as many as 12 more oil-producing countries to collaborate with OPEC in cutting oil output in order to bolster global oil prices, as the price per barrel of the commodity slips back to \$55, the Financial Times reported today. Del Pino said at

an energy forum in Moscow that oil ministers from OPEC member states were considering whether they should make further cuts to production beyond the 1.8 million barrels-per-day cut the group has had in place since July, or whether they should extend the existing deal. Del Pino added that between 10 and 12



Del Pino // File Photo: Venezuelan Government.

additional countries had been invited to participate in the production cuts, Reuters reported. Last November, OPEC and Russia agreed along with a few other countries outside the group to curb oil output in an attempt to counter the three-year-long oil glut that had driven down global oil prices and had been at least partially responsible for economic struggles in some oil-exporting countries, including Venezuela. Russian Energy Minister Alexander Novak seemed less enthusiastic about making further production cuts, saying on Wednesday that oil prices were stabilizing at a "suitable" level, the Financial Times reported.

Mexican Election Poses No Risk to Oil Contracts: Regulator

Mexico's National Hydrocarbons Commission, or CNH, the country's top oil regulator, on Sept. 29 said the country's upcoming presidential election will pose no risk to already-signed oil contracts, despite a pledge from leading candidate Andrés Manuel López Obrador that he will review them if elected president, Reuters reported. To date, some 70 exploration and production contracts have been signed following the 2013 energy reform, which opened the country's energy sector to foreign and private investment. "These are completely

NEWS BRIEFS

Brazil's Petrobras Could Be Privatized in the Future: Minister

Privatizing state-controlled oil company Petrobras is feasible in the long run, Brazilian Mines and Energy Minister Fernando Coelho Filho said Monday, amid criticisms over other state asset sales, Reuters reported. "I think it is going to happen. It is a way," Filho said on a late-night interview show, according to a report on G1's website. The ministry's office did not have an immediate comment on Coelho Filho's remarks.

Chile's Colbún Plans Wind Farm in Antofagasta Region

Chilean energy company Colbún is planning to build a 607-megawatt wind farm in the Antofagasta region of Chile, ReNews reported Monday. The Horizonte wind farm will cover some 30 square miles. Colbún won the rights to the project in a government tender. The terms of the tender allow Colbún to spend up to four years studying the development, followed by a three-year construction period.

Brazil's Oil Regulator Clears Four Companies to Bid for Pre-Salt Rights

Brazilian oil regulator ANP has authorized four more oil companies to bid on tenders this month for exploration and production rights in the pre-salt region off the coast of Brazil, the regulator said Tuesday, Reuters reported. A local unit of U.S.-based Chevron was cleared for bidding in the second and third pre-salt rounds, which are set to be held on Oct. 27. Brazil's OP Energia was cleared to bid in the second round, and China's CNOOC Petroleum Brasil and Colombia's Ecopetrol were also authorized to bid in the third round. Last week, ANP released a list of 11 companies that had been cleared to bid at the upcoming auctions.

solid contracts,” said Juan Carlos Zepeda, the head of the CNH. He said there is “no risk” of Mexico’s government revoking them. López Obrador, the current front-runner in public opinion polls ahead of the July election, has been critical of the energy reform enacted by current President Enrique Peña Nieto, proposing a nationwide referendum on the reform and saying he would review current contracts. “The entire energy framework is in the Constitution, and that provides it with durability and makes it very difficult to repeal,” said Zepeda. Constitutional changes require a two-thirds majority in Congress. The reforms were enacted to allow Pemex to enter into joint-venture contracts as a way to help the cash-strapped national oil company develop more projects that it would not have been able to afford to fund on its own. In the future, the government hopes to go further with the auctions, putting more and bigger blocks up for auction, Zepeda said.

RENEWABLES NEWS

Norway’s Statoil Enters Brazil Solar Market

Norwegian energy company Statoil on Wednesday announced it had signed an agreement to acquire 40 percent in the “construction-ready” 162-megawatt Apodi solar asset in Brazil, marking the company’s entrance into the

“The Apodi asset is a sensible first step into the solar industry.”

— Irene Rummelhoff

solar market, CNBC reported. Statoil will be acquiring a share of Scatec Solar, an independent solar company based in Norway. The two companies had agreed on an “exclusive cooperation” for potential future solar projects in Brazil, according to Statoil. The facility’s construction will begin this month, with the

goal of producing electricity by the end of next year. The Apodi solar facility will be located in the northeastern Ceará State. The project is expected to provide electricity to some 160,000 households. “As part of Statoil’s strategy to actively complement our oil and gas portfolio with profitable renewable energy sources, we have so far focused on offshore wind, where we have a unique competitive advantage building on over 40 years with oil and gas activities,” said Irene Rummelhoff, the company’s executive vice president for new energy solutions. “The Apodi asset is a sensible first step into the solar industry,” she added.

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the government’s take in the oil business without private players threatening to leave the country. Private interest in the oil industry remains strong, as evidenced by the number of consortia participating in the bidding contest for small oil fields. New bidding rounds are expected in the short term. This is particularly positive, since the sector has suffered from a lack of investment in exploration and production in recent years, which explains the evolution of crude output—total output shows a 4.1 percent decline from its peak in November 2014, but after excluding the output of the ITT project that started in 2016, the reduction across mature fields is 12.9 percent.”

A **Jose L. Valera, partner at Mayer Brown:** “Moreno’s government is not turning out to be Correa 2.0, as Correa and his loyalists expected. Moreno’s government is uncovering and bringing to light all sorts of murky deals, shady public accounts and corruption that took place over the past years. The oil-sector projects under audit include 1) the Pacifico Refinery, a joint venture between Petroecuador (51 percent) and PDVSA (49 percent) with Odebrecht as the main contractor and where little can be shown for the hundreds of millions already spent; 2) the Pascuales Cuenca fuels pipeline, which is showing serious soil stability issues and a lack of facilities for pressure control; and 3)

POWER SECTOR NEWS

Peru Aims for 100% Electrification of Rural Areas by 2021

Peru has set a target to provide electricity to 100 percent of rural residents by 2021, through building new transmission lines, creating rural systems and installing solar PV modules, PV-Tech reported Wednesday. The head of the Ministry of Energy and Mines, Cayetana Aljovín,

the overhauling of the Esmeraldas refinery, which can’t operate at nameplate capacity and is producing gasoline that cannot meet quality specifications. Their problems, among many others, are a big setback for the country’s oil sector, which is the main source of revenue for the government. The sector does require deep reforms, and the Moreno administration is likely to bring them forward. Bringing to light prior malfeasance is a good start. Also encouraging is Moreno’s declared policy change concerning exploration and production activities. The prior service model provided no incentives for exploration and ensured that Ecuador’s production remained stagnant, at best. The Moreno administration has announced that future contracts will be under a joint venture or ‘participation’ model. When companies will have a right to keep a percentage of the production, they will have the proper incentives to risk capital in exploration. This is what the country needs to replenish its reserves and ensure greater production.”

A **Ramiro Crespo, president of Analytica Securities in Quito:** “Thanks to the lack of transparency in the oil sector, one way of getting into the oil business in Ecuador is to get into politics. Under Moreno’s incompetent predecessor, corruption was rampant in the sector, and the state oil companies were

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ratified the electrification commitment at the sixth International Energy Day Congress. “The estimated investment to completely close the electrification gap in Peru is [\$1.05 billion], and it will benefit 2.9 million Peruvians,” Alijovín said. She added that there are several transmission projects that about to begin development, including the Aguitia to Pucallpa line, the Mantaro to Nueva Yanango to Carapongo line, which is set to be awarded this month, and the Tintaya to Azángaro line, which is set to be awarded in November.

POLITICAL NEWS

Russia Would Provide Venezuela Military Support: Maduro

Venezuelan President Nicolás Maduro expressed confidence on Wednesday that Russia would provide his country with military support if necessary, McClatchy reported. Maduro’s comments at an energy forum in Moscow followed comments in August by U.S. President Donald Trump that he was not ruling out a “military option” in Venezuela. Maduro and other Venezuelan officials have long accused



Rubio // File Photo: U.S. Senate.

the United States of planning coup attempts and invasions in Venezuela, and until Trump made the comments in August, U.S. officials had always denied any military intentions in the South American country. “I am sure, even if we do not ask, we will be given even more support to boost Venezuela’s defense capacity and sovereignty,” Maduro said Wednesday. Maduro met with Russian President Vladimir Putin earlier

THE DIALOGUE CONTINUES

How Will Mexico’s Elections Affect Peña Nieto’s Energy Sector Reforms?

Q **Andrés Manuel López Obrador, widely known as AMLO, said Sept. 5 in Washington that if elected Mexico’s president, he would review the oil contracts that were signed after the country’s historic oil-sector reforms, adding that he did not trust those who had agreed to the deals on the country’s behalf. Should companies hold off on investing in Mexico’s energy sector until after next year’s presidential elections? What risks are outside investors facing in the run-up to the election, and what protections exist for investors if AMLO or another presidential candidate with similar views about the energy sector is elected? How likely is AMLO to reverse Mexico’s energy reforms if he becomes president?**

A **Steven P. Otilar, partner Akin Gump Strauss Hauer & Feld, LLP:** “A López Obrador administration could impair the progress of the energy reforms, but it is unlikely they could be stopped altogether. It is difficult to amend the Mexican Constitution, as it requires the approval of two-thirds of the members of Congress and subsequent approval by a majority of the states. It was not until the key political parties united under the ‘Pacto Mexico’ in 2013 that the will existed to amend the Constitution to allow for true competition in the oil and gas sector. Thus, a president opposing such reforms would not be able to reverse them unilaterally. In addition, the contracts signed with foreign investors in Rounds 1 and 2 provide for international dispute resolution. If a new president in Mexico unjustly terminates such agreements, Mexico would face substantial claims for expropriation under the United Nations Commission on International Trade Law. That is not to say a president in

Mexico has no power to stop the progress of the reforms. Governmental agencies such as SENER, CNH and ASEA are subject to influence by the executive branch. Just like the U.S. post-Macondo, a president could

“A president opposing such reforms would not be able to reverse them unilaterally.”

— Steven P. Otilar

effectively stop activity by refusing to issue any necessary approvals or permits. Another risk could be the use of administrative rescission rights that exist in the private oil and gas contracts, which would be governed by Mexican law and courts. While never the original intent, these provisions could be subject to abuse, and it would be up to the Mexican judiciary to prevent the unjust termination or suspension of contracts. If he reviews the production-sharing contracts and licenses granted (which anyone can do as they are online), Mr. López Obrador would find that his government, through the CNH and SENER, have run one of the most transparent and open oil and gas tender processes the world has ever seen. Further, in the NAFTA negotiation process, it is likely additional protections will be implemented, tying open energy markets to free trade overall. Ultimately, it will be the Mexican people who will suffer if an opposition president actively hinders the progress of the energy reform for political gain.”

EDITOR’S NOTE: The comment above is a continuation of the Q&A published in last week’s issue of the Energy Advisor.

NEWS BRIEFS

Mexican Authorities End Search for Quake Victims

Authorities on Wednesday ended their search for victims of last month's powerful earthquake in central Mexico, which killed hundreds of people, Reuters reported. Rescue workers on Wednesday pulled the body of the last person known to be missing from the rubble of a collapsed office building in Mexico City. In all, 369 people were killed in the Sept. 19 earthquake. Ninety-eight others were killed in a Sept. 7 quake off the coast of Chiapas.

Brazilian Olympic Committee Head Accused of Bribing IOC Officials

Brazilian police on Thursday arrested the head of the country's Olympics committee, Carlos Arthur Nuzman, on allegations of conspiring to bribe members of the International Olympic Committee to pick Rio de Janeiro as the host for the 2016 Olympic Games, Reuters reported. Brazilian investigators say Nuzman helped arrange a \$2 million bribe in exchange for the committee selecting Rio. A former director of Brazil's national Olympics committee, Leonardo Gryner, was also arrested in a new phase of the investigation into corruption surrounding last year's Olympic Games, the police said. Nuzman's lawyer has said his client is innocent.

Brazil's Meirelles Reportedly Hires Social Media Experts

Brazilian Finance Minister Henrique Meirelles has hired social media experts to help boost his image online ahead of next year's presidential election, Reuters reported Wednesday, citing sources familiar with the matter. The move is the one of the strongest signs that Meirelles is considering running for president. He hired analysts linked with the Getúlio Vargas Foundation to help analyze his social media presence and build a communication plan.

on Wednesday and said threats from the United States must be taken seriously. Maduro added that Venezuela's cooperation with Russia had made his country's military "three times stronger over the past 15 years." Maduro added, "Putin is the leader of the emerging world, the world we want to live in. Putin carries the banner of decorum, dignity and peace." Maduro also accused the United States of trying to bully Venezuela and the world, adding Venezuela has no nuclear arms, weapons of mass destruction or military bases in other countries. U.S. Senator Marco Rubio (R-Fla.), one of Maduro's most outspoken critics in the United States, dismissed Maduro's comments about the United States threatening Venezuela. "The only threat to Venezuela is the Maduro regime itself," said Rubio. "And the only ones invading are the Castro agents who control it."

U.S. Expels 15 Cuban Diplomats Following Sonic Attacks

The U.S. State Department on Tuesday expelled 15 Cuban diplomats in protest of what it said was Cuba's failure to protect American envoys in Havana from a series of mysterious attacks that caused hearing loss and other ailments, the Associated Press reported. The State Department gave the Cuban ambassador in Washington a list of 15 names and ordered the diplomats to leave the country within one week, according to officials. The order came after a U.S. decision last week to reduce the size of its embassy in Havana by 60 percent. At least 22 Americans, including a new victim identified this week, were affected by the sonic attacks, in which powerful beams of sound were targeted at the envoys. A smaller number of Canadian diplomats were also affected. U.S. officials stressed that they were not accusing Cuba's government of the attacks, but rather said that the country's government had failed to prevent the incidents. "We continue to maintain diplomatic relations with Cuba, and we will continue to cooperate with Cuba as we pursue the investigation into these new attacks," said Secretary of State Rex Tillerson, the AP reported. Tillerson added that the expulsion of

the Cuban diplomats was a proportional move following Washington's recall of some of its envoys from Havana. "This order will ensure equity in our respective diplomatic operations," he said, The New York Times reported. Cuba's government blasted the Trump administration's decision, saying it was using the situation to kick out Cuban envoys without proof that their government was involved. Cuban Foreign Minister Bruno Rodríguez Parrilla called the move "eminently political" as well as "unwarranted and unjustifiable." Rodríguez added that U.S. officials should have reported the incidents earlier to Cuba's government and said the United States has denied Cuba access to the affected American envoys and the doctors who treated them, hampering Cuba's ability to assist in the investigation. He added that Cuba's government would also not allow any third party to attack the diplomats and dismissed the symptoms reported by the U.S. personnel as "science fiction." FBI agents investigating in Cuba have been unable to determine the cause of the incidents, The New York Times reported.

ECONOMIC NEWS

Argentina's Gov't Faces Growing Trade Deficit

Argentina is facing a growing trade deficit amid high costs and a strong peso, which has led to pressure on the government to lower taxes or allow the country's currency to fall, Reuters reported Tuesday, citing analysts and businesses. "Today, Argentina is 20 percent more expensive than Europe, 15 percent more expensive than the United States and 5 percent more expensive than Brazil," Martin Guaita, chief executive of bottler Envases del Plata, told the wire service. Argentina has posted a \$4.5 billion trade deficit this year, after recording a trade surplus of \$2.4 billion last year as a recession crimped demand for imports. The country's budget assumes a wider trade deficit next year, with a 6.8 percent increase in imports and a 5.6 percent rise in exports, Reuters reported.

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used as cash cows without meeting proper accounting standards, which the audit will undoubtedly reveal. The shoddy construction of these series of major projects, which was probably repeated in other industries like electricity, inflicted a greater damage on state coffers than on the industry itself. The investigation of Vice President Jorge Glas and others is just beginning to confirm the scale of the theft. The audits also provide an opportunity in the very capable hands of Oil Minister Carlos Pérez, a career private-sector oilman, to clean house and emulate at least the partial privatization that went ahead in Brazil and Colombia, providing greater controls of these assets—and increase in value—by shareholders, markets, district attorneys and public opinion in general. The greatest failure was in refining, with at least \$3.7 billion thrown out of the window or embezzled. Ecuador should consider getting out of this low-margin, dirty business and concentrate on oil production, increasing profitability and cleaning Ecuador's urban air. Under Pérez, whom I deeply respect, Petroecuador has successfully resumed selling oil in the open market, highlighting the amount of graft in the previous administration's oil trading and shipping, with billions in shady loans-for-oil deals with China that will require further legal review."

A **Leonardo Sempértegui, partner at Sempértegui Ontaneda in Washington:** "The auditing process is a direct consequence of the clamorous collective petition for transparency about the use of public resources in the execution of energy, extractive industries and infrastructure projects over the last 10 years in Ecuador. It is safe to say that most of the energy experts in Ecuador, myself included, believe that corruption is the main reason for the found operational problems in projects. They were poorly conceptualized, designed and executed (in some cases, starting construction without final designs)—decisions that can only be explained by

scandalous negligence or ignorance (which is not likely), or plain corruption. Since the auditing will be focused on new or upgraded facilities (pipelines, refineries, etc.), I don't think exploration and exploitation activities would be severely affected. Regarding the management of the oil sector, President Moreno's government is starting to send some encouraging signals. The hydrocarbons minister is a well-qualified and reputable professional, the government has made clear that it is not going to cover up corruption scandals from the previous regime, and it is talking about looking for new private investors under more conventional

“Transparency ... is a matter of attitude more than regulation.”
— Leonardo Sempértegui

production-sharing agreements, discarding the services contract that resulted in damaging both the state and the operator. Let's hope these good hints do not stop at good intentions. One of the main pending tasks is the restructuring of the state oil company (Petroamazonas EP), to make it an efficient corporation, about which the government has been silent. Beyond the Petroamazonas-specific reform, there is no need for major changes in the sector, since the current hydrocarbons law provides the tools to attract investments. Transparency (which probably is the most needed characteristic now) is a matter of attitude more than regulation. Public, international auctions should be the rule, and directing contracting should be a very limited exception."

The Advisor welcomes comments on its Q&A section. Readers can contact editor Gene Kuleta at gkuleta@thedialogue.org.

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