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FEATURED Q&A

Does Ecuador's Oil Sector Need Major Reforms?



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 said earlier this year that 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 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) 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

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TODAY'S NEWS

POLITICAL

Odebrecht Hired Peru's President as Consultant: Jailed Ex-CEO

The jailed former CEO of Odebrecht said the construction company, which is embroiled in a multi-country corruption case, hired Peruvian President Pedro Pablo Kuczynski as a consultant a decade ago. Kuczynski denied the allegation.

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ECONOMIC

Fifth Round of NAFTA Talks to Begin in Mexico

As talks on renegotiating the deal get underway today in Mexico City, Mexican officials said they plan to respond to tough U.S. demands.

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POLITICAL

Ecuadorian Vice President Indicted in Graft Case

Ecuadorian Vice President Jorge Glas, who was stripped of his official duties in August, was indicted in connection with the multi-country Odebrecht bribery case.

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Glas // File Photo: Ecuadorian Government.

POLITICAL NEWS

Ecuadorean Vice President Indicted in Corruption Case

Ecuadorean Vice President Jorge Glas and 12 others were indicted Tuesday on corruption charges in connection with the multi-country graft case involving Brazilian construction company Odebrecht, Agence France-Presse reported. Glas, who is to face trial, has been in preventive custody since Oct. 2. Ecuadorean President Lenín Moreno on Aug. 3 stripped Glas of all of his official duties as vice president after the corruption allegations surfaced. Ecuadorean prosecutors accuse Glas of receiving \$13.5 million in bribes through an uncle who has also been arrested, in exchange for giving favorable treatment to Odebrecht in the awarding of construction contracts. Glas denies the charges. In an interview last month, he told Agence France-Presse that Odebrecht was seeking revenge against him because he played a key role in kicking the company out of Ecuador in 2008 following a dispute over a hydroelectric plant. Before becoming vice president in 2013, Glas was Ecuador's minister of strategic sectors. If convicted, Glas faces three

to five years in prison on the charge of unlawful association. Prosecutors have warned that Glas and the other defendants could also be slapped with more serious charges, including bribery and illicit enrichment. Last December, Odebrecht and affiliated petrochemical company Braskem pleaded guilty to bribery charges in the United States and agreed to pay a combined \$3.5 billion in fines to resolve charges with authorities in the United States, Brazil and Switzerland in connection with the scheme to pay \$788 million in bribes to officials in 12 countries, mainly in Latin America.

Odebrecht Hired Kuczynski as Consultant: Ex-CEO

Marcelo Odebrecht, the jailed former CEO of Brazilian construction conglomerate Odebrecht, told prosecutors that the company had hired Peruvian President Pedro Pablo Kuczynski to work as a consultant for the company a decade ago, Reuters reported, citing a report by El Comercio on Tuesday. Kuczynski was elected president last year, and ran for Peru's top office in 2011, as well. He denied the allegations as opposition lawmakers demanded that he submit to questioning by a congressional

NEWS BRIEFS

Colombia's Constitutional Court Backs Peace Accord's Tribunals

Colombia's constitutional court ruled late Tuesday that the special justice tribunals proposed in the peace deal between the government and the Revolutionary Armed Forces of Colombia, or FARC, rebel group are constitutional, ahead of a vote in Congress on the matter, Reuters reported. The court upheld most of the provisions from the peace accord for the special courts. The courts will mete out alternative sentences to demilitarized rebels, including landmine removal for ex-leaders of the FARC, who have been convicted of war crimes. Congress is currently holding debates on a law that would approve the tribunals. It is expected to be put to a vote this week.

Brazilian Amazon Deforestation Rate Falls

Brazilian representatives at the global climate talks in Germany this week said the deforestation rate in its Amazon conservation areas fell by 28 percent over the past year, to its second-lowest level in decades, the Associated Press reported Tuesday. Brazil said satellite data show 159 square kilometers (61 square miles) of deforestation in the rainforest over the 12 months ending in July of this year, down from a 221 square-kilometer loss of forested land in the Amazon during the previous year.

MercadoLibre May Move Headquarters Out of Argentina: CEO

Online retail-service giant MercadoLibre may move its headquarters out of Argentina, the company's CEO said, The Wall Street Journal reported. The comment in a tweet from Marcos Galperin follows a tax dispute between the company and Argentina's tax authority, which has been considering a plan to charge it \$28 million in benefits that the company received.

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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 **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

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committee. Reuters was unable to verify exactly what Odebrecht told prosecutors last week during a meeting in Curitiba, Brazil. He has been providing details to prosecutors on bribes that the company paid to regional politicians in exchange for lucrative contracts. El Comercio reported that Odebrecht said his company had hired Kuczynski in order to mend relations with him after he opposed highway contracts that had been awarded to the company in 2005 while Kuczynski served in the cabinet of former President Alejandro Toledo. The former CEO said the company may have funded Kuczynski's 2011 presidential campaign, as was customarily done by the company for leading candidates, El Comercio reported. Kuczynski said he never had professional ties with the construction company and did not receive campaign funding from the company.

ECONOMIC NEWS

Mexico to Respond to U.S. NAFTA Demands as Talks Resume

Mexico plans to respond to U.S. demands for changes to content rules for vehicles and an automatic expiration date clause, or "sunset clause," for the North American Free Trade Agreement, or NAFTA, during this week's negotiation round, a top government official said Tuesday, Reuters reported. The fifth round of negotiations starts today in Mexico City. The United States has made certain demands that are seen as disadvantageous to Mexico and Canada, and the U.S. Chamber of Commerce has called them "poison pills." The demands include a 50 percent minimum U.S. limit in NAFTA automobile content, the elimination of a dispute mechanism and the inclusion of the sunset clause, which will end the pact after five years if its terms are not renegotiated. Mexican Economy Minister Ildefonso Guajardo has said Mexico will respond to the auto-content and sunset-clause proposals. "Those responses will be angled very logically toward what we're hearing from the business world in Mexico and the United States," Guajardo said.

THE DIALOGUE CONTINUES

Must Brazil Choose Between Growth & Fighting Graft?

Q **The lower house of Brazil's Congress on Oct. 25 voted for the second time this year to spare President Michel Temer from a trial before the Supreme Court on corruption charges. Members of the leftist Workers' Party argued that Temer should stand trial, saying the charges against him were more serious than those leveled against former President Dilma Rousseff of the Workers' Party, who was impeached last year on accusations of violating budgetary rules. However, Temer's allies in the lower chamber argued Temer should be allowed to serve out the rest of his term for the sake of the country's political and economic stability. Which is more urgent for Brazil: pursuing corruption investigations—wherever they may lead—and punishing the guilty, or reviving the country's crippled economy and reigniting stalled social progress? What bearing does Temer's ability to sidestep a graft trial twice have on future investigations of other politicians? Should former President Luiz Inácio Lula da Silva be allowed to run for president next year, despite the corruption charges against him?**

A **Roberto Simon, lead analyst for Latin America in the Geopolitical Intelligence team at FTI Consulting:** "Brazil's never-ending corruption scandals have taken a toll on economic recovery and, to some extent, on the implementation of a much-needed reform agenda. The negotiation over a pension system reform, crucial for Brazil's fiscal consolidation, is a good example. In early May, the Temer administration was very close to securing the necessary two-thirds majority in both houses of Congress for overhauling the existing pension system, including a substantial increase in the retirement age. Although deeply unpopular,

the president—a veteran PMDB operator and former speaker of the house—had amassed an impressive power in Congress. Then, the infamous 'JBS tapes' emerged, exposing Temer's compromising chat with the owner of the meatpacking giant. Months later, Temer is now in a much safer position and will very likely remain in office until January 2019. Yet a broad pension reform is unlikely. However, this is not to say that Brazil faces a trade-off between fighting corruption and growing the economy. Despite all the instability, over the past year Brazil passed a series of ambitious policies that can pave the way to a more sustained growth cycle. More importantly, improvement in the rule of law is a precondition for Brazil to reach higher levels of development and build a healthier, more open and just economy. The key question is whether the country can gradually improve its political system, starting at next year's election. For now, more than 60 members of the Chamber of Deputies and one-third of the Senate are facing Operation Car Wash-related accusations at the Supreme Court. But the case of Lula is different. Legally, having no elected or cabinet position, Lula does not enjoy a partial immunity from prosecution. If Lula's Car Wash conviction is confirmed by a federal judicial panel, he is out of the presidential race. This will likely happen, although when exactly is unclear. The Workers' Party rightly calculates that removing Lula only a few months before the election would embolden the left and strengthen the narrative that the former president—now comfortably leading all polls—was undemocratically blocked from power."

EDITOR'S NOTE: The comment above is a continuation of the Q&A published in Tuesday's issue of the Advisor.

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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 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 **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

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."

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