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Featured Q&A *with the Energy Board of Advisors*

Q **Record oil prices were the headline energy story in 2005. What will be the big energy story in Latin America in 2006? What single event or happening will have the greatest impact on Latin America's energy sector next year?**

A **Guest Comment: R. Kirk Sherr:** "The two big stories for next year are closely related and neither results from a single event. First, by the end of the year, the region's continuing underinvestment in energy infrastructure will likely force some countries into a 'crisis' investment mode, especially regarding electric generation capacity. Across the region there has been a general failure to attract significant new energy sector investment. Ongoing project delays due to environmental issues, slow permitting and politicized regulatory processes (i.e., tariff increases) all compound the problem. As a result, many countries are now at risk for more widespread electricity shortages. Second, governments will continue recent efforts to renegotiate terms for energy projects. With oil and gas prices high and stable, and considering that many countries will have new governments in place by the end of the year, the desire for better terms is not surprising. What remains to be seen, however, is the effect that this contractual uncertainty has on foreign direct investment in the region. It's probably a safe bet that investors will take a 'go slow' approach until there is greater clarity on the new leaders and the new regional dynamics. As a result of these two trends, expect to see many energy sector opportunities in the region, but relatively few investors."

A **Board Comment: David Goldwyn:** "The most significant event in Latin America's energy sector in 2006 will be the emergence of Bolivia's new gas framework under Evo Morales and industry's reaction to it. A pitched battle is under way in Latin America between the private/capitalist

Q&A continues on page 4

PHOTO OF THE WEEK

Bolivian President-elect Evo Morales on Monday said he would respect the existing ownership of international oil company assets in his country. See related story, page 2.

Photo: MAS Party Web site.

Inside This Issue

ENERGY SECTOR BRIEFS

Suez Sells 8.43 Percent of Tractebel Energia

Suez Energy South America announced Friday it had sold an 8.43 percent stake in **Tractebel Energia**—the largest private generator of electricity in Brazil—for 715 million reais ($US 311 million). Suez, which retains a nearly 70 percent stake in Tractebel Energia, said the sale was part of a plan to increase Tractebel's liquidity and free float.

Source: company statement.

Petrobras to Sell Japan Ethanol in New Joint Venture

Brazil's **Petrobras** and Japan's **Nippon Alcohol Hanbai** on Monday signed a contract creating the **Brazil-Japan Ethanol Company** which will operate in Japan with the objective of importing and commercializing some 20 million liters of sugarcane-based ethanol made in Brazil by the year 2008. Petrobras says it will use the association with Nippon to seek solutions to technical problems in introducing ethanol in Japan. Petrobras sees the endeavor as part of its international expansion efforts and believes its presence in Japan will open the door to other markets. The joint venture will be known in Japanese as **Nippaku Ethanol KK**.

Source: Agencia Brasil, Kyodo News.

Skanska Names Gustavo Vago President of Latin America

Swedish energy sector construction giant **Skanska** has named Gustavo Vago its new President for Latin America. The current President, Mario Piantoni, will retire at the end of the year. Vago was most recently Vice President and Operating Director for the region.

Source: company statement.

Oil & Gas News

Bolivia's Evo Morales Says Foreign Oil Companies Safe in His Country

Bolivian President-elect Evo Morales yesterday said he would respect the existing ownership of international oil company assets in his country after winning a surprisingly strong victory Sunday in national elections over moderate candidate Jorge Quiroga. Morales, who Washington has feared will unravel efforts to combat illicit drug growth in the Andean nation, had campaigned for more government control over the nation's fast-growing energy industry. "The government will exercise its right to state ownership of Bolivia's hydrocarbons," Morales said at a press conference in broadcast by a local television station, Bloomberg News reported, adding "That doesn't mean confiscating or expropriating multinationals' assets." Morales won Sunday's vote by more than 51 percent, according to initial estimates. The comments by Morales on foreign investment mirrored efforts by populist President Hugo Chavez of Venezuela, who more than six years ago was elected on a wave of anti-establishment sentiment in his country. While some companies feared Chavez' rhetoric would spoil the country's business climate, many foreign oil companies have held their ground in Venezuela, albeit under less favorable contract and concession terms than before. While foreign companies may take comfort from Morales' comments, the US administration of George W. Bush perhaps found little solace. Morales yesterday pledged to "change the history" of his country by challenging the US, and promoting production of coca, the leaf used to make cocaine, but also traditional medicine in Bolivia, according to Bloomberg News. "Long live coca, no to the Yankees," Morales declared Sunday night at his campaign headquarters in Cochabamba, Bolivia, according to reports. Former President Jorge Quiroga, the second-place finisher, won about 31.3 percent of the vote and conceded late Sunday in the capital La Paz, asking for unity among Bolivia's economically and racially segregated citizenry. Spanish oil giant **Repsol YPF**, which controls a third of Bolivia's vast but under-developed gas reserves, has been in touch with Morales. The company's chairman, Antonio Brufau, called Morales Monday to congratulate him and to express his "willingness to work together for the good of Bolivia," a spokesman told Bloomberg News.

"The government will exercise its right to state ownership of Bolivia's hydrocarbons...That doesn't mean confiscating or expropriating multinationals' assets."

– President-elect Evo Morales

Chevron Will Convert Venezuela Contracts to Joint Ventures

US-based oil giant **Chevron** has agreed to transform its two operating contracts in Venezuela into joint ventures with state oil company **PDVSA**, yielding to government pressure for a larger share of revenue, Reuters reported. PDVSA should have a stake of between 60 and 70 percent in the future joint ventures, according to Energy Minister Rafael Ramirez. Under Venezuela's new hydrocarbons law, oil firms have to pay a 30 percent royalty and 50 percent tax. Chevron's Boscan field produces more than 100,000 barrels per day of crude, alone accounting for about a fifth of non-PDVSA oil output in Venezuela. Venezuela, the world's fifth-largest oil exporter, earlier this year ordered 22 local and foreign firms holding 32 contracts to change them to joint ventures, saying that old operating contracts signed under previous administrations were unfair. Fifteen companies with operating contracts have already agreed to sign transitional agreements to set up joint ventures with PDVSA, which will have a majority stake. The US giant **ExxonMobil Corp**. has not yet agreed to the new deals, and reportedly has only until the end of the year to do so or risk losing its concessions, according to the BBC. "Exxon risks losing Venezuelan operations if it fails to comply," the report stated. Exxon and **Repsol YPF** jointly operate the Quiamare La Ceiba oil field.

Petrobras November Oil Output Rises on Stronger Foreign Results

Brazilian state oil company **Petrobras** said this week it produced a daily average of 2.016 million barrels of oil equivalent (BOEs) in November, according to Agencia Brasil. This result was 16.1 percent higher than in November 2004, and up 1 percent in comparison with October 2005. The company's global production abroad amounted to 252.062 barrels per day in November, 4 percent more than in October. The resumption of production in the south of Argentina contributed to this, according to the report. Counting both domestic and foreign production, Petrobras' average daily production last month was 2.268 million barrels, 10 percent more than in November 2004, and 1.3 percent more than in October 2005. Through November, Petrobras' average daily production this year stands at 1.834 million barrels, around 1.678 million of them from domestic fields. The waters off Rio de Janeiro are Petrobras' leading source of oil and gas in Brazil, contributing a total of 1.574 million BOEs daily. Among foreign sources, Argentina is first, with 96,788 BOEs per day, followed by Bolivia, with 55.509. Domestic natural gas production in November amounted to 44.8 million cubic meters per day, 3.4 percent more than in October.

Pemex Considering Construction of New $4 Billion Gas Refinery

The head of Mexican state oil company **Pemex** said Tuesday that he is contemplating building a seventh refinery in Mexico. Chief executive Luis Ramirez told reporters the refinery would be built in the Gulf coast state of Veracruz or on the Pacific coast, according to the Associated Press. Ramirez says the facility would get Pemex closer to meeting domestic demand for gasoline. The Mexico government must approve funds to build the $4 billion complex, however. In related news, Ramirez said that Pemex will resume offering natural gas drilling contracts to private companies after a favorable court decision Monday, the *Houston Chronicle* reported. Contracts will be offered starting in February. Pemex will offer two contracts worth $1 billion after a Supreme Court ruling went against legislators who

Board Member Profile

The **Energy Advisor** *is pleased to profile a different member of its Board of Advisors in each issue. Subscribers can pose questions to the Board by contacting Robert Simpson at rsimpson@thedialogue.org.*

David Goldwyn, President
Goldwyn International Strategies LLC

David L. Goldwyn is President of Goldwyn International Strategies LLC, an energy consulting firm. Goldwyn has advised the World Bank on power sector reform in Latin America, assisted the US Department of State and the warring parties in the Sudanese civil war on wealth sharing options, advised the Federal Government of Nigeria on its Extractive Industries Transparency Initiative implementation program, and advised Fortune 100 companies on political risk, economic sanctions, and corporate social responsibility issues.

David Goldwyn

Goldwyn served as Assistant Secretary of Energy for International Affairs from July 1999 through January 2001 and as Counselor to the Secretary of Energy from 1998-1999. At the Energy Department, he was the principal adviser to Secretary Bill Richardson on international energy policy. He led international conferences of the energy ministers of Latin America and Asia and led senior level international energy policy dialogues with energy, power and petroleum ministries of Venezuela, Mexico, and Bolivia and represented the Department in Binational Commissions with Mexico.

From 1997-1998, Goldwyn served as Senior Adviser/Counsel to Ambassador Bill Richardson at the United Nations. Goldwyn also served the US government as Chief of Staff to Under Secretary of State for Political Affairs (1993-1997) and an Attorney-Adviser in the Office of the Legal Adviser at the State Department (1991-1992). He was an attorney with the New York law firm of Paul, Weiss, Rifkind, Wharton and Garrison from 1986 to 1991.

Goldwyn is a frequent public speaker and is interviewed about energy policy in broadcast and print media. He authored a series of works on energy sector issues. Most recently, he was the co-editor of a new book on international energy security, Energy and Security: Towards A New Foreign Policy Strategy, (Johns Hopkins University Press/Wilson Center Press 2005).

Goldwyn received a Bachelors of Arts degree from Georgetown University, a Masters in Public Affairs degree from the Woodrow Wilson School of Public and International Affairs at Princeton University and a law degree from New York University School of Law.

Goldwyn is Chairman of the Board of Global Giving, a foundation dedicated to using the internet to match donors with projects in the developing world.

sued to block the practice.

Power Sector News

Rolls-Royce Wins $71 Million Brazil Generator Contract

The UK-based **Rolls-Royce Group PLC** said Monday that it had won a $71 million contract to supply gas generator units for an offshore production system used by Brazilian state oil company **Petrobras**. The new generating sets were ordered by **Charter Development LLC-CDC**, the company said, and will be situated in the Marlim Sul field, off the coast of Rio de Janeiro in the Campos Basin. Rolls-Royce said it has now received orders for 23 RB211 gas turbine generator sets for Petrobras offshore projects, totalling over $280 million in revenues over the past four and a half years.

Political News

Caribbean Should Have Dealt with Venezuela as a Bloc, Caricom Says

Caribbean Community (Caricom) governments may have made a mistake in not discussing an offer for concession fuel from Venezuela before committing themselves to the deal, a senior Caricom official said, according to the *Jamaica Gleaner* Monday. Edwin Carrington, secretary general of Caricom, said regional governments have come to realize that the offer from President Hugo Chavez to sell oil cheaply "has turned out not necessarily to be so," the report stated. He told a news conference that it would have helped governments if leaders had discussed a common regional position prior to signing onto the Petrocaribe initiative. The article did not mention which aspects of the Petrocaribe agreement is now troubling signatories. Under the plan, Venezuela's state-owned energy company **PDVSA** will reportedly supply signatories (Trinidad & Tobago and Barbados elected not to participate) with 185,700 barrels of oil daily. As part of the agreement, a fund has also been established for social and economic programs, with Venezuela making an ini-

Q&A continued from page 1 ...

model for energy investment and the state owned/social model. Brazil and Colombia represent the capitalist model, with competitive frameworks that allow private companies to majority own and operate concessions. This model attracts foreign capital, but does not predominate in the countries with the greatest reserves. Venezuela and Bolivia represent the social model where state owned companies may retain majority ownership and/or control, with levels of tax or royalty shares heretofore believed to be uncompetitive. The social model will see state owned companies (from inside and outside the region) invest in infrastructure and in concessions for strategic reasons despite rates of return that international oil companies find marginal at best. If the Morales model follows Venezuela's example and succeeds—by attracting state owned or foreign capital and increasing investment—then we will see a transformation in the frameworks of the entire region. The hurdle rate for international oil companies (IOCs) will be officially lowered, the gateway for dominance of state-owned investors will be open wide and Mexico's potential for a reform allowing foreign capital into its upstream sector will be further diminished. Only a failure of the model to increase capacity or a crash in oil prices will reverse the trend for years to come. If the Morales model fails—by not attracting investment, by leaving Bolivia impoverished, by establishing a floor on rates of return below which IOCs or even modern state owned companies like Petrobras will not step in, then the future of the sector will remain in play. Bolivia will be both a bellwether and a battleground."

> "If the Morales model follows Venezuela's example and succeeds—by attracting state owned or foreign capital and increasing investment—then we will see a transformation in the frameworks of the entire region."
>
> *– David Goldwyn*

A **Board Comment: Roger Tissot:** "I think there are a number of energy issues that will grab attention in 2006. In Venezuela, having achieved the transition of nearly all the petroleum contracts to the Chavez regime, it is time now to make the process work. That's not an easy task considering the number of regulatory and operational uncertainties. Moreover, will oil prices allow President Hugo Chavez to go ahead with proposed petro-diplomacy projects or will he be required to reconsider if oil prices weaken. In Bolivia, with the election of Evo Morales, the hydrocarbon issue will become even more relevant, with implication to the entire region, including the future of a Southern Cone energy ring. Then look at Colombia and Peru for possible surprises. These two countries are the region's 'contrarians' in terms of petroleum policies. Will a significant discovery make either of these two countries 'popular' again? Initially only small players visited the offices of ANH in Bogota, but increasingly large companies are paying attention to Colombia, and Peru's Camisea is also attracting the interests of IOC executives. Next, Brazil is moving toward oil export status. The success of Brazil petroleum policies is reducing the country's energy dependency, and it is expected to become an important petroleum exporter. Finally, and perhaps the most important, is the outcome of Mexico's elections and the future of that country's energy sector. Will Mexico open up, and under what conditions? Would a more 'open' Mexico result in a realignment of investment strategies by IOCs in, for example, Venezuela or Brazil?"

A **Board Comment: Roger Stark:** "Assuming Evo Morales has the necessary votes to avoid a run-off before the Bolivian Congress, his presidency has the potential

Q&A continues on page 6

tial contribution of $50 million, while additional money will flow through savings from direct trade or from the financed portion of oil purchases, according to the *Gleaner* report. The Caribbean countries will also be allowed to defer payments for 30 percent of their imports for 15 years at an interest rate of two percent per year, and if oil goes above $50 per barrel, the interest rate will fall to one percent per year, with payment for 40 percent of the imports being spread over 25 years. But Carrington told reporters what troubled him was that there had been no effort among regional leaders to come up with a unified position in advance. "The sad thing was that there was no regional discussion among us as to how we would respond to this initiative," he said. "That was really the weakness," Carrington said.

Brazil and Venezuela Presidents Inaugurate Joint Refinery Project

The presidents of Brazil and Venezuela on Friday officially initiated a joint $2.5 billion oil refinery project in Brazil's northeast that is expected to boost the countries' strategic alliance, Reuters reported. Brazil's state-controlled **Petrobras** and **Petroleos de Venezuela (PDVSA)** will begin construction of the refinery near Recife, the capital of Pernambuco state, in 2008, with production beginning in 2011. The countries will share the costs of the project, which is expected to process 200,000 barrels of oil a day. Brazil and Venezuela have entered into alliances on infrastructure, coal mining and steel ventures as well as cooperation in energy and fuel production, and they plan to take part in joint military exercises. Brazilian President Luiz Inacio "Lula" da Silva's approval ratings have dropped since June, when his party and government aides were accused of embezzling public funds to buy votes in Congress. Lula would lose next October's presidential election should he face long-time rival and Sao Paulo Mayor Jose Serra, two polls showed this week. At a ceremony commemorating the refinery's foundation being laid, Venezuela's President Hugo Chavez told Lula, "I'm sure you'll still be president in 2011." Chavez faces reelection in July.

Economic News

Central American Economies Hit Hard by High Oil Prices

Central American countries have been hit hard by high oil prices in the last three years, the UN's Economic Commission for Latin American and the Caribbean (CEPAL) said. The sub-region's spending on energy rose from $2.3 billion in 2002 to $5.19 billion in 2005, the agency said in a statement on Tuesday. The increased cost amounted to 2.5 percent of GDP for Central American nations in 2005, while the annual average price per barrel rose from $28.20 three years ago to $50.31 this year. Oil spending jumped 121.6 percent in Nicaragua, 112 percent in Costa Rica, and 107.2 percent in Guatemala. CEPAL said the surge in spending on oil drove the deficit in the current account balance of payments up from $3.65 billion to $5.424 billion, with oil purchases' share of the deficit rising from 73 percent to 96 percent. The oil bill in Honduras accounted for 145 percent of its current account deficit in 2005, 45 percent to 56 percent in Costa Rica, El Salvador and Guatemala, and 24 percent in Nicaragua and Panama.

Mexico's Economy Should Grow in Near Term, Surveys Say

Mexico's economy should continue to grow strongly in the near term, New York-based research group **The Conference Board** announced yesterday, citing new research. The "leading index" for Mexico's economy remained unchanged in October following four consecutive gains, and the coincident index increased 0.3 percent, the research organization said. "Oil prices and stock prices were the main contributors to this month's weakness in the leading index, but in recent months the strengths among the leading indicators were relatively more widespread," the Conference Board said in a press release. Despite no change in October, the leading index continued to grow at about a 10 to 11 percent annual rate in recent months, well above the 3 to 4 percent rate reached in early 2005, according to the release.

POLITICAL & ECONOMIC BRIEFS

Mexico's Public Outcry over US Border Wall Continues to Build

Public outcry continues to build in Mexico against the notion of a new border wall built by the US to keep out illegal immigrants. The Mexican government pledged Tuesday to block the plan and organize an international campaign against it. Foreign Secretary Luis Ernesto Derbez called the wall notion "stupid." "What has to be done is to raise a storm of criticism, as is already happening, against this," Derbez said.

Source: Associated Press.

Argentina's GDP Grew a Stronger-than-Expected 9.3 Percent in Oct

Argentina's economy grew 9.3 percent in October compared with the same month last year, the South American country's Economy Ministry reported Tuesday. The figure was higher than market expectations of 8.9 percent and represents a seasonally adjusted rise of 0.7 percent. "Argentina's economic indicators continue to surprise on the upside," investment bank **UBS** said in a research note.

Source: UBS.

Brazil's Real Currency Declines on Central Bank Intervention

Brazil's real currency tumbled for the ninth straight session on Monday after the Central Bank intervened once again to weaken the currency. The real fell nearly 2 percent to 2.382 to the dollar, marking its weakest close since August 30. The central bank has sought to weaken the real in order to make exports more competitive. Brazil Monday posted a November current account surplus of $1.74 billion on the back of a stronger trade surplus, up from a $222 million deficit in the same month a year ago.

Source: Reuters.

Featured Q&A

Continued from page 3

to effectuate a sea-change in the framework for owning, developing and allocating natural resource revenues in the region. Relations between the US and various countries in the region (including Bolivia) are approaching an all-time low. While trade in natural resources, technology and energy know-how could serve an important role in regional integration (not to mention create opportunities to exploit comparative advantages in lieu of 'zero sum' competition), the regional politics are trending away from the collaborative spirit required to make integration work. Morales' platform centers on legalization of coca farming and on asserting greater control over Bolivia's natural resources (most notably oil and natural gas). The former is already irritating US/Bolivian relations, while the latter may threaten the economic interests of US energy companies and other foreign investors. Together, these policies have the potential to eliminate any 'middle ground' available for compromise. Morales can follow the Chavez model of foreign relations, he can emulate the more moderate leftists in the region, or he can chart his own path. With respect to regional energy markets, the key issue in coming months comes down to a simple, but profoundly important, choice: adhere to doctrinaire populist ideologies that have won over voters, or pursue pragmatic policies that achieve social justice goals AND encourage foreign investment."

A **Board Comment: Luis Giusti:** "Highlights for 2006 in the Latin American energy network include an expansion of Trinidad-Tobago LNG facilities, which currently account for 10 million tons per annum of liquefied gas to the US. In Colombia, the recent institutional reform of the oil and gas industry has oil companies flocking to that country. The new activities will arrest the production decline and perhaps return Colombia to the oil export market. In Peru, progress continues in the Camisea gas development, the most ambitious project in the history of that country, with ca. $2 billion investment. Camisea will alleviate the trade deficit and convert Peru into an exporter by 2007. Brazil will continue improving its oil and gas industry, spearheaded by Petrobras and with a wide participation of private capitals. Nevertheless, there are also concerns in the energy sector. In Bolivia the result of Sunday's elections will translate into a deeper rejection of private participation in the natural gas developments, which will most certainly result in a paralysis of future possibilities. In Venezuela the frequent changes of rules and breaches of contracts by the government have instilled confusion and uncertainty, jeopardizing the possibilities of future expansions. Ecuador is seeing international investors leave the country, as a result of excessive bureaucracy, political volatility and unstable investment climate. Finally, the Mexican presidential elections of next June should prove definitive for the future of oil and gas in that country. Oil reserves have plummeted in recent years as a result of insufficient investment. Unless a serious reform to allow private investment in the oil industry is undertaken, the country is bound to a short-term demise as an exporter."

Luis Giusti
Photo: CSIS.

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David L. Goldwyn *is President of Goldwyn International Strategies, LLC.*

Roger Tissot *is Director, Markets and Countries Group, PFC Energy.*

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