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Latin America Advisor | Energy

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

Q: Chilean President Michelle Bachelet last Tuesday announced a program designed to boost the country's slowing economic growth through investment measures, including international tenders for contracts at oil and gas blocks, and coal deposits in southern Chile. Will the so-called "Chile Invests" plan achieve the goal of diversifying the import-dependent country's energy sources? What needs to fall into place in order for the energy-specific aspects of Chile Invests to become successful?

A: Guest Comment: Nelson Altamirano: "There is no doubt Chilean energy import dependency is high and needs to be counter balanced with local resources. Oil related imports were 26 percent of total imports during 2006. This single item was higher than total imports of capital goods or consumption goods. The plan to reduce this dependency includes developments in hydropower, natural gas, coal, nuclear and renewable resources. So, calling for hydrocarbon exploration in the southern region in association with ENAP or not is only one step, but very important. Investors will go south if there are real prospects of finding natural gas and prices do not follow the current Argentine model. ENAP is confident about the first condition, and the government (CNE) increased the size of the non-regulated electrical market last year. CNE also allowed prices for small consumers to go up 12 percent. So, there are good prospects to attract foreign investment. If exploration is successful, as it had been in Argentina before 2000, the southern region may become energy self-sufficient, and Methanex may finally get a reliable supplier. In this case, oil imports may be reduced by a few points. The big question is whether those discoveries would be enough to supply the populated central region or the mining north. The most realistic assumption is that those discoveries will complement the huge Aysen hydropower project, and some electricity-natural gas swaps between Chile and

Q&A continued on page 6

PHOTO OF THE WEEK

Pemex CEO Jesus Reyes Heroles said this week that Mexico's oil reserves will run out in 9.6 years under current production rates. See story on page 4.

Photo: Mexican government.

Inside This Issue

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ENERGY SECTOR BRIEFS

Eni, Petrobras Planning New Biodiesel Plants in Africa

Italian energy company **Eni SpA** is in discussions with Brazilian national oil company **Petrobras** over building biodiesel plants in Brazil, Angola and Mozambique that could export the fuel to Italy, the Associated Press reported Tuesday. A Petrobras executive told the AP that Eni officials showed interest in the accord. Petrobras-Eni ethanol projects also may be considered, but the two companies are focusing for now on African projects to export biodiesel to Italy, the report stated.

Brazil's Cosan Posts Third Straight Quarterly Profit

Brazil's **Cosan SA Industria e Comercio**, the world's biggest sugarcane processor, last week reported net income of 63.4 million ($US 30 million) for the fiscal third quarter ended January 31, its third consecutive profitable quarter as earnings continue to be boosted by growing demand for sugar-based ethanol, Bloomberg News reported. Sales grew 48 percent year-on-year in the fiscal third-quarter to 970.8 million reais, Cosan said. It said it sold a record 395 million liters of ethanol in the quarter.

Industrial Nanotech Wins $3.7 Million Petrobras Contract

Florida-based **Industrial Nanotech, Inc.**, a small business focused on nanotechnology, announced Monday that **Petrobras** has requested production of 50,000 gallons of its thermally-insulating and corrosion-protective pipeline coating, valued at more than $3.7 million. The order is scheduled for delivery in June of 2007, and is "the beginning of an anticipated strong revenue stream" for Industrial Nanotech, the company said.

Oil & Gas News

French Bank Sues DR Government for "Catastrophic Losses"

French bank **Societe Generale** says it has suffered "catastrophic losses" from its investments in the Dominican Republic's power sector and on Friday filed a $680 million lawsuit against the country, Reuters reported. The bank claims that its subsidiary, Los-Angeles-based **TCW Group Inc.**, has lost hundreds of millions in revenue since its 2004 purchase of half of Dominican power distribution company **EDE Este** due to government mismanagement of the electricity sector. "The Republic's continuing intentional, wrongful, willful, and reckless actions and omissions have caused catastrophic losses," Societe Generale stated in its claim, which was filed under the terms of a Dominican-French bilateral investment treaty. The French bank also requested arbitration under rules of the UN Commission on International Trade Law. The bank claims that the Dominican Republic breached contracts, did not enforce rate increase agreements, and has not tackled widespread electricity theft, according to Reuters. "They're not honoring the contracts that were put in place for the private player," said Blair Thomas, head of infrastructure and energy at TCW. Thomas said the government has not let EDE Este turn off power to people who steal it. EDE Este powers six southeastern Dominican provinces and most of the capital of Santo Domingo, according to local daily *Dominican Today*. The state-run power company owns the other half of EDE Este.

"They're not honoring the contracts that were put in place for the private player."

— Blair Thomas

Petrobras-Led Group in $4 Billion Purchase of Brazil's Ipiranga

Brazil's state-owned energy company **Petrobras** on Monday announced that it and two local partners—petrochemical firm **Braskem** and **Ultrapar Participacoes**—plan to buy Ipiranga, the South American country's second-biggest fuel distributor, in a $4 billion deal that represents a major consolidation in the petrochemical and fuel distribution sectors. "Petrobras intends to have a more relevant role in petrochemicals than it has had in the past few years," Petrobras President Sergio Gabrielli said of the deal. "The Ipiranga negotiation is yet another step in the strategy of consolidating important economic groups in Brazil, with a relevant Petrobras presence in them." Braskem, Latin America's largest petrochemical company, said in a statement the deal represented "a new stage in the process of consolidation of the Brazilian petrochemical sector" and said it was an important step toward its becoming one of the world's 10 top petrochemical firms. Braskem's stocks surged on the announcement. According to the agreement, the Ultrapar Group will act as the purchaser of Ipiranga in the name of the other partners. Petrobras will spend $1.3 billion on the deal, Braskem will come up with $1.1 billion, and Ultrapar will issue stocks worth about $1.6 billion. Ultrapar will absorb the

Petrobras President Sergio Gabrielli said the $4 billion deal is "yet another step in the strategy of consolidating important economic groups in Brazil, with a relevant Petrobras presence in them."

Photo: Petrobras Investor Relations.

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Ipiranga fuel distribution network in Brazil's south and southeast regions. Petrobras will take over the Ipiranga distribution network in the north, northeast, and midwest. Last year, Ipiranga registered $30 billion reais ($US 14.4 billion) in net revenues, with EBITDA (earnings before interest, taxation, depreciation and amortization) at $1 billion reais and net earnings of $534 million reais. The transaction is subject to approval from Brazilian regulatory agencies. The regulators will consider long-term complaints from Iparanga's refining arm that Petrobras' government-dictated fuel pricing policies are stifling private competition, which accounts for about 2 percent of Brazil's refining capacity, Reuters reported.

Colombia Sets Date for Ecopetrol Share Sale: August 27

The Colombian government will sell the first shares in state oil company **Ecopetrol** SA on the **Bogota Stock Exchange** on August 27, Armando Zamora, the president of the National Hydrocarbon Agency (ANH) said, Bloomberg News reported. Zamora said the first part of a total 20 percent stake worth about $3 billion is earmarked for private pension funds and other institutional investors. The offering is the country's largest asset sale ever. Colombian President Alvaro Uribe wants to sell the stake to finance investment in oil production and exploration as the Andean nation seeks to maintain its decreasing self-sufficiency in petroleum. Colombia, Latin America's fifth-largest oil exporter with more than 1.5 billion barrels of proven oil reserves, is investing in efforts to develop new wells and expand production capacity after forecasting it would become a net importer in 2011. However, after recently announced discoveries of hydrocarbons by firms operating in the country, analysts have revised their predictions of production capacity, Colombian daily *El Tiempo* reported on March 13. Colombia's oil self-sufficiency should extend to 2014, three years later than was previously expected—without taking into account new discoveries. Zamaro said in the past year 252 million barrels of reserves were added, surpassing the goal of 200 million barrels for the peri-

Paulson Praises IDB's Push for Biofuels in Latin America

US Treasury Secretary Henry Paulson Jr. on Monday praised new Inter-American Development Bank (IDB) programs on alternative fuel development in Latin America.

Speaking in Guatemala during a meeting of the governors of the IDB this week, Paulson specifically cited the IDB's "commitment to contribute to the biofuels initiative launched by President Bush and President Lula." Paulson, a former head of investment bank **Goldman Sachs** and a Bush cabinet member since last year, added that the initiative "will help countries reduce their dependence on imported oil, create jobs, and improve economic growth."

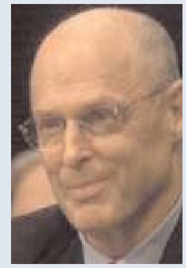
Paulson

Photo: US Treasury.

The IDB has been exploring alternative energy projects for several years, and these efforts gained momentum in 2006. "In contrast to the discussions sparked by the 1970s energy crisis, the region's countries today are in the center of the current debate on the subject, both due to their growing energy needs and because of potential role of some of them as major suppliers of alternatives to fossil fuels," IDB President and former Colombian diplomat Luis Alberto Moreno said in a press release.

In a seminar sponsored by the German government, Moreno cited examples of solar and wind power projects in Mexico and Brazil that will serve as models for future initiatives, according to an IDB press release. Moreno pointed out that advances in technology have reduced the costs of renewable energy sources, in the case of solar energy, from $200 to $3 per installed watt. In Mexico, the state of Oaxaca will put into operation a 250-megawatt wind farm in 2008, while Brazil is building two wind power projects with a combined generating capacity of 425 megawatts, he added.


Moreno

Photo: IDB.

Guatemalan Minister of Energy and Mines Carmen Urizar said that her government has "accepted the challenge to gradually replace fossil fuels with renewable energy," according to a release. She added that access to energy is crucial for countries where a large proportion of the population has unmet needs. "Eliminating poverty is the priority objective of our energy policy," she said.

Some Latin Americans feel that that the responsibility for migrating away from fossil fuels and other climate-improving efforts should reside with the US and industrialized countries that used hydrocarbons for a century in order to grow their economies. [Editor's note: see commentary on this topic from Carlos Alfredo Lazary Teixeira, Alec Watson and Marco Monroy in the February 8, 2007 edition of the Dialogue's daily *Latin America Advisor*.]

In response to those critics, Moreno described a new IDB initiative in which the Bank will help to clear away roadblocks to the generation and use of renewable energy and work to develop mechanisms through which entities in industrialized countries receive credit in exchange for financing projects that reduce greenhouse gas emissions in the countries of Latin America.

Paulson was in Peru on Wednesday for meetings with President Alan Garcia. The visits to Guatemala and Peru were his first in those countries as treasury secretary.

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od. The government, which owns a 100 percent stake in Ecopetrol, will invest about $2.5 billion annually over the next five years in production and exploration. After the initial sale of shares, the government will probably sell part of the stake on the **New York Stock Exchange** next year, the ANH president said. "If the entire offering isn't sold on the local market, we'll probably sell shares in New York," Zamora said. "We don't believe the Colombian market has the capacity to absorb these shares." The sale will give Ecopetrol the power to make its own financing decisions and allow its board to choose its chief executive instead of being appointed by Colombia's president. Colombia's partial sale of Ecopetrol runs counter to the strategies of several South American governments, who have taken over ownership of oil production from foreign firms. Venezuela, Ecuador and Bolivia have recently moved toward nationalizing their petroleum industries in order to boost state oil revenues.

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Inter-American Dialogue Conversation on

Ecuador's Foreign Policy Agenda

with

María Fernanda Espinosa
Ecuador's Minister of Foreign Relations

Friday, March 23, 2007
8:30 – 10:00 a.m.

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CEO: Pemex Needs a New Model to Reverse Decline in Reserves, Output

Mexico needs to come up with a new model for operating state-owned oil monopoly **Pemex** amid a sharp decline in oil and gas reserves in recent years because of a lack of investment, Pemex CEO Jesus Reyes Heroles said Sunday, according to Bloomberg News. To reverse a fall in production and a 50 percent drop in reserves since 2002 that has left the company in a "critical" situation, Pemex needs to pay less taxes, be given more capital, and have greater autonomy in making decisions, Reyes Heroles said. "In the global market, the lack of flexibility works against the success of the company," Reyes Heroles was quoted as telling Pemex workers in the city of Veracruz. "Overall, Pemex's situation is critical and merits immediate attention." Reyes Heroles said Pemex's reserves will last only 9.6 years at current production rates. Pemex reported proven oil and gas reserves of 15.5 billion barrels as of Jan. 1, down from 16.5 billion a year earlier and 30.8 billion in 2002, according to Bloomberg News. Mexican President Felipe Calderon on Sunday called for strengthening Pemex's finances and increasing the rate at which it replaces reserves, as well as other measures, but repeated a pledge not to privatize the company. "We need to act now to guarantee the future," Calderon said. "It's not worth anything that the oil is ours if in the medium term we can't take advantage of it." Analysts say Mexico needs to open up its energy sector to allow private-sector participation and to halt the decline in production levels. The country's Constitution prohibits private investment in oil and gas exploration or production.

Jesus Reyes Heroles said Sunday his company faces a "critical" situation.

Photo: Mexican Presidency.

Petrobras Chief Calls for Changes to Energy Pricing in Argentina

Sergio Gabrielli, the head of Brazilian state-owned oil and gas company **Petrobras**, on Tuesday called for changes in the way energy prices are set in neighboring Argentina, saying investment in Argentina's energy sector is hampered by the current system, Reuters reported. "We believe that the price system is not a system that could stimulate much investment," Gabrielli was quoted as saying. "We believe that there is a need for some changes in the sector, especially in the area of derivatives and also natural gas so that they can convey more adequately signals of relative scarcity of these products." Gabrielli said more investment is needed in Argentina, the biggest source of foreign production for Petrobras, to reverse a decline in oil and natural gas reserves. The government of Argentine President Nestor Kirchner has kept in place controls on energy prices in order to contain relatively high inflation, which has hovered around an annual rate of 10 percent. As a result, the country has faced energy shortfalls due to a lack of investment in creating supplies, and friction over energy issues with neighbors like Chile and Brazil.

Political News

Shannon Says Pres. Bush's Trip to Latin America Was Important

The top US diplomat for Latin America, Thomas Shannon, said Tuesday that President George W. Bush's March 8-14 visit to Latin America was "important and incredibly useful." "This trip was especially important because it comes after the year of 2006, which from our point of view was kind of the year of elections," Shannon said at a meeting hosted by the Inter-American Dialogue. "Half of the democracies in the Hemisphere had some kind of major election. And because of that, because of the sensitivity of the elections, we had to be careful about our travel schedule in 2006," he said, explaining that Bush traveled to the region just once last year for an annual conference on security and prosperity in Cancun, Mexico. This year's conference is scheduled to take place in Ottawa in August (Editor's note: see also http://www.spp.gov). Shannon acknowledged that the US has been distracted from Latin America by the Middle East. "It's evident that a lot of other people have forgotten about the region," he explained.

Shannon
Photo: US govt.

Bolivia's Morales Says He Would Not Run in Early Presidential Election

Bolivian President Evo Morales announced Monday that he would not be a candidate in an early presidential election, Reuters reported. "No one here is thinking about a re-election, what we have to do is to be responsible with the people. I personally think I've done my bit with the process of change," Morales told reporters in the eastern city of Sucre. Morales said Friday that presidential elections could be held as early as next year once an assembly finishes rewriting the Andean nation's Constitution, which is scheduled to be completed by December of this year at the earliest. However, a presidential spokesman later said that Morales would run if his supporters asked him to.

Economic News

US Should Not Consider Free Trade Deal with Colombia—AFL-CIO

A pending free trade agreement with Colombia should not even be considered until Colombia takes steps to protect unionized workers from violence and other abuses, the AFL-CIO—the US' largest labor federation—said Friday. In a press release posted on its Web site, the AFL-CIO said it sent a letter to members of Congress on Thursday outlining its opposition to the agreement and noting that Colombia is the most dangerous country in the world for trade unionists, citing the murder of 2,262 union officers and rank-and-file members since 1991. The AFL-CIO criticized US President George W. Bush for not raising the issue of violence against trade unionists last Sunday during a meeting in Bogota with Colombian President Alvaro Uribe.

IDB: Possible US Recession Would Hurt Latin American Economies

A possible recession in the United States would hurt Latin American economic growth, the Inter-American Development Bank (IDB) said at its annual meeting in Guatemala on Monday. "Through its effects on the volumes and prices of Latin American exports, a US recession would translate into at least two percentage points less growth in the region," the bank said in its annual report, released Monday. The US-based National Association for Business Economics last month forecasted US economic growth at 2.7 percent this year, the slowest rate since 1.6 percent in 2002, Bloomberg News reported. The IDB said the current outlook suggests growth in Latin America and the Caribbean will slow to between 4 to 4.5 percent in 2007 from 5.3 percent last year. Although poverty rates have declined in Latin America and the Caribbean to below 40 percent for the first time since 1980, poverty remains a top concern.

POLITICAL & ECONOMIC BRIEFS

IDB Forgives $4.4 Billion in Debt from Five Countries

The Inter-American Development Bank's board of governors has approved 100 percent debt relief for Bolivia, Guyana, Haiti, Honduras, and Nicaragua, the IDB said Friday. In a press release, the IDB said it will forgive approximately $3.4 billion in principal payments and $1.0 billion of future interest payments from those countries.

Argentine Economy Grew 8.5 Percent in 2006

Argentina's economy expanded 8.5 percent in 2006, the fourth straight year of 8-9 percent growth since the South American country's 2001-2002 economic collapse. In a research note published last Friday, **J.P. Morgan Chase** analyst Florencia Vazquez said Argentina's economy grew 8.6 percent in the fourth quarter compared to the same three months a year earlier, driven mainly by consumption. Vazquez wrote that "stellar economic performance looks set to continue this year."

In Mexico, Bill Gates Calls for Relaxation of US Migration Rules

During a visit to Mexico on Tuesday, the world's most wealthy individual, **Microsoft** Chairman Bill Gates, argued for revising US immigration rules that would allow for more high-skilled workers to enter the country, Reuters reported. "I'm a big believer that as much as possible, and there's obviously political limitations, freedom of migration is a good thing," Gates was quoted as telling reporters. "I think every country in the world should make it easier for people with high skills to come in," he said. However, some Latin American leaders have bemoaned a "brain drain" abroad to US universities and businesses.

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Featured Q&A

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Argentina may allow the central region to receive some natural gas. The north will continue depending on foreign energy resources."

A **Guest Comment: Juliette Kerr:** "The measures to increase production of domestic energy sources are positive and can certainly be part of a successful strategy to improve Chile's energy security and reduce the country's dependence on imported gas from Argentina. However, such a strategy must also include plans that are already underway for LNG imports. This is because, even with greater private investment, Chile is unlikely to be able to raise oil and gas production in the Magallanes region sufficiently to completely substitute oil and gas imports. Any increase in coal production is also likely to be limited, and Chile is not a strong producer in the types of crops that would enable it to become a major biofuels producer or consumer."

> "Chile is unlikely to be able to raise oil and gas production in the Magallanes region sufficently."
>
> — *Juliette Kerr*

A **Guest Comment: Leonardo Suarez:** "I believe this is positive for the market, but it's not enough. There are a lot of [regulations that are] not investor friendly, fundamentally in environmental situations. [President] Michelle Bachelet promised a new regulatory framework and a new environmental law, but the market still doesn't know this law. For this reason, a lot of projects are paralyzed and uncertainty [causes] a lot of investors to stop their investments ... In my view, the energy sector needs a lot of change, a lot of investments, and the government is advancing very slowly. Investors need the government to send the new environmental law to Congress soon to make it clear where the policy is going."

> "Investors need the government to send the new environmental law to Congress soon to make it clear where the policy is going."
>
> — *Leonardo Suarez*

Nelson Altamirano *is a Visiting Scholar at the University of California at San Diego's Center for Iberian and Latin American Studies.*

Juliette Kerr *is a Senior Research Analyst for the Americas & Energy at Global Insight.*

Leonardo Suarez *is Head of Research at Larrain Vial in Chile.*

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Subscription Inquiries are welcomed at freetrial@thedialogue.org

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1211 Connecticut Avenue, Suite 510
Washington, DC 20036
Phone: 202-822-9002 Fax: 202-822-9553

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