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Inter-American Dialogue

LATIN AMERICA ADVISOR | Energy

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

Q The Ecuadorean government has offered to drop plans to develop the Andean nation's biggest oilfield if rich countries and environmental groups pay it some $350 million per year to leave the oil in the ground and thereby protect natural habitat. What do you think of Ecuador's proposal? Is it an innovative approach to protecting the environment, or is it blackmail?

A Guest Comment: Yolanda Kakabadse: "This oil field is located under one of the most exceptional national parks in the world, and is under the category of *zona intangible* (untouchable area) because of local indigenous communities, which have little contact with the external world. The proposal to keep the oil in the ground and seek funds from donor countries and organizations is an innovative and creative way to prioritize social and biodiversity goals in the Ecuadorean Amazon region, which to a large degree has been devastated by oil exploration projects in the last 40 years. The basis for success would be the recognition on the part of the developed world of a voluntary effort to present alternatives not only to economic tools for conservation but also in line with the global energy debate, carbon emissions, and climate change. Debt conservation swaps could be an option. This proposal does not undermine the importance of oil production for Ecuador. Existing oil operations urgently need to be modernized in order to increase efficiency and productivity. Such measures will have a positive impact on public revenues and will complement long-term environmental services (biodiversity, water, ecotourism, etc.) provided by exceptional natural areas, such as the Yasuni National Park."

A Board Comment: Roger Tissot: "I would not define the government action as blackmail. Governments are free to choose how best to exploit their natural resources, but they also have global obligations, one of which is the protection of the environ-

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PHOTO OF THE WEEK

Elizabeth Thompson, the minister of energy of Barbados, said Saturday the planned auction this year of offshore oil blocs will open up "a new economic frontier" for the Caribbean nation. See story on page 3.

Photo: www.iisd.ca

Inside This Issue

ENERGY SECTOR BRIEFS

IEA Raises Forecast for Global Oil Demand

The International Energy Agency on Tuesday raised its forecast for 2007 growth in world oil demand by 420,000 barrels per day (bpd) to 1.7 million bpd. The IEA's fourth straight monthly increase in its forecast of global oil demand growth is expected to put pressure on the Organization of Petroleum Exporting Countries, whose members include Venezuela, to increase oil exports and bring down prices, which have risen by about $20 per barrel since January.

PDVSA Bonds Follow Declines in Europe, US

Prices for state-owned **Petroleos de Venezuela** (PDVSA) followed US and European bonds in tumbling Tuesday after former US Federal Reserve Chairman Alan Greenspan predicted an end to a surge in global liquidity, Bloomberg News reported. PDVSA's 10-year note dropped 0.80 cents to 77.10 cents on the dollar, the lowest point since it was issued in April in what was Latin America's biggest corporate debt sale ever.

Chile's AES Gener Obtains $440 Million Loan to Build New Plant

Chilean electricity generation company **AES Gener** said Thursday it obtained a $440 million, 15-year loan to help finance construction of its Nuevas Ventanas generating project, Reuters reported. AES Gener, which is controlled by US power company **AES Corp.** and is Chile's second-largest electricity generator, said the loan was obtained from a consortium of international banks lead by **Fortis** and **Calyon**. Nuevas Ventas will be a thermoelectric and coal-fired plant next to an existing AES Gener plant in central Chile.

Oil & Gas News

Argentine Banker Is in Talks with Repsol to Acquire 25 Percent of YPF

Argentine banking magnate Enrique Eskenazi is negotiating with Spanish oil and gas company **Repsol** to buy a 25 percent stake in Repsol's Argentine unit, **YPF**, in a deal worth some $3 billion, local daily *La Nacion* reported on Tuesday. Eskenazi is willing to pay between $300 million and $500 million in cash for YPF, and is seeking additional financing with the help of **Citigroup**, **Goldman Sachs**, and **UBS**, according to the report. However, unnamed executives close to Eskenazi said a deal "is not imminent" and would not be finalized for another four to six months. Argentine Planning Minister Julio de Vido predicted last week a deal would be wrapped up in less than five weeks. According to Reuters, De Vido said the government, which holds a golden share in YPF, would not block the deal. However, he said state-owned oil and gas firm **Enarsa** could seek in the future to buy YPF, which Repsol bought for about $15 billion when it was privatized in 1999.

Argentine Planning Minister Julio de Vido said the government would not block the deal.

Ecuador Wants Foreign Investment, But Not at Expense of State Role

As an oil-rich nation producing far below its capacity, Ecuador is "very much interested in attracting foreign investment," but not at the expense of a state role in the sector, the country's minister of economic and production policy coordination, Mauricio Davalos, told a Washington audience on Wednesday. Davalos reaffirmed the government's desire to exercise close control of the Andean nation's energy sector. "Since the 1980s and 1990s, the policy has been to take out the state from many activities," he said at an event sponsored by the Inter-American Dialogue. "The consequences of that have been that an oil-exporting country imports most of its fuels," he explained. He lamented that Ecuador's oil production and refining capacity have decreased to just half its potential. Ecuador, the fifth-largest oil producer in South America, gets 55 percent of its annual export income from its oil sector, according to the Associated Press. Some analysts have said Ecuador needs to attract foreign investment to develop its oil sector and keep up production, especially given inefficiencies at state-owned **Petroecuador**. Davalos said the government's priority in the energy sector is expanding hydroelectric power, which accounts for 50 percent of energy consumption in Ecuador, while imported thermal energy accounts for 40 percent. He said no new dams have been built since 1984, and blamed previous governments for failing to develop hydroelectric power. Davalos also noted that the World Bank and Inter-American Development Bank decided not to provide financing for such projects.

Alberto Acosta Resigns as Ecuador's Energy Minister

Alberto Acosta resigned Thursday as Ecuador's energy minister in order to run for a seat in the country's planned Constituent Assembly, local daily *El Comercio* reported.


Acosta
Photo: Telesur

Acosta, who had held the post ever since President Rafael Correa took office in January, had proposed a plan not to explore for oil in Ecuador's Yasuni National Park in exchange for payments from abroad [see related Q&A on page 1], and had clashed with Carlos Pareja, the president of state-owned oil company **Petroecuador**, over the idea.

Barbados to Auction Concessions for Offshore Oil Drilling

Twenty five oil companies from around the world plan to participate in auctions later this month for concessions to drill for oil in offshore Barbados, local newspaper *The Nation* reported on Sunday. In a press conference on Saturday, Barbados' minister of energy, Elizabeth Thompson, described the auction process, which runs to November, as opening up "a new economic frontier" for the Caribbean nation and providing the island with an opportunity to earn "substantial revenues." Barbados, which currently has no offshore oil exploration and produces just 1,000 barrels of oil per day from 240 onshore wells, plans to auction licenses for the rights to drill for oil in 20-25 offshore bloc, according to *The Nation*. Thompson said the government was looking for companies with best practices in environmental matters to explore for oil. The companies interested in the auctions include such firms as **Exxon**, **Shell**, **BHP Billiton**, **Hess**, **Anadarko Petroleum**, **Statoil**, **Petro-Canada**, and **Petrobras**.

US Senate Rejects Proposal for Refinery Construction Incentives

The US Senate on Wednesday rejected a proposal to provide financial incentives for building oil refineries on surplus federal lands, which some supporters of the proposal say is needed to reduce dependence on refineries in foreign countries, such as Venezuela, Reuters reported. In a 52-43 vote, the Senate rejected the amendment to an energy bill by Sen. James Inhofe (R-OK), with opponents arguing that oil companies would be able to avoid US environmental regulations by building refineries on surplus federal lands. Opponents of the amendment also said oil companies have made record profits off high crude and gasoline prices, and did not need any government help to build refineries. Inhofe said it was dangerous for the US to rely on foreign refineries. "The fact is that Americans are paying more at the pump because we do not have the domestic capacity to refine the fuels consumers demand," Inhofe said. "If my colleagues do not want to increase domestic production to meet their constituents' demand, then they are for importing more from the rest of the world."

Featured Q&A

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ment. Ecuador is a poor country with significant social needs. Oil is Ecuador's main source of hard currency. The government is therefore posing a fair question to the international community: Would you help us finance our social development and in the process protect the environment by financing the non-exploitation of a large oil field in an environmentally sensitive area? The main issue is perhaps credibility. By receiving payment for non-development of a known oil reserve, the government could be seen as privatizing petroleum reserves not for an IOC (international oil company) but for the organizations financing the non-development of the project. Would Ecuadorean law allow such a provision? Also, would future governments honor the deal? The government should also pay attention to the country's hydrocarbon potential outside ITT, including Petroecuador's current assets, and develop a strategy aimed at increasing explo-

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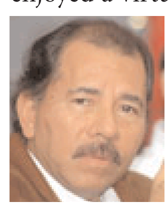
Power Sector News

ThyssenKrupp Unit Awards Alstom Contract to Build Plant in Brazil

The Brazilian steelmaking unit of German technology group **ThyssenKrupp** has awarded a 330 million-euro ($US 439 million) contract to French power company **Alstom** to build a 490 MW turnkey combined cycle power plant, Alstom announced on Tuesday. In a press release, Alstom said it would provide all engineering, procurement, and construction services to deliver the plant, to be located the city of Sepetiba in southern Rio de Janeiro state. The plant will be fueled by blast furnace waste gas from a new steel mill, which will be built concurrently by ThyssenKrupp's Brazilian steelmaking unit, with excess energy exported to the national grid, Alstom said.

Nicaraguan Government Fines Union Fenosa $2.45 Million

The Nicaraguan government has fined Spanish power company Union Fenosa $2.45 million for failing to adequately respond to customer complaints, China's Xinhua news service reported on Tuesday. "Union Fenosa has refused to recognize the authority of the Consumer Defense Directorate in processing users' complaints about their service, despite a Supreme Court resolution", Antonio Fernandez, an official at Nicaragua's trade, commerce, and finance ministry, was quoted as saying. Union Fenosa, which Nicaraguan President Daniel Ortega has threatened with intervention if it did not end daily blackouts, is frequently accused by users of incorrect billing and charging for unwarranted services, according to Xinhua. The government accuses the Spanish company, which since 2000 has enjoyed a virtual monopoly in power distribution in Nicaragua, of not investing enough in the country's power system. The company retorts that the government will not let it raise prices in step with higher fuel costs. Cesar Zamora, general manager of the Nicaraguan unit of US power company **Ashmore Energy**, told the weekly *Latin America Energy Advisor* in January that Nicaragua's power sector has suffered from a lack of investment. Zamora said $250 million was needed to be invested over the next year and a half to end electricity rationing, and that $500 million should be invested over the next five years to restructure the Central American nation's energy sector [Editor's note: see related Q&A in the January 17, 2007 issue of the *Energy Advisor*.]



Ortega
Nicaraguan govt. file photo.

Economic News

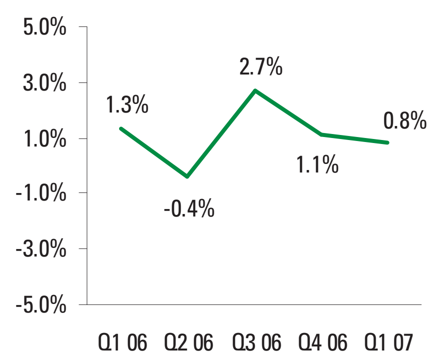
Morales Says Andean Nations Should Jointly Lobby for US Trade Benefits

Bolivian President Evo Morales proposed Thursday that Andean leaders travel together to the United States to lobby for an extension of trade benefits. Hosting a summit of heads of state from the Andean Community of Nations (CAN) in the Bolivian city of Tarija, Morales said he and his counterparts from Ecuador, Colombia, Peru, and Chile should act as a single bloc in securing an expansion of trade benefits in return for their continued cooperation in fighting drug trafficking. "Maybe separately we cannot move forward quickly, but I am sure that together we can advance," Morales said, according to a CAN press release. US trade benefits granted to Bolivia, Colombia, Ecuador, and Peru under the Andean Trade Promotion and Drug Eradication Act (ATPDEA) are set to expire at the end of this month, and the four countries have been lobbying intensely for their renewal. Morales said the US has an obligation to extend the trade preferences because of its "co-responsibility" in the fight against drug trafficking, and criticized what he called Washington's approach to renewing benefits. "It is not possible they give us a drop by drop extension of ATPDEA—two months, six months, one year—if they really want effective support in the fight against narcotrafficking." Officials from the four Andean countries say failure by the US to extend the benefits could seriously harm their economies and cost hundreds of thousands of related jobs. Chile, an associate member of CAN, has a free trade agreement with the United States. Peru and Colombia have pending free trade deals with the US which are awaiting approval by the US Congress. The deal with Colombia faces an uphill battle in the US Congress due to Democrats' concerns about Colombia's record of protecting trade unionists from violence as well as alleged ties between the government and illegal, right-wing paramilitary groups. In related news, Colombian lawmakers on Thursday approved the free trade deal with the US, according to Reuters.

Brazilian Economy Grew 0.8 Percent in First Quarter

Brazil's economy expanded 0.8 percent in the first quarter this year compared to the fourth quarter of 2006, a result that Planning Minister Paulo Bernardo called "adequate" on Wednesday, when official figures were released, according to Reuters. The services sector grew 1.7 percent in the first quarter, while industry edged up 0.3 percent, and agriculture, due to seasonal shifts, grew 2.4 percent, according to data from national statistics agency IBGE, Reuters reported. Government spending increased 3.5 percent, investments 2.1 percent, and household consumption 0.9 percent compared to the fourth quarter. The fourth quarter's expansion from the prior period was revised to 1.1 percent, up from a previously reported 0.9 percent. Gross domestic product grew 4.3 percent in the first quarter compared to the year-earlier period, which was lower than the market consensus forecast of 4.8 percent, according to **IDEAglobal**, whose own estimate was 5.0 percent. Bernardo said he believes economic growth will be higher during the remainder of the year, according to Reuters. "We've established a target of 4.5 percent growth for this year. We still think we'll hit it and possibly beat it," Bernardo was quoted as telling reporters in Brasilia. Economists expect that Brazil's Central Bank will continue to cut its benchmark interest rate, now at a record low 12 percent, to help spur growth, Reuters reported.

Brazil Quarterly GDP Growth
Q1 2006-Q1 2007



Source: IBGE.

POLITICAL & ECONOMIC BRIEFS

FARC Demands Safe Haven as Condition for Prisoner Swap

Colombia's largest rebel group, the FARC, will not free 60 hostages it holds until the government creates a safe haven area for negotiating a prisoner exchange, the FARC's number-two commander, Raul Reyes, said in comments published on Tuesday, according to Reuters. However, a spokesman for the government of President Alvaro Uribe said Tuesday its policy of never ceding territory to the rebels had not changed. Last week, Uribe released some 150 imprisoned FARC rebels in a gesture aimed at initiating a prisoner swap.

Chavez Makes Surprise Visit to Cuba to Meet With Castro

Venezuelan President Hugo Chavez made a surprise visit to Cuba on Tuesday to meet with his counterpart, ally, and mentor Fidel Castro, the Associated Press reported. Castro and Chavez met for six hours during Chavez's "working visit," discussing bilateral relations, climate change, and other issues. It was Chavez's sixth trip to Cuba since the ailing Castro underwent intestinal surgery last July and temporarily handed over Cuba's reins to his brother, Raul Castro.

Peruvian Economy Forecast to Grow 7.2 Percent This Year

Peru's economy will expand 7.2 percent in 2007, up from a previous forecast of 6.8 percent, Bloomberg News reported on Friday, citing Central Bank President Julio Velarde. Construction, manufacturing, and retail sales will all grow at least 8 percent this year, offsetting slowing export growth as metals prices decline, Velarde said.

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ration and production. The government needs to improve PetroEcuador's operating and management capabilities. Second, Ecuador's 'country risk' needs to be lowered if new investments by IOCs are expected. A significant component of Ecuador risk is caused by poor contractual credibility and constant conflicts with IOCs."

A **Board Comment: Raul Herrera:** "At his inauguration on January 15, Ecuadorean President Rafael Correa discussed, among other matters, the importance of the environment and indigenous rights, as well as the serious gap in conventional wisdom in connection with matters that have great value but perhaps a low or no price and vice versa (*i.e.*, a high price but low or no value). The recent pronouncements by the Ecuadorean government to consider limiting the development of its biggest oilfield (known as the ITT block) falls into one of those dichotomies. In this line of thinking, the conservation of the environment may not be given its proper value when compared to the value assigned to the returns from oil exploration. It is said that the ITT block comprises important environmental and cultural diversity, including a national parkland and natural reserve, and houses about 900 indigenous persons who are nomadic to this area. The Ecuadorean government's position does not appear to be by any means a negotiation posture (or even worse blackmail) with regards to the interested oil companies, but rather it demonstrates a very different approach to dealing with the country's limited natural resources, which over time may actually be worth significantly more then than if exploited now at today's prices."

A **Guest Comment: Hernando Otero:** "Some proposals deserve to get the benefit of the doubt. That is why Ecuador's offer to preserve the Yasuni National Park and leave its oil reserves untapped in exchange for international compensation is definitely worth careful consideration. Skeptics might suggest Ecuador's government is merely raising the stakes on the upcoming bidding process to develop the Ishpingo-Tiputini-Tambococha oil field. However, if Ecuador's proposal is serious, there are important institutions and mechanisms already in place that can help. There is a set of global, regional, and domestic regimes that allow the monetization and subsequent trading of verifiable reductions in carbon emissions (carbon credits). Though the current global regime under the Kyoto Protocol most likely to be of choice in this case only credits reforestation projects, there has been increasing recognition of the impact of deforestation of carbon emissions and the value of conservation. As a result, changes allowing conservation efforts to generate carbon credits could be forthcoming. For example, the World Bank was recently able to take an important first step and obtain G-8 support for an investment fund that would compensate less-developed countries for their efforts to this end. Private investor interest in the fund would certainly be enhanced if carbon credits are eventually made available to hedge investment risk. Unfortunately, it is unclear whether Ecuador's offer will hold until all the pieces fall into place. "

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