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FEATURED Q&A

How Will Falling Oil Prices Affect Petroleum-rich Countries?

Q Oil prices made small gains early this week on news that OPEC countries might decrease production. But lower crude prices, which have fallen 15 percent since last year, have forced petroleum-rich countries like Venezuela, Ecuador, and Mexico to revise their budgets to account for decreasing oil revenues. How will government spending in these countries be affected by the drop in oil prices? What is the potential fallout of reigning in the hefty spending of recent years?

A **Guest Comment: Jeremy Martin:** "Clearly, petroleum producers have grown accustomed to—and developed their budgets—based upon elevated prices. For years, government coffers filled from the oil windfall, particularly in countries that had adopted a "resource nationalist" posture of higher taxes and royalties. One need not be a PhD economist to surmise that declining oil prices causes fiscal imbalances and demands budgetary trade-offs for petroleum-dependent economies. Spending sprees to garner domestic and international political support are unlikely to be sustained with such vigor while prices trend downward. To wit, in Venezuela trade-offs will likely include scaling back geopolitical ambitions such as Petrocaribe and engender a more conciliatory approach to foreign oil companies that can bring significant capital and technology to Venezuela's oil patch. Mexico appears to be dealing

with their trade-offs by increasing government spending on infrastructure and energy and running budget deficits; current budget legislation in the Mexican Congress (which factored oil at an average price of \$70 a barrel for 2009) points to the largest budgetary shortfall since 1990. And, surely the bold announcement by the Calderon government to remove Pemex from the federal budget seeks to add some fiscal flexibility. Recent price trends may also cause some dyspepsia for those keen on solidifying the role for renewables as well as proponents of large-scale projects such as the

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World Bank President Robert Zoellick Visits Haiti

World Bank President Robert Zoellick on Wednesday finished a three-day visit to Haiti, but offered no immediate debt relief in the aftermath of storms that ravaged the country. See story on page 2.

Photo: World Bank.

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NEWS BRIEFS

During Interview With Univision, Palin Calls Chavez a "Dictator"

In her first interview with a Spanish-speaking news organization, US vice presidential candidate Sarah Palin on Wednesday called Venezuelan President Hugo Chavez a "dictator" and said she is not ruling out sanctions against his country, the BBC reported. The full-length interview is scheduled to air Sunday morning on Univision's "Al Punto," program, hosted by Jorge Ramos. During the interview, the Republican Alaska governor also said the US needs to reinforce its borders to keep out illegal immigrants. She also said she opposed giving driver's licenses to undocumented immigrants.

US Secretary of State Arrives in Mexico for Talks On Drug Trade

US Secretary of State Condoleezza Rice arrived in Mexico Wednesday for two days of talks on the illegal drug trade. Rice met in Puerto Vallarta with her Mexican counterpart, Patricia Espinosa, The New York Times reported. Mexico had pressed for the meeting in an effort at better coordination with the US against drug cartels. In addition to discussing the illegal drug trade, the two administration officials also talked about the global financial crisis.

Brazil's Central Bank Sells Nearly \$300 Million in Dollar Swaps

Brazil's central bank on Wednesday sold \$299.5 million in dollar swaps Wednesday, Reuters reported. The bank offered 6,000 in a second auction, the 13th consecutive session it has offered the securities. Brazil is undertaking the sales in order to inject more liquidity into its economy.

Economic News

During Visit, Zoellick Offers No Immediate Debt Relief to Haiti

Wrapping up a three-day visit Wednesday to storm-ravaged Haiti, World Bank President Robert Zoellick said the country finds itself at a "tipping point," but held back from immediately offering debt relief to the country, the AP reported. Zoellick met with President Rene Preval and

Zoellick stopped short of offering immediate debt relief to Haiti.

toured Gonaives by helicopter, saying the city's ruin "makes your eyes pop." The World Bank has offered \$25 million to help Haiti rebuild after the storms and floods. The bank is expected to approve the grants next month. Zoellick also said Haiti could have its debt canceled by the middle of next year if it meets targets to fight corruption and hike public investments. However, he stopped short of moving to immediately cancel Haiti's debt to the bank. Haiti also must rebuild infrastructure and move forward with projects to manage its watershed so that future storms do not cause similar devastation, Zoellick said. Deforestation has left Haitian hills bare, making the country more vulnerable to floods. Altogether, Haiti has debts of \$1.7 billion to its creditors. Critics have argued that allowing Haiti, the poorest country in the Western Hemisphere, to remain saddled with \$1 million in debt payments each week will hamper its recovery from the storms. The World Bank previously pledged a \$10-million grant to help the country respond to its food crisis. Private companies have also pledged millions to help Haiti recover from the storms in August and September, which killed nearly 800 people in the country.

Mexico Central Bank Chief: Investment Banks Acted Unethically

Investment banks acted unethically in their marketing of derivatives to companies, Mexico's central bank leader told the *Financial Times*. Central bank governor Guillermo Ortiz added it was irresponsible for banks to market derivatives to companies without knowing those clients' overall exposure to risk, as some have claimed. Ortiz is also questioning whether banks were acting in the companies' best interests or simply helping firms "put their balance sheet on the casino." Especially troubling, Ortiz said, were the sale of knock-out options, which were marketed as an inexpensive way for companies to hedge against unfavorable currency fluctuations. However, in buying the instruments, firms became exposed to huge losses. Ortiz recently met with other Latin American central bank leaders in Chile, where Ortiz said he saw how similar other



Guillermo Ortiz

File Photo: Mexican Gov't.

countries' experiences were with the shaky financial products. Officials in Brazil say related problems may scar more than 200 firms. Brazilian paper manufacturer **Aracruz** wants banks to renegotiate its contracts with currency derivatives. The Brazilian securities commission is giving companies until November 14 to publicize details about their exposure to derivatives.

Political News

Fourteen Face Charges in Peru Oil Bribery Scandal

A prosecutor in Peru has filed charges against 14 people, including four state oil executives, the CEO of a Norwegian company and nine other defendants in Peru's oil bribery scandal. Prosecutor Oscar Zevallos said a judge is currently considering whether to accept the charges filed

Tuesday, which include corruption, criminal conspiracy and influence trafficking, according to the AP. The scandal has already led to the ouster of President Alan Garcia's chief of cabinet and six other cabinet members. Defendants are accused of participating in a scheme to trade kickbacks for government contracts. Among those charged is Jostein Kjerstad, the CEO of **Discover Petroleum**. If convicted, Kjerstad could face up to eight years in jail. After the scandal broke, Garcia froze five contracts that Discover won in an alliance with the state oil company, **Petroperu**. The chairman of Discover's parent company told a newspaper in Oslo that the charges are fueled by politics and are without merit. The company previously said it had paid legal fees of more than \$63,000 to Romulo Leon, who served in Garcia's administration during his first term in office in the 1980s and early 1990s. Leon allegedly was heard talking about bribes with Alberto Quimper, a government oil official.

Alleged Drug Ring Leader Arrested in Mexico City

An alleged leader of Mexico's Sinaloa drug cartel was arrested earlier this week in a shootout with police in Mexico City, the AP reported. In all, police arrested 16 alleged members of the ring Monday, including Jesus "The King" Zambada, prosecutors said Wednesday. Zambada is the brother of cartel leader Ismael "El Mayo" Zambada, who allegedly heads the drug ring with Joaquin Guzman, according to authorities. Attorney General Eduardo Medina said Jesus Zambada is accused of leading the ring's activities in central Mexico and allegedly moved methamphetamines and cocaine through Mexico City's international airport. Medina called Zambada's arrest "one of the most significant of the government of President [Felipe] Calderon." Medina said investigators also suspect Zambada in connection with the killings of several people who were decapitated and dumped near the airport last year. "He is one of the most important importers of cocaine and methamphetamine to this country from South America," said the director of the Attorney General's organized crime office.

Featured Q&A

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oil sands in Canada. They may not yet be panicking in Caracas, Mexico City and Quito but with price and consumption trends looking increasingly dour, that day may not be too far off."

A Board Comment: Beatrice Rangel: "Falling oil prices are bound to severely affect all producing countries that failed to understand the workings of international commodity markets. Indeed, commodity markets are about the most sensitive to economic cycles booming during expansion and boosting during recessions. Thus oil-producing nations should have saved for the rainy weather just like Chile has done with its copper proceeds. Sadly for Venezuela and Ecuador, the Chilean example was not followed because leaders of both nations were convinced that the scarcity and strategic value of oil sealed the cycles away. To their minds, both China and India would continue their record breaking growth while the United States would do nothing about energy diversification. The ongoing

financial crisis however seems to have shattered such expectations. China and India's growth, while nurtured by domestic market growth, has a high export component. Recession in the United States and Europe does not bode well for Chinese and Indian exports. The United States is slowly but surely reacting to high oil prices by initiating energy diversification and savings. Venezuela and Ecuador thus are now facing dire challenges to maintain growth and political stability. Most proceeds from the oil bonanza have been spent in consumption to the detriment of investments. Consumption levels need to be reigned in if both nations are to avoid a protracted period of stagflation. But reducing consumption means reducing the living standards of the lower income strata. These make up the constituencies of both governments and their reaction to scarcity is unpredictable. In the case of Mexico, political gridlock has hampered reform particularly in the energy sector. Lower oil prices combined with decreasing remittances triggered by the slowdown of the US economy and the

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During his term, Calderon has put more muscle into the fight against drug traffickers. He has used police and federal troops to take back territory from cartels. In January, authorities arrested Alfredo Beltran Leyva, allegedly a top lieutenant of the Sinaloa cartel. Also, Medina said that almost 48,000 members of drug rings have been arrested since Calderon was sworn in nearly two years ago. However, violence connected to the illegal drug trade has surged, with cartel members battling each other and also carrying out attacks against police and civilians.

Company News

Suspected Shining Path Guerrillas Raid US Company's Mining Camp

Dozens of armed invaders, suspected to be members of the Shining Path, raided a US

company's mining camp in Peru earlier this week, according to Reuters. At least 30 rebels attacked the camp of **Doe Run**, marking this month's third similar attack by rebels. The incident happened Monday morning in the region where the St. Louis-based company is searching for minerals in the southern Andes. The rebels stole food, medicine, radios and, according to local news organizations, dynamite. The Shining Path twice attacked army units, leaving 17 people dead. In one of the attacks, members of the guerrilla group detonated a roadside bomb as a line of military vehicles drove past. Peruvian President Alan Garcia has been trying to gain the upper hand against the rebels by deploying soldiers to the country's coca-growing areas. Officials estimate those regions are home to approximately 300 guerrillas. Shining Path members have killed more than 30 soldiers and other authorities since Garcia took office.

Featured Q&A*Continued from page 3*

immigration enforcement policies of the Bush Administration are bound to significantly impact Mexico's rate of growth and potentially social peace."

A Guest Comment: RoseAnne Franco: "A lower oil price environment is compelling these countries to prioritize, maintaining domestic social spending at the forefront and casting foreign commitments aside. For Venezuela, oil revenues account for half of the government budget and the Chavez Administration has declared austerity paramount. Caracas is likely to retrench spending by delaying capital expenditures in recently nationalized segments of the economy and by renege on foreign commitments, such as the construction of a greenfield refinery in Nicaragua. The government will stave off cuts to domestic social spending as long as possible, but Caracas may also opt to tap central bank reserves, which total about \$36 billion and an extra-budgetary development fund (FONDEN), with an estimated \$14 billion yet to be dispersed. In Mexico, hydrocarbon revenues have grown to account for almost 40% of the budget and high oil prices have permitted Mexico to delay deeper fiscal reform. Coupled with declining oil production, the Calderon government will be obliged to reduce state transfers and fuel subsidies will be under increasing pressure. Ecuador has already stated that its foreign debt payments would be the first to be cut; like Venezuela, it seeks to shield its social welfare programs. Should there be any major shortfalls, Quito recently stated it may look to countries such as Venezuela for financing. Given Caracas' priorities, Quito may have to reconsider its contingency plan."

A Guest Comment: Luisa Palacios: "For the time being, Mexico has been the only one to revise its 2009 budget assumptions to account for lower oil prices and lower growth—although the revised assumptions of 1.8 percent growth and \$70 a barrel might still seem

optimistic. But Mexico did not revise expenditures downwards, at least not yet. This is because a rule change taking Pemex capex out of the federal budget is allowing some fiscal flexibility while at the same time allowing the country to comply with its balanced budget rule. Venezuela presented for the first time in years a budget with a more realistic oil price outlook of \$60 a barrel—it generally underestimates oil prices, which allows significant discretionary expenditures throughout the year—but the growth outlook at 6 percent seems unrealistic. While Ecuador has not presented an official budget, the current transitional budget with \$85 a barrel and of 3.5 percent growth is highly optimistic—the authorities have hinted that the oil price assumption will be revised downwards. Both Mexico and Ecuador will experience in 2009 very important electoral contests (presidential, congressional and local elections in Ecuador and midterm congressional elections in Mexico), which make the emerging fiscal constraints a problem for the incumbents. However, a scenario of fewer fiscal resources puts political pressure particularly on Venezuela even if it does not face an electoral contest in 2009 (it will face local elections in November 2008). Social and political demands on the Venezuelan government are likely to increase when for the first time in many years the government will start to experience fiscal constraints."

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