INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR

BOARD OF ADVISORS

Diego Arria
Director,
Columbus Group

Genaro Arriagada
Nonresident Senior Fellow,
Inter-American Dialogue

Joyce Chang
Global Head of Emerging Markets Research, JPMorgan Chase & Co.

W. Bowman Cutter
Former Partner,
E.M. Warburg Pincus

Dirk Donath
Senior Partner,
Aimara Capital LLC

Jane Eddy
Managing Director, Corporate & Govt. Ratings Group,
Standard & Poor's

Marlene Fernández
Corporate Vice President for Government Relations,
Arcos Dorados

Peter Hakim
President Emeritus,
Inter-American Dialogue

Donna Hrinak
President,
Boeing Brazil

Jon Huenemann
Vice President,
U.S. & Int'l Affairs,
Philip Morris Int'l

James R. Jones
Co-chair,
Manatt Jones Global Strategies LLC

Craig A. Kelly
Director, Americas International Gov't Relations,
Exxon Mobil

John Maisto
Director,
U.S. Education Finance Group

Nicolás Mariscal
Chairman,
Grupo Marhnos

Thomas F. McLarty III
President,
McLarty Associates

Carlos Paz-Soldan
Partner,
DTB Associates, LLP

Beatrice Rangel
Director,
AMLA Consulting LLC

José Antonio Ríos
Chief Executive Officer,
Vadium Technology Inc.

Gustavo Roosen
Chairman of the Board,
Envases Venezolanos

Andrés Rozental
President,
Rozental & Asociados and Senior Fellow,
Brookings Institution

Everett Santos
President,
DALEC LLC

Shelly Shetty
Head, Latin America Sovereign Ratings,
Fitch Inc.

FEATURED Q&A

Will Latin America Be Able to Improve its Refining Capability?

Q One of the challenges that Latin American countries must address is the high level of petroleum products they import to meet their needs, the executive secretary of the Latin American Energy Organization, Victorio Oxilia, said recently. Although the region accounts for about 20 percent of the world's oil reserves, it produces a much smaller percentage of petroleum derivatives such as gasoline and diesel. Is this a big challenge for the region? With numerous new refineries and refinery-upgrading projects in the works, will Latin America significantly increase its production of petroleum products and reduce its imports? What has been standing in the way of that goal?

A Francisco Monaldi, visiting professor of energy policy at the Harvard Kennedy School: "Latin America has about 20 percent of the world's oil reserves, 13 percent of the crude oil production, 9.5 percent of the oil consumption and 8 percent of the refining capacity. Consumption growth has been more rapid than refining growth, transforming the region into a net importer of products during the last decade. Investing in refining would be less profitable than investing in upstream, even if all the products were exported. So national oil companies (NOCs), which are typically cash-strapped, even during the recent oil boom, have better uses for their investment budget. Moreover, given that most countries subsidize domestic consumption, refining is often a terrible proposition. As a result, private companies have rarely been attracted to refining, and the ones who have done it generally have not been successful. In the case of NOCs, they still have to shoulder the cost of the domestic market because they are forced to import the products to sell them at a loss. Still, investing to extract more oil keeps being more attractive than building a refinery. In fact, importing products makes the subsidy explicit and might help to make it politically more

Continued on page 3

Cartes Takes Office as Paraguay's President

Horacio Cartes returned the Colorado Party to power Thursday in Paraguay, taking office as the landlocked country's president. In his inaugural speech, the tobacco magnate vowed to fight poverty and improve the country's economy. See story on page 2.

Photo: Paraguayan Government.

Inside This Issue

FEATURED Q&A: Will Latin America Be Able to Improve its Refining Capability? 1

Cartes Takes Office as Paraguay's President 2

Ecuador Abandons Yasuni Conservation Initiative.....2

Brazil May Criminalize Reading Others' Email 2

Nicaragua to Begin Drilling for Oil, Gas Off Caribbean Coast.....2

Workers Return to Chile's Escondida Mine Despite Lack of Agreement.....3

Copyright © 2013, Inter-American Dialogue

NEWS BRIEFS

Brazil May Criminalize Reading Others' Email

Brazil's government is considering a measure that would make it a crime for people to read others' email messages without their consent, the Associated Press reported Thursday. Communications Minister Bernardo Silva said the measure would be part of broader legislation regulating civilian computer use. The legislation comes after revelations that the United States engaged in electronic spying in Brazil and other Latin American countries. Foreign Minister Antonio Patriota voiced concerns about the spying this week to U.S. Secretary of State John Kerry during his visit to Brazil.

Nicaragua to Begin Drilling for Oil, Gas Off Caribbean Coast

Nicaraguan energy minister Emilio Rappaccioli said Thursday that the country will begin drilling for gas and oil off its Caribbean coast this weekend, BBC News reported. **Noble Energy** will drill the first well 168 kilometers offshore in an area that belonged to Colombia until last year. In November, the International Court of Justice made a ruling that extended Nicaragua's maritime boundaries.

Chile's BCI Seeking $400 Million Capital Increase

BCI, the third largest bank in Chile, will ask shareholders to approve a $400 million capital increase according to a statement filed to Chile's regulator by the bank Wednesday, Reuters reported. The capital increase will partly be used to finance the bank's $883 million purchase of **City National Bank of Florida**, which was sold to BCI by Spain's **Bankia** in May and is pending regulatory approval in both the United States and Chile.

Political News

Cartes Takes Office as Paraguay's President

Tobacco magnate Horacio Cartes was sworn in Thursday as president of Paraguay, returning the Colorado Party to power. In his inaugural speech, Cartes vowed to fight poverty in Paraguay, which is among the region's poorest countries.

> "I'm in politics to serve my people, improve the future of new generations and treasure our identity as a free, independent and sovereign people."
>
> *— Horacio Cartes*

"I'm not in politics to make a career of it or become wealthier," said Cartes, BBC News reported. "I'm in politics to serve my people, improve the future of new generations and treasure our identity as a free, independent and sovereign people." Cartes also said he would "put the fatherland first" and "create opportunities for all" in the fight against poverty. Cartes, a political newcomer who had not voted for most of his life, was elected in April with nearly 46 percent of the vote. He defeated Efraín Alegre of the Authentic Radical Liberal Party by nine percentage points. In selecting members of his cabinet, Cartes has chosen technocrats and business people for key positions rather than naming top party members, which has been the tradition of Paraguayan presidents. Cartes' Colorado Party had previously ruled for six decades, including during the 1954-1989 military rule of Gen. Alfredo Stroessner. In 2008, the Colorados were defeated by the leftist coalition of Fernando Lugo. Lugo was removed from office last year in a lightning-fast impeachment, but was elected this year to the country's Senate. Lugo's ouster led to Paraguay's exclusion from the Mercosur trade bloc. The presidents of the Mercosur nations, Argentina, Brazil, Uruguay and Venezuela, have said that Paraguay would be allowed to rejoin the group after Cartes' inauguration. However, Paraguay has said it will refuse to return until Venezuela no longer holds the group's rotating presidency. Venezuela is scheduled to hold the position until July 2014. Paraguay has criticized Venezuela's inclusion in Mercosur and did not invite Venezuelan President Nicolás Maduro to Cartes' swearing-in ceremony. Paraguay's foreign minister, Eladio Loizaga, has said that he wants to focus first on relations with Paraguay's close neighbors. "We have pending issues with Argentina, with Uruguay; we have to resolve all that," said Loizaga. "Mercosur will be later because our priority is bilateral relations."

Economic News

Ecuador Abandons Yasuni Conservation Initiative

Ecuador's government has abandoned a plan in which the Andean nation sought donations from wealthy countries in order to forgo drilling in parts of the Yasuni National Park in the Amazon rain forest, BBC News reported. President Rafael Correa said that rich nations had not given adequate support to the initiative, leaving Ecuador with no choice but to start drilling. "I have signed the executive decree for the liquidation of the Yasuni-ITT trust fund and through it, end the initiative," Correa said in a televised speech. "It was not charity that we sought from the international community, but co-responsibility in the face of climate change." Even with oil exploration, most of the park will remain untouched, with drilling affecting only 1 percent of its area, said Correa. The president had launched the conservation initiative in 2010. The goal was to raise $3.6 billion, half the value of the reserves in

Correa

Photo: Ecuadorean Government.

Copyright © 2013, Inter-American Dialogue

the national park's Ishpingo-Tambococha-Tiputini, or ITT, oil field. However, Correa said Thursday that only $13 million in donations had been raised. "The world has failed us," he said. Environmental groups protested the program's end outside the presidential palace in Quito. The park is also the home of indigenous communities such as the Tagaeri and Taromenane groups. The Yasuni-ITT trust fund has said that the prevention of drilling would keep 400 million metric tons of carbon dioxide from entering the atmosphere. Seventy-eight percent of Ecuadoreans oppose drilling in the park, according to the trust fund. Matt Finer, a scientist at the U.S.-based Center for International Environmental Law, said the program's end was "deeply disappointing," the Associated Press reported. "The Yasuni-ITT Initiative was the lone exception to the relentless expansion of hydrocarbon projects deeper into the most remote tracts of the western Amazon," he told the wire service. "Now there is really no viable alternative to stop the wave of drilling slated for the most biodiverse region of the world."

Company News

Workers Return to Chile's Escondida Mine Despite Lack of Agreement

Workers have returned to work at Chile's Econdida mine after a 24-hour work stoppage, BBC News reported today. The 2,500 workers at the world's largest copper mine, which is controlled by **BHP Billiton**, still have not reached agreement with the company over their demands for better pay, an annual bonus and improved working conditions. Workers will meet again tonight to decide whether to call another strike. "We are in a state of alert," said union leader Marcelo Tapia. The strike, which halted the mine's operations from Wednesday morning to Thursday morning, also shuttered BHP Billiton's Spencer and Cerro Colorado mines. BHP Billiton owns 57.5 percent of the Escondida mine, and **Rio Tinto** owns 30 percent of it. Neither company has commented on the strike.

Featured Q&A

Continued from page 1

compelling to slash it. Therefore, structurally it is hard to develop the refining sector in a region in which it has been hard to develop even the much more attractive upstream. In the long term, it will only happen if countries can credibly commit not to subsidize the domestic market and if access to capital is abundant and cheap."

Roger Tissot, independent energy economist: "Latin America's refining infrastructure was designed to produce massive volumes of products that the region no longer requires and for which the market is not very attractive (fuel oil), while its capacity to produce higher value-added products, such as gasoline and diesel, was limited. That resulted from a strategy based on maximizing the export of crude oil while reducing the costs and challenges of building large, complex refining infrastructures. However, with rapid urbanization and population growth, the domestic demand for automobiles increased rapidly, resulting in more imports of high value-added products. Local refining companies were slow to improve their ability to supply demand. First, most of the refining market is controlled by the state, limiting opportunities for private refineries to compete. Second, countries used costly subsidies that sheltered consumers from international market price volatility but were extremely costly to refineries. Third, national oil companies, playing the role of government cash cows, were unable to secure enough funding to carry out large investment projects. Confronted with massive import bills, most countries in the region have developed expansion plans for their refining infrastructure based on an import substitution argument: costly imports can be substituted by domestic production which will also help industrialization efforts. However, all of these initiatives are promoted by national oil companies responding to government policy goals. Generally, the market has reacted skeptically to the expected benefits for NOCs. Ironically, the region is embarking on these massive expansion plans at the same time as North American refineries are seeking new markets. Their competitiveness is strengthened thanks to an increasing supply of domestic shale oil, a weaker U.S. dollar and the still very low cost of capital. As such, Latin America's new refineries will face stiff competition from North America. Without a doubt, some of the proposed projects will succeed, most likely those from the more efficient NOCs. Others may never be built or, worse, could become white elephants. Instead of engaging only in massive refining expansion plans, governments should rethink their subsidy policies, which are regressive and inefficient. City planners and authorities should also rethink a model centered around the automobile."

> "Latin America's refining infrastructure was designed to produce massive volumes of products that the region no longer requires."
>
> *— Roger Tissot*

Alexis Arthur, energy policy associate at Institute of the Americas: "Across Latin America, the region's refineries have been unable to keep pace with rising demand, particularly in the transport sector, even as many countries' oil production has increased. There are several reasons for this. One is simply insufficient investment in local refining capacity. This is changing, with several projects underway. Interestingly, the Chinese, who have been significant financiers of upstream oil operations in Latin America, have begun investing in the downstream sector. CNPC's investment

Continued on page 4

Copyright © 2013, Inter-American Dialogue

Featured Q&A

Continued from page 3

in the $12 billion Pacific Refinery in Ecuador is just one example, and we are likely to see more in coming years. Another reason for the region's relative decline in refining capacity is tightening regulations, meaning that pre-existing refineries are unable to produce the quality of gasoline or diesel that meets national standards. Finally, we cannot discount the impact of the new, abundant supplies to the north, particularly the United States. Gulf Coast refineries have responded more quickly to the rising demand, with Latin America as their largest overseas market. U.S. petroleum product exports to Mexico, for example, have nearly tripled since 2004, according to the U.S. Energy Information Administration. And early reports indicate that U.S. refineries' exports and profit margins are up this summer. Overall, the United States is likely to remain a significant exporter to the region in the short term. Now if these factors are indicative of a trend toward a more integrated Western Hemisphere market for petroleum products, this is not necessarily a bad thing. And while improvements in refining capacity in Latin America are to be welcomed, it may be some time before we see any significant turnaround."

> "While improvements in refining capacity in Latin America are to be welcomed, it may be some time before we see any significant turnaround."
>
> — ***Alexis Arthur***

Paulo Valois Pires, partner at L.O. Baptista, Schmidt, Valois, Miranda, Ferreira & Agel in Rio de Janeiro: "Brazil has currently 16 refineries, of which 12 belong to Petrobras. Petrobras holds 98 percent of total Brazilian refining capacity, estimated at 2.1 million barrels per day. Brazil is using around 95 percent of its capacity, refining an average of 2 million barrels per day, of which 82.1 percent are produced in Brazil and 18.9 percent imported. In 2012, the cost for the importation of byproducts (mainly diesel, gasoline and liquefied petroleum gas) was approximately $18.2 billion, and the revenues arising from byproduct exports were approximately $10.9 billion. Earlier this year, the government successfully auctioned a great number of exploration blocks; some of them will likely produce oil in five years or so. This means that the gap between exports and imports of byproducts could worsen unless new refinery projects are implemented, such as the "Abreu e Silva" Refinery in the state of Pernambuco. It seems that this is the intention of the Brazilian government: to reduce the gap between byproduct exports and imports. The challenge of new refinery projects is huge due to the government's policy of imposing domestic prices through Petrobras which do not necessarily follow the prices of byproducts worldwide. This may create hurdles for financing such new projects, especially in times of available capacity for refining in other areas of the world."

The Advisor *welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

Latin America Advisor
is published every business day by the Inter-American Dialogue, Copyright © 2013

Erik Brand
General Manager, Publishing
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Megan Cook
Reporter, Assistant Editor
mcook@thedialogue.org

Inter-American Dialogue

Michael Shifter, President

Peter Hakim, President Emeritus

Genaro Arriagada, Nonresident Senior Fellow

Sergio Bitar, Nonresident Senior Fellow

Joan Caivano, Director, Special Projects

Maria Darie, Director, Finance & Administration

Mary Ellen Flather, Senior Director of Strategy and Development

Claudio Loser, Senior Fellow

Nora Lustig, Nonresident Senior Fellow

Margaret Myers, Director, China and Latin America Program

Manuel Orozco, Director, Remittances and Development Program

Tamara Ortega Goodspeed, Senior Associate, Education

Jeffrey Puryear, Vice President, Social Policy

Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at:
1211 Connecticut Avenue NW, Suite 510
Washington, DC 20036
Phone: 202-822-9002 Fax: 202-822-9553
www.thedialogue.org ISSN 2163-7962

Subscription Inquiries are welcomed at freetrial@thedialogue.org

The opinions expressed by the members of the Board of Advisors and by guest commentators do not necessarily represent those of the publisher. The analysis is the sole view of each commentator and does not necessarily represent the views of their respective employers or firms. The information in this report has been obtained from reliable sources, but neither its accuracy and completeness, nor the opinions based thereon, are guaranteed. If you have any questions relating to the contents of this publication, contact the editorial offices of the Inter-American Dialogue. Contents of this report may not be reproduced, stored in a retrieval system, or transmitted without prior written permission from the publisher.