INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ ENERGY

FEATURED Q&A

Should the Bolivian Government Have Ended Fuel Subsidies?

Q On Dec. 26, Bolivian President Evo Morales issued a decree canceling heavy subsidies on gasoline and diesel fuel, citing the heavy preponderance of fuel smuggling across the border, and thus triggered a rise in fuel prices by more than 70 percent. The change was met with widespread protests, riots and a national transport strike. Morales reversed his decision on Dec. 31. Should Morales have ended fuel subsidies in Bolivia? What are the political ramifications for the move and its subsequent reversal? What else can the government do about widespread fuel smuggling? Is the government likely to cut subsidies in the future?

A Iván C. Rebolledo, managing partner of TerraNova Strategic Partners LLC and president of the Bolivian American Chamber of Commerce: "By all means, the government's announcement that it could no longer afford to subsidize fuel prices, which had been frozen for over six years, was the right thing to do. Bolivia's international capital reserves are beginning to dwindle in light of decreased foreign direct investment—especially in the hydrocarbons and mining sectors. It has been reported that more than $350 million of subsidies had illegally benefited those selling fuel to neighboring countries where the price was much higher. Without a doubt, this has been Morales' biggest political setback since his inauguration in 2006 and I believe it can continue to have serious consequences as further economic calamities might rear their ugly heads in the coming months. This cutback on fuel subsidies should have been done very gradually over the past few years and will certainly now need to be done in the not so distant future. The irony of this whole scenario is that those with the lowest incomes, who most likely voted for Morales, would have been the hardest hit

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Chilean Government Reaches Deal to End Gas Protests

Mining and Energy Minister Laurence Golborne negotiated a deal to end protests in Chile's southern Magallanes region, where residents balked at cuts to fuel subsidies that would have raised prices by nearly 17 percent.

File Photo: Chilean Government.

Inside This Issue

ENERGY SECTOR BRIEFS

Petrobras Offering at Least $3 Billion in Bond Issue

Brazil's state-owned oil company, **Petrobras**, is offering at least $3 billion in bonds, which will be offered in a multi-tranche deal, Reuters reported Wednesday. The global bond issue will be made up of bonds maturing in five, 10 and 30 years. **BTG Pactual**, **HSBC**, **Itaú**, **JP Morgan** and **Banco Santander** are managing the bond issue. The senior unsecured notes may be issued as early as this week and are to be used for general corporate needs, Dow Jones reported.

PetroEcuador Names New Head, Refinery Blast Cuts Output

PetroEcuador named a new chief of the state-run oil company on Wednesday, Reuters reported. Marco Calvopina will replace Manuel Zapater, who headed the company for 10 months, in an effort to boost production, which currently stands at 475,000 barrels per day. Meanwhile, the company announced Monday that an electricity outage caused a blast and damaged the Shushufindi refinery, which is now operating at half capacity, Bloomberg News reported.

Chile's Transelec Sells $240 Mn in Bonds, Aims to Invest $1 Bn by 2015

Chile's largest electric-transmission company **Transelec** issued $240 million in five-year and 28-year inflation-indexed bonds, the company announced Wednesday. The company plans to invest $1 billion between 2011 and 2015 to increase capacity, Dow Jones reported Jan. 14, citing Valor Futuro newswire. Transelec is controlled by a Canadian consortium led by **Brookfield Asset Management**.

Oil & Gas News

Brazil's Offshore Deposits Are Double Gov't Estimates: Report

Sub-salt oil deposits off the coast of Brazil hold at least 123 billion barrels of oil, more than doubling the government's estimates, according to a report coauthored by Hernani Chaves, a former **Petrobras** geologist and a professor at the Rio de Janeiro State University, and Cleveland Jones, a professor at the same university. "We started with a skeptical view and finished with bigger numbers," Chaves said in an interview with Bloomberg News published Wednesday. "When we got the first results I said: 'Something is wrong, it's too big.' " Setting out to demonstrate that the government's 50 billion-barrel reserve estimate was too high, the study actually puts a 90 percent probability that the area contains a much higher estimate of 123 billion barrels of proven reserves. The authors also found a 10 percent chance that the region holds 206 billion barrels of oil and natural gas, which would make Brazil the leader in proven reserves in Latin America, surpassing Venezuela. However, the study also estimates that the size of the country's largest field, Libra, holds about 5 billion barrels, in comparison to the government's estimate of 15 billion. Petrobras' proven reserves rose by 7.5 percent in 2010 to 16 billion barrels but the company expects that figure to rise to 35 billion barrels by 2014. Petrobras is investing more than $200 billion to develop the Atlantic Basin's subsalt fields, a costly, technical challenge as engineers tap fields that lie two miles below the surface and an additional two to four miles beneath the ocean floor.

> "We started with a skeptical view and finished with bigger numbers."
>
> *— Hernani Chaves*

Chilean Government Reaches Deal to End Gas Protests

Chile reached an accord on Tuesday to end gas protests that raged for a week in the southern Magallanes region, where residents balked at the proposed hike in natural gas prices by 16.8 percent. The government sent Mining and Energy Minister Laurence Golborne, who was appointed to the energy post in a cabinet reshuffle on Sunday, to negotiate the deal, Reuters reported. The government agreed to scale back the price increase to 3 percent, in line with inflation, and also increased subsidies for the poorest residents of the region. Protests and strikes broke out with the support of local officials the week prior upon news that the government would slash subsidies, leading to the arrest of nearly 200 people and the death of two women when a truck broke through a barricade.

Power Sector News

AEI Sells Energy Companies, Iberdrola Acquires Brazil's Elektro

Spain's biggest power utility, **Iberdrola**, on Thursday announced that it will buy Brazil's **Elektro Eletricidade & Servicos** for 1.77 billion euros ($2.38 billion), Bloomberg News reported. Iberdrola bought the stake from Houston-based **Ashmore Energy International** (AEI), which owns and operates several energy infrastructure businesses in emerging markets. AEI said Wednesday that it has sold its stakes in 10 operating companies, selling 80 percent of its assets, for $4.8 billion in a major restructuring of the company. Also included in the sale are 52 percent of Colombia's **Promigas**, 60 percent

> ***Iberdrola will likely pay for the deal with proceeds from the Spanish government's 22 billion-euro power bond sales program.***

Featured Q&A

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with the ending of fuel subsidies. To combat the fallout from this scenario, Morales announced a 20 percent increase in salary—mostly geared to the police, armed forces and the health and education sectors. This action did little to appease the masses. In the end, he abrogated the original decree with the message that the will of the citizenship was obeyed."

A **Jose Valera, partner at Mayer Brown LLP in Houston:** "The government of Bolivia has budgeted $1 billion for the importation of gasoline and diesel in 2011. Due to the subsidy measures again in effect, the government will resell those products for $500 million in the domestic market and bear the cost of the other $500 million. This huge drain on the treasury is aggravated by the fact that large volumes of these products are smuggled out to neighboring countries with higher fuel prices, something the government says it can do little about. Bolivia has subsidized fuels at least since the early 1990s, but back then the subsidy was paid to local producers who had economic incentives to explore for and produce oil and invest in refining and processing capacity. Now, five years after the industry's nationalization, the government is in the fuel business, has not increased refining capacity and has to subsidize foreign exporters. There has also been a marked decline in oil exploration and production due to the very low prices paid by the government to the few private sector producers that remain, as well as the lack of managerial, technical and financial capacity by state-owned YPFB to carry out such activities itself. The government now realizes that squeezing local producers is not good long-term policy. Since domestic demand for fuels is increasing, the policy choice is between incentivizing the private sector to produce and invest more or keep importing fuels from other countries. It was good politics for a while to squeeze the local producers, but the drain to the treasury has now become all too real. The second policy choice relates to the continuation of subsidies. Two things will happen: local producers will be paid more so that production and investment increase, and subsidies will be cut, albeit at smaller increments over a longer period of time."

A **Maria Velez de Berliner, president of Latin Intelligence Corporation in Alexandria, VA:** "The elimination of subsidies was the right move to bring rationality to the gasoline and diesel market. But it was not an effective political move for Morales who lost the support of his core constituency. Morales learned that dividing and conquering the opposition in Media Luna was less costly than hitting the livelihood of those who put him in power, and who can take him down by the same tactics he used to unseat his predecessor. Despite the policy reversal, the transport sector will still raise prices by about 25 percent, causing continued strikes and road blockages that will adversely affect Bolivia's economy. Despite commitments by oil companies to invest $812 million in 2011, Bolivia will not soon return to being a net exporter of hydrocarbons. As it is, Brazil, its largest customer, is importing the minimum required to fulfill the 'take or pay' clause of its import contract with Bolivia. Given the gasoline and diesel price differentials among Bolivia (low) and Brazil, Chile, Peru and Argentina (all high), the incentive to smuggle will continue if smugglers do not have access to more profitable economic activity. But it is not only price. Smuggling is abetted by the weakness of Bolivia's institutions and its endemic corruption. So far, subsidies are the glue that holds Morales and his base together. Morales' hold on power will be precarious if his base and the industrial establishment in Media Luna, ironically, find common ground in opposing the future lifting of subsidies; the former for economic and the latter for political reasons."

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of Peru's **Calidda** and 50 percent of Chile's **Chilquinta**. **Pampa Energía** will buy AEI's Argentine assets, including a 90 percent stake in **Empresa Distribuidora de Energía Norte** (Eden) and a 77.2 percent stake in **Empresa Distribuidora Eléctrica Regional** (Emdersa). Iberdrola will own 99.68 percent of Elektro, which supplies electricity to São Paolo state. It intends to integrate Elektro with **Neoenergia**, a Brazilian company in which it holds a 39 percent stake. According to Victor Peiro, an analyst at **Caja Madrid Bolsa**, the move improves Iberdrola's "geographical diversification" and it will likely pay for the deal with proceeds from the Spanish government's 22 billion-euro power bond sales program.

Eletronuclear Offered $2 Billion Loan From French Banks

A group of five banks, led by France's **Société Générale**, offered Brazil's state-owned nuclear company, **Eletronuclear**, $2 billion in financing for the country's third nuclear plant, Angra III, Dow Jones reported Tuesday. The offer is subject to approval by Brazil's Senate. In late December, the Brazilian Development Bank (BNDES) approved 6.1 billion reais for the project, which will also receive 890 million reais in financing from state-run utility **Eletrobras**, Eletronuclear's parent company. The 1,400 megawatt Angra III is set to come online in 2015 at a total cost of $5.92 billion. Meanwhile, the president of Eletronuclear, Othon Luiz Pinheiro da Silva, said the company plans to submit a list of 40 sites for the possible construction of new nuclear power generators to the Mines and Energy Ministry by the middle of this year. "Brazil's Northeast region is a strong candidate for a number of sites. The region lacks the kind of water resources necessary for development of hydroelectric power. Other parts of Brazil are better suited to the hydroelectric option," he said. Any site would have to be approved by both the government and

Pinheiro

File Photo: Eletrobras.

Congress. According to Pinheiro, it takes between eight and 10 years to build a nuclear plant and each one would have a generating capacity of approximately 1,000 megawatts at a cost about $3 billion each.

Biofuels News

British Group Partners With Cuba's Zerus on Renewable Energy Project

Havana Energy, a subsidiary of the United Kingdom's **Esencia Group**, agreed to form a joint venture with **Zerus**, a state-owned Cuban company, to build up to five biomass power plants fuelled by bagasse on the island nation, the *Financial Times* reported Sunday. The pilot project, which is expected to cost $50 million, will be built near Havana at Ciro Redondo Sugar Mill and will be followed by four more plants in the second stage of the project. Havana Energy will invest $250 million in the venture, while Zerus will supply land and sugar cane. Havana Energy estimates that seven percent of Cuba's energy needs are currently met by renewable energy sources. However, Nelson Labrada, Cuba's vice-minister of sugar, said "It is possible via the sugar mills and bagasse-based power plants to generate up to 40 percent of the energy needs of the country today." Havana Energy said it has identified 56 sugar refineries that would be suitable for biomass power generation in the country. The construction on the pilot plant will begin this year.

The pilot project, which is expected to cost $50 million, will be built near Havana.

Political News

Haitian Authorities File Charges Against Duvalier

Authorities in Haiti briefly detained and filed charges against former dictator Jean-Claude "Baby Doc" Duvalier on Tuesday, who unexpectedly returned to his homeland Sunday after 25 years in exile. Duvalier, 59, was charged with corruption, theft and abuse of power allegedly committed during his 15-year rule, which ended when he fled the country in 1986 amid a popular revolt, Reuters reported. The former strongman was escorted from the hotel where he had been staying since his arrival in the Haitian capital and taken to a prosecutor's office where authorities questioned Duvalier over allegations that he stole money from the impoverished country's treasury and committed human rights abuses during his rule. "His fate is now in the hands of the investigating judge," said Port-au-Prince Chief Prosecutor Aristidas Auguste. "We have brought charges against him." An investigating judge must now review the charges and decide whether a criminal case against Duvalier should proceed. After being questioned for several hours, Duvalier was released from the prosecutor's office, but was ordered to remain in Haiti. "He doesn't have the right to go anywhere," said the judge, Carves Jean. Duvalier's surprise return to Haiti came during an especially tense time for the country, the poorest in the Western Hemisphere. The country is in the midst of a political crisis after an inconclusive presidential election Nov. 28 and is still grappling with the aftermath of last year's catastrophic earthquake as well as an ongoing cholera epidemic. Human rights groups were pleased by Duvalier's detention, but also urged Haitian authorities to undertake a full investigation of the allegations against Duvalier. While in office as "president for life," Duvalier presided over a paramilitary force that "carried out widespread and systematic human rights violations including torture, arbitrary detentions and enforced disappearances," Amnesty International Special Advisor Javier Zuniga told Reuters. Some abuses committed by the paramilitaries, called the Tonton Macoutes, were "crimes against humanity," said Zuniga. "A cycle of impunity has prevailed for decades in Haiti, with victims of abuses and their families denied justice for way too long—now the opportunity has come for justice, truth and reparations," he added. On Sunday, Duvalier said he returned to the Caribbean nation to show solidarity and participate in the country's "rebirth." Meanwhile, Former Haitian President Jean-Bertrand Aristide, who has been living in exile in South Africa for six years, may join Duvalier for another surprise return to the country, the Associated Press reported. Aristide sent a letter to supporters saying that he is ready to return to Haiti at any time. U.S. State Department spokesman P.J. Crowley wrote in a series of posts that what Haiti "needs is calm, not divisive actions that distract from the task of forming a new government."

Duvalier

Photo: Le Nouvelliste.

García, Piñera Vow Partnership Despite Maritime Dispute

The presidents of Peru and Chile vowed Wednesday in Santiago not to let a dispute over maritime boundaries hurt relations between the two countries, EFE reported. Peru's Alan García during a visit with his Chilean counterpart, Sebastián Piñera, said the pair discussed the lawsuit

"Peru and Chile are going to respect what the courts decide, and they are going to always be respectful of the law and international treaties."

— Sebastián Piñera

over maritime boundaries, which Peru brought against Chile in 2008 before the International Court of Justice in The Hague. García and Piñera said their countries will respect the court's ruling when it is handed down and added the case will not derail the countries' common objectives to promote economic integration in an effort to fight poverty and underdevelopment. "Peru and Chile are going to respect what the courts decide, and they are going to always be respectful of the law and international treaties," said Piñera. García added that "Peru should never fall into the condition of an international pariah," by not accepting a ruling of the ICJ. Piñera stressed that the maritime boundary dispute should be separated from the rest of the countries' bilateral relations. "We're showing a modern, wise attitude of collaborating on what is of mutual interest and leaving at The Hague that which separates us," said Piñera, adding that the two countries "are not only at the best moment of their relations, but have a world of possibilities" before them. Among those possibilities, said Piñera, is bilateral trade, which which reached $3 billion last year. García expressed hope that Peru's next president, who is to be elected in April, will continue working closely with Chile. "I hope that the next Peruvian government will continue along this line of affirmation and discussing at the highest level, directly, all the problems of our relationship," said García.

Obama Administration Cancels 'Virtual' Border Fence

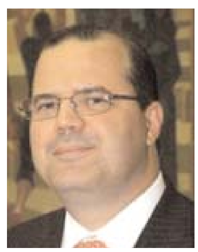
The administration of U.S. President Barack Obama on Jan. 14 canceled the so-called "virtual fence" project along the Mexican border, which had been intended to use video cameras, radar and other types of technology to guard against illegal immigration and smuggling, Reuters reported. The project, run by **Boeing**, had faced problems including cost overruns and missed deadlines. The project had cost $1 billion to cover just 53 miles of the border in Arizona, according to the Department of Homeland Security. Instead, currently available surveillance systems will be used, said Homeland Security Secretary Janet Napolitano.

The project had cost $1 billion to cover just 53 miles of the border in Arizona.

Economic News

Brazil's Central Bank Hikes Key Interest Rate to 11.25 Percent

Brazil's central bank on Wednesday raised its benchmark overnight rate a half point to 11.25 percent, beginning a series of rate increases amid rising concerns about inflation and a strengthening real, Bloomberg News reported. The bank's policy committee, led by new central bank chief Alexandre Tombini, voted unanimously to boost the Selic rate for the first time since July. Expectations for inflation have increased since the bank's Dec. 22 quarterly inflation report due to crop damage caused by heavy rains and rising prices for commodities, Virgilio Castro Cunha, the head of fixed-income strategy at **Bank of America** in São Paulo told Bloomberg News. Inflation grew more last month than economists had expected. The year-end inflation rate stood at 5.91 percent, the fastest calendar-year rate since 2004 when inflation increased 7.6 percent. The central bank's target for inflation is 4.5 percent, plus or minus two percentage points. Policymakers' vote to raise the interest rate amounts to a decision to start "a process of adjustment in the benchmark interest rate whose effects, coupled with macro-prudential measures, will contribute to a convergence of inflation to the target trajectory," the central bank said in a statement.



Tombini

File Photo: Brazilian Central Bank.

POLITICAL & ECONOMIC BRIEFS

Death Toll From Flooding in Brazil Could Approach 1,000

Flooding and mudslides have left 730 people confirmed dead near Rio de Janeiro and authorities disclosed a list of at least 207 that remain missing after a week of relief efforts, Dow Jones reported Wednesday. Though some of the missing may be found in the region's hospitals, many are expected to be found amid the rubble and floodwaters. Flash floods and rains continue to affect southern Brazil and have killed at least one person in São Paulo.

Guatemala Extends State of Siege in Violence-Plagued Province

Guatemala will extend a month-long state of siege that began on Dec. 19 in the province of Alta Verapaz for an extra month, the Associated Press reported. Guatemalan President Álvaro Colom said the efforts have been successful but "more needs to be done" in the area, which was taken over by Mexico's Zetas drug gang in 2008. The siege allows the army to conduct searches and detain people without a warrant, ban gun possession and control local media.

Cuba: Washington's Loosening of Restrictions Insufficient

Cuba's government said Sunday that the Obama administration's decision to lift some travel restrictions and make it easier for Americans to send money to the island nation were "positive" steps, but "well below what was hoped for," the Associated Press reported. The changes, announced Jan. 14, will let any American to send Cubans as much as $2,000 a year. Previously, only relatives could send money. Students and religious leaders will be able to go to Cuba under the plan.

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A Bernardo Prado, director and editor of Hidrocarburos Bolivia: "The government overestimated its popularity and found no other alternative but to reinstate fuel subsidies. However, those six days with the decree in force were sufficient to open the Pandora's Box that this populist government struggled so hard to keep sealed. The political consequences of this misstep are just beginning to pass to the Morales administration, including the president's worst ever decline in popularity (he went from 54 percent to 30 percent), and a completely worn cabinet, to the point where union leaders and indigenous movements are calling for the Energy and Finance ministers' heads. The government mentioned smuggling as justification to cut the subsidies, but I'm not sure that is the main reason. The fact that Bolivia is paying about $27 per barrel of produced oil, a price well below international values, has discouraged foreign investment in exploration and production activities. At these prices, finding and producing oil in Bolivia is not a profitable business. There is where I think the problem lies; since President Morales decreed the nationalization of hydrocarbons in May 2006, the oil industry has entered a state of lethargy. Although it had some shining accomplishments, those were not bright enough to avoid being obscured by the nationalization process. Leaving behind the usual rough speech against foreign investors, President Morales seems to be finally aware that foreign oil companies need better economic conditions to invest and operate in Bolivia. But a better price alone does not solve the problem. No matter how many more dollars you end up receiving for a barrel of oil, without a consistent legal framework and a fair taxation regime, investments in Bolivia will continue to be a chimera. The Bolivian government is now facing the challenge to motivate investors, cut subsidies without affecting the people's pockets and prove the success of the nationalization process."

A Álvaro Ríos, partner-director of Gas Energy Latin America, director of DIInternational for Latin America and former minister of hydrocarbons of Bolivia: "The measure was intended to kill four birds in one shot, but it was too strong on the social and economic side, causing inflation and panic, which is why the government had to regress. First, by raising diesel and gasoline prices, the price at the wellhead for oil to be sold in the internal market could have risen from $27 per barrel to around $50 or $60 per barrel, thus encouraging investment. Second, the government's public spending has been increasing in the past few years and it was an easy way to collect $1 billion annually from Bolivian citizens. Third, it was an easy way to cut fuel smuggling across the borders to neighboring counters, where prices are three to four times higher. Fourth, with increased oil production in five to seven years, the country could produce oil to feed its refineries and not have to import around 25,000 barrels per day with a cost of another $1 billion. It is quite a necessary measure, but too strong for the Bolivian economy and its social structure."

A Carlos Miranda, energy consultant in La Paz and former hydrocarbons superintendent of Bolivia: "Using heavy state subsidies, Bolivian fuel prices have been too long and far behind the market. Populist President Morales was not able to support the political cost of losing popularity by increasing prices to the consumer. Reversing the measures has put the government in the worst of all possible worlds. Subsidies are paid with uncommitted gas income. Facing increase in the demand and market prices, these funds are becoming insufficient. Figuring out how to cut subsidies without increasing prices to the consumer is the government's biggest challenge."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

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