NATIONAL SECURITY AND LATIN AMERICA: CHALLENGES AND OPPORTUNITIES ON ENERGY COOPERATION

HEARING

BEFORE THE

SUBCOMMITTEE ON NATIONAL SECURITY AND FOREIGN AFFAIRS

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MARCH 11, 2008

Serial No. 110–177

Printed for the use of the Committee on Oversight and Government Reform

Available via the World Wide Web: http://www.gpoaccess.gov/congress/index.html
http://www.oversight.house.gov

U.S. GOVERNMENT PRINTING OFFICE

50–229 PDF WASHINGTON : 2009

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NATIONAL SECURITY AND LATIN AMERICA: CHALLENGES AND OPPORTUNITIES ON ENERGY COOPERATION

TUESDAY, MARCH 11, 2008

House of Representatives,
Subcommittee on National Security and Foreign Affairs,
Committee on Oversight and Government Reform,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. John F. Tierney (chairman of the subcommittee) presiding.

Present: Representatives Tierney, Shays, Braley, Welch, Burton, Lynch, and Platts.

Staff present: Dave Turk, staff director; Andy Wright, counsel; Hank Smith and Andrew Howell, interns; Davis Hake, clerk; Nick Palarino, minority senior investigator and policy advisor; Mark Lavin, minority Army fellow; and Todd Greenwood, minority professional staff member.

Mr. Tierney. Good morning. Did you have difficulty getting in, Mr. Farnsworth? We apologize for that, we are glad that you are with us.

A quorum is now present. The Subcommittee on National Security and Foreign Affairs, the hearing entitled, "National Security and Latin America: Challenges and Opportunities on Energy Cooperation," will come to order. I ask consent that only the chairman and ranking member of the subcommittee be allowed to make opening statements, and without objection that is so ordered. And I ask that the hearing be kept open for 5 business days so that all members of the subcommittee be allowed to submit a written statement for the record; again without objection, so ordered.

Good morning and thank all of you for joining us here. Today we are going to conduct oversight of the U.S.' National Security Policy in the Western Hemisphere by exploring energy security issues in Latin America. It is an area that I think we all agree begs more attention, given all that is going on in the world today and understanding how important our neighbors are.

On its way to producing 30 percent of the world's gross domestic product, the United States imports enormous amounts of energy, mostly in the form of oil. One need look no further than our strategic interest and troubling history with oil exporting nations in the Middle East to recognize that "petrol politics" are a critical element of our national security policy.

This nexus between national security and a energy policy is self-evident, yet it has not received a commensurate amount of attention, and integrating these policies is vital to our national security interests.

Two former directors of the CIA, John Deutch and James Schlesinger, have leveled significant criticism of the U.S. approach. In the 2006 report entitled, "National Security Consequences of U.S. Oil Dependency," they concluded: "Over many years and administrations, the U.S. government has failed to pay sufficient attention to energy in its conduct of foreign policy or to adopt a consistent approach to energy issues. The result is that energy matters typically appear on the foreign policy agenda as a surprise, usually in times of crisis, or as the unexpected consequence of other foreign policy actions." Retired military leaders and other prominent businessmen have also called for a more integrative approach to our Nation's energy and foreign policy. In a 2006 report, "Recommendations to the Nation on Reducing U.S. Oil Dependence," the Energy Security Leadership Council summarized by saying: "Put simply, the reliable and affordable supply of energy—'energy security'—is an increasingly prominent feature of the international political landscape and bears on the effectiveness of U.S. foreign policy. At the same time, however, the United States has largely continued to treat 'energy policy' as something that is separate and distinct, substantively and organizationally, from 'foreign policy.' This must change. The United States needs not merely to coordinate but to integrate energy issues with its foreign policy."

The Deutch/Schlesinger Report had a number of recommendations going forward. They noted, for example, that the United States should "increase efficiency of oil and gas use" and "switch from oil-derived products to alternatives." Because of the national security challenges in the Middle East, they also recommend that the U.S. Government should "[e]ncourage supply of oil from sources outside the Persian Gulf."

Latin America's substantial energy reserves supply 28 percent of the U.S. petroleum imports and 95 percent of our natural gas imports. The Middle East, by contrast, currently provides 17 percent of U.S. oil imports.

We have invited a panel of energy and security experts to be with us here today to examine all the issues surrounding energy in Latin America and to ask what challenges exist for U.S. national security and what opportunities can our country take to maximize Western Hemispheric energy supplies, to improve our relations with our Latin American neighbors, and to strengthen our national security.

As noted by the title for this hearing, our energy relationship with Latin America is filled with both challenges and opportunities. Done correctly, I am hopeful that we can turn existing challenges into opportunities and create win/win situations.

Mexico's government, for instance, predicts that it will run out of oil reserves within 8 years. As the second largest supplier of oil for the United States, how will Mexico's potential oil production crisis affect U.S. national security? How will Mexico's diminishing oil reserves affect Mexico itself? Mexico relies on revenues from its oil to fund much of its government's work. What will happen when this revenue dries up, and what can the United States do now to help?

Venezuela, the fourth largest supplier of oil to the United States, is also experiencing diminishing oil production. Political tensions in the region, highlighted by the recent military posturing between Venezuela and Colombia, and the volatile relations between Venezuela and the United States present significant additional challenges. How should the United States approach these sets of challenges?

Looking beyond oil, Latin America holds tremendous potential and opportunities for non-traditional sources of energy. Brazil is already the world's second largest producer of ethanol, trailing only the United States. With oil prices above $100 per barrel, the market for ethanol is growing and many Latin American countries are well positioned to take advantage of this growth by creating their own resource-efficient production.

Many Latin American countries are also ideally positioned to capitalize on the growing demand for solar and wind energy. As we grapple with impending consequences of climate changes, we must ask ourselves how our foreign policy can encourage positive developments in Latin America's nontraditional energy sector.

A foreign policy that carefully considers energy security could help meet the energy demand of the United States, grow the economies of Latin American countries in ways that benefit all the people of those countries, and help stem the flow of greenhouse gases into the atmosphere.

On all of these critical questions, we look forward to hearing from our distinguished panel of experts. Now, I would like to recognize Mr. Shays for his opening remarks.

[The prepared statement of Hon. John F. Tierney follows:]

Subcommittee on National Security and Foreign Affairs hearing entitled,
"National Security and Latin America:
Challenges and Opportunitieson Energy Cooperation"
March 10, 2008
Opening Statement of Chairman John F. Tierney

Good afternoon and thank you all for being here today.

Today, the Subcommittee conducts oversight of U.S. national security policy in the Western Hemisphere by exploring energy security issues in Latin America.

On its way to producing 30 percent of the world's GDP, the United States imports enormous amounts of energy – mostly in the form of oil. One need look no further than our strategic interests and troubling history with oil-exporting nations in the Middle East to recognize that "petrol politics" are a critical element of our national security policy.

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On all these critical questions, I look forward to hearing from our distinguished panel of experts.

Mr. SHAYS. Thank you, Mr. Chairman, for holding today's hearing. The issue of energy in the Western Hemisphere is especially timely in light of the recent events in Colombia and Ecuador. President Bush in his 2006 State of the Union speech stated our problem very clearly: America is addicted to oil. Access to reliable and plentiful energy is directly related to our economic prosperity and to our national security.

The sad reality, however, is that many of the world's leading oil-producing nations are either politically unstable or, in some cases, at serious odds with the United States, or both. We must recognize the role played by the Organization of Petroleum Exporting Countries, referred to as OPEC. OPEC members produce 40 percent of the world's oil and hold 80 percent of proven reserves. OPEC nations are the strategic pivot of world politics and the global economy, and they know it. Two Latin American nations, Venezuela and Ecuador, are members of OPEC.

In recent years, our engagement in Latin America has been constrained by governments which express hostility toward the United States. Some also appear to have ties to terrorist organizations. This presents a tangible threat to our energy supply and our national security. For this reason we should be paying more attention to this critical region, but we cannot talk about hemispheric energy resources without discussing the political challenges facing Latin America.

The United States has two obligations. One, we, the Congress and the administration, must step up efforts to promote conservation and diversification energy sources. Congress must continue to find a commitment to research and investment in alternative fuels.

Two, we must also continue to work with our partners in the hemisphere to ensure political and economic stability as well as respect for the rule of law in each nation.

I thank all of our witnesses for being here today, and I hope we will have the opportunity to hear from administrative witnesses in the future. This would enable us to further determine how the executive branch is addressing the geo-politics of the Western Hemisphere.

Thank you again, Mr, Chairman, for holding this vital hearing, and thank you again, as well, to our witnesses.

[The prepared statement of Hon. Christopher Shays follows:]

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

TOM DAVIS, VIRGINIA
RANKING MINORITY MEMBER

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Representative Christopher Shays
Opening Statement

"National Security and Latin America: Challenges and Opportunities on Energy Cooperation"

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I thank all of our witnesses for being here today and I hope we will have the opportunity to hear from administration witnesses in the future. This would enable us to better determine how the executive branch is addressing the geopolitics of the western hemisphere.

Thank you again Mr. Chairman for holding this vitally important hearing.

Mr. TIERNEY. Thank you, Mr. Shays.

We will now receive testimony from the witnesses that are before us here today. I want to begin by introducing them.

Today we welcome David L. Goldwyn, who is president of Goldwyn International Strategies LLC, an international energy consulting firm. He is a senior fellow in the energy program at the Center for Strategic and International Studies and serves on the Council of Foreign Relations Task Force on Energy Security, and the Council Center for Preventive Action Task Forces on Angola, Venezuela, and Bolivia.

Mr. Goldwyn served as Assistant Secretary of Energy for International Affairs, Counsel to the Secretary of Energy and National Security Deputy for the United Nations Ambassador Bill Richardson. Mr. Goldwyn also served in the office of the Under Secretary for Political Affairs at the State Department under President George H.W. Bush and President Clinton, acting as Chief of Staff from 1993 to 1997.

Mr. Paulo Sotero is the director of the Brazil Institute of the Woodrow Wilson Center, a nonpartisan institute that fosters research, study, discussion and collaboration among a full spectrum of individuals concerned with policy and scholarship in national and world affairs. For the past 17 years Mr. Sotero was the Washington correspondent for Estado de Sao Paulo, a leading Brazilian daily newspaper. Since 2003, he has been an adjunct lecturer at Georgetown University both in the Department of Spanish and Portuguese, and in the Center for Latin American studies of the Edmund A. Walsh School of Foreign Service.

Mr. Sotero is also co-author of a recent article examining how Brazil can use its environmental assets as an element of soft power to assert its role in the world.

Mr. Ray Walser is a Senior Policy Analyst for Latin America at The Heritage Foundation. He is a 27-year veteran Foreign Service Officer with the State Department assigned to Colombia, Costa Rico, Mexico, and Nicaragua. He has also served as the director of the program of Western Hemisphere Area Studies at the Foreign Service Institute from 2005 to 2007. Dr. Walser was also a visiting professor of International Relations in Latin American politics at the U.S. Military Academy at West Point, NY.

Eric Farnsworth is the vice president of the Council of Americas, an international business organization consisting of companies representing a broad spectrum of sectors. Mr. Farnsworth is also on the Advisory Committee on International Economic Policy of the U.S. Department of State and recently co-authored the article Discovering the New World, which addresses how the next U.S. President should approach relations with Latin America.

I want to welcome all of you here this morning. It is the policy of the subcommittee to swear you in before you testify, so I would ask if you would all please rise and raise your right hands.

[Witnesses sworn.]

Mr. TIERNEY. The record will reflect that all answered in the affirmative. Again, I appreciate all of you being here this morning. Your statements are going to be placed in the record without objection, so you need not feel compelled to read the entire statement.

Even Mr. Goldwyn's, who I mentioned earlier was about this big, but it was informative, so it was worth the read on that.

We give 5 minutes for opening statements. You will see 1 minute remaining, the light will come on, then the red light comes on after that. We understand that you might go a bit over. We want you to finish your thought and your sentence or whatever, but please try to keep it as close as you can on that so that all of the witnesses can get their testimony in, and we can have a good dialog back and forth.

Mr. Goldwyn, would you please open with your remarks.

STATEMENTS OF DAVID GOLDWYN, PRESIDENT OF GOLDWYN INTERNATIONAL STRATEGIES, LLC; PAULO SOTERO, DIRECTOR OF THE BRAZIL INSTITUTE, WOODROW WILSON CENTER; RAY WALSER, PH.D., SENIOR POLICY ANALYST FOR LATIN AMERICA, DOUGLAS AND SARAH ALLISON CENTER FOR FOREIGN POLICY STUDIES, THE HERITAGE FOUNDATION; AND ERIC FARNSWORTH, VICE PRESIDENT, COUNCIL OF AMERICAS

STATEMENT OF DAVID GOLDWYN

Mr. GOLDWYN. Thank you, Mr. Tierney. Thanks for your attention to this issue. Thank you for the opportunity to testify. My apologies for the small print. As my colleague helpfully suggested, I was reducing my carbon footprint by using smaller print and fewer pages.

This issue, national security and energy, is extremely important, and in my mind there is no question that today the United States is more energy-insecure than any time since 1975. Our dependence on oil and the dependence of our allies and our friends is a huge strategic vulnerability. It frays coalitions when we try and do things on Sudan, which I know, Mr. Chairman, you have paid attention to, but also on non-proliferation on terrorism. It enriches our adversaries, competitors, and with that enormous oil wealth they can act with impunity toward their own people and also toward their neighbors.

It makes energy markets more fragile because the wealthier countries get, the more they want to sit on their oil rather than produce it, and it makes prices volatile and puts our economies at risk.

We have evidence, as you have suggested, in the hemisphere. Venezuela's wealth has turned it into a competitor, and that is how I would term it, really. They are an ideological competitor, they are a competitor for influence in the region right now, and they have an ability to do enormous things by the debt of their other countries, give oil and products away and compete for political influence in a way that we are not competing with.

Argentina, Bolivia, and Ecuador are good examples of the resource curse, and I think cases where both their countries are still poor and underdeveloped, and they have economic models which are likely to make them less stable, not more.

This challenge is very well studied and understood. You mentioned the Council on Foreign Relations study. I think all the experts agree there is no such thing as energy independence. We cannot drill our way out of this. There is no silver bullet, there is no one solution that is going to get us off dependence on oil. There is nothing we can do for ourselves that is going to help us be more secure unless we do it for our allies and friends as well, and because we consume in the United States 20 million barrels a day. The world consumes 86 million barrels a day, an enormous amount of energy, there is no fix that is going to happen before a couple of decades. It is going to be gradual, it is going to be incremental.

But I think people also agree that we will have to deal with the existing suppliers in the interim and manage our way through, and the time to get started on this problem was yesterday.

So I think that the diagnosis is well established, and the key elements of solution are outlined pretty well, also. Controlling domestic demand is one. Hurrying technological change helping the market is a second one. Integrating energy and foreign policy is a third.

And then competing asymmetrically for political influence using soft power, or whatever the term is, but basically trying to make themselves relevant to other countries in the region by using our influence, our culture and political influence.

But these solutions seem to be politically impossible to accomplish, and I want to talk about four of them really briefly. Demand is the key. Transportation in the United States, oil is for transportation, 75 percent of every barrel. If we do not deal with planes, trains, and automobiles, we do not deal with this problem. And the way this problem gets fixed has been well established in Europe and Asia. They use taxes, and they already have cars that are more efficient than we even aspire to. They have cars that make 40 miles a gallon. We are only hoping for 35 by 2020, and 40 isn't even on the table.

And that is politically acceptable in those countries. CAFE standards that would be way higher than we have now, that would be another way. There are other tradable permits and other economic means, but if we do not find a way to make it necessary or make the price of gasoline so high that alternatives are commercially viable, big money will not come into alternatives; the structure of transportation will not change; and we will not do anything on this problem. All the R&D and technology is wishful thinking and window dressing unless the price of gasoline stays maybe not higher than where it is now, but basically so it cannot go below where it is right now.

So that is really No. 1. Hurrying the technology is important. We have a lot of money in R&D. It is deployment. It is actually seeing whether these technologies can be deployed at a commercial scale.

Now venture capitalists, when we do this, if they think that they can make money on these alternatives for 20 and 30 years, so it goes back to price, but if we do have the right market for it, then government can play an extremely important role in deployment, in trying to accelerate technology.

A third area is just integration of energy and foreign policy. We have suggestions for the wiring diagram in the Council on Foreign Relations study, but it is really a mind-set that needs to change. We need to do a lot of things to look at that, how we make ourselves more secure.

Now, one of the ways we do this is make energy high policy. We should be talking to China, president to president, about the influence of their investment policy on regional stability. We should also be talking to them about efficiency. We should also be talking to them about how they control demand in their own economy, but you cannot do that at the sub-ministerial level and make any progress.

The same thing with Europe. If we are worried about Russian monopoly and Russian dominance of Europe, we need to be talking head of state to head of state to Europe about alternate pipelines, about not being dependent on Russian gas, about efficiency in their system. Lots of other things we ought to focus on.

Conflict resolution. Do you want 600,000 barrels a day? Solve the conflict in the Niger Delta. Where is that on the U.S. policy agenda?

Collective energy security. We built the International Energy Agency, and we did it at 40 percent of the world's—60 percent of the world's consumers. Today it has 40 percent because the Chinese and the Indians are not in. We ought to bring them into our collective system rather than leaving them on the outside.

Promoting reform and transparency—I have testified before Congressman Shays on that issue—is a way of ensuring long-term stability, and we ought to use our economic power. We ought to demand reciprocity from other people who are closing their markets to us while our markets are open to them. Not as a sledge hammer, but we have a free trade agreement or trade promotion authority. We ought to get something back in return.

And the sugar tariff with Brazil is a classic example. If we want to build support in the region, bring Brazil closer, build regional security, promote jobs, create development. Lifting the sugar tariff is not an issue about the corn syrup lobby; lifting the sugar tariff is a strategic move to make ourselves more important in Latin America.

But we do not treat it that way. We do not talk about it that way, and it does not get that kind of prominence. That is the kind of thing that we need to do.

The last thing, and my colleagues will talk about this more than I, is we need to compete asymmetrically. We will not get countries to reverse nationalization nor to give us access to resources by saying we really, really need the oil. The way we do it is, we are better partners; our model is better, and that means we have to talk to them about the issues they care about which are not just drugs and terrorism, particularly, in the hemisphere.

We need to talk to them about development, about martialization of societies, about poverty, because that is what has driven this move for nationalization; and if we can talk to them about their issues and we use tools like trade promotion or free trade agreements, bilateral or regional, but also the kind of development assistance, technical assistance that matters to them, we are more important. We matter to them, we talk to them about things that are important, and they are much more likely to adopt policies that are consistent with ours.

But we treat them, basically, as countries which ought to snap to when we have a policy and, in Iraq or someplace else, and then we kind of ignore them on the other issues, and we give them the Washington consensus. And when it doesn't work out as well as any of us hoped, we are not really back to them with another model which is why Venezuela is mopping the floor with us in that region, because they have a model even though it is a bad one, and we are not competing. So we need to compete that way.

In conclusion, let me just say that I understand these are all hard political issues, but the two things that you all are doing which are really important is speaking the truth to the American people about what it takes to get the problem fixed, and then hold our Government accountable for having policies that do it.

Thank you for your attention.

[The prepared statement of Mr. Goldwyn follows:]

Testimony of David L. Goldwyn before the House Subcommittee on National Security and Foreign Affairs; Committee on Oversight and Government Reform
"National Security and Latin America: Challenges and Opportunities on Energy Cooperation"

March 11, 2008

Energy Security and US Foreign Policy

Mr. Chairman and Members of the Subcommittee, it is an honor to speak with you today about the importance of energy security for national security in Latin America and the world at large. US dependence on oil for transportation, and the dependence of our allies and friends, undergirds nearly every major foreign policy challenge the US faces today. The wealth oil provides our adversaries and competitors, the impunity they enjoy, the growing competition for energy resources by consuming nations, the competition for political influence with producers, and the growing threat to a free market for trade in energy, all undermine the ability of the Unites States to project its foreign policy, to advance our values, to deter terror and proliferation, and protect our economy. For too long the US has failed to integrate its approach to foreign policy and energy security, to the detriment of both interests. By tackling the issues of the role of oil in transportation and the intensity of carbon in energy demand at home, we can be empowered to transform the role of oil in the global economy abroad, and greatly reduce national security threats that range from Iran's ability to sustain a nuclear program, to Russia's ability to dominate its neighbors, to the ability of Venezuela to compete with the US for leadership in the hemisphere. Serious action on energy security is at the core of any viable national security strategy for the United States. I am grateful to the Committee for its attention to the issue.

In the Hemisphere, US influence on markets, democracy and security is declining fast. Most of our longstanding bilateral and multilateral energy dialogues are not functioning. We have no sustained strategic engagement on energy with two of the three key producers: Venezuela and Brazil. With this diplomatic neglect, we have seen overall investment decline, production flatten, and resource nationalism rise in some key producing nations. All of this is evidence that the US needs a fresh approach to energy diplomacy in the hemisphere. The United States will enhance its energy security by engaging the region on issues that concern its people: job creation, poverty alleviation, migration, and trade promotion. An asymmetrical approach, one that addresses a broad range of issues rather than just energy security, may pay dividends equal to or greater than one focused solely on energy. The US must also ensure that it has the flexibility to utilize sub-regional energy dialogues and that any new framework strengthens, rather than weakens the energy diplomacy mission of the Department of Energy. I will discuss the US's growing energy security problem, domestic and international solutions to this problem, current energy trends in the Western hemisphere, their impact on US foreign policy, the status of existing energy security dialogues in the hemisphere, and the utility of a fresh approach.

I. The US's Growing Energy Security Problem

The United States is more energy insecure today than it has been in nearly thirty years. We are insecure because the global oil market is more fragile, more competitive and more volatile than it has been in decades. Global demand for oil is strong, powered by global economic growth, especially in China and developing Asia. Global supply has been constrained, first by underinvestment by international oil companies, then by production restraints by OPEC following the crash of oil prices in 1998, and now due to restrictive economic frameworks in many producing nations and internal instability in others. The consequence of this market is that nominal oil prices are high, oil producers are earning enormous economic rents from these prices, and spare capacity of oil is only around 2 million barrels per day (bbl/d). In an 85 million barrel per day market every marginal producer of oil can command global headlines by threatening actions that could impact global oil prices.[1] Oil remains a strategic commodity primarily for transportation and we have failed to develop substitutes we can shift to. The future looks grimmer than the past. Absent a major change in transportation technology or policy, global oil consumption will nearly double by 2030 and dependence on OPEC supply will grow. The outlook for prices is bullish: so far we are consuming oil faster than we are discovering new supplies.

[1] http://www.eia.doe.gov/emeu/international/oilother.html

As dire as these projections sound, this is not the worst news. The worst news is that the energy dependency of the US, our allies in Europe and developed Asia, and the growing dependence of rising powers such as China and India is rapidly eroding US global power and influence around the world. US power is challenged in five ways.

First, the dependency of consuming nations on oil, or in some cases natural gas supply, or for access to exploration acreage in a producing country, makes them reluctant to join coalitions the US leads to combat weapons proliferation, terrorism or aggression. The most salient examples are long standing French, Russian and Chinese resistance to sanctions on Iran, or before the war, on Iraq; China's resistance to oil sanctions on Sudan; and of course long standing US tolerance of repression in the Middle East that we would have sanctioned in any non oil producing part of the world.

Second, when exporters have very high revenues, with earnings far in excess of that needed to finance their own budgets; they can act with impunity against their own people and also towards the US and their neighbors. It is costly for President Chavez to build support for his competing economic vision by providing subsidized oil and products to his neighbors or purchasing the bonds that finance their debt. It was a luxury for former Russian President Putin to renationalize his energy sector, restrict foreign access to his pipeline system, and see production flatten while demanding open access to Europe. It is costly for Iran to have paid down its international debt and increased its foreign reserves to withstand potential sanctions. None of these governments could finance their internal budgets – or their foreign policy approaches – if oil were $25 or even $50 per barrel. Even Saudi Arabia's economic reform movement, borne in the days of $10 oil in 1998, evaporated when oil reached $30 per barrel in 2000. Enrichment of our competitors or adversaries harms U.S. security interests in every part of the globe.

A third problem is that the restricted access to new oil exploration acreage impedes the ability for supply to respond to higher prices from increased demand. Most of the world's oil reserves (and nearly all of the low cost easy to access reserves) are controlled by governments, most of whom do not allow the free market access to develop and exploit it. The denial of foreign exploration for oil by Saudi Arabia and Kuwait, as well as new restrictions on access to acreage in Russia, limits the ability of high prices to attract new supply. Moreover, as oil prices rise, many governments that have been open to foreign investment (Russia, Venezuela, Bolivia, Argentina, Ecuador) are now far less receptive to foreign investment, curtailing the ability of supply to respond to market signals and driving prices higher. These governments need not use foreign capital to invest in production, they can use their own. But the fact is that other than Saudi Arabia, few in OPEC are making these investments and monopoly control of a strategic commodity impedes a rational market response to growing global demand for oil and poses a serious risk to the global economy.

A fourth and closely related problem is that this "tight" market is undermining the fluidity and fairness of the market for available oil supplies and exploration acreage. New competitors like China and India, are trying to negotiate long term supply contracts (at market prices) to ensure that they have supplies in the event of a crisis or supply disruption. These countries are not cornering significant amounts of oil at this time, but the trend is counter to the market system that operates so efficiently. In addition competition is also fierce because newly developing non-market economies that must import oil (China and India) are using government subsidies to compete with private companies for access to acreage. From an economic point of view it may not matter if China loans Angola $3 billion at low interest to gain part of an exploration block if the oil is produced. But China gains an enormous geopolitical advantage by this act, which neither the U.S. nor international oil companies can compete with. During the past few years, China has demonstrated a willingness to deepen its oil trading relationships with countries whose ties to the United States are strained, such as Iran and Sudan, and previously Iraq, taking advantage of US sanctions policy and leading to fears that Beijing will form oil-for-arms, military-client relationships with nations under boycott by the United States. This has put China into a position of geopolitical rivalry with the United States. As Russia decides whether to build a new oil pipeline to China or to a port close to Japan, it influences the foreign policies of both nations in a way the U.S. cannot compete with.

A fifth issue is that oil dependency makes the US economy vulnerable to the price volatility that results from supply and demand shocks. The source of these price shocks in the global oil market is increasingly from internal disruptions: the Venezuelan strike of 2003, shut in production in the Niger Delta today, the Libyan and Iranian revolutions, insecurity and instability in Iraq. The system of collective energy security established through the International Energy Agency, including our own Strategic Petroleum Reserve, has effectively deterred producers from attempting an oil embargo. But we cannot deter internally generated threats and disruptions, only manage them.

II. The Importance of the Western Hemisphere

Latin America is a strategic region for US foreign policy for many reasons. We are neighbors, trading partners, investment partners and we share deep familial and cultural ties. The hemisphere is democratic, with one notable exception. In the energy sphere, the hemisphere provides the US with a large portion of our diversity of oil and gas supply. For this reason, the failure of the hemisphere to realize its potential for growth is a serious concern for US and global energy security. Latin America is far closer to the US market than the Middle East. While the investment climate in key Latin American countries is deteriorating as state control increases, even in Venezuela access to exploration acreage remains superior to that in the Middle East. Additionally, the non-OPEC producers in this region exert counter-pressure on OPEC's monopoly power.

Mexico and Central and South American nations delivered just over 13% of global oil production in 2006[2], and possess approximately 8.7% of global oil reserves, with 6.1% in Venezuela and .9% in Mexico alone.[3] The region is also a major refining center, with 9.7% of the world's refining capacity. Regional refineries are designed to serve the specialized needs of US markets. The most important exporters, Venezuela and Mexico, consistently rank in the top four sources of US oil supply along with Canada and Saudi Arabia. Venezuela averaged 1.42 million barrels per day (m/bpd) in 2006; Mexico averaged 1.7 m/bpd in that year[4].

III. Energy Trends in the Hemisphere

In Latin America today we see two trend lines. One trend is towards rising state control of energy resources – in Venezuela, Argentina, Bolivia and Ecuador in particular. The concern here is that this trend will limit the growth of global supplies of oil and gas by undermining the value of existing investments, discouraging future investment or barring foreign investment altogether. The economic consequence of these trends is that the hemisphere will contribute less to the diversification of oil supply, thereby increasing the importance of OPEC supply and over time undermining economic development in the region. The political consequences of these trends in the short run are the. decline of US influence in the region to competing ideologies and the erosion of democratic structures.
A second trend is towards creative fiscal regimes that welcome foreign investment and require state owned companies to compete with international companies, with independent regulators that promote fair and efficient regulation. Countries observing this model are increasing production or stalling the decline of existing reserves. Brazil, Colombia, Trinidad and Tobago and Peru are key examples of this creative model.

When we consider that Mexico so far continues to bar foreign investment in its upstream oil and gas sector, and the size of the reserves and production of the countries practicing the resource nationalism model, the net effect is negative. Foreign investment in the oil sector is shifting away from South America to North America, particularly to Canada's oil sands. When we compare 2006 to 2005, only Brazil and Trinidad managed to increase production significantly, while other countries faced decline or very modest gains[5].

A. The Rise in State Control

Venezuela and Mexico are the most important oil exporters in the hemisphere. While Brazil, Colombia, Ecuador, and Argentina are important destinations for foreign investment, and helpfully produce enough oil to meet their own

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[2] EIA World Production of Crude Oil, NGPL, and Other Liquids, and Refinery Processing Gain, Most Recent Annual Estimates, 1980-2006 http://www.eia.doe.gov/emeu/international/oilproduction.html

[3] EIA World Proved1 Reserves of Oil and Natural Gas, Most Recent Estimates. PennWell Corporation, *Oil & Gas Journal*, Vol. 104.47 (December 18, 2006). Oil includes crude oil and condensate. Data for the United States are from the Energy Information Administration, *U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, 2005 Annual Report*, DOE/EIA-0216(2005) (November 2006). Oil & Gas Journal's oil reserve estimate for Canada includes 5.2 billion barrels of conventional crude oil and condensate reserves and 174.0 billion barrels of oil sands reserves.

[4] US Imports by Country of Origin http://tonto.eia.doe.gov/dnav/pet/pet_move_impcus_a2_nus_ep00_im0_mbblpd_a.htm

[5] Brazil increased production by 127 thousand bpd, T&T increased by 9.3 thousand barrels. Mexico decreased by almost 77 thousand bpd and Venezuela decreased by 60.5 thousand bpd. As a region, Mexico, Central America and South America increased production from 2005-2006 by 10.8 thousand bpd.

domestic needs and make some contribution to the global export market, they are not strategic suppliers to the global market at this time. Only Mexico, Brazil and Venezuela produce more than a million barrels per day. Bolivia has enormous gas reserves, but exports mostly to Brazil and modestly to Argentina. Only Trinidad and Tobago is a key supplier to the world gas market.

From those countries now committed to increasing state control, the US faces two key challenges: the loss of production growth and diversity of supply from the region if new economic frameworks are unattractive to foreign investors and, most critically, the loss of US influence from well financed political competition.

The Economic Impact of Rising State Control

The recent wave of changes in contractual terms and dramatic changes in tax regimes in Venezuela, Bolivia, Ecuador and in recent years Argentina, threatens to slow new investment and eventually deepen instability and poverty in these nations as well as destroy shareholder value for the companies invested there. The deterioration in the investment climate for energy in these countries is primarily an economic threat, helping to lock in constrained supply and high prices. We are seeing the revision of economic terms at a time when producers rather than companies hold more market power.

Venezuela passed a hydrocarbons law that mandated a 51% share by the national oil company and a higher royalty rate. Operations, such as those under Operating Service Agreements, which may have stretched the legal interpretation of the law when they were begun, were subject to a strict and adverse legal interpretation when they appeared to be poor earners for the government. Taxes once renounced, like the export tax, have been revived so that the government can earn, in essence, a fixed 33.33% royalty. The impact, according to expert analysts like Deutche Bank and Wood Mackenzie, is a massive flight of investment capital from Venezuela's heavy oil sector to Canada's oil sands, effectively freezing development of the hemisphere's largest oil reserves during one of the greatest oil booms in history. The forced restructuring of Venezuela's heavy oil joint ventures has led to serious commercial disputes. Some have been settled, others are in negotiation or arbitration. The net impact on Venezuela's credit and credibility are quite negative, again with serious negative long term consequences for the global oil market and Venezuela's own economy.

In Bolivia President Evo Morale's May 1, 2006 decree declared that the state would take control of all gas fields. Royalty payments to the Bolivian government at the largest gas fields, including San Alberto and San Antonio, will now increase from 50% to 82%. All producers are obliged to sell at least 51% of their holdings to the Bolivian government, with the value of that share to be assessed by audit and negotiation. The state will take 60% of production from other fields. Bolivia has left itself an open door through which it can compromise or retreat: details of new contracts are to be worked out on a case-by-case basis. But companies were given only six months to renegotiate contracts or be expelled. More respectful negotiations eventually ensued, and some companies signed new contracts. But Bolivia is reportedly now unlikely to meet its contractual commitments for gas supply to its neighbors and its prospects for greatly expanding gas exports is still highly uncertain.

In Ecuador, President Palacios sought to increase windfall revenues from 30% to 50% and to renegotiate production sharing contracts, while still embroiled in disputes over company claims for refunds of value added tax payments denied by the government. Ecuador has now seized and will attempt to operate an oil field developed by Occidental Petroleum. Argentina reversed a successful fiscal regime by imposing export taxes and other restrictions which have returned it to being a net oil importer.

The net effect of these developments is that new investment in these countries is virtually frozen at a time when prices should be driving new exploration and production. It is notable that even China, which is aggressively competing for exploration acreage worldwide, is not a major player in the hemisphere. As of 2006, China held less than 10% of upstream assets in the hemisphere, primarily recent acquisitions of Western assets in Ecuador and Peru, and enjoys no preferential access in Venezuela at this time. No new investment has been made under Venezuela's 1998 Hydrocarbons law. New investment is unthinkable in Bolivia until existing companies can determine the extent of their losses. Ecuador's investors are mulling legal action for expropriation and suspension of existing investments. The future growth potential of the hemisphere is being undermined and the region's economies risk a major contraction if oil prices drop significantly anytime over the next decade.

B. The Market Model

The hemisphere is not monolithic. We have seen remarkable success stories like Brazil, Colombia and Peru, which have created independent regulators and obliged their national energy companies to compete with outside companies for exploration rights. Such progressive cases provide bright spots in the region. Brazil has received enormous, and well deserved credit for the contribution that sugar based ethanol has made to its self sufficiency in oil. But equal credit should go to Brazil for a remarkable change in its terms for welcoming foreign investment, which made Brazil one of the most desirable destinations for exploration. Brazil's aggressive oil production strategy increased domestic oil production by 1 m/bpd over 10 years. In 1995, Brazil produced less than 700 m/bpd. In 2006 they produced close to 2.165 m/bpd. Their jump in domestic production has had as great an impact on reduction in oil imports as anything else.

Competition has also made Petrobras a better company and a fearsome global competitor. Peru is set to become a net gas exporter if plans to build an LNG terminal and production from the Camisea project by 2011 meet expectations. Peru has already agreed to export 500 million cubic feet of natural gas to Mexico when the project comes online. But these market based energy producers are not the dominant economic models in the hemisphere, are not major oil exporters and, with the exception of Brazil, do not operate in the countries with the greatest reserves. Colombia is battling a rapid decline of its reserves and production.

Mexico

Mexico has been a long time reliable supplier, but its upstream oil sector has been closed to foreign investment and it is projected to decline unless this policy changes or unless the Mexican government dramatically increases the amount of PEMEX earnings it can keep for capital investment. In 2004 PEMEX paid the government 60% of its revenues. Mexico has enormous oil potential on its side of the Gulf of Mexico and a change in policy could both change global oil markets and create a formidable source of wealth for development of the country itself. Mexico's new government, following a bitterly contested Presidential election, is poorly equipped politically to address the country's decline as an oil power. There are positive steps under way. PEMEX is significantly increasing its capital spending this year. There is legislation under consideration in Mexico which would allow limited partnership with foreign oil companies in the Gulf of Mexico. Any incremental step which Mexico can take would be helpful to the global oil market.

IV. The Impact of Hemispheric Energy Trends on US Foreign Policy

The most important challenge to the US from these hemispheric energy trends is political, not economic. US influence in the hemisphere is waning in key areas, support for liberalized markets and free trade is declining, and democratic structures are under stress as populist governing models reduce the space for political opposition. The November 2005 Mar De Plata Summit of the Americas could not produce a consensus statement. Military cooperation with nearly ten countries has been suspended for the failure of these neighbors to conform to US orthodoxy on the International Criminal Court. The US could not muster support for its candidate for Secretary General of the Organization of American States.

Much of this decline is self-inflicted. The hemisphere has not been a priority for US foreign policy for many years, other than as target for our counternarcotics policy. Bilateral relations are focused on whether the hemisphere supports US policy in other areas. The image of the US is declining in the hemisphere due to US policies in the Middle East and human rights issues raised by our treatment of detainees from Abu Ghraib to Guantanamo. Non-military aid for development assistance and child survival is declining for budgetary reasons. The US is widely perceived as insensitive to the region's concerns and our influence has been harmed as a result.

The Venezuelan Challenge

For the first time since the fall of the Soviet Union, the US now has an ideological and political competitor for political influence, arising primarily from Venezuela.

High oil prices have enabled President Chavez to maintain very high revenues for his government, allowing increased domestic social spending, high levels of foreign assistance, and modest reinvestment by PDVSA in countries in South America and the Caribbean. President Chavez has a competing vision from that of the United States on a broad range of issues. He opposes the US on trade integration, our liberal (versus his Bolivarian) model of democracy, on Iran and Iraq, and seeks to exclude the US from regional economic energy arrangements in South America and the Caribbean. His economic policy is to raise taxes and royalties on foreign energy investment, demand majority control of projects, and in the non-oil sector to seize land or other underutilized industrial resources for the state.

Venezuela competes with the US in the hemisphere, offering aid for solidarity. Venezuela has capitalized on the different needs of the hemisphere's sub regions by creating PetroCaribe, PetroAndina and Petrosur to foster cooperation and joint investment on a sub regional basis. It has created an alternative trade grouping called ALBA, the Bolivarian Alternative for the Americas – which attempts to force nations to choose between trade agreements with the US and with Venezuela. Venezuela is also identifying places where trade liberalization has a negative impact and stepping in to provide redress. Venezuela purchased debt issues from Argentina and Ecuador, and when the Colombia free trade agreement with the US threatened Bolivia's soybean crop, Venezuela agreed to purchase it.

The jury is still out on whether the Venezuelan economic model is viable if oil drops back to $60, but it is extremely unlikely. It is unclear whether Venezuela's neighbors support the Bolivarian vision and will really allow joint investment, or if they are just accepting President Chavez's assistance. But the political challenge to the US vision for the region is unmistakable –and so far unanswered.

The Venezuelan model has been an issue in every nearly every election in the hemisphere. In Bolivia, the mobilization of long disenfranchised indigenous forces – aided by years of US assistance in party building and election organizing – led to the election of President Evo Morales, who is following the Venezuelan model. In Peru, Alan Garcia defeated Ollanta Humala, a proponent of the Venezuelan model, in a close election. In Mexico, the PAN candidate Felipe Calderon closed a large gap with his PRD opponent Manuel Lopez Obrador when Obrador asserted he would follow the Venezuelan model if he was elected.

Given these mixed results we should be careful not to overstate the salience of the Venezuelan model or to dismiss too quickly the forces that gave rise to it in the first place.

The Roots of the Anti-markets Approach

It is important to understand what is behind the challenge to the US model. We are seeing the rise of state control and forced revision of contracts for two reasons. One is that trade liberalization and increased GDP growth have not led to poverty alleviation or inclusion of excluded minorities in countries like Venezuela, Bolivia, Ecuador and Peru, leading to a rejection of liberalized markets and the Washington consensus in many countries. Another is that growing populations have increased the pressure for governments to raise revenues in economies that are still resource dependent, so governments are appropriating the best available source of cash regardless of the long-term consequences. This latter trend has led to higher taxes and royalties all over the world, including the UK.

The US should protest violations of contracts or expropriations where these takes place and deny benefits such as bilateral trade agreements to countries that do not respect the agreements they have signed. The US suspension of free trade agreement talks with Ecuador is a good example of this. But the market will either tolerate or punish the economic actions of governments that raise tax and royalty rates or other fiscal terms adversely. If companies can make money under the new terms offered by Venezuela or Bolivia, they will pursue these opportunities. If companies cannot profit, they will close their operations, and if countries do not spend their own capital to develop their resources, then production will fall, their revenues will shrink, and the popularity of their programs will shrink with them. This may lead to higher energy prices, but foolish economic policy is not a basis for US government intervention.

The Need for a New Hemispheric Foreign Policy Approach

What the United States lacks is a positive agenda in the hemisphere, one that recognizes the need to improve education and infrastructure, addresses the negative social impacts of trade liberalization, and offers the respect and cooperation of the US to those countries that work with us. This will advance US interests no matter what the price of oil is. We need to address legitimate issues like poverty and advocate how our model can address them. Examples of this are addressing trade barriers to agricultural imports, expanding educational opportunities in the US for future leaders, improving the visa application process, expanding military to military contacts, especially exchanges under the International Military Education and Training Program, dealing with migration issues with Mexico in a spirit of respect and fairness, supporting World Bank and Inter American Development Bank infrastructure programs in the hemisphere, supporting the development of civil society and the capacity of democratic institutions and treating our relations with our hemispheric neighbors as intrinsically important, not as litmus tests of loyalty to the US on Iraq or other issues external to the region itself. In countries where we face ideological competition, like Venezuela and Bolivia, it is crucial that we do not abandon the field. We need to increase our diplomatic engagement and defend our way of thinking.

I believe that Bolivia's 2006 actions marked the nadir of the turn toward repudiation of contracts in the hemisphere in countries other than Venezuela. Countries like Bolivia and Ecuador are too poor and frankly too insignificant to global energy markets to sustain the kind of behavior they are engaging in. Powers like Brazil can communicate this to Bolivia better than the U.S. can. The US should maintain dialogue with Bolivia and give it our best, even if unwelcome, advice and cooperate where we can.

Venezuela is a more complicated case. Venezuela is a competitor, but it is not likely to halt supply to the US as an act of political warfare unless we embargo them first. They have in fact remained reliable suppliers of oil and products, despite the heated rhetoric reported in the media. An act of energy aggression by Venezuela against its neighbors is also unlikely at this time. Any hope Venezuela has for regional leadership would evaporate if they used their oil wealth for acts of military aggression against a neighbor. Withdrawing oil supply from the market will harm their new friends and future markets as well as cut the government's supply of revenue. The US could, would and should use the Strategic Petroleum Reserve to redress the unlikely event of a production halt by Venezuela, or another (equally unlikely) strike by its workers. For now, the Venezuelan challenge to the United States is ideological.

Here too US policy has failed to understand what factors have led to President Chavez's enormous popularity. Venezuelan governments prior to the Chavez government governed poorly, practiced corruption, ignored poverty and excluded minority sectors of its society. The Chavez government came to power determined to return control of energy policy from the national oil company to the government ministry, to reclaim some of the oil rents held by the national oil company for the government's own account, and to change the economic terms of its acreage allocation from those set when oil was $10. This is a policy the US would support in any other country. The government has spent lavishly and allegedly unwisely on social programs, but this is what we pray most African government would do with their own oil wealth. The famous strike of 2002-2003 was a battle between the national oil company and the government and the government won. I cannot imagine the US supporting the PEMEX in a battle against the Mexican Government for control of the PEMEX Board of Directors. The US rhetorical support for the coup that displaced the President for a day was foolish, destructive and devastating to our bilateral relations.

Where Venezuela has gone wrong economically is by changing contract terms with impunity and hostility rather than by negotiation with companies who have been its partners for decades, invested billions in its energy sector, and created the production that now enriches the nation. The manner in which the recent changes have taken place has been short sighted, destructive and unnecessary. Venezuela has changed its interpretation of its own tax laws, but it is provocative and disingenuous to accuse companies of being tax cheats as a consequence. Time will tell whether the attractiveness of Venezuela's tremendous oil and gas reserves overcomes the pain inflicted by the way these changes have been made. Oil companies tend not to be emotional about these issues as long as they are making money.

Where Venezuela has gone wrong politically is by using legal methods to restrict freedom of the press, prosecution to intimidate political opposition, and constitutional assemblies to unbalance formerly balanced institutions like the Supreme Court and national election commission. The regime itself, helped by the failure of a political opposition to mount a campaign describing what it was for, and high oil prices sufficient to fund the government and external programs at the same time, did not appear to need to use either tactic to win large majorities. The recent failure of a referendum which would have extended President Chavez' term demonstrate that the tolerance of the Venezuelan people for the current regime has its limits. These internal governance issues should be the focus of a regional policy, which includes, but is not led by the United States. We should have objective assessments as to whether Venezuela's actions are undermining any other important US security interests. The recent conflict over Colombia's hot pursuit of FARC terrorists into Ecuador is a case in point. By letting the parties bringing a serious conflict to the OAS, and not making this a bilateral issue (despite Venezuela's attempts to do so) the conflict was defused and US interests have a better prospect of being advanced. Venezuela has positioned itself as an ideological competitor to the United States in the hemisphere. We need not and should not treat Venezuela as an enemy; we should, however, try to compete. We should also end our dialogue via the media and resume, at this point or in the next administration, the dialogue between our senior foreign affairs, commerce, energy and cultural officials. We should work with Europe and with hemispheric partners to reinforce a message of respect for democratic institutions.

V. The Status of Current Dialogues and the Need for a Fresh Approach

The US has had a number of bilateral and multilateral energy policy forums in the hemisphere over the years. Some are active, while others have lapsed or are stagnant. These forums are platforms to understand market dynamics, share best practices on energy efficiency and conservation, share understanding on ways to enhance energy production, and exchange views on how a nation's energy policies may be enhanced or reformed to promote the nation's own policy. These policy dialogues are also essential for building the understanding and relationships that are essential for trade promotion and conflict resolution.

The premier multilateral energy forum was the Hemispheric Energy Initiative (HEI), a multilateral meeting of the hemisphere's energy ministers, with many active subgroups, which was co-chaired by the US and Venezuela. The HEI is dormant due to the status of our relationship with Venezuela, leaving us with no effective forum at all. Bilaterally the US had a Principal Coordinators Energy Dialogue with Venezuela as well as a thirty-year technical cooperation agreement with Venezuela. The bilateral Venezuelan dialogues were suspended for political reasons.

The US has a trilateral energy policy dialogue with Canada and Mexico, which has addressed electric power, energy conservation, harmonization of standards and market outlooks. It has taken many forms, but it functions very well.

What remains of engagement is not adequate. A fresh approach, which engages the United States with all the region's producers and consumers, is sorely needed.

A Fresh Approach to the Hemisphere

The United States need to re-engage the hemisphere on issues that matter to its governments and its people.

Trade and Development. Underdevelopment remains the region's greatest economic and political challenge. The US needs to resume a dialogue on development and trade with regional partners that looks with humility on what policies have and have not worked in the past. The potential for hemispheric trade to lift living standards in Latin America and in the US is great. Bilateral trade promotion agreements, and eventually a regional agreement, are the best tools for binding the interests of our countries together and promoting internal policies in the region that will promote growth. The US can help its own energy security needs and support regional agricultural development by lifting the ethanol tariff.

Strategic Energy Dialogues. The US should resume a diplomatic dialogue with hemispheric partners on energy. We may have some of these on paper, but they need to have the diplomatic attention that has been lacking. The lack of a sustained high-level engagement with Brazil is a case in point. We also need a new Hemispheric Energy Cooperation Forum with a strong private sector forum. The US needs to engage producing countries with successful policies, such as Brazil, Colombia and Peru, as well as competitors like Venezuela. We need to engage the consuming countries as well, in the Caribbean and Central America, as well as the Southern Cone, to address policies that favor consumers. One lesson we have learned from the HEI is that different regions of the hemisphere have different needs – some focus on power generation, others on integration of their grids, still others on access to oil and gas. The United States may be able to forge stronger bonds, and frankly compete more effectively on an energy security vision for the region, if we can organize along sub-regional lines, and meet in plenary when the timing is right. I think we have to recognize that while there is a state of conflict among the producing nations, a hemisphere-wide forum will face great challenges in achieving any meaningful consensus.

Bolster Energy Diplomacy. We should also deepen the international energy diplomacy capacity of the Department of Energy. The Department of Energy's relationships with civil servants in ministries across the globe provide a bridge across changes in government here and there. They can talk when the politics of non-energy issues obstruct dialogue among the foreign ministries. It is easier to get Energy Ministers together for regular meetings than Secretaries of State. Their staff should be expanded and serious program budget established to make our cooperation more than rhetorical. It is true that for true reform to be achieved, foreign ministers and heads of government will have to be involved, as this will be the key to integrating energy security into foreign policy. However, there should be flexibility on the bureaucratic leadership to allow the Department of Energy to take the lead in many of the substantive negotiations.

VI. A Strategic US Energy Security Policy

The US cannot address its energy related security challenges in this hemisphere, or any region, solely through a tactical adjustment in regional policies. We are not safe if our allies are still dependent on imports from our adversaries. For this reason any talk of energy independence is misguided and misleading. The United States need a strategic energy policy that addresses the degree to which we and others rely on oil as a transportation fuel, that sets us on a path to reduce the intensity of carbon in our economy, and that uses diplomacy to get us through the 20-30 years it will take make these transformations at an acceptable economic cost. I believe the US must lead at home to lead abroad.

I suggest ten steps to advance the US on this new course.

Lead at Home

1. Limit demand by significantly increasing automobile efficiency

75% of US oil imports go to transportation. We cannot reduce our vulnerability to oil exporters unless we set a course to change the transportation paradigm to one which uses far less oil as a transportation fuel. This will take decades but we need to start now. We cannot predict which path will take us there: hybrid engines, other advanced engines, cellulosic fuels, or plug in hybrids. Ideally the US would price gasoline and jet fuel at its real cost: one that properly reflects the external costs of gasoline use—from pollution all the way to security commitments to petroleum producers. In such a case market forces would produce the most efficient responses. Europe and Japan do this by tax policy and their per capita consumption and the rate of demand growth is far lower than in the United States. Their vehicles already get 35 miles per gallon or more. If this path is not viable for the US, even with price relief for the poor, we are left with second best responses such a fleet standards and fuel mandates. We should not rule out tax policy, however. While largely opposed to an additional gasoline tax over the past few decades, opinion polls indicate that Americans are now changing their minds and that they would be receptive to it if the proceeds were devoted to funding development of alternative technologies.

The recently passed Energy Independence & Security Act makes helpful, but not dramatic progress on fuel efficiency by raising the Corporate Average Fuel Economy (CAFÉ) 40% to 35 miles per gallon by 2020. It will reduce fuel consumption by 1 to 2 million barrels per day, depending on whose statistics you believe. But demand will grow by 2020, as will the number of cars on the road and perhaps the number of miles driven. These gains are important but will not make much of a dent in the magnitude of our oil consumption or our national security vulnerability. Europe already mandates 40 miles per gallon and is soon expected to raise that level to 49 miles per gallon. Japan is set to attain 47 miles per gallon by 2015.[6]

2. Adopt a national technology policy that changes the transportation paradigm, reduces GHG emissions, and breaks the bottleneck existing today in alternative fuels, alternative vehicles, and nuclear energy

The United States invests millions of dollars in energy research and development, and the Energy Independence & Security Act authorizes millions more, but for the most part these funds represent a political potpourri of programs rather than a focused energy strategy. A National Technology Strategy operated and funded without earmarking congressional funds could target the key bottlenecks in critical technologies, such as the high cost of breaking down cellulose to make ethanol, and the storage of hydrogen in vehicles and carbon sequestration. An ideal energy technology program would focus on deployment and commercialization of alternative fuels and engines

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[6] http://www.technologyreview.com/Energy/20067/page1/.

3. Remove bureaucratic hurdles and invest in infrastructure: gas pipelines from Alaska, deep conversion refineries, and a modern flexible power grid

We should make a priority of breaking the political impasse obstructing a new gas pipeline from Alaska to the Continental US. A new gas pipeline would bring plentiful supplies of natural gas from the North Slope to US markets. We should move quickly to modernize and expand our aging electrical grid into a decentralized smart grid with two way metering that can withstand human attacks and acts of God. Smart grids, which can quickly divert power around disruptions, can help us meet the power needs of this high-tech century. The Energy Independence & Security Act establishes a federal policy to deploy the smart grid, requiring the Department of Energy to report to Congress on its deployment and establish a Smart Grid Advisory Committee and Task Force. However, while the act mandates that the Department of Energy reimburse 20% of qualifying Smart Grid investment and allows utilities to recover their Smart Grid investments by raising rates, it does not allocate any substantial additional funding to what will be a major overhaul of the entire U.S. power grid.

4. Modernize our strategic energy defenses

Current US strategic reserve policy does not reflect recent changes in the oil market or new threats to energy supply. When the Strategic Petroleum Reserve (SPR) was created in 1975, refining capacity was abundant, private companies owned large inventories of crude and gasoline, and the United States feared an embargo overseas, not a loss of inventory at home. Three key steps need to be taken to update US strategic reserve policy. First, we should return to the fill target of 90 days worth of oil imports—established when the SPR was created in 1975—as opposed to the current 60 day target, as this is the optimal size for a 21st century strategic reserve. Second, the United States must expand its strategic reserves of crude to include gasoline, jet fuel, diesel and natural gas while redressing the risk of maintaining all US strategic reserve facilities in a centralized location near the Gulf Coast, which is far from major consumption centers like California, Chicago, New York, and Washington. Tax credits should be given to private companies to encourage them to maintain adequate oil inventories as well as a decentralised network of reserves in the US that can withstand a terrorist attack or natural disaster. Third, we need a formal process to use the reserve. As no relief was given during the Venezuelan oil strike of 2002 and barely any after Hurricane Katrina in 2005, the market must be reassured that strategic reserves will be readily accessible when needed. The Secretary of Energy must be empowered to recommend SPR decisions directly to the President through a coordinated and transparent process unhindered by political or bureaucratic resistance.[7]

5. Get serious about climate change and promote energy conservation and efficiency across the board

The only way that alternative technologies can compete with hydrocarbon based technologies on a commercial scale is if there is a cap on carbon that drives the price to $25 o $30 per ton in today's money. This is the only way that investors will put commercial scale money into commercial scale projects. Companies need to know that there is a long term floor price for carbon that will enable them to make money from changing technologies. Everything follows from this: investment in more efficient cars, carbon sequestration, and efficient buildings and appliances.

There is much government can do – from providing a legal and regulatory framework for carbon to building codes, appliance standards, combined heat and power systems, weatherization systems, and the federal Emergency Management Program. With rising oil prices, many energy saving programs have already become promising private sector initiatives that could be expanded even more through public funding. Indeed, the Energy Independence & Security Act creates new efficiency standards for residential and commercial appliances and lighting. The Act also includes a mandate requiring federal buildings to reduce their overall 2005 energy levels 30% by 2015. It requires a 55% reduction (from 2003 levels) in the construction and reconstruction of federal buildings by 2010, and a 100% reduction by 2030. However, the Act does not include a parallel mandate for commercial and residential buildings, which offer the biggest opportunity for energy and carbon emission savings. The Act encourages the increased efficiency of these buildings through DOE funded programs; however, a mandate did not survive the political process.

Lead Abroad

If the United State leads at home, we will have the political credibility to lead change abroad. But we must also accept that we will be dependent on hydrocarbons for the next two or three decades. In the interim we need to

[7] David Goldwyn and Michelle Billig, "Building Strategic Reserves," *Energy and Security*, chapter 21.

maintain security and stability of supply, and engage oil producing and consuming nations, both to advance our security interests and to build a coalition for change.

1. Promote stability and conflict resolution in key producers: the Middle East, Africa and Latin America
The US needs to promote the domestic and regional security and stability of its key suppliers through its foreign policy, as they directly affect America's energy and national security. It is therefore in the US's best interest to help—in tandem with our allies and partners—resolve regional conflicts and to strengthen the capacity of our suppliers to counter terrorist or military threats. Addressing conflict in the Niger Delta could restore 600,000 barrels per day of oil production. A credible Middle East peace process could reduce the fear premium on oil by $10. A secure Iraq, with a viable oil sharing law could add 2-3 million barrels per day of oil production to global supplies.

2. Modernize our collective energy security system
The US should create a broad energy security alliance for developing Asia in tandem with other regional powers. This alliance would resemble prior cooperation on nuclear technology with Japan by helping to solidify our alliances and secure stability in Asia with a broad program ranging from energy cooperation to nuclear proliferation.[8] We should modernize collective energy security to reflect our growing interdependence by opening access to strategic reserves and the International Energy Agency's coordinated Emergency Response System to emerging power consumers outside the IEA like China and India. We should also include countries like Thailand, Singapore, and Indonesia in such a system in order to build an even stronger collective energy security system with consuming nations who will have common interest with us. By including countries like China and India as partners with a shared safety net, we can try to avoid allowing their energy insecurity to turn them into adversaries in the world energy market We can also achieve security cooperation by collaborating on automotive and power technology projects and jointly pursuing gas, coal, and future energy alternatives.

3. Promote reform and transparency
To ensure the long term stability of oil producers, and to avoid the conflict borne of abuse of oil wealth, ensuring the security of domestic governance should also be a higher priority of US foreign policy. We must elevate the priority of anticorruption and transparency in our foreign policy, through programs such as the Extractive Industries Transparency Initiative, to promote long term energy security.

A new foreign policy strategy should prioritize candid and respectful engagement with energy producing countries on their internal policies as well. US leaders and policymakers should no longer fear publicizing their concerns about our suppliers, as this candidness will not "jeopardize the relationship." On the contrary, the relative silence of the United States and other countries on Africa's kleptocracy, Russia's recent backpedaling on the rule of law, and political repression in the Middle East undermines reformers in those countries and foments resentment. The US doesn't need to impose reforms in an arrogant and unilateralist fashion, but it should work together with its partners and internal reformers to achieve transparency, economic opportunity, and rule-based societies in energy producing countries. It is unlikely that any state in this globalized market will cease to export gas or oil to punish the United States and its partners.

4. Promote a free market in energy and wield the "monopsony wedge"
The US market is one of the freest in the world; however, the majority of the most resource rich countries in the world significantly limit foreign investment in their energy markets. During its next round of talks, the World Trade Organization should prioritize rules of open access and fair competition in the energy sector. The US and EU have the obligation to enforce fair competition where they can, and they should offer the carrot of preferential access to their own energy reserves and markets to those countries that allow free market access. If these steps fail, the "monopsony wedge" stick should be considered, to deny unlimited access to energy market to those countries that deny consuming countries access to theirs. However, this option may be more effective as a threat than a course of action.[9] We can also promote efficient use of energy abroad by encouraging reductions in energy subsidies abroad and by promoting the use of energy saving technologies in the developing world.

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[8] John Ryan, "APEC's Regional Approach to Energy Security," *Energy and Security*, chapter 9.
[9] "OPEC in Confrontation with Globalization," *Energy and Security*, chapter 3.

5. Use energy as a tool of soft power

As a nation, America is more powerful militarily and economically than at any time in its history. However, its "soft power"—the degree to which other nations emulate its values, seek its alliance, and respect rather than fear it—has hit a low point. New powers like China and India are emerging, and they may endeavor to counter the enormous military strength of the United States. The US has boosted its national power and prestige in the past by using its power to rebuild nations, educate populations, and feed the hungry. As nearly a third of the world is without access to electricity, we and our partners could make huge developmental inroads through a global electrification program. High oil prices are especially taxing on developing countries reliant on the global energy market for fuel. US efforts to improve efficiency could have a positive impact on development. We should expand the US Agency for International Development's (USAID) Energy Partnership Program because it has a proven record of bringing US best practices to utilities and government agencies in developing countries. We should use the World Bank and regional development banks to ensure that developing nations modernize and evolve into future economic allies, not foes. The United States does not have much leverage over most of the critical energy supplying countries, and so it needs to use the tools that it does have to promote energy security policies: a major stake in the World Bank and the International Monetary Fund; and membership in the Group of Eight (G-8), the OECD, APEC, and the United Nations. The US should work with its allies to use debt relief and trade and infrastructure financing as incentives to promote better governance.

Conclusion

Mr. Chairman as you can see from this lengthy analysis, there is much to be done to address America's energy insecurity. It will require new approaches to energy and foreign policy. It will require fresh policy approaches, money, and creative diplomacy. But more than anything it will require leadership. As a citizen I thank the committee for its leadership on this critical issue.

Mr. TIERNEY. Thank you very much.
Mr. Sotero.

STATEMENT OF PAULO SOTERO

Mr. SOTERO. Thank you, Mr. Chairman. I am grateful for the invitation, and I bring you greetings from the President of the Wilson Center, former Congressman Lee Hamilton from Indiana. We are grateful for the support the U.S. Congress provides for the work we do at the Wilson Center.

Relations between the United States and Brazil reached a new level of maturity in the last two decades thanks to two historic developments: on the one hand the consolidation of democracy and economic stability in Brazil; on the other hand the end of the cold war which freed Washington to rethink its policies toward the neighbors in the Americas. That is the important context in which Brazil should be viewed by the U.S. policymakers interested in the challenges and opportunities for energy cooperation in the Americas.

Over the last three decades, Brazil has established itself as a leader in the sustainable production of ethanol. This renewable fuel has replaced close to half of the national consumption of gasoline for light vehicles in the country and is a key component of the national energy matrix which is not only the cleanest in the world but also put Brazil on the verge of obtaining energy self-sufficiency.

As the graph shows, close to half of all energy used in Brazil are 44 percent comes from clean and renewable sources. It compares to 13 percent in the rest of the world, and 6 percent in the OACD countries. Huge offshore oil and gas reserves found recently along the southern coast of Brazil will ensure self-sufficiency in approximately 5 years. When fully developed, which should happen in approximately 10 years, the new reserves will make Brazil both a major global oil exporter and Latin America's leading producer, supplanting both Venezuela and Mexico.

The potential geo-political implications of Brazil's success in the energy field should not be lost to those who believe that the Americas should be and can be a space of peace, democracy, stability, and economic and social progress.

I would like to focus on renewable energy. This is the topic that led Presidents Luiz Inacio Lula da Silva and George W. Bush to make clear their understanding that Brazil and United States stand at a moment of promise and can work together to advance their own national/international interests. One year ago, during a visit to Sao Paulo by President Bush, the two leaders launched a joint initiative to promote research and development of biofuels in the Americas.

Since the mid-1970's, the Brazilian sugar cane industry experienced massive investments in science and technology both from private and public sectors. Today sugar cane is the basic input, not only for sugar but also for a diverse range of value-added products, particularly ethanol for cars.

Just last month ethanol consumption exceeded the use of gasoline. More than 85 percent of all new cars sold in Brazil, many of them built by American companies, are flex fuel. Their tanks can be fueled with either ethanol, gasoline, or any mixture of the two in the country's 33,000-plus service stations. Sugar cane is by far the most successful and efficient feed stock for the production of biofuels.

Several international studies conducted by respected institutions, including many of the U.S. Government, have independently corroborated the environmental and economic benefits of Brazilian sugar cane ethanol. These benefits remain unmatched by any other type of biofuels produced on a commercial scale.

The energy balance of Brazilian ethanol is four and a half times better than that of ethanol produced from wheat or sugar beet, and almost seven time better than corn ethanol. As a result, Brazil ethanol achieves a reduction of greenhouse gas emissions of up to 90 percent compared to gasoline today. Ethanol for sugar cane also offers high productivity, higher productivity than other alternatives.

New varieties of sugar cane developed for Brazil and improved processing techniques will double yields. The result is that without any increase in and use, these technological improvement can double the production of sugar cane in Brazil. Sugar cane currently occupies only 2.3 percent of Brazil's total arable land. Half of that is dedicated to the production of ethanol. This means that with about just 1 percent of the country's arable land, Brazil had replaced nearly half of our gasoline consumption.

Harvesting of sugar cane is being fast mechanized. Labor conditions for seasonal workers involved in manual harvesting have improved markedly, but, as demonstrated by a recent finding by Federal inspectors of violations of labor conditions in one operation in Sao Paulo, enforcement remains key.

Nearly 85 percent of all the sugar cane grown is harvested in the Southern Central region of Brazil. The remaining production comes from the Northeast. Both regions are well over 1,000 miles from the Amazon rain forest. The future expansion of sugar cane production will occur in South Central Brazil, particularly in the degraded pastures, further improving our efforts to reduce greenhouse emissions.

The process of ethanol production has the added advantage compared with other biofuels of being a net source of electric power. Bioelectricity is reduced by burning sugar cane byproducts: bagasse and straw in steam boilers. The power generated from this process not only makes our processing mills 100 percent self-sufficient but they also sell surplus electricity into the national electricity grid.

It is estimated that generation capability could rise to an average of as much as 15,000 megawatts by 2020, enough electricity to supply 15 percent of the country's electricity needs or the equivalent of electricity consumption in today's Sweden or the Netherlands.

It is for these reasons that Brazilians have become promoters of ethanol for themselves and for the rest of the world. Sugar cane ethanol is far superior than ethanol made from other feed stocks in terms of energy balance, environmental efficiency, productivity, and cost effectiveness. Its production should be expanded and international trade encouraged. There is ample room for expansion of production and trade beyond Brazil. Maybe more than 100 countries have the conditions to do this, to be engaged.

Sugar cane has all the prerequisites to become a global commodity. This will not happen, however, until developed countries, starting with United States, abandon the perverse logic now in place which raises barrier for the trading of biofuels and allow fossil fuels-based products to move freely around the globe unimpeded by trade or any other barriers.

Thank you very much.

[The prepared statement of Mr. Sotero follows:]

House of Representatives Committee on Oversight and Government Reform Subcommittee on National Security and Foreign Affairs

The Honorable John F. Tierney, Chairman

Public hearing on National Security and Latin America: Challenges and Opportunities on Energy Cooperation

March 11, 2008 - Room 2154 of the Rayburn House Office Building

Testimony given by Paulo Sotero
Director of the Brazil Institute, Woodrow Wilson International Cenetr for Scholars

Mr. Chairman, I am grateful for your invitation to appear before the House of Representatives Subcommittee on National Security and Foreign Affairs to share my views on the important topic of this hearing. I bring greetings to you and to the members of the subcommittee from the president of the Wilson Center, former Congressman Lee H. Hamilton, from Indiana. We are grateful for the support the US Congress provides for the work we do at the Wilson Center. The Brazil Institute, which I direct, is supported by private funds and foundation grants. The Institute receives no direct federal funding. The Institute is part of the Woodrow Wilson Center, which receives today roughly a third of its funding through a federal appropriation. I would like to clarify, however, that I appear here today on my own behalf, as an observer and analyst of Brazil-US relations. I ask your permission to summarize my written testimony, which I would like to have included on the record of this session.

Relations between the United States and Brazil reached a new level of maturity in the last two decades thanks to two historic developments: on the one hand, the consolidation of democracy and economic stability in Brazil; on the other, the end of the Cold War, which freed Washington to rethink its policies towards its neighbors in the Americas.

That is the important context in which Brazil should be viewed by U.S. policymakers interested in the challenges of and opportunities for energy cooperation in the Americas. Over the last three decades, Brazil has established itself as a leader in the sustainable production of ethanol. This renewable fuel has replaced close to half of the national consumption of gasoline for light vehicles in the country and is a key component of the national energy matrix—which is not only the cleanest in the world, but also has put Brazil on the verge of attaining energy self-sufficiency.

Recent, huge offshore oil and gas reserve discoveries along the southern coast of Brazil will ensure self-sufficiency in approximately five years . When fully developed, which should happen in approximately 10 years, the new reserves will make Brazil both a major global oil exporter and Latin America's leading producer—supplanting both Venezuela and Mexico. Brazil's Petrobrás explores and produces oil in 25 countries, including in the United States. The potential geopolitical implications of Brazil's success in the energy field should not be lost by those who believe that the Americas should be and can be a space of peace, democracy, justice, stability and economic and social progress.

Allow me, Mr. Chairman, to focus first on renewable energy. This is the topic that led presidents Luiz Inácio Lula da Silva and George W. Bush to make clear their understanding that Brazil and United States stand at a moment of promise and can work together to advance their own national and international interests. One year ago, during a visit by President Bush to São Paulo, the two governments launched a joint initiative to promote research and development of biofuels in the Americas. Last week, officials and representatives of the industry on both countries had a meeting in Washington to take stock of the progress made so far and map out the next steps.

The U.S.-Brazil biofuels initiative has three main objectives: to create an international standard for biofuels, working bilaterally and multilaterally; bringing the economic and the energy security-related benefits of biofuel production to the hemisphere; and coordinating and advancing technical cooperation and promoting R&D.

Last week in Washington, the International Biofuels Forum (U.S., Brazil, EU, China, India, South Africa) held its third meeting. The bilateral initiative made most of its progress in this area. The issues remaining for creating an ethanol standard (water content) are not between the US and Brazil, but rather between Brazil and Europe. The second part of the initiative—to bring the benefits of biofuels to our hemispheric neighbors—centers on the joint Brazil-U.S. biofuel programs aimed at promoting biofuel production in Dominican Republic, El Salvador, Haiti, and St. Kitts & Nevis. Feasibility studies are under way, and we should work to expand the number of countries included in these programs. The third area is technical cooperation and R&D. A Brazilian delegation visited the largest U.S. labs in mid-September. Brazilian government will host a U.S. delegation soon. Following these visits, a joint work plan will be developed and implemented. The Brazilian sugar and Ethanol trade association, Unica, proposed last week that governments and private sector of both countries should work together in a joint managing committee to organize the possibilities of cooperation.

In the last three decades, the Brazilian sugarcane industry experienced massive investments in science and technology, both from the private and public sectors. Today, sugarcane is the basic input not only for sugar but also for an incredibly diverse range of value-added products, particularly ethanol to power our cars and break our society's dependence on fossil fuels. Much of the following information I reference in my testimony comes from industry leaders in the private sector, which is the dominant actor in Brazil's biofuels production.

According to Marcos S. Jank, the president and CEO of Unica, "sugarcane is set for another quantum leap, this time to offer the world a dual source of clean, renewable energy. Beyond sugar and ethanol, sugarcane is now providing electricity, at a time when it is urgently needed to power Brazil's economic growth."

Just last month, ethanol consumption in Brazil exceeded the use of gasoline. Ethanol production and use make a significant contribution to reduce greenhouse gas emissions and fight global warming.

Without question, sugarcane is by far the most successful and efficient feedstock for the production of biofuels. Several international studies conducted by respected institutions - including many in the United States government - have independently corroborated the environmental and economic benefits of Brazilian sugarcane ethanol. These benefits remain unmatched by any other type of biofuels produced on a commercial scale.

The energy balance of Brazilian ethanol is 4-and-a-half times better than that of ethanol produced from wheat or sugar beet, and almost seven times better than corn ethanol. As a result, Brazilian ethanol achieves a reduction in greenhouse gas emissions of up to 90% compared to gasoline today.

Ethanol from sugarcane also offers higher productivity than other alternatives. Brazil already produces 7,000 liters of ethanol per hectare (or, about 750 gallons per acre) on average. New varieties of sugarcane developed for Brazil and improved processing techniques will double yields. The result is that without any increases in land use, these technological improvements can double the production of sugarcane in Brazil.

Sugarcane currently occupies only 2.3% of Brazil's total arable land. Half of that is dedicated to the production of ethanol. This means that with about just above 1% of the country's arable land, Brazil has replaced nearly half of our gasoline consumption.

As you know, the Brazilian territory is larger than continental United States. Nearly 85% of all the sugarcane grown is harvested in the south-central region; the remaining production comes from the northeastern coast. Both production areas are well over 1,000 miles from the Amazon rainforest. Future expansion of sugarcane production will occur in south-central Brazil, particularly on degraded pastures, further improving our efforts to reduce greenhouse gas emissions.

In a world faced with the challenge of climate change, sugarcane ethanol is a particularly attractive renewable source of energy. It is not only economically profitable, but it is also environmentally sound. Because of efficiency gains, the current price of ethanol in Brazil is just 30% of what it was three decades ago, when the country decided on its large-scale use. Today, Brazilian ethanol is competitive with gasoline when the price of oil is at $40 dollars a barrel or higher, making it viable without any government subsidies.

The process of ethanol production has the added advantage, compared with other biofuels, of being a net source of electric power. Bioelectricity is produced by burning sugarcane's byproduct: bagasse and straw, in steam boilers. The power generated from this process not only makes our processing mills 100% self-sufficient but they also sell surplus electricity into the national electricity grid.

Until recently, about two-thirds of the sugarcane's energy potential, contained in the bagasse and straw, went un-harnessed. But this is changing dramatically. Sugar and ethanol plants in Brazil already have the potential to generate an average of 1,800 megawatts in surplus electricity, which is equivalent to 3% of Brazil's overall needs today. With increased use of biomass from sugarcane and the use of high efficiency boilers, it is estimated that generation capacity could rise to an average of as much as 15,000 megawatts by 2020. That is enough electricity to supply 15% of the country's electricity needs, or the equivalent of electricity consumption in Sweden or the Netherlands.

It is for the reasons listed above that Brazilians have become promoters of ethanol- for themselves and the rest of the world. Sugarcane ethanol is far superior than ethanol made from other feedstock in terms of energy balance, environmental efficiency, productivity and cost-effectiveness. Its production should be expanded, and its international trade encouraged. There is ample room for such expansion and trade beyond Brazil.

More than one hundred countries - including the United States - grow sugarcane around the world, most of them emerging nations in tropical and sub-tropical regions. Switching from gasoline to sugarcane ethanol would increase their energy independence and provide energy security for countries that import ethanol because the number of suppliers would not only substantially increase in quantity, but also diversity.

In this scenario, one hundred developing countries could supply biofuels to the world, instead of the twenty oil producing countries that do so now, most of them located in volatile regions. Sugarcane can make a significant contribution to development by turning many of these countries into producers and exporters of ethanol. The potential positive geopolitical implications of such effort should be obvious. In a recent visit to Nicaragua, the Brazilian president heard from his Nicaraguan counterpart, Daniel Ortega, that he would like to see his country more reliant on sugarcane ethanol and less dependent on oil, which today comes mostly from Venezuela.

Sugarcane ethanol has all the prerequisites to become a global commodity. This will not happen, however, until developed countries, starting with the United States, abandon the perverse logic now in place, which raises barriers to the free trade of biofuels and allows fossil fuels-based products to move freely around the globe, unimpeded by trade or any other barriers. If we are serious about climate change and energy security, we should end this distortion.

Brazil's successful experience shows that sugarcane ethanol can be produced efficiently and sustainably in developing countries, without causing market disruptions or affecting the supply of food or prices. In fact, sugar prices decreased by almost 20% last year while Brazil substantially increased its ethanol production. Brazil's successful experience shows ethanol is a part of an integrated agri-food system which generates competitive food, feed, fibers and bioenergy.

The development of a cost-effective bioenergy sector in emerging countries can make a very positive contribution to development by reducing the oil import bill in these countries, while supplying electricity to rural areas not yet connected to national grids, providing new jobs and export opportunities and fostering the efficient use of ecosystems.

In spite of its very positive environmental, energy and economic records, sugarcane ethanol still faces varying degrees of criticism, particularly regarding the potential loss of carbon stocks that could result from land use changes. The industry recognizes that this is a legitimate concern. As Marcos S. Jank, the president of Unica, said last week in a conference in Washington "biofuels would be of no interest if their production released more carbon in the atmosphere than the CO2 emissions they avoid by replacing fossil fuels."

Mr Jank added that "if reducing greenhouse gas emissions is to be our goal, then no production of any feedstock, for biofuels or any other use, should take place in areas where carbon stocks are substantial. However, before banning the use in specific areas, sound scientific studies should measure the quantity of carbon that is stocked in each of the current and potential production areas."

It is on the basis of such studies that we will be able to establish the carbon balance that would result if these areas were used for the production of feedstock. Comprehensive calculations do not currently exist, so it cannot be taken for granted that land conversion will in fact create a "carbon debt" or that agricultural expansion will necessarily take place in sensitive areas.

One issue raised about the potential negative impact of sugarcane ethanol production is its indirect impact on the Amazon in particular, and on land use in Brazil in general. Outside of the Amazon region, Brazil has 200 million hectares (or, 500 million acres) of under-utilized pasture land, much of it degraded. Recent scientific, independent research showed that the use of degraded pastures for sugarcane production in Brazil generates a "carbon credit," because sugarcane captures larger amounts of carbon than the quantities of carbon that are stocked in these degraded pastures. On the other hand, none of the available models today provide a sound assessment of changes in agricultural production that might be taking place in the world as a result of expanded feedstock production in major biofuels producing countries.

I will conclude by briefly commenting on the recent discoveries of substantial oil and gas reserves in Brazil. Conservative estimates announced last November by Petrobrás, the Brazilian oil company, indicate that the new fields potentially have recoverable reserves of 5 to 7 billion barrels. This is roughly equivalent to between 35% and 55% of Brazil's current existing reserves of around 14 billion barrels. According to Márcio Rocha Mello, president of the Brazilian Association of Petroleum Geologists, there may be at least 50 billion barrels of recoverable reserves in the main area of production called Campos field. These calculations do not include the potential of onshore oil production, which has received less attention (only 7% of the country's huge territory has been selected for prospection/exploration) but may bring more news in coming years.

Brazil's higher profile in energy is and should be seen by Washington as positive news. Asked recently about the possibility of Brazil joining OPEC once it becomes a petroleum exporting country, foreign Minister Celso Amorim signaled the country's interest with an important caveat. "It is not part of our vision to participate in a cartel that has price increase as an objective", he said. "Brazil wants to participate in a group of countries that has influence on oil policy" in order, to, among other things, "supply the needs of poorer countries".

Mr. TIERNEY. Thank you, Mr. Sotero.

Dr. Walser.

STATEMENT OF RAY WALSER

Mr. WALSER. It is a pleasure to be here. I come from The Heritage Foundation, but the views I express today are essentially my own and do not represent any official position of The Heritage Foundation.

Mr. TIERNEY. I am not sure, you might have to draw that microphone closer to you.

Mr. WALSER. OK, thank you. This is sort of my virgin appearance.

Mr. TIERNEY. That is all right. These microphones are getting to be a little tricky on people. Thank you.

Mr. WALSER. My first appearance before Congress, I have to sort of get over my jitters here, but thank you for having me today. It is a pleasure to be with you.

I would agree with Mr. Goldwyn that energy security begins at home. In the testimony that I have prepared, I have raised a couple of points. Heritage has taken very strong views on the importance of market-based solutions for their expiration, looking at such undertakings as nuclear energy, capping the shale reserves of Colorado and the like. So I will not go further into that area. It is not my area of particular expertise.

First of all, I think the United States is very fortunate to have two solid reliable energy suppliers are our NAFTA partners. North America, we do remain energy interdependent, and I think both Canada and Mexico recognize this. As long as we stick with our NAFTA commitments, as long as we recognize that a prosperous Canada and a more prosperous Mexico are in our national interest, we can have strong confidence in our capacity to work with our neighbors north and to the south.

Clearly, the oil sands at Alberta hold an immense amount of recoverable petroleum. Yes, their extraction and production costs are higher, but this is certainly a very promising area of development. It is my understanding that some of the linkages between the United States and Canada, particularly pipelines and transmission, electrical transmission lines are areas that need some attention and considerable updating.

The petroleum situation in Mexico, as pointed out in numerous reports, is less rosy. March 18th will mark the 70th anniversary of oil nationalization in Mexico, and Mexicans will celebrate the event; yet, overall, Mexicans will have little reason to be jubilant. As all the witnesses point out, Mexico's production is reaching decline, as you made reference to in your opening remarks, Mr. Chairman.

Clearly, the Mexicans believe that there is a considerable amount of reserves to recover: something in the order of about 100 million barrels of various categories of reserves, sufficient, according to the Mexican energy secretary, for 60 years of meeting Mexico's needs. But getting to it is increasingly costly, PEMEX is short on capital. It clearly needs strategic partners to move forward.

The problem is that the Mexican Constitution, of course, prevents any foreign ownership or participation, or even domestic participation in oil exploration.

At this point, we cannot—I think that Mexico is waking up to this fact; will it wake up fast enough? Hard to tell. We cannot alter Mexico's, that is considered to be a sovereign decision, but we can continue to demonstrate a constructive approach to bilateral relations and promote favorable climate for future energy cooperation.

One of the pieces of legislation that is before Congress these days, the Merida initiative to deal with counter-narcotics threat can help set a very important or, by participating, can send a very important message to our colleagues or friends to the South.

I will not say anything more to add to Mr. Sotero's statement as to the importance of Brazil. It is a giant. It is growing. We have to pay attention to it. I concur with the other two witnesses that removing the 54-cent per gallon tariff on Brazilian ethanol can have a catalytic effect on U.S. Brazilian relations. It can encourage Brazilians and others to invest in research on promising second-generation biofuels such as cellulosic ethanol, and it could perhaps bring us a little closer together in dealing with international trade talks in the DOHA Round.

Final comment, I have extensive remarks regarding Mr. Chavez. I presume that he will be discussed in the discussion session. That he is mopping the floor with the United States, well, yes. If you spend the sorts of money that he is using his grow revenues as a kind of massive ATM machine for domestic spending; to prop up the Castro-ite Communist regime in Cuba; to purchase influence in PetroCaribe and acquire Russian arms, yes, he has a lot of money. And I think that money that he is throwing around is sort of the key.

He is also engaging in considerable acts of self-containment. You can see the reaction to his engagement with the FARC in Colombia, his interventions in Peru and elsewhere. So he in some respects is his own worst enemy.

I think we have a dilemma ahead of us. I think that Mr. Chavez at home is increasingly less popular. He runs into some very serious domestic issues. The failure of the constitutional referendum in 2007 gave hope to the opposition circles that the Venezuelans may be able to select new leadership in 2012.

What we have to be very careful is that in designing a policy to deal with Venezuela that we try to avoid alienating the Venezuelan people who are going to be around, and hopefully our friends in a post-Chavez world. Clearly, as our colleague said, there is no silver bullet. What we can do is to continue to work for democratic developments, constitutional governments, the rule of law.

We should definitely continue to strengthen our ties with the passage of pending free trade agreements with Colombia and Panama, and we should not move forward into a protectionist stance, which will probably be the most harmful national policy decision we could make, vis-a-vis the Western Hemisphere.

Thank you.

[The prepared statement of Dr. Walser follows:]

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CONGRESSIONAL TESTIMONY

Meeting Energy Challenges in the Western Hemisphere

Testimony before
The Subcommittee on National Security and Foreign Affairs
Committee on Oversight and Government Reform
United States House of Representatives

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My name is Ray Walser. I am the Senior Policy Analyst for Latin America at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

One cannot isolate the challenge of preserving energy security in the Western Hemisphere from the overall global challenges the United States faces. Today we face a rising growth in demand for petroleum, driven by the rapid economic growth in China, India and elsewhere; by the narrowing margin between global petroleum supply and capacity and demand; by continued uncertainty and instability on the Middle East and by systemic assaults on the efficiency of state-run energy companies to fund everything from social welfare programs, government operating budgets, arms purchases and aid and subsidized oil to foreign friends. We see increasing dominance by national energy companies as they expand their share of petroleum exploration and production at the expense of the traditional corporate energy titans like ExxonMobil, Shell and Chevron.

With oil closing at $106 a barrel, we all begin to think we are experts on energy security. Today and in the months and years ahead meeting U.S. energy needs will be critical to the success of U.S. foreign policy.

Energy Security Begins at Home

Dr. Kim R. Holmes, Vice President, Foreign and Defense Studies at Heritage writes in Liberty's Best Hope: American Leadership for the 21st Century released just last week, "The next President of the United States must develop a strategy to thwart the capacity of coercive or unfriendly regimes to use energy resources as an economic weapon. Regimes that withhold or restrict energy supplies as an instrument of national policy threaten not only regional stability and prosperity, but also the economy and national interests of the United States." Dr. Holmes, along with Dr. Stuart Butler, have already established a solid set of guidelines in their 2007 Heritage Backgrounder, "Twelve Principles to Guide U.S. Energy Policy."

The U.S. faces a critical need to encourage domestic petroleum production. It seems as if the U.S. has unilaterally disarmed itself in the competition for energy supplies by imposing a host of unnecessary restrictions on domestic energy production and upon offshore exploration of the Continental Shelf. Indeed, in the past three decades, we've thwarted construction of refineries and nuclear power plants that could have helped to ease the competition for energy supply and secured greater energy independence.

Further taxes on the major domestic oil producers confers an additional comparative advantage on Organization of Petroleum Exporting Countries (OPEC) and other non-U.S. suppliers whose imports are not subject to most of these provisions, will lower incentives for new investments and add more costs to finished products at the pump. There is growing doubt that the recent rush to develop corn-based ethanol and other alternative and renewable energy sources will bring genuine relief or true energy security. New subsidies and mandates threaten to turn us into victims of the law of unintended consequences. By creating a minor bonanza for corn-growers and agro-industry giants, we have succeeded in driving up food prices both in the U.S. and abroad, something that will be noted by consumers abroad, particularly by the poor of the lesser developed world who may face deprivation and possibly starvation. We have also closed off our markets to biofuel producers abroad.

Our NAFTA Partners

The U.S. is very fortunate to have two solid, reliable energy suppliers as NAFTA partners. Neither Mexico nor Canada belongs to OPEC. Our North American populations are closely interconnected by trade, investment and migration patterns. We share key democratic values and look to competitive, free markets to resolve many of the material challenges before us. We have periodic and productive fora for regular consultation and strong intra-governmental links. Canada and Mexico are respectively our first and third most important trading partners and our first and third/fourth suppliers of energy, respectively.

In North America, we remain energy interdependent. As long as we stick with our NAFTA commitments, as long as we recognize that a prosperous Canada and more prosperous Mexico are in our national interest, we can have strong confidence in our capacity to work with our neighbors, north and, hopefully, south.

The immense deposits of oil sands of Alberta contain recoverable reserves equal to those of Saudi Arabia but will impose higher extraction and production costs. Access and use of these reserves will remain a key to supplying the U.S. with oil from a stable, friendly source, influenced mainly by the movement of markets, not political whim. Canada experts such as my colleague Chris Sands at the Hudson Institute point out the need to be attentive to more technical issues such as upkeep and improvements in transnational infrastructure, especially for electrical transmission lines and pipelines to avoid bottlenecks and disruptions in supplies

The petroleum situation in Mexico is less rosy. Mexico is the world's fifth largest oil producer and the third or fourth largest supplier to the U.S. Yet, in many respects Mexico is paying the price for its past bout with resource nationalism. The Mexican oil industry was nationalized under President Lazaro Cardenas in 1938 which led to the creation of Petroleos de Mexico (PEMEX). March 18th will mark the 70th anniversary and will be celebrated widely in Mexico. Yet, overall, Mexicans may have little real reason to be jubilant as this time.

Since 1938, a heavy reliance on PEMEX`has powered Mexico's development but the petroleum monopoly has also served as a huge fount of corruption to sustain workers' unions, inefficient bureaucrats and state and national politicians. Today earnings from PEMEX cover 42% of Mexico's national budget. State ownership of subsoil wealth and hydrocarbons remains firmly embedded in the Mexican psyche and political ethos. A majority of Mexicans continue to oppose opening PEMEX to private and foreign investment.

PEMEX is, say most oil experts, in serious trouble. It is the world's most indebted oil company. Output from Mexico's flagship oil field Canterell in the Gulf of Mexico peaked in 2004. The Canterell field once produced 60 percent of Mexico's petroleum. The filed now yields 42 percent of national output, dropping by 5.7 % in 2007. Production difficulties continue as a result of under-investment. Four of every 10 gallons of gasoline consumed in Mexico are imported from abroad, as is much of Mexico's natural gas.

PEMEX has, according to Mexico's Energy Secretary, around 100 billion barrels of various categories of reserves, a quantity sufficient to meet Mexico's energy needs for another 60 years. But PEMEX is increasingly being forced to exploit less accessible land locations and drill deeper, more than 1000 meters, beneath the Gulf of Mexico to replace the declining output of Canterell. PEMEX is short on investment capital to get the job done and ideally needs strategic partners to remain viable.

Mexico's leadership is awakening to its dilemma but will it do so fast enough? President Calderón is sounding the alarm bell and some within the Mexican political class appear open to modifications of the constitution to permit private Mexican, if not foreign, investments in PEMEX. Mexican telecommunications billionaire Carlos Slim is often identified as a potential investor in PEMEX. But there are also signs that populist leaders, such as defeated presidential candidate, Andres Manuel López Obrador, will employ disruptive tactics to derail any legislative initiative.

The U.S. will observe with keen interest future developments in Mexico. While we cannot alter what Mexicans consider a sovereign decision, no more than Mexicans can alter our decisions on immigration reform, we can demonstrate a constructive approach to bilateral relations and promote a favorable climate for energy cooperation. The United States can also work in other ways with Mexico, notably through the passage of the package of counter-narcotics assistance known as the Merida Initiative that can help President Calderón beat back the threats posed by deadly drug cartels.

Brazil

The future direction of energy policy in South America will to a very large degree be determined by developments in Brazil. With its 190 million citizens and a $1.83 trillion dollar economy, Brazil has become the globe's eighth largest economy. It has developed in the past decade strong macroeconomic stability and combined market growth with novel and effective programs aimed at tackling poverty and improving human capital. It is a center for regional trade via MERCOSUR and a major player on the international commodities and economic scene. It is also a potential leader for a more unified South America. But it can, as The Heritage Foundation's <u>2008 Index of Economic Freedom</u> indicates, do much more to improve its current score of 101 out of 157 nations.

In 1997, Brazil opened the way for energy competition. The national oil company, Petroleo Brasileiro, SA, [Petrobras] engages in energy partnerships with foreign investors and is developing into a global energy powerhouse. It intends to invest approximately $112 billion and is spending $5 billion in exploration and drilling in the Gulf of Mexico. Off Brazil's coast, recent discoveries – the Tupi field and the Jupiter gas field - have substantially raised the hope that Brazil may actually equal or surpass the reserves of Venezuela and become a net exporter of oil. Petrobas could become one of the five biggest integrated energy companies in the world by 2020.

The 2007 memorandum of understanding between Brazil and the U.S. was an important symbolic step forward for sugarcane-based ethanol and draws together the two nations responsible for 70% of global ethanol production. As noted previously, there is good reason to be concerned about the negative consequences of subsidized corn-based ethanol production in the U.S. While Brazil's ethanol producers are apparently working at full capacity, eventually removing the 54-cent per gallon tariff on Brazilian ethanol would help promote free trade in biofuels and could have a catalytic effect on U.S.-Brazil relations. I will note that this proposition was most recently endorsed by Federal Reserve Chairman, Mr. Ben Bernanke. This positive move could also encourage Brazilians and others to invest in more research in promising second-generation bio-fuels such as cellulosic ethanol. Also working with Brazil to revitalize the Doha Round of global free trade talks will strengthen our hand and forge a stronger U.S.-Brazil partnership.

Populism and Resource Nationalism in the Andes

There is nothing new about resource nationalism in Latin America. As noted before, Mexico nationalized its oil industry in 1938. Nations as diverse as Chile, Peru and Bolivia previously nationalized key exports commodities such as copper, tin, etc. The rise in the last decade of what scholar Alvaro Vargas Llosa has termed the "carnivorous left" has brought a political movement that blends old-style *caudillo* leadership, polarizing politics, statist, socialist economic policies, intensified resource nationalism and anti-Americanism. The "carnivorous left" controls an important swath of Central and South America.

The chief proponent of this "carnivorous," populist approach, President Hugo Chávez of Venezuela, commands the largest proven reserves of petroleum in the Western Hemisphere and potential reserves that might potentially equal those of Saudi Arabia. In 2008, President Hugo Chávez still relishes the role of being the pit bull of 21st century populism; a Juan Domingo Perón with Petroleum or, in the descriptive language of Miami Herald correspondent, Andres Oppenheimer, a "narcissistic-Leninist" leader.

Chávez achieved political power via the ballot box, but during his nearly ten years in office has substantially replaced representative democracy with an authoritarian model that removes customary checks and balances on power, produces top-down leadership and undercuts basic political and press freedoms. He has become an unreliable partner on three accounts.

In accordance with his Bolivarian, anti-American agenda, Chávez favors reducing/breaking the linkage of interdependence and integration with the U.S. for political rather than economic reasons. He looks to China and other markets to reduce Venezuela's dependence on the U.S. oil market and on U.S.-based refineries and distribution systems, notably CITGO. Chávez has forged what he terms an "axis of unity" with Iran's Mahmoud Ahmajinedad and signed over 200 bilateral agreements. Whether these are viable undertakings or the Potemkin villages of bilateral diplomacy remains to be seen. Iranian-Venezuelan connections open fresh worries about potential challenges to U.S. security against terrorism and subversion. As OPEC members, Venezuela and Iran are price hawks seeking to lower production and raise prices. Chávez has lobbied in OPEC's inner councils to convert the organization into a Robin Hood instrument for accelerating the global redistribution of wealth.

Chávez uses his oil revenues as a massive ATM machine for domestic spending and to prop up the Castroite Communist regime in Cuba ($2-$4 billion, annually), to purchase influence with smaller, energy-dependent Caribbean and Central American nations via PetroCaribe and to acquire substantial quantities of Russian arms ($5 billion). He has dispatched bags of soft political cash as far as Argentina and is lending support to advance the electoral prospects of the leftist Farabundo Marti Liberation Front (FMLN) in El Salvador in 2009. Chávez's recent up-tick in support for the Revolutionary Armed Forces of Colombia (FARC) and his momentary flirtation with war threats against Colombia leads to serious questions about his long-term ambitions regarding the future stability and democratic governance of Colombia. The enormous costs of these undertakings draw away from productive investments in energy and other sectors of productive growth.

Chávez' milking of the national petroleum company, Petróleos de Venezuela (PdVSA) does not come without costs. A massive 2002 strike led to the firing of 20,000 employees. Since 1999 there have been five different heads of PdVSA and bureaucratic instability and mismanagement reigns. Production has not recovered 2002 levels, although record oil prices make it easier for Chávez to conceal mismanagement and investment and exploration shortfalls. In 2007, Chávez, as part of his re-nationalization campaign, tightened control over joint oil ventures in the Orinoco Belt, where he in essence confiscated approximately $6 billion in foreign assets. This action and the failure to reach a settlement led to Exxon's recent international suit and judgment against PdVSA that rankled Chávez and caused him to threaten to cut off oil supply to the U.S. Under Chavez's management, PdVSA has declined as a reliable international supplier.

While Chávez pursues his aggressive agenda and erodes the efficiency and long-term viability of his energy sector, Washington understands that a sudden reduction in the price of oil would ripple through PdVSA and Venezuela, severely undercutting Chávez and his ability to govern. Mounting inflation, widespread food shortages, and violent crime have lessened Chávez approval ratings and his domestic grip appears to have slipped. The failure to achieve popular approval of a package of constitutional reforms in December 2007 has raised hope in opposition circles that the Venezuelan people may be able to select new leadership in 2012. Whatever steps the U.S. takes regarding

Venezuela and our energy relationship, we need to keep in mind the enduring need for the friendship of the Venezuelan people in a possible, post- Chávez world.

The prudent course is to attempt to diversify our sources of supply to more reliable, more market-oriented producers. The U.S. should not automatically assume that Chávez's 21st century socialism will last as long as the Castro regime in Cuba.

The Chávez movement has emboldened two other Andean "carnivores" – Evo Morales in Bolivia and Rafael Correa in Ecuador -- to embrace similar policies of resource nationalism. The nationalization of gas fields in Bolivia in May 2006 has set in motion strong regional tensions and divisions within Bolivia. Rafael Correa has tackled Occidental Petroleum, withdrawn from free trade negotiations and reduced anti-drug cooperation.

Energy Security, Democracy and Competitive Markets Are Closely Linked

There is no silver bullet, no quick solution to creating greater energy security in the Western Hemisphere. The Western Hemisphere, with one glaring exception, is made up of 35 sovereign states committed to democratic governance. Nations committed to democracy, free markets and more open trading account for more than 85% of the GDP of Central and South America. Some carnivores may face extinction quicker than we imagine.

The best guarantee for future energy security remains a stable, democratic Hemisphere, with relationships based on genuine respect for democracy, constitutional government with real checks and balances and the rule of law. We must continue to provide incentives that encourage governments to adopt free markets principles and to embrace domestic reform. Our ties can be strengthened by prompt passage of pending free trade agreements with Colombia and Panama.

The U.S. must continue moving forward not backward on trade. Protectionism is a prescription for international failure that will reduce the chances for stimulating economic growth and development in the Western Hemisphere. Freer trade may not resolve all problems in the Hemisphere but it remains the most powerful instrument for change readily available to American policy makers. Finally, we must work to refurbish America's image abroad and restore American leadership.

In general, the U.S. people and its representatives cannot afford to neglect the Western Hemisphere. Whether it is energy security, meeting new transnational security threats, responding to the challenges of poverty and inequality or strengthening democratic institutions, the United States has a constructive and productive role to play.

Mr. TIERNEY. Thank you very much.
Mr. Farnsworth.

STATEMENT OF ERIC FARNSWORTH

Mr. FARNSWORTH. Thank you very much, Mr. Chairman, Mr. ranking member, members of the subcommittee. I am really pleased to be here with you today. I am very honored by the invitation.

As you know, and as we have already discussed the United States, as the world's top energy consumer, depends on a stable and secure supply of energy on a cost-effective basis. And given this reality, I fully agree with the opening statements that both of you made in terms of the strategic importance of energy and how it needs to be integrated into the overall foreign policy aspects of the United States.

The Eastern Service Center, Mr. Chairman, has abundant energy resources. We have discussed that a little bit. In fact, after the Middle East, our hemisphere has the second largest global production capability. Nations in the Western Hemisphere that are rich in natural resources are in some cases using the opportunity to develop their resource endowments in a manner that leads to board-based economic growth and poverty reduction, and so the potential for true partnership in the Western Hemisphere, we believe, is readily apparent.

What is not apparent at this time, however, is the means by which Latin America will be able to draw the massive direct foreign investment that is needed to maximize exploration and production of the natural resources. The United States is well poised to provide such investments in the form of private-sector-led initiatives and expertise, but countries in the region must also do their part by creating stable and transparent investment climates.

In this regard, countries such as Brazil, Canada, Colombia, Peru, and Trinidad, and Tobago have made important reforms to their energy sectors. Other countries have gone the other way, taking steps that have dissuaded investment, therefore reducing their own prospects in the global economy.

Within this framework, let me note a couple of points if I can. We have discussed a lot of these issues already, so I am just going to be very brief, but let me start closest to home in North America.

North America, as we have discussed, is the most important energy region for the United States, which is often overlooked because Canada and Mexico are two of our closest friends, stable democracies which are joined to us through NAFTA and a multitude of other linkages. It is important, I believe, that we not take these relationships for granted either in energy or more broadly. Canada and Mexico are consistently among the top three exporters of energy to the United States.

Canada is the world's second largest proven oil reserves, after Saudi Arabia. Of course, the vast majority of those are in the oil sands deposits. Canada is also a large producer of natural gas and supplies most of the natural gas imported to the United States.

In the electricity sector, we are closely linked through trade and integrated networks. For its part, Mexico is a huge energy producer in the Western Hemisphere, although Mexico's production levels have begun to decline, as we have already discussed.

Mexican officials believe that their nation enjoyed substantial undiscovered gas reserves, but greater investments required to confirm and take advantage of these reserves to the extent, in fact, they exist. We have already talked about the oil reserves that exist in the deep water and other places.

Such investment, we believe, is actually urgent, incredibly. At this time, Mexico actually imports natural gas from the United States despite having massive potential reserves. Because of their investment climate, they are actually importing from the United States, and that has a huge impact on national budgets and balance of payments.

Several mechanisms have deepened North American energy cooperation. NAFTA, of course, opened energy trade among the three countries by eliminating tariffs and restrictions on the quantity if imports. As well, the Trilateral Security and Prosperity Partnership that was created in 2005 was designed to increase cooperation and information-sharing among the three countries in North America. Energy is a part of that dialog, and we strongly believe that it should continue.

Much has been done, but much remains to be done. U.S. energy security is inextricably linked to its two neighbors, and greater progress must be made to harmonize regulations and standards, and to improve infrastructure as well.

As has already been discussed, Mexican officials will need to find ways consistent with their Constitution and laws to reform their energy sector to draw the increased foreign investment that is needed to increase reserves and set the Mexican economy on a course for greater development over time.

Brazil, as we have also heard, is an emerging player in hemispheric energy markets, and Secretary of State Rice's pending trip there later this week offers the opportunity to highlight a number of important advances. Of course, Brazil is at the forefront of developing renewable energy, and we have heard a lot about that, and I would simply affiliate myself with those comments in terms of alternative energy.

In addition, by working with Central American and Caribbean countries to help them develop or advance biofuel production capacity, the United States and Brazil are working to promote development in these countries and decrease their dependence on traditional fuel.

So what we have is U.S. collaboration with Brazil working in conjunction with willing partners in Central America and the Caribbean to develop energy partnerships which will benefit all parties, and I think this is a wonderful example of ways that collaboration along areas of specific and tangible interest can pay real benefits and address some of the issues that we are seeing in terms of challenges to the United States and the hemisphere from other countries that we have already discussed just a little bit.

Of course, I will be the fourth and final member of the committee to call for the elimination of or the reduction of the tariff on sugar-based ethanol. We believe that is an important aspect as well.

Outside of biofuels, Brazil is also an important producer of oil, although most of its oil is consumed domestically. This may change. We have heard, of course, about the finds just recently in the very, ultra deep water off Brazil, but one thing to note is that because of the location, extraction is extremely difficult and costly, and the results there are not yet guaranteed. But these very promising developments are well worth watching.

Very quickly, if I may, on the Andean region, which, of course, includes only two members of OPEC in the Western Hemisphere that we have discussed, this offers perhaps the greatest contrast in terms of what is really going on in the Western Hemisphere. Energy politics in the Andean region, I think, encapsulates very much what is going on more broadly in the Western Hemisphere. Colombia and Peru, for example, offer examples of nations which desire foreign investment and have taken appropriate steps to attract it. We believe that will increase to the extent that the U.S. free trade agreement with Colombia is voted on and goes forward.

On the other side of the ledger, Bolivia, Ecuador, and Venezuela have taken steps to assert a much more significant state role over their respective energy sectors, steps which have directly or indirectly reduced the appetite of investors to participate in those markets.

And, really, that is a shame because the region is poor, and it is in desperate need of additional resources for development, but without the ability to explore, develop, and sell resources at top prices into tight global markets, it is the people of the region, we believe—not international oil and gas companies or investors—who are paying the true long-term costs of the resource nationalism that is sweeping parts of the region.

So let me leave it at that. Thank you again for the opportunity, and I look forward to your questions.

[The prepared statement of Mr. Farnsworth follows:]

COUNCIL OF THE Americas

National Security in Latin America: Challenges and Opportunities on Energy Cooperation

HEARING BEFORE THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON NATIONAL SECURITY AND FOREIGN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
MARCH 11, 2008

ERIC FARNSWORTH
VICE PRESIDENT

***** As Prepared for Delivery *****

Good morning, Mr. Chairman and members of the Subcommittee. It is a privilege to be with you to discuss a topic of such importance and timeliness. As you know, the Council of the Americas ("Council") is a leading policy voice on Latin American, Caribbean, and Canadian issues. For over 40 years, our mandate has been to promote democracy, open markets, and the rule of law throughout the Americas. Thank you for the invitation to speak before you today.

The Western Hemisphere as an Energy Opportunity

While the United States is the world's largest energy producer, it is also the world's number one consumer of energy and an overall net importer of energy products. Given this reality, it is a national security priority for the United States to develop and maintain partnerships with energy producing countries. The Western Hemisphere has abundant energy resources. In fact, it has the second largest global production capability in the world (after the Middle East). The United States already has partnerships with energy exporting countries in the hemisphere. We believe the United States should deepen these existing ties and work to build new strategic relationships in the region.

Deepening and pursuing energy relationships with countries in the Western Hemisphere is strategic for the United States because it strengthens our energy security by increasing our access to energy resources and because the proximity of these resources—in our hemisphere—reduces costs. Developing energy partnerships with countries in the region is also smart policy for other reasons. Such relationships deepen our ties with a region that the United States has too often been perceived as neglecting. And they do so around an issue of interest and of benefit to the United States and to Western Hemisphere countries.

For natural resource-rich countries in the Western Hemisphere, an energy partnership with the United States is strategic because of the investment and, ultimately, the revenue such a relationship can bring. Many countries in the region are lacking the investment needed to maximize exploration, production, and distribution of their natural resources. The United States is well-poised to provide such investment in the form of private sector-led initiatives and expertise. But to attract such investment, countries in the region must do their part as well by creating stable and transparent investment climates. Several countries, such as Brazil, Canada, Colombia, and Trinidad and Tobago, have made important reforms to their energy investment regulations.

Latin America also needs the revenue from natural resources to foster growth and development. If countries can harness growth and development from the sale of natural resources to reduce inequality this will benefit citizens across the Americas. Reduced inequality is also good for democracy because it creates more stable political environments. More equal, stable, and democratic countries are good for Latin America and for the United States.

Select Developments and Opportunities in the Hemisphere

The Western Hemisphere is a large and diverse region. With that in mind, I want to highlight some of the more recent developments and areas of opportunity.

North America

North America is the most important energy market for the United States. Canada and Mexico are consistently among the top three exporters of oil to the United States. Canada has the world's second largest proven oil reserves, after Saudi Arabia. The majority (more than 95 percent) of Canada's reserves are in oil sands deposits in the province of Alberta. Canada is also a large producer of natural gas—the second largest in the Western Hemisphere—and supplies most of the natural gas imported by the United States. In the electricity sector, Canada and the United States are closely linked through trade and integrated electricity networks. Mexico is the second largest producer of oil in the Western Hemisphere, although many analysts predict that without a greater focus on exploration and efficiency, Mexico's production levels will eventually decline. Mexico also believes it has undiscovered gas reserves that are estimated to be substantial, but greater investment is required to confirm and take advantage of these reserves.

There are several important mechanisms through which the United States has deepened energy cooperation with its neighbors. The North American Free Trade Agreement opened up energy trade among the three countries by eliminating tariffs and restrictions on the quantity of imports. The Security and Prosperity Partnership (SPP) between the United States, Canada, and Mexico was created in 2005 to increase security and prosperity through greater cooperation and information sharing among the countries in North America. SPP ministers from the three countries recently met in Mexico, where the United States was represented by Secretary of Commerce Carlos Gutierrez and Secretary of Homeland Security Michael Chertoff. This meeting was in preparation for an upcoming SPP meeting between President Bush, President Felipe Calderon of Mexico, and Canadian Prime Minister Stephen Harper. This SPP leaders' meeting will take place in New Orleans in April.

As part of the SPP, the North American Energy Working Group (NAEWG) seeks to increase cooperation and trade in energy within North America. The NAEWG is led by the departments of energy in each country and works on three main topics: market facilitation, technology, and clean energy. Most recently, the NAEWG has resulted in a trilateral agreement on energy science and technology, which seeks to harmonize energy efficiency standards for key consumer products in the three countries, among other commitments.

Much has been done in the North American energy sector, but much still remains to be done to fully integrate the energy markets of the United States, Canada, and Mexico. U.S. energy security is inextricably linked to its two neighbors, and greater progress must be made to harmonize regulations and standards, improve infrastructure, and increase exploration and production of Mexican energy.

Central America and the Caribbean

Central America and the Caribbean are net energy importers, with one exception. Trinidad and Tobago is rich in natural gas and is the largest supplier of liquefied natural gas (LNG) to the United States. Trinidad and Tobago also sends nearly three quarters of its oil exports to the United States, although this amounts to not even one percent of U.S. oil imports.

Central America and the Caribbean are emerging producers of sugarcane ethanol, largely destined for export to the United States, one of the world's largest ethanol consumers. El Salvador produces about half of these ethanol exports, but Costa Rica, Jamaica, and Trinidad and Tobago also contribute. The United States and Brazil are currently working with the Dominican Republic, El Salvador, Haiti, and St. Kitts and Nevis to help them develop or advance biofuel production capacity.

Notable in Central America is Plan Puebla Panama, an initiative begun in late 2001 to integrate Southern Mexico with the countries of Central America in a number of areas, including electricity. Plan Puebla Panama is taking the first steps toward linking NAFTA and CAFTA countries more formally and should be looked at as a model for deeper economic integration in the hemisphere.

The Andean Region

Colombia

Colombia has the sixth largest proven oil reserves in Latin America. It exports about half of the oil it produces, with much of the exports going to the United States. Since 1999, oil production in Colombia has been on the decline, in part due to lack of investment in exploration. To turn this situation around, in 1999 Colombia began implementing a series of regulatory reforms to attract foreign companies to invest in its oil sector. Colombia now has high levels of exploration. For example, in the first half of 2007 alone, Colombia signed 11 new contracts for production and exploration. Some have even called Colombia's new investment climate for oil and gas one of the world's most favorable.

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The U.S.-Colombia Trade Promotion Agreement would improve the trade and investment climate for U.S. companies in Colombia even more. A TPA with Colombia would be of significant benefit to U.S. investors in Colombia's energy sector.

Peru

Since the Camisea gas fields began operations in 2004, Peru has been steadily on its way to becoming a net exporter of natural gas and liquefied natural gas. Peru has the fifth largest natural gas reserves in Latin America and discovered new reserves in the Camisea fields in January of this year. Construction of an LNG plant is underway and potential markets include Mexico and the United States.

Ecuador

In Latin America, Ecuador is second only to Venezuela in oil exports to the United States. While Ecuador has the fourth largest proven oil reserves in Latin America, it is only the sixth largest producer. Ecuador has not been able to increase production over the last several years because of a lack of investment in exploration. In 2006, Ecuador amended its hydrocarbons law to increase the revenue owed to the state by private oil companies. A presidential decree later the same year increased the state's revenue to 50 percent. A subsequent presidential decree in October of last year further increased the state's share of private companies' oil revenues to 99 percent. These changes apply to existing contracts.

Bolivia

Bolivia has the second largest proven gas reserves in Latin America, behind Venezuela. In 2006, Bolivia nationalized its hydrocarbons sector. Since then, investment in production and exploration has declined. Bolivia exports the majority of its gas to Argentina and Brazil.

Venezuela

With the largest proven reserves in Latin America, Venezuela is one of the top ten producers and exporters of oil in the world. Venezuela is one of only two Western Hemisphere members of OPEC, the other being Ecuador. Nearly two-thirds of Venezuela's oil exports go to the United States, while Venezuelan oil makes up about 10 percent of U.S. oil imports. Since 2001, Venezuela has implemented a number of changes to the terms under which private oil companies can invest in Venezuelan oil. The most notable changes include increases in royalties and taxes and the requirement that Venezuelan state oil company Petroleos de Venezuela, or PDVSA, have a majority stake in projects. Venezuela has also reduced PDVSA's independence from the government. While PDVSA no longer makes available detailed reports, many analysts estimate that production has declined due to increased inefficiency and decreased investment.

Brazil

On the eve of Secretary of State Condoleezza Rice's trip to Brazil, the opportunity to discuss Brazil's recent developments in energy is particularly timely. As part of Brazil's efforts to play a more robust global role, it is at the forefront of advances in renewable energy. Brazil is one of the world's largest producer's of ethanol and the world's largest exporter of the alternative fuel, which it makes from sugar cane. Brazil seeks to expand the market for biofuels and increase the production capacity of other countries. The United States is also one of the world's largest producers and consumers of ethanol, although U.S. ethanol is made from corn.

The Council is a strong supporter of the U.S. collaboration with Brazil on biofuels, and we applaud the U.S.-Brazil Memorandum of Understanding on Biofuels Cooperation, which was signed almost exactly a year ago with the purpose of sharing research and promoting the use and production of biofuels globally. By working with Central American and Caribbean countries—currently with the Dominican Republic, El Salvador, Haiti, and St. Kitts and Nevis—to help them develop or advance biofuel production capacity, the United States and Brazil seek to promote development in these countries and decrease their dependence on traditional fuels. Just last week the U.S.-Brazil Biofuels Steering Group and Advisory Board met to review progress and plan next steps. Such cooperation is a clear example of the benefits of greater U.S. engagement with Western Hemisphere countries on energy matters, particularly in efforts to diversify energy sources. Of course, to be most effective, the U.S. tariff on sugar-based ethanol would also have to be reduced or eliminated.

Outside of biofuels, Brazil is also an important producer of oil—Latin America's third largest—although most, if not all, of its oil is consumed domestically. But this may change. Just last year, Brazil discovered Tupi, which, with an estimated 5 to 8 billion barrels of oil, is what some believe to be one of the largest oil fields found in two decades. And just this year, Brazil made another discovery off its coast, an oil field it calls Jupiter. The size of Jupiter has not yet been determined, but Petrobras, Brazil's state oil company, believes it could be as large as Tupi. Both Jupiter and Tupi are deepwater fields, which makes extraction difficult and costly. If the Tupi and Jupiter predictions are correct, Brazil would have more proven oil reserves than Mexico and as much or more than the United States.

Conclusion

Mr. Chairman, members of the Subcommittee, energy is a strategic matter for the United States, and support for increasing partnership in hemispheric energy should be a priority. For the Western Hemisphere, particularly Latin America and the Caribbean, energy offers perhaps the most significant potential engine of growth and development. Such long-term, mutual interests should form the basis of U.S. engagement in the region generally, and should be developed even as short-term political disagreements may arise.

Thank you again for the opportunity to be with you today. I look forward to your questions.

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Mr. TIERNEY. Thank you, Mr. Farnsworth.

Thank all of you for your testimony here this morning. We have a period of time here maybe we can get some uninterrupted dialog going back and forth.

Mr. Braley, you are recognized for 5 minutes.

Mr. BRALEY. Well, thank you, Mr. Chairman, for holding this important hearing. Coming from a State that I represent, Iowa, which is at the forefront of the renewal energy explosion in this country, and given that today is the day we are voting on a resolution honoring the 150th anniversary of the Iowa State University of Science and Technology, which has been instrumental in training and educating a lot of people from Latin America over the last century. This is an issue that is very important to me. One of the things that is also important to me is what type of progress we have been making in democratic reforms throughout Latin America. I remember about 30 years ago writing a research paper on the role of the CIA and IT&T in the overthrow of the Allende Regime in Chile. And so I am going to ask all of my panelists, all the panelists here to comment on a portion of Mr. Goldwyn's written statement where he said what the United States lacks is a positive agenda in the hemisphere, one that recognizes the need to improve education and infrastructure addresses the negative social impact of trade liberalization and offers the respect and cooperation of the United States to these countries that work with us.

And, Mr. Goldwyn, since you are the author of that remark, I am going to ask your other panelists to comment on that first, and then come back to you. But what I would like to ask you all is, first, do you agree with his assessment? Second, if so, why do you think the United States currently lacks this positive agenda?

Mr. FARNSWORTH. I'd be happy to start. Thank you very much, and if I could just note that my father actually attended Iowa State University, and I was born in Ames, so I appreciate the plug and congratulate Iowa State for the wonderful work that they do.

I would think that these comments are, in general, accurate as to why that may be the case. The way that U.S. domestic issues are developed oftentimes have unintended consequences for the Western Hemisphere that are not seen in the same way that we perhaps see the issues ourselves.

Let me just give you three or four very quick examples. One is U.S. immigration reform discussions, seen one way in Washington or on the United States side of the border; seen completely differently in the Western Hemisphere. Trade policy discussions seen one way in Washington, seen completely differently in Colombia, Peru, Panama, other countries. Let us discuss, for example, the whole idea of NAFTA seen one way on this side of the border, seen another way in Canada and Mexico. And so these discussions that are very, very complicated domestically, politically, we view them as is normal in a domestic political sense, but we do not necessarily have the same understanding of how those issues, or appreciation of how those issues play in the Western Hemisphere.

Now, I think that there are a number of very positive steps that the United States has been taking in the Western Hemisphere on a bipartisan basis: the passage of the Peru trade agreement in December I think is a wonderful example of bipartisan collaboration along those lines. We have been working very closely with some of our partners on the security discussions. The Merida initiative has come up, and that is one way to advance these discussions further, and there is a bill, a bipartisan bill, that has been introduced into Congress in terms of increasing the amount of direct foreign assistance and development assistance for the Western Hemisphere, and I think that should be very seriously considered as well.

I do not think that there is necessarily a determination to undercut Latin America or not to collaborate with Latin America or to not appreciate Latin America. Simply until we raise these issues in the overall discussions of our foreign policy, including on the energy side, I do not think we will have, necessarily, an appreciation of how our domestic policies are actually impacting the region and how we can mitigate, perhaps, negative impressions and negative effects of those aspects.

Mr. BRALEY. Dr. Walser.

Mr. WALSER. A couple of comments. I am not a representative of the Bush administration, I was a former State Department employee up until last year, so I guess I still have a certain affinity for the Department of State and the official views.

But the Bush administration, I think, has done a reasonably good job. It has introduced a Millennium Challenge Account which is designed to program assistance to performance. Clearly, the problems there oftentimes seem to be implementation of compacts and the funding. I think that overall aid increases have been substantial under the Bush administration.

Again, this is in a very tough resource environment. I think that the desire of the administration and probably most in Congress is to provide more assistance to Latin America, particularly targeting those areas that were highlighted in the President's trip last March, which is the social agenda. It definitely cries for more U.S. assistance, but a creative approach rather than just sort of throwing money at the problem.

Clearly, as I mentioned in my testimony, free trade agreements, going ahead with the Colombia and Panama free trade agreements, will be a very positive sign that we are, indeed, a reliable partner, and I think that, clearly, we need to utilize American assistance in the future to assist, to address the social agenda but also look at areas of Latin American competitiveness, to look at educational reform, to look at the sorts of things that particularly, say, an Andreas Oppenheimer talks about is the need to try to capitalize on the current overall economic growth in Latin America, but to make it more competitive, more prepared to meet the challenges of a globalized world.

There is a lot of work to be done in the next administration. I think this administration has done a reasonably good job, but there is plenty more to do in the future.

Mr. TIERNEY. Thank you. Thank you, Mr. Braley.

Mr. Burton, you are recognized for 5 minutes.

Mr. BURTON. First of all, let me apologize, Mr. Chairman, for being late. I had another meeting I had to go to, and I hope I am not redundant in what my comments are that I am going to make.

Obviously, South America and Central America, Mexico, are very, very important as far as our energy resources are concerned.

We are also, as my colleague said, I just read his notes, very dependent on the Middle East as well as all OPEC countries. But the thing that bothers me is that we continue to depend so much on foreign oil to the detriment of the United States, and I think it is extremely important that we start thinking in a more realistic way.

When we talk about alternative energy sources, and this is not the subject of this hearing, but when we talk about that, we are talking about something that is going to take place maybe 5, 10, 15 years down the road. We do not know how long it is going to take for us to make the transition to the non-inter-combustible engine. So it is going to take some time.

Our dependency on foreign oil from countries like Venezuela, Chavez and Mexico which may or may not be a stable country in the future, we just do not know, as well as OPEC with the problems we have in the Middle East are things that really concern me. It seems to me that one of the things we ought to be doing while we try to make this transition to more environmentally safe energy sources and move toward energy independence is to realize that we have to start doing something to protect ourselves now. And that means that we ought to be considering drilling in the ANWR.

I have been up there. We could do it in an environmentally safe way, and we can get one to two million barrels of oil a day out of there. We have, according to some sources, as much as 500 years of natural gas, if we can drill in those areas where natural gas is supposed to be. We can drill off the Continental Shelf 100 miles out, 90 miles out and get an awful lot of energy that will keep us from depending as much as we do on foreign oil.

Right now, Castro, Raul now, has cut a deal with the Chinese to drill within 45 miles of the U.S. coastline because their territorial possession, if you will, goes out halfway between us and Cuba. So if they drill 40 miles out from Cuba, that is within 50 miles of the United States, and they will be drilling into our oil reserves because those oil reserves are not just contained in one soft small spot, they spread out. And so they will be drilling into oil that we could be getting to become more energy independent in the short run on fossil fuels.

And we cannot even drill 90 miles or 100 miles out? It just does not make any sense, especially when we see ourselves becoming more and more dependent on foreign energy sources.

So I am anxious to hear what the panel has to say. I mean, I presume they have made their opening remarks, and I will read their opening remarks. But I feel very strongly that during this transition period from fossil fuels to other sources of energy is going to take time, and we ought to be more realistic.

And I know my colleagues, many who are very close to the environmental lobby, are reluctant to start doing some of these things that I think are absolutely necessary if we are not to get ourselves in a real bind down the road, if things break out in the Middle East. If we have a war in the Middle East, which could very well happen; if Mr. Chavez goes bananas down there, we get about 25 percent of our oil from there. If something happens in Mexico, we're up the creek without a paddle. And that is why we need to start thinking about not only foreign energy sources and alternative energy sources, but what we are going to do, internally, to protect this country.

With that, thank you very much, Mr. Chairman.

Mr. TIERNEY. Thank you, Mr. Burton.

Mr. Welch, you are recognized for 5 minutes.

Mr. WELCH. Thank you very much, Mr. Chairman. Thank the witnesses very much for your excellent testimony. I missed the beginning, but I have had a chance to read your comments.

Mr. Goldwyn, I just wanted to ask you a couple of questions. In an article you wrote, unless we change our foreign policy course for the next couple of decades, we are going to enrich OPEC and the producers that maintain high prices and weaken the ability of the United States or allies to influence these countries, which is exactly the opposite of what the goal is of most people around here.

I am wondering if you can just explain in some detail, but briefly, how you see us developing the kind of producer/consumer compact that you also wrote about there.

Mr. GOLDWYN. Sure. Thanks for the opportunity, Congressman.

Let me start on the consumer side. Consumers have an awful lot of power. Neither the Venezuelans nor the others can eat the oil. They have to sell it to someplace. They have to sell it to refineries that can use it. We did ourselves a tremendous amount of good in 1975 when we formed the IEA. We pooled strategic resources; we have effectively deterred embargoes for 30 years; we have pooled resources on new technologies, and we really changed the market.

So I think if we bring the Chinese and the Indians in, in particular, we have more in common in stable prices, controlling demand, efficient vehicles in two countries in the world. But as long as we are competing for resources on the outside, we are going to have destructive competition. So if we bring them in, that collective energy security system, make them want to be a member of the club, we can use a lot of our economic power.

We can also do things like demand reciprocity. We can say we are consuming nations, if you do not give us upstream access, then we are not going to let you build an LNG plant here. We are not going to give you access to our—it has to work both ways. And we can help ourselves that way.

In dealing with producers, I think we need a compact or at least to engage producers. Although I do not think—in a formalized system, I think we need to point out examples of, to use the hemispheric example, Brazil.

Mr. WELCH. Yes.

Mr. GOLDWYN. In a country that says with an open framework that brought in foreign investment that allowed the government to make money and companies to make money, they dramatically increased their production and their prosperity.

Then you look at the other models, Mexico for internal reasons, Venezuela has harsher terms for other reasons, Russia for another one, and say, that way instability and disaster lies, because, ultimately, the price may soften, and then it will take 10 years to build the new resource in ANWR and anyplace else. So I think that is a conversation we can have.

Mr. WELCH. Thank you.

Now, kind of followup on that, Mr. Sotero. You are from Brazil?

Mr. SOTERO. Yes.

Mr. WELCH. Whereabouts?

Mr. SOTERO. Sao Paulo.

Mr. WELCH. Well, when I got out of law school, I hitchhiked from Presidente Prudente to Sao Paulo to Rio, across the Matta Grosso, and I made it.

Mr. SOTERO. Wonderful.

Mr. WELCH. You have a nice country.

Mr. SOTERO. It is much changed now. The roads are paved.

Mr. WELCH. They weren't then. They were not then.

Here is the question. Brazil has, obviously, exploded. They elected "a socialist" just before the election of Lula. The stock market plunged, and there was great apprehension, but, obviously, since then Brazil has demonstrated a vibrant economy and very powerful energy sector, and its model is somewhat different, obviously, than Venezuela and Bolivia. And my question is: What is the model that you would describe for Brazil versus these other countries that have adopted, I gather, resource nationalism?

Mr. SOTERO. Sir, it is somewhat different in political terms from Venezuela because we are very proud of being a democracy, and President Lula is very much a part of it. He is a man that ran for the presidency three times, lost and ran a fourth time and won, so the label being "a socialist," he is the most left-wing person we ever elected for President of Brazil. He is also the first man of the people to be elected president in a very unequal society. This is very important, symbolically and effective, in effect in real terms for us. And President Lula understood very well something that Brazilians, after living for 30 years with near hyperinflation, had had enough.

So in spite of the fact he had had the political life, denouncing a lot of economic programs that to foster economic stability, in order to be elected president of that country that had conquered inflation—and that was then in 2002 in the path of economic stability—the president basically embraced an economic program which is a classic capitalist market-driven economy with, obviously, many problems.

I would say that we have somewhat told about the business climate, this is recognized in Brazil. We have to improve a lot in the business climate in order to foster investment. It is President Lula himself who recently, before introducing a bill to reform our tax system, saying that to invest in Brazil is to be punished.

So we are very aware of the problem. Brazil has an open press. All the problems we have are clearly in front of society.

Mr. WELCH. Thank you. Yes, that is very good.

Just one last question, Dr. Walser. What is the effect, if the United States drops all tariffs on Brazilian ethanol?

Mr. WALSER. I would actually like to defer to Mr. Sotero, but my understanding is that at this particular point Brazil is operating at a fairly full capacity and is meeting sort of domestic demands. So you would begin to open up a market for expansion.

Now, I think that the argument is that the lands that would be cultivated would not encroach upon the Amazon, but there would be some pressures to push into potentially sensitive environmental areas. And other than that, I am afraid my expertise does not carry me much further, so I do not want to venture down the road.

Mr. WELCH. Dr. Sotero.

Mr. SOTERO. Could I add something?

Mr. WELCH. Yes, go ahead.

Mr. SOTERO. The worst thing the United States could do is to suddenly open up, because this would probably disorganize our internal market. We produce ethanol mainly for internal use, for domestic use in Brazil. We can produce much more, and this is important to do this in a cooperative engagement.

There are ways that you can continue to improve your production of corn ethanol, produce the productivity of that. Actually Senator Lugar proposed some ideas in a bill that he introduced, I believe, last year which are to, for instance, make the subsidy vary according to oil prices and make the subsidy, the tariff actually a stabilizer of prices in the American market.

Actually the members of the Brazilian industry welcomed the effort in the United States to create the market for ethanol here. We just wanted, and that is what they keep saying, that Americans get more creative in the way you apply the policy to develop the sector in Brazil in a way that could allow Brazilian ethanol, and ethanol not only for Brazil, from other places including the Caribbean, including all the areas to come to the United States.

Mr. WELCH. Thank you. Thank you, Mr. Chairman.

Mr. TIERNEY. Thank you, Mr. Welch.

I ask, generally for the panel here, the premise of this hearing was that there was a lot we could do within this hemisphere if we started cooperating and we looked at everybody's strengths and tried to work in a manner that maximizes everybody's strengths on that. So we ask each of you, the next President coming in, what would the advice be in terms of trying to reach out, understanding the differences of the different political situations in each country, how would we go about trying to find some cooperative way to maximize each country's strength to the benefit of their neighbors?

Mr. GOLDWYN. I will take it. I think, let me start with structures and then policies. I think the first thing we need to do is go back to engaging at a senior level of all the countries to hear their agenda as well as ours. We had the Summit of the Americas process. We used to meet at the foreign minister level, but also justice ministers and things like that. We talked to countries about both of our agendas. So I would resume that. It is a sign of respect. It is also a way to hear what their concerns are.

Second, I would revive the trade agenda, and I think we will have our own spin on it, I think, in a new administration in terms of environmental labor standards, but I think the culture has changed in Latin America on that as well. So we have something to put on the table.

Third, I think we ought to have a serious conversation about poverty and social exclusion, and what we can do. It is not an American problem to fix, but there are certain ways that we can help: build civil societies that we can build structures, lessons we have learned. Just paying respect to that issue I think would help an awful lot, and I think that will pay dividends on bilateral policy because if we have a good relationship with Brazil and respectful relationship with Argentina, that if we want to talk about the Venezuelan model and why our model is better, our model is better economically, socially, politically, or whatever it is, then we have reasonable partners to talk to, and they can have that conversation in the hemisphere. And that is a much better strategy than the United States just waving a stick. So I would start it there.

Mr. SOTERO. This is still, I would say, along the same lines. In case of Brazil, what is important is engage with Brazil. It is something that has to be said about this administration that is, in terms of the case of Brazil, the Bush administration did very well to Brazil. It what? It engaged, it was interesting that a very conservative leader of the United States and a very left-wing leader of Brazil recognized that the common interest of both countries were convergent, and started at least this initiative on biofuels. That is very important.

In Brazil, we are aware of our social problems. There is—and I have been saying this for years—we recognize that there is nothing you have to do to help us solve our social problems that we do not have to do first. It is very clear, and we are making progress on that front in Brazil. But I think an agenda that really is inclusive, that takes, makes the social policy for the region is a central element and that differentiate between countries.

Countries in Latin America, the notion, actually, in Brazil we do not even use much "the notion of Latin America." We say, our diplomats like to say this is a French concept. We are in South America, we are individual countries, we have different needs. Brazil can solve many of its own problems; it is a matter of allocation of resources and fight this in Congress, like you do here.

But I think a more open attitude and an attitude that avoids something that has been natural throughout the years from America, to avoid this patronizing view of Latin America. Latin America, the region does not need that. We need partners, and in the case of Brazil, clearly. On energy, we are not asking you to do anything for us; we are working together, we can work with you. We can contribute.

And again, on oil the same thing. PetroGrass, which is in 25 countries including the United States, it operates here, is also a company that, among other companies, other, many Brazilian companies that are here not—but, in general, I think that it is mental change, mentality change that has to happen in the United States and see us as neighbors and partners.

Mr. TIERNEY. Thank you. Doctor.

Mr. WALSER. I would see sort of four basic points continuing to advance the free trade agenda. I do not think it is time to back off on that, the commitments, or to review them. I think we have to move forward on free trade.

I think it would be useful if a new administration would try to pull together the very sorts of strands into a kind of comprehensive educational, health, and poverty alleviation. It would be tangible, it would have broad bipartisan support with the goal being to develop human capital in the Western Hemisphere for sort of global competitiveness, continue to sustain the Millennium Challenge Account.

I think the fourth area where Latin America may be very interested in our assistance is dealing with security issues, particularly the continuing threat of drugs and the rising threat of gangs and lawlessness that affect many areas from Brazil to Central America to Mexico. Showing some understanding for this basic security problem, utilizing our military assets in different and creative ways could show continued U.S. engagement in the hemisphere.

Mr. TIERNEY. Thank you. Mr. Farnsworth.

Mr. FARNSWORTH. Thank you, Mr. Chairman. I completely agree that engagement should be the watch word in terms of our relations with the hemisphere. I think if you ask Latin and Caribbean leaders what benefit they get from a close relationship with the United States, a lot of them will have to pause and think about it for a minute. But if you ask some of those same leaders, what benefit do you get from a partnership, for example, with Venezuela or other countries, they can immediately give you answers.

Now, that is not to say we agree with that model, but it is to say that I think the United States for a period of time has been very good about asking or presenting an agenda that we have and the very important national security issues that we have, but not doing such a good job of listening to what the agenda may be from the Western Hemisphere countries themselves. And when we do listen, we don't necessarily deliver on what the requests are. It does not mean we have to give everything that is requested. Some things would be impossible, or impractical, or frankly, against our own interest.

But I think we need to start by changing the tone of the relationship. The word partnership has been used, the words in terms of building a true understanding of a mutual agenda. I think that is exactly right, and we are not going to agree with all the countries all the time in the Western Hemisphere. But, for example, energy is one area where we can collaborate closely with some countries, and that is to all of our benefit.

Another area of trade has been mentioned but, for example, the Congress just renewed the Andean trade preferences for all four countries, which I think is marvelous. I mean, you even have two countries that were part of that which strongly disagree with the United States, Ecuador and Bolivia. And yet we are reaching out, we are engaging, and we are continuing to have dialog even when we strongly disagree with a number of things that those countries are doing. And so I think that should be the watch word.

I also think it would be, frankly, a real setback for U.S. interests in the region if we do not deliver on the things we have already committed to delivering, particularly the Colombian-Panama trade agreements. And I think it would also be a real opportunity missed if we do not move forward in support of the Mexican government with the Merida initiative, so I would start there.

Mr. TIERNEY. Well, thank you for that, the premise being that energy would be one good area that we should all find some agreement on as opposed to something to fight about.

Mr. Shays is recognized.

Mr. SHAYS. Thank you very much. I appreciate all of you being here. Let me ask you first a more generic question. Why is the claim that the world has peaked in oil when there are so many parts of the world that have not yet been examined? And so, tell me that.

Mr. GOLDWYN. Well, the peak oil theory looks at the size of fields that we have known about over years and said the basic, if you look back over the last 20 years, the huge, giant fields, we have only discovered really one, I think it is Kashagan in the Caspian. So if they think that while the reserves are there, these big, large fields have been drained.

The other factor we are dealing with is the unknown, which is that really only in western countries are reserves actually audited. And so you have people like Matt Simmons, who look at Saudi Arabia and say they have not had a real audit, and if you look at the amount of money that they are spending trying to squeeze the last drop of oil out of some of the existing reserves, it is really kind of worrisome, because if you have all of this other oil, why would you be spending that much money when you can put a straw in the ground and take it out for three dollars?

So it is a combination of the lack of transparency. The sort of pattern of discoveries has been made, and they say that not that, basically, we have peaked in terms of production, but we still have a long way to go. I think it is belied by——

Mr. SHAYS. Do you all basically agree with that answer? I mean, I think the biggest tragedy that has befallen us this century has been that after September 11th, I think the President had a magnificent opportunity to say we are going to be energy independent, and he would have said to me, you are going to get what you want, conservation; but I want nuclear power, I want to mine the slopes on the outer continental shelf of the Atlantic Ocean. And we would have had alternative source and so on. It would have been everybody giving a little and getting a lot in return.

And I would disagree, I think, pretty strongly with The Heritage Foundation. I think you have to have government intervention. The President said to me a number of years ago, I was asking about conservation, and he said the market will get us there. But the market is not getting us there, and I look at Toyota as the only company that really seemed to look at better ways to deal with the energy challenge.

Give me a redeeming quality of Mr. Chavez. I mean, my view was we went after him big time and failed, and so, clearly, we have an enemy. But was there ever a point in the relationship where we could have had a decent relationship with him had we not targeted him? Or was there no way but to target him, one?

And, No. 2, just tell me—I'll start with you, Mr. Farnsworth, tell me some redeeming qualities about his leadership and the good that he might be able to do for the hemisphere.

Mr. FARNSWORTH. Absolutely. On the theory that no human is all good or all bad, but, thank you, sir.

I think that a redeeming quality of Mr. Chavez is that he is genuinely concerned with the well-being of his people. I really believe that he is concerned with poverty and underdevelopment. I really believe that.

I do not necessarily think he is addressing it in the appropriate way, and I do not think what he is doing outside of his borders is appropriate in any way. But, having said that, I believe that is one redeeming quality, and to the extent that those issues are firmly put on the agenda because they are relevant for Latin America more broadly, that is not a bad thing. These issues need to be address because, if they are not, we see what has been happening through some countries in the Andes, which is that governments are elected to power, and they are trying to respond to the needs of their people, as they view them. And they take policy actions that may be against the policy interests of the United States.

And so there is a very real strategic component for the United States to be active in supporting and partnering with countries in the region to address some of these social development issues.

Mr. SHAYS. Dr. Walser.

Mr. WALSER. My comment, clearly, the April 2002 was seen as a turning point. I was not involved with Latin American affairs at the time. I have talked with a number of people who are policymakers, and I am sure that Members of Congress have had even further briefs.

The argument is that he was not a target of any U.S. operation; that, in fact, he received warnings.

Mr. SHAYS. I do not mean that we were looking to assassinate him, but we actively tried to defeat him. I should have clarified that.

Mr. WALSER. And, clearly, what he played upon was our not embracing immediately the democratic charter and supporting a democratically elected head of government. But I think that did constitute a turning point in which he had drawn on a deep sort of sense of anti-Americanism. His Boliviarian program leads him, ultimately, to sort of clashing with the United States.

On his redeeming side, he represents, yes, his social aspirations for the marginalized people. He also represents a large racial group, either Mestizo or indigenous, who have not been included in the politics of many of the countries in the Andes. And he has wide resonance because he is different.

He is not like the traditional elites, and, clearly, the elites of Latin America still control much of the politics and are, really, sort of have to confront the social realities of their own countries in the future.

Mr. SHAYS. Thank you.

Mr. SOTERO. I agree that is the redeeming quality of Chavez. Obviously, we in Brazil, in generally, I want to tell you he is not popular at all. He is probably one of the most unpopular leaders of the hemisphere, in Brazil. He reminds us of something we had before, which is the military figure in government. We do not like it, we fought to defeat that.

In terms of the missed opportunity, I think was precisely that the April 12th episode in which, by coincidence, the leaders of Latin America, of the region, were meeting in Costa Rico that day or the day after, and they all said, this is a coup, and this is against the Democratic Charter. And believe me, when Latin America tells you, this is a coup, take it seriously, because we have seen them all.

Unfortunately, the United States did not act immediately. Secretary Powell, I believe, was traveling in the Middle East. He came back to Washington a few days later, went to the OAS ministerial meeting there, and finally declared a U.S. position denouncing the coup. That was too late.

But that was a missed opportunity, because had the United States sort of denounced the coup, I think you would have preempted a lot of Mr. Chavez's behavior. And later on in the administration, I think the lesson was learned: Instead of answering to every provocation by Mr. Chavez, the administration kept silence. And because Mr. Chavez is the type of leader, precisely now when he is in a weaker position, that he lives off of the microphone. That is what he needs.

Actually, the other day in an episode between Colombia and Ecuador, a very tragic episode, he immediately jumped in and started promoting more conflict. And the countries of the hemisphere meeting at the OAS counteracted, and one of the end results—and Brazil was very much part of that—was to isolate Mr. Chavez from the problem, isolate the problem and deal with the problem. Venezuela is not part of the group of countries that is now managing the situation and will propose a solution.

Mr. GOLDWYN. I can add to that. On the first part of the question, I think 1998 to 2000 at least, the time that I was in Government, we had a very civil relationship with Venezuela. Now the State Department, I think, formerly had supported the other side. When President Chavez was campaigning, I think there were only two minor people at the State Department who were willing to see his team.

But we had pretty civil discussions, and I was the principal coordinator with Bernardo Alvarez, now the Ambassador but then the deputy minister. And we talked about energy, and they were at the process of, basically, having the government get control over the national oil company, something we preach in other countries, but we had a problem with the style in which Venezuela did it.

And we disagreed, I would say, on 8 out of 10 of the items on the agenda, and we did it pretty openly and with a pretty big team. But it was a very open, civil discussion, that we do not think this is the right way to go, we do not think this is going to be good. You do not think you are going to get investment here, we need better data. But we had a very civil, very normal conversation, and we had it pretty often. So we had a good sense of where the other side was.

There was a dialog. There was investments going on, and they were responsive to TUS investment projects there. So I thought it was pretty civil, and I think April that was damaging.

I think the three positive things I would say about President Chavez, one is that he does spend the oil money on his people. I spent a lot of time in Sub-Saharan Africa working on those issues, and that is what we are trying to get those governments to do. Is it political? Sure. Is it wasteful? Probably. But it is happening, and that is a good thing. Having a government have control over the national oil company so the government policy dictates things is an orthodoxy we preach everywhere.

If PEMEX was sort of in revolt against the Mexican government, there is no way we would be siding with PEMEX. We want the government to get control over its resources. We would run that policy in a whole different way, but in the theory that governments ought to control state-owned enterprises. That was pretty sensible, and there was an awful lot of corruption in the Venezuelan system there.

There was another one of these Council studies, since there has been sort of a negotiated democracy in Venezuela for years. There was huge corruption, poor distribution. The old regime was pretty bad, also, and so there were legitimate issues that President Chavez took up, so he had the right agenda, but it has been done in a way that is completely unnecessary, gratuitous, and has been repressive on the press and, in democracy, in a way that, frankly, given President Chavez's popularity, he never needed to do. And that has engendered a tremendous backlash.

But I would say for the future, for the next administration or for whatever, I think it is possible for us to repair our relationship with Venezuela, and I think if we can keep the United States out of the middle of Venezuelan politics, the Venezuelan people still have power. They still have voice, and it is our job to make sure and to speak up if their voice is trampled on.

But I think Venezuela has the potential to evolve as long as we do not make ourselves basically the center of their politics and the way in which people can campaign to stay in power because we are the bogey man.

Mr. TIERNEY. Thank you. It is amazing how we keep learning that lesson, whether it is Pakistan or Venezuela, is it not?

Mr. Lynch, you are recognized for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman. We have seen a lot of, well, we have had a lot of talk about engagement which I agree is important, but, Mr. Goldwyn, you also referenced in your written testimony the challenge with Venezuela, and you advocate for "an objective assessment as to whether Venezuela's actions are undermining the other important U.S. security interests."

There have been some very recent reports in The Washington Post and in other publications regarding the question of whether Mr. Chavez is possibly funding FARC, and that would truly present a U.S. security interest matter. If this link is confirmed, and it does not look good, if this link is confirmed, what do you think our response should be? I know you are calling for engagement and cooperation, but if Mr. Chavez is actively supporting and funding a terrorist organization as labeled by the United States and Europe, how should that affect our policies toward Venezuela and the other relationships that you spoke of?

Mr. GOLDWYN. I have seen those reports, and if they are true, that is a very serious allegation. And our objective is to get, if it is true, is to get Venezuela to stop.

I think diplomatically, the way that I would do that is not for the United States to put itself in the center and basically point, say we are going to start imposing sanctions on Venezuela. I would start with the Colombians. They are the ones who are directly affected. I would go to the neighbors and say, if this is true, supporting these kinds of insurgencies, certainly inimical to the interests of all of the countries of the region; I would go to the United States third and say, you have just issued a statement where Colombia apologized for crossing the border, but Venezuela and every other country agreed that it is completely inappropriate to giving safe harbor and comfort to terrorist organizations.

And I would try and work, diplomatically, through the region, through regional leaders to get them to stop, because that is the real objective. If that fails, or if we cannot get regional support for this initiative, I think then you look at stronger measures. But I think the idea is to hold countries accountable to their neighbors first, and I think we saw a great example in this conflict between Colombia and Ecuador where President Chavez jumped into the middle of it, but in fact, Colombia and Ecuador worked this out, and they did it both bilaterally, and they did it multilaterally.

And the fact that we had a position but we stayed on the sidelines, facilitated the expeditious resolution of that conflict. So I think we need to keep that in mind. We just need a little bit of nuance in how we get there, but in terms of the gravity of the accusation, I agree with you completely, and that is a prime example of something where U.S. security, our support, our support for Colombia, probably our advisors down there are implicated.

Mr. LYNCH. Mr. Sotero.

Mr. SOTERO. Can I just add something about this? It would be probably important to understand, for instance, where Brazil would place itself in this.

Mr. LYNCH. Sure.

Mr. SOTERO. What conditions, the government's position in this vis-a-vis the Colombia, Ecuador issue and Venezuela, is the impact of drug trafficking, organized crime in our society? And we know for a fact in Brazil that some of that has directly connections with the FARCs. The master mind there, the main drug lord in Brazil was arrested by the Colombians in FARC-controlled territory and sent to Brazil.

So when we act in Brazil, and it is more and more clear to Brazilian society, that we are going to have to take a stand about the actions of FARC that was once gorilla movement, a social movement, etc., that has deteriorated, basically, into an organization that is involved in narco-trafficking, in kidnapping of people, etc. So this issue is very important, and I totally agree with Mr. Goldwyn in this: the engagement should go in that direction because Brazilian society is fed up with crime, and we know that crime in big cities, in major cities in Brazil, is directly connected to narco-trafficking coming from the Indian region.

Mr. LYNCH. Mr. Walser.

Mr. WALSER. It is without doubt that Chavez is offering sort of moral and political support for the FARC beginning with his engagement in the humanitarian exchange process for which he was invited to participate through the exchange of, or the release of six different hostages. Increasingly, he became strident in his moral and political support, raising them from a narco-terrorist group to a belligerent force, what he called a revolutionary force for a Bolivarian cause.

Mr. LYNCH. If you could, Doctor, I understand those facts. I have been following them very closely.

Mr. WALSER. OK.

Mr. LYNCH. I just want to know what you suggest our response might be to that.

Mr. WALSER. I would agree with my colleagues. At this particular point a direct response does not appear appropriate. I think that it is reminding our leaders in the region such as Brazil the importance that if you do not want waters violated by other armed forces, you also have to not allow hostile forces, terrorist groups, even revolutionary insurgencies, to take safe haven in your own country, and I am saying particularly in Venezuela.

So it is up to regional players to remind Chavez of his responsibilities. I think it is up to us to try to use our intelligence capabilities, our capacity in information-gathering and monitoring drug traffic to help bolster the case and to truly try to understand as much as possible what is going on in an opaque environment such as Venezuela.

Mr. LYNCH. Good.

Mr. Farnsworth, if you would?

Mr. FARNSWORTH. Thank you very much. Very quickly, I think we first need to establish the facts on the ground. We have seen the press reports, but we need to see exactly what was in those computers and source those, appropriately. I believe that is being done now, but in the interim I agree completely, the United States should not be the middle of this story; the United States should be ensuring that we stay out. Venezuela should be in the headlines here, and I think the steps that we can take with our regional partners, I think, are very positive.

But let me add one additional element, if I can, and that is on the energy side, because Venezuela, of course, has massive resources. And it is through the energy well that President Chavez is able to conduct some of these activities. I think this is particularly why we believe that cooperation with other countries in the region on energy is so strategically important. Yes, it provides alternatives for the United States in terms of our own energy needs, but it also provides alternatives for the region in terms of their strategic needs. So they do not have to depend, necessarily, on the largess of folks like the President of Venezuela.

The relationship we are developing with Brazil, again I come back to, which is very, very positive because it is bringing in some of the smaller states in the Caribbean and Central America which have no production capacity of oil and gas on their own, and yet they are brought into this energy equation in a very productive and positive way.

So these are issues where we can collaborate with willing partners that produce a positive model and a positive agenda and, I think, over the long term will have very positive results.

Mr. LYNCH. Thank you. Thank you, Mr. Chairman.

Mr. TIERNEY. Thank you, Mr. Lynch.

Mr. Burton, do you have any questions?

Mr. BURTON. Yes, Mr. Chairman, thank you.

Chavez has been, according to the information we found on that hard drive or was found by the Colombian government, has been working with the FARC since 1992, and I cannot believe that Colombia would be lying about what they found on that hard drive; and Chavez ha given FARC $300,000,000. In addition to that, he has exported his philosophy of government to Ecuador, tried to improve in Nicaragua, and so what he is trying to do, he is trying to do what Che Guevara couldn't do back when Cuba was moving toward revolutionizing all of Central and South America.

I am concerned about all of that, but I am more concerned—and Colombia is an ally of the United States, and they have been doing a great job, President Uribe is doing a great job down there. I do agree with you that we ought to push for the free trade agreements and the extensions that we just passed. We should have that free trade agreement for Colombia very quickly because I think all that—and I do also agree with you that we should not be the central figure in trying to deal with these problems down there. The OAS and other organizations should be doing the job, and we should just be in support mode because nobody like Big Brother telling everybody else what to do. So I agree with all that.

My big concern is if all hell breaks loose down there, and all the people in Venezuela do not like this guy—I was chairman of the Western Hemisphere Subcommittee for a long time, and I am senior Republican on that committee now—and I have people coming to my office all the time from the business community and people who have been hurt by the Chavez, and their rights have been shortened or removed entirely by their political approaches down there—so the people down there are not thrilled with him of course.

I know that he is giving money to some parts of the country where they have not had health care or education for a long time, and I think he does that more for political support than anything else. But the thing that concerns me, and you can comment on this, is what does the United States do if there is a problem down there?

Let's say that he goes into Colombia and with Ecuador and/or some way a spark takes place and we have an ignition down there, and we have a war. And the ability of the United States to get energy from there is diminished. Right now, we have gasoline that could go up to $4 or $5 a gallon, and the impact on our economy is pretty evident.

If we have a cut in supply from Venezuela or the Middle East, if things go awry over there, Iran is trying to develop a nuclear program, they have threatened Israel, and Israel is not going to stand by and let that happen. So if we had a conflict arise, occur in the Middle East and in South America, i.e. between Colombia and Brazil and Ecuador and other countries down there, what do you think the United States would do as far as our energy resources?

Right now, it has been said by many that if that occurred, we would not have an alternative strategy other than to use our emergency supply of oil that we have until it runs out, and then we would be at the mercy of these folks whose oil we are not going to be able to get. And it is not just oil for gasoline, it is oil for creating energy, electricity, for a whole host of things, making plastics, all kinds of things that we need to survive as a country.

And so, in a worst case scenario, what do you think the United States should do to protect ourselves against severe problems that take place in Central America, South America, and in the Middle East?

We have had those problems already in the Middle East. Saddam Hussein invaded Kuwait. We do not think that is going to happen again, but it could. We could have a problem. In South America, we have had problems. Communists took over a number of countries, and they were moving toward revolution all over that place down there, and we moved toward democracy, and under Reagan we were able to democratize all of those countries, but it appears as though there are countries moving to the left down there now.

So my question is very simple. What should the United States do to protect itself against cataclysmic things that might occur in the Middle East and in South America where we get a great deal of our energy, and how do we protect ourselves?

Mr. GOLDWYN. If I can take the first shot at that one, first I would say in terms of Venezuela, that is an extremely unlikely scenario. I think, even as we saw with the strike down there in 2002, Venezuela needs its own energy resources. It can spend down its reserves for a while, but a deliberate move by Venezuela to basically cutoff exports, I think, is unlikely.

Mr. BURTON. I mean in a worst case scenario, because nobody has a crystal ball.

Mr. GOLDWYN. In a worst case scenario, say, all the Venezuelan supply comes off the market.

Mr. BURTON. Well, or it is reduced dramatically, and we have a huge reduction from the Middle East and it impacts on our economy. So what should United States do to protect itself against that.

Mr. GOLDWYN. We would activate, I mean, we planned for this kind of a catastrophe in 1975, and I would not dismiss at all not only the U.S. strategic petroleum reserve, but we built through the International Energy Agency a coordinated emergency response mechanism, which means we convene all of these consuming countries; we all agree to an immediate stock draw, which is a way of showing the market that there are huge supplies close to markets here in the United States that we can release that can completely replace Venezuelan supply, and Venezuelan supply and some others, for a significant amount of time. So that is step one, is we do a stock draw.

Step two is we implement some demand conservation measures. Countries like Canada tend to go to demand conservation before a stock draw. There we free up things like suspending the Jones Act so we can allow the different kinds of oil to come in; we probably release some of our own domestic fuel standards so that kind of gasoline that is only appropriate in Chicago can be used in California, so, essentially, make our market a little bit more liquid.

Probably, before all those, we would go to existing suppliers, and we are back to the Saudis, people who have an excess capacity which is defined by the IEA, a supply they can put on in 90 days, and get them to release some of their commercial stocks. And then that triggers—all of those actions trigger an action by other producers to start ramping up production and try to grab a piece of that market.

The other thing we would do, frankly, is do what we did not do on September 12th, is we would probably go back to people and say we need to be doing an awful lot more in terms of getting ourselves, transforming our economy, to get off of oil. And then we might look at legislation.

Personally, I would come back to Congress and say now is the time to look at significantly higher fuel efficiency standards as a way to look at measures to change the transportation system. Long term, this may happen one way or the other. We need to change the transportation paradigm and not wait for a crisis to occur. If it does occur, we have planned for this, and we could deploy immediately to ameliorate the most significant economic effects.

Mr. TIERNEY. Thank you. Thank you, Mr. Burton.

Mr. BURTON. Anyone else have a comment on that?

Mr. WALSER. I think the other point would be if there were actual military aggression, that Chavez's forces crossed into Colombia for an action, then I think we would have seen a very different scenario in which the United States should have been prepared to support an ally, at least within, I was thinking—what I thought of was, is he going to exercise the [phrase in foreign language] option? Is he going to play his own sort of Falklands there? But he clearly backed off fairly quickly last Friday.

So there is the scenario, as you mentioned, for potential military aggression, but I would not say it is a likely one at this time. And I think the evidence of the last week is that it, hopefully, will not replay itself.

Mr. BURTON. If I may make one more comment, not a question. I hope you are all right, and if we ever do have that kind of a problem, and it goes on for an extensive period of time, the economic chaos that would occur in this country would be severe. And we need to plan and move toward energy independence and not rely on foreign sources as much as we do.

Mr. TIERNEY. Thank you.

Mr. Welch, you are recognized for 5 minutes.

Mr. WELCH. Thank you. One of the themes that each of you is presenting, I think, is it is better for us to be engaged than to be confrontational in that within Latin America the countries that are engaged, rather than have a kind of populous confrontational approach to politics, seems to work better.

And two questions, and maybe each of you can just address it very, very briefly, as we have 5 minutes. But what would you identify in the United States is the impediments to us to adopting a policy of engagement which requires, obviously, a certain amount of restraint when what are considered by many here are provocative actions incite us to be confrontational?

And, on the other hand, what are those constraints in countries, say, like Venezuela where they choose confrontation in the relations with us over some type of cooperation?

So, just very briefly, what are the things we have to do in this country to move toward cooperation in Latin America like the same? And I would really like to hear, briefly, each of you respond to that, and I will start with you, Mr. Goldwyn.

Mr. GOLDWYN. Skilled leadership and pay attention.

Mr. WELCH. Skilled leadership and what?

Mr. GOLDWYN. That there really is no impediment; we just have to have people who are charged with diplomacy and knows something about the region, pay attention to it, invest their time in it, and follow this policy. I mean, there really is no impediment to it. We just have other things that have crowded Latin America off the agenda, and sometimes particular political interests or constituencies have a disproportional influence over the people who get those jobs in the State Department.

Mr. WELCH. Right. Thank you.

Mr. GOLDWYN. So just skilled leaders.

Mr. WELCH. Mr. Sotero.

Mr. SOTERO. Knowing and understanding the issues in their complexity. And in the case of Brazil, one major constraint in the whole dialog has been for years now, the whole subject on trade negotiations which maybe now it is the opportunity with commodity prices this high.

And maybe the American taxpayer does not need to spend this much public money to support the foreign sector. You could be much more selective in what you do here, and that could unlock, for instance, the DOHA Round, and get a lot of goodwill in Brazil. Brazilians like to engage with United States. There are 400 plus American companies in Brazil. They have been there forever, and Brazilians think that both Ford and GM are Brazilian companies.

So again, stay focused, pay attention, keep diplomats and people highly skilled, highly knowledgeable, about the region.

And another example, a simple example, something that could do wonders to Brazil-U.S. relations, reengage in a negotiation of a tax treaty with Brazil. A tax treaty between Brazil and the United States would probably do more to bilateral relationships, bilateral engagement than any trade agreement in the foreseeable future.

Mr. WELCH. Thank you. Dr. Walser.

Mr. WALSER. I think the biggest challenge will be to continue to grow Latin America to move beyond the commodities boom, to get stable and sustainable growth that can carry out into the next decade. I think that the biggest challenge and the biggest constraint are developing Latin America's democratic institutions so that they truly deliver the democratic benefit.

The problem we have is that we have said that if you vote, you are going to have a better government. Well, that does not necessarily win the case. Latin Americans vote, but they do not necessarily get better governance. Somehow or another, that institutional barrier, those political bodies that have stood in the way of genuine reform have to be reformed.

Mr. WELCH. Thank you. Mr. Farnsworth.

Mr. FARNSWORTH. I would agree very much with your comment that, indeed, with Latin America engagement works a lot better than confrontation, and there are long historical reasons for that which we need not go into. But I think, as a general approach, that works.

I think that to the extent that there are times when the United States finds itself needing to do something more directly or perhaps more quickly, to the extent we have already developed a reservoir of goodwill with our friends and allies in the region that can be called on to support us in those times of need, I think that is very good. And that has to start with an engagement now when times are not necessarily bad.

Mr. WELCH. Right.

Mr. FARNSWORTH. So that we develop those strong relations.

And the last point I would make on that is the one thing we really have not discussed today, is the whole idea of people-to-people exchanges. I mean, the number of folks between North America and Latin America that are going back and forth is immense. And that in some ways is the best way to develop the relations with the neighbors to the South with one exception: And that is that, given the change to security paradigm in the United States since September 11th, and the appropriate changes that have occurred, nonetheless, the view from Latin America from students and visiting professionals and people who normally would simply travel to the United States and develop those relationships has been that, well, maybe it is a little bit more pain than it is worth.

So they go to Europe, or they go to Africa, or they go to Asia. And so we are losing a whole cadre of emerging leaders from the region that we normally would have taken for granted as a developing relationship with the whole region.

So to the extent that we can concentrate on things like increased Fulbrights, increased visitors exchange programs, increased cultural activities, I think that would be a very, very good place to consider.

Mr. WELCH. Thank you very much.

Mr. TIERNEY. Mr. Shays.

Mr. SHAYS. Two questions. First, I am stunned when the United States gets so actively involved in another country's election because, if it was in reverse, if Venezuela told me that I should support Barak Obama or John McCain or Hillary Clinton, I would probably do the exact opposite, if it was so aggressive.

So tell me, why do we think that somehow our getting involved in their elections will get the result we want?

Mr. SOTERO. Let me say something as to Latin America. In Brazil, really what you think about our election really does not matter much. We are going to vote the way we are going to vote, like, I believe, it is exactly the same way Americans think and should think.

In general, Brazil is a very big country. In other countries, I think that you are right in your assessment. Maybe by declaring your support to this or that you identify, you produce the opposite, you energize the position to that person.

Mr. SHAYS. We would make it illegal for you to spend money in the United States. Is it legal for us to spend money in Venezuela or Brazil to help elect the candidate of our choice?

Mr. SOTERO. No. In Brazil, I know it is not legal at all.

Mr. WALSER. I do not think that the United States backs particular candidates. In 2006, you had, what was it, 11 or 12 elections. There was probably one where there was some apparent interpreted as interference which was to, in Nicaragua, when the embassy—I think Ambassador Trivelli spoke against or interpreted statements against Daniel Ortega.

I think we were very studious in keeping out of the Mexican elections, very close to us, very contentious.

Mr. SHAYS. Well, I do not think we were in Venezuela. In fact, if we wanted to defeat him, we probably should have endorsed Chavez and said he was our closest friend, and we have been working all the time with him.

Mr. WALSER. I have always agreed. But I think that separately supporting, what I mean, both sides are doing through the MED and the NDIRI is supporting the institutions in political process. I think that is a legitimate undertaking which has been long endorsed by——

Mr. SHAYS. As long as it is not partisan to favor one candidate.

Mr. WALSER. Right.

Mr. SHAYS. Mr. Sotero, I have a number of wonderful Brazilians who live in my district who are there, illegally.

Mr. SOTERO. Yes.

Mr. SHAYS. And they make huge arguments about why they are such good citizens in the United States. But I would love to know if I went to Brazil and extended my visa, and then sought to get work in Brazil, what would be the attitude of the government?

Mr. SOTERO. You would not be able to because we are actually, unfortunately, very bureaucratic in the way we do things. So you would not have any of the documents necessary to get employment in Brazil.

Mr. SHAYS. Well, could I not get an employer to hire me, illegally?

Mr. SOTERO. Sir, it is unlikely. We have some illegal immigrants from the neighboring countries, 50,000 Bolivians, a number of people from Colombia that live in Brazil, illegally. They live in the informal sector which is very huge in Brazil because of excessive regulation. Half of new jobs created are, euphemistically, called the informal sector.

But I fully understand what the problem is here. There may be, according to Brazilian government estimates there may be some 800,000 Brazilians living in the United States, about 83 percent, that are estimated that they are——

Mr. SHAYS. Let me tell you, they are wonderful neighbors. I mean, not next-door neighbors, but in the community. But it is something we are wrestling with, and it is just—anyway, thank you.

Thank you, Mr. Chairman.

Mr. TIERNEY. Thank you, Mr. Shays.

Let me just ask, Mexico, by most of the accounts we anticipated today, may be out of oil in 2016. I think if they give almost 623,000 barrels to the United States, what is the impact on the United States when that happens? What is the impact on Mexico when that happens? Mr. Farnsworth.

Mr. FARNSWORTH. Thank you, Mr. Chairman. I think it is a very important question, it is a very timely question.

I think in the first instance, Mexico itself understands this. The president is a former energy minister. He is very, very capable, I believe. His energy minister is quite good. The head of PEMEX is a former Ambassador to Washington. They understand the issues, they understand the imperatives, they understand the urgency. In fact, right now the administration in Mexico City is trying to work with the congress, which it doesn't control a majority to try to get through legislation that would open up in parts at least some of this sector.

The complication is, as you know, that this is a constitutional issue in Mexico, and it is deeply ingrained in the Mexican psyche, and it is not something that will be able to be changed, necessarily, until the——

Mr. TIERNEY. Will you tell us a little bit about the constitutional provision and what might be done to it that is going to satisfy that psyche and also get to the result that you think is favorable?

Mr. SHAYS. Why is it a constitutional issue, I do not know.

Mr. FARNSWORTH. It was created in the Mexican constitution when the oil sector was nationalized during the revolution in the last century. And it has formed a basis of Mexico's understanding of itself as a nation, because what they essentially did is they, euphemistically, kicked out international oil company and international investors to be able to control the national resources and to reserve the resources for the Mexican people.

And so the Mexican people, themselves, see ownership of these issues, and so it is not something that can just be changed by decree. It really has to be constitutionally reformed. And it would be like our own Constitution in a certain sense would need that type of reform. That is the complication.

Now, having said that, there may be ways to change that with contracts that would allow in partnerships and sharing, and I think that is what is being explored right now, and that could be a short-term solution. Ultimately, in order to get to the reserves that people believe are there, particularly in the deep water of the Gulf of Mexico, Mexico needs investment, management expertise, and a better understanding of how to get to those resources which they currently do not possess.

Mr. TIERNEY. So I am wondering, since that is such a short period of time, and constitutional changes take long periods of time—and you answered me in part there—what is it that we can do to work with them as they work to some of these sort of informal arrangements, or whatever? And do you think there is no arrangement that you can envision that would allow them to both keep the psyche intact that, this is our oil, but we are going to work cooperatively with other people and have them work for us to produce more oil?

Mr. Sotero, you may comment.

Mr. FARNSWORTH. Let me just make one quick point, if I can be responsive to the question, because I think that it is extraordinarily complicated for the United States to be helpful in that particular issue, and so working with friends and allies, for example the Canadians, who have developed a very interesting model for investment where the Canadians themselves continue to own the resources but yet have found a way to develop the resource and get them to market and monetize them.

Mr. TIERNEY. I was wondering why they could not do that.

Mr. FARNSWORTH. There are models out there. Brazil has done some very interesting things. Colombia is doing things, and by bringing the parties together for discussion with the Mexican body politic, I think that could be very helpful.

Mr. TIERNEY. I have to tell you, I would assume that it is very interesting to people who think they want to own their own resources. I think Mr. Goldwyn mentioned that earlier, as why would you argue against that, particularly with a bad history in the past with people abusing it in fraud and waste, or whatever. But there has to be some accommodation where it all works.

Mr. Sotero.

Mr. SOTERO. Well, Brazil used to have a state monopoly on oil exploration. PetroGrass was created in the 1953 year, and the slogan was, "The Oil Is Ours." There was the same sense of identity.

Well, the oil is ours, but we understand now to take it from down there for consumption, we need partners. We do not have all the money to invest in PetroGrass. We changed the model. PetroGrass has controlled 55 percent by the government, but its shares are in the stock market traded there, and we have waste contracts. There are foreign companies from all over the world working with PetroGrass, as PetroGrass works in 25 other countries as a Brazilian multinational company.

Now, I think it may be useful for the Mexicans, and there has been contacts to look into the Brazilian example. There may be some lessons, interesting lessons, there to make PEMEX become a more efficient company. It may sound as a contradiction in terms for Americans, but I can assure you PetroGrass is a state-controlled company that is very, very efficient because it knows precisely what market it operates, and that market determines that it has to be an efficient company.

So I believe, again, maybe engagement in the hemisphere can open up ways for PetroGrass, and maybe later in the future even better than this, or to be better run.

Mr. TIERNEY. Well, they provide such a large part of the revenues from Mexico, and if we think that we have immigration issues now, and I was expecting, Mr. Goldwyn, that you might want to comment on that—Dr. Walser or both of you—what happens if that dries up and there is no other resource.

President Calderon is not able to increase the tax situation, as he has been trying to do. I would think that it becomes a large impetus for people to go where they can support their family somewhere.

Mr. GOLDWYN. Well, it depends on how they react. I am somewhat optimistic now that the party that was out had this idea. Now that it is not in power it is sort of against it. There is a potential compromise there which will allow probably not U.S. companies but other state-owned companies like Statt Oil and like PetroGrass to come in there in a very limited way, experimental way look in the Gulf.

So I am somewhat optimistic. It can go two ways with a country like Mexico. This oil well is not always great for countries. One possibility is that Mexico makes itself much more competitive for manufacturing other kinds of business, and it sort of migrates out of the oil business. Or the other is it stands still and does nothing, and they just lose revenue, and then you have job loss, drop of standard of living, increased migration across the border, which is the U.S. concern.

But there is this odd correlation between countries, you know, which do not have great oil wealth and their ability to reform their economy is to make them more prosperous, like the [phrase in foreign language] in the Middle East.

The answer for us, though, is if Mexico declines in a significant way, we import more Middle East oil probably a little bit more from Africa, and significantly more from the Middle East.

Mr. TIERNEY. And I am telling you it is not just a problem for us on immigration; it is a problem for them. There are some pretty good people, innovators that, you know, people that they know enough to go someplace else and make themselves a success; they'll probably do a bang-up job staying home on that.

Anybody have any final statements? Dr. Walser, do you want to make a comment on that?

Mr. WALSER. Just that it is important to continue to grow Mexico. I mean, PEMEX loses 42 percent of its money to support the national budget. This money could be shifted, obviously, to investment if it could operate as a basic going concern.

Tax reform, economic growth in Mexico could take some of the pressure off of PEMEX to allow them to invest in oil exploration, but again that is a long-term challenge.

Mr. SOTERO. Sir, as Eric mentioned, obviously, the findings of oil in Brazil has to be concretely verified. But they are very, very significant. PetroGrass, as I tell you, is a very competent company, is the world leader in deep water drilling. This oil is five kilometers down, but we already take oil from three kilometers down very well, and so it is a matter of investment, but there is, I think, a lot of positive thinking going on in Brazil that the country could emerge in a framework of 10 to 15 years as also an exporter of oil. So it could be a player in that market, also.

Mr. TIERNEY. Thank you. Let me thank all of you for your participation today. We are going to revisit this issue, and we may take a congressional delegation down to the area to talk in more detail with people.

We see this as a very serious issue of security as well as economics, and I think the challenges are enormous, but the opportunities are even larger on that, and you have helped us frame that issue today. So thank each and every one of you for your participation. We really do appreciate it. Thank you.

[Whereupon, at 12:03 p.m., the subcommittee was adjourned.]

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