

# Oil and Peace in Colombia: Industry Challenges in the Post-War Period



by Alfonso Cuéllar<sup>1</sup>

## Introduction

In July 1983, Occidental Petroleum announced a major oil find in the department of Arauca, Colombia. The discovery of the Caño Limón field was a watershed moment for the Colombian oil industry and for the country as a whole. By the end of the decade Colombia would achieve self-sufficiency and would attract significant investment in exploration that would pay off years later, with the discovery of the gigantic Cusiana and Cupiagua fields. The enormous resources that would emanate from Caño Limón would lead commentators to speak—mistakenly—about an “Arauca Saudita.”

On July 14, 1986, there was another event which would also have a profound impact on oil exploration and development in the country. At that time few would have imagined its significance and how it would mark the beginning of a notorious era in Colombia. The news item was succinct: near the municipality of Carmen de Tonchalá, Norte de Santander, guerrillas of the Ejército Nacional de Liberación (National Liberation Army, or ELN) had dynamited the recently inaugurated Caño Limón-Coveñas oil pipeline. Rescue crews had been sent to the area. The pumping of oil was stopped for safety reasons. The attack was a precursor of things to come. In that year alone, there would be 18 terrorist attacks against the Caño Limón-Coveñas pipeline.<sup>2</sup>

By 2015, the pipeline would have been hit 1,317 times, an average of one per week, with a peak of 166 in 2001 and over 3.6 million barrels of oil spilled in the Colombian countryside. From 1986-2014, the pipeline had to be shut down for a total of 3,701 days; the economic value of oil spilled was US\$276 million and repair costs amounted to \$335 million.<sup>3</sup> This guerrilla activity—including kidnappings and extortion of oil

<sup>1</sup> The author is President and Managing Director of Hill+Knowlton Strategies Colombia and Director for H+K’s Energy Practice in Latin America.

<sup>2</sup> Author interview of Ecopetrol spokesman, Bogotá, October 28, 2015.

<sup>3</sup> Author interview of Ecopetrol spokesman, Bogotá, October 22, 2015; Fiscalía General de la Nación, Estableciendo los hechos, 2015, 17, 26. The investigation by the Fiscalía of environmental damage caused by attacks against the pipeline was presented in Washington, D.C., on October 29, 2015.

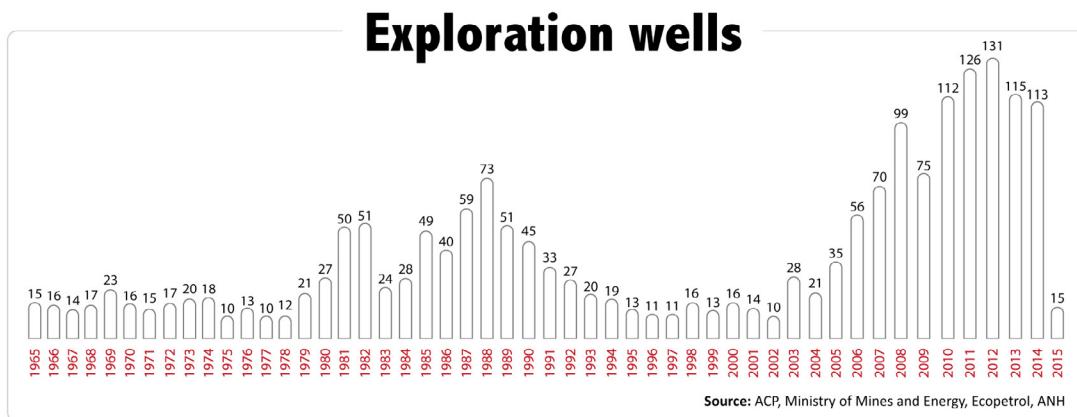
company executives and workers, initially by the ELN and in subsequent years by the Fuerzas Armadas Revolucionarias de Colombia (Revolutionary Armed Forces of Colombia, or FARC) as well—would influence the behavior of oil companies, both the state-owned Ecopetrol and foreign multinationals in the regions in which they operated.

As the Colombian government nears a peace agreement with the FARC and prepares to begin negotiations with the ELN, there is a view among government officials, opinion leaders, and the media that the oil industry will be one of the clear winners once a peace accord is signed. The expectation is that absent guerrilla sabotage, oil will flow unimpeded and exploration activity should surge in regions where insecurity previously made it impossible. As with everything in Colombia, this vision is not necessarily accurate. Other challenges, both national (involving the legal framework) and regional (increased community dissatisfaction in areas of oil exploration and extraction) which could negatively impact this positive outlook. This report analyzes the current state and future of hydrocarbons exploration, development, and production in a post-conflict scenario.

### The Unexpected Boom

At the turn of the 21st century, the outlook for Colombian oil production was grim. Although production had peaked in 2000 at just over 800,000 barrels per day, all indicators pointed to a steep decline. Top prospects Gibraltar (Occidental Petroleum) in the department of Norte de Santander and Niscota (British Petroleum) in the Casanare-Boyacá border had failed to materialize. Private industry estimates had predicted oil and gas reserves of over a billion barrels each. The reality was 20 times less. Expected doomsayers in the industry and in the Colombian Congress predicted that Colombia would lose its self-sufficiency by 2005 unless new reserves could be discovered and developed. Since the mid-1990s and because of the country’s deteriorating security situation, seismic activity had slowed down significantly and exploration wells numbered in the low teens.

### Exploration Wells



Then came 2001. In a frenzy of attacks, the ELN and the FARC hit the Caño Limón pipeline 170 times, leading the two partners in the venture—Occidental and Ecopetrol—to shut down production for several months. Investigations would later show that the majority of the bombs were placed by the FARC, who were battling the ELN for control of Arauca. At that time, income from royalties was being siphoned off by

the latter.<sup>4</sup> The combination of increased security threats and an onerous government share of revenues compared to other Latin American producers<sup>5</sup> led to a virtual standstill in exploration activity. In 2001, only 10 exploration wells were drilled, tying the country's record for the worst performance since 1975.<sup>6</sup>

Faced with these difficulties, the new administration of President Álvaro Uribe (2002-10) recognized that the association contract framework,<sup>7</sup> which had played a positive role in attracting companies to the country in the 1980s, had run its course. Tweaking the contract terms would not be enough to bring in the needed levels of investment at a time that other regions of the world were more competitive (i.e. West Africa, Azerbaijan).

Under the leadership of Minister of Mines Luis Ernesto Mejía and the president of Ecopetrol, Isaac Yanovich, the traditional Colombian oil and gas policy structure was upended. Ecopetrol, which until 2003 had been both the obligatory partner of private companies and their regulator, was transformed into a stand-alone entity. It could, therefore, focus on its core activity: the exploration, production, transportation, and distribution of hydrocarbons. (It would later be listed on the Bogotá Stock Exchange and 10 percent of its shares would be sold to investors.)

The role of assigning areas and blocks for exploration, setting commercial terms, and paying royalties to the national, regional, and local governments was transferred to the newly created National Hydrocarbons Agency (ANH).

Today, it seems logical to separate the two competing functions, but that was not the case at that time. There was uncertainty about Ecopetrol's ability to compete internationally and, more significantly, skepticism that the ANH could piece together an attractive package for investors. Reaction was slow at first, as is typical in an industry with long-term horizons like oil and gas. But within a few years, exploration wells spiked to 70, then 99.<sup>8</sup> This renewed interest coincided with the doubling and then tripling of the world price of oil. Equally relevant was a substantial improvement in the security situation in Colombia due the Democratic Security policies of the Uribe administration. Attacks against pipelines and other infrastructure fell dramatically, to less than 40 in 2010.<sup>9</sup>

Ironically, none of the above explains fully how the country went from producing approximately 500,000 barrels per day as recently as 2007 to over a million barrels a day in 2015. The huge increase was possible thanks to the massive use of secondary and tertiary recovery techniques on old fields, which were finally economically viable due to high global oil prices. These fields of heavy oil were extremely expensive to develop, given the high water content and cost of treating the extracted oil. For example, the Rubiales field, which produced merely 700 barrels of heavy oil per day in 2003, reached 220,000 barrels per day in a decade.<sup>10</sup> And Colombia, which had long been viewed as a bit player in international oil markets, entered the top twenty oil producing countries worldwide.

<sup>4</sup> "FARC y ELN se enfrentan por el botín de Arauca," *El Tiempo*, November 4, 2001. Investigation by the Fiscalía General de la Nación, shared with author by oil industry source. During the period of 2000-2002, there was a competition for access to royalties between the Domingo Laín front of the ELN and the 10<sup>th</sup> and 45<sup>th</sup> fronts of FARC in Arauca. For several years, the region had been the sole area of influence of the ELN, local authorities were constantly extorted for contracts and resources, When the FARC was unable to reach an agreement with the ELN to share the proceeds, war was declared between the two guerrilla groups. This included bombing the pipeline.

<sup>5</sup> In Colombia the government's share of oil revenues was 85-90 percent, compared to 55-60 percent in Peru and Argentina.

<sup>6</sup> Asociación Colombiana de Petróleo (ACP), *Hidrocarburos*, 14 edition, September-November 2015, 8.

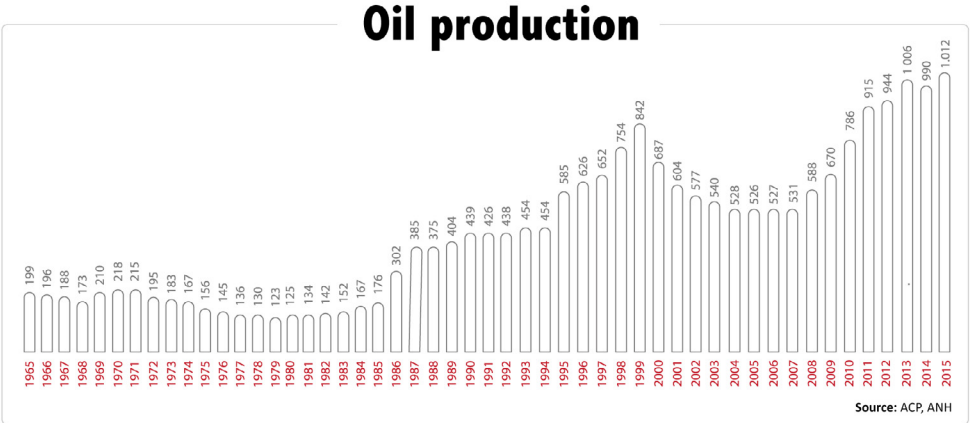
<sup>7</sup> Under this system established in 1974, private companies were allowed to partner with Ecopetrol in an association contract. The split was 50 percent for Ecopetrol and 50 percent for the private partner, once a discovery was made.

<sup>8</sup> ACP, *Hidrocarburos*, 14 edition, 9.

<sup>9</sup> Ministerio de Defensa de Colombia, September 2015.

<sup>10</sup> *La República*, July 30, 2015.

**Oil Production in Colombia**



No oil industry can survive, however, with only secondary recovery. Quite notably, Colombia has not had a major new discovery since the Cupiagua field in 1992. What this means is that Colombia’s long-term oil industry prospects depend on exploration and the opening up of new basins. The dramatic fall in global oil prices beginning in the second half of 2014 hit the country hard at a time that the industry, which had viewed positively the Uribe administration’s policies, had begun to express criticism of the negative impact of fiscal decisions taken by the government of President Juan Manuel Santos (2010-). This included a surcharge on the wealth tax, the elimination of several deductions, and a broader tax reform approved in 2014.<sup>11</sup>

Adding to the industry’s disaffection were two policies—one adopted by the Santos administration and the other a feature of Colombia’s 1991 Constitution—that were making day-to-day operations a nightmare for the companies.

**The Law of Unintended Consequences**

The reform of the structure of royalties was the brainchild of the Santos administration’s first Minister of Finance, Juan Carlos Echeverri. Historically, one of the staples of Colombia’s oil policy has been to guarantee the transfer of funds to the regions where exploitation of hydrocarbons occurs. The underlying rationale is that oil exploration and development are disruptive for local communities and thus they should receive part of the proceeds. For several decades, the formula was simple: 20 percent of revenue was allocated to the producing departments and municipalities and to the port and transportation hubs. The amounts themselves are staggering: between 1992 and 2010, the departments of Arauca and Casanare alone received five and six billion dollars, respectively, in oil revenue transfers.<sup>12</sup>

However, the money was not well spent. Mismanagement and corruption, according to the Comptroller General’s Office (Contraloría General), was rampant. The media highlighted extravagant projects, with one in particular standing out: a wave-making pool in Arauca, Arauca. By contrast, Yopal, the capital of Casanare, still does not have an aqueduct.

<sup>11</sup> For an overview of Colombia’s recent tax reforms, see Gustavo Flores-Macías, “The Political Economy of Colombia’s 2012 and 2014 Fiscal Reforms,” in James E. Mahon Jr., Marcelo Bergman, and Cynthia Arnson, eds., *Progressive Tax Reform and Equality in Latin America*, Woodrow Wilson Center Reports on the Americas, 35 (Washington, D.C.: Latin American Program, 2015), 101-26; <https://www.wilsoncenter.org/publication/progressive-tax-reform-and-equality-latin-america>

<sup>12</sup> Departamento Nacional de Planeación, Gobierno de Colombia, *Regalías de hidrocarburos, 1992-2013*.

Echeverri persuaded Congress that there had to be a more efficient manner to spend the substantial amounts of money generated by oil production in ways that would benefit the entire country. He framed it as the need to “spread the jam around,”<sup>13</sup> a statement that would later be misinterpreted and become synonymous with political patronage. The new royalties law established more stringent parameters on how the funds should be spent (i.e. 10 percent for investments in science and technology), reduced the total amount sent to producing regions, and focused on attacking extreme poverty. Widely lauded in Bogotá for the emphasis on transparency, the changes did not play well in the oil and gas producing regions. For the people living there, the changes appeared to be a losing, zero-sum game. Royalty receipts in Arauca went from \$300 million in 2011 to \$120 million in 2012, while revenues to Casanare dropped from \$420 million to \$300 million in the same time period.<sup>14</sup> These decreases occurred even before the collapse of oil prices in 2014.

Deprived of resources which they felt were rightfully theirs, governors, mayors, and local communities channeled their discontent against the oil companies. The number of protests and work stoppages skyrocketed.<sup>15</sup> The issue of revenue-sharing has not been resolved and will likely become more challenging once a peace accord is reached. Echeverri, who left the Finance Ministry to become president of Ecopetrol in March 2015, will continue to be on the frontlines of these conflicts.

A second set of policy issues around oil extraction emanates directly from Colombia’s 1991 Constitution, the country’s ratification of International Labor Organization (ILO) Convention 69, several laws and decrees, and rulings by the Constitutional Court.<sup>16</sup> Taken together these mandate consultations with indigenous and Afro-Colombian communities as a prerequisite to the exploitation of natural resources. The aim is to respect and protect the cultural, social, and economic heritage and rights of these minorities.

The implementation of the laws and regulations concerning prior consultation (*consulta previa*) has been difficult. The crux of the problem lies in contrasting interpretations of the meaning and consequences of “consultation.” For the government and the oil industry, the requirements are met by informing the communities of the projects, listening to their concerns, and accepting some, but not necessarily all, the community’s recommendations. Some indigenous and Afro-Colombian leaders believe that they have veto power over projects and at times have tried to enforce their will. However, while the Constitution guarantees the right to consultation, Article 332 is explicit in affirming that the Colombian state owns the subsoil and its natural resources. In this dispute, there is no neutral arbitrator.

The Santos administration attempted to resolve this conundrum by introducing legislation setting out the framework for consultations. But it found itself caught in a Catch-22 situation: in order to present the bill, it needed to consult with communities who were themselves reluctant to agree on new language that would weaken their leverage and power over decision making. The difficulty has been compounded by disputes within various Afro-Colombian communities over who can legitimately claim to represent the community. In a speech on October 15, 2015, to the Colombian Oil Association (ACP), President Santos announced that this obstacle had been overcome, that consultations with indigenous communities on the future law had already taken place, and that in the coming weeks, these would be held with representatives of the Afro-Colombian communities.

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<sup>13</sup> In Spanish, “ *vamos a repartir la mermelada en toda la tostada.*”

<sup>14</sup> Departamento Nacional de Planeación, *Regalías de hidrocarburos.*

<sup>15</sup> “*Así se ha vivido la caída de las regalías en los municipios,*” *El Tiempo*, February 18, 2015.

<sup>16</sup> See: [http://www.upme.gov.co/Memorias%20Convocatoria%20Redes%20de%20Alto%20Voltaje/MININTERIOR\\_CONSULTA-PREVIA.pdf](http://www.upme.gov.co/Memorias%20Convocatoria%20Redes%20de%20Alto%20Voltaje/MININTERIOR_CONSULTA-PREVIA.pdf)



ELN explosion at crude oil holding pools along the Caño Limón - Coveñas Pipeline.  
Photo credit: La Voz del Cinaruco

In the same speech, Santos emphasized that the pace of consultation over specific projects had quickened, quite apart from discussions over the proposed law; they now took months, not years. Santos also addressed another area of concern—the process for granting environmental licenses and permits—and indicated that the amount of time had been reduced from 12-14 months to a mere quarter of that time.

### From Boom to Crisis

During both the Uribe and Santos administrations, the Colombian government became accustomed to the oil boom. In the five year period between 2010 and 2014, oil and gas investment surpassed \$20 billion and represented 30 to 40 percent of total foreign investment. In 2013 alone, oil and gas development brought into state coffers over \$13 billion in taxes and royalties. The oil sector accounted for 29 percent of fiscal revenue in 2014.<sup>17</sup>

As the government was quick to point out, oil and gas income is equal to 12 years of government spending on social programs or 60 percent of public investment on massive road infrastructure projects or the entirety of Colombia's educational budget.<sup>18</sup> Production in 2015 of one million barrels a day generates \$340 million a month for government investments in a range of programs.<sup>19</sup>

The government is optimistic about maintaining the same production levels through 2018 and the National Planning Department has used this estimate for its budgetary projections. The oil and gas industry, however, does not share the government's optimism. It is quick to point out that only 15 exploration wells were drilled in 2015 (47 had been planned), compared to 113 in 2014, and 131 in 2013. Colombia's success rate is between 15 and 20 percent, even in the best case scenarios.<sup>20</sup> Current industry estimates are that the country risks losing its self-sufficiency in oil by 2022, if not earlier. Significant new finds are

<sup>17</sup> Presentación, viceministro de Energía, Carlos Fernando Erazo, "La Visión del Sector de Hidrocarburos," Bogotá, December 10, 2014.

<sup>18</sup> Ibid.

<sup>19</sup> Speech by President Juan Manuel Santos, "50 años de la Asociación Colombiana de Petróleo," October 15, 2015.

<sup>20</sup> ACP, Hidrocarburos, 14 edition, 10.

rare. The average Colombian wells produce 3,000 barrels per day.<sup>21</sup> Although U.S. company Anadarko's Kronos discovery offshore in July 2015 generated excitement over the opening up of a new basin, what was found is gas, not oil.

In light of the above, the Ministry of Mines and the National Hydrocarbon Agency have taken several steps aimed at assuaging the industry's concerns. In April 2015, they announced a plan to boost productivity and employment in the mining and energy sector, which included better terms for offshore development and extended contract commitments. In September 2015, the Santos government promised to increase the studies of Colombia's geology, simplify the assignment of areas and licenses, grant fiscal incentives for new exploration, and optimize the licensing process. And in October, the ANH proposed the creation of duty free zones for companies interested in investing in secondary and tertiary recovery.<sup>22</sup>

### Cundinamarca, not Dinamarca

Oil exploration and development is always challenging in practice. Colombia's conflict adds an additional dimension. As Colombians often say, using dark humor, we are in Cundinamarca—the name of a Colombian department—not Dinamarca (Denmark), where peace abounds.

What sets Colombia apart is the existence for 50 years of two guerrilla groups that decided decades ago to consider the oil industry a legitimate military target. The guerrillas justified their violence according to two logics. One was ideological—based on the premise that multinationals were looting the country's scarce natural resources; the other was practical—oil income filled the coffers of their enemy, the Colombian government, and more specifically, the military. Based on these considerations, first the ELN and then the FARC built criminal enterprises that involved widespread extortion of contractors and subcontractors, the kidnapping of oil executives and workers (both foreign and Colombian), and training in explosives. Paradoxically, the guerrillas also helped fix the pipeline. Judicial investigations found that in some cases, damaged infrastructure ended up being repaired by the same group that had caused the damage. That is, the guerrillas would be paid by the oil companies to fix what they had destroyed in the first place.

Local authorities were intimidated, coopted, or murdered. (In 2001 alone, Arauca's two congressmen were assassinated). According to the Fiscalía, royalties were diverted into the coffers of the guerrilla organizations.

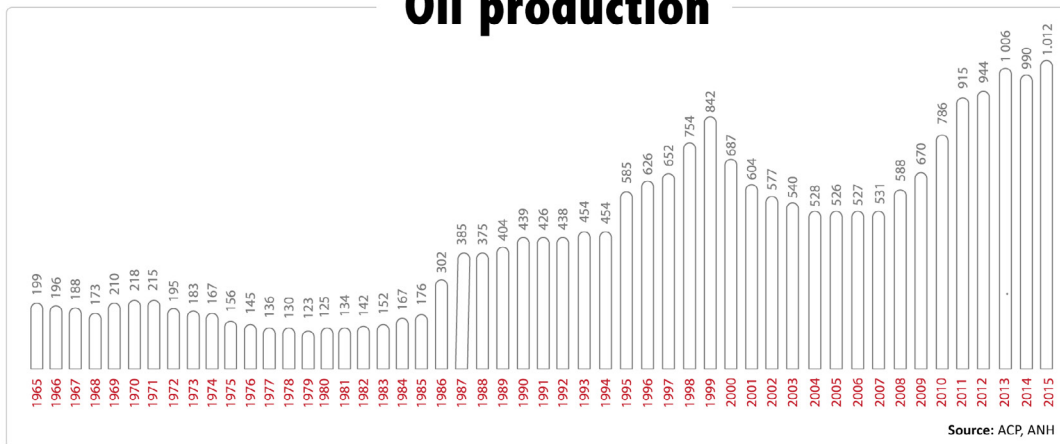
Given this clear and present threat, the oil companies adopted several precautionary measures to safeguard their personnel and property. Travel by employees on local roads was restricted and helicopters became the preferred mode of transportation. High fences were erected, installations became enclaves, interaction with communities was delegated to specialists, and overall security was managed by professionals in the field. Companies reached agreements with the armed forces in order to protect oil and gas operations. At first this happened informally but over time became required practice. The military's support was mainly logistical and involved industry payment (by the hour) for helicopter transportation, along with lodging, food, and other amenities. The agreements drew the ire and criticism of human rights

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<sup>21</sup> Walter Molano, "The Emerging Market Advisor," BCP Securities, LLC, July 6, 2015.

<sup>22</sup> "El país podría duplicar reservas de crudo sin nuevos hallazgos," Portafolio, October 29, 2015. Oil recovery is categorized in three phases. In secondary recovery, pressurized gas and water are injected in the reservoir to drive the residual crude oil and gas remaining after the primary oil recovery phase to the surface wells. In tertiary recovery, different materials are injected to improve the flow between oil, gas and rock, and to recover crude oil remaining after the primary and secondary oil recovery phases.

## Oil production



organizations and led to accusations about the privatization of the army.<sup>23</sup> The security situation for oil companies also attracted the attention of the U.S. Congress, which in 2002 and 2003 approved \$99 million in assistance specifically for the protection of oil installations, particularly in Arauca where Occidental Petroleum’s operations were located.<sup>24</sup>

### A Brave New World

As of this writing in December 2015, it is widely expected that the negotiations between the Colombian government and the FARC will culminate in a peace agreement in 2016. Though on a slower timetable, preparatory talks with the ELN are also ongoing. For the oil industry, a positive outcome in both negotiations is critical for there to be meaningful change on the ground.

If only FARC combatants demobilize, the immediate impact would be felt only in regions where they have been the leading disrupter and criminal organization, i.e., the departments of Putumayo and Caquetá. In Putumayo, the FARC’s 32nd and 48th fronts have caused havoc for several years; as recently as June 2015 they stopped 28 trucks and ordered the drivers to spill the oil in nearby creeks. Caquetá is the heart of FARC operations and was off limits for the industry for decades. Only a few companies ever considered investment in that region and one of them had four Chinese employees kidnapped.<sup>25</sup> Exploration and production, though carried out in some areas, has always been a risky proposition and has only been made possible by a massive military and police presence. Both departments are considered, however, to have enormous potential.<sup>26</sup>

An agreement with the ELN would significantly alter the dynamic in northern Casanare, Arauca, and Norte de Santander (Catatumbo). Attacking and extorting the oil industry has been the principal modus operandi of the Domingo Laín front, historically the ELN’s strongest military and financial organization. Its dismantling could be a game-changer.

If negotiations with the ELN do not prosper—it is more fundamentalist than the FARC—it will be very difficult for the oil companies to abandon a security-first approach in the majority of the regions in which they operate. Additionally, there is concern that disaffected FARC members could join the ELN absent successful negotiations with both organizations. (Though the two organizations have had serious

<sup>23</sup> See: <https://www.hrw.org/legacy/worldreport99/special/corporations.html>

<sup>24</sup> “For oil companies, defense abroad is the order of the day,” Wall Street Journal, February 7, 2002.

<sup>25</sup> “Las Farc liberan a cuatro ciudadanos chinos secuestrados en 2011,” El Tiempo, November 22, 2012.

<sup>26</sup> Author conversation with a former Colombian viceminister of Mines and Energy, Bogotá July 10, 2015.



differences at the leadership level, the more criminal elements of the two guerrilla groups have more in common. The right-wing paramilitary organizations of the 1990s and 2000s were riddled with former ELN members.)<sup>27</sup>

Uncertainty regarding the ELN process is not the only difficulty for the oil industry in the post-conflict period. Just as for Colombians as a whole, the prevailing mindset will have to change. It will take time to gather the courage to leave the ringed compounds and mingle among the locals in Arauca, Caquetá, and Putumayo. A single kidnapping could set back the process of confidence-building months, even years.

According to the Colombian government, one of the key objectives of peace is to empower communities that have been abandoned by the state and under the influence of illegal armed groups. Many communities in oil-producing regions are already quite active in expressing their grievances. It is unlikely that this situation will change; on the contrary, protests and work stoppages could grow in number once the fear of violent retaliation dissipates. The oil industry will not be alone in confronting this reality; but given the importance of oil revenues for government finances, it is critical that companies begin to plan for the new world that awaits them.

Most observers of the peace process in and outside Colombia agree that the signing of a peace agreement between the government and the FARC is just a first step in building peace. The hard part will be the implementation of the accords. And for that to succeed, financial resources will be critical. Raising taxes on individual or corporate income—or pursuing broader tax reform—constitutes an expensive and politically-fraught solution compared to expanding oil and gas exploration and development and, thereby, government income. The prize is evident: according to the National Hydrocarbons Agency, Colombia has potential reserves of 26 billion barrels of oil and 349 trillion cubic of gas, ten times the country's current proven reserves. The challenge for the industry is not only to find the resources in the ground, something which ultimately is a question of geology. Equally important, as this paper has argued, is effectively managing the risks above ground.

## About the Author

Alfonso Cuéllar is President and Managing Director of the Colombia office of Hill + Knowlton Strategies, a consulting firm with offices in 7 countries in Latin America. He also leads H+K Strategies' Energy Regional Practice, assisting national and multinational clients in the region. Cuéllar's career has spanned more than two-and-a-half decades in the media, the private sector, diplomacy, and crisis management. Most recently, he served as Deputy Chief of Mission and Minister Counselor at the Embassy of Colombia in Washington, D.C. Previously he was editor-in-chief of *Semana*, Colombia's leading news magazine, and has been the recipient of several prestigious journalism awards, including a Knight Fellowship from Stanford University. For several years, he worked as the government and public affairs team leader for British Petroleum in Colombia and served as BP's press officer for Latin America. Earlier in his career, he served as foreign editor of *El Tiempo*, Colombia's largest newspaper. Cuéllar graduated from Allegheny College in Pennsylvania, where he majored in Political Science.

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<sup>27</sup> The paramilitary organizations—the Autodefensas Unidas de Córdoba and others—coaxed ELN members to join them by offering financial benefits and also by intimidation: join or die. Many of these ELN recruits later rose within the ranks and were responsible for several massacres.

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