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FEATURED Q&A

Has Shelving its Pension Reform Set Brazil Back?



Brazilian President Michel Temer last month shelved the country's pension reform, which has been seen as crucial to the country's long-term fiscal health. // File Photo: Brazilian Government.

Q Brazil on Feb. 16 effectively shelved its controversial pension reform when President Michel Temer ordered the country's military to take charge of security in Rio de Janeiro, blocking any constitutional reforms while a federal intervention is underway. Political Affairs Minister Carlos Marun acknowledged that the government didn't have enough votes in Congress to push through the pension reform. How important is the pension reform to Brazil's long-term fiscal health, and what does Temer's "Plan B" for the economy involve? What will be the fallout now that the pension reform it has been shelved? Will the reform, which international investors and ratings agencies have generally favored, fare any better under Brazil's next president?

A Lisa M. Schineller, managing director of S&P Global Ratings: "S&P Global Ratings downgraded Brazil's sovereign credit ratings to 'BB-' in January due to slower-than-expected progress in passing structural fiscal legislation to correct the country's large fiscal imbalances. The downgrade also incorporates our view that resistance within the public sector will likely limit the pace, breadth and depth of timely reform under the next administration as well, coupled with uncertain policy prospects and difficulties in managing coalition dynamics after the election. The challenges in advancing pension reform is one example of this dynamic. All of this is in the context of the fact that fiscal weakness is a prominent sovereign credit rating weakness. General government deficits that have averaged 9 percent of GDP between 2015 and 2017; net general government debt reached 57 percent of GDP in

Continued on page 3

TODAY'S NEWS

ECONOMIC

Cuba Imposes New Restrictions on Imports

Cuba's central bank has imposed the new restrictions in an effort to lower foreign debt and address a shortage of cash. Companies will need to obtain a letter of credit from the monetary authority for purchases above \$100,000.

Page 2

BUSINESS

Pemex to Seek Foreign Partners for Oil & Gas Projects

The company may bring foreign partners into two heavy crude projects in the Gulf of Mexico, among other areas, its CEO said.

Page 3

POLITICAL

Brazilian Court Denies Lula's Bid to Remain Free

Brazil's Superior Court of Justice, in a unanimous decision, denied former President Luiz Inácio Lula da Silva's bid to remain out of jail while he appeals his corruption conviction.

Page 2



Lula // File Photo: Lula Institute.

POLITICAL NEWS

Brazilian Court Denies Lula's Bid to Remain Out of Jail

In a unanimous vote, Brazil's Superior Court of Justice on Tuesday denied a bid by former Brazilian President Luiz Inácio Lula da Silva to remain out of jail while he appeals the corruption conviction against him, O Estado de S.Paulo reported. A lower appeals court in January upheld Lula's corruption conviction

“This process is like we are still in the time of the Inquisition, where no evidence was needed, only convictions.”

— Luiz Inácio Lula da Silva

and increased his sentence to 12 years from the original nine and a half years on corruption and money laundering charges, on which Lula had been convicted last July. Tuesday's 5-0 decision means that the popular former president could be behind bars within weeks, even as he continues his appeals. Lula is the frontrunner ahead of Brazil's October presidential election. However, Brazilian law bars the candidacy of any politician who has a criminal conviction that has been upheld on appeal. Lula, who oversaw strong growth and falling inequality during his 2003-2011 presidency, faces six more trials related to corruption, Reuters reported. Lula has denied wrongdoing and has said that he is being persecuted in order to prevent him from returning to the presidency. “This process is like we are still in the time of the Inquisition, where no evidence was needed, only convictions,” Lula told Metropole radio early on Tuesday. Lula's lawyer, Supulveda Pertence, later said the former president was being subjected to a “Kafkaesque trial,” Agence France-Presse reported. Despite his popularity, 40 percent of

Brazilians disapprove of him, with many seeing him as responsible for systematic corruption that prosecutors have uncovered since his presidency, and also for the severe recession that Brazil suffered after he left office. [Editor's note: See [Q&A](#) in the Feb. 1 issue of the Advisor on whether Lula's political career is over.]

ECONOMIC NEWS

Cuba Imposes New Restrictions on Imports

Cuba's central bank has imposed new restrictions on imports by state-run companies in a bid to curb mounting foreign debt and address a cash shortage, Reuters reported Tuesday. The new rules require firms to obtain a letter of credit from the central bank for purchases above the equivalent of \$100,000. While the move will likely lead to a short-term plunge in imports, it could also result in a purge of non-essential or insolvent companies, according to the report. Since its communist revolution in



Castro // File Photo: Radio Rebelde.

1959, Cuba has struggled to maintain steady momentum in its centralized economy. Pavel Vidal, a former Cuban central bank monetary specialist, told Reuters that state-run banks would now function as an additional filter to ensure companies were solvent and could pay for imports. “They have figured out that the government can renegotiate the foreign debt, but if the state companies do a poor job managing their finances they face the same problem over and over again,” said Vidal, who teaches at a university in Colombia. Next

NEWS BRIEFS

AMLO Widens Lead Ahead of Mexico's Presidential Election

A new poll shows Mexican leftist presidential hopeful Andrés Manuel López Obrador has extended his lead to 14 points, Reuters reported. AMLO, as he is known, has 35 percent support ahead of the July 1 election, according to a survey by Parametria conducted last week. Polling in second place, Ricardo Anaya of left-right coalition For Mexico in Front, slipped to 21 percent, while former finance minister and ruling Institutional Revolutionary Party hopeful José Antonio Meade slid for the second consecutive month, to 16 percent from 18 percent.

Chile's Outgoing President Proposes New Constitution

Michelle Bachelet, Chile's outgoing president, on Tuesday sent a proposal to Congress for a new constitution that would ensure equal pay for men and women and advance a host of other socially progressive priorities, the Associated Press reported. A moderate socialist, Bachelet hands the presidency off on Sunday to conservative President-elect Sebastián Piñera. Some lawmakers criticized the timing of Bachelet's move, but others said it sets a policy agenda that Piñera will need to address when he takes office.

Latin America's Number of Drilling Rigs Increases by 11%: Baker Hughes

Houston-based Baker Hughes said Wednesday that its count of the number of drilling rigs the industry has actively exploring for or developing oil or natural gas in Latin America in February stood at 199, an increase of 20 rigs over the same month last year, an 11 percent increase. As a region, Latin America had more than twice as many rigs in operation than both Europe and Africa, and nearly as many as Asia.

month, Raúl Castro is scheduled to step down from the Cuban presidency, marking the first time in more than half a century that a member of the Castro family has not had a firm hand on the island's economy. [Editor's note: See [Q&A](#) on Cuba's economic ties in the Jan. 18 issue of the Advisor.]

BUSINESS NEWS

Pemex to Seek Foreign Partners for Oil & Gas Projects

Mexican state-run oil company Pemex this week amped up its outreach to foreign partners in the face of increased competition and declining production, Reuters reported Wednesday. Chief executive Carlos Treviño told an industry conference Tuesday that Pemex might bring foreign companies into two heavy crude



Treviño // File Photo: Pemex.

oilfields in the Gulf of Mexico's shallow waters. "The name of the game in Pemex right now is partnership," said Treviño. Earlier this week, he said Pemex will look for partners for two deep-water blocks that it won in a January auction. Treviño also said Pemex hopes that Russia's Lukoil will take part in Mexico's bidding processes for both midstream and upstream business, Russian state-run news agency Sputnik reported. Lukoil said in November that the two companies were planning to discuss the establishment of a joint venture to implement new projects. Pemex is also looking into ways to deepen energy cooperation with Jamaica, Mexican Foreign Minister Luis Videgaray said Tuesday on a Caribbean trip.

FEATURED Q&A / Continued from page 1

2017, up from 40 percent in 2010. Also, the social security deficit (for private and federal workers) rose to 4.1 percent of GDP last year—more than half the overall deficit, and more than double the primary (noninterest) general government deficit of 1.8 percent of GDP. While the Temer administration has held the line on discretionary spending, its ability to do so has become increasingly more challenging. Nondiscretionary spending accounts for about 85 percent of total central government spending, with social security-related spending alone about a third of the total. Given the ongoing worsening of Brazil's aging profile, age-related expenditure will put incrementally higher pressure on the budget—and absent changes make it very difficult to comply with the constitutional cap on spending passed in 2016. However, so will payroll-related spending. The next administration will face a complex fiscal scenario upon assuming office. Tackling these fiscal challenges will require broad-based support across party lines and branches of government to pass controversial constitutional amendments following this October's elections."

A **Thomas Rideg, president of M-Brain Americas Inc.:** "This reform is indeed important to Brazil's long-term fiscal health as the Brazilian public pension system is the nation's largest primary expense, representing about 13 percent of GDP. This figure is comparable to nations with average populations that are much older than that of Brazil, meaning that as Brazil's population gets older, the public pension burden will increase to unsustainable levels if no reforms take place. Shelving the reform now to pick it up in a few months will not have such a material impact in the short term other than a slight potential decrease in investor confidence. The most unfortunate impact of the shelving of this reform is that it adds one more big item to the busy agenda of Brazil's new government in 2019. All in all, investors

have increasing confidence in Brazil, with a more positive than negative presidential election outlook for October, meaning that many of the needed reforms will likely be carried out. It would be easier on the new government if this reform were already handled. It is important that focus of the reform

“All in all, investors have increasing confidence in Brazil...”

— Thomas Rideg

be done is such a way so as not to punish the Brazilian workers contributing to the INSS, who at the age of their retirement will receive a percentage of their salaries as pensions based on the average of their salary history. The reform must protect these contributors' return on investment and instead focus more severe measures on where the pension system is hurting the country the most, which is on the extravagant rewards of public service employees that receive early retirement benefits at the same levels of their career salaries, often extending to spouses and former spouses."

A **Monica de Bolle, senior fellow at the Peterson Institute for International Economics:** "The pension reform was a crucial pillar of Temer's 'Bridge to the Future,' the document prepared in 2015 laying out the PMDB's vision for fixing Brazil's longstanding structural problems. It has been widely recognized that the spending cap approved in December 2016 would only be viable with the enactment of a broad reform to the country's pension and social security system. Spending on pension and other social security benefits are projected to rise

Continued on page 4

FEATURED Q&A / Continued from page 3

from about 8 percent of GDP to well over 10 percent in the next three years. As a result, these expenditures are likely to consume much of the budget without significant reform, while adding to Brazil's worrisome deficit and debt trajectories. The decision to abort the reform given its unpopularity and lack of congressional support is a blow to the country's medium-term fiscal sustainability, and one of the main reasons for the recent credit downgrades by both S&P and Fitch. After the general elections in October, the new administration will need to urgently find a way to place pension reform at the top of its priorities. Temer's 'Plan B' is basically a list of pieces of legislation and other initiatives that are either already being considered by Congress or have been widely discussed in the past. Although some of the measures contained therein are positive, they do not address Brazil's grave fiscal challenges, nor do they serve as 'substitutes' for pension reform. Whether the next administration will have any success where the Temer government has failed will depend on a host of factors, including the willingness to take up an unpopular reform in a context of heated political tensions, as well as on the ability of the new executive branch to sway what is likely to be a highly fragmented Congress in 2019."

A **Milko Matijascic, researcher at the Institute of Applied Economic Research (IPEA) in Brasilia:** "Postponing the pension reform was inevitable, since it is unpopular and general elections will take place in October. To compensate, the federal government intends to reinforce its support for a set of 15 projects, which are already being discussed in Congress and involve issues such as the autonomy of the central

bank, reinforcement of regulatory agencies, state recovery and privatization of Eletrobras, as well as several important micro-economic reforms. All of these measures can have a positive impact on investors' expectations. Nevertheless, even the ruling

“**Social security will be a top priority for the next president's agenda.**”
— Milko Matijascic

party representatives in the legislature are skeptical about achieving these reforms, given that the electoral campaigns will begin in April. Social security reform represents a challenge because markets are demanding a reduction in high levels of public spending in order to reduce the public deficit and free up more resources for public investment, which is essential for resuming economic growth. The argument makes sense, even considering that long-term projections give rise to much controversy and are subject to large statistical margins of error. In the short term, it seems that the markets have absorbed the new scenario well. However, social security will be a top priority for the next president's agenda, since without it the ratings agencies will maintain Brazil's negative assessment, making it very difficult to get resources from foreign institutional investors and improve the investment climate in Brazil."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org.

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