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## FEATURED Q&A

# Does Paraguay's Tax System Need a Major Overhaul?



Paraguayan Finance Minister Lea Giménez earlier this month created a commission to study the country's tax system and propose changes. // File Photo: Paraguayan Government.

**Q** Paraguay's finance ministry on July 4 established a commission of experts to study the country's tax system and submit a series of modernization proposals to the new government, which will take office Aug. 15. During his campaign, ruling party candidate and now President-elect Mario Abdo Benítez said Paraguay should maintain its current tax system to continue attracting investment, while opposition candidate Efraín Alegre called for higher taxes on the agricultural sector to increase social spending. Paraguay has among lowest tax burdens in the region, but the country's social expenditure is also markedly low, Reuters reported in March. Will Abdo make major changes to the tax system during his presidency? What would a tax reform in Paraguay look like? What are the current system's biggest shortcomings, and how can they be solved?

**A** R. Andrew Nickson, honorary reader in public management and Latin America studies at the University of Birmingham: "The decision by Finance Minister Lea Giménez to establish a tax commission only weeks before leaving office is odd as she consistently opposed calls for tax reform since taking office in June 2017. It is unlikely that the new government will carry out any serious tax reform, and the tax commission looks more like a public relations exercise to placate the international community, which has been pressing for fiscal reform for years. The appointment by Abdo of his brother, Benigno López, as finance minister is indicative. López has already said that he does not plan to bring in major tax increases. There have long been calls to increase taxes on Paraguay's soybean growers, whose contribution to

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### ECONOMIC

## Inflation to Hit One Million Percent in Venezuela: IMF

Venezuela's rate of inflation will skyrocket to one million percent by the end of the year, according to the International Monetary Fund.

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### BUSINESS

## Popular Reports Rise in Q2 Profits

Puerto Rico-based Popular Inc. reported net income of \$279.8 million for the second quarter, an increase from \$183.6 million in the same period last year.

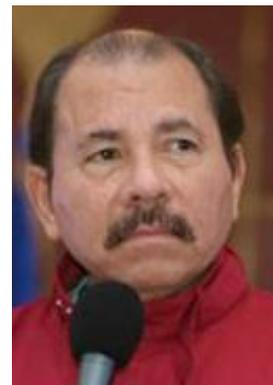
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### POLITICAL

## Nicaragua's Ortega Rejects Call for Early Elections

Nicaraguan President Daniel Ortega rejected calls for an early presidential election in the Central American country, where more than 300 people have been killed in three months of violent clashes.

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Ortega // File Photo: Nicaraguan Government.

## POLITICAL NEWS

## Nicaragua's Ortega Rejects Call for Early Elections

In an interview broadcast Monday, Nicaraguan President Daniel Ortega rejected calls for an early presidential election in the Central American country, where more than 300 people have been killed in three months of violent clashes. "To move up the elections would create instability, insecurity and make things worse," Ortega said in the interview on Fox News. In the interview, Ortega also denied that he is in control of paramilitary groups that have been blamed for the majority of the killings. Foreign interests and his political opponents control the paramilitaries, he said. That assertion is contrary to findings documented by international organizations and Nicaraguan human rights groups, the Associated Press reported. Last week, the Organization of American States approved a resolution condemning rights abuses committed by police and armed groups of pro-government civilians. Ortega added that he was open to his government continuing Catholic Church-mediated talks with the opposition.

## BUSINESS NEWS

## Popular Reports Rise in Profit for Second Quarter

Puerto Rico-based Popular Inc. on Monday reported net income of \$279.8 million and adjusted net income of \$121.3 million for the second quarter. The figures rose from a net income of \$91.3 million in the first quarter and \$183.6 million for the second quarter of last year. "These results were primarily driven by strong top line revenue growth in our Puerto Rico franchise, where the economy continues to recover from the impact of Hurricane Maria," Popular's president and chief executive officer,

Ignacio Álvarez, said in a statement. "We look forward to closing the acquisition of Wells Fargo's auto loan business in Puerto Rico in the third quarter, which will contribute favorably to our earnings in the second half of the year." In reporting its earnings, Popular added that it had a net interest margin of 3.81 percent in the second quarter, as compared to 3.89 percent in the first quarter. The financial services company also said that its nonperforming loans held in-portfolio increased by \$36.4 million as compared to the first quarter. Popular's provision expenses declined to \$60.1 million in the second quarter, as compared to \$69.3 million in the first. Popular also said that on May 22, its Puerto Rico banking subsidiary, Banco Popular de Puerto Rico, entered into a termination agreement with the Federal Deposit Insurance Corporation to terminate all of its shared-loss agreements connected to its acquisition of assets and its assumption of liabilities of Westernbank Puerto Rico, which occurred through a transaction in which the FDIC assisted in 2010. As a result of that agreement with the FDIC, assets covered under shared-loss agreements, including \$514.6 million worth of covered loans and approximately \$15.3 million in covered real estate owned assets, were reclassified as noncovered.

## ECONOMIC NEWS

## IMF Expects Inflation to Hit One Million Percent in Venezuela

Inflation in Venezuela will reach one million percent by the end of the year, according to calculations by the International Monetary Fund. Alejandro Werner, director of the IMF's Western Hemisphere department, wrote in a blog post Monday that the South American country's GDP will fall approximately 18 percent this year as a result of a significant decline in oil production, micro-level distortions and large macroeconomic imbalances. The country earns 96 percent of its national income through oil sales, but oil production has been stalling, reaching a

## NEWS BRIEFS

## López Obrador to Take Command of Mexico's Security Strategy: Aide

Mexican President-elect Andrés Manuel López Obrador plans to personally handle Mexico's security strategy in order to fight the country's widespread violence, a top aide told The Wall Street Journal. After taking office Dec. 1, López Obrador plans to combat the corruption that fuels violence and keep closer watch over state governors, said the aide, Alfonso Durazo.

## Brazil Infrastructure Needs More Investment: COFCO Official

Brazil could boost its competitiveness in global agriculture markets by investing more in infrastructure and diversifying its transportation network, said Eduardo Gradiz Filho, head of grains and oilseeds at COFCO, the Chinese commodities trader, Reuters reported Monday. The South American country is too dependent on trucks to ship farm products, and transportation costs weigh on its competitive advantage, he added. COFCO said Brazil has the greatest potential to boost food production to meet the needs of a growing global population.

## Rising Number of Young Borrowers Taking Out Mortgages in Jamaica

The number of borrowers under age 30 who are taking out mortgages in Jamaica has risen over the past four years, according to the National Housing Trust, the Jamaica Gleaner reported Sunday. The trust also said that women are accounting for a larger percentage than men among mortgage borrowers in Jamaica. While just 13 Jamaicans between ages 18 and 25 secured mortgages in fiscal year 2015, that number grew to 183 in the 12-month period ending last March. In the 26-30 age group, there were 359 borrowers in fiscal year 2015 and 912 in the last fiscal year.

30-year low of 1.5 million barrels a day in June, according to OPEC data, Agence France-Press reported. This would be the third year in a row that Venezuela has experienced double-digit drops in GDP. "We expect the government to continue to run wide fiscal deficits financed entirely by an expansion in base money, which will continue to fuel an acceleration of inflation as money demand continues to collapse," Werner wrote. An inflation rate of one million would mean Venezuela is in a similar situation to Germany in 1923 and Zimbabwe in the late 2000s, he added. Hyperinflation and a lack of foreign exchange have triggered the collapse of economic activity in Venezuela, which, in addition to shortages of food, electricity and water, have led thousands to migrate to other countries in the region, the AFP reported.

## Workers' Party Would Hike Bank Taxes in Brazil: Haddad

Brazil's Workers' Party would increase taxes that banks must pay if it wins the presidency in this October's election, former São Paulo Mayor Fernando Haddad told Reuters on Monday. Haddad, the main economic advisor for the party, said the tax hike would be a method of forcing banks to lower their margins and also charge customers lower fees. He said banks that do not lower their margins would have to pay a higher tax rate. State-run banks, such as Caixa Econômica Federal and Banco do Brasil, would lead the banking sector in lowering credit margins, said Haddad. The Workers' Party has insisted that it will run former President Luiz Inácio Lula da Silva, who is currently imprisoned after his conviction on corruption charges, as its candidate. "The party is not evaluating any hypothesis other than Lula's candidacy," a Workers' Party spokesman told Reuters July 17. However, the wire service cited three unnamed party officials in reporting that the party is undergoing internal debate about other potential candidates and that Lula and his allies are getting closer to the idea of attempting to transfer support for him to another candidate.

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the fiscal effort remains minimal despite accounting for over one-third of total exports. The current official figure for the tax burden is around 10 percent of GDP, one of the lowest in the Americas. It is also highly regressive, with indirect taxes such as VAT accounting for over two-thirds of the total. With adjustments, the real tax burden is even lower. In this way, the fiscal structure has contributed to the spiraling inequality of income in the country during the recent period of rapid economic growth. Abdo is beholden to the powerful business groups that dominate policymaking in Paraguay. He will likely continue the policy of President Horacio Cartes, who covered the fiscal gap by foreign borrowing via bond issues, which doubled the country's external debt. There is general agreement among specialists that a serious tax reform would need to reduce the level of tax-deductible expenses for high-income citizens, attack the evasion of company tax, include a new tax on unprocessed cereal exports such as soybeans and rice, and reduce the difference between the commercial value and the 'fiscal value' of rural land, on which property tax is levied. The road to tax reform in Paraguay will be rocky. Powerful interests that benefit from the current arrangement will continue to block change by judicial means, paying off corrupt members of Congress to argue that it is 'against the constitution.'

**A Sebastián Acha, executive director of PRO Desarrollo Paraguay:** "The creation of the special commission was generally not well received. Primary sector producers (agriculture and livestock sectors especially), as well as industrial sectors, have harshly criticized the commission's focus, which exclusively centers on the eventual increases of tax aliquots instead of more important issues, according to public opinion: first, reducing tax evasion and, second, improving the quality of public spending. In relation to tax evasion, I man-

age an annual study on Paraguay's underground economy, which in the past five years has been shown to total approximately 40 percent of GDP, revealing the low efficiency of tax collection. Since the national agreement and historic fiscal reform in 2004, tax revenue has quintupled, but public spending has also proportionally multiplied. The firm position of these different sectors apparently drove members of the commission to clarify that there will be no changes to the tax system without first resolving the two points I mentioned above. It would be a huge mistake if the president-elect does not fulfill his promise of maintaining the tax system, since he committed to eradicate clientelism, adopt a firmer fiscal policy and improve the quality of public spending."

**A Brian Turner, professor and chair of the Department of Political Science at Randolph-Macon College in Ashland, Va.:**

"Paraguay's tax system generates insufficient revenue to meet social spending needs, lacks progressivity and suffers from maldistribution of the tax burden between sectors, with the country's most dynamic sector, agribusiness, the most lightly taxed. As former Finance Minister Dionisio Borda noted in a recent publication, agriculture contributes only 5.9 percent of total corporate taxes. While Paraguay has satisfactorily managed its growing external debt, maintenance of the low tax burden will mean debt service will put increasing pressure on the budget. On announcing the creation of the Comisión Técnica Económica Tributaria, Finance Minister Lea Giménez noted that tax pressure had fallen to below 10 percent of GDP. A serious tax reform would have to tackle the low rates of contributions from agribusiness and the 10 percent limit on personal income taxes for the highest earners. Abdo stated in March that his government would seek multilateral credits to boost income for social spending and maintain the low tax rates to continue to attract investment, although he

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did allow for the possibility of revisions to the personal income tax. Any reform would meet powerful political obstacles, as governability will depend on securing support from members of the Colorado Party aligned with outgoing President Cartes, and indeed from the clientelist demands of most members of Congress and the local party 'sections.' Abdo might choose to wage a partial campaign against corruption and nepotism, but he is not likely to have the political capital necessary to fight corruption and seek a serious tax reform."

**A** **Juan Francisco Facetti, professor and researcher at the Universidad Nacional de Asunción and consultant on governance:** "The new government needs a system with simple taxes that are easy to manage. The current system's main problem is evasion. Before incorporating new taxes or raising current tax rates, the government should first review if everyone is included in the system and if they are, whether they are paying their share. For this, technology should be the basis for control, intensifying interconnections between public offices involved in tax collection. One proposal is to generate fiscal incentives for the use of electronic means of payment to formalize sales through banking networks even more and to implement electronic billing as a mechanism for transparent operations. The new government will incentivize fiscal exemptions that help increase investment and job creation. It also plans to gradually reduce tax benefits for some import regimes and sales of capital goods, with the aim of strengthening control and transparency mechanisms to reduce evasion. It also proposes eliminating incentives that are redundant or don't generate any major socioeconomic improvements. Regarding personal income tax, the government proposes studying the application of limits to deductibles in order to ensure an increase in revenue, as well as the possibility of implementing more progressive taxes.

The government should start a debate on changing the structural focus of taxes to be a generator of fiscal resources, thus gradually eliminating the possibility of deductions that do not constitute spending on education, health, social security and similar issues. Finally, there should be a complete revision of the rates of excise taxes of sectors that affect health and the environment. This government should increase taxes on tobacco, alcoholic beverages, fuels and luxury items."

**A** **Fernando Masi, director of Centro de Análisis y Difusión de la Economía Paraguaya (CADEP):** "Paraguay has one of Latin America's lowest levels of tax revenue as a percentage of GDP. This can be explained by the country's low tax rates, the levels of tax exemptions and high tax evasion. It is argued that the low tax rates are an important attraction for foreign direct investment, but low tax revenues limit the state's capacity to provide adequate conditions for the market economy, including skilled and healthy labor, infrastructure and optimal connectivity. Despite its low collection rate, Paraguay has significantly expanded public spending in health, education and infrastructure over the past 15 years. However, public health coverage remains low, and infrastructure and education have not progressed in terms of quality improvements. Higher tax revenues are necessary. Direct taxes (to corporate and personal income) constitute only 20 percent of total revenue. Personal income tax generates just 0.009 percent of GDP because there are multiple deductions, and the maximum rate is 10 percent. The agricultural income tax amounts to just 0.2 percent of GDP, and tax exemptions annually cost 1.3 percent of GDP for the state. Meanwhile, the real estate tax represents just 1 percent of all tax revenues. With these numbers, Paraguay's economic model is unsustainable. Tax reform is urgent."

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