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Featured Q&A With Our Board of Advisors

Q President Alejandro Toledo's appointment of seven new independent cabinet ministers earlier this month appears to have at least temporarily calmed the political waters in Peru. With this latest cabinet shuffle, do you believe that Toledo will have finally achieved a comfortable level of political stability? What are the prospects for the government's privatization program in the current political environment?

A Guest Comment: Carlos Mateo Paz-Soldan: "The formula being sold to Peruvians is that President Toledo will take a 'back seat'—leaving his capable and well-respected prime minister, Carlos Ferrero Costa, and his new council of ministers, to have a greater say in governing the country's day-to-day affairs. While this arrangement is at odds with Peru's presidentialist government structure and tradition, this framework may be the key to the survival of Toledo's presidency until 2006. On the economic front, this should be a good year for Peru, as the country focuses on the monumental task of entering free trade negotiations with the US. Exports are up 20 percent in relation to the same period last year, led by growth in the mining/energy and textile/apparel sectors, and a strong showing by the agribusiness sector. Moreover, the expected arrival in August of gas from the Camisea project will be a further boon to the economy. The open question is: what

will presidential aspirant (and former President) Alan Garcia's posture be? With Toledo supposedly in the 'back seat,' a blatant attempt to undermine this new ministerial cabinet will probably backfire with most Peruvians. However, Garcia's presidential aspirations may largely hinge on how successful this cabinet is in stabilizing the country politically; developing the consensus necessary to engage the US in a free trade agreement; and pursuing the stalled privatization program."

Continued on page 4

PHOTO OF THE DAY



Brazilian bingo hall workers on Thursday protest a presidential decree banning their operations as a result of a recent gambling corruption scandal. The banner is addressed to the president's chief of staff and reads "Jose Dirceu, Your Job Cost Mine!"

Source: Agencia Brasil.

Inside This Issue

FEATURED Q&A: Is Peru's More Stable Following the Recent Cabinet Shuffle?	1	Inflation Slows in Brazil During February, But Less Than Expected.....	3
Mexico: "Trial" Needed to Determine Whether UN Office Was Spied On	2	Femsa Posts 35 Percent Increase in Q4 Profit, Boosted by Panamco Buy.....	3
Chilean Lawmakers Push for Royalty Tax on Foreign Firms' Copper Mining	2	Weapon Buys Stoke Fears of Arms Race in Southern Cone.....	3

NEWS BRIEFS

Peru's Aero Continente Ends One-Day Strike

Employees of Peru's largest airline, **Aero Continente**, on Thursday ended a one-day strike to protest what it alleged was government favoritism toward the local subsidiary of Chilean rival **Lan Chile**. Aero Continente said it ended the strike after transport officials agreed not to renew permits for Chilean-registered planes after April 15.

Source: Reuters.

Chile's Codelco Looking for Partner to Develop Copper Mine

Chilean state-owned copper miner **Codelco** is seeking a partner to develop a \$600 million mine in northern Chile. The mine would begin producing 150,000 metric tons of copper in 2007 or 2008. Codelco, the world's largest copper miner, expects output to grow 10 percent this year to 1.8 million tons.

Source: Bloomberg News.

IMF Chief Headed to Brazil

International Monetary Fund Managing Director Horst Kohler will visit Brazil next week. Kohler is expected to stress the importance of continued reforms under Brazil's \$14.8 billion loan agreement with the IMF. An unnamed Fund official denied that the visit was linked to investor concerns about the impact a recent corruption scandal might have on reforms.

Source: Reuters.

Iusacell Reports Wider Q4 Losses

Debt-laden Mexican mobile operator **Iusacell** on Thursday reported a fourth-quarter 2003 loss of 1.318 billion pesos (\$US 119 million), up from 546 million pesos in Q4 2002. Iusacell ended 2003 with a total of \$810 million in debt.

Source: Reuters.

Political News

Mexico: "Trial" Needed to Determine Whether UN Office Was Spied On

Mexican Foreign Minister Luis Ernesto Derbez said Thursday that it would be difficult to ascertain whether the United States or Britain spied on Mexico's United Nations delegation without some sort of legal investigation, Mexican daily *El Universal* reported. "If there is no trial, surely there will be no verification as to whether there was or was not espionage," Derbez told reporters. The minister's comment followed revelations by a former member of British Prime Minister Tony Blair's cabinet that her government had bugged the office of UN Secretary General Kofi Annan in the lead-up to the war in Iraq. Former International Development Secretary Clare Short said she decided to divulge the alleged bugging after the United States was accused of similar eavesdropping on the offices of some Security Council members, including Chile and Mexico, before the war, according to Reuters. A United Nations spokesman said that such a bugging operation on the secretary general's office would be illegal. Blair, who already faces widespread popular criticism for his decision to join the US in the Iraq invasion, asserted that British security services operated within national and international law. On Wednesday, Britain dropped charges against a government translator who admitted leaking a top-secret US document requesting British assistance in bugging UN Security Council members. The document prompted Mexico's and Chile's former United Nations ambassadors to allege that their offices near UN headquarters in New York had been bugged a year ago. At the time, both countries were nonpermanent members of the Security Council and opposed the invasion of Iraq.

Economic News

Chilean Lawmakers Push for Royalty Tax on Foreign Firms' Copper Mining

Chilean lawmakers on Thursday appealed

to President Ricardo Lagos to support a royalty tax on copper mined by foreign multinationals, and vowed to introduce legislation establishing the tax, Reuters reported. "We have asked President Lagos to support the decision by the parties of the [ruling Concertacion alliance] to move forward with a royalty," said Antonio Leal, president of the mining committee in the lower house of Congress. "If the government does not, we are going to present a bill ourselves, but we want to have the support of the government." Lagos has said he would not change rules for foreign investment, despite poll data indicating that a majority of Chileans support such a tax. Legislators are proposing a 2-3 percent tax applicable to the mining firms' sales, production, or profits. The companies have warned that such a tax would hurt investment in the sector. In November, Mining Minister Alfonso Duranto pledged to keep the tax framework for foreign investors intact, in spite of the legislative push to introduce a royalty tax. Forty percent of the world's copper reserves are in Chile, as

Q&A Index

A review of the featured Q&A in the Latin America Advisor for the week ending February 27, 2004.

Monday: Is Criticism of the Bush Administration's Trade Strategy Justified?

Tuesday: Is a Peaceful Solution to Haiti's Crisis Still Possible?

Wednesday: Will Repatriation Stem the Flow of Illegal Mexican Immigrants?

Thursday: Why is Colombia Having Such a Hard Time Privatizing Bancafe?

Friday: Is Peru's More Stable Following the Recent Cabinet Shuffle?

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are some \$20 billion in mining investment. World copper prices have risen 70 percent over the past year and are at their highest level in eight years, according to Reuters.

Inflation Slows in Brazil During February, But Less Than Expected

Inflation in Brazil, as measured by the IGP-M inflation index, slowed to 0.69 percent in February, Reuters reported. The decline from an 0.88 percent increase in wholesale, consumer, and construction prices in January was smaller than expected, and came amid continued concerns by the Central Bank about a possible trend of accelerating inflation. According to the minutes of the meeting earlier this month of the Bank's monetary policy committee (Copom), released yesterday, the Bank said Brazil may miss its inflation target of 5.5 percent for this year. The Bank held its benchmark Selic interest rate steady at 16.5 percent this month for the second straight month, following cuts totaling 10 percentage points between June and December of last year. In a research note this morning, investment firm **UBS** noted that the IGP-M index recorded a 1.61 percent increase in wholesale prices last month, up from 1.13 percent in January. "This points to the Copom's concerns ... and suggests that the need for caution may persist," UBS said.

Company News

Femsa Posts 35 Percent Increase in Q4 Profit, Boosted by Panamco Buy

Mexican bottler and brewer **Femsa** on Thursday reported a 35 percent increase in its fourth-quarter net profit compared to the same period of 2002, according to Reuters. Net profit during the quarter totaled 1.023 billion pesos (\$US 91 million) and was boosted by Femsa's acquisition in May 2003 of Latin American bottler **Panamerican Beverages** (Panamco), which made Femsa the second-largest Coke bottler in the world. The company noted that its financial earnings would not be comparable on a year-on-year basis until the third quarter of this year.

Weapon Buys Stoke Fears of Arms Race in Southern Cone

By Chris Heaney

Chilean Minister of Defense Michelle Bachelet on Thursday confirmed that Chile would meet with Peru in March and April to assuage Peruvian concerns that Chile is stockpiling weapons and to discuss both sides' military spending plans.

Bachelet called such a meeting the "best way to clear up all those issues and definitively make transparent in a working group what we're spending in [the ministry of] defense," Chilean newspaper *El Mercurio* reported.

Chile's planned purchase of several warships and expected delivery of 10 F-16 fighter jets next year has prompted strong reactions in its northern Andean neighbor in recent months, most notably from Peruvian Minister of Defense Roberto Chiabra, who this past week has repeatedly accused Chile of stockpiling weapons for its armed forces and upsetting the region's strategic arms balance.

Bachelet denied Chile was starting an arms race and said the arms purchases were to renovate its fleet with modern technology, a claim which some analysts dispute.

"If you analyze some of the [Chilean purchases], for example the F-16s, that's not refurbishing their fleet. They are high-tech fighters that they didn't have before," Peruvian political analyst Richard Dawson told the *Advisor*.

Chiabra's accusations come while he himself is denying that Peru's recent decision to acquire four Italian warships was provoking an arms race. Chiabra appears before Peru's Congress in coming days to explain the purchase.

Chile has not just been experiencing diplomatic tensions with Peru, but also with Bolivia, which in recent months has stepped up its historic demand that Chile return coastal lands seized during a 19th century war between Chile, Bolivia, and Peru.

Regional disputes have caused some observers to wonder whether tensions could eventually escalate into a regional military conflict.

However, Miguel Diaz, a political analyst at the Center for Strategic & International Studies, believes the recent arms upgrades are unlikely to result in any sort of arms race, and that the focus on military preparedness is misplaced in countries that face a greater threat from nontraditional security issues such as terrorism and crime.

Dawson noted that Peru's alarmist calls may also serve to divert attention away from unpopular President Alejandro Toledo's political woes.

"Toledo in some way needs an external enemy ... to fortify interior relations in the same way as Carlos Mesa has done [with Chile] in Bolivia," Dawson stated.

If anything, Diaz told the *Advisor*, the recent concern over a possible arms buildup suggests Chile might need to pursue an agreement with Peru on transparency in defense spending, similar to an arrangement Chile has with Argentina.

"If countries are beginning to wonder about each other's defense spending, the regional move towards making these kinds of expenses more transparent becomes that much more of an imperative," Diaz said.

Featured Q&A*Continued from page 1*

A **Guest Comment: Carola Sandy:** "The political environment could remain relatively calm for at least a few months if President Toledo upholds his promise to give the new cabinet room to govern and if the official coalition backs the executive's proposals in Congress. Nearly 80 percent of voters, according to opinion polls, support the appointment of a cabinet composed mainly by technocrats and Toledo's stance has improved mar-

“President Toledo has made far too many mistakes to achieve 'a comfortable level of political stability' with only a partial shake-up of his cabinet ...”

– *Gregory Schmidt*

ginally (his ratings rose from 6 percent in early February to about 10 percent last week). Still, the Toledo administration's image remains very low and the political environment remains fragile. Mid-February opinion polls showed that 70 percent of voters did not expect President Toledo to remain in office until 2006, and the cabinet reshuffle alone probably did not change the public's view. Factors that could prolong the current political calm include the government's intention to spend more on education, public health, and infrastructure (aimed at preempting social turmoil) and the more tactful stance of the new cabinet towards the opposition parties (Prime Minister Ferrero said that the cabinet would study the proposals submitted by Alan Garcia's APRA). For now, it appears that recent accusations of corruption against President Toledo's siblings have not raised political noise, but further developments will be key to monitor. Prospects for privatizations remain overall weak, given the fragility of the political situation; however, the new approach adopted by the govern-

ment of listing the public enterprises in the Lima stock exchange could yield encouraging results."

A **Guest Comment: Gregory Schmidt:** "President Toledo has made far too many mistakes to achieve 'a comfortable level of political stability' with only a partial shake-up of his cabinet, the so-called '*gabinete conversado*.' His popularity remains abysmally low, his fractured party lacks a majority in Congress, and the climate can only become more partisan with general elections looming in early 2006, if not earlier. Nevertheless, the changes in the cabinet and Toledo's promise to give his ministers more freedom of action do appear to have provided his government with a new lease on life. If Toledo makes good on his promise and the new cabinet continues to receive enough tacit support in Congress, his administration might even be able to claim some significant accomplishments before the end of its term. The new economy minister, Pedro Pablo Kuczynski, certainly has the technical skill and vision to accelerate the granting of concessions to private firms, but he must be able to convince Peruvians—especially those in the provinces—that these policies will promote broad-based development that benefits all. Otherwise, he risks provoking the sort of regional mobilization that brought an end to his earlier tenure as economy minister, or even a broader backlash against privatization, as occurred recently in Bolivia. It is interesting to note that Kuczynski authored a book on the breakdown of Peruvian democracy in the 1960s, when an earlier '*gabinete conversado*' did not meet a happy fate."

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