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Featured Q&A With Our Board of Advisors

Q Peru's Congress last week approved a 1-3 percent royalty tax on mining companies' sales amid strong opposition from the companies. Do you expect investment in the sector to be hurt as a result of the tax?

A **Guest Comment: Alejandro Ore:** "In the process of attaining minerals from Peru, the mining companies do not contribute to the state financially, aside from what very marginal taxes they pay which, in turn, are paid in every nation of the world. We consider the royalty an economic compensation, not a tax or fee. It is compensation that the companies which use Peru's resources should pay to the state. In the US, businesses pay royalties; here in Peru, businesses also pay royalties to other businesses when concessions are made. These businesses had the right to charge royalties, but Peru could not. Therefore, I believe that we are not acting against private investment. I think that it is a just compensation for the mining companies to pay the royalty tax, which is not flat, but instead ranges from zero to 1, 2, and 3 percent."

A **Guest Comment: Leni Berliner:** "I believe some exploration and development companies will quit Peru as a consequence of the new fiscal regime. Many companies—Canadian, South African and otherwise—that have invested millions of dollars

exploring for hard rock minerals in Peru over the last twelve years are not yet in production, and therefore do not have tax stabilization agreements. Peru has not benefited as it had hoped from the mining 'boom,' which began in the early 1990s. There are myriad reasons for this, but they boil down to two sets of problems: 1) on the whole, local companies have failed to enter into workable joint ventures with foreign companies; and 2) Peru is too centralized to benefit from mining operations which are located everywhere but the center. A royalty on gross sales—*i.e.*, another tax—addresses neither of these problems.

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PHOTO OF THE DAY



Mexican Finance Minister Francisco Gil on Thursday expressed concern about the impact of expected US interest rate hikes on Mexico's economy. See related story on page 3.

Photo: BBC.

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NEWS BRIEFS

IMF Mission to Visit Argentina This Weekend

A mission from the International Monetary Fund (IMF) is scheduled to arrive in Argentina this weekend to review the government's compliance with a \$13.3 billion loan agreement. The visit comes amid a failure by Argentina and foreign bondholders to reach a restructuring deal on some \$100 billion in defaulted debt, a key condition for continued IMF support. Argentina's representative to the IMF, Hector Torres, said he expected Argentina to pass the review. "I think there should be no problems with the third review," Torres said.

Source: Reuters.

Chile's Central Bank Holds Interest Rates Steady

The Chilean Central Bank on Thursday held its benchmark interest steady at 1.75 percent. In a statement, the Bank said economic data since its last monetary policy meeting had been in line with its own forecasts. "As was anticipated, monthly inflation increased due to movements in the price of fuels and the exchange rate, an effect that is forecast to be principally transitory," the Bank said. The Bank expects annualized inflation of 3 percent over the next two years.

Source: Central Bank.

LanChile Reports Increase in Passenger Traffic

Airline LanChile's passenger traffic grew 19.9 percent in May, the airline said Thursday. Measured in passenger-kilometers, domestic passenger traffic rose 9.4 percent in May, while international passenger traffic increased 22 percent. Cargo traffic grew 28.8 percent.

Source: company statement.

Economic News**Effect on Mexico of Expected US Rate Hikes Worry Finance Minister**

Mexican Finance Minister Francisco Gil on Thursday expressed concern about the effect of higher US interest rates on Mexico's economy, Reuters reported. "We're concerned insofar as higher interest rates make capital costs in Mexico more expensive," Gil said. The US Federal Reserve is expected to raise interest rates by 0.25 percentage points at its June 29-30 meeting and continue to raise them thereafter to keep inflation under control. Gil said Mexico's floating exchange rate, adopted after US monetary tightening in 1994 helped push Mexico into a financial crisis and currency devaluation, would this time shield Mexico's from market volatility.

Gil said Mexico's floating exchange rate, adopted after US monetary tightening in 1994 helped push Mexico into a financial crisis and currency devaluation, would this time shield Mexico's from market volatility stemming from expected US interest rate hikes.

ty. "The rising interest rates in the US have already had an effect in Mexico, but [have not caused] a loss in international reserves because we have a floating exchange rate," the Mexican finance minister said. He said Mexico now has a "bellows" to deal with such shocks.

Foreign Minister: Brazil Would Join Group of Eight if Invited

Brazil would join the Group of Eight rich nations if invited, Foreign Minister Celso Amorim said Thursday, according to Reuters. Several members of the G-8—made up of the United States, Japan, Germany, France, Britain, Italy, Canada, and Russia—have reportedly suggested Brazil, along with India and China, could be invited to join due to their growing international influence. "If we are invited, we would be ready to join and I think we, together with India and China, and others, would represent all the interests of developing countries," Amorim said. Brazil,

India, and China have joined forces to pressure developed nations to lower trade barriers from the developing world, particularly agricultural commodities. Amorim established the G-20 group of developing nations at global trade talks last September as part of that effort. The Brazilian foreign minister denied there were contradictions in Brazil's joining a group of wealthy nations whose positions on trade Brazil has opposed.

IMF Completes Review of Bolivia Loan Program

The International Monetary Fund (IMF) said Thursday its executive board had completed a third review of Bolivia's one-year, \$126 million loan program. In completing the review, the IMF's board waived some loan conditions. It also extended the loan through the end of the year and

increased it by \$63 million "to support the government's 2004 economic policies." In a statement, IMF First Deputy Managing Director Anne Krueger said Bolivia's government was focusing on limiting the fiscal deficit, obtaining financing from the international community, strengthening the financial sector, and implementing a strategy to develop the country's hydrocarbon resources. Krueger said the "efficient development of Bolivia's hydrocarbon resources" would allow the government to develop a new antipoverty program. Bolivia, one of the poorest countries in the Hemisphere, is struggling to develop a plan to export its vast natural gas reserves amid opposition by the country's largest labor union and other groups, who decry the "plundering" of Bolivia's natural resources by foreign companies and are demanding the nationalization of the country's hydrocarbon sector. The government of President Carlos Mesa plans to hold a referendum on the export of natural gas on July 18.

Company News

Wells Fargo Teams Up with HSBC in Mexico on Remittances

Wells Fargo & Company, the fifth-largest bank in the United States, on Thursday announced a partnership with **HSBC Mexico** aimed at increasing its market share of the money transfer business. Wells Fargo said in a statement that a new partnership will more than double the size of its current consumer remittance distribution network in Mexico to over 3,000 banking stores and 8,200 ATMs. The deal involves an account-to-account product whereby banking customers can send money from a Wells Fargo bank account directly to an HSBC Mexico bank account. Some observers have noted that big US banks have been slow to penetrate the remittances market. Manuel Orozco, a consultant to the Inter-American Dialogue, wrote in a Pew Hispanic Center study that "in the US-Mexico channel ... American financial institutions account for no more than 3 percent of the remittance traffic." Some experts say that lack of ATMs in rural areas, high percentages of "unbanked" customers both in the US and Mexico, and a culture of suspicion of banks among Latin Americans are several reasons for this. Hector Garcia, a vice president for business development at Wells Fargo, told the *Advisor* that efforts are underway at the bank to make stores and branches more inviting to prospective clients, and to establish better trust in local communities between migrants and Wells Fargo branches. Consumer remittances to Mexico exceeded \$13 billion in 2003.

Hylsamex Plans New Share Issuance to Pay Down Debt

Mexican steelmaker **Hylsamex** said Thursday it plans to issue new shares in a move to raise money and pay down its approximately \$962 million in net debt, Reuters reported. Hylsamex, which is looking to take advantage of current high steel prices after years of struggling to make a profit, will propose the capital increase at a June 25 shareholders' meet-

ing. It plans to issue up to 180 million new "L" shares with limited voting rights, pending approval by Mexico's securities and banking regulator. After a year, the shares can be converted into ordinary "B" shares, with full voting rights. Hylsamex's majority shareholder, Mexican conglomerate **Alfa**, said it will not subscribe to the new shares, as it plans to spin off the company. The company, Mexico's third-largest steelmaker, has recently benefited from high global prices for steel, driven by an economic recovery in the United States and strong demand in China. Hylsamex posted a \$63 million first-quarter net profit, as revenue rose 30 percent from the same quarter of 2003 to \$461 million. On Monday, it forecast second-quarter EBITDA (earnings before interest, taxes, depreciation, and amortization) of between \$190 million and \$210 million. The steelmaker's B series shares fell 6.61 percent yesterday to close at 16.11 pesos, while its CPO series shares ended down 6.21 percent at 16.30 pesos. Analysts attributed the declines to the planned share issuance as well as to profit taking.

Political News

Haitian Leader Pleads for Continued US Military Presence

Haiti's interim prime minister said Thursday he hoped the United States would leave a small force in his country after the United Nations takes over peace-

keeping operations in the country, the Associated Press reported. "The armed gangs, they will not go out if they know there are American Marines in Haiti," said Gerard Latortue. "This is the only force in the world ... they will respect." Latortue, who assumed power after a widespread revolt forced former President Jean-Bertrand Aristide to resign on February 29, said a sudden departure might be interpreted by Haitians "as the end of support of the American government." Latortue made the remarks while meeting with US Rep. Mark Foley (R-FL), who agreed that the US should keep a small force in Haiti. "When it comes to credibility, training, equipment, and the most important part of that is backup, the United States is the force that everyone knows you don't want to deal with," Foley stated. The UN took over responsibility for peacekeeping operations from the US-led multinational force at the beginning of this month. The US' 1,900 troops have stayed past their June 1 deadline to help Haiti with relief efforts following devastating floods that killed several hundred people and wiped out entire villages in the country's southeastern region along the border with the Dominican Republic. However, the US forces is scheduled to leave at the end of this month. Brazil, which has sent 1,200 soldiers to Haiti, is leading the UN force, which is expected to reach 8,000-strong. Latortue has said he hopes the UN force will remain until an elected president takes over in February 2006.

Q&A Index

A review of the featured Q&A in the Latin America Advisor for the week ending June 11, 2004.

June 7: **How Will Brazil's Highest Court Rule on Pension Reform?**

June 8: **What Hurdles Remain For a Resolution of Venezuela's Political Crisis?**

June 9: **Will Lucio Gutierrez See His Term Through to its End in January 2007?**

June 10: **How Effective Will Mexico's New Energy Minister Be?**

June 11: **Will a New Royalty Tax Hurt Investment in Peru's Mining Sector?**

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Featured Q&A*Continued from page 1*

In Peru there has been opposition to mining, largely based on ignorance, from local communities or people claiming to represent local communities. Peru would be much better served if it would decentralize management of natural resources and strengthen the analytic, planning, and fiscal capacities of local govern-

“Peru faces a delicate balancing act involving two of the country's most relevant economic weaknesses: a low tax revenue and a low level of investment.”

- *Sebastian Briozzo*

ments. If the legislature could successfully earmark mineral royalties for this purpose (which is highly doubtful), that could begin to address the problem; however the Peruvian executive branch is not likely to be able to manage dedicated funds in the necessary manner. Furthermore, the proposed fiscal regime is likely to make Las Bambas, a large copper property (still 'being privatized' after many years of trying), less attractive. Peru is not the only place with a weak executive branch and lawmakers who fail to properly understand the mining sector. They exist in Bolivia as well. Bolivia's debt restructuring agreements with the World Bank are predicated on receipt and use of export earnings from oil and gas and mining projects. If Bolivia refuses to sell oil and gas, or if perceived country risk gets any higher and stymies implementation of new productive projects, it could very quickly have a very big problem. Both Peru and Bolivia would be well advised to cease playing politics with their natural resources.”

A Guest Comment: Sebastian Briozzo: "Peru faces a delicate balancing act involving two of the country's most relevant economic weaknesses: a low tax revenue and a low level of investment. Peru's fis-

cal revenue to GDP ratio is still one of the lowest in Latin America, and raising it over time will be necessary in order to increase economic policy flexibility and mitigate high social needs. However, given Peru's already high tax rates, the solution should be directed more toward expanding the tax base in order to minimize the effect on investment. Eliminating a large framework of tax exemptions was part of the original government plan. However, increasing political and social problems have shortened the government's horizon, making it difficult to move ahead with structural issues, as other measures with a more immediate effect on revenue became more attractive. Increasing the level of taxation on the most dynamic sector in the economy is therefore risky. Without a significant increase in the levels of investment in the economy from the current low of 20 percent of GDP, Peru will be unable to reach economic growth rates significantly above the current 4 percent that would allow the country to reduce poverty over time.”

Alejandro Ore is President of the *Peruvian Congress' Energy and Mines Commission.*

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