



# Inter-American Dialogue

## LATIN AMERICA ADVISOR

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### Featured Q&A With Our Board of Advisors

**Q** Rising fuel costs, high debts, and economic hard times have hit some Latin American airlines hard. What is the outlook for air carriers in the region? Do you see consolidation in the sector as a strategy to overcome financial difficulties? What is a winning strategy for Latin American airlines going forward?

**A** **Guest Comment: Giovanna Caccialanza:** "In recent months, regional traffic has strengthened in Latin America as demand for passenger travel services has recovered. The strongest regional airlines (such as LAN Airlines and its affiliates in Peru and Ecuador) have launched new, intra-regional routes and routes to the US and Europe, and continue to add capacity. Strong traffic trends and the financial difficulties of several regional carriers may lure foreign carriers to add capacity as well, which will challenge the competitive environment. LAN's competitive advantages in capacity management, aircraft utilization, and cost structure will allow it to remain profitable and maintain or enhance its market position in the long term. This is not the case for the financially weaker regional carriers, which are struggling with soaring fuel costs and high debt loads. As far as consolidation, greater scale and route coverage allows a carrier to increase aircraft rotation and maximize capacity utilization, a key strategy in an industry where fixed costs are high. Cost management and efficiency

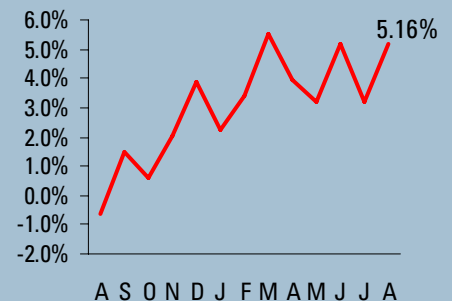
in the operation of routes are also winning strategies. Although over the past few years there has been some regional consolidation activity (mostly out of Brazil), I believe that consolidation will be constrained by the burdensome liabilities of potential targets, both financial and labor-related, and the financial difficulties of potential buyers. The stronger regional carriers may not pursue acquisition opportunities that jeopardize their financial profile, and the North American carriers are loaded with their own financial troubles."

**A** **Guest Comment: Bob Booth:** "Rising fuel costs, high debts, and economic hard times are not just limited to Latin American avia-

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### CHART OF THE DAY

**Mexico Economic Activity**  
Aug 2003-Aug 2004



See related news brief on page 2.

Source: INEGI.

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## NEWS BRIEFS

**Mexican Economic Activity Rose 5.3 Percent in August**

Economic activity in Mexico grew 5.2 percent in August compared to the same month of 2003, government statistics agency INEGI said Tuesday. By sector, economic activity in agriculture grew 6.9 percent year-on-year in August, followed by industry (5.2 percent) and services (5.1 percent).

Source: INEGI.

**Venezuela Approves Telefonica's Purchase of BellSouth Unit**

Venezuelan telecommunications regulator Conatel has approved the acquisition by the mobile unit of Spain's **Telefonica** of the local mobile operations of **BellSouth**, a Telefonica executive said Tuesday. Conatel gave its approval on the condition that the BellSouth unit, **Telcel**, continue to offer all services that it currently provides, including fixed wireless service and Internet access. In March, Telefonica announced an agreement to purchase BellSouth's Latin American mobile assets for \$5.8 billion.

Source: Reuters.

**Southern Peru Copper Corp. Workers Threaten Strike**

Workers at Peruvian mining firm **Southern Peru Copper Corp.** will go on strike on November 3 if a fired worker is not reinstated, a union leader said Tuesday. "We have informed the company and the labor authorities," said union leader Guillermo Panca. "We hope this issue of our comrade is resolved, although they are sticking to their guns." The worker was fired for misconduct during a 13-day strike last month. Workers are demanding a one-time bonus as a result of high world copper prices.

Source: Reuters.

**Economic News****Argentine Supreme Court Rules Against Depositors on Pesification**

A two year-old battle in Argentine courts over the forced conversion of dollar-denominated deposits into devalued pesos in 2002 ended Tuesday when the Supreme Court ruled against depositors, Reuters reported. Yesterday's ruling was seen as a key victory for the government of Argentine President Nestor Kirchner in its efforts to stabilize an economy and financial system devastated by the economic collapse in 2002. "The Court's ruling should discourage further lawsuits from depositors against the local banks, improving the outlook of the country's banking system," investment bank **Credit Suisse**

*Yesterday's ruling was seen as a key victory for the government of Argentine President Nestor Kirchner in its efforts to stabilize an economy and financial system devastated by the economic collapse in 2002.*

**First Boston** said in a research note published this morning. Thousands of Argentines had filed lawsuits to recover the full value of their deposits after the caretaker government of former President Eduardo Duhalde abandoned Argentina's convertibility scheme, by which pesos were set at a one-to-one exchange rate with the US dollar. Duhalde had offered depositors compensation of two pesos per dollar, but many Argentines held out hope for a better return. The peso now trades at about three per dollar. The reversal of the so-called "pesification" by the Supreme Court would have meant even greater losses for the country's battered banking system, which saw assets converted into devalued pesos.

**Political News****Haitian Rebel Warns of Possible Revolt Against Interim Government**

A Haitian rebel leader on Tuesday threatened to revolt against the country's inter-

im government if it did not come to the aid of the storm-battered city of Gonaives, the Associated Press reported. Winter Etienne said his group was demanding the government, which took power in March following the ouster of exiled former President Jean-Bertrand Aristide on February 29, construct 200,000 new homes in Gonaives, which was devastated last month by flooding and mudslides brought by Tropical Storm Jeanne. Some 3,000 people died as a result of the flooding and mudslides. Etienne said he had also demanded the government rebuild roads and repair clogged canals in Gonaives, and give each student in the city \$55 for uniforms, shoes, and school fees. The rebel leader said he told interim President Boniface Alexandre "that if he cannot respond positively, clearly, and precisely to all the demands of the communi-

ty of Gonaives, that he must turn over power to someone else who can." If Alexandre does not turn over power, "then we will do the same thing we did before to get rid of Aristide," Etienne said.

**Company News****Bombardier Denies Choice for New Plant Narrowed to Mexico, Brazil**

Canadian aircraft maker **Bombardier** on Tuesday denied statements by Mexican President Vicente Fox that the company had narrowed its choices for the site of a new assembly plant to Brazil and Mexico, Reuters reported. "We have never to my knowledge mentioned Brazil or Mexico," said Bombardier spokeswoman Dominique Dionne. "There are other parts of the world that have come up with proposals on components, so there are a lot of different states being considered, but I don't think there is a strict competition between those two countries." Fox said earlier in the day he had been told by

Bombardier executive chairman, Laurent Beaudoin, that the jet maker would choose between Brazil and Mexico for the location of an assembly plant. "[Beaudoin] mentioned the choice would be between Brazil and Mexico," Fox was quoted as telling reporters at the end of a three-day state visit to Canada. Dionne said Beaudoin only asked Fox about the competitive advantage of locating sub-assembly operations in Mexico for Bombardier's existing aircraft programs. "They never even talked about the new aircraft program." The proposed plant is part of a \$2 billion program to develop the Montreal-based company's new C-Series jet, which seats 115-135 passengers. Bombardier expects to complete an evaluation of the project in December, and will recommend to its board whether to go ahead with the project in January or February. Bombardier executives have said the new jets could be built in Montreal, Northern Ireland, or the United States.

### Commission Approves Loan to Colombia Telecomunicaciones

A Colombian government commission on Tuesday approved a \$140 million loan to state-owned fixed-line telephony company **Colombia Telecomunicaciones** to pay off debts to foreign joint-venture partners, Reuters reported. Colombia Telecomunicaciones will borrow the money in the form of nine-year loans at preferential rates, probably from Colombian banks, according to company President Alfonso Gomez. In two weeks, the government commission, comprised of congressmen and officials from the ministry of finance, will consider the company's request to borrow an additional \$210 million to pay back foreign joint venture partners, which have lodged court claims for some \$1 billion in compensation for lower-than-expected returns on joint-venture contracts. Colombia Telecomunicaciones has already paid \$136 million to Canadian equipment supplier **Nortel Networks** and Sweden's **Ericsson**, which had originally demanded more than \$800 million. Other foreign firms awaiting payment are Germany's **Siemens**, France's **Alcatel**, and NEC Corp. and **Itochu Corp.** of Japan.

## The Dialogue Continues

*A continuation of the October 26, 2004 Q&A*

**Q** The foreign ministers of nine South American countries signed an agreement last week to merge the Mercosur common market—made up of Argentina, Brazil, Paraguay, and Uruguay—with the Andean Community—composed of Bolivia, Ecuador, Colombia, Venezuela, and Peru—according to *Miami Herald* columnist Andres Oppenheimer. What is the significance of the agreement? Does it represent the creation, as former Argentine President Eduardo Duhalde stated, of a "United States of South America?" Or is South America still too divided both economically and politically to effectively unite?

**A** Guest Comment: James Kenworthy: "The idea of political and even monetary union in South America is not realistic in the near term because of historical antipathies and differing developmental priorities. But a single South American market based on economic, trade, and investment integration is not unrealistic given the nearly 50-year history of efforts toward that end. South America already has two major economic groupings—Mercosur—and the Andean Community—which comprise nine of the 12 countries in that continent and which have been slowly coming together to harmonize their policy, legal, and regulatory regimes for trade and investment similar to the early evolution of today's European Union. Moreover, there are good reasons for a single South American market. For one, many of the South American countries are already attracted to attaching themselves to Brazil's large and dynamic economy via a Mercosur/Andean Community union.

For another, the Free Trade Agreement of the Americas (FTAA) effort appears moribund and no longer reflects the United States' purposes or modalities for it. Moreover, given the apparent political drift in Washington away from free trade agreements, the future of this initiative is uncertain. Finally, the EU is already Brazil's biggest market and most of the other nations would like eventually to enhance their economic opportunities with the EU via a Mercosur/Andean Community economic union."

**A** Guest Comment: Thomas O'Keefe: "I would not hold my breath that anything significant is going to come out of this. In over 13 years of existence, Mercosur has failed to achieve a common market and is still only a partial free trade area. The common external tariff is in shambles. Although the Andean Community is more advanced in terms of institutional development and common laws and regulations with respect to intellectual property, services, and free movement of labor, it still has a number of serious issues pending regarding enforcement of Community legislation. The fact that a Peronist *politico* is touting the event as the creation of the United States of South America is warning enough that this agreement is likely to be nothing more than meaningless and empty rhetoric without any substance to show for it."

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**James Kenworthy** is an international trade and investment consultant.

**Thomas O'Keefe** is President of the Mercosur Consulting Group, Ltd.

**Featured Q&A***Continued from page 1*

tion. Other problems are economies of scale—one US carrier (American) which serves the region and has approximately 50 percent of the market between the US and Latin America has a fleet of aircraft which exceed the number of aircraft operated by all the Latin American airlines which serve the United States. But the glass may be half full, not half empty. First, the region is recovering and demand is growing faster in the region than anywhere else, perhaps with the exception of the Asia/Pacific region, which was hit a lot harder because of the SARS outbreak and other factors, and Latin America has the highest yields (as reported by the US majors which serve the region). Second, there are several success stories in the region, *i.e.*, LAN, which is 'the model' (by creating a Pan American 'brand' with subsidiaries in Peru, Ecuador, and the Dominican Republic, Argentina, and Brazil next) and which has reported record profits for the past four years—and will report a record third-quarter profit this week. Others include Copa Airlines of Panama, which is profitable and growing as it develops its 'hub of the Americas' in Panama; Grupo TACA, which started the whole idea of 'horizontal equity alliances' in the early 1990s, and which includes six Central American subsidiaries and a Peruvian subsidiary, TACA Peru, which is also profitable; and TAM in Brazil, which continues to produce profits in spite of everything. Third, there is the beginning of an LCC (low cost carrier) development, led by Gol in Brazil and soon expanding to Argentina and other markets in the region. That has the 'Southwest effect' of stimulating a market which has 500-plus million people and where less than 10 percent use air transportation."

**A** **Guest Comment: Stephen Trent:** "The Latin market is certainly as affected as any of the other global markets in terms of the fuel price problem. You have a lot of variation within the sector because some airlines have been conscientious about fleet planning, while others have not. As a

region, Latin American airlines have been somewhat more conscientious about planning their fleets than in other parts of the world. You still have some carriers continuing to lose money, and some carriers have not done such a great job with strategic planning as have others. Some capacity needs to come out of the market. LAN airlines has a great strategy moving forward. For one, even though it has increased capacity over the last couple of years, some of this capacity increase has come from higher utilization of existing aircraft. The other thing that LAN has done is they have been careful about laying out a strategy to rejuvenate their cargo business, and because cargo is such an important component of total revenue compared to other airlines in the Americas or even Europe, this actually gives LAN airlines a natural hedge to high jet fuel prices. Generally speaking in the Americas, cargo, which has a lower demand elasticity than the passenger business, has not been an important revenue component. In terms of outlook for the region, you're going to see some regional governments have to make some hard decisions about their respective flag carriers, some of which are losing money and don't have a strategy for dealing with factors such as protracted high jet fuel prices. Those carriers who can flexibly deploy their capital (such as those that have recently IPOed, or plan to IPO) should do relatively well. Some of the smaller carriers, like Peru's Nuevo Continente, whose fuel supplier is now demanding cash for payment, could be worse off."

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**Giovanna Caccialanza** is Director of Corporate Finance at Fitch Ratings.

**Bob Booth** is Chairman of Aviation Management Services, Inc.

**Stephen Trent** is Vice President of Latin America Equity Research at Citigroup Smith Barney.

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Senior Fellow

Subscription Inquiries are welcomed at  
freetrial@thedialogue.org

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1211 Connecticut Avenue, Suite 510  
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Phone: 202-822-9002 Fax: 202-822-9553

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