



Inter-American Dialogue

LATIN AMERICA ADVISOR

BOARD OF ADVISORS

Bernard Aronson
Managing Partner,
ACON Investments
LLC

Diego Arria
Director,
Columbus Group

Genaro Arriagada
Board Member, Banco
del Estado de Chile

Joyce Chang
Global Head of
Emerging Markets
Research, J.P. Morgan
Chase & Co.

Adrian Cruz
Senior Partner,
ACPZ Venture Capital,
LLC

W. Bowman Cutter
Partner,
E.M. Warburg
Pincus

Dirk Donath
Managing Director &
Founding Partner,
Pegasus Capital

Myles Frechette
Former US
Ambassador to
Colombia

Wallace Gardner
Vice President,
Worldwide Sales,
Chubb & Son

Michael Gavin
Head of Latin
America Econ.
Research, UBS

George W. Grayson
Professor of Govt.,
The College of
William & Mary

Peter Hakim
President,
Inter-American
Dialogue

Donna Hrinak
Co-chair, International
Trade, Competition,
and Government
Affairs Practice,
Steel Hector & Davis

Jon Huenemann
Principal,
International
Department,
Miller & Chevalier

James R. Jones
Co-chair,
Manatt Jones
Global Strategies LLC

Paul Laudicina
Vice President,
A.T. Kearney

Thomas F. McLarty III
President, Kissinger
McLarty Assoc.

Beatrice Rangel
President & CEO,
AMLA Consulting

José Antonio Ríos
International President,
Global Crossing

Everett Santos
CEO, Emerging
Markets
Partnership

Roger Scher
Head of Latin
American
Sovereign Ratings,
Fitch Ratings

Tony Smith
Partner,
Schmeltzer, Aptaker
& Shepard

Subscribers may pose questions to the Board of Advisors for the Featured Q&A by contacting the Editor at rsimpson@thedialogue.org

Featured Q&A With Our Board of Advisors

Q Sky-high world oil prices are a bonanza for net oil exporters in Latin America. But do high oil prices come with a cost? Are they hurting economic and fiscal reform efforts in Latin America?

A Guest Comment: Roger Stark: "The spike in global oil prices is bad news for the region as a whole. Oil exporters are benefiting from a short-term increase in cash flow, but oil price spikes also trigger long-term moves towards alternate fuels, alternate technologies and fuel efficiency, so current price levels are unlikely to be sustainable. The regional economy will also suffer as a result of increased inflationary pressure and a reduction in disposable income. Venezuela is the largest beneficiary of higher oil prices. However, as illustrated by its recently-announced Petrocaribe initiative, the Venezuelan government is diverting petrodollars for political and diplomatic purposes, thereby reducing benefits to the national/regional economy. Non-productive initiatives and corruption often take up such a large percentage of oil revenues that many supposedly 'oil-rich' macro-economies actually realize only a fraction of potential benefits. Latin America continues to suffer from a substantial infrastructure and foreign investment deficit. Equally important, hemispheric leaders (north and south) have failed to develop a much-needed strategy for regional energy integration. In this context, the economic distortions

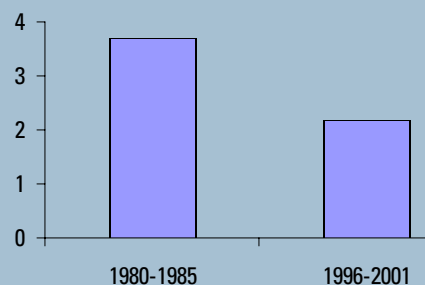
caused by high oil prices have the potential to undermine efforts at fiscal reform and damage an economically underperforming region."

A Guest Comment: David Goldwyn: "Structural and economic reforms are stalled in the Hemisphere for political reasons. High oil prices will have a negative impact on growth in most of the region, further undermine structural reform and economic diversification in oil-exporting countries, but possibly force the reduction in subsidies of products in oil- and distillate-

Continued on page 4

CHART OF THE DAY

Infrastructure Investment in Latin America & the Caribbean
% of GDP



Investment in Latin American and Caribbean infrastructure has fallen too far behind, according to a World Bank report. See related story on page 2.

Source: World Bank.

Inside This Issue

FEATURED Q&A: Do High Oil Prices Come with a Cost for Latin American Oil Exporters?	1
Production, Exports Drive Strong Second-Quarter Growth in Brazil	2
Report: Region Needs to Invest More in Infrastructure	2
Ecuador Requests 10-km Border Zone Be Kept Free of Drug Crop Fumigation	2
Carlos Slim Says He Holds Stakes in BellSouth, SBC, and Verizon	3
Capitol Hill Watch: A Weekly Look at US Congressional Activity on Latin America	3

NEWS BRIEFS

Lopez Obrador Retains Lead in Mexico's 2006 Presidential Race

Former Mexico City Mayor Andres Manuel Lopez Obrador remains the frontrunner in Mexico's July 2006 presidential race, according to a **Consulta Mitofsky** opinion poll conducted August 17-21. The poll found that 37.9 percent of respondents said they would vote for Lopez Obrador of the the opposition PRD party, while 25 percent said they prefer former Tabasco state Governor Roberto Madrazo of the opposition PRI party. A fifth of respondents said they would vote for former Interior Minister Santiago Creel of the ruling PAN party.

Source: *Bloomberg News*.

Peruvian Government Submits Surprisingly Low 2006 Budget

The government of Peruvian President Alejandro Toledo has submitted to Congress a lower-than-expected budget for 2006 worth 50.692 billion soles (\$US 15.5 billion). The budget, which is essentially the same as this year's budget, was a surprise, given intense pressure for public-sector pay raises and other increases. "There's no fiscal splurge in the 2006 budget," said Cecilia Blume, a top advisor to Prime Minister Pedro Pablo Kuczynski.

Source: *Reuters*.

Chilean Central Bank Raises 2005 Economic Growth Forecast

Chile's Central Bank on Wednesday boosted its economic growth forecast for this year to 6-6.5 percent, up from a previous estimate of 5.25-6.25 percent. However, the Bank also raised its 2005 inflation forecast from 2.8 percent to 3.8 percent, in part due to record-high oil prices.

Source: *Reuters*.

Economic News**Production, Exports Drive Strong Second-Quarter Growth in Brazil**

Brazil reported higher-than-expected economic growth for the second quarter, as strong industrial production and exports more than offset a downturn in domestic demand. The economy grew at its fastest pace in more than a year, according to government statistics agency IBGE, increasing 1.4 percent since from the first quarter and 3.9 percent from the second quarter last year. Exports surged to a record \$29 billion in the second quarter, driving gains in investment and Brazil's currency, the real. The strong growth was also attributed to the Central Bank's efforts to provide

speed up economic growth and remain competitive with China and other Asian countries, according to a report published Wednesday by the World Bank. Spending on infrastructure in the region has fallen from 3.7 percent of GDP in 1980-1985 to less than 2 percent of GDP today, the report said. "Progress in Latin America and the Caribbean has generally been slower than in other middle-income countries, notably China," said Marianne Fay, a World Bank economist and co-author of the report. "[Latin America and the Caribbean] has now fallen behind for electricity, roads, and fixed telephone lines, with only cellular telephony and access to safe water and sanitation facilities performing comparatively well." Less than a third of national road networks in Latin America and the Caribbean are in good

“ The outlook for inflation remains very positive and supports our call for an interest rate cut in September. ”

- HSBC analyst Luis Cezario

greater credit access for families, and some banks reported consumer lending in the second quarter grew 50 percent year-on-year, according to Reuters. Nine interest rate increases by the Bank since last September, aimed at curbing inflation, have crimped consumer demand and lowered overall profits for some companies in Brazil during the first half of 2005. However, amid a slowdown in inflation and a widespread decline in wholesale industrial prices in August, most analysts expect the Bank to start lowering its benchmark Selic interest rate next month from a two-and-a-half year high of 19.75 percent. "The outlook for inflation remains very positive and supports our call for an interest rate cut in September," HSBC analyst Luis Cezario said in a research note on Wednesday. Analysts expect inflation to slow to about 5.3 percent this year.

Report: Region Needs to Invest More in Infrastructure

Latin American and Caribbean countries need to invest more in infrastructure to

condition, the report said, while the region has fallen behind middle-income countries in energy generation capacity. The report noted that private investment in infrastructure has plunged, falling from a peak of \$71 billion in 1998 to \$16 billion in 2003. Attracting private investment will require governments to strengthen their legal, regulatory, and institutional frameworks, make contracting more transparent, and improve returns for investors. Government involvement remains key to infrastructure development, the report said.

Ecuador Requests 10-km Border Zone Free of Drug Crop Fumigation

A ten-kilometer area should be created on Ecuador's border with Colombia where fumigation of illegal crops is prohibited, Antonio Parra, Ecuador's minister of foreign relations said on Wednesday, Colombian daily *El Tiempo* reported. "The consequences of aerial spraying on Ecuadorean territory, human, vegetative and animal health concern us," Parra said during a daylong visit to neighboring

Colombia. Meeting in Bogota with his Colombian counterpart, Carolina Barco, Parra said a strip 10-kilometers wide should be set aside to protect the health of the people residing there, some of whom have reported respiratory and stomach problems as a result of aerial spraying carried out by Colombia's government. Ecuador—which has repeatedly asked for the creation of a fumigation-free zone—and Colombia share a 586-km long border, where difficulties involving the presence of guerrillas and internally displaced people fleeing the conflict among rebels, paramilitaries and the Colombian government have strained relations. Wind has caused chemicals from Colombia's aerial spraying program to cross the border, according to residents on the Ecuadorean side. However, Colombian officials insist that the amounts of glyphosate—a herbicide used to fumigate crops—are not dangerous to people or the environment. Barco said on Wednesday that Colombia wants "to listen to the Ecuadorean proposals and share information that we have concerning fumigation." The visit is part of an ongoing bilateral dialogue to determine ways to improve security along the countries' shared border—as well as drug trafficking, migration and fumigation issues. During a meeting with Barco on July 25, Parra said it is necessary that Colombia establish a system of permanent vigilance on the border with Ecuador to keep guerrilla operations in check, Ecuadorean daily *El Comercio* reported.

Company News

Carlos Slim Now Holds Stakes in BellSouth, SBC and Verizon

Mexican billionaire and Latin American telecom magnate Carlos Slim said this week he holds stakes in US telecommunications companies **BellSouth Corp.**, **SBC Communications**, and **Verizon Communications**, Bloomberg News reported Wednesday. Slim, who had not previously disclosed that he holds shares in BellSouth and Verizon, did not specify the nature of the holdings. He served as a director on the board of SBC until last year. "The US telecom companies are very

Capitol Hill Watch

A weekly look at US congressional activity on Latin America

Kolbe Says US Soldiers Should Not be Used to Patrol Mexico Border

Despite increasing concerns about illegal immigration and violence along the US-Mexico border, Republican congressman Jim Kolbe of Arizona said Wednesday that US soldiers should not be used to patrol the border. "We do use the military along the border in an appropriate fashion," Kolbe told a town hall meeting. "We use the National Guard for unloading trucks, paving and building roads, and building walls. Where I don't agree is using military for domestic law enforcement. That is not the job they are trained to do." Earlier this month, the governors of Arizona and New Mexico declared a state of emergency along their borders with Mexico, calling for more federal assistance to control immigration. During a visit to Arizona on Monday, President George W. Bush vowed to help southwestern states enforce their border with Mexico. Kolbe is one of several lawmakers to propose a guest-worker program that would allow immigrants to legally work in the US.



Jim Kolbe
Photo: Office of Rep. Kolbe

Source: San Pedro Valley News-Sun, White House press release.

Coleman Says Latins Now More Suspicious of US Aims in Latin America

Senators Norm Coleman (R-MN), Mel Martinez (R-FL) and Rep. Jeff Miller (R-FL) returned yesterday to the United States from a four-day trip to South America, where they visited Brazil, Chile, Colombia and Uruguay. Coleman, who chairs the Senate Foreign Relations Western Hemisphere subcommittee, and his colleagues were in the midst of a four-country visit to South America when US religious leader Pat Robertson made his now-retracted statement calling for the assassination of Venezuelan President Hugo Chavez. Coleman said the remark tapped into suspicions held not just by Chavez but by people throughout Latin America. "We were in Brazil, and it was articulated to us by a number of folks, that many Brazilians believe we will invade the Amazon and take it over," said Coleman. "They think we went into Iraq for oil, and if we're going to go into Iraq for oil, then why not take over the most resource-rich region in Latin America? This view is held even among academicians, among thoughtful individuals. We're already facing some challenges in terms of the perception of America and what our intentions are, and those kinds of comments only fuel the paranoia that unfortunately exists."

Source: Saint Paul Pioneer Press.

strong, have a great future, good cash flow, a strong financial position, and high yield," Slim was quoted as saying. In April, he collected \$1.1 billion after selling a 13.7 percent stake in US long-distance company **MCI** to Verizon. In Latin America, he controls the region's largest mobile operator, **America Movil**, as well as Mexico's

biggest fixed-line operator, **Telefonos de Mexico**. Slim and his family also hold a nearly 11 percent stake in US-based fiber network operator **Global Crossing**, according to a filing with the US Securities and Exchange Commission in January.

Featured Q&A*Continued from page 1*

importing nations. Historically, oil producers have overspent and over-borrowed during boom years, rather than investing in debt repayment, infrastructure, or education. These risks remain. Most regional growth in 2004 and 2005 was from a commodity boom, which will

“Historically, oil producers have overspent and over-borrowed during boom years, rather than investing in debt repayment, infrastructure, or education.”

- *David Goldwyn*

enable countries like Chile to balance higher oil costs with other commodity exports. Venezuela will enjoy enormous revenue growth, can easily manage its product subsidies, and already trends to greater state control of the economy. Argentina may restore production incentives to try to catch what may be sustained high prices. Brazil's use of bio-fuels will insulate it from a crude oil price shock. Growth was already slowing in Mexico, where fiscal and structural reforms are stalled, and election year politics could lead Mexico to spend whatever oil revenue surplus it earns. Reform of Mexico's energy sector will be paralyzed until after the next presidential election, at the minimum. Central America and the Caribbean will face great pressure to liberalize product prices as the high cost of product imports drains national treasuries."

A Guest Comment: Roger Tissot: "The reaction from Latin American oil-producing countries varies substantially depending on the political conditions of the country. In Venezuela, the petroleum windfall has helped the Chavez administration consolidate and centralize its power, expand income distribution

mechanisms (e.g., *misiones*), and boost economic growth via massive government spending. In Mexico, oil revenues have permitted an unviable status quo to continue at Pemex and have postponed much needed fiscal reform. Ecuador is perhaps the biggest loser. Oil rents have delayed economic reform and actually raised expectations for even more government spending. The latter is evident in the recent crisis in the Oriente, as the final agreement with locals could 'eat' a substantial size of national fiscal revenues. Meanwhile, Brazil has benefited the most. In the past, external oil shocks resulted in hyperinflation and low economic growth. Brazil's imminent self-sufficiency in oil production helps reduce its fiscal vulnerability to oil shocks. Overall, governments have used oil revenues to increase consumption (Venezuela, Mexico), strengthen their fiscal balance (Ecuador, Colombia), and reduce external vulnerabilities (Brazil). However, despite high rates of growth, the windfall has not translated into a substantial improvement in the standard of living. On the other hand, most countries have improved their macroeconomic management, thus avoiding Dutch disease pressures."

Roger Stark is a Partner at Kirkpatrick & Lockhart LLP.

David Goldwyn is President of Goldwyn International Strategies LLC.

Roger Tissot is Director, Latin America Countries Group at PFC Energy.

Latin America Advisor

is published every business day by the Inter-American Dialogue, Copyright © 2005

Erik Brand,
General Manager, Publishing

Robert Simpson,
Editor

Devin Finn,
Reporter

Danielle Jetton,
Computer Services Coordinator

Inter-American Dialogue:

Peter Hakim,
President

Michael Shifter,
Vice President, Policy

Joan Caivano,
Director of Special Projects

Dan Erikson,
Director for Caribbean Projects

Claudio Loser,
Senior Fellow

Judith Morrison,
Executive Director, Inter-Agency Consultation
on Race in Latin America

Marifeli Perez-Stable,
Vice President for Democratic Governance

Jeffrey M. Puryear,
Vice President, Social Policy

Viron Vaky,
Senior Fellow

Subscription Inquiries are welcomed at
freetrial@thedialogue.org

Latin America Advisor is published every business day by the Inter-American Dialogue
1211 Connecticut Avenue, Suite 510
Washington, DC 20036
Phone: 202-822-9002 Fax: 202-822-9553

The opinions expressed by the members of the Board of Advisors and by guest commentators do not necessarily represent those of the publisher nor do they represent any consensus of belief. The analysis is the sole view of each Advisor and does not necessarily represent the views of their respective employers or firms. The information in this report has been obtained from reliable sources, but neither its accuracy and completeness, nor the opinions based thereon, are guaranteed. If you have any questions relating to the contents of this publication, contact the editorial offices of the Inter-American Dialogue. Contents of this report may not be reproduced, stored in a retrieval system, or transmitted without prior written permission from the publisher.