INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR

Featured Q&A *With Our Board of Advisors*

Q According to Brazil's national association of investment banks, mergers and acquisitions activity in the South American country is set to reach at least $38 billion this year, down from a record in 2006 but still considered high. What is driving M&A activity in Brazil this year? What kinds of reforms are needed to spur additional growth in M&A activity in Brazil?

A Guest Comment: Antonio Aires: "Low interest rates, economic stability, and international liquidity are the major drivers for Brazil's M&A activity in 2006 and 2007. The stock exchange and recent IPOs have also been an important driver, as they channel IPO funds, not only to organic growth but also to the acquisition by the newly listed companies of competitors or strategic businesses. According to a periodic report on M&A issued by KPMG, M&A transactions in 2007 so far are concentrated in shopping centers; food, beverages, and tobacco; chemical and petrochemical products; metallurgy and steel; information technology; company services; electrical and electronic equipment; telecommunications and media; sugar and ethanol; financial institutions; and real estate. According to the same study, of 182 transactions in the first semester of 2007, 83 were domestic (Brazilian-controlled company buying control of a Brazilian-controlled company) and 32 were cross border (foreign-controlled company buying control of a Brazilian-controlled company). The remainder included other types, such as the acquisition by Brazilian-controlled companies of foreign companies abroad and of foreign-controlled companies located in Brazil. In the short term, the increase in M&A transactions depends on the maintenance and improvement of the macroeconomic situation, with low inflation, high liquidity, and lower interest rates. Also, the effects of the recent international financial crisis must not be steep and immediate, reducing export prospects and thus negatively impacting Brazil. Improvements in infrastructure (roads, ports, airports, water and sewage, and

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PHOTO OF THE DAY

US Defense Secretary Robert Gates (left) met Tuesday with the president of El Salvador, Tony Saca, in San Salvador, Gates' first stop as part of a five-day, five-country tour of Latin America.

Photo: Pentagon.

Inside This Issue

NEWS BRIEFS

Finance Minister Says Inflation in Mexico Under Control

Mexican Finance Minister Agustin Carstens said Tuesday that inflation was under control and promised government action if prices rise in an "unjustified" manner, Bloomberg News reported. Speaking before the lower house of Congress, Carstens said that while prices have risen recently and higher food costs would "surely" lead to wage increases this year, inflation is not out of control "nor does it threaten to become so." Economists have raised their 2007 inflation forecasts for Mexico to 3.81 percent from a previous estimate of 3.65 percent, according to Bloomberg News.

Nationwide Strike Shuts Down Public Transport in DR

A nationwide strike Tuesday by public transportation workers demanding higher pay and lower energy costs in the Dominican Republic left commuters stranded and forced some businesses to close, Bloomberg News reported. Victor Geronimo, a leader of an umbrella group of labor unions and activists that organized the strike, said about 90 percent of public transportation in the country wasn't operating.

Mexican Rebel Group Offers Deal to Halt Bombings

Mexico's EPR rebel group pledged Tuesday to stop bombing fuel pipelines, as it did last month and in July, if businesses affected by the disruption in energy services support its demands that the government free two fellow activists, according to Reuters. The government has denied that it is holding the two, while the EPR denied Tuesday that it is using the allegedly imprisoned activists to legitimize its violent tactics.

Political News

Venezuela and US Seek Cooperation on Rebel-Held Hostages in Colombia

Venezuela and the United States are discussing ways to cooperate in seeking the release of three US defense contractors being held hostage by Colombia's FARC rebel group, Venezuelan Foreign Minister Nicolas Maduro said Tuesday, according to the Associated Press. Maduro said he met for an hour Monday with US Assistant Secretary of State for Western Hemisphere Affairs Thomas Shannon, during which Shannon urged Venezuela to seek proof from the rebels that the three Americans, seized in 2003 after their plane crashed in the Colombian jungle, were still alive. The meeting between Maduro and Shannon—the first such high-level encounter between US and Venezuelan diplomats in years amid ever souring relations—came a week after Venezuelan President Hugo Chavez appealed to US President George W. Bush to support efforts to negotiate an exchange of FARC-held hostages for captured rebels. Chavez, who was invited by the government to help broker an exchange, is expected to meet with senior FARC officials in Caracas next week. Despite what he described as "very cordial" talks with Shannon, Maduro said there were still several issues that divided the US and Venezuela, specifically worries that the US was planning to attack Iran to derail its alleged nuclear weapons program. "There are many issues that drive us apart, including the idea of some members of the Bush administration to go after Iran," Maduro was quoted as saying by the Associated Press. Venezuela has defended Iran from the US charges, saying Iran has the right to pursue a peaceful nuclear energy program.

Company News

Royal Bank of Canada to Acquire Caribbean's RBTT for $2.2 Billion

Royal Bank of Canada announced Tuesday that it would acquire Caribbean bank **RBTT Financial Group** for about 13.8 billion Trinidad & Tobago dollars ($US 2.2 billion) in cash and stock, beating out rival suitors in a deal that will bring the Canadian bank into new markets. RBTT had reportedly begun discussions with several banks, including Canada's **Scotiabank** and **CIBC**, in April. In a joint press release, the banks said RBC's TT$40 per-share offer represents an 18 percent premium over the Port of Spain-based bank's September 28 closing share price. The deal will expand RBC's Caribbean presence beyond its branches in the Bahamas, Cayman Islands, and Barbados. "This is a transformational acquisition for RBC in the Caribbean, one that extends our reach into many important markets, notably Trinidad and Tobago, Jamaica, and the Dutch Caribbean," Peter Armenio, RBC's head of US and international banking, was quoted as saying in a press release. With the acquisition, RBC said it would become the second- and third-largest player in Jamaica and Trinidad & Tobago, respectively. As a result of the deal, the top four banks in Jamaica would be Canadian-owned, the *Jamaica Gleaner* reported.

ICSID Awards Sempra Energy $172 Million in Dispute with Argentina

Sempra Energy said Tuesday an international arbitration panel awarded it $172 million, including interest, to settle a dispute with the Argentine government over a decline in value in the company's investment in two Argentine natural gas holding companies. In a press release, the San Diego, CA-based Sempra said the International Centre for Settlement of Investment Disputes (ICSID) last Friday ruled in favor of its claim that the natural gas holding companies—**Sodigas Pampeana** and **Sodigas Sur**—had lost value "as a result of measures taken by the Argentine government in early 2002," when utility rates were frozen amid an economic collapse. "We hope that the government of Argentina will honor its legal obligations as we seek immediate enforcement of the award," Sempra Executive Vice President and General Counsel Javade Chaudhri was quoted as saying in a press release. The Sodigas companies, in which Sempra has a 43 percent stake, control **Camuzzi Gas Pampeana** and

Camuzzi Gas del Sur, which together make up the largest natural gas distributor in Argentina, servicing about 45 percent of the country. Despite last week's ICSID ruling in favor of Sempra, the legal office for Argentina's treasury department said Argentina did not have to pay because of an April 2007 agreement with **Camuzzi International**, an Italian company that controls the two Camuzzi gas distributors, according to Reuters. Under that agreement, the two distributors were allowed to raise rates in exchange for dropping a separate claim by Camuzzi at the ICSID and pledging to invest in Argentina, something Sempra had not wanted to do, Reuters reported. "For that reason the economic damages imposed by the World Bank organism should be entirely taken on by Camuzzi Gas del Sur and Camuzzi Gas Pampeana," the treasury department was quoted as saying in a statement. Sempra is just one of several foreign companies to have filed a claim against Argentina at the ICSID stemming from losses suffered during the country's 2001-2002 economic collapse. Disputes with foreign companies have tarnished the country's investment image. According to a preliminary study by a group of economists, Argentina lost about $6 billion a year in direct foreign investment from 2001 to 2005 when compared with its regional peers, in part due to broken contracts and perceived arbitrary decision-making on the part of the government, Reuters reported on Tuesday.

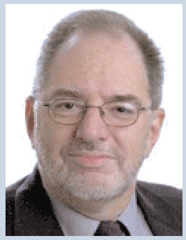
Petrobras Evaluating ExxonMobil's LatAm Assets, but no Offer Made Yet

Brazilian state-run oil and gas company **Petrobras** is evaluating US oil giant **ExxonMobil**'s Latin American assets, but has not made an offer to buy them, Petrobras' international operations director, Nestor Cervero, said Tuesday, according to Reuters. "The evaluation is being made but so far there is no offer, Cervero was quoted as telling reporters in Lisbon. The Brazilian press has speculated that Petrobras is preparing to bid for ExxonMobil's **Esso** unit in Argentina, and possibly elsewhere in Latin America, including Brazil, Reuters reported. Exxon Mobil has not confirmed reports it plans to leave the region.

By the Numbers

A Monthly Look at Latin American Data by the Dialogue's Claudio Loser

Education, Investment Keys to Region's Medium-Term Growth

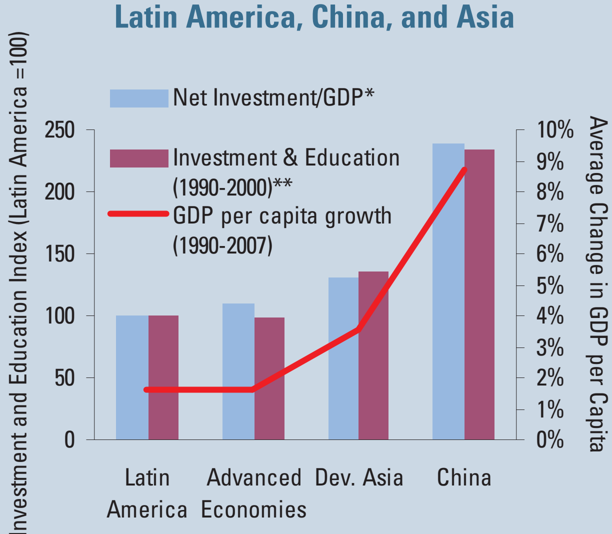


WASHINGTON, DC—Latin America seems to have done well during the recent turmoil in world financial markets. The final verdict is not yet in, and the markets are far from being calm, but the region has shown great resiliency, and is recovering.

The story is unfortunately more sobering when we look at the medium-term prospects for economic growth. In recent years, Latin America's economic growth rate has picked up and is only slightly below the growth rate for the world at large. Moreover, its pace of growth has been about in line (in per capita terms) with that of the more advanced economies. However, growth has lagged behind other areas of the world, particularly developing Asia and China. Per capita income exceeds that of developing Asia by 70 percent, in equivalent purchasing terms, but the gap is narrowing. It would be disingenuous to make simple projections on the basis of historical performance (as any good investment brochure should warn us). In per capita terms, Asia has grown by an average of five percentage points more than Latin America. If we were to assume that growth in Asia slows down and the difference is cut in half, Asia would catch up in about 20 years, and only somewhat more than 10 years if the differential growth rate remains as it has been the last 15 years or so.

The key question that this column will try to answer is if there are some obvious differences that may explain the different behavior of different regions since the early 1990s. Per capita income has grown by about 1.6 percent a year in Latin America and advanced economies, 3.5 percent in developing Asia, excluding China, and 8.7 percent in China. It is true that the availability of abundant low-wage labor explains some of the growth in Asia. However, the chart above shows a striking link between economic growth, investment, and changes in education levels.

Investment, Education, and Growth in Latin America, China, and Asia



Source: Inter-American Dialogue, IMF, World Bank.
**investment net of estimated depreciation, or capital replacement. Depreciation assumed to be equivalent to 10 percent of GDP, or about 3-5 percent of the capital stock*
***Weights of investment and education are 80 percent and 20 percent, respectively.*

Fundamentally, the chart indicates that higher investment and schooling are associated with (and result in) higher economic growth, as is illustrated by the Asian example. There may be additional issues, like the working of institutions, the rule of law, and similar structural aspects. But these are the ones that will be reflected in higher incentives to invest, and thus in higher capital accumulation. Interestingly, the per capita

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Featured Q&A

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energy) are also required, and privatization programs and studies for this purpose are under way. Finally, Brazil still needs to revamp its heavy tax structure and reform its labor laws, not to speak of eliminating bureaucracy. Education and training are also an important issue. These are medium- and long-term changes that will increase Brazil's investment attractiveness."

A Guest Comment: Roberto Teixeira da Costa: "From the lowest point during the beginning of the audit crisis up to October 1, Brazil's Bovespa stock index has shown an increase of more than 35 percent. But even the optimists are considering that reaction was perhaps too fast and prices are at their highest level. For M&A activities, the stock market indicators are certainly good, but are not the only ones to be considered for buyers or sellers of corporations. Among other aspects, the concession of investment grade to Brazil, which for stock market purposes is perhaps being reflected in the prices of shares traded on the stock exchange for new corporate entrants in the Brazilian market, could very well be a relevant factor. Certain guidelines of the government's Growth Acceleration Program, which are not yet very clear from the investor perspective, could be an additional factor stimulating the undecided. For sellers or potential partners, an obvious question mark is always the price. Nobody wants to feel they have not made the best deal because they did not have the patience to wait. Obviously, certain structural macroeconomic reforms would be helpful, but they are not the decisive factor in the present circumstances to foster the growth of such activity."

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By the Numbers

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rate of growth of Latin America and the advanced economies is very similar, and the levels of investment and of enhancement in education also about the same, but this is little consolation in light of the large difference in income for both regions. Per capita GDP is about four times as high for the developed world than for Latin America, and there is little chance to catch up in the near future.

The challenge is to create the conditions for more rapid growth, namely better use of educational expenditures, as my friend Jeff Puryear of the Dialogue and his colleagues at PREAL (Partnership for Educational Revitalization in the Americas) suggest; more fiscal resources devoted to really productive investments, and less to consumption; and an infrastructure conducive to higher private investment. This is a tall order, but one that is absolutely necessary to restore the relevance of Latin America in the world.

Claudio Loser is a Senior Fellow at the Inter-American Dialogue and former Head of the Western Hemisphere Department at the International Monetary Fund.

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