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FEATURED Q&A

Would a Tax Cut Spur Job Growth and Investment in Ecuador?

Q Ecuador's production minister, **Nathalie Cely**, announced Sept. 1 that the Correa administration will propose a three percentage point tax cut for businesses—to 22 percent from 25 percent—to help boost job growth and investment. Will the proposed tax cut achieve those two goals? Will the tax cuts and some 30 other new laws that the administration is rewriting in the industry, finance and other sectors help build trust between the private and public sectors in Ecuador? What role do you believe international investment will have in Ecuador's economic outlook in the near to mid term?

A **Nathalie Cely, Ecuador's coordinating minister of production, competitiveness and commercialization:** "The new legal framework offered by our national government provides security for all domestic and foreign investments. The Production Code presents a favorable investment landscape for both new and existing investors. The phasing out of the three-point income tax places Ecuador among the countries with the lowest rate of income tax in the region. Additionally, companies that reinvest their profits receive a 10 point reduction in their income tax on the amount of reinvested earnings. New investments that are part of high-priority sectors (tourism, logistic services, high-tech industries and sustainable use of natural resources) will include a 100 percent exemption from income tax

for five years. The Production Code also generates tax incentives for green industries, improved productivity and international promotion. The environment is favorable for investment in Ecuador. The national government is interested in attracting investors who will be both profitable and responsible in meeting their tax obligations, and in their relationships with their workers, the environment and the community. Roughly a dozen international companies from various sectors, including production, food, energy and textiles, have

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Lula's Cabinet Chief Resigns Amid Corruption Allegations

Erenice Guerra, the cabinet chief for Brazilian President Luiz Inácio Lula da Silva, resigned Thursday amid accusations that she and her sons sought bribes from companies doing business with the government. See story on page 2.

File Photo: Brazilian Government.

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NEWS BRIEFS

Mexico's Gulf Coast Braces for Hurricane Karl

Mexico's central and southern Gulf Coast braced this morning for Hurricane Karl, which is expected to make landfall today. At 4 a.m. local time, the Category 3 hurricane was about 70 miles east-northeast of Veracruz with winds of up to 120 miles an hour, according to the U.S. National Hurricane Center. On Thursday, Mexico's state oil company, **Pemex**, evacuated platforms in the Gulf of Mexico after Karl swept across the Yucatán Peninsula, Reuters reported.

One Dead as Zelaya Supporters Clash With Honduran Police

Honduran police used tear gas and a water cannon to break up a demonstration of supporters of exiled President Manuel Zelaya Wednesday in San Pedro Sula, injuring three and killing a local street vendor, the Associated Press reported. A police spokesman said that the protesters were trying to disrupt a government-sponsored celebration. Demonstrators deny the charge.

Jamaican Bank Cleared of Violating Money Laundering Act

Jamaica's **National Commercial Bank** (NCB) was cleared Wednesday of charges that it breached the Money Laundering Act, the *Jamaica Gleaner* reported. Under the act, financial institutions must report deposits of greater than \$50,000. NCB was taken to court after investigators probed the account of Norris Nembhard, who is currently serving a prison sentence in the United States for conspiracy to export cocaine. The magistrate ruled that the directive to file the reports is tantamount to a regulation and must be published in the country's official gazette to become law.

Political News**Brazil Cabinet Chief Steps Down Amid Accusations of Corruption**

The cabinet chief in Brazilian President Luiz Inácio Lula da Silva's administration resigned Thursday amid corruption allegations, Bloomberg News reported. Erenice Guerra, who formerly was a top aide to ruling party presidential candidate Dilma Rousseff, said she was stepping down in order to defend herself from accusations that she and her children solicited bribes from companies doing business with the country's government. "I need peace and time now to defend myself and my family, so that the truth prevails," Guerra wrote. Guerra's execu-

“I need peace and time now to defend myself and my family, so that the truth prevails.”

— Erenice Guerra

tive secretary, Carlos Eduardo Lima, will replace her on an interim basis, said Lula's spokesman, Marcelo Baumbach. Brazil's *Veja* magazine reported Sept. 11 that **Capital Consultoria**, a lobbying firm that Guerra's two sons control, allegedly charged fees totaling 5 million reais (\$2.9 million) in order to help cargo airline **MTA Linhas Aereas** win a contract with Brazil's postal service. The airline, based in São Paulo, has denied any business dealings with Guerra or her children. Guerra has denied wrongdoing and has threatened to sue *Veja* for slander. In an article published Thursday, businessman Aldo Wagner told the *Folha de S. Paulo* newspaper that he was asked to pay the lobbying firm a 5 percent commission in order to secure a 9 billion real loan for his energy company, **ERDB do Brasil Ltda.** from Brazilian state development bank BNDES. Wagner told the newspaper that he discussed a stalled solar energy project

with Guerra in Brasília when she was executive secretary to Rousseff. Guerra's office denied that she met with Wagner. Wagner also told *Folha* that he refused to pay 450 million reais to the consulting firm and BNDES rejected the loan. In Rio de Janeiro,



Rousseff told reporters that Guerra was right to resign and prepare to defend herself. Rousseff added that the development bank made the right decision in rejecting the loan, as it would have been the country's most expensive energy project. She also questioned the accuracy of *Folha*'s reporting. "This story seems to me like the one about buying and selling land on the moon," said Rousseff. In a televised debate Sunday, Rousseff said she highly respects Guerra, who succeeded her as cabinet chief. In a statement, BNDES said it rejected the loan because the 2.3 billion reais it was seeking was incompatible with the size of the company. The bank added that ERDB failed to submit proper guarantees. In a *Datafolha* poll published Thursday, Rousseff widened her commanding lead ahead of the country's Oct. 3 presidential election. In the poll, she gained one percentage point to register 51 percent support while her main rival, former São Paulo state Gov. José Serra had 27 percent. Green Party candidate Marina Silva had 11 percent.

File Photo: Brazilian Government.

Economic News**Former Chief of Argentine Central Bank Predicts Continued Inflation**

The former president of the Central Bank of Argentina, Martín Redrado, warned Thursday that the Argentine economy is showing signs of exhaustion at a discussion hosted by the Inter-American Dialogue. Redrado said the government has drained the country's fiscal resources and "looking forward we will see more inflation, less growth." Redrado was ousted from his position at the helm of the

central bank over a dispute with President Cristina Fernández de Kirchner over the appropriation of \$6.6 billion in reserves to finance the public debt. He contends that the administration's expansionary policies are driving inflation to an unsustainable level, threatening to spiral wages and prices out of control. Redrado also criticized the erosion of the trade surplus through a misaligned exchange rate and the raiding of the country's fiscal assets but said that, due to high commodity prices, he does not predict an immediate crisis. Currently, the official inflation rate is 11.1 percent, but independent economists peg the figure about 25 percent. Fernández's administration on Thursday unveiled its 2011 budget bill, which plans to again use foreign reserves to meet debt repayments and forecasts the economy will grow 4.3 percent in 2011 with 8.9 percent inflation. The bill is expected to meet resistance from the opposition, which accuses the government of underestimating growth and inflation in order to use additional tax revenue without congressional oversight.



Redrado

File Photo: Redrado
Financial.

Company News

Scotia Capital Acquiring Brazilian Unit of Commerzbank

Canada's **Scotia Capital** is acquiring a Brazilian unit of **Commerzbank**, Scotiabank said Thursday. The Canadian Press reported. **Bank of Nova Scotia**, or Scotiabank, said that it has reached an agreement with the German bank to acquire the unit, São Paulo-based **Dresdner Bank Brasil**. The deal is not "materially significant," said Scotiabank, which did not disclose the terms of the agreement. "Scotia Capital has been actively expanding our wholesale business in key Latin American markets where we see tremendous potential for growth and we are very optimistic about the opportunity in Brazil," said Mike

Featured Q&A

Continued from page 1

shown interest in investing in Ecuador in the coming years for a total of more than \$4 billion. There is ample security for foreign investors in Ecuador. The decision to remove ourselves from old investment treaties because of new require-

“There is ample security for foreign investors in Ecuador.”

— *Nathalie Cely*

ments in our constitution will not in any way diminish legal certainty because the new Production Code presents an equally reliable alternative. Virtually all of the important provisions that are part of the investment treaties are included in the Production Code. The code defines the concept of investment while permitting and encouraging the signing of investment contracts between the investor and the state. It also provides incentives and alternative dispute mechanisms in regional forums."

A **Walter Spurrier, president of Grupo Spurrier and director of Weekly Analysis in Guayaquil:** "I am very skeptical that there will be an income tax cut. And if there is

Durland, Scotia Capital's co-CEO. The Canadian bank has been present in Brazil for nearly 40 years and the acquisition

Scotiabank has nearly 1,900 branches in the region.

will allow it to broaden its offerings, said Rob Pitfield, Scotiabank's group head of international banking. "Latin America is an increasingly important part of

one, more important than taxes are the uncertainties regarding property rights and labor policy. The trend for salaries to be hiked at a rate surpassing inflation and productivity deters investment in labor-intensive industries, so the job-increase goal is unlikely to be satisfied. Also deterring investment are Ecuador's repeal of bilateral investment treaties (in process) and refusal to sign FTAs with the United States and the European Union. More probable would be including tax breaks among the incentives for specific investments within a Korean-style industrialization policy. This will certainly find opposition from elsewhere in the administration, particularly the Ministry of Finance. Since its very beginnings, the government has been toying with this strategy, which dovetails with the president's belief that governments should micromanage markets, as well as with his bend to authoritarian rule. A new industrial policy may succeed in attracting foreign investment, in particular in the context of government-to-government agreements. For instance, an ambitious project for a new refinery, with a cost close to one-fourth of Ecuador's GDP, would require constructors and equipment suppliers to get shares in the venture in lieu of monetary payment. Multinationals, however, would be harder to attract given the considerations above, or at least until the protracted overhaul of Ecuadorean legislation to bring it in tune with the new constitution is completed."

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Scotiabank's international strategy and we continue to build on our already strong franchise by delivering superior service," said Pitfield. Last week, Scotiabank announced that Scotia Capital would broaden its mandate in order to take advantage of opportunities in wholesale banking. Scotiabank is the largest bank operating in the Caribbean and is growing its operations in Mexico and elsewhere in Latin America. It has almost 1,900 branches and 32,000 employees in Latin America.

Featured Q&A*Continued from page 3*

A Vicente Albornoz, Director General of the Corporation of Development Studies in Ecuador (CORDES): "Between 2006 and 2009, real private investment in Ecuador fell by 27.4 percent. During this period, corporate taxes have not risen, so lowering them, as suggested by the minister, will not spur a recovery in private investment. The fall in private investment is caused by a loss of confidence from the private sector in the government. There have been countless criticisms by the president and members of his cabinet against oil companies, mining companies, banks, media companies and against some exporters of agricultural goods. At the same time, the government has not shown any interest in fiscal responsibility and in 2009, the deficit was the largest in Ecuadorean history. A new constitution, three tax reforms and a labor reform in less than four years have also added to the legal instability and distrust in the government. A marginal reduction in corporate taxes will hardly rebuild the damaged relationship between the government and the private sector."

A Ramiro Crespo, president of Analytica Securities in Quito: "Recent announcements by the Ecuadorean government point to a greater interest in foreign investment. Strategic Sectors Minister Jorge Glas has presented some \$8 billion in infrastructure projects for which Ecuador is inviting foreign participation and production

Minister Nathalie Cely said Ecuador will cut the corporate tax rate to spur investment and hiring. Foreign direct investment (FDI) meanwhile has spiked from the 2009 low, as there have been foreign takeovers in the insurance, mining and bottling industries. Nestlé has announced it aims to invest some \$450 billion in the medium term in Ecuador to boost production. The increase in FDI stems from the strong economic growth in the region rather than from confidence in a more business-friendly policy by the populist administration. The government has also issued small signs of fiscal prudence in paring down its own investment targets in light of limited access to foreign credit. The reduction of the corporate tax rate, in itself, is unlikely to trigger major new investments. The new hydrocarbons law, which went into effect in July, already cut oil companies' taxes to that level. Additionally, Ecuador's legislature on Sept. 14 repudiated bilateral investment treaties with Britain and Germany, proof of the administration's lack of coherence in attracting foreign capital. A real tax reform would put depreciation of assets and amortization of losses in tune with business realities. Moore's Law is irrelevant in Ecuador: a computer cannot be expensed in less than three years, when already obsolete."

The Advisor welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.

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