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FEATURED Q&A

How Did the Dominican Republic Incur its Budget Deficit?

Q Former Dominican President Leonel Fernández on Nov. 13 delivered a televised speech in the wake of violent protests over tax increases proposed to address a major budget deficit. He denied that corruption played a role in creating a $4.6 billion deficit, despite a 7 percent growth rate, and defended President Danilo Medina's plan to raise fuel, property and sales taxes in order to address the gap. How did the country come into such a big budget deficit? Will the proposed tax increases be enough to address it? How is the public outcry and debate affecting the Medina administration's ability to pursue its policy agenda?

A Christopher Mitchell, professor emeritus of politics at New York University: "Intense debate focuses on the sources of the budget deficit. Ex-President Leonel Fernández traces the 2012 spending overruns to low tax receipts, electricity subsidies, re-capitalization after two bank failures in 2003 and needed public works investment. Many business and civic leaders, economists and well-respected journalists dissent, citing excessive 2012 campaign spending, possible corruption and payments to promote a widely expected presidential run by Fernández in 2016. Even the governor of the central bank reported that his institution had received only 22 percent of the sum for recapitalization that the former president claimed had been paid to it. The new array of taxes, now approved as law by Congress, will probably serve as an adequate revenue 'patch' for the time being. However, the deficit debate poses a stressful political dilemma for the governing PLD. The administration's societal critics and partisan opponents assert that the Fernández government's overspending may have violated both the constitution and a varied set of laws. Yet newly-inaugurated president Danilo Medina is not in a strong position to investigate, or to exculpate, his prede-

Continued on page 3

Argentina's Government Facing $24 Billion Technical Default

Argentina is facing a technical default on approximately $24 billion worth of bonds after a U.S. district court judge ordered it to pay holders of defaulted bonds, which President Cristina Fernández de Kirchner's government has refused. See story on page 2.

File Photo: Argentine Government.

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NEWS BRIEFS

Colombian Central Bank Unexpectedly Cuts Interest Rate

Colombia's central bank on Friday unexpectedly cut its benchmark interest rate, Bloomberg News reported Friday. The move, a 4-3 decision by the central bank's board, lowered the rate a quarter point to 4.5 percent, its lowest level in a year. The decision came on the heels of the collapse of **Interbolsa**, the country's biggest brokerage, and the second consecutive month of contraction in industrial output.

Peruvian Economy to Grow 6 Percent This Year: IDB

Economic projections from the Inter-American Development Bank predict that the Peruvian economy will end 2012 with a 6 percent growth rate and continue to grow at 5.5 percent next year, Peru's state-run Andina news agency reported Sunday. Fidel Jaramillo, the IDB's representative in Peru, said the country is well positioned in the face of global economic uncertainty because of its debt and reserves profiles, as well as higher public and private investment.

Calderón Tries to Officially Rename Mexico

Outgoing Mexican President Felipe Calderón plans to propose a constitutional reform that would rename the country's official name from "Estados Unidos Mexicanos" to simply Mexico, the Associated Press reported. "Mexico doesn't need a name that emulates another country and that no one uses on a daily basis," he said, though the idea has received widespread criticism. The country adopted the name in 1824 after independence from Spain, but it is rarely used outside of official documents.

Economic News

Argentina Faces $24 Billion Technical Default After Judge's Ruling

Argentina is facing a technical default on approximately $24 billion worth of bonds after a U.S. district court judge in New York ordered it to pay $1.3 billion to the holders of defaulted bonds at the same time it makes a payment to holders of restructured debt, Reuters reported. Last Wednesday, U.S. District Judge Thomas Griesa ordered the government to deposit enough money into an escrow account by Dec. 15 to pay the holdouts, who rejected debt restructurings in 2005 and 2010. "It is hardly an injustice to have legal rulings which, at long last, mean that Argentina must pay the debts which it owes," Griesa said in a statement, the Associated Press reported. "After 10 years of litigation this is a just result." Argentine Economy Minister Hernán Lorenzino responded on Thursday to the judge's order by vowing to use all legal avenues to fight Griesa's decision. "We'll fight all decisions that are against the interests of our country," said Lorenzino, who added that the government would lodge an appeal today with the U.S. 2nd Circuit Court of Appeals. Argentina will fight all the way to the U.S. Supreme Court and take its case to international bodies, Lorenzino added. "We still believe the U.S. justice system will fix this in a way that won't affect Argentina, its legitimate creditors and, in an international context where the importance of these decisions is patent ... in terms of the financial international architecture," he said. If Argentine President Cristina Fernández de Kirchner refuses to pay the holdouts, hedge funds that the government refers to as "vulture funds," U.S. courts could block Argentina's payments to the holders of restructured debt, triggering a technical default, Reuters reported. "It's a mess. This does not help Argentina. Default could happen," Alberto Ramos, an analyst at **Goldman Sachs** in New York, said Thursday, the AP reported. "The markets will react negatively to this."

Lorenzino

File Photo: Argentine Government.

Political News

Brazil's Rousseff Fires Senior Officials in New Corruption Scandal

Brazilian President Dilma Rousseff has fired several senior government officials amid corruption allegations, BBC News reported Saturday. Among the officials dismissed were Rosemary de Noronha, the head of the regional office of the presidency in São Paulo, as well as Deputy Attorney General José Weber Holanda. Also implicated were two brothers whom Noronha recommended for their government positions. The brothers, Paulo and Rubens Vieira, are accused of directing the scheme, according to police. "By presidential decision, all the government employees under investigation by the Federal Police will be dismissed or fired from their positions," Rousseff's office said Saturday in a statement, Reuters reported. Rousseff also ordered all agencies involved in the investigation to open internal probes. The scandal came to light after a government official who had received a bribe decided to notify authorities. On Friday, authorities arrested six people on charges of influence peddling. They are accused of providing businesses with permits in exchange for bribes. The accused have not responded to the allegations, BBC News reported. Noronha had been in her position since 2005 and was a close aide to then-President Luiz Inácio Lula da Silva, Rousseff's predecessor, Reuters reported. Lula and Rousseff have not been accused in the scandal. The

Rousseff ordered all agencies involved in the investigation to open internal probes.

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scheme came to light on the heels of the "mensalão," or "big monthly payment" vote-buying scandal. Several officials have been convicted and sentenced in that scheme, including José Dirceu, Lula's former chief of staff, who was sentenced earlier this month to 10 years and 10 months in prison.

Company News

Ally Financial Selling Latin American, European Units to GM

U.S.-based **Ally Financial**, the former financing arm of **General Motors**, will sell its units in Latin America and Europe to GM, Reuters reported Nov. 21. The Latin American and European operations amounted to approximately $16.1 billion in assets as of the end of the third quarter, said Ally. **GM Financial** expects the deal to add between $300 million and $400 million to its annual earnings before taxes. GM sold a controlling stake in GMAC, Ally's former name, to **Cerberus Capital Management** in 2006 and has been working since then to rebuild its finance operations. GM and Cerberus are still shareholders of Ally, which is headquartered in Detroit. After a bailout, the U.S. government still owns 74 percent of Ally. In May, Ally announced that it would sell its international units in an effort to repay taxpayers. Including dividend payments, Ally has repaid $5.8 billion of the $17 billion it owed the U.S. government. In October, Ally agreed to sell its Mexican insurance operation to **ACE Ltd.** for $865 million and its Canadian car finance and deposit unit to **Royal Bank of Canada** for $4.1 billion.

The U.S. government still owns 74 percent of Ally Financial.

Featured Q&A

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cessor. Most members of Medina's economic team are holdovers from the recent Fernández years (2004-2012), and Fernández's televised speech exhibited much of the patriotic symbolism of a full presidential address. The PLD controls both the executive and legislative branches, and it enjoys influence in the judiciary as well. That extensive authority may lead to wide-ranging vulnerability to public disapproval if Fernández continues to be unpopular and his political influence remains conspicuous."

A Bernardo Vega, editor in chief of 'La Lupa sin Trabas' and former ambassador of the Dominican Republic to the United States: "The increase in spending and investments during an election year has become a tradition in the Dominican Republic, but what happened this year was extraordinary. By the time Danilo Medina took office, expenditures grew by 34 percent and public investment by 134 percent. The new government had to admit that it inherited a deficit of 8.5 percent of GDP. The agreement with the IMF had expired in February and the government of Leonel Fernández, in order to help his party's candidate, increased spending. But this continued after the elections, since Fernández wanted to complete a number of works before handing over power. During the term of the IMF agreement, the government was negotiating a tax reform, since tax collection represented a very low percentage of GDP. Now, Medina has gotten Congress to pass it, but he hasn't adequately reduced spending. The number of public employees, for example, is double that of the end of Joaquín Balaguer's administration in 1996. The main opposition party, the PRD, is divided and ineffective, but social groups—above all, middle-class youth—have organized protests. The IMF publicly criticized Fernández's management this year. A recent survey found that only 34 percent approve of Medina's management, though just three months ago he won the election with 51 percent of the vote. Nonetheless, he is seen favorably by 54 percent. Meanwhile, Fernández had a 49 percent approval rate in April, but now only 22 percent of the population approves of his management. This has been interpreted as a manifestation of the fact that the population blames him for the unpleasant measures that Medina took."

A Mary Fernández Rodríguez, founding partner at Headrick Rizik Alvarez & Fernández in Santo Domingo: "The IMF has established that the Dominican Republic has a government deficit of 8.5 percent of GDP, the highest in its history. The deficits began in 2008, with yearly average deficits of 3 percent of GDP. Former President Fernández and the current economy minister, Temístocles Montás, argue the current shortfall is a result of a reduction in tax collections, increases in electric sector subsidies, the increase of international oil prices, transfers to the central bank to cover interest payments on government debt and increases in expenditures to complete public works. However, the causes Fernández identified do not account for the total deficit, with the majority of it likely caused by his expressed desire to complete public works prior to the end of his term last August. These deficits constitute a violation of the Constitution and Dominican laws (such as the Budget Law). Such laws invalidate any government expense not approved by the appropriate authority, in this case Congress, and establish that appropriations approved by Congress constitute the total expense which the government may incur. Based on published reports, it seems that the proposed tax increases will account to 2 percent of GDP, which only constitutes approximately 25 percent of the 2012 deficit. It is hard to determine how this will affect President Medina's ability to pursue his agenda. However, it is clear

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Featured Q&A

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that he will be compelled to significantly cut government expenses and prosecute public and private corruption in order to retain public trust."

Rosario Espinal, professor of sociology at Temple University in Philadelphia: "Over the past eight years, former President Leonel Fernández conveyed a sense of optimism and progress. Even in the midst of the 2008 financial meltdown in the United States, he reiterated that the Dominican economy was shielded from negative impacts. With national budgets ever growing and loans available under International Monetary Fund (IMF) agreements, the country experienced economic growth with moderate inflation. Fernández's ambivalence about another re-election bid led his Dominican Liberation Party (PLD) into limbo in early 2011, while the Dominican Revolutionary Party (PRD) gained in popularity. But once he settled on supporting Danilo Medina, Fernández announced that with public works, the PLD would quickly move ahead in the polls. By early 2012, out of an IMF agreement, the government had embarked on many infrastructure projects to be completed before the May 20 election, or before Aug. 16, when Fernández was leaving office. Corruption scandals and nepotism, widely denounced during the electoral campaign, gained even more significance after the size of the fiscal deficit was known and a major tax hike was announced in early October. There have been protests on the streets ever since, and Fernández has become the focus of public outcry as the man behind the fiscal mess. Not helping the situation is the fact that Medina left Fernández's cabinet practically intact, and those suspected of wrongdoing remain in high-ranking posts. Short of ways to renew itself, and with popular discontent running high, the PLD is likely to face more troubles ahead."

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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