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FEATURED Q&A

How Will Higher Bank Taxes Affect Ecuador's Economy?

Q President Rafael Correa last month announced a plan to increase taxes on bank holdings abroad as well as a financial services excise tax in order to boost monthly aid payments to poor Ecuadoreans. The move would raise between $200 million and $300 million annually to pay for 'other wealth redistribution activities' as well as increasing the monthly subsidies to the poor. How significant a tax increase is Correa's move for the country's financial sector? How will it affect bank customers? Will the plan have any influence on the country's February 2013 election?

A Jeanette Sánchez, Ecuador's coordinating minister of political economy: "The government of Ecuador believes in meeting the needs of all its citizens, particularly the poor and disadvantaged. Socially and economically, countries thrive when the markets work for the benefit of all society, not just a select few. To this end, strategic tax reforms are being proposed by the government that will end tax breaks for the banks and finance a government fund that provides modest stipends to support low-income citizens, including the elderly, people with disabilities and single parents. In particular, the main measures will end a tax exception that has allowed banks to pay a 12 percent income tax, increasing their rate to 22 percent, while also revising the formula for calculating advanced income taxes that will result in a minimum gross income tax of 3 percent. Additionally, non-credit financial services will be taxed at a 12 percent value-added rate. The proposed plan will allow Ecuador to increase the monthly stipend to about 1.8 million poor people from $35 to $50. The banking sector in Ecuador is strong and thriving, having raked in nearly $400 million in profits last year. The government views a healthy, vibrant financial system as a key to the country's continued long-term growth.

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Colombia Pulls Out of World Court Over Nicaragua Ruling

Colombia's government announced Wednesday that it will no longer recognize rulings of the United Nations' International Court of Justice. Colombian President Juan Manuel Santos blasted the court for its ruling in a dispute between Colombia and Nicaragua. See story on page 2.

Photo: Government of Colombia.

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NEWS BRIEFS

U.S. Appeals Court Freezes Argentine Debt Repayment Order

A U.S. appeals court has put on hold a New York judge's order last week for Argentina to pay $1.3 billion into escrow for holders of its defaulted debt by Dec. 15, the *Financial Times* reported today. The decision helps calm fears of an imminent default. A 2004 law bars the government from making the bondholders a better offer. A hearing has been set for Feb. 27.

Preliminary Bids for Vivendi's Brazil Holding Lower Than Hoped

France's **Vivendi** has received four non-binding offers of over $7.7 billion for **GVT**, its Brazilian broadband company, Reuters reported Wednesday. Citing unnamed sources familiar with the situation, the report states that the offers are more than a billion dollars below what Vivendi hoped to get from the sale of GVT, which services 120 cities in Brazil. Bids were submitted by **DirecTV**, **América Móvil**, **Liberty Global** and a group of private equity funds, according to the report. Final bids are expected in early January.

Argentine Gov't to Allow Firms to Charge More for New Gas Output

Argentina's government on Wednesday said it will let oil and gas companies charge much more for new natural-gas production, Dow Jones reported. The CEO of recently nationalized state oil company **YPF**, Miguel Galuccio, hailed the news, saying it will help fund the company's ambitious exploration and production plan and make YPF more attractive to foreign investors. "This opens a new perspective for developing gas in Argentina. All the gas projects that we plan to launch this year now become very attractive for investors," Galuccio told reporters.

Political News

Colombia Pulls Out of World Court Over Nicaragua Maritime Ruling

The government of Colombian President Juan Manuel Santos announced Wednesday that it will no longer recognize the rulings of the United Nations' International Court of Justice, BBC News reported. Colombia's announcement came nine days after the World Court ruled that several islands off Nicaragua's Caribbean coast belong to Colombia, but also awarded Nicaragua more maritime territory. Nicaraguan officials welcomed the ruling, but Santos reacted angrily to it. "The borders between nations cannot be in the hands of a court of law," said Santos. "They must be drawn by agreement between the countries involved." Colombia would use "peaceful means" to work out the dispute with Nicaragua, Santos added. Colombia's exit from the World Court amounts to it pulling out of the 1948 Bogotá Treaty, in which it agreed to abide by the court's rulings. The court's decision extended Nicaragua's maritime territory by approximately 19,000 square miles in an area that is potentially rich in oil. The claims over the Caribbean territory date from the early 1800s when Latin American nations were declaring independence from Spain. Colombia and Nicaragua signed a treaty in 1928 to settle the issue over the islands' territory. However, the Sandinista government that was in power in the Central American nation in the 1980s unilaterally nixed the treaty, saying it was signed under pressure from the United States. In 2007, the World Court upheld the treaty, ruling that the islands were Colombian territory.

U.S. Wants Progress in Protecting Human Rights in Honduras: Official

The U.S. government is looking for "tangible progress" in protection of human rights in Honduras, a top White House official said Wednesday after meeting with Honduran President Porfirio Lobo in Tegucigalpa, the Associated Press reported. Denis McDonough, President Barack Obama's deputy national security advisor, told the AP that "the fight against violent crime and impunity cannot be

Featured Q&A

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These reforms aim to maintain this growth while also broadening the country's economic base. We are committed to helping all sectors of society not only meet their basic needs, but prosper and thrive."

Alberto Bernal, head of research at Bulltick Capital Markets in Miami: "As always with populism, the decision to tax the banks more heavily will generate windfall revenues in the short term but it will also generate huge long-term economic costs to the population. Increased taxation of banks will generate increased income redistribution at this time, but it will further reduce the willingness of capitalists to invest in this country. It is no secret that Ecuador is completely out of the radar scope of international investors. A clear barometer of this undeniable fact is the realization that very few houses on Wall Street actually write research about Ecuador any longer. While Colombia, Peru, Panama, Brazil and Chile, to name just a few examples, continue to receive massive amounts of international investment, which naturally generates increased employment, Ecuador is receiving much less than 1 percent of its GDP in foreign direct investment. This is very bad news for a country that carries the U.S. dollar as its legal means of exchange. The decision to tax banks more heavily will reduce the availability of credit because in a dollarized system base money only grows if the country's balance of payments shows a surplus. The anti-business policies, such as lambasting banks, that President Correa has implemented since taking office implies that the capital account will not help to push the balance of pay-

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conducted at the expense of human rights." The U.S. government is holding back $50 million in aid to Honduras, approximately half its aid to the Central American nation, over concerns including corruption in the country's military and police forces, a problematic criminal justice system and killings of judges and journalists. Last week, the United States again began sharing radar intelligence with Honduran forces. U.S. officials had suspended the cooperation for four months after Honduran forces shot down civilian aircraft suspected of being linked to drug trafficking. During that four-month period, Honduran pilots received retraining, their operating procedures were revised and officials pledged to refrain from threatening or destroying civilian aircraft in flight. In addition to pressing for greater progress on human rights, McDonough said that at no time recently "has our engagement been so robust." Arturo Corrales, Honduras' foreign minister, said his country welcomes support from the United States. "Our talks were very productive and we identified short and long-term measures," he told reporters after meeting with McDonough, the AP reported. "We spoke about legacies and how we can create bridges so that others who come can do the same."

McDonough

File Photo: StarTribune.

Economic News

Bank of America Boosts Venezuelan Bonds to 'Buy'

Bank of America has raised Venezuelan bonds to a "buy" rating on the heels of President Hugo Chávez's latest trip to Cuba for cancer treatment, Bloomberg News reported. Chávez, who left Tuesday for Cuba, has been fighting a still-undisclosed form of cancer since his diagnosis in June 2011. His new round of treatment, known as hyperbaric oxygenation, has led to speculation that he may be forced to step down for health reasons. A new regime could end policies of nationalization and currency controls that have been in place under Chávez, Bank of America economist Francisco Rodríguez wrote in a note to clients. "There is the risk that government paralysis resulting from his absence could delay the adoption of an exchange-rate adjustment, but this is partly offset by the likely positive reaction that the market would have if Chávez were to step down due to a deterioration of his health," Rodríguez wrote. Chávez has open-ended authorization from Venezuela's Congress to travel, but he aims to be back at least for the Jan. 10 start of his new term, according to a Reuters report.

The Dialogue Continues

What Is Behind the Rise of Latin America's Middle Class?

Q The middle class in Latin America has grown by more than 50 percent over the last decade, according to a report released by the World Bank on Nov. 13. The study found that the middle class and the poor now account for about the same percentage of the population; nonetheless, around 38 percent of the populace belongs to a 'vulnerable class' that lacks the economic security of the middle class. Which countries have seen the greatest gains to their middle classes? What lessons should countries that have been less successful take from them? How can governments improve the security of their 'vulnerable class?' Are social mobility and inequality metrics also improving?

A Jacqueline Pitanguy, executive director of Citizenship, Study, Research, Information and Action (CEPIA) in Brazil and a member of the Inter-American Dialogue: "Latin America, as a whole, and certain countries like Brazil, Colombia and Mexico in particular, has undergone processes of income distribution resulting in remarkable changes in the class structure of their societies. Growth, combined with social policies, explain this phenomenon, which has led to a sharp decline in inequality. The recent World Bank report on the rise of the middle class in Latin America recognizes the difficulty in defining 'middle class.' While economists tend to focus on income level, sociologists highlight education, occupation and asset ownership, among others. In order to achieve a more balanced concept, the report anchors its definition on two variables: income level and economic security, understood as a low probability of falling back into poverty. Low income is usually accompanied by a low level of education, scarce access to health and justice resources and lack of a protective network of social and family relations that mitigates the vulnerability. And even within the report's definition of middle class, there are important variations in the level of economic security within this class. The report also points to a large portion of the population situated between the poor and the middle class, defined as a 'vulnerable class' due to their lack of economic security. Achieving economic security and sustainability of the gains is, in my view, the main challenge for countries like Brazil that experienced social mobility basically through distributive programs. Strong investments in public education and in access to health, including family planning, as well as improvements in gender equality and access to justice, are crucial for improving the security of those in the lower range of the middle class and of the mobility of the vulnerable class."

Editor's note: The above is a continuation of a Q&A published in Tuesday's issue of the Advisor.

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Featured Q&A

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ments upward, meaning that import substitution and high commodity prices remain the only two sources of stability in Ecuador's macroeconomic equation. This is not good news for the poor in Ecuador. Still, the populist move just taken by the administration will further increase Correa's lead ahead of the election."

Daniela Chacón Arias, political analyst at Profitas S.A.: "The bill that President Correa sent to the National Assembly has a political motive and was proposed after presidential candidate Guillermo Lasso, a former bank director, made a campaign promise that he would increase government subsidies to the country's poor. Lashing out against the financial sector will always be a smart political move in a country where people still remember with bitterness and anger the 1999 financial crisis when many Ecuadoreans lost their life savings. If approved, this bill could prevent banks from capitalizing part of their profits and, therefore, extending more loans. In turn, this will affect bank customers who will see fewer opportunities to obtain credit. This will especially affect small- and medium-sized customers. With less credit available, fewer people will be able to start or grow businesses, create jobs or invest in national industries. That will have a negative long-term effect on the health and growth of the economy. And what is most worrying is the message that this type of bill sends to national and international investors about the safety of their investments. Finally, it is important to mention that one of the bill's provisions seeks to do away with bank secrecy. The bill states that the country's tax authority can request any information from banks at any time regarding any customer's financial transactions without the requisite of there being an investigation for tax fraud or other crimes in which customers have the constitutional right to defend themselves."

> "The decision to tax banks more heavily will reduce the availability of credit."
>
> *— Alberto Bernal*

Mauricio Pozo, former Ecuadorean minister of finance and executive president of economic consulting firm Multienlace: "The proposal is more a political action than a technical decision. It may provoke a decrease in banks' capital, which means serious difficulties in promotion of financing. The banks require continuously more capital in order to lend money to clients. The other dangerous intention of the Correa government is the authorization for the tax authority to investigate clients' deposits in private banks. The measure may produce a reduction in deposits and increase the risk of a systemic financial problem. It also is a bad precedent to use new laws to target specific sectors of the economy, such as the financial sector in this case."

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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