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FEATURED Q&A

Is Brazil's Oil Royalty-Sharing Debate Finally Over?

Q Last November, Brazilian President Dilma Rousseff vetoed part of a royalties bill that increases the amount of revenues from oil production that non-producing states receive. Rousseff's change will exempt existing contracts from the bill. Additionally, she issued a decree mandating that regional and municipal governments use future royalties for education. Does the passage of the bill put the country on track for long-awaited new concession auctions? Or is it likely to be held up by years of lawsuits? How has the industry reacted? And what are the likely consequences for Brazil's oil sector and the economy more broadly?

A RoseAnne Franco and Ruaraidh Montgomery, Latin America upstream research analysts at Wood Mackenzie in Houston: "The partial veto by President Dilma Rousseff halts what had been a steady rise in uncertainty on the regulatory and fiscal fronts in recent years in Brazil. The move helps protect current oil revenue flows to major oil producing states, particularly Rio de Janeiro in its preparation for the World Cup in 2014 and Olympics in 2016, and earmarks future royalties for education. To be sure, Rousseff 's predecessor saddled her with an unresolved royalty redistribution debate. The discovery of the Lula (then Tupi) field in 2006 was a game changer as Brasília viewed the discovery as further de-risking of the Santos basin and sought to adjust its fiscal regime. Nevertheless, the remaining piece of oil reform failed to pass the Lula administration and dogged the first half of the Rousseff government. For the oil industry, companies have been treading water since the last offshore round held in November 2008. Brazil risked not having any exploration acreage by 2015-2016 due to contractual relinquishments from earlier rounds. Resolution of the royalty debate opens the door to Round 11 in 2013, which intends to offer some 170

Continued on page 4

Ecuador's Government Opens Antitrust Probe of Banks

Ecuador's antitrust watchdog agency has opened an investigation of several banks after they warned customers that a new tax could harm the country's financial system. President Rafael Correa has often criticized the country's banks. See story on page 2.

File Photo: Ecuadorean Government.

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NEWS BRIEFS

Cuban Health Ministry Confirms 51 Cases of Cholera in Havana

The Cuban government has confirmed 51 cases of cholera in Havana after the outbreak was detected earlier this month, BBC News reported Tuesday. A food seller, who had the caught the disease during a previous outbreak in eastern Cuba has been identified as the source. Prior to last July, Cuba had not experienced significant numbers of cholera cases in decades. Health ministry officials say that measures taken have put the disease in an "extinction phase."

Costa Rica's Government Looks To Stem Capital Inflows

The Costa Rican government is planning to propose legislation that would target short-term capital inflows which have inflated the country's currency, Bloomberg News reported. The colón has gained 2.2 percent against the dollar this year, more than any other regional currency tracked by Bloomberg. President Laura Chinchilla plans to send Congress legislation next week that would increase the percentage of inflows that investors must keep in longer-term deposits as wells as the taxes on profits from those investments.

Germany's Allianz Opens Brazil Reinsurance Offices

Allianz Global Corporate & Specialty has opened offices in São Paulo and Rio de Janeiro after Brazil granted it a license for a reinsurance operation, Bloomberg News reported Tuesday, citing a company statement. The company's parent, Munich-based **Allianz**, has been working to expand its underwriting in emerging markets. Allianz is Europe's largest insurance company.

Political News

Maduro Stands in for Chávez in State of the Nation Speech

Venezuelan Vice President Nicolás Maduro stood in for ailing President Hugo Chávez Tuesday in delivering a short state of the nation speech to lawmakers, the Associated Press reported. During the address, Maduro announced that Chávez has named former Vice President Elías Jaua as the country's foreign minister. Since being named vice president in October, Maduro had also remained foreign minister.

Maduro

File Photo: Venezuelan Government.

Opposition leader Henrique Capriles said Tuesday that Jaua's appointment should be subject to review because it is unclear what authority Maduro was acting under in announcing the appointment. About a dozen opposition lawmakers walked out of the National Assembly chamber during Maduro's speech. Among them was María Corina Machado, who said it was improper for government decisions to be made from Cuba, where Chávez is hospitalized. "The government of Venezuela today is in Cuba, and that's in violation of the constitution," said Machado. The country's oil minister, Rafael Ramírez, dismissed the allegations of government critics who have argued the special legislative session was illegal because delivering the state of the nation speech is the president's duty. "There's no constitutional controversy," said Ramírez, who called the legislators who walked out of the chamber in protest "the most extremist sector of the far right." Maduro has said that Chávez remains president, though it is unclear if or when he will be well enough to return to Venezuela. Chávez, who was re-elected in October after saying he had been cured of cancer, has not been publicly seen or heard from since his fourth cancer surgery on Dec. 11. He delivered televised remarks during past medical trips to Cuba, but has not done so this time. During his state of the nation address a year ago, Chávez spoke for nine hours, even as he was undergoing cancer treatments. Standing in for Chávez on Tuesday, Maduro handed National Assembly President Diosdado Cabello two red books containing the government's report after speaking for about 15 minutes.

Economic News

Ecuador Investigating Banks Over Warnings About New Taxes

Ecuador's government is investigating whether banks ran afoul of the country's antitrust laws when they warned customers that new taxes to raise money for anti-poverty programs risked harming Ecuador's financial system, Bloomberg News reported Tuesday. Pedro Paez, the head of the Superintendency for Control of Market Power, the country's anti-monopoly watchdog agency, said he's investigating whether Ecuador's largest banks acted together last year in sending emails about the new taxes. "We've got a collective, simultaneous action from the most important banks, the dominant operators in the market," Paez told the news service in an interview. "We began the investigation. We still don't know all the facts." Paez did not name the banks, but said penalties could lead to fines of as much as 12 percent of the banks' annual sales. Ecuador's four largest banks, **Banco del Pichincha, Banco de Guayaquil**, **Banco de la Producción** and **Banco Bolivariano**, sent clients emails, placed phone calls and put out television advertisements criticizing the tax after the government approved it last October, the president's office said in a Nov. 19 statement. The next day, Ecuador's banking regulator said it had fined top executives of the banks $7,886.82 each for "sending confusing messages that could generate adverse reactions or interpretations with irreparable consequences in detriment of the public interest." The tax was an effort to raise $320 million for anti-poverty programs that provide poor families monthly cash payments of $50. President Rafael Correa has criticized banks, saying they have improperly influenced national politics. In next month's presidential election,

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Correa faces Guillermo Lasso, a former chief executive officer of Banco de Guayaquil. The antitrust agency's probe is most likely an effort to scare banks into not opposing Correa's policies, Walter Spurrier, the director of Guayaquil-based economic research organization Grupo Spurrier, told Bloomberg News. "The law opens the door to call collusion anything that represents action from an association in defense of its interests," said Spurrier. "It's to be able to attack any organization that disagrees with public policy." An executive of Banco Pichincha told the news service Tuesday that its officials met with the antitrust agency in December about the matter. Representatives of the other three banks could not be reached for comment.

Company News

Itaú BBA International Hires Two Prominent Bankers

Itaú BBA International, a London-headquartered unit of Brazil's **Itaú BBA**, has hired two prominent bankers to become members of its board, Reuters reported Monday. The move is expected to help the bank bolster its business in Europe, a top executive told the wire service. Itaú BBA hired Robert Pickering and Gay Huey Evans as members of the board, according to Almir Vignoto, the chief executive of **Itaú BBA UK**. Pickering is a former banker with **JPMorgan Cazenove** and Evans is a former official of Britain's Financial Service Authority. The bank currently has 50 bankers and traders in London and could add another 20 before the end of the year, Vignoto told Reuters. The bank wants to strengthen areas including sales and products, capital markets, as well as corporate and investment banking, he said. "The main goal of building up a more diversified board of directors is to take advantage of their expertise in the local corporate banking market and the British regulatory environment," Vignoto added. **Itaú Unibanco**, Brazil's largest private-sector bank, is looking to investment banking to help drive revenue now that credit is slowing in Brazil, where interest rates are at record-low levels.

The Dialogue Continues

Which Issues Will Define the Brazil-Mexico Agenda?

Q Brazilian President Dilma Rousseff is planning to visit Mexico this year, likely in March, Reuters has reported. The two countries have been at odds in recent months over an automobile trade dispute, but there are some indications that trade relations may improve. Will Rousseff and Mexico's newly sworn-in president, Enrique Peña Nieto, get along well? What are the key issues that will define their bilateral agenda in the near term? Where are there openings for increased economic and political cooperation in both the public and private sectors?

A Jaime Zabludovsky, vice-president at IQOM Inteligencia Comercial, president of the Mexican Foreign Affairs Council and CONMEXICO and former Mexican undersecretary for international trade negotiations and ambassador to the European Union: "The accelerated expansion of trade has been essential for Brazil's economic growth. Brazilian export growth has profited from supplying commodities in a timely manner, mainly to Asia. Meanwhile, the commodity export boom, capital inflows and industrialized economies' monetary policies appreciated the real, exposing Brazilian industry's fundamental competitiveness problems. Brazil today faces a growing industrial trade deficit. Mexico's economic scene is quite different; the NAFTA member is positioned to take advantage of almost 20 years of macroeconomic stability and trade liberalization. Mexico learned to benefit from its vicinity to the U.S. market, and is today a highly successful export platform. The Mexican domestic market, on the other hand, is relatively weak. Reforms are needed to raise growth from 3-4 percent per year to 5-6 percent. Prospects for this to happen are the strongest in a very long time. An FTA with Brazil would strategically position Mexico as the only manufacture exporter in the world with preferential access to the highly desired Brazilian market. Brazil has liberalized its economy only to South American commodity-exporting neighbors. However, an FTA with Brazil faces, at least, two relevant obstacles in Mexico: strong opposition on the part of

> "[Mexico] is positioned to take advantage of almost 20 years of macroeconomic stability and trade liberalization."
>
> *— Jaime Zabludovsky*

Mexican agricultural producers and the concurrence of Peña Nieto's ambitious reform agenda. Fiscal, education, and energy reforms, and the improvement of competition in the telecommunications and transportation sectors, most likely will account for most of the new administration's efforts. Mexico also just embarked on trade negotiations with its NAFTA partners and eight other countries in Asia and Latin America. The Trans-Pacific Partnership is, by far, the most relevant international trade negotiation in the near future—and it will also demand Peña Nieto's political capital and leadership. The complex economic situation that Rousseff's administration is facing, combined with Peña Nieto's reform agenda, offer little room for comprehensive bilateral trade negotiations. The best option for both governments is to wait for the appropriate time and avoid the temptation of enacting sectorial pacts that would only undermine the coalitions in favor of comprehensive liberalization under a future FTA."

Editor's note: The above is a continuation of a Q&A published in the Jan. 8 issue of the Advisor.

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Featured Q&A

Continued from page 1

onshore and offshore blocks, including highly prospective blocks along Brazil's equatorial margin. And the inaugural pre-salt round is finally more firmly on the horizon. Brazil houses some of the most sought-after exploration acreage in the industry; with resolution of the royalty debate, Brasília is once again signaling more legal certainty and welcoming foreign operators."

Francisco Ebeling Barros, member of the board of Economics and Energy Policy of the Brazilian Institute of Oil, Gas and Biofuels in Rio de Janeiro: "When Minister Edison Lobão announced on Sept. 18 that there would be two bidding rounds next year, the 11th under concession contracts and the first one under recently approved production-sharing contracts, he made clear that the new division of royalties had to be approved. Without that decision, the legal uncertainty of the contracts would be bigger than the oil companies' desire to acquire new exploration licenses. For the government, the cost of holding back the bidding rounds to help Petrobras achieve its investment goals has exceeded an unacceptable threshold. The government is pushing hard to unleash the investor's animal spirit. This includes oil and gas bidding rounds. In this sense, it seems clear that the new auctions will take place. It is not difficult to forecast a greater participation of Chinese oil companies, under both systems, but also of Norwegian Statoil. Dilma Rousseff's decision mandating that regional and municipal governments use future royalties for education is welcome and it is very likely that producing states will be compensated by some mechanism. Nevertheless, this decision is slightly flawed because future royalties will not match the 10 percent of GDP investment target. But one cannot complain about Dilma's decision, despite the Brazilian media's criticism that she has been excessively interventionist in economic affairs."

Gianna Bern, president of Brookshire Advisory and Research in Chicago: "No matter what Brazilian President Dilma Rousseff does, the potential exists for continued domestic debate on royalties among producing and non-producing states. Legislators have to be wary of Brazil's competitive position among global oil-producing countries. While Brazil is still an attractive market for the oil industry, it has to compete for investment opportunities with other oil- and gas-producing countries such as Russia, Canada, Angola, the United States and Australia, to name just a few. The industry is indeed waiting for another bid round. The key here is structuring bid rounds and investment terms to attract the greatest amount of participation by the global oil industry. Ultimately, oil producing companies will compare the economics (and politics) of investing in Brazil's deepwater versus opportunities elsewhere. The debate has definite implications for the future growth of Brazil's oil sector and its economy. The global oil industry, and other investors, will be looking for investment-friendly energy policies in Brazil."

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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Erik Brand
General Manager, Publishing
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Rachel Sadon
Reporter, Assistant Editor
rsadon@thedialogue.org

Inter-American Dialogue

Michael Shifter, President

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Subscription Inquiries are welcomed at freetrial@thedialogue.org

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