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FEATURED Q&A

What Steps Should El Salvador Take to Improve its Economy?

Q An IMF team returning from a two-week trip to El Salvador last month urged authorities to 'stage a national dialogue with political parties and key stakeholders' ahead of next year's presidential election. The purpose would be to find agreement 'on the basic policies that will safeguard macroeconomic stability during the transition to a new government.' What are the most contentious issues in El Salvador's economy today? Is it likely that a national dialogue like the IMF describes will be helpful in addressing them? What steps should El Salvador take to grow its economy and create more jobs? Is the Funes administration likely to follow the IMF's advice?

A Heather Berkman, senior analyst for Latin America at the Eurasia Group: "El Salvador has struggled to regroup following the 2009 economic crisis, and despite the Mauricio Funes administration's best efforts, growth has remained sluggish. The government increased taxes through a number of fiscal reforms and has focused on boosting spending on social programs. However, its reliance on short-term debt in local markets and external loans and reluctance to cut subsidies has meant that debt as a percentage of GDP rose to 55 percent last year. Expectations for growth this year are muted. Funes has relied on a coalition of both the left-of-center FMLN and more conservative parties such as GANA and PCN to pass his economic policies, and even the conservative Arena party agreed to a number of reforms and a bond issuance last fall. Congress and the Funes administration have largely been in sync in terms of the overall direction of economic policy, and Funes has largely followed the advice of the IMF. Despite this, the economy just hasn't grown. El Salvador isn't as competitive as its regional counterparts in terms of human capital, natural resources, and infrastructure, and so it struggles to attract investment. At this point, the February 2014 presidential race looks to be

Continued on page 3

Argentina Makes Proposal to Pay Bond Holdouts

The government of Argentine President Cristina Fernández de Kirchner on Friday proposed paying creditors who have refused prior debt restructurings a fraction of the amount that a U.S. judge said the bondholders should receive. See story on page 2.

File Photo: Argentine Government.

Inside This Issue

FEATURED Q&A: What Steps Should El Salvador Take to Improve its Economy?.....1

Argentina Submits Proposal to Pay Bond Holdouts.....2

Brazil Finance Ministry Puts Off Tax Increase on Autos Until Next Year.....2

Chile's State-Owned Codelco Sees 5.1 Percent Annual Output Drop.....2

Measure to Overhaul U.S. Immigration System Clears Hurdle.....2

U.S. Cigar Maker Wins Latest Legal Battle Against Cuban Firm.....3

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NEWS BRIEFS

Measure to Overhaul U.S. Immigration System Clears Hurdle

Members of a bipartisan group of U.S. senators on Sunday said they have resolved all major issues holding up a pending deal to overhaul the country's immigration system, Reuters reported. The U.S. Chamber of Commerce, the biggest business group, and the AFL-CIO, the largest labor group, reached an agreement on a guest-worker program on Friday, clearing the way for the writing of a full bill.

Venezuela's Maduro Accuses Opposition of Seeking Violence

Acting Venezuelan President Nicolás Maduro, on Saturday accused his rival, Henrique Capriles, of seeking to provoke violence by scheduling a campaign rally in the same state where Maduro is planning to rally supporters, the Associated Press reported. The two men are facing off in the country's April 14 presidential election triggered by the death of Hugo Chávez. Maduro told supporters that Capriles' decision to rally in Barinas, Chávez's home state, amounted to a "provocation." An advisor to Capriles said "various political events can be held on the same day."

Jamaica's Lower House Approves Lottery Scam Crack Down

A bill that aims to more effectively prosecute criminals involved in Jamaica's illegal lottery scam passed the country's House of Representatives on March 26, the Jamaica Information Service reported. The bill, which is expected to be signed into law soon, makes it easier for police to investigate and apprehend people involved with an advanced-fee fraud network that has bilked millions of dollars from elderly United States residents.

Economic News

Argentina Submits Proposal to Pay Bond Holdouts

Argentina's government on Friday proposed paying the holders of $1.3 billion of the country's defaulted bonds an amount equal to one-sixth of what a judge in the United States has said the bondholders should receive, Bloomberg News reported. One analyst said the South American country's move amounted to it "thumbing its nose" at the court. Argentina's filing of the proposal happened an hour before a court-imposed deadline and now clears the way for the U.S. Court of Appeals in New York to rule on a case brought by creditors, led by **Elliott Capital Management**'s **NML Capital Ltd.** The holdouts refused to accept debt restructurings after Argentina's massive $95 billion default in 2001. In a 22-page letter filed with the U.S. court on Friday, Argentina said it would submit a bill to the South American country's lawmakers that would allow holders of the defaulted bonds to exchange them for new bonds. The proposal amounts to Argentina "ignoring (even thumbing its nose at) the court," Joshua Rosner, an analyst at **Graham Fisher & Co.** told Bloomberg News in an emailed note. The Court of Appeals, which can issue a new ruling at any time, could find that Argentina must pay holders of defaulted bonds immediately. That would expose the country to an additional $43 billion in claims and could trigger a new default, the government has said. Eugenio Bruno, an attorney at **Estudio Garrido** in Buenos Aires told Bloomberg News in an email that the government's proposal is similar to past restructuring offers that NML and other creditors have rejected.

A new ruling by the U.S. court that Argentina pay holdouts immediately could trigger a new default, Argentina has said.

Brazil Finance Ministry Puts Off Tax Increase on Autos Until Next Year

Brazil's finance ministry has postponed scheduled increases in taxes on the sale of cars and trucks until 2014, Reuters reported Saturday. The government hopes to stimulate demand for manufactured goods and spark economic growth that has been stubbornly sluggish for more than a year. The IPI tax on manufactured products was lowered in 2012 for vehicles in a package with other stimulus measures introduced by President Dilma Rousseff. "The car industry is very important for Brazil's economy, it accounts for 25 percent of industrial production," Finance Minister Guido Mantega said on local television. "So, to keep industrial output growing, it is important that the auto industry keeps growing." Last week **General Motors** said it had laid off 598 workers at its São José dos Campos plant in São Paulo state in the face of softening auto demand and high labor costs. **Volkswagen**'s Brazilian unit last month slashed its growth outlook for Brazil passenger-car sales to around 2 percent, from an earlier forecast of as much as 7 percent growth, Dow Jones reported. That would be the slowest growth in a decade for Brazil's auto industry, according to the report.

Mantega

File Photo: Brazilian Government.

Company News

Chile's State-Owned Codelco Sees 5.1 Percent Annual Output Drop

Chile's state-owned copper company, **Codelco**, the world's largest producer of the metal, experienced a 5.1 percent drop in annual output due to lower ore grades, Bloomberg News reported Thursday. The lower grades are coming from the company's aging mines in the Atacama Desert. The Chuquicamata mine, which is a century old, experienced a 20 percent decline in output, which brought last year's overall output to 1.647 million tons, as com-

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pared to 1.735 million tons in 2011, the company said. Codelco's chief executive officer, Thomas Keller, is spending $25 billion to tap new areas as the company turns away from exhausted mines. That amount is a record level of investment and comes as Codelco has reached the milestone of handing $100 billion over to the government, said Keller. Last year, the company had capital expenditures of $4.1 billion. The company added that it is 78.5 percent complete with its Ministro Hales project. Codelco was also hit by a two-week strike at the country's Angamos port. That labor unrest has led to additional protests in support of the workers at Angamos at other ports in Chile and has impeded some of Codelco's shipments, said the company's chief financial officer, Iván Arriagada. Codelco has stored about 30,000 tons of the metal that is awaiting shipment, Arriagada added. The protests at ports have not affected the company's production, he said.

Keller

File Photo: Codelco.

U.S. Cigar Maker Wins Latest Legal Battle Against Cuban Firm

Virginia-based tobacco company **General Cigar** said Friday that it won a court ruling in an ongoing 16-year legal battle with Cuba's **Cubatabaco** to determine rightful ownership of the Cohiba trademark in the United States. Cubatabaco had brought its complaint before the United States Trademark Trial and Appeal Board after losing a hearing before the Second Circuit Court. The TTAB ruled that because U.S. federal courts have held that Cubatabaco cannot sell its Cohiba cigars legally in the United States, Cubatabaco lacks any property interest in the Cohiba mark. Cohiba cigars were first created in Cuba after that country's revolution, but the Cuban version has never been legally sold in the United States due to the U.S. embargo on Cuba, *Cigar Aficionado* reported. General Cigar has sold its Dominican-made version of the Cohiba cigar in the United States since the early 1980s.

Featured Q&A

Continued from page 1

tight, and as with every election in El Salvador, investors worry about whether a change in government and the possibility of a FMLN-led administration will usher in more heterodox economic policy. Such concerns are probably overblown given El Salvador's dependence on the U.S. economy and multilateral aid, and the fact that Hugo Chávez is no longer around to support his regional allies."

> "Expectations for growth this year are muted."
>
> — ***Heather Berkman***

A Joydeep Mukherji, managing director in the sovereign ratings group at Standard & Poor's: "It is difficult to undertake a fruitful national dialogue during an election year. However, such a dialogue could create a stronger consensus on economic policies and also depoliticize and strengthen the judiciary and regulatory bodies, thereby reducing the perception of risk and boosting economic growth and job creation. The country already has a business-friendly economic framework (including free-trade agreements, a strong private sector and liberal laws on foreign investment). However, El Salvador's economic progress has been constrained by the legacy of its civil war. The peace accords in 1992 ended 12 years of armed conflict, but did not lead to a shared vision of the country's economic and political future. Today, more than 20 years later, both ARENA and FMLN remain dominated by long-time leaders with much mutual ideological antagonism. Mauricio Funes, the country's first center-left president since the end of the civil war, has pursued generally moderate policies that have created some tension with more hardline elements within the FMLN without gaining the confidence of the local private sector. Political polarization has contributed in recent years to a power struggle between the president and the legislature (where neither main party now has a majority), as well as to antagonistic relations with the private sector. Moreover, a divided Congress creates a cumbersome and protracted decision-making process on important issues. Such factors have taken a toll on private sector investment. S&P placed a negative outlook on the country's sovereign rating in December to reflect the risk that continued polarization would limit GDP growth, potentially contributing to a rising burden of fiscal and external debt."

A Mike Allison, associate professor of political science at the University of Scranton, and Christine Wade, associate professor of political science and international studies at Washington College in Chestertown, Md.: "Following the 2012 legislative and municipal elections, the two largest political parties of the Nationalist Republican Alliance (ARENA) and the Farabundo Martí National Liberation Front (FMLN) have been at odds over most political issues. With presidential elections scheduled for 2014 and legislative and municipal elections scheduled once again for 2015, the likelihood of a grand bargain between the FMLN, ARENA and President Mauricio Funes and his administration is slim. While Mr. Funes was elected at the head of the FMLN's presidential ticket in 2009, he is not from the FMLN. His centrist economic vision is not shared by either the FMLN or the ARENA, or their presidential candidates. The FMLN prefers an activist state that protects and invests directly in society's most vulnerable while ARENA prefers an activist state that protects and benefits private business. These perspectives represent fundamental philosophical divisions between the two parties that were not altered by

Continued on page 4

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Featured Q&A

Continued from page 3

the peace process or addressed in the accords. It remains to be seen whether recent cooperation among members of Congress, mayors and the executive branch in designing conditions to sustain the March 2012 gang truce will translate into cooperation in other areas. Gang violence and organized crime have been two of the major impediments to growth, diverting resources from the national budget and from private businesses that have to invest in security and extortion payments, and inhibiting foreign and domestic investment. Any strategy to improve El Salvador's economy must include comprehensive measures to deal with insecurity in a holistic manner."

> "Corruption, always a problem, remains near record levels."
>
> — *Douglas Farah*

Douglas Farah, senior fellow at the International Assessment and Strategy Center: "The most contentious issues in El Salvador's economy today are the almost complete lack of job creation, government policies that have failed to adequately address the problems of citizen security and the rule of law, and the growing power of drug trafficking organizations in the legal economy. Fundamental to creating an environment in which investment and job creation are possible are the twin issues of security and rule of law. Neither has been addressed in any fundamental way for more than a decade. Corruption, always a problem, remains near record levels. The failure of adequate government policies in these fields predates the Funes administration and, with the highly polarized nation heading toward elections, a real national dialogue is unlikely. This economic stagnation is taking place as the nation's 'narco economy' is booming and making significant inroads into the legitimate economy. Awash in money, groups like the Cartel de Texis, Los Perrones and a small section of the Mara Salvatrucha (MS-13) gang allied with these regional drug trafficking organizations are moving their investments into the productive sector and the real estate sector. Much like the cartels in Colombia in the 1990s, these groups are primarily in business to launder money rather than to make a profit. They can undercut the legitimate business enterprises, take market share and increase their political and economic presence. Legitimate business are pushed out of the market, and it becomes increasingly difficult to attract new investment. Given these factors and the fragmentation of the political parties, it is unlikely such a consensus could be reached."

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

Latin America Advisor
is published every business day by the Inter-American Dialogue, Copyright © 2013

Erik Brand
General Manager, Publishing
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Inter-American Dialogue

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Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at:
1211 Connecticut Avenue NW, Suite 510
Washington, DC 20036
Phone: 202-822-9002 Fax: 202-822-9553
www.thedialogue.org ISSN 2163-7962

Subscription Inquiries are welcomed at freetrial@thedialogue.org

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