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FEATURED Q&A

Can Puerto Rico's Power Company Be Turned Around?

Q Indebted Puerto Rican state power company PREPA in early September announced that it had hired Lisa Donahue of AlixPartners as chief restructuring officer as part of an August agreement with creditors that allowed the company to delay payment on some credit lines. Donahue's role will be to negotiate with creditors and develop a business plan, which must be presented by Dec. 15, and then a full restructuring plan, due by March 2. What are the biggest challenges facing PREPA and Donahue's efforts? What should be done to get the company on the right track?

A José J. Villamil, chairman of the board of Estudios Técnicos, Inc. in San Juan: "I have stated many times that most of PREPA's problems are not of PREPA's making. A long history of political interventions is, to a large extent, the reason for its present situation. Subsidies have been generously legislated, government agencies don't pay their electricity bills, and municipalities don't pay for their energy consumption (in lieu of taxes that would generate much less than PREPA's foregone income). In addition to the company's appallingly high debt, dealing with political considerations is possibly the biggest challenge faced by PREPA and Donahue. We need to distinguish two very different areas of concern. One is the financial situation and the impact on creditors. The other is the cost of energy. The former is Donahue's main concern, the latter is what concerns locals the most. Not much can be done to resolve the cost problem unless there is a major restructuring of PREPA's debt. There is broad agreement that Puerto Rico needs to move to more diversified energy sources and a more competitive system in order to lower costs, but unless PREPA's debt burden is significantly lowered, it won't be possible, at least for the foreseeable future. Should PREPA outsource electricity production, as with EcoEléctrica and AES now,

Continued on page 4

Mexico Police Arrest Alleged Head of Juárez Crime Cartel

Mexican Attorney General Jesús Murillo Karam told reporters Thursday that federal police had captured alleged Juárez Cartel crime boss Vicente Carrillo Fuentes, "one of the most important of the most important that Mexican justice had to capture." See story on page 2.

Photo: Government of Mexico.

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NEWS BRIEFS

Argentine Senate Approves Energy Bill Promoting Investment

Argentina's Senate early Thursday morning approved a bill aimed at increasing incentives to attract foreign investors to develop its shale gas and oil reserves, Reuters reported. The bill, which has the president's support, passed the Senate 38 to 28 and is expected to pass in the lower house, the Chamber of Deputies, later this month. Legislators worked out a deal with governors of oil-producing provinces to advance the reforms. [Editor's note: See Q&A on the bill in this week's issue of the *Energy Advisor*.]

U.S. Defense Secretary Sets Out on Six-Day Tour of South America

U.S. Defense Secretary Chuck Hagel departed Thursday on a six-day tour of South America, Agence France-Presse reported. Hagel is scheduled to visit Colombia, Chile and Peru to meet with counterpart defense ministers. In Colombia, Hagel will highlight Washington's continuing support for the government's counter-insurgency operations and its efforts to clinch a peace settlement with the FARC rebels, the Pentagon said.

Mitsubishi UFJ Names Roderick Fraser to Head Latin America

Mitsubishi UFJ Financial Group said Thursday it has named Roderick Fraser as managing director for Latin America corporate and investment banking. Fraser will be responsible for the bank's oil, gas and petrochemicals activities in Latin America. As a production engineer, Fraser has worked at **Amoco**, **Esso**, and **Fuel Resources**. In the banking sector, he has worked at **Standard Bank**, **WestLB** and **J.P. Morgan Chase** with a focus on the oil and gas sectors.

Political News

Latest Poll Puts Neves Slightly Ahead in Brazil Presidential Runoff

A new national poll shows right-of-center candidate Aécio Neves would win Brazil's presidential election in the second round runoff scheduled Oct. 26, Agência Brasil reported today. The **Ibope** poll shows PSDB candidate Neves in front of incumbent President Dilma Rousseff with 46 percent of the vote compared to Rousseff's 44 percent. Considering a margin of error of 2 percentage points, however, the two candidates are in a technical tie. Ibope polled 3,010 people between Oct. 7-8 for the survey, which was commissioned by TV Globo and the newspaper *O Estado de S. Paulo*. In the first round vote last Sunday, Rousseff won 41.59 percent of the valid votes to Neves' 33.55 percent. Marina Silva, the socialist party candidate who finished a surprisingly weak third, said on Thursday she will wait for political pledges from pro-business candidate Neves before backing him in the runoff, Reuters reported. An endorsement from Silva, who had 22 million votes despite failing to move onto the next round, would increase Neves' chances of unseating Rousseff and ending 12 years of Workers' Party rule. Aides say Silva is seeking "progressive" commitments from Neves to defend the rights of Brazilian Indians and landless peasants, issues that are not part of Neves' platform. A former minister of the environment, she also wants Neves to commit to "sustainable development," Reuters reported.

Silva said Thursday she will wait for political pledges from Neves before endorsing him.

Mexico Police Arrest Alleged Head of Juárez Crime Cartel

Federal police in Mexico on Thursday said they had captured alleged Juárez Cartel crime boss Vicente Carrillo Fuentes, CNN reported. Carrillo, 51, was detained along with a bodyguard at a checkpoint in the northern city of Torreón, according to Monte Alejandro Rubido, the head of Mexico's National Security Council. A former police officer known as "El Viceroy," Carrillo Fuentes surrendered quietly to authorities, who had been conducting a "discreet" operation searching local homes for him, *Excélsior* reported. The United States had issued a $5 million reward for information that would lead to his arrest. In the United States, Carrillo Fuentes faces charges for drug trafficking, conspiracy, money laundering, tampering with a witness and "ordering the intentional killing of individuals to prevent communication of information," according to CNN. His arrest comes a week after another top cartel leader was caught. Authorities said last week that they arrested Héctor Beltrán Leyva, leader of the Beltrán Leyva Cartel. Mexican Attorney General Jesús Murillo Karam told reporters Thursday that Carrillo Fuentes is "one of the most important of the most important that Mexican justice had to capture."

Economic News

Tribunal Orders Venezuela to Pay ExxonMobil $1.6 Billion for Assets

An arbitration tribunal at the International Centre for Settlement of Investment Disputes, or ICSID, in Washington on Thursday released a long-anticipated decision finding that Venezuela's government must pay Houston-based **ExxonMobil** around $1.6 billion to compensate for its 2007 nationalization of the company's Cerro Negro assets, Bloomberg News reported. At one time, the company was seeking more than of $10 billion in the case, but that figure had been reduced over the years. A separate decision by the Paris-based ICC in

Subscriber Notice

The Advisor *will not be published on Monday, Oct. 13, in observance of the Columbus Day holiday in the United States. Delivery will resume on Tuesday.*

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2012 ordered Venezuelan state oil company **PDVSA** to pay ExxonMobil $908 million, according to Reuters. That year, Hugo Chávez, the late firebrand leftist president of Venezuela, said he was withdrawing the country from ICSID and would not honor its rulings. In a cash-strapped position today, however, Venezuela is looking to curry favor with sources of international capital but faces difficult tradeoffs. "While Venezuela has been willing to compensate claimants in the past, the government is clearly working with limited liquidity and already faces tough policy tradeoffs between servicing its liabilities and importing basic goods to satisfy its base," **Eurasia Group** analyst Risa Grais-Targow said in a research note to clients Thursday.

Mexico Inflation Marks 7-Month High Yet Remains in Check

Mexico's state statistics agency said Thursday that consumer prices rose 4.22 percent in the 12 months through September, Reuters reported. While the inflation figure is above the 4.15 percent rate reached in August and marks a 7-month high, a combination of seasonal and non-core factors, such as school tuition rate increases and some perishable food price spikes, were behind the uptick, according to analysts. "Still-subdued domestic demand conditions and the significant amount of slack in the economy should prevent the emergence of either demand-pull or cost-push pressures on inflation," **Goldman Sachs** analyst Alberto Ramos said in a research note Thursday. Mexico's government targets a 3 percent inflation rate, plus or minus one percent. Mexico's Central Bank, led by Agustín Carstens, said last month that inflation will probably end the year at about 4 percent and fall to 3 percent in the first half of 2015, when Mexico changes the way it prices gasoline under new energy sector reforms, Bloomberg News reported.

Carstens

File Photo: Government of Mexico.

In Focus

Cárdenas Touts Growth, Defends Tax Plan in Washington

By Megan Cook

Cárdenas

Photo: Megan Cook.

WASHINGTON—"Colombia has a remarkable economy," Finance Minister Mauricio Cárdenas said Thursday at the Inter-American Dialogue, highlighting the country's growth rate, which was revised upward by the International Monetary Fund Wednesday to 4.8 percent for the year, at the same time that the IMF revised its region-wide growth estimate downward.

"If I were to pick one statistic to highlight, it would be the investment rate, which has gone from 14 percent 15 years ago ... today it's 30 percent of GDP, the highest in Latin America " Cárdenas said. Investment has become the key to the country's development goals, Cárdenas noted, which is why the government passed a fiscal rule during President Juan Manuel Santos' first term to put a ceiling on the deficit and reduce debt so investors "see commitment to fiscal responsibility." And maintaining investor confidence was a goal as the government presented a controversial tax proposal to Congress last week, he added.

The bill, which is intended to close a financing gap of $26.2 billion over the next four years, has three parts: a wealth tax, a surcharge on corporate earnings and a financial transaction tax. The first two taxes are already in place but under proposed legislation would be extended for four years, while the corporate profit tax would be raised.

The government says the additional revenues are necessary to expand social programs and close the gap between rural and urban Colombians. The money raised would go to infrastructure, sanitation, irrigation and especially early childhood education, the minister said. "That's where we need the resources," he added. Currently, 2.4 million children younger than five years of age live in households below the poverty line and cannot afford preschool, according to the government. "Age five is too late to begin" education, Cárdenas said. The minister characterized the reform as "progressive taxation," saying the intent of the legislation is to target revenue to the poor, leave the middle class untouched and raise taxes on the top end of the income spectrum.

Another important part of the reform is a new measure to criminalize tax evasion "for the first time in the history of Colombia's legal system," Cárdenas noted. Citizens who don't declare foreign assets worth over $4 million can be charged and face jail time, and the government is seeking tax information exchange agreements with countries it does not already have them with, he said.

Debate on the tax bill in Congress is just starting, but Cárdenas said he is "very optimistic" about the reform's prospects. The government's original proposal, which included not only an extension but an increase in the wealth tax, was revised after objections from business leaders. In a statement released Oct. 3, the day the bill was submitted to Congress, ANDI, Colombia's largest business association, also criticized the continuation of the wealth tax. The organization asked the government to "take advantage of 2015 to make a structural tax reform that eliminates the multiple distortions in our tax system" to make Colombia more competitive.

Editor's note: See Q&A with critics of the tax plan in Thursday's Advisor.

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Featured Q&A

Continued from page 1

and continue to operate the distribution network, lowered production costs would almost certainly result. Major improvement in costs to consumers, however, would require significant investment in new network infrastructure, something not feasible at this moment. Outsourcing production, but not distribution, could improve PREPA's bottom line, but would probably not do much for lowering energy costs. It is almost certain that Puerto Rico will continue to be a high energy cost jurisdiction for many years. This, however, is not Donahue's main concern."

Carlos J. Fernández Lugo, chair of the Environmental, Energy & Land Use Practice Group at McConnell Valdés: "PREPA faces numerous daunting challenges in addition to its level of debt. Among them, a trend of declining revenues spanning many years; energy losses in excess of industry standards; a high level of past-due accounts receivable (led by government accounts); excessive dependence on expensive fuel oil as its main source of energy; an outdated generation fleet that will not comply with U.S. Environmental Protection Agency regulations; insufficient capital to substitute generating units or convert them to natural gas; conversion plans behind schedule; and no clearly articulated strategy to address the generating units on the north coast of the island. In addition, PREPA must comply with statutory mandates in the recently enacted energy reform and will be subject to regulation by the newly created Energy Commission. On top of it all, we must remember that PREPA is not a 'regular' utility. It is owned by the Commonwealth, and its policies are shaped by the government. There are limits to what it can do. PREPA must be prepared to follow strategies it has not pursued in the past, such as private investment in key elements of its infrastructure, including generation. Due consideration should be given to new legislation that could help expedite PREPA's efforts. The integration of renewable energy sources should also serve to diversify PREPA's portfolio and help stabilize energy prices, but steps must be taken by PREPA to permit the financing of such projects in the current environment. Ultimately, PREPA's situation and the involvement of the chief restructuring officer may provide cover for measures that may previously have been too costly to implement from a political standpoint."

Ivonne Lozada, executive director of the Public Policy Institute at the Ana G. Méndez University System: "There is little doubt that Ms. Donahue and AlixPartners have the expertise to face the serious financial and operational problems that torment PREPA. The challenge is to bring an outdated power-generating company to 21st-century standards without raising costs for financially-stretched Puerto Ricans and without firing employees. At least that is the political desideratum. The reality that Alix has never faced in its successful record is the strong political tides, both partisan and non-partisan, that move the Puerto Rican government structures. Unions and management do not behave the same way as in the United States. The power of the media, especially newspapers and radio political analysts, is unheard of stateside; and PREPA is, simply put, bankrupt, cashless and without credit. Donahue's largest challenge is concocting a formula whereby PREPA becomes more efficient in its personnel and administrative endeavors while trying to maintain the same quantity of employees. Privatization is a dirty word in the island's politics, particularly in the center-left spectrum that is the dominating force in the ruling Popular Democratic Party. Energy production should shift to gas and renewables, but those capital-intensive solutions are simply not available unless private parties are part of them. The final challenge is to produce a plan in a couple of months that not only convinces PREPA, but also the political system, the people of Puerto Rico, the creditors and the ratings agencies—not necessarily in that order."

Latin America Advisor
is published every business day by the Inter-American Dialogue, Copyright © 2014

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Megan Cook
Reporter, Assistant Editor
mcook@thedialogue.org

Inter-American Dialogue

Michael Shifter, President
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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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