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## FEATURED Q&A

### *How Effective Are Economic Stabilization Funds?*

**Q Chile's economy grew relatively slowly last year amid lower prices for its top export, copper, and weaker mining investment, and it withdrew around $500 million from its Economic and Social Stabilization Fund (ESSF), which was established in 2007 to support government revenue in economic downturns. How has Chile's economic stabilization program done in response to the downturn in commodities prices? How well have other countries' stabilization vehicles performed, such as those in Peru and Norway? What factors make some such programs more successful than others?**

**A Veljko Fotak, assistant professor of finance and managerial economics in the School of Management at the University at Buffalo:** "It is too early to judge the success of Chile's stabilization program in the context of the recent plunge in commodity prices. Yet, when copper prices fell by more than 60 percent in 2008-09, the Chilean government acted very aggressively by withdrawing money from the stabilization fund. The result was modest (about 1 percent) GDP shrinkage in 2009 followed by strong growth (almost 6 percent) in 2010. While we don't have a perfect counterfactual to isolate the fund's impact, Chile's economy proved to be amongst the most resilient during that crisis, both compared to its regional peers and to the wider globe. So far, withdrawals in 2014 and 2015 have been more modest, but that is probably because the decline in copper prices was not as dramatic as in 2008. Norway's fund is not really a stabilization fund; it is more of an intergenerational savings fund. Its 'spending rule' limits the amount spent in any budgetary year to 4 percent of the fund's value, constraining its usefulness as a stabilization fund. Peru recently announced its biggest fiscal deficit in recent times, as it is increasing spending and cutting taxes to stimulate growth. While the government has hinted that it

*Continued on page 2*

### DEA Chief Steps Down in Wake of Agents' Prostitution Scandal

Michele Leonhart, the head of the U.S. Drug Enforcement Administration, will step down next month. Her departure followed a report that DEA agents in Colombia attended "sex parties" that were funded by drug cartels. See story on page 2.

*File Photo: U.S. Department of Justice.*

# Inside This Issue

**FEATURED Q&A:** How Effective Are Economic Stabilization Funds?.....1

U.S. DEA Chief Quits in Wake of Agents' Prostitution Scandal.....2

New York Governor Wraps Up Trade Mission to Cuba .....2

Argentina Sells $1.4 Billion in Bonds to Local Banks, Investors.....3

Walmex Reports 9 Percent Increase in First-Quarter Profit.....3

**The Dialogue Continues:** Can the U.N. Win the Battle Against Impunity in Guatemala?.....3

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## NEWS BRIEFS

### New York Governor Wraps Up Trade Mission to Cuba

New York State Governor Andrew Cuomo wrapped up a two-day trade mission to Cuba on Tuesday with a tour of the Port of Mariel before returning to Havana to meet with First Vice President Miguel Díaz-Canel, the governor's office announced. Josefina Vidal, director general of the U.S. division at Cuba's Foreign Ministry, met Cuomo's delegation at the airport Monday, and he later met with Cuba's minister of foreign trade, Rodrigo Malmierca. With the trip, Cuomo became the first governor from the United States to visit Cuba since relations began to thaw last December, BBC News reported.

### Head of Venezuela's National Assembly to Sue News Outlets

The head of Venezuela's National Assembly, Diosdado Cabello, said Tuesday that he will sue several news organizations for publishing reports connecting him to drug trafficking, the Associated Press reported. In a posting on Twitter, Cabello said he would sue Venezuela's *El Nacional* and *Tal Cual* newspapers as well as online news site La Patilla and Spanish newspaper *ABC*. The news outlets reported in January that Cabello's former bodyguard had defected to the United States where he is to testify that Cabello has involvement in drug trafficking. Cabello has denied the accusations.

### Chile's Codelco Restarts Salvador Mine Operations Following Rains

Chilean state-owned copper miner **Codelco** said Tuesday that operations at its Salvador mine in Chile restarted on April 20 after a three-week shutdown caused by historic rainfall that hit the normally arid region, Reuters reported.

# Political News

## U.S. DEA Chief Quits in Wake of Agents' Prostitution Scandal

The head of the U.S. Drug Enforcement Administration will step down next month in the wake of a government investigation that found DEA agents in Colombia attended "sex parties" with prostitutes paid for by drug cartels. "Michele Leonhart, the administrator of the Drug Enforcement Administration, informed me today of her decision to retire. She will depart the agency in mid-May," Attorney General Eric Holder said Tuesday in a statement, *The Guardian* reported. "I want to express my appreciation to Michele, not only for her leadership of the DEA since 2007, but also for her 35 years of extraordinary service to the DEA, to the Department of Justice and to the American people." Leonhart's resignation came after a congressional hearing last week in which Leonhart faced tough questions from members of the House Oversight Committee about a report that agents had participated in cartel-funded parties with prostitutes, *The New York Times* reported. The day after the hearing, Rep. Jason Chaffetz (R-Utah) and Rep. Elijah Cummings (D-Md.) issued a statement expressing a lack of confidence in Leonhart. "Administrator Leonhart has been woefully unable to change or positively influence the pervasive 'good old boy' culture that exists throughout the agency," said the statement, which several other committee members supported, *The Guardian* reported. "Ms. Leonhart has lost the confidence of this committee to initiate the necessary reforms to restore the reputation of a vital agency." On Tuesday, White House Press Secretary Josh Earnest declined to comment on reports of Leonhart's pending departure, but instead said the Obama administration was concerned about revelations in the report. The White House had "concerns about the material that was presented in the report that raised legitimate and serious questions about the conduct of some DEA officers," said Earnest. "The president, as you know, maintains a very high

Chaffetz

*File Photo: U.S. House of Representatives.*

**Featured Q&A**

*Continued from page 1*

does not yet need to tap its stabilization fund, having large reserves stored allows it to act more aggressively in its economic stimulus. Truth is, Chile's fund in 2008-2009 stands out as the best example of successful implementation of a stabilization fund. Strong and clear rules for governance are paramount. In that sense, the most important determinant of the success of any government fund is how insulated it is from excessive political interference. This starts by establishing clear rules about withdrawals, as politicians will always be tempted to raid their national funds to provide a short-term boost to their economy, as we have seen, for example, in Botswana, Venezuela and Russia. Second, a fund needs well-defined goals and objectives. Too many have vague mandates hinting at stabilization, wealth-transfer and development goals. Clearly, such broad and different goals are not always compatible, and clear priorities need to be established."

**Janice E. Plumstead, senior economist at the Canada West Foundation:** "Chile's Economic and Social Stabilization Fund is ranked among the top sovereign wealth funds with an approximate market value of $14.7 billion as of February. Fund investments are made in a diversified portfolio of treasury bills, sovereign bonds and equities in various currency denominations. Slow economic recovery from the global financial collapse of 2008 has reduced interest rates world-

*Continued on page 4*

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standard for anybody who serves in his administration, particularly when it comes to law enforcement officials. And the [inspector general's] report raised serious concerns about that conduct." Leonhart has also been at odds with the administration over marijuana policy. She has opposed moves by states such as Colorado and Washington to legalize the drug's use, though President Barack Obama has said such moves should be allowed to go proceed, *The New York Times* reported.

# Economic News

## Argentina Sells $1.4 Billion in Bonds to Local Banks, Investors

Argentina sold about $1.4 billion in U.S. dollar-denominated bonds to local banks and institutional investors on Tuesday, *The Wall Street Journal* reported. While the sale showed the country can raise money domestically despite being shut out of global credit markets, the bonds were priced at a relatively high 9 percent annually, twice what Argentina's neighbors have paid to raise debt recently. The government touted the sale as a success. "This is an important milestone because it had been quite a while since Argentina has tested the market," Economy Minister Axel Kicillof told reporters. "There is demand for bonds, and investors are willing to invest in Argentina." The government says it plans to use the money to fund infrastructure programs. On Monday, New York-based ratings agency **Moody's** downgraded additional categories of Argentina's debt over increased risks of default related to a bitter court fight in New York with bondholders, *Ambito Financiero* reported. **NML Capital**, the unit of billionaire Paul Singer's hedge fund Elliott Management Corp. that Argentina's government has labeled "vulture funds," said it had started a probe into Argentina's issuance Tuesday of local-law bonds, Bloomberg News reported. NML sent a letter to **Deutsche Bank AG** seeking information on the local debt sale and whether the bank is offering the bonds to investors outside the country, according the report. A federal judge in New York said last month that Argentina can't make payments on notes issued to global investors, even if those securities were sold under domestic law, until NML and other holdout creditors who sued for full repayment get the $1.7 billion they're owed.

# The Dialogue Continues

## *Can the U.N. Win the Battle Against Impunity in Guatemala?*

**Q U.S. Vice President Joseph Biden earlier this year called for the renewal of the U.N.-backed International Commission against Impunity in Guatemala (CICIG), an independent body created in 2006 to fight organized crime and corruption, as a condition of U.S. aid to the Central American nation. While many Guatemalan civil society groups have urged extending CICIG's mandate when it expires in September, President Otto Pérez Molina has expressed doubts about its future, and some critics have said the body is unconstitutional, unsuccessful and biased. How successful has CICIG been in its first years of operation? Should its mandate be extended? What factors are shaping the debate, and what will most likely be the outcome?**

**A James Meyer, partner at Harper Meyer in Miami:** "There is very little question that the mandate and goals of the United Nations' International Commission Against Impunity in Guatemala (CICIG) have been and remain admirable and, at moments in recent history, the institution has been a critical source of hope in an otherwise seemingly hopeless situation. However, the execution of the plan, which was developed and designed outside of the country, was far from flawless. In fact, the institution found itself accused of being a source of some of the same societal ills that it was designed to mitigate against, and as it became increasingly politicized, if not in reality, certainly in perception. With that, regardless of perspective, it seems clear that the original mission has become greatly compromised. Perhaps the only real solution going forward would be to dramatically reform the project, taking the lessons of the recent past and applying them to a new organization which would need to be designed with the help and cooperation of qualified Guatemalans to avoid and withstand the nature of politics in Guatemala. Mere edicts from the United Nations or the United States alone, however, will not help the current or successor institution succeed in achieving its goals. A more insightful approach will be needed in order for such a project to have any of the intended and much-needed impact."

*Editor's note: The above is a continuation of a Q&A published in the April 16 issue of the* Advisor.

# Company News

## Walmex Reports 9 Percent Increase in First-Quarter Profit

**Wal-Mart de México**, or Walmex, on Tuesday reported a 9 percent increase in profits for the year's first quarter, Reuters reported. The company, Mexico's largest retailer, said it had profit of 5.174 billion pesos ($339 million) for the quarter that ended March 31, as compared to 4.75 billion pesos in the first quarter of last year. However, Walmex's profit was below analysts' expectations. In a recent poll, six analysts surveyed by Reuters had expected the retailer to post profit of 5.558 billion pesos for the quarter. Walmex said Tuesday that its revenue grew 9 percent to 111.7 billion pesos. The company, which opened 11 new stores in the first quarter, added that its same-store sales increased 4.9 percent in the January-through-March period.

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## Featured Q&A

*Continued from page 2*

wide and with them, rates of return on investment. Investments held in Chile's sovereign wealth fund have taken the hit as highlighted in February's results, which show a negative return on fund investments over the last three years. This should be contrasted against the fund's overall return since inception in 2007 which is positive. But low investment returns in the short term don't mean the fund is in trouble. Since inception in 2007, the government has made contributions to the fund in five of the eight years, not including 2015. Accrued interest and capital gains from investments less administrative costs have added to the total balance over time. Withdrawals made in 2009, 2010 and 2014 have decreased the fund's balance but not to a point of depletion. These withdrawals have been made in accordance with the fund's purpose, which is to stabilize the economy and reduce deficits in times of economic downturn. Chile's ability to develop a strong institutional framework around the Economic and Social Stabilization Fund has contributed to the success of the program so far. Even subnational jurisdictions such as Alaska or Alberta with mixed experience managing their resource-based savings funds can learn from Chile's economic stabilization program."

**Marvin Fernandes, research fellow at Cambridge University's Newton Centre for Endowment Asset Management:** "Two factors that determine the success of stabilization funds in a stabilization scheme are the relative size of the fund (resulting from how much is set aside and compounded during good times) and the government's handling of public finances. Stabilization funds are no substitute for sound fiscal management. Governments must plan public finances on the basis of cautious commodity price forecasts. The $500 million withdrawal from Chile's Economic and Social Stabilization Fund (ESSF) in 2014 works out to about 3.3 percent of the fund's current $15 billion value. This is similar to Norway's 4 percent of fund value withdrawal rule. It is therefore tempting to make comparisons and recommendations based on the Norway model such as harvesting risk premiums by being a long-term investor. However, Chile has different needs. Besides economic, political and cultural differences, the two resources are different in terms of prices and stores, and its fund size is much smaller. It must therefore follow its own path. So while ESSF is a stabilization fund, the Norway Fund has a smaller stabilization remit and a larger remit of saving for intergenerational equity. The key question is therefore whether the institutional design of the ESSF captures a large enough share of resource revenue and generates adequate return for future stabilization programs and exerts optimum pressure to maintain fiscal discipline—and here it might compare with other funds' design (including Norway's 4 percent rule and governance framework). Thereafter, if the design needs to be adapted, it should be one that suits Chile's specific needs."

> "Politicians will always be tempted to raid their national funds to provide a short-term boost to their economy."
>
> — ***Veljko Fotak***

*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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