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THEDIALOGUE

FEATURED Q&A

Will Colombia's Tax Reform Plan Win Approval?

Colombian President Juan Manuel Santos has expressed confidence that Congress will pass the tax reform this year, adding that it will not be delayed by the government's peace talks with the FARC rebels. // File Photo: Colombian Government.

Q Colombian President Juan Manuel Santos said May 11 that the government's tax reform plan, an effort to raise revenues amid falling income from oil and coal exports, will win approval in Congress this year. The comprehensive package affects levies including personal and corporate taxes as well as the value-added tax. Will lawmakers approve the package this year? How important is the tax reform to Colombia's economy, and what will happen if it is not approved? Which industries will the tax reform most affect?

A Daniel Velandia O., head of research and chief economist for Colombia at Credicorp Capital in Bogotá: "A structural tax reform is imperative for the adjustment of the economy to remain orderly following the sharp drop in oil prices since 2014. In fact, it is worth noting that oil-related fiscal revenues for the central government will fall from 3.3 percent of GDP in 2013 to a projected 0.1 percent of GDP this year, implying a huge hole in public finances that only a structural tax reform will be able to fill amid a very rigid fiscal budget (for example, regional transfers, pensions and security). For that purpose, the government established a commission of experts in February 2015 to analyze the current tax system and present a structural tax reform proposal. This commission estimates that under the current scenario, government revenues need to be increased by 1.5 percent of GDP by 2018 to meet the fiscal rule. In other words, should a structural tax reform not be approved this year, the fiscal rule is likely to be breached and thus, a sovereign rating action could be observed on the current BBB rating as soon as December, further increasing uncertainty and risk perception on

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TODAY'S NEWS

ECONOMIC

House Committee OKs Puerto Rico Restructuring Bill

The U.S. House Natural Resources Committee approved legislation that would establish an oversight board to help Puerto Rico restructure its more than $70 billion of debt. The measure is expected to pass the full House of Representatives, but its future in the Senate is uncertain.

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BUSINESS

Brazil Taps New Leaders for State-Run Banks

Brazil's Finance Ministry named Paulo Rogerio Caffarelli to head Banco do Brasil and Gilberto Occhi to lead Caixa Econômica Federal.

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ECONOMIC

Mexico Lowers Growth Forecast for Next Year

Mexican central bank chief Agustín Carstens said lower U.S. industrial production would mean slower GDP growth in Mexico for 2017.

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Carstens // File Photo: Mexican Government.

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ECONOMIC NEWS

House Committee Approves Puerto Rico Restructuring Bill

Hotly contested legislation in the U.S. House of Representatives to set up an oversight board to help Puerto Rico restructure its more than $70 billion of debt won approval in the Natural Resources Committee on Wednesday in a 29-10 vote, The Hill reported. Republicans cast all 10 votes against the bill, although Rep. Raúl Labrador (R-Idaho), a Freedom Caucus member who helped draft the bill, voted yes. Rep. Norma Torres (D-Calif.) voted "present." The bill is expected to pass the full House in early June, after the Memorial Day recess, but its future in the Senate remains unclear, as leading voices on both sides of the aisle have expressed strong reservations. Senate Majority Leader Mitch McConnell (R.-Ky.) on Tuesday said his chamber was "anxious to take up" whatever the House could pass, The Wall Street Journal reported. The White House supports the measure. Committee Chairman Rob Bishop (R-Utah) on Wednesday batted down amendments that would have removed language limiting Puerto Rico's minimum wage, eased economic aid to the island, and banned the Federal Reserve from purchasing Puerto Rican bonds or paying down the commonwealth's debt, according to The Hill. Even if the bill passes, Puerto Rico has a long climb out of debt and a shaky foundation to build upon. "The local government faces continuous structural problems including tax evasion, complex and perpetually imbalanced budgets, incoherent long-term fiscal planning, lack of transparency and monopolistic public service structures," the Inter-American Dialogue's Ben Raderstorf wrote in a **paper** earlier this month. [Editor's note: See related **Q&A** in the May 12 issue of the Advisor.]

Senate Majority Leader Mitch McConnell said his chamber was "anxious to take up" whatever the House could pass.

Brazil Official Seeks to Lift Ban on Foreign Land Ownership

The cabinet minister in charge of Brazil's privatization plans, Wellington Moreira Franco, told Reuters on Wednesday he will push to lift current limits on foreign ownership of agricultural land. In an interview, Franco called the restriction on sales of agricultural land to foreigners, a measure adopted in 2010 by leftist President Luiz Inácio Lula da Silva, "nonsense," saying that interim President Michel Temer will reconsider the ban. "The government will discuss the issue, see how it can solve this. It is something completely unreasonable," Franco told Reuters. The ban was put in place to prevent foreign capital for acquiring increasingly valuable land in Brazil as the commodities boom got into full swing. Companies in Brazil's pulp and sugar industries have been pushing for a repeal of the policy. Meanwhile, Brazil's Landless Workers Movement, or MST, this week promised a new wave of farm occupations in Brazil to protest the Temer administration's policies. The movement will target "idle" farm land owned by members of the interim government and its backers. "There are many [government] ministers who own unused lands that should be distributed to the people. We have five million families in Brazil who don't have access to land," MST spokeswoman Marina do Santos told Reuters Tuesday.

Franco // File Photo: Brazilian Government.

NEWS BRIEFS

Three Journalists Disappear in Colombia

Three journalists have disappeared in a remote region of Catatumbo in Colombia within a period of days, CNN reported Wednesday. Spanish journalist Salud Hernández went missing recently while working in the region, which has a heavy organized crime presence. Then Colombian television network RCN said two of its journalists, Diego D'Pablos and Carlos Melo, also vanished. Colombian President Juan Manuel Santos ordered an army commander and the national police director to oversee search efforts.

Mexican Central Bank Lowers Growth Forecast for 2017

Mexico's central bank, led by Agustín Carstens, on Wednesday lowered the country's growth forecast for 2017, saying gross domestic product would grow between 2.3 percent and 3.3 percent next year, The Wall Street Journal reported. Its previous estimate was for growth of 2.5 percent to 3.5 percent. The central bank lowered the forecast due to a dimmer outlook for U.S. industrial production, said Carstens. The bank added that it expects the economy to grow between 2 percent and 3 percent this year.

Jamaica Spending $52 Mn on Smart Meters to Curb Power Theft

Jamaica Public Service (JPS), the island's state-owned power utility, expects to spend $52 million over the next five years on smart meters in an effort to curb electricity theft, the Jamaica Gleaner reported Wednesday. JPS said that it conservatively estimates that 180,000 consumers are illegally connected to its grid, a number equivalent to more than a third quarter of its customer base.

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BUSINESS NEWS

New Leaders Tapped for Brazilian State Banks

Brazil's Finance Ministry on Wednesday named two new officials for state-run banks Banco do Brasil and Caixa Econômica Federal, Bloomberg News reported. Finance Minister Henrique Meirelles tapped Paulo Rogerio Caffarelli, currently corporate executive director at steel producer Cia. Siderurgica Nacional to replace Alexandre Abreu at the helm of Banco do Brasil. Also, Gilberto Occhi, who had been now-suspended President Dilma Rousseff's minister of integration until last month will lead Caixa Econômica Federal. Banco do Brasil is the country's largest bank by assets, and Caixa has the country's second-largest domestic loan portfolio. Caffarelli previously worked for Banco do Brasil for three decades, in posts including vice president for the international area and wholesale banking. Caffarelli also previously worked at Brazil's Finance Ministry. Occhi, an attorney and longtime employee of Caixa, was the bank's head of government affairs from 2013 to 2014. As president of Caixa, Occhi replaces Miriam Belchoir who, like Abreu at Banco do Brasil, was appointed by Rousseff. Brazil's Senate suspended Rousseff two weeks ago, installing her vice president, Michel Temer, as interim president. Rousseff faces trial in the Senate on charges that her government manipulated the country's budget ahead of her re-election in 2014 to hide a growing deficit, charges she denies.

Caffarelli // File Photo: Brazilian Government.

Lenovo Reports 46% Growth in Latin America Business

Hong Kong-based consumer technology company Lenovo said today its Latin America business grew 46 percent in fiscal year 2015. "Margins improved with Brazil performance stabilization having a significant impact overall," the company said in a statement. Lenovo's Americas region saw record PC market share of 14.8 percent for the quarter, driven by strong shipments in North America and Latin America. In its mobile business, however, the Americas region suffered because the planned launch of the Moto G was delayed until this year's first quarter. In 2014, Lenovo bought the Motorola Mobility smartphone business from Google for nearly $3 billion. In its earnings release today, the company said its Motorola sales have been slower than anticipated. "These results show integration efforts did not meet expectations," Lenovo said, adding that was "applying learnings quickly." Lenovo posted a full-year loss due to mergers and acquisition costs, and its first-quarter profits missed analysts' estimates.

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Colombia. As the government's current support in Congress represented by the 'Unión Nacional' alliance lies at 51 percent in the Senate and 59 percent in the House of Representatives, we think that the government should get enough votes to pass the reform later in the year. Having said that, political risks exist amid the ongoing peace process with the FARC as Santos' political capital strongly depends on its development and final result. Hence, Colombia will continue to go along a bumpy road for a while."

Erich Arispe, director in the sovereign group of Fitch Ratings: "Colombia has been able to absorb the oil shock due to a credible inflation-targeting regime, exchange-rate flexibility and a healthy banking system. Colombia's fiscal policy flexibility, though, is constrained by a narrow revenue base, a rigid expenditure profile and limited fiscal savings. Oil fiscal revenues could plummet to 0.1 percent of GDP in 2016 from a peak of 3.3 percent in 2013. The government has managed to contain fiscal deterioration with revenues derived from 2014 tax changes and expenditure postponements (0.7 percent of GDP in 2016), but the central government deficit will likely top 3.6 percent of GDP in 2016. The government has stated it plans to introduce a revenue-positive tax reform in 2016 as part of a credible strategy to reduce the deficit and stabilize public debt. This reform would reflect the input of international and local experts and could aim to simplify the tax system, improve its efficiency and broaden the tax base in addition to raising fiscal revenues. Fitch believes that the government is likely to obtain approval for tax reform in 2016, as Colombia has a track record of providing policy responses to fiscal challenges. Nevertheless, the transition through Congress could pose dilution risks to the reform's structural goals and/or collection targets, due to weakened government popularity, positioning of government coalition members ahead of the 2018 elections and delays in finalizing and obtaining approval for the peace process. The challenge of the reform is to balance fiscal objectives against their impact on economic activity and taxation levels for formal businesses."

> **"Oil fiscal revenues could plummet to 0.1 percent of GDP in 2016 from a peak of 3.3 percent in 2013."**
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> **— Erich Arispe**

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Munir Jalil, director and senior economist for the North Andean region at Citi Research: "We believe Congress will approve a tax reform before the year ends. Its approval is a priority for the government, and there is clarity for both the staff and policymakers that the consequences of not doing so would be significant. For one, rating agencies most likely will downgrade the country if the tax reform is not approved, which means the cost of funding will be increased. In addition, if Colombia is not compensated for the reduction in oil revenues with fresh revenues, the government would have to pick between increasing its debt or reducing its expenditures, both of which have negative consequences. Hence, while being optimistic about the likelihood the tax reform will be approved, we are still skeptical in terms of the type of tax reform that will be approved. The government has said that this time around, it wants a tax reform that is 'structural,' in the sense that it simplifies the tax code and makes tax calculation and payment transparent and efficient. The latter means tax exemptions will have to be eliminated. We have doubts about the government's ability to get all the current exemptions removed, which means Congress could end up approving a tax reform that is different in scope from the one the government proposed. All in all, we are of the view that for foreign investors and rating agencies, as long as the tax reform is able to raise between 1.5 and 2 percent of GDP, the country will be able to avoid a rating downgrade and all the negative consequences that it would bring."

> **"Rating agencies most likely will downgrade the country if the tax reform is not approved."**
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> **— Munir Jalil**

Jorge Lara Urbaneja, partner at Arciniegas, Lara, Briceño & Plana in Bogotá: "Santos' inauguration brought good news for Colombia. There was a continuation of pro-business state policies and the internationalization of the Colombian economy. One of Santos' campaign promises was no new taxes. In the following two years, Colombia experienced the highest growth in Latin America. Unemployment rates fell below 10 percent for the first time in modern history. However, the economic atmosphere changed along with the initiation and orientation of the peace talks with the FARC in Havana. The question was not whether the Colombians and their government should terminate a 50-year confrontation, but how should it be accomplished and at what cost for the working sector. The peace talks became a source of contradicting and alarming news that severely weakened Colombian production. Simultaneously, the government had overextended its size and expenses, even though Congress had approved the 'Fiscal Rule' law years before, to set a control on public expenditure. By 2014, the government was forced to impose an improvised tax reform so as to generate immediate income, overlooking long-term fairness and effectiveness. Now, in order to address the problem, a designated high-level commission has presented an integral tax package that should reorganize the whole tax system on long-term basis, making it more stable and predictable. Congress should approve this tax reform because of technical reasons it is necessary to completely replace the one in effect now. Hopefully, the result of this improvised approach will not make Colombia an even more costly place to invest, work and compete in the international market."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Nicole Wasson
Reporter, Assistant Editor
nwasson@thedialogue.org

THEDIALOGUE

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Washington, DC 20036

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Subscription Inquiries are welcomed at **freetrial@thedialogue.org**

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