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FEATURED Q&A

Will Colombia's Controversial Tax Reform Be Voided?



Former Colombian Vice President Germán Vargas is challenging the country's tax reform in the Constitutional Court. // File Photo: Colombian Government.

Q A tax reform that took effect in Colombia at the beginning of this year is facing a challenge in the country's Constitutional Court. Former Vice President Germán Vargas is challenging the reform, saying procedural errors in the law's passage last year violate the constitution. The reform raises taxes on some individuals and reduces them for companies, beginning next year. How likely is the reform to be struck down? What would be the consequences for the government, individuals and companies if the Constitutional Court invalidates it? What effects is the tax reform already having on Colombia's economy?

A David Ross, global fund manager at La Financière de l'Echiquier in Paris: "A number of changes went into effect this year that optimists called a tax reform. It wasn't. It was a modest shift lower in the high corporate income tax rates, offset by a shift upwards in individual tax rates. The effective corporate tax rate of 37 percent went to 33 percent for 2019 and will gradually drop to a permanent rate of 30 percent in 2022. Meanwhile, the top bracket for individuals rose from 33 percent (labor income) or 35 percent (capital) to 39 percent, which has made it unpopular as the electorate sees their taxes increase. While in theory the lower corporate rates should help to structurally reform Colombia's economy, allowing its companies to be more globally competitive, inducing more domestic and foreign investment, and shifting the economy's potential GDP growth permanently higher with higher productivity over time, the corporate tax cut is too timid to make much of a difference. Even at the eventual 30 percent, it will be well

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TODAY'S NEWS

POLITICAL

Peru's Vizcarra Closes Congress, Lawmakers Revolt

Peruvian President Martín Vizcarra dissolved the country's Congress, a move that would trigger new elections within four months. However, legislators rejected it, suspending Vizcarra's powers and swearing in Vice President Mercedes Aráoz as acting president.

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BUSINESS

Brazil's Batista Sentenced to Eight Years in Prison

Once Brazil's richest man, businessman Eike Batista was convicted of market manipulation.

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ECONOMIC

Argentine Officials Say Country Meets Conditions for IMF Disbursement

Officials including central bank chief Guido Sandleris said Argentina has met its goals in order to receive a \$5.4 billion tranche from the International Monetary Fund.

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Sandleris // File Photo: Argentine Government.

POLITICAL NEWS

Vizcarra Dissolves Peru's Congress, Lawmakers Revolt

Peruvian President Martín Vizcarra announced Monday that he was dissolving the country's Congress, but lawmakers rejected the move, suspending Vizcarra's powers and swearing in Vice President Mercedes Aráoz as the country's new president, *La República* reported. Vizcarra delivered a televised address, saying that he was dissolving Congress in order to break a long-running political impasse. The opposition-controlled Congress has stymied his efforts to push through anti-graft reforms that he says are needed. "Peruvian people, we've done everything we can," Vizcarra said Monday, *The Wall Street Journal* reported. "However, it's clear that the obstruction will continue." Vizcarra also accused Congress of attempting to stack the country's Supreme Court. Defiant legislators refused to leave Congress. "This is the behavior of a dictator," said opposition lawmaker Víctor Andrés García Belaúnde. Another legislator, Jorge del Castillo of the APRA Party, said Vizcarra would face criminal charges for dissolving Congress. Lawmakers swiftly suspended Vizcarra for 12 months and named Aráoz the country's acting president. "I accept this with fortitude," Aráoz said in an address to lawmakers, *The New York Times* reported. It was unclear whether Vizcarra would accept Congress' move to suspend him. Peruvian law requires legislative elections within four months after a dissolution of Congress. However, it was not clear whether legislators would comply with the order from Vizcarra, nor was it clear what efforts Vizcarra would make to ensure that his order took effect. Peru's president has the ability to dissolve Congress and call new elections if it delivers the government two no-confidence votes. Vizcarra argued that Congress' move to vote in new court magistrates without implementing his proposed reforms effectively amounted to the second time it has rejected a confidence vote, *The Wall Street Journal* reported.

ECONOMIC NEWS

Argentine Officials Say Conditions Are Met for IMF Tranche

Top Argentine economic officials said Monday that the country has achieved the goals it agreed on with the International Monetary Fund in order to receive the next tranche of \$5.4 billion under its standby deal with the lender, *Bloomberg News* reported. "Argentina, as I've said many times, has complied with all targets required for this disbursement to happen," central bank chief Guido Sandleris said at a conference that local newspaper *Clarín* hosted. He also suggested that the approval has been delayed because of the IMF's own bureaucratic process. "The IMF sometimes is a bureaucratic institution that moves at its own pace," he said, *Bloomberg News* reported. The next loan disbursement for Argentina has been up for approval since Sept. 15, but political uncertainty regarding the presidential election has sparked doubts. Peronist opposition candidate Alberto Fernández in the August primaries trounced incumbent President Mauricio Macri, setting the stage for what analysts expect will be Fernández's victory this month. [Editor's note: See related [Q&A](#) in the Aug. 14 issue of the Advisor.]

BUSINESS NEWS

Sempra Energy to Sell Interests in Peru Units to Yangtze

Sempra Energy on Monday announced a deal to sell its equity interests in its Peruvian operations for \$3.59 billion in cash to China Yangtze Power International, subject to closing adjustments for working capital and net indebtedness. The agreement includes Sempra's sale of its 83.6 percent stake in Peruvian utility company Luz del Sur and its interest in energy

NEWS BRIEFS

U.S. Appeals Court Allows Creditor to Resume Efforts to Seize Citgo

The U.S. Court of Appeals for the Third Circuit on Monday lifted an impediment that had frozen efforts by defunct Canadian gold miner Crystallex to seize Venezuela's 100 percent ownership stake in Citgo, Venezuelan state oil company PDVSA's U.S.-based refiner, as compensation for a \$1.4 billion government debt, *The Wall Street Journal* reported. The ruling marks a defeat for Venezuela's U.S.-backed opposition leaders, who have been fighting to avoid the refiner's seizure since taking effective control of the company. [Editor's note: See related [Q&A](#) in the Aug. 30 issue of the Energy Advisor.]

Paraguay's Economy Shrinks 3 Percent in Q2 in Worst Decline Since 2009

Paraguay's economy shrank 3 percent in the second quarter, marking the country's worst economic decline since 2009, the central bank said Monday, *Reuters* reported. The central bank added that poor performance in key sectors such as grains and livestock were to blame for the drop in GDP. From January to June, the economy contracted 2.5 percent, the central bank said, though it maintained its growth estimate for 2019 at 1.5 percent, expecting recovery due to an improved soy crop forecast.

Brazil's Batista Convicted, Sentenced to More Than Eight Years in Prison

Businessman Eike Batista, who was once Brazil's richest man, was convicted Monday of market manipulation and sentenced to eight years and seven months in prison, the *Associated Press* reported. A federal court also fined him 82.8 million reais (\$20 million). Batista was found guilty of using undisclosed information for his own benefit.

service firm Tecsur and Inland Energy, Luz del Sur's generation business. The deal is expected to close in the first quarter of next year, and it is subject for approval by Peru's anti-trust authority and the Bermuda Monetary Authority, the U.S.-based company said. "It directly supports our mission of building North America's premier energy infrastructure company," Jeffrey



Martin // File Photo: Sempra Energy.

W. Martin, Sempra's chairman and CEO, said in the statement. "Proceeds from this transaction will be used to strengthen our balance sheet and meet the growing capital needs of our core utilities in California and Texas," he added. Meanwhile, an active sales process continues for Sempra's electric business in Chile, which includes the company's 100 percent stake in Chilquinta Energía and Tecnoed, MarketWatch reported.

Pemex Seeking to Take Over Drilling at Talos Energy Find

Mexican state oil company Pemex is seeking to take over drilling operations in the area off Mexico's southern Gulf coast where U.S. company Talos Energy discovered nearly one billion barrels of crude, Reuters reported Monday, citing two former Mexican energy officials and two company executives with knowledge of internal Pemex discussions. The discovery in 2017 marked the first find by a foreign firm since Mexico's oil industry was nationalized nearly 80 years earlier. Now, Pemex is reportedly looking to run the drilling operations amid President Andrés López Obrador's push to strengthen the state oil company. His predecessor, Enrique Peña Nieto, oversaw

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above the worldwide average of 23 percent, or even the emerging market BRICS average of 27 percent. Capital goes where it is most welcome, and that is still not Colombia. As an example, non-oil/non-mining foreign direct investment in Colombia fell 38 percent over the last two years, and nothing in these tax rates will change that trend. Furthermore, it does appear that there is a strong case for the court repealing the law, and if it is repealed, given its unpopularity, it seems unlikely that the law would be reconsidered, leaving Colombia's economy in a permanently uncompetitive position."

A Oscar Ardila, head of investor relations and responsible investing at AshmoreAVENIDA: "Designed as a tool to promote investment and economic growth, the tax reform was by no means a perfect device. Aimed at raising 14 trillion pesos in 2019, the controversial reform is expected to generate only 7 trillion pesos. Moreover, there will be a loss in the collection of between 5 trillion pesos (in 2020) and 9 trillion pesos (in 2022) from the VAT reduction of the capital goods imports, and a loss of 8 trillion (in 2020) to 11 trillion (in 2022) from tax cuts to businesses. The tax reform, although imperfect, was needed to facilitate the country's adjustment to the new macroconditions of a devalued peso and lower oil revenues. Its main provisions included modifications to

the consumption, income and wealth taxes, as well as the strengthening of measures to prevent tax evasion. Nonetheless, as with any other negotiation, the passing of the reform required commitments from the government, among them the tightening of the national budget and cuts to subsidy

“The tax reform, although imperfect, was needed to facilitate the country's adjustment to the new macroconditions of a devalued peso and lower oil revenues.”

— Oscar Ardila

programs. Those commitments may need a more aggressive stance to withstand the lost revenues. Despite the court's ruling, from a fiscal standpoint, an adjustment to the reform may be needed in the medium term. Considering growth expectations for 2019, the reform is one of the tools that may prove efficient to put Colombia on a growth path once again. Thus, the key macroeconomic question now is not what the consequences of the invalidation of the tax reform law will be, but rather what fiscal path Colombia will follow to continue promoting growth without risking a widening deficit."

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an energy reform that ended Pemex's monopoly and opened the country's energy sector to private companies' participation, Reuters reported. Talos found oil in a shallow-water field, which it dubbed Zama. Pemex could have a potential claim to control over Zama because it has drilling rights to an adjacent field, and the oil deposits most probably extend into Pemex territory, though the firm has not yet proved that, according to the report. "If Pemex does end up operating it, that would not send a good signal to private investors," one executive from an oil major with several offshore projects in

Mexico told the wire service. Neither Pemex nor the Energy Ministry responded to Reuters' requests for comment. Last month, Talos received a two-year contract term extension and regulatory approvals for additional exploration activities on Block 7, which is located in the offshore part of Mexico's Sureste basin, under its production-sharing contract, World Oil reported. Talos operates Block 7, which includes Zama, in a consortium with partners Sierra Oil & Gas and Premier Oil. It was the first such extension granted to a private company in offshore Mexico, according to the report.

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A **Richard Francis, director of Latin American sovereigns at Fitch Ratings:** “The financing law passed in 2018 was heavily watered down from the government’s original proposal and, though it is revenue positive in 2019, it will lead to significant revenue losses beginning in 2020 as corporate tax rate cuts and investment incentives take hold. As such, Fitch did not view the law as an important bill to structurally reduce the fiscal deficit as predicated by the country’s fiscal rule (targeting a 1 percent of GDP fiscal

“**Fitch did not view the law as an important bill to structurally reduce the fiscal deficit...**”

— Richard Francis

deficit by 2027) and needed to stabilize the debt-to-GDP ratio (which has risen to nearly 44 percent by our calculations from just 30 percent in 2013). The court is expected to rule on the matter on Oct. 14 one way or the other, and it is difficult to predict how the court will rule. If the court rules that the bill is unconstitutional, a key point to watch is if the ruling would be retroactive. That is, would it invalidate the tax measures put in place at the beginning of the year? If the ruling were retroactive, it would mean a significant revenue loss for the government in 2019, which would be difficult to make up so late in the year. The government has highlighted the positive impact of the financing law on investment and growth, stating that the trend growth rate has risen to 4 percent because of the law. Fitch believes the impact is positive but much less than the government’s estimates. So a loss would be only

marginally negative for growth, in Fitch’s view. It is important to note that Colombia’s Constitutional Court has frequently ruled on fiscal and economic matters (although this case revolves around procedural errors, not the law itself). This does have an impact on the perception of judicial security by investors.”

A **César Caballero, manager at Cifras & Conceptos in Bogotá:** “The tax reform, or ‘financing law,’ has been the subject of 23 lawsuits. Some seek to eliminate certain articles, and others the entire law. The court already has a positive stance on the former vice president’s suit, and everything seems to indicate that there is a majority tendency to decide in that regard. The government expects some elements that would change its effect, such as allowing its validity for the final months of this year. In essence, what is most likely and predictable is that the law will be declared unconstitutional because of various defects, including: 1.) Collection this year will be smaller, because elements such as amnesty for declaration of assets outside the country has already happened, and there is an over-collection of 10 percent of the goals; 2.) Collection next year will be fiscally positive, since all the new exemptions will be eliminated, and they would generate an additional fiscal gap of between 6 trillion and 8 trillion pesos; and 3.) For entrepreneurs and individuals, we will again have the version of the tax plan that the Santos administration approved. The government will have to decide if it will present the tax reform again in November. In this scenario, it will face many difficulties in Congress.”

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

LATIN AMERICA ADVISOR
is published every business day by the
Inter-American Dialogue, Copyright © 2019

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Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at 1155 15th Street NW, Suite 800 Washington, DC 20005

www.thedialogue.org

ISSN 2163-7962

Subscription inquiries are welcomed at ebrand@thedialogue.org

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