Latin America Advisor

The Interactive Forum for the Region's Leaders — **Tuesday, February 18, 2003**

Today's Top News

Advisor ANALYSIS

Q **Argentine Economy Minister Roberto Lavagna expects his government to announce this year a proposal to restructure $95 billion in sovereign debt on which the country defaulted over a year ago. What kind of offer do you think the government will make, and how will it be received by creditors?**

A **Guest Commentary: Suhas Ketkar:** "Any debt restructuring proposal by the Argentine government will undoubtedly involve heavy penalties on creditors. Argentina's total external debt is as high as 120 percent of this year's projected GDP and 400 percent of this year's projected exports of goods and services. Since the consensus level of sustainable debt is thought to around 50 percent of GDP and 200 percent of export earnings, the haircuts Argentina is likely to propose will range between 50 and 60 percent at the very least. It is possible that even steeper haircuts will be needed because roughly $40 billion in debt owed to official creditors cannot be restructured. As a result, obtaining the necessary reductions in the debt-to-GDP and debt-to-exports ratios (without touching official creditors) would require haircuts of 70 to 80 percent. Needless to say, the initial creditor reaction would be quite negative and hostile. They would eventually accept the haircuts, but only if Argentina manages to put its house in order and convinces creditors of its willingness and ability to carry the restructured debt load."

> "In Argentina, the IMF... has taken a leap in the dark, looked around, and taken yet another."
>
> -- Steve Hanke

Guest Commentary: Steve Hanke: "Argentine Economy Minister Roberto Lavagna has stated that the government will offer creditors a 'menu' of restructuring options for the $95 billion in sovereign debt on which it defaulted. After Argentina played chicken with the IMF and won, it is doubtful that the *maître d'hôtel* will present an appetizing menu, however. Some creditors hold out hope that the new IMF program will jump-start the Argentine economy, producing more favorable terms. They shouldn't hold their breath. The centerpiece of the program is a floating exchange rate regime, coupled with inflation targeting. Since Argentina's Central Bank was established in 1935, the peso has depreciated against the US dollar by a factor of 9.6 trillion. If Argentina's history is a guide, we can expect more of the same. Indeed, for a sobering picture of the much-

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touted inflation targeting, all we have to do is look at Brazil's travails. Inflation remains stubborn, with the IPCA inflation rate for January coming in at 2.25 percent month-on-month. That's the highest January rate since 1994. In Argentina, the IMF -- true to form -- has taken a leap in the dark, looked around, and taken yet another."

Suhas Ketkar is Senior Economist & Head of Emerging Market Analysis at the Royal Bank of Scotland.

Steve Hanke is Professor of Applied Economics at The Johns Hopkins University.

Political News

Bolivian President Meets with Aides to Discuss Spending Cuts

Bolivian President Gonzalo Sánchez de Lozada met with top advisors Monday to discuss ways to reduce spending and lower the government's budget deficit following his retreat from an income tax proposal that sparked widespread violence last week. Sánchez de Lozada is reportedly considering a reduction in the number of cabinet positions and limiting staff expenses as a means to save money, the Associated Press reported. The president also said Sunday he would stop accepting a salary. The Andean nation was rocked by some of the worst violence since its return to democracy in 1982 last week after police demanding better pay joined demonstrators upset over a proposed 12.5 percent income tax. Protesting police exchanged gunfire with soldiers protecting the presidential palace in the capital city of La Paz, triggering anti-government riots and looting that left an estimated 29 people dead and almost 200 injured. Thousands of protesters marched through La Paz yesterday and called on Sánchez de Lozada to resign. [Editor's note: look for related Q&A in tomorrow's issue of the *Latin America Advisor*.]

US Government Worker Killed by Colombian Rebels

For apparently the first time in Colombia's 40-year old guerrilla war, rebels have killed an American working for the US government, according to a Reuters report. US State Department spokesman Charles Barclay said he had "reliable reports" that members of the country's largest guerrilla group, the Revolutionary Armed Forces of Colombia (FARC), had killed a US citizen working for the government as well as a Colombian soldier, and had kidnapped three other US crew members from a plane after it made an emergency landing on Thursday in Caqueta province. "It has been confirmed that ... a sergeant of our army and a US citizen were murdered," Colombian President Álvaro Uribe said in a statement. On Saturday, thousands of Colombian troops and special mobile units searched parts of Caqueta for the captives. The US has more than 500 personnel in Colombia, according to Reuters, including 270 civilian contractors and 267 military personnel. By law, none of the more than 70 reported US Special Forces troops in Colombia can have a combat role, however.

Economic News

Little Progress in WTO Talks; Brazil Offers Plan on Drug Patent Impasse

Three days of World Trade Organization (WTO) talks ended Sunday in Tokyo with little progress on lowering tariffs worldwide. Deep divisions on agriculture and pharmaceuticals between the United States, Europe and developing countries again surfaced as key obstacles to further trade liberalization. For a time during the weekend, there was some hope for progress on the controversy over allowing developing countries access to pharmaceuticals. At issue has been Washington's demand that extra restrictions be placed on the kind of diseases to be covered under proposals to broaden access to life-saving drugs. The potential breakthrough came when Brazil, in an effort to overcome the impasse, offered a plan on Saturday that would allow the United Nations' World Health Organization to decide whether poor countries had the capacity to manufacture generic drugs themselves in order to address public health crises. If not, they would be able to set aside patent rights and import copies of drugs developed by major pharmaceutical companies based in wealthier states. Brazil plans to officially submit the proposal for review at next week's meeting of an intellectual property committee under the 145-member WTO in Geneva, Kyodo News reported. USTR Robert Zoellick declined to comment specifically on the Brazilian proposal.

Mexican Economy Expanded 1.9 Percent YoY in Q4 2002

Mexico's economy grew 1.9 percent in the fourth quarter of 2002 compared to the same period a year earlier, the finance ministry reported Friday. The ministry said slumping exports were offset by strong consumer demand. "The lack of vigor in sectors linked to external demand was seen [in the fourth quarter], with a clear recovery process seen in those sectors oriented toward domestic spending," the ministry said. Still, the weaker-than-expected growth for the quarter was up just slightly from 1.8 percent growth recorded in the third quarter. Mexico's economy grew 0.9 percent for the year 2002, up from a 0.3 percent contraction in 2001, the ministry said. The country has been hit by the economic slowdown in the United States, which buys 90 percent of Mexico's imports. The government projects growth of 3.0 percent in 2003.

Venezuela Watch

A Summary of the Latest Headlines from Venezuela ...

- The government of President Hugo Chávez and opposition leaders are expected to sign a pact today in which they promise not to resort to violence in resolving their tense standoff. Besides condeming violence, the eight-point agreement includes calls to respect freedom of expression and using the media to promote peace. The pact also includes a commitment to abstain from using aggressive language.
- Venezuela's Central Bank said Friday the economy shrank nearly 17 percent in the final quarter of 2002, driven by a devastating, opposition-sponsored general strike which virtually shut down the country's oil industry in December.
- Oil output could reach 2.8 million barrels day (bpd) within a month, close to pre-strike levels of 3 million bpd, when restrictions on sending tankers to Venezuelan ports are lifted, the head of state-run **Petróleos de Venezeula** said Monday.
- Chávez said Sunday interest rates should be fixed in order to reverse the country's deteriorating economic situation. The president suggested a maximum rate of 30 percent for commercial bank lending rates, compared with well over 40 percent at present.
- In response to opposition leader suggestions that businesses may need to suspend their operations rather than sell at a loss, Chávez threatened to seize control of businesses that fail to ensure a supply of food and other essential goods for the public.
- Venezuela's largest private energy generator and distributor, **Electricidad de Caracas** (EDC), on Monday reported a 53.1 billion bolivar ($US 33.2 million) loss during 2002 compared with a 89.2 billion bolivar profit in 2001. The company said a drop in demand of electric energy, increases in fuel prices and Venezuela's currency devaluation contributed to the poor results.

Sources: Reuters, Associated Press

Company News

Brazil's Paraná State Takes Back Control of Water Utility

The government of Brazil's Paraná state forced a consortium led by France's **Vivendi** to relinquish control of local water utility **Sanepar** for allegedly mismanaging investment in the utility and failing to provide adequate water quality. The Paraná government, the majority stakeholder in Sanepar, annulled a four-year-old agreement which ceded management responsibilities to Vivendi, the world's largest water company. Paraná Governor Roberto Requião accused Vivendi and other private shareholders, including local asset management firm **Opportunity**, of raising prices to boost their own profits, while water quality in cities, including the state capital Curitiba, has been poor. The seizure of Sanepar may stoke investor concern in Brazil if the country cannot promise to protect private investment interests, according to Bloomberg News. [Editor's note: look for related Q&A in February 21, 2003 issue of the *Latin America Advisor*.]

Ecuador Allows Firms to Restart Oil Pipeline Construction

The Ecuadorean government lifted a suspension on the construction of a key oil pipeline after the pipeline builder agreed to repair environmental damage, an official said Friday, according to Reuters. Ivan Murillo, undersecretary in the environment ministry, said **OCP Ecuador** was


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authorized to renew construction of the $1.3 billon heavy crude pipeline near an ecologically sensitive area following the company's promise to reforest the area and clean up a river polluted with construction materials. The government, however, also plans to seek monetary compensation for the damage, Murillo said, while a ministry tribunal will determine whether OCP violated local forestry laws. The government suspended construction of the pipeline last month due to tree damage. Environmentalists have opposed the route of the pipeline through the Mindo-Nambillo forest, a bird habitat and ecotourism destination outside of the capital city of Quito. The pipeline would have the capacity to transport up to 450,000 barrels of oil per day and provide an important source of export revenue to the Andean nation. If construction goes as planned, the pipeline should begin pumping later this year. OCP is controlled by a consortium which includes **EnCana Corp.**, **Agip Petroleum**, **Occidental Petroleum Corp.**, **Perenco**, **Repsol-YPF**, **Perez Companc**, and Argentine construction firm **Techint**.

Unibanco to Buy Back up to 278 Million Reais of its Own Shares

Brazil's **Unibanco** on Friday announced plans to buy back as much as 278 million reais ($76 million) worth of its own shares in order to take some of its stock out of circulation. In a news release, the bank said it would buy back 10 percent, or 256.2 million, of its ordinary shares, and 5.6 percent, or 3.03 billion, of its preferred shares, over the next three months, Bloomberg News reported. Unibanco will use spare cash to buy back the stock, some of which has fallen 7.2 percent this year. Brazil's third-largest private bank last week reported a record annual profit of 1.01 billion reais for 2002, amid strong customer growth. Unibanco posted a 10.4 percent year-on-year increase in fourth-quarter profit, to 266 million reais.

Brazilian Authorities Okay Sale of Stake in Gol to AIG

Brazil's aviation regulator (DAC) on Friday gave airliner **Gol Transportes Aereos** permission to sell a 20 percent stake to US insurance company **American International Group** (AIG) for $26 million, Reuters reported. The two-year-old Gol, Brazil's fourth-largest airline with a 17 percent market share, plans to use fresh capital injected by AIG, the world's largest insurer, to expand its fleet to a total of 26 aircraft by year end. DAC said Gol's board of directors will also have to approve the deal.

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