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## LATIN AMERICA ADVISOR

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### FEATURED Q&A

#### What's Good (and Bad) about Latin America's Business Climate?

**Q** Some Latin American countries attracted near-record foreign direct investment last year, as continued economic growth and relative political stability brought investors from around the world into the region. Looking ahead, what makes the region attractive to foreign and domestic investors, and what policy, legal, and regulatory changes would increase Latin America's appeal? How does Latin America's business climate compare to other parts of the world that are competing with it for investment?

agreement did not independently lead to more investment. When investment did come, foreign firms tend to have higher levels of productivity and wages. Yet, the major finding was that foreign firms in the region continue to be divorced from the larger economy, falling far short of generating the backward linkages that help countries develop, and in many cases foreign firms wiped out locally competing firms. China, the developing nation that was the largest recipient of investment, deploys government policy to link foreign firms

*Continued on page 4*

**A** **Guest Comment: Kevin Gallagher:** "The fact that Latin America received foreign investment upwards of \$130 billion is good news. The challenge now is to help translate foreign investment into development. A new report titled "Foreign Investment and Sustainable Development: Lessons from the Americas" released last month by 14 economists from across the hemisphere found that foreign investment was concentrated in but a handful of countries in the region—with Brazil, Mexico, Argentina, Chile and Venezuela receiving more than 80 percent of the total. Foreign firms have chosen to locate in Mexico and the Caribbean because they are export platforms to the United States, and those firms that located in South America did so to sell to domestic markets and gain access to natural resources. Interestingly, the authors found that having a free trade



#### Bachelet Directs Cabinet to Adopt Austerity Measures

Chilean President Michelle Bachelet on Thursday directed her ministers to adopt austerity measures, saying a slowdown in government spending may help contain inflation.

*Photo: Chilean government.*

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## NEWS BRIEFS

**Embraer Profit Rises on Strong Global Sales**

Brazilian aircraft manufacturer **Embraer** said on Thursday its second-quarter net profit more than doubled to 176.3 million reais (\$112.8 million), Reuters reported. Sales gains helped push results above the 79.7 million reais net profit posted in the year-earlier period. Embraer said the acquisition of new clients such as **ETA Star** group of Dubai and Brazil's **TRIP Linhas Aereas** increased firm orders.

**Pemex Reduces Oil Output Forecast for 2008**

Mexican state oil company **Pemex** expects to produce 2.8 million barrels per day (bpd) this year, down from its initial forecast of 3.1 million bpd, according to Reuters. Pemex's deputy director of Exploration and Production Vinicio Suro attributed the lower output to the natural decline of Pemex's Cantarell oil field. The new projection represents an 8 percent decrease from 2007 and comes as Mexican President Felipe Calderon has submitted reforms in Congress that would allow some private sector involvement in the industry.

**Petrobras Begins Producing Oil in Seas Off Nigeria**

Brazilian national oil company **Petrobras** said Thursday it began producing oil in waters off Nigeria. Petrobras holds a 13 percent stake in the Agbami Field. Its other partners are Norway's **StatoilHydro**, San Francisco-based **Chevron**, as well as Nigeria's **National Petroleum Corporation** and **Famfa Oil**, the concessionaires. Production is expected to peak in the second half of 2009, and should represent 13 percent of the volume of oil Petrobras produces abroad.

## Economic News

**Chavez to Nationalize Santander's Banco de Venezuela**

Venezuela will nationalize the local unit of Spain's **Banco Santander**, the South American country's third-largest bank in terms of deposits, Bloomberg News reported. Chavez said he will pay fair compensation for **Banco de Venezuela**, which Santander bought from the government in 1996, in order to increase state control of the financial services industry. "I want to get it back because it's the bank of Venezuela—that's its name," Chavez said

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“We're going to recuperate Bank of Venezuela. We're very much in need of a bank of that magnitude.”

— Hugo Chavez

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Thursday in comments on state television. "We'll put it at the service of Venezuela, because the bank was very profitable," Chavez said. Chavez was reportedly interested in taking over the bank to prevent Santander from selling the operations to another private bank. "They wanted to sell the bank to a Venezuelan banker, and as head of state I'm saying no. Sell it to the government, to the state," Chavez said in his remarks, according to AFP. "We're going to recuperate Bank of Venezuela. We're very much in need of a bank of that magnitude," Chavez said. Chavez was in Spain just last weekend, where he met with officials to mend relations after a diplomatic spat earlier in the year between the two countries. Banco Santander bought 93.4 percent of the shares of Banco de Venezuela in 1994 for \$351.5 million, according to the report. Venezuela has an active banking sector, with no single player holding more than 15 percent market share. **Banesco - Banco Universal** is the largest bank in Venezuela, with a 14.2 percent market share. **Banco Mercantil** is the second largest, with an 11.5 percent market share by deposits, Bloomberg News said.

**Bachelet Tells Ministers to Cut Expenses to Contain Inflation**

Chilean President Michelle Bachelet on Thursday directed her ministers to adopt austerity measures, saying a slowdown in government spending may help contain inflation, Bloomberg News reported. Government spokesman Francisco Vidal told reporters in Santiago that fighting inflation was the government's top priority. The government will reduce spending on travel, cars and other items, Vidal said. Ministers will be expected to travel "tourist class" for flights shorter than 10 hours, according to the report. Bachelet

has promised not to cut money to social projects. But Chile's economy is not making things easy on Bachelet. June industrial production declined by 0.9 percent over a year ago, **JP Morgan** analysts said in a research note today, and unemployment rose by 0.4 percent to 8.4 percent, worse than expected, according to the investment bank. "The data flow validate our view that the economy is going through a stagflationary phase promoted by a recessionary inflation spike," JP Morgan analysts said in the note.

## Political News

**Senior Senator Splits with McCain, Willing to Meet with Cuba, Venez.**

US Senator Arlen Specter (R-PA) said Wednesday he hopes to meet with Cuban President Raul Castro and Venezuelan President Hugo Chavez during a trip to Latin America this month, the Associated Press reported. Specter's statement prompted Democratic pundits to criticize the split between the senior Republican and his fellow senator and presidential



Arlen Specter

File Photo: Office of Sen. Arlen Specter.

candidate John McCain (R-AZ) over meeting with "adversaries" to the US, which McCain has sharply accused his rival, Barack Obama, of being too willing to do. "I'm a firm believer in dialogue," Specter told reporters this week, adding that he met with Fidel Castro during previous stops in Cuba and talked to him about drug interdiction. Specter said he'd like to follow that up with Raul Castro, as well as to discuss trade and tourism during a visit there. He said he believes the United States is "on the cusp" of re-establishing formal relations with Cuba, according to the AP report.

## Company News

### Telefonica Q2 Results Strong in Latin America as Profit Falls Overall

Spain's **Telefonica** said Thursday its second-quarter profit dropped 20 percent after a gain from the sale of an asset boosted earnings a year earlier, Bloomberg News reported. Net income fell to 2.06 billion euros (US\$3.21 billion) from 2.57 billion euros a year earlier, Telefonica announced. A key telecom player across Latin American markets, Telefonica hopes the region will continue to fuel growth as its home market of Spain goes through an economic soft spot. Revenue in Latin America grew 8.7 percent to 5.37 billion euros, while European sales outside Spain were unchanged at 3.5 billion euros, according to Bloomberg News. The company's sales are forecast to expand this year 11 to 14 percent in Latin America, while European sales outside Spain are forecast to rise 4 to 7 percent.

## In Focus

### Brazil, Colombia and Mexico Lead Region in World Bank Loans

by Matthew Schewel, *Advisor* Reporter

Washington, DC—The World Bank invested \$4.6 billion in Latin America during the 2008 fiscal year, with Brazil, Colombia, and Mexico constituting the Bank's largest finance recipients by volume, Pamela Cox, the Bank's Vice President for Latin America and the Caribbean, told a press conference on Tuesday at its headquarters in Washington, DC.

Cox, who has been in the regional VP post for nearly three years, said the figures, which have yet to be finalized, were comparable to the previous year's numbers for the region, and accounted for nearly one-fifth of all World Bank lending.

In all, the Bank funded fifty-eight programs in Latin America during the past fiscal year, which ended on June 30. It also unveiled new products under Bank President Robert B. Zoellick, which included a \$10 million "fast dispersion" grant to Haiti in the midst of the country's recent food crisis.



Pamela Cox

File Photo: World Bank.

Cox underlined the Bank's efficient response to the food crisis as evidence of its engagement in the region. "I think with the food and energy crisis, that's an example of how very quickly we've thought to work with the countries that are most affected to help them cope in a number of ways," Cox said in the briefing. In the coming year, the Bank plans to put resources into "safety net" projects already in place in the region, with rapid operations for Honduras and Nicaragua already scheduled for approval by September.



Augusto de la Torre

File Photo: World Bank.

Energy and food topped the Bank's list of "critical issues" for 2008, along with climate change, trade quality, and increasing opportunities for poor people in the region. Cox said that these four issues will remain priorities for the Bank, with \$5 billion in loans projected for the 2009 fiscal year.

Cox expressed confidence in Latin America's financial stability when questioned on the threat of inflation. She cited strong financial regulation of Latin American markets by independent central banks.

"Countries have been doing the right things so that when the rainy day comes, such as now, they're in a much better position than they might have been in the past," she said.

Augusto de la Torre, the Bank's chief economist for Latin America, told Bloomberg Television on Wednesday that inflation was expected to top 8 percent this year, and posed a "challenge" to countries in the region.

"Central banks are being put to the test," said De la Torre, echoing Cox's assessment.

[Editor's note: look for Q&A in the *Advisor* next week about tools available to central banks in the region to fight inflation.]

**Featured Q&A***Continued from page 1*

with the economy, which has helped foreign investment translate into robust growth."

**A Guest Comment: Jorge Kamine:** "Investors have been attracted to the region by strong macroeconomic performance, sustained growth, and opportunities to make investments that capitalize on the high global commodity prices, in particular natural resources and agricultural products. Local and regional capital markets have matured and become attractive as sources of capital and liquidity for investors, which have thus far weathered the US credit crisis. The international credit rating agencies have helped validate the positive outlook through their upgrades of Brazil's and Peru's sovereign credit ratings and thereby opened the door to new classes of investors. However, the capital inflows have been concentrated in a handful of countries, and the effects of high commodity prices have not been uniform. My focus has been the importance of investments in the energy sector and infrastructure in promoting regional growth and competitiveness, as most recently demonstrated by the energy crises suffered by Brazil and the Southern Cone, and the ability to attract those investments. The challenge has been attracting investment given the resurgent political risks and the legal and regulatory uncertainties that can be addressed by governments. Investors have been reticent to invest where there are uncertainties about the awarding or renewal of key concessions, the regulatory framework, and approval of tariff increases. Government efforts to better communicate and equitably spread the benefits of these investments can help mitigate the political risks for investors."

**A Guest Comment: Francisco Acuña:** "One of Latin America's greatest challenges to exploiting opportunities for foreign and domestic investment over the long term is the lack of a reliable and efficient legal system that can be trusted

by both citizens and foreign investors. Instead of merely focusing on technical fixes or economic reforms, some Latin countries need to invest more political and social capital on deeper reforms within their justice systems. In recent decades, several Latin American governments have made efforts to implement economic reforms. Review successful cases like Chile, Uruguay, and Costa Rica, and you see that they are the ones that also developed the type of judicial systems that brought security to both national and foreign investors. Countries that made economic reforms without improving their legal systems have lagged both in economic growth and in

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“Countries that made economic reforms without improving their legal systems have lagged.”

— *Francisco Acuña*

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foreign investment. Why then, has it been so difficult to move forward with serious legal reforms? Meaningful judicial reforms usually require far more political and social effort than economic reforms. These legal reforms, however, are paramount to the region's ability to make itself more competitive for investment. In addition to attracting more business, a reliable political and legal system also makes it easier for societies to support other reforms which can benefit the economy even further and thus, attract more foreign investment."

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