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Acute dollar shortage at the heart of Venezuela's latest political crisis

The latest political crisis in Venezuela, in which the Supreme Court of Justice (TSJ) officially took over the functions of the opposition-controlled National Assembly (AN), only to shed these extra powers in the face of an intense domestic and international backlash, has been driven primarily by economic concerns. Some US$2.2bn in bond debt repayments fall due on 12 April, with renewed concerns about the government's capacity to make the payment.

The TSJ, which in the past year has ruled against every piece of legislation put forward by the AN-controlled Mesa de la Unidad Democrática (MUD), and which mid-year declared the legislature 'in contempt' for refusing to obey its orders, defended its decision to assume the competencies of the assembly partly on the basis of the need for approval of strategic financing deals between the government and third parties.

These deals, potentially including one with Russia's state oil giant Rosneft, could bring in much-needed foreign currency. In theory, all new debt, including development finance and Chinese credit, requires prior congressional approval. Foreign investors and creditors are nervous, because the MUD has repeatedly insisted that any new debt contracted by the Maduro government and/or the state oil company, Petróleos de Venezuela (Pdvsa), and not submitted to the assembly for approval would technically be illegal, and that creditors might have no claim on it in down the line.

The Maduro government accuses the opposition of deliberately denying new credit in an attempt to worsen the already-dire economic situation in the country, and in a bid to force the radical left-wing administration into a default on its debt. The MUD in reply questions why it should be pressurised by the ruling Partido Socialista Unido de Venezuela (PSUV) into rubber-stamping debt financing, when it has been unable to pass any other bill since its mid-term congressional election victory in December 2015.

Recently, new loans worth around US$44m from the CAF-Development Bank of Latin America have apparently been held up, with the regional bank wary of extending finance to a country whose legislature had not approved the borrowing. There has also been speculation that new loans from China have likewise been subject to delay, on similar concerns in Beijing.

The latest TSJ ruling came in response to a query submitted by a group of lawyers, who asked the supreme court how pending oil financing deals between the executive and third parties might be approved given the legal

uncertainty surrounding the assembly. In response, the TSJ ruled that seeing as the assembly was in contempt, it would consider the deals instead. It added that there was "no impediment whatsoever" to the Maduro executive agreeing these deals. Early last year, the TSJ granted Maduro sweeping decree powers to legislate without consulting the assembly, which in its latest ruling it expanded further.

While the TSJ has now reversed its decision to take over the functions of the legislature (and restrict parliamentary immunity), it appears to have left in place the powers for Maduro to make deals on behalf of Pdvsa without assembly approval.

Fuel shortages also beg questions

Fuel shortages in Venezuela, home to the world's largest land-based oil reserves, should be unthinkable, yet the petrol pumps in Caracas ran dry in late March. Pdvsa blamed temporary transport problems and managed to restore supplies within a few days. The MUD maintains that the company has been cutting back on imports of refined fuels and derivatives so as to meet its April bond payments. There was also a suggestion that Venezuela had bumped up supplies to regional members of its preferential oil scheme, Petrocaribe, in a bid to shore up political support at the OAS.

In March, *Reuters* reported that Pdvsa was negotiating a new financing deal with Rosneft in return for a stake in the Petropiar joint venture. In late 2016, Venezuela put up 49.9% of Pdvsa's US subsidiary Citgo as collateral for loan financing from Rosneft. Maduro bypassed the assembly, to consternation, with the MUD and other critics accusing the government of selling off state assets without consent. The other 51% of Citgo had previously been used (just weeks before) as collateral for an earlier bond restructuring, again bypassing the assembly, meaning that Citgo is now 100% mortgaged, in effect.

It is unclear if this alleged new deal with Rosneft will materialise, and whether Pdvsa/the Maduro government is depending on Rosneft, in effect, to help make its latest debt payment (a Pdvsa-issued 2026 bond). There are ongoing fears of default, either accidentally through the mismanagement of scarce funds, or simply due to insufficient funds. According to a *Bloomberg* report on 4 April, the implied probability of non-payment in the next 12 months surged to 56% in March, up from 40% in February, based on credit-default swaps data. The financial wire noted that this was the biggest jump in the perceived risk of a short-term default since November 2016, when Pdvsa missed coupon payments due on bonds and had to use a 30-day grace period (during which time the Citgo financing deals were arranged).

Ray Zucaro, chief investment officer at the Miami-based RVX Asset Management, told *Bloomberg* that in his view there was still the willingness and ability to pay, but that "they're really pulling the coins out of the sofa….Do I think they have the entire $2 billion dollars right now? I think they have a little here, and a little there. I think they'll be able to cobble it all together. Fighting a political war and defaulting at the same time would just open up too much for them".

A near-complete absence of economic data makes it difficult to know how much money the government has coming in, how much it has saved and how much it hoped to source externally, in advance of the looming debt repayments. However, an anonymous government source recently told local media outlets that Pdvsa was indeed "counting on" help from Russia to make the April payment.

If Venezuela does not cobble together new finance immediately, it probably still can make the scheduled repayments, but financing would be very tight. International reserves stood stagnant at a 15-year low of US$10.4bn at the end of March: in theory this provides ample funding, but the problem is that the vast majority of central bank (BCV) reserves are held in gold. The latest data on the BCV's gold holdings dates to January – and is complicated by the fact that reporting is in local currency – but it appears that around three-

quarters of foreign reserves are held in gold and one-quarter in cash. As a result, if the government had to tap reserves to make the April repayment, it would wipe out nearly all of the BCV's liquid dollar holdings.

The prospect of rebuilding the reserves thereafter – in order to provide cushioning ahead of the other repayments due this year (US$1.9bn falls due in May-September, followed by US$1.6bn in October and US$1.9bn in November) – is low in the current weak oil price scenario. Indeed, the export price of Venezuelan oil fell by 12% in March to US$41.46/b, amid ongoing bearish sentiment in the global oil market. The government could opt to sell some more gold reserves. Given the time constraints, it is doubtful whether it could arrange a sale in time for the looming 12 April repayment, however.

BCV repo option?

Venezuelan media, as well as *Reuters*, reported on 3-4 April that the BCV was considering some kind of repurchase (repo) option to raise funds for the April payment. Quoting Deputy Rafael Guzmán (of the moderate opposition party Primero Justicia), the local news website *Crónica Uno* reported that the BCV had been in talks with a New-York based investment fund identified as Fintech Advisory about securing US$500m in financing, potentially by using BCV-held Pdvsa bonds worth US$1.5bn as collateral. Guzmán, a member of the national assembly's finance commission, alleged that the BCV had begun talks three weeks earlier. "They intend to do an operation; we do not know if it is via repo or a direct leverage with Pdvsa bonds," he was reported as saying. "These are desperate measures, because Venezuela has to fulfil its obligations in April and apparently does not have the resources".

Guzman also suggested that the Venezuelan government was considering offering dollar-denominated bonds to local banks in exchange for their foreign currency positions in order to raise funds

In February, *Reuters* reported that Venezuela was evaluating a repo agreement with the Japanese investment bank Nomura, also centred around offering Pdvsa bonds as collateral. According to Guzmán, this operation fell apart after the crisis with the TSJ, with Nomura "preferring not to get involved".

A new currency

Just before the political crisis blew up, Maduro announced changes to how the currency system functions. The changes concern just one of the two official exchange rates. The 'Dipro' rate, which is fixed at BsF10:US$1 and reserved exclusively for government imports of essential items (food and medicines), will remain unchanged. The ostensibly floating 'Simadi' or 'Dicom' rate, which is used for private-sector imports, will be replaced. Maduro was short on details and did not say whether this would imply a devaluation from the current Simadi rate of BsF710:US$1, but with the black-market rate standing at BsF3,800:US$1 in late March, this is likely to be the case. The president said that twice-weekly auctions would be reinstated to sell foreign currency to the private sector. However, he did not specify how the auctions would function, or what amount of foreign currency would be provided.

Immediately thereafter, the crisis erupted between the TSJ and the national assembly. There have been no further announcements about the pending changes to the FX regime, and it is unclear whether the planned new system will be shelved until the political situation becomes more stable.

Regardless, this tinkering with the currency regime is unlikely to have a positive impact on the availability of foreign currency. If anything, the Maduro government likely plans to reduce even further the availability of US dollars to private sector importers. These currency auctions were already trialled in recent years, but the promised 'regular' auctions were in fact erratic and sporadic, amid the growing shortage of dollars. As such, and with dollar shortages even more acute now, there is considerable scepticism about the plan to reinstate this system.

REGIONAL ECONOMY REVIEW

CHILE

Heading for a technical recession?

Chile's economy slowed down during 2016, a trend that seems to have intensified in the final quarter. Early signs for this year point to the country entering its first technical recession since 2009.

A technical recession is usually defined as two consecutive quarters of negative GDP growth (typically measured on a year on year basis), and the prospects of that happening in Chile are increasing. In mid-March, the central bank released revised GDP data for Q416, according to which economic growth slowed to a disappointing 1.6% in overall calendar 2016. On a year-on-year basis, growth fell from 1.8% in Q316 to just 0.5% in Q416.

On a quarter-on-quarter basis, the data is grimmer. GDP grew by 0.9% q-on-q in Q316, but contracted by 0.4% q-on-q in Q416. Another q-on-q contraction in the first quarter of 2017, therefore, could pitch Chile into a narrowly defined technical recession.

At first glance, the economy picked up a bit in January. According to the national statistics institute (Imacec), the activity indicator, a proxy for GDP, registered growth of 1.1% year-on-year in January. Yet February saw the start of an extended strike at the Escondida copper mine, which dragged on well into March before concluding. This alone will have a significant downward effect on Q117 GDP. The London-based consultancy Capital Economics expects things to improve in Q217, but still concludes that "the economy will struggle to grow by more than 1% over this year as a whole".

The headline story for Chile in 2016 was a slowdown in activity linked to weakness in mining and business services. The mining sector contracted by 2.9% over the year, as companies cut back on activity levels in response to a combination of factors including relatively weak international prices (even though there was a recovery in copper prices during the year), declining ore grades and poor weather conditions. Business services, a sector that includes architecture and engineering works, contracted by 1.8%. Heavy rains had a negative impact on the wine industry.

Reflecting this, investment spending fell by 5% year-on-year in Q416. Exports were down by 2.0% year on year in the same period (albeit fruit exports bucked this trend). There were some bright spots, including growth in personal services and the retail sector. Consumer spending slowed a little but remained an important force in the economy, growing by 1.1% in the fourth quarter.

The headline inflation rate fell to 2.7% in February. This, together with the more sluggish activity levels, has moved the central bank to cut the benchmark interest rate. The latest move was a 25bps cut to 3.0% in March. Analysts expect monetary policy to continue with an easing bias. An official statement from the bank said "if the recent economic scenario persists… it could be necessary to increase the monetary impulse."

Despite the more sombre outlook, Economy Minister Rodrigo Valdés has remained optimistic. In an interview with Bloomberg in late March, he commented, "look beyond GDP and you'll see that the economy is finally beginning to point upwards". He cited as positives increasing copper prices (which would help reduce the size of the fiscal deficit), lower interest rates, a stock exchange rally, and higher investment spending by public sector companies. He also pointed to a decision by the US retail giant Walmart to invest US$800m to open 60 new retail outlets as a sign that private sector sentiment was turning. The minister described the destruction caused by forest fires earlier this year and the Escondida strike as two negative shocks to the economy. Whether these would tip the country into a technical recession was still unclear, he said, but the important point was that these were one-off setbacks, and would fade in importance as 2017 progresses.

BRAZIL

Still uphill on the fiscal front

The government's long struggle to bring the fiscal accounts under control is far from over. On 29 March, Finance Minister Henrique Meirelles announced spending cuts of BRL42.1bn (US$13.6bn), designed to keep to this year's objective of limiting the primary fiscal deficit to not more than BRL139bn (US$45bn). The cuts were announced later than expected and were also larger than analysts had expected.

There were two main reasons for these larger-than-expected adjustments. One was that a government plan to re-calculate its debt – an accounting move that would have given it an additional BRL8.7bn to play with this financial year – had been delayed. The other was that the current government has to correct for its predecessor's generosity in doling out a wide range of payroll tax exemptions. The previous administration (led by the impeached former president Dilma Rousseff, 2011-2016), had granted these exemptions to companies operating across 56 economic sectors. Typically, instead of paying a 20% payroll tax for a range of social security contributions, the benefitting companies instead paid rates of only 2.5% or 4.5%.

Meirelles intends to roll back these exemptions (a process known as desoneração) in almost all cases, with the exception of public road and rail transport, civil engineering and the infrastructure and communications sectors. Doing this will require congressional approval. The restored rates of payroll contribution are expected to come into effect from mid-2017, meaning that they will boost revenues by BRL4.8bn (US$1.55bn) in the second half of this year. The finance minister continues under pressure to encourage economic recovery; he has been careful to argue that the removal of the payroll tax exemptions is not in itself a tax increase, although it will help raise revenue.

Meanwhile, various indicators continue sending mixed messages about the state of the economy. The government's primary deficit in February, of BRL23.5bn (US$7.6bn), was significantly larger than the BRL19bn (UD$6.15bn) that analysts had predicted. This was taken as a sign that tax revenue is lagging, because the economy is still not emerging from recession. Officials said that greater transfers to state level administrations and an increase in pension benefits were also a factor.

At the end of March, there was more disappointing news, with unemployment in the rolling three months to the end of February rising to 13.2%, up from 12.6% in the previous period to end-January. Meanwhile the central bank's IBC-Br activity indicator fell by 0.26% in January relative to the previous month. This too was more than the 0.1% contraction that market analysts had been predicting. Mario Mesquita, chief economist at Itaú Unibanco, made the point that unemployment is always one of the last things to start improving at the tail end of a recession.

A potentially major new threat to the recovery in March appeared to be receding as we went to press in early April. This was a scandal in the meat processing industry, triggered by a federal police investigation into allegations that health inspectors were being bribed to ignore the adulteration of meat products. In the immediate aftermath of the allegations, countries ranging from China to Chile announced partial or full restrictions on imports of Brazilian meat. Total meat exports are worth around US$8bn a year, or 0.5% of GDP, so there was a significant risk of serious economic losses, and perhaps more importantly, a risk of a yet another further blow to the still-fragile business and investor sentiment in the country. However, by late March it was clear that only a minority of Brazil's meat-packing plants were being investigated, and many importers began to lift the restrictions that they had earlier imposed.

Other factors may come into play supporting the long-awaited recovery. The outlook for foreign direct investment (FDI) was given a boost by news that three international groups had successfully bid a total of US$1.2bn to win four airport concessions. Fraport of Germany, Vinci of France, and Flughafen Zuerich of Switzerland between them won contracts to operate airports at Porto Alegre, Fortaleza, Salvador and Florianopolis. The new operators have also committed to a further US$2.12bn worth of investments during the 25-30-year concession terms. Meirelles' hope is that an inflow of foreign investment into public private partnerships (PPPs) in infrastructure will help stimulate the economy at a time when fiscal problems prevent the government itself from doing any serious pump-priming of its own.

Another potential positive is that Brazil's inflation rate is continuing to come down. The annual rate in the year to mid-March fell to 4.7%, the lowest in over six years, with lower food inflation playing a part. The Banco do Brasil has been cutting the benchmark Selic rate in steps of 25-75bps since October 2016, and looks likely to continue doing so. The central bank president, Ilan Goldfajn, said in an interview with Japan's Nikkei at the end of March that deeper rate cuts were an option that was being considered. Goldfajn added that manufacturing and agriculture would be the first to come out of recession, but "the service sector will take longer, because it was the last one to be affected".

MEXICO

Trump factor not as bad as feared?

Ever since Donald Trump won the US elections last November, there have been two rival scenarios for the Mexican economy in 2017. Under one, Trump's policies on trade and immigration will be an unmitigated disaster for Mexico, disrupting the second largest economy in Latin America and pushing it into recession. Under the other, they will not be as bad as feared. The Mexican economy will muddle through and might even do quite well. The outcome is still uncertain, but the probability of the "muddle through" option appears to be rising.

The official view in Mexico City is still that the Trump administration will be bad for the Mexican economy. The finance ministry has just cut its forecast for this year's real annual GDP growth down to a range of 1.3%-2.3%, from 2.0%-3.0% previously. In releasing the new forecast, it commented: "Although weakness in global growth has started to dissipate, uncertainty about the new US government's policy direction poses downside risks for the Mexican economy." Almost at the same time as the new finance ministry forecast, Mexico's central bank (Banxico) announced its fourth consecutive increase in the benchmark interest rate, taking it to 6.5%, its highest in eight years.

But there has also been good news. The IGAE index of global economic activity, a monthly GDP proxy, recorded a year-on-year increase of 3% in January, or 2.5% in seasonally adjusted terms, showing continuing strength in both manufacturing and agriculture. There was a stronger than expected trade performance in February, with a non-oil trade surplus of US$684m. Admittedly, capital goods imports weakened, suggesting, according to Alberto Ramos of Goldman Sachs, that there is weak investment spending momentum.

Perhaps most remarkably, the Mexican peso, which went into freefall after the US elections, has now bounced back. From MX$18.50/US$ on 8 November the peso plummeted to MX$22/US$ at its weakest point in January, but has since been steadily appreciating, reaching MX$18.70/US$ on 31 March. Part of this recovery reflects Banxico's tightening of interest rates, but it is hard to escape the conclusion that there has also been a recovery in confidence in the immediate future of the Mexican economy. Data from the Commodity Futures Trading Commission in late March indicates that traders have reduced the number of net short contracts against the peso to a level not seen since before the US election, indicating the scope for further peso appreciation in the near term

To complete this picture of resilience, there is also good news on the fiscal front. The finance ministry projects a primary fiscal surplus equivalent to 0.5% of GDP in 2017 – the first surplus of its kind since 2008. Fiscal austerity is still required – another spending cut equivalent to 0.2% of GDP is planned for 2018 – but the intensity of the adjustment is reducing.

All this may change, of course. There is still uncertainty over what the Trump administration will do, but the latest 'smoke signals' suggest that its policies may be less harmful than initially feared. A leaked copy of a draft letter to the US Congress suggests that the White House is not planning a complete overhaul or rejection of the North American Free Trade Agreement (NAFTA), as had initially been expected (or as the Trump election campaign rhetoric

suggested). Instead, the aim seems to be to allow for the use of temporary protective tariffs (known as a 'snap-back' provision) if there is evidence of damage to US industrial sectors. For the moment, there has been little further talk on the US side of a border adjustment tax. President Trump's political difficulties over healthcare and travel bans have also been reassuring for Mexico. Bill Adams, an analyst at PNC Financial Services Group, recently commented: "Financial markets seem to be betting that inertia will be as powerful a force in US trade policy as it is in US healthcare policy".

ARGENTINA

Debating poverty again

According to official data released by the national statistics institute (Indec), 30.3% of the population was living in poverty in the second half of 2016, down from 32.2% in the second quarter of the same year. The numbers could be read as good news for President Mauricio Macri, who proclaimed "zero tolerance" of poverty when he took office in December 2015 and who has argued that his policies are bringing the country out of recession. Yet the Indec poverty numbers have been a political football for some years now, and are likely to remain subject to varying interpretations.

The former government led by President Cristina Fernández (2007-2015) was notorious for its manipulation of Indec, which was obliged to produce 'good news' data, and leaned upon to stop publishing data considered inconvenient.

The last time Indec had published a poverty survey was in October 2013, when it claimed that only 4.7% of Argentines lived in poverty. No further surveys were carried out in that government term, but the 4.7% figure was used by President Fernández to claim during a June 2015 visit to the UN's Food and Agriculture Organisation (FAO) headquarters in Rome, Italy, that poverty rates in Argentina were lower than those in either Germany or Denmark. The claim was widely ridiculed and dismissed as unbelievable. Shortly thereafter, in July 2015, a private survey carried out by the Universidad Católica Argentina (UCA) put the poverty rate in Argentina at 28.7%. After the Macri administration took office in December of that year, a major effort was made to rebuild Indec as an impartial and credible statistical agency. Indec relaunched the regular poverty survey last year. It now defines poverty as a situation in which households have insufficient income to afford a basket of basic food and non-food items – currently costing the equivalent of around US$800 a month for a family of four.

While the Macri government can claim to be more in touch with reality than its predecessor, it cannot entirely escape criticism over the poverty numbers. Indec's rebuilt poverty index shows a short-term falling trend, but only over two very recent measurement points. The UCA, by contrast, shows an upward trend. It has continued carrying out its own separate survey, which is now the only methodologically-consistent series that covers the last few years. This shows that poverty has gradually and steadily been increasing, reaching 32.9% in Q316 (above the Indec number). On UCA's measurement, a total of 13m Argentine are now living in poverty. UCA said that the Q316 poverty rate was 3.9 percentage points higher than at the end of 2015, and the highest level in the last seven years. High inflation during Macri's first year in office, along with sharp increases in public utility tariffs, have taken a toll.

The UCA data also suggests that inequality is increasing, with the gap between the richest and poorest 10% widening. According to Augustín Salvia, one of those responsible for the UCA survey of 5,700 homes, "A large part of the Argentine population is excluded. Something more than economic growth is required. Social programmes are not enough to guarantee a platform of lasting inclusion". His view is that in reality poverty and indigence numbers have been stagnant in Argentina over the last decade – in effect, a criticism of all governments. To tackle them, long term national and regional development policies would be needed, together with steps to increase productivity in small and medium-sized firms, he says.

REGION

Poll finds Venezuelan support for dollarisation, but Ecuador serves a cautionary tale.

Venezuela's local currency, the Bolívar Fuerte, appears to be at the point of total collapse. There are some calls for dollarisation as part of an eventual orthodox economic adjustment in the country, but conditions in Venezuela may not be appropriate.

In its latest (March) Venezuela country survey, the private regional market research firm Datincorp found that almost two thirds of Venezuelans (62%) would support dollarisation of the country, replacing the current national legal tender, the Bolívar Fuerte, with the US currency.

Notably, among those respondents most supportive of dollarisation were the C, D and E social classes (corresponding to middle-low to low earners), where support was at 45%-46%. These are those sectors most battered by the high double digit monthly inflation in the country. These low-income sectors are also, supposedly, the main support base of the left-wing Bolivarian Revolution, which is dogmatically opposed to dollarisation, arguing that it serves as a tool of control for the 'imperial' US.

In the higher-income A-B Venezuelan classes, by contrast, support for dollarisation was just 9%. These sectors already have US dollar accounts abroad, and travel frequently to havens like Miami. As such, they may feel the need for dollarisation. And with access to dollars in Venezuela, their lives are not particularly affected by inflation. By age group meanwhile, 29% of 18-30 year olds, 44% of 31-50 year olds and 28% of those aged over 51 backed dollarisation, while the gender split was 50%-49% for men and women.

The national assembly's finance commission put inflation at 42.5% in the first two months of the year alone, the highest recorded price increases for the period since inflation data began to be compiled in 1945. On that basis, the commission projects inflation of 679.7% by year-end 2017. The main cause of inflation, soaring money supply, shows no sign of diminishing, as the central bank (BCV) prints local currency hand over foot to finance the cash-strapped Maduro government.

The BCV, which appeared to stop releasing money supply data earlier in the year, has now put up some fresh data on its website, according to which the total amount of local currency in circulation – M2 – was 13.3 trillion bolivars as of 24 March, up a startling 202.9% year on year. That is the fastest rise in money supply since records began in 1940, according to local media. Money supply in the US in the same period rose by 6.4%, as newswire *Reuters* pointed out.

Given this situation, it is little wonder that the poorest Venezuelans see dollarisation as a solution. The US currency, long seen as a safe haven at times of economic crises in Latin American countries, is desperately sought in Venezuela as a means of survival, and has long been used hand-in-hand with the local currency. According to websites that publish the nominally illegal but widely used black market exchange rate, it was trading at BF4,201.6/US$ as of 6 April, whereas the secondary (officially floating) Dipro (or Simadi) rate, was priced at BF710.6/US$. In other words, the parallel rate was trading at six times the official market rate.

The main advantage of dollarising a country in economic crisis it that it razes inflation and restores stability almost immediately, allowing the local economy to get back on its feet, and the government, consumers and investors to plan ahead. In a column for the daily *El Nacional*, however, the local economist Pedro Palma uses Ecuador as a reason to suggest that dollarisation is not a panacea. He identifies several reasons for this.

Venezuela, like Ecuador, is heavily reliant on oil exports (albeit Ecuador is less so than Venezuela). The country dollarised in 2000, in response to a systemic banking crisis. It restored stability to the economy, and since then has had broad popular support.

The fall in global oil prices since mid 2014 has seriously hurt the Ecuadorean economy, with a steep decline in dollar earnings, creating a severe liquidity problem. The response of the left-wing government led by President Rafael Correa was to attempt to maintain (and even increase) its high public spending levels and continue with planned capital investment schemes, so as to cushion the economy. To do this, however, it was obliged to contract expensive, short-term debt (following a default in 2008, Ecuador finally returned to international capital markets in June 2014, but at a price). Yet despite these efforts, private consumption, the mainstay of the economy, gradually fell away. And without liquidity, or much domestic demand, private sector activity ground to a halt. As the global oil price shock continued into 2015-2016, the country tipped into a technical recession, which it has since struggled to climb out of.

Another important downside of dollarisation for Ecuador is that it has made its non-oil exports very uncompetitive in global markets (including in its main traditional markets in neighbouring Peru and Colombia), thereby preventing the country from diversifying its economic base, and entrenching its reliance on oil.

And with US dollar appreciation in the past few years encouraging imports, domestic production has also suffered. To address this and more importantly to safeguard liquidity, the Correa government in early 2015 imposed temporary import safeguards (which ultimately further weighed down the domestic economy).

Finally, with interest rates effectively set externally (by the US Federal Reserve), the Quito government is unable to use monetary policy to stimulate (or cool) the domestic economy as needed. It therefore has to rely almost exclusively on fiscal policy as its main policy lever to guide the economy, which, as is now evident in Ecuador, can be very costly. The new govern-

ment due to take over in May from the outgoing 10-year old Correa administration faces a very difficult scenario, with a fiscal 'reckoning' in the form of a public spending adjustment inevitably on the cards, even as the oil sector remains in the doldrums, making for a very complicated situation.

No dollars for anyone

According to the respected Venezuelan consultancy Ecoanalítca, less and less currency is being made available to local importers, evidencing the Caracas government's efforts to hoard dollars for upcoming external debt payment obligations. (The state oil company, Pdvsa, owes US$2.2bn in bond payments in April alone.)

Ecoanalítca estimates that just US$6.9m in foreign currency was made available to the private sector for imports in March, down by 38% from the US$11.2m processed in February. The central bank of Venezuela allocates US dollars using the two official exchange rates. The Dipro rate, set at B$10/US$, is used exclusively for essential imports of food and medicines, and the complementary Dicom market rate, trading at over B$70/US$ in early April, which is used for all other imports. Ecoanalítca calculates that just US$4.2m was allocated to the private sector at the Dicom rate in March, with US$2.7m allocated for essential goods at the Dipro rate (the State now effectively monopolises essential goods imports). Currency allocation is at its lowest level since 2009, Ecoanalítca's Asdrúbal Oliveros says, noting the fact that in June 2014, before the oil price shock, allocations for the private sector were running at US$160m per day. Ecoanalítca calculates that Venezuela's total imports fell by 29% in the first two months of 2017 (with public sector imports down 16% and private sector purchases down 10%).

PERU

Flooded with bad news

Peru's much anticipated recovery under the liberal economic new government led by the investment-banker turned president Pedro Pablo Kuczynski has failed to materialise. The minority and politically-novice Kuczynski administration got off to very slow start after taking office in late July last year, bitterly disappointing (admittedly-high) local private sector and foreign investor expectations. The country was then hit by two successive major shocks. The first of these was the Odebrecht bribery scandal, which has implicated the last three governments and prompted extreme investor nervousness. The second relates to the unprecedented heavy rains in northern coastal zones of the country starting in December last. Now in their fifth month, the rains, which have spread down as far as Lima province, have caused over US$3bn in flood and landslide damages, on latest government estimates, and destroyed infrastructure in half of the country's regions.

Interviewed at the presidential palace by the financial newswire *Bloomberg* in early April, Kuczynski admitted that the floods, the worst in two decades, would mean lower economic growth this year. Initially, the government had forecast a real GDP growth rate of 4.8% this year (from 3.9% in 2016), but now, in the wake of the Odebrecht scandal and the floods disaster, the president said that the government had reduced its forecast to a range of just 3%-3.5% this year, before rebounding in 2018 to about 4%-5%. Speaking on 4 April, Economy Minister Alfredo Thorne said that first quarter GDP results looked "fairly weak", at about 2% at best.

Thorne noted that this year's El Niño Costero (a coastal version of the larger El Niño Pacific Ocean climatic phenomenon) had been weaker than those registered in Peru in 1983 and 1998. However, the destruction this time round was much more dramatic, not least because of the rapid economic growth in Peru in the last decade, including rapid and typically unplanned urbanisation, with the accompanying informal development of local infrastructure and services, much of which simply collapsed and washed away under the force of the flood water and landslides.

The extension of damage, Thorne said, reflected the fact that the Peruvian economy is about 10 times its size back in 1982-1983. As such, this year's El Niño Costero destroyed 242 bridges, whereas in the 1982-1983 emergency, 47 bridges were lost. Likewise, 198,000 homes have been lost to date in 2017, compared to 111,000 in 1997-1998 and 94,000 in 1992-1993. Other reports, including the latest (31 March) update from the Centro de Operaciones de Emergencia Nacional (Coen), estimated that just over 205,000 homes have been lost. On Coen data, almost one million people in all in Peru have now been affected by the emergency (950,498), with 101 deaths to end-March.

On the other hand, Thorne noted, while 2,629km of roads have been destroyed to date this year, in the 1982-1983 floods, which were very severe, 2,600kms were lost. And in terms of cultivated areas, the losses will be smaller this year, he noted, albeit the country's agricultural sector questions this (*see sidebar*). Thorne tried to minimise the concerns about the economic impact, emphasising that increased public spending would help the economy back on its feet in the second half of this year. Like the president, he insisted that 2018 would see a much better result.

Steep agricultural losses

According to Héctor Carrasco, president of the Convención Nacional del Agro Peruano (Conveagro) and the Sociedad Peruana de Criadores de Alpacas y Llamas, estimated flood losses in the farming and livestock sector to date amount to some PEN2.1bn (US$640m). He noted that over 90,000 hectares of banana, cane, rice and other grains have either been destroyed or could not be harvested. Carrasco said that the government's promised emergency payment for farmers of PEN1,000 per hectare (about US$308) was "insufficient". The supply losses will keep food price inflation in Lima and elsewhere elevated until at least the third quarter, private economists estimate.

With 15,000 people forced out of their homes, the government's immediate priority is to ensure adequate shelter for these people. Thorne has already pledged at least US$741m for reconstruction works. Kuczynski insisted that funds for the emergency and repair effort were not a problem, saying that the government would dip into its "substantial savings", as well as taking on additional loans, to finance the reconstruction effort. Thanks to fairly prudent financial management over successive governments, Peru has room for fiscal manoeuvre. The government could draw on the fiscal stabilisation fund (Fondo de Estabilización Fiscal, FEF), or alternatively (and perhaps preferably), on its contingency reserve, which holds about US$1bn. The government will also be eligible for preferential multilateral funds for reconstruction from the likes of the Inter-American Development Bank (IBD), the World Bank and the CAF-Development Bank of Latin America, which will also lend important technical support.

Kuczynski said he expected the budget deficit to increase by about 0.5% of GDP this year on the back of the reconstruction effort, potentially taking it to 3%, above the initially-targeted 2.5%. However, he stressed that he did not expect the public debt burden to exceed 24%-25% of GDP.

On 26 March, the central bank (BCRP) revised its growth and inflation forecasts for the year. The BCRP president, Julio Velarde, reported March inflation of 3.97%, up from 3.25% in February, due to a temporary price shock related to the flood emergency, which has severely disrupted supplies, including in the capital Lima (home to a third of the population). Velarde said the spike was transitory, and would subside. Nonetheless, the BCRP has increased its 2017 inflation forecast by one percentage point to 2.4%. Even so,

this is still within the BCRP's target range of 1%-3%, and is "still one of the lowest in the region", he noted. Reflecting the inflation spike, the BCRP subsequently left the benchmark interest rates unchanged at 4.25%, where it has been for a year now. There had been hopes for interest rate reductions in support of investment this year, but that will now be delayed until inflation re-stabilises, which could take some months. The BCRP has revised down its real GDP forecast from 4.3% to 3.5%.

A local economic consultancy, Maximixe, has estimated the total flood damages to date at US$5bn, above that of another consultancy Macroconsult, which put it at just over US$3bn, similar to the government's estimate. Maximixe calculated the damages in the northern region of Piura alone at US$1.7bn, putting the costs in Lima province at US$1.2bn and in the rest of the country at US$2.4bn. Still others put it higher again at US$6bn, which would be 3% of GDP.

Cited by the business daily *Gestión*, economist Carlos Casas of the Universidad del Pacífico (UP) noted that these damages should be understood as disinvestment, or negative investment, on the basis that the reconstruction effort, which could last 3-4 years, is effectively an effort to rebuild capital stock that existed as of December 2015. In that sense, the disaster will damage the economy's growth capacity over an extended period, as it has lost vital inputs. Nevertheless, Casas agreed with the Thorne that the reconstruction effort would positively contribute to aggregate demand, amid increased public demand in infrastructure, with a boost to the private sector from the need for housing.

Macroconsult has now lowered its 2017 GDP forecast from 3.5% to just 2.9%, while Maximixe has cut its forecast from 3.8% a 3.1%, but with downside risk to a low of 2.45 should the rains extend out to May.

Ratings agency Moody's Investors Service is less pessimistic, maintaining its 2017 growth forecast of 3.7%, with upside risk to 4% on the basis of the government's planned fiscal stimulus. Also taking a positive view, the chief economist of BBVA Research, Francisco Grippa, emphasised that would be a 'natural rebound from Q1 2018, as those sectors affected by the rains bounce back.

REGION

Women's labour participation in Latin America

Marking International Women's Day on 8 March, the UN's Economic Commission for Latin America and the Caribbean (ECLAC) noted a plateau in the participation of women in the labour market in Latin America, with a lot of women stuck in low productivity sectors. ECLAC called for the creation of quality jobs that recognise women's abilities, levels of instruction and productivity.

According to a report by ECLAC's Gender Equality Observatory[1], while regional labour market indicators have demonstrated a positive trend over the past decade, the labour participation rate for women has stagnated at around 53%, while over three quarters of women who are employed (78.1%) work in what ECLAC defines as 'low productivity sectors', where the pay is worse, social security coverage is low, and there is less exposure to technology and innovation. Likewise, women's unemployment rates are

systematically higher than those of men. According to the Gender Equality Observatory, these employment inequalities "are based on a social system that reproduces stereotypes and maintains a sexual division of labour which limits the participation of women into the labour force".

Between 2002 and 2013 for example, the unemployment rate in Latin America cumulatively fell by 2.8 percentage points, but beginning in 2015, that trend began to reverse. Regional unemployment in 2015 was put at 7.4%. For women however, the unemployment rate was a higher than average 8.6%, whilst for men it was lower at 6.6%. Based on preliminary data for 2016, average regional unemployment rose again to 9.0%, an increase of 4.1m people. Again, women were more affected, with the female unemployment rate increasing by an estimated 0.7 percentage points last year, whereas for men the increase was a lower 0.3 points.

In a press release to mark Women' Day, ECLAC's executive secretary, Alicia Bárcena, noted that labour indicators for the region "continue to show large gender gaps between men and women with regard to access to opportunities and rights", which she also related to the aforementioned systemic social inequalities. These structural factors, she continued, "pose an obstacle to overcoming poverty and inequality in the region, as well as to women's attainment of economic autonomy – even more so if one considers the current context of economic contraction".

ECLAC also notes that while the unemployment rates for women and men do vary depending on the country, the gender gap is always favourable to men, with the exception of Mexico, where male unemployment slightly exceeds that of women (by 0.1 percentage points). However, in other countries in the region like Belize and Jamaica, the gender gap is in excess of seven percentage points, it stressed.

As in most economic and social indicator studies, poor women suffer the most. According to ELAC, in the first quintile in 2013, 14.9% of women were unemployed (compared with 10.5% of men). In the third quintile, female unemployment was at 7% with male unemployment at 4.9%, while in the highest-income quintile these percentages fall to 3% and 2.5%, respectively.

For ECLAC, employment policies "should be capable of modifying the current structure of inequality, confronting the existing gender bias in the labour market". It also calls for "the recognition and redistribution of time spent on unpaid labour", so that the responsibility of caring for children, dependent persons and older adults does not fall exclusively on women.

PANAMA

IMF positive a year on from the Panama Papers

On 17 March, the International Monetary Fund (IMF) released a positive concluding statement following its recent mission to Panama, but stressed the need for continued progress towards financial integrity. The country's growth model, it noted, relies on its ability to remain a competitive and attractive destination for international financial, business, and transportation services. Continued progress with tax transparency and financial integrity are essential to preserve this model, it emphasised.

The Fund noted that the Panamanian economy is expected to remain among the most dynamic in the region. The economic outlook is favourable, albeit set against the backdrop of heightened external uncertainty, it noted. The government's commitment to fiscal discipline and "its efforts to strengthen the fiscal framework and enhance institutional capacities contribute to ensuring sustainability, and need to be complemented by a comprehensive monitoring of fiscal risks", it advised. "As a regional financial centre, the comprehensive monitoring of systemic risks and a strong macro prudential and crisis management framework are important to safeguard financial stability".

The IMF expects economic growth of 5.1% in 2017 and about 5.5% over the medium term, supported by the expanded Panama Canal and the wide range of investment projects currently in the pipeline. The 5.1% forecast for this year is considerably less than the 5.9% forecast by the UN's Economic Commission for Latin America & the Caribbean (Eclac), which has calculated preliminary growth of 5.2% for 2016. Notably, the Fund expects an increase in inflation to about 2% in 2017, from just 0.7% in 2016, as fuel prices continue to normalise and economic activity strengthens somewhat.

Fiscal consolidation is slated to continue, in line with the Social Fiscal Responsibility Law (SFRL) deficit targets, implying a gradual reduction of the non-financial public sector (NFPS) deficit over the medium term and allowing NFPS debt to fall as a % of GDP. Meanwhile, the current account deficit is projected to narrow to about 3% of GDP over the medium term, "driven by a diversification of exports into primary commodities". This deficit will be financed by broad-based foreign direct investment, the statement observes.

Risks

The IMF identifies as "key risks" factors relating to the external environment and also the extent of Panama's progress in strengthening tax transparency and measures in support of anti-money laundering and combatting the financing of terrorism (AML/CFT). It notes that the authorities completed several important policy actions over the past year. These included the commitment to implementing the automatic exchange of tax information by 2018; ratification of the Organisation for Economic Co-operation and Development (OECD)'s Multilateral Convention on Tax Matters; and the adoption of key pieces of domestic legislation that form the legal basis for the automatic exchange of tax information, a strengthening of the revenue administration's powers, and reinforcement of the accounting requirements for companies and foundations registered in Panama.

The Fund notes that to "obtain a positive assessment under the [OECD's] Global Forum's fast-track procedure in mid-2017, it is essential to address the remaining deficiencies, including strengthening the revenue administration's human, procedural, and [information and communication technology] ICT capacities to ensure the effective exchange of tax information".

REGION

Mercosur-EU deal – still uncertain

Ahead of a new round of talks with the European Union (EU), foreign ministers from the Southern Common Market (Mercosur) – excluding Venezuela – met in Argentina on 9 March to discuss the ambition to finally close the long-awaited Mercosur-EU free trade by the end of this year.

The ministers from Argentina, Brazil, Paraguay and Uruguay expressed optimism about sealing a deal, in the pipeline for almost two decades now. They stressed the need to boost trade at a time when economic protectionism appears to be on the rise. "In a world with many uncertainties, the government has one certainty: being closed off to the world has not brought us good results", remarked Argentina's foreign minister, Susana Malcorra. She added that for Mercosur "it is necessary to be open to opportunities and to react quickly".

Mercosur's current pro-trade stance chimes with the EU's outward-looking approach. In a meeting on 10 March, the president of the European Council (EC), Donald Tusk, told the council that Europe was "very committed to international trade" despite "protectionist sentiments reappearing". However, Mercosur's timeline for closing a deal with the EU this year could be overly ambitious. This year will be a busy one for the EU, which is also analysing negotiating trade deals with Mexico and Japan. Furthermore, the EU is also preoccupied with the UK's exit the bloc ('Brexit'), as well as with important elections in France This means that it might be "too soon" to anticipate a final EU-Mercosur agreement and, moreover, there still are "many areas that require further negotiation", an EU official told the Spanish daily *El País*.

The Mercosur-EU talks first began back in 1999, but have subsequently been on-off. After a lengthy period on ice, talks finally resumed in 2015, with a formal exchange of offers in May 2016. Talks on the agriculture chapter have probably been the most difficult over the years, with Argentina and Brazil demanding that the EU to reduce its restrictive tariffs on beef and other meat imports. Led by France, and backed by the likes of Ireland and Poland, the powerful EU agriculture lobby resisted for years. And it is not clear if these sticking points can be fully resolved, as EU farmers continue to resist.

Meanwhile, in a blow to Brazil, the EU ordered a temporary ban on Brazilian meat products on 21 March, amid concerns about health and safety standards, prompted by scandal in Brazil's food processing export industry. The incident was dealt with fairly rapidly by the Brazilian authorities, resulting in a gradual removal of the bans imposed by Europe, China, Russia and elsewhere, nonetheless it reinforced the fact that any future trade deal will also have to include a "chapter on regulatory requirements and food safety standards for agriculture imports", a delegate from the European Commission stressed.

On 3April, the EU Commissioner for Agriculture and Rural Development, Phil Hogan, said that Brazil's food scandal should have no bearing on the EU-Mercosur talks. Hogan stressed that the Brazilian scandal was "a separate issue". "It affects Brazil. It doesn't affect all of the other Mercosur countries, so it would be quite unfair to link them", he stated.

Nonetheless, Hogan, himself Irish, signalled that a final deal with Mercosur was some way off, and that the EU was in no hurry to dance to Mercosur's more urgent tune at this stage. "They've been quite slow, and so there is no reason to be concerned that we are going to come to a speedy resolution – unless there is a considerable lowering of ambitions on the part of the Mercosur countries" he concluded, in comments relayed by European media.

URUGUAY

Getting closer with China

It may seem improbable – a free trade agreement (FTA) between giant China (the world's second largest economy with a population of 1.38bn people) and Uruguay (ranked 77th by GDP with a population of just under 3.5m). But officially, at least, discussions seem to be moving forward. Uruguay's President Tabaré Vázquez, who visited China in October last year, says that the plan remains to finalise a bilateral FTA by the end of 2018. There are still a number of obstacles facing the deal, however.

In March, China's ambassador to Uruguay, Dong Xiaojun, said there would soon be news on the proposed bilateral FTA. "We have the pleasure of being Uruguay's main trade partner since 2012" he told newspaper *La República*, noting that "trade with China represents up to one-third of Uruguay's total trade flows. Both sides are interested in an FTA. It is a big step for both countries and we are ready to take it". Discussions on an agreement date were triggered with President Vázquez's visit to Beijing in October 2016, when both sides said they would aim to complete a deal within two years. Uruguay exported US$1.094bn worth of goods to China in 2016, 15.6% of its total exports, while its imports from China were valued at US$1.142bn, accounting for 15.2% of its total merchandise imports (bilateral trade values are higher if services are included).

While formally speaking, things may be progressing, there are a number of obstacles that will be in play. Chief among these is that Uruguay, along with Argentina, Brazil, and Paraguay, is a member of the Southern Common Market (Mercosur), and Mercosur rules prevent any individual member negotiating an FTA with a third country independently. However, one member can be authorised by the others to do so. Uruguay was previously allowed to negotiate its own FTA with Mexico. Last year, it appeared that the necessary authorisations for a Uruguay-China deal would be forthcoming. President Mauricio Macri of Argentina said he had no objections to his neighbour's talks with China, which he said were "very encouraging" – although he said he would prefer Argentina to be included. In late October, Vázquez said that none of Uruguay's partners had raised any objections. Despite that, some analysts believe that Brazil in particular may have objections and could have second thoughts.

A lot will depend on the exact terms of the deal. Broadly, economists believe that an FTA would boost Uruguay's agricultural and livestock exports to China, but could potentially harm the local manufacturing sector. A report written for the Uruguayan parliament's international affairs commission warns that Uruguay could be "flooded" with cheap manufactures made in China. Uruguay's *El País* newspaper says that one research paper written for the Montevideo government suggests up to 35,000 jobs could be lost in the manufacturing sector.

Economist Marcel Vaillant argues that the impact will be less severe. He notes that Uruguay has already been opening up to the global economy since the 1990s and that patterns of production employment have shifted accordingly.

For example, manufactured goods with a strong component of domestically-supplied agricultural and livestock inputs have tended to hold their own, because they have a degree of comparative advantage. By contrast, there have been job losses and an increased reliance on imports for other types of manufactures, where Uruguay had little ability to compete with external offers in the globalised marketplace.

Vaillant notes that because of Uruguay's preferential trading relations with its Mercosur partners, Argentina and Brazil have largely supplied these other types of manufactures to date. Signing an FTA with China therefore, might mean that Uruguay imports less manufactures from its Mercosur partners, replacing them with more competitive Chinese products. This would be a net gain for Uruguay, but a net trade loss for its Mercosur neighbours.

So, it is foreseeable that Argentina and Brazil may yet object to the FTC. They will also be concerned to prevent Uruguay being used as "way in" to their markets for low-priced Chinese goods.

Cheese and Videogames

It is hard for a small economy like Uruguay to be competitive in international trade. But a new report by the World Bank suggests a way forward: finding a niche role in international value-added production chains. "The fact that global production chains are fragmenting allows a small country like Uruguay to specialise and become competitive in some links in the chain without having to be responsible for the whole process, thereby gaining productivity and increasing quality employment" said Alberto Criscuolo, one of the report authors.

The report looks at how this can work in a traditional sector – the dairy industry – and in a new area, information and communications technology (ICT). In the dairy sector, it suggests that Uruguay can further increase exports by developing more specialised products (both perishable and non-perishable) including powdered milk and butter, cheddar and artisanal cheeses. Uruguay started early developing its ITC industry and is a significant player in some areas like video-games and animation: tech exports are running at around US$90m a year. The report says there is further potential for growth here too, and that the government should support it by building connectivity and logistics, and taking steps to reduce transaction costs.

REGION

Tax ratios growing, but still skewed

Tax revenue in Latin America and the Caribbean (LAC) is still low as a proportion of GDP, although the countries in the region are slowly catching up with the more developed economies of the Organisation of Economic Cooperation and Development (OECD). As a rule, LAC countries tend to be over-reliant on indirect taxes, such as value added tax (VAT) or other sales taxes; they also tend to be under-reliant on personal income tax.

Determining the 'correct' level of taxes for Latin America and the Caribbean is open to much debate and contention, and typically depends on economists' views about the ideal relative sizes of the public and private sectors in any given country. Once that ratio is established, it is also necessary to seek a

'correct' level of revenue (equal to or in excess of expenditure), so as to achieve medium or long-term fiscal equilibrium and give governments the flexibility to respond to economic shocks.

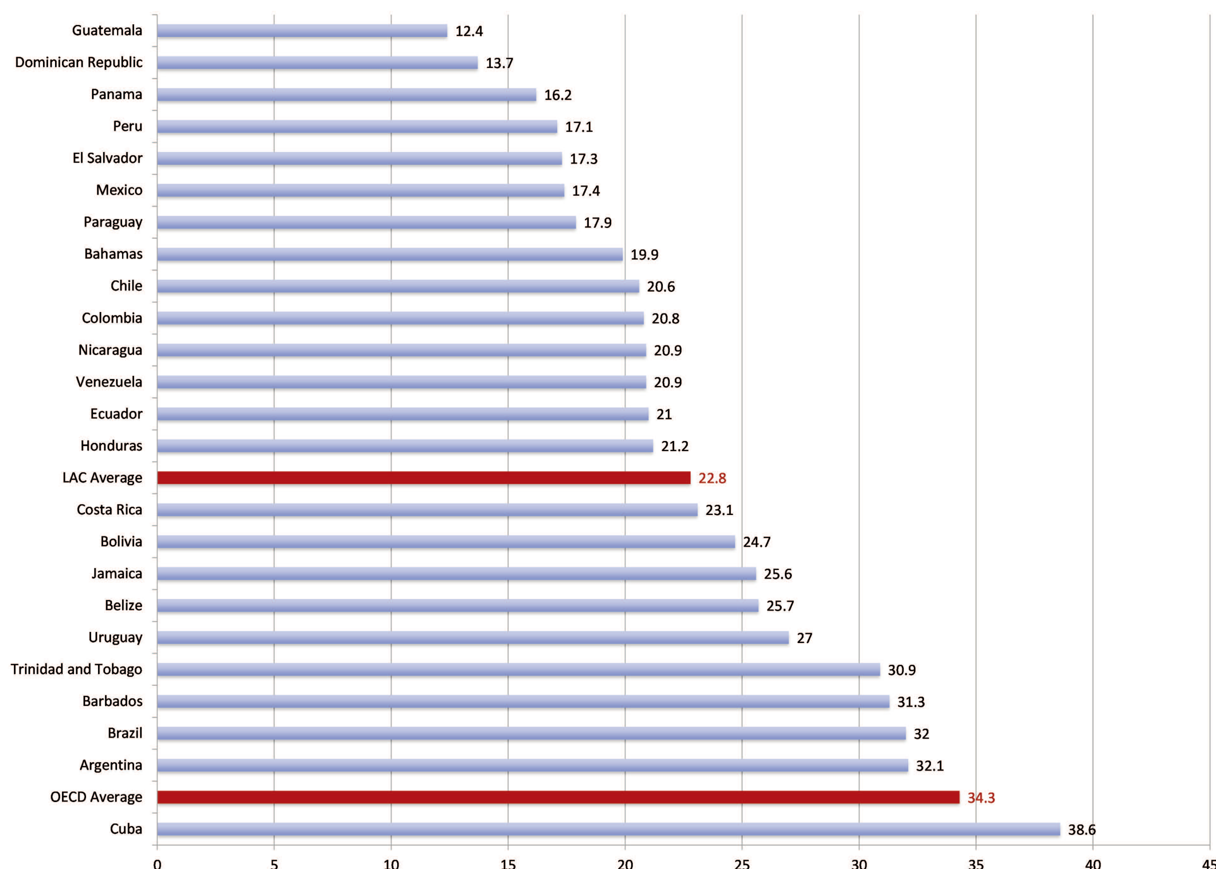
A good starting point is to determine current fiscal income levels in the region. One very useful source to this end is the annual '*Revenue Statistics in Latin America and the Caribbean*', published jointly by a range of institutions, including the UN Economic Commission for Latin America and the Caribbean (ECLAC), the Inter-American Development Bank (IDB), the Inter-American Centre of Tax Administrations (CIAT), and the OECD,

The latest report, released in March, contains detailed statistics up to and including 2015. Its first major finding is that while LAC tax revenues are still comparatively low compared to those in the more developed economies, they are slowly catching up.

The average tax-to-GDP ratio in LAC in 2015 was 22.8%, up from 22.2% in 2014. This was still more than ten percentage points lower than the OECD average in 2015, which stood at 34.3%. The LAC-OECD gap has been narrowing, however. It has fallen every year since 1990, with the exception of the global financial crisis years of 2008 and 2009. In 1990, for example, the LAC's tax-to-GDP ratio was 15.8%.

The main explanation for the continuing difference between the OECD and LAC is that the LAC countries still collect a lot less in personal income tax and social security contributions. The former is a function of generous personal allowances, sometimes-ineffective tax administrations, and high levels of personal tax evasion. The latter reflects the fact that large proportions of LAC workers are informal, paying no payroll taxes – but also receiving few or no social benefits.

Tax-to-GDP ratios (total tax revenue as % of GDP), 2015



Another salient point is that there is a wide disparity of tax ratios throughout the region. At the high end, perhaps appropriately for a socialist economy, Cuba had a tax-to-GDP ratio of 38.6% in 2015, making it the only country in the region with a rate higher than the OECD average. Other comparatively high tax burdens were found in Argentina (32.1% of GDP), Brazil (32.0%), Barbados (31.3%) and Uruguay (27.0%). At the low end sat Guatemala (12.4% of GDP), the Dominican Republic (13.7%), Panama (16.2%) and Peru (17.1%).

LAC countries appear to rely more heavily on those taxes that are easier to collect. They tend to depend more on Value-Added Tax (VAT), for example, which is regressive (it has a greater impact on poorer people). Indirect taxes provided almost half of total LAC tax revenue (49%), compared to an average of one third (33%) in the OECD. Equally, LAC countries rely much less on personal income taxes, which are more progressive (their impact is greater on the rich than on the poor). In 2015, on average, personal income tax accounted for 8.8% of LAC tax revenues, compared to 24% in the OECD. In fact, the overall rise in tax revenues as a proportion of GDP achieved in 2015 – totalling 0.6 percentage points – was largely due to a 0.5 percentage point surge in VAT receipts. This, combined with smaller increases in social security and personal taxes, was enough to offset a 0.2 percentage point fall in corporate income tax revenues.

The latest report also notes that there are variations in the way VAT is collected. For the first time, it has compiled VAT revenue ratio (VRR) tables, which measure actual as a proportion of maximum potential revenues from the tax. A VRR of 100% implies that there is no loss of revenue from exemptions, reduced rates, fraud, evasion, or tax planning.

Jamaica (25%) and Mexico (32%) had low VRRs, while Bolivia (101%) and Paraguay (93%) had high VRRs. This is because in the first two countries there are very extensive VAT exemptions. Bolivia and Paraguay, on the other hand, have few exemptions, and have invested in efforts to reduce VAT evasion (although there is a suggestion that their VRRs may be overstated because of under-reporting of the informal sector in these economies).

A number of countries in the region have suffered a loss of tax revenues because of the end of the recent global commodities boom, and an associated fall in royalties and other taxes levied on their dominant extractive industries. According to the report, hydrocarbons-related public revenues in 10 selected countries in the region fell from 6.8% of GDP in 2014 to 4.4% in 2015, and further dropped to an estimated 2.6% of GDP in 2016. Mining revenues, on the other hand, dropped from 0.5% of GDP in 2014 to 0.4% in 2015, and to just 0.3% in 2016 (estimated).

The report also analyses the tax performance of sub-national governments in nine countries (essentially provincial or state authorities), with a special focus on the relative tax autonomy enjoyed by these entities in Argentina, Brazil, Chile and Mexico. As a rule, sub-national local governments were found to raise revenues mainly from recurrent taxes on property, consumption, local businesses and motor vehicle licensing. Payroll taxes were of particular importance to Mexican states, amounting to around 40% of their total receipts. Local governments were found to have a high degree of tax autonomy in Argentina, Brazil and Mexico, but not so in Chile, where almost 60% of revenues depended on tax sharing agreements with central government.

Bárcena renews call for fiscal responsibility

Alicia Bárcena, ECLAC's executive secretary, reiterated her call for fiscal responsibility at the 29th Regional Seminar on Fiscal Policy, held in Santiago, Chile, in late March. "In addition to the complex external scenario, the region is facing such structural problems as falling public and private investment, stagnated productivity, persistent inequality, low tax revenues and the poverty that still affects 175m people in Latin America and the Caribbean" she said. She went on to stress that governments seeking to get their economies back onto a more accelerated growth track are facing additional pressures on their fiscal policies. A new ECLAC report, '*Fiscal Panorama of Latin American and Caribbean 2017* was also launched at the seminar. This estimates that the average fiscal deficit in Latin America remained stable at around 3% of GDP in 2016, as countries in the north of the region narrowed their deficits to an average of -2.2% of GDP, while those in the south saw their average deficits widen to -4.0% of GDP. The report called for "careful stewardship of social spending and public investment" in the short term, with a medium and longer term emphasis on reducing tax evasion and avoidance, currently estimated at 6.7% of regional GDP, or US$340bn, and emphasised the need to shift towards a greater reliance on direct taxation.

REGION

Megacity growing pains

Latin America's largest cities continue to grow, a process that creates economic opportunities, but also a wide range of stresses and strains. At a public forum held in late March in Buenos Aires, the mayors of Miami and Buenos Aires, along with the head of government of Mexico City, explained some of the challenges they face.

Horacio Rodríguez Larreta (Buenos Aires), Miguel Angel Mancera (Mexico City) and Tomás Regalado (Miami) started out by recounting similar stories to those attending a forum on 29 March – 'Latin American cities facing global challenges' – organised by the Spanish newspaper *El País*. All three noted a major influx of people into their cities over several decades. These waves of newcomers overflowed, in a largely unplanned manner, across geographic and institutional boundaries. Rodríguez Larreta noted that 'sideways' population growth had created a vast urban sprawl pushing out beyond the formal boundaries of Buenos Aires city and spreading into large areas of Buenos Aires province (the metropolis as a whole is known as Greater Buenos Aires, and now has around 13m inhabitants).

One of the implications of this is that the city for which he is responsible sees its population double every morning, as hundreds of thousands of people commute in to work. It then falls again in the evening as they return to their homes in Greater Buenos Aires. This daily ebb and flow plays havoc with institutions and services designed with a more static population in mind. The mayor noted that up to 70% of patients in the city's hospitals, and many of the students in its schools, live in the province.

Miguel Angel Mancera had a similar story but with bigger numbers. Considered in the past to be no more than an administrative unit of the federal government, Mexico City now has the same level of autonomy and self-government as the country's States, complete with its own constitu-

tion. The city's GDP is growing at around 4.2% per annum, double the rate of the country as a whole.

Mancera says his challenge is not just to meet the formal obligation to provide services for 9mninhabitants, but also to cope with the "reality" of the needs of a further 17m, spread out over neighbouring states. Regalado described Miami, with a population of under 3m, as "the Latin American city that is closest to the United States." It too has experienced a major population influx, largely composed of immigrants. The latest census showed that 62% of its current inhabitants were born outside the US. Because the sea has prevented sideways expansion, Regalado (who was born in Cuba) noted that much of the growth in Miami has been vertical, with a concentration of skyscrapers, some reaching up 80 floors or more. According to the mayor, around 600,000 people sleep every night in downtown Miami, but the daytime population rises to 1.4m, as office workers flood in.

The growth of Latin American cities is part of a global trend. At present, around 3.3bn people, over half the world's population, live in urban areas. The region is ahead of that curve – it is already one of the most urbanised in the world, with roughly 80% of the Latin American and Caribbean population living in cities, a proportion that is expected to rise to 86% by 2050. Rodríguez Larreta said that new approaches were vital, because otherwise unplanned growth would make services impossible to manage. Much closer coordination was needed to address the problems of the wider urban area over and above institutional boundaries.

All three city leaders agreed that security and law enforcement pose particularly significant challenges. Reflecting the current debate under the new Donald Trump administration in the US, for Regalado a major issue is the relationship between immigration and law enforcement. He said that both Miami's police and the education system have a commitment to serve the local community irrespective of immigration status. In other words, with a wave of deportations of illegal immigrants in prospect, these services are not going to be involved in federal immigration enforcement actions. Like many US cities, the Miami authorities seek a relationship of trust with all residents, whether they are legal residents or illegal immigrants. He noted that the Florida state constitution specifically mandates an obligation to educate all children, whatever their (or their parents') immigration status.

Rodríguez Larreta explained policing difficulties in Buenos Aires. The Federal Police traditionally was responsible for the city of Buenos Aires, and for almost four decades there had been a discussion over whether to transfer part of that force to the city, for direct management.

Despairing of that transfer ever happening, Mauricio Macri, his predecessor as mayor, created a new 6,500-strong Metropolitan Police force for the city. Elected Argentina's president in 2015, Macri finally transferred part of the federal police to the city – a total of 20,000 additional officers. Among his tasks as a newly elected mayor, Rodríguez Larreta has to merge the two forces (with different pay scales, pension schemes, working hours and even different equipment) into a single unit. The Buenos Aires commented that it was difficult to ascertain whether crime rates are rising or falling in different parts of the city, because proper reporting systems are still lacking. One of his new projects is to equip the police with GPS-enabled devices that can be

used to track patrols and crime reports, so as to form an overall picture of what is happening in the city.

Unlike Miami, both Mexico City and Buenos Aires have to manage large shanty-towns, where millions of poor and vulnerably families receive insufficient services. Mancera explained how Mexico City has developed a service called 'El Médico en Tu Casa' ('A doctor in your home') which has visited 2m households to offer basic medical services. The programme has been run with the involvement of students from 17 state and private universities. It is designed to target people who would never otherwise visit a medical clinic. For his part, Rodríguez Larreta observed that around 250,000 people were living in shanty towns in Buenos Aires, saying that his dream was to eventually to urbanise those areas, delivering to these residents a full range of services.

REGION

Corporate Radar

Carlos Slim drives a Chinese auto: Carlos Slim, Mexico's telecoms billionaire, in launching an intriguing new venture with a Chinese automobile company. Giant Motors, a company 50% controlled by Inbursa, Slim's financial holding, has signed an agreement with JAC Motors of China to begin to assemble vehicles in Mexico. Chori Group of Japan is also involved in the project. Two Chinese designed and manufactured sports utility vehicles (models SE12 and SE13) are being launched. Giant Motors will focus on domestic sales and exports to South America. The venture, worth an initial US$230m, is not focusing on the US market, the destination for most of Mexico's car exports.

"We don't depend on NAFTA at all, not for exports, or for supplies. For us, this is where the opportunity lies" said Elías Massri, CEO of Giant Motors. He described the new models as being designed for young Mexican consumers interested in "connectivity, security, and financing" who were contemplating buying their first car. The SE12 is expected to sell for MX$259,000 (US$14,000) with the SE13 costing a little more at MX$299,000 (US$16,5000). Speaking of his Chinese partners, Massri said, "They have a clear intention to go global, in contrast to what we see in globalised countries that want to go backwards". Analysts said that Chinese car exports to Brazil, Russia and the Middle East have dropped recently, meaning companies are interested in Mexico in its own right, and as a gateway to other South American markets. Domestic Mexican car sales remain strong, rising by 6.5% year-on-year in February. Giant already assembles trucks and vans under agreement with another Chinese company, FAW, at a plant in the state of Hidalgo. The same plant will be used to assemble the JAC Motors SUVs.

Separately, Elías Massri, Giant Motors' CEO for Latin America, told *Forbes Mexico* that the company is hoping to roll out a made-in-Mexico electric vehicle by 2018. According to a 6 February Forbes report, it will be manufactured in a joint venture with Moldex, a subsidiary of Grupo Bimbo, the world's largest bread maker. "We are developing a new Mexican electric vehicle that will not only be assembled in Mexico, but also designed and modelled to meet the needs of Mexican consumers," Massri stated, suggesting that the new cars would be introduced in 2018 as electric taxis as in Mexico City.

New CEO at Escondida: Global mining group BHP Billiton has appointed Brazilian engineer Mauro Neves as the new chief executive at Escondida, the world's largest copper mine. BHP has a 57.5% controlling stake in the mine, which accounts for around 5% of global copper output. Neves, who worked for nine years as global head of coal for Vale, will face a difficult task. His appointment was announced shortly after an inconclusive end to a 43-day strike at Escondida, considered the longest of its kind in the history of Chilean private sector mining (albeit it was shorter than a 74-day strike at state-owned Codelco's El Teniente mine in 1973). The Escondida strike ended with management and unions unable to agree a wage settlement. The main union, representing 2,500 workers, said they were returning to work after invoking Article 369 of the labour code, which allows them to extend the existing collective labour agreement for 18 months. In effect, this means that the dispute has been kicked forward in time. It is estimated that Escondida lost around 120,000 tonnes of copper production during the stoppage; the company has warned it made losses of at least US$712mn during the strike and will have to reduce planned production levels for 2017.

JBS Accused: JBS – Brazil and the world's largest meat-packing and exporting company – has had a bad press recently, having to face two separate allegations of misconduct. The first was when the company was named in a federal police investigation into allegations that health inspectors had been bribed to approve the sale of meat past its sell-by date or otherwise adulterated. The second was an allegation that JBS has for years been processing meat from livestock reared on illegally de-forested lands. IBAMA, Brazil's environmental agency, ordered the closure of two JBS meat processing plants, along with a further 13 owned by other companies, in the state of Pará. They stand accused of using livestock reared on land cleared by the burning of forests. IBAMA has also imposed a BRL24m (US$7.7m) fine on JBS. The company has rejected both accusations of wrong-doing and said it will appeal against the IBAMA ruling.

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