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Education – Latin America's big problem

Is the Latin American education system broken? There is a certainly a sense that it is not working as well as it should. Some believe under-par schools and teachers are one of the root causes of the region's poor economic performance, certainly when compared to other parts of the developing world such as Asia. Here, we look at some of the arguments, plus the reforms being attempted by different countries.

The consensus among experts is that education in Latin America is falling short. Jorge Sequeira, director of United Nations' Educational, Scientific and Cultural Organization (UNESCO)'s Regional Education Bureau, based in Santiago, Chile, last year said that around half of students in Mexican schools were not acquiring the necessary "basic competencies", a situation replicated in other countries in the region in which international student assessment tests have been carried out.

Gabriel Sánchez Zinny, president of Kuepa, an education technology company, suggests that many of the region's economic problems boil down to education. "It would be better to focus the debate on competitiveness, productivity, and education, which are the root causes of inequality of opportunity, rather than on income differentials, which are the result," he has said. The president of the World Bank (WB), Jim Yong Kim, on a recent visit to Peru, described education as a "machine that can end inequality". He said, "Increasing the spend on education should be a policy of the state, it is not something that can be done by one government. It will take 10, 20, 30 years. The key is to develop good teachers. Education should be prestigious. It is necessary to increase salaries, so that the best become teachers. It happened in South Korea and in Finland. That's the big challenge for Latin America."

There is much debate over the validity of test results and rankings, but those that do exist highlight deficiencies in Latin American education. Among of the most respected are the Programme for International Student Assessment (PISA) tests carried out every three years by the Organisation for Economic Co-operation and Development (OECD). These assess the performance of 15-year old students in mathematics, reading and science. The last set of results was published in 2012 and covered 65 countries. Eight Latin American countries took part and were all ranked towards the bottom end of the table. Chile, the best placed, came in at 51st, followed by Mexico at 53rd, and Uruguay at 55th. Colombia (62nd) and Peru (65th) were the worst performers in the PISA list.

UNESCO runs a separate test known as TERCE (Third Regional Comparative and Explanatory Study), which covers a larger group of 15 countries in the region. This assessment tests students at the ages of eight and eleven, and also evaluates school context (a factor not considered by the PISA). The latest TERCE results showed a degree of improvement on the last measurement in 2012. Here too, Chile headed the ranking, followed by Costa

Rica, Uruguay and Mexico. Among the worst performers in this ranking were Nicaragua, Paraguay and the Dominican Republic.

In May 2015, the OECD published the results of a new wider study of schools in 76 countries around the world, described by the OECD's Director for Education and Skills, Andreas Schleicher, as "the first time we have a truly global scale of the quality of education". Once again, no Latin American country made it to the top half of the rankings, which were dominated by Asian countries (Singapore, Hong Kong, South Korea, Japan and Taiwan were top of the list). Chile once more was the best-placed Latin American country (ranked 48th), followed by Mexico (54th), Uruguay (55th) and Argentina (62nd).

Latin America's Education Rankings					
OECD PISA Tests		UNESCO TERCE Tests		OECD Maths & Science	
Country	Rank out of 65 countries	Country	Score (0-1000)	Country	Rank out of 76 countries
Chile	51	Chile	557	Chile	48
Mexico	53	Costa Rica	546	Mexico	54
Uruguay	55	Uruguay	532	Uruguay	55
Costa Rica	56	Mexico	429	Argentina	62
Brazil	58	Colombia	526	Colombia	67
Argentina	59	Brazil	524	Peru	71
Colombia	62	Argentina	509	Honduras	74
Peru	65	Peru	505		
		Ecuador	491		
		Guatemala	489		
		Panama	482		
		Honduras	479		
		Nicaragua	479		
		Paraguay	469		
		Dominican Republic	456		
Source: *BBC, OECD, UNESCO*					

Although not exclusively about education, another 2015 report, the World Economic Forum (WEF)'s Human Capital Index (HCI), published annually, also suggests that Latin American countries are performing relatively poorly. The HCI is compiled by evaluating levels of education, skills, and employment available to people in five distinct age groups between 15 to 65 years across 124 countries. It is based on the idea, expressed by WEF chairman Klaus Schwab, that "talent, not capital, will be the key factor linking innovation, competitiveness, and growth in the 21st century". Scandinavian countries do particularly well in this ranking (Finland, Norway, and Sweden take the top three positions). Some Latin American countries do get into the top half of this table, led by Chile (ranked 45), Uruguay (47), Argentina (48) and Mexico (58). But the majority are in the bottom half, including Brazil (78) Nicaragua (90) and Venezuela (91).

"It would be better to focus the debate on competitiveness, productivity, and education, which are the root causes of inequality of opportunity, rather than on income differentials, which are the result."

– Jorge Sequeira, UNESCO.

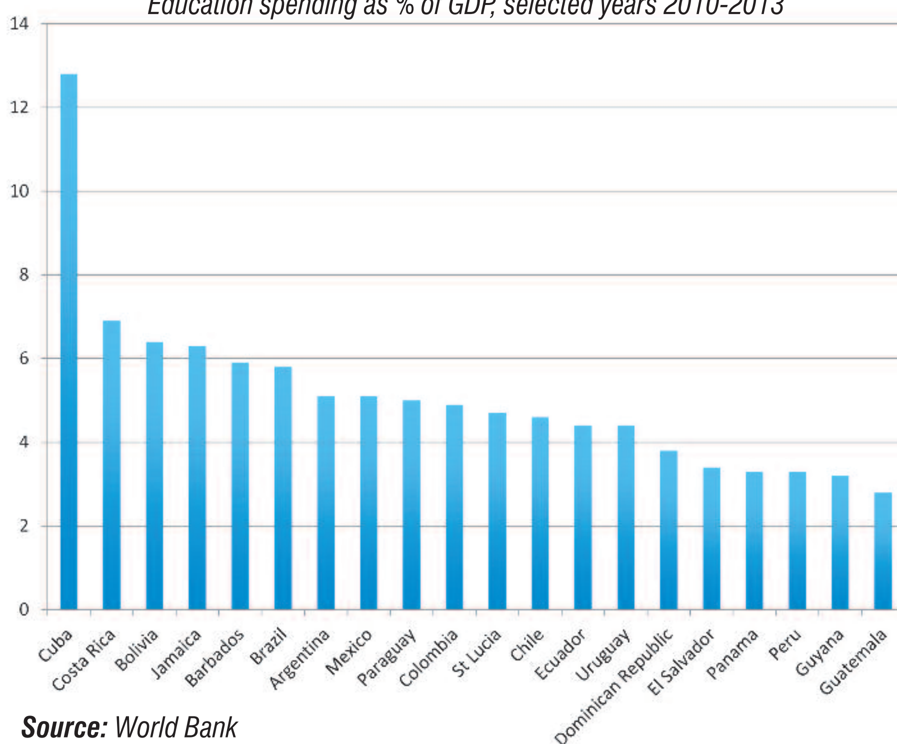
One of the key problems is that poor education levels tend to trap people in unemployment or low productivity, lower paid jobs, often in the informal sector of the economy. UNESCO's Sequeira has pointed out that despite improvements in primary school attendance, Latin America is still not meeting the goal of universal literacy. "We still have large numbers of people who are functionally illiterate, people on the margins of society, who form part of the roughly one-third of the total work force in Latin America that operates in the informal sector" he said. He notes that informality (working outside the tax and benefits system), poverty and illiteracy are all closely connected. The International Labour Organisation (ILO) estimates that 27m Latin Americans between the ages of 15 and 24 are in the informal sector. Putting the positive side of the same argument, World Bank president Yong Kim notes that according to the data, for every year of schooling people receive, their future income earning potential rises by 10%.

While acknowledging that real improvements have been made in some areas, analysts say they have not been enough to truly address the issues. One example is total spending on education, which according to UNESCO now averages 5.2% of GDP across the region, up from 4.5% ten years ago. While the WB's Yong Kim stresses the need to put more resources into education, many others warn that the quality, rather than just the quantity of the spend, is important. Some say that focusing all of the spend on teachers' salaries could overshadow efforts to deliver training, innovation and classroom technology improvements. Others argue for targeted investments in certain key areas such as early childhood and pre-school education.

What is evident is that education reform is being considered or pursued by more countries in Latin America. There is at least a growing awareness that something needs to be done. Sometimes rather different approaches are being taken. Ironically perhaps, it is Chile – revealed as one of the better-performing countries in the student rankings – which has seen one of the most politically intense debates over education. After years of student agitation over inequalities between public and private sector education provision, the centre-left government of President Michelle Bachelet in 2014 passed legislation to give equal, non-selective access to state-owned and state-subsidised schools. It also introduced free university education. The total cost of these reforms is estimated at around US$8bn, to be funded from new tax reforms.

"Mexican schools are failing to give their pupils three things: "the capacity for clear expression through language; the capacity for critical thought; and an understanding of mathematics."

– *Manuel Molano, IMCO.*



In Mexico, education reforms were also introduced in 2014, as part of a wider package of legislative changes designed to improve competitiveness, including the opening up of the energy sector to private sector companies. The Nobel Prize-winning US economist Joseph Stiglitz recently said that he expects the Mexican education reform to be the most significant of all the structural changes implemented by the government (even more than the dismantling of the state monopoly in oil and gas), because it is likely to have the greatest long-term effect on growth. Here, the changes have focused on moving towards a national curriculum, and guaranteeing greater equality of access to schooling. But the most controversial element, involving a confrontation with the country's hitherto-powerful teachers' unions, has been the requirement for regular teacher performance assessments. Critics of

the unions complain about their longstanding control over the hiring and firing of teachers and their tolerance of low education standards, disadvantaging students' future life chances. Yet more than a year after their introduction, some of these reforms are still being resisted, particularly in the poorer southern states of the country.

Alberto Serdán, of a local education lobby, Mexicanos Primero, says, "the average number of school years per pupil in Mexico is low, at 8.3, compared to 14 in other countries. But we aren't just low on years. The school calendar offers only 200 days of class a year, and within that there are only 572 hours of effective teaching. Compare that to South Korea, where there are around 1,200 hours of effective teaching per school year." Manuel Molano of the Instituto Mexicano de la Competividad (IMCO), a public policy think tank, says Mexican schools are failing to give their pupils three things: "the capacity for clear expression through language; the capacity for critical thought; and an understanding of mathematics".

In Colombia, the government has taken its poor performance in the PISA tests to heart and created its own indicator, a new annual education quality index (Índice Sintético de Calidad Educativa, ISCE), which was officially launched in March 2015. ISCE is a composite score for each school, on a 1-10 scale, comprising four elements. The first two measure student progress and achievement levels, using Colombia's existing annual student tests, know as Saber. The third and fourth measure efficiency and the school environment. The ISCE is based on a system used successfully in the Brazilian state of Minas Gerais. According to Colombia's education minister, Gina Parody, "We will be able to say 'you have scored 5 and you need to improve to 6. If the school's staff meets this objective, everyone from the janitor to the head teacher will receive an additional monthly salary". According to the first ISCE results, Colombia's primary schools scored an average of 5.13, with secondary schools on 4.9 and middle schools on 5.53. The government calculates that all will need to lift their scores to at least 7 if Colombia is to meet its objective of being 'the best-educated country in the region' in ten years' time. It will measure the ISCE on a year-on-year basis to try to focus all schools on the need for improvement.

> "In Brazil, the latest major education initiative was the approval of a law in June 2014 requiring the federal government and all state and municipal administrations to gradually increase their education spending to reach 10% of GDP within a decade (by 2024)."

In Brazil, meanwhile, the latest major education initiative was the approval of a law in June 2014 requiring the federal government and all state and municipal administrations to gradually increase their education spending to reach 10% of GDP within a decade (by 2024). The increased spend is to be achieved through the earmarking of 75% of oil royalties for the education sector. The law also will offer incentives to schools that improve their performance, as measured by the Index of Basic Education Development (Indice de Desenvolvimento da Educação Básica, IDEB), along with setting targets for universal primary and secondary education. At present, Brazil's education spend is roughly 6.5% of GDP. The law also requires all schools to offer two parallel timetables (giving students and their families the option of attending a morning or afternoon shift).

Peru also performed poorly in the PISA tests but did rather better in the UNESCO TERCE assessment. Since taking office in 2011, the government led by President Ollanta Humala has been focusing on building or refurbishing schools in the poorer areas of the country. Asked if Peru's education system is one of the weakest in the region, Ricardo Cuenca, of the think tank Instituto de Estudios Peruanos (IEP), responded, "Far from it. The state school system here is above the Latin American average." Policy makers are nevertheless identifying areas for improvement. One issue is that many of the smaller schools lack head teachers. And where there are head teachers, many find up to 70% of their time taken by administrative tasks. Some therefore argue that there is a need to strengthen educational leadership and to boost the training – and the salaries – of teachers.

MEXICO

Come fly with me

Mexico's automotive industry boom is well known – it has lifted the country to number one in Latin America by annual vehicle production, and to number seven in the world. Coming up close behind the Mexican auto sector is another potential success story – aerospace. While there isn't yet a commercially produced Mexican aircraft (something which may change in the next few years), a proportion of the components of most of the world's aircraft are already 'Made in Mexico'. Things have come a long way for the country since the days of the low-wage maquiladora assembly plants.

Some of the factors behind Mexico's auto sector boom may also help its aerospace development. The automobile story goes back to the 1960s, when local assembly operations began. Gradually, these became more sophisticated. They benefited from Mexico's closer integration with the US through the North American Free Trade Agreement (NAFTA), signed in 1994. In Mexico's northern states, the work force gradually became more skilled, locally trained managers and technicians emerged, and more recently, the virtual collapse of Detroit as a car-manufacturing sector pushed more US and international companies to set up shop in Mexico. The numbers now are impressive. Since the current Mexican government took office in December 2012, a total of US$22.6bn worth of car plant investments have been announced. Mexico has overtaken Brazil as the largest car producer in Latin America. It is now the seventh largest in the world, as well as being the world's fourth largest vehicle exporter.

The aerospace story is much more recent – it goes back a little over ten years – but it looks promising. A number of aerospace 'clusters' have sprung up. One of the first companies to arrive was Industria de Turbo Propulsores (ITR) of Spain. Bombardier, Safran, and Airbus followed it, among many others. According to the economy ministry, there are now five key clusters, in Baja California (comprising 70 companies), Sonora (53), Querétaro (41), Chihuahua (35) and Nuevo León (32). In the last eight years, the number of companies in the sector has tripled to around 300. Together they employ an estimated 32,600 staff. Over the same eight years, aerospace exports have grown at an average rate of 14.2% per annum, and currently stand at around US$5.4bn. According to government officials, Mexico is now ranked 15th in the world by value of its aerospace component exports. The government wants to push the country further up the rankings to 10th in the world by 2020. It has also set other targets for that date, such as doubling exports to US$12bn, boosting employment to 110,000, and seeking to increase local content to 50%.

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While most of the aerospace clusters are located in Mexican states bordering the US, Querétaro is the exception, located further to the south. Here, the state government has supported the development of an "aerospace corridor" attracting international companies with tax incentives and a dedicated university – the Universidad Aeronáutica de Querétaro (UNAQ). According to the UNAQ rector, Jorge Gutiérrez de Velasco Rodríguez, the curriculum has been co-developed with the companies. That way, employers have "the knowledge that our students and the skills that the students get at the end of the training course are really pretty much close to what they will use at any plant". He adds that students who in the past sought to emigrate to the US are now migrating within Mexico to development poles such as Querétaro, which they see as a local "land of opportunity". "Our vision is developing more complex, value-added goods. Not just hand-crafted but mind-crafted", Gutiérrez told the Houston-based broadcaster *KHOU*.

Marcelo López, the state's minister for sustainable development, says there are 14 universities in the area offering a supply of engineering graduates. "We don't have oil, but we do have talent" he says. López adds that while the logistics costs to ship components to the US border are higher than in other clusters, security is better, as the state is off the main drug smuggling routes into the US. Among the local companies is General Electric Infrastructure Querétaro (GEIQ), a high-tech operation that carries out aerospace, renewables, and energy R&D. The company's director, Vladimiro de la Mora, told the Spanish newspaper *El País* that the average age of his staff was 33.

Foreign Direct Investment (FDI) in Mexico's aerospace industry 2010 -2014		
	US$m	**% of total**
Querétaro	492.6	43.9
Chihuahua	219.4	19.6
Baja California	189.4	16.9
Distrito Federal	84.9	7.6
Sonora	51.3	4.6
Nuevo León	27.1	2.4
Tamaulipas	26.5	12.4
Hidalgo	13	1.2
Jalisco	8.5	0.8
San Luís Potosí	3.1	0.3
Yucatán	2.6	0.2
Coahuila	2.2	0.2
Aguascalientes	1	0.1
TOTAL	1,121.60	100
Source: *Consultancy Regional*		

The pace of development is rapid. A fully 'made in Mexico' aircraft may not be that far away. In April, Oaxaca Aerospace said it had unveiled a prototype for police and security forces' use. General Manager Rodrigo Fernández said Project Pegasus PE-210A, launched in 2011, aimed "to make an innovative aircraft, completely different from what already existed, with modern engineering, using software and advanced tools". A dedicated team had sought greater aerodynamic efficiency through new designs. The company aims to produce at least 12 commercial planes by 2019. Meanwhile, Airbus Group Mexico's chief executive Fréderic García has said that the maturity of the Mexican aerospace components industry means that the company could consider local helicopter assembly "between the short and medium term". Airbus currently manufactures doors for its A320 planes in Mexico, along with cabling for the A380s and electro-mechanical parts for the A350s. García said Mexico was attractive for aerospace investment because of its free trade agreements, investment incentives and developed supply chains. Given the priority placed on safety and quality certification in the aerospace industry, García also noted the importance of the fact that Mexico has signed a Bilateral Aviation Safety Agreement (BASA) with the US.

If the aerospace sector does take off, as many hope, it, along with the auto industry before it, will offer an interesting perspective on the wider development of manufacturing in Mexico. In the early stages of development of the maquiladora (or 'in-bond' assembly) industry, critics feared that that Mexican manufacturing for the US market would be trapped in a low-wage, low-value added stage of development. However, it does seem that manufacturing has come a long way, with at least part of the sector joining higher-skilled, higher-paid and higher value added parts of the supply chain.

China may have had a role in this. Some analysts have pointed out that at the turn of the century – 15 years ago – China's special economic zones undermined the competitiveness of many mid-to-low end Mexican manufactured products. Because of Chinese competition, Mexican textile exports dropped

43% from US$7.6bn in 2002 to US$4.3bn in 2012. But the suggestion is that out of necessity Mexico re-focused on higher value-added automotive, aeronautical and electronic products. Between the same years, Mexican automotive exports grew 152% to US$70.3bn, while electronics exports were up 73% to US$74.9bn. These higher-end products remained competitive because of NAFTA and Mexico's greater proximity to the US; they have remained so more recently as Chinese wage costs have risen above Mexico's. Clothing and textiles production has not disappeared from Mexico, but it has migrated from the north of the country to the poorer south, to cities like Campeche and Veracruz.

MEXICO

Divorce shakes Omnilife

Divorce is a personal and often bitter affair. But it gets a lot more difficult when the two people involved are business partners and co-owners of a major company. Welcome to the ongoing battle between Jorge Vergara and Angélica Fuentes, which is shaking up Mexico's Omnilife and the Chivas de Guadalajara football team.

The relationship between Jorge Vergara and Angélica Fuentes is over. They got married seven years ago with a spectacularly luxurious five-day wedding party in India. The bride and groom arrived on elephants. They were last seen together in February at another celebrity-studded party in Guadalajara, to celebrate Jorge's 60th birthday. Clearly, however, things had already begun to take a turn for the worse. By 1 April, security guards and state police had thrown a protective cordon around the headquarters of their jointly owned company (Vergara 51%, Fuentes 49%). Vergara announced that Fuentes had been sacked and was being denied entry; also that the couple were getting divorced.

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Vergara has a reputation as a self-made man. He started out running a restaurant but made his first major break in 1991 when he set up Omninutrition, a multi-level marketing (MLM) operation selling dietary supplements. MLM companies pay commissions to their sales people not only on their direct sales, but also on the sales of others that they recruit. Regulatory authorities often warn that some MLM operations can be dangerously similar to illegal pyramid schemes, prone to collapse when no new distributors can be found. In its early stages, the company sold products provided by a similar (and legal) operation, Herbalife of the US. The Mexican operation grew independently and extremely rapidly. Company sources say that Omnilife, as it is now known, employs around 6,000 people in 19 countries and in 2013 had sales of US$1.7bn. It also claims to be involved in a wide range of activities including financial consulting, publishing, music and television production. But perhaps its best-known asset is the Chivas de Guadalajara football team. Although the team hasn't won the Mexican league since 2006 (and has been in danger of relegation), the Chivas have an enthusiastic following, and obtain significant revenues from TV transmission rights in the US.

Angélica Fuentes also has a business background. Her family is from Ciudad Juárez in Chihuahua, where it controls Grupo Imperial, an important energy and manufacturing group (gossip magazines dubbed her 'La Reina del Gas'['the Gas Queen']). A graduate in finance from the University of Texas, she held a series of management positions and is a former president of the trade body Asociación Mexicana de Gas. After her marriage to Vergara, he remained chairman of the board at Omnilife while she became its chief executive officer. She also introduced her own perfume brand to the range of products sold: Angelíssima. Some accounts say that she ran the company in an authoritarian fashion, demanding personal loyalty and building up her own group of managers and advisors.

After the split, both sides began a legal battle. Vergara said Fuentes had been sacked and was responsible for "irregular situations" meriting investigation in state and federal courts for presumed "illicit and malicious actions". In particular, his lawyers said Fuentes had been preparing three illegal contracts to try and increase her shareholding stake in the company. A state judge in Jalisco consequently issued a preliminary order preventing her from trading in Omnilife-Chivas shares and ratifying her dismissal. But on 28 April the same judge, after hearing her lawyers' arguments, reversed the order and ruled that Fuentes should be reinstated as CEO.

Vergara's lawyers say the reversal is itself illegal and have taken an appeal against it to a federal court. They also claim an audit shows that Fuentes defrauded the company by around MXN3-4bn (US$195.1m – US$260.1m). According to lawyer Javier Coello of Vergara's team "Angélica Fuentes served herself with a big spoon. She penetrated the company like damp".

Vergara himself was keen to establish the superiority of his managerial record. "People talk of the company growing since she took over", he told local journalists. "Well, I opened up a presence in 20 countries in 11 years, and she closed down our offices in three countries in six years. So during her time the company didn't grow, it shrank". Fuentes' lawyers, meanwhile, have stressed that no evidence of corruption has actually been presented. "Those famous three or four billion pesos are just being talked about in the media, nothing concrete has been presented to the courts", said Ismael Reyes, a member of her legal team.

It is not clear how the conflict will end. But both sides are fighting it out at various levels. On 29 May, Omnilife salespeople demonstrated in Mexico City in support of Vergara. One of them, Roque Jasso, told journalists that the company's staff wanted Angélica Fuentes "to leave us alone". And at a recent football match some Chivas fans held up banners that read 'Juntos vs. Angélica' ('Together against Angélica').

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REGION

Corporate radar

Odebrecht and FCC win Panama Metro contract

Brazil's civil engineering giant Construtora Norberto Odebrecht, in partnership with FCC Construcciones of Spain, was declared the winner of the bidding for the Línea 2 Panama City Metro contract, with a US$1.86bn proposal. The consortium led by the two companies defeated competition from PANAMetro (led by China Harbour Engineering) and UTE PANAMÁ II (led by Dragados of Spain and ICA of Mexico). The Línea 2 contract requires the winning consortium to build 22kms of passenger railway with 16 stations, linking Tocumen in the south of Panama City up to San Miguelito, where it will connect with Línea 1. Odebrecht/FCC also built Línea 1, stretching for 16kms, at a cost of US$2.1bn. It opened to the public in April 2014. The new contract for Línea 2 includes responsibility for design and construction, auxiliary services and stations, railway tracks and equipment and rolling stock. Although Odebrecht/FCC were declared the winners, at the end of May the contracting process was officially suspended to give the authorities time to consider a formal complaint by the PANAMetro group, which alleged that two members of the technical assessment committee (including Óscar Ramírez, rector of the Universidad Tecnológica de Panamá) previously worked as consultants for companies in the winning consortium.

LATAM Airlines reports unexpected Q1 loss

LATAM airlines, the largest Latin American commercial airline, formed by

LAN of Chile and TAM of Brazil, reported an unexpected loss of US$39.9m in the first quarter of 2015.

The airline said that the loss, similar to the US$41.3m deficit registered in Q114, reflected a weak Brazilian Real, which had offset operational gains and cost reductions. The consensus among analysts, as reported by *Reuters*, had been that LATAM would achieve a Q115 profit of US$42m. In a press release, the company said that its non-operational results were affected by a non-cash US$205m loss suffered mainly by TAM as a result of a 20% depreciation of the Brazilian currency during the quarter.

Operating revenues were down 12.2% to US$2.791m in Q115, while costs dropped 16.3%. Costs per available seat kilometres (ASK) were down 17% year-on-year, which the company said was largely due to lower jet fuel prices. As a result of the cost reduction, operating profits doubled to US$227m. The operating profit margin rose to 8.1%, up from 3.5% in the comparable year-earlier period. LATAM expects to take delivery of 17 new aircraft between July and March 2016, including 11 Airbus A321s and 4 Boeing 787-9s.

> "OHL has denied any irregularities at its Mexico subsidiary, insisting that it operates within local law and honours the terms of its contracts. OHL Mexico generates around 30% of the parent company's global income. Earlier, the Spanish group had announced an18.7% fall in Q115 net profits to EUR49.1m, attributed in part to lower toll revenues in Mexico, caused by the effect of lower inflation on pricing mechanisms."

OHL hit by corruption allegations

The Spanish toll-road operator OHL has been hit by allegations of corruption and impropriety in Mexico. The share price of its local subsidiary, OHL Mexico, dropped sharply in late May, after Mexico's federal ministry of communications and transport said it would seek an audit of the company's contracts with the Estado de México (Edomex). This followed earlier leaks of telephone conversations apparently showing that the company improperly increased toll charges for motorists using the Viaducto Bicentenario highway in Edomex. Executives were also alleged to have discussed bribing Mexican judges and paying for a five-day holiday for the Edomex communications secretary, Apolinar Mena. Mena, along with Pablo Wallentin, OHL Mexico's head of institutional relations, resigned in the wake of the allegations.

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Pacific Rubiales accepts Alfa/Harbour takeover bid

The board of Pacific Rubiales, the Canada and Colombia listed private oil company, on 21 May said that it had agreed to accept a takeover bid mounted by Mexico's Alfa Group and Harbour Energy of the US. Under the terms of the offer, Alfa and Harbour Energy will pay C$6.50 (US$5.32) a share for 81.05% of the company, valuing it at US$6.4bn. Alfa already owns a minority stakeholding in Pacific Rubiales; under the terms of the deal Alfa and Harbour Energy will each end up holding a 50% stake in Pacific Rubiales.

The offer price represents a 35% premium on the Pacific Rubiales share price on 4 May, the day it was first revealed. Despite unanimous acceptance from the Pacific Rubiales board, which said "the transaction delivers significant and immediate value to company shareholders" a group of individual shareholders led by Caracas-based Alejandro Betancourt said it was "extremely disappointed" at the terms and would vote against the deal in July.

Pacific Rubiales produces around 150,000 barrels per day (bpd), mostly from Colombian oil fields. Its share price has dropped steadily since 2014, on the back of the fall in international oil prices, the expiry of some of the company's key production licences in Colombia, and concern over its levels of debt. The licence to operate the Piri-Rubiales field ends in June 2016.

Looking beyond the short term however, Pacific Rubiales is attractive to Alfa and Harbour as a vehicle for developing in Latin America, including bidding for new licences in Mexico. The terms of the bid also includes a debt-restructuring proposal.

Itaú profits beat expectations

In early May the leading Brazilian bank Itaú Unibanco Holding reported net recurring first quarter profits of BRL5.808bn (US$1.88bn), ahead of market expectations. Net recurring profits is a measure that excludes once-off items and charges. The latest results were attributed to rising interest income and improved cost control. Measures to reduce risk also had an effect, with non-performing loans falling for the 11th consecutive quarter.

"According to a report by Economática, a local consultancy, profitability across Brazilian listed companies slumped in Q115. The consultancy said that net profits reported by 317 listed companies slumped by 41.4% to BRL25.762bn (US$8.557bn)."

However, sector analysts noted that the poor performance of the wider Brazilian economy was having an impact on the bank's accounts. Recurring profit margins dropped to 24.5% in Q115, down from 24.7% in Q414. According to a report by Economática, a local consultancy, profitability across Brazilian listed companies slumped in Q115. The consultancy said that net profits reported by 317 listed companies slumped by 41.4% to BRL25.762bn (US$8.557bn). Itaú Unibanco was the second largest company by net profits behind state-owned Banco do Brasil and ahead of (the also state-owned) energy company Petrobras. Economática said that Itaú, along with Banco do Brasil and Bradesco, was part of a group of banks that had reported improved profits despite the country's growing macroeconomic difficulties. The consultancy said that taken as a group, the 25 banks listed on the Bovespa (the São Paulo stock exchange) had reported a 42.8% increase in Q115 profits to BRL17.8bn. This contrasted with mining companies at the other end of the spectrum: a group of five led by Vale had reported combined losses of BRL9.83bn (US$3.28bn) in Q115, compared to profits of BRL5.81bn (US$1.94bn) in the comparable year-earlier quarter.

Spotify tunes in to Latin America

Spotify, the music-streaming service, says it is focusing marketing efforts on Latin America. According to Gustavo Diament, its director for the region, the company is operating in 17 countries and hopes to grow revenues from the area to 15% of its global total. Spotify launched in Mexico only two years ago, but that country now is the fifth largest market by revenue out 58 worldwide.

"Mexico is getting close to overtaking Germany in revenue terms" Diament said. According to Spotify, by the end of last year it had 15m paying subscribers and around 60m active users around the world. Diament said that the key to boosting revenues in Latin America was the ability of consumers to pay for the service via their mobile phones. Monthly subscription rates vary from COP11,499 (US$4.81) in Colombia to PEN16.90 (US$5.37) in Peru. These rates have been pitched below the US$9.99 charged in the US to premium subscribers, who get an ad-free music stream.

The company is trying to reach more deals whereby the Spotify service is "bundled" into a single subscription rate charged by the mobile phone operators for a range of services, rather than being sold as a stand-alone service that subscribers have to opt in to and pay for separately.

It also needs to work with artists who believe they are not getting adequate royalties (among them is the US singer Taylor Swift, who has withdrawn her catalogue from Spotify). Diament claims that Spotify has paid over US$2bn in royalties, but notes that this goes to music labels and rights owners, with Spotify having no direct control over what proportion goes to the artists themselves.

BRAZIL

Growing political pressure on Levy

There is no universally accepted textbook approach on how to deliver a successful fiscal austerity programme; economists still argue bitterly about it. Apart from a multitude of technical issues however, it is clear that getting the politics right is critically important. Joaquim Levy, Brazil's finance minister, is facing some strong political crosswinds as he tries to steer Latin America's largest economy back towards recovery.

According to his officials, Finance Minister Levy had a cold on Friday 22 May. That sent ripples of concern running through Brazilian and international financial markets. What worried them most was that the minister stayed away from a press conference to announce BRL69.9bn (US$22.1bn) worth of government spending cuts. Planning Minister Nelson Barbosa made the announcement on his own.

"According to his officials, Finance Minister Levy had a cold on Friday 22 May. That sent ripples of concern running through Brazilian and international financial markets. What worried them most was that the minister stayed away from a press conference to announce BRL69.9bn (US$22.1bn) worth of government spending cuts. Planning Minister Nelson Barbosa made the announcement on his own."

According to press reports Levy, who was said to be seeking deeper cuts of BRL80bn, had really stayed away, not because of a cold, but to signal his disagreement. This led to rumours of a split within the government and the possible resignation of the finance minister, regarded by financial markets and the business community as a key figure in the attempt to get Brazil back on track. Levy subsequently denied that there had been a split. "I didn't think of quitting at all", he said.

Yet the incident underlined the difficult path he has to tread. Subject to intense scrutiny, the minister is seeking to deliver a balanced message that can be summarised along the lines of "more austerity is needed – but have faith that growth will come". That, of course, is always a difficult message to get across. Levy told reporters, "There are people who think everything is solved. It isn't. We still have work to do". In other comments, he acknowledged that the federal government has an ongoing problem of "systematically insufficient revenues".

But he stresses that it is not just a question of raising taxes; Brazil needs deeper structural reforms. Speaking to businessmen in Rio, Levy sought to reassure them that he was looking beyond austerity and working on pro-growth measures, including an agricultural stimulus plan and a package of measures to promote infrastructure investment.

On a recent visit to London, Levy's message to investors was that "Brazil is going through a period of economic adjustment. Our priority has been to ensure the sustainability of public finances as the basis for a new growth cycle. We expect the current slowdown of our economy to be temporary". According to Juan Jensen, of the consultancy Tendências, "Levy first acted as a fireman to put out the fiscal fire. Although the job is not done on the fiscal side, he is signalling that there are other things he can do to get the economy going".

Getting the federal congress to approve adequate spending reductions is a complex and on-going battle. In late May, Levy got approval for a new set of measures. They included regulation MP665, limiting access to unemployment benefits (increasing the prior qualifying period in employment from 6 to 12 months); and MP664, restricting access to otherwise generous sickness and pension benefits. But some of these gains were offset by a congressional decision to change the way pension payments are calculated, which ultimately will increase costs. It is difficult to calculate the full impact of these measures. One assessment by economists at Itaú Unibanco is that they will save BRL2bn this year, but could add expenditure equivalent to 0.5% of GDP by 2040. Levy also faces a major longstanding structural problem, in that the vast majority of

public spending in Brazil is ring-fenced by constitutional mandates. In 2014, for example, only 6% of total budget spending was discretionary.

Perhaps the most difficult period for a minister pushing through an austerity programme are those months between the first announcement of belt-tightening measures and any initial signs of success, or of economic 'green shoots', usually in the form of data releases that can be positively interpreted. Levy, who was appointed in January, is still trapped in that politically challenging period. So far, he has no data to show that things are getting better. Admittedly, the government's primary budget surplus improved on a month-on-month basis to BRL10.08bn (US$3.18bn) in April, but this was still well below the BRL16.6bn achieved in the same month last year. The primary surplus in the first four months of the year was down 54.4% on the comparable period in 2014. The overall deficit (which includes debt interest payments) rose to an unsustainably high 7.8% of GDP in the 12 months to March 2015 (compared to 6.2% last year and to 2.2% in 2010).

The minister's most frequently mentioned fiscal target is to achieve a primary fiscal surplus equivalent to 1.2% of GDP this year, after a 0.63% deficit in 2014. He also intends to boost the primary balance to 2% of GDP in 2016. On current trends, many economists believe this won't be achieved. A research note by Capital Economics says part of the current deficit reflects the government's expensive and ineffective foreign currency (FX) swaps programme, which is now being wound down. Putting this to one side, the primary balance has deteriorated this year because of a worsening local and regional government budget performance, and a deteriorating balance in the INSS social security fund. Capital Economics forecasts that the best that Levy can hope for to deliver is a primary surplus of 0.2% of GDP this year, rising to 1% in 2016.

According to Brazil's national statistics institute (IBGE), first quarter GDP fell by 1.6% year-on-year (and 0.2% quarter on quarter). The unemployment rate rose to 6.4% in April, up from 6.2% in March. Inflation, pushed up by a depreciating Real, has risen to 8.2%, almost double the central bank (BCB)'s target of 4.5%. Economists believe the inflation rate has peaked and will now trend down, but are expecting the BCB to have to tighten interest rates again in June, following a 50bps hike in the benchmark Selic rate to 13.25% in early May. In other words, all the data in Brazil is currently pointing towards continuing stagflation.

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DOMINICAN REPUBLIC

Flourishing in spite of everything

In spite of its many structural problems, the Dominican Republic (DR) should be one of the fastest growing economies in the region in 2015. This is partly due to a fall in inflation, which has enabled the Banco Central de la República Dominicana (BCRD) to lower interest rates. It is also due to the diversification of the economy and the resilience of business sectors operating in the country.

In mid-May 2015, the BCRD governor, Héctor Valdez Albizu, forecast real GDP growth of around 6% this year. Previously, the central bank had been looking for an expansion of 5%. Whatever the result, the DR will be one of the fastest growing economies in the Latin America & Caribbean region. Albizu indicated that growth would come from tourism, thanks in part to the strengthening US economy, a key source market, and inwards foreign direct investment (FDI) of around US$2.3bn.

In late March the BCRD cut its key interest rate by 50 basis points to 5.75%. The bank noted that annual inflation in February had fallen to just 1.02%, well below the official target of 4.0%±1%. The BCRD now expects inflation to remain below target for the remainder of 2015. Core inflation, at 2.76%, is also well below long term norms.

The BCRD reported growth in economic activity and credit to the private sector of 6.6% and 13.4% respectively in the 12 months to January. Moreover, the recent improvement in government revenues means that the overall budget deficit for the year should be about 2.4% of GDP. The current account deficit is expected to be around 2.0%.

In its April *World Economic Outlook*, the International Monetary Fund (IMF) took a broadly similar view, albeit it was slightly less optimistic than the BCRD as to overall GDP growth and the current account deficit; it anticipates that exports and imports will grow by 6.9% and 9.8% respectively.

Dominican Republic	
Macroeconomic metrics in 2015 as the IMF sees them	
GDP US$bn	66.2
Real GDP growth %	5.1
GDP per capita US$	6,044
Population mn	10.8
Total investment % GDP	20.3
Savings % GDP	17.9
Gov't. Primary net borrowing/lending (% GDP)	0.2
Gov't deficit (% GDP)	2.4
Government gross debt (% GDP)	30.5
Inflation %	3.0
Growth in exports of goods & services %	6.9
Growth in imports of goods & services %	9.8
Source: *IMF, World Economic Outlook Database, April 2015*	

Recent commentary from other multilateral agencies has also been favourable. The World Bank (WB)'s latest (March 2015) overview highlighted the strong economic growth of recent years and praised the reforms undertaken in the past year or so to improve the ease of doing business in the country. According to the WB, the Dominican Republic stands alongside Jamaica and Trinidad & Tobago as one of the countries in the region in which the authorities have done the most to make it easier for local entrepreneurs to start-up a business.

However, the WB noted that the poverty rate in the DR (reported at 41% in 2011) was higher than in 2000 (32%), if lower than in 2004 (when it was nearly 50%). One problem is that much of the economic growth has taken place in capital-intensive industries like telecommunications and mining. Much of the growth in employment, meanwhile, has taken place in low skilled jobs within the informal sector. Following the conclusion of its Article IV consultation with the government in mid-November 2014, the IMF reported that growth in 2014 had been driven by the tourism and construction sectors; while the current account was benefiting from strong gold exports, an improvement in the terms of trade and healthy remittances, as well as the increased tourism revenues.

One of the strengths of the DR's economy is its diversification, with a range of sectors contributing to overall GDP growth in recent years. The growth in tourism, for example, has meant that the contribution of hotels, bars & restaurants to headline growth has generally been 0.2%-0.3% per annum.

According to the central bank, this sector grew by 7.5% in 2014, boosting overall GDP growth by 0.5 percentage points. Three sectors achieved double-digit growth in 2014, mining (20.3%), construction (13.8%) and private sector education (13.0%). And since 2010, agriculture, transport & storage, real estate services and financial services have also all been fairly consistent contributors to overall growth. The local economy has also benefited from a recovery in the fortunes of the manufacturing sector – particularly outside the Free Zone.

Conversely, construction has been quite volatile. In fact, the contraction in the construction sector in 2011-2012 was a key reason for the deceleration in the overall pace of growth in those years. Following a rise of 8.3% in 2010, real annual GDP growth slowed to 2.8% in 2011 and 2.6% in 2012. Growth has since recovered.

Dominican Republic:

Contributions to GDP Growth (%)

	2010	2011	2012	2013	2014
Agriculture	0.4	0.4	0.2	0.2	0.3
Mining	0.0	0.3	0.2	1.0	0.3
Free Zone Manuf.	0.3	0.3	0.0	0.0	0.1
Other Manuf.	0.9	-0.1	0.1	0.7	0.6
Construction	1.1	-0.2	-0.7	0.7	1.2
Hotels, bars & restaurants	0.3	0.2	0.2	0.3	0.5
Transport & storage	0.3	0.2	0.2	0.3	0.5
Real estate services	0.6	0.1	0.2	0.2	0.4
Commerce	1.3	0.1	0.6	0.1	0.5
Financial services	0.6	0.1	0.2	0.2	0.4
All Others	1.9	1.1	1.2	0.8	2.0
Tax adjustment	0.6	0.3	0.2	0.3	0.5
TOTAL GDP GROWTH	**8.3**	**2.8**	**2.6**	**4.8**	**7.3**

Source: *BCRD*

It is worth noting that the recent improvement in the DR's economic fortunes have been in spite of a number of persistent structural problems. According to the World Economic Forum (WEF)'s *Global Competitiveness Report 2014-2015*, the DR is the 101st most competitive country in the world, of 144 assessed, hardly impressive. The latest score represents a moderate improvement relative to the country's competitiveness ratings for 2013-14 (105/148), 2012-13 (105/144) and 2011-12 (110/142). The DR's relative competitiveness is similar across most of the aspects considered by the WEF (with rankings of between 94 and 107). Areas of comparative strength include market size (ranked at 68), business sophistication (73) and technological readiness (84).

Other recent assessments of the general business environment in the Dominican Republic are also rather unflattering. The World Bank's *Ease of Doing Business 2015* report ranks the Dominican Republic at 84th out of 189 countries assessed. Other countries similarly ranked include Uruguay, Costa Rica, the Seychelles and Kuwait. Trinidad & Tobago and Jamaica, the other two countries in Latin America and the Caribbean in which the business environment has been improving, are ranked at 79 and 58 respectively.

The WEF's recent (early May) biannual *Global Travel & Tourism Competitiveness Report* ranked the DR at 81st out of 141 countries considered. By this measure, its competitiveness in the global travel & tourism industry is similar to that of Jamaica (76) and Guatemala (80), but ahead of that of Honduras (90), El Salvador (91) and Nicaragua (92). Regional leaders in travel and tourism sector competitiveness include Panama (34), Costa Rica (42), Barbados (46) and Puerto Rico (55).

Globally, the DR stands out for the official prioritisation of travel & tourism (at 5/141). Its overall score is lifted by its international openness (63), air transport infrastructure (65), tourist service infrastructure (56) and ground/port infrastructure (64). However, its score is brought down by safety/security (120), human resources (97), price competitiveness (110) and environmental sustainability (131).

As a part of its research for the *Global Competitiveness Report 2014-2015*, the WEF asked businesses within each of the countries surveyed to identify the most problematic factors in the local operating environment. In the DR, no one problem stands out. Several are identified by a similar (and relatively low) number of respondents. The top five problems are tax rates (mentioned by a weighted 15.6% of respondents), access to financing (11.5%), corruption (10.4%), inflation (9.0%) and an inadequately trained workforce (8.9%). In nearby and richer Trinidad & Tobago, by contrast, which is more favourably assessed overall by the WEF, a weighted 15%-19% of survey respondents fretted about inefficient government bureaucracy, corruption, a poor work ethic and crime/theft.

Dominican Republic	
Global Competitiveness Index rankings [out of 144 unless specified otherwise]	
GCI 2014-15	101
GCI 2013-14 (out of 148)	105
GCI 2012-13	105
GCI 2011-12 (out of 142)	110
Institutions	116
Infrastructure	98
Macroeconomic environment	94
Health & primary education	107
Higher education & training	99
Goods market efficiency	94
Labour market efficiency	107
Financial market development	99
Techological readiness	84
Market size	68
Business sophistication	73
Innovation	103
Weighted average responses for the most problematic factors for doing business:	
Tax rates	15.6%
Access to financing	11.5%
Corruption	10.4%
Inflation	9.0%
Inadequately educated workforce	8.9%
Inefficient government bureaucracy	7.5%
Source: *World Economic Forum, Global Compeitiveness Report 2014*	
Memo: Dominican Republic - Global Travel & Tourism ranking of 81/141.	
Source: *World Economic Forum, Global Travel & Tourism Competitiveness Report 2015*	
Memo: Dominican Republic - Ease of Doing Business ranking of 84/189 (and rising), similar to Costa Rica, Uruguay, Seychelles and Kuwait.	
Source: *World Bank, Doing Business 2015*	

In short, the DR does not just have the benefits of a diversified economy: it also benefits from resilient businesses, which have adapted well to a frequently challenging environment. Meanwhile, international bond investors assess that the government's finances are moving in the right direction. In January, the government raised US$1bn in 10-year notes at a yield of 5.5%; and US$1.5bn in 30-year bonds at a yield 6.85%. In April 2014, the government had raised US$1.25bn from issuing 30-year bonds at a yield of 7.45%. The funds raised from the latest issues will be used to retire more expensive debt.

Looking forward, the DR should continue to benefit from the growth of the US economy. This should contribute to broad-based expansion across most sectors of the economy. Domestic demand will remain firm. Taking a longer-term view, the government has been advised to continue to focus on reducing poverty. The World Bank has identified five priority areas for the next four years. These include: further improvement of the business climate and access to funding for the country's 60,000 small and medium-sized enterprises (SMEs); improvements to infrastructure (including efforts to reduce losses from the power sector and the rolling out of a national broadband network); the construction of dams and other infrastructure to reduce the country's exposure to natural disasters; improved fiscal management; and better social protection for 1.3m people through the Progresando con Solidaridad program.

ECUADOR

IESS reform ruffles feathers

In economic and financial terms, the politically contentious move to end the state's set annual contribution to the social security institute does not put the system at risk.

On 14 April, Ecuador's National Assembly passed a contentious new reform ending the government's automatic contribution to the Instituto Ecuatoriano de Seguridad Social (IESS) of an amount equivalent to 40% of pensions paid to retirees, amounting to about US$1bn a year.

Passage of the law resulted in the departure of the left-wing Avanza party from the coalition with the ruling Alianza País. It also resulted in the departure from the cabinet of Ramiro González, the leader of Avanza, the industries minister and a former president of the IESS. President Rafael Correa has committed the government to maintaining pensions paid by the IESS. However critics of the move, including the departed González, have severely questioned the financial and economic impact of the ending of the automatic payment. The government has also been accused of a cynical short-term move at a time of weak oil export prices, which has put a strain on public finances. In May, it moved to seize seven private pension funds, fuelling further criticism (*see sidebar*).

Private funds taken over by BIESS

Seven private pension funds were formally transferred to the BIESS in late May. By far the most important is the Fondo de Cesantía del Magisterio Ecuatoriano (FCME – the teachers' fund), which has around 130,000 members and assets of US$419m. The transfer, ordained in legislation approved in September 2014, evoked comparisons with the 2008 nationalisation of private pension funds by Argentina's government, given that it comes at a time when the Correa government is struggling to sustain social spending amid a sharp fall in oil income. The government's rationale for bringing the funds under the aegis of the BIESS was that they had received State support in the past.

IESS

The IESS serves Ecuadoreans who are not in the armed forces or the police (the security forces are catered to by their respective social security agencies). It has four major functions. It administers the payment of pensions to people who have retired from work, whether because of age or incapacity, and also oversees the provision of benefits to widows and other relatives of former contributors.

Payments are also made for short-term disability, maternity and burial expenses. The IESS runs the public sector health and health insurance system (including the operation of hospitals) and also administers the workplace risks insurance system. Finally, it includes the Seguro Social Campesino (SSC) program, which administers the payment of welfare benefits to rural peasants and small fishermen.

The IESS operates also operates the Banco del Instituto Ecuatoriano de Seguridad Social (BIESS). This bank provides mortgages and unsecured loans to IESS contributors. Its products include loans to people who might otherwise face the risk of imprisonment for non-payment of alimony. To a certain extent, the BIESS also acts as a state-owned policy/development bank, extending loans on concessional terms to Ecuador's tourism sector. The BIESS is looking to sell its investment in its subsidiary, Quito Lindo SA, which in turn owns the well-known Hotel Quito.

The pensions system (whether for retirement or other purposes) is, in financial terms, by far the largest element of the overall IESS. Total outgoings in 2014 amounted to just over US$6.5bn, or 95.5% of the amount budgeted. This included US$3.86bn (98.6%) on pensions, US$1.86bn (97.6%) for the health/health insurance system, US$421m (86.7%) on the SSC program, US$193m (97.8%) on workplace risks insurance payments and US$195m (57.5%) on general operating expenses.

Total income in 2014 was, at US$6.36bn, only marginally less than outgoings. Most of the income comes from contributions from employers and employees. Employees contribute 9.35% of their salaries (unless they work for banks, insurers or other financial services companies, in which case the percentage is 11.35%). Employers contribute 11.15% of employees' salaries.

"In short, the government's financial contribution represents about 16% of the total income of the IESS, and about one quarter of the income of the central part of the social security system."

There are no maximum earnings limits for contribution purposes. The minimum earnings level used to calculate contributions is US$292 per month. If the employee earns less than this, their employer must make a contribution based on a minimum of US$292 per month.[1] The SSC program is funded by small contributions from employers (0.35% of beneficiary's income), participants (2.50%), contributors to the main social security program (0.35%) and a general contribution from the main social security funds (0.5%).[2]

The allocations of contributions received for workplace risks insurance (at US$190m) and the SSC program (US$460m) were broadly in line with the outgoings in 2014. Allocations for other/general expenses were higher than the outgoings, at US$292m. Allocations for health/health insurance were, at US$1.45bn, significantly below the outgoings. Allocations of contributions to pensions amounted to US$2.94bn. The remaining US$1.03bn, which was allocated to old age pensions, was the government's automatic contribution. Other income amounted to US$292m.

In short, the government's financial contribution represents about 16% of the total income of the IESS, and about one quarter of the income of the central part of the social security system. Had the government's contribution been determined on the basis of what was needed – rather than being set automatically at an amount equivalent to 40% of pensions – it would have had to pay about US$120m less than it actually did in 2014. In addition, the government's contribution appears manageable in terms of its total spending of around US$41bn (or 39.3% of GDP), and an IMF – forecast budget deficit this year of over US$5bn (or about 5.4% of GDP), with gross public sector debt of US$35bn (34% of GDP) or so.[3]

Upon passage of the reform, President Correa insisted that the government was not abandoning pensioners, and suggested that the demographics of Ecuador's workforce is such that contributions from/for younger workers should be sufficient to cover pensions. In 2010, 6.2% of the population was aged 65 or older. Some 62.9% were of working age, with 18.6% aged between 15 and 24. The remaining 31% of the population was under the age of 15. The total fertility rate was 2.75 per woman and life expectancy was 75 years. On this basis, the president's observation appears reasonable.

[1]International Group Program, *Summary of Social Security and Private Employee Benefits*, Ecuador, 2012
[2]IESS, *Informe de Rendición de Cuentas* 2014.
[3]IMF *World Economic Outlook* database, April 2015.

Instituto Ecuatoriano de Seguridad Social
Selected Metrics - 2014
Total outgoings US$6,527mn, of which:
Pensions: US$3,864mn
Health/ Health Insurance: US$1,856mn
SSC program: US$421mn
Total income: US$6,363mn, of which:
Automatic contribution from government: US1,034mn
Number of contributing members (end) 2014: 3.11mn
Number of pensioners: 360,000
Number of beneficiaries of SSC program: 1.18mn
Source: *IESS*

Correa was also keen to make the point that his government, in office since 2007, has in that period increased the basic monthly pension from US$3 per month to almost US$60 per month. Under the latest reform, housewives will also be included in the state pensions system for the first time. Again, given the left-wing administration's focus on improving the amount and coverage of pensions since 2007, it seems somewhat unlikely that it would now seek to bolster the financial situation of the IESS by cutting the benefits paid. It could seek to boost contributions to the IESS by lifting the contribution rates for employees and/or employers; and President Correa did not rule out this option in future. (It also seems likely that the retirement age will be lifted eventually, as per the trend worldwide). Above all, however, the government could lift contributions by further extending the coverage of the system.

Coverage has been growing steadily. Over the course of 2014, the total number of economically active contributors rose from 2.95m to 3.11m. The number of contributing members in the SSC increased from 1.15m to 1.18m, while the number of pensioners in the main social security system grew from 340,000 to 360,000.[4] This is in the context of a country with a total population of 16.24m and a working age (15-64 years) population of around 10m, according to the United Nations Department of Economic & Social Affairs/Population Division.

However, the increase in coverage has been from a low base. A 2010 report from the International Labour Organisation[5] (ILO) found that 65% of the economically active population made no contribution to IESS and therefore were not entitled to receive benefits from it. Indeed, the ILO identified low coverage as the principal problem in Ecuador's social security system.

Older people (aged over 65) classed as poor are entitled to receive a conditional cash transfer each month through a program known as the Bono de Desarollo Humano (BDH). This is currently paid at US$50/month. In 2010, some 43% of people over the age 65 and not covered by the IESS or the BDH lived in poverty, according to the ILO. By contrast, among older people with coverage, the poverty rate was 33%. The ILO noted that the system was highly regressive, in that half of the total pension subsidies were effectively going to people in the top income decile – i.e. those who were in remunerative employment in the formal economy.

In short, the change to the way in which IESS is funded can be seen as an increase in flexibility and a possible reduction in subsidies for a system that overwhelmingly favours wealthier Ecuadorians. The government insists that it remains committed to existing pensions and benefits, and may save some money as a result of the ending of the automatic contribution.

Arguably, even if the government had not ended the set 40% contribution, the amount of its contribution does not appear to be particularly onerous in terms of the overall economy, overall government spending or overall public sector debt – not withstanding the fact of a short--term liquidity crisis in this dollarised economy on the back of the collapse in oil prices in 2014/2015.

Conclusion

Medium term, the demographic trends in Ecuador mean that payments from newly enrolling contributors should rise relative to payments to pensioners. If the government wishes to strengthen the IESS, it could accelerate the growth in coverage – which has in any case been rising thanks to the latter inclusion of self – employed workers – and promote employment in the formal sector (notwithstanding that this is harder given the slippage in energy prices). Taking a longer – term view, the government could further reinforce the system by establishing a sovereign wealth fund (SWF) that, at least in part, had a mandate to reinforce the IESS.

[4] IESS, *Informe de Rendición de Cuentas* 2014.
[5] ILO, *Towards a Universal Pension Protection Scheme – Ecuador*, by Ruth Alicia Lucio Romero, 2010

REGION

The differing fortunes of financial centres in Latin America and the Caribbean

The March 2015 Global Financial Centres Index report and Long Finance/ Financial Centre Futures (GFCI 17), published by the Qatar Financial Centre (QFC), shows how the relative competitiveness of financial centres in the Latin America and Caribbean region has changed over the last six months.

The provision of financial services is a competitive business. The decision of a financial services company to undertake a particular activity in a particular place is influenced by various factors. It is also influenced by perceptions. For eight years now the Global Financial Centres Index (GFCI) has quantified the relative attractions of financial centres around the world on a semi-annual basis. GFCI 17, the latest survey, was published in March 2015.

The GFCI

The Global Financial Centres Index (GFCI) was created in 2005 and first published in March 2007. It assesses the competitiveness of financial centres around the world on the basis of two sources of data. One source of data involves instrumental factors that make a financial centre competitive. These factors include: the business environment, financial centre development, infrastructure, human capital and reputational & general factors. The other source of data involves responses from a survey 3,527 financial services professionals globally. The respondents were asked for their perceptions of competitiveness in relation to those centres with which they are familiar. These responses were collected over the two years to the end of December 2014 and resulted in 28,494 individual assessments of centres. The responses are discounted for age, with less weight being given to older responses.

A new GFCI is published every six months. The March 2015 GFCI is the 17th of the series. It assesses 82 centres globally, for which sufficient numbers of survey responses were received. There are another 14 associate centres, which will be incorporated when enough survey responses become available.

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The GFCI 17 survey found that New York, London, Hong Kong and Singapore remain the four leading global financial centres. New York, with a rating of 785 points (out of a possible 1,000) is in first place, if only one point ahead of London (784). Hong Kong (758) and Singapore (754) also have similar overall ratings. All four lifted their ratings relative to the GFCI 16 (September 2014). Tokyo (722), Zurich (719) and Seoul (718) all vie for fifth place in the latest survey. The five lowest-ranked centres of the 82 rated globally were St Petersburg (569), Cyprus (551), Tallinn (531), Athens (499) and Reykjavik (484).

In Latin America and the Caribbean, the GFCI 17 survey found that the financial centres assessed in the Caribbean islands were generally in a stronger position than those on mainland Central and South America. The British Virgin Islands (BVI) had an overall rating of 657, and was ranked in 34th position of the 82 centres assessed. The Cayman Islands and Bermuda, with respective ratings of 650 and 648, were close behind, in 39th and 41st place. Other centres assessed included São Paulo (644/ 43rd), Rio de Janeiro (638/ 47th), Panama (637/ 48th), Mexico City (623/56th) and the Bahamas (597/69th).

The financial centres in the large economies slipped in terms of ratings and rankings relative to their positions in GFCI 16. In the case of São Paulo and Rio de Janeiro, this may have been the result of the fairly difficult economic conditions in Brazil over the previous six months. Conversely, the ratings and/or rankings of the other centres improved.

The GFCI surveys also classify each of the centres according to three criteria. One is connectivity – the extent to which a centre is well known globally and to which professionals elsewhere consider it to be connected to other financial centres. Depending on the connectivity, the centre will be rated as global, transnational, or local. Another criterion is diversity, which is the breadth of financial services sectors represented in a centre. The third criterion is specialty, the depth of a particular sector in relation to one or more industry sectors: investment management, banking, insurance, professional services and government/regulatory.

None of the centres in Latin America and the Caribbean have sufficient connectivity to be considered global. The BVI are assessed as being both transnational and well specialised – with depth in professional services. Globally, the only other three centres similarly classified as transnational specialists are Abu Dhabi, Casablanca and Shenzhen.

The Cayman Islands are seen as a transnational contender. This centre is well connected, but lacking the breadth of sectors present in the BVI. In addition, the Cayman Islands' rating for banking is not sufficiently larger than its overall rating for it to be assessed as having depth in banking. Other transnational contenders globally include Bahrain, Edinburgh, Gibraltar, Jakarta and Jersey. Of the other centres in Latin America and the Caribbean, Mexico City and São Paulo are considered to be local (in that they appear to have relatively low connectivity to other centres) but diversified, in that they include organisations that are active in a variety of financial services businesses. The Bahamas, Bermuda, Rio de Janeiro and Panama are seen as evolving centres, apparently lacking (for now) breadth of activities or clear depth.

Also significant are the identities of those regional centres that are not included in the GFCI 17. There are three centres that are classified as associate centres, in that insufficient numbers of survey responses were received from the financial services professionals who were interviewed. These are Buenos Aires, Santiago and Trinidad & Tobago. The GFCI 16 survey had included Buenos Aires, because enough survey responses had been received. The survey does not include Bogotá, Lima, or Caribbean centres such as Barbados or Curaçao.

The GFCI report highlighted that in Latin America and the Caribbean the general trend in ratings for the various centres has been upwards. São Paulo has achieved the largest improvement since 2007. We would attribute this to the virtuous circle of lower inflation, lower interest rates and currency stability evident for most of the last eight years, particularly when Brazil's economy benefited from higher prices for energy and iron ore.

Recent reports from regulators in the BVI, the Cayman Islands and Bermuda also generally confirm positive trends. On 4 May 2015, for instance, the Bermuda Monetary Authority (BMA) noted that gross premiums written by the island's insurance sector in 2014 amounted to US$163bn, or 35.3% higher than in 2013. Net premiums increased by 41.4% to US$139m. At the end of last year, total assets and capital/surplus amounted to US$608bn and US$192bn respectively. The sector is dominated by commercial (re)insurers, for whom 2014 premiums, year end assets and year end capital/surplus were, respectively, US$130bn, US$482bn and US$138bn. Captives accounted for the remainder. In the first three months of 2015, the BMA registered 14 new insurers and five new insurance intermediaries.

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In early 2015, the BVI Financial Services Commission (BVIFSC – the omnibus financial services regulator) noted that local financial centre operations continue to grow by a number of measures. The number of companies incorporated in the BVI each quarter has been around 12,000. At the end of last year, there were an accumulated total of just under 458,000 companies. There were also 1,061 private trust companies and 659 limited partnerships. The number of trusts and other fiduciaries domiciled in the BVI has also been rising, if slowly, and stood at 226 at the end of December. The centre is also home to 2,142 mutual funds (almost all of which are professional or private funds, rather than funds that are widely distributed to the public) and 631 holders of investment business licences and other investment managers. The BVI is also home to a significant community of captive insurers (145) and domestic insurance companies (37), as well as about 40 brokers, agents and other functionaries.

Although the Cayman Islands has been contracting as a banking centre in terms of the number of banks (195 as at the end of March this year) and cross-border assets (US$1.37trn as at the end of June last year) it is, by that measure, still the sixth largest banking centre globally, according to the Cayman Islands Monetary Authority (CIMA – the central bank and omnibus financial regulator). The number of trusts has remained broadly unchanged at 140 over the last year or so. The number of mutual funds licenced by the CIMA has also remained steady at about 10,800, while the number of fund administrators has slipped from 134 to 112 since 2010. Conversely, the number of company services providers (115) has been rising gradually. Over the course of 2014, 22 new foreign insurers were licenced, taking the total to 760 (most of which were captives or Segregated Portfolio Companies). As of the end of March this year, these companies were writing annual premiums of around US$12.5bn, and had assets of US$54bn. Some 90% of the Cayman Islands' insurers are covering risks in North America. The centre is home to around one third of medical captive insurers globally: the most important lines include medical malpractice liability and workers compensation insurance.

The CIMA is introducing the Regulatory Enhanced Electronic Forms Submission system (REEFS). This will enable applicants for licences to lodge forms and make payment of fees online. A benefit for the regulator is that the new system will only allow properly completed forms to be submitted, along with the fees. A benefit for the applicant is that it will be possible to track the progress of an application. REEFS will also produce reports that will make it easier for the regulator to ensure that it is continuing to deliver an efficient service to all stakeholders in the Cayman Islands' financial sector.

A number of conclusions can be drawn from the GFCI 17 and the various announcements from the regulators in the leading financial centres in the region. In the leading centres, the regulators and the other protagonists understand that continual process improvement is essential. They also know that sales/marketing is essential: as the methodology of the GFCI reports recognises, perceptions matter as much as the reality. The leading jurisdictions are quite different in terms of their specialisation(s): this means that they are competing far more with centres in other parts of the world than with each other.

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The fortunes of São Paulo and Rio de Janeiro as financial centres will depend on a return of growth to Brazil's economy and the end of the tightening of monetary policy by the Banco Central do Brasil (BCB). Although recent economic trends in Mexico have been more favourable than in Brazil, the financial services community in Mexico City faces more competition from providers and centres in the US than do their peers in São Paulo and Rio de Janeiro. Conversely, the other centres will flourish if they can leverage clear strengths such as close links to Colombia (in the case of Panama) and trusts (in the case of the Bahamas).

Govt push on mining

The Honduran council of ministers in late May declared 18 zones in the country mining reserves, as the government led by President Juan Orlando Hernández moves to accelerate investment interest in the country's mining potential. A new mining law was approved in 2013, ending a moratorium on new mining permits introduced in 2006 by the former president Manuel Zelaya (2006-2009).

Presidential advisor Ebal Díaz confirmed that 18 zones, situated in the departments of Comayagua, Choluteca, Colón, El Paraíso, Francisco Morazán, and Santa Bárbara among others, have been designated exploration zones. This comes in the run-up to a promotional event in August being hosted by the Consejo de Minería y de Industria Extractiva, Comercio e Inversiones (Comicoin) under the banner 'Honduras is open for mining', to which some 400 foreign mining companies have been invited. In early March, a Honduran delegation also took part in the 2015 conference organised by the Prospectors & Developers Association of Canada (PDAC), a key annual industry summit.

While underlining that Honduras has sufficient mineral resources to generate employment and spur economic development, Comicoin suggests that investment conditions are not yet attractive enough. While stressing that environmental protection is fundamental, it advocates a faster approvals process and better juridical security. According to Comicoin, around 64 companies currently are seeking exploration permits from the Inhgeomin. That is some way off the 200 unused concessions that officials hoped to revoke and re-issue upon approval of the new mining law in 2013, and it is unclear how many new permits have been approved since then; nonetheless activity in the sector appears to be rising.

The 2013 mining law

Aside from lifting the moratorium on new concessions, the January 2013 mining law approved addressed gaps in the previous (1999) law left incomplete after the supreme court of justice repealed 13 articles in 2005. It also (marginally) increased the tax burden on mining companies, albeit at less than 6% (on net sales and exports taxes minus production costs) it remains pretty low in comparison to other countries. At the time of its approval, critics claimed the new framework had been drafted following some 'consultation' with Canadian government agencies; Canadian mining companies already having some interests in the country.

The law also created a new Honduran institute of geology & mines (Inhgeomin), replacing the mining promotion board, Defomin, which had been a dependency of the environment ministry (Serna). Unlike its predecessor, Inhgeomin sits directly under the presidency. Annual mining revenues amount to about US$300m or so.

Organisations including the national coalition of environmentalist networks of Honduras (CNRA) objected to the law. The CNRA warned that it opened the door to open-pit mining. It also complained that the consultation process set out in the law "theoretically allows communities to say no to mining, but only after the exploration concession has already been granted and after there is a contract established with mining companies".

It also noted that mining was not prohibited in populated areas, which could permit "forced expropriation and the destruction and displacement of communities". Finally, the CNRA expressed concern that the law failed to protect "water sources that communities depend upon […] except for those that have been declared and registered, which are a minority". These complaints apparently went unheeded.

Potential

According to Comicoin's president, Reinaldo Ecónomo, there are about seven metallic mines and some 300 non-metallic mines in the country at present, mostly located in the Valle de Sula, an area in the north of the country surrounding the country's main business city, San Pedro Sula; as well as in the area surrounding the capital, Tegucigalpa. Environmentalists warn of many small illegal mines, some with ties to organised crime. The country has reserves of iron ore, gold, silver, lead and zinc, plus deposits of antimony, marble and precious stones.

Chinese premier swings through the Andean

China's Prime Minister Li Keqiang visited Colombia and Peru on 21-24 May as part of a regional tour that also included stops in Brazil and Chile. During his stopovers in the two Pacific Andean countries, Li signed a series of economic cooperation agreements and offered Chinese financing and expertise for the development of ambitious infrastructure projects.

Prime Minister Li arrived in Bogotá from Brasília on 21 May. After a meeting with Li at the Casa de Nariño presidential palace, President Juan Manuel Santos announced in a joint press conference that the two countries had signed new technical cooperation agreements in the areas of investment, infrastructure development, agriculture, education and tourism. President Santos highlighted the support offered by Li to two major infrastructure projects.

The first is the construction of a 500km highway to run alongside the Meta River, linking the cities of Puerto López in the central Meta department to Puerto Carreño, the capital of the eastern Vichada department, on the border with Venezuela. Chinese construction firms have expressed an interest in the public tender processes for the so-called 'fourth generation (4G)' roads, which the Santos administration wants to build in the next few years; and Li, accompanied by a 120-strong delegation, assured Santos of Chinese interest in the project. Santos said that the scheme, which also involves the dredging of the Meta River in order to make it navigable, would allow for the development of Colombia's eastern Orinoquía region. "This is the road that we have long been dreaming of," Santos declared, adding, "it will allow us to develop this entire region".

The second project is a development programme for the port city of Buenaventura, which Santos said would "bring new life" to Colombia's main Pacific port, which is the main hub for Colombia-China trade. Santos said that Li had expressed Chinese interest in collaborating with the development plans, which among other things involve the construction of a new industrial park in Buenaventura aimed at turning the city into a new "development pole".

Li said that China "wants Colombia's development opportunities to be properly exploited". He also emphasised China's interest in singing a free trade agreement (FTA) with Colombia. Bilateral Colombia-China trade has increased by a factor of 15 over the last decade to reach US$17bn in 2014. Santos said the potential to increase this trade further was "enormous".

Li continued to Lima on 22 May, where he was received by President Ollanta Humala. The two leaders evaluated the impact of the bilateral FTA signed in 2009 and went over the integral strategic association agenda drafted in 2013, which aims to deepen bilateral economic ties. The two leaders announced 10 bilateral cooperation agreements in areas including industrial investment, technical and economic development, energy development and the construction of a systemic molecular evolution lab.

Bi-oceanic railway

China's Li and Peru's Humala also signed a memorandum of understanding on a joint feasibility study for the construction of a new bi-oceanic railway line linking Brazil's Atlantic port of Açu in Rio de Janeiro state to Peru's Pacific port of Bayóvar in the northern region of Piura. The exact route is still being evaluated.

The idea is that the 10,000km railway, with a price tag of US$10bn, would facilitate

Chile

Speaking at the China-Chile business forum on 25 May, President Bachelet said that China's support to "attain the much-desired physical integration of South America through bi-oceanic corridors" would be invaluable. Chile's *Diario Financiero* reported that Bachelet had informed Li that Chile had hosted a meeting of government officials from Argentina, Brazil and Paraguay in mid April to discuss two bi-oceanic corridors: one from Brazil's state of Matto Grosso, passing through Paraguay and Argentina to Chile's northern ports; another from the Brazilian port of Porto Alegre through Argentina, and the proposed US$1bn trans-Andean Agua Negra tunnel to Chile's port of Coquimbo (Region IV).

trade between China and South America. Li commented that the proposed scheme would "expand the connectivity between South America's Pacific countries and Asia, reaffirm trade ties and help boost a new type of industrialisation in the South American continent".

Humala suggested that the proposed railway would "consolidate Peru's geopolitical position as a natural gateway to South America". Pointing out that bilateral trade has increased by 40% since the 2009 Peru-China FTA, to reach US$15.4bn last year, Humala said the railway could boost trade further.

From China's perspective, the railway would cut the cost of shipping the huge quantity of primary commodities – metallic minerals and agricultural products – that it buys from the region. Li sought to assuage concerns about the environmental damage that such a massive infrastructure project across the heart of the continent would cause, claiming, in a joint declaration with Humala, that "it is essential to protect the environment in order to create this infrastructure".

Li concluded his visit to Peru by meeting local businessmen to discuss opportunities in Peru and China. He then headed to Chile for the final leg of his regional tour (24-25 May), where he told his host, President Michelle Bachelet, that China was not only interested in one bi-oceanic railway across South America but also in financing several other 'tributary' lines.

Ambev acquires BBC

The world's largest brewer and the largest drink's manufacturer in Latin America, Brazil's Ambev, has reached an agreement to acquire Colombian craft brewery, Bogotá Beer Company (BBC). An Ambev statement said that the deal would help to "boost the growth and innovation plans of BBC in the medium and long term in Colombia, one of the most vigorous economies in Latin America". Despite a lack of details in the released information, the acquisition includes BBC's brewery, located 20km from Bogotá, and its 27 points of sale. BBC was founded in 2002 and since then it has developed 13 craft beers "inspired by classic European styles and with traditional and natural ingredients".

Merentes denies dollarisation rumours

Venezuela's central bank (BCV) president Nelson Merentes has dismissed the "campaign of rumours" about dollarisation, which in late May intensified alongside the continuing slide in the black market exchange rate, which at one point tipped over BF400/US$1 before coming back in to about BF366/US$1. The free-floating official FX rate, the Simadi, closed at BF199.9/US$1 on 25 May, according to latest BCV data.

Merentes did not deny that the BCV is holding meetings with public and private financial sector authorities about potential changes to the country's three-tiered exchange rate system, which is increasingly distorted amid the ongoing dollar scarcity, heavily exacerbated by the BCV's expansionary monetary policy. While international reserves have now dipped to US$17bn, the broad M2 money supply continues to grow at a mind-boggling rate, driving inflation through the roof.

Deputy Jesús Faría, of the ruling Partido Socialista Unido de Venezuela (PSUV), who sits on the congressional finance committee, said the dollarisation rumours were part of the 'economic war' being waged against the country by international right-wing forces. "We will never become an appendix of the North American economy," he told *Globovisión*.

However, Faría acknowledged that discussions were underway about the simplification of the existing three-tiered system, with a view to moving to two FX rates, one fixed and one free, for example.

The dollarisation rumours, which have been rumbling since April, really took off after Ford Venezuela in early May said it had reached agreement with the Caracas government to sell some of its stock in dollars, in order to alleviate the dollar shortages that had forced the company to paralyse production for want of imported parts.

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