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Q&A-Power generation, renewables to drive LatAm clean energy transition; Colombia could lose IG rating without tax reform: Mauricio Cardenas



The energy transition in Latin American countries will be driven by sectors such as power generation and renewables like hydrogen, as fuel price hikes are nearly impossible to implement from a political point of view and state-owned oil companies are in tricky financial straits, **Mauricio Cardenas, former Colombian finance and energy minister** told the Reuters Global Markets Forum on Tuesday, May 4.

"Power generation ... is the bright spot, investment in renewable energy is growing fast in several countries," he said, adding that land use and deforestation were the main challenges in these nations.

Cardenas, now a senior research scholar at Columbia University's Center on Global Energy Policy, said Colombia could lose its investment-grade credit rating after widespread unrest caused President Ivan Duque to withdraw a long-anticipated tax reform proposal, unless some reforms are eventually passed.

He also said he could make a presidential run in 2022. "But only if I see that a centrist, pragmatic and socially responsible option is viable."

Following are edited excerpts from the conversation:

Q: What do you make of the withdrawal of the tax reform bill in Colombia?

A: It was a necessary step. Population did not respond well to the proposal. It generated a very negative reaction because a lot of measures proposed implied greater taxes on the middle class.

Q: What are your thoughts on newly appointed finance minister Jose Manuel Restrepo? Besides coming up with an alternative tax reform, what will be his other big challenges?

A: Restrepo, the new finance minister, is a well-regard figure. Comes from the Conservative Party and has played a good role as trade and Industry minister. But (he) now has a huge challenge ahead: explain to the population the need of a reform, that if not passed, would make Colombia lose its investment grade (IG rating), at least by Fitch.

Also, he needs to generate revenues to sustain social expenditures for two to three years, as poverty climbed to 41.5%.

Another issue is to drastically cut the 2022 budget. Government expenditures were 19% of GDP in 2019 and are now 24% of GDP, they need to go back to approximately 20% of GDP in 2022.

Q: What reforms would be palatable to the public and investors? Do you see a path for Colombia to retain its IG rating?

A: The reform that will be passed will look very different from what was initially intended. It will have more taxes on the rich -- wealth, dividends, less deduction, and a higher rate on top brackets -- and at the firm level it will keep the 33% corporate tax rate for longer. The idea in a reform passed in 2019 was to bring that rate to 30% in 2023. That will not happen now.

With a reform that produces 1% of GDP in revenues, Colombia will keep its IG.

Q: Switching over to energy -- how has COVID-19 has impacted the energy transition in Latin America? Is there less political will to push through necessary reforms, or has it opened up better opportunities?

A: Raising fuel prices has shown to be almost next to impossible in these circumstances. Ecuador in 2019 and now Colombia with the proposed VAT (value-added tax) on gasoline. So, energy transition will come from other sectors, such as power generation. This is the bright spot. Investment in renewable energy is growing fast in several countries. And some cities, such as Bogotá and Santiago, are making important progress in the electrification of buses. Land use and deforestation are the main challenge. Need to

be more aggressive on this front, especially in the protection of the Amazon. News from (President Jair) Bolsonaro's on Earth Day Summit commitment are encouraging, but one needs to remain vigilant.

Q: A few months ago, you wrote that LatAm nations ought to pursue investments in green hydrogen. Could you run us through the rationale for why that would be a good investment? Are governments on track to pursue these investments?

A: On H2 (hydrogen), Chile is clearly ahead of the pack, has a well established program with government support for research and development. The issue is who can produce green H2 at the lowest cost. Chile has solar energy, but not so much water. Colombia has the water, but solar energy is only beginning. Transport to Asia is another issue to consider. In H2 of ammonia, LATAM will need to compete with Australia in the Japanese market.

Q: In countries with state-controlled energy companies that may already be under financial stress, like Pemex, what incentives could drive clean energy development and adoption?

A: On oil, very different outlook for the various national oil companies. Ecopetrol in better shape than its peers in LATAM, although it will need to take a lot of debt to buy ISA (power transportation) from the government. Petrobras now in a tough spot as privatizations could be delayed and petrol prices controls will impact negatively its financials. Pemex is not delivering on its promises in terms of production and needs permanent support from the federal government to pay back its debts.

Q: Do you foresee difficulties for Ecopetrol to finance that debt?

A: On ECO/ISA debt should not an issue. What I don't see is a significant ability to raise equity at this point. Ecopetrol announced that it intended to buy ISA with a new capitalization. I don't see that happening.

Q: Should developed countries be obligated to aid emerging markets in the energy-transition process? And considering the rising tide of nationalism, what's the best way countries can coordinate a policy response on climate change?

A: Obligation is a strong word. I see more interest in multilateralism, especially in the U.S. government. But that does not necessarily mean more money from developed markets for energy transition. Now the focus is on vaccines, and it will remain (so, for the) next two years.

Avoiding populism is increasingly hard these days. Look at Peru. Colombia, Peru, Chile and Mexico could all end up taking that direction. The club of the countries that were well managed in the region!

Q: With the developing world set to be the biggest source of emissions growth, what financing mechanisms are needed to facilitate the move to cleaner energy?

A: So, energy transition crucially depends on finance. I see a role for Inter-American Development Bank but also for the newly created Development Finance Corp. They can provide long term loans at competitive rates, but also take some project risk. That's the name of the game now, and it is what the (U.S. President Joe) Biden administration should look at.

Q: Any political plans of your own on the cards?

A: On my side, if I see a window, I will run for the presidency in 2022. But only if I see that a centrist, pragmatic and socially responsible option is viable. I would avoid the extremes, that now seem more appealing to the electorate.

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