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LAND *of* OPPORTUNITY

Business-friendly government reforms are luring law firms—and their clients—to a rising Mexico. By Susan Beck

White & Case's Vincente Corta Fernandez, left, and Jones Day's Fernando de Ovando

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REFORMING MARKETS

Open for Business

Paraguay, Colombia, Argentina & Chile have all recently been praised for encouraging investment but which is the best bet for investors?

By Maria Jackson

The economic map of Latin American continues to be redrawn. Although Brazil remains the region's top dog, Mexico is growing more quickly. Elsewhere, Colombia recently overtook Argentina as the third-largest economy in Latin America, following Argentina's much-publicized currency woes.

Over the past decade, almost annually, a new thriving economy has been highlighted as the 'one to watch' as Latin America's resource-rich countries have capitalized on the commodities boom. But as China's demand wanes, it seems that the time of eye-watering growth rates is over, at least for now. The Inter-American Development Bank (IDB) forecasts economic growth of around 3 percent for Latin America during 2014, nearly half of the 5.8 percent recorded in 2010.

The message from the International Monetary Fund (IMF) is clear: to secure growth, Latin America needs to lay long-term foundations and focus on reform not stimulus. Chile has long been admired for its pro-business regime, while Colombia and Paraguay have made great strides to increase their attractiveness to foreign investors in recent years. Even Argentina appears to be reversing its suspicious attitude towards foreign investment as it looks to encourage economic growth.

BUILDING BLOCKS

The urgent need for infrastructure continues to dominate Latin America's economic agenda. According to the IDB, investment in infrastructure in the region needs to double from the 2.5 percent of gross domestic product (GDP) that is currently being spent to meet demand. The IDB suggests that around half the increase should flow from the private sector, which would represent approximately $100 billion a year.

Countries are looking to public-partner partnership (PPP) models to help fund their ambitious infrastructure programs, and the race is on for those nations without PPP frameworks in place to create attractive regimes for private investors. Paraguay, for example, recently passed the Public-Private Alliance Act to promote investment in public infrastructure projects including highways, ports, airports and social and electric infrastructure. Paraguay currently invests around $400 million a year in infrastructure, while government sources have admitted that it should be spending around $2 billion a year to catch up to its neighbors. The new law aims to address that shortfall.

"The law seeks to establish standards and mechanisms to promote, through innovative public-private participation, investments in public infrastructure as well as in the production of goods and provision of services that are themselves the subject of agencies, entities, public companies and companies in which the government is party," says Hugo T. Berkemeyer, partner at Paraguayan law firm Berkemeyer Attorneys & Counselors. "For the first time, the government assumes the role of a responsible modern state, leaving behind sterile and paternalistic customs."

Paraguay certainly has the money to invest; its economy grew by 13.6 percent in 2013, driven by recovery in its agriculture sector.

Although Colombia may not be witnessing the double digit growth rates of Paraguay, its economy expanded by 4.3 percent in 2013, according to Colombia's national statistics agency DANE. It also expects a bumper 2014, with estimates from the country's Finance Minister, Mauricio Cárdenas, suggesting that the economy will grow by 4.7 percent this year. In a large part, this is due an expected $12 billion investment in infrastructure projects, which PPP will play an important role in fulfilling.

"Foreign investors have been very interested in Colombia's PPP program," says Alessia Abello, partner at leading Colombian law firm Posse, Herrera & Ruiz. "Evidence of which is the massive participation of companies from Spain, France, Israel, Austria, China, Mexico, Costa Rica, Brazil, Italy, India, Peru and Portugal in the prequalification processes held by the National Agency of Infrastructure ("ANI") at the end of 2013."

In 2012, Colombia announced its intentions to increase the amount of yearly investment in infrastructure from 1 percent to 3 percent of GDP, or from $3 billion to $9 billion a year and implemented a new act on PPPs to stimulate private investment in its program. However, Colombia's PPP contract structure is currently experiencing some problems: ANI has published all documents of the projects, opened nine bidding processes but is yet to close any of them

"Many think that the structuring and technical studies of certain projects were not complete, others say they lack updated information (some studies are from 2010). Many companies insist on the fact that the financial model of the Government is not consistent with the current financial market," says Abello. "On the other hand, the financial market has been eager to participate even in project finance structures but the risk allocation of the contracts has made their participation more expensive than initially expected by the government."

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—ALESSIA ABELLO, POSSE, HERRERA & RUIZ

As Abello goes on to explain, ANI responded to the comments by increasing all government payments to concessionaires by 10 percent, with the intention that these additional funds would help to close the financial models of private investments. It also established the National Development Bank in an attempt to create credit enhancements to support private banks in the financing of the program.

"To be fair with ANI, it has made great efforts in trying to change the risk allocation of the contract and in general, is listening to investors and trying to address all the concerns," she says. "And it has, in some cases, made important changes; today's risk allocation is better for investors than the one from previous PPP programs, but unfortunately the changes are not enough."

The atmosphere of skepticism has been heightened by recent steps taken by ANI that have worked to undermine investor confidence in the country's PPP program.

"ANI unilaterally modified the payment schedule of an existing concession (Ruta del Sol 3) and a control agency made a seizure of the payments of another concession, payments that were previously assigned to a trust to back the issuance of bonds from that concession." says Abello. "While ANI has been quite active in trying to undo the seizure, both missteps have generated important negative reactions from investors and banks and generated a lack of trust in the legal stability of the concession agreement, and therefore a lack of trust in the projects."

There have also been some concerns that Chile's infrastructure program may experience some wobbles, following the election of the country's new center-left president Michelle Bachelet. The former administration had a sweeping program of infrastructure projects tabled to be put up for auction between 2010 and 2014, worth over $11 billion.

"The infrastructure program was necessary for the country's reconstruction after the 2010 earthquake and tsunami," says Jaime Carey, managing partner of Carey, which is Chile's largest law firm. "The program will continue but probably not with the intensity of the last four years."

In March, Chile's construction chamber (CChC) presented $40 billion worth of infrastructure projects to the new government, highlighting concessions as the most appropriate method of attracting private investment. It still remains to be seen how many of the projects will be endorsed by President Bachelet.

FEELING TAXED

Infrastructure development may be the most pressing aim for Latin American governments, but to attract private investors reforms in other areas, particularly tax and governance issues, have also been prioritized.

Tax collection has long been a challenge for the region and governments have been focusing on boosting their revenues in this area; according to the IDB, Latin America has managed to increase collection by 2.7 percent of GDP over the past twenty years but governments still only receive 17 percent of GDP. However, the challenges of increasing the tax base need to be weighed against the demands of luring foreign investors. Chile, for example, which has traditionally taken a very pro-business route to tax matters, is looking in the opposite direction under the leadership of President Bachelet. In April, she submitted a tax reform bill to Congress that proposes raising corporate taxes from 20 percent to 25 percent and that also looks to abolish the Taxable Profits Fund (or 'FUT') - a mechanism that companies can use to gain tax exemptions on reinvested company profits.

"There is concern relating to the tax reform as it is granting the tax authorities extremely broad powers relative to anti-elusion provision that may be too discretionary," says Carey. "There are other aspects of the reform that are very complicated from a technical point of view which do not seem feasible to apply. In general terms this reform, depending on the final approval, could deter foreign investment and reduce economic activity."

It is an interesting step for Chile, which has long been seen as a flag bearer in the region for pro-business policies. Luckily, it is not a common theme; generally speaking, tax reform in Latin America is currently looking to promote foreign investment.

In 2012, Colombia passed a significant tax reform bill that reduced corporate tax to 25 percent and looked to streamline the country's complex tax regime and bring it in to line with OECD standards.

ALESSIA ABELLO
POSSE, HERRERA & RUIZ

JAIME CAREY
CAREY

"We believe that the tax reform brought a positive outcome due to the introduction of new regulation governing permanent establishments and thin capitalization rules," says Enrique Gomez-Pinzón, the executive partner of Holland & Knight's Bogotá office. "The latter, as far as it introduces a more serious debate regarding the actual development of this kind of regulation in the country, should lead to a more attractive and solid legal and tax environment for foreign investors."

Even countries such as Argentina have realized that they need to take a more pragmatic approach to foreign investment.

A NEW ERA

Argentina fell out of international favor in 2012 when it re-nationalized oil company YPF. The controlling shareholder, Repsol, launched a $10.5 billion compensation claim, which was finally settled in February 2014 with Argentina agreeing to pay the Spanish energy company $5 billion. It is an embarrassing backdown for Argentina but crucial if the country is to attract foreign investment to help it exploit its promising shale reserves.

"Considering the current energy situation in Argentina and the need of foreign investment and technology to develop this area, the settlement with the Spanish oil company Repsol was considered a very good message for foreign and local investors," says Enrique Stile, partner at leading Argentinean firm Marval, O'Farrell & Mairal. "There is no doubt that the Vaca Muerta shale oil and gas deposit should be in production soon."

In addition to the settling of the Repsol case, there are other indicators that Argentina is keen to present a more internationally respectable face. After Argentina held its mid-term polls last October, there has been an attempt to polish its political image.

"New measures were taken to accelerate the devaluation and reduce the breach between the official exchange rate and what is called the blue market," says Stile. "There was also a change in the methodology of the National Statistics and Censuses Institute, which is the Argentine government agency responsible for the collection and processing of statistical data, such as inflation rate, consumer price index and unemployment. Those changes were aimed at making the stats more transparent and credible."

Stile adds that a process to reduce, or in some cases eliminate, subsidies on activities in areas such as energy and transportation has also started. It bodes well for future investment possibilities.

It is not only Argentina that is working to project a new climate of stability to investors.

Although Colombia has long provided a fair and stable framework for foreign investors, its security situation put off companies worried about getting caught up in the 50-year old armed conflict between the FARC guerrilla rebels and the government. In the last 12 years the country has focused on improving the security situation and it has paid dividends: in 2012, Colombia received over $15 billion of Foreign Direct Investment.

"Colombia´s government is in the middle of peace negotiations with the guerrillas and we are confident the end of the armed conflict is near," says Gomez-Pinzón. "At the same time, the government has maintained clear rules of law guaranteeing a level playing field and tax incentives in certain key sectors that make it very attractive to invest in Colombia. Companies are learning that Colombia is one of the really reliable countries to place their investments in the region."

There is no doubt that the economic fortunes of the region remain in flux. Chile, which has long been perceived as a safe haven for business in Latin America, is beginning to lose ground, while Argentina is being forced to bend backwards to attract new investment. Colombia is currently flying high but as emerging economies such as Paraguay continue to work hard to lure foreign money, the competition is heating up.

Latin America is open for business but investors may have their work cut out deciding where to put their money. ■

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