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FEATURED Q&A

Is Paraguay's Economy Headed for Investment Grade?

Q Ratings agency Moody's Investors Service last month increased Paraguay's sovereign rating from Ba2 to Ba1 with a stable outlook, one step away from investment grade, citing progress implementing fiscal reforms passed in 2013, increased infrastructure investment, moves to diversify the economy and improving governance. Is Paraguay's economy on the right track, and what would it take for the country to reach investment grade? Could flare-ups over social issues, such as strikes and concentrated land ownership, hamper progress?

A Gerardo Ramón Ruiz Godoy, a senior partner at Paraguay Consulting Group Business Advisers: "There have been important successes. Paraguayan governments since 2003 have emphasized maintaining order in economic policy, implementing prudent and necessary fiscal reforms, improving revenues and maintaining financial discipline with successive years of fiscal surplus, a low level of inflation and exchange rate control. These conditions remained unchanged over the years. In this scenario, there was development and strengthening of the financial system, the primary production sector and services, and it ultimately generated significant investment in the areas of construction, industry and trade, providing a great impetus to the economy. To this can be added the major public works begun by the current government, all in a climate of political stability and an improvement in the administration of justice, which creates the necessary environment so that Paraguay can become an attractive, safe and profitable destination for capital. There is still a need for greater investment of public resources directed to education and employment programs and assistance for small producers to reduce poverty, which according to recent government reports decreased from 23.8 percent in 2013 to 22.6 percent in 2014. Social sectors,

Continued on page 4

Venezuela-U.S. Friction Raises Questions Ahead of Summit

Venezuelan President Nicolás Maduro said supporters have collected more than 8 million signatures on a petition against the executive order issued last month by U.S. President Barack Obama declaring Venezuela a "security threat." See story on page 2.

File Photo: Government of Venezuela

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NEWS BRIEFS

American Eagle Outfitters Expanding Into Chile, Peru

American Eagle Outfitters has announced plans to expand into Chile and Peru, *Forbes* reported Monday. The clothing retailer has entered a multi-year licensing deal with **Eurofashion Limitada**, a division of Chile's **Cencosud**, which will open the first Chilean American Eagle store in the second half of 2015 and will launch the company's first outlet in Peru in early 2016. American Eagle already operates in Colombia, Panama and Mexico.

Brazil Should Reduce Government Spending: Bradesco CEO

The CEO of **Banco Bradesco**, one of Brazil's largest private sector banks, said Monday that the government has the ability to tighten its budget and should curb spending to "give the country relief," Reuters reported. At a bank event in São Paulo, Luiz Carlos Trabuco said the government's target for the primary budget surplus of 1.2 percent of gross domestic product is feasible. Last month, Brazil's central bank approved Bradesco's request for a $1.5 billion capital increase.

Standard & Poor's Reduces Credit Rating of Pacific Rubiales

Ratings agency **Standard & Poor's** has downgraded the credit rating of **Pacific Rubiales**, Colombia's second-largest oil producer, from BB+ to BB with a negative outlook, *Portafolio* reported Friday. Citing the company's weak financial and credit indicators due to lower international oil prices, S&P said it revised the financial risk profile of the company from "intermediate" to "significant." On Monday, the oil company announced that it has hired Frederick Kozak as its new corporate vice president of investor relations.

Political News

Venezuela-U.S. Friction Raises Questions Ahead of Summit

Venezuelan President Nicolás Maduro said supporters have collected more than 8 million signatures on a petition rejecting the executive order issued last month by U.S. President Barack Obama declaring Venezuela a "security threat" and imposing sanctions on seven Venezuelan officials over human rights violations, *El Universal* reported. Maduro, who had set a goal to gather 10 million signatures, has said he will bring the petition to Obama at the Summit of the Americas this week in Panama, a potentially uncomfortable encounter that could upstage goodwill the United States hoped could prevail at the first Summit to include Cuba, a country it has only recently started to foster better relations with. Maduro has seized on the executive order to amplify the image of the United States as an aggressive imperialist in the region and boost his popularity at home. Last Friday, U.S. Assistant Secretary of State for the Western Hemisphere Roberta Jacobson said the issue had been "blown way out of proportion," the *Miami Herald* reported. She described the executive order language as "infelicitous" but essentially boilerplate required to implement sanctions. Leaders across Latin America have been both critical of the U.S. order while expressing concern about the political situation in Venezuela. Colombian President Juan Manuel Santos, a firm ally of the United States, rejected the sanctions approach on Monday. "We have always said that unilateral sanctions are counterproductive in the long run," Santos told a Colombian newspaper, EFE reported. Meanwhile, 19 former Ibero-American presidents, a number of which have been critical of Maduro's administration, denounced the "alteration of democracy" in Venezuela through the so-called Panama Declaration, to be presented Thursday ahead of the Summit, asking the heads of state to find an "alternative" to solve the Venezuelan crisis and calling for the release of Venezuelan political prisoners. It remains to be seen whether the drama will recede as a sideshow at the Summit or blow up into something more significant. "Predicting what Maduro will do is very hard at this point," Peter Hakim, the president emeritus of the Inter-American Dialogue, told reporters Monday at a press briefing in Washington. Thomas F. "Mack" McLarty, who as White House special envoy to the region launched the first Summit in 1994, told reporters that "it's pretty hard to argue against human rights and democracy, and I hope that the president will get some broad support from other leaders in the region in that regard." Hakim said countries such as Brazil, Chile, Mexico and perhaps even Cuba could help defuse tensions at the Summit should Maduro try to amplify the friction for domestic political gain.

> "Predicting what Maduro will do is very hard at this point."
>
> — *Peter Hakim*

U.K. Dismisses Argentine Legal Efforts Over Falkland Oil Projects

The United Kingdom's Foreign Office on Monday dismissed new threats by Argentina's government to prosecute oil firms drilling near the Falkland Islands, which the South American country claims as their own and calls the Malvinas, MercoPress reported. British oil companies **Falkland Oil and Gas**, **Rockhopper Exploration** and **Premier Oil** announced last week that they had discovered oil and gas at the Zebedee well north of the islands. A decades-long dispute over sovereignty of the islands has made oil drilling by London-based companies controversial, and Argentine foreign ministry officials said last week they would use a 2013 law to prosecute oil companies for operating illegally in Argentine territory, BBC News reported. Daniel Filmus, Argentine secretary for Malvinas Affairs, said that the new efforts to try to find hydrocarbons in the area "carry a huge

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environmental risk." "We want the owners of the companies to be tried according to Argentine laws and international statutes," he said, according to MercoPress. However, the British government dismissed the charges. "We are satisfied that the Islands have the right to develop their hydrocarbons sector as a legitimate commercial venture with international oil and gas companies... Argentine domestic law does not apply to the Falkland Islands," a U.K. spokesman said. Tensions over the islands have been rising in recent weeks as Argentina marked the 33rd anniversary of a war over the islands, and British Defense Secretary Michael Fallon announced plans to update defense and communications systems on the islands.

Economic News

Mexican Consumer Group Pushes for More Drivers to Get Insured

A consumer advocacy group in Mexico is rolling out a campaign to get more people to sign up for car insurance, *La Razón* reported Monday. The National Commission for the Protection and Defense of Users of Financial Services, or Condusef, is highlighting in a consumer education campaign the notion that auto insurance is an investment and form of asset protection, as opposed to an expense, according to the report. Only about 32 percent of Mexico's 25 million automobiles are insured, according to a National Survey of Financial Inclusion released in 2012. Mexico's government has said that other countries in Latin America, including Chile, Colombia, Argentina and Brazil, have 75 percent of their drivers insured. Condusef is reminding consumers that last year a new law passed in Mexico requiring drivers to have a minimum of liability insurance while driving on federal roads or bridges.

Only 32 percent of Mexico's 25 million drivers have insurance.

The new law is "pushing the culture of insurance" that should increase the market for auto insurance companies, José Juan Carreno, an analyst with **Corporativo GBM SAB**, told Bloomberg News in January. "It's positive for the industry in general." However, harmonizing state and federal laws and encouraging police enforcement could prove to be difficult, according to the report.

The Dialogue Continues

Are Arbitration Bodies Effective If Parties Won't Pay Up?

Q The International Center for Settlement of Investment Disputes last month awarded U.S.-based glass container manufacturer Owens-Illinois $455 million because of Venezuela's nationalization of two of the company's plants in 2010. However, Venezuela, which withdrew from ICSID in 2012, may seek to annul or otherwise refuse to pay the award, and the company cautioned it could not predict when it would receive the funds. How effective are arbitration bodies like ICSID when countries can refuse to comply with their rulings? What incentive do countries have to comply with arbitration decisions? What recourse do companies have?

A Julissa Reynoso, former U.S. ambassador to Uruguay, and Mark Beckett, both partners at Chadbourne & Parke: "While Venezuela has withdrawn from the ICSID Convention, international investment awards can continue to be enforced against Venezuelan assets in other jurisdictions that are parties to the ICSID and New York Conventions. Venezuela remains a party to dozens of other investment treaties, many of which have arbitration provisions that apply even if the ICSID Convention is unavailable. The conventional wisdom is that states have the same incentive to comply with awards that they have to enter investment treaties: they want to encourage useful inflows of capital. The view has been that if a state habitually fails to comply with its obligations (including by failing to pay awards), this will send a negative signal to investors. The actual significance of the treaties as an inducement to investment is debated, and capital sometimes lacks long-term memory. But this was the premise on which the treaties were entered, and it seems safe to conclude that they continue to play an important role in attracting investment. There are signs we are entering a period of adjustment. Only a few Latin American states (Venezuela, Bolivia and Ecuador) have withdrawn from ICSID. However, other states have denounced treaties because they regard them as too intrusive into their domestic prerogatives. Indonesia, for example, has announced it will withdraw from 60 treaties, and South Africa has abandoned selected treaties. In the case of Latin American states that have entered into bilateral investment treaties (BITs) but have denounced the ICSID Convention, investors, depending on the terms in the BITs, may still be able to pursue arbitration. Many BITs provide investors different options for submitting claims to international arbitration, such as the ICSID Additional Facility, ad hoc arbitration under UNCITRAL Rules, ICC Arbitration and others. Globally, there are still more than 2,500 treaties covering 50 percent of global foreign direct investment, meaning that while this system may be fine-tuned, it isn't disappearing any time soon."

> "There are signs we are entering a period of adjustment."
>
> *— Julissa Reynoso and Mark Beckett*

Editor's note: The above is a continuation of a Q&A published in the March 31 issue of the Advisor.

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Featured Q&A

Continued from page 1

workers and peasants constantly demand greater reforms and government assistance. However, except for extraordinary cases, their actions have always been peaceful and order has been maintained at all times. And that behavior is far from much of the violence that exists in other countries of the region, which is reassuring to investors."

A Sebastián Acha, executive director of La Asociación Pro Desarrollo Paraguay and former Patria Querida member of Paraguay's Chamber of Deputies: "Paraguay's economic growth will need to be underpinned by sustainable development policies aimed at job creation, educational reform, financial inclusion and anchoring the formal economy. Fiscal reforms sealed in 2013 (although initiated in 2003) and the freedom of information act have contributed to improved governance and greater accountability of politicians, despite some enforcement wobbles here and there. Both the government and the private sector have been betting on infrastructure, through sovereign bond issuances and public-private partnerships, respectively, although red tape is hindering performance. Diversifying the economy will prove vital in graduating from a commodities-based export economy to creating a secondary industrial market and a working class capable of delivering high-quality and innovative services. To reach investment grade, the underlying and overlapping legal framework surrounding our new investor-friendly laws must adapt and mesh harmoniously with one another, lest we see further enforcement gridlocks. The government will need to address basic investor concerns such as legal, judicial and political certainty, all of which can either heighten or hamper progress. To exacerbate incentives and continue creating an attractive market, it must endorse and invest in innovation and technology. Flare-ups over social issues that are treated through periodic government hand-outs and are not properly analyzed through an inclusive policy lens will hinder progress. These measures merely provide myopic solutions and do not tackle the root of the problem. Social issues need to be addressed through financial and educational inclusion, to bolster productivity and help formalize the economy."

> "Paraguay still has to prove that it can diversify its economy in ways that promote jobs growth and insulate it to a greater degree."
>
> *— Donald Richards*

A Donald Richards, professor of economics at Indiana State University: "While an improvement in its bond rating is certainly good news to the Paraguayan government, which will enjoy lower borrowing costs as a result, this by itself hardly constitutes important social progress for the country as a whole. The infrastructure improvements noted are mostly geared to making more efficient and attractive Paraguay's integration into global commodity markets, particularly soybeans, and will have very limited positive employment effects. Paraguay still has to prove that it can diversify its economy in ways that promote jobs growth and insulate it to a greater degree than at present to reversals in international commodity prices. If it cannot manage this, then it may find another change of heart by international investors. The recent upgrade of Paraguay's debt is also predicated on political stability, a factor that could become problematical if the jobs situation doesn't improve. Paraguay has a long history of economic boom and bust tied to commodity production for export and construction. There are few signs that this familiar structure has changed in any important way."

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