

# **Factors Global Investors have to face in Latin America – Some highlights**

*By Héctor Ferreira\**

## **I) INTRODUCTION**

Latin America has been, since the origin of the countries which constitute it nowadays, a place open to foreign people and foreign investments.

Historically, immigrants brought to this region, not only their work and the dream of a new life in these territories, but also knowledge, techniques and commercial ideas that contributed to its development. The families of these foreign people are currently an important part of the inhabitants of our countries.

The territories of Latin America with its natural resources, minerals, flora, fauna, and so forth, were at the beginning, the main attractiveness to this region and the way to persuade foreign investors to invest here.

However, these elements are not enough to captivate modern investors, who need a perfect combination of factors to feel comfortable in a region, nowadays, and essentially: political and economic stability; transparency and legal security and absence of corruption.

Nobody invests in a country which is politically and economically unstable, which is insecure because of social turmoil even if the country has abundant natural resources.

The time in which only the natural resources were enough to “seduce” investors belongs to the past. One of the most important challenges Latin American Governments have today is to provide its people with employment as a way to stimulate and achieve social and economic development.

In order to reach these goals, it is absolutely necessary to furnish the investors with conditions to obtain and increase the profits of its companies in a suitable environment.

On the other hand, a lot of Latin American countries, with similar conditions in terms of land, weather, temperature, etc. currently compete for the same investors in the same markets.

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In fact, Professor *Julio C. Porteiro*<sup>1</sup> stated that in a market it is not only important the national offer but also the international one. Hence, knowledge about the regional market, in which an investment is made, is an important prerequisite for the success of the project.

Investments are, currently, the most important source of development that Latin American countries have. Not only small economies like Uruguay need investments to survive but also autarchic economies like the Brazilian, expect to receive investments to be, among others, more efficient.

In order to obtain the goals already mentioned it is essential to take into account three key groups of factors.

Before investing, global investors consider some key legal, institutional and regulatory factors, for example, promotion of investments, the kind of government regime, the political system, legal security, and so forth.

This paper will analyze how these different factors influence investments in different Latin American countries and the region as a whole. These are the top issues lawyers should consider to facilitate global investments in the region.

## **II) LEGAL FACTORS**

The legislation of a country where an investor plans to operate is of utmost importance; therefore, the prospective investor should carry out a thorough pre – investment study to get to know: available tax benefits, Competition rules, Consumers' rights, differences in treatment between national and foreign investors if any, and so forth.

A country and a region that expect to receive investments from foreign countries have to strongly defend their independence in the elaboration of the Law while complying with the principles of law regulated by international rules.

It is important for a country to have a democratic and egalitarian system with clear rules, since an erratic legislative system, where in a short term important topics have different solutions, is not convenient.

Another key legal factor is the strong promotion of investment in specific strategic areas, in which a country has particular advantages (e.g. natural resources).

For instance, Uruguay in the 90's, promoted the Forestry Industry very strongly, granting tax benefits and exonerations to companies which were interested in this activity.

Nowadays, Uruguay has an important part of its territory (more than one million and a half hectares) with trees that were planted ten or fifteen years ago and are currently being cut and exported to foreign countries.

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<sup>1</sup> Porteiro, Julio Cesar, "Evaluación de Proyectos de Inversión. Perspectiva Empresarial", FCU, Montevideo 2003.

Moreover, as a consequence of its legislative policy, important corporations from Europe are currently investing in Uruguay in projects which will involve more than two thousand- million dollars, and provide employment in regions economically depressed.

Two pulp mills are being built, and one of the reasons is the number of existing trees derived from the continued promotion together with the speed in which they grow.

Chilean Professors *Nassier Sapag Chain* and *Reinaldo Sapag Chain*<sup>2</sup> stated that the study of the feasibility of a project includes an important chapter: that embodies the review of the Law of the country in which the investment will be made. It is impossible to develop a project without information about the law of the country and its regional environment.

The creation of a legal system that grants security to these projects requires political decisions (like Acts) which pursue to attract investments. As an example of this concept, article 1st of the Uruguayan Act 16.906<sup>3</sup> (Investment Promotion) regulates this aspect in the following terms:

*“(National Interest) - The promotion and protection of the investments made by national and foreign investors in the Uruguayan territory is declared of a national interest.”*

On the other hand, the same Act in its second article establishes that the treatment of the investments either Uruguayan or not, will be the same, stressing that the principle of Equality is part of the system. .

Another example in which it is possible to identify a key legal decision to obtain foreign investments has been the “Bank Secrecy” concept.

Uruguay for example, has a strict bank secrecy law (Act 15.322<sup>4</sup>, Article 25), which guarantees the complete privacy of bank depositors, but at the same time allows disclosure of information when instructed by a Court, limited to cases involving criminal acts or in family proceedings (e.g. child support, alimony or marital assets disputes).

Limitation on bank secrecy is balanced within the legitimate desire and need of taxpayers to preserve their privacy and the national and international need to be protected against crime and violation of the law.

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<sup>2</sup> Sapag Chain, Nassier and Sapag Chain, Reinaldo, “Preparación y Evaluación de Proyectos”, Forth Edition, Mc. Graw – Hill Interamericana, Santiago de Chile 2000.

<sup>3</sup> Uruguayan Act 16.906, “Interés Nacional, Promoción y Protección”, passed by the Executive on January 7, 1998.

<sup>4</sup> Uruguayan Act 15.322, “Sistema de Intermediación Financiera”, passed by the Executive on September 19, 1982.

In the world, Uruguay is well known as a country which strongly respects the bank secrecy, a law that permitted and permits to continue having an important number of banks in spite of the most devastating crisis of its history in 2002.

Investors have to feel confident with the legislation of a country and this is only possible if this country provides foreign persons and companies with a combination of legal elements and principles of Democracy, Equality, Freedom, Transparency, No Discrimination, No Corruption, and No Changes in the Rules of the Game.

### **III) INSTITUTIONAL FACTORS**

As it has already been stated, there are also institutional aspects which are essential for a country, and in general for a region, that expect to be a centre of investments.

Global investors prefer to allocate their economic resources in countries which respect the Fundamental Rights, have democratic principles and a republican government system.

A State with an institutional structure in which the referred conditions are considered, is usually organized on the basis of a written Constitution, which can only be amended pursuant to its legal provisions.

All amendments must necessarily end up in a plebiscite, and only with the voters' approval may the Constitution be validly amended.

The majority of the Constitutions in force in Latin America nowadays have the following essential components: i) the recognition of the Fundamental Rights of the person, ii) the consecration of a republican government system, iii) limitations placed upon the public power.

Another important principle that is well valued by investors is the "Separation of Powers".

*Montesquieu*<sup>5</sup> expressed in "*The Spirit of Laws*", that there are three powers that have to be organized in a coordinated way in which one controls the other. This principle is closely linked to the idea of a democratic State and of the "State of Law".

Montesquieu stated that when the Legislative and Executive Power are in the head of the same person, freedom is impossible.

An application of this principle is the denominated "System of weights and counter balances" which is the basis of the Constitutions in Latin America.

A practical example of this principle, which is part of the Uruguayan system, is that its Parliament, in addition to its law-making duties, exercises major controlling powers such as for instance, to demand reports from public authorities; to grant or refuse its

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<sup>5</sup> Charles de Secondat, Baron de la Brède et de Montesquieu, "De l'Esprit des Lois", Chapter VI, Book XI, Ediciones Altaya S.A., Barcelona, 1996.

consent to many decisions, including the appointment and removal of authorities; act as arbitrator regarding controversies between public corporations and the Executive; among others.

Finally, another aspect of the principle of the Separation of Powers is the independency of the Judiciary.

In order to have a believable judicial system which provides all possible guaranties to national and global investors, it has to be independent.

Following this idea, Judges have to be “career judges” and make decisions without pressures from the other Powers.

If for example Judges of a country were designated by the Executive Power in a direct way, the separation of powers would not be fulfilled and one of the three Powers will go beyond the other.

It is a fact, that the separation of powers and the independence of the Judiciary diminishes corruption inside the system and provides more guaranties.

The principles analyzed are usually recognised and protected in Latin America. The violation of those principles may jeopardize the trust on any country for foreign investors.

#### **IV) REGULATORY FACTORS**

Some regulatory factors have an extraordinary influence at the moment of deciding to invest in Latin America.

There are different possible approaches but, according to my point of view, the best way to treat this subject is considering specific factors in particular that have to be taken into account to improve the “investment environment” in our region.

i) Modern Guaranties: The Civil and Commercial Codes of Latin American countries include sections in which they regulate the traditional guaranties like Pledges, Mortgages or personal guaranties.

However, with the globalization of the market, it is frequent that global investors need other kind of guaranties which should come from their countries. It is very unusual that an investor begins a project and at the same time has specific assets to offer as guarantee (Pledge or Mortgage) or, on the other hand, a wealthy friend to present as a personal guarantee, despite of the fact that the World Bank and other international organizations of credit, grant specific guaranties for some projects.

Latin American governments have to regulate alternative guaranties to avoid this situation, providing ways to present guaranties granted in the investor’s country of origin for example.

Hence, the regulation of guarantees given by banks has to be a part of the modern guarantee systems in Latin America.

Examples of these modern guaranties are Letter of Credits, banking deposit pledges, patronage letters or comfort letters, among others.

ii) Limited Liability Companies: Latin American systems have to provide global investors with different legal structures to develop their activities. Multinational companies that expect to invest in a country should have the possibility to select among several different legal structures.

Investors in Latin America usually choose a corporation, whether locally organized or as a branch of a foreign corporation, in the case of medium-size and large companies, or select a limited liability company, in the case of smaller businesses.

However, it is important that the legal system of the Latin American countries gives investors other options suitable to apply to their projects, like for instance: financial investment corporations, financial intermediation corporations, and tax-free zone users. Also, it is useful to have other legal structures non – profitmaking, like foundations, which are necessary in some projects.

iii) Insolvency and Bankruptcy System: Many international companies that establish a branch in a foreign country have problems not only to collect debts from their debtors in individual proceedings, but also to collect them in rehabilitation or bankruptcy proceedings.

Latin American countries have to regulate an updated and serious Insolvency and Bankruptcy System in order to prevent situations in which some companies request a restructuring proceeding and continue “living” when its economic situation is in a critical stage (“virtual bankruptcy”).

In some systems there is an "automatic stay" which is similar with what in Uruguayan System is named as "Moratoria Provisional". The "Moratoria Provisional" implies a protection for the debtor since all actions against the debtor and the debtor's property are interrupted when the "Moratoria Provisional" is granted by the Court.

This measure will remain in force and effective until the Court approves a restructuring proceeding or declares the bankruptcy of the company.

Modern Insolvency and Bankruptcy systems attempt to avoid unnecessary delays in the proceedings and for instance, if a company cannot present the required documents or finished its commercial activity, the bankruptcy is declared immediately.

Currently, there are two aspects that have to be balanced, which are the principle of the “Enterprise Conservation” and the idea according to which only the competent and efficient enterprises can be accepted in the market.

Global investors need clear rules and a system in which an insolvent enterprise receives the benefit of a reorganization proceeding, but if its situation is unchangeable the bankruptcy must be declared to purify the market.

iv) Clear Administrative Proceeding: The access to public tenders or purchases in the context of governmental proceedings is basic for the investor. Transparency and strict compliance with the law are absolutely essential.

There is an important group of global investors who are interested in obtaining public contracts, for instance, building bridges, railroads, highways, etc. for the State.

It is absolutely necessary that Latin American governments have “Administrative Proceedings” to select their suppliers which can be either national or international.

The selection proceeding has to consider different factors in relation to the applicant supplier e.g. the price, the guarantee offered to cases of breach of contract, records of the company, etc.

Moreover, it is relevant to regulate situations in which one of the possible suppliers presents his own innovative project to the State. The State should give this supplier more points in the contest public tender.

Other ways to select suppliers to do public works, like the direct nomination by the State, are not convenient, because they might imply “unfair competition”.

## **V) CONCLUSIONS**

1) Latin America has been, historically, a region in which investors felt comfortable and found an appropriate environment to develop their projects.

2) There is not a unique formula to create a correct “environment” for global investors, being key legal, institutional and regulatory factors indispensable to achieve this target.

3) Nowadays, global investments are an important part of the development of the countries in this region, providing employment, new sources of financing, better quality of life, etc.

Global Investment promotion by the Latin American Governments is absolutely necessary through Acts that clearly regulate benefits for some strategic areas in which the country has particular advantages (e.g. natural resources).

4) Global investors seek in a region and specifically in a country, institutional stability, not only economic but also political.

The respect for the Fundamental Rights, the Rule of Law and the principles of Separation of Powers and Equality, are some of the bases that make a country appealing for Global Investments.

5) There are many regulatory factors which have influence in the development of a country that expects to receive international investments.

Summing up the most important ones are: the existence of ways to use modern guarantees, a variety in terms of legal structures, an Insolvency and Bankruptcy system with a correct balance between the principle of the “enterprise conservation” and the idea according to which only the competent enterprises can be accepted in the market, and a clear administrative proceeding.