WORLD ECONOMIC FORUM

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Regional Agenda

# System Initiative on Long-Term Investing, Infrastructure, and Development

## Infrastructure Public-Private Working Group (IPPWG) Argentina

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## Contents






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## Context

Argentina has long been an enigmatic player in the global economy. Ranked among the world's richest countries in the early 1900's – with income per head just behind the United States and ahead of Germany, France and Italy – through decades of political instability and misguided economic policy, Argentina has fallen behind significantly. This is most evident in Argentina's infrastructure development, with Argentina ranking 122nd out of 140 for quality of overall infrastructure in the World Economic Forum *Global Competitiveness Report 2015-2016.* The new government under President Mauricio Macri is clearly positioning infrastructure development as key catalyst for boosting Argentina's economy, achieving sustainable growth and ultimately, eliminating poverty. To meet its long-term goals and reach its optimal infrastructure provision, Argentina will need to invest around $300 billion by 2024, largely to come from foreign investment.

Following years of economic and social turmoil, President Macri's administration has recently taken several measures to restore investor trust by adopting free market principles and implementing institutional reforms. As Argentina slowly moves towards economic normalization, new challenges are emerging that will determine the course of its economic recovery, including the incipient regulatory reform process, threats of fiscal weakness and the functionality of local capital markets, among others. They are emerging in a new context in which the government and regulators are ready to engage in an open dialogue with the global and local business community represented by the World Economic Forum Infrastructure Public Private Working Group (IPPWG).

The IPPWG was launched as a one year country-specific effort as part of the World Economic Forum System Initiative on Long-Term Investing, Infrastructure and Development. Recognized and endorsed by the Argentinian government, it serves as a platform for business leaders and key stakeholders to speak with a coordinated business voice to foster an enabling environment for private-sector participation in the financing of major infrastructure projects in Argentina.

The IPPWG aims to identify challenges faced by the business community, propose potential solutions and stimulate the interest of the public and private sectors to achieve consensus on a set of issues that need attention not only in the short to medium term but also explicit public and private commitment to their resolution.



**We welcome the establishment of the IPPWG in Argentina. Infrastructure investment in this country is crucial to removing bottlenecks, generating employment and providing basic services to the sectors that need them most. We trust this forum will reinforce networking and cooperation between the Argentine government and domestic and international business entities, bringing knowledge and experience-sharing in infrastructure and capacity development, and encouraging infrastructure investment in Argentina.**



Alfonso Prat Gay, Minister of Finance of Argentina

# First IPPWG Workshop: Continuing the pace of reform to rebuild trust

Following decades of policies that kept local markets closed to the world and starved the country of foreign investment; Argentina is reintegrating the global economy. Restoring investor confidence in a sector such as infrastructure, which requires long-term vision and stable returns on investment, will be achieved only through modernizing the regulatory framework. Generating the right regulatory environment by creating clear rules and predictable frameworks for local and global business is a priority for the new government, illustrated by the submission of a new PPP bill that aims to provide better risk allocation and increased protection of political risks. The objectives of the first IPPWG gathering were to highlight some of the ongoing efforts undertaken by the government, analyse the effects of the various regulatory reform proposals, and identify the challenges faced by the business community.

The discussion focused on three key areas: fiscal, legal and capital market reform.

## Fiscal reform

*Discussion Leader: Daniel Vardé, Partner, Deloitte*

Fiscal policy should be consistent with the national development strategy and the desired model for the future of the country, including a predictable impact on public well-being in areas sucgh as public infrastructure, transportation and power generation, while attracting foreign investors and businesses.

Participants identified the following root causes of low investment levels:

- A combination of legal and fiscal issues, accumulated over a decade of fiscal instability
- Yearly increases in the cumulative fiscal burden

Among the **challenges** that Argentina is currently facing in this area, participants highlighted the following:

- Misalignment between various levels of government: National, provincial and municipal governments do not have the same priorities, especially on issues related to the judicial system and professional services. Better alignment on these issues may strengthen investment levels.
- Bureaucracy is considered an impediment to investment: Simplification of bureaucratic processes would minimize the impact in long-term project cost structure. Straightforward and automated processes could reduce response time and accelerate projects.
- Fiscal instability: improving fiscal stability will be key to creating an enabling environment for long-term investment.

Communication, simplicity and transparency will be necessary at all stages of reform. In addition, the IPPWG selected the following **concrete measures** to improve investment environment:

**Tax incentives**

- *Reduce fiscal burden to boost investment levels.* Boosting long-term infrastructure investment should start with reducing fiscal burden, with tax incentives as an instrument for enabling private-sector investors to fund infrastructure projects. Investment funds whose main asset class is infrastructure should have a special tax regime (when considering capital and income tax). Another proposal would be to create dedicated sovereign funds for infrastructure with private contributions on long-term time horizons, where investors obtain a (refundable) credit tax up to a maximum limit.
- *Increase the number of capital market-oriented tax incentives.* Historically, public bonds have always competed with private bonds and receive more favorable tax treatment. The taxation treatment on any bond issued by a corporation or Special Purpose Vehicle (SPV) or issued as result of securitization should be at least equal or better than taxation treatment of public bonds. These incentives should mainly focus on basic infrastructure project funding such as: hospitals and health institutions, schools or habitat and housing.
- *Implement tax incentives to reduce labour cost.* One of the biggest difficulties for Argentina in attracting investment is labour cost, including the cost of risk insurance (ART cost), labour claims and legal costs. This situation positions Argentina well behind countries like Brazil or Mexico in terms of competitiveness. Reforming the income tax system will be essential, including updating brackets, making the system more progressive and efficient, and creating or improving incentives to increase the tax base and reduce loopholes so as to enhance redistribution (and lower public deficit). Reducing these costs will also help to reduce the infrastructure project cost matrix, improve productivity and reduce investment risks. Local taxes, sales (VAT) and property taxes, and payroll taxes (social security contributions) were also signaled as elements to be analysed within fiscal reform given the tax burden of investing in Argentina. Also, the tax on checking account debits and credits is no longer tenable.

Despite these recommendations, the IPPWG recognizes that the probability of Argentina lowering taxes is rather low in the near future as the fiscal deficit is expected to last through 2017.

### Subsidy reduction

- *Pursue subsidy reform in a socially responsible way:* Reform of subsidies (for individuals and families in need) and price adjustment are needed to restore incentives for investment and better management of resources. While most changes in subsidies and prices are needed immediately, some should be progressively implemented and others segmented. This should be done with care, as they directly impact some levels of society disproportionately more than others, keeping in mind that society-wide benefits will be evident in the medium term. In this context, public service companies have a comprehensive understanding of the consumer's real needs in terms of subsidy allocation; they may there provide valuable advice to the government on where to redirect.

### Collection of best practices

- *Study the experience of other countries addressing similar challenges*: Using the knowledge of the IPPWG members and the platform provided by the World Economic Forum.

- *Establish an interdisciplinary team of experts:* Professionals in tax systems, capital markets and infrastructure projects will be needed to create an efficient incentive mechanism to attract investment in infrastructure and fully understand the problems related to:
  - Import/export retention
  - Depreciation regime
  - Treatment of VAT technical balances
  - Tax litigation for infrastructure

- *Seek citizen endorsement:* Clear communication of the necessary changes and their benefits are crucial. The tax system, besides being progressive, should be simple and transparent for both individuals and businesses. The government must better communicate new policies, their bills and resulting plans/programmes/projects by involving the main subject protagonists, and, at least in the early stages of the idea or design phase, all actors concerned (state and non-state actors, that is to say including the private sector and civil society).

## Legal reform

*Discussion Leader: Ezequiel Barrenechea, Executive Vice-President, Corporacion America*

A number of initiatives to reform legal and regulatory frameworks have been initiated to improve the country's financing capacity, increase transparency and speed up investment in infrastructure. Participants addressed legal reform from two main angles:

*Status of the legal framework Argentina:* Participants considered it necessary to modernize the general legal regime to increase legal certainty. This requires adjustments and modifications in the recent Civil and Commercial Code, the Law on State Responsibility, the Law on Administrative Procedures and a new law regulating arbitration, among others. It also requires ensuring quick and fair resolution of disputes (court, claims, arbitration, etc.) in cases inherited from the previous government. These changes are not expected to have an immediate impact on investment but rather to generate the necessary legal certainty and predictability.

Beyond that, participants agreed that:
- Recent reforms of the Civil Code (2015) weakened validity of local arbitrage, which could require foreign arbitrage/law or other mitigations
- FX risk management could require specific tools (solutions in Colombia, Peru and Chile were cited as best practice examples)

– Rebuilding trust will require demonstrating real fulfilment of commitments by the State. This includes (quick) implementation of reasonable solutions to pending conflicts in private-state contracts, particularly those due to non-fulfilment by the state.

*The new Public-Private Partnership (PPP) bill*: the PPP law recently approved by the National Congress is expected to provide a valuable tool for improving the legal framework for investors. The enactment of the New Law on PPP is considered very important for generating greater investment as well as providing security guarantees when contracting with the state (e.g. extra sovereign guarantees, guarantees from multilaterals, leveled power of the state within the contracts, etc.). The compensation clause for early termination, including provisions for lost profits and consequential damages, is an important addition to the current risk scheme. In addition, the possibility of international arbitration in case of disputes would have the potential to encourage investors to develop projects in Argentina. It would be important to provide regulated systems in which political risk insurance and a culture of respect of contracts are widespread.

**BOX 1: The new PPP law vs. the current Concession/BOT schemes**

*Argentina has tried on several occasions to enhance* its competitiveness and attract foreign investment by passing legislation aimed at increasing private-sector participation in its economy. Several laws and decrees currently govern PPPs, concessions and Built-Operate-Transfer schemes; by comparison the new PPP law proposes changes to the PPP investing landscape in several important ways:

– Guarantee of a transparent process for tenders: If bids for projects tendered are equal, however, priority must go to the Argentine company
– Remedies in case of breach: Compensation must be fully paid if the government terminates the contract (no lower than non-depreciated investment)
– International arbitration: Investors will have the option of taking the government to third-party arbitration (including the International Centre for Settlement of Investment Disputes - ICSID). The contracting parties have the option of including – or not – an international arbitration clause in their contracts
– Step-in rights: The contractor is entitled to enter into loan agreements on the condition that in case of default by the borrower, the PPP contract is assigned to the creditor or to third-party financiers
– Property damage liability: To be based on the Civil and Commercial Code and not the Law on State Responsibility No. 26,944
– A national auditing office will be created to inspect contracts
– A PPP Unit will be established to guarantee and promote transparency and engagement with the public

With the new PPP framework being put in place, the authorities are now focusing on the creation of a PPP Unit with the objective of having the first projects launched in 2017. An express authorization to execute projects under this regime has been approved by the Congress and included in the 2017 Budget.

## Capital markets

*Discussion Leader: Manuel Sanchez, Managing Director, BlackRock*

Argentina's capital markets remain significantly underdeveloped and unprepared to meet the current and future needs of the economy. Establishing local capital markets on both the equity and debt side is a long, drawn-out process as it requires the step-by-step establishment of financial instruments, legal frameworks, reporting and governance standards, and financial infrastructure. The country also desperately needs to increase local participation (including pension funds) and create mechanisms to capture domestic savings.

### Emerging Capital Markets 2025: The next chapter of foreign investment

As part of the World Economic Forum's project on Accelerating Capital Market Development in Emerging Economies, recent conversations with global investors looked at how factors that influence investment allocation decisions in emerging markets will change over the next 10 years, to identify specific barriers to foreign investment in certain markets that could be affected as a result of a policy change. The discussion focused on six markets, including Argentina. The outcomes are summarized below:

#### ARGENTINA

#### SUMMARY OF PARTICIPANT OUTLOOK ON THE MARKET

Argentina is "in vogue" as an investment destination, but investors express concern about the sustainability of this interest. To rebuild investor confidence, participants suggest that the government continue progress towards better transparency and governance within its capital markets, while promoting more local-currency instruments and activity. Additionally, macro-level reforms, such as fiscal rule and currency stability, could improve the investment climate.

#### SELECT BARRIERS TO FOREIGN INVESTMENT IDENTIFIED BY PARTICIPANTS

**Capital controls** – A number of regulations (e.g., minimum holding periods) limit foreign participation.
**Pension fund activity** – Local pensions are over-invested in local equity. They can hold board positions in those companies, leading to transparency concerns.
**Currency regime** – Investor concern that the peso is overvalued limits interest in local-currency assets.
**Legal framework** – Despite recent progress, concern remains about the reliability of published data and the level of investor protection.

#### POTENTIAL POLICY ACTIONS SUGGESTED BY PARTICIPANTS

**Reduce capital controls** – Reduce the minimum holding period for foreign investors, currently 120 days. Streamline the currency regime to simplify investor entry and exit. Improve trust in the legal framework – Demonstrate commitment to enforcing the legal framework, potentially by resolving previous violations around minority shareholder protection to set legal precedents. Alternatively, consider issuing corporate debt under a foreign legal system to increase confidence in the short term, and then adopt similar principles in the local system in the long term.

**Create incentives to improve the domestic investor base** – Divest the pension system from local equities to reduce foreign investor concerns around transparency and better insulate savings from domestic business cycles. Create tax incentives for domestic investors in local debt and equity (e.g., tax amnesty for local bond investors).

**Simplify the range of offerings** – Divest dollar liabilities (e.g., promote issuance in pesos rather than issuance of ADRs) to reduce currency risk and increase local market liquidity. Reduce unnecessary complexity in the various types of debt instruments available to investors. Monitor debt issuance from local governments, regulating and consolidating as needed to ensure market is not flooded with public debt.

1 Source : The Project Management Institute (PMI)

**BOX 2: Creation of a National Project Management Office (PMO)**

By nature, infrastructure projects require huge capital investment, long-range planning, continuous management, commitment of time required, human resources and they involve numerous risks. Estimation and management of cost is the major challenge combined with schedule changes. Above all, stakeholder management is highly essential and equally difficult. Various factors such as government policies, national and international politics, mismatch of user needs and objective conflicts among stakeholders are some of the main challenges to any infrastructure project.

To attract capital to Argentina for investment in infrastructure projects, the country needs to offer not only a stable/transparent environment from a legal and financial perspective, but also must prove its capacity to deliver projects. Organizations waste $122 million for every $1 billion invested owing to poor project performance and only 64% of projects globally meet objectives[1]. With shrinking project outcomes, shifting global trends and an uncertain economy, countries like Argentina must shift their thinking and embrace project management as a strategic competency that can reduce risk, cut costs, improve success rates and bring transparency.

Some of the issues discussed during the session included the importance for the government to use internationally recognized project management standards and the benefits of creating a National Project Management Office (PMO), similar to other countries around the world. A strong PMO could deliver two distinct areas of improvement to the country: It would help the Argentinian government to choose the right projects to deliver and, it would help deliver projects correctly, on time, on budget and bringing the right benefits to society and the economy.

# Conclusion

A range of regulatory and institutional measures are being pursued in Argentina to reduce risk for investors and rebuild trust. Despite these, the country's massive sovereign debt default in 2001, expropriation of foreign companies, systematic non-respect of contractual commitments and political unpredictability contribute to Argentina's reputation as a high-risk investment.

To re-establish the country as a legitimate and competitive destination for private investment in infrastructure, Argentina will need to restore the level of confidence of investors by getting the risk model right – including a solid, predictable and well-structured political, regulatory and legal framework. This can be achieved not only by fostering a valuable private-public dialogue but also by empowering policy-makers that have courage to bring positive change and innovate. In this context, the IPPWG will build on this initial dialogue to continue fostering an enabling environment for private-sector participation in the financing of major infrastructure projects in Argentina.

# Annex:

EMERGING CAPITAL MARKETS 2025

# Country profile: Argentina

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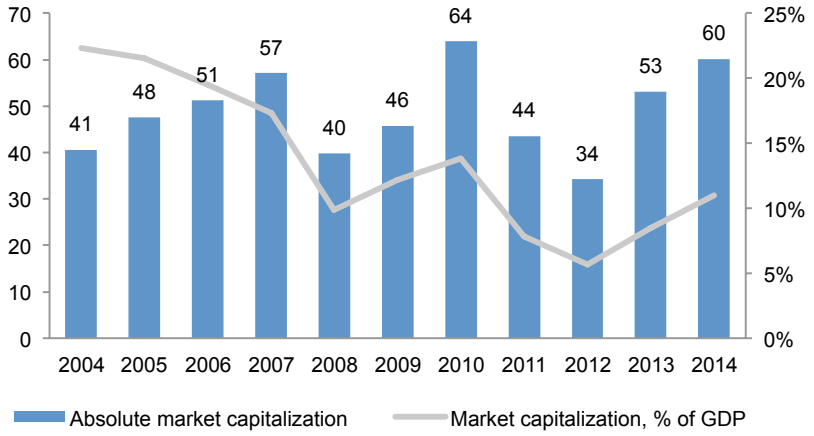
## COUNTRY OVERVIEW

| | | | |
|---|---|---|---|
| GDP ($US, nominal, 2014) | $548B | UNDP Human Development rank, 2015 | 40 / 188 |
| Population, 2014 | 43.4M | WEF Global Competitiveness rank, 2016 | 104 / 138 |
| GDP per capita ($US, nominal, 2014) | $12,751 | World Bank Ease of Doing Business rank, 2015 | 121 / 189 |

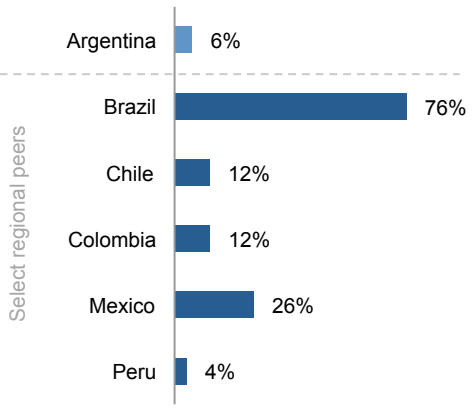
## EQUITY MARKET OVERVIEW

The most prominent equity exchange in Argentina is the Bolsa de Comercio de Buenos Aires (BCBA). The government under President Mauricio Macri is increasingly opening up the market to foreign investors (e.g., by reducing minimum holding periods), though a number of barriers remain. Argentina was reclassified in 2009 by MSCI from an Emerging to Frontier Market, though it will be considered for a reinstatement of Emerging Market status as part of MSCI's 2017 Annual Market Classification Review.

**Equity market capitalization, 2004-2014**
US$B (left axis); % of GDP (right axis)




**Equity market turnover ratio, 2014**
Traded volume / market capitalization

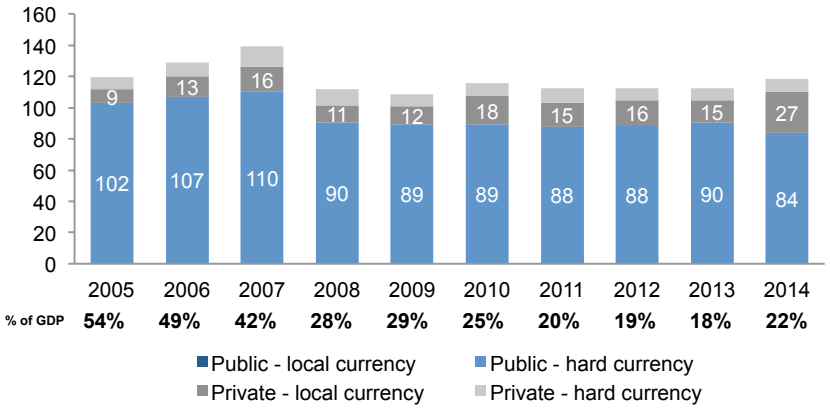



## DEBT MARKET OVERVIEW

**Sovereign debt**
After defaulting on $80B of debt in 2001, Argentina reentered the international bond market in 2016 with an issuance of $16.6B in US dollar-denominated debt of varying maturities. It has a B- credit rating from S&P as of May 2016.

**Corporate debt**
The recent sovereign debt sale has spurred new corporate issues. However, lower investor interest has forced some to reduce their offerings or raise yields.

**Debt securities outstanding, 2005-2014 (Q4 values)**
US$B; includes domestically and internationally-issued debt



EMERGING CAPITAL MARKETS 2025

# Country profile: Argentina

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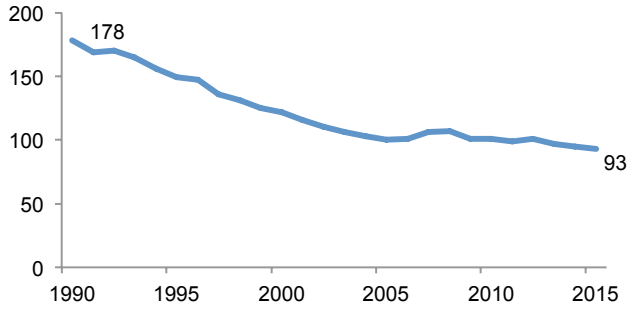
## ISSUER LANDSCAPE

- Listed companies on the equity market are primarily from the banking and utility sector; the top 10 firms contributed 70% of market capitalization of BCBA in 2010
- Between 2004 and 2012, corporate bond issues raised $40B for companies, while ~ $4B was raised through equity offerings
- In April 2016, the Argentine government issued $16.6B in sovereign bonds, the largest debt sale in emerging markets

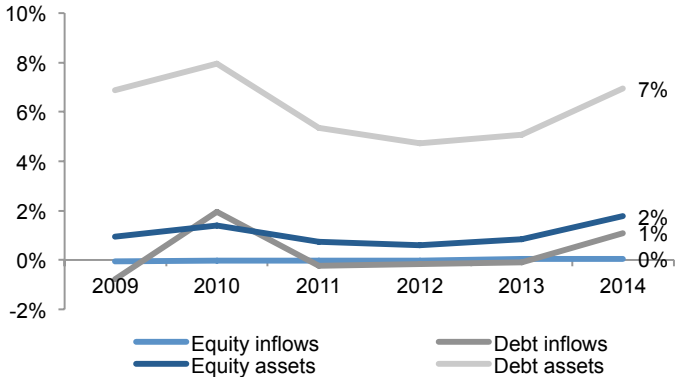
**Listed companies on domestic stock exchange**
1990-2015




## INVESTOR LANDSCAPE

- The average free float in Argentina as of 2012 was 29%, compared to a 21-23% average for Latin American equity markets
- Strict requirements for foreign equity investors (e.g., require having a bank account in Argentina to purchase shares) cause many to invest via ADRs rather than directly; however, there was significant foreign demand for the 2016 sovereign debt sale ($68B in offers)
- Argentina's mutual fund industry accounts for 2% of GDP (vs. up to 20% for regional peers)
- Its largest institutional investor is its public pension fund, which manages $55B

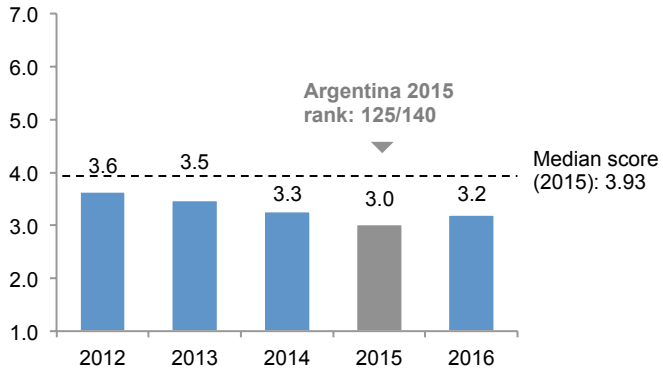
**Portfolio inflows and foreign-held assets, 2009-2014**
% of GDP




## POLICY AND REGULATORY ENVIRONMENT

- Each market in Argentina, including equity and debt securities markets, have different listing requirements and regulations
- Capital markets were largely self-regulated until 2012, when Argentina passed a bill that gave greater authority to the regulator, Comisión Nacional de Valores (CNV)
- Under President Macri, the government has begun relaxing capital controls, (e.g., reducing the minimum holding period on securities from 1 year to 120 days)

**Level of securities exchange regulation, 2012-2016**
WEF Global Competitiveness Report; 1 = not at all; 7 = to a great extent




Sources: World Bank, IMF, BIS, UNDP, WEF, Wall Street Journal, Bloomberg, Thomson Reuters, CNBC, US State Dept., OECD, MSCI

# Working Group Members

Andrés Barberis, Head of Autopistas Abertis, **Argentina Abertis Infraestructuras SA**
Pablo Miedziak, Chief Financial Officer, **Aerolineas Argentinas**
Luis Blaquier, Executive Subdirector of Operations, **ANSES**
Alejandra Caballero, President, Nacion AFJP, **Banco de la Nacion Argentina**
Gonzalo Diz, Deputy General Manager Business Dev., **Banco de la Provincia de Buenos Aires**
Manuel Sanchez, Head, Latin America, **BlackRock Infrastructure Investment Group**
Roberto Belchior, Managing Director, **BM&F Bovespa SA**
Daniel Gustavo Ciaffone, Director Business Development, **Bridas Energy Corporation**
Jorge Kogan, Senior Advisor to the Vice President of Infrastructure, **CAF**
Sebastian Berardi, Senior Associate, **Canada Pension Plan Investment Board (CPPIB)**
Miguel Angel Boggiano, Founder and Chief Executive Officer, **Carta Financiera**
Ezequiel Barrenechea, Executive Vice-President, **Corporacion America**
Luis Pescarmona, Chief Executive Officer, **Corporación IMPSA SA**
Julio Molinari, President Latin America, **Danfoss**
Daniel Vardé, Partner, **Deloitte**
Gustavo Schettini, Chief Executive Officer, **Energy Consulting Services S.A.**
Carlos Ortega, Senior Director, Construction Solutions, **FTI Consulting**
Alex L. Bottan, President, **GE International Inc.**
Guilherme Caixeta, Vice President, **GIC Private Limited**
Sebastián Katz, Undersecretary of Finance, **Government of the Province of Buenos Aires**
Silvia Hoevel, General Director, Banca Empresa; **Grupo Supervielle**
Antonio Luis Estrany y Gendre, Vice-Chairman, Global Banking ; **HSBC Bank Argentina SA**
Marnix van Iterson, Managing Director / Chief Representative, **ING Bank NV**
Gabriel Goldschmidt, Head, Infrastructure, Latin America, **International Finance Corporation (IFC)**
Martín Rodríguez Pardina, Managing Partner, **Macro Consulting**
Hector Mairal, Partner, Marval, **O'Farrell & Mairal**
Jacobo Cohen Imach, VP General Counsel, Government Relations Director, **MercadoLibre**
Franco Moccia, Minister of Infrastructure, **Ministry of Infrastructure of the Province of Buenos Aires**
Ricardo Delgado, Undersecretary, **Ministry of Interior, Public Works and Housing**
Pablo Bereciartua, Undersecretary, **Ministry of Interior, Public Works and Housing**
Camilo Di Boscio, Undersecretary , **Ministry of Interior, Public Works and Housing**
Marcelo Busellini, Director of PPP, **Ministry of Interior, Public Works and Housing**
Pedro Sorop, Chief of Cabinet of the Minister of Transportation, **Ministry of Transport**
Andres Gartner, Chief Advisor, **Ministry of Transport**
Hiroaki Ito, President Director, **Mitsubishi Argentina SA**
Natalia Zang, Undersecretary, **Office of the President of Argentina**
Ricardo Torres, Chief Executive Officer, **Pampa Energia**
Milagros Mostaza, Managing Director – EMEA, **Project Management Institute (PMI)**
Alejandro Di Capua, Partner, **Puente**
Alberto Santos, Director, Business and Relationship Management – Americas, **S&P Global Ratings**
Pablo Orlandi, Director Energy, **Sideco Americana**
Cesar Guzzardi , Head of Country Management Office, **Siemens AG**
Ana Giros, Chief Executive Officer, Europe and Latin America, **SUEZ**
Gustavo Nieponice, Partner, Managing Director, **The Boston Consulting Group**
Julieta Abad, Transport Sector Consultant, **The Inter-American Development Bank**
Helena Houston, Managing Director, Latin America, Southern Region, **Thomson Reuters Ltd**
Pablo Chauvet, Economic Affairs Officer, **ECLAC**
Rubén Signorini, Head of Argentina, **Willis Towers Watson**
Alejandro Vega Cigoj, Head of Corporate and Commercial Business, **Zurich Insurance Group**

## Special Guests

Rogelio Frigerio
Minister of Interior, Public Works and Housing of Argentina

Alfonso Prat Gay
Minister of Finance of Argentina

Gustavo Lopetegui
Secretary for Public Policy Coordination

# Contact details

Katerina Labrousse
World Economic Forum
katerina.labrousse@weforum.org

Joseph Losavio
World Economic Forum
Joseph.Losavio@weforum.org

Andre Belelieu
World Economic Forum
andre.belelieu@weforum.org

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The World Economic Forum, committed to improving the state of the world, is the International Organization for Public-Private Cooperation.

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World Economic Forum
91–93 route de la Capite
CH-1223 Cologny/Geneva
Switzerland
Tel.: +41 (0) 22 869 1212
Fax: +41 (0) 22 786 2744
contact@weforum.org
www.weforum.org

World Economic Forum USA
3 East 54th Street, 18th Floor,
New York, NY 10022, USA
Tel.: +1 212 703-2300
Fax: +1 212 703-2399
contact@weforum.org
www.weforum.org