

To: Participants, Nested and Overlapping Regimes Conference
From: Mauricio Baquero-Herrera
Re: Open regionalism in the Andean countries: existing and divergent treaty arrangements and approaches and its consequences for the trade in financial services
Date: February 13, 2006

The Andean Countries i.e., Bolivia, Colombia, Ecuador, Peru and Venezuela are immersed in an unprecedented environment of unilateral openness to foreign markets (including financial markets) and in simultaneous deeper sub-regional economic integration through the Andean Community as well as in the gradual implementation of a range of multilateral and bilateral, extra-sub-regional commitments and advancing negotiations with non-member countries as to a variety of trade/investment/economic integration schemes. This complex integration matrix, which affects the provision of financial services in the sub-region, has its roots in the original Andean integration process and it is based upon the policy of open regionalism.

In this sense, this memo firstly studies the policy of open regionalism as it is understood in Latin America. Secondly, it introduces the main features of the Andean integration process underlying the strong political influence that marked the origin and development of the Andean Pact and its subsequent transformation into the Andean Community. Third, it focuses on the Andean Countries' different approaches towards liberalisation of financial services that are converging as their various obligations are being implemented. To that end, through a comprehensive view of the origins of the Andean integration as well as by differentiating the approaches, commitments and clauses of the several treaties and agreements actually in place, this memo tries to address some of the questions issued by the conference organisers. Readers and discussants have to bear in mind that the integration of financial services by means of treaties is a subject that has come to the international scene quite recently. At the same time, developing countries have been extremely cautious when undertaking commitments at multilateral, regional and sub-regional levels related to the opening of their boundaries to the provision of financial services.

In the Andean countries case, there is evidence of nesting institutions related to the provision of financial and banking services. However, due to the lack of regulation in the field of financial services provision at sub-regional level (the Andean Commission has not issued it yet) as well as in all NAFTA-like type of agreements individually signed by some of the Andean countries (no Protocols or Annexes found), the evidence of conflicting overlapping institutions and rules is still theoretical. This author foresees that the result of the negotiations undertaken by some Andean countries and USA towards the establishment of a NAFTA-like Free Trade Area will pave the way for the harmonisation of rules regarding the trade in banking and financial services intra sub-region and with the global economy. Such outcome is not the consequence of thoroughly designed economic, financial and external policies at Andean domestic and supranational levels. It almost happened by chance. Hopefully, this circumstance will help avoiding the complexity of the nesting evidenced.

1. What is open regionalism?

Open Regionalism is the principle upon which different models of regional integration involving developing countries, such as APEC¹ and the six arrangements actually in place in Latin America and the Caribbean,² have carried out economic integration during the last decade. Different attempts to define it have been made. Some conceive open regionalism as the reduction in barriers on imports from non-member countries as a consequence of the liberalisation of trade among members.³ Others go beyond trade liberalisation and relate open regionalism with social access.⁴ However, its original conception by the APEC countries was aimed at maintaining consistency with WTO norms.⁵ In this sense, open regionalism is “(...) a dynamic process in which economic agreements serve as intermediate steps towards integration with the world economy.”⁶

(*) The author is a Colombian lawyer specializing in Colombian financial law, LLM in Banking and International Financial Law (University of London), and a PhD candidate (Queen Mary University of London). He teaches financial law and economic integration at the Universidad Externado de Colombia. Part of the research work was conducted while a Research Fellow at the Centre for Commercial Law Studies, Queen Mary, University of London. The author is also Associate Executive Director of the SMU Law Institute of the Americas, Head of the Secretariat of the London Forum for International Economic Law and Development Law and Associated Member of the Argentinean Institute of International Law. He can be reached at m.h.baquero-herrera@qmul.ac.uk

¹ APEC is the Asia-Pacific Economic Cooperation established in 1989. APEC's 21 Member Economies are Australia; Brunei Darussalam; Canada; Chile; People's Republic of China; Hong Kong, China; Indonesia; Japan; Republic of Korea; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; The Republic of the Philippines; The Russian Federation; Singapore; Chinese Taipei; Thailand; United States of America and Viet Nam. Although APEC did not define open regionalism as such, early APEC advocates understood Open Regionalism as *unconditional nondiscriminatory liberalisation (or concerted unilateralism)*. As “member states liberalize trade within the bloc, so they simultaneously cut trade barriers on imports from external countries as well.” WORLD BANK, TRADE BLOCS, (2000), at 99, http://www.worldbank.org/research/trade/pdf/trade_blocs2.pdf, last visited April 17, 2004. See also Stephan Haggard, *The Political Economy of Regionalism in Asia and the Americas*, EDWAR MANSFIELD & HELEN MILNER, (Editors), THE POLITICAL ECONOMY OF REGIONALISM, (Columbia University Press, 1997).

² They are the Latin American Integration Association, LAIA (regional); the Central American Integration System, SICA (sub-regional); the Central American Common Market, MCCA (sub-regional); the Caribbean Community and Common Market, CARICOM (sub-regional); the ANDEAN COMMUNITY (sub-regional, countries located in the North Cone of South America); and the Common Market of the South, MERCOSUR (sub-regional, countries located in the North Cone of South America). The new South American Community of Nations is not included on the list as it is more a purpose than a proper scheme yet with bodies and institutions.

³ Open regionalism studied as a way of limiting the negative effects of regionalism and as a modest external liberalisation by trade blocs aimed at producing Pareto improvements. See Wei Shang-Jin & Jeffrey A. Frankel, OPEN REGIONALISM IN A WORLD OF CONTINENTAL TRADE BLOCS 440-453 (IMF Staff Papers 45, no. 3 1998), <http://www.imf.org/external/Pubs/FT/staffp/1998/09-98/pdf/wei.pdf>, last visited March 17, 2004

⁴ See Clark W. Reynolds, OPEN REGIONALISM LESSONS FROM LATIN AMERICA FOR EAST ASIA (Working Paper #241 1997), <http://www.nd.edu/~kellogg/WPS/241.pdf>, last visited March 17, 2004

⁵ See Vinod K. Aggarwal, *Withering APEC? The Search for an Institutional Role*, August 1999. See also Andrew Elek, *Open Regionalism Going Global: APEC and the New Transatlantic Economic Partnership*, Pacific Economic Paper No. 286, December 1998; and Woo Yuen Pau, *APEC after 10 Years: What's Left of "Open Regionalism"?* Paper presented at APEC Study Centre Consortium Conference, Auckland, New Zealand, 30 May - 2 June 1999, available at <http://www2.auckland.ac.nz/apec/papers/woo.html>, last visited 15 June, 2005

⁶ See Germán Creamer, *Open Regionalism in the Andean Community: A Trade Flow Analysis*, available at http://www1.cs.columbia.edu/~gcreamr/papers/Pandeng_World_Trade2_S.pdf, last visited 10 June, 2005. This paper contains an interesting analysis related to the different approaches to

After taking into consideration the debate over “globalism vs. regionalism,” Bergsten⁷ studies open regionalism as an effort to reconcile the potential conflicts between these two concepts. According to him, the “(...) concept represents an effort to achieve the best of both worlds: the benefits of regional liberalization, which even the critics acknowledge, without jeopardizing the continued vitality of the multilateral system.”⁸ He proposes five possible definitions, being the first four of them directly related to liberalisation of trade in goods by lowering tariff barriers, as follows:

1) Open Membership in the regional arrangement: “Any country that indicates a credible willingness to accept the rules of the institution would be invited to join.”⁹ This option may create difficulties for the original members to reach deep integration as the schedules and process of liberalisation were established according to the needs of the founding countries. 2) Unconditional most-favoured-nation (MFN) treatment by which trade liberalisation would be extended unconditionally to all of the members’ trading partners. No new preferences or discrimination would be created. This approach has the potential of affecting the regional scheme and its negotiating power as it simply allows any non-member to join in as a simple “free-rider” without gaining any sort of reciprocity. 3) Conditional MFN. The regional group as such would offer to generalise its reductions of barriers to all non-members that agreed to take similar steps. It is mainly based on reciprocity. 4) Global liberalisation, meaning continuous reduction of barriers on a global basis while pursuing each group’s regional goals. All Andean countries are members to the GATT so, implicitly, have taken this view.¹⁰ 5. Trade facilitation through non-tariff and non-border reforms. Measures such as customs harmonisation and mutual recognition of product standards could be used to that end as well as cooperation in enforcing national competition policies and deregulation of key domestic markets.

According to Renato Ruggiero, former Director-General of the WTO, open regionalism is “(...) the gradual elimination of internal barriers to trade within a regional grouping (. ..) at more or less the same rate and on the same timetable as lowering of barriers towards non-members. This would mean the regional liberalization would in practice as well as in law be generally consistent with the MFN [most favored nation] principle.”¹¹

open regionalism and multilateralism. See also Garnaut, Ross. 1994. “Open Regionalism: Its Analytic Basis and Relevance to the International System.” *Journal of Asian Economics* 5, no. 2 (Summer): 273-90.

⁷ C. Fred Bergsten, OPEN REGIONALISM (Institute for International Economics, Working Paper 97-3 1997), <http://www.iese.com/publications/WP/1997/97-3.htm>, last visited June 15, 2005

⁸ *Ibid*

⁹ *Ibid*. This may create what is called the “broadening vs. deepening” dilemma.

¹⁰ These four definitions can be also found in the paper by Wei Shang-Jin & Jeffrey A. Frankel, OPEN REGIONALISM IN A WORLD OF CONTINENTAL TRADE BLOCS, 5-6, NBRE Working Paper 5272, September 1995

¹¹ This definition is provided by Saman Kelegama, *Open Regionalism in the Indian Ocean, How relevant is the APEC model for IOR-ARC?*, 257, *Journal of the Asia Pacific Economy* 5(3) 2000: 255–274 quoting Panagariya 1999: 504 at Panagariya, A. ‘*The regional debate: an overview*’, *The World Economy* 22(4): 477–511, 1999

This memo considers “Open regionalism” from the perspective introduced by ECLAC¹² in the mid 1990s. It was a response to the changes towards regional integration in the early 1990s. Although the policy of import substitution, which it advocated in the 1960s was left aside, ECLAC continued providing guidance to the process of economic integration within the context of openness in which all economies of the region were involved.

As stated by ECLAC, it is “a process of growing economic interdependence at the regional level, promoted both by preferential integration agreements and by other policies in a context of liberalization and deregulation, geared towards enhancing the competitiveness of the countries of the region and, in so far as possible, constituting the building blocks for a more open and transparent international economy”.¹³

Open regionalism contains two antithetical propositions.¹⁴ On the one hand, it advocates regional integration as opposite to multilateral or global integration. Regionalism implies certain preferences among the members and a degree of protection against non-members. On the other, it proposes openness to other countries, blocs and economies through different means, among them, multilateralism.

This two-folded definition implies an enormous degree of multiple interactions:¹⁵ first of all, those within the region, sub-regions and bilateral arrangements and secondly, those outside the region, sub-regions and other arrangements, which could be negotiated and agreed in blocs or individually. There is as well a high degree of difficulty as to finding the right balance among the particular concerns and interest of

¹² ECLAC is the United Nations Economic Commission for Latin America and the Caribbean. Its Spanish acronym is CEPAL. ECLAC has developed its own school of thought being extremely influential within the region during the 1950s and 1960s. Its “Historical structuralism” was based on the ideas and work of Raul Prebisch, Celso Furtado and Jorge Ahumada, among others. See <http://www.eclac.cl/acerca/default-i.asp>, last visited July 28, 2003. See also Bela Balassa, *Regional Integration and trade liberalisation in Latin America*, X No. 1, JOURNAL OF COMMON MARKET STUDIES 58, 59-60 (1971)

¹³ ECLAC, OPEN REGIONALISM IN LATIN AMERICA AND THE CARIBBEAN. ECONOMIC INTEGRATION AS A CONTRIBUTION TO CHANGING PRODUCTION PATTERS WITH SOCIAL EQUITY. (1994), <http://www.eclac.cl/cgi-bin/getProd.asp?xml=/publicaciones/xml/7/4747/P4747.xml&xsl=/tpl-i/p9f.xsl&base=/tpl-i/top-bottom.xsl>, last visited September 26, 2003 [hereinafter *open regionalism*]. See also Gary C. Hufbauer, THE FUTURE OF REGIONAL TRADING ARRANGEMENTS IN THE WESTERN HEMISPHERE (Institute for International Economics 1998), <http://www.sice.oas.org/geograph/papers/ie/hufbauer0998.asp>, last visited September 26, 2003. See also SELA, GUIDE TO LATIN AMERICAN AND CARIBBEAN INTEGRATION 2001, 4, (Permanent Secretariat of SELA 2001). Document available at <http://lanic.utexas.edu/~sela/AA2K1/ENG/docs/Integra/SPDi5-01/SPDi5-01-2.htm>, last visited September 09, 2003 (hereinafter *Guide*), at 9. See also Shahid Javed Burki & Guillermo E. Perry, *Towards Open Regionalism. Introduction to* SHAHID JAVED BURKI ET AL, (Editors), TOWARDS OPEN REGIONALISM, (Annual World Bank Conference on Development in Latin America and the Caribbean, 1997) at 3, 3-9

¹⁴ Eduardo Mayobre, *The Rules of the World Game in Latin America's Foreign Policy*, 53 CAPITULOS del SELA 51, 60 (1998) (commenting on the concept of open regionalism). See also Percy S. Mistry, Open Regionalism: Stepping Stone or Millstone toward an Improved Multilateral System? In JAN JOOST TEUNISSEN, REGIONALISM AND THE GLOBAL ECONOMY. THE CASE OF LATIN AMERICA AND THE CARIBBEAN, (FONDAD, The Hague, 1995) at 11, 11-18. See FRITZ MACHLUP, A HISTORY OF THOUGHT ON ECONOMIC INTEGRATION, (THE MACMILLAN PRESS LTD, 1977) at 17, footnote 4 (discussing the implications of integration: discrimination and non-discrimination)

¹⁵ See SELA's Permanent Secretariat, *Some Thoughts of the Dynamics on Latin America's and the Caribbean's External Relations*, 55 CAPITULOS del SELA 7, 8-9 (1999) (discussing the implications of open regionalism).

the member countries of the region or sub-regions, and those of the region as a whole in the negotiations with other countries (such as US) and blocs (EU).

1.1 Open regionalism supposes regionalism

The Cartagena Agreement is the oldest and most representative *De Iure* means of Andean regionalism. This Treaty signed in 1969 has created two important mechanisms of sub-regional integration among the Andean countries: the Andean Pact (1969- 1996) and the Andean Community (1997-up to now). Both schemes pursued, as a first step, the progressive economic integration of their member countries through the opening of their trade in goods. The Andean Pact promoted a Free Trade Area (FTA) of goods among its members. After more than 35 years, in January 2006 the Andean Community finally achieved a fully operating FTA.

Equally, firstly under the Andean Pact and later on by transforming into the Andean Community, member countries carried on with the purpose of creating a custom union without being successful in achieving it. Furthermore, the Andean countries in 1999, under the frame of the Andean Community, decided to move forward towards the creation of a Common Market (originally planned to be functional by 2005), which will imply the free trade in financial services among its members.

After studying the historical evolution of the Cartagena Agreement since its creation in 1969, there appear to be four main features of the integration process of the Andean countries. These characteristics can be named as follows: 1) Granting of differential treatment and preferences to less developed countries; 2) A politically led process; 3) Highly institutionalised structures, and 4) A process of economic integration based on antithetic economic policies. These features have certainly played a key role in the successes and failures of the Andean scheme.

1.1.1 Differential treatment

Differential treatment is considered not only a feature but also a principle of economic integration in both the Andean sub-region and the whole Latin American region.¹⁶ It's aimed at balancing the asymmetries present among the member countries of a determined integration scheme. It has been introduced in almost all South-South agreements in the region. Small and middle size countries have traditionally reacted against arrangements that do not consider their different levels of development. The Andean Pact¹⁷ and the Caribbean Community and Common Market¹⁸ (CARICOM) were established as a consequence of the dissatisfaction of their member countries

¹⁶ See Mauricio Baquero-Herrera, *A Decade of Open Regionalism in Latin America: The need for effective and efficient articulation, coordination, cooperation and convergence* in J.B Attanasio and J.J. Norton (Editors), *MULTILATERALISM V. UNILATERALISM: POLICY CHOICES IN A GLOBAL SOCIETY*, 257, BIICL and SMU, 2004

¹⁷ The Cartagena Agreement was signed in 1969 setting up the Andean Group or "Pacto Andino", with the aim of creating a customs union. The Andean Community and the Andean Integration System started operating in 1997,

when the Protocol of Trujillo (1996) started to apply

¹⁸ It is a customs union established in 1973 set up among Antigua and Bermuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago. The CARICOM's web site is <http://www.caricom.org>

with the outcome of the first Latin American effort of economic integration: the Latin American Free Trade Area (LAFTA). These sub-regional agreements, as opposed to LAFTA, were composed of a more homogeneous grouping of countries, territorially linked and with related types of economies. These countries shared a common understanding of their situation, as one of economic dependency and underdevelopment rather than of economic complement, regional integration being their only way of 'getting out from under'.¹⁹

The Cartagena Agreement conceded special treatment to relatively less developed Andean countries such as Bolivia and Ecuador.²⁰ To Vargas-Hidalgo (1979) the special treatment given to these two countries, being the least developed members, was the most distinctive element of the Andean Pact's organisation.²¹ However, this author considers the unequal distribution of costs and benefits among the members as one of the problems common to all economic integration systems formed by developing countries,²² describing it as "the root cause of all the major conflicts experienced by developing countries within integration systems".²³

The Oil crises in the 1970s and the debt crisis in the 1980s with their consequent balance of payment problems induced a deep recession and a severe contraction in imports.²⁴ "The general economic paralysis in the region, coupled with the emergence of a new development strategy based on market opening, undistorted relative prices and privatisation/deregulation seemed to be the final deathblow for regional integration."²⁵ However, the Andean integration process showed in this devastating crisis one of its more important strengths: its endurance and commitment to prevail despite the difficulties of a different nature that have impeded its development and delivery of its main objectives.

¹⁹ Middlebrook, Kevin J. Regional Organizations and Andean Economic Integration. *Journal of Common Markets Studies*, Volume XVII, No. 1, September 1978, page 65

²⁰ *Ibid*, at 64 –65. See also Avery, William P. and Cochrane, James D., *Sub-regional Integration in Latin America: the Andean Common Market*, *Journal of Common Markets Studies*, Volume XI, No. 1, pages 85 to 102. Differentiated treatment according to levels of development is also established in CARICOM. See Article 3 of the Treaty Establishing the Caribbean Community and Common Market (CARICOM) available at <http://www.sice.oas.org/trade/ccme/ccme2.asp>, last visited February 10, 2006. Other arrangements, such as the Central American Common Market, MERCOSUR and the Group of Three, do not formally contemplate differentiated treatment among its member countries on the basis of their level of development. However, either through the treatment of tariffs or considerations established in further Protocols as is the case in MERCOSUR (Ouro Preto 1994), preferential treatment is granted. See SELA, THE TREATMENT OF ASYMMETRIES IN REGIONAL AND SUB-REGIONAL INTEGRATION PROCESS. Document available at <http://lanic.utexas.edu/~sela/AA2K/EN/docs/spdddi6-973.htm>, last visited February 8, 2006

²¹ See Vargas-Hidalgo, Rafael. The crisis of the Andean Pact: lessons for Integration among Developing Countries. *Journal of Common Markets Studies*, Volume XVII, No. 3, March 1979, pages 213-216

²² *Ibid*, at 213 to 226

²³ *Ibid*, at 213

²⁴ Devlin Robert and Estevadeordal, Antoni. What's Mew in the New Regionalism in the Americas? in Bulmer-Thomas Victor (ed) *Regional Integration in Latin America and the Caribbean: The Political Economy of Open Regionalism* London: Institute of Latin American Studies, 2001, page 20. See also ECLAC Publications. *América Latina en el umbral de los años ochenta, 1979*, 2a. ed., 1980. Economic Commission for Latin America and the Caribbean. Santiago, Chile. See also O'Keefe, Thomas Andrew. *Latin American Trade Agreements*. Transational Publishers, Inc. New York. 2001. Page 1-9.

²⁵ *Ibid*, Devlin and Estevadeordal, page 20

The Heads of State, at the Galápagos Presidential Meeting, December 1989, “decided to take the process into their own hands and introduce the changes needed.”²⁶. A new phase fostered by the leadership of the Andean Presidents will introduce the Andean Pact to the new policies that later on will constitute what is called “open regionalism”, features that it preserves up to this day. The Andean Pact was transformed into Andean Community in 1996. However, within the structural transformations happening during the 1990s, the feature of preferential treatment did not receive any change as it was established in the original Cartagena Agreement (CA).

To sum up, from its origin the CA provides for harmonious and balanced development among member countries. This important aim, which has been present in the black letter of the Treaty since 1969, requires the establishment of concessions among a scheme of medium and small sized developing countries, which has proven costly. In practical terms, more developed member countries, as a natural reaction, protect their own interest leaving the less developed ones with no other options but withdrawing or seeking for better deals. This is the case of Bolivia, which has signed agreements with Mexico, MERCOSUR and Chile opening its markets to the whole continental Latin America.

Furthermore, granting special concessions and preferential treatment is traditionally implemented through the establishment of certain conditions related to tariffs and non-tariffs, which are proper of the liberalisation of trade in goods. In this sense, after more than three decades, the full liberalisation of trade in goods is almost complete intra sub-region by the conformation of the Andean Free Trade Area (AFTA). Additionally, the protective characteristic of the original Andean Pact gave way to a strategy of openness and free trade with non-members adopted also by the poorest member countries of the CA. Therefore and within this context, the question about the need for considering special treatment should be contemplated.

Finally, it is important to reflect on the meaning of conferring preferential treatment to less developed countries when implementing the Andean Common Market (ACM), in particular in the area of the liberalisation of financial services: Should the other member countries grant special concessions to Bolivian or Ecuadorian financial operators or accept the slow opening of the financial markets of the countries in mention? Can, in any given case, Decisions of the Commission of the Andean Community (CAC) be considered in breach of the Cartagena Agreement (CA) when they do not grant special conditions to small-sized member countries? It certainly creates an important amount of legal risk among participants and leaves the chance for future forum shopping when issues related to the trade in financial services need to be resolved.

1.1.2 Politically lead process

After its creation through the Cartagena Agreement, the Andean Pact passed through different stages. Following an important boost in the early years, the inclusion of

²⁶ SELA (Latin American Economic System) “Latin America and Caribbean integration schemes in the face of the international crisis” (1999). Document available at <http://lanic.utexas.edu/~sela/AA2K/EN/docs/spclxxvdi9-2.htm>, last visited February 8, 2006

Venezuela in 1973²⁷ and the sudden abandonment of Chile in 1976²⁸ marked a very difficult first decade.²⁹ The political will of the member countries, or the lack of it, was one of the most important elements present or missed in the early years of the Cartagena Agreement. Its original mechanisms and objectives needed strong and enduring political commitment. In order to make the whole system functional member countries set up two main bodies: the Commission and the Board, which in the long run became influenced by the political attitude of their members.

Between May 1989 and December 1991, the Presidents of the Andean countries convened on nine occasions³⁰ to evaluate and try to revive the process. The impetus of the Presidents at the time ended up in the institutionalisation of the Andean Presidential Council (APC) in Machu Picchu 1990,³¹ one of the most important changes in the structure of Andean integration. Since then, fourteen meetings have taken place in which core decisions were made in order to progressively deepen sub-regional integration by achieving a Free Trade Area, a Customs Union and a Common Market.³²

Without any doubt, the introduction of the APC has contributed to the dynamism of the sub-regional integration effort during the last decade. Not only were co-related economic policies and structural reforms implemented in each member country during the recent years but also the strong political commitment and direct influence by the governments have moved the Andean scheme towards the achievement of its goals, at least formally.

An overview of the efforts undertaken during the last years by the Andean leaders proves on the one hand, the direct influence of their political will and, on the other, the fragility of the process, which heavily relies on the leadership of the Andean Presidents.

Due to the consistent work of the Andean Presidential Council, it only took about four years to build up a solid and efficient process towards the establishment of a Free Trade Area, an agreement on a Common External Tariff (CET) and a deadline for the

²⁷ For an explanation of the overall consequences of Venezuelan late entry to the AP, see Avery & Cochrane, *supra* note 20, at 99-101. See also Middlebrook, *supra* note 19, at 79-80

²⁸ After the military coup in 1973, Chile adopted policies incompatible with those supporting the Andean initiative. See Middlebrook, *supra* note 19, at 81-82. See also Vargas-Hidalgo, *supra* note 21 at 223

²⁹ For a comprehensive analysis of the 1974-1976 crisis of the AP, see Rafael Vargas-Hidalgo, *supra* note 21, at 213-226

³⁰ Caracas, February 3, 1989; Cartagena, May 25 and 26, 1989; Galapagos, 17 and 18 December 1989; Machu Picchu, 22 and 23 May, 1990; Lima, July 28, 1990; Bogota, August 7, 1990; La Paz, November 29 and 30, 1990; Caracas, May, 17 and 18; and Cartagena, December 3 and 5, 1991. In April 1992, Peru's membership was suspended when its President, Alberto Fujimori, abrogated the Country's Constitution and closed the Courts and Congress. The Andean Presidential meetings resumed three years afterwards in Quito, September 5, 1995

³¹ See Instrument for the Creation of the APC, Machu Picchu, Peru, May 23, 1990.

³² A complete set of the documents issued in each one of the Andean Presidential summits 1989-2002 can be found in Spanish at <http://www.comunidadandina.org/cumbreSC/Presidentes.pdf>, last visited February 8, 2006

establishment of the Andean Common Market.³³ However, only a period of political turmoil in 1992, when Peruvian obligations were suspended, was enough to stop the meetings of the Andean Presidents affecting the speed and overall results of the process during the following years.³⁴ Equally, during the last two years we have been witnessing the attitude of the Venezuelan President Hugo Chavez towards the Andean Community. He has decided to lead Venezuela to become a full member of MERCOSUR notwithstanding that the Andean Community as a whole has entered a process of integration with MERCOSUR and the South American countries created in 2005 the South American Community of Nation. This lack of political will by one of the members is affecting the coherence of the Andean integration process and the efficiency of the Andean Integration System.

At the same time, consequence of open regionalism, Colombia, Peru and Ecuador started negotiating a Free Trade Agreement with USA in 2004. This process undertaken by three of the five members has badly influenced some of the important decisions taken by the Andean countries as members of the Andean Community. In fact, core issues related to the formulation of a Common External Tariff and the formation of the Andean Common Market by 2005 were stopped. In addition, as the intra sub-region negotiations concerning the liberalisation of financial services were delayed, it is clear now that the chapter on financial services of the Andean countries-USA FTA agreements is the basis of such negotiations among the Andean countries.

The decision of these three countries has also created a political mismatch with other members such as Venezuela and probably Bolivia taking into consideration its new government. The difficulties between USA and Venezuela have become more obvious as well as the tendency of the Latin American population to elect left-wind governments.

The Andean Pact was created in a period where state-led institutions and programmes were influential in domestic models of development. Even though, a change in the economic policies during the 1990s promoted privatisation and the diminution in the size of the State, and also lessened Constitutional Presidential attributions, the dependency of the Andean Community on the political will of its leaders has not changed. Furthermore, the institutions and bodies re-invented in the last reforms are still strongly influenced by the local governments with little room for private entrepreneurs. The political behaviour of the Venezuelan President during the last years coupled by the decision of Colombia, Ecuador and Peru of negotiating a Free Trade Agreement with USA are another examples of the weakness of the AC's structure which is badly affected by the lack of political will among its members.

This sense of "public ownership" of the process has kept private initiative far from convinced of the real benefits of the sub-regional scheme. Interest groups remain

³³ In La Paz, Bolivia, November 1990, the Andean Presidents brought forward the deadline for forming the AFTA by up to 31 December 1991 and to define the ACET by 1991. (Supposed to be in place 1995). The dead line for ACM establishment was 1995

³⁴ The entire process was affected by external political factors, which happened in April 1992 and 1993. Peru's membership was suspended (See Decision 321, 25 August 1992, at <http://www.comunidadandina.org/normativa/gace/g101a150.htm>, last visited February 8, 2006) when its President, Alberto Fujimori, abrogated the Country's Constitution and closed the Courts and Congress in 1992. In addition, following impeachment procedures, Venezuelan President Carlos Andres Perez was forced to resign in 1993

cynical about the achievement of the Andean aims. Their position within the Andean committees is frequently cynical, an example of it can be found in the last Andean Summit in Quirama, Colombia 2003.³⁵

This strong political control over almost all the main bodies and institutions of the Andean Integration System (AIS) may be conducive to a rapid process of implementing the guidelines issued by the Andean Presidential Council, assuming there is consensus and political will. Nevertheless, the structure becomes utterly bureaucratic when the Presidential commitments are not duly and timely implemented, coming to be unfulfilled promises. Due to the remaining politicisation of the Andean bodies and institutions, the AIS is highly vulnerable to external shocks such as political changes and misunderstandings among member countries.

These circumstances define Andean Integration as a “top down process” which heavily relies on the Presidential leadership of their members whose guidelines are being implemented by means of an elaborated system of bodies and institutions. In this sense, the Andean Community still substantially depends on the political limitations of its leaders than on the rule of law. It has been one of its historical features and legacies. However, it is indeed a millstone able to sink the pace of integration when the sub-region enters into political turbulent phases. This weakness in the structural design of the Andean Community threatens both the internal and external undertakings currently going on.

1.1.3 Highly institutionalised structures and forums

Andean integration has produced a complex web of Institutions and bodies entrusted with different tasks and responsibilities within the sub-region. The Andean Presidents met at Trujillo Peru in March 1996 and approved the Trujillo Protocol by which introduced changes to the Cartagena Agreement. This Protocol created the Andean Community and established the Andean Integration System (AIS)³⁶ in order to promote effective co-ordination between the different bodies and institutions (about 14) that comprise it. The AIS was also set up to deepen Andean sub-regional integration, promote its external presence and consolidate and strengthen actions related to the integration process.³⁷

The Andean Integration System is composed of the Andean Presidential Council (APC) as the highest-level body;⁴³ the Andean Council of Ministers of Foreign Affairs (ACFM) or the political leadership body;⁴⁴ the Commission (CAC), the main

³⁵ See speech by Luis Carlos Villegas Echeverri, Quirama, Colombia, 2003

³⁶ Article 6 of the Cartagena Agreement as amended available at <http://www.comunidadandina.org/ingles/treaties/trea/andetriel.htm>. See a general overview of the Andean Integration System at <http://www.comunidadandina.org/ingles/site.htm>, last visited February 8, 2006

³⁷ Article 7 Cartagena Agreement as amended

³⁸ *Id.* at Section A, articles 11 to 14

³⁹ *Id.* at Article 11

⁴⁰ *Id.* at Articles 13 and 14

⁴¹ *Id.* at Article 12

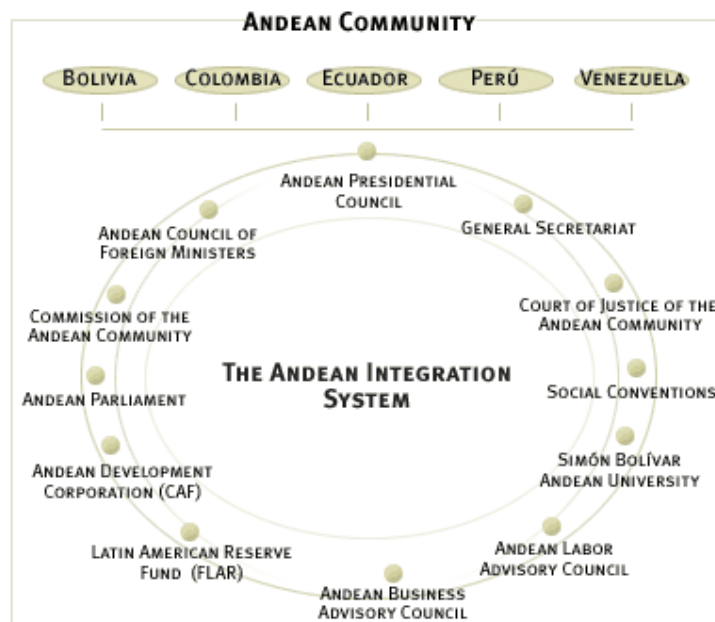
⁴² *Id.* at Section B, articles 15 to 20

⁴³ *Id.* at Section A, articles 11 to 14

⁴⁴ *Id.* at Section B, articles 15 to 20

policy-making body;⁴⁵ the General Secretariat (AGS) acting as the executive body of the system;⁴⁶ the Court of Justice of the AC (CJAC), the judicial body;⁴⁷ the Andean Parliament (AP) or the deliberative body;⁴⁸ the Advisory Institutions,⁴⁹ the Financial Institutions,⁵⁰ Social Conventions,⁵¹ and finally, the Simón Bolívar Andean University.⁵²

Table 1. The Andean Integration System⁵³



There is strong political control over almost all the main bodies and institutions. This may be conducive to a rapid process of implementing the guidelines issued by the Andean Presidential Council, assuming there is consensus and political will. Nevertheless, the structure becomes utterly bureaucratic when the commitments become unfulfilled promises. Therefore, this formally impressive System is still in its early stages of being fully operative. Only the rule of law will bring real balance to it. It will happen when the responsibilities of each one of the bodies and institutions comprising the AIS are clearly determined, when Supranationality and direct

⁴⁵ *Id.* at Section C, articles 21 to 28

⁴⁶ *Id.* at Section D, articles 29 to 39

⁴⁷ *Id.* at Section E, articles 40 and 41

⁴⁸ *Id.* at Section F, articles 42 and 43

⁴⁹ They are the Andean Business Advisory Council (ABAC) and the Andean Labour Advisory Council (ALAC). *Id.* at Section G, Article 44

⁵⁰ They are CAF and FLAR. *Id.* at Section H, Articles 45-46

⁵¹ The social conventions are intergovernmental institutions created to complement the integration efforts in other fields different from the economic and trade sectors. These are the Hipólito Unánue created to support the member countries' efforts to improve their peoples' health and the Simón Rodríguez Convention to promote social and labour integration.

⁵² For more information see <http://www.comunidadandina.org/ingles/who/university.htm>, last visited February 11, 2006

⁵³ Source: Andean community web page available at <http://www.comunidadandina.org/ingles/who.htm>, last visited January 20, 2006

application of Andean regulation become more than a formality and when the authority of the CJA is fully respected in every member State. In this sense, the independent work of the Secretariat putting together coherent proposals to that end could introduce dynamism and co-ordination to the system.

1.1.4 Antithetic economic policies: From Import-substitution policies to neo-liberal policies leaving the region vulnerable to external shocks and social inequalities

The early regional integration and sub-regional attempts (i.e., LAFTA and Andean Pact) were conducted within the framework of the import substitution industrialisation policy.⁵⁴ The international economic factors of the 1970s as well as the first petroleum crisis in 1978 and the increasing external debt of the Latin American countries made the economies of the region more dependent on international markets. This escalating reliance on external funding and the consequent external debt crisis of the 1980s changed the attitudes of these countries towards regional integration.⁵⁵

On 20 August 1982, Mexico announced the unilateral suspension of principal payments on its foreign debt and the external debt crisis started. The end of the Cold War in 1989 brought fears within the region that international capital flows might be allocated in the former Soviet countries. Therefore, it was essential for all Latin American economies to participate and be competitive in the world economy.⁵⁶ Neo-liberal policies introduced in the domestic context geared up to the opening of the Latin American markets,⁵⁷ eliminating the “anti-exportation bias” inherent to the inward-oriented industrial development strategies.⁵⁸ The “lost decade” of the 1980s, instead of ending the on-going process of regional and sub-regional integration, encouraged it under new policies, which promoted the opening of the markets to foreign trade. The resultant need to do so invigorated integration schemes during the 1990s.

This “new regionalism”⁵⁹ is based upon a different policy framework that promotes open and competitive private market-based economies within a democratic

⁵⁴ This policy was based on ECLA’s model. At that time, it argued consistently that Latin American countries were peripheral to the more industrialised economies, which were considered the centre. To transform this relationship, Latin American economies must develop industrialisation programs led by the States in order to limit their role as mere exporters of raw materials to the centre. By temporally introducing tariffs, selectively and moderately to those elaborated goods produced by the countries in the centre, industrialisation through import substitution would achieve economic development. See 1, *supra* note 2, at 6-7. See also F.A.G KEESING & P.J. BRAND, POSSIBLE ROLE OF A CLEARING HOUSE IN THE LATIN AMERICAN REGIONAL MARKET 390, 411-413 (IMF Staff Papers Vol. 10 1963)

⁵⁵ Rubens Antonio Barbosa GCVO, *The Evolution of the Integration Process in South America*. Introduction to MARTA HAINES FERRARI, THE MERCOSUR CODES, at xi (BIICL 2000), at xiv

⁵⁶ *Guide, supra* note 13, at 8-9. See also Bela Balassa, *The Process of Industrial Development and Alternative Development Strategies*, ESSAYS IN INTERNATIONAL FINANCE, No. 141, Dec. 1980 at 6-12. (International Finance Section, Department of Economics, Princeton University)

⁵⁷ Barbosa, *supra* note 55, at xviii. See also *Guide, supra* note 13, at 45. RENATO BAUMANN ET AL., LOS PROCESOS DE INTEGRACION DE LOS PAISES DE AMERICA LATINA Y EL CARIBE 2000-2001: AVANCES, RETROCESOS Y TEMAS PENDIENTES. (The processes of integration of the Latin American and Caribbean Countries 2000-2001: gains, drawbacks and issues to define) 30-31 (CEPAL, División de Comercio e Integración 2002), <http://www.sice.oas.org/geograph/westernh/eclac02.pdf>, last visited February 10, 2006

⁵⁸ See ECLAC, *Open Regionalism, supra* note 13, at 1

⁵⁹ See Devlin & Estevadeordal, *supra* note 24

institutional setting. It involves the following premises: “Deepening grade liberalisation and lock-in reforms, market driven and attraction of foreign direct investment, creating and diversifying trade and dynamic productive transformation, geopolitics, institutional modernisation and enhanced regional co-operation. At the same time, it applies simple liberalisation programs, irreversible commitments, GATT/WTO rules of liberalisation, it is highly reciprocal and uses automatic schedules to liberalise trade with limited negative lists.”⁶⁰

As countries in the region shared the same market-oriented economic policies, “the impact of concessions given to each other was not very different from the concessions given to third countries.”⁶¹ Consequently, bilateral and trilateral arrangements appeared, as well as several preferential trading arrangements. The Partial Scope Agreements provided for in the Montevideo Treaty 1980, which created the Latin American Integration Association (LAIA), brought about MERCOSUR.⁶² Reciprocal free trade areas were negotiated mainly by Chile and among sub-regional schemes. The establishment of the G-3 between Colombia, Mexico and Venezuela is another example. It also allowed the establishment of North-South agreements such as NAFTA and the consequent Free Trade Agreement signed between USA and Chile. Furthermore, the whole South-South agreements started to shake as a consequence of the negotiations towards the establishment of the Free Trade Area of the Americas (FTAA).

The inward-looking model was strongly affected by the external debt crisis and finally collapsed. An antithetic outward oriented strategy was embraced and it is currently in place. As a result of the economic liberalisation and structural adjustment programs and the tremendous effect of neo-liberal policies on the approach of the countries towards regional integration, a worrying degree of vulnerability from external shocks is still present in all schemes.

Mid and late 1990s witnessed the Tequila crisis of 1994 (the first time that Latin America experienced an important impact generated by financial globalization⁶³), the transnationalisation of finance, the tele-information revolution, the Asian (1997) and Russian (1998) crises, and also the Brazil and Argentinean crises (starting in 1999). All of them evidenced the fragility of the region from externalities.⁶⁴

⁶⁰ See presentation by Devlin & Estevadeordal, TRADE AND COOPERATION: A REGIONAL PUBLIC GOODS APPROACH, (2002), http://www.netamericas.net/Documents/Presentations2/Presentation_NET%20AMERICAS%20OAS%202002_1.ppt, last visited February 8, 2006. See also Antoni Estevadeordal, REGIONAL INTEGRATION AND REGIONAL COOPERATION IN LATIN AMERICA 12-13, (2002), http://www.adb.org/documents/events/2002/trade_policy/NRA_pres.pdf last visited February 8, 2006. Also Devlin & Castro, REGIONAL BANKS AND REGIONALISM: A NEW FRONTIER FOR DEVELOPMENT FINANCING 3, (Integration and Regional Programs Department, Working Paper No. 13, IDB, INTAL-ITD-STA 2002), <http://www.iie.com/publications/papers/devlin-castro0202.pdf>, last visited February 9, 2006

⁶¹ *Guide, supra* note 13, at 24.

⁶² See ECLAC, *Open Regionalism, supra* note 13, at 5. See also THOMAS ANDREW O’KEEFE, LATIN AMERICAN TRADE AGREEMENTS (Transnational Publishers, Inc. New York. 2001).

⁶³ Juan F. Rojas Penso, *The Effects of the Crisis on Integration*, 57 CAPITULOS del SELA 33, 33 (1999).

⁶⁴ See SELA & AECI, THE ECONOMIC LABYRINTH. THE AGENDA OF LATIN AMERICA AND THE CARIBBEAN TO COPE WITH THE INTERNATIONAL FINANCIAL CRISIS, (Ediciones Corregidor, 1999).

Notwithstanding the structural and second generation reforms placed in the region, the impact of the circumstances affecting the international economy and the local economic crisis led ECLAC again to speak of the "lost half decade" of the Latin American and Caribbean region⁶⁵. Until recently, sub-regions such as MERCOSUR and the Andean Community had started to work on the establishment of harmonised macroeconomic policies, particularly exchange, financial and fiscal policies.

To sum up, regional integration in the Andean countries has been based on policies which underlined trade in goods and do not prepare the region for the changes and effects of the international economy, leaving it vulnerable to external factors.

Conclusion

During the last decade the Andean leaders have been pushing member countries towards deeper internal and external integration. However, the implications of supporting these commitments on a scheme which scores very high on political risk, depends on sluggish institutions, considers granting differential treatment among its members within an environment of globalised open trade and does not have a coherent formulation and therefore implementation of economic policies are far from clear. The Andean sub-regional economic integration is akin to an organic process. Its common elements interact together affecting each other organically. Therefore all must be fine-tuned. By strengthening their weaknesses, they will conduct to the construction of coherent internal processes of economic integration as well as building blocks aimed at procuring a balanced immersion within the global economy.

1.2 Open regionalism supposes integrating with no members of the regional scheme

1.2.1 Open regionalism and the features of the Andean Integration

As advocated by ECLAC, open regionalism promotes economic interdependence at the regional level through preferential integration agreements. "What differentiates open regionalism from trade liberalization and non-discriminatory export promotion is that it includes a preferential element, which is reflected in integration agreements and reinforced by the geographical closeness and cultural affinity of the countries of the region."⁶⁶

ECLAC recognises the reality of the general application of the policies based on trade liberalisation throughout the region as a consequence of the external debt crisis. Its view today stresses that open regionalism should take into consideration the problem of equality of opportunities for all countries to obtain the benefits of integration. In this sense, it proposes on the one hand a gradual and progressive tariff reduction process to ease the adjustment of production activities in countries or sectors

⁶⁵ ECLAC, PRELIMINARY OVERVIEW OF THE ECONOMIES OF LATIN AMERICA AND THE CARIBBEAN 2003, (December 2003), <http://www.eclac.cl/publicaciones/DesarrolloEconomico/3/LcG2223PI/lcg2223-i.pdf>, last visited February 8, 2006. See also NORMAN GIRVAN, THE LOST HALF DECADE IN LATIN AMERICA AND THE CARIBBEAN, <http://www.acs-aec.org/column/index66.htm>, last visited February 8, 2006.

⁶⁶ ECLAC, *Open Regionalism*, *supra* note 13.

considered to be less capable of competing within an enhanced market. On the other, it considers the adoption of agreements on special treatment to less developed countries. In addition, it argues that integration in some cases could be facilitated without the need for discriminatory or special measures, i.e. avoiding severe rules of origin or including clauses that enable the greatest number of members to accede to existing agreements. So, sustainable development, balancing economic growth with environmental preservation and social equity will be achieved.⁶⁷

As a consequence, countries unilaterally or through bilateral, sub-regional and regional agreements have become more open to other markets in the region. However, this openness finds Latin American countries engaged in treaties of a different nature and scope. The variety of concessions granted to each other and to non-members generates great complexity. It may restrain trade and bring about legal uncertainty as articulation and convergence have not been attained yet.

The Latin American open regionalism is also based on ECLAC's view that "unilateral, regional and multilateral liberalization processes can all build upon one another provided that Governments have a clear picture of the interests at stake."⁶⁸ The construction of building blocks for a more open and transparent international economy necessarily requires the leadership of the governments. In this sense, open regionalism implies the importance of the political leadership of governments of the member countries. Subsection 1.1.2 emphasised the significance of the Andean Presidential Council (APC) in moving forward the Andean integration process in times of crisis as well as on setting up core goals such as the establishment of the Andean Common Market by 2005. However, such dependency on the will of the Andean leaders is also a weakness of the Andean Community.

Open regionalism encourages as well the construction of building blocks aimed at procuring a balanced immersion within the global economy. Consequently, ECLAC's approach poses the challenge of balancing the forces and local interests towards regional integration and global economic immersion.⁶⁹ Following Mistry and Tussie, open regionalism seems to be conducive to more effective multilateralism.⁷⁰ An adequate response to this undertaking implies a certain degree of institutionalism. ECLAC's definition sustains as well that open regionalism promotes economic interdependence at the regional level through various policies in a context of liberalisation and deregulation, geared towards enhancing the competitiveness of the countries of the region. In this sense, the establishment of the adequate economic policies is a challenge posed to those countries embracing it.

⁶⁷ *Id.*

⁶⁸ Secretariat of ECLAC, *Globalization and Regionalization: A View from Latin America and the Caribbean*, 58 CAPITULOS del SELA 51, 63-64 (2000) (discussing the implications of open regionalism to the governments within of the region).

⁶⁹ Carlos Moneta, *More Than Ever World Reality Requires Coordination and Cooperation Between SELA Member States*, 57 CAPITULOS del SELA. 117, 117-119 (1999). See also comment on open regionalism at the IDB web page at <http://www.iadb.org/exr/topics/integration.htm> last visited March 16, 2004

⁷⁰ See Percy S. Mistry, *supra* note 14, at 11 and 15. See also Diana Tussie: A "new multilateralism can emerge from the regional units with countries having a first direct say at the regional rather than multilateral level, as they do now, where power asymmetries are wide and affinities limited." Diana Tussie, *Multilateralism's New Approach in the Global Economy*, 53 CAPITULOS del SELA 29, 43 and 45 (1998).

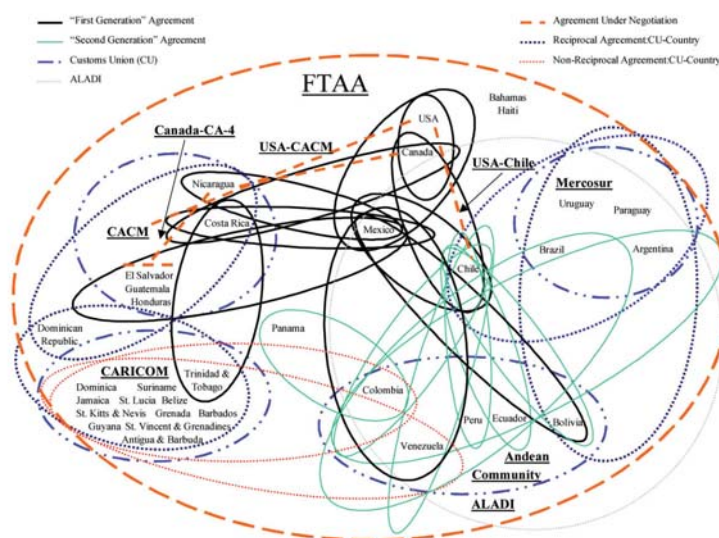
Conclusion

If the definition of open regionalism as stated by ECLAC contains the features present in the Andean processes of integration, their weaknesses, as identified in subsection 1.1, affect not only the sub-region but also may influence its relationships with other countries and blocs and the progressive liberalisation of the trade in banking and financial services.⁷¹

2 Consequences of Open Regionalism: Evidence of nesting: Main treaties signed by Andean countries with no Andean Community members containing clauses related to financial services affecting the provision of banking services

The implementation of the policy of open regionalism has promoted integration among Latin American countries. As a result they have engaged in a plethora of agreements of different nature. Figure 1 shows the famous “spaghetti bowl” prepared by the Inter-American development bank. It is an evidence of nesting agreements and institutions in the Hemisphere.

Figure 1. Trade Agreements Signed and Under Negotiation in the Americas



As for financial and banking services, in general, there are three forms of *De Iure* integration actually in place in the Andean sub-region. All these approaches differ in their methodologies and the scope of their commitments. Some of the clauses of these treaties might not be consistent with each other. Not all of them consider the liberalisation of trade in banking and financial services. The first one is the

⁷¹ See Baquero-Herrera, *Supra* note 16. See also Mauricio Baquero-Herrera, *The Andean Community: Finding her feet within changing and challenging multidimensional conditions*, Vol. No. 10 Issue No. 3, Law and Business Review of the Americas, 577-612 (Summer 2004).

multilateral approach under the WTO umbrella. Mainly all countries of the Andean region are currently WTO members and GATS member nations. Therefore, the framework for the liberalisation of the trade in financial services applies to them according to their specific commitments and limitations on market access and national treatment.

The second one comprises the Latin American Integration Association (LAIA) that mainly focuses on the liberalisation of the trade in goods. The third one relates to North-South regional agreements such as NAFTA and the NAFTA-like type of agreements (i.e. the proposed FTAA (under stand still negotiations), G-3, Mexico-Bolivia FTA and the bilateral Preferential Trade Agreements such as the US-Chile, US-Central America⁷² and the US-Andean Countries⁷³ under on going negotiations). Fourth relates to South-South regional and sub-regional schemes such as the Andean Community (CAN), Central American Common Market (CACM), the Caribbean Community and Common Market (CARICOM), the Common Market of the South (MERCOSUR) and the South American Free Trade Area.

The fifth one promotes financial integration through the unilateral openness of the capital account and the liberalisation of rules of entry to foreign banks within an environment of increasing macroeconomic stability. It was carried out by Central and South American countries as a consequence of the economic crises of the 1980s and 1990s. Individual domestic structural reforms were implemented under the guidance and monitoring of international multilateral institutions which mandates were evolving towards these kinds of roles related to the international financial arena. The adoption, implementation and compliance of certain economic policies prescribed as the solution to the underlying structural failures of the developing countries of the region was under way. These circumstances promoted a *De Facto* financial integration through the allowed activities of banks mainly from USA acting internationally and multinationally in the region.

As stated in an article written by Norton and Baquero,⁷⁴ the *de iure* and *de facto* approaches to financial and banking integration in Latin America are based on different cultures of economic integration and group negotiations as well as unilateral concessions towards that end.

At the multilateral level, the nature of such endeavours has shaped agreements under the WTO, which results in the financial and banking services have been very limited. Basically, commitments by members focus on market access through commercial presence (GATS mode 3). At the regional level, NAFTA is a model of regional integration that promotes stronger commitments by members, establishing deeper and cleared rules aimed at gaining access not only through commercial presence but also by means of cross-border provision of financial and banking services. At the sub-regional level, the models of economic integration actually in place in Latin America have gradually promoted basically trade in goods. Until recently, such schemes are

⁷² Under the US Congress scrutiny at the time of writing this thesis

⁷³ Under negotiations at the time of writing. Peru reached an agreement with USA at the end of 2005.

⁷⁴ See Joseph J. Norton and Mauricio Baquero-Herrera, *Financial Services in the FTAA Area: Sifting through the "Spaguetti Bowl" of Existing and Diverging Treaty Arrangements and Approaches Within the Western Hemisphere- The Need for a Viable Convergence Process*, to be published in Law and Business Review of the Americas, (Winter 2005)

reaching the point of negotiating and establishing rules for the liberalization of trade in services.

As an increasing number of Latin American countries are engaging in NAFTA-like type of agreements, this model is becoming a standard in the region. In this sense, the old tradition of Latin American economic integration that considers granting preferential treatment to less developed countries as a principle is crashing with the egalitarian NAFTA approach to free trade. This circumstance will also influence the future negotiations for the liberalization of the trade in services in the WTO. Developing countries have gained special treatment under the actual multilateral agreements. However, if the FTAA finally adopts a NAFTA approach, negotiations at multilateral level would be much different. It is difficult to assess the effects of all these various treaties at a domestic level as their simultaneous gradual implementation is still going on. But, what one can foresee, and it has been the purpose of the referred article to propose, is the acute need for strong local, sub-regional, regional and Hemispheric institutions as well as promoting the core function of the “rule of law” throughout this process.

This section analyses the treaties actually in place and those under negotiations which clauses relate to the liberalisation of banking services in the Andean region. To that end, it takes into account the GATS general obligations and the specific commitments and limitations on market access and national treatment; it considers the agreements which include liberalisation of financial services under LAIA and the so-called NAFTA-like agreements.

2.1 A first approach: differentiation of main commitment and clauses

2.1.1 Assessment on the liberalisation of banking activities by the Andean countries gained under GATS

After going through the GATS schedules of the Andean countries regarding banking services, it is important to underline the following: First of all, it is clear that the list of commitments and limitations reflected the regulatory status quo of the domestic Andean banking regulation at the time of finishing the Financial Services negotiations. However, by virtue of these countries adopting the agreement, their commitments and actual limitations are locked-in to the Treaty. It refrain their governments from back-peddalling on important issues providing with it legal certainty to foreign suppliers of banking services. Secondly, even though the schedules are complex documents difficult to interpret, they were at the time a source of information on regulatory limitations not available to foreign banking services providers at the time. In this sense, the principle of transparency started to play a key role in this regard.

Thirdly, in relation to market access they are also important observations. Generally, access to Andean banking markets in all modes of supply is subject to authorisation by local supervisory authorities. This requirement has been in use almost globally through different means. In addition, all Andean countries require the incorporation of a bank and other financial intermediaries as stock companies. In consequence, a foreign institution wanting to operate in any Andean market should go over all requirements set up by the domestic regulation aimed at granting authorisation to

operate and at requesting such authorisation from the local supervisory authority. They also should be ready to incorporate domestically adopting the referred legal form. Almost all countries accept the establishments of foreign banks' branches prior allocation of capital required to other domestic financial institutions of the kind. (Colombia will not longer be the exception). In Colombia, Peru and Venezuela, due to their general exemption to MFN treatment, market access depends on whether or not the country of origin of the banking service supplier grants satisfactory possibilities of access to its markets for such Andean domestic suppliers of financial services.

Forth, there are important advances on national treatment under commercial presence (mode 3). All Andean countries registered NONE limitations on national treatment regarding the main banking operations. This is an important locked-in achievement taking into consideration the protective nature and in some cases hostile position of the Andean countries against foreign institutions during the 1970s and 1980s. It also reflects the effects of both, the unilateral opening of domestic markets towards FDI undertaken individually by the Andean countries during mid 1980s and early 1990s and the consequences of the common policy towards foreign capital embodied in supranational Andean regulation.⁷⁵

Fifth, there are no commitments on cross-border banking operations (mode 1), consumption abroad (mode 2) and temporal presence of natural persons (mode 4). Bolivia, Colombia, Peru and Venezuela recorded UNBOUND in their schedules. It means that all these countries retained the right to maintain or impose regulation limiting market access and national treatment to foreign banking service providers. Only Ecuador displayed a more liberal approach to opening banking services to foreign providers through some of these modes of supply. This country recorded NONE to cross-border and consumption abroad being fully committed to grant market access and national treatment. However, still included UNBOUND in mode 4.

Finally, the actual regulation in place of the Andean countries has diminished the original limits scheduled on the Financial Services Agreement. Some of the restrictions on market access have been modified lessening requirements or eliminating some of them, as seen in the Colombian case. This provides a great opportunity in the Doha round to seek for the elimination of some measures different from authorisation⁷⁶ and legal form.⁷⁷

2.1.2 Agreements of the Andean Countries with other countries of the region under LAIA's framework: mainly focused on trade in goods

The second form of banking integration under the framework of a Treaty or a *De Jure* approach has been developed in the sub-region, first, through the Latin American

⁷⁵ See Decision 219 (1991) which establishes the regime for the Common Treatment of Foreign Capital and Trademarks, Patents, Licensing Agreements and Royalties. Article 2 indicated that foreign investors must have the same rights and obligations as those to which national investors are subject, except as provided for in the national legislation of each member Country.

⁷⁶ Licensing is a precondition to adequate prudential regulation. In this sense, it will always be a measure limiting market access to foreign providers

⁷⁷ Andean countries are Civil Law based jurisdictions. Therefore, the requirement for a specific legal form is proper of the commercial regime of those countries. This is other measure that will always be present. Cooperative banks should also be allowed as the domestic regulation allows this form as it is the Colombian case.

Integration Association (LAIA) umbrella. The Montevideo Treaty 1980 (MT 1980) creates LAIA and establishes an area of economic preferences,⁷⁸ which comprises three different mechanisms. 1) A regional tariff preference, which member countries will reciprocally grant to each other. 2) Regional scope agreements in which all member countries participate, and 3) Partial scope agreements in which all member countries do not participate and exclusively bind the signatory member countries or those who may wish to adhere.

The MT 1980 is the regional legal framework for the economic relationships of the Andean Community members with other countries in the region. Under LAIA's scope, they have established preferential trade agreements such as economic complementation and partial scope agreements. From this point of view, LAIA's approach to Latin American economic integration has proven to be adequate: Instead of creating a single and rigid regional arrangement, LAIA promotes different levels of economic integration among Latin American countries. This framework has supported natural partnerships among countries in the region. However, a process of convergence able to lead all those different arrangements towards the achievement of deeper economic integration has been difficult to attain.⁷⁹ After more than 20 years, a formal process of integration between the Andean Community and MERCOSUR forming the South American Community of Nation has timidly started.⁸⁰

The increasing number of preferential trade arrangements, economic complementation and partial scope agreements engaging Andean Community member countries with countries outside the sub-regional scheme raises serious questions about the ability of member countries agreeing on a common and coherent foreign policy. Any single country in the region has adhered to the Andean Community. In contrast, individual Andean countries have become associate partners of MERCOSUR.⁸¹

Individual Andean Countries have signed several agreements with sub-regional schemes such as CARICOM and MERCOSUR and with other countries such as Chile, Panama and Cuba. All of these agreements mainly relate to rules on trade in goods. However, while recognising the importance of trading in services for the economies of the contracting parties, they emphasise that co-operation in this field would be important under WTO regulations.

2.1.3 NAFTA-like Free Trade Agreements

The third *De Jure* approach to banking integration by means of a Treaty is that of the NAFTA-like agreements. These agreements follow the NAFTA model adopting its structure, methodology and main clauses. Examples of the NAFTA-like agreements are the FTAA⁸² as well as the G-3 Accord⁸³ and several bilateral Preferential Trade

⁷⁸ See *MT80* at Article 4

⁷⁹ See Baquero-Herrera, *Supra note* 16.

⁸⁰ See Cusco Declaration on the South American Community of Nations, 8 December 2004, available at <http://www.comunidadandina.org/ingles/document/cusco8-12-04.htm>, last visited 19 June 2005

⁸¹ This is the case of Bolivia and Peru. Venezuela has announced its decision of seeking full MERCOSUR's membership during 2005. On the other hand, Paraguay is threatening withdrawal from it. See EL TIEMPO, *En arranque de la Cumbre XXVIII de Mercosur, Paraguay amenaza con retirarse*, 18 June, 2005

⁸² Under on-going negotiation at hemispheric level

Agreements (PTA) signed individually or as a group by some Latin American countries and US.⁸⁴ These Treaties are based on NAFTA involving not only trade in goods but also services.⁸⁵ Additional subjects related to the provision of banking and financial services are also included in the Treaty such as rules on senior management and boards of directors, new financial services, cross-border trade, non-conforming measures, self-regulatory organisations, payment and clearing systems, a financial services committee as well as consultations and dispute settlement. It makes them a comprehensive and self-contained type of agreements. NAFTA-like agreements do not have clauses conferring special treatment to the parties.

In contrast, NAFTA is a Free Trade Area which goes well beyond trade in goods, it does not establish a common market, it is not a customs union with a common external tariff, it does not cede sovereignty to common economic or political institutions and it does not contemplate the free movement of labour. In addition, this agreement does not embrace any agricultural or social common policies and it does not set up special funds to remedy the imbalances that may be present among its members.⁸⁶

Other characteristics that differentiate these kinds of agreements from the others in the Western Hemisphere are their North-South original nature, their mixture of Common Law/Civil Law based member countries as well as the different languages involved. Other sub-regional agreements such as the Andean Community or MERCOSUR share the features of being of a South-South nature joining mainly Civil Law based and Spanish speaker nations.⁸⁷

NAFTA and the NAFTA-like agreements seem to be the kind of Type II of agreement according to the typology created by Liesbet Hooghe and Gary Marks quoted by Alter/Meunier.

2.1.3.1 Main features of the NAFTA model on banking integration⁸⁸

The treatment of financial services providers in the early 1990s was the focus of the U.S. financial services industry which wanted to expand globally. To that end, the establishment of equal rules for the treatment of foreign providers was a core goal to be attained internationally. “The U.S. Government, cognizant of the significance of financial services to international trade figures, took up the cause and elevated

⁸³ Comprising Colombia-Mexico and Venezuela

⁸⁴ Such as the US-Chile, US-Central America and the US-Andean Countries

⁸⁵ These chapters are as follows: FTTA [3rd Draft 2003 Chapter XVI, especial text on Financial Services], NAFTA [Chapter XIV], G-3 Accord [Chapter XII] and PTAs: [CHILE-USA: Chapter XII, Central America-USA: Chapter XII, Andean countries-USA (possibly Chapter XII)]

⁸⁶ See Professor Miguel Otero-Lathrop, *MERCOSUR and NAFTA: The Need for Convergence*, Vol. No. IV Issue No. 3, NAFTA Law and Business Review of the Americas, 116, 118 (Summer 1998).

⁸⁷ Brazil being the only but representative exemption

⁸⁸ For thorough studies on NAFTA rules related to financial services, see K.N. Schefer, *INTERNATIONAL TRADE IN FINANCIAL SERVICES: THE NAFTA PROVISIONS* (Kluwer Academic Publishers, 1999)]. See also Kenneth L. Bachman, Scott N. Benedict and Ricardo A. Anzaldúa, *Financial Services Under the North American Free Trade Agreement: An Overview*, 209-231 [Judith H. Bello, Alan F. Holmer and Joseph J. Norton eds., *THE NORTH AMERICAN FREE TRADE AGREEMENT: A NEW FRONTIER IN INTERNATIONAL TRADE AND INVESTMENT IN THE AMERICAS*, (The Section of International Law and Practice, The American Bar Association and the International Lawyer, 1994)].

financial services to a high priority item in trade agreement talks.”⁸⁹ Two significant achievements of the US administration in the 1990s in accomplishing free trade in financial services were the Agreement on Financial Services under GATS, (1999) and Chapter 14 of NAFTA, (1994).⁹⁰

Chapter 14 of NAFTA was “lauded by the United States as a model for future liberalization efforts in the Western Hemisphere and elsewhere.”⁹¹ It explains why NAFTA became the model of the following PTA to be negotiated and signed in the Hemisphere. NAFTA relies on a top-down “list or lose it” approach which provides enhanced transparency by means of a negative list.⁹² The concept of modes of supply is only used to define trade in services but is not applied to scheduled commitments as the GATS does, procuring also with it greater transparency.⁹³

According to Norton, NAFTA is based on the following core principles: (1) treaty standards of MFN and national treatment conditioned upon requirements of effective market access; (2) trade provisions focused more on “rules of origin” than on tariff schedules; (3) broad treatment of services (including trade and investment matters); (4) increasing transparency; and (5) a world-class intellectual property system.⁹⁴

As for services, NAFTA bases its provisions on a group of well-defined rules, as follows:⁹⁵ 1) The basic obligation of national treatment is extended to all services providers in all levels (country, state or province).⁹⁶ 2) MFN treatment must be accorded to all services providers of the member countries.⁹⁷ 3) Countries must grant the better of national or MFN treatment to the other NAFTA countries (standard of treatment clause).⁹⁸ 4) A general prohibition on local presence as a condition for the cross-border provision of services. Service providers cannot be forced to establish or maintain an office or other local presence, or to be a resident in a NAFTA country as

⁸⁹ See Constance Z. Wagner, *The New WTO Agreement on Financial Services and Chapter 14 of NAFTA: Has Free Trade in Banking Finally Arrived?*, Vol. No. V Issue No. 1, NAFTA Law and Business Review of the Americas, 5, at 10 (Winter 1999). See also See Mary E. Footer, *GATT and the Multilateral Regulation of Banking Services*, 27 INT’L LAW. 343 (1993)

⁹⁰ *Ibid* at 10 and 11

⁹¹ *Ibid* at 11

⁹² “If a services area is not expressly excluded or qualified by reservation, the area is deemed to be automatically included under the NAFTA core rules” See T. Bloodworth, J. Norton and W. Sladek, *“Transborder Supply of and Investment in Services”* 169, at 176, [Joseph J. Norton & Thomas L. Bloodworth eds., NAFTA AND BEYOND A NEW FRAMEWORK FOR DOING BUSINESS IN THE AMERICAS, (Kluwer Academic Publishers, 1995)]

⁹³ See John H. Jackson, William J. Davey and Alan O.Sykes, Jr. LEGAL PROBLEMS OF INTERNATIONAL ECONOMICS RELATIONS Fourth Edition, 889 and 890, American Casebook Series, West Group, 2002.

⁹⁴ See Joseph J. Norton, *“The NAFTA “Process” in Context”*,5, 8-9, 5-56 [Joseph J. Norton & Thomas L. Bloodworth eds., NAFTA AND BEYOND A NEW FRAMEWORK FOR DOING BUSINESS IN THE AMERICAS, (Kluwer Academic Publishers, 1995)].

⁹⁵ The structure of the description of these rules is based on John H. Jackson, William J. Davey and Alan O.Sykes, Jr. LEGAL PROBLEMS OF INTERNATIONAL ECONOMICS RELATIONS Fourth Edition, at 863-864, American Casebook Series, West Group, 2002. Provisions dealing with the supply of services are contained in Chapter 12 on cross-border trade in services, Chapter 13 on telecommunications and Chapter 14 on financial services. Additionally, the mentioned chapters are related to Chapter 11 on direct investment and Chapter 17 on temporary entry of business persons and in conjunction with various treaty annexes and specific reservations and exceptions to the Treaty. See also T. Bloodworth, et al *supra* note 92, at 173.

⁹⁶ NAFTA art. 1202.

⁹⁷ NAFTA art. 1203.

⁹⁸ NAFTA art. 1204.

a condition for providing services in the domestic market.⁹⁹ 5) NAFTA countries must accord to service suppliers the better of national or MNF treatment for both right-of-establishment and port-establishment operations.¹⁰⁰ 6) General coverage of movement of consumers and temporary movement of persons. 7) Important rights and obligations such as freedom for inward and outward transfers, prohibitions on performance requirements, international accepted disciplines on expropriation and binding international arbitration for settlement of investor-state disputes will be granted to services providers establishing a commercial presence in NAFTA countries, including providers from non-NAFTA countries.

Transparency is a principle which is not generally defined by the Treaty as GATS does.¹⁰¹ However, NAFTA sets out specific rules for telecommunications¹⁰² and financial services.¹⁰³ Consultation mechanisms, requirements of public notice and hearings, intergovernmental exchanges of information, “judicial review” of administrative decisions as well as the creation of various working study groups are instruments aimed at making domestic regulations more understandable to the citizens of the parties and to generate discussions towards further negotiations able to deliver future greater liberalisation.¹⁰⁴ NAFTA also promotes transparency through the methodology designed to establish qualifications and limitations to its main rules. By allowing reservations to them, this method certainly provides substantial flexibility to member countries.¹⁰⁵ The Treaty has several annexes in which members list their non-conforming laws and other measures. What is not included on the list is liberalised. Measures listed can be renewed or amended.¹⁰⁶ However, when an allowed non-conformed measure is liberalised by a Party, that member cannot increase the restrictiveness of such measure.¹⁰⁷

Regarding financial services, this is one of the sectors in which NAFTA establishes special rules tending to limit its broad core rules.¹⁰⁸ First of all, regarding all modes of supply, commercial presence or mode 3 is promoted by NAFTA. An investor of another Party should be permitted to establish a financial institution in the territory of a Party in the juridical form chosen by such investor as well as to participate widely in a Party's market.¹⁰⁹ However, country members are not obliged to authorise financial services providers of any other NAFTA member to carry on operations or to solicit

⁹⁹ NAFTA art. 1205. Cross-border provision of services is explicitly covered. It includes “(...) the production, distribution, marketing, sale and delivery of a service (including access to and use of NAFTA countries’ service) as well as the purchase, use of, or payment for a service.” This approach to cross-border provision of financial services certainly is innovative when compared to the GATS. *See* John H. Jackson, William J. Davey and Alan O.Sykes, Jr. *LEGAL PROBLEMS OF INTERNATIONAL ECONOMICS RELATIONS* Fourth Edition, at 864, American Casebook Series, West Group, 2002

¹⁰⁰ NAFTA art. 1204.

¹⁰¹ NAFTA art. 102.

¹⁰² NAFTA art. 1306.

¹⁰³ NAFTA art. 1411.

¹⁰⁴ *See* T. Bloodworth, et al *supra* note 92, at 175

¹⁰⁵ NAFTA art. 1206.

¹⁰⁶ “(...) to the extent that the amendment does not decrease the conformity of the measure”. *See* NAFTA art. 1206 (1) (c).

¹⁰⁷ *See* T. Bloodworth, et al *supra* note 92, at 175

¹⁰⁸ Along with land transportation, professional services and telecommunications. *See* T. Bloodworth, et al *supra* note 92, at 176. *See* NAFTA Chapter fourteen. *See* also Joseph J. Norton, *FINANCIAL SECTOR REFORM IN EMERGING ECONOMIES*, 268-274, BIICL, 2000.

¹⁰⁹ NAFTA article 1403 (1) and (2).

business in their territories.¹¹⁰ In this sense, the Parties are allowed to require an investor of another Party to incorporate under the Party's law any financial institution it establishes in the Party's territory or to impose terms and conditions on establishment.¹¹¹ In this sense, cross-border branching of financial institutions is subject to national discretion.¹¹² Only financial service providers can benefit from the framework of market access as this section of NAFTA defines "investor of another Party" as an investor of another Party engaged in the business of providing financial services in the territory of that Party.¹¹³

Cross-border regulation on trade in financial services is an important feature of NAFTA. It has specific regulation regarding this mode of supply¹¹⁴ which in its definition includes both consumption abroad (mode 2) and temporary presence of business-persons (mode 4).¹¹⁵ The Treaty makes sure that countries will grant access to financial services providers through cross-border operations. It contrasts with the little achievements attained by the GATS/FSA on mode 1. As an example, when assessing the commitments of Andean countries on national treatment and market access related to cross-border banking operations,¹¹⁶ all Andean countries but Ecuador recorded UNBOUND maintaining the right to put in place measures imposing limitations to cross-border operations at any time, under the frame of the Agreement. Due to the broad GATS rules on transparency, the awareness of foreign suppliers regarding such measures could be very limited.

This is not the NAFTA case which details four rules on cross-border provision of financial services as follows: 1) The adoption of any measure restricting any type of cross-border trade in financial services by cross-border financial service providers of another Party is prohibited.¹¹⁷ 2) Persons located in the territory of a Party, and its nationals wherever located are allowed to purchase financial services from cross-border financial service providers of another Party located in the territory of that other Party or of another Party.¹¹⁸ This measure also covers mode 2, consenting consumption abroad of financial services. 3) Parties are allowed to apply any kind of prudential regulation measures to this mode supply, including requiring registration of cross-border financial service providers of another Party and of financial instruments.¹¹⁹ 4) Consultations on future liberalisation of cross-border trade in financial services will be carried out.¹²⁰ 5) "Rules of origin" apply to cross-border trade.

¹¹⁰ See John H. Jackson, William J. Davey and Alan O. Sykes, Jr. *LEGAL PROBLEMS OF INTERNATIONAL ECONOMICS RELATIONS* Fourth Edition, at 867-868, American Casebook Series, West Group, 2002. NAFTA does not follow the "European passport" approach to financial services providers of the members. See also Chapter 4.

¹¹¹ Consistent with Article 1405. See NAFTA 1403 (4)

¹¹² See T. Bloodworth, et al *supra* note 92, at 186

¹¹³ NAFTA 1403 (5) (b) and (c)

¹¹⁴ NAFTA article 1404. NAFTA Chapter twelve contains general regulation on Cross-border trade. Equally, national treatment is accorded to cross-border operations. NAFTA 1405 (3)

¹¹⁵ NAFTA Article 1416

¹¹⁶ See *Supra* 2.1.3.2.4

¹¹⁷ Unless a country has listed reservations. NAFTA article 1404 (1) establishes certain conditions.

¹¹⁸ NAFTA article 1404 (2). This obligation does not require a Party to permit such providers to do business or solicit in its territory.

¹¹⁹ NAFTA article 1404 (3).

¹²⁰ NAFTA article 1404 (4).

The regulation of “rules of origin” certainly is a crucial subject matter in NAFTA. According to article 1211,¹²¹ benefits may be denied to any financial service provider 1) that is owned or controlled by nationals of a non-Party, and 2) that has no substantial business activities in the territory of any Party. Benefits may also be denied to a non-Party which does not maintain diplomatic relations with the Party, or because the non-Party is subject to measures maintained by the denying Party that prohibit transactions with the enterprise.

With regard to temporary movement of persons related to financial services, apart from the rules relative to cross-border operations, NAFTA prohibits members to require financial institutions of another Party to engage individuals of any particular nationality as senior managerial or other essential personnel. It also forbids Parties to require that more than a simple majority of the board of directors of a financial institution of another Party should be composed of nationals of the Party, persons residing in the territory of the Party, or a combination of such rules.¹²²

Secondly, financial services providers are granted national and MFN treatment throughout NAFTA territory. Investors of another Party, financial institutions of another Party and investments of investors of another Party in financial institutions are granted treatment no less favorable than that a Party accords to its own investors, its own financial institutions and to investments of its own investors in financial institutions, in like circumstances. National treatment covers the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments in financial institutions in the territory of a Party.¹²³ The national treatment standard is satisfied if a NAFTA Party affords “equal competitive opportunities” to institutions, investors, and their investments from other NAFTA countries.¹²⁴ Equally, investors of another Party, financial institutions of another Party, investments of investors in financial institutions and cross-border financial service providers of another Party are granted treatment no less favorable than that a Party accords to the investors, financial institutions, investments of investors in financial institutions and cross-border financial service providers of any other Party or of a non-Party, in like circumstances.¹²⁵

Thirdly, transparency is specially regulated within a frame of core rules as follows: 1) Parties are obliged to provide in advance any measure of general application that the Party proposes to adopt in order to allow comments on it.¹²⁶ 2) Regarding specific applications, NAFTA establishes special timeframes and procedures. The local authority is obliged to inform the status of its application on request of the applicant. Such authority must adopt an administrative decision on completed application within 120 days, after holding all relevant hearings and being received all necessary information. Governmental responses to individual inquiries in general measures should be responded in 180 days.¹²⁷ 3) There are exemptions regarding information

¹²¹ This measure from Chapter 12 on Cross-border trade in services is applicable to financial services by virtue of NAFTA article 1401 (2)

¹²² NAFTA article 1408

¹²³ NAFTA articles 1405

¹²⁴ NAFTA articles 1405 (5)

¹²⁵ NAFTA articles 1406

¹²⁶ NAFTA article 1411 (1)

¹²⁷ NAFTA article 1411 (2), (3), (4) and (6)

related to the financial affairs and accounts of individual customers of financial institutions or cross-border financial service providers as well as confidential information. 4) Transfer information in electronic or other form, into and out of the Party's territory, for data processing where such processing is required in the ordinary course of business of such institution is permitted.¹²⁸

Forth, NAFTA allows the Parties to adopt or maintain reasonable measures for prudential reasons, such as:¹²⁹ (a) the protection of investors, depositors, financial market participants, policyholders, policy claimants, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service provider; (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers; and (c) ensuring the integrity and stability of a Party's financial system. Equally, the parties can prevent or limit transfers by a financial institution or cross-border financial services provider to, or for the benefit of, an affiliate of or person related to such institution or provider. If a NAFTA member gives effect to the prudential measures of another Party,¹³⁰ the country according recognition is compelled to negotiate for similar treatment to the other NAFTA members.¹³¹

Fifth, NAFTA regulates new financial services and data processing,¹³² topics structured in a similar fashion as in the GATS Understanding on Commitments in Financial Services that Latin American countries did not accept at a multilateral level.

2.1.4 NAFTA-like Agreements in place between AC members and non-members

2.1.4.1 The Group of Three (G-3 Accord) and the PTA between Bolivia and Mexico

Colombia, Mexico and Venezuela entered into a treaty on free trade in accordance with the GATT, conferring upon it the nature of a Partial Scope Economic Complementation Agreement (PSECA) under LAIA's framework.¹³³ It would create a market of 136 million people, "becoming one of the largest free trade zones created in Latin America after the NAFTA."¹³⁴ After three years of negotiations and discussions based upon different approaches and structures, the final agreement adopted the NAFTA's structure including sectors such as services, investment, government procurement and intellectual property. None of these subjects was negotiated before in the previous Latin American South-South regional, sub-regional or bilateral PTAs.¹³⁵ It is important to note that the Andean Pact members at the time

¹²⁸ NAFTA article 1411 (5)

¹²⁹ NAFTA article 1410

¹³⁰ NAFTA article 1406 (2), (3) and (4)

¹³¹ See T. Bloodworth, et al *supra* note 92, at 185-186

¹³² NAFTA article 1407

¹³³ See Article 11, Montevideo Treaty 1980. The G-3 Accord is the AAP.CE No. 33 1994 under LAIA. It entered into force in 1995. The G-3 agreement is available at http://www.sice.oas.org/Trade/G3_E/G3E_TOC.asp, last visited October 28, 2003

¹³⁴ See Laura C. Reyes M., *Beyond NAFTA-Latin America*, Vol. I Issue No. 3, NAFTA Law and Business Review of the Americas, 156, 160 (Summer 1995).

¹³⁵ See SANDRA ZULUAGA & OLGA LUCIA LOZANO, EL GRUPO DE LOS TRES (G-3): LAS NEGOCIACIONES COMERCIALES ENTRE COLOMBIA, MEXICO Y VENEZUELAa, (The Group of Three (G-

failed to act as a bloc in achieving a 5 + 1 agreement during the negotiation process¹³⁶ coupled by the absence of a real interest by the remaining Andean partners to join the G-3 Accord as a bloc. Later on Bolivia signed an independent PTA with Mexico very similar in structure to the G-3 Accord and, therefore, to NAFTA. Peru and Ecuador have not started any negotiations yet with Mexico. However, they are in the process of negotiating a PTA with US which is very similar in its structure to NAFTA.

The agreement has been formally successful regarding the implementation of the gradual tariff reductions. By July 2004 a great deal of sectors was fully open. The achievement of a complete G-3 Free Trade Area for goods did not collide with the Andean regulation at the time, as the Andean CET was suspended until May 2005.¹³⁷ As for trade in services, in particular, banking services, little information is available on this specific area apart from the framework of the Treaty. The absence of Protocols or Annexes on non-conforming measures creates legal uncertainty and lack of clarity about the actual application of the general commitments made by the Parties and their effects on domestic banking regulation.

Bolivia and Mexico signed a PTA on 10th September 1994, which entered into force in January 1995. It has the nature of a Free Trade Area under GATT's framework and it is a Partial Scope Economic Complementation Agreement according to LAIA's framework.¹³⁸ The arrangement, following NAFTA, covers general aspects such as trade in goods, trade in services, technical barriers to trade, public sector procurement, investments, intellectual property, administrative matters and rules related to dispute settlement. According to article 1-01, the objectives of the agreement are based on the principles of national treatment, most-favoured nation treatment, and transparency. Essentially, the agreement as a whole and specially chapter XII related to Financial Services is identical to the G-3 Accord, which displays some small differences though. Equally, as in the G-3 case, there is not a Protocol or Annex on non-conforming measures related to banking and financial services.

2.1.4.2 Main Features of the G-3 Accord and the PTA between Bolivia-Mexico Applicable to Banking Activities

The objectives of the G-3, same as NAFTA, are based on the principles of national treatment, most-favoured nation treatment, and transparency.¹³⁹ Equally, as a NAFTA-like agreement, the Treaty did not formally establish distinctions among its members according to their level of development. Article X of the agreement establishes the general principles applicable to the trade in services and article XII focuses on trade in financial services.

3), the Commercial Negotiations between Colombia, Mexico and Venezuela), 181, 163-186, [Antoni Esteveordal & Carolyn Robert eds., LAS AMERICAS SIN BARRERAS. NEGOCIACIONES COMERCIALES DE ACCESO A MERCADOS EN LOS AÑOS NOVENTA, (The Americas with No Boundaries: Commercial Negotiations Towards Granting Market Access in the 1990s), (BID 2001)]

¹³⁶ It was mainly due to the lack of special treatment to be granted to the less developed Andean partners and the broader agenda proposed by Mexico at the time. See Zuluaga & Lozano, *supra* note 135

¹³⁷ See Decisions 580 and 610. at the time this thesis was written the Andean countries had not reached an agreement on the Common External Tariff proper of a Custom Union.

¹³⁸ AAP.CE/31 between Bolivia and México, 10/ September, 1994. Available in Spanish at http://www.sice.oas.org/Trade/mexbo_s/mbind.asp, last visited 28 June, 2005

¹³⁹ See article 1-01 G-3.

The regulation regarding the right of establishment is the first main difference between NAFTA and G-3 in terms of the provision of banking services. In fact, NAFTA¹⁴⁰ displays broad rules on this subject. It is based on the principle that an investor of another Party should be permitted to establish a financial institution in the territory of a Party in the juridical form chosen by such investor. The G-3 Accord, in turn is very restrictive limiting the juridical form and types of operations allowed to the foreign investor to the legal framework of the parties. This is an important variation. For instance, the Colombian legal structure promoted at the time a highly specialised type of banking sector. Financial institutions were allowed to undertake specific operations and the scope of their investments was limited. Equally, all banking institutions were and still are required to incorporate as limited public companies,¹⁴¹ also in Venezuela¹⁴² and Mexico.¹⁴³ The Parties made sure that the Treaty respected this legal tradition of their domestic banking regulation. Instead of introducing non-conforming measures to the general clause, members changed the original drafting moving away from the NAFTA model in this regard.

Equally, NAFTA extends the benefits of the rules on right of establishment only to investors of another Party engaged in the business of providing financial services in the territory of that Party.¹⁴⁴ The G-3 Accord does not include this clause as well as does not take into consideration the NAFTA's principle by which an investor of another Party should be permitted to participate widely in a Party's market.¹⁴⁵ In this sense, both foreign investors and foreign banking services providers benefit from the referred rules although they are subject to the local restrictions in the field that, in any case, should grant national treatment.

The regulation of "rules of origin" is a crucial subject matter regulated in NAFTA article 1211. The G-3 only establishes that benefits may be denied partially or totally to any financial service provider 1) that is owned or controlled by nationals of a non-Party, and 2) that has no substantial business activities in the territory of any Party.¹⁴⁶ This rule is important for the G-3 members as Mexico has important foreign presence in its banking sector which may limit the expansion of such institutions to Colombia and Venezuela.

In relation to cross-border trade, G-3 provisions are quite similar to NAFTA.¹⁴⁷ Parties are obliged to permit cross-border transactions of any financial service according to the non-conforming measures listed in an Annex.¹⁴⁸ Same can be said

¹⁴⁰ NAFTA Article 1403 (1)

¹⁴¹ See Estatuto Organico del Sistema Financiero de Colombia, Article 53

¹⁴² See Ley General de Bancos y Otras Instituciones Financieras de Venezuela, Article 11 (1)

¹⁴³ See Ley de Instituciones de Credito de Mexico, Article 8

¹⁴⁴ See *Supra* 2.3.1 and NAFTA Article 1403 (4) and (5)

¹⁴⁵ NAFTA 1403 (2)

¹⁴⁶ The other reasons for denial included in NAFTA such as a non-Party which does not maintain diplomatic relations with the Party, or because the non-Party is subject to measures maintained by the denying Party that prohibit transactions with the enterprise were eliminated by G-3 Parties.

¹⁴⁷ Although G-3 does not reproduce Article 1404 (4) regarding consultations on future liberalisation of cross-border trade in financial services.

¹⁴⁸ NAFTA Article 1409, G-3 Accord Article 12-15. This is another important issue to consider as it seems that G-3 members did not complete any Protocol on non-conforming measures. It may mean that all G-3 regulations and principles are actually in force. Therefore, domestic prohibitions such as limiting the cross-border purchase of insurance products from foreign providers to Colombian citizens

regarding national treatment. However, G-3 eliminated all NAFTA measures aimed at gaining clarity and greater certainty in relation to granting national treatment in states and provinces of Federal States. This exclusion may create problems of legal interpretation as Mexico and Venezuela are Federal States.¹⁴⁹ Rules on MFN treatment are identical although G-3 separated the MFN principle from regulation on the recognition of prudential measures in a separate article. Clauses on transparency, financial services committee, consultations, new financial services and data processing as well as senior management and boards of directors are also shaped according to NAFTA but introducing minor changes.¹⁵⁰

As for the PTA between Bolivia and Mexico, chapter XII related to Financial Services is identical to the G-3 Accord with some minor differences.¹⁵¹

2.1.4.2.1 The absence of a Protocol or an Annex on non-conforming measures: is trade in financial services totally liberalised?

According to Article 12-15, within the following eight months after the entry into force of the agreement,¹⁵² G-3 members would include in a Protocol all non-conforming measures applicable to articles 12-04 to 12-07 and 12-14 which embody the main rules on financial services. The G-3 Accord is the Partial Scope Agreement of Economic Complementation No. 33 signed under LAIA's framework. In this sense, LAIA's General Secretariat keeps a record of all different agreements signed under the scope of the Montevideo Treaty 1980 and acts as a depositary of all of them. To date, LAIA's General Secretariat acknowledges 5 additional Protocols to the G-3 Accord all of them related to tariffs applicable to certain goods. There is not evidence of the existence of the Protocol on Financial Services.¹⁵³

This observation conducts to two contrasting interpretations. The first one concludes that as a consequence of the nature of the Treaty and its negative list approach, the core principles applicable to trade in financial services are fully enforceable since 1 October 1995. This statement is based on the methodology and binding nature of the NAFTA-like agreements. The introduction of non-conforming measures is an essential part of the Treaty. Parties agreed in Article 12-15 to give themselves a convenient period of time to introduce the non-conforming measures related to financial services. Due to the absence of a Protocol on non-conforming measures and once the deadline was reached without having any notice, communication, Protocol or

are not applicable to Mexican and Venezuelan providers and, by virtue of the MFN clause, to all other Andean Countries providers. Although this is debatable, it creates legal risks.

¹⁴⁹ G-3 eliminated NAFTA Article 1405 (7)

¹⁵⁰ G-3 also introduces in the chapter on financial services provisions related to payment systems, safeguards and other exemptions regulated in NAFTA Chapter XXI

¹⁵¹ See ACGS, *Comparación de los Acuerdos Bolivia-México y Colombia-Venezuela-México*, document SG/di 733, 27 May, 2005. Mexico and Bolivia negotiated longer periods for Bolivia to accommodate to the consequences of the PTA. This was the method used to manage asymmetries among Parties.

¹⁵² The G-3 Accord was signed in September 1990 but entered into force on the 1st January, 1995.

¹⁵³ On request, LAIA General Secretariat replied on 30th June 2005 through communication ADM-SAC/627-2010/05 that up to that date, the G-3 parties have not deposited in LAIA the Protocol of non-conforming measures. Furthermore, the Secretariat stated they do not have knowledge of the elaboration of such list of non-conforming measures by the Parties. The Mexican Secretary of Economy confirmed the absence of such Protocol through electronic communication 2/RRS/GMR/almg., received on 11 July, 2005.

announcement by the Parties on the postponement of the effects of article 12-15, provisions 12-04 to 12-07 and 12-14 of the Accord started to apply accordingly.

The second, on the contrary, considers that provisions 12-04 to 12-07 and 12-14 of the Accord are not applicable yet due to the inexistence of the Protocol of non-conforming measures. It means that the Parties, due to different reasons, tacitly agreed on deferring liberalisation of financial services. The mid-1990s was a period of international financial crisis, contagion and uncertainty. Mexico went through a period of huge economic difficulties influencing the whole region by means of the so-called “tequila effect”.¹⁵⁴ Venezuela¹⁵⁵, Colombia¹⁵⁶ and Bolivia¹⁵⁷ were also affected not only by the Mexican crisis, but also by other international financial crises that took effect within that period.¹⁵⁸ In this sense, putting on hold liberalisation of financial services, more than a rational decision was a need.

In the same vain, article 12-15 of the PTA between Bolivia and Mexico gave to the Parties one year to list all non-conforming measures in an Annex to article 12-15. There is not evidence of the existence of such Annex. This Treaty also came into force in 1995, the parties being affected by the same economic and difficult circumstances considered above.

2.1.5 Treaties based on a classic model of economic integration

Sub-regional agreements such as the Andean Community and MERCOSUR comprise the fourth *De Iure* approach to banking integration. They are based on the Balassian model of Preferential Trade Agreements.¹⁵⁹ These Treaties consider integration as an evolving process starting as a Free Trade Area which only takes into account trade in goods, followed by a Customs Union whereby all member countries agree on setting up similar tariffs applicable to non-members. Finally, the process should reach a

¹⁵⁴ See Douglas Arner and Thomas Slover, *The Mexican Currency Crisis of 1995*, 95-150, [Arner, Yokoi-Arai and Zhou eds., FINANCIAL CRISES IN THE 1990s (BIICL 2001)]. See also

¹⁵⁵ See Ruth de Krivoy, *The Venezuelan Banking Crisis, 1994-5*, 151-175, [Arner, Yokoi-Arai and Zhou eds., FINANCIAL CRISES IN THE 1990s (BIICL 2001)].

¹⁵⁶ Ignacio Lozano E, *Colombia's Economy at the Turn of the Century: Reforms and Results of the Free-market paradigm*, Banco de la República, Colombia, 2001. See also Andres F. Arias, *The Colombian Banking Crisis: Macroeconomic Consequences and What to Expect*, Banco de la República and University of California at Los Angeles (UCLA). August 2000

¹⁵⁷ Agustin G. Carstens, Daniel C. Hardy and Ceyla Pazarbasioglu, *Banking Crises in Latin America and the Political Economy of Financial Sector Policy*, IMF March 2004

¹⁵⁸ See Joseph J. Norton, 'Asian Contagion' and Latin America 285-320, [E. Aguirre and J. Norton eds., REFORM OF LATIN AMERICAN BANKING SYSTEMS. NATIONAL AND INTERNATIONAL PERSPECTIVES, (Kluwer Law International, 2000)]. See also Roberto Frenkel, *Globalización y Crisis Financieras en América Latina*, 80 Revista de la CEPAL, 41-54, Agosto, 2003; The Economist, *The Tequila Hangover*, London, Abril 8, 1995, Vol.335, Iss. 7909, pg. 65; Manuela Tortora, *The Recent Systemic Crisis and the Management of the International Financial System: A Latin American Perspective*, 361-369, [Arner, Yokoi-Arai and Zhou eds., FINANCIAL CRISES IN THE 1990s (BIICL 2001)]; Roberto Chang y Andrés Velazco, *The 1997-98 Liquidity Crisis: Asia Versus Latin América*, 413-452, [Leonardo Hernández y Klaus Schmidt-Hebbel, eds., BANKING, FINANCIAL INTEGRATION, AND INTERNATIONAL CRISES (Banco Central de Chile, 2002)]. See also Basel Committee on Banking Supervision, SUPERVISORY LESSONS TO BE DRAWN FROM THE ASIAN CRISIS, Working Papers No. 2, June 1999, available at http://www.bis.org/publ/bcbs_wp2.pdf, last visited 15 November 2004. In the same vain Stephen Valdez with Julian Wood, AN INTRODUCTION TO GLOBAL FINANCIAL MARKETS, 351-366, (Palgrave MacMillan, 4th Edition, 2003)

¹⁵⁹ Bela Balassa, THE THEORY OF ECONOMIC INTEGRATION, London : Allen & Unwin, 1962

Common Market which becomes the highest phase of economic integration. It is characterised by the free circulation of goods, services, capital, and people. Only at this stage trade in financial services is considered. At the same time, differential treatment and the concession of preferences to less developed members is a principle which is an important part of the Latin American approach to economic integration.

All South-South schemes (i.e. CACM, CARICOM, CAN and MERCOSUR) adopted this fourth approach. Due to different reasons, reaching the stage of a Customs Union has been difficult to all these sub-regional agreements. Equally, the aim of reaching a Common Market has been set up within the last decade. It explains why, until recently, Latin American countries are getting into the trend of negotiating the formal liberalisation of the trade in financial services. It also illustrates why many of them are not familiar with the NAFTA-like approach and resent its equal treatment to the parties in the clauses of the treaty without taking into consideration the evident asymmetries which are present among the nations of the Hemisphere. During the negotiations toward the establishment of a Common Market, member countries in all these South-South schemes adopted the GATS as a model covering the four modes of services supply. However, in the Andean Community case, Decisions 439 and 510 shaped the process of liberalisation of financial services under a negative list.

3. The way possible overlapping situations regarding the provision of banking and financial services in the Andean countries could be avoided

Article 1-02, (2) of the G-3 Accord establishes as a general rule that in the event of inconsistency between provisions of G-3 and any other Treaties and agreements signed by the Parties, the G-3 Accord prevails to the extent of the inconsistency. However, G-3 acknowledges that Colombia and Venezuela are members of the Andean Community (AC). In consequence, article 1-03 sets up especial rules according to which Chapters III, IV, V (Section A), VI, VIII, IX, XVI, and XVIII of the G-3 Accord do not apply to Colombia and Venezuela.¹⁶⁰ Therefore, the Andean Community provisions prevail over G-3 rules on such matters to those two countries. It is important to notice that Chapter XII on financial services was not included in article 1-03.

The Preferential Trade Agreement (PTA) between Bolivia and Mexico does not have a special rule creating an exemption to the commitments undertaken by Bolivia within the Andean Community (AC). In this sense, the likelihood of conflicts between some specific measures of this PTA and the supranational regulation in place and the structures of the AC regulation could be extremely high.

However, in both cases, (G-3 and Bolivia-Mexico PTA) due to the lack of a Protocol or an Annex related to non-conforming measures applicable to banking and financial services as well as the absence of a supranational regime issued by the Commission of the Andean Community related to banking and financial services, conflicts between these two approaches are still theoretical.

¹⁶⁰ These sections are mainly related to trade in goods (among others, national treatment and market access to goods, automotive sector, agricultural sector, rules of origin and safeguards. The Chapter on Intellectual Property is also excluded)

As seen, Venezuela, Colombia and Bolivia are engaged in very similar NAFTA-like agreements with no members which have special rules regarding banking and financial services. The remaining countries, i.e., Peru and Ecuador are actually negotiating NAFTA-like PTAs with USA. As a result, at the end of the process, there will be a harmonised approach to the liberalisation of financial services that the Andean Community should adopt as a starting point. Based on similar principles accepted by its members in different agreements with non-members, the difficulties found among the Andean countries at sub-regional level to reach an agreement on supranational regulation applicable to banking and financial services could be overcome. At the same time, due to these circumstances the possible overlapping created by different approaches to banking and financial integration will be reduced to the GATS and NAFTA methodologies.