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MERCOSUR: LESSONS FROM THE RECENT PAST — THE CASE OF THE FINANCIAL SERVICES

Eva Holz

I. MERCOSUR: ITS RELEVANCE & GENERAL OVERVIEW

A. INTEGRATION AND LIBERALIZATION OF TRADE

The Asunción Treaty and the subsequent Protocols adopt and generate pragmatic structures and mechanisms. They center around the regulation of instruments for the progressive reduction and eventual elimination of tariff barriers, and the annulment of any non-tariff barriers that exist in the signatory countries. The treaty, however, is innovative when compared to previous integration schemes because it establishes a process of linear, gradual, and automatic reductions of tariffs, while at the same time it setting goals to establish a common external tariff and coordinate macroeconomic policies. In terms of the treaty’s institutions and bodies, pragmatism is evident in the transitory, flexible, and simple nature of the structures it creates to allow for more fluid adaptation to existing regimes in each of the signatory countries.

As a result of previous Latin American integrationist experiences with varying degrees of success, the Party States of the Mercado Común del

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1. Treaty of Asunción, Mar. 26, 1991, 30 I.L.M. 1041. The Asunción Treaty was signed by Argentina, Brazil, Uruguay, and Paraguay, and went into effect on November 29, 1991—the same day it was filed with ALADI as Partial Scope Economic Complementation Agreement No. 18. This first agreement for the formation of a common market was supplemented by a second document, the Brasilia Protocol, signed December 17, 1991, and was followed by a third document, the Ouro Preto Additional Protocol. Protocol of Ouro Preto, Dec. 17, 1994, 34 I.L.M. 1244 (1995) [hereinafter Ouro Preto].

Sur, or Common Market of the Southern Cone (MERCOSUR), did not attempt, at an initial stage, to enter more deeply into potentially conflictive aspects or areas in terms of their structure or harmonization. This is a logical attitude given that, in any case, the most urgent steps relate to trade areas, the facilitation for the circulation of goods between countries, and the reduction and elimination of trade barriers.

The road to trade liberalization has been paved with foreseen difficulties. It takes a long time, even among developed countries, to achieve some degree of economic convergence and simultaneously keep the path to the liberalization of trade and services. Therefore, it has not been surprising that the goal set forth in the Asuncion Treaty to create a Common Market on December 31, 1994, a date that was clearly too ambitious, has been postponed formally and informally two times. During the meeting of the Consejo Mercado Común (CMC) (Spanish, Common Market Council), the highest MERCOSUR decision making body, held August 4-5, 1994, it was acknowledged that the original goal would not be met. Accordingly, it was agreed to start a new convergence period, beginning January 1, 1995. Such agreement was reflected in a number of decisions made by the CMC (Decision Numbers 3/94, 5/94, 6/94, 7/94, 8/94, 9/94, and 10/94), and later in decisions made at the Ouro Preto CMC meeting of December 17, 1994. The CMC established a new schedule under which the Free Trade Area, not fully completed to date, would come into full force as of January 1, 2000, and the Customs Union as of January 1, 2006.

Because of the Brazilian crisis and its impact on the region, this schedule was implicitly modified in 2000 and 2001 with the adoption of certain decisions of the MERCOSUR Re-launching CMC. These decisions covered a range of areas such as market access; improvement of the dispute settlement system; and analysis of the structure of bodies depending on the Common Market Group (or Grupo Mercado Común (GMC), MERCOSUR’s highest executive body), the Trade Committee, or the Common External Tariff (Numbers 22/00, 25/00, 26/00, 27/00 respectively), whose objectives were to analyze and solve difficulties related to the operation of MERCOSUR encountered in their respective areas of competence. Later, CMC Decision Number 7/01 postponed to 2001 the terms that previous decisions related to the MERCOSUR Re-launching had set for the year 2000. Note that such decisions of the MERCOSUR Re-launching Council imply a relatively positive response in view of the

3. CMC Decisions 3/94, 5/94, 6/94, 7/94, 8/94, 9/94, and 10/94. On December 17, 1994, the CMC meeting in Ouro Preto adopted the following: (1) CMC Decision 22/94, which created the Common External Tariff, lists of exceptions to the CET, and lists of convergence for the capital goods, computer technology, and telecommunications sectors; (2) CMC Decision 23/94 on the Origin Regimen for products not included in the CET or with specific requirements, which are all subject to the Original Regime set forth in CMC Decision 6/94; (3) CMC Decision 24/94 on the Regime for Final Adjustment to the Customs Union; and (4) CMC Decision 25/94 approving the Customs Code—the basic regulation for MERCOSUR customs territory.
critical situation facing Member countries since 1999, that brought forth serious difficulties in the implementation of the MERCOSUR Agreement.\(^4\)

B. MERCOSUR’s Negotiating Capacity In Trade Agreements

Regardless of the ups and downs in the economic integration process of MERCOSUR, the four Party States have undoubtedly formed a coherent group, especially in terms of consideration and negotiation with interlocutors or economic agreements at international fora. It is interesting that in the different processes of economic and political analysis, regional circumstances are identified with those of MERCOSUR. In this sense, the expression is used as an equivalent of the Southern Cone area of South America. In addition, the fact that countries signing the Asuncion Treaty have sometimes joined efforts when making proposals to international interlocutors has led to the perception of MERCOSUR as an economic and political unit and, hence, the two-fold effect of generating internal cohesion and a common front before the different external interlocutors.

Concrete institutional expressions of this nature and of joint international negotiation policies are already suggested in Decision Number 32/00 of the CMC vis-à-vis MERCOSUR Foreign Relations, which reaffirms the commitment of Party States to negotiate trade agreements jointly with third party countries or groups of countries outside the area, at least wherever tariff preferences are agreed. Later, this trend was defined relative to Negotiations with Third Party Countries in Decision Number 08/01 of the same body, which resolved to accelerate the bilateral negotiation processes of which MERCOSUR is a part, in particular the ongoing negotiations with the European Union (EU). The latter also includes a mandate to the Pro Tempore Presidency of MERCOSUR to convene the Consultative Council, following the agreement signed by the MERCOSUR Party States and the Government of the United States, in order to study the possibility of initiating bilateral negotiations under a four-plus-one format. To this effect, a Negotiation Group has been organized with the priority of defining a common negotiation platform. Dr. Enrique Iglesias, the president of Inter-American Development Bank (IDB), has been invited to act as Senior Advisor of the Negotiation Group.\(^5\)

One aspect of great relevance for the continuity and success of this new role of MERCOSUR lies in each of its Party States’ policies, particularly those of Brazil and, to some extent, Argentina, toward MERCOSUR and the region. This refers to the importance they will attribute to MERCOSUR’s best interests as a whole, especially where those interests may clash with others in the national sphere.

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4. Id.
5. CMC Decision 32/00 (June 30, 2000), available at http://www.scc.oas.org/trade/mrcrsr/decisions/Dec3200.asp (quoting CMC Decision 08/01 (June 22, 2001)).
At this stage, the fact that MERCOSUR is negotiating necessarily as a block with the Free Trade Area of the Americas (FTAA), the United States, and the EU, will constitute an element of alignment and consistency necessary for the regional agreement. The joint policy of such negotiations, with developed countries as counterparts, will make it an imposition and an obligation to preserve consistent parameters that adjust to policies and macroeconomic coordination and, in addition, are consistent in setting tariffs as a prerequisite to successful progress.

C. Financial Globalization and Macroeconomic Strengthening

In light of the successive Asian, Russian, and Brazilian crises, followed by the Turkish and recent Argentine crises, it becomes imperative to question whether the benefits of globalization and financial integration justify the absorption of their costs and risks. Liberalizing the circulation of goods, services, and capital generates trade growth, resulting in product growth. Additionally, resources and capital become more efficiently located and used, contributing to the well-being and improved standards of living of many societies subject to the integration framework. Regarding financial globalization, many countries in Asia and Latin America have had the opportunity to modernize their industries and economies, at least in part, due to their free access to available external savings, regardless of the need to recognize the advisability of protecting their dependency on very short-term capitals. On the other hand, the growing perception of risks—relative to crises or to a higher probability of a crisis extension—and the resulting costs to societies in terms of the loss in well-being for the population, requires a profound study in order to avoid, or at least mitigate, them.

Precisely, the increasing possibility of “contagion” due to financial globalization should not lead us to lose sight of factors inherent to each country that represent the underlying causes of their fragile nature in resisting external blows. This leads inexcusably to the need for macroeconomic strengthening of each of the countries themselves, beyond integration processes, as a true way to mitigate individually the impacts of financial globalization. Furthermore, globalization may contribute to deepen crises due to the persistent application of imbalanced macroeconomic policies. Under such circumstances, the investors’ loss of confidence in the maintenance of policies in a given country could act as a trigger to spark the crisis, therefore causing them to withdraw their investments and close access to international credit.

What the Asian, Russian and Brazilian crises have had in common, despite each responding to partially different reasons, is that they were generated and aggravated by persistent macroeconomic inconsistencies, resulting from the persistence of unsustainable structural deficits and significant external debt (mostly too short-termed) or any other similar deficit-financing mechanisms, without substantial corrections of the reasons...
generating them. It is essential that macroeconomic policies of countries lead to sustainable values in terms of deficit, debt, and product growth.

II. FINANCIAL LIBERALIZATION: REFLECTIONS

A. MACROECONOMIC COORDINATION IN REGIONAL INTEGRATION

1. Macroeconomic Situation in the MERCOSUR Countries: 1999 – 2002

Implementation of MERCOSUR gave rise to a rapid and extensive increase of trade flows among the member countries. For example, Argentine exports to Brazil rose from $1.67 billion to $7.7 billion U.S. dollars in 1997.6

Brazil, with a Gross Domestic Product (GDP) of approximately $500 billion dollars, has a significant influence on MERCOSUR trade. For example, Argentina represents approximately 40 percent of Brazilian production, whereas Uruguay and Paraguay’s combined production does not amount to even 5 percent of Brazil’s production. Brazil’s substantial production helps explain why Brazilian macroeconomic stability is so relevant in the region.7 Brazilian production also has repercussions on the level of regional trade, which notoriously increases during periods of stability—a result that has been seen since the implantation of the Real plan. It is clear, however, that growth of trade in the region has resulted from a relatively higher level of prices in Brazil as compared to its trade partners, and by a preferential rate of customs duties among them. Thus, the increase of trade in the region, at least in part, took place at the expense of an increase in the Brazilian trade balance. For example, in 1993, the Brazilian trade surplus reached $13.3 billion dollars, while in 1998 the trade deficit was over $6 billion dollars. Over this same period, Uruguayan and Argentine exports to Brazil increased by 150 percent and 188 percent respectively (even considering goods that are hard to place on other markets and that are exported under MERCOSUR special regimes).8

As a result of the economic climate in Brazil, the exchange rate experienced sustained pressure from mid-1998, when the Russian crisis broke out.9 This pressure caused a significant loss of reserves, which, coupled

7. See sources cited supra note 6.
9. See Holz Dallas, supra note 6, at 2; Holz London, supra note 6, 1-2; Banking in MERCOSUR, supra note 6, at 130-31.
with the increasing fiscal deficit of the government and political factors,\textsuperscript{10} caused the Central Bank of Brazil to withdraw from the exchange market on January 15, 1999. Devaluation of the Real finally became stable at approximately 50 percent of its value, although it showed an upward trend during the last months of 2000 and throughout 2001.\textsuperscript{11} Together with exchange measures, the Brazilian government adopted various substantive measures to reduce the fiscal deficit, making it possible for the economic and financial variables to become stable during the year 2000.\textsuperscript{12} Thus, during the year 2000, industrial activities in Brazil grew approximately 7 percent, exports grew 17 percent, and imports grew 14.6 percent. Inflation was almost 6 percent.\textsuperscript{13} Over the years 2001 and 2002, the economy stabilized and grew slightly, inflation was kept under control, and the Real oscillated between 3 and 3.5 Reals per U.S. dollar (mostly due to political uncertainty prior to Brazilian elections at the end of 2002).

\begin{enumerate}
\item a. Repercussions

The Brazilian crisis eliminated overvaluation of the Real, which involved, among other things, the modification of trade flow within the MERCOSUR due to a drop in exports to Brazil, and an increase in Brazilian exports to other member countries of the Agreement.\textsuperscript{14} Taken together, these elements lessened demand for goods and services in the countries of the region, leading to a drop in production. The prices of the various goods and services also dropped, resulting in a recessive effect. Production fell in all countries in the region, especially in Argentina and Uruguay, which experienced drops of 3.5 percent in GDP. Unemployment rose substantially, reaching 14.5 percent in Argentina, 6.3 percent in Brazil, 11.2 percent in Uruguay, 9.0 percent in Paraguay, and 10 percent in Chile. And, finally, inflation rates in these countries also dropped.\textsuperscript{15}

The significant variation in the economic situation of the various MERCOSUR member countries, together with the correction of many prices of goods and services traded intra-regionally, had ongoing repercussions on the evolution of integration. However, the final results will depend significantly on the type of mechanisms used to mitigate the impact of such price changes.

\item b. The Impact on Argentina and its Consequences on Uruguay

The recessive adjustment of 1999 led to a drop in the price of tradable goods. During the first half of 2000, an improvement in the merchandise account was observed, resulting in a surplus. Unfortunately, recession

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\textsuperscript{10} See sources cited \textit{supra} note 9.
\textsuperscript{11} \textit{Id.}
\textsuperscript{12} \textit{Id.}
\textsuperscript{13} \textit{Id.}
\textsuperscript{14} See Holz Dallas, \textit{supra} note 6, at 4; Holz London, \textit{supra} note 6, at 1-2; Banking in MERCOSUR, \textit{supra} note 6, at 131.
\textsuperscript{15} \textit{Id.}
\end{flushleft}
continued during 2000.\textsuperscript{16} Since the implementation of the convertibility plan in 1989, the exchange rate in Argentina was fixed, parity being established at one peso per U.S. dollar.\textsuperscript{17} During 2000, unemployment rates continued to be close to 15 percent. Although exports showed an upwards trend, the GDP dropped slightly, public income continued to fall, and, despite successive attempts to contain public expenditure and increase collecting, the deficit in public accounts continued to rise.\textsuperscript{18} At the end of the year, this led the government to request financial assistance, or shielding, from the International Monetary Fund (IMF) in the amount of $39,700,000 U.S. dollars, announced at the beginning of 2001.\textsuperscript{19} During 2001, the situation was further complicated by the closure of foreign capital markets and the deterioration of fiscal accounts.\textsuperscript{20}

In March 2001, the Minister of Economy changed three times.\textsuperscript{21} The most recent Minister, Cavallo, promoted a plan to make the country’s economy competitive again, calling for more spending cuts. Some of the measures adopted included taxes on bank transactions, unilateral modification of MERCOSUR customs duties, sectoral reactivation plans with special tax treatment for sectors considered to be strategic, and the creation of a trade dollar, which involved a change in the convertibility exchange system. Cavallo also adopted measures to improve the external debt profile. Simultaneously, in order to obtain domestic credit, he reduced the reserves of financial institutions and modified their composition, admitting National Government obligations for the purpose of constituting the reserve.\textsuperscript{22} In this way, the strength of the financial system was undermined, increasing its exposure to government risk. Halfway through the year when the bid for domestic obligations failed, Cavallo admitted that he did not have domestic credit and introduced a budgetary ruling of zero deficit, also applicable to the provinces which were temporarily authorized to finance their excess expenditure by issuing obligations with cancelling power (quasi-currencies, like the LECOP and the Patacones).\textsuperscript{23} The debt in the government’s paying capacity and the 1989 Bonex Plan led to a persistent drain on the system’s deposits. Consequently, recession worsened as investments dropped over 20 percent, lessening domestic consumption, and consequently reducing GDP.\textsuperscript{24}

Finally, the economy collapsed in December 2001, and new economic and financial rules were issued by the government (such as Law 25.561, dated January 7, 2002), which were focused on employment, reasonable income for the population, and reducing indebtedness in the financial sys-

\textsuperscript{16} Banking in MERCOSUR, supra note 6, at 132.  
\textsuperscript{17} Id.  
\textsuperscript{18} Id.  
\textsuperscript{19} Id.  
\textsuperscript{20} Id.  
\textsuperscript{21} Id.  
\textsuperscript{22} Id.  
\textsuperscript{23} Id.  
\textsuperscript{24} Banking in MERCOSUR, supra note 6, at 132-33.
At the same time, however, those new rules meant the collapse of the paying system and the credit chain, and the end of confidence in Argentina's financial system. Moreover, the new rules destroyed Argentina's reputation in the international credit and financial markets. For example, on December 24, 2001, the Argentine government defaulted on its debt of $141 billion U.S. dollars. As a result, the convertibility currency rule was changed (one peso to every $1 U.S. dollar), but suddenly, in January 2002, the peso was only worth one third of a U.S. dollar. Consequently, nearly all deposits were frozen—meaning that depositors could not withdraw their savings from the banking system (corralito). In addition, banks had to accept that many debts named in U.S. dollars or other strong currencies could be cancelled by paying in the Argentine devaluated currency (peso) at nominal parities (one peso equaling one dollar when the peso at the time was worth one third of a U.S. dollar), but depositors had to be maintained and finally paid back in the currency of the original deposit or at a parity to be fixed by the executive power in order to preserve the value of the saving, called pesificación asimétrica. This meant insolvency for all financial institutions. During 2002, it is estimated that bank losses due to asset depreciation amounted to $20 billion U.S. dollars. As a result, some international banks, such as New Scotia, quit their operations in Argentina. The subsequent economic measures applied by the new government during 2002 and the first part of 2003 were unsuccessful, especially the attempted rebuilding of the financial system. The IMF and other international financial organizations criticized the inconsistency of the government's economic measures. Today, the public debt is still in default. Since July 2002, the economy has begun its recovery, but still without the assistance of a local operating banking system. There is no domestic or international credit, and international trade is mostly financed by other international financial institutions.

The collapse of Argentina's financial system first had an impact in January 2002, on banks operating in Argentina and Uruguay when the restrictions imposed on operations in Argentina forced Argentine bank clients to withdraw their deposits from the Uruguayan branches of the same institutions. This was soon followed by a general run of most Argentine depositors and international banks from all Uruguayan financial institutions, due to the fear of having deposits frozen in Uruguay in the

25. Id.
26. Id.
27. Id.
28. Id.
29. Id.
30. Id.
31. Id.
32. Banking in MERCOSUR, supra note 6, at 133.
33. Id.
34. Id.
35. Id.
event similar measures as those imposed in Argentina should be adopted by the Uruguayan government.\textsuperscript{36} As the crisis in Argentina continued in 2002, its negative impact on the Uruguayan economy increased over the same period, causing continuation of the depositors’ run from Uruguayan banks. In the context of currency exchange, in June 2002, Uruguay abandoned its crawling peg system, allowing the Uruguayan peso to float.\textsuperscript{37} A month later, in July, a bank holiday was declared, four private banks were suspended (not liquidated, but closed), and deposits on two seriously illiquid state-owned banks where extended for two years, to be paid in the currency in which the deposit was established.\textsuperscript{38} Rules for solvent banks (international banks) were not changed. There was no general freezing of deposits or any change in the currency of deposits.\textsuperscript{39} From January to July 2002, Uruguay’s financial system lost over 40 percent of its deposits.\textsuperscript{40}

Finally, on December 27, 2002, Law Number 17.613 was passed, establishing a new procedure for the liquidation of the four suspended banks and broadening Banco Central del Uruguay (BCU) (Spanish, Uruguayan Central Bank) regulatory and controlling powers over private and public financial institutions, as well as on private bank shareholders, directors, and managers.\textsuperscript{41} On the other hand, public debt was not in default, and in May 2003 a voluntary extension was agreed upon by international and local Uruguayan debt holders.\textsuperscript{42}

2. \textit{The Need for Macroeconomic Coordination}

The need for consistent macroeconomic policies is increased within a regional integration process. In fact, a comparison of various experiences and MERCOSUR itself reveals that macroeconomic coordination represents an unavoidable foundation upon which consolidation of integration agreements must rest. In the case of the MERCOSUR region, the situation over the last few years reveals once again that the lack of close coordination among the governments of the Parties in the definition and implementation of the macroeconomic variables underlies all the difficulties that have been threatening the continuity of MERCOSUR since 2000.\textsuperscript{43}

Relevant monetary, currency, and inflation policies, and the situation and evolution of the balance of payments and the balance of trade are some of the aspects affecting each of the countries simultaneously. For this reason, all stages of macroeconomic policy implementation—from in-

\textsuperscript{36} \textit{ld.}
\textsuperscript{37} \textit{ld.}
\textsuperscript{38} \textit{ld.}
\textsuperscript{39} \textit{ld.}
\textsuperscript{40} \textit{ld.}
\textsuperscript{41} \textit{ld.}
\textsuperscript{42} \textit{ld.}
\textsuperscript{43} See the foregoing trade desadjustments and the beginning of Argentinean and Uruguayan crises at Part II.A.1.a & b.
itial definition to the necessary and permanent follow-up process to mon-
itor their evolution on a daily basis—require coordinated thought on the
part of all governments in the countries undergoing integration processes.

The more progress is observed in the liberalization of the flow of trade
and services due to the implementation of the integration agreement, the
greater are the repercussions on the rest of the Party States of mal-adjust-
ments on the main economic variables in any of the member countries. One example of this can be seen—even in the early stages of the opening-
up process in MERCOSUR—by observing the adjustments that the radi-
cal change in the Brazilian foreign exchange criteria gave rise to and will
still require, and that led to an unforeseeable and unaligned fluctuation in
the relative prices of goods and services at the level of the other
MERCOSUR partners.44

An essential step toward the improvement of coordination will be to
intensify the flow and quality of information that countries exchange, rel-
ative to public and private sectors. In addition, information transparency
must be enhanced, including, for example, information regarding interna-
tional reserves, foreign debt—especially short-term foreign debt—and
capital flows from each of the countries. This information, with its fol-
low-up, will enable a more precise assessment of the situation and risks
facing each of these countries and the region. Enhanced quality informa-
tion will influence the adoption of more accurate and appropriate eco-
nomic measures by facilitating analysis and discussion from the other
partner countries.

B. POLITICAL COMMITMENTS IN THE IMPLEMENTATION OF
COORDINATED MACROECONOMIC POLICIES

Preventing distortions in the macroeconomic policies of the region re-
quires both an intensification of coordination among countries, and a
high level of reciprocal and political commitment. Each government is
responsible not only for the sound development of the variables in its
own country, but also for ensuring that its own policies are not obstacles
to the development of economies in the other member countries of the
integration agreement. From the outset of MERCOSUR, this commit-
ment was taken up by the four Party States in an implicit and consensual
manner, with the understanding that none of the signatory parties of the
Asuncion Treaty would fail to comply.45

However, since 1999, shortcomings of this commitment have been evi-
denced, as the commitment has not been complied with on more than one
occasion. Thus, the new integration stages within the scope of
MERCOSUR will call for more formal and intense mechanisms to keep
macroeconomic coordination commitments among the countries. Any

44. Id.
45. The Top Level Working Group was created between 2000 and 2001. Before that,
there were no institutional mechanisms or procedures regarding macroeconomic
issues.
breach in coordination rules should involve pertinent and detrimental consequences for the offender.

The initial steps in that direction are first suggested in Decision Number 6/99 of the CMC, which calls for the creation of a Top Level Working Group in the sphere of the Meeting of Ministers of Economy and Presidents of Central Banks, with the objective of coordinating macroeconomic policies in the Member States. The fields covered are inter-temporal sustainability of the countries' public and external accounts, the alternatives for macroeconomic coordination and a working program proposal to that end, the harmonization of statistical macroeconomic and financial information, and the intensification of information relative to methodological criteria used by each State to prepare its respective economic indicators. Likewise, Decision Number 30/00 of the CMC entrusts Ministers of Economy and Presidents of Central Banks with the preparation of a harmonized statistic based on a common methodology in the macroeconomic and financial services areas. Harmonization will start with the information included in the Nominal Fiscal Results and Primary Fiscal Government Result, the Governmental Net Debt, the Consolidated Public Sector, and the level of prices. Indicators relative to fiscal aspects must be published from September 2000. Harmonized statistics were first published on October 21, 2001.

This process must be expedited and further developed for the sake of regional economic well-being, as well as for MERCOSUR integration perspectives. Clear commitments must be made regarding macroeconomic variables and their convergence. Non-compliance with those commitments may cause diplomatic and/or economic penalties to the offender—penalties that should be established according to severity.

C. CLEAR POLICIES IN BANK INTEGRATION

To date, MERCOSUR and its Party States have not addressed financial liberalization in depth. Apart from preparing lists of offers and commitments for service liberalization, it is remarkable that, despite subscription to the Montevideo Protocol, no progress has been made in the incorporation of financial services to such lists. Moreover, restrictions and limitations to liberalization, expressed by the countries when the initial list of commitments was prepared in the framework of the

46. CMC Decision 6/99 (June 15, 1999).
47. CMC Decision 30/00 (June 30, 2000).
48. No advances were achieved in 2002 or 2003. See Banking in MERCOSUR, supra note 6, at 137-38, for details.
49. CMC Decision 13/97 (Dec. 15, 1997); Montevideo Protocol—Financial Service and Initial List of Specific Commitments Annex, CMC Decision 9/98 (July 23-24, 1998). This initial list was revised at the First and Second Round of Negotiations on Specific Commitments that were formally finalized, the first by CMC Decision 1/00 (June 29, 2000), and the second by CMC Decision 56/00 (Dec. 14, 2000). Both decisions approved the countries' lists of specific commitments. CMC Decision 36/00 (June 29, 2000).
Montevideo Protocol, have not been altered.50 Recall that the first list simply gathered the commitments that each country had previously presented as a list to the World Trade Organization (WTO), with no additional considerations, even in cases where it was feasible without having to introduce changes at the level of national legislation.51 Note that since 2001, the work of the Services Group includes the detection and incorporation of the country’s commitments to the lists, non-restricted areas in terms of internal regulations, and, despite this, not included in the specific commitments. Furthermore, such lists of offers and commitments were created and presented under those conditions, despite the fact that the information relative to the existing spaces for greater openings and liberalizations was then available as a result of the work conducted by Subgroup IV.52

The lack of political will to start with the necessary liberalization to harmonize and integrate financial sectors was reaffirmed with Brazil’s decision, expressed at Sub-group IV and included in their Minutes 1/95 of October 20, 1995, that postponed consideration of attempts to harmonize any aspect related to derogation of restrictions to access and invest in the financial sector by companies from a MERCOSUR country in any of the other Party States until the year 2000.53 This situation clearly reflects the lack of commitment to move forward in financial integration and to reduce, and finally eliminate, restrictions to competition that are still present in some countries.

The opening up of the range of activities granted to bank institutions and investing regimes, which took place in the MERCOSUR countries during the 1990s, was not a consequence of the Agreement; instead, it was due to national policies of some of the Party States following international trends.54 On the other hand, at the present time, as the whole region and its Party States are immersed in macroeconomic crises, it is neither timely nor advisable to address a financial liberalization agenda. The macroeconomic instability that conspires against commercial integration has a stronger negative impact in the case of financial integration due to the possible systemic and contagious repercussions in the financial systems of each country. Only when the region reaches stability will it be able to reconsider its agenda and aim at a financial opening and integration within MERCOSUR.

In due course, this process should undoubtedly be approached carefully in order to avoid excesses in deregulations with prudential implica-

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50. See discussion and sources cited supra note 49.
51. Id.
52. CMC Decision 13/97 (Dec. 15, 1997); CMC Decision 9/98 (July 23-24, 1998); CMC Decision 36/00 (June 30, 2000); WTO, complete text of the Final Agreement, Uruguay Round, and the GATS.
53. CMC Decision 9/95 (Dec. 6, 1995).
tions or with strong lack of protection of the weaker segments in the financial systems of each country. These elements, according to evidence, have neither been analyzed nor coordinated.

D. OPPORTUNITIES FOR LIBERALIZATION IN BANKING ACTIVITY

An analysis of the financial system regulations in the countries of MERCOSUR reveals that there is plenty of room to liberalize such services to increase competition. This declaration is especially valid in an integration context, as many of the restrictions addressed have a particular impact on the supply of financial services that can be developed in any MERCOSUR country, and on the foreign investment (from companies in other Party States) in each one of them.

Over the last decade, Member countries have expanded the range of activities granted to banking institutions and have admitted, in one way or another, foreign investment in the sector, which is the consistent trend in the rest of Latin America. These changes have occurred while they have imposed stricter prudential rules to the whole of their banking system. As previously mentioned, the Agreement did not open up banking regulation and the investing regime; it was part of the national policies of some of the Party States following international trends. On the contrary, many aspects of the modifications and strengthening of prudential rules imposed in each of the Party States were due to a coordinated policy decided at the MERCOSUR level.

Nevertheless, comparing these advances with the general international trend, there is still ample room for expansion in the banking industry. In addition, the levels of liberalization admitted by each one of the Party States vary. This may have potential repercussions by creating uneven conditions for competition in the sector. For example, in terms of banking activity, the MERCOSUR countries do not admit universal banks—meaning that banking institutions cannot normally provide all the range

55. Id.
56. International organizations, like Bank of International Settlements (BIS), International Organization for Securities Commissioners (IOSCO), International Association for Insurance Supervisors (IAIS), IMF, WB, IADB, and WTO, foster the liberalization and opening up to foreign investment and competition in financial sectors. Some of them, on the other hand, also promote the strengthening of the prudential requisites (i.e. BIS, IMF, WB, and IADB).
57. All the MERCOSUR countries have adopted requirements for credit risk-weighted capital of at least 10 percent of the assets. Another valuable example is that, on the basis of the Subgroup's policy harmonization efforts concerning the struggle against legitimization of assets from illegal activities, which is set out in Recommendation No. 01/00 and was submitted to the GMC, this body adopted CMC Resolution 53/00 regarding “Minimum Regulation Standards to be adopted by Central Banks for the prevention and repression of money laundering.” In turn, this Resolution gave rise to CMC Decision 40/00 (Dec. 14-15, 2000) (adopting the “Cupertino Convention among Central Banks in the Party States to the MERCOSUR, for the prevention and repression of procedures aiming at the legitimisation of assets from illegal activities”). In addition, GMC Resolution 20/01 stipulated that the Party States should adopt the information transparency rules recommended by the Basle Committee before December 31, 2005.
of financial services, operate as securities agents, or render any other services related to the capital market. Furthermore, they cannot perform activities related to insurance. On the other hand, there is some opportunity to make the investment scheme of banking institutions both more flexible, which enables them to invest in the capital market sector and in non-financial institutions and, in turn, establish financial and insurance clusters, and also more freely accepting of foreign investment in the sector.

Liberalization may possibly exist in other areas because there are no regulatory obstacles preventing it. Unfortunately, countries neither offer nor commit to greater openings in the framework of negotiations of the Montevideo Protocol and the Financial Services Annex to allow for liberalization. This is apparent in the areas of trans-boundary supply, foreign consumption of insurance, and banking services, where none of the countries have consolidated their offers. Another example is the horizontal commitments of Brazil in insurance and banking services, relative to foreign investment or to the limitation in the employment of foreign staff, that exceeds the existing constitutional and legal restrictions.

The above observations do not call for countries to maximize the level of opening that is possible in their financial services to achieve integration. However, they will duly require a common approach strategy to cautiously attain liberalization stages that are in themselves balanced in order to avoid competitive distortions among the integrated countries. This harmonization is essential so that when the access of financial institutions to other MERCOSUR countries that are not the country of origin becomes liberalized, the institutions' trend to establish themselves or to provide financial services from one country and not from others—caused by a difference in the schemes related to activities and investment allowed in the banking sector—can be avoided.

For example, Paraguay is the only MERCOSUR country today that fully allows universal banks. In full integration contexts where other countries do not admit this broad activity to their financial systems, it is likely that all banks in the region would settle in Paraguay to take advantage of greater business opportunities that the universal activity grants. In addition, from the Paraguayan subsidiary or branch, these banks could offer greater services to their customers throughout the region. Likewise, if Brazil maintains its present restrictive foreign investment scheme in the banking sector, in an integration context, international and regional banks would settle in any other MERCOSUR country to provide all banking services to their Brazilian customers through that branch, and they could then request to be acknowledged as an institution installed

58. Banking in MERCOSUR, supra note 6, at 102-12.
59. Id.; see Holz Latin American, supra note 54, at 6.
60. CMC Decision 13/97 (Dec. 15, 1997); CMC Decision 9/98 (July 23-24, 1998); CMC Decision 36/00 (June 30, 2000).
61. Banking in MERCOSUR, supra note 6, at 108.
within MERCOSUR to provide services to the Federative Republic of Brazil.

To mitigate the impact of this expansion and increased competition, it may be temporarily necessary for some of these governments to protect key areas in banking services along this road to liberalization. For example, it may be wise not to completely dismantle all the benefits or protections to sectors, such as the local banking sector, or to certain institutions that have social objectives. These partial policies reduce the more potentially negative impacts of integration and can be appropriate instruments for the gradual opening of the markets.

The greater competition, resulting from the opening of markets and a certain level of deregulation, may cause a trend toward banking concentration and consolidation, at least in the short run, as part of the possible strategies of the financial institutions to reduce the effects of the growing presence of new competitors. In any case, facilitating market access that adds to the general phenomenon of globalization and internationalization can alleviate the trend toward concentration. On the other hand, consolidation of the banking sector may constitute an institutional strengthening factor—one necessary to preserve the solvency of the system in a more competitive and deregulated environment.

E. LIBERALIZATION MECHANISMS

Another necessary aspect involves the instruments specifically used to integrate MERCOSUR financial sectors, which clearly convey the influence and solutions of the General Agreement on Trade and Services (GATS) agreement of the WTO. In light of the results attained, this strategy has not met the expectations of its supporters.

The approach and concrete solutions to integrate services as set out in the Montevideo Protocol are very similar to those of the GATS,62 with the exception that the most-favored nation clause has no limitations in the former agreement, but does in the latter. This analogy is again observed in the Annex to Financial Services in the Montevideo Protocol, which includes the solutions of Annex to Financial Services of the GATS. Moreover, Decision Number 36/00 of the CMC adopts the GATS services classification of the WTO to classify services within the scope of MERCOSUR. In short, the instrument used by MERCOSUR to approach liberalization of trade in services has been that of a trade agreement—the GATS—with the aim of creating a Free Trade Area. This approach differs from the one used by the EU to create a Common Market.

There are many reasons why the MERCOSUR Member countries adopted this approach rather than favoring solutions similar to those adopted by the EU.63 On one hand, this strategy can be attributed to the

62. CMC Decision 13/97 (Dec. 15, 1997); CMC Decision 9/98 (July 23-24, 1998); CMC Decision 36/00 (June 30, 2000).
63. Banking in MERCOSUR, supra note 6, at 127.
optimism with which the mechanisms and solutions of the GATS were seen. Moreover, many institutional and organizational differences exist between the EU and the MERCOSUR, which hindered MERCOSUR's adoption of the EU's solutions and instruments. Finally, this is probably the only path that enables the simultaneous achievement of progress in the integration of services, while implementing it with the care and within the timeframes imposed by the restrictions on access in force and political difficulties. Another element adding to the complexity of the mechanism under study lies in the fact that the liberalization, resulting from the preparation of banking service lists with a high degree of disaggregation, makes the opening and the negotiation of offers and commitments included therein very fragmented and complex. It is very difficult to compare offers by analyzing their equivalents.64

On the other hand, a different and necessary approach to the study of the process toward financial integration may be obtained by comparing the existing regulatory restrictions in the national schemes to the commitments and offers in each country within the framework of the Montevideo Protocol, at the different negotiation rounds conducted by the Services Group. Since the signing of the Montevideo Protocol, the approach to the negotiation for the opening of services was the definition of the areas of service, where each country individually prepared its own list of offers and commitments at a later stage. Moreover, this led each country to propose offers and commitments at the MERCOSUR analogous to those each had previously presented to the WTO. This situation remains unchanged today. Unfortunately, there are areas where liberalization would be possible with no regulatory obstacles to prevent it, but the countries neither offer nor promise a greater opening within the framework of the Montevideo Protocol and the Annex to Financial Services. One illustration of this is in the area of trans-boundary supply and foreign consumption of banking and insurance services, where none of the countries has consolidated its offer.65

Another related issue is the need to deepen and systematize the coordination between the MERCOSUR bodies in charge of the harmonization process (Sub Group IV) and the liberalization negotiations (Services Group). Better coordination between the two would give the Services Group necessary tools, such as up-to-date information, to put adequate pressure on the representatives of the Member countries to improve their offers and strengthen their commitments during liberalization negotiations.

In light of the points raised and the evolution of bank integration over the years, it is advisable to rethink whether this strategy is truly the best one to implement the aforementioned integration process. One suggestion is to invert the concept of the lists of offers and commitments and gradually liberalize the universe of services first, similar to goods liberali-

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64. Id.
65. Id.
zation, with the exceptions stated by each country in the list corresponding to the nature of the service involved.

III. PRUDENTIAL REQUISITES IN LIBERALIZATION AND GREATER COMPETITION

In terms of prudential rules, the MERCOSUR countries have made and are currently making efforts to harmonize and approach solutions. In addition, that coordination has been aimed at increasing the requirements by adapting to, and in some cases exceeding, international recommendations. The policy adopted at the MERCOSUR level to strengthen prudential rules in each Member Country does not mean all difficulties and asymmetries have been resolved. For example, all MERCOSUR countries maintain minimal net worth requisites during the operation of the financial institutions, whose amounts are calculated following the recommendations of the Basel Committee (relation between the capital or computable net worth items and risk-weighted assets). However, the content of such demand is diverse, and its comparative analysis is difficult. Also, when comparing the application of the Basle Committee’s recommendations in the four countries, even when all the countries apply the recommendations, capital composition is unequal and asset weighting varies from country to country.\textsuperscript{66} Thus, Argentina requires a minimal proportion, whose range depends on the goods under consideration, of 8 percent capital in terms of the assets weighted by risk. Brazil, Uruguay, and Paraguay require 10 percent, though the latter’s Central Bank (the BCU) is entitled to increase that minimal proportion up to 12 percent. Furthermore, the differentiation between basic and supplementary capital (Tier 1 and 2 of the Basle Committee) is not present in the Paraguayan standards.\textsuperscript{67} In the remaining MERCOSUR countries, the items admitted in one or the other, and their consideration, maintain certain differences, such as when computing inflation and revaluing goods in the admission and treatment of subordinate debt.\textsuperscript{68} Differences are also noticeable in the way each country weighs its assets against risk when applying their requirements of capital.\textsuperscript{69} This leads to the question of whether some of the remaining asymmetries become significant when strengthening national financial systems and their integration potential.


\textsuperscript{67} See sources cited supra note 66.

\textsuperscript{68} Id.

\textsuperscript{69} Id.
Beyond some difficulties when interpreting or comparing the requirements in each country, it is essential that they all regulate and implement the Basle recommendations in full, in relation to the composition of capital and its amount, by weighing it in terms of the different risks the institution may face.

In a liberalization and deregulation context, which is characteristic of integration, it is inevitable to preserve and strengthen the soundness of banking systems for the sake of financial stability. No models exist that may be transplanted in terms of prudential regulations. Similarly, control must respond to the new and more deregulated framework, which requires training and experience and implies a certain amount of application time.

The special importance of domestic financial systems, which is intensified in a potential integration context, lies in its close impact on the macroeconomic variables and in the ease with which the difficulties of this sector can be transmitted to other countries of the region and in the world through payment systems and inter-banking credits and deposits. Thus, it is necessary to balance the opening of the banking sector with the preservation of its soundness, but there are no recipes to accomplish this. There are institutional factors, aspects related to pre-existing regulations, and even elements relative to the circumstantial situation of the banking sectors that have a direct influence on the rhythm and degree of liberalization, and therefore, on the subsequent cautionary adjustments.

Whereas deregulation can generate a certain idleness in the banking sector, this can be a transitory factor of financial fragility. The new context for greater openness that enables new types of business and opportunities to financial stakeholders simultaneously requires new rules that are clear and intense, which shifts the objective of the standards to the new reality of the sector and the mobility of operators. It is necessary to give support to the development of a banking sector that is adequately capitalized, has good liquidity and management, and can correctly balance risk and profitability. This, in turn, also implies fluid and transparent information, correct regulation, and prudential control. Thus, training and adjustments in control and regulations that help keep pace with economic agents are required. It also implies more emphasis, for example, on internal banking management systems, risk management, internal control, stronger implementation of international standards in terms of accounting, and auditing. It is important to develop sound commercial practices and simultaneously facilitate the differentiation between debtors before international credit markets, which will look closely at all improvements and modifications that may be introduced in these emerging countries. All of this should be done without drowning the benefits sought by liberalizing the banking sector, which may easily happen if the opening is either very sudden or excessive.
IV. MERCOSUR STRATEGIES FOR FUTURE NEGOTIATIONS WITH THIRD PARTIES ON FINANCIAL AREAS

A. Location

In the scope of negotiations related to trade liberalization agreements, MERCOSUR, as a political factor, could become very relevant if it established strategies oriented toward strengthening and developing its activity sectors. Negotiations or agreements regarding the opening up of the economies or the financial sectors of the MERCOSUR countries should be actually implemented only after the macroeconomic and institutional situation of all its member countries returns to normal. In relation to future negotiations and/or agreements, focus will be on the use of MERCOSUR's political capacity in the stable growth of banking institutions and activities throughout the region. At the same time, the joint negotiation policy of such negotiations, with developed countries as counterparts, will benefit the implementation of the MERCOSUR integration process. Negotiations with developed countries will obligate MERCOSUR to preserve consistent parameters that adjust to the policies and macroeconomic coordination, and require consistency in setting tariffs as an essential requisite to advance them successfully.

In this regard, and as a means to approach a feasible strategy, bear in mind that the trend of international organizations, vis-à-vis the liberalization of financial markets and the simultaneous strengthening of prudential standards, will maintain its influence in the whole of Latin America and within this hemisphere in the MERCOSUR countries.\textsuperscript{70} Recall that even when reforms introduced in the MERCOSUR countries in the 1990s expanded the activities permitted to the banking institutions and made pre-existing restrictions for foreign investment in the sector more flexible, there were still significant margins for a possible liberalization.\textsuperscript{71} Stricter prudential rules and standards must necessarily be implemented to accompany the liberalization process, as was the case in the 1990s.

On the other hand, in order to prepare a strategy to negotiate new trade agreements, especially those relative to accessing markets to supply financial services, some elements relative to the banking sector should be noted:

- In order to compete successfully in global financial markets (electronic banking and merged capital markets), considerable investment must be made in technological development.
- Competition in the globalized financial sector implies that smaller institutions will be unable to survive due to their more limited range of services and proportionally higher fixed costs as compared to larger enterprises. Customers, even investors and consumers, will be attracted to lower prices in services rendered and easier access (via home computer or at the supermarket) to any

\textsuperscript{70} See supra Part II.D.
\textsuperscript{71} Id. at Part II.E.
financial service they want, which will be offered mostly by the largest institutions.

- Some local Latin American financial institutions, mainly Chilean and Brazilian, have started to develop strategies and make investments to position themselves in this new context. They are incorporating cutting-edge technology, undergoing reengineering, and acquiring smaller financial institutions both in their countries of origin, as well as in third party countries. Their core assets are the know-how they develop, based on the best technology and management models that enable them to globally offer a wide range of financial services in any market.

- The MERCOSUR countries, with the exception of Brazil, have made their schemes more flexible to admit foreign investment unilaterally in the banking sector, which has not granted them returns in terms of accessing other markets. In addition, this could imply a special difficulty to local financial clusters that might require the support of joint governmental policies to overcome the barriers that block their access to other countries when trying to render financial services. A similar analysis may be conducted in terms of the possibility of encouraging and strengthening regional financial clusters. The latter, on the other hand, may become a useful tool to mitigate the trend of financial concentration in the largest multinationals that have recently generated uncertainty as to the soundness of their policies when countries and regions where they are established get into critical situations.

B. CONTEXT AND STRATEGIES

In order to neutralize or mitigate the trend to direct liberalization spurred by international organizations and by the majority of countries in the developed world, MERCOSUR should focus its external negotiations by granting the financial institutions of its Member States at least gradual concessions to allow them access to provide financial services in foreign markets. These aspects are essential for MERCOSUR Party States to obtain greater benefits in such negotiations, and the latter do not result in mere openings of economies to the trade flows coming from third-world countries. This bears special significance in light of the potential growth of the banking sector in the MERCOSUR countries. The direction that negotiations take in the international arena may define how and who will be able to develop this potential for expansion.

GATS and the Basle Committee are factors of great influence on the banking regulations of MERCOSUR countries and on Latin America in

73. Id.
74. Id.
75. See supra Part II.D.
The first emphasizes liberalization, and the second emphasizes the strengthening of prudential standards in the banking sector. Recently, recommendations of the World Bank (WB), the IMF, and the IADB have been contributing to both trends—greater opening and increased prudential requirements in the financial activity.

The four MERCOSUR countries have signed the GATS, which promotes competition in the financial sectors by avoiding anti-competitive practices in those institutions, and a greater efficiency in the allocation of resources and services of the financial industry. These concepts are being implemented in different ways by each country: first, Argentina in great depth, and recently, Brazil has privatized several federal banks. In addition, they have dismantled pre-existing monopolies in the banking sector. This has been done without designing or foreseeing a common strategy in the framework of the WTO, which should be corrected. Furthermore, the United States and other countries, such as the United Kingdom and Germany, have been negotiating directly with some of the countries—mainly Brazil and Argentina—to open financial markets. In the context of these bilateral negotiations, it is easy for any of the developed countries to preclude the access of MERCOSUR entities into their own market, such as by stating the exception to prudential standards accepted by GATS. This circumstance would hardly take place during a joint negotiation by the block due to the greater power of the group.

In terms of fundamental aspects, the MERCOSUR countries benefited from the adjustments they introduced to their financial systems between 1980 and the late 1990s. Privatization, mergers, readjustments, and banking modernization produced positive effects. On the other hand, the lack of common strategies at the level of MERCOSUR, vis-à-vis an opening in foreign investment in the banking sector, may have a negative influence in the development of local financial institutions. These institutions may require consistent governmental policies to overcome the barriers that prevent foreign institutions from operating in some countries. It would be recommendable to help local institutions face the growing trend towards concentration around international financial conglomerates. It is true that these conglomerates contribute investment, business expertise, technology, and innovation. However, excessive concentration may lead—in the case of a crisis of any of these international institutions—to dramatic consequences at the global level, especially in countries where their presence is more prevalent. It may also contribute to more volatility in capital flows, consequently causing restrictions in domestic credit, insofar as multinational financial institutions move their resources from one region to another quickly, following decisions of their headquarters in response to changing circumstances and better business

76. Id.
77. Id.
79. Id.
opportunities. Accordingly, the new Basle capital rules, which come into force in a couple of years, will likely bring about a reduction of investment on the part of international banks or financial conglomerates in the region. Therefore, the generation of strategies to strengthen and develop negotiation opportunities for regional entities (including clusters) may represent an efficient way to preserve competition in the local markets. Furthermore, this helps avoid or at least mitigate an excessive concentration in financial oligopolies, and simultaneously diminish the risks of a potentially greater volatility of capital flows or of a potential crisis at the level of any financial institution operating in a highly concentrated market.
A. REGULATION

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GMC Res. 36/00 (June 26-28, 2000) (Deepening of specific commitments in services).

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Annex 1B: General Agreement in Services.

Financial Services Decision.
Sectorial Specific Commitment List.

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Uruguayan Round Final Act Summary

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b. Capital markets:


d. Insurance:

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c. Insurance:

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