



**Capacity Building -  
Implementation and  
Administration of Free  
Trade Agreements:  
Service- Investment Provisions**

Brian Staples

**Inter-American  
Development Bank**

Integration and Trade  
Sector

**POLICY BRIEF**

No. IDB-PB-153

December 2011

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**Inter-American Development Bank**

2011

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## **Introduction**

In the late 1980s and early 1990s, Latin American countries began adopting economic reforms that have led to a surge in free trade agreements (FTAs) and to important challenges related to the implementation of these agreements. Countries have embraced reforms aimed at dismantling protectionist measures in their own markets and at promoting a more open and dynamic pattern of integration into the world economy. In several countries, trade in services and investment rulemaking have been at the forefront of the reforms being undertaken. Many countries have felt that easing restrictions on foreign investment could foster economic growth, and removing barriers to trade in services could lead to lower prices, improved quality, and greater variety. In fact, services play a key role in the economy. More efficient financial and telecommunication services not only benefit consumers, but also help improve the overall economic performance of a country, as these services are a key input into the production of goods and other services. Changes in technology over the past 20 years have resulted in services becoming increasingly tradable, therefore promoting the growth of new exports. Several Latin American countries have taken advantage of these new opportunities; for example, Costa Rica exports services related to information technologies as well as professional services, whereas Mexico exports communication and distribution services, and Chile is well known for its transportation and distribution export services (R. Saéz, 2010).

Services trade exporters and investors have benefitted from increased market opening, particularly from unilateral—but also from bilateral and regional—liberalization. In fact, since 1994, Latin American countries have signed numerous FTAs to expand their trade opportunities both outside the region, reaching out to the largest economy in the Western Hemisphere—the United States—and also more recently to Canada, and among themselves. Moreover, they have gone beyond the Western Hemisphere and negotiated trade agreements with partners such as the European Union (EU), China, Japan, Singapore, and South Korea, among others.

The proliferation of FTAs signed by Latin American countries raises the issue of implementation; that is, as noted by Anabel González (2009: 2), the “specific measures or actions adopted by a government to allow a trade agreement to be fully put into practice.” González also notes that the process to implement FTAs in Latin America has, in recent years, become more demanding. The United States, for example, has devised a verification process for its partners, which determines whether the conditions for compliance with the agreement have

been met. Gonzalez adds that “implementing preferential trade agreements at the national level takes on a relevance which until now had been rare in Latin American countries, accustomed generally to enacting international treaties without the prior exercise of determining whether its obligations have the degree of specificity required to be applied directly and the extent to which they do or do not modify domestic law” (2009: 5). In fact, traditionally in most Latin American countries, an international FTA becomes domestic law once it has been signed and entered into force, following legislative approval (S. Saéz, 2005). The implementation process can be even more challenging in cases where the agreements result in increased liberalization. This is particularly true of trade in services, as service liberalization requires the elimination of discriminatory barriers, which affect services *and* services providers, and may also entail the removal of non-discriminatory barriers that restrict trade. Moreover, the benefits of liberalization may depend on the sequencing of reforms and also on the complementary and regulatory measures put in place to reap the benefits of this liberalization. This is why numerous Latin American countries, Peru being a prime example, have gone beyond the implementation process of their FTAs to identify the type of complementary measures that should be adopted to ensure that their economic agents can take advantage of new market access opportunities offered by the newly signed trade agreements. It is also of vital importance to ensure that there is a well-functioning regulatory framework in place so all stakeholders can share the benefits.

This paper draws on the experience of Mexico in the North American Free Trade Agreement (NAFTA) and on the experiences of four Latin American countries in the implementation of their services and investment obligations in their FTAs with the United States: Chile (United States-Chile FTA<sup>1</sup>), Costa Rica and El Salvador (Dominican Republic-Central America-United States FTA, or CAFTA-DR<sup>2</sup>), and Peru (United States-Peru Trade Promotion Agreement, or PTPA<sup>3</sup>), referred to herein as the “other” or “new” FTAs. The paper highlights the provisions of these agreements (investment, cross-border trade in services, financial services, and telecommunications), and then discusses the processes and results of their implementation, as well as the domestic political constraints.

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<sup>1</sup> The United States-Chile FTA was signed on June 6, 2003 and entered into force on January 1, 2004.

<sup>2</sup> The CAFTA-DR is the first free trade agreement between the United States and a group of smaller developing economies. It was signed on August 5, 2004 and entered into force for El Salvador, Guatemala, Honduras, and Nicaragua during 2006, for the Dominican Republic on March 1, 2007, and for Costa Rica on January 1, 2009.

<sup>3</sup> The PTPA was signed on April 12, 2006 and entered into force on February 1, 2009.

## **1. Investment Rulemaking: From NAFTA to CAFTA-DR and Beyond**

The NAFTA negotiations between the United States, Canada, and Mexico marked the first time a Latin American country entered into a free trade agreement containing provisions and disciplines on investment and trade in services. In 2000, six years after the entry into force of the NAFTA, the United States began negotiating new FTAs (with Chile and Singapore<sup>4</sup>), which included investment and trade in services obligations. In 2002, the U.S. Congress enacted the Bipartisan Trade Promotion Authority Act (TPA) outlining the country's objectives for the negotiation of trade agreements, including those that were under negotiation. Several of these objectives, particularly in the case of investment, had their origin in the NAFTA experience with international arbitration. The main investment objectives under the TPA were to “reduce or eliminate artificial or trade-distorting barriers to foreign investment, while ensuring that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States, and to secure for investors important rights comparable to those that would be available under United States legal principles and practice.”<sup>5</sup>

NAFTA expanded on the investment and services rules of the Canada-United States Free Trade Agreement (CUSFTA)<sup>6</sup> by broadening the concepts of “investment” and “investor.” Unlike the CUSFTA, which covers only business enterprises or controlling interest in business enterprises, therefore excluding portfolio investment and real estate, the “asset-based” definition of investment in NAFTA covers a broad list of assets that are expressly linked with the activities of an enterprise. It excludes, however, those transactions that might occur in capital or money markets with no connection to a specific investment and claims to money that arise solely from commercials contracts.<sup>7</sup>

The asset-based definition of investment in the United States-Chile FTA, the CAFTA-DR and the PTPA refers to “every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.” It is accompanied by an illustrative list of assets.

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<sup>4</sup> The United States-Singapore FTA was entered into force on January 1, 2004.

<sup>5</sup> See Bipartisan Trade Promotion Authority Act of 2002, Div. B., Title XXI, Trade Act of 2002, Pub. L. 107-210, 116 Stat. 933 (2002).

<sup>6</sup> The Canada-United States FTA was entered into force on January 1, 1989.

<sup>7</sup> See Article 1139 of the NAFTA.

NAFTA and the other FTAs also broaden the CUSFTA definition of investor, which only included U.S. or Canadian nationals. For example, CUSFTA excluded from the coverage of the agreement an enterprise incorporated in the United States (with large U.S. business activities) and controlled by non-U.S. and non-Canadian shareholders in its investment in Canada. In contrast, NAFTA covers individual investors (citizens or permanent residents) of a NAFTA country and enterprises organized under the laws of a NAFTA country and controlled by nationals or non-nationals of that country in their investments in another NAFTA country. There is no requirement that the enterprise be controlled by nationals of a NAFTA country. The same is true for the other FTAs. If investors of a non-Party control the enterprise, however, benefits can be denied if the enterprise has no substantial business activities in the territory of the Party under whose laws it is constituted. The denial-of-benefits clause also provides that the host state may deny benefits of the agreement if it does not maintain diplomatic relations with the non-Party, or if it adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise.

In addition to the key definitions, the chapter on investment in NAFTA includes three pillars: a market access component, a protection element, and the dispute settlement mechanism. The market access component consists of four provisions: national treatment, most favored nation (MFN) treatment, performance requirements, and senior management and boards of directors. NAFTA and the other FTAs provide for national treatment and MFN treatment in all phases of an investment from the establishment to the sale. These two provisions extend to the investors of another FTA country and their investments (subsidiaries).

NAFTA and the other FTAs also prohibit imposing specific performance requirements for both goods and services in all phases of an investment. The agreement requires that performance requirements to achieve a particular level or percentage of local content, to purchase local goods and services, to impose trade- or foreign exchange-balancing requirements, to restrict domestic sales of goods or services, to export a given level or percentage of goods or services, to transfer technology, and to act as exclusive supplier of goods and services be prohibited as a condition of the establishment, acquisition, expansion, management, conduct, or operation of a covered investment. The first four requirements are also prohibited as a condition for receiving an advantage (that is, a subsidy or an investment incentive). There is, however, no such limitation on requirements to locate production, provide a service, train or employ workers,

construct or expand particular facilities, or carry out research and development. Moreover, there are some exceptions to the performance requirement prohibition. For instance, the FTAs provide that requirements to achieve given levels of domestic content or to purchase local goods and services are allowed, provided that they are not applied in an arbitrary or unjustifiable manner or do not constitute a disguised restriction, if these measures are necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of the agreement; to protect human, animal or plant life or health; or to conserve exhaustible natural resources. Finally, the prohibition on performance requirements does not apply to some of the abovementioned requirements with respect to export promotion and foreign aid programs, procurement by a state enterprise, and the content of goods necessary for an importing Party to qualify for preferential tariffs or tariff quotas.

The fourth provision, which contains a market access component, covers senior management and boards of directors. It requires that no Party may require that an enterprise of that Party, which is an investment of an investor of another Party, appoint individuals of any particular nationality to senior management positions. However, the FTAs also provide that a Party may require that a majority of the board of directors of an enterprise that is an investment under the agreement be of a particular nationality, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment.

The FTAs set out reservations to the provisions on national treatment, MFN treatment, performance requirements, and senior management and boards of directors. Annex I exempts existing “non-conforming measures” of an FTA country from one or more of these four obligations. A non-conforming measure is any law, regulation, procedure, requirement or practice that violates certain requirements of an investment agreement; for instance, a law permitting a non-national to establish a factory only if a certain percentage of output is exported does not conform with the article on performance requirements.

Some reservations in Annex I set out liberalization commitments. Some of these commitments took effect immediately while others were phased in over time. With a number of non-conforming measures, the fully phased-in liberalization commitments will eliminate the measure. If a non-conforming measure set out in Annex I is made less non-conforming or eliminated, whether by unilateral action or because of a liberalization commitment, it cannot

subsequently be amended by or replaced with a new measure that is more non-conforming (“ratcheting”).

Annex II reservations are much broader in scope than the Annex I reservations in that each one exempts an entire sector, subsector, or activity from the FTA provisions referred to above and may maintain existing, or adopt new or more restrictive, measures that do not conform with any of these four obligations.

On the protection front, NAFTA requires each Party to accord to the treatment of investments of another NAFTA Party in accordance with international law, including fair and equitable treatment and full protection and security. In response to the interpretation of some NAFTA tribunals<sup>8</sup> arguing that the minimum standard of treatment provision goes beyond what is required by the customary international law minimum standard of treatment, the NAFTA Parties, through the NAFTA Free Trade Commission (FTC), issued an interpretation on July 31, 2001 affirming that NAFTA Article 1105 on minimum standard of treatment prescribed treatment in accordance with the minimum standard of treatment under customary international law. The FTC also stated that the obligation to provide “fair and equitable treatment” was not a separate, additional obligation. The new U.S. FTAs include this new language in the text of the agreements.<sup>9</sup>

The treatment in case of strife is included in the provision on minimum standard of treatment in the United States-Chile FTA, whereas there is an article on treatment in case of strife in CAFTA-DR and the PTPA. The text states that each Party shall accord to investors of another Party, and to covered investments, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife. Existing measures relating to subsidies or grants are exempt. The new FTAs also call for restitution or compensation to the investor when he suffers a loss in the territory of another Party resulting from requisitioning of its covered investment or part thereof by the latter’s forces or authorities; or destruction of its covered investment or part thereof by the latter’s forces or authorities, which was not required by the necessity of the situation. The United States-Chile FTA and the PTPA state that compensation has to be “prompt, adequate, and effective,” whereas CAFTA-DR states that it “shall be in accordance with customary

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<sup>8</sup> See *Pope & Talbot, Inc. v. Canada*.

<sup>9</sup> See Interpretation of the Free Trade Commission of Certain Chapter Eleven Provisions, July 31, 2001: <http://www.state.gov/documents/organization/8060.pdf>

international law.” Annex 10-D of the CAFTA-DR sets out limitations for the submission to arbitration under the investor-state dispute settlement section of a claim alleging a breach of this provision (Article 10.6.2). It states that no investor may submit to arbitration a claim alleging that Guatemala has breached the article on treatment in case of strife as a result of an armed movement or civil disturbance and that the investor has incurred loss or damage by reason of or arising out of such movement or disturbance. A similar provision exists for investors of Guatemala with respect to other Parties.

The FTAs also require each Party to allow transfers relating to investments of investors of other FTA countries to be made freely and without delay into and out of its territory. Parties must allow transfers to be made in a freely usable currency (as defined in the Articles of Agreement of the International Monetary Fund [IMF]) at the market rate of exchange prevailing on the date of transfer. The FTAs allow for exceptions or limitations. Hence, a Party may prevent a transfer through the equitable, non-discriminatory, and good faith application of its laws relating to bankruptcy, insolvency, or the protection of the rights of creditors; issuing, trading, or dealing in securities, futures, or derivatives; criminal or penal offenses; financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities; or ensuring compliance with orders or judgments in judicial or administrative proceedings. The chapters on investment permit returns in kind and the United States-Chile FTA allows for limitations to the transfers of returns in kind.

On expropriation, NAFTA states that no Party may directly or indirectly nationalize or expropriate an investment of an investor in its territory or take a measure tantamount to nationalization or expropriation except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and on payment of compensation. Such compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place (“date of expropriation”), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Moreover, it shall be paid without delay and be fully realizable. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

Building on the NAFTA experience and debates in NAFTA tribunals, the new FTAs signed by the United States include an annex on expropriation, which indicates that the state

action cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment. The annex also explains that the determination that an indirect expropriation has occurred requires a “case-by-case, fact-based inquiry.” To this end, the annex lists a number of factors to be considered, among others, by a tribunal when assessing whether there has been an indirect expropriation, namely, the economic impact of the government measure; the extent of interference with distinct, reasonable investment-backed expectations; and the character of the government action. Finally, the annex clearly states that “except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment do not constitute indirect expropriations.” Moreover, the text of the expropriation article is more succinct and simply states that “no Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization except when done for a public purpose, in a non-discriminatory manner, on payment of prompt, adequate, and effective compensation, and in accordance with due process of law (...).” The FTAs also make clear that the expropriation provision does not apply to the issuance of compulsory licenses granted in connection with intellectual property rights and the TRIPS Agreement.

In the Annex on Customary International Law in the new FTAs, the Parties confirm their shared understanding that “customary international law” generally and as specifically referenced in the articles on minimum standard of treatment and expropriation and compensation, results from a general and consistent practice of states that they follow from a sense of legal obligation. With regard to the article on minimum standard of treatment, in international law the customary minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.

Other obligations in NAFTA and the new FTAs include the provision on special formalities and information requirements. The FTAs state that nothing in the article on national treatment must be construed to prevent a Party from adopting or maintaining a measure that prescribes special formalities in connection with covered investments, such as a requirement that investors be residents of the Party or that covered investments be legally constituted under the laws or regulations of the Party, provided that such formalities do not materially impair the protections afforded by a Party to investors of the other Party and covered investments pursuant

to the investment chapter. Moreover, notwithstanding the articles on national treatment and MFN treatment, a Party may require an investor of another Party, or a covered investment, to provide information concerning that investment solely for informational or statistical purposes.

NAFTA and the new FTAs also state that nothing in the investment chapter is construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with the chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

NAFTA also sets out procedures for the settlement of disputes arising between NAFTA countries and investors of other NAFTA countries with respect to the obligations of the NAFTA investment chapter, as well as the provisions of the competition policy, monopolies, and State enterprises chapter concerning the exercise by state enterprises and monopolies of regulatory, administrative, or other governmental authority. The United States-Chile FTA follows the same approach, but the CAFTA-DR (which does not include a chapter on competition policy) and the PTPA do not cover disputes related to competition policy. NAFTA and the other FTAs investor-state dispute settlement mechanisms also cover articles of the investment chapter that were incorporated in the chapter on financial services, namely the provisions on transfers, expropriation, and compensation, special formalities and information requirements, denial of benefits, and environmental measures.

Therefore, in addition to having access to the state-to-state dispute settlement mechanism of the FTA, an investor of one Party may submit to arbitration a claim that the other Party has breached an obligation under the investment chapter (or the abovementioned obligations in the chapters on competition policy, monopolies, and state enterprises, and on financial services) *provided* the investor or enterprise has incurred loss or damage by reason of, or arising out of, that breach. The new FTAs also cover disputes arising out of an investment authorization or investment agreement.

The FTAs have adopted the “no U-turn” approach.” As noted by Menaker and Thornton (2010: 17), this “approach allows recourse to international arbitration even if resort has first been made to local courts, but requires the claimant to provide a written waiver with its Notice of Arbitration ‘of any right to initiate or continue before any administrative tribunal or court under the law of either Party, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach’ of the (...) agreement.” Moreover, in the Annex on

Submission of a Claim to Arbitration, the new FTAs state that an investor of the United States may not submit to arbitration under the investor-State dispute settlement section a claim that Chile or a CAFTA-DR country or Peru has breached an obligation under the FTA if the investor or the enterprise, respectively, has alleged that breach of an obligation under the FTA in proceedings before a court or an administrative tribunal of Chile, a CAFTA-DR country, or Peru. The United States-Chile FTA includes the same wording in the case of an investment agreement or investment authorization.

One of the main innovations in the new U.S. FTAs is the transparency of arbitral proceedings. Although traditionally, arbitration has been regarded as confidential, such confidentiality “may be viewed as inappropriate for investor-state arbitration where investment disputes may implicate important issues of public interest or policy and where awards in favor of investors are paid from the public.” The NAFTA FTC had already clarified in an interpretation on July 31, 2001 “that there was no implied duty of confidentiality in a NAFTA Chapter Eleven arbitration and that nothing in the NAFTA precluded the Parties from ‘providing public access to documents submitted to, or issued by, Chapter Eleven tribunals.’” They agreed to release documents publicly, subject to redaction of confidential business or privileged information.<sup>10</sup> It is worth noting that “NAFTA tribunals had disagreed on whether a disputing Party could publicly release documents generated during the arbitration proceedings” (Menaker and Thornton, 2010: 12).<sup>11</sup>

Two novel features of the new FTAs are open hearings and submission of *amicus curiae*. On October 7, 2003, the United States and Canada officially agreed to consent to open public hearings at all NAFTA Chapter Eleven arbitrations to which either is a Party, and on July 16, 2004, the NAFTA FTC released a statement confirming Mexico’s agreement to open hearings.<sup>12</sup> As to submissions of *amicus curiae*, in 2001 two NAFTA tribunals (Methanex Corp. v. United States of America and United Parcel Service of America, Inc. v. Canada) operating under the UNCITRAL Rules found that they had the authority to accept non-Party or *amicus* submissions.

Another innovative element of the investor-state dispute settlement mechanism in the new FTAs, which also benefited from the NAFTA experience, is the issue of frivolous claims. If

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<sup>10</sup> See Interpretation of the Free Trade Commission of Certain Chapter Eleven Provisions, July 31, 2001, <http://www.state.gov/documents/organization/8060.pdf>

<sup>11</sup> Also see S.D. Myers v. Canada and Pope & Talbot Inc. v. Canada.

<sup>12</sup> See Statement of Canada on Open Hearings in NAFTA Chapter Eleven Arbitrations, <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/open-hearing.aspx?larg=en>. For the July 16, 2004 NAFTA FTC Joint Statement, see: <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/JS-SanAntonio.aspx?lang=eng&view=d>

the tribunal determines that, as a matter of law, the claim is invalid or if the tribunal lacks competence, an objection may be raised within 45 days, and the tribunal must consider such objection within 150 days. The agreement underlines the tribunal's authority to award reasonable costs and attorneys' fees in the event of any decision on a preliminary objection, taking into consideration whether the claimant's claim or the respondent's objection was frivolous.

Finally, the new FTAs call for the establishment of an appellate body to review the awards rendered in arbitrations. NAFTA exempts from dispute settlement the decision by Canada following a review under the *Investment Canada Act* and a decision by Mexico's National Commission on Foreign Investment (*Comisión Nacional de Inversiones Extranjeras*, or CNIE) with respect to whether or not to permit an acquisition that is subject to review. These decisions are also exempted from Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures).

The new FTAs also include annexes on public debt. Annex 10-F of the United States-Chile FTA states that an investor of the United States or a covered investment that is a Party to an investment contract under Chile's *Estatuto de la Inversión Extranjera, Decreto Ley 600 de 1974* shall receive the better of the treatment required under the agreement or the investment contract. Annex 10-H of the PTPA states that pursuant to Legislative Decrees 662 and 757, Peru may enter into agreements known as "stability agreements" with covered investments or investors of another Party. As part of a stability agreement, Peru accords certain benefits to the covered investment or the investor that is Party to the agreement. These benefits typically include a commitment to maintain the existing income tax regime applicable to such covered investment or investor during a specified period of time. Annex 10-H also underlines that a stability agreement may constitute one of multiple written instruments that make up an "investment agreement," as defined in the PTPA. Where that is the case, a breach of such a stability agreement by Peru may constitute a breach of the investment agreement of which it is a part.

## **2. Implementing Investment Rules**

With the exception of telecom and financial services in Costa Rica and the new foreign investment law in Mexico, no other laws were modified in Mexico, Chile, Costa Rica, El Salvador, and Peru to implement the investment rules in their FTAs with the United States. All

these countries had negotiated several FTAs, signed onto numerous bilateral investment treaties, and substantially liberalized their investment regime to attract foreign investment with a view to fostering economic growth and development, and benefiting from an open trade policy.<sup>13</sup>

## 2.1 The Experience of Mexico

The basis of foreign investment policy in Mexico stems from the Constitution of 1917. One of the most important provisions in the constitution is Article 27, which reserves the ownership of land and water within the national territory to the state, and grants the state the power to transfer ownership rights to private individuals, thereby constituting private property. Section I of Article 27 provides that only Mexican individuals and companies have the right to acquire the dominion of land and water, albeit the state has the discretionary power to grant the same right to foreigners. Article 27 gives the Mexican government the power to expropriate private property for public use, and gives all subterranean land—including all minerals, gases, and hydrocarbons—to the Mexican government. It also prohibits foreign ownership of any land within 100 kilometers of Mexico's border and within 50 kilometers of Mexico's shoreline. Further, the Mexican nation itself has control over the transfer of land to private persons. The article was introduced to break up the monopolies on land, water, and natural resources held by a privileged few. As a result, large parcels of land formerly owned by rich individuals, companies, and religious organizations were taken over by the Mexican government in the 1930s. It also facilitated the nationalization of foreign oil and gas interests in 1938.

Traditionally, Mexico had been very distrustful of foreign investors; thus foreign investment was limited to some sectors where investors were subject to performance requirements, such as mandatory joint venture with majority Mexican ownership. Still other industries were reserved for state ownership or for Mexicans only. As the country began to pursue the economic policy of import-substitution-industrialization (ISI) in the 1930s, barriers to foreign investment became more prevalent.

In 1973, Mexico promulgated its most restrictive investment law to date, the Law to Promote Mexican Investment and Regulate Foreign Investment (*Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*), known as the 1973 Investment Law.<sup>14</sup> Essentially, this law mandated that foreign ownership in Mexican enterprises could not exceed 49 percent.

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<sup>13</sup> For a list of these trade and investment agreements, see <http://www.sice.oas.org>

<sup>14</sup> Published in the Official Gazette of the Federation (*Diario Oficial de la Federación*) on March 9, 1973.

However, foreign ownership was not allowed in seven basic economic areas, including exploration of petroleum, railroad operations, and telegraph communications, and eight basic domestic activities, including some resource exploitation, radio and television stations, and domestic automotive transportation. Minority foreign ownership was permitted in companies involved in exploitation and use of minerals (maximum of 34 to 49 percent); secondary petrochemicals (maximum of 40 percent); automotive manufacturing (maximum of 40 percent); and, other activities not specified by the law (maximum of 49 percent). By giving the Mexican authorities wide discretionary powers, the law created uncertainty for investors.

In addition, the 1973 Investment Law established the CNIE, whose main function was to determine, based on a list of 17 criteria, the allowable degree of foreign participation in economic activities not specified by the existing law. The law also established the National Registry of Foreign Investment (*Registro Nacional de Inversión Extranjera*, or RNIE). Inscription was required of both foreign investors and Mexican corporations with any degree of foreign investment.

In 1984, Mexico's approach towards FDI began to change with the new "Guidelines for Foreign Investment and Objectives for its Promotion." Majority foreign ownership of Mexican corporations in certain industrial and tourism-related industries was allowed. Such investment, however, was slow and cumbersome and was permitted only with the approval, on a case-by-case basis, of the Mexican Foreign Investment Commission (FIC). Moreover, cases of minority ownership (shares up to 49 percent) no longer required authorization, but simply needed to be registered. However, several exceptions were made.

By the late 1980s, Mexico began to gradually relax the interpretation of the 1973 Investment Law. The 1989 Regulations (*Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*) allowed foreign investors to establish corporations in Mexico with majority foreign capital in several sectors, and maintain wholly owned subsidiaries in some activities. However, the regulations often conflicted with the law itself, which also created uncertainty among investors.

The NAFTA was a watershed agreement for Mexico. The country was seeking not only to secure its access to U.S. and Canadian markets, but also to attract investment from North America. To implement NAFTA, the *Ley de Inversión Extranjera* (Foreign Investment Law, or

FIL) was promulgated on December 27, 1993.<sup>15</sup> It abrogated the 1973 Investment Law, as well as the Act pertaining to Article 27 of the Constitution (*Ley Orgánica de la Fracción I del Artículo 27 Constitucional*)<sup>16</sup> and the Emergency Presidential Decree.<sup>17</sup> The main objective of the new law was to consolidate the market openings locked in by NAFTA and to eliminate performance requirements banned by the agreement. Of the 704 activities included in Mexico's industry classification list (*Clasificación Mexicana de Actividades y Productos*, or CMAP), only 10 were reserved to the State and 16 to Mexican nationals

The main statutes governing foreign investment in Mexico are now the Constitution of 1917 and the 1993 Foreign Investment Law, which was amended in 1995, 1996, 1998, 1999, 2001, and 2006. The most recent reform was published in the Official Gazette of the Federation on July 18, 2006. Implementing Regulations for the Foreign Investment Law and the National Foreign Investment Register were published in the Official Gazette on September 8, 1998.

In 1995, investment in communications via satellite and railways, storage, transport, and distribution of natural gas was liberalized, which required modifications to the constitution (Ramírez, 2009). Moreover, since 1999 the LIE has allowed for 100 percent ownership in Mexican companies in the following sectors: manufacturing and assembly of goods in the auto parts industry, construction, holding companies of financial groups, commercial banks, securities firms, and securities specialists (Ramírez, 2009). The 2006 reform permitted 100 percent foreign ownership in financial leasing companies, financial factoring companies, and limited purpose financial corporations.

Under the FIL, foreign investors may hold up to 100 percent of the equity in Mexican companies and open and operate establishments in all economic activities that are not expressly reserved or regulated specifically in the Law itself. However, areas limited to government investment include petroleum and other hydrocarbons; basic petrochemicals; electricity; generation of nuclear energy; radioactive minerals; telegraph; radio telegraph services; postal services; issuing of banknotes and minting of coins; control, supervision, and surveillance of ports, airports, and heliports; and any other areas that may be expressly reserved by specific legislation. There are no other sectors reserved for the Mexican State, apart from those listed in

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<sup>15</sup> The Foreign Investment Law was published in the Official Gazette of the Federation on December 27, 1993, and has been amended by Orders published therein on May 12, 1995; June 7, 1995; December 24, 1996; January 23, 1998; January 19, 1999; June 4, 2001; and July 18, 2006.

<sup>16</sup> This statute, entered into force on January 26, 1926, pertains to the acquisition of immovable assets by foreign individuals and Mexican companies.

<sup>17</sup> This decree, published on July 7, 1944, mandated that foreigners obtain a permit to acquire assets and to establish or modify a Mexican company that had foreign partners.

the constitution and Article 5 of the FIL. The 1998 Regulations (*Reglamento de la Ley de Inversion Extranjera y del Registro Nacional de Inversiones Extranjeras*) define the scope of some of the reserved activities; for instance, the reservation on activities in the electricity sector does not apply to private generation of electricity under certain conditions.

The FIL restricts investments in certain activities to Mexican nationals or firms, with a “foreigner’s exclusion clause.” This clause relates to the express agreement contained in the company’s articles of association establishing that it will not admit as partners or shareholders, either directly or indirectly, foreign investors or firms that have a foreigners’ admission clause. The reserved activities are domestic land transportation of passengers, tourism, and freight (excluding messenger and parcel services); retail sale of gasoline and distribution of liquefied petroleum gas; broadcasting and other radio and television services (with the exception of cable television); credit unions; development banking institutions; and professional and technical services expressly reserved by sector-specific legislation. In these activities, foreign investors may not participate directly or through trust funds, agreements, or any other mechanisms that give them control.

Up to 10 percent of investment in production cooperatives can be foreign; up to 25 percent in firms providing domestic air transportation; air-taxi services, and specialized air transport; and up to 49 percent foreign in insurance institutions; bond institutions; currency exchange houses; general deposit warehouses; companies mentioned in Article 12*bis* of the Stock Market Law; retirement fund management companies; the manufacture or commercialization of explosives, firearms, cartridges, munitions, and fireworks (excluding the acquisition or use of explosives for industrial and extractive activities); printing and publication of newspapers for circulation only in Mexico; series-T shares in companies that own agricultural, ranching, or forestry lands; fresh water, coastal, and exclusive economic zone fishing (excluding aquaculture); integrated port administration; port pilot services for vessels carrying out inland navigation; under the terms of the respective law, companies involved in the commercial exploitation of ships engaged in inland and coastal navigation (excluding tourist cruises, marine dredging activities, and implements for port construction, conservation, and operation); supply of fuel and lubricants for ships, airplanes, and railway equipment; and concessionaire companies under the terms of Articles 11 and 12 of the Federal Telecommunications Law.

Successive reforms to the FIL between 2001 and 2006 eliminated investment limitations in various sectors, but in others CNIE approval is required for foreign investment to exceed 49 percent of the firm's equity. These sectors include port services for ships engaged in inland navigation operations, such as towing, mooring, and lighter age; shipping companies engaged in the operation of ships solely for high-seas traffic; concessionaires or permit holders for aerodromes for public service; private education services, from preschool to high school levels; legal services; credit information companies; securities rating institutions; insurance agents; cellular telephone services; construction of pipelines for petroleum and refined oil products; drilling of petroleum and gas wells; construction, operation, and exploitation of railroads considered as a means of general communication; and supply of public railway services. CNIE approval is also required for foreign investment to exceed 49 percent in companies with activities that are not specifically regulated when the total value of the company's assets exceeds the amounts determined annually by the commission.

Although investment does not require prior authorization, all foreign investors and Mexican firms with foreign ownership must register with the RNIE kept by the Ministry of the Economy. Failure to do so on time results in a fine or sanction.

Under Article 27, Fraction I of the Mexican Constitution, foreigners may not directly own land or water in the restricted zone, which is located within 100 kilometers of the country's borders and 50 kilometers of the coastline. Nonetheless, the FIL authorizes foreign investment in Mexican companies that acquire real estate in the restricted zone for the purpose of engaging in nonresidential activities. In the case of residential activities, a Mexican bank that acts as a trust fund must obtain rights over real estate, and the Ministry of Foreign Affairs must approve the purchase. Foreigners may also invest in a Mexican company that owns immovable property in the restricted zone, for nonresidential purposes, provided that the articles of association of the company in question contain a clause whereby foreigners agree to be considered as nationals and not seek protection from their governments with respect to such assets, and the Ministry of Foreign Affairs is notified.

For sectors reserved to Mexican nationals or those that impose limits on foreign investment stakes, a larger foreign share may be held through the "neutral investment" mechanism, which is not included in the calculation to determine the percentage of foreign investment in a Mexican company. This capitalization mechanism, which is provided for in the

FIL, allows Mexican companies to issue shares that only give pecuniary rights to their holders, with either limited or no corporate rights. The mechanism also allows authorized trust funds to issue neutral instruments. The Ministry of the Economy and, where applicable, the National Banking and Securities Commission, must authorize neutral investment operations.<sup>18</sup> In addition, NAFTA also required Mexico to change its expropriation regime. The main changes consisted in establishing that the compensation in case of expropriation would be equivalent to the fair market value and that it would be paid within one year. It is worth noting that NAFTA Article 1110 on expropriation only requires that compensation be paid “without delay and be fully realizable.”

Mexico did not experience any major hurdle with respect to implementing NAFTA provisions on investment. The country had already begun the process of liberalizing its investment regime under Miguel de la Madrid’s government (1982–1988). The administration of Carlos Salinas de Gortari (1988–1994) continued this trend with the 1989 Regulations mentioned previously.

The Mexican Senate approved NAFTA on November 22, 1993 and signed it on December 17, 1992, and the agreement was published on December 20, 1993.<sup>19</sup> The main opposition in the Mexican Senate came from the *Partido de la Revolución Democrática* (PRD), which called for the debates to be broadcast live (radio and television),<sup>20</sup> given that this issue was of national interest.<sup>21</sup> No specific reference to the investment provisions was made during the Senate discussions in November 1993. In fact, the implementation of the NAFTA was not controversial in Mexico before its entry into force on January 1, 1994.

## 2.2 The Experience of Chile

The only change that took place in the Chilean legislation was as a result of the World Trade Organization (WTO) agreements. In October 2003, prior to the entry into force of the United States-Chile FTA, Law No. 19.912 was enacted to modify Chilean legislation so as to fully implement the results of the Uruguay Round. Paragraph 3 of Article 24 of the law eliminated the measures (performance requirements) notified by Chile pursuant to Article 5.1 of the WTO

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<sup>18</sup> Articles 18, 19 and 20 of the LIE.

<sup>19</sup> See Official Gazette of the Federation: [http://www.senado.gob.mx/comisiones/LX/grupo\\_tlcian/content/legislacion\\_tlcian/index\\_legislacion.htm](http://www.senado.gob.mx/comisiones/LX/grupo_tlcian/content/legislacion_tlcian/index_legislacion.htm)

<sup>20</sup> For more on the debates, see [http://www.senado.gob.mx/index.php?ver=sp&mn=3&sm=5&lg=LV\\_III&str=libre+comercio](http://www.senado.gob.mx/index.php?ver=sp&mn=3&sm=5&lg=LV_III&str=libre+comercio)

<sup>21</sup> [http://www.senado.gob.mx/index.php?ver=sp&mn=3&sm=3&lg=LV\\_III&id=216](http://www.senado.gob.mx/index.php?ver=sp&mn=3&sm=3&lg=LV_III&id=216); and

[http://www.senado.gob.mx/index.php?ver=sp&mn=3&sm=2&lg=LV\\_III&tp=Primer%20Periodo%20Ordinario&np=NOVIEMBRE%2018,%20%201993&d=8&str=libre%20comercio](http://www.senado.gob.mx/index.php?ver=sp&mn=3&sm=2&lg=LV_III&tp=Primer%20Periodo%20Ordinario&np=NOVIEMBRE%2018,%20%201993&d=8&str=libre%20comercio).

Agreement on Trade-Related Investment Measures (TRIMS).<sup>22</sup> The performance requirements were included in Law No. 18.483, referred to as the “Chilean Automotive Statute.”

The legal framework for foreign investment in Chile is essentially based on two laws: the Foreign Investment Statute, or Decree Law 600 of 1974,<sup>23</sup> and Article 47 of the Constitutional Organic Law of the Central Bank, also known as Chapter XIV of the Compendium of International Exchange Regulations. Expropriation is regulated by the *Ley Orgánica de Procedimiento de Expropiación*, which is now part of Law Decree No. 2186 of 1978. Paragraph 24 of Article 19 in Chile’s constitution states that the only way to be deprived of one’s own property is as a result of a law which authorizes expropriation as a result of a public purpose or national interest.<sup>24</sup>

### **2.3 The Experience of El Salvador and Costa Rica**

In El Salvador, the investment regime is governed by Decree No. 732 of October 14, 1999. Article 106 of the constitution states that private property cannot be expropriated unless it is for public need or social interest, and with compensation.<sup>25</sup> In Costa Rica, Article 45 of the constitution governs expropriation.<sup>26</sup> The country does not have a foreign investment law or specific regulations for foreign investment.

### **2.4 The Experience of Peru**

In Peru, the investment framework falls under the purview of Article 63 of the constitution, which covers issues related to expropriation and which allows disputes to be submitted to national or international arbitration (in compliance with Article 10.16 of the PTPA on submission of a claim to arbitration). Under Peru’s constitution, international treaties are automatically part of the domestic legislation, which means that given that Peru is a contracting state to the New York Convention (officially known as the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958) and therefore the convention is part of the Peruvian’s domestic legislation, there is no need to implement the commitment in Article 10.26.7

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<sup>22</sup> See Document G/TRIMS/N/1/CHL/1 of January 19, 1996 and Document G/TRIMS/N/1/CHL/1/Add.1 of December 1, 2003.

<sup>23</sup> Decree Law No. 600 was amended on December 16, 1993 and on June 16, 2005 by Law No. 20.026. It was further amended by Law No. 20.097 of April 8, 2006.

<sup>24</sup> See [http://www.leychile.cl/Consulta/Exportar?radioExportar=Normas&exportar\\_formato=pdf&nombrearchivo=DTO-100\\_22-SEP-2005&exportar\\_con\\_notas\\_bcn=True&exportar\\_con\\_notas\\_originales=True&exportar\\_con\\_notas\\_al\\_pie=True&hddResultadoExportar=2423\\_02\\_2010-01-07\\_0.0%23](http://www.leychile.cl/Consulta/Exportar?radioExportar=Normas&exportar_formato=pdf&nombrearchivo=DTO-100_22-SEP-2005&exportar_con_notas_bcn=True&exportar_con_notas_originales=True&exportar_con_notas_al_pie=True&hddResultadoExportar=2423_02_2010-01-07_0.0%23).

<sup>25</sup> See <http://www.constitution.org/cons/elsalvad.htm>. Article 106 states: *La expropiación procederá por causas de utilidad pública o de interés social, legalmente comprobados, y previa una justa indemnización.*

<sup>26</sup> See <http://www.constitution.org/cons/costaric.htm>.

of the PTPA on the enforcement of an award. The same can be said of the other countries covered in this paper.

Peru's investment framework also includes the Foreign Investment Law (Legislative Decree No. 662), the Framework Law for the Growth of Private Investment (Legislative Decree No. 757), and the Law for the Promotion of Private Investment in Public Infrastructure Works and Public Services (Supreme Decree No. 059-96-PCM). Like Chile, the only change that took place in the Peruvian legislation was as a result of the TRIMS agreement. Legislative Decree No. 1035, published on June 25, 2008, eliminated the performance requirements (local content requirements) included in the following laws: Legislative Decree No. 653 (*Ley de Promoción de las Inversiones en el Sector Agrario*), Law No. 27037 (*Ley de Promoción de la Inversión en la Amazonía*), Law No. 27360 (*Ley que Aprueba las Normas de Promoción del Sector Agrario*), and Law No. 28342 (*Ley Complementaria a la Ley N°27143 -Ley de Promoción del Desarrollo Productivo Nacional*). These performance requirements were also banned in the PTPA.

Although not strictly related to the PTPA, Law No. 28933 (*Ley que establece el sistema de coordinación y respuesta del Estado en controversias internacionales de inversión*) was published beforehand on December 16, 2006; the objective of the law was to create a coordinated response system to investment disputes and to resolve such disputes by negotiation and mediation whenever possible. Law No. 28933 establishes a special commission that includes members of various relevant government agencies to monitor ongoing and potential investment disputes and to represent the state in such disputes with foreign investors. The permanent members are the Ministry of Economy and Finance (Chair), the Ministry of Justice, the Ministry of Foreign Affairs, and the investment promotion agency, ProInversión. The nonpermanent members are case specific. The special commission participates in the hiring of lawyers and professionals, appoints arbitrators, contributes in the process, approves funding, and defines the responsibilities of public entities involved.<sup>27</sup>

Unlike other countries covered in this study, Peru made a special effort to not only focus on the implementation process but to also implement reforms that would improve Peru's national competitiveness. In order to be "more efficient" and enact the laws to implement the agreement and take advantage of the PTPA, the Peruvian Congress, published Law 29157 on December 20,

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<sup>27</sup> Supreme Decree 125-2008-EF (published on October 23, 2008) approves the regulations of Law No. 28933, amended by Law No. 29213, which established the system of coordination and response of the government in international investment disputes, as appears in the annex and becomes an integral part of this Supreme Decree.

2007, which temporarily delegated legislative powers to the executive branch for 180 days beginning in January 2008. Of the 99 Legislative Decrees that were enacted, 12 relate to the implementation of the PTPA, per se, 84 to reaping the benefits of the agreement (or *aprovechamiento*), and three (3) to both. Several of the decrees which have to do with *aprovechamiento* seek to boost investment in nontraditional exports; promote investment in the energy sector, particularly with respect to renewable resources; improve the country's infrastructure; cut red tape; encourage public-private partnerships (PPP), promote infrastructure sharing and local loop unbundling in telecom; expand and modernize ports infrastructure; and increase Peru's competitiveness. They include, among others:

- Legislative Decree No. 994, which promotes private investment for the irrigation of uncultivated lands with agricultural potential;
- Legislative Decree No. 1002, which promotes investment to generate electricity using renewable resources;
- Legislative Decree No. 1011, which simplifies procedures for entering into a Legal Stability Agreement (LSA) with the Peruvian government to guarantee the stability of certain legal rules (including taxation) applicable to private investment;<sup>28</sup>
- Legislative Decree No. 1012, which enacts the general framework that seeks to encourage public PPPs to create jobs and facilitate the process to promote private investment;
- Legislative Decree No. 1014, to foster investment in the provision of public services and public infrastructure;
- Legislative Decree No. 1019, which allows access to the infrastructure of the important public service telecom providers; and
- Legislative Decree No. 1022, which modifies the Law for the National Port System.

### **3. Rules on Cross-Border Trade in Services**

As mentioned above, NAFTA is the first free trade agreement negotiated by a Latin American country that includes services trade. The chapters that apply to services trade are those covering investment, cross-border trade in services, telecommunications, financial services, and temporary

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<sup>28</sup> Under the old rules, investors were required to sign their LSA first, which delayed the investment, whereas under Legislative Decree No. 1011, the investment can be made first as long as before doing so the investor files a petition with the Peruvian Investment Promotion Agency (ProInversión) requesting the LSA.

entry of businesspersons. There is also a separate chapter on government procurement covering both goods and services.

The chapter on cross-border trade in services covers government measures that affect the production, distribution, marketing, sale, and delivery of services; the purchase or use of, or payment for, a service; the access to and use of distribution and transportation systems in connection with the provision of a service; the presence of a service provider of another Party in its territory, or in other words, the maintenance by service providers of a local presence; and the provision by service providers of a bond or other form of financial security as a condition for the provision of a service.

NAFTA and the other FTAs discussed in this paper expand on the services covered by the CUSFTA. Services that were not covered by CUSFTA were not subject to the obligations of the agreement, whereas in NAFTA and the other FTAs, the services provisions apply to all services, with the exception of financial services covered in a specific chapter; air transport services (other than aircraft repair and maintenance services and specialty services); services covered by the cultural exemption for Canada in NAFTA; procurement (covered in the chapter on government procurement); and subsidies and grants. As is the case in the WTO General Agreement on Trade in Services (GATS), which entered into force in January 1995, the new FTAs also make clear that the chapter on cross-border trade in services does not apply to a “service supplied in the exercise of governmental authority,” which means any service that is supplied neither on a commercial basis, nor in competition with one or more service suppliers.”

The definitions in NAFTA and the other FTAs are nearly identical for cross-border trade in services or cross-border supply of a service, enterprise, enterprise of a Party, professional services and specialty air services.

As in the case of the investment chapter, which covers investment in goods and services, the new FTAs provide for national treatment, which means that each Party shall accord to service suppliers of another Party treatment no less favorable than that it accords, in like circumstances, to its own service suppliers. Unlike GATS, this obligation is of general application and unconditional. Moreover, the FTAs provide that the standard treatment for a province or a state (NAFTA) or regional level of government (other FTAs) is the most favorable treatment that it accords to service providers of the country which it forms a part. This means that in the case of NAFTA, for example, if a province or a state treats its own service providers better than those

from other provinces or states, the treatment of its own service providers sets the standard. The investment chapter includes a similar provision for investors. The FTAs also grant MFN treatment, as each Party shall accord treatment no less favorable to service suppliers of one Party than the treatment it accords, in like circumstances, to service suppliers of any other Party or non-Party.

All the FTAs prohibit a Party to require a service supplier of another Party to establish or maintain a representative office, or any form of enterprise, or residency in its territory as a condition for the cross-border supply of a service. Thus, service providers do not have to establish a local presence if the service can be provided more efficiently through cross-border trade.

NAFTA and the other FTAs set out reservations or non-conforming measures to the provisions on national treatment, MFN treatment, and local presence. Annex I of the agreements, which is subject to the ratchet clause, as noted in the investment section, exempts existing non-conforming measures of an FTA country from one or more of the three above-mentioned obligations, whereas Annex II lists reservations taken by each Party with respect to specific sectors, subsectors, or activities for which it may maintain existing, or adopt new or more restrictive, measures that do not conform with these three obligations. The United States-Chile FTA, CAFTA-DR, and the PTPA also allow a Party to maintain (Annex I) or adopt a new restrictive measure that violates the market access obligation, which was not included in NAFTA. It is worth noting that this obligation covers both cross-border trade in services and investment in services. The market access obligation sets out four types of quantitative measures that Parties are not allowed to maintain against service suppliers from other Parties, as well as a specific type of legal measure which Parties are not allowed to use to restrict service suppliers from other Parties. These measures are the same as those found in Article XVI of the GATS, although they do not include limitations on foreign capital.

Two other novel provisions that also apply to both cross-border trade in services and investment in services, and not found in NAFTA, are transparency in development and applications of regulations and domestic regulation. The transparency obligation sets out various procedural requirements with respect to the process for developing and applying regulations. These include requirements for each Party to respond to enquiries regarding their regulations and to address in writing the comments received on proposed regulations at the time of their

adoption, and the allotment of a reasonable period of time between the publication of regulations and their application. On domestic regulation, the new FTAs reproduce part of the text of GATS Article VI on domestic regulation (paragraph 3 and 4) with some adjustments. The article requires that Parties provide information concerning the status of an application waiting on authorization to provide a service, and also mandates that any such measures that a Party adopts or maintains are based on “objective and transparent criteria,” and are “not more burdensome than necessary to ensure the quality of the services.” It is worth noting that NAFTA Article 1210 on licensing and certification requirements addresses some issues related to domestic regulation and mutual recognition. The other FTAs have separate provisions on mutual recognition that set out the possibility for Parties to recognize the “education or experience obtained, requirements met, or licenses or certifications granted in a particular country.” Such recognition may be realized through harmonization or mutual agreement, or accorded autonomously. Parties must also give the opportunity to each other to try and meet the requirements established in mutual recognition agreements with third countries.

The new FTAs include specific provisions on implementation which commit the Parties to consult annually, or as otherwise agreed, to review the implementation of the chapter on cross-border trade in services and consider other trade in services issues of mutual interest. The United States-Chile FTA includes an additional paragraph that is not found in the CAFTA-DR and the PTPA. It states that, among other issues, the Parties will consult with a view to determining the feasibility of removing any remaining citizenship or permanent residency requirement for the licensing or certification of each other’s services suppliers. The PTPA included a side letter from the United States (dated April 12, 2006) notifying the Government of Peru that upon entry into force of the agreement, the United States would initiate a review of state-level measures for the states of California, the District of Columbia, Florida, New Jersey, New York, and Texas in the following services subsectors: accounting, architecture, dentistry, engineering, legal services, nursing, medical general practitioners, and paramedics. Within one year of the entry into force of the PTPA, the United States committed to reviewing measures requiring permanent residency or citizenship.<sup>29</sup>

NAFTA Article 1210 (3) obliges each NAFTA country to eliminate, within two years of the agreement entering into force, any citizenship or permanent residence requirements set out in

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<sup>29</sup> For more information of the side letter, see: [http://www.sice.oas.org/Trade/PER\\_USA/PER\\_USA\\_e/asset\\_upload\\_file180\\_9512.pdf](http://www.sice.oas.org/Trade/PER_USA/PER_USA_e/asset_upload_file180_9512.pdf).

its Annex I reservations that it maintains with respect to the licensing or certification of professional service providers. If a NAFTA Party does not comply with this requirement, other NAFTA Parties may maintain or reinstate an equivalent requirement in the same sector but may not otherwise retaliate. NAFTA Article 1210 (4) provides for consultation with respect to the feasibility of removing remaining citizenship or permanent residency requirements.

The CAFTA-DR and PTPA include a provision that requires all Parties to allow transfers and payments relating to the cross-border supply of services to be done freely and without delay and in a freely usable currency. As mentioned earlier, a similar provision is found in the investment chapters of all trade agreements covered in this paper. The chapters on cross-border trade in services also include a denial of benefit provision similar to the one found in the investment chapters.

All the agreements include annexes on professional services. The NAFTA and United States-Chile FTA texts are almost similar. They both include a section on the development of professional standards (also included in the CAFTA-DR and the PTPA) encouraging licensing bodies to develop mutually acceptable standards and criteria for licensing and certification. A review of the implementation of these provisions is to occur at least once every three years. The PTPA states that the Parties shall establish a working group on professional services no later than one year after the entry into force of the agreement, comprising representatives of each Party, to facilitate the development of professional services standards.<sup>30</sup>

NAFTA and the United States-Chile FTA also include a section on foreign legal consultants which requires, subject to reservations, each Party to ensure that a national of another Party is permitted to practice or advise on the law of any country in which that national is authorized to practice as a lawyer. The same section also provides for consultations with relevant professional bodies to obtain recommendation on issues such as the development of standards and criteria for the authorization of foreign legal consultants and efforts towards future liberalization. Another section on temporary licensing engineers (also included in the PTPA) provides for the Parties to establish a work program to be undertaken in conjunction with its relevant professional bodies that provides for the temporary licensing in its territory of engineers licensed in the territory of the other Party. In the case of Chile and Mexico, this only applies to

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<sup>30</sup> The working group shall report to the commission on its progress, including with respect to any recommendations for initiatives to promote mutual recognition of standards and criteria and for temporary licensing, and on the further direction of its work, no later than 18 months after establishment of the working group. See Annex 11-B (9).

civil engineers and other specialties that each country may designate. The chapters on cross-border trade in services in the new FTAs also include annexes on delivery services, which explicitly brings the services under the scope of the agreement and defines them; all Parties must maintain open market access for these services.

Under Annex 11.3 of the CAFTA-DR, pertaining to special commitments, Costa Rica agrees to repeal a regime in the area of contract law and to enact a new legal regime applicable to contracts of representation, distribution, or production (Distribution – Dealer Protection Regime, addressed in the next section). In the case of El Salvador, Annex 11.13 of the CAFTA-DR states that Articles 394 through 399-B of the commercial code shall apply only to contracts that were entered into after such articles entered into force, and that it shall not apply to any distribution contract that a person of the United States enters into after the date of entry into force of the CAFTA-DR, as long as the contract so provides. The annex also indicates that Parties to a distribution contract shall be permitted to establish the mechanisms and forums that will be available in the case of disputes. If a distribution contract makes specific provision for indemnification, including a provision providing for no indemnification, Article 397 of the commercial code shall not apply to that contract. Finally, under Salvadoran law, a distribution contract shall be treated as exclusive only if the contract states so expressly. The CAFTA-DR also states that El Salvador shall encourage Parties to distribution contracts made after the date of entry into force of the FTA to include provisions providing for binding arbitration of disputes and specifying methods for determining any indemnity.

Finally, NAFTA includes an annex on land transportation that requires Parties to designate contact points. Also the Parties must provide a report to the Free Trade Commission that assesses progress respecting liberalization during the fifth year after the date of entry into force of this agreement and during every second year thereafter until the liberalization for bus and truck transportation set out in the Parties' schedules to Annex I is complete.

#### **4. Implementing the Rules on Cross-border Trade in Services**

In most cases, there were few or no changes made to the legal framework of the Parties to the FTAs covered in this paper with respect to implementing the cross-border trade in services obligations of the agreements they signed with the United States. One notable exception is Costa Rica's obligation on its Distribution – Dealer Protection Regime.

## 4.1 The Experience of Mexico

In the case of Mexico and NAFTA, to comply with NAFTA Article 1210 (3) the country eliminated all its nationality requirements to exercise any profession at the federal level, with the exception of the following professional and technical services which are reserved to Mexican citizens: aircraft pilots, ship captains, first mates, naval architects, ship engineers, crews of Mexican flag ships and aircraft, airport managers, harbor pilots, customs brokers, and train crews.

In Mexico, professions are regulated at both the federal and state levels. To practice a regulated profession, it is necessary to hold a special license (*cédula profesional*) issued by Mexico's Public Education Ministry (*Secretaría de Educación Pública*, or SEP), which entails that the professional must possess a diploma recognized by the SEP and must have completed a social service.<sup>31</sup> Under Article 5 of the Mexican Constitution, each State in the Federation has discretion to determine the professions that require a diploma.<sup>32</sup>

To foster the negotiation of mutual recognition agreements, the SEP, through the *Dirección General de Profesionales* (DGP) and in collaboration with the different professional associations has created 12 special committees (*Comités Mexicanos para la Práctica Internacional de la Profesión*, or COMPI). These 12 groups are composed of representatives of professional associations, the academic sector, the private sector, and the government (education, trade, and immigration), the latter as observers. The professions represented in the 12 COMPIs are engineers, foreign legal consultants, accountants, architects, actuaries, psychologists, agronomists, pharmacists, medical doctors, nurses, odontologists, and veterinarians. As of October 2007, Mexico had negotiated three MRAs in the framework of NAFTA; accountancy, engineering, and architecture.<sup>33</sup>

The most interesting discussion with respect to the implementation of the NAFTA chapter on cross-border trade in services has to do with the United States-Mexico cross-border trucking commitments taken by the United States. Under Annex I of the NAFTA, the United

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<sup>31</sup> As noted in the WTO Trade Policy Review of Mexico in 2008, the social service provides "an opportunity for students to pay back part of the cost of their education to society and to contribute to the academic training and professional skills development of the social service provider. This requirement also applies to foreigners and Mexicans who studied abroad."

<sup>32</sup> According to the WTO Trade Policy Review of Mexico in 2008, states can also determine "the conditions that must be fulfilled to obtain such a diploma and the authorities responsible for issuing it. In the Federal District, the exercise of professions is governed by the Law Regulating Article 5 of the Constitution passed by the Congress of the Union, the latest amendment." See Law Regulating Article 5 of the Constitution relating to the Practice of Professions in the Federal District, published in the Official Journal on May 26, 1945 (latest amendment published on December 22, 1993).

<sup>33</sup> For more information, see Poblano (2004).

States agreed to allow, three years after the signature of the NAFTA, Mexican motor carriers into the four U.S. bordering states—Arizona, California, New Mexico, and Texas—and Mexico would allow U.S. motor carriers into Mexico's six border states. The second part of the commitment was that six years after the entry into force of the NAFTA, Mexican motor carriers would be entitled to travel throughout the United States and U.S. motor carriers would be entitled to travel throughout Mexico. NAFTA also permitted a Mexican citizen to establish, three years after the signature of the NAFTA, an enterprise in the United States to provide truck services for the transportation of international cargo between points in the United States; and seven years after the date of entry into force of the NAFTA, bus services between points in the United States. NAFTA also kept in place the moratorium on grants of authority for the provision of truck services by persons of Mexico between points in the United States for the transportation of goods other than international cargo.

On December 17, 1995, President Clinton issued an executive order extending the moratorium on cross-border trucking with Mexico, arguing that Mexican motor carriers were not as safe as U.S. motor carriers, therefore requesting more time to evaluate the situation. As a result, the Mexican government initiated a NAFTA Chapter Twenty state-to-state dispute. An arbitration panel was formed, and on February 6, 2001 the panel unanimously concluded that the United States had violated NAFTA by refusing to allow Mexican motor carriers into the four U.S. border states as required by the agreement. The “Panel unanimously determine[d] that the United States. (...) breach[ed its] obligations under Annex I (reservations for existing measures and liberalization commitments), Article 1202 (national treatment for cross-border services), and Article 1203 (most favored nation treatment for cross-border services) of NAFTA. An exception to these obligations is not authorized by the “in like circumstances” language in Articles 1202 and 1203, or by the exceptions set out in chapter nine or under Article 2101.”<sup>34</sup> The panel authorized Mexico to impose economic sanctions on the United States but the newly elected President, George W. Bush, indicated that he would begin admitting Mexican motor carriers into the country by January 1, 2002, which led Mexico to choose not to impose retaliatory tariffs at that time.

In 2001 the U.S. Congress passed Section 350 imposing 22 requirements that the Department of Transportation (DOT) had to fulfill before granting any Mexican motor carrier a

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<sup>34</sup> See <http://www.worldtradelaw.net/nafta20/truckingservices.pdf>.

license to operate in the United States beyond the “commercial zone,” one of which called for all carriers to be physically inspected in Mexico by U.S. inspectors before qualifying for a U.S. operating license.<sup>35</sup> Mexico agreed to the plan in 2006, and shortly after, the DOT began preparing for the opening of the border to some Mexican motor carriers.

On February 23, 2007, the United States announced the “Mexican Truck Demonstration Project,” which would allow 100 approved Mexican-domiciled motor carriers into the United States within 60 days. The plan was based on “reciprocal rights,” covering U.S.-domiciled motor carriers to enter Mexico. In 2007, the U.S. House of Representatives adopted an amendment to the Fiscal Year 2008 Transportation, Treasury, Housing, and Related Agencies Appropriations Act to cut funding from the demonstration project, but President Bush signed the Consolidated Appropriations Act *and* the DOT continued the project. In September 2008, as part of the demonstration project, a few Mexican eighteen-wheeler trucks were permitted to cross the border into the United States to make deliveries in Chicago, Illinois. This decision was followed by numerous protests against the program. The opponents argued that many more Mexican trucks and drivers could soon be on U.S. freeways. On March 3, 2011, a full decade after the NAFTA panel had issued its report, U.S. President Barack Obama and Mexican President Felipe Calderon announced that the two Parties had come to a resolution of this outstanding dispute and that they had reached a preliminary agreement aimed at resolving the bilateral dispute over access of Mexican trucking services to the U.S. market. Finally, on March 11, 2009, Congress removed funding from the project. Mexico retaliated on March 16, 2009 with tariffs on a variety of U.S. agricultural and industrial products. Once the final agreement was reached on July 6, 2011 on a new cross-border trucking program, Mexico announced that it would immediately lower by 50 percent the retaliatory tariffs it had slapped on some U.S. exports. The remaining 50 percent of the value of the tariffs will be suspended when the first Mexican operator is expected to receive operating authority under the new program.

## **4.2 The Experience of Costa Rica**

Costa Rica amended the *Ley de Protección al Representante de Casas Extranjeras*, N° 6209 and repealed Article 361 b) of the *Código de Comercio*, Law No. 3284.<sup>36</sup> The CAFTA-DR liberalizes previous long-standing restrictions on distribution created through dealer protection regimes. The

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<sup>35</sup> See Department of Transportation and Related Agencies Appropriations Act, 2002, Pub. L. No. 108-87, § 350, 115 Stat. 864.

<sup>36</sup> See *Law No. 8629* of November 30, 2007.

regime locked services exporters into exclusive and quasi-permanent relationships with local dealers, making them impossible to break and thus giving incumbent dealers effective monopolies, independent of performance. Under the CAFTA-DR, such dealer protection regimes was modified in Costa Rica so that Parties to future dealer distribution agreements may terminate them without indemnification at the end of the contract period or renewal period. Exclusivity may only be required if agreed and written into the contract, and arbitration is cited as a preferred method to resolve disputes. Therefore, under Annex 11.13 of the CAFTA-DR, which applies bilaterally between the United States and Costa Rica, U.S. suppliers are allowed to contract the terms of their distribution relationship, including the length of the contract and how to calculate indemnity for termination, as well as whether or not it will be an exclusive relationship. Although this component of the CAFTA-DR does not apply multilaterally among the CAFTA-DR Parties, it represents liberalizing reform of the distribution sector in Costa Rica, which did not schedule distribution commitments under the GATS.

### **4.3 The Experience of El Salvador**

In El Salvador, the government adopted the International Services Law (*Ley de Servicios Internacionales*, or LSI). The law is not related to the implementation of the CAFTA-DR Chapter on Cross-Border Trade in Services; rather, it is related to CAFTA-DR Article 3.4.3 under which El Salvador committed to phasing out subsidies on industrial goods in accordance with Article 27.4 of the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) by December 31, 2009. Although an extension was granted to El Salvador and other countries in the phasing out of these subsidies, El Salvador adopted the LSI to ensure that the services benefiting from the Law on Export Processing Zones and Marketing (*Ley de Zonas Francas Industriales y de Comercialización*) would not be affected. The law regulates the establishment and operation of parks and centers with incentives similar to those received by the free zones, including tax exemptions for developers, administrators, and service companies. The LSI covers international distribution, international logistics operations, call centers, information technology, development and research, repair and maintenance of marine vessels and airships, entrepreneurial processes, hospital medical services, and international financial services. Firms operating under the LSI are exempted from income and municipal taxes, as well as from tariffs on imports of capital and intermediate goods.

## **5. Rules on Financial Services**

The financial services sector has evolved at a rapid pace over the last two decades. Improved technology, the opening up of financial systems to international competition, and deregulation have changed the financial landscape. Trade in financial services (cross-border and investment) has also grown rapidly. NAFTA was the first agreement to address financial services in a comprehensive manner in the Americas. The CUSFTA provisions on financial services were, for the most part, concession-based, which means each Party had granted the other limited concessions. With the exception of insurance, national treatment and other key provisions did not cover financial services.

The NAFTA chapter on financial services is independent of the chapters on investment and cross-border trade in services. It is very much self-contained. With respect to investment, the chapter on financial services applies to measures adopted or maintained by a Party relating to financial institutions and other investors of another Party, as well as investments of such investors in financial institutions in the Party's territory. The same is true for the other FTAs covered in this paper. This means, for example, that if an investor of a CAFTA-DR country is a financial institution, or if an investment being made by an investor of another CAFTA-DR country is in a financial institution, the chapter on financial services applies and the investment chapter does not. A financial institution is not defined in terms of the activities that an enterprise carries on; rather, it is defined in terms of how it is regulated in the country in which it is located. If an enterprise carrying on a particular activity is regulated as a financial institution in a CAFTA-DR country, it is covered by the chapter on financial services. If an enterprise carrying on the identical activity in another CAFTA-DR country is not regulated as a financial institution, it is covered by the investment chapter. A financial institution is defined as any financial intermediary or other enterprise that is authorized to do business and regulated or supervised as a financial institution under the law of the Party in whose territory it is located. A financial institution of another Party, including a branch, is one located in the territory of a Party that is controlled by persons of the other Party. It would therefore include a subsidiary of a U.S.-owned bank located in Peru. The definition would also include a financial institution in El Salvador controlled by the incorporated U.S. subsidiary of an enterprise of a non-CAFTA-DR country, such as a European bank. However, it would not include a financial institution controlled by a

U.S. branch of a European bank. Therefore, only subsidiaries from third countries can benefit from these FTAs.

With respect to cross-border trade in financial services, the concept of cross-border trade is identical to the one found in the chapter on cross-border trade in services. It covers cross-border trade as defined by mode 1 under GATS, cross-border supply; mode 2, consumption abroad; or mode 4, presence of natural persons. In NAFTA, financial services are services of a financial nature, including insurance, and services that are incidental or auxiliary to services of a financial nature. In the new FTAs, financial services include any service of a financial nature, and financial services include all insurance and insurance-related services and all banking and other financial services (excluding insurance), as well as services incidental or auxiliary to a service of a financial nature. The definition of financial services is not linked to that of financial institution because, as previously mentioned, a financial institution is defined in terms of how it is regulated. Therefore, a financial service may or may not be provided by a financial institution.

The provision on scope and coverage in the chapter on financial services incorporates a number of articles from the chapters on cross-border trade in services (Denial of Benefits) and investment (Transfers, Expropriation, and Compensation; Special Formalities and Information Requirements; Denial of Benefits; and Investment and Environment). In the CAFTA-DR and the PTPA, the article on transfers and payments related to the chapter on cross-border trade in services is also incorporated. Moreover, the investor-state dispute settlement of the chapter on investment is incorporated into the chapter on financial services solely for claims that a Party has breached the articles on expropriation and compensation, transfers, denial of benefits, or special formalities and information requirements, as incorporated.

The provision on scope and coverage in the new FTAs also states that the chapter on financial services does not apply to measures adopted or maintained by a Party relating to activities or services forming part of a public retirement plan or statutory system of social security, nor does it apply to activities or services conducted for the account or with the guarantee or using the financial resources of the Party, including its public entities. However, the chapter shall apply if a Party allows any of these activities or services to be conducted by its financial institutions in competition with a public entity or a financial institution. Annex 12.1.3(a) of the PTPA further clarifies the language relating to activities or services forming part of a public retirement plan or statutory system of social security. The language in the NAFTA is

very similar, but does not refer to activities conducted in competition between financial institutions or between public and private entities. The new FTAs benefited from being able to include the language of the GATS annex.

In the CAFTA-DR, there is also a two-year period allowing the Dominican Republic and each Central American country to agree on non-conforming measures.

Given that the chapter on financial services covers both investment in financial institutions and cross-border trade in financial services, it is worth highlighting that some obligations apply to both investment and cross-border trade, whereas others cover one or the other. The provisions which apply to investment include the national treatment obligation, which requires each Party to provide to investors of another Party and to investments of the investors in financial institutions treatment that is no less favorable than that it accords, in like circumstances, to its own investors, its own financial institutions, and to investments of its own investors in financial institutions. The national treatment provision covers all phases of an investment from establishment to sale. The NAFTA also contains language on states and provinces (NAFTA Article 1405(4)) not included in the other FTAs, but the most recent FTAs covered in this paper allow the application of the “home-state rule,” under which states can discriminate against banks or insurance companies established in other states. Echandi (2001: 287) notes “countries such as El Salvador and Guatemala were interested in allowing their banking groups to penetrate the U.S. market to serve their Salvadoran and Guatemalan communities. Providing best-in-state treatment would have prevented the United States from applying the home-state rule that traditionally has applied to some financial services.”<sup>37</sup>

The new FTAs also contain a provision on payment and clearing systems setting out the obligation of each Party to provide national treatment by granting financial institutions of another Party established in its territory access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. The text clearly indicates that this obligation is not intended to confer access to the lender of last resort facilities in the host country.

A novel feature included in the most recent FTAs is the article on market access for financial institutions, which is very similar to GATS Article XVI (2) on market access, albeit the limitations on foreign capital in financial institutions were not included. However, unlike the

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<sup>37</sup> Echandi (2010, p. 287).

GATS, the article does not cover cross-border trade in financial services, only investment. Under this article, each Party must refrain from imposing any of the quantitative restrictions listed in the provision (see for example, CAFTA-DR Article 12.4), which “applies horizontally on the basis of a negative list approach, in principle allowing the Parties to list all non-conforming measures.” In the case of the United States-Chile FTA, the approach is slightly different. The article on market access for financial institutions “applies only to commitments in insurance and insurance-related services, following a positive list approach” (R. Sáez, 2010: 150). Annex 12.9 on specific commitments in the United States-Chile FTA borrows from the NAFTA approach and the article on “right of establishment with respect to certain financial services” (NAFTA Article 1403). For banking and other financial services, the approach taken by the Chileans is that of the negative list approach of NAFTA.

The article on new financial services in NAFTA and the other FTAs requires a Party to allow financial institutions of another Party to provide any new financial services that it permits its own financial institutions. The Party may determine the institutional and juridical form through which the service will be provided, and may require authorization for the supply of the service. Under the United States-Chile FTA, as in the EU-Chile FTA, “the introduction of a new financial service is permitted, provided that its introduction does not require the Party to adopt a new law or modify an existing law. However, the regulatory authorities can refuse the authorization only for prudential reasons” (R. Sáez, 2010: 151).

The chapter on financial services includes a provision on senior management and boards of directors. It states that the host country cannot require financial institutions of another Party to engage individuals of any particular nationality as senior managerial or other essential personnel, nor can more than a minority of the board of directors of a financial institution of another Party be composed of nationals of the Party, persons residing in the territory of the Party, or a combination thereof.

The FTAs set out reservations, existing non-conforming measures to the obligations on national treatment, MFN, market access for financial institutions (except NAFTA which does not include this obligation), senior management and boards of directors, and establishment in the cases of the United States-Chile FTA (Annex 12.9) and NAFTA. The concept of “ratcheting” is also included, albeit a note in the non-conforming measures of the United States-Chile FTA indicates that ratcheting does not apply to market access for financial institutions and the right of

establishment of certain financial services. The PTPA has a similar note regarding market access for financial institutions. Chile's chief negotiator for financial services stated that the country "felt some discomfort with ratcheting for requiring a specific juridical form." He noted that "experience in the regulation of financial services shows that requiring a specific juridical form (generally incorporation) is needed to ensure appropriate public disclosure" (R. Sáez, 2010: 151).

There are two specific obligations on cross-border trade in financial services. First, national treatment is granted only to a limited number of services, which are those explicitly covered in an annex to the agreement. Unlike the NAFTA, the new FTAs do not contain a standstill clause. Therefore, except for listed services, there is no limitation on the Parties from adopting more restrictive measures. The second obligation requires Parties to allow consumption abroad, but this obligation does not require a Party to permit services providers from another Party to do business or solicit in its territory. Moreover, without prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration of cross-border financial service suppliers of another Party and of financial instruments.

The following standards apply to both cross-border trade in financial services and to financial institutions, investors, and their investments in financial institutions. First, the provision on MFN treatment obliges the Parties to accord to investors of another Party, financial institutions of another Party, investments of investors in financial institutions, and cross-border financial service suppliers of another Party treatment no less favorable than that it accords, in like circumstances, to the investors, financial institutions, investments of investors in financial institutions and cross-border financial service suppliers of a non-Party. NAFTA and the other FTAs, as is the case in the GATS annex on financial services, allow a Party to recognize prudential measures of another Party or of a non-Party. Such recognition may be accorded unilaterally; achieved through harmonization or other means; or based upon an agreement or arrangement with another Party or a non-Party. The text of the chapter on financial services also stipulates that the Party according recognition of prudential measures shall provide adequate opportunity to another Party to demonstrate that circumstances exist in which there are or will be equivalent regulation; oversight; implementation of regulation; and, if appropriate, procedures concerning the sharing of information between the Parties. Where a Party accords recognition of prudential measures, the Party shall provide adequate opportunity to another Party to negotiate

accession to the agreement or arrangement, or to negotiate a comparable agreement or arrangement. A Party is therefore not bound to accord MFN treatment to another Party. As noted by Echandi (2010: 290), this “provision may be of particular importance for countries such as the United States, which condition the establishment of foreign financial institutions in their territory on compliance with numerous regulatory and prudential requirements.”

Transparency is another obligation of general application in the chapter on financial services. The provision requires that each Party, to the extent practicable, publish in advance any regulations of general application relating to the subject matter of the chapter that it proposes to adopt and provide interested persons and another Party a reasonable opportunity to comment on these proposed regulations. Each Party’s regulatory authorities must also make their requirements available to interested persons, including any documentation required for completing applications relating to the supply of financial services. Decisions on completed applications must be made within 120 days, and the applicant must be promptly notified. Finally, the transparency obligation does not require a Party to furnish or allow access to information on the financial affairs of individual customers or any other confidential information. In addition, in both the CAFTA-DR and the PTPA, each Party commits to promote regulatory transparency in financial services. As noted by Raúl Sáez (2010: 152), the article builds on NAFTA Article 1411 “but goes further in imposing transparency and dialogue on the regulators,” as each Party shall maintain or establish appropriate mechanisms that will respond to inquiries from interested persons regarding measures of general application covered by the chapter. Sáez underlines that there was “some concern (...) about how soon Chile’s agencies and Central Bank would be able to fully comply; [given that] the obligations required setting up special offices and training personnel,” so a two-year grace period after the entry into force of the trade agreement was included in Annex 12.11 of the United States-Chile FTA. In the case of the PTPA, the grace period is 18 months after the entry into force of the agreement (Annex 12.11).

The CAFTA-DR also contains a provision on domestic regulation that states that except with respect to non-conforming measures listed in its Schedule to Annex III, each Party shall ensure that all measures of general application to which the chapter applies are administered in a reasonable, objective, and impartial manner.

All the FTAs include a provision on self-regulatory organizations (SROs) requiring a financial institution or a cross-border financial service supplier of another Party to be a member

of, participate in, or have access to, and SRO to provide a financial service in or into the territory of that Party. The new FTAs state that the Party shall ensure observance of the national treatment and MFN obligations by such SRO. The new FTAs also include a provision on expedited availability of insurance products stating that the Parties recognize the importance of maintaining and developing regulatory procedures to expedite the offering of insurance services by licensed suppliers. In addition, an article on exceptions prevents “limits on the application of measures for prudential reasons” (R. Sáez, 2010: 151). The other exception relates to monetary, credit, and exchange rate policies.

Finally, the chapter on financial services covers both state-to-state disputes and investor-state disputes. In the latter case, if the claimant alleges that the measure that was violated is of a prudential nature, the Financial Services Committee (composed of a representative of each Party’s authority responsible for financial services) will decide the case and its decision will be binding on the tribunal.

In the case of the United States-Chile FTA, the country’s chief negotiator for financial services emphasized that “one major outstanding issue was still unresolved when the financial services chapter was closed: capital controls and the balances-of-payments exceptions.” This issue was finally resolved at the highest political level. Annex 10-C (investment chapter) applies to measures that Chile adopted that could be subject to dispute settlement by U.S. investors when applying a restriction on payments and transfers. The claim must be submitted within one year after the measure is adopted. The objective is to distinguish between volatile and nonvolatile capital flows, “reflecting Chile’s application of the URR [unremunerated reserve requirements] to address the former in the 1990s.” (R. Sáez, 2010: 154). The same language can be found in the PTPA.

## **6. Implementing the Rules on Financial Services**

### **6.1 The Experience of Mexico**

Mexico’s experience with implementing the rules of the chapter on financial services took an unexpected turn with the 1995 financial crisis. Mexico’s reservations for financial services in NAFTA were mostly with respect to the articles on establishment and national treatment restricting foreign investment in existing financial institutions. Mexico included a set of transitional limits that were lifted as part of the government’s response to the crisis.

NAFTA Article 1403 on establishment of financial institutions allowed Canadian and U.S. financial institutions to open subsidiaries in Mexico, subject to foreign market share limits scheduled for gradual elimination by December 31, 1999. Several laws were amended to comply with Article 1403, as well as Article 1405 on national treatment and Article 1408 on senior management and boards of directors.<sup>38</sup> In addition, the Regulations for the Establishment of Affiliates of Foreign Financial Institutions (*Reglas para el Establecimiento de Filiales de Instituciones Financieras del Exterior*) were adopted.<sup>39</sup> During the transition period, subsidiaries were subject to individual and/or aggregate market share limits applicable to each type of institution. “Individual and aggregate market share limits were set for particular affiliates, whereas aggregate market shares were defined for all NAFTA affiliates established in Mexico. Certain intermediaries were not subject to market share limits including securities specialists, general deposit warehouses, management companies of investment companies, foreign exchange firms, bonding companies, and pension fund management companies” (WTO, 1997).

As a result of the financial crisis, the Mexican government instituted a number of capitalization and debt-relief programs, and passed financial reform legislation in March 1995, liberalizing ownership and capital limit requirements for banks. The government lowered the amount of equity a NAFTA investor would need to hold for a bank to be considered a NAFTA affiliate from 99 percent to 51 percent.

In terms of maximum market share of Canadian and U.S. institutions, initially NAFTA set an individual limit of 1.5 percent of the banking sector’s aggregate capital and an aggregate limit of 8 percent. The individual limit was to remain constant during the transition period (January 1, 1994– December 31, 1999), whereas the aggregate limit was scheduled to increase from 8 percent in 1994 to 15 percent by January 1, 2000. NAFTA also imposed a permanent limit on the size of NAFTA bank affiliates, a permanent market share limit of 4 percent.

The financial reform legislation of 1995 allowed the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público, or SHCP) to authorize on a case-by-case basis the acquisition by NAFTA-based banks of Mexican banks that exceeded the 1.5 percent (during

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<sup>38</sup> The Credit Institutions Law (*Ley de Instituciones de Crédito*), the Securities Market Law (*Ley del Mercado de Valores*), the Law to Regulate Financial Groups (*Ley para regular las Agrupaciones Financieras*), the General Law on Organizations and Auxiliary Credit Activities (*Ley General de Organizaciones y Actividades Auxiliares del Crédito*), the Investment Company Law (*Ley de Sociedades de Inversión*), the Federal Law on Bonding Institutions (*Ley Federal de Instituciones de Fianzas*), and the General Law of Insurance Companies and Mutual Institutions (*Ley General de Instituciones y Sociedades Mutualistas de Seguros*). The Credit Institutions Law (*Ley de Instituciones de Crédito*) was also amended to comply with Article 1407 on new financial services and data processing.

<sup>39</sup> *Reglas para el Establecimiento de Filiales de Instituciones Financieras del Exterior* of April 21, 1994.

the NAFTA transition) and 4 percent market (which was supposed to be permanent as of January 1, 2000) share limit. The individual and aggregate market limits were to still apply to new establishments of financial institutions. The 1995 reforms raised the aggregate capital limit to 25 percent for NAFTA-based banks, including the capital of acquired banks authorized by SHCP on a case-by-case basis.

In January 1999, the Credit Institutions Law (*Ley de Instituciones de Crédito*), the Securities Market Law (*Ley del Mercado de Valores*), and the Law to Regulate Financial Groups (*Ley para Regular las Agrupaciones Financieras*) were amended in order to allow foreign investment to participate up to 100 percent in the capital of commercial banks, financial groups, securities brokerage firms, and securities market specialists. However, the total percentage of foreign investment in other financial institutions (including general deposit warehouses, financial leasing companies, financial factoring companies, currency exchange houses, and insurance and bonding institutions) remains limited to 49 percent of the paid-up capital. Mexico does not allow foreign investment in credit unions and development banks (WTO, 2002). The reform resulted in a major increase in foreign participation. The share of foreign-controlled banks in total assets rose from 24 percent in 1998 to above 80 percent today, “which makes Mexico the country with the largest ratio of foreign bank ownership in Latin America” (WTO, 2008).

## **6.2 The Experience of Chile**

With the exception of its law allowing the establishment of insurance companies as branches, Chile did not have to modify any law in order to comply with the obligations in the chapter on financial services. The change in legislation with respect to this insurance law was introduced in the context of reforms to the capital market discussed by Chile’s National Congress. In fact, the legislative passage of the financial services commitments was largely uneventful, because two very sensitive issues had been avoided. The most controversial request from the United States during the negotiation was the elimination of the prohibition on direct branching for U.S. banks and insurance companies. Chile did not agree to the request and direct branching is not allowed in Chile (R. Sáez, 2010). Nonetheless, Chile agreed to allow the establishment of U.S. insurance companies as branches in Chile but this commitment does not include direct branching. Chile’s chief negotiator for financial services noted “Chile can choose how to regulate branches, including their characteristics, structure, relationship to their parent company, capital

requirements, technical reserves, and obligations regarding risk patrimony and their investments. The capital of these branches will be separated from that of the parent, as is currently the case of foreign banks branches established in Chile” (R. Sáez, 2010: 154).

The other main request had to do with lifting the limit on investment abroad of pension funds. In fact, the “United States requested the lifting of the limit on investment in foreign financial instruments, arguing that the limitation was something similar to a performance requirement and a trade barrier for U.S. asset management firms willing to supply Chilean pension funds” (R. Sáez, 2010: 156). Given that at the time the Chilean government was already trying to lift that limit through domestic legislation, and that certain U.S. pension funds had similar limitations, Chile rejected this request.

### **6.3 The Experience of El Salvador**

El Salvador was already quite open to foreign investment in the financial sector before the CAFTA-DR negotiations. The country had participated in the financial services negotiations at the multilateral level, and had accepted the Fifth Protocol annexed to the GATS, incorporating it into its legislation by means of Legislative Decree No. 653 of 13 March 1999, published in the Official Journal No. 97 of May 26, 1999. El Salvador committed to granting access to foreign financial institutions through the establishment of branches or participation in the ownership of domestic banks and to financing houses up to a maximum of 75 percent of the capital, “provided that they are prime institutions and subject to prudential regulation and supervision in their countries of origin.” In the case of foreign natural persons, the maximum percentage is 25 percent (WTO, 2010). However, insurance branching was not allowed.

As a result of CAFTA-DR, El Salvador agreed to lift insurance branching restrictions within three years.<sup>40</sup> In El Salvador, insurance companies must be organized and operate in the form of closed end public limited companies of indefinite duration with their capital divided into registered shares. The Law on Insurance Companies (*Ley de Sociedades de Seguros*, Decree No. 844 of October 21, 1996) and its amending legislation, in particular Decree Laws No. 893 of November 21, 1996 and No. 910 of December 14, 2005 authorize branches of foreign insurance companies that were operating in El Salvador at the time of its enactment to continue operating, but does not permit the establishment of new branches (WTO, 2010).

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<sup>40</sup> See Annex III of the CAFTA-DR, Schedule of El Salvador, Section A, p. III-ES-5. For Guatemala, Nicaragua and the Dominican Republic, the restrictions were to be eliminated within four years.

On portfolio management services, the CAFTA-DR includes a specific commitment to permit the cross-border provision of portfolio management services by asset managers located abroad to collective investment schemes located in another Party. El Salvador agreed to adopt necessary laws and regulations within four years of the entry into force of the agreement.<sup>41</sup> Annex 12.9.2 of the CAFTA-DR (Specific Commitments, Section C) states “El Salvador shall allow a financial institution (other than a trust company), organized outside its territory, to provide investment advice and portfolio management services, excluding (a) custodial services, (b) trustee services, and (c) execution services that are not related to managing a collective investment scheme, to a collective investment scheme located in the territory of El Salvador.” The CAFTA-DR text also underlines that “the Parties recognize that El Salvador does not currently have legislation regulating collective investment schemes, and no later than four years after the date of entry into force of the Agreement, El Salvador will implement adopt a Special Law regulating collective investment schemes.

#### **6.4 The Experience of Costa Rica**

In contrast to the other CAFTA-DR countries, Costa Rica already had laws in place regulating collective investment schemes at the time of the CAFTA-DR negotiations: the *Ley Reguladora del Mercado de Valores*, No. 7732 of December 17, 1997 in the case of investment funds, and *Ley de Protección al Trabajador*, No. 7983 of February 18, 2000 in the case of pension funds and complementary pension funds.

The key reform Costa Rica agreed to in the financial sector in CAFTA-DR is the elimination of the state monopoly in insurance, which had been in existence since 1924 through the National Insurance Institute (*Instituto Nacional de Seguros*, or INS). First, Costa Rica agreed to enact a law that established an independent insurance regulatory authority separate from and not accountable to any supplier of insurance services, with adequate legal powers, legal protection, and financial resources. Second, Costa Rica agreed to allow, on a non-discriminatory basis, insurance service suppliers of any Party to establish and effectively compete to supply insurance services directly to the consumer in its territory for all lines of insurance, except compulsory automobile and occupational risk insurance, by January 1, 2008, and the latter two types of insurance by January 1, 2011. By no later than the entry into force of the agreement,

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<sup>41</sup> The Dominican Republic agreed to the same time table, whereas Guatemala and Nicaragua agreed to implement commitments as soon as the appropriate laws are passed and regulations established.

Costa Rica agreed to liberalize the purchase of all types of insurance, except compulsory automobile and occupational risk insurance by Costa Ricans abroad (akin to mode 2 in the GATS). The country made more limited commitments on the supply of insurance on a pure cross-border basis (akin to mode 1 in the GATS), in the latter case only relating to space launching of freight (including satellite), maritime shipping, and commercial aviation. Such insurance covers any or all of the following: the goods being transported, the vehicle transporting the goods and any liability arising there from; insurance risk relating to goods in international transit; retrocession and reinsurance, services necessary to support global accounts, auxiliary insurance services, and insurance intermediation services are liberalized, which means that these services can be supplied by cross-border insurance suppliers without establishment in Costa Rica and that those suppliers can indeed solicit Costa Ricans for business.<sup>42</sup>

As noted by Echandi (2010: 295), the main result of the CAFTA-DR was the establishment of a regulatory authority for insurance and the ability for the INS to “compete on equal footing with private services suppliers in the [Costa Rican] insurance market.” For the United States, one of the key objectives from the beginning of the CAFTA-DR negotiations was the opening of the insurance sector in Costa Rica. The United States had two additional objectives: for Costa Rica to allow financial services providers to establish branches in the country and to level the playing field between public and private banks in the country. But as highlighted by Echandi (2010: 269), “in the end, the United States opted for gradual access to the Costa Rica insurance market and gave up its intention of obtaining branching with respect to any other financial services and leveling the playing field between public and private banks in Costa Rica.” In fact, the introduction of several bills in Costa Rica’s Legislative Assembly addressing these two issues facilitated this decision by the United States. In addition, in a side letter to the CAFTA-DR, Costa Rica stated that it would make “reasonable efforts” to pursue those reforms in the legislative assembly.<sup>43</sup>

Unlike telecom, the formal request for the liberalization of the Costa Rican insurance sector came late in the game in the CAFTA negotiations, albeit the United States had expressed interest in the opening of the insurance sector since the beginning of the negotiations. On December 15, 2003, two days before the end of what was supposed to be the last negotiating round, the United States tabled a proposal seeking the liberalization of the insurance sector in

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<sup>42</sup> See Annex 12.9.2 of the CAFTA-DR, Section H: Specific Commitments of Costa Rica on Insurance Services.

<sup>43</sup> Also see the side letter at: [http://www.sice.oas.org/trade/cafta/caftadr\\_e/asset\\_upload\\_file792\\_3970.pdf](http://www.sice.oas.org/trade/cafta/caftadr_e/asset_upload_file792_3970.pdf).

Costa Rica. Trade Minister Alberto Trejos underlined that the U.S. insurance liberalization proposal was put forward too late for Costa Rica to complete the necessary technical work in time to conclude negotiations during that round. While the other four Central American countries concluded their negotiation on a comprehensive CAFTA-DR deal with the United States on December 17, 2003, the Costa Rican delegation went home to seek further guidance from their capital on making a number of concessions.

By the December negotiating round, the Costa Ricans had drafted a text for the gradual and selective market opening of private network services, Internet services, and mobile wireless services. However, along with needing more time to study the U.S. proposal on insurance, they also wanted to get a better deal on textiles and agriculture, including sugar, poultry, beef, pork, onions, and potatoes. Costa Rica's trade minister told *Inside U.S. Trade* "when free trade agreement negotiations between the U.S. and Costa Rica reconvene in January [2004], Costa Rica will be looking to the U.S. for improved market access offers on textile and agricultural products. Otherwise, it will be difficult for Costa Rica to open up its telecommunications and insurance markets."<sup>44</sup>

Tactics used by the Costa Rican negotiating team gave it leverage. All along the negotiations the Costa Ricans had briefed members of their private sector, and had emphasized the need for a balanced agreement. With a view to affecting the negotiation outcome to its advantage and with the full support of its private sector, Costa Rica withheld its signature from a CAFTA-DR deal. Good managerial and organizational skills, as well as solid technical expertise, strengthened its choice of tactics and increased its bargaining leverage.

The United States and Costa Rica reconvened negotiations and reached a deal on January 25, 2004. For Costa Rica, the biggest difference on insurance between what was on the table in December and what was agreed to in January was that the country wanted to be allowed to develop a regulatory framework before opening its market, according to a Central American official.<sup>45</sup>

The decision to liberalize the insurance sector in Costa Rica was not as difficult as it was in the case of telecom. Although there was a state monopoly providing insurance services, there were many loopholes in practice that allowed, for example, Costa Ricans to buy insurance abroad and for multinationals doing business in Costa Rica to be covered by their parent

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<sup>44</sup> Inside U.S. Trade, January 2, 2004.

<sup>45</sup> Inside U.S. Trade, January 30, 2004.

company's insurance contracts. Moreover, the liberalization of insurance services did not ignite the same type of opposition because trade unions representing the employees of the state-owned monopoly lacked the political clout of their telecom colleagues.

The three main laws governing the Costa Rican insurance sector at the time of the CAFTA-DR negotiations were the *Ley de Monopolio del Instituto Nacional de Seguros* (Law No. 12), *Ley de Reorganización del Instituto Nacional de Seguros* (Law No. 33), and the *Ley de Monopolio de Reaseguros* (Law No. 6082). They granted the INS a monopoly over all types of insurance, including life insurance, damage and civil liability, and reinsurance. The sector did not have a regulatory body at the time of the CAFTA-DR negotiations.

Costa Rica had not completed the implementation of the agreement by the time of the referendum on the CAFTA-DR, which took place on October 7, 2007. This was the first public referendum on trade agreement. The CAFTA-DR entered into force in Costa Rica on January 1, 2009, approved by a 52-48 margin, where three-fifths of the eligible population exercised their right to vote.

To implement its obligations in the insurance sector, Costa Rica enacted the Insurance Market Statute No. 8653 (*Ley Reguladora del Mercado de Seguros*, or LRMS),<sup>46</sup> which “provides, among other things, the regulatory framework for: (i) authorizing, regulating, supervising, and developing insurance, reinsurance, insurance intermediation, and auxiliary service activities; and (ii) supervising consumer rights.” The law also “creates the necessary conditions for both developing the insurance market and guaranteeing effective market competition among the participating entities in this market” (Araya, 2010). It ended the INS monopoly over the insurance sector amending Law No. 12 and repealing Law No. 33.<sup>47</sup>

In addition, the new law created the General Insurance Superintendence (*Superintendencia General de Seguros*, or SUGESE) as the key regulatory body in the insurance sector. SUGESE operates under the framework of the National Council for the Supervision of

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<sup>46</sup> The law was published in the Official Gazette (*Alcance N° 30 a La Gaceta N° 152*) on August 7, 2008.

<sup>47</sup> The law also amends other laws such as the Law of Financial Management and Public Budgets (*Ley Administración Financiera y Presupuestos Públicos*) 81831 of September 18, 2001; Law of the INS Fire Brigade (*Ley del Cuerpo de Bomberos del INS*), 8228 of March 19, 2002; Law of Integral Reform on Stupefacients, Psychotropic Substances, Nonauthorized Use of Drugs and Connected Activities (*Ley Reforma Integral de la Ley sobre estupefacientes, sustancias psicotrópicos, drogas de uso no autorizado y actividades conexas*), 8204 of November 26, 2001; the Market Securities Regulating Law (*Ley Reguladora del Mercado de Valores*), 7732 of December 17, 1997; the Exonerations Regulating Law, its repeal and exceptions (*Ley Reguladora de exoneraciones vigentes, su derogatoria y sus excepciones*), 7293 of March 31, 1992; and the Law of Competition Promotion and Effective Consumer's Defense (*Ley Promoción de la Competencia y defensa efectiva del Consumidor*), 7422 of December 20, 1994. In addition to Law No. 33, it also repeals Article 9 of the Market Securities Regulating Law (*Ley Reguladora del Mercado de Valores*), 7732 of December 17, 1997; Article 39 of the Complementary Pensions Private Regime Law and amendments to the Market Securities Regulating Law and Code of Commerce (*Ley Régimen privado de pensiones complementarias y reformas de la Ley Reguladora del Mercado de Valores y el Código de Comercio*), 7523 of July 7, 1995; and Article 124 of the Organic Law of the Central Bank of Costa Rica (*Ley Orgánica del Banco Central de Costa Rica*), 7558 of November 3, 1999.

the Financial System (*Consejo Nacional de Supervisión del Sistema Financiero*, or CONASSIF), and is funded by the Central Bank of Costa Rica. To allow time for the establishment of SUGESE, the Pension Superintendence (*Superintendencia de Pensiones*, or SUPEN) performed its activities during an 18-month transition period.

The only entities that can operate in the Costa Rican insurance market are those complying with the minimum capital and suitability requirements established by Law No. 8653 and its corresponding regulation. The following entities are subject to an authorization process: insurance entities, reinsurance entities, insurance brokerage companies, insurance agency companies, and representation offices. It is also necessary to register insurance policies, technical notes, and related auxiliary services. SUGESE must accredit insurance brokers and insurance agents (Araya, 2010).

The regulations implementing Law No. 8653 include, among others, the following:

- The Regulation on Authorization, Registration, and Operation Requirements for Supervised Entities by SUGESE (*Reglamento sobre Autorizaciones, Registros y Requisitos de Funcionamiento de Entidades Supervisadas por la Superintendencia General de Seguros*),<sup>48</sup> which covers the requirements; the authorization process; the analysis areas; SUGESE's evaluating criteria that must be followed when examining the administrative authorization requests; and the operating requirements that the supervised entities must follow after registration; and
- The Regulation on Capital Requirements for Insurance and Reinsurance Entities (*Reglamento sobre la Solvencia de Entidades de Seguros y Reaseguros*), which covers everything related to assets and liabilities; evaluation of supervised entities; minimum income and capital requirement; technical provisions; reserves; and the asset investment regime to support it.<sup>49</sup>

Other decrees and regulations were also adopted, including the following:<sup>50</sup>

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<sup>48</sup> Issued by CONASSIF. Article 6 of the *Acta* N° 744-2008 dated September 18, 2008 and published in the Official Gazette (*La Gaceta*) N° 184 on September 24, 2008.

<sup>49</sup> Issued by CONASSIF. Article 7 of the *Acta* N° 744-2008 dated September 18, 2008 and published in the Official Gazette (*La Gaceta*) N° 184 on September 24, 2008.

<sup>50</sup> *Decreto sobre aplicación de la garantía estatal a favor del Instituto Nacional de Seguros*, Executive Decree N° 34924-MP-H-COMEX of November 26, 2008, published in the Official Gazette (*La Gaceta*) N° 237 of December 8, 2008. There is also the *Reglamento general sobre sociedades administradoras y fondos de inversión*. Article 28 of the *Acta* 569-2006 of CONASSIF, held on April 6, 2006, published in the Official Gazette (*La Gaceta*) N° 87 of May 8, 2006. 3). Finally, there is the Reform to the Agreement SP-A-036 "*Requisitos y procedimientos de aprobación para la utilización de administradores de cartera por parte de las entidades reguladas*," SP-A-120 of SUPEN.

- The Regulation of Insurance Trade (*Reglamento de Comercialización de Seguros*), which regulates all insurance entities, intermediaries, operators, and international providers and establishes the insurance intermediaries' obligations with their clients; minimum parameters of information provided to the customer; dispute resolutions; claims related to activities performed by insurance companies and their intermediaries; and the requirements for individuals to participate as intermediaries;
- The Regulation on Dispute Resolution (*Reglamento de Reclamaciones*), which establishes the structure for consumers and insurance companies to resolve their differences related to indemnifications/compensations.

As of December 2010, SUGESE had authorized five insurance companies to compete with the former monopoly state insurance provider, including *Seguros del Magisterio*, America Life Insurance Company (Alico), *ASSA Compañía de Seguros*, Pan American Life Insurance de Costa Rica, and *MAPFRE Seguros de Costa Rica*. New competitors may also enter the market in 2011, when compulsory automobile and occupational risk insurance are liberalized.

## **6.5 The Experience of Peru**

The financial services sector in Peru was already liberalized at the time of the PTPA negotiations, which means that very few changes were necessary to implement the Trade Promotion Agreement. The Supervisory Authority for Banks, Insurance, and Pension Funds (SBS) (*Superintendencia de Banca, Seguros y AFP*), established in 1931, had been responsible for regulating and monitoring companies in the financial system for many years, including in the insurance and private pensions sectors. Its goals, functions, and responsibilities are detailed in Law No. 26702, the General Law on the Financial System and the Insurance System and the Organic Law on the SBS (*Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia*), which contains the main legal provisions with respect to the financial services sector.

The SBS regulates private banking companies, financing institutions, nonbank microfinance institutions, government-owned institutions (Bank of the Nation, Development Financing Corporation, Agricultural Bank), financial leasing companies, insurance companies, and pension funds (AFP).

Legislative Decree 1052, published on June 27, 2008, is the main piece of legislation that served to implement Peru's obligations under the chapter on financial services of the PTPA.<sup>51</sup> It amended articles 11, 20, 21, 22, 39, 42, 43–49, 52, 81 and 92 of Law No. 26702, the name of Title IV of the third section of the same law, and article 335. It also repealed articles 291 and 292. Essentially, Decree 1052 allows for the cross-border provision of certain financial services (insurance related to maritime shipping and commercial aviation, space launching, and freight, among others), as indicated in Peru's commitments in cross-border trade in Annex 12.5.1 of the PTPA. It also removes the economic needs test (Article 12.4) for representatives of foreign financial institutions, and regulates representatives of foreign insurance companies. Moreover, it allows foreign financial institutions covered by Law No. 26702 to be established in Peru through branches. With respect to issues regarding transparency (Article 12.11 of the PTPA), Decree 1052 modifies the SBS process of granting authorizations to operate in Peru. Specifically, the decree requires that the SBS explain the reasons in case of a denial, given that the PTPA states that "on the request of an unsuccessful applicant, a regulatory authority that has denied an application shall, to the extent practicable, inform the applicant of the reasons for denial of the application" (Article 12.11.11). The same applies if the denial is related to the position of director general, manager, or chief executive officer of a supervised company.

The other main decree related to the implementation of the PTPA in financial services is Legislative Decree No. 1028, published on June 22, 2008, which also amends Law No. 26702. It includes regulations to follow the recommendations of Basel II related to capital measurement and capital standards, and implemented PTPA commitments related to transparency. More specifically, it states that the SBS shall, to the extent practicable, publish in advance any regulations of general application relating to the subject matter of Law No. 26702 that it proposes to adopt and the purpose of the regulations, and provide interested persons a reasonable opportunity to comment on the proposed regulations. When adopting regulations, the SBS should address in writing substantive comments received from interested persons with respect to the proposed regulations, and should allow reasonable time between publication of final regulations and their effective date.

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<sup>51</sup> Its official title is "*Decreto Legislativo que modifica la Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros, Ley N° 26702, para incluir las disciplinas del acuerdo de promoción comercial entre el Perú y los Estados Unidos de América.*"

Other legislative decrees were also passed, albeit the changes they implemented were not specifically related to the PTPA. Legislative Decree 1008, published on May 6, 2008, amended provisions of the Law of the Private Pension Fund Management (*Texto Único Ordenado de la Ley del Sistema Privado de Administración de Fondos de Pensiones*), approved by Supreme Decree N ° 054-97-EF, referring to the minimum yield and the overall investment limits. It also amended articles 23 and 25-D to cover potential losses that private administrators of pension funds (AFP) can generate through fraud or negligence. The decree also promotes investment in securities issued by entities whose economic activity is mainly performed abroad by increasing the limit from 20 percent to 30 percent of the managed fund. Another decree not specifically related to the implementation of the PTPA is Legislative Decree No. 1061, published on June 28, 2008. It modifies the Securities Market Law, and establishes the following transparency obligations that the National Commission Supervisory of Enterprises and Securities (CONASEV) shall comply with: i) to publish in advance any regulations of general application that it proposes to adopt, as well as the purpose of the regulations, ii) to provide interested persons a reasonable opportunity to comment on the proposed regulations, iii) at the time it adopts final regulations, to address in writing substantive comments received from interested persons with respect to the proposed regulations and to allow reasonable time between publication of final regulations and their effective dates.

Legislative Decrees 1063 and 1046 are two other decrees not specifically related to the PTPA implementation. Legislative Decree 1063, published on June 28, 2008, approves the Government Procurement Act by the Commodity Exchange (*Ley de Adquisiciones Estatales a través de la Bolsa de Productos*). This decree aims at improving the competitiveness of agricultural production by authorizing any government entity to buy goods through the commodity exchanges supervised by CONASEV. Legislative Decree 1046, published on June 26, 2008, includes amendments to Legislative Decree No. 862, the Law on Investment Funds and their Management Companies (*Ley de Fondos de Inversión y sus Sociedades Administradoras*), with an objective of reducing administrative costs and facilitating the participation of companies in the stock market to allow greater competition. The decree also offers greater protection and better conditions to stock market investors.

## 7. Rules on Telecommunications

The opening of the telecom sector to competition in the 1990s convinced numerous WTO members of the need to elaborate a set of regulatory principles and to establish separate entities as regulators to ensure regulatory neutrality towards all market participants. In fact, during the Uruguay Round negotiations, concerns related to establishing a regulatory environment conducive to market entry were discussed at length. Several participants suggested that regulatory disciplines might be inscribed as additional commitments in schedules as a way of safeguarding the value of market-access commitments undertaken. Post-Uruguay Round, WTO members succeeded in elaborating a set of principles covering matters such as competition safeguards, interconnection guarantees, transparent licensing processes, and the independence of regulators in a commonly negotiated text called the WTO Reference Paper of April 24, 1996.<sup>52</sup>

At the regional level in the Americas, NAFTA was the first trade agreement to include a code of regulatory behavior on telecommunications, but as NAFTA Chapter Thirteen was negotiated before the WTO Reference Paper, it does not cover all the issues addressed in the reference paper. NAFTA builds on CUSFTA Annex 1404.C, and applies to measures relating to access to public networks and basic services within a NAFTA country by persons of other NAFTA countries, the terms upon which persons of other NAFTA countries may provide enhanced services within or into a NAFTA country and standards respecting the attachment of terminal and other equipment to the public network in each NAFTA country. Moreover, except to ensure that persons operating broadcast stations and cable systems have continued access to and use of public telecommunications transport networks and services, NAFTA Chapter Thirteen does not apply to any measure adopted or maintained by a Party relating to cable or broadcast distribution of radio or television programming. NAFTA 1301 sets out limitations on the scope and coverage of the chapter. Nothing in the chapter on telecommunications shall be construed to a) require a Party to authorize a person of another Party to establish, construct, acquire, lease, operate, or provide telecommunications transport networks or services; b) require a Party, or require a Party to compel any person, to establish, construct, acquire, lease, operate, or provide telecommunications transport networks or services not offered to the public generally; c) prevent

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<sup>52</sup> The Ministerial Decision on Negotiations of Basic Telecommunications, adopted in Marrakesh on April 15, 1994, allowed negotiations on basic telecommunications to continue beyond the conclusion of the Uruguay Round. As a result, the talks resumed in May 1994 and ended in February 1997, with new commitments by 69 WTO members. The Fourth Protocol of the GATS, adopted on April 30, 1996, entered into force on February 5, 1998. These negotiations also resulted in the WTO Reference Paper, a set of regulatory principles for WTO members to consider adopting in their schedules of basic telecommunications commitments. By the end of the negotiations on basic telecommunications, 63 WTO members included commitments on regulatory disciplines, and 57 of these committed to the principles of the reference paper.

a Party from prohibiting persons operating private networks from using their networks to provide public telecommunications transport networks or services to third persons; or d) require a Party to compel any person engaged in the cable or broadcast distribution of radio or television programming to make its cable or broadcast facilities available as a public telecommunications transport network.

NAFTA 1303 covers enhanced services. It requires that any licensing, permit, registration, and other procedure respecting the provision of enhanced services be transparent and non-discriminatory, and that the provision of information under such procedures be confined to demonstrating financial solvency and compliance with applicable standards or technical regulations. NAFTA 1303 also prevents the Parties from requiring providers of enhanced services to offer their services to the public generally, cost-justify their rates, file a tariff, interconnect with any particular customer or public network, or conform to any standard other than that relating to interconnecting with a public network. NAFTA 1304 sets out requirements respecting standards relating to the attachment of terminal and other equipment to public networks.

NAFTA also includes a provision on monopolies, which states that where a Party maintains or designates a monopoly to provide public telecommunications transport networks or services, and the monopoly, directly or through an affiliate, competes in the provision of enhanced or value-added services or other telecommunications-related services or telecommunications-related goods, the Party shall ensure that it does not use its monopoly position to engage in anticompetitive conduct in those markets, either directly or through its dealings with its affiliates, in such a manner as to affect adversely a person of another Party. Such conduct may include cross-subsidization, predatory conduct, and the discriminatory provision of access to public telecommunications transport networks or services. Moreover, NAFTA also indicates that to prevent such anticompetitive conduct, each Party shall adopt or maintain effective measures, such as accounting requirements; requirements for structural separation; rules to ensure that the monopoly accords its competitors access to and use of its public telecommunications transport networks or services on terms and conditions no less favorable than those it accords to itself or its affiliates; or rules to ensure the timely disclosure of technical changes to public telecommunications transport networks and their interfaces.

In addition to provisions on transparency and on the relation to other chapters (where the chapter on telecom shall prevail to the extent of any inconsistency with another chapter), and an article on definitions, NAFTA also includes a provision on “Relation to International Organizations and Agreements” where the Parties recognize the importance of international standards for global compatibility and interoperability of telecommunication networks or services and promote those standards through the work of relevant international bodies, including the International Telecommunication Union and the International Organization for Standardization. NAFTA also includes an article on technical cooperation and other consultations where the Parties shall cooperate in the exchange of technical information, the development of government-to-government training programs and other related activities to encourage the development of interoperable telecommunications transport services infrastructure. In implementing this obligation, the Parties shall give special emphasis to existing exchange programs. In the second paragraph of this provision, NAFTA Parties agree to consult with a view to determining the feasibility of further liberalizing trade in all telecommunications services, including public telecommunications transport networks and services.

The new FTAs covered in this paper build on the WTO Reference Paper and contain more extensive telecom regulatory principles than NAFTA. On scope and coverage, the chapter in the United States-Chile FTA applies to measures adopted or maintained by a Party relating to (a) access to and use of the public telecommunications *network* and services and (b) obligations of *major suppliers* of public telecommunications services, whereas the CAFTA-DR and the PTPA do not make reference to public telecommunications networks and the obligation in (b) above, but instead they apply to suppliers of telecommunications services more broadly. The three chapters also apply to the provision of information services and other measures relating to public telecommunication networks or services. Measures relating to broadcast or cable distribution of radio or television programming are excluded from coverage, except to ensure that enterprises operating broadcast stations and cable systems have continued access to and use of public telecommunications networks (United States-Chile FTA only) and services. Moreover, as in NAFTA, the agreements set out limitations on the scope and coverage of the chapter. Finally, one important note is that the chapter on telecommunications in the CAFTA-DR does not apply to Costa Rica; instead the country undertook specific commitments set out in Annex 13.

With respect to access to and use of public telecommunications *networks* (NAFTA and the United States-Chile FTA) and services, under all the agreements enterprises of another Party must have access to and use of any public telecommunications service, including leased circuits, offered in the territory of a Party or across its borders, on reasonable and non-discriminatory terms and conditions. Each Party shall also ensure that enterprises of another Party are able to use public telecommunications services for the movement of information contained in databases or stored in machine-readable form. Parties to the agreements are also permitted to take measures to (a) ensure the security and confidentiality of messages or (b) protect the privacy of nonpublic personal data of subscribers to public telecommunications services, as long as these measures are non-discriminatory. The only conditions that a Party may impose on access to and use of public telecommunications networks or services are those related to safeguarding the public services responsibilities of providers of public telecommunications networks or services, in particular those related to universal service, and to protect the technical integrity of public telecommunications networks or services. Such conditions may include: (a) a requirement to use specified technical interfaces and (b) a licensing, permit, registration, or notification procedure that is transparent and an expeditious process to file the applications there under, CAFTA-DR and the PTPA state that applications have to be filed in accordance with the Party's national law or regulation.

The new FTAs cover the obligations relating to interconnection with suppliers of public telecommunication services and those relating to major suppliers in articles 3 and 4 of the chapter on telecommunications, respectively. With respect to interconnection, under the new FTAs, suppliers of public telecommunications services in the territory of a Party must be able to provide, directly or indirectly, interconnection with the suppliers of public telecommunications services of another Party. These suppliers must be required to take reasonable steps to protect the confidentiality of commercially sensitive information of, or relating to, suppliers and end-users of public telecommunications services and only use such information for the purposes of providing those services. The United States-Chile FTA clarifies that this is to be done in accordance with the Party's domestic law. The CAFTA-DR requires each Party to provide its telecommunications regulatory body the authority to require public telecommunications suppliers to file their interconnection contracts. The new FTAs also define (a) the general terms and conditions for interconnection between *major* suppliers and the facilities and equipment of

suppliers of public telecommunications services; (b) options for interconnecting with major suppliers; (c) public availability of interconnection offers; (d) public availability of the procedures for interconnection; and (e) public availability of interconnection agreements with major suppliers. For a CAFTA-DR Party that does not have an existing commitment under the GATS to ensure that a major supplier in its territory provides interconnection at cost-oriented rates, an equivalent obligation in CAFTA-DR becomes effective two years after the date of entry into force of the agreement, or January 1, 2007, whichever comes sooner. The agreement establishes conditions for setting interconnection rates in the transition period (Annex 13.4.5).

Under the new FTAs, major suppliers are required to accord suppliers of public telecommunications services of another Party non-discriminatory treatment. Such treatment is not qualified in the United States-Chile FTA, whereas in the CAFTA-DR and the PTPA it should be no less favorable than that accorded to the major supplier's subsidiaries, their affiliates, or any nonaffiliated service supplier. On competitive safeguards, the new FTAs also limit anticompetitive practices by major suppliers, such as anticompetitive cross-subsidization, using information obtained from competitors with anti-competitive results and not making available, on a timely basis, to suppliers of public telecommunications services, technical information about essential facilities and commercially relevant information.

On unbundling of network elements, major suppliers are required, under the new FTAs, to provide suppliers of public telecommunications services of another other Party access to network elements, including leased circuit services, on an unbundled basis on terms and conditions and at cost-oriented rates that are reasonable and non-discriminatory for the supply of public telecommunications services. In addition, the CAFTA-DR and the PTPA require the terms, conditions, and cost-oriented rates to be transparent. The Parties to the agreements are free to determine which network elements may be required to be made available in their territories and the suppliers that may obtain such elements, as long as this is done in accordance with national law and regulations. The United States-Chile FTA further limits this provision by specifying the criteria that should be applied by the competent body in determining the network elements to be made available. It states that at a minimum a Party's competent authority shall consider "whether access to such network elements as are proprietary in nature is necessary, and whether the failure to provide access to such network elements would impair the ability of suppliers to public telecommunications services of the other Party to provide the services they

seek to offer; or other factors as established in national law or regulation, as that body construes these factors.”

On co-location, under the new FTAs, major suppliers must ensure to suppliers of public telecommunications services of another Party physical co-location of equipment necessary for interconnection on terms and conditions at cost-oriented rates that are reasonable and non-discriminatory. The texts differ, however, in that the CAFTA-DR and the PTPA require that the terms and conditions of supply also be transparent. The United States-Chile FTA, on the other hand, stipulates that major suppliers must also provide to suppliers access to unbundled network elements on terms and conditions at cost-oriented rates that are reasonable and non-discriminatory.

On resale, the texts of the new FTAs require that the Parties ensure that major suppliers in their territories offer for resale to suppliers of public telecommunications services of another Party, reasonably priced public telecommunications services that such major suppliers provide at retail to end-users that are not suppliers of public telecommunication services. The texts also require that major suppliers in their territories do not impose unreasonable or discriminatory conditions or limitations on the resale of such services. An equivalent obligation that applies to suppliers (as opposed to major suppliers) of telecommunications services is set out in a separate article in the CAFTA-DR and the PTPA. In Annex 13.4(5) (b), the annex to the United States-Chile FTA chapter on telecommunications, the United States establishes that a reseller that obtains, at wholesale rates, a telecommunications service that is available only to a category of subscribers may be prohibited from offering such service to a different category of subscribers. In CAFTA-DR and the PTPA, all members to the agreements can impose this type of limitation

In terms of number portability and dialing parity, the new FTAs establish that suppliers (major suppliers in the case of the United States-Chile FTA) must provide number portability, to the extent technically feasible, and dialing parity to suppliers of public telecommunications services of another Party. Number portability must be provided on a timely basis and on reasonable terms and conditions. El Salvador, Guatemala, Honduras, and Nicaragua may take into account the economic feasibility of providing number portability. Major suppliers must also afford non-discriminatory access to telephone numbers and related services with no unreasonable dialing delays to suppliers of public telecommunications services of another Party. Article 14.3.4 of the PTPA is more precise, and refers to “non-discriminatory access to telephone numbers,

directory assistance, directory listing, and operator services with no unreasonable dialing delays.”

The CAFTA-DR and the PTPA incorporate an additional provision by which major suppliers have to afford access to their poles, ducts, conduits, and rights-of-way to suppliers of public telecommunications services of another Party on terms and conditions, and at rates that are reasonable and non-discriminatory. For El Salvador, Annex 13.4.8 of the CAFTA-DR states that this provision shall apply when its law provides that poles, ducts, conduits, and rights-of-way constitute essential resources.

Except for the provisions on interconnections that are not related to major suppliers, none of the provisions in the new FTAs relating to major suppliers of public telecommunications services apply to suppliers of commercial mobile services in member countries to the agreements or to rural telephone companies in the United States. Under the new FTAs, a state regulatory authority in the United States may exempt a rural local exchange carrier from these obligations. El Salvador, Guatemala, Honduras, and Nicaragua may also exempt a rural telephone company in its territory from such obligations, provided that the rural telephone company supplies public telecommunications services to fewer than two percent of the subscriber lines installed in the Party’s territory. These provisions do not preclude an authority of a Party member to the agreement from imposing the above measures upon suppliers of commercial mobile services or on rural telephone companies. In the PTPA, Peru may exempt a rural telephone company that has at least 80 percent of its total fixed subscriber lines in operation in rural areas from the obligations on resale, number portability and dialing parity, unbundling of network elements, and co-location. The total number of subscriber lines supplied by a rural telephone company includes all subscriber lines supplied by the company and by its owners, subsidiaries, and affiliates. In addition, for 10 years following the date of entry into force of the PTPA, Peru may exempt service suppliers that supply public telecommunications services in rural areas from these obligations. Any exemption is applicable only with respect to the public telecommunications services supplied in rural areas.

Regarding submarine cable systems, the new FTAs establish that providers of submarine cable systems must accord non-discriminatory treatment for access to such systems. In CAFTA-DR and the PTPA, the treatment provided by operators of submarine cable systems must also be “reasonable,” although no definition is provided for this term. The obligation applies to a

supplier authorized to operate submarine cable systems as a public telecommunications service in CAFTA-DR and the PTPA. In the United States-Chile FTA, on the other hand, the Parties are free to classify a submarine cable system within their territories as a public telecommunications service supplier and, on that basis, decide whether or not to apply the obligation.

On conditions for the supply of information services, the new FTAs establish the information requirements that may not be imposed on an enterprise in a Party's territory that it classifies as a supplier of information services, and that supplies such services over facilities that it does not own. Notwithstanding this provision, a Party is allowed to take appropriate action to remedy the anticompetitive behavior of an information service supplier, or to promote competition or safeguard the interest of consumers.

With respect to independent regulatory bodies and government-owned telecommunications suppliers, the Parties in the new FTAs commit to having an independent telecommunications regulatory body and to ensuring that its decisions and procedures are impartial with respect to all interested persons. In addition, CAFTA-DR rules out discriminatory treatment in favor of government-owned suppliers of public telecommunications services or information services. The PTPA refers to a Party's central level of government.

Concerning universal service, the United States-Chile FTA and CAFTA-DR establish that any universal service obligation maintained by a Party must be administered in a transparent, non-discriminatory, and competitively neutral manner and should not be more burdensome than necessary for the kind of universal service defined. Under the United States-Chile FTA, the obligation also applies to universal service obligations that a Party adopts, thereby allowing the Parties to impose new such obligations. The PTPA states that each Party has the right to define the kind of universal service obligations it wishes to maintain, and shall administer those obligations in a transparent, non-discriminatory, and competitively neutral manner. Also, each Party shall ensure that its universal service obligation is not more burdensome than necessary for the kind of universal service that it has defined.

On licenses and other authorizations, the new FTAs permit that a Party requires a supplier of public telecommunications services to have a license to supply the service. The CAFTA-DR and the PTPA also permit their Parties to require concession, permit, registration, or other type of authorization. The new FTAs also list the type of information that shall be made publicly available when a license or other type of authorization is required.

With respect to the allocation and use of scarce resources, the new FTAs indicate that each Party shall administer its procedures for allocating and using scarce telecommunications resources, including frequencies, numbers, and rights-of-way, in an objective, timely, transparent, and non-discriminatory manner. The provision in the United States-Chile FTA further establishes that the Parties must also make the current state of allocated frequency bands publicly available, but shall not be required to provide detailed identification of frequencies allocated for specific uses. In CAFTA-DR and the PTPA, the latter provision also applies, but is limited to frequencies allocated for specific government uses. Each Party retains the right to exercise (United States-Chile FTA), establish, and apply (CAFTA-DR and the PTPA) its spectrum and frequency management policies, provided that this is done in a manner that is consistent with the provisions of the agreement. Article 14.10.4 of the PTPA states that “when making a spectrum allocation for non-government telecommunications services, each Party shall endeavor to rely on an open and transparent public comment process that considers the overall public interest. Each Party shall endeavor to rely generally on market-based approaches in assigning spectrum for terrestrial non-government telecommunications services.”

Regarding enforcement, competent authorities must have the authority to enforce the Party’s measures relating to the obligations set out in the following articles: Access to and Use of Public Telecommunications Services, the Obligations Relating to Suppliers of Public Telecommunications Services, the Additional Obligations Relating to Major Suppliers of Public Telecommunications Services, and the Submarine Cable Systems. Also, they may impose effective sanctions, which may include financial penalties, injunctive relief (on an interim or final basis), or the modification, suspension, and revocation of licenses or other authorizations.

The new FTAs include procedures for resolving domestic telecommunications through recourse to telecommunications regulatory bodies, reconsideration, and judicial review. These supplement two articles in the chapter on transparency of each agreement: Administrative Proceedings (18.4) and Review and Appeal (18.5).

Concerning transparency, NAFTA and the new FTAs spell out the types of measures relating to access and use of public telecommunications services that each Party shall make publicly available. They list measures relating to (a) tariffs and other terms and conditions of service; (b) technical interfaces; (c) bodies responsible for preparing, amending, and adopting standards-related measures affecting access and use; (d) conditions for attaching terminal or

other equipment to the public telecommunications network; and (e) notification, permit, registration, or licensing requirements. The CAFTA-DR and the PTPA incorporate an additional measure dealing with procedures relating to judicial and other adjudicatory proceedings. Subject to the articles on publication and on notification and provision of information in the chapter on transparency, the CAFTA-DR and the PTPA also require (a) the prompt publication (or otherwise make publicly available) of rulemakings of a Party's telecommunications regulatory body and end-user tariffs filed with its telecommunications regulatory body, and that (b) interested persons be provided with adequate advance public notice of, and the opportunity to comment on, any rulemaking that its telecommunications regulatory body proposes.

The new FTAs also include a provision on flexibility in the choice of technologies impeding the Parties from preventing suppliers of public telecommunications services from having the flexibility to choose the technologies that they use to supply their services, including commercial mobile wireless services. The language used in the United States-Chile FTA makes this a "best-endeavors" clause, whereas if such impediments are imposed under the CAFTA-DR and the PTPA, they must conform to legitimate public policy interests.

Finally, the Parties to the new FTAs recognize the importance of relying on market forces to achieve wide choices in the supply of telecommunications services. To this end, each Party may forbear from applying regulations to a telecommunications service that the Party classifies as public telecommunications service as long as its telecommunications regulatory body determines that enforcement of such regulation is not necessary to prevent unreasonable or discriminatory practices, or the protection of consumers, and forbearance is consistent with the public interest.

## **7.1 The Special Case of Costa Rica**

As mentioned above, the CAFTA-DR's chapter on telecommunications does not apply to Costa Rica. Instead, the country undertook specific commitments that cover regulatory principles and market access set out in Annex 13 of the agreement. First, Costa Rica committed to enact a new legal framework to strengthen the telecommunications incumbent provider, the *Instituto Costarricense de Electricidad* (ICE), through its appropriate modernization, no later than December 31, 2004.

With respect to selective and gradual market opening, Costa Rica committed to a market access standstill. Costa Rica shall allow service providers of another Party to supply telecommunications services on terms and conditions that are no less favorable than those established by or granted pursuant to its legislation in force on January 27, 2003. As provided in Annex 13 of the CAFTA-DR, it also committed to allow telecommunications services providers of another Party, on a non-discriminatory basis, to effectively compete to supply directly to the customer, through the technology of their choice, the following telecommunications services in its territory: private network services, no later than January 1, 2006; Internet services, no later than January 1, 2006; and mobile wireless services, no later than January 1, 2007.

The section on regulatory principles in Annex 13 states that the regulatory framework on telecommunications services that the Government of Costa Rica shall have in force as of January 1, 2006, shall conform to the following provisions, among others:

- Regarding universal service, Costa Rica has the right to define the kind of universal service obligations it wishes to maintain. Such obligations will not be regarded as anticompetitive per se, provided they are administered in a transparent, non-discriminatory, and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined. This text, as noted above, was later included in the PTPA;
- Regarding independence of the Regulatory Authority, Costa Rica shall establish or maintain a regulatory authority for telecommunications services, which shall be separate from and not accountable to any supplier of telecommunications services. Costa Rica shall ensure that its telecommunications regulatory authority is authorized to impose effective sanctions to enforce domestic measures relating to the obligations set out in Annex 13. This regulatory authority may include jurisdiction over spectrum management, universal service, tariffing, and licensing of new market entrants. The decisions and the procedures of the regulatory authority shall be impartial with respect to all market participants;
- Regarding transparency, Costa Rica shall ensure that applicable procedures for interconnection to a major supplier and either its interconnection agreements or referenced interconnection offers are made publicly available. Costa Rica shall also make all licensing or authorization criteria and procedures required for

telecommunications service suppliers, as well as the terms and conditions of all licenses or authorizations issued, publicly available;

- Regarding the allocation and use of scarce resources, Costa Rica shall ensure that procedures for the allocation and use of limited resources, including frequencies, numbers, and rights-of-way, are administered in an objective, timely, transparent, and non-discriminatory manner by a competent domestic authority. The Republic of Costa Rica shall issue licenses for use of spectrum directly to the service providers, in accordance with Article 121, Item 14 of the *Constitución Política de la República de Costa Rica*;
- Concerning regulated interconnection, Costa Rica shall ensure that public telecommunications services suppliers of another Party are provided interconnection with a major supplier in a timely fashion, under non-discriminatory terms, conditions, and cost-oriented rates that are transparent and reasonable, and have regard to economic feasibility. Costa Rica shall also ensure that a service supplier requesting interconnection with a major supplier has recourse to an independent domestic body to resolve disputes regarding appropriate terms, conditions, and rates for interconnection within a reasonable time;
- With respect to the access to and use of the network, Costa Rica's commitment replicates most of the language found in CAFTA-DR Articles 13.2.1 to 13.2.4. A visible difference between the texts is that the measures that Costa Rica may take to ensure the security and confidentiality of messages or protect the privacy of nonpublic personal data of subscribers to public telecommunications services, and that limit access to and use of the network, are not made subject to a non-discrimination requirement. Costa Rica also excluded the text found in CAFTA-DR Article 13.2.5(b) allowing Parties to impose conditions on access to and use of public telecommunications networks or services necessary to protect the technical integrity of public telecommunications network or services. An indicative list of conditions was also excluded from Costa Rica's commitment;
- Regarding the provision of information services, Costa Rica may not require an enterprise of another Party in its territory that it classifies as a supplier of information services and that supplies such services over facilities that it does not own to (i) supply

such services to the public generally; (ii) cost-justify rates for such services; (iii) file tariffs for such services; (iv) interconnect its networks with any particular customer for the supply of such services; or (v) conform to any particular standard or technical regulation for interconnection other than that for interconnection to a public telecommunications network. Notwithstanding the previous sentence, Costa Rica may take any action referred to in clauses (i) through (v) to remedy a practice of supplying information services that it has found in a particular case to be anticompetitive under its law or regulations, or to otherwise promote competition or safeguard the interests of consumers;

- Regarding competition, Costa Rica shall maintain appropriate measures for the purpose of preventing suppliers who, alone or together, are major suppliers from engaging in anticompetitive practices, such as not making available, on a timely basis, technical information about essential facilities and commercially relevant information that is necessary for them to provide public telecommunications services;
- With respect to submarine cable systems, the commitment of Costa Rica replicates CAFTA-DR Article 13.5, whereas on flexibility in the choice of technologies Costa Rica commits to not prevent suppliers of public telecommunications services from having the flexibility to choose their technologies. The text used is identical to that in CAFTA-DR Article 13.14, except that Costa Rica does not explicitly state that the obligation applies to the supply of commercial mobile wireless services.

Costa Rica did not schedule specific commitments relating to resale, number portability, dialing parity, unbundling of network elements, co-location, access to rights-of-way, and forbearance.

## **8. Implementing the Rules on Telecommunications**

### **8.1 The Experience of Mexico**

The NAFTA chapter on telecommunications did not require Mexico to change any of its laws, but the country was already preparing a new law on telecommunications, the Federal Telecommunications Law (*Ley Federal de Telecomunicaciones*, or LFT), which was published in the Official Gazette of the Federation on June 7, 1995. The law governs the entire Mexican telecommunications industry. Its purpose is “to govern the use, utilization and exploitation of the

radio-electrical spectrum, of the telecommunications networks, and of satellite communication.”<sup>53</sup> More broadly, it is intended to “promote efficient development of telecommunications; exercise the authority of the State on these matters to ensure national sovereignty; to promote a healthy competition among the different telecommunications service providers in order to offer better services, diversity and quality for the benefit of the users and to promote an adequate social coverage.”<sup>54</sup> A few months earlier, in March 1995, Article 28 of the constitution was amended to allow foreign participation in telecommunications and to eliminate the state monopoly for the establishment and operation of satellite systems.

It is worth noting that Mexico was one of the first Latin American countries to open up its telecommunications market, an achievement that included the introduction of competition and the liberalization of foreign investment. In 1990, the Mexican Government initiated the privatization of *Teléfonos de Mexico* (Telmex), which, at the time, was a state-controlled telephone company. The privatization process ended in 1994, when the state sold its remaining shares in Telmex. The privatization came with a concession title that will expire in 2026 (corresponding to a 50-year concession from 1976, the date of the original concession title). Under the concession title, Telmex was granted a monopoly for long-distance and international telephony until December 31, 1996. For other services, such as local telephony, wireless telephony, paging, trucking, or value-added services, the entry of new operators was allowed. The concession also included obligations with respect to infrastructure expansion, in particular in rural areas; improvement of the quality of the services; and infrastructure interconnection (WTO, 2002). Telmex was required to review its tariffs to eliminate cross subsidies between local and long-distance services, and it established regulations governing interconnection agreements.

Under the LFT, a concession is required to use a frequency band; operate public telecommunications networks; make commercial use of radio and television channels; provide satellite services (including through ground stations); occupy geostationary orbital positions and satellite orbits allocated to Mexico; and exploit signal transmission and reception rights for frequency bands associated with foreign satellite systems that may cover or provide services in Mexican territory. Concessions can only be granted to natural or legal persons of Mexican nationality, and foreign equity participation is limited to 49 percent, with the exception of mobile

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<sup>53</sup> See LFT, Article 1.

<sup>54</sup> See LFT, Article 7.

telephony services where foreign investors may acquire a higher percentage of the equity by making a request to CNIE (WTO, 2008).

Mexico's Ministry of Communications and Transport (*Secretaría de Comunicaciones y Transportes*, or SCT), through its Vice-Ministry of Communications, acted as the regulatory authority for the industry until August 1996. At that time, the government established an independent organization, the Federal Telecommunications Commission (*Comisión Federal de Telecomunicaciones*, COFETEL), as an independent regulatory body, with technical and operational autonomy. COFETEL's main functions include issuing administrative telecommunications regulations; giving opinions on the granting, amendment, extension, and assignment of concession titles and permits; submitting the frequency band allocation program for approval by the SCT; coordinating the bidding procedures for the exploitation of geostationary orbital positions and satellite orbits allocated to Mexico; maintaining the telecommunications register (concession titles, tariffs, etc.); promoting and overseeing interconnection agreements and the provisions of concession titles; and proposing to the SCT the imposition of sanctions on those found to be in breach of the law or administrative regulations.<sup>55</sup> In May 2007, to increase competition, COFETEL issued a resolution on number portability, which enables users of both fixed and mobile telephony to keep their telephone numbers if they decide to change service provider.<sup>56</sup>

In addition to the LFT, the legal framework includes the 1960 Federal Radio and Television Law, which regulates the broadcasting service. Other laws and regulations include the 1940 General Means of Communications Law, the 1990 Telecommunications Regulations, and the regulations and resolutions issued by the SCT and COFETEL. The latter include, for example, the 1997 Satellite Communications Regulations and the rules for international (2004), long distance (1996), and local (1997) telecommunications services (WTO, 2008).

Mexico adopted the Fourth Protocol to the GATS, as well as the reference paper to this protocol on pro-competitive and transparency practices. Mexico's offer essentially consolidated the basic features and principles contained in the LFT. Although most services were included in Mexico's offer, radio broadcasting, cable television, and satellite transmission services were excluded. With respect to national treatment, all telecommunication services included in

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<sup>55</sup> Article 9 of the Federal Telecommunications Law, added in the amendment published in the Official Journal on April 11, 2006. The latest amendments are available at: <http://www.diputados.gob.mx/LeyesBiblio/ref/lftel.htm>.

<sup>56</sup> COFETEL Press Release No. 22 of May 30, 2007.

Mexico's schedule were bound (except for the presence of natural persons as specified in the horizontal commitments). Market access for cross-border supply was bound with the only restriction that international traffic must be routed through the facilities of an enterprise with a concession granted by the SCT. As allowed in the LFT, market access through commercial presence was bound at a ceiling of 49 percent foreign participation and remains subject to the granting of a concession title or permit as mentioned above (WTO, 2002).

The United States questioned the implementation of Mexico's WTO commitments, and, in August 2000, alleged that Mexico had adopted anticompetitive and discriminatory regulatory measures, had tolerated certain privately established market access barriers, and had failed to take needed regulatory action in its basic and value-added telecommunications sectors (WTO, 2000). In April 2002 a panel was established to settle the dispute. In June 2004, the WTO's Dispute Settlement Body adopted the panel's report, which concluded, inter alia, that Mexico had failed to ensure the application of cost-oriented international interconnection rates (in breach of Sections 2.1 and 2.2 of the WTO Reference Paper, inscribed in Mexico's GATS Schedule of Specific Commitments); had failed to impose regulatory measures to prevent anti-competitive practices on the part of the main telecommunications operator (in breach of Section 1.1 of the WTO Reference Paper, inscribed in Mexico's GATS Schedule of Specific Commitments), and had failed to ensure access to and use of public telecommunications networks on reasonable and non-discriminatory terms (in breach of Section 5 of the GATS annex on telecommunications. A similar commitment was made under NAFTA 1302).<sup>57</sup>

## **8.2 The Experience of Chile**

Chile did not have to adopt or modify any law to implement the chapter on telecommunications in the United States-Chile FTA. Chile's telecommunications sector was fully privatized during the 1980s. As noted in a WTO (2009) trade policy review of Chile, "in 2008 there were 16 fixed telephony providers, 3 mobile telephony providers and 32 companies offering Internet access. *Telefónica* continues to occupy a dominant position with 60.1 percent of the fixed telephony segment and 45.7 percent of the Internet segment. In mobile telephony, Movistar accounted for 42.6 percent of subscribers. The state is not involved in the provision of telecommunications services, although it plays a regulatory role."

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<sup>57</sup> WTO Document WT/DS204/R of April 2, 2004.

The Ministry of Transport and Telecommunications (*Ministerio de Transporte y Comunicaciones*, or MTT), through the Undersecretariat for Telecommunications (*Subsecretaría de Telecomunicaciones*, or SUBTEL), formulates sector policy; implements and enforces the corresponding legislation (including technical regulations); administers the radio frequency spectrum; decides on applications for concessions, permits, and licenses; and applies administrative sanctions in accordance with the law. SUBTEL is in charge of implementing and overseeing the application of the General Law on Telecommunications (*Ley General de Telecomunicaciones*, or LGT) (Law No. 18.168, published on October 2, 1982). Pursuant to Article 8 of the LGT, a concession is required for offering public telecommunications services. SUBTEL grants concessions through supreme decrees. Once granted, a concession to provide telecommunication services is valid for 30 years. The LGT establishes a general free-pricing regime for the provision of telecommunications services, but also stipulates that if the Tribunal for the Defense of Free Competition (*Tribunal de Defensa de la Libre Competencia*, or TDLC) determines that some services are not being supplied under competitive conditions, tariffs may be set (Article 29 of the LGT). The services liable to have their tariffs set are the local public and national and international long-distance telephone services (excluding mobile telephony), and signal switching and/or transmission services provided as an intermediate service or as private circuits. The Ministry of the Economy participates in price setting and, together with the MTT, signs tariff decrees. The TDLC decides when to set the tariffs of those telecommunications services that are liable to tariff setting under the law (WTO, 2009).

Concessions to provide public telecommunications services and intermediate services are granted to enterprises established in Chile, irrespective of the origin of the capital. Interconnection tariffs are set by law, and maximum tariffs may be established for concession holders who occupy a dominant position in any of the services liable to price setting. As highlighted in WTO (2009), “the holders of concessions to provide public telecommunications services and intermediate long-distance telephony services must establish and accept interconnections [Article 25 of the LGT]. Any interested party may offer additional services through the public networks, by connecting equipment to those networks; the marketing of these services does not require the prior agreement of the public telecommunications services concession-holders, who may not discriminate between providers of additional services.” Chile adopted the Fourth Protocol to the GATS, as well as the WTO Reference Paper to this protocol

on pro-competitive and transparency practices, although Chile made no commitments on the supply of basic local telecommunications under the GATS (but did so under the United States-Chile FTA).

### 8.3 The Experience of El Salvador

The legislative framework for El Salvador's telecommunications sector was modified on several occasions during the last few years to take into account liberalization commitments, including the country's specific commitments under the Fourth Protocol to the GATS and its obligations under the WTO Reference Paper. El Salvador privatized its state monopoly in the telecom sector in 1997. The National Telecommunications Administration (ANTEL) was divided into two entities: the *Compañía de Telecomunicaciones de El Salvador* (CTE), dedicated mainly to fixed-line telephony services, and *Internacional de Telecomunicaciones*, dedicated mainly to mobile telephony services. As of October 2009, El Salvador had 11 fixed-line telephony operators, five mobile telephone line operators, and 11 international long-distance operators. Foreign-owned operators mainly dominate the market, and more than 90 percent of the fixed telephony market is in the hands of CTE alone (WTO, 2010).

El Salvador's Law on Telecommunications (*Ley de Telecomunicaciones*, or LT)<sup>58</sup> and its Regulations have been amended in order to consolidate the liberalization undertaken in the past few years.<sup>59</sup> Most recently, in June 2010, El Salvador's Legislative Assembly approved a reform to the LT modifying Article 29, enabling number portability to be implemented.<sup>60</sup> The LT does not establish requirements with respect to the origin of operators' capital, and foreign-owned private operators are the main suppliers of telecommunications services.

The LT states that, subject to payment, every commercial telecommunications network operator must provide access to essential resources to any operator that asks for them, without discrimination of any kind. Under the LT, "essential resources" defined in Article 19 include, inter alia: interconnection, at all levels, for the purpose of terminating or transferring telecommunications originating in the network of one of the Parties to another network selected

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<sup>58</sup> See <http://www.csj.gob.sv/leyes.nsf/ed400a03431a6889%2006256a84005aec75/e1a8785714b31a1906256d050061801f?OpenDocument>.

<sup>59</sup> As of October 2009, the legislative framework includes: the Law on Telecommunications (Legislative Decree No. 142 of November 6, 1997), its amendments (Legislative Decree No. 387 of April 27, 2001; Decree No. 518 of December 16, 2004; Executive Decree No. 911 of January 12, 2006; and Legislative Decree No. 211 of January 19, 2007) and its Regulations (Legislative Decree No. 64 of May 15, 1998, as amended by Executive Decree No. 94 of August 29, 2008); the Law Establishing the General Supervisory Authority for Electricity and Telecommunications (Legislative Decree No. 808 of November 12, 1996), its amendments (Legislative Decree No. 175 of December 4, 1997), and its Regulations (Executive Decree No. 56 of May 13, 1998); and the Law on the National Electricity and Telephony Investment Fund (Legislative Decree No. 354 of July 29, 1998) and its amendments (Legislative Decree No. 859 of May 30, 2002).

<sup>60</sup> See [http://economia.terra.com.co/noticias/noticia.aspx?idNoticia=201006102304\\_EFE\\_15122275](http://economia.terra.com.co/noticias/noticia.aspx?idNoticia=201006102304_EFE_15122275).

by the end user; signaling; the handover of automatic identification of the number of the user originating the communication; billing data; the portability of the user's telephone number; collocation; unbundling; and the listing of users in the telephone directory. However, essential resources do not include lease circuits, and poles, ducts, conduits, and rights-of-way, which are defined as “related resources” (*recursos asociados*). As noted above, the CAFTA-DR incorporates an additional provision by which major suppliers have to afford access to their poles, ducts, conduits, and rights-of-way to suppliers of public telecommunications services of another Party on terms and conditions, and at rates that are reasonable and non-discriminatory. El Salvador negotiated a special annex (CAFTA-DR Annex 13.4.8), which stipulates that this provision shall apply to El Salvador when its law provides that poles, ducts, conduits, and rights-of-way constitute essential resources.

Although the unbundling of the fixed-line network for the interconnection of commercial telecommunications networks is considered to be an essential resource under the LT, “regulations that specify how the unbundling is to be carried out have still to be approved and, accordingly, the unbundling is not being implemented. Draft regulations that would make good this deficiency are under consideration” (WTO, 2010).<sup>61</sup>

Under the LT, operators interested in providing public telephony services must obtain an operating concession from the General Superintendence for Electricity and Telecommunications (*Superintendencia General de Electricidad y Telecomunicaciones*, or SIGET), an autonomous entity attached to the Ministry of the Economy that is responsible for applying and monitoring compliance with the rules and regulations on telecommunications.<sup>62</sup> These concessions, which are valid for 30 years without limitation, are granted irrespective of the nationality of the provider, provided the registration requirements are met.<sup>63</sup>

One issue related to the implementation of CAFTA-DR has been a law promulgated in 2008 by El Salvador, which imposes a \$.04/minute tax on incoming international telephone calls. Salvadoran carriers have passed on the cost of this tax to foreign carriers in the form of higher termination rates. The imposition of this tax has resulted in a 100 percent increase in call termination rates for calls from the United States to El Salvador. In August 2008, El Salvador modified the law to exempt calls from other Central American countries from payment of this

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<sup>61</sup> WTO (2010). This is the case in the April 2010 version of the regulations to the LT: [http://www.siget.gob.sv/attachments/1399\\_Reglamento\\_de\\_la\\_Ley\\_de\\_Telecomunicaciones\(abril\\_2010\).pdf](http://www.siget.gob.sv/attachments/1399_Reglamento_de_la_Ley_de_Telecomunicaciones(abril_2010).pdf).

<sup>62</sup> SIGET is also responsible for administering and overseeing the radio-frequency spectrum.

<sup>63</sup> Concession and licenses for free-to-air broadcasting services are granted to Salvadorans.

tax. The U.S. Trade Representative has raised questions about this tax in the context of El Salvador's adherence to its commitment in the GATS Annex on Telecommunications and provisions of the CAFTA-DR, particularly the provision ensuring reasonable access to and use of El Salvador's public telecommunications network. Consultations were taking place at the time this paper was being written.

## 8.4 The Experience of Peru

The telecommunications sector in Peru was already liberalized at the time of the PTPA negotiations, which means that, as was the case for the financial services sector, very few changes were necessary to implement the Trade Promotion Agreement.

Major changes took place in the Peruvian telecommunications sector in 1991 with the enactment of Legislative Decree No. 702 (November 8, 1991), which eliminated the state's exclusive rights to provide telecommunication services and created a new regulatory agency, OSIPTEL (*Organismo Supervisor de la Inversión Privada en Telecomunicaciones*), with the purpose of establishing a legal framework to attract Peruvian or foreign private investment and protect consumer rights. To achieve this latter objective, the Law mandated the interconnection of public service networks and prohibited anti-competitive practices. The sector's legal framework was consolidated in 1993 with the adoption of the Telecommunication Law (Supreme Decree No. 013-93-TCC of May 6, 1993) and subsequent regulations (WTO, 2000).<sup>64</sup>

The privatization process was very gradual in Peru. A consortium led by *Telefónica Internacional de España* bought the shares of the state-owned companies (CPT S.A. and ENTEL PERU S.A.) and was given a concession contract, a five-year monopoly period (from 1994 to 1999) for local fixed telephone services and long-distance national and international services. All other telecommunications services were liberalized. As part of its obligations set out in the concession contract, *Telefónica del Perú* "had to ease the high demand for telecommunications services, through the expansion and modernization of the basic telecommunications infrastructure" (WTO, 2000). In 2004, *Telefónica del Perú's* concession agreement was renewed until 2024.

The fixed telephony and national and international long-distance markets are still highly concentrated in Peru. At the time of the signature of the PTPA in 2006, *Telefónica del Perú* had

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<sup>64</sup> For more information, see <http://www.mtc.gob.pe/indice/comunicaciones.asp#c1>.

95.6 percent of the total number of fixed telephony lines; the remainder belonged to seven other operators, whereas the company controlled 66 percent of the market for national and international long-distance services. Moreover, *Telefónica Móviles* was the leading mobile telephony operator with 58 percent of the lines in service. But it is worth noting that the privatization has been deemed a success. A study by the World Bank (2006) shows that the coverage and quality of the service has increased dramatically and that rates have tended to fall, with some exceptions for new services.

In addition to OSIPTEL, which is responsible for the rates applicable to users, competition in the sector, interconnection, quality of the service, settlement of disputes between operators and application of the corresponding penalties, and dealing with complaints from users, the other institution which has responsibilities for the sector is the Ministry of Transport and Communications (MTC). The MTC is competent for market access issues; allocation, control and monitoring of scarce resources; administration of the Telecommunications Investment Fund (*Fondo de Inversión en Telecomunicaciones*, or FITEL);<sup>65</sup> the national telecommunications plan; the national frequency allocation plan; the adoption of regulations; and approval of monitoring equipment (WTO, 2007b).

As mentioned above, the legal framework was already very developed at the time of the PTPA negotiations, in particular with the Telecommunications Law, which classifies telecommunications services into carrier services, teleservices or final services, distribution services, and value-added services. The first three of these services require a special concession before they can be provided. Value-added services that require their own telecommunications networks separate from those of the carrier services or teleservices require special authorization from the MTC (WTO, 2007b).

In the context of the implementation of the PTPA, Legislative Decree 1019 was published on June 10, 2008 and the Law on the Access to the Infrastructure of the Major Suppliers of Public Telecommunications Services (*Ley de Acceso a la Infraestructura de los Proveedores Importantes de Servicios Públicos de Telecomunicaciones*) was approved.<sup>66</sup> In

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<sup>65</sup> FITEL is part of the Ministry of Transport and Communications. It was created by Supreme Decree No. 013-93-TCC of May 6, 1993 and is now operating pursuant to Law No. 28900 of November 4, 2006. It seeks to promote universal access through private investment in regions where demand does not guarantee profitability. For more information, see <http://www.fitel.gob.pe/contenido.php?ID=36>.

<sup>66</sup> See <http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/01019.pdf>.

addition, Legislative Decree No. 1021 was published on June 14, 2008, which granted OSIPTEL the right to establish rules on the unbundling of network elements.<sup>67</sup>

With respect to number portability, a study commissioned by OSIPTEL determined that it was not economically feasible to have number portability in the fixed telephone services. This led to the adoption of the Law for Number Portability for Mobile Services (*Ley de Portabilidad Numérica en los Servicios Móviles*) published on April 4, 2007.<sup>68</sup>

## 8.5 The Experience of Costa Rica

The telecommunications obligations and commitments made by Costa Rica in the CAFTA-DR were undoubtedly the most politically sensitive of all the issues covered in the agreement. This also meant that the implementation of these obligations and commitments would be challenging.

Before discussing the specifics of the CAFTA-DR implementation in the telecommunications sector in Costa Rica, it is useful to recall the key elements that made opening this sector very difficult. First, although President Abel Pacheco stated on numerous occasions during the CAFTA-DR negotiations that his country would not open the telecom sector to private participation, these negotiations offered a unique opportunity to Costa Rica's main trading partner, the United States, to push for the liberalization of some of the country's monopolistic practices, in particular in the telecommunications sector.<sup>69</sup>

*Instituto Costarricense de Electricidad* (ICE), an autonomous state institution created in 1949 to develop and produce hydroelectric power, was given the right to operate telecommunications services in 1963. The telecom components of the ICE Group at the time of the CAFTA-DR negotiations included *ICE Telecomunicaciones* providing basic local, long-distance, and mobile telephony, and *Radiográfica Costarricense* (RACSA) offering value-added services, Internet connection, and satellite communication services. Even if the constitution did not establish a monopoly in favor of these institutions, de facto, a state monopoly existed in Costa Rica in the telecom sector at the beginning of the CAFTA-DR negotiations, as only the ICE Group held concessions to operate in this sector.

In March 2000, the government of President Miguel Angel Rodríguez attempted to open up the sector to private investment without much success. Dubbed the *combo energético*, the new

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<sup>67</sup> See <http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/01021.pdf>.

<sup>68</sup> See *El Peruano*, April 4, 2007: [http://www.mtc.gob.pe/portal/comunicacion/politicas/normaslegales/Ley\\_28999.pdf](http://www.mtc.gob.pe/portal/comunicacion/politicas/normaslegales/Ley_28999.pdf).

<sup>69</sup> See for instance the newspaper *La Nación* of San José, October 6, 2003.

ICE law would have allowed private investment in the telecom and electricity sectors without privatizing the ICE. The new law (*Ley de Transformación del ICE*) was adopted by 45 of the 55 members of the Costa Rican legislative assembly on March 20, 2000. To demonstrate their opposition to this new law, trade unions (in particular, those of ICE) and students associations organized strikes and riots all over the country requesting the withdrawal of the new ICE law. To appease those who had been protesting in the streets for several days against the liberalization of the telecom and electricity sectors, the government took the decision in early April to send the law to the Special Joint Committee (*Comisión Especial Mixta*), made up of representatives of trade unions, civil society, and various political bodies. On October 26, 2000, after examining various options to reform these sectors, the committee recommended a focus on the institutional strengthening of the ICE but rejected the liberalization of the *combo energético*. Other attempts in 2000 and 2002 to open up the telecom sector to private investment suffered the same fate and were never approved (WTO, 2007a).

The United States was aware of the political sensitivities related to the telecom sector in Costa Rica. In a visit to the country on October 1, 2003, 10 months after the beginning of the CAFTA-DR negotiations, U.S. Trade Representative Robert Zoellick made clear that he was not asking for the privatization of the telecom sector, but rather for the opening of this service industry. He stated, however, that Costa Rica had to open its telecom sector if it wished to ensure its participation in the CAFTA-DR. In meetings with Costa Rica's minister of foreign trade, several members of the legislative assembly and representatives of the private sector, Zoellick reiterated to his hosts that this issue had to be dealt with in the FTA. He also mentioned that he was prepared to exclude Costa Rica, if necessary, when sending the CAFTA-DR text to the U.S. Congress.

Costa Rica's government was a major proponent of the CAFTA-DR and did not want to be excluded from it. Following Zoellick's visit, the Costa Rican newspapers began to discuss the "price" the country would have to pay for not being a party to CAFTA-DR. The papers reported that the United States accounted for over 50 percent of the country's exports in 2002, while the Netherlands came second at 5.9 percent and Guatemala third at 4.5 percent. More than 1,600 Costa Rican firms had exported 1,800 products to the United States that year.<sup>70</sup> Two-thirds of these firms were small and medium-sized firms. Costa Rica's export promotion agency,

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<sup>70</sup> See *La Nación*, October 13, 2003.

PROCOMER, stated that a total of 146,000 jobs (including 73,000 direct jobs) linked to the export of goods to the United States would be lost in Costa Rica should the country be excluded from the CAFTA-DR.<sup>71</sup> Moreover, the United States also accounted for 40 percent of all FDI in the country in 2002. Costa Rican population was relatively satisfied with the quality of telecom services provided by the ICE.

As mentioned previously, by the December negotiating round in 2003, which was supposed to be the last round, the Costa Ricans had drafted a text for the “gradual and selective” market opening of private network services, Internet services, and mobile wireless services. But since they needed more time to study the U.S. proposal on insurance and also wanted to get a better deal on textiles and agriculture, the Costa Ricans announced that they would not conclude the negotiations, but rather go back home to seek further guidance on the package to be negotiated. Back in Washington, D.C., on January 25, 2004, they reached a deal with the United States. On telecom, Costa Rica highlighted that it had negotiated a separate annex on based on the text it had presented to the United States. The Report of the U.S. Industry Sector Advisory Committee for Trade Policy Matters Services (ISAC 13) of March 2004 commented that “while these commitments are somewhat modest, they represent significant progress for the Costa Rican market.”<sup>72</sup>

The implementation of the CAFTA-DR in Costa Rica proved to be extremely controversial. Trade unions in the Costa Rican telecom sector opposed any form of liberalization and privatization in that sector, and since they were one of the most vocal members of the coalition against free trade and the CAFTA-DR, they made reforms of the telecom sector (and its state monopoly) a prominent issue before, during, and after the negotiations. Former President and Nobel Peace-Prize winner Oscar Arias, who took office for a second time on May 8, 2006, announced on April 13, 2007 that his government would put the agreement to a referendum. As mentioned above, the referendum took place on October 7, 2007 and was the first public referendum on a trade agreement across the world.<sup>73</sup> Costa Ricans approved the CAFTA-DR (51.6 percent of voters backed the agreement, while 48.4 percent voted against it), and in 2008

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<sup>71</sup> See *La Nación*, October 22, 2003.

<sup>72</sup> US Industry Sector Advisory Committee for Trade Policy Matters Services (ISAC 13) (2004, p. 16).

<sup>73</sup> For more information, see [http://www.nacion.com/ln\\_ee/2007/abril/14/latinoamericaya-070415034428.hggo05y7.html](http://www.nacion.com/ln_ee/2007/abril/14/latinoamericaya-070415034428.hggo05y7.html).

the United States and other Parties to the CAFTA-DR agreed that Costa Rica could have until January 1, 2009 to complete the legislative steps required to join the agreement.<sup>74</sup>

On May 14, 2008, the Costa Rican Legislative Assembly formally approved the opening of the telecommunications market by voting in favor of the new General Telecommunications Law (No. 8642) by a 35–14 margin.<sup>75</sup> The law was published in the Official Gazette of Costa Rica on June 30, 2008. This historic vote ended the state-monopoly of the ICE, which has achieved better fixed-line coverage than any other operator in Latin America but has had much less success in the mobile telephony business, with month-long waiting lists for mobile services. On August 13, 2008, the *Ley de Fortalecimiento y Modernización de la Entidades Públicas del Sector Telecomunicaciones* (LFMT) (No. 8660) was approved and published in the Official Gazette of Costa Rica. The objective of the law was to strengthen the public entities of the telecommunications sector and to address a key concern of many CAFTA-DR opponents in Costa Rica as to whether ICE could compete in an open market, since it had often operated at very little profit, and had kept rates low thanks to government subsidies.

Laws 8642 and 8660 provide a complete overhaul and a new platform for the telecom industry in Costa Rica, giving the executive branch authority to supervise the telecommunications sector, and creating a regulatory body, the *Superintendencia de Telecomunicaciones* (SUTEL), which began to operate on January 26, 2009. The General Telecommunications Law allows national and foreign companies to enter the Costa Rican market into the mobile, internet, and VoIP telephony segments, which were previously exclusively concentrated in the hands of ICE. It establishes mechanisms of grids and service allocation, regulation, use and exploitation, management, and control of the radio-electric spectrum. It subjects physical or juridical persons—public or private, national or foreign—that operate grids or provide telecommunications services originating, finishing, or passing through the Costa Rican territory to this law and to Costa Rican jurisdiction. The law also creates the National Telecommunications Fund (FONATEL), to be administered by SUTEL. FONATEL’s mission is

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<sup>74</sup> CAFTA-DR first entered into force between El Salvador and the United States. Article 22.5 of the agreement, as amended by the United States and El Salvador on March 10, 2006, states that “Unless the Parties otherwise agree, the Agreement shall not enter into force for any signatory after two years from the entry into force of the Agreement.” Given that the Agreement entered into force in El Salvador on March 1, 2006, this means that the original deadline for Costa Rica was March 1, 2008. The other CAFTA-DR countries gave Costa Rica a second deadline of October 5, 2008 which was also missed because Costa Rica had not yet implemented the intellectual property rights provisions of the CAFTA-DR, having faced two separate high court reviews due to changes to the country’s Biodiversity Law. On November 11, 2008, the implementation of the CAFTA-DR was completed. Following a proclamation from President George W. Bush on December 23, 2008, the Agreement entered into force between the U.S. and Costa Rica on January 1, 2009 making Costa Rica the last of the CAFTA-DR countries to formally join the pact.

<sup>75</sup> See *La Nación* of May 15, 2008: [http://www.nacion.com/in\\_ee/2008/mayo/15/pais1537156.html](http://www.nacion.com/in_ee/2008/mayo/15/pais1537156.html).

to foster universal access, universality of service, and solidarity in the telecommunication sector.<sup>76</sup>

The General Telecommunications Law is based on neutral technology and convergence. A telecom supplier is authorized to provide services that are technologically feasible as long as it has a license. If a provider seeks to render services that require use of the radio spectrum, then such provider needs a concession. Otherwise, the provider should request an authorization (i.e., Internet services, etc). Concessions are only granted through bidding processes and are given for a 15-year term renewable for a maximum of 10 additional years. Authorizations are given, at the request of the provider, for a 10-year term, and are renewable for a 5-year term, for a maximum of three renewals.

The LFMT clearly separates the three roles of the Costa Rican state in the telecommunications sector: policymaking role, regulatory role, and its role as an operator. The law transformed the former Ministry of Environment and Energy (MINAE) into the Ministry of Environment, Energy, and Telecommunications (MINAET), and created the National Telecommunications Plan. It also relaxed the ICE procurement mechanisms and establishes new parameters for its indebtedness, strategic associations, and creation of trusts. In fact, it creates the Advisory Council on Energy and Telecommunications to evaluate the ICE's debt and makes recommendations to the executive power. It amends the Public Services Regulatory Authority Law (*Ley de la Autoridad Reguladora de los Servicios Públicos*) (No. 7593) of August 9, 1996, and creates SUTEL for the regulation and control of the country's telecommunications activities and the management of FONATEL. The law stipulates that SUTEL will act as an independent regulatory agency within the legal framework of the Regulatory Authority for Public Services (ARESEP). The law also gives SUTEL the responsibilities to grant, revoke, transfer, and declare the lapsing and extinction of the radio-electric spectrum frequencies concessions, to approve fees, and to guarantee the ICE and its corporation's financial and administrative autonomy. SUTEL is funded by the annual fees paid by network operators and telecom service providers and the new Vice-Ministry of Telecommunications, which is under the MINAET and is responsible for overseeing the telecom sector.

In addition to the two abovementioned laws, a number of regulations have also been adopted, including the Regulations for the General Telecommunications Law (*Reglamento a la*

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<sup>76</sup> FONATEL will use a 1.5 to 3 percent tax on communications services to support universal access.

*Ley General de Telecomunicaciones*),<sup>77</sup> the Regulations for the Access and Interconnection of Telecommunications Networks (*Reglamento de acceso e interconexión de redes de telecomunicaciones*),<sup>78</sup> the Regulations for Universal Access, Universal Service, and Solidarity (*Reglamento de acceso universal, servicio universal y solidaridad*),<sup>79</sup> and the Regulations for the Telecommunications Competition Regime (*Reglamento de régimen de competencia en telecomunicaciones*).<sup>80</sup>

The actual implementation of the opening of the telecom sector in Costa Rica has been challenging. At times, ICE has shown reluctance towards competition submitting objections against the issuing of authorizations, slowing down interconnections negotiations, and often criticizing SUTEL's decisions. SUTEL began to issue authorizations in July 2009 to new companies interested in providing Internet, VoIP, and corporate telecom service. It took an entire year for ICE to sign interconnection contracts. The first companies to reach access/interconnection agreements with ICE, in July 2010, were the cable television company Amnet, public telephone operator BBG Global AG, and three VoIP providers: Ticom, CallMyWay, and Intertel Worldwide. Amnet was finally able to launch its own cable modem service, becoming the first operator to offer Internet access in competition with the incumbent. By July 2010, SUTEL had awarded 86 telecom authorizations.

The process leading to the bidding for the award of concessions of three licenses for spectrum blocks in the 850MHz, 1800MHz, and 2100MHz bands also proved to be arduous. It took SUTEL almost two years to define the regulations for market entry, to assure that adequate frequencies were available, and to negotiate with the ICE for use of existing cell phone towers. A public auction was to be completed in May 2010 for three new operators to enter the mobile market, but the process was postponed. In early August 2010, Costa Rica's Constitutional Court granted the government a maximum of three months to complete the competitive public tender. On December 14, 2010, *América Móvil*, Mexico's largest wireless provider, known in Costa Rica as the company Claro, and Spain's *Telefónica* (which will become Azules y Platas) made bids for concessions in the cellular phone market. Kingston, Jamaica-based mobile operator Digicel Group, London-based Cable & Wireless, and Luxembourg-based Millicom International

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<sup>77</sup> Decree No. 34765-MINAET of September 22, 2008 published in the Official Gazette No. 186 of September 26, 2008.

<sup>78</sup> Enacted by ARESEP on October 6, 2008 and published in the Official Gazette No. 201 of October 17, 2008.

<sup>79</sup> Ibid.

<sup>80</sup> Ibid.

Cellular were among companies that did not make bids, though they had previously expressed interest.

Finally, tensions between SUTEL and the former regulator of ARESEP (who left in May 2010), in part on the issue of adequate financial and human resources for SUTEL, also slowed down the process. In July 2010, the Comptroller General's Office of Costa Rica approved the budget of each organization for 2011. ARESEP will have a budget of ¢9.286 million and SUTEL of ¢5.339 million. Both entities involved in the regulation of public services are financed by a percentage (*canon regulatorio*) charged to supervised entities.

## **9. Conclusion**

This paper has reviewed the investment and trade in services provisions of the NAFTA and the other free trade agreements negotiated by the United States, the CAFTA-DR, PTPA, and United States-Chile FTA, as well as the implementation process and efforts of Mexico, Chile, Costa Rica, El Salvador, and Peru. Clearly, not all trade negotiations are identical as the political and economic environments in which they take place shape them, which explain why the implementation process varies from country to country, and from issue to issue. In fact, the negotiation and implementation of an FTA include an international dimension and a domestic component. This is particularly true for services and investment issues.

As shown by the experience of Costa Rica, particularly in the telecom sector, if the negotiation has resulted in an increased level of liberalization, in part due to the external pressure of a key and powerful trading partner, the vested national interests which opposed this liberalization may “use” the implementation process as their final attempt to block the agreement or the reforms establishing the regulatory framework to fully implement the liberalization. Even in a context where the government builds coalitions and alliances with other parties or transnational actors during the negotiating phase, the implementation process provides an opportunity for opponents to attempt to frustrate the government’s efforts. The United States-Mexico cross-border trucking case provides interesting lessons to that effect. In contrast, when the negotiations entail no legislative or regulatory changes because the agreement serves to lock in the status quo, it is unlikely that the implementation phase will be controversial, as the trade agreement does not require the government to adopt any measure. This is particularly the case if the country has ratified other trade agreements where it also locked in the same status quo (e.g.,

Chile). In other cases, the implementation is used to adopt laws, which are not controversial, albeit necessary to implement other trade obligations, as both Chile and Peru did with respect to TRIMS Agreement.

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