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Proceedings of the Fifth Annual Seminar on Legal Aspects of Doing Business in Latin America: Free Trade - The Door Opens: Chapter I: Update on Laws Affecting Business

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CHAPTER I: UPDATE ON LAWS AFFECTING BUSINESS

BRAZIL

Antonio Mendes[1]

By way of background I would like to say that we should first recall that Brazil has suffered five economic shocks in recent years, which were the so-called Heterodox Plans. Each of them was different in what they attempted to achieve and in the mechanisms that they utilized. They all, however, had a common denominator. They were prepared by economists who had no regard for the law. The economists thought of themselves as being above the law and saw themselves in the position of being almost in a state of war, and they could do as they pleased. Those economists thought that the law should not be a barrier to their grim plans and that the goals would justify the means; so they did as they pleased.

At that time, people were so fed up with inflation and the problems that inflation brought that they were receptive to the economists' ideas; which is why the economists were able to get away with their plans for such a long time. For example, when President Fernando Collor de Mello was inaugurated, he announced the initial Collor Plan on the very same day of his inauguration. Collor attempted to convey the idea that he was fulfilling his campaign promises and it became almost unpatriotic to challenge what the Collor Plan proposed to do. The general feeling at the time was "let us give the Plan a chance to work despite all the legal questions and the constitutionality of various measures adopted by the Plan."

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As we know these Plans did not work, and eventually people resorted to the courts to claim their rights. Initially the law suits came on an isolated basis; then they became an avalanche. More recently Minister Marcílio Marques Moreira, who is presently the minister in charge of bringing good common sense back to economic planning, took the position that the law should be respected. This position is very comforting to lawyers since this position reflects a change in policy making. There also is an expectation that we will not undergo new economic plans and whatever is to be done will be done through legal mechanisms instead of adopting provisional measures which would have the force of law and are pushed through congress.

The government now sends bills to congress on an orderly basis and fights, through political means, to achieve its goals. Sometimes the government gets what it wants and sometimes it does not, but at least Brazil is now back to where it should have been from the very beginning. Parallel to this situation, the government has been taking action to liberalize the country and change some positions which were previously sacred in the economy. These changes are welcome, but they have a severe impact on the existing economic order. The result is that we now have a rather complex situation. The changes are welcome, but they are causing substantial pain in terms of recession, unemployment, lower salaries and higher costs of living. In summary, this is the background against which industry and commerce must work.

Given this background, I now would like to discuss recent developments. What I have done is to pick out, in an almost haphazard way, items that might be of interest to you.

The first item is foreign exchange. We have had tight exchange controls in Brazil for many years. The foreign exchange system was administered by the Central Bank. The Central Bank would set the foreign exchange rates by which Banco de Brasil would operate. Although other banks were technically free to trade, in fact, they were forced to operate at the rate at which Banco de Brasil operated. These foreign exchange rates were called the "administered rates." All foreign exchange transactions required some consent from the Central Banks. For example, imports and exports, foreign loans, foreign investments, remittances of dividends, remittances of profits and almost every other transaction required either an import license or a Central Bank Certificate of Registration; otherwise, no transaction could be undertaken.

Parallel to all of this, we had the black market, or the "parallel market." At one point in time, the black market was very illegal, very questionable and people would shy away from it.

The Collor Plan created two exchange markets, both of which were controlled and supervised by the Central Bank. One of the markets is the commercial market, which corresponds to the previous official market where foreign trade and investment registration is conducted. The other market is the tourist market, which was devised initially to promote tourism but enlarged from time to time to encompass all transactions. For instance, you may now buy software through the tourist exchange market, make remittances for maintenance of children or pay a hospital bill.

Both markets operate on a free rate and as a result the Central Bank no longer establishes rates for Banco de Brasil which forces other banks to operate at those rates. Instead the Central Bank lets the market establish its own rate, and occasionally interferes. When the Central Bank does interfere with the market, it does so through purchase and sale of either gold or foreign currency itself. That way the Central Bank can still influence the exchange rate, but only by either selling reserves or purchasing a substantial amount of foreign exchange. This system is more or less what you see in the exchange markets of other developing countries.

There is however, one very interesting aspect of this tourist foreign exchange market. When the government created the tourist market, it was not totally free. For example, you could not go to the tourist market and buy $1 million United States dollars and send it abroad for investment in Switzerland. Tourists could only buy amounts necessary for certain items. Thus, you had to have a reason which was acceptable under the regulations. The foreign exchange system could have easily developed into a situation where the commercial market operated at one level, the tourist market operated at another level and the black market would operate at yet another level.

The government's idea was to do something which would eventually lead to the unification of the exchange markets, with the final goal of having total freedom of exchange. The government changed the tourist market regulations to allow banks in Brazil to freely trade with banks abroad with no limitations, no restrictions and no prior approval required. The banks could do anything they wanted. Therefore, there is total freedom of exchange; provided it is done amongst financial institutions.

This aspect of the tourist market provides a sort of communication base between the tourist market and the black market. For example, a bank in Brazil that has dollars to exchange but cannot find buyers in the tourist market at profitable rates can sell them to a foreign bank abroad. As a result, the transaction will be at the same rate as those in the black market. The government also has created other

mechanisms which allow banks to either buy or sell cruzeiros in Brazil by transacting with Brazilian financial institutions and then making those funds available to their clients abroad. In 1960, the black market was an illegal market and no one serious would touch it. Today, the black market continues to be illegal *per se* and serious people continue not to touch it. However, there are a number of transactions that are legal and that can be easily carried out through financial institutions. It all depends on how aggressive one is in taking advantage of these transactions.

Before the tourist market was created, parties interested in getting foreign currency at better rates used a mechanism known as "blue chip swaps." Although there were a few other mechanisms, most parties utilized the blue chip swap mechanism. What parties did, more or less, was to default. A party with cruzeiros in Brazil who wanted to get dollars abroad would usually go through a bank, which would act as an intermediary to contact a party abroad who wanted to have cruzeiros. The foreign party would then buy blue chip stock in the United States or Europe and sell those stocks to the party having cruzeiros. The party having cruzeiros would then buy shares of the blue chip stock, paying in cruzeiros, and then immediately sell the blue chip stock abroad for dollars.

When blue chip swaps started, they were very questionable. Everyone was very concerned as to what would be the reaction of the Brazilian monetary authorities. Then an article appeared in a Brazilian newspaper called *Gazette American Cheo*, which Brazilians like to compare to the *Wall Street Journal*. The newspaper contained a lengthy article describing, in detail, the transaction and all of the steps necessary to carry it out. The initial question was what would the Central Bank do after the article appeared. The Central Bank did nothing; clearly indicating that it did not want to interfere. The Central Bank held the position that those types of operations were not really against the governmental policy of moving from a strictly controlled exchange market to, eventually, a free exchange market. So in the area of foreign exchange, we believe that by the end of the Collor government Brazil will have total freedom.

Given the situation, how does this reflect on companies investing in Brazil? We know that companies investing in Brazil would always go through the commercial exchange market to get foreign currency registration which enables the company to take profits outside Brazil or to repatriate their investment when they sell their shares. I believe people will continue to use the commercial exchange market for foreign investment. As a result, the two markets are now very close. For

example, two or three weeks ago the tourist market was operating at rates lower than the commercial market, which is very unusual.

Presently we have a number of investors taking positions in foreign exchange expecting that this situation will reverse itself within, say, sixty to ninety days, and they can make a gain on the differential. In sixty to ninety days we will find out whether that will happen. Foreigners should continue to make investments through the regular commercial market, but be aware of these changes and know that eventually the two markets will mingle into one market, which we expect will be a totally free market.

In the area of foreign capital registration, we have a few problems which have pestered investors for quite some time. One problem is called "contaminated investment" or "financial income." The Central Bank devised a very nice rule pursuant to which the Central Bank looks into the profits of a company and allocates those profits to a particular source of income. If that income came from operational sources, then the income would be good income and would qualify for registration. If the income came from financial investments, then the income would be bad income and would be seen as a deviation of economic activity since the company should have invested its money in its business and not in the financial market. Bad income did not give rise to foreign capital registration and, under certain circumstances, could not even be remitted abroad.

The Contaminated Investment or Financial Income Rule was enacted in 1975 and remained in place until recently. The Rule was an annoyance for many companies, because, as inflation became very high, companies had to watch their cash position and financial income. If a company had more financial income than operating income, then a lot of problems with foreign capital registration were created.

The Central Bank finally abolished this rule. As of January 1, 1992, the rule is gone and the Central Bank will no longer try to differentiate among types of income. As a result, everything that a company earns, whether coming from operations or from investments, qualifies for remittance.

Another problem which pestered investors was the average exchange rate. If an investor made a profitable investment and the investor decided to reapply profits into the business, then the profits were treated as if they were an additional investment and the investor was entitled to foreign capital registration for that amount. The Central Bank computed the amount on the following basis: it took the original amount in cruzeiros and converted that original amount, at the date of actual shifting of the investment, from a profits retained

earnings account to the capital account at the average exchange rate during the period — which meant that, if that period were a long one, the amount of foreign investment return that an investor would get would be minuscule. This computation acted as an incentive for companies to remit profits abroad rather than to re-invest in their business. That rule was also changed and investments are now registered at their foreign currency value on the date when the reinvestment is made.

Another change came about in the area of tax. Brazil used to have a supplementary income tax at rates ranging from 40% to 60% that would apply to all profits in excess of 12% of the investment base — the foreign currency investment basis. This tax was abolished and, from the end of December 1992, the tax will no longer be applied. The tax will still be applied to remittances which were made or which may be made based on the year 1991, but not from then onwards.

Brazil also has created special investment vehicles as incentives for investment in Brazilian capital markets. These special investment vehicles enjoy great flexibility in foreign currency movements and enjoy a favorable tax advantage. The tax rules state that one pays no tax on capital gains made in Brazil and one pays only a 15% tax on dividend or interest income earned from investment. Those who invest in the Brazilian capital market through one of these vehicles may send their money in, and may take their money back, with no restriction at all. The upward gain in value of the stocks is not subject to taxation; only dividend income is subject to taxation — which is generally the smallest portion of the income. These rules mean that all of these investments are basically tax free.

These capital market vehicles were created for institutional investors. Institutional investors have great flexibility in selecting vehicles for their investments. Individuals may take advantage of these vehicles if they come through one of the institutional investors, such as a fund, but individuals may not invest in their own name. They have to come through an investment fund which is controlled by an investment company outside Brazil. The idea is to avoid allowing Brazilians to take their money abroad and invest in Brazilian stocks through these vehicles, which would give them much better tax treatment than they would have if they were to invest in Brazil by normal means. Brazilians are subject to a 25% personal income tax rate; all investments in the stock market are subject to that same tax rate. Investments coming from abroad are subject to a zero rate and there is much incentive to increase foreign investment in Brazil.

Authorities overcame the problem of individual investment by not allowing direct investments other than by institutional investors, and

only allowing individuals to invest through accepted investment vehicles — basically an investment fund.

On the subject of corporate income tax, the government has tried to de-index the economy by de-indexing taxation altogether. That did not work and the government is now bringing indexation to tax collection again by creating a new index called UFIR, and all income tax is based on that index. In addition, the government is moving toward a taxation system where companies pay tax on a monthly basis.

In 1992, companies have gone through a period of adjustment. Companies have to pay their tax for 1991, and they will have to pay their tax for 1992 on a current basis. Thus, companies will have a lot of tax payments, because both 1991 and 1992 taxes will be paid simultaneously. Certain rules were implemented to make the transition a little easier on companies. However, the important aspect of all of this is that companies will have to pay tax on a monthly basis. Companies may either do that based on real figures on their monthly balance sheets, or they may do that based on estimates.

Companies may carry tax forward, but they may not carry tax backward. If a company makes profits one month it will be able to offset those profits against income losses in future months, but not against losses in the proceeding months. Companies make their final adjustment at year's end. There are some other changes in terms of rates and changes in taxation of financial income which are very technical and which time will not allow me to discuss.

ARGENTINA

Cosme Beccar Varela[2]

First, let me discuss what had occurred in Argentina before the legislative reforms. Argentina had a very strong state intervention program with two different aspects. The first crucial aspect of intervention involved direct state activity in different economic areas. The second aspect of state intervention concerned, and still does concern to a limited extent, tight and intricate regulations of different private activities — regulations which were difficult to understand and follow. These two methods of state intervention directly affected the development of Argentina.

In fact, in 1985, President Alfonsín tried something similar to the new plan, except it was more short-sighted. President Alfonsín created the Alsal Plan. The Alsal Plan created a lot of hope, but that hope did not last too long.

When President Menem was elected in 1989, Argentina was facing hyper-inflation at a rate never before seen in Argentina. This situation caused President Alfonsín to resign before his term had finished. From a constitutional viewpoint the resignation of President Alfonsín was strange and awkward, but President Alfonsín did not have any other choice because of the drastic impact of hyper-inflation in the country. Prices were rising almost as they had in Germany after the First World War. When hyper-inflation begins, as experienced in Argentina, it can be interesting, but also dangerous — hyper-inflation accelerates at various degrees so that one cannot predict how quickly or high it will rise. Thus, one must act quickly upon it.

Today, there is an agreement between the two existing political parties in Argentina — the Radical Party and the Peronist Party. President Alfonsín belongs to the Radical Party, but the Peronist Party is the party in control of government today. Initially, the Radical Party supported President Menem's proposal to congress to cope with the hyper-inflation, even though the proposal was not popular. In the shade of this agreement between the two parties, two very important laws were enacted: Law 23,696 and Law 23,697.

Argentina gives each enacted law a number. As you can imagine, practicing law in Argentia can be an impossible task when there are

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about 23,000 decrees, resolutions and other regulations issued by the government every year. The lawyer must ask the client first what the law governs. When the client answers the lawyer is only then able to give advice. One cannot construe a law unless one can first find it. I make this comment because the goverment keeps promising that it is going to make an actualization of all these laws. The laws will be put on computer so that one may push a button and know exactly what is in force at that precise moment, but they never do that because then it would be one of the most important deregulations that we may have. One would know that these numbers should be changed — a particular law is not 23,696 but, say, 251. The laws that are really valid in the country are much fewer than these higher numbers indicate.

Well, the first law was called the "Reform of the State," whereby congress authorized the executive power to sell many of the state companies and many or most of the state buildings that were being used for governmental purposes. This law was very important because most of these state-owned companies were accruing losses for the government which were extremely high — the railroads alone were losing $1 million United States dollars a day. One may imagine that for a bankrupt economy to lose $1 million a day in just one state-owned company is almost an unbearable burden. Law 23,696 also authorized the government to change some of its practices. These changes led the way to the deregulation.

The second law was called the "Declaration of Emergency." It was Law 23,697, enacted immediately after Law 23,696. This law permitted the government in one single stroke to put down the very complicated foreign investment laws that had been enacted by the previous government. There was also a very bold Minister of Economics who did many things and took many steps in this same regard, but he did not dare to do many of the things that are being done now. One of the things that he did not dare to do was to fully open the economy to foreign investors. The registration procedure and the approvals required were sometimes very complicated, and they depended so much on the will of the officers in charge that one had to run a great risk when investing in the country.

In one single chapter of this new Declaration of Emergency law, the foreign investment regime was practically abolished. We now have a single registry where any investor can register an investment and be done with it. There is no need for any decree or any resolution of any official of the government — and all the areas are opened, provided they are productive.

Foreign investors do not need to associate themselves with any

local partner. The only requirement is to have a majority of directors on the board that are residents of the country — but the residents may be foreigners. If a foreigner goes to the country and takes residence there, he may join the board and comply with this requirement of the corporate law (which is an old requirement, and not in the foreign investment law) and thereby obtain the possibility of doing business in the country.

In this law there is a provision easing the restrictions for private companies, of any size, allowing the issue of negotiable instruments. This provision is very important to reduce the monopoly of the financial market held by banks and other financial entities. Any company may issue a negotiable instrument, following certain procedures administered by the stock exchange commission to obtain approval of the state of the company and the balance sheets. There are some other procedures which are also easy to comply with. These negotiable instruments may be offered at much lower rates of interest than the rates available at banks. These lower rates offer a possibility for development which is to be appreciated.

In addition, the Declaration of Emergency law suppresses all kinds of subsidies to private companies. Many of the important Argentine companies are living on subsidies from the state. For example, the aluminum company is a very important and crucial company. It has, more or less, a monopoly in the country, but it lives off substantial support from the state. The same happens in other fields. This support has been suppressed by this law and these subsidies are now abolished; consequently the deficit of our budget will be reduced.

There came afterwards, on March 31, 1991, the Convertability Law, which is a very bold law — I think it was patterned on the German Verons Reform after the Second World War. This law has been effective for the present. The law declared that the Argentine currency was freely convertible into United States dollars, and that the United States dollar would become the second currency of the country. Argentina now has two currencies: the Argentine currency and the United States dollar. One may now contract in dollars as well as australes.

The conversion rate was declared by law to be one dollar was equal to 10,000 australes. The Convertability Law was then supplemented by a second law converting the austral into a new currency called the peso which became legal on January 1, 1992. A peso is equal to 10,000 australes. This change will simplify accounting, because of the elimination of the need for the enormous figures. For example, if one compares one of these new pesos, which are theoretically equal to one dollar, to the currency in force in the country in 1967, one would have to

add about twenty-five zeros to the old peso in order to obtain one peso of today. It is an enormous figure — impossible to imagine.

This law also declared that all indexation, all monetary adjustment to debts, would be terminated. This declaration created many problems in court because it was a difficult law to apply. But it became, to a certain extent, effective between private parties, although not as much with the government. The government managed to obtain some kind of indexation, especially with regard to tax credits, through enormous rates of interest.

Additionally the oil industry was liberated to the extent that today the oil producers are no longer required to sell their crude oil to the state company, YPF, which is now in a partial state of dissolution. The labor laws also were eased and the requirements for dismissal were reduced. The powers of the unions also are being reduced, through certain tricks that I do not have time to discuss, and the unions are very much deflated. This situation is ironic, because the current president came to power through the support and with the money of the unions.

We have had recently, around November 1, 1991, a decree that was called the "Deregulation Decree," Decree 2,284 of 1991, which is more or less a program of privatization and deregulation made by the government. It is a decree that is being much discussed because it is not clear whether the government has the power to issue such a decree. The government said it was going to send the decree to congress to be ratified, which has not yet been done. This lack of action is a little grey zone in the whole scheme. The decree, if it is going to be taken literally, is a step in the direction of deregulation that should grant the right to any private person who wants to enter any activity today, held by any monopoly, of any kind, to immediately do so without any further request.

Of course, this plan is too good to be true. Although the government is gaining public relations benefits through the general declarations of the decree, private investors are not seeing results yet. For example, a client of mine might ask me how to make use of this decree, saying that the client wants to open a communications system and has entered into agreement with Intersat to communicate directly. I would say, "This is true. You have the right under this decree, but if you do that they will come with the police and they will shoot your antenna." Unless one has a private police force with which to resist, one may suffer. So many of the things that are being talked about are more or less like that. The issue boils down to who has the political strength, and sometimes the physical strength.

This fact leads me, with the closing of this short exposition, to the

dangers of the privatization process. The first danger that I can see is that the executive branch has assumed many powers that do not belong to the executive branch under our constitution. Even the President, ministers and the congressmen are running a big danger because there is in our constitution, as a result of our experience with dictatorships in the past century in Argentina, a provision called Article 29. This Article says that those who grant extraordinary powers to the executive branch will be considered traitors. The punishment corresponds to that for traitors, and is given by the penal code — perpetual imprisonment. If somebody someday, for political reasons, wants to challenge all these decrees and laws, they have good leverage with this Article. I am a little worried about the careless way in which many of these resolutions and decrees are being issued.

There is another danger, which is what the government keeps talking about, the lack of "transparency." The government always says that we want transparency in all capital markets and all these rapidly occurring privatization programs. One almost has to be "in the know" to be aware of when public bidding A, B, or C, or number one or two or three will take place, and when to present one's bid. It is very difficult. One has to find the office that is in charge in the middle of this enormous jungle of bureaucracy that is being dismantled. Then one sees a fellow sitting there at a desk. He is the one in charge of this, and no one knows him — even the one next door does not know — but here is the man who has the key to everything. So the transparency which is required in order to comfort the population that everything is being done correctly, is still badly needed.

Another problem is that private monopolies are resulting from the speedy privatization. Even the United States Embassy has presented some protests to the Argentine government because some American companies thought they were unduly held out of certain public biddings. This problem is a black spot on the whole thing. As a final comment, I would say that something very new and very important is going on. For lawyers it will be a very interesting challenge.

COLOMBIA

Carlos Urrutia, Jr.[3]

Speaking about legal developments in Colombia these days is quite a task, because there have been many changes. This past year has seen perhaps the greatest issuance ever of laws affecting business; new laws, decrees and regulations have been effectuated in practically all areas. There also is a new constitution.

President Cesar Gaviría Trujillo's government, inaugurated eighteen months ago, has made a substantial effort to open the economy, focusing primarily on the regulation of foreign trade and investment. The government is actively participating in bilateral and multilateral negotiations with other Latin American nations, the United States and members of the General Agreement on Tariffs and Trade (GATT), with an eye towards playing a much more significant role in the world market.

Colombia's economy has changed dramatically in the course of this past year. Throughout the previous decade, Colombia exported capital as did most other Latin American nations. However, Colombia was on the verge of a severe foreign exchange crisis from 1986 through 1989. The government was forced to consider renegotiating its foreign debt, an option that had been successfully avoided for most of the decade. The crisis never materialized, and the Colombian foreign currency reserves have been growing steadily for the past fourteen months — mainly because of the strength of its so-called minor exports, which now comprise more than 70% of Colombia's export revenues.

Colombia is now a major world supplier of coal, fresh-cut flowers, bananas, oil and coffee. The opening of the economy furthered this growth. Although the import regime also was liberalized, Colombia had a favorable balance of trade in 1991. This growth is not due to the revenues originating from the drug trade which is, of course, a very sensitive subject; the increases of Colombian exports and foreign exchange revenues are primarily due to legitimate businesses. Money does come in from the drug trade, but the economy is not dependent on that money.

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Unquestionably, one of President Gaviría's foremost policy concerns has been to integrate Colombia into areas of the world economy. The government is pursuing negotiations to revitalize the Andean Pact. Colombia also has been negotiating with the United States, Mexico and Canada to guarantee itself a role in whatever the North American Free Trade Agreement (NAFTA) creates.

Changes in Colombia have not been limited to economic issues. As far as Colombians are concerned, the most important development in 1991 was the adoption of a new constitution. Although the basic structure of Colombian institutions remain essentially the same, important changes were adopted to strengthen democracy. The new constitution emphasizes issues that were previously downplayed, especially in the fields of civil and human rights. Citizens now have more access to a special action which was established as a last resort for the protection of constitutional rights, and a new court was created to operate as the highest court for constitutional matters.

The former constitution provided that the only way to amend the constitution was to present a proposed amendment to congress, which would then have to approve it in two different legislatures. Several attempts to make substantial amendments to the constitution were unsuccessful, either because congress did not approve them or because they were declared unconstitutional by the supreme court. The new constitution was adopted by a constitutional assembly, which was called in a very awkward manner. The government issued a decree, essentially, calling for a new constitutional assembly. The constitutional assembly process was sort of a plebiscite calling for a new amendment and for the constitutional assembly to be elected. All of this was very highly debated and a sensitive issue because lawyers, at least for the most part, thought that this was unconstitutional. Although the new constitution became effective in July of 1991, it may be challenged in the future.

As far as business regulations are concerned, Andean Pact negotiations to liberalize the foreign investment regime went on for many years. Several attempts were made. First there was Decision 220, issued in 1989, which was unsatisfactory because it was too restrictive; at least two of the member countries issued regulations which were more liberal than what Decision 220 theoretically allowed.

In late March of 1991, the Andean Pact Commission issued Decision 291, which essentially eliminated all prior restrictions on foreign investments within the region and returns to the individual member countries the power to adopt their own rules concerning issues such as 1) the rights accorded to foreign investors, 2) the need to obtain prior approval to effect an investment, 3) the rules applicable to dispute

resolution and 4) the requirements concerning technical assistance and license agreements. Perhaps one of the most important aspects of Decision 291 is that it provides that all companies — Colombian, foreign, or mixed — operating within the region are entitled to take advantage of the trade liberalization programs, provided that their products fulfill the origin requirements set forth in the implementing regulations.

In 1991, based on the powers that Decision 291 returned to each government, Colombia issued two resolutions. Resolution 49 of the National Council of Economic and Social Policy (CONPES) was abrogated by Resolution 51, issued in October of 1991, which further liberalized the international investment statute.

The following are the most significant aspects of Resolution 51. Resolution 51 is governed by the principle of equal treatment of foreign investors vis-á-vis Colombian investors. It allows investments in intangibles such as technology, patents and trademarks. There is no limit to foreign ownership in local companies. Foreigners may invest in all areas of the economy except national defense and the disposal of dangerous and toxic waste. Foreign investors are entitled to repatriate all of their after-tax profits — a significant change from Resolution 49, issued in February, which had limited the possibility of repatriation to 100% of registered investment. Six months later, this resolution abolished all limits.

As a general rule, investments are not subject to prior government approval. However, investments in gas, oil, mining, financial institutions, insurance and public services require authorization from competent government agents. Public services include utilities, mail services, communications and waste disposal. Portfolio investments through special funds created to make investments in capital markets, are permitted. These special funds are commonly known as country funds and may be either individual funds, in which a person wanting to invest in the local stock market can create his or her own tailor-made fund, or vehicles for institutional investors called institutional funds.

The statute also applies to Colombian investments abroad. Recent resolutions of the Board of Directors of Banco de la República provide that Colombians are entitled to make investments outside the country without prior approval, provided that the investment does not exceed $500,000 United States dollars. The new constitution reassigns the powers concerning monetary policy to the board of directors of the Central Bank; the Banco de la República.

There previously existed a body called the Junta Monetaría, which was essentially composed of members of the cabinet, two or three technicians and the banking superintendent. The new constitution at-

tempts to create an independent body for monetary policy similar to the United States Federal Reserve. The board of directors of the Central Bank is an independent body; the only member of the cabinet who is also a member of the board is the Minister of Finance. Therefore, monetary policy powers are vested in the board of directors of the Central Bank.

Another change in foreign investment policy applies to free zones. Decree 2,131 of 1991 contemplates three different types of free zones: 1) those for industrial goods and services, 2) those for tourist services and 3) those for technological services. The latter two are significant innovations intended to promote the tourist industry and research and development in science and technology. The facilities and activities that may exist in a tourist free zone include hotels, travel agencies, restaurants, conferences, transportation services, sports, cultural activities and recreational activities. The tourist free zones, a new idea, is primarily a government endeavor to attract foreign exchange. In countries such as Spain and México tourism has done wonders, and the Colombian government hopes to tap the tourism market to develop something similar to what has been done in those countries.

In terms of exchange controls, the most important piece of legislation is Resolution 57 of 1991, which was one of the last resolutions issued by the former Monetary Board. This resolution implemented Law 9 of 1991, which adopted a new exchange control regime. The importance of the new regime is that, although it maintains a certain degree of control, it allows much more freedom and flexibility in all aspects dealing with foreign exchange transactions.

The new regime abandoned the centralized system controlled by the Office of Exchange of the Banco de la República. Previously, all foreign exchange transactions had been centrally controlled by the Central Bank through what was known then as the Officina de Cambios. The new regime completely dismantled the Officina de Cambios, and very few of its functions were transferred to a new office within the Central Bank. Essentially, the new regime decentralizes the exchange control system and assigns the duties to the banks. The banks are now responsible for managing the exchange control system.

For example one can go to a bank and buy foreign currency to pay for imports or other legitimate transactions, and the banks are charged with ensuring that the transaction is a "foreign exchange operation." The system has therefore been streamlined and expedited. Previously, if one needed foreign currency, one would have to apply for an exchange license, and processing the application could take several weeks. One would lose money in the process because of a system of constant devaluation, in which any delay would cause financial loss.

Obtaining prior exchange licenses is no longer necessary to remit money abroad. There are two foreign exchange markets. The first and most important is the exchange market, the Mercado Cambiario, which composes the bulk of foreign exchange transactions, including imports, exports, services rendered to Colombian residents, foreign indebtedness, airplane tickets and marine transportation services. The second is what is known as the free market, which is composed of foreign exchange revenues originating from the sale of goods and services to foreign tourists, and also from what are known as donation transfers. Colombians who live abroad whether in the United States, Europe or elsewhere, send money back to their families, and that money essentially belongs to the free market.

Resolution 57 contains a new provision concerning exchange obligations which are denominated in foreign currency. For example, a contract may stipulate that payment will be made in United States dollars. The new regime maintains that obligations stipulated in the foreign currency must originate from foreign exchange operations, which are essentially all legitimate transactions that compose the free market and the exchange market.

Significantly Resolution 57 provides that obligations arising from foreign exchange operations must be discharged in foreign currency or in Colombian pesos at the representative market rate, which is certified on a daily basis by the Superintendent of Banks. This rate takes into account the quotations for the purchase and sale of foreign exchange of foreign currency made during the previous date by the local financial institutions. This rate is published daily and eliminates what was known formerly as the official rate of exchange.

This so-called official rate still exists, but no longer has any real impact since private transactions must abide by the representative market rate. The official rate is issued by the Monetary Board of the Banco de la República and applies solely to redemption of "certificates of exchange," and perhaps to other minor aspects. However, as far as day-to-day business is concerned, the representative market rate is far more important than the official rate. For example there is a significant difference between the official rate, which is approximately 715 pesos per dollar today, and the representative market rate, which is approximately 630 pesos per dollar, a difference of over 10%. Since the exchange rate is negotiable, one goes to the bank that will pay more for the currency one is selling or charge less for whatever currency one is buying. Thus, the official rate has all but been abandoned.

Other obligations stipulated for foreign currency do not arise from foreign exchange operations as defined by Resolution 57. These obligations must be paid at the representative market rate that was in

force when the obligation was incurred. For example if you have a contractual obligation that has been denominated in foreign currency and the underlying transaction was not a foreign exchange operation, you would assume the devaluation and suffer a substantial exchange loss. Therefore, it is not advisable to denominate contractual obligations in foreign currency unless they are actually part of a foreign exchange operation.

Foreign indebtedness continues to be subject to registration. That is, foreign credits and foreign loans obtained by local businesses must still be registered with the new office in the Central Bank; no longer with the Oficina de Cambios. Registration of loans is important because it allows the borrower to make the payments due under the loan. One very significant aspect of the new legislation is that violations of the foreign exchange regime are no longer sanctioned as a criminal offense. Previously any violation of the foreign exchange regulations contained in Decree 444 of 1967 was sanctioned by monetary penalties, and nonpayment of the sanction could result in arrest. That structure has been eliminated.

In the foreign trade area Colombia, like most other Latin American nations, has opened its economy to foreign competition. The new regulations on importation have eliminated prior restrictions that usually protected local industrial sectors. The concepts of prior import license and prohibited import lists have been virtually eliminated, and one may now freely import goods and services without obtaining prior governmental approval. Furthermore, tariffs have been brought down to levels between 0% and 20% with very few exceptions. The most important exception is the local auto industry; in order to protect the Colombian auto industry import duties and surcharges are set between 30% and 40%, depending on the type of vehicle.

Essentially, import duties have decreased dramatically. The government recently eliminated the "import surcharge." The surcharge has been incorporated into the general tariffs within the levels mentioned above. The government also has created a Ministry of Foreign Trade, which is charged with all foreign trade-related issues. The new Minister of Foreign Trade directs all bilateral and multilateral negotiations on business or trade. The new law also provides for the Committee for Services and Technology within the Ministry of Foreign Trade. This Committee is charged with registering all technical assistance, license agreements, transfer of technology agreements and engineering services agreements. However, the new Committee is not yet operating; the former Royalties Committee is still charged with these duties, but probably will not exist for much longer. One need now only register a contract, rather than obtain prior approval.

CHILE

Raúl Toro[4]

In the last two years the legislative process in Chile has changed drastically. For seventeen years, preceding 1990, committees appointed by the executive operated in the shadows. Very few people — even attorneys with government connections — knew what was happening in those closed conference rooms where laws were discussed and enacted by executive decree. The legislative process is radically different now. The legislative process has returned to the pre-1973 system where congress, and the executive, share responsibility in enacting laws and permanent regulations. Permanent regulations normally take the form of law, and cannot be changed unless amended by law. I think this is important to remember, because it is different from administrative regulations of agencies or even of government officials.

We have done a lot of legislative work in Chile. Congress has been very active in the past two years and hundreds of pieces of legislation have gone through congress. The reason for this activity was a consensus on the need for certain reforms. From a political point of view, the discussion does not take place before the Chilean Senate or House of Representatives necessarily, but takes place through political maneuvering behind the scenes and political discussion outside Valparaiso, the city where congress is now seated. The new laws and the new entities created by the new laws will require implementing regulations.

I spent a few days in Washington, D.C. three weeks ago attending a seminar on foreign investment funds. Many people in the audience asked why Chile will not do away with foreign exchange regulations, and why there are so many regulations here and there. I will take the liberty of illustrating the point through my experiences in the United States. When I was in New York in 1972, the company I worked with had a budget of $4 million United States dollars per annum for a special department which devoted itself to assure compliance with United States regulations, be they federal, state or local. When I refer a client to a United States attorney and the client comes

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back to Chile, the client tells me that the United States has hundreds and hundreds of regulations in different areas. I am not for regulation or for deregulation. Regulations are a necessity of life, but the simpler the better.

I think that the regulatory process in Chile is generally simple enough. Most of you who have advised clients doing business in Chile will attest to the fact that the regulation process is not that complicated. It is not a jungle of paperwork or red tape. Things are rather straight-forward and I could give you dozens of examples of how the system works in an expedient manner.

Now, in the past year-and-a-half to two years, there have been many new laws in different areas. Although most laws deal with domestic matters, I have selected some laws which affect international businesses in Chile owned by United States or foreign corporations or individuals. The areas are investment, labor and industrial property law.

For instance, Chile has a new set of regulations issued by the Central Bank dealing with American Depository Receipts (ADR). While successful as a country, Chile was particularly successful as a private enterprise in having the Chilean Telephone Company listed on the New York Stock Exchange through ADRs. In a couple of weeks, more than $60 million United States dollars were raised through the ADR mechanism. Again, the use of ADRs might not be a new animal for you, but for Chile it was. Therefore, regulations were required from the Central Bank relating to the foreign exchange control. However, I should not use the word "control" with foreign exchange regulations. The word "control" merely means to monitor the inflow and outflow of money relating to ADRs and the conversion of receipts into shares of the Chilean Telephone Company. Also, a rule was required which dealt with tax matters.

We also had changes in the labor law area. These changes related to collective agreements, the right to strike, the union and the federation of unions — which is in a way a novelty. The principle of free hiring and free firing is kept with slight modifications or amendments. The right to severance or termination payment has been on the books for the last thirty years with different captions, ceilings and floors. Basically, the rule of a severance payment of one month's salary per full year of service or a fraction in excess of six months stays on the books.

In order to balance the law, there is a new provision which allows an employer to terminate an individual's employment agreement in case of a deteriorated economic condition of the company or the employer's industry. That particular provision did not exist before. In

general terms, the ceiling for severence pay is the equivalent of eleven years of services. Although the cap is eleven years, the employer and the employee can agree to unlimited termination pay after seven years of service.

In mid-size and large companies most workers, particularly blue collar workers, sign-up for just one single collective agreement, which does not mean that they are forced to join a union. Employees in Chile can sign a collective agreement, however union membership is not compulsory. Although workers have the right to unionize, it is not mandated when there is a labor force of more than twenty to twenty-five individuals under the same employer. I would say that more than 90% of the labor force is bound by a collective agreement, which generally lasts for two or three years.

When it comes to unions, you may know that less than 15% of the work force in Chile belong to a union. The tendency is for employees to become unionized. However outside the large corporations, including the state-owned copper companies, unions traditionally are not looked upon favorably. The strength is in the collective agreement, and obviously the employees can appoint a representative, a delegate or a committee of employees to negotiate for the whole work force.

When it comes to the right to strike, congress introduced a new law last year limiting the duration of a strike. Prior to the new law, certain procedures were meant to make the strike a more balanced contest. The first steps of the old process would lead to a dead end, where after sixty days the strike had to stop. The workers were forced to go back to work under the previous, or old, employment or collective agreement.

Under the new law, the right to strike is unlimited in the sense that the strike could last until the issues are settled with the employer. Happily, however, the longest strike that I can remember in the last two years lasted about two or three weeks. There has not been a single strike that has disrupted the employer and the industry at large; the new law has worked.

Employees have a good sense of handling their rights, their negotiating power and enforcement of their entitlements. However aside from fringe benefits, which are fairly standard for collective agreements, I do not know of any labor dispute settlement that has ended with an adjustment to salaries below the rate of inflation or consumer price index. So far, the whole idea of collective negotiations is to keep the purchasing power of money up-to-date and to cope with inflation. In addition, there is an automatic cost of living adjustment at least every six months.

In the financial area, there have also been developments. Chile

made changes to the debt-for-equity swap regulations issued by the Central Bank some years ago. The idea behind the new regulations is to de-block the money or investments under the so-called Chapter 19 or debt-for-equity swap mechanism. The old regulations provided, as a general rule, that capital investment would be blocked for ten years and profits could be repatriated or remitted after four years. The new law provides that if you pay a toll, you may repatriate your investment after three years. Although I have not made the mathematical computation in any case as to whether this change is good or bad, those companies that got into Chile under the Chapter 19 rules four or five years ago did very well. Perhaps paying a 25% toll could still be good business.

Chile attracted a lot of money toward the end of the first quarter last year because interest rates in Chile were higher than in the international market, even considering Chile's relative minor position in the international money market. This tremendous inflow of short-term money disrupted or imbalanced the numbers kept by the Central Bank. To curb this inflow of money, the Central Bank imposed a 20% forced deposit on loans coming into Chile. To register a loan was a matter of a twenty-four hour wait. A half an hour is spent filling out a form, and twenty-four hours is spent getting the form registered by an intermediary bank and authorized by the Central Bank.

Registration is good to get money in and out of Chile very quickly. The forced deposit however, which is still in effect, has created some problems. Initially some foreign investors, who were committed to loans under the previous rules, were adversely affected by the administrative decision. For example a large United States oil company filed a claim because it felt the administrative decisions, which changed the rules of the game, were discriminatory. The matter was settled subsequent to that claim.

Other changes have occurred in industrial property law. A new law covers patents, trademarks and industrial designs. In September of 1991, permanent regulations were enacted by law. The system is more up-to-date. Although the new law is not 100% to the taste of Ms. Carla Hills, the law will be discussed when Chile negotiates a free trade agreement with the United States. A couple of issues in the new law still bother the United States government. The Chilean government will have to deal with those issues.

In the patent and trademark area, Chile finally adhered to the Paris Convention, which has been internationally enforced for almost one hundred years. In addition, Chile ratified certain United Nations Conventions. These ratifications make the whole system more reliable and more stable when it comes to doing business in Chile by a foreign investor.

Regulations also have been issued for residents of Chile who wish to invest outside of Chile. Chile is concerned with excess dollars in the Chilean economy. Due to the size of the Chilean economy, Chilean and foreign joint ventures in Chile may wish to invest outside Chile. Some already have investments in Argentina, México, Ecuador and the United States. Also, the private pension fund has been very successful financially and has accumulated over ten billion dollars. I believe there will be regulations in the future which will allow pension funds to invest part of their funds outside Chile.

VENEZUELA

Carlos J. Sarmiento Sosa[5]

Since 1989, the government has applied a new economic scheme characterized by the restructuring and privatization of some companies. This economic scheme includes the liberalization of the foreign investment law, the modification of the income tax law, the modification of labor laws, the modification of financial market setting, the abolition of price controls, the setting bank interest and exchange rates and the establishment of incentives for non-traditional products. Moreover, Venezuela has decided to join the General Agreement on Tariffs and Trade (GATT). The economic freedom that has been restricted since 1961 was restored in 1991. Today, any person may engage in lucrative activity without limitation. There are no exchange controls in the country and the price of the dollar is set by the financial market. Today about sixty-two Bolivars are equal to one United States dollar.

The Code of Commerce is the legal text regulating investors, companies and commercial activities. It provides that two shareholders are required to constitute a corporation. There is no minimum or maximum capital limit. Generally the board of directors administers the company and, under the law, a certified public accountant must be appointed. Incorporation takes approximately thirty days, and the Public Registry Law sets the fees that a corporation must pay to the Mercantile Registry.

Decision 292 of the Andean Pact granted juridical life to multinational Andean companies in Spanish Empresas Multinacionales Andinas (EMAS). EMAS are those Andean enterprises domiciled in any country of the Andean Pact where it was incorporated, merged or transformed. EMAS and their subsidiaries will receive similar treatment as national enterprises and may share the sectors reserved therefore. Moreover EMAS have the right to transfer abroad up to 100% of their proven net profit coming from the investment, and they are not subject to double taxation.

In reference to the Andean Pact Free Commerce Zone, the countries of the Andean Pact decided to establish and develop a free commerce zone, or a region without commercial barriers. Beginning Jan-

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uary 1, 1992, Venezuela, Colombia and Bolivia, and beginning July 1, 1992, Peru and Ecuador, will become participants in the Free Commerce Zone. This agreement will give an ample economic space for more than 92 million inhabitants, a gross product of about $150 billion United States dollars, an annual purchasing capacity of $23 billion United States dollars in goods and services and an inter-subregional commerce with an inter-annual growth rate of 35%.

With regard to relations with outside countries, the Andean nations are entitled to negotiate bilateral or regional preference agreements with countries of the Latin American Integration Association, of Central America and the Caribbean. México, as well, was invited to participate in negotiations to reach commercial agreements between México, Columbia and Venezuela within the frame of a "group of three." Similarly, Chile and other Latin American countries were invited to join the Andean Pact.

The Venezuelan government recently enacted two important laws: the Organic Labor Law, and the Income Tax Law. The Organic Labor Law, enacted in May, 1991, improves benefits for workers. These benefits include unemployment insurance proportionate to length of employment, prior notice before termination proportionate to length of employment, better working hours and participation in profits and annual benefits of the company. Moreover, the percentage of Venezuelan workers required in companies is increased to 90%. The Organic Labor Law also addresses working conditions regarding safety and the environment, and sets certain requirements which benefit the health of employees. The law also addresses minimum salaries, and vacations. The minimum is about $110 United States dollars.

The Income Tax Law of 1991 sets the maximum tax rate for individuals, enterprises and companies. The maximum tax rate is 30% for companies involved in mining activities. Venezuela will tax enterprises involving exportation of oil and hydrocarbons at a 67.7% rate. For nonresident individuals, a different tax rate applies. The Income Tax Law also establishes regular inflation adjustments to enterprises to cover the problem of inflation. Agricultural activities are not subject to tax.

Other aspects of taxation in Venezuela affect municipal laws, social security laws, housing policy law, unemployment law and the law establishing the National Institute for Educational Cooperation. Finally, it is important to mention that the Cartagena Agreement, Decision 40, establishes rules to avoid double taxation between two Andean countries having commercial exchanges.

One special matter that all investors in Venezuela must take into consideration is legal fees. Parties generally agree to legal fees accord-

ing to the importance of the legal matters, the prestige of the law office, the client's economic capacity, the time invested by the lawyer and other relevant aspects. Regarding international investors, international fees are often determined based upon time invested by the lawyer. However, minimum regulation fees approved by the national bar association apply in the majority of the regions of the country. There is a minimum fee for the incorporation of companies. This regulation does not apply within Caracas.

Last year, Venezuela began the privatization process by opening to private capital areas of the economy that were restricted in the past. During 1991, Venezuela privatized several state companies: three banks, an airline company, a shipyard, a telephone company and a cellular telephone service. These companies, except for the banks, have been sold to corporations formed by foreign and Venezuelan investors, producing foreign exchange income to Venezuela of about $2.1 billion United States dollars. The recently enacted privatization law guarantees the continuation of the privatization process. Companies in different economic areas, including cement plants, energy plants, hotels, sugar mills, land companies and food processing plants, will be privatized in the short term pursuant to the Venezuelan Investment Fund plans. The National Ports Institute also has been restructured recently and the government is planning the same for other services, such as sewage and water supply. Concessions for the construction and maintenance of highways will soon be granted to private investors, as well.

The Initiative for the Americas in Venezuela represents a firm commitment by President Bush to form a society to insure the success of this silent revolution. This Initiative is based upon three main points: debt, investment and commerce. First, the creation of a Free Commerce Zone in the Americas has received hemispherical support. For 1991, the United States and other Latin American countries reached bilateral commercial agreements regarding a Free Commerce Zone. Negotiations are currently being held with Canada and México to establish a Free Commerce Zone in North America.

Chile, Jamaica and Bolivia have received initial benefits of this program in the form of a pardoning of $263 million United States dollars of pending debt corresponding to food assistance. Debts of Bolivia, Nicaragua, Haiti, Guyana and Honduras have also been reduced by $1.3 billion United States dollars due to the Initiative for the Americas. Loans have been negotiated through the Inter-American Development Bank (IDB) with the objective that the Latin American and Caribbean countries will liberalize their investment system and begin to privatize state companies.

The Initiative for the Americas also proposes to create the Multilateral Investment Fund (MIF), with an approximate capitalization of $1.5 billion United States dollars. This fund will supply the necessary means for regional economies, including Venezuela, to become more attractive areas for international investors during this period when South American countries must compete for United States investment with Eastern Europe and Southeast Asia.

Two new laws, the Environmental Communal Law and the Law to Promote and Protect Free Competition, should also encourage United States investment in Venezuela. The Environmental Communal Law establishes policy guidelines to protect the environment. This law will have a crucial impact on enterprises in Venezuela. Venezuelan enterprises will have to consider industrial waste disposal. This law provides for penalties, including imprisonment for directors and managers of enterprises, for those in violation of the law. Investors must carefully consider the language and intent of this law, because judicial authorities do not yet have enough knowledge and experience in its interpretation.

The Law to Promote and Protect Free Competition was enacted at the end of January 1991. This law seeks to promote the efficiency of production by restricting monopolistic behavior. It will also prohibit manipulation of economic freedom. It penalizes violations by corporations and individuals through the imposition of fines.

Presently, congress is considering approval of the following laws to establish mechanisms to regulate freedom of commerce. 1) The Law of Industrial Property will adjust to the Andean Pact Decision 311 regarding Industrial Property. This law will establish criminal penalties to punish both piracy and counterfeiting in trademark matters. 2) The General Banking and Other Credit Institutions Law creates a progressive opening to foreign activity in banking and in the financial system. 3) The Law of Insurance and Reinsurance Companies contemplates the possibility of international investment in the insurance market. 4) The Organic Law of the Budget System will create a special fund in the Treasury to avoid irregular fluctuations in the petroleum market. 5) The Organic Law for Decentralization will ensure the funds are delivered to regional governments, and will support efficiency and stability in the political decentralization process. 6) The Added Value Tax Law will establish a general tax on transactions. 7) The Consumer Protection Law will protect consumers. 8) Finally, the Judicial Branch Organic Law will establish new rules in the judicial system prohibiting political interference in judicial activities. Further, it will establish certain mechanisms to guarantee impartiality in appointing judges.

Other bills must be promoted, such as the Antitrust Law that is currently in the congress. These new laws evidence a very real tendency of the government towards establishing a free economy and an open market, supported by a stable democratic system. The investor now has the opportunity to do business in Venezuela with the certainty that the investment will be guaranteed.

Finally, I am sure that the lesson of the recent events in Venezuela will not affect the actual economic plan of the government. The majority of the country agrees that the government must go to a free market with no limitations other then those established in the law.

NICARAGUA

Jose Evenor Taboada[6]

Nicaragua has been in the news for the last several years, unfortunately, because of the political problems and the struggle for democracy. It is our expectation that from now on Nicaragua will again become reported in the news as a place of growth and opportunity for the Nicaraguan people as well as for foreign investors.

Legal changes have occurred in Nicaragua as a result of the political changes in Nicaragua. More important than the change in the law is the change in the attitude of the new government and of the whole Nicaraguan people. That is what makes it possible to see Nicaragua as a new and stable opportunity for investment.

Basically, our country continues to be governed by a constitution that was enacted in 1987. This constitution gives great power to the executive branch, and thus provides a framework that allows the executive to make substantial changes in the legal environment.

There are several major events that are taking place within the country, as well as in Nicaragua's relations with other countries, that are very important to understand. The first major event is the effort that has been made to clear up the matter of external debt. Last year, Nicaragua was able to pay its arrears with the World Bank, the IDB and the International Monetary Fund, therefore opening up new opportunities for new loans. Lending from these institutions had been cut off since the early 1980s — in the case of the IMF, 1982; in the case of the World Bank, 1984; and in the case of the IDB, 1983. Currently, these sources of financing have reopened. Last year, a loan from the World Bank of $110 million United States dollars was made to support the structural adjustment that was being carried out by the government. Another loan of $135 million United States dollars from the IDB was also signed last year. A standby agreement with the IMF of $35 million United States dollars was also signed last year. Further, the bilateral cooperation of many countries has been assisting Nicaragua — in one sense, to help to pay the huge external debt of Nicaragua, and in another sense to help finance the new restructural adjustment plan that is in force in Nicaragua. This cooperation is extremely important because it helps open many opportunities that have been closed in the past for loans from the multilateral institutions.

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6. Jose Evenor Taboada is with the firm of Taboada and Associates in Managua, Nicaragua.

Also in this area a big effort was made last year at the Paris Club to reach an agreement with the creditor countries. Under that agreement, which was signed in December of 1991, concessions were made to Nicaragua that went beyond the concessions that in the past the Paris Club had made to other debtor countries. Currently, Nicaragua is in the process of bilaterally negotiating with each creditor country the particular agreement to carry on the basic understanding reached in Paris in 1991. This agreement is also very important because it will again bring the opportunity for obtaining official financing, supplier financing, and other surces of financing which are badly needed in the country.

A third area of financing — that of banking — is still in the process of being defined. During the last negotiations with the creditor banks, in 1985 or 1986, Nicaragua was not able to pay the debt, even under the rescheduled terms that had been agreed upon in 1984. Consequently, the relationship with the banks was fully interrupted. There have been approaches to solving those problems, and it is likely that in 1992 realistic negotiations will result in the situation with the commercial banks being cleaned up.

Currently there are some banks which are making loans to Nicaragua, but on very limited terms. These loans are mostly in the area of pre-export financing, or financing with the guarantee that the given product whose manufacture was financed will be exported. The important point is that the banks are coming back again, and are trying to lend money to Nicaragua. Also, the banks are making available additional resources to finance the development of the country.

Regarding the changes in the law that have taken place in Nicaragua, I would like to first mention the new Foreign Investment Law. This law was enacted in 1991 and provides a basic scheme of benefits for investors who successfully complete an investment contract with the government.

The procedure established by the law is extremely simple. The enterprise or individual trying to make an investment in Nicaragua first fills out an application in the Ministry of the Economy. Then after consultation made internally with the particular government branches involved, or in the areas where investment will be located, an agreement is signed. This agreement provides that first, there will be access to foreign exchange for full remittance of all profit made in Nicaragua; second, there will be full access to foreign exchange in case the investor wants to repatriate the whole of the capital invested and third, in the event of an expropriation made because of public interest, full compensation in foreign exchange will be paid to the foreign investor.

This matter of expropriation, of course, was a very controversial topic when the law was discussed. The expropriation that had occurred in the past left a bitter taste in Nicaragua and abroad. Some people were just trying to forget the past but the majority recognized the fact of life that sometimes, because of public interest, the government must take over a business. In such an event, the majority saw that it is important to ensure the foreign investor that the recovery of the investor's money is guaranteed by law.

The Foreign Investment Law does not grant any particular tax relief for the foreign investor. It is mainly a law to ensure that the investor will have access to foreign exchange for repatriation of capital and profit, but the law allows in the contract some tax exemptions to be granted to the investor. Under our current legal framework, therefore, the matter of tax exemption must be found in other laws.

The Foreign Investment Law is administered by the Ministry of the Economy. In fact, most of the regulations are left for the contract to be signed with investors and provides to the investor the means of access to foreign exchange to obtain or repatriate the foreign exchange needed for the investor's business. For a tax exemption one must look to two different laws.

First is the Decree on Export Promotion, enacted in 1991. Under this law exports of "traditional products" and "non-traditional products" are given different tax exemptions. The most important exemption goes to non-traditional products. Non-traditional products are, basically, new products not delineated in the law as traditional export products. Among the traditional export products delineated are cotton, coffee, sugar, lobster and shrimp. The main fields of production are left outside the definition. Therefore, investors venturing into these new opportunities may obtain full access to the benefit of the law.

The Decree on Export Promotion also concerns the need to sign a contract with the government in order to first define the field of production, and then to define the benefit that exporters will obtain. Mainly those benefits are temporary exemption from income tax, exemption from local taxes and other benefits that relate to, for example, corporate taxes, corporate creation and transfer of shares. Under this law, the benefits are only granted until 1996. This deadline is not because there is no possibility of extending the benefits longer, rather, the government, at this stage, thought it important to establish a framework which would be beneficial to investors during the presidency of Mrs. Chamorro.

The other law which would give investors substantial benefits in the field of tax exemptions is the Decree on Free Industrial Zones. Under this Decree, enterprises are free to develop free zones. Develop-

ers of free zones, upon authorization by a governmental commission, will obtain a tax exemption for their income for up to fifteen years. They also have a tax exemption for all imports that are made in order to develop the free zone. There are several exemptions which in fact allow developers of free zone enterprises to pay no taxes at all — local or national.

Also in the same area, developers of free zone industries obtain full exemption of tax income for up to ten years, and thereafter a reduced tax exemption of 60%. Therefore, enterprises that are operating in the free zones will enjoy a very favorable tax position.

Transfer of ownership of land within the free zone is also exempted from taxation. In this regard effort is being made by the present government to attract investment to create export industries in order to narrow the trade deficit — imports now average $1,000 million United States dollars a year, compared with exports, which average only $300 million United States dollars.

For the purpose of establishing a framework acceptable for foreign and local investors, a new law was enacted allowing the creation of commercial private banking. Under the Decree of 1979, all commercial banking activity was nationalized and it was established that banks would be created and operated by the government. Foreign banks were allowed to continue operating in Nicaragua but were not allowed to take deposits from the public. This restriction caused all of them to leave the country within one or two years after the decree. Today, under the new law, it is possible to open banks. After some months of the law's operation, six banks and several financial institutions have been authorized to operate and are currently operating in the country. The minimum financial requirement to create a bank is $2 million United States dollars.

Related to this matter of banking is the monetary law. There has been no major change in the monetary law which requires Nicaraguan transactions to be denominated in cordobas, but on the other hand, denomination in foreign currency is allowed for international transactions. Moreover, payments that are going to go abroad for any reason can be denominated in foreign currency. With the inflow of foreign currency from multilateral institutions and bilateral collaboration, the Central Bank has so far been able to fill the needs of Nicaraguans and foreigners for foreign exchange. There has been, in this sense, substantial change in practice compared to what was done in the past.

The last point that I would like to make concerns, again, the matter of tax. As I stated before there are several ways to obtain partial or full exception, but those who cannot gain such benefits must pay the required taxes. The current rate for corporations is 35.5% of net

income. For individuals the rate ranges between 8% (after a minimum income level is reached) and 30.5%. Today there is a major effort to reduce all taxes on imports and the expectation is that in 1992, the maximum tax on imports will range between 10% and 20%. This range has been set up in negotiations with the International Monetary Fund, the World Bank and other multilateral organizations. It is important to remember, though, that the tendency is towards a reduction of taxes.

MÉXICO

Fausto C. Miranda[7]

Economies are creatures of social and institutional structure and do not function separately from the social, economic and political values of society. In September 1982 the social values of the population were intact but, with the protectionist economic and political values of Luis Echeverría Alvarez with José López Portillo México's two most dispicable and destructive Presidents of this century, México was on the verge of collapsing. México's economy was practically destroyed, and the reserves of the Central Bank were wiped out. We were the second most indebted country in Latin America and our financial system was unconstitutionally expropriated by a "desperado."

If we survived as an independent country, it was because of the fortitude of México's social values of unity and of fidelity to oneself, to family, to society and to the nation. México proved, again, its resilience, spiritual strength and determination to succeed.

Today, México has one of the fastest growing economies; labor, the private sector and government are united and working towards a common objective — a better México. We welcome investment from all over the world; we import consumer and durable goods from all over and we are on the threshold of eliminating man-made obstacles to Mexican and foreign investment. We are the country to invest in — not only to participate in México's growing market, but to benefit from its geographical location, human and natural wealth and to play an active role in the global economy. These facts are important to keep in mind if United States businesses are to regain the competitiveness they have lost, vis-á-vis the European Economic Community and Asia, preserve employment and properly serve their shareholders. It is also important for attorneys with a wide international practice, if they are to serve their clients in an area of the world that offers the opportunity to place service of free trade; fair, clean and honest business practices; and that contributes to the economic health of the Americas, particularly to the well being of those who live below the poverty level. Few endeavors in life offer, as does the legal profession, the opportunity to earn a good living, while doing good for the human being — the individual.

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From December 1, 1970, to mid-1985, I would not have accepted an invitation such as this. An attorney must always speak the truth, and I could have not spoken of México as the place to invest in with the pride, the confidence and the faith that I do today.

México's errors began on December 1, 1970, with Luis Echeverría Alvarez and continued with José López Portillo to November 30, 1982. During those "tragic dozen" years México passed, inter alia, the Law to Promote Mexican Investment and to Regulate Foreign Investment, the Law on the Control and Registration of the Transfer of Technology, the Law on Inventions and Trademarks and a new mining law — the Law Regulating Article 27 of the Constitution in the Area of Mining. The objective, they claimed, was to prevent México from being taken over by foreigners; strengthen Mexican investment; insure that México would receive the latest state of the art technology at fair prices; enhance creativity and develop Mexican patentable inventions; have access to others' pharmaceutical and chemical patents to produce, at lower costs, what was needed by the population and industry; preserve for Mexicans and the future generations of Mexicans the wealth of our mineral resources and to "buy Mexican" to satisfy the needs of Mexicans with Mexican-made products, to protect Mexican industry and to preserve Mexican jobs. Inebriated by the high price of oil, benighted by the egocentricism of a government which was to administer the "great Mexican wealth" and intoxicated by the lack of patriotism of a few businesspeople — beneficiaries of protectionism, who claimed "we have made it," — the federal government and some large business groups went on a borrowing spree, mortgaging the future of our children and grandchildren.

Thus, México pursued industrialization through import substitution and protectionism with high tariffs and non-tariff barriers in trade; subsidized inefficient industry and protected an industry producing poor quality, scarce and expensive capital, and consumer goods. Moreover México not only failed to develop new inventions and technology, but deprived ourselves of what others had. México restricted, or practically eliminated, direct foreign investment, halting economic and social development. Foreign capital ceased to come and whatever came was on a minority basis under the control of a few shortsighted Mexican businesspeople, who sang "lo and behold" to those who had given them a private hunting preserve.

In addition, México controlled the exchange rate; eliminated foreign currency bank accounts; restricted access to other currencies and forced exporters to sell at a price set by the government, all foreign exchange received on exports, including loans; and discouraged Mexican investors and small savers, who, concerned over the future of

their children, remitted their funds abroad, at an estimated $40 billion United States dollars. The government owned more than 1,000 businesses, ranging from complex industrial companies such as PEMEX, to restaurants and night clubs. Our foreign debt grew to over $100 billion United States dollars, of which $86 billion United States dollars were government foreign debt. Our fiscal deficit, which in 1969 was 2.2% of Gross Domestic Product (GDP), became 17.2% of GDP in 1982. Of our export revenues, 34% went to service foreign creditors. Annual inflation reached levels of 160%, and our currency was devaluated 24,000%; that is, two hundred and forty times.

The preceding were the fruits of protectionism, of trade barriers, of regulating foreign investment, of budget deficits, of government borrowing, of isolationism and of populism. Nationalism, protectionism and chauvinism destroy economies of nations and hurt societies. The United States' economy will not be helped by restricting foreign investment because the Japanese buy the Rockefeller Center or Europeans buy your industries. Your negative balance of payments will not improve if the United States Congress closes your borders; unemployment rates will not diminish because Lane Kirkland and other labor leaders tell the public that in México and the rest of Latin America labor has no rights, is exploited and will take away American jobs — few countries on earth protect labor as does México. More jobs will not be created by electing Mr. Duke so he may hunt Mexicans, Nicaraguans and Cubans in Texas, California and Florida. Likewise, jobs will not result by electing Mr. Buchanan and by refusing to look past your borders; entitlements cost the tax payers and do not balance federal budgets.

The medicine is not to do what we did in México from 1970 to 1982. The remedy is balancing the budget; opening up borders to competition; bringing in foreign investment and entering into free trade agreements with as many nations as possible. Above all, though, the remedy is to return to what made the United States, after World War II, produce more goods and services than all the rest of the world together: hard work, dedication, strength of character, determination, love and pride in your country which, in the past, made the American Dream come true. If you think I am not objective ask a fellow attorney from the Southern Hemisphere, Mr. Raúl Toro from Chile, what happened under Salvador Allende and how Mr. Augusto Pinochet's excellent free trade legislation turned Chile around.

Protectionism and closed borders do not work; be they in the Northern or Southern Hemispheres, developing or underdeveloped countries. What works, everywhere, is a free market economy, where the individual and business flourish; where competition enhances creativ-

ity, improves quality and reduces prices; where opening to foreign investment brings new technology, and fresh and innovative thinking; where elimination of subsidies erases inefficiency and laziness, reduces fiscal deficits and allows lower taxes. Free trade enables industry to better compete, acquiring inputs which cost less but are of better quality, and avails the final consumer access to better products at a lower cost. México saw this change.

When Mr. Miguel de la Madrid took office as México's President he said, "México will not disintegrate in my hands." Mr. Carlos Salinas, our current President, has stated, "proposals that give preference to a few to the detriment of the majority must be rejected. This is the case of excessive protectionism from foreign competition, inordinate regulations that give rise to monopolies and promote abuse. . . . These anachronistic practices divide the citizens into two groups: the few that derive the benefits, and the many who must pay for them. They hinder productive efforts, favor privileged relations and paralyze initiative. . . . Stability means sound public finances and open competition. . . . The countries that have had substantial deficits and have closed their economies have not promoted progress in their societies; they have promoted stagnation." Mr. de la Madrid started the restructuring of México's economic and legal structures and Mr. Salinas has rapidly modernized México. We Mexicans respect both of these gentlemen.

The following is some of what we have done. In 1986, México joined the General Agreement on Tariffs and Trade (GATT). In 1987, México signed the Bilateral Framework Understanding Between México and the United States on Trade and Investment. México adopted five of GATT's Tokyo Round Codes on licensing, customs valuation, anti-dumping, standards and subsidies. In addition, México formally requested negotiations with the United States towards a North American Free Trade Agreement (NAFTA). Chile and México executed a free trade agreement. México, Venezuela and Colombia are now working towards the creation of a free trade zone.

México has also privatized most government owned businesses. Among the most significant privatizations are the airlines, the steel mills, the mining industry, the banking industry, all the nightclubs and all the restaurants.

México has also reduced import tariffs from 100% in 1986 to a maximum level of 20% at present, with a weighted average tariff of only 11%. We have moved from a restrictive import regime, which in 1985 required import permits for practically all items, to a regime where approximately 3% of the total tariff number require import permits.

México has reduced inflation and balanced the budget, eliminated subsidies, and done away with exchange controls. There is now a program of rapid deregulation of industry and commerce in all areas — from petrochemicals to fisheries; from agriculture to telecommunications.

The most significant changes are the following: the constitutional amendments which permitted the reprivatization of the banking industry; the reversion to land tenure policies which allow México's agricultural peasants to have private property, to associate among themselves with private business and to freely dispose of their parcels; the granting to stock corporations of access to agriculture; the repealment of the Law on the Control and Registration of the Transfer of Technology of 1982, a carryover of the 1972 law and the passing in 1991 of the Law for the Promotion and Protection of Industrial Property, which repealed the Law of Inventions and Trademarks of 1976. Finally the promulgation of Regulations on Foreign Investment in 1989 and on mining in 1990, notwithstanding that the 1973 and the 1975 Foreign Investment Law and Mining Law are still in effect, are the prelude to permitting 100% foreign investment in several areas.

I will make reference to these last two laws presently, but before that let us look into the future. Most likely, all the material presented here concerning foreign investment law will be obsolete by 1993. With or without a NAFTA, México will continue to eliminate regulations which always impede growth and will eliminate man-made obstacles to progress. México hopes that the legislators in the United States Congress do not object to the NAFTA, or make its terms unacceptable to Mexicans through policies of short-sighted protectionism or unpatriotic political manipulation.

In 1992 México, on the optimistic side, will have a negative trade balance of $14 billion United States dollars; pessimistically, it could be closer to between $18 billion and $20 billion United States dollars. The repatriation of funds, and new foreign investment in 1992 under the present laws and regulations will not give us a favorable balance of payment. Privatization will only give us an additional $8 billion United States dollars. Not much is left to privatize. Hence, the answer is more foreign investment and more direct foreign investment. Mexican labor, government and businesspeople have learned the lesson. Capital goes where there are laws which give national treatment to foreign capital and where both local and foreign capital are subject to clear and transparent laws which give security, allow long term security and permit the owners of capital return on their investment as well as to increase their wealth and remunerate their savings and hard work.

To the extent that others do not try to pressure México, the government will eventually change the constitution. The areas of growth where there are real bottlenecks are those which are reserved for the Mexican government such as oil, basic petrochemicals, radioactive minerals, nuclear energy, electricity and railroads. These are the areas that are classified as strategic in the Mexican constitution, and represent the areas most resistant to liberalization.

As to oil, México's requirements are immense. In spite of México's status as a world producer, we are not satisfied in our need for refined products. If México is not pressed, while we will not give concessions for the transfer of oil, we will I think, give foreign investment an active role.

In strategic industries the opportunities are endless, and we will open them; we need to do so. It is most important, however, not to create obstacles by pressuring México. We know when and how to do it.

We still have the 1973 Foreign Investment Law and while discretionary authority is one of the worst things that can happen to any country that has authoritarian laws, in this case it has worked very well. The very same discretionary authority that the Foreign Investment Law gives the executive branch of government to regulate foreign investment was that which enabled the present government to erase obstacles to foreign investments.

We have exclusively reserved for the Mexican government: 1) oil and hydrocarbons (with one caveat); 2) basic petrochemicals (also with a caveat); 3) exploitation of radioactive minerals; 4) nuclear energy production; 5) generation of electricity; 6) the railroads; and 7) telegraphic and radiotelegraphic communications. We have exclusively reserved for Mexicans: 1) radio and television; 2) urban, interurban and federal road transportation; and 3) national air and maritime transportation (but this is also qualified with a caveat).

In the area of gas distribution there are great possibilities today. Mexican majority ownerships by law or by regulations will happen in the mining industry, secondary petrochemicals and in automotive components. However, there is a caveat that we will get to in a little while.

One hundred percent foreign investment is now allowed without the need of a special permit or authorization in what most people wrongly call "maquiladoras," which are actually production sharing facilities. One hundred percent investment also is allowed in the "Temporary Imports for Exportation" program. Here the requirements are minimum. You need initial sales of exports of $1 million United States dollars the first year. You may sell 20% within México, or 30% if one-third of the sales are in the border area.

Foreign trade companies may be 100% foreign owned with no special permits or requirements, provided they do not export oil products. The initial paid-in capital must be no less than $100,000 United States dollars, and must be increased to $400,000 United States dollars by the fourth year. These companies are required to export $3 million United States dollars the second year, $5 million United States dollars the third year and thereafter their export growth must increase 10% above the annual total increase of México's manufacturing exports.

México also allows direct foreign investment without any special requirement or permit in 547 of México's 754 economic activities. The requirements are that: 1) a maximum of $83 million United States dollars be invested in fixed assets only in the preoperating stage; 2) investment be with funds of the foreign investor or with foreign loans, not with Mexican loans; 3) paid-in capital be at least 20% of the investment in fixed assets; 4) the company maintain a favorable balance of payments during the first three years of operations; 5) industrial facilities not be established in congested areas, such as México City, Monterrey, Guadalajara and their surrounding municipalities; 6) they give permanent employment and training; 7) they use adequate technologies; and 8) they observe environmental rules and regulations to the letter of the law. The Foreign Investment Commission may waive one or most of these requirements when good cause is shown. Adherence to the environmental regulations, however, will not be waived. Our environmental laws are tougher than any of those in the United States, with the exception of California.

In addition to the 547 economic areas previously mentioned, there are forty more which allow 100% foreign owned investment if different requirements are met. The requirements are very simple and logical, they require that: 1) the investment must have a positive impact on México's balance of payments; 2) the investment must compliment Mexican investment; 3) employment must be created; 4) the investment must contribute to development of areas of lesser economic growth; and 5) the investment must bring in new technology.

Another area which allows 100% foreign investment involves a very interesting concept called the "Twenty Year Trust." One of the beauties of discretionary authority is that you can always "fool the law." In a way these trusts have effectively repealed the Foreign Investment Law, because industries which the law reserves for Mexicans are open to foreigners through the Twenty Year Trust vehicle. In gas distribution, maritime transportation, air transportation and petrochemicals which are normally reserved to Mexicans, foreign investment may come in on a 100% basis. In maritime and air transportation and petrochemicals you can do the same as in the caveats men-

tioned above. México classifies petrochemicals into categories. In the mining area, there is a law which requires 51% Mexican participation in ordinary concessions for most minerals, and 66% in national reserves. The discretionary authority allows us to create trusts to get around the law. Three types of trusts are possible: 1) a thirty year trust for exploration, 2) a twelve year trust for exploitation and 3) the twenty year trust referred to above. This scheme is something which is beautiful — the unconquerable mind of lawyers and their creativity.

For all practical purposes we have no limitations on foreign investment. The oil industry, for example, is reserved for the Mexican government, but the American companies are drilling down there and they are striking oil. We are building at present five new refineries. In two or three years we will have excellent, competitive refineries.

In the railroad industry it is the same. Although the railroads are owned by the government pursuant to the constitution, private railroad companies service the railroads and are building and administering terminals and depots.

The Foreign Investment Law is a bargaining chip that México has with the United States. My advice to you is to not let the press tell you the United States economy is so sick and to not let your labor leaders tell you that México will steal jobs from you. México's "lost decade" is evidence as to the effects of protectionism. México's free trade and balanced budget evidence what can be accomplished.