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**THE REGULATION OF FOREIGN DIRECT INVESTMENT IN MEXICO
AND THE NORTH AMERICAN FREE-TRADE AGREEMENT**

by

CHRISTIAN NADEAU (c)

A thesis submitted to the Faculty of Graduate Studies and Research in partial
fulfilment of the degree of Masters of Law.

Institute of Comparative Law
McGill University
Montreal, Quebec
April 1992



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SHORT TITLE

THE REGULATION OF FOREIGN DIRECT INVESTMENT IN MEXICO AND
NAFTA

(TOTAL CHARACTERS = 62)

This thesis is dedicated to the children of Mexico in the hope that investments and NAFTA will provide them a brighter future and to the friends who have rendered this thesis an unforgettable experience .

ABSTRACT

The legal environment for foreigners doing business in Mexico has undergone radical changes since 1984 following its debt crisis. Mexico became a member of the General Agreement on Tariffs and Trade in 1986 and changed its economic development policy from import substitution and inner growth to export diversification, promotion and an open economy. This abrupt change occurred through the implementation of new laws and regulations liberalizing the Mexican economy.

This thesis, after presenting an overview of Mexico, examines the new business environment prevailing in Mexico focussing on the laws and regulations affecting foreign investments and and foreigners in Mexico. It then compares Mexico's foreign direct investment [FDI] regulations with those of Canada and the United States in relation to the Canada-U.S. Free Trade Agreement of 1988. Since Mexico's FDI concerns and policies are similar those of Canada, this comparison provides useful perspectives for a prospective analysis of acceptable FDI regulations in a North American Free Trade Agreement [NAFTA].

With the enactment of new FDI regulations in 1989, foreigners can have 100% ownership of their Mexican operations to the exclusion of approximately 50 economic sectors where their participation is limited or excluded. These sectors are mainly in the field of natural resources and transportation. Other forms of investment, on the securities market or in temporary trusts, provide a mean to ease some of these restrictions. Also, nearly unrestricted FDI is possible for the establishment of *maquiladora* plants exporting 100% of their production. These plants for the most part assemble American parts for re-exportation of the finished product to the United States. In this case, the U.S. does not levy duty on the assembled product. The *maquiladoras* provide insight on the future of trade liberalization with the United States and Canada.

The restrictions that formerly applied on transfers of technology, intellectual property, importations and land ownership have also been liberalized to the benefit of foreign investors. The same is true of the fiscal policy and foreign exchange controls.

The adoption by Mexico of industrialized country standards and principles has led to the negotiation of a NAFTA between Canada, the United States and Mexico. Further investment liberalization will be a major part of the price Mexico will need to pay for the successful conclusion of NAFTA. Such liberalization will benefit Mexico's development provided that it retains a few of the prevailing restrictions and the legal means to implement future policies on investment, thus ensuring for itself a part of the benefits of FDI.

*** This Thesis Encompasses All Regulations In Place Before March 31, 1992.**

RESUMÉ

Depuis 1984, des changements radicaux dans l'environnement légal dans lequel opèrent les entreprises étrangères au Mexique sont survenus. Ceux-ci ont été provoqué par la crise financière auquel ce pays a fait face en 1982. En 1986, le Mexique a adhéré à l'Accord Général sur les Tariffs et les Douanes suite au changement de la politique de développement économique par la substitution des importations et le développement "interne" à une économie fondée sur la promotion d'exportations diversifiées dans un marché libre et ouvert. Ces changements brutaux ont été implanté par l'adoption de nouvelles lois et règlements qui libéralisent l'économie mexicaine.

Cette thèse, après une présentation du Mexique, examine ce nouveau régime légal qui affecte les investisseurs étrangers et leurs opérations une fois implantés au pays. Ensuite, elle compare la réglementation des investissements étrangers directs [IÉD] avec celles du Canada et des États-Unis en relation avec l'Accord de Libre-Échange Canada-États-Unis de 1988. Vu que les politiques et les soucis mexicains sur les IÉD sont similaires à ceux du Canada, cette comparaison apporte des perspectives utiles pour une analyse prospective d'une réglementation acceptable des IÉD dans un Accord de Libre-Échange Nord Américain [ALENA].

L'adoption d'un nouveau règlement sur les IÉD en 1989 a permis aux étrangers de détenir jusqu'à 100% de participation dans leur opération mexicaine à l'exclusion d'environ 50 secteurs économiques où leur participation est limitée ou exclue. Ces restrictions sont principalement dans le secteur des ressources naturelles, de la construction et du transport. D'autres formes d'investissements, par le biais du marché boursier ou l'établissement d'un trust temporaire, offrent des moyens pour diminuer l'impact de ces restrictions. De plus, des IÉD sans aucune restriction sont possibles pour l'établissement d'usines "*maquiladoras*" qui exportent 100% de leur production. Ces usines pour la plupart font l'assemblage de composantes américaines pour ré-exporter le produit fini aux É.U. Dans ce cas, les États-Unis n'imposent aucune douane sur le produit assemblé. Les *maquiladoras* ouvrent une fenêtre sur l'avenir suite à une libéralisation du commerce avec les États-Unis et le Canada.

Les restrictions qui s'appliquaient auparavant aux transferts de technologie, à la propriété intellectuelle, aux importations et aux restrictions territoriales ont également été libéralisé au bénéfice des investisseurs étrangers. La même chose est vraie de la politique fiscale du Mexique et des restrictions sur l'échange de la monnaie.

L'adoption par le Mexique de normes et principes communs aux pays industrialisés a permis la négociation d'un Accord de Libre Échange Nord Américain. De plus amples libéralisations quant aux investissements sera une partie importante du prix que devra payer le Mexique pour conclure un ALENA. Dans l'ensemble, une telle libéralisation bénéficiera au développement du Mexique si il conserve les moyens légaux d'implanter ses futures politiques en la matière lui assurant une partie des bénéfices des IÉD.

**** Cette Thèse Est à Jour Jusqu'au 31 Mars 1992.**

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INTRODUCTION

Mexico has always been a leader among developing countries. For example, Mexico was a pioneer with the expropriation of the petroleum industry in 1938. It was one of the most faithful supporters of the New International Economic Order movement of the 1970's, along with the G-77 group. Neighbour of a world power, Mexico has maintained a defiant attitude towards the United States for a long time. Mexico preferred a practically state controlled economy to economic neoliberalism, believing -successfully until 1982 that in this way it could achieve more acceptable economic development. Its regulations on foreign direct investments followed the same path, being very restrictive. Investments, if allowed, were selected through a long, narrow and discretionary selection process and were only permitted in a limited number of sectors.

Mexico has recently modified its policies toward foreign direct investment. From a very restrictive, conservative and close to hostile attitude until 1984, Mexico has totally changed its ways. Under the tremendous pressure of its public debt and an unprecedented economic crisis, Mexico has changed its economic policy from internal growth, financed by lending institutions, coupled with a policy of import substitution, to development through increased trade and investment. Mexico has suddenly established wide-open borders. In 1986, Mexico became a member of the General Agreement on Tariffs and Trade,¹ taking the

¹ General Agreement on Tariffs and Trade [GATT], *opened for signature* October 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700, 55 U.N.T.S. 187. *Decreto por el que se Aprueba el Protocolo de adhesión de México al Acuerdo General Sobre Aranceles Aduaneros y Comercio, adoptado en la ciudad de Ginebra, Suiza.* D.O., September 11, 1986; D.O., October 29, 1986 (Senate's approval). See generally R. English, "The Mexican Accession to the General Agreement on Tariffs and Trade" (1988) 23 Texas J. Int'l. L. 339 and also D. Story, "Trade Politics in the Third World: a Case Study of the

international community by surprise. This new war medicine administered to Mexico's economy is the reason for the discussions taking place now concerning a North American Free-Trade Agreement [hereinafter NAFTA]. Not so long ago, such an agreement would have been unthinkable.

In this new context, a study of the regulations and of the measures of control which apply specifically to the *gringos extranjeros*² in Mexico is of interest. In this paper, we will first study the laws regulating foreign direct investment [hereinafter FDI] in Mexico to better understand what is at stake in the NAFTA negotiations.

We will begin by describing Mexico as a whole: the country and its economy. We will then trace the path that Mexico has followed with respect to FDI until the adoption of the *Ley para promover la inversion Mexicano y regular la inversion extranjera*³. The evolution of the legal context is important to understand the magnitude of the reforms in FDI regulations of 1984⁴ and 1989⁵ and the importance of the NAFTA negotiations for Mexico.

Mexican GATT Decision" (1982) 36 Int'l. Organization 767. Canada is member of the GATT since 1948, (1948) Can. T.S. 31.

² Slang expression for foreigners.

³ *Ley para Promover la Inversion Mexicano y Regular la Inversion Extranjera* D.O., March 9, 1973. (reproduced in (1973) 12 I.L.M. 643). [hereinafter the *Foreign Investment Law*] Also reproduced in: BANAMEX, *International Trade and Investment Opportunities in Mexico*, (Banco Internacional S.N.C.: Mexico, 1990).

⁴ *National Foreign Investment Commission of Mexico, Guidelines for Foreign Investment and Objectives of its Promotion* (1984) [hereinafter the "Guidelines"].

⁵ *Reglamento de la ley para promover la inversion mexicana y regular la inversion extranjera*, D.O., May 16, 1989. [hereinafter 1989 Regulations]

After having presented this overview, we will examine the laws governing FDI in Mexico. Foreign corporations must meet different requirements if they are considering exporting the majority of their production, as in the case of *maquiladoras*,⁶ or if they intend to supply the domestic market through a "classic" investment. In the latter case, the establishment of an industry is submitted to a thorough review process in a limited number of sectors or to a simple registration process. We will go beyond this process to detail in the following chapter the specific legal environment in which foreign corporations operate. They must obey specific limitations on their imports, technology transfers, money exchange and property rights.

The final section of this thesis will deal with the implications of a NAFTA for Mexico and its FDI regulations. The first step will be to examine the regulations of FDI in Canada, the United States and the resulting provisions of the Canada-United States Free-Trade Agreement⁷ on investment and the investment flows in America. Since Mexico and Canada have followed a similar course with their policies on investment, the FTA provides an insight into possible regulations of FDI in NAFTA.

⁶ *Maquiladoras* are in-bond assembly plants where only a fraction of their production is allowed to be sold on the domestic market. The parts come in Mexico to be put together and then re-exported to other countries.

⁷ *Canada-United States Free Trade Agreement*, December 22, 1987 and January 2, 1988, H.R. Doc. No. 216, 100th Congress, 2nd Sess. 297, reproduced in: (1988) 27 Int'l. L. M. 281; External Affairs (Canada), *Accord de Libre-Echange entre le Canada et les Etats-Unis*, Copy 4-01-88, (External Affairs: Ottawa, 1988).

These elements will be integrated by looking at what is at stake in these negotiations and what course Mexico should adopt to safeguard its interests, preserve its culture and continue its economic development for the ultimate benefit of its population in a manner acceptable to all Parties of NAFTA.

CHAPTER I : MEXICO - AN OVERVIEW

A - General Overview of the Country

1) The Country, its People and Government

Mexico has an area of 1 967 547 km², which is roughly the equivalent of the Canadian prairies. Of that surface, 60 % constitutes arid or semi-arid land, however, 17 % of the total area is suitable for farming, 48 % is suitable for livestock farming and 29 % is forested.⁸

The population of the country is booming.⁹ In 1989, it was estimated to be 83 million inhabitants and it is expected to reach the 100 million mark by the end of the century. Close to one-third (31 %) of the total population lives in Mexico City. Forty-three percent of Mexicans are under fourteen and the annual growth rate of the population is two percent. Eighty-seven and a third percent of the population is literate,¹⁰ having an average per capita income of 2 360 US \$.¹¹ Mexican society, as is the case in many developing countries, is polarized

⁸ *Encyclopedia Universalis*, V. 15, (Universalis: Paris, 1990) at 246.

⁹ This factor is to be kept in mind when analyzing Mexico's laws or policies. The fact that 1.3 million people annually enter the work force is an important economic factor. See generally F. Alba, *The Population of Mexico: Trends, Issues, and Policies*, (Transaction Books: New Brunswick, N.J., 1982).

¹⁰ *L'Etat du Monde 1991-1992*, (La Découverte: Paris, 1991) at 166. Note that Canada, as the United States, has a literacy rate of 95 %.

¹¹ The Mexican government spent 2.1 % of its budget on education in comparison with 6.8 % for the U.S.A. and 7.1 % for Canada in 1988. As to per capita income, the figures are far more striking : in the USA, it stands at 21 925 US \$ per capita and in Canada at 21 910 US \$ per capita in 1990. (source : *Ibid.*)

between rich and poor: the top five percent of the population earns over twenty-five percent of the national income, the bottom forty percent of the population earns less than half that amount.¹² The official language is Spanish, making Mexico the largest hispanic state in the world.

At the administrative and constitutional levels, Mexico is a federal republic composed of 31 states and of one federal district. The central government retains the majority of the power. Only a small part is delegated to local administrations, except for public service matters.¹³ The federal executive power lies in the hands of the President of the Republic. He is both head of State and of Government. Elected by the people, his mandate is for six years and is non-renewable. He is assisted in his executive functions by a group of sixteen Secretaries.

The legislative power is exercised by the Congress which is bicameral. The Chamber of Deputies is the first level and deputies are elected for three years. The Senate is the second level and senators hold their offices for six years. The

¹² Note that *inequality* in income distribution between the population has not changed since 1950 (when figures on household income are available). As the GDP grew more than ten times between 1940 and 1980, only the upper middle-class has grown. In real terms, the GDP per capita tripled. Yet at the bottom end, 40 % of the population received 12 % of the total income as opposed to the top 20 % who earn 55 % of the country's revenue. (figures of 1983). The figure is even more imbalanced when you take in account the regressive taxation system, deemed "one of the most regressive tax systems (and most lightly taxes business elite) in all of Latin America", J. M. Cypher, *State and Capital in Mexico - Development Policy since 1940*, Series in Political Economy and Economic Development in Latin America, (Westview Press : Boulder (Colorado), 1990) at 72. [hereinafter J.M. Cypher] See also P. Aspe & J. Beristain, *Toward an Estimate of the Evolution of Inequality in Mexico*, in P. Aspe & P. Sigmund, *The Political Economy of Income Distribution in Mexico*, (Holmes & Meier: New York, 1984) at 31.

¹³ See J.H. Pena, "La Constitution Politique du Mexique" (1987) 18 R.G.D. 323. The Mexican Constitution is reproduced and commented by G.H. Flanz & L. Moreno, "Mexico", in: A.P. Blaustein & G.H. Flanz, *Constitutions of the Countries of the World*, (Oceanna: New York, 1988) (rev. Apr. 1988).

majority of deputies and senators are members of the *Partido Revolucionario Institucional* (PRI).¹⁴ All official legislative acts are published in the *Diario Oficial de la Federacion*¹⁵. Note that since its creation in 1929, the *Partido Revolucionario Institucional* has always been in power. It essentially groups the Mexican bourgeoisie, labour unions and the agrarian sector. This party is still in power today, even though opposition parties such as the *Frente Democratico Nacional* (FDN) and the *Partido de Accion Nacional* (PAN)¹⁶ are very active.¹⁷ Its political stability has helped maintain Mexico's continuous development.¹⁸

¹⁴ Their role is not very extensive : "...Congress rarely does more than give approval to a statutory draft submitted by the Executive." S.F. Maviglia, "Mexico's Guidelines for Foreign Investment: The Selective Promotion of Necessary Industries" (1986) 80 A.J.I.L. 283. [hereinafter Maviglia] For an example of the importance of the P.R.I. in the Mexican politics, see Annex I, "Electoral Results in Federal Elections and Composition of the Congress, 1979-1988". (Source: Presidency of the Republic, Federal Electoral Commission)

¹⁵ [hereinafter cited as D.O.]

¹⁶ See D. Story, "The PAN, the Private Sector and the Future of the Mexican Opposition", in: J. Gentleman (ed.), *Mexican Politics in Transition*, (Westview Press: Boulder, 1987) at 261.

¹⁷ The President of Mexico, Carlos Salinas de Gortari, entered into office December 1, 1988, with 50.36 % of the popular vote - and widespread accusations of tampering election results since there was a computer blackout during the final countdown of the ballots. (source : *ibid.*) See generally Colegio Nacional de Ciencias Politicas y Administracion Publica, *Elecciones 1988: Que Paso ?*, (Diana: Mexico, D.F., 1988).

¹⁸ This point of view is widely debated. In 1929 however there were over 50 political parties in the elections and since 1917 they had all finished in bloodshed. Mexico's political stability, where every President held power for the prescribed six years before leaving office, is in high contrast with the political scene of other countries in the region. Though not perfect (corruption is widespread), it is not a dictatorship nor a lesser breed of political procedure, as it is often viewed by the American press. M.C. Meyer, "Understanding Contemporary Mexico : the Uses and Abuses of History" in : J. R. Ladman, *Mexico - a Country in Crisis*, (Texas Western Press: El Paso, 1986); W.P. Glade, "Mexico: Party-Led Development" in: R. Wesson (ed.), *Politics, Policies, and Economic Development in Latin America*, (Hoover Institution Press: Stanford, 1984) at 94; B. Kozolchyk, "Mexico's Political Stability, Economic Growth and Fairness of its Legal System, (1988) 18 Calif. West. J. Int'l. L. 105; P. Ganster, "Political Change and Stability in Mexico: The Historical Context" (1988) 18 Calif. West. Int'l. L. J. 131. *Contra*: J. Castorena, *La democratie Au Mexique: diagnostics et potentiels* (Doctoral Thesis: Montreal U, 1991).

The President also has the power to enact decrees and regulations for specific laws. He holds a delegated legislative power for international trade matters.¹⁹ In the event of a national state of emergency, he has extraordinary legislative power.²⁰ For example, it was using that extraordinary legislative power that the petroleum industry was nationalized by way of Presidential decrees in the late 1930's. The decrees enacted then are still in effect today.

The judicial power is held by the Courts. It is under the supervision of the Supreme Court of Justice of the Nation. Judges are nominated by the President, subject to the approval of the Senate.²¹ The legal system prevalent in Mexico is of a civilian nature: private law matters are regulated by the *Codigo Civil*.²²

All these actors have been at the centre of the economic evolution of Mexico. As a country sharing a large border with a powerful nation, Mexico's contemporary history is characterized by its high degree of nationalism and of suspicion towards foreign investment and ownership in its territory. That preoccupation is reflected in every part of the Mexican Constitution.

¹⁹ *Constitucion Politica de los Estados Unidos Mexicanos (1917)*, D.O., February 1, 1917, art. 89(1), as modified in 1938. See J.H. Pena, *supra*, note 13.

²⁰ *Ibid.*, art. 29 and 49.

²¹ See Z. V. Chayet, "The Selection of Mexican Federal Judges" (1990) 20 Calif. West. Int'l. L. J. 3.

²² J. Camil & J.E. Herget, "The Legal System of Mexico" in *Modern Legal Systems Cylopedia*, vol. 1, (W.S.Hein : Buffalo, 1985) at para. 1(2).

2) The Mexican Economy²³

Over the years, Mexico has enjoyed a steady growth in its economy. From 1940 to 1982, it successfully adopted a policy of development through increased state intervention and import substitution. These economic policies were close to the economic theories of underdevelopment proposed by the late Raoul Prebisch and the U. N. Economic Commission for Latin America, created in 1948.²⁴ The main objectives of the Mexican Government were "industrialization with limited income distribution and (secondarily) agricultural modernization".²⁵

From the 1940's until 1970, Mexico enjoyed a period of growth and industrialization, moving away from an agrarian economy. Problems such as the devaluation of the Peso and high inflation affected the 1940-1950 period, but on the whole economic growth has been steady with an average annual increase of 6.2 % in GDP. Problems started to emerge in the agrarian sector of the economy in the mid-sixties.²⁶ In approximately the same period, from 1950 to 1970, the

²³ For a complete and indigenous study, see L. Solis, *La realidad economica mexicana: retrovision y perspectivas*, 17th ed., (Siglo Veintiuno Mexico, 1988).

²⁴ They were first adopted by the President Lazaro Cardenas during his term in 1934-1940.

²⁵ J. M. Cypher, *supra*, note 12, at 6.

²⁶ "In the second half of the 1960's agricultural growth suddenly slowed abruptly, this being followed (after 1970) by a marked deterioration in the agricultural trade balance and a fall in the per capita availability of domestically produced food grain. The crisis of the agricultural growth was at its most severe between 1965 and 1975 (...). The agricultural sector was unable to keep pace with rising urban demand. Urbanization posed critical problems with regard to food marketing and changes in the composition of the diet (...). It should be recognized from the outset that, regardless of the problems associated with particular state policies, any agricultural development strategy would have been hard put to accommodate these intense demand pressures." J. Heath, "An Overview of the

population nearly doubled.²⁷

Since the 1970's, Mexico has benefited from the discovery of large unsuspected petroleum reserves.²⁸ With this precious resource - and income - in hand, Mexico chose what it thought would lead to greater economic sovereignty and faster growth : further development of its economy through external financing and higher protectionism.²⁹ With the increasing availability of capital, the country was able to chose in which sector it wanted to invest. So it did - and the international financial community financed at will the expansion of Mexico's petroleum industry among other sectors. Public spending reached a high of 36 % of the GDP and many enterprises were bought by the State.³⁰

In that period, FDI was quite high even though it was tightly controlled. Investments were increasing on average by 17 % annually until 1981, when they reached a peak of 2.5 billion dollars (US). In fact, FDI had been growing

Mexican Agricultural Crisis", in : G. Philip (ed.), *The Mexican Economy*, (Routledge: New York, 1988) at 131.

²⁷ *Traumatico giro economico de Mexico en 10 anos: Banamex*, (Traumatic Economic Turn of Mexico in 10 years : Banamex), Mexican Department of Economic Studies, reproduced in : "Excelsior" (11 December 1989) at 1. The population factor is a very important one in the Mexican economy. With a growth rate between 2.5 (1980's) and 3.5 (1960's), the population doubles every 28 or 20 years.

²⁸ Major oil discoveries in Mexico had occurred before, between 1915-1925, in the Golden Lane fields. From 1940 to 1972, until the Reforma and the controversial Campeche fields were found, there were no major oil discoveries. These discoveries were particularly important, since in the 1950's, Mexico had been importing oil to cover its domestic consumption as PEMEX was inefficient.

²⁹ A. T. Kate *et al.*, *La politica de proteccion en el desarrollo economico de México*, (Fondo de Cultura Economica: Mexico, 1978).

³⁰ The number of publicly owned corporations rose by 78 % under President Echevaria's term to approximately 600 during his sexenio (1970-1976). By 1982, there were more than 1,200 public corporations. J. Cypher, *supra*, note 12, at 96.

constantly between 1955 and 1982. A recent study by the OECD reveals that "in the last period (1978-1982), marked by an economic boom and the assertiveness of the role of Mexico as a petroleum exporting state, the average influx of FDI has doubled in comparison to the 1974-1977 period and tripled in relation to the 1960's."³¹

In 1982, with the sudden drop in world oil prices, high interest rates and a western recession, Mexico was incapable of meeting its obligations.³² It was a major crisis : Mexico, as a whole, was close to bankruptcy.³³ The value of the Peso was plummeting.³⁴ From 1982 to 1988, when the total population rose from 73 to 83 million inhabitants, the GNP increased at a rate of -0.5, -5.3, 3.7, 2.8, 3.7, 1.5 and 1.1 annually. FDI shrank to a small 400 million in 1983. In the same period, inflation reached a record high of 160% and the purchasing power of the average person decreased by 60%. Along with these problems, the severe earthquake which shook Mexico in 1985 had serious consequences for the

³¹ "...pendant la dernière période (1978-1982), marquée par le boom économique et l'affirmation du Mexique comme pays exportateur de pétrole, le flux moyen des I.E.D. a doublé par rapport à 1974-1977 et triplé par rapport aux années 1960" (translation of the author) from the study of W. P. Nunez, *L'investissement direct international et l'industrialisation mexicaine*, Coll. Etudes du Centre de Développement (OCDE: Paris, 1990).

³² "For the past few years, Mexico has been riding for a fall by using big export earnings from oil to keep the Peso overvalued, even though annual consumer price inflation averaged 27 % in 1980-81 and the money supply shot up as the economy grew by about 8 % a year. In February, the government, at last, let the Peso float and it fell sharply against the dollar". "The World's Biggest Borrower hasn't got a Bean" *The Economist* (21 August 1982) at 49.

³³ R.L. Morgan *et al.*, "Legal Issues Arising from the Mexican Economic Crisis" (1984) 17 *Vanderbilt J. Trans. L.* 367.

³⁴ The value of the peso had been stable (and overvalued) since the Second World War. The aim of the devaluation was also to support Mexico's new export policy. S. Weintraub, *Mexican Trade Policy and the North American Community*, Significant Issues Series, (Center for Strategic and International Studies: Washington, 1988) at 37.

capital's economy.³⁵ These circumstances widened the gap between the social classes as the wealthier section of society put their capital in foreign banks.³⁶

This crisis has led President de la Madrid to adopt vigorous reforms and a drastic shift in economic policy towards neoliberalism. Except for the nationalization of the banks and the implementation of exchange controls,³⁷ subsequent changes have been oriented towards deregulation, privatization, reduction of tariffs and overtures to encourage FDI. The economic picture is brighter nowadays. The reforms and the liberalization movement, started by President de la Madrid and implemented by Salinas have begun to bear fruit.³⁸ International trade now accounts for 14,3 % of Mexico's GDP, a five percent increase from 1980. FDI, encouraged by the debt-for-equity swap programs and privatization, has increased to 2.6 and 4.5 billion \$US in 1988 and 1990 respectively. More significant is the increase in the value of exports, which reached 26.8 billion \$US in 1990 compared to 4 billion \$US in 1982. Of that figure, 78% was due to petroleum exports in 1982 which dropped to 35% in 1990. Imports however have increased more rapidly than exports (32.8 billions \$US in 1990).

³⁵ In downtown Mexico, some buildings are still without walls, having been steel reinforced and waiting for further funding to repair them.

³⁶ It is estimated that 30 to 60 billion \$US owned by Mexicans is now invested in foreign banks, mainly in the United States, S. Zamora, "Mexico and the Global Financial Market: Capital Flight as a Factor in National Economic Policy Making" (1988) 18 Calif. West. J. Int'l. L. 35 at 37; V. de Murguía, *Capital Flight and Economic Crisis*, (Center for U.S.-Mexican Studies, U. of California: San Diego, 1986).

³⁷ The nature of these controls will be seen *supra*, Chapter 3, Section A (3). See generally G. Gouraige, "International Banking: Nationalization of Mexican Banks and Foreign Exchange Controls - The Nationalization Decree" (1983) 24 Harv. Int'l. L. J. 212.

³⁸ That is the opinion of I.M.F. researcher A. Ize in *Trade Liberalization Stabilization and Growth: Some Notes on the Mexican Experience*, Working Paper, Fiscal Affairs Dept., (I.M.F.: Washington, 1990).

At the international trade level,³⁹ the United States is Mexico's principal economic partner. The American market absorbs 85 % of all Mexican exports. With an exchange of 63.3 billions \$US in value in 1989, Mexico constitutes the U.S.'s third largest trading partner following Canada and Japan. The total volume of trade between Canada and Mexico was 960 million \$US for the same period. Only 6.5 % of Mexican goods are exported to Canada. These goods are essentially car parts and motors, television, radio parts, computer and office equipment, precious metals and crude oil. These are subject to an average duty of 2.4 %, car parts being assessed at a 0.1 % rate and duties over 20 % in real terms being levied on textiles and shoes.⁴⁰

With this global picture of Mexico and its economy, we can now concentrate on the evolution of the Mexican approach to F.D.I.

³⁹ Please note that the FDI flows in between Canada, the U.S. and Mexico will be discussed *infra* in Chapter IV, Section B (2).

⁴⁰ You will find a complete list of the goods traded between the three countries, with a description of their value and duty rates in Annex II.

B - Historical Overview of the Mexican Approach to FDI

1) 1876 - 1973 : From Domination to Control⁴¹

From 1876 to 1911, Mexico was under the rule of the dictator Porfirio Diaz. He believed that by permitting and encouraging foreign investments in the mining sector, the basic Mexican industries would follow a development similar to that of industrialized States. These open-ended policies led to a very high level of foreign ownership and control which reached 25 % of the lands and 50 % of the global wealth of the country.⁴²

With the lack of success of these policies, caused by the deficiencies in Mexico's internal development, the need for foreign investment grew larger. Natural resources were then over-exploited. The labour force fell victim to the abuses of the country's leader. This explosive situation led to a revolution which lasted 10 years, from 1910 to 1920. One of the main themes of this revolution was the recovery of control of the economic destiny of the country by its citizens. That ideal is kept alive today through the Constitution.

⁴¹ A detailed account of this evolution can be found in the work of H.K. Wright, *Foreign Enterprises in Mexico* (U. of North Carolina Press: Chapel Hill, 1971), at 51 and ff. See also B. Sepulveda Amor and A. Chumacero, *La inversion extranjera en Mexico*, (Fondo de Cultura Economica: Mexico, D.F., 1973).

⁴² *Ibid.* See also C.- H. Stephan, *Le Mexique économique*, 3rd ed., (Chevalier & Rivière: Paris, 1905).

The Mexican Constitution was promulgated in 1917. It embeds the first restrictions on the economic activities and on the land ownership rights of foreigners. The effect of its provisions is that any foreigner has to act as a Mexican. This expressed in section 27 in these terms :

Ownership of the lands and waters within the boundaries of the national territory is vested originally in the Nation (. . .) The Nation shall at all times have the right to impose on private property such limitations as the public interest may demand, as well as the right to regulate the utilization of natural resources, which are susceptible of appropriation, in order to conserve them and to ensure a more equitable distribution of public wealth. (. . .) The State may grant the same right to foreigners [exploitation of natural resources], provided they agree before the Ministry of Foreign Relations to consider themselves as nationals in respect of such property, and bind themselves not to invoke the protection of their governments (. . .) Under no circumstances may foreigners acquire direct ownership of lands or water within a zone of 100 kilometres along the frontiers and 50 kilometres along the shores of the country.⁴³

This important territorial restriction on foreigners can be further explained by the dramatic effect of the dictatorship of Antonio Lopez de Santa Anna in the middle of the 19th century. He gave up roughly one-half of the Mexican land to the United States.⁴⁴ That led to the creation of the American states of New-Mexico, Texas, Nevada and the southern part of California and that is why the Fathers of the Constitution were careful to prevent any other foreign intrusion into their homeland.

⁴³ *Constitutions of Countries of the World - Mexico, supra*, note 13 at 22.

⁴⁴ *Peace Treaty of Guadalupe Hidalgo between the United States and Mexico*, February 2, 1848, 9 Stat. 922, T.I.A.S. no. 960.

Laws⁴⁵ and regulations⁴⁶ were adopted in the years that followed to define the Calvo Clause enacted in the Constitution.⁴⁷ In the FDI context, these laws regulated corporate "take-overs" by imposing hefty penalties on Mexican corporations who sold their shares to foreigners without the prior authorization of the International Relations Ministry.

In 1936, the Congress adopted a law to allow the expropriation of private property by the Federal Executive branch.⁴⁸ The Executive could act to expropriate for a wide variety of reasons, for example the protection of a commercial enterprise in the common interest of the Nation. On these legal bases the government nationalized the railways in 1937 and the petroleum industry in 1938.⁴⁹ To this day, PEMEX, a state company, still controls all of the petroleum industry.⁵⁰ It attributes only "service contracts" to foreign

⁴⁵ D.O., January 21, 1926. The Calvo clause is still in effect today, as it is inscribed in the Constitution. This issue is one of the many aspects that NAFTA will have to overcome since it will certainly establish an arbitration process.

⁴⁶ D.O., March 29, 1936.

⁴⁷ The Calvo doctrine, based on a theory developed by the Argentine jurist Carlos Calvo, censures all diplomatic or armed intervention as a legitimate mean to collect public or private debt and to assert private claims. Through this, any international dispute has to be resolved through the country's national courts to the exclusion of a foreign tribunal.

⁴⁸ *Ley de expropiación*, D.O., November 25, 1936.

⁴⁹ It is interesting to point out that this date seems as important to Mexico as the day of its independence in 1820. Across the country monuments can be found commemorating this event along side independence monuments. For a historical perspective at that time, See J. S. Herzog, "Le Mexique et les Compagnies Pétrolières" (1939) 30 *Les Annales de l'Economie Collective* 47 and F. Bach, "La Nationalisation des chemins de fer" (1939) 30 *Les Annales de l'Economie Collective* 66. (Available at the library of l'Ecole des Hautes Etudes Commerciales, Montreal).

⁵⁰ For a summary of PEMEX's activities, see "Pemex and the Petroleum Sector", in: *The Mexican Economy*, *supra*, note 26.

corporations.⁵¹ The intervention of the State in the economy through this vehicle had increased consistently until 1985. In that period, over 1,200 state corporations were created.⁵²

During the troubled years of the Second World War, the President made use of the special legislative powers available to him in the case of a national crisis or emergency.⁵³ The war had provoked a massive influx of foreign capital into the economy. The President proclaimed a decree intended to preserve Mexican participation in its national corporations by limiting foreign ownership of any such corporation to a maximum of 49 % of its shares.⁵⁴ That decree was a precursor to legal restrictions on FDI and the standard maximum of 49 % of foreign participation. Along with this general restriction, other decrees followed to create a Mix Interministerial Review Commission, to ban any foreign participation in the communications, air transport, petrochemical, and the electrical

⁵¹ See C.C. Joyner, "Petroleos Mexicanos in a Developing Society: The Political Economy of Mexico's National Oil Industry" (1982) 17 G. Washington J.Int'l. L. & Econ. 63. Note however that more of these contracts have been handed on to foreigners in recent years and especially since the NAFTA talks began. Canada's export insurance agency, Export Development Corporation, has established a 500 million \$ line of credit with PEMEX. (External Affairs (Canada), *NAFTA - Situation Report no 1*, (Extrnal Affairs: Ottawa, 1991) at 3. This is a change from PEMEX's previous policies. A. Megadelli, *Investment Policies of National Oil Companies: A Comparative Study on Sonatreh, NIOC and PEMEX* (Praeger: New York, 1980).

⁵² This large number of state corporations made Mexico's economy similar to a centrally-planned economy causing a lot of inefficiency and corruption. L. Rubio, "Mexico in Perspective: an Essay on Mexico's Reform and the Political Consequences" (1990) 12 Houston J.Int'l. L. 235. Note that this figure has decreased to only 269 public corporations as of March 1989. Part of President Salinas National Development Plan, the same figure was down to 941 in 1985 and 390 in 1989 (Source: Hacienda, Mexico: *A New Economic Profile*, (Ministry of Finance and Public Credit: Mexico, 1991) at 15. [hereinafter *New Economic Profile*]

⁵³ *Decreto que establece la necesidad transitoria de obtener permiso para adquirir bienes a extranjeros, y para la constitucion o modificacion de sociedades mexicanas que tengan o tuvieren socios extranjeros*, D.O. July 7, 1944.

⁵⁴ D.O., June 29, 1944.

power sectors of the economy. All decrees enacted during the war were later repealed, except those regulating the economy.

Mexico followed this policy until the election of President Echevaria in 1970. He proposed a new economic policy promoting a more equitable income distribution. The Government wished to make *public investment* a pivot for economic growth. Food, housing and consumer goods were subsidized through government entities. Debt was preferred over equity: access for FDI was further restricted.⁵⁵ Mexico thus gained control of foreign capital and investment inside its borders.⁵⁶

2) 1973 - 1992 : From Control to Openness⁵⁷

In 1973, the year of the oil shock, Congress promulgated the *Law for the Promotion of Mexican Investment and the Control of Foreign Investment*.⁵⁸ In

⁵⁵ This policy, along with the international petro-dollar context, is one of the factor of Mexico's huge foreign debt. For example, the government borrowed in order to nationalize the petrochemical primary industry in 1971. D.O., February 9, 1971. The policy's of President Echevaria were consistent with the works of the economist Raymond Vernon. See R. Vernon, *El dilema del desarrollo economico de Mexico - Papeles representados por los sectores publico y privado*, (Diana: Mexico, 1966); R. Vernon (ed.), *Public Policy and Private Enterprise in Mexico*, (Harvard U. Press: Cambridge, 1964).

⁵⁶ The birth of the *maquiladoras*, in 1965, will be explained in the chapter treating this particular aspect of Mexican FDI regulations, *infra*, Chapter II, Section B.

⁵⁷ The complete history of Mexico's regulation of F.D.I. is found in H.K. Wright, *Foreign enterprise in Mexico*, *supra*, note 41. For the 1970-1976 period, See C. Tellos, *La politica economia de Mexico, 1970-1976*, (Siglo Veintiuno: Mexico, 1978).

⁵⁸ *Foreign Investment Law*, *supra*, note 3. Regulations also accompanied the Act to govern technical aspects of the Foreign Investment Registry. *Reglamento del Registro Nacional de Inversiones Etranjeras*, D.O. December 28, 1973. It is interesting to mention that at the same time, Canada and Australia, who both have a high level of foreign ownership, adopted acts similar the same year. (*Foreign Investment Review Act*, S.C. 1973-1974, c. 46; *Foreign Takeovers Act* 1975, No. 92 of 1975,

substance, this law gathers all the existing regulations, establishes a National Foreign Investment Commission and generally tightens the rules on foreign investment.⁵⁹ Mexico felt stronger and more independent than before following the discovery of important oil reserves in its territory and the seemingly endless increase of the value of crude oil.⁶⁰ It was also encouraged by the heated discussions taking place in the United Nations concerning the establishment of a New International Economic Order.⁶¹ The participation of foreign corporations

Acts of Parliament of the Commonwealth of Australia, Assented to August 28 1975) See M. Sexton, "Regulation of Direct Foreign Investment : A case of Delayed Reaction in Canada and Australia" (1974) Aust. Bus. L. R. 95. They both implement a central review board and have many similarities with the Mexican law, though less vindictive than the latter. See the studies of M. Voghel, "Etude comparative des mesures de contrôle de l'investissement étranger au Mexique, en Australie et au Canada" (LL. M. Thesis, McGill, 1979), W.S. Barnes, "Foreign Investment in Canada and Mexico : An Agenda for Host Country Screening" (1977) 1 Boston College Int'l. & Comp. L. J. 1 and W.A.W. Neilson, "Control of Foreign Investment in Australia - A Canadian Viewpoint" (1974) Business L. R. 95.

⁵⁹ That opinion is expressed by A. B. Hyde & G. Ramirez de la Corte, "Mexico's New Transfer of Technology and Investment Law - To What Extent Have the Rules Changed ?" (1976) 10 Int'l. Lawyer 231 and shared by F.M. Latey & M. Sierra de la Garza, "Mexico - Are the Rules Really Changing ?" (1973) 7 Int'l. Lawyer 560.

⁶⁰ Note that the Andean Pact member countries had enacted an Investment Code in that same period. See generally C.F. Schill, "The Mexican and Andean Investment Code: An Overview and Comparison" (1974) 6 Law & Policy in Int'l. Bus. 437; E. Murphy, "Andean Common Market and Mexico: A Foreign Investment Profile" (1978) 13 Texas Int'l. L. J. 135; Commentary, "Legal Problems of Investment in the Andean Common Market" (1979) 1 Houston J. Int'l. L. 29. For an overview of the existing legislations in Latin America, consult the Organisation of American States Department of Legal Affairs Study, *A Comparative Study of Latin American Legislation on the Regulation and Control of Private Foreign Investment*, OEA/Ser. G CP/INF, 680/75 (Washington : General Secretariat of the Organisation of American States, 1975), D.L. Greenwald, "Multinational Enterprises in the Context of Latin American Integration: The Andean Agreement Model" (1973) 11 San Diego L. R. 245. See also J.L. Esquiros, "Foreign Investment: Revision of the Andean Foreign Investment Code" (1988) 29 Harv. J. Int'l. L. 169.

⁶¹ *Charte des droits et devoirs économiques des États*, U.N. Off. Doc. (1976) A/29/9631; reproduced in: B. Stern, *Un Nouvel Ordre Économique International?*, (Economica: Paris, 1983) and in J.Y. Morin, F. Rigaldies & D. Turp, *Droit International Public (Tome I)*, (Thémis: Montréal, 1986). Mexico was a promoter of this then new economic theory which aimed to exclude foreign intervention from the economic activities and choices, such as expropriation, of a sovereign State. The New International Economic Order, for example, proclaimed the right of a State to determine himself the proper amount of compensation in the event of expropriation to the exclusion of any foreign jurisdiction. J. Castenada, *Charte des droits et devoirs économiques des États*, (1974) Ann.

in any investment project was limited to 49 %, except in the case of the *maquiladoras*.⁶² The Foreign Investment Act reasserted the existing ban on foreign participation in economic activities reserved for the Government or Mexicans.⁶³

This Act constitutes a step forward along the path Mexico had been following since 1917 towards more independent industrialization. The pillars on which the Act rested were threefold :

- i) The proposed foreign investment must not have negative effects on Mexican enterprises;
- ii) The investment must not permit the creation of a monopoly in sectors where no Mexican enterprise exists;
- iii) The utility of such an investment will be recognized as long as it is deemed "fair" and that it corresponds to a *need of Mexico*.

It is important to note that a few months before the adoption of the Law, the Congress had adopted the *Law on the Registration of the Transfer of Technology and Use and and Exploitation of Patents and Trademarks* which was

Francais de Droit International, This Charter did not receive a wide application in positive international law. See the opinion of arbitrator R.J. Dupuy in *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. Government of the Arab Republic of Lybia*, reproduced in: (1977) 104 *Journal du Droit International* 350. See also J. Mendelson, "Compensation for Expropriation: The Case Law" (1985) 79 *Am. J. Int'l. L.* 414.

⁶² This specific decree was enacted in 1972 by the President and was not applied retroactively. It was only in 1989 that it was modified, surprising many by the magnitude of the changes.

⁶³ *Foreign Investment Law*, *supra*, note 3, Article 2, par. 4 and art. 4, par. 2. For a list of the reserved sectors, see *supra*, Chapter 2, Section A(2).

aimed directly at foreign enterprises.⁶⁴ This law created within the Ministry of Industry and Commerce a National Registry for the Transfer of Technology. Any contract falling into the wide scope of the law would be deemed null, void and of no effect if it was not properly registered. These laws established a tight web to screen any foreign investment or takeover of a Mexican firm. The most important new feature of the law was the 49% rule regarding foreign capital in domestic firms. Exceptions to this rule were very limited and rarely granted.⁶⁵

The *Foreign Investment Law* remained unchanged until 1984. From 1973 until 1982, Mexico was on a borrowing spree in order to finance its industrialization and its public corporations. This trend was intensified during the term of President Jose Lopez Portillo which ended in confusion in 1982. At that time, there was a substantial drop in international oil prices,⁶⁶ a 90 billion dollar debt,⁶⁷ the devaluation of the Mexican peso,⁶⁸ the nationalization of

⁶⁴ *Law on the Registration of the Transfer of Technology and Use and and Exploitation of Patents and Trademarks*, D.O., December 28, 1972 reproduced in (1973) 12 I.L.M. 421. [hereinafter: the Transfer of Technology Law] This Law was repealed by the *Law on the Registration of the Transfer of Technology and Use and and Exploitation of Patents and Trademarks*, D.O., January 11, 1982. This law was also repealed in 1991 with the *Law on Promotion and Protection of Industrial Property*, D.O., June 27, 1991. On these laws, see *supra*, Chapter 3, Section B(2).

⁶⁵ Maviglia, *supra*, note 14, at 293. By 1984, there had been no more than 100 or 150 Mexican Companies authorized with majority foreign investment.

⁶⁶ A 17 % drop occurred that year and the prices decreased consistently after that to a 12\$ per barrel low in 1986. (Source: OPEP, *Facts and Figures* (1991))

⁶⁷ This figure is the evaluation by the Mexican Treasury of the aggregate public and private external debt: 87.6 billion \$. (Source: The Economist, *Mexico - A Country Profile*, (EIU: London, 1992)).

⁶⁸ Stable since 1976, the Peso dropped from 26 Pesos to the dollar U.S. to 97 at the end of 1982. The exchange rate is now close to 2,700 Pesos to the dollar U.S.

commercial banks⁶⁹ and the imposition of foreign exchange controls.⁷⁰

These events prompted President Miguel de la Madrid to redefine the Mexican economy in a more liberalized form.⁷¹ While struggling with the restructuring of the debt, inflation and a disastrous earthquake, De la Madrid liberalized the *Foreign Investment Law* slightly through "Guidelines" published as advertisement in major North American newspapers.⁷² They did not change the substance of the *Foreign Investment Law*, but set forth exceptions to the 49 % rule for companies wishing to locate outside the concentrated industrial centers, that would create new jobs and produce goods suitable for export.⁷³

These "Guidelines" did not have a major effect on investors, since there had been only a limited change of attitude from Mexico. They created confusion

⁶⁹ *Decreto que establece la nacionalizacion de la Banca Privada*, D.O., September 1, 1982. All commercial banks, with the exception of Citibank and the labor union *Banco Obrero*, were nationalized. It is said that the banks were used as a scapegoat by the President as being the source of Mexico's economic difficulties. See generally Gouraige, *supra*, note 37.

⁷⁰ *Decreto que establece el control generalizado de cambios*, D.O., September 1, 1982. The imposition of foreign exchange control was exceptional in light that there had never been a control on the peso. This Decree was issued the same day of the nationalization Decree.

⁷¹ *Ley Reglamentaria del Artículo 131 de la Constitucion Politica de los Estados Unidos Mexicanos en Materia de Comercio Exterior*, D. O., January 13, 1986. The Congress enacted this law specifically to allow the Executive to liberalize foreign trade.

⁷² "On February 16th, 1984, the Foreign Investment Commission, in plenary session, made and promulgated a resolution which was immediately reported in the U.S. press as a relaxation of the rules on foreign equity participation. In fact, nothing was promulgated in an official way." F. V. Perry, "The Foreign Investment Transaction in Mexico" (1985) 8 *Loyola of L.A. Int'l. & Comp. L. J.* 67 at 71. For example, see the add in "The New York Times" (17 February 1984) at 29.

⁷³ *Guidelines*, *supra*, note 4. These exceptions applied to a limited number of sectors of greater need for Mexico. They included farm machinery, food processing equipment, textile manufacturing equipment, high powered motors, generator, turbines, telecommunications, computers, plastics, advanced biotechnology and motorcycles. On these "Guidelines", see generally J.C. Trevino, "Mexico: The Present Status of Legislation and Governmental Policies on Direct Foreign Investments" (1984) 18 *Int'l. Lawyer* 297.

since they were not published in the *Diario Oficial*. Investors soon discovered that the Foreign Investment Commission had not lost any of its discretionary power and that their projects still required the Commission's approval.⁷⁴

In 1988, President Salinas de Gortari was elected to office. From the outstart, he clearly stated his position : Economic recovery was possible with an economic reform program and the country, the society and the politics had to be modernized.⁷⁵ A year later, pursuant to the beginnings of economic reform, the regulation of FDI changed drastically. This change came as a surprise both by the manner in which it was done and due to the magnitude of the changes.⁷⁶ This time, the Regulations were published in the *Diario Oficial* as an "interpretation" of the 1973 Foreign Investment Act. This "interpretation" greatly reduces the discretionary power of the Foreign Investment Commission by setting clear guidelines. It also allows 100 % foreign ownership in all areas of the economy not prohibited by the Constitution or the Foreign Investment Act.⁷⁷

⁷⁴ R. R. Williams, "Has Mexico Kept the promise of 1984 ?" (1988) 23 Texas J. Int'l. L. 417.

⁷⁵ See generally *Plan Nacional de Desarrollo 1989-1994*.

⁷⁶ One Mexican lawyer predicted that "the existing laws, regulations and policies governing foreign investments in Mexico [would] not change substantially during the initial years of [President Salinas'] administration." H. Rojas, "Foreign Investment in Mexico: Practical Solutions, 1989 Policies" (1989) 7 Int'l. L. Quart. 1 at 14.

⁷⁷ Note that in 1984, Canada adopted a similar change of attitude towards openness which was brought with the election of a Conservative Government. The Conservatives liberalized and trimmed the screening process of F.D.I. by adopting the *Investment Canada Act* and repealing the *Foreign Investment Review Act*. *Investment Canada Act*, R.S.C. 1985, c. 28 (1st supp.). See *supra*, Chapter 4, Section A (1).

In May 1991, the Congress adopted a new Transfer of Technology and Intellectual Property law.⁷⁸ This law replaces the previous one and conforms to recognized international standards.⁷⁹ From this historical perspective, we will proceed to an analysis of these new laws and regulations which affect FDI.

⁷⁸ *Law on Promotion and Protection of Industrial Property*, D.O., June 27, 1991. This Law was adopted by the first Chamber of the Mexican Congress the same day that the American Congress adopted the fast-track approach for the NAFTA negotiations.

⁷⁹ See *infra*, Chapter 3, Section B. The tight restrictions imposed by the previous laws were abolished in favour of standards of protection and transfer of technology requirements modeled on what is found in the United States and Canada.

CHAPTER II : INVESTING IN MEXICO

- FACING THE *FOREIGN INVESTMENT LAW*

In this chapter, we will see how foreign investors are affected by the *Foreign Investment Law* and its revolutionary *1989 Regulations*. There are three ways to invest in Mexico, each of which has corresponding legal requirements. The three categories of investment are "classical" FDI, portfolio investment and the *maquiladoras*.

A - The Foreign Investment Law and the 1989 Regulations

1) Aim of the Law and Definition of Foreign Investment

The purpose of the *Foreign Investment Law* is to "promote Mexican investment and to regulate foreign investment in order to stimulate a just and balanced development and consolidate the country's independence".⁸⁰ A preference can be implied in this statement favouring Mexican investment and tight control of foreign investments. With respect to this end, the Law achieved its goals.

The Law establishes the National Commission on Foreign Investment which is responsible for its application.⁸¹ The Commission reviews investments

⁸⁰ *Foreign Investment Law, supra*, note 3, art. 2.

⁸¹ *Ibid.*, art. 11. *Comision Nacional de Inversiones Extranjeras*. [hereinafter Commission or Foreign Investment Review Commission]

following the Law, its guidelines and the criteria it has defined. Given wide discretionary powers, the Commission is composed of the President, the Secretaries of the Interior, Foreign Affairs, Finance and Public Credit, National Resources, Labour and Social Welfare and Industry and Commerce.⁸² The notion of "foreign investment" covers everyone. It is defined as any investment done by a person, moral or physical who is of any nationality other than Mexican.⁸³ This definition is extended to "foreign economic entities without legal personality" or to a "Mexican business enterprise with majority foreign capital or which foreigners are entitled, *by any title, to control the management of the enterprise*".⁸⁴

A resident of Mexico with permanent immigrant status, titled an *inmigrado*, will be considered a Mexican national for the purposes of his investment.⁸⁵ However, in the event that the investment is tied to a foreign

⁸² The composition of the Commission might appear exhaustive; in Canada, until the 1984 *Investment Canada Act* which allowed the Minister of International Trade and External Affairs to act alone, the *Foreign Investment Review Act* submitted all reviewable investments to the approval of the Privy Council. *Foreign Investment Review Act*, *supra*, note 58, art. 28. On the discretionary power of the Commission, see Maviglia, *supra*, note 14, at 290.

⁸³ *Foreign Investment Law*, *supra*, note 3, art. 2. Companies are defined generally as "the companies incorporated in accordance with the commercial legislation of the Mexican Republic or the companies and associations organized in accordance with the civil laws of the states thereof" 1989 Regulations, *supra*, note 5, art. 1, par. IX.

⁸⁴ *Foreign Investment Law*, *supra*, note 3, art. 2. This notion of management control is very broad. This same notion has been used thoroughly in the *Transfer of Technology Law*. (emphasis of the author)

⁸⁵ An "inmigrado" is a person which has been residing in Mexico for a minimum period of five years. The conditions and activities regulating these persons are found in the *Ley General de Poblacion*, D.O., December 11, 1973 and the *Regulations* in the D.O., November 19, 1976.

economic decision centre,⁸⁶ it will be deemed "foreign investment" and subject to review. Such investors are considered foreigners and thus excluded from investing in the economic sectors reserved to Mexican nationals or to the State.⁸⁷

It is interesting to note that the *1989 Regulations* were innovative, stating that investments by "International Financial Development Institutions" are not to be considered as having been made by foreign investors, if two conditions are met. First, the shares the investor acquires must be transferred to the Ministry of Commerce and Industrial Development within twenty years of the date of their initial acquisition. Secondly, the financial development institution must abstain "from conditioning the acquisition of shares of restrictive agreements or clauses of any type".⁸⁸ Any acquisition of shares, property or companies by a "foreign investor" is subject to the *Foreign Investment Law* and the review of the Commission.

⁸⁶ The *1989 Regulations* define what is deemed to be a "foreign economic decision centre" in order to limit the Foreign Investment Commissions' discretionary powers. Individuals are in that category when "(1) They directly or indirectly render subordinate personal services to a foreign investor or (2) They depend on a foreign investor to sell goods and services produced by such foreign investors". *1989 Regulations, supra*, note 5, art. 4.

⁸⁷ *Ibid.*, art. 6.

⁸⁸ *1989 Regulations, supra*, note 5, art. 9. The *General Resolution no. 1* enumerates which "Development Financial Institutions" are recognized for this purpose. They are the *International Economic Cooperation Fund of Japan* (OECF), the *Finnish Industrial Cooperation Fund for Developing Countries* (FINNFUND), the *German Economic Cooperation Society* (DEG), the *Swedish Industrial Cooperation Fund for Developing Countries* (SWEFUND), the *Danish Industrialization Fund for Developing Countries* (IFU), the *Dutch Financial Corporation* (FMO), the *International Financial Corporation* (CFI) and the *Interamerican Investment Corporation* (CII) of the *Interamerican Development Bank*. *Resolucion general numero 1 que establece un procedimiento expedito para que la Comision Nacional de Inversiones Extranjeras emita resoluciones especificas*, D.O., June 21, 1989, rule 4. [hereinafter *General Resolution no. 1*]

2) The 1989 Regulations : Mexico Opens its Borders to Foreign Investment

With the *1989 Regulations*, Mexico completely reversed its policy on FDI. From limited access, mandatory review and a maximum 49% of foreign capital participation, the new regulation allows investments with 100% participation without review, with few exceptions.⁸⁹ The discretionary power of the Commission was reduced and the *1989 Regulations* established "transparent criteria to avoid discretion on the part of the authority".⁹⁰ For the investor, many opportunities are now available when basic requirements are met. The changes happening in Mexico are real: they go far beyond the paper on which laws are printed.

There is doubt however about the constitutionality of these new regulations. The President has the power to enact such regulations though he can not contradict a law validly adopted by Congress.⁹¹ The notification procedure, which is not subject to review by the Commission, contradicts the *Foreign*

⁸⁹ There are 141 economic sectors of activity included in these exceptions out of a total of 753 classified sectors. The next section deals with these exceptions. The *1989 Regulations* are central to President Salina's new economic plan: "A thorough review of the statement of purposes preceeding the New Regulations, reveals that the simplification of Mexico's foreign investment legislation was an indispensable step to implement the new administration's economic model. Mexico could not have attempted to open its economy and modernize its industrial infrastructure without a substantial change of attitude towards foreign investment". J. Camil, "Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model" (1989) 12 *Houst. J. Int'l. L.* 1 at 22. [hereinafter Camil]

⁹⁰ *General Resolution no. 1, supra*, note 88 at Statement of Purposes.

⁹¹ *Mexican Constitution, supra*, note 19, at art. 89, para. 1. We assert that one of the reasons to proceed by the way of a regulation instead of amending the *Foreign Investment Law* was to bypass the Congress. President Salinas thus avoided major opposition and media attention to the reform. J.F. Torres-Landa, "The Changing Times: Foreign Investment in Mexico", (1990) 23 *J. Int'l. L. and Pol.* 801 at 838.

Investment Law and is thus technically unconstitutional.⁹² The contrary opinion has been expressed as well on the basis that the *1989 Regulations* do not contravene the *Mexican Constitution* as they were issued by the President and approved by his Cabinet.⁹³ In any event, a challenge of the *1989 Regulations* is unlikely to have the time to occur as the *Foreign Investment Law* will be modified or replaced by a new law following NAFTA as it was done in the case of the *Transfer of Technology Law*.⁹⁴

The review process has been replaced with a process by which the foreign investor need only notify the National Registry of Foreign Investment of his investment which can be done after entry in Mexico.⁹⁵ To qualify for automatic registration, the investment must meet six preliminary conditions. The proposed investment must include a capital investment,⁹⁶ be financed from abroad,⁹⁷ be

⁹² One respected author found that the *1989 Regulations* contradicted directly the *Foreign Investment Law* in five points. See I. Gomez-Palacio, "The New Regulation on Foreign Investment in Mexico : A Difficult Task" (1990) 12 *Houston J. Int'l L.* 253 at 255.

⁹³ Opinion of Mexican lawyer L. M. Diaz's *Legal Opinion Addressed by Dr. Luis Miguel Diaz to Licenciado Miguel Jauregui, Chairman of the Mexican Legislation Committee, American Chamber of Commerce of Mexico*, Mexico, July 13, 1989. See also M. Beccerra, *Produire et Investir au Mexique*, at 5. [Text of a presentation at conference entitled "Doing Business in Mexico: The Free Trade Challenge" organized by the Trade Centre for Policy and Law, held in Ottawa January 15, 1992]

⁹⁴ [Interview with Mexican Official, NAFTA Negotiator, held in Ottawa February 24, 1992]. See *infra*, Chapter V, Section B.

⁹⁵ *1989 Regulations*, *supra*, note 5, art. 42. The Registry was created in 1973 to record information on individuals and corporations making investments, Mexican corporations with foreign participation, trusts with foreign beneficiaries, stocks detained by foreigners and the Commissions Resolutions. *Foreign Investment Law*, *supra*, note 3, art. 23. Such a notification procedure exists as well in Canada for the acquisition by foreigners of a Canadian business of a value less than 5 millions dollar Canadian. *Investment Canada Act*, *supra*, note 77, art. 11. (50 million \$Can. in the case of indirect acquisition)

⁹⁶ *1989 Regulations*, *supra*, note 5, art. 5(1). The amount of capital is submitted to a maximum level as determined by the Ministry of Commerce and Industrial Promotion [hereinafter SECOFI]. At the present time, the maximum amount of capital allowed is 100 million U.S. dollars. *1989*

established outside of specific geographic zones,⁹⁸ maintain a positive foreign exchange balance for the first three years of operation,⁹⁹ generate employment,¹⁰⁰ use adequate technology and respect environmental laws.¹⁰¹ These specific requirements provide the investor with guidelines on which he can assess his investment's recevability. Above all, there is a presumption that facilitates meeting the preliminary conditions. The Regulation establishes a presumption to the effect that "foreign investors shall be deemed to have complied with the requirements established in this article simply by acquiring shares of the capital stock of the companies that are incorporated in accordance with the regime established in this article."¹⁰² Therefore any investor is deemed to have complied with the six preliminary requirements when he invests in Mexico.

Regulations, at transitory art. 4. Note that it would be surprising for a proposed investment of greater value to be denied access to Mexico on that basis alone.

⁹⁷ *Ibid.*, art. 5(2). This measure is in place to ensure fresh hard currency is brought in Mexico. There is a softening provision for investors already established in the country as they can reinvest either dividends or retained earnings which will be considered foreign capital. *Resolucion general numero 2 que establece criterios para la aplicacion de diversas disposiciones del Reglamento de la Ley para Promover la Inversion Mexicana y Regular la Inversion Extranjera*, D.O., June 21, 1989, at rule 10. [hereinafter General Resolution no. 2]

⁹⁸ An investor with majority ownership can not invest or establish operations in Mexico City or Guadalajara since these cities are overindustrialized and overcrowded. The rest of the country is open for investment. 1989 *Regulations*, *supra*, note 5, art. 5(3); *General Resolution 2*, *supra*, note 97, rule 12; *Decreto por el cual se establecen zonas geograficas para la decentralization industrial y el otorgamiento de estímulos*, D.O., January 22, 1986.

⁹⁹ This measure applies to 100 % foreign-owned subsidiaries who need to "maintain, as a minimum requirement, a balanced accumulated foreign currency budget for the first three years of operation", *ibid.*, art. 5(4). In the case of an acquisition, the three year term is calculated from the date of acquisition. In other cases, it is established as "the date they obtain their first income". *Ibid.*, art. 5(4), para. 2.

¹⁰⁰ New corporations with majority participation have the obligation to "generate permanent employment and establish continuous training ... for workers" *ibid.*, art. 5(5).

¹⁰¹ *Ibid.*, art. 5(6).

¹⁰² *Ibid.*, art. 5.

Furthermore, a special transitional provision created a three-year period during which the *1989 Regulations* were partially suspended with respect to the acquisition of a majority interest in existing Mexican corporations.¹⁰³ This three-year grace period was useful for multinationals who wanted to acquire their subsidiaries. As long as foreigners carried investments in new fixed assets to the equivalent of 30% of the fixed assets value, increased paid-in capital by 20% of new capital investment and balanced their foreign currency operations for a period of three years, they could benefit from this temporary provision. Such investors must still meet the conditions required for incorporation with 100% foreign capital which is easily achieved, given the presumption in their favour.

3) Economic Activities with Limited Access to FDI

The *Foreign Investment Law* follows a combination of a key sector approach and of a centralized review system in its application.¹⁰⁴ In effect, entire sectors of the economy are excluded in full or in part from foreign participation. The advantage of this method is its clarity: investors, even though they might not like it, know what to expect.¹⁰⁵ Foreign investors are allowed to invest up to a maximum percentage of participation. Below that level of

¹⁰³ This period ends May 17, 1992. *Ibid.*, Transitional Provision, para. 6.

¹⁰⁴ On the different approaches, see A.M. Rugman, D.J. Lecraw and L.D. Booth, *International Business - Firm and Environment*, Series in management, (McGraw-Hill: New York, 1985), at 274 ff.; C.D. Wallace, *The Legal Control of the Multinational Enterprise - National Regulatory Techniques and the Prospects for International Controls* (Kluwer: The Hague, Boston, 1983).

¹⁰⁵ The United States has a liberal approach to FDI as it claims to be "open for business and foreign investments". Yet serious impediments are often imposed on the foreign investor wishing to establish operations in the United States by a string of laws in a variety of sectors which can impede on the foreign investor in a discriminatory manner. See *supra* Chapter 4, Section A(2).

participation, the approval of their investment is automatically granted.¹⁰⁶ The 1989 Regulations have liberalized this provision by permitting a higher stake in some of the limited sectors with the formal approval of the National Foreign Investment Commission.¹⁰⁷ In this case, the Commission bases its decision on the notion that the investment is complementary and does not replace internal investment, that it contributes to exports and creates jobs with higher wages.

The sectors restricted to foreigners participation can be divided into four groups.¹⁰⁸ The first group contains all the economic sectors reserved to the State, the second group comprises all sectors reserved to Mexican nationals, the third group contains sectors where foreign participation is allowed but limited to a certain level and the fourth group includes the sectors where foreign participation is unrestricted but still subject to review by the Commission.

i) Only the State may engage in any one of the following eleven activities: gas and petroleum production and refining, radioactive mineral exploitation, refining and treatment, electricity production, transmission and supply, railway transportation, telegraph, banks, trusts and mutual funds.¹⁰⁹ As can be seen,

¹⁰⁶ *Foreign Investment Law*, *supra*, note 3, art. 5.

¹⁰⁷ *1989 Regulations*, *supra*, note 5, art. 5.

¹⁰⁸ A complete description of the 141 regulated activities as listed in the *Mexican Catalog of Economic and Productive Activities*. See Annex III.

¹⁰⁹ *Foreign Investment Law*, *supra*, note 3, art. 4. The banks, nationalized in 1982, are now in the process of being privatized by the Government. See the *Law on Credit Institutions*, D. O., July 18, 1990. This law establishes new rules for the administration and surveillance of banks. Foreigners can buy shares to a maximum level of 30 % of the value of the capital. However, the participation of individuals, foreign or Mexican, is limited to 5% (10 % with an authorization from the Ministry of Finance). With this policy, the Government intends to disperse the ownership of banks. It has caused some resentment in the financial community and foreign banks are pressuring to be allowed a higher stake in their capital. [Interview held in Mexico city with Gilberto Sierra-Valdes, Ministry

the Government holds large interests in the energy field. This has been the case since 1938 when Mexico first nationalized the petroleum industry.¹¹⁰

ii) The second group includes activities reserved to Mexican nationals. Essentially, these thirty-three activities are related to the fields of forestry, gas distribution, air, water and land transportation, credit, financial and insurance institutions.¹¹¹

iii) The third group comprises thirty-nine activities where foreign participation is allowed but only in a limited way. The limitations vary from 34 % or to 49 % of the capital of the corporation involved in such activities. Investment to a maximum level of 34% is allowed in the areas of exploitation and refining of coal, sulphur, metal and phosphor.¹¹² At the 40 % mark, there are the manufacture of secondary petrochemical products, of car and truck electrical systems, body, gear, suspension, breaks and "all other parts and accessories for

of Finance, privatization sector, May 24, 1991] The opening of the financial services sector in Mexico has brought the support of Canadian banks for NAFTA. [Interview with Regional Representative in Mexico for the Royal Bank, held in Mexico City May 22, 1991]; Royal Bank, *Why Should Canada Get Involved in NAFTA?*, Econoscope Special Edition, (Royal Bank: Montreal, 1991).

¹¹⁰ Apparently, the petroleum industry is not part of the negotiations on NAFTA as the United States know that would be as unpopular in Mexico as an opening of borders to Mexican workers in the United States. The spin-off industries would, however, be included. [Interview held with an American diplomat, NAFTA negotiator, in Mexico city, May 21, 1991]

¹¹¹ The complete list of activities is found in the *Foreign Investment Law*, *supra*, note 3, at article 4. They are: Forest exploitation and implantation, gas distribution, transportation of construction materials and other specialized transportation of merchandise, moving services, inter and intra city buses, taxis, air taxi, taxi stations, school and tourist buses, coastline and high-sea towing, air transport with planes registered in Mexico, credit cooperatives, public warehouses, money exchange services, financial advice and promotion, loan institutions and all other credit institutions, stock trading services, investment companies, bond services, independent pension funds management, custom broker services, management of ports. Note that all professional services are also restricted to Mexican nationals by law.

¹¹² *Ibid.*, art. 5.

a car or a truck".¹¹³ A maximum level of foreign participation of 49 % is allowed in fishing,¹¹⁴ exploitation and refining of minerals,¹¹⁵ manufacture of explosives, fireworks, firearms,¹¹⁶ transportation on rivers and lakes, telephone and telecommunication services.¹¹⁷

An innovation of the *1989 Regulations* is that foreign investors can participate in a corporation operating in the second or third group of economic sectors on a temporary basis through special trusts for an *unlimited level of participation*. These trusts are subject to specific rules and can be established for a maximum of twenty years.¹¹⁸ A Mexican bank acts as trustee, acquiring the shares for the benefit of the foreign investor who provides the capital. Using this mechanism, the foreign investor has the benefit of dividends but no voting rights.

The Commission has the authority to authorize such investments and the conditions the investor must meet are stringent. In order to benefit from a positive review, the company acquired must be experiencing financial or foreign

¹¹³ *Ibid.*, art. 5.

¹¹⁴ This includes fishing in deep, shallow and fresh water and breeding.

¹¹⁵ Minerals included in this sector are gold, silver and other precious metals, mercury, antimony, lead, zinc, copper, feldspath, gypsum, barytum, fluorine, salt, graphite, as well as all other minerals needed to obtain other chemicals and other non-metallic minerals. See E. Losanno Rocha, "Operating a Mine in Mexico - an Overview of the Legal Considerations" (1982) 27A Rocky Mountain Mineral L. Inst. 431.

¹¹⁶ Retail selling of firearms and munitions is also restricted to a 49 % foreign participation.

¹¹⁷ *1989 Regulations*, *supra*, note 5 art. 5.

¹¹⁸ *Ibid.*, art. 23.

currency difficulties¹¹⁹ and must require new capital to finance new technology, modernize its production and increase exports. In addition to these conditions it must be shown that no Mexican investor could be identified, that Mexicans with preferential stock rights have waived such rights and that the foreign investment will be in cash or consist of a capitalization of the company's liabilities.¹²⁰ Final approval will be granted only if the foreign investor allows SECOFI to participate and cooperate in the establishment of guidelines compatible with Mexico's general economic development policies.¹²¹

iv) The fourth group includes activities where foreign direct investment may represent a 100% stake in the corporation but, in order to do so, require the preliminary approval of the Commission. This sector, with a total of 58 activities, is by far the largest. The relevant activities include agriculture, livestock breeding, construction,¹²² drilling of gas, petroleum and water wells, schools,¹²³ judicial, accounting and brokerage services, the management of bus terminals, highways, international bridges, airports and services associated with financial and

¹¹⁹ This means "in a situation of extreme financial imbalance, a state of insolvency... that is the consequence of (a) the existence of large amounts of liabilities... (b) the drastic decline in their total sales" *Ibid.*, art. 23 (1).

¹²⁰ *Ibid.*, art. 23 and 24.

¹²¹ *Ibid.*, art. 26.

¹²² Including residential, commercial and industrial construction, the construction of electrical plants and transmission lines, water treatment plants, pipelines, rail roads, roads and streets, the erection of cement or steel structures, the installation of hydraulic lift and electrical systems in buildings, telecommunications and other specialized facilities, demolition, foundations and excavations.

¹²³ "Schools" include all levels of education, from kindergarten to university and folk, art, commercial or technical specialized schools.

insurance institutions.¹²⁴

These restrictions are less stringent than they were only five years ago. Telecommunications where foreign investment is allowed up to 49 % were previously reserved to the State. Fourteen petrochemical industries have been reclassified in order to allow a minority foreign participation rather than total State control. With respect to insurance, the legal foreign participation level was raised from 15% to 40%. Such a liberalization occurred as well in banking and mining sectors.¹²⁵

As a whole, the basic structure of the review process for foreign direct investment has not changed in Mexico: the Commission still acts as a funnel in the selection of restricted investments. The main difference is that the end of the funnel is as large as its entry! Investors, finding greater opportunities and flexibility, have reacted very positively to these changes.¹²⁶

4) The Review Process and the Foreign Investment Review Commission

¹²⁴ 1989 Regulations, *supra*, note 5, art. 7.

¹²⁵ A new Regulation issued in December 1990 has opened to foreign corporations 1 million of the 3 million hectares of land previously reserved to the State. The aim is to attract new technology and a general modernization in small and medium enterprises. See D.O., December 9, 1990. This has increased the cumulative foreign investment by 30 % annually up to 512.4 million \$ U.S. in this sector in 1991. (Source: Direcccion General de Inversion Extranjera, SECOFI).

¹²⁶ FDI, increased from 394 million in 1984 to 4.628 billions U.S. dollars in 1990. (Source: *A New Economic Profile*, *supra*, note 52 at 26)

When an investment falls in the category where a review is required, the National Foreign Investment Commission is responsible for that task.¹²⁷ The review process is critical since it is discretionary and there is no appeal. The Commission meets once a month to determine the receivability of the proposed investments. In doing so, it takes into account seventeen factors as enumerated in the *Foreign Investment Law*. These relate to the country's national investment policy, its balance of payments, the creation of jobs, the incorporation of domestic inputs, the technology involved and the location of the proposed investment. Generally, the Commission will examine "to what extent [the investment] complies with, and contributes to the achievement of national development policy objectives".¹²⁸ The Commission may consult related Government departments and businesses, seeking advice on the investment. These seventeen factors are adjustable to the governments policy. Proof of lays in the fact that in 1990 the Commission received 300 applications for review and did not deny any.¹²⁹

The review procedure itself is short. It has been trimmed to a maximum of 45 days.¹³⁰ If, after that period, the Commission has not taken a position, the

¹²⁷ *Foreign Investment Law*, *supra*, note 3, art. 11. The composition of the Commission has not changed with the 1989 Regulations. See *supra*, Chapter I, Section B.

¹²⁸ *Ibid.*, art. 13 (XVII).

¹²⁹ Investment Canada, *The Opportunities and Challenges of North American Free Trade: A Canadian Perspective*, (Ottawa: Investment Canada, May 1991) at 77. [hereinafter *Challenges of NAFTA*]

¹³⁰ Before, the period necessary to review an investment was from 12 to 16 months. Note that Canada had a similar "performance" with its Foreign Investment Review Agency until its transformation in 1984. This irritant was abolished in the *Investment Canada Act* which allowed the Investment Canada Agency only 45 to 60 days to review an investment failing which it would be accepted. *Investment Canada Act*, *supra*, note 77, art. 19.

investment is accepted.¹³¹ It is not unusual that foreign investors will discuss their proposal with the Commission before submitting it for formal review. That way, he knows what the chances are for a favourable review in advance - and may choose not to lose time.¹³²

Once the investment is made, the Commission monitors its performance. In the event of default or fraud on the part of the foreign investor, the Commission has the power to sue the company and its administrators.¹³³ The foreign investor is required to submit an annual performance report. The foreign currency balance requirement is generally found to be the most difficult to sustain for the foreign investor.¹³⁴

5) Criticism and Comment

As can be seen, the changes in Mexico are real. There is an effective liberalization of the economy in all sectors. As a whole, the *1989 Regulations* brought a tornado of fresh air into a country where foreign investment was suffocating in a closed environment. Investments were increasing in Mexico until 1982, yet, it is likely that these would have been higher and would have included

¹³¹ *1989 Regulations, supra*, note 5, art. 2.

¹³² [Interview with Mexican lawyer held in Mexico city, May 21, 1991].

¹³³ The Law stipulates stiff penalty and joint responsibility of administrators and managers in the advent of default and the non-payment of dividends by the corporation. *Foreign Investment Law, supra*, note 3, art. 27-28.

¹³⁴ Opinion of Mexican Accountant. [Interview held in Mexico City, May 25, 1991].

more technological innovations without the cumbersome review process.¹³⁵ The 1982 crisis proved that Mexico could not, without serious prejudice to its economy and people, hold the course it had chosen any longer. This reversal of policy is a major gamble for the future made by President Salinas - and it seems to be working. Since 1988, foreign investment in Mexico is increasing and inflation has been reduced.¹³⁶ This trend towards liberalization is a step closer to a North American Free Trade Agreement.¹³⁷

From a hostile attitude towards *gringos extranjeros* willing to invest in Mexico's potential, the government now makes every possible effort to attract these same *gringos extranjeros* in an attempt to revitalize the country. The twenty year limitation on financial development institutions participation, the temporary investment trusts and the maintenance of maximum participation or review in 141 sectors clearly show some hesitation by the Mexican Government to relinquish the assets of national determination gained through increased control over foreign investors. For example, the fact that these temporary investment trusts, which allow foreign participation in sectors reserved to Mexican nationals, are limited to a period of twenty years shows that the government sees this as a transitional period after which it hopes to regain control. The fact that the *Foreign*

¹³⁵ The level investment in 1989 and 1990 illustrate this point. Other factors, such as the *Transfer of Technology Law*, also impeded the use of modern technology and the flow of investment.

¹³⁶ Investments were up by 31 % and 36 % in 1990 and 1989 respectively from the preceding year to 4.628 billion and 3.53 billion dollars U.S. respectively (these figures include portfolio investments through the Mexican trust mechanism and debt-equity swaps). In comparison, FDI was at .391 billion dollar U.S. in 1984. (Source: *A New Economic Profile*, *supra*, note 52, at 26)

¹³⁷ The implications of this policy and the NAFTA will be discussed *infra* at Chapter V. This step forward will need to be followed by further restructuring and liberalization, comments D. B. Hodgins, "Mexico's 1989 Foreign Investment Regulations: A Significant Step Forward, but is it Enough ?" (1990) 12 Houston J. I. L. 361 at 369.

Investment Law has not been modified throughout this process illustrates this point also - and is an existing impediment to foreign investment. Whether the return to previous policies will be possible is uncertain.

One must remember however that these changes, the cornerstone of Mexico's new economic policy, are only one element of in the changing picture. The *1989 Regulations* indicate a new choice in favour of equity. Mexico has begun to repay its debt entering a "gentleman's agreement" with private banks.¹³⁸ An open attitude towards FDI will help bring capital to the country without increasing the pressure on the already burdened public finances of Mexico. Furthermore, it will bring much needed technology transfers to its industry. The changes are real - but are they permanent? Given that perspective, a NAFTA would incorporate, in a binding agreement, most of the changes put forward by the government and secure access to Mexico for the future.

B - Foreign Investment in the Securities Market : The Neutral Shares

1) The Trust Mechanism for Mexican Investment and Portfolio Investments

The *1989 Regulations* have opened new opportunities for foreign investors eager to invest on Mexico's *Bolsa de Valores*.¹³⁹ The new regulations create a trust mechanism through which foreigners may participate in

¹³⁸ That is the expression used by a banker in Mexico referring to the attitude the Government had adopted throughout the negotiations which led to a conclusive agreement [Interview of Regional Representative, Royal Bank, held in Mexico city, May 22, 1991].

¹³⁹ Stock Exchange. *1989 Regulations*, *supra*, note 5, art. 13-15. The securities market in Mexico is regulated by the *Securities Market Act*, D.O., May 15, 1975. See generally S. Wolff, "A Study of Mexico's capital Markets and Securities Regulation", (1987) *Vand. J. of Trans. L.* 385.

sectors reserved to Mexican nationals which are listed on the stock exchange. One of the aims of this mechanism is in part to bypass the restrictions imposed on the participation of foreigners, in order to bring fresh capital in Mexico. By creating this mechanism, Mexico has been successful in attracting foreign capital: in 1990 the level of portfolio investment reached a record high of 1.6 billion dollars U.S.,¹⁴⁰ indicating that this mechanism has had a substantial positive impact.¹⁴¹

The mechanism is applied through Mexican investment trusts, owned and operated exclusively by Mexican banks.¹⁴² The Mexican corporation issues shares designated "N" (for neutral) for which only Mexican investment trusts can subscribe.¹⁴³ The trustees subsequently issue "Certificates of Ordinary Participation" to the foreign investor for an amount equivalent to the number of "N" shares subscribed for by the trustee [hereinafter COP]. The COP's allow the owner of the certificate to benefit from economic rights to the exclusion of voting rights. These COP's, once issued, can be traded on the stock exchange.¹⁴⁴ "Foreign financial entities" can receive these certificates as deposit and may list

¹⁴⁰ (Source: Banco de Mexico)

¹⁴¹ This favorable response is seen, by Mexican officials, as a temporary step before more direct investments occur. [Conference of M.A. Nunez, SECOFI's NAFTA Negotiations Trade Representative, given on the occasion of a symposium on NAFTA, organized by the SDIE, the CCIL and the SQDI held in Montreal, March 4, 1992].

¹⁴² These types of trusts have been established since 1973 to allow foreigners to benefit as trustees of land and immovable property in zones where foreign ownership of land is constitutionally impossible. The excluded area consists in a strip of land of 50 km long along the coast of the country and 100 km along the borders. These land trusts and their effects on foreign investors will be discussed *infra*, at Chapter III, Section A.

¹⁴³ 1989 Regulations, *supra*, note 5, art. 13(I).

¹⁴⁴ This is possible by trading COPs to other foreigners or selling the COP back to the trustee. The selling process follows the same process in reverse.

these on foreign stock exchanges.¹⁴⁵ For the American market, there is a special provision for the issuance of such certificates called "American Drawing Rights" which has been successful.¹⁴⁶

The most important element with respect to these shares is that the "N" shares "shall not be computed to determine the amount and proportion of foreign investors' interest in the capital stock of the issuing companies".¹⁴⁷ This will be useful for the foreign investor who already has a stake in a Mexican corporation listed on the market in which he wishes to invest above the prescribed limit.

All Mexican public corporations which "carry out or plan new investments to expand their economic activities" may allow foreign entities to invest in this manner with SECOFI's permission.¹⁴⁸ Series "A" shares, reserved for Mexican nationals, are simply transformed "N" shares, held by the financial institutions.

2) Criticism and Comment

The new opportunity created by this mechanism has been welcomed by foreign investors as can be seen from the amount of money that has been

¹⁴⁵ 1989 Regulations, *supra*, note 5, art. 13 (III). The entire operation takes about 48 hours. Technically, the foreign investor will send a purchase order for an amount equivalent of the value of x shares. The Mexican investment trust will buy that value of shares and then issues the COP to the foreign investor. Their value is directly linked to the value of the shares on the stock market.

¹⁴⁶ See M.A. Houston & S.A. Brecher, "American Drawing Rights: Increasingly Popular Financial Instruments" (1990) 169 *Journal of Accountancy* 144.

¹⁴⁷ 1989 Regulations, *supra*, note 5, art. 13, para. 3.

¹⁴⁸ *Ibid.*, art. 14.

invested through it, standing at 1.6 Billion U.S.\$ in 1991.¹⁴⁹ There has been an injection of fresh capital and modernization possibilities which are consequent with President's Salinas policies. Yet, they again show the hesitation of the Mexican government between increased foreign investment and control over its economic sovereignty. The establishment of these trusts is, in a sense, allowing to be done indirectly what can be done directly. As Mexico increases its participation in international trade, this method of circumventing the rules will be scrutinized by the international community. If this experience proves favourable, the restrictions on foreign investment will most likely be relaxed, allowing foreigners to own "real" voting shares. In case the experience is negative, the rules could just as easily be tightened.¹⁵⁰

The high level of investment in "N" shares has concerned, to some extent, the Organization for Economic Development and Cooperation [hereinafter OEDC]. The OEDC has been closely monitoring the evolution of Mexico's FDI regulations and the NAFTA talks, as they do not know what will happen to these investments after a NAFTA.¹⁵¹ This specific issue will be addressed in the NAFTA and will be discussed in chapter five of the thesis.

¹⁴⁹ (Source: SECOFI)

¹⁵⁰ Mexican officials confirmed this desire to keep a half open door on foreign investment control, though they insisted that a reversal of the opening policy was for real and that chances for this were nil in the near future. [Interview with a Mexican Official of the NAFTA Office, SECOFI, held in Mexico, May 22, 1992]; [Interview with a NAFTA Trade Representative, SECOFI, held in Ottawa, February 24, 1992].

¹⁵¹ [Telephone interview held with an Official of the OEDC Fiscal Affairs Department, Paris, February 3, 1992].

C - Export Industry : The *maquiladoras*¹⁵²

1) Definition

The final option for the foreign investor who wishes to establish an totally export-oriented company and benefit from Mexico's abundant and cheap labor is through the *maquiladoras* program, established in 1965. In 1964 the United States had suddenly terminated employment for the 185,000 Mexican seasonal agriculture workers used for harvesting. During the Second World War and throughout the years that followed, missing manpower was replaced by seasonal workers. The *Bracero Program*, established in 1951 to pursue this temporary immigration permitted seasonal work in agriculture. Later, under pressure from the agriculture lobby, Washington closed its borders by ending the *Bracero Program* in 1964 in order to employ more Americans.¹⁵³ At that time, Mexico was faced with a rising population in the North and high unemployment in the region, which was exacerbated by the end of the *Bracero Program*. In order to provide employment for these displaced workers, Mexico allowed that equipment assembled "in-bond" in industries located in a 20-km strip along its North border not be subject to imports duty.¹⁵⁴ Mexico thus created the *Programa Nacional Fronteriza* better known as the *maquiladora*

¹⁵² See generally Z.V. Chayet and E.A. Bustamente, "The Mexican Maquiladora Industry: Legal Framework of the 1990's" (1990) 20 California W. Int'l. L. J. 263 [hereinafter Chayet]. Note that the term "*maquila*", from which the term *maquiladora* is derived, designates the amount of corn that a farmer pays the miller for his grinding services.

¹⁵³ See J. R. Garcia, *Operation Wetback: The Mass Deportation of Mexican Undocumented Workers in 1954*, (Greenwood Press: Westport, Conn., 1980).

¹⁵⁴ J.E. Tarbox, "An Investors Introduction to Mexico's Maquiladora Program" (1987) 22 Texas J. Int'l. L. 109 at 113. [hereinafter Tarbox]

program. Since 1965, the maquiladora industries have been streamlined and liberalized to foster foreign investment and economic growth.

The *maquiladoras* are a special breed of Mexican companies. They can be described as "Mexican production facilities that manufacture, process or assemble raw materials or intermediate products imported in-bond for eventual re-export".¹⁵⁵ A *maquiladora* industry is defined legally as "a company, individual or establishment, service or any other kind of in-bond program approved and registered with the competent authority engaged in the transformation, assembly or repair of merchandise or raw materials *originating from abroad and temporarily imported to be returned abroad*."¹⁵⁶

The corollary is that the United States does not impose duty on the re-exported production of the maquiladora plant when its components are of American origin. A duty is charged on the value added to the product resulting from the treatment it receives in Mexico.¹⁵⁷ If the components assembled are not of American origin, they may still benefit from provisions of the Generalized System of Preference of the GATT. The United States are however very sensitive to such preferential access to their market for products of Newly Industrialized

¹⁵⁵ Banca Serfin, *The Maquiladora Industry*, (Serfin : Mexico, 1990) (leaflet) at 3. [hereinafter *Maquiladora Industry*]

¹⁵⁶ *Regulations to the Customs Law of Mexico*, D.O., June 18, 1982, art. 135. (emphasis of the author)

¹⁵⁷ United States International Trade Commission, *Tariff Schedules of the United States Annotated*, items # 9800.00 to 9807.00. This special provision has been an irritant for some American labour unions. See Commentary, "The Approaching Confrontation Over Item 807.00 of the Tariff Schedule" (1972) 4 *Law & Policy in Int'l. Bus.* 628.

countries like Mexico.¹⁵⁸

The *maquiladoras* have grown steadily since their birth in 1965. Today, approximately 2,000 *maquiladoras* are in operation, generating 500,000 jobs, 12.7 billion \$U.S. in exports and bringing 3 billion \$US of hard currency into Mexico.¹⁵⁹ It is the second most important economic sector after the national oil company, PEMEX.¹⁶⁰ *Maquiladora* operations are distributed among the fields of electric and electronic parts, accessories and machinery accounting for 41.1% of the total, in transportation equipment and accessories for 23.6%,¹⁶¹

¹⁵⁸ See USITC, *Probable Economic Effect Redesignation of Certain Articles from Certain Countries as Eligible for Duty-Free Treatment Under the U.S. Generalized System of Preferences, Volume I-Introduction and Locator, Volume II-Commodity Digests*, Publication 2256, (USITC: Washington, 1990); USITC, *President's List of Articles which May be Designated as Eligible Articles for the Purposes of the U.S. Generalized System of Preferences*, (USITC: Washington, 1990).

¹⁵⁹ In 1965, 12 *maquiladoras* were established, that figure increasing to 620 and 119,00 workers in 1980. (Source: USITC) Nowadays, there are 2,000 *maquiladoras* in operation, over 60 % being owned by American corporations. Presently, only nine Canadian corporations operate a *maquiladora* in Mexico. (Source: *Challenges of NAFTA*, *supra*, note 129 at 75). At first designed to employ the dismissed predominantly male *Bracero* workforce, the *maquiladoras* workforce is at 62% composed of females.

¹⁶⁰ This is a result from the fact that large multinationals corporations have benefitted from this program, such as Honda, General Electric, Samsung, Chrysler, Ford, General Motors, Eastman Kodak, Matsushita, Zenith, Hoover, Essilor, Sony, Hyundai and Alcoa-Fujikura. See D.C. Bennet and K.E. Sharpe, *Transnationals Corporations versus the State: The Political Economy of the Mexican Auto Industry*, (Princeton U. Press: Princeton, 1985).

¹⁶¹ This is an important factor in the evaluation of the free-trade talks. Through the imports of American cars with such Mexican parts, all these parts come in Canada without any duty through the Canada-U.S. Free-Trade Agreement. Ford, GM and Chrysler operate 42 *maquiladora* plants in Mexico. See "the Canadian-U.S. experience in Auto Trade since 1965: Its Relevance for Free Trade Negotiations with Mexico", Commentary no 24, (C.D. Howe Institute: Toronto, 1990); H. Shaiken and S. Herzenberg, *Automation and Global Production: Automobile Engine Production in Mexico, the United States, and Canada*, (Center for U.S.-Mexican Studies, University of California: San Diego, 1987); Booz, Allen & Hamilton, "A Comparative Study of the Cost Competitiveness of the Automotive Parts Manufacturing Industry in North America", (Booz, Allen & Hamilton: Toronto, 1990) (Study conducted on behalf of the Automotive Parts Manufacturers' Association of Canada). The rules of origin for this sector are a crucial part of the negotiations. See USITC, *Rules of Origin Issues related to NAFTA and the North American Automotive Industry*, Publication no. 2460, (USITC: Washington, 1991). For an overview of Mexico's car industry legal environment, see

and in textiles, shoes and leather for 7%.¹⁶² Now an integral part of Mexico's economy, the establishment and rules of operations of the *maquiladoras* are part of Salinas reforms and receive full Government support.¹⁶³

2) Implementation and Operation of a *Maquiladora*¹⁶⁴

The implementation and operation of a *maquiladora* are regulated by rules which are more relaxed than those applying to "classical" foreign direct investment. This is evident when one considers the nature of these corporations who do not interact directly with the population nor with the State. There is no ceiling on the amount invested in a *maquiladora* and 100 % foreign ownership is permitted. The activities from which foreign investment is excluded, however, are also excluded from the *maquiladora* program.¹⁶⁵

generally J. Camil, "Mexico's Auto Industry: The Last Bastion of Protectionism Falls ?" (1990) 12 *Houston J. Int'l. L.* 191.

¹⁶² (Source : *Maquiladora Industry*, *supra*, note 155, at 4). The textiles sector is one of the major "soft sectors" at stake for Canada and the United States in the event of a NAFTA in a long term view. A recent study from Ernst & Young conducted on behalf of the Ministry of Industry, Science and Technology concluded that there would be few negative effects after a NAFTA in the textile industry (slightly more in the apparel industry) of Canada. Ministry of Industry, Sciences and Technology, "A Study of the Competitiveness of the Mexican Textile and Apparel Industries in a North American Free Trade Context", (ISTC, Ottawa: 1991).

¹⁶³ The *maquiladora* industry was streamlined in 1983 by President de la Madrid with the *Decree for the Development and Operation of the In-Bond Export Industry*, D.O., August 15, 1983. Salinas went further with the *Decree for the Development and Operation of the Maquiladora Exportation Industry*, D.O., December 22, 1989 [hereinafter *Development Decree*].

¹⁶⁴ See N. C. Clement, "An Overview of the Maquiladora Industry" (1987) *California J. Int'l. L.* 55; D. Engle, "Mexico's Maquiladora Program: An inviting Alternative for U.S. Manufacturers" (1985) 14 *Tax Mgmt. I. J.* 117. [hereinafter Engle]

¹⁶⁵ *Foreign Investment Law*, *supra*, note 3, art. 5.

Geographically, a *maquiladora* can be established anywhere in Mexico, with the exception of the over-industrialized cities.¹⁶⁶ Most establishments have chosen the most northern border, at the door of the United States.¹⁶⁷ With the *1989 Regulations*, the expansion of existing *maquiladoras* is now unrestricted and is not subject to approval by the Commission.¹⁶⁸ Furthermore, the acquisition of existing corporations operating in the *maquila* activities does not need approval by the Ministry.¹⁶⁹ When in operation, the *maquiladora*, apart from respecting the national laws, needs only to respect the "in-bond" process and to maintain a favourable foreign currency balance.

The establishment of a *maquiladora* is subject to a few formalities which are not reviewed by the Commission. The investor need only complete the necessary form and have it approved by SECOFI.¹⁷⁰ Before 1989, the investor was also required to notify the National Registry of Foreign Investment and other

¹⁶⁶ Specifically, the areas designated for "industrial development" are available for the establishment of a *maquiladora*. *Development Decree, supra*, note 163, art. 6, which refers to the *Decree Establishing Geographic Zones for Industrial Decentralization and the Granting of Stimulae*, D.O., January 22, 1986.

¹⁶⁷ Over 78 % of all *maquiladoras* are in the border cities of the North. This fact can also be explained by the fact that until 1972, the *maquiladoras* were limited to a 20-km strip along Mexico's North border. D.O., October 31, 1972. The number of *maquiladoras* located in interior areas is increasing. (Source: *Challenges of NAFTA, supra*, note 129 at 75).

¹⁶⁸ *1989 Regulations, supra*, note 5, art. 29 (II).

¹⁶⁹ *Ibid.*, art. 6.

¹⁷⁰ This is an administrative formality which takes three working days to process. The investor is required to give a description of his enterprise, his product, the nature of the operations which will be conducted in Mexico and a list of the products that will be imported. This form is filed with the Mexican Maquila Industry Registry and must be updated yearly. SECOFI in fact acts as an adviser for foreigners and assists them in completing the form properly in order to ensure a successful application - to the extent that many investors do not require the services of lawyers for this task [Interview with a Mexican Lawyer, Law firm Sepulveda, S.C., held in Mexico City, May 22, 1991].

ministries.¹⁷¹ Now, there is a "unitary filing window" where the potential investor addresses one formal request which is then distributed to the relevant ministries. This notification process is simpler than the one a "classical" foreign investor would face. Note that the *maquiladora*, like any national enterprise operating in the area, will need to obtain various municipal and district permits.¹⁷²

The means by which a foreign investor may implement a *maquiladora* are threefold. First, he can be a direct owner. Since 1972 local participation is not required in order to form a *maquiladora*, though the investor will be required to act through a Mexican corporation.¹⁷³ With this option, the investor has direct control of his business, his patents and technology. Secondly, he may choose to subcontract. The foreign corporation provides the raw materials and components to an established *maquiladora* subcontractor. The subcontractor assembles the product and re-exports the goods to the foreign corporation. Thirdly, the new decree allows "shelter operations". This type of operation is one whereby the foreign corporation provides technology, know-how and raw materials but does not participate further in the whole operation. The Mexican *maquiladora* charges the foreign corporation a mutually agreed upon price per unit produced. The goods are exported by the Mexican corporation.¹⁷⁴

¹⁷¹ *Foreign Investment Law, supra*, note 3, art. 52 and following. The departments informed were the Ministry of Finance, the National Chamber of Manufacturing Industry, the Public Property Registry, the Health Department, the Mexican Social Security Institute and the National Workers Housing Fund Institute.

¹⁷² Tarbox, *supra*, note 154 at 122.

¹⁷³ D.O., October 31, 1972.

¹⁷⁴ *Development Decree, supra*, note 163, art. 13. See *Maquiladora Industry, supra*, note 155 at 7.

Once the application is authorized the *maquiladora* is provided with a special import licence valid for an indefinite period, exempting the *maquiladora* from paying duty on its temporary imports.¹⁷⁵ With that licence, the *maquiladora* is ready to begin its operations. From a practical point of view, the operation of a *maquiladora* is rather simple. Most work along side a "twin plant" established in the United States where service, research and financial operations will be conducted. The American plant exports the goods to be assembled to its Mexican sister plant. The Mexican plant assembles or, in a few cases, repairs the parts of the product coming from the parent company and ships them back into the United States.

The exports to Mexico are subject to a minimal control.¹⁷⁶ The *maquiladora* operator must deposit a bond of a value equivalent to the duty he would pay on the imported products plus 10%, corresponding to the penalty which would be levied if there were irregularities. This bond is returned once the product is re-exported.¹⁷⁷ Raw materials must be re-exported a maximum of one year after their entry. The *maquiladora* may import, for an indefinite period, tools, packaging material, machinery and, since 1989, computer and communication equipment, environment control and work safety devices.

¹⁷⁵ *Ibid.*, at 4. Note that until 1989, import licences had to be re-issued every two years. The importation licence requirements will be discussed *infra*, in Chapter III, Section A.

¹⁷⁶ *Ibid.*, art. 4. With the *Development Decree*, this control is on a random basis, which allows businesses and Mexican customs officers to save time.

¹⁷⁷ *Ibid.*, art. 7. The english expression of "in-bond industry" comes from this practice used to designate the *maquiladoras*.

Of course, the return of these products to a given country is subject to that country's laws and regulations. In the case of the United States, a duty is levied only on the value-added by the assembly or manufacturing of the product as long as its original components are American. This implies that there is virtual free-trade of these goods between the U.S. and Mexico. The basis for this aperture lies in article 9800.00 of the *U.S. Harmonized Tariff Schedule* which states that "products of the United States when returned after having been exported, without having been advanced in value or improved in condition by any process or manufacture or other means while abroad [shall enter duty-free]".¹⁷⁸ The subsequent articles, 9806.30 and 9807.00, constitute a deviation from the preceding article. They stipulate that all products exported from the United States to be assembled abroad, without modification, will be charged duty only on the value added to the product by the assembly process. Goods exported from Mexico to Latin American countries are potentially eligible for preferential treatment with respect to duty rates. Concessions are made through the Latin American Integration Association, formerly known as the *Latin America Free Trade Association*.

Another way for Mexican businesses to gain access to the lucrative American market is through the GATT's Generalized System of Preference [hereinafter GSP]. The standards of production and Mexican content are high in order to be eligible to the GSP. The goods "must be wholly the growth, product,

¹⁷⁸ *Tariff Schedule of the United States Annotated*, *supra*, note 157, art. 9800.00. Mexico is not the only country benefiting from this U.S. Tariff aperture. See USITC, *Production Sharing: U.S. Imports Under Harmonized Tariff Schedule Subheadings 9802.00.60 and 9802.00.80, 1986-1989*, Publication no. 2365, (USITC: Washington, 1991); USITC, *Production Sharing: U.S. Imports Under Harmonized Tariff Schedule Subheadings 9802.00.60 and 9802.00.80, 1987-1990*, Publication no. 2469, (USITC: Washington, 1991).

or manufacture of the beneficiary developing country [e.g. Mexico], or ... substantially transformed into a new and different article of commerce in the beneficiary developing country."¹⁷⁹ Close to 10 % of the *maquiladora* production exported to the United States enters through the GSP.¹⁸⁰ In order to adhere to this provision, the Mexican *maquiladora* goods must be taxed by Mexico and have a minimum of 35 % genuine Mexican components.¹⁸¹

In principle, all goods produced by a *maquiladora* must be re-exported from Mexico. This was the case until 1983, when the possibility of selling a maximum of 20 % of the production in Mexico was allowed. This was possible with the authorization of SECOFI which applied stringent rules when evaluating whether or not to permit sales on the domestic market. Apart from paying duty, the operator of the *maquiladora* was required to demonstrate that the product had no Mexican equivalent, that there was no Government incentive for that product, that there was a minimum of 20 % Mexican content and that it filled a need for basic items unavailable in Mexico. This burdensome task often discouraged many from selling on the domestic market.¹⁸² With the Salinas "revolution", the *maquiladora* operator can obtain a two-year licence to sell on the Mexican market up to 50% of what he produces above his normal production

¹⁷⁹ Department of the Treasury, United States Customs Service, *Importing in the United States* 19 (June 1986) at 24, cited in Tarbox, *supra*, note 154 at 136.

¹⁸⁰ (Source: USITC)

¹⁸¹ SECOFI, *Mexico - Conditions and Risks for Business*, (SECOFI : Mexico, 1989) (leaflet). The GSP is important to Mexico's economy, states I. Molina, "La renovacion del sistema generalizado de preferencias arancelarias y sus implicaciones para Mexico", in: M. Garcia and G. Vega (eds.), *Mexico-Estados Unidos, 1984*, (El Colegio de Mexico: Mexico, D.F., 1986) at 13. Note that an investor can have an advanced binding ruling by the U.S. customs as to its compatibility with the GSP U.S. requirements.

¹⁸² *Development Decree*, *supra*, note 163, art. 12-14; Chayet, *supra*, note 152 at 270.

level. The duty imposed on the product will be lowered as the Mexican content of the product increases. The maquiladora operator must still face the basic requirement of a favourable foreign currency balance.¹⁸³

Finally, it must be pointed out that *maquiladoras* are not a fiscal paradise. They are subject to the same taxation scheme as is a Mexican corporation. The taxation rates are progressive and vary depending on the location, the type of corporate entity and, of course, the corporation's income.¹⁸⁴ There are some tax incentive programs for the establishments in specific sectors or geographic locations.¹⁸⁵

3) *Maquiladoras*: An Insider's-view to a North American Free Trade Agreement?

Maquiladoras may, indeed, provide a crystal ball to see what the situation will be after a North American Free Trade Agreement. The *maquiladoras* have been running rather smoothly since 1965 and have experienced an enormous increase in the past 10 years. This seems to have been to the overall

¹⁸³ *Ibid.*, art. 19-24.

¹⁸⁴ See generally Price Waterhouse, *Doing Business in Mexico* (S. Lefler: New York, 1989), with update in 1990, 1991 at chapter 21. [Hereinafter *Doing Business in Mexico*]

¹⁸⁵ Decree Establishing Tax and Administrative Incentives for the Operation and Modernization of Commercial Centres in the Northern Border Strip and Free-Trade Zones for Companies, D.O., June 8, 1984.

benefit of all the parties involved.¹⁸⁶ The *maquiladora* investor benefits from Mexico's large manpower resources, which are available at low costs, just south of the attractive American market.¹⁸⁷ Mexico has benefited from these industries through the training of employees, jobs created, technology transfers and increased exports which bring hard currency.¹⁸⁸ The synergy of this partnership has also benefited the United States, supporting 1,000,000 jobs

¹⁸⁶ "The elimination of the *maquiladora* program by the Mexican government would have the most adverse effect on U.S. employment (...) After the full multiplier effects, the reductions in employment would rise to 145,000 jobs." U.S. Department of Labour (1987 Survey); "The elimination of the *Maquiladora* program in Mexico would result in an increase in U.S. imports from other countries, increased U.S. prices and lower output and employment in the American economy. (...) The elimination of the *maquiladora* regime would bring about a decrease of \$ 2.6 billion in the U.S. and a loss of 76,000 jobs." Ciemex-Wharton, "The implication for the U.S. economy of Tariff Schedule item 807 and Mexico's *Maquiladora* Program", cited in: Embassy of Mexico (Washington), "Myths and Facts about the North American Free Trade Agreement", (SECOFI : Washington, 1991) at 17. (short collection of studies on the NAFTA with a positive view on their effect on the economies of Mexico and the United States)

¹⁸⁷ The Mexican wage level is approximately 0.85 to 1.50 U.S. \$ an hour. This compares advantageously to other countries which are rapidly industrialising such as Korea, where wages range from 2.40 to 3.00 U.S. \$ an hour on average. The issue of workers rights in that context is one of the main arguments for NAFTA's opponents, and especially the labour unions. See L. Laurin, "Tout près de nous, l'enfer" (1991) 1 Réseau Canadien D'Action 17 (Coalition of unions and popular associations against NAFTA); S. Sinclair, "The Mexican Connection - How a U.S.-Canada-Mexico Trade Deal Would Doom Canada to Third World Status", in: Canadian Centre for Policy Alternatives, *Paying the Price*, (CCPA: Toronto, 1991). Note however that the leader of the main opposition party, Cuahctemoc Cardenas of the *Frente Democratico Nacional*, does not seem to be overly concerned by this issue. [speech delivered by Cuahctemoc Cardenas at the UQAM, in Montreal, May 3, 1991]. (tape on file)

¹⁸⁸ The general opinion of authors is favourable for this type of free industrial zone when they are designed accordingly to the needs and goals of a given country. They are a mean to generate industrial development in a developing country by allowing foreign investment to benefit from the countries specific comparative advantages and they present a "neutral and flexible instrument of industrial policy (...) which has proven to be valuable means for achieving developmental goals usually attributed to industrialization" J. D. Amado, "Free Industrial Zones : Law and Industrial Development in the New International Division of Labour" (1989) U. Pa. J. Int'l. Bus. L. 80, at 83. S.W. Bettwy, "Mexico's Development: Foreign Trade Zones and Direct Foreign Investment" (1985) 22 Comp. Jurid. Rev. 49; S. Salcedo, *An Evaluation of the Panamanian Free Trade Zone* (LL. M. Thesis: Harvard, 1988) (A comparative study of Panama's, Mexico's and China's free trade zones); See also U. N. Conf. on Trade and Dev., *The use of Free Trade Zones as a Means for Expanding and Diversifying Exports of Manufactures from the Developing Countries*, U.N. Doc. TD/B/C.2/125 (1973); B. Jayawardena, "Free Trade Zones" (1983) 17 J. World Trade L. 427; Note, "Foreign Trade Zones in Latin America: A Spectrum of Possible Uses, (1988) 23 Texas J. Int'l. L. 117.

indirectly.¹⁸⁹ Most *maquiladoras* assemble parts of American origin. Some American corporations involved in the *maquiladoras* have declared that they would have been forced to locate elsewhere without their Mexican counterparts.¹⁹⁰ Apart from these tangible benefits, the mere fact that these industries will allow Mexico to repay its 85 billion U.S. \$ debt to private banks, many of them American, is in itself an important benefit for the U.S.

The view through the *maquiladora* crystal ball is somewhat foggy. Some Mexicans fear increased competition by the American industry. The border areas are overcrowded and conditions are worsening. Environment related problems in the *maquiladora* North border area are numerous.¹⁹¹ Labor rights

¹⁸⁹ Tarbox, *supra*, note 154 at 110. See the overall favorable conclusions of the USITC studies on the tariff items 9806 and the *maquiladoras*. USITC, *The Impact of Increased U.S. - Mexico Trade on Southwest Border Development*, Publication no. 1915, (USITC: Washington, 1986); USITC, *Imports under Items 806.30 and 807.00 of the Tariff Schedule of the United States, 1982-1985*, Publication no. 1920, (USITC, Washington, 1986); USITC, *The Use and Economic Impact of TSUS Items 806.30 and 807.00*, Publication no. 2053, (USITC: Washington, 1988); USITC, *Imports under Items 806.30 and 807.00 of the Tariff Schedule of the United States, 1985-1987*, Publication no. 2144, (USITC: Washington, 1988).

¹⁹⁰ "United States Representative Jim Kolbe (Ariz.) recently conducted a survey of *maquiladoras* operated by American companies. Eighty-two percent of these companies said "they would have been forced to relocate in Asia or close their doors had they not begun to participate in the *maquiladora* program." *Austin-American Statesman*, February 15, 1987, at C7, cited in Tarbox, *supra*, note 154, at 113; "If all of the *maquiladoras* were shut down tomorrow, many jobs would not return to the United States. Instead, they would go to Taiwan, Hong Kong, Singapore or Korea." Federal Reserve Bank of Dallas, *Mexican Maquiladoras Growth: Does it Cost U.S. Jobs?*, cited in: *Myths and Facts about NAFTA*, *supra*, note 186 at 17.

¹⁹¹ See S. R. Ross (ed.), *Ecology and Development of the Border Region*, (Asociacion Nacional de Universidades y Institutos de Ensenanza Superior: Mexico, D.F., 1983); S.N. Weston, "U.S. - Mexico: Coping with Environmental Problems at the Border" (1986) 9 *Loyola of L. A. Int'l. & Comp. L. J.* 117; E.C. Rose, "Transboundary Harm Hazardous Waste Management and Mexico's Maquiladoras" (1989) 23 *Int'l. Lawyer* 223; D. Maes, "Transboundary Waste Dumping: The United States and Mexico Take a Stand" (1987) 27 *Natural Resources Journal* 941.

of the *maquiladora* workers are, to say the least, uncertain.¹⁹² Occupational health hazard such as nausea, dizziness and fainting from inhaling machinery cleaning solvents have been reported.¹⁹³ The poor conditions existing in the North have resulted in some *maquiladoras* establishing themselves elsewhere in the country. The benefits to American workers are unclear as well: are some companies forced to operate *maquiladoras*? Answering this question is a difficult and hazardous task. Nevertheless *maquiladoras* are healthy industries which successfully operationalize a American-Mexican partnership.

The fog gets thicker as we look further North, towards Canada as only nine Canadian corporations have a *maquiladora* in Mexico.¹⁹⁴ Also, under the current FTA, a program similar to the *maquiladoras* could not be established in Canada without countervailing provisions 404, 405 and 408 of the Agreement. These provisions eliminate duty drawbacks, prohibit the implementation of duty

¹⁹² S. Peters, "Labour Law for the Maquiladora: Choosing Between Workers Rights and Foreign Investment" (1990) 11 Comp. Lab. L. J. 226. See also A. Bartow, "Rights of Workers in Mexico" (1990) 11 Comp. Lab. L. J. 182. For a comparative study of labour laws in each of the trade partners, See Labour Canada, *Comparison of Labour Legislation of General Application in Canada, the United States and Mexico*, (Labour Canada: Ottawa, March 1991) (unpublished Study). The issue of labour rights is encompassed in the more global issue of human rights in Mexico. Improvements have been made yet much is still to be done, admits the Executive Secretary of Mexico's National Commission on Human Rights, Rosario Green [Conference held at the Faculty of Law, University of Montreal, February 6, 1992]. Note that the issues of human rights, as well as environment, will not be addressed in the NAFTA talks. However, their are ongoing trilateral "discussions" going on in parallel of the trade negotiations on these topics as the American Congress' approval to NAFTA is linked on progress at the bilateral level in this field. See *Response of the Administration to Issues Raised in Connection with the Negotiation of a North American Free Trade Agreement*, Office of the President, May 1, 1991 at 3-1 and ff. [Interview with Canadian Official, NAFTA Coordination Committee, held in Ottawa May 10, 1991]

¹⁹³ Mack and Greenbaum, "Constructive Criticism", *Forbes*, May 23, 1983, at 50. See also R. A. Sanchez, "Health and Environmental Risks of the Maquiladora in Mexicali" (1990) 30 *Natural Resources Journal* 163.

¹⁹⁴ The full assessment of the *maquiladoras*, NAFTA and Canada will be developed *infra*, in Chapter V.

exemption programs when performance requirements are attached to them. These are essential elements of a *maquiladora*.¹⁹⁵

In the event of a NAFTA, the American and Canadian *maquiladoras* will lose their relevance.¹⁹⁶ They will be integrated into the Mexican economy. There will be no need to segregate operations on each side of the border as all the production of Mexican corporations will enter duty-free to the United States and Canada. The event of a NAFTA will help future *maquila* assembly plants to locate further away from the border and closer to Mexican cities and serve the domestic market, unclogging the North border region. *Maquiladoras* which are already in operation will most probably continue to conduct their business after some reorganisation on either side of the border. This reorganisation will most likely be as gradual as the implementation of the trade agreement itself.¹⁹⁷ The *maquiladoras* may serve as role models for the increasing number of businesses which subcontract part or all of their elements of production which are labour intensive.¹⁹⁸

¹⁹⁵ FTA, *supra*, note 7, art. 404, 405 and 408.

¹⁹⁶ The future of *maquiladoras* operated by third Parties of a NAFTA is uncertain as Mexico wants to maintain this program after NAFTA. See *supra*, Chapter V, Section 2(B).

¹⁹⁷ The discussions now propose for an implementation period of twelve years [Interview with NAFTA Official, Office of the Deputy Chief Negotiator for Mexico, held in Mexico City, May 23, 1991].

¹⁹⁸ USITC, *The Likely Impact on the United States of a Free Trade Agreement with Mexico*, Publication no. 2353, (USITC: Washington, 1991) at 5-5.

CHAPTER III : MEXICO'S BUSINESS ENVIRONMENT

A foreigner who wishes to invest in Mexico is likely to encounter a series of laws of specific reference to his business operations. This chapter will first review the laws directly governing the business environment of foreign firms such as constitutional limitations to ownership of property, imports of the corporation and its currency operations. Secondly, the elements affecting the firm's inner operations will be addressed. These include fiscal policy, intellectual property rights and transfer of technology obligations. This review will demonstrate the extent of the import substitution and domestically financed growth policy and its subsequent reversal. Of course, an enterprise, whether foreign or domestically owned, operating in Mexico is subject to all Mexican laws and regulations, including environmental¹⁹⁹ and labour laws.²⁰⁰

The business regulatory environment followed the policy of inner growth in order to achieve more independence from industrialized countries. With the

¹⁹⁹ *Law to Achieve Ecological Balance and to Protect the Environment by Preventing and Controlling Pollution of the Atmosphere*, D.O., November 1988; *Law to Protect the Ecology and Environment from Dangerous Substances*, D.O., November 1988. The Secretariat of Urban Development and Ecology (SEDUE) is responsible for the enforcement of these laws.

²⁰⁰ These two sectors of the law are evolving rapidly in Mexico nowadays as they are the object of talks parallel to the NAFTA negotiations between mainly the U.S. and Mexico, though Canada participates. XX, "Free Trade Negotiations with Mexico: Environmental Matters" (1991) 3 *Int'l. Environmental Aff.* 219. For an overview of the environment regulations in Mexico, see T.C. du Mars and S. Beltran del Rio, "A survey of the Air and Water Quality Laws of Mexico" (1988) 28 *Natural Resources Journal* 787, S.P. Mumme *et al.*, "Political Development and Environment Policy in Mexico" (1988) 23 *Latin American Research Review* 7. As regards labour laws, see Labour Canada, *Comparison of Labour Legislation of General Application in Canada, the United States and Mexico*, (Labour Canada: Ottawa, March 1991). On NAFTA, see the opinion of the President of the Canadian Federation of Labour, J. McCambly, "North American Free Trade Requires a Charter of Labour" (1991) 4 *Canadian Speeches/Issues* 47 and S.T. Reyes, "Labour Market Interdependence Between Mexico and the United States" in: C.W. Reynolds *et al.* (ed.), *The Dynamics of North American Trade and Investment - Canada, United States, Mexico*, (Stanford U. Press: Stanford, 1991) at 241.

exception of foreign exchange controls, a web of regulations had been spun around the foreign firm over the years. This web was further secured by the *Foreign Investment Law*, allowing for tighter control of the business and maximisation of the benefits to Mexico. Investors not only had to go through the review process and settle for a maximum of 49% participation, they also needed to operate their business within the intricacies and the limits imposed by Mexico. As stated above, this policy worked in the period 1950-1970, when food exports permitted Mexico to assume this policy. The 1970-1982 period led to the burdensome public debt of Mexico since this policy was maintained and helped with the creation of public enterprises, while the agricultural sector was in crisis and oil revenues were insufficient to finance its economic program.²⁰¹ President Salinas, following the example of President de la Madrid, has swept away this web to harmonize Mexico with industrialized world policy trends.²⁰²

Now, the foreign investor may take advantage of Mexico's enormous debt through the *Programa de Intercambio de Deuda Publica por Capital* or Debt-for-Equity Swap Program.²⁰³ This program allows a foreign investor to buy a part of the debt Mexico owes to private banks, at a discounted rate of approximately 40%.²⁰⁴ The foreign investor may then liquidate the value of the debt in pesos

²⁰¹ A.T. Katz, *La politica de proteccion en el desarrollo de Mexico*, *supra*, note 29.

²⁰² See *Plan nacional de Desarrollo, 1989-1994*, *supra*, note 75 at para. 2.2 ("La estrategia: Modernizar Mexico").

²⁰³ *Programa de Intercambio de Deuda Publica por Capital*, D.O., March 30, 1990. This program is part of the new deal that Mexico has struck with private banks under the Brady Plan, as they accepted, for the first time, to forgive part of Mexico's medium- and long-term debt, provide a reduction of interest rates and new loans. See T.C. Ebenroth & G. Gandara, "El Plan Brady y la negociacion de la deuda mexicana" (1990) 40 *Comercio Exterior* 303. USITC, *Review of Trade and Investment Liberalization Measures by Mexico (Phase I)*, *supra*, note 279 at 1-4.

²⁰⁴ (Source: Citicorp Investment Bank)

through the Mexican government to finance his local expenses. A program of this nature had been in place since 1986, but had been suspended in early 1988 as the increased cash flow caused further inflation.²⁰⁵

The present system works on an auction basis, where a foreign investor presents a detailed bid, proposing the nature of investment and value of debt, secured by a deposit. Note that public enterprises being privatized are eligible for auction financing bids as well. SECOFI announces the "winner" within 60 days of the closing of the bidding.²⁰⁶ At the beginning of the program, 3.5 billion dollars U.S. were ear-marked for the auction program which was sold out in two auctions. This was more rapid than planned and for the time being, there is no other debt to be acquired through this program until the government decides otherwise.²⁰⁷

²⁰⁵ This program was complex, establishing a set of economic priorities to which were linked nine different levels of swap values ranging from 75% to 100% of the nominal face value designated by the government. M. B. Baker, "Debt-Equity Swaps and Mexican Law: The Interplay Between Law and Regulation" (1988) 9 North West. J. Int'l. L. 333. *Maquiladoras* could benefit of this program as well, benefiting for example Volkswagen who financed a 250 million dollar U.S. investment this way. (Source: EIU, *Mexico - Conditions and Risk for Business*, *supra*, note 67 at 33) See E.A. Gonzalez, *The Maquiladora and Debt-equity Conversions Program of Mexico*, (LL. M. Thesis: U. of Texas, 1987).

²⁰⁶ J. F. Torres Landa, "Report on the New Rules for Operation of Debt-Equity Swaps in Mexico" (1990) 25 Int'l. Lawyer 733 at 734.

²⁰⁷ Debt-for-Equity Swaps, a useful tool of development, are not a panacea. Some critics argue that these investments would have been made in any case and that they cause inflation. See United Nations Centre on Transnational Corporations, *Foreign Direct Investment, Debt and Home Country Policies*, UNCTC Current Studies, (UN: New York, 1990) ST/CTC/SER.A/20.

A - The Outer-Firm Environment: Property, Imports and
Foreign Exchange Regulations

1) Property Restrictions for Foreigners : "Ownership" Through a Trust

The Mexican Constitution contains a provision forbidding foreign ownership of lands in a zone which represents close to half of the country's entire surface. This zone, as mentioned above, is a 100km strip along the borders and a 50km strip along the shores of Mexico.²⁰⁸ This imposes a harsh restriction for foreigners, especially those wishing to invest in the hotel business and in *maquiladoras*. The impossibility of foreign ownership in that zone is not without issue. A widely accepted interpretation of the Constitution allows foreigners to hold beneficiary rights through a Mexican trust, where the trustee is a Mexican bank. This mechanism has been used for a long time²⁰⁹ and has been legally recognized since 1971.²¹⁰ This first presidential decree on the matter authorized a fiduciary "ownership" by foreigners for a maximum period of 30 years.

²⁰⁸ *Mexican Constitution, supra*, note 19. at. art. 27 (1).

²⁰⁹ Note that not every attorney recommended this strategy: "In the past, many foreign land holdings in the "restricted areas" were arranged through bearer stock companies incorporated by Mexican nationals, who would subsequently endorse the stock over to foreign investors. This, obviously, was in violation of constitutional limitations.", Camil, *supra*, note 89, at 15. A stiff penalty and a maximum of nine year prison term is the penalty facing the offender of this territorial restriction. *Foreign Investment Law, supra*, note 3, art. 31.

²¹⁰ *Acuerdo que autoriza a la Secretaria de Relaciones Exteriores para conceder a las instituciones nacionales de credito, los permisos para adquirir como fiduciarias el dominio de bienes inmuebles destinados a la realizacion de actividades industriales o turisticas, en fronteras y costas*, D.O., April 30, 1971.

The *Foreign Investment Law*, enacted two years later, detailed the conditions and requirements for the establishment of a land trust.²¹¹ It required the Foreign Investment Commission to institute guidelines governing the criteria and procedures by which such trusts could be established.²¹² The final approval of a project lay in the hands of the Ministry of Foreign Affairs on a case by case basis. It is the Mexican financial institution which must apply for the permit on behalf of the foreigner wishing to construct or buy industrial or tourist facilities inside the prohibited zone. Once the institution is granted the permit, a certificate of immoveable participation may be issued to the foreigner. This certificate is nominative, non-amortizable and the beneficiary does not acquire any real property right on the land or building he uses. The certificate is valid for a maximum of thirty years.²¹³ The foreign investor also has the option of leasing of the premises for a maximum period of ten years from the trustee. At the end of the period, all rights of *usus* and *abusus* on the premises are transferred to a Mexican national.²¹⁴

The 1989 *Regulations* did not change the Constitution. They secured the rights of beneficiaries of land trusts by allowing a renewal of the certificate for periods of thirty years by establishing consecutive trusts.²¹⁵ The conditions for renewal are the same as for the original establishment. As long as the *Foreign*

²¹¹ *Foreign Investment Law*, *supra*, note 3, art. 18-22.

²¹² The precise conditions were never fully established.

²¹³ The option to renew was non existent as the trusts could "under no circumstances exceed thirty years". *Foreign Investment Law*, *supra*, note 3, art. 20.

²¹⁴ *Ibid*, art. 20. "... on expiration of the trust, it may transfer ownership rights to persons legally qualified to acquire them."

²¹⁵ 1989 *Regulations*, *supra*, note 5, art. 20.

Investment Law and the first obligations of the foreign corporation were respected, renewal will be granted. The new Regulations also implement an automatic issuance of permits from the Ministry of Foreign Affairs for investments admissible without review from the Commission and for *maquiladoras*.²¹⁶ This foreign ownership exclusion is very peculiar to Mexico. The land trusts system does not seem to have hampered investors.²¹⁷ A thirty year, renewable trust is in most cases better than being a tenant.

2) Import Licence Requirements

Until the beginning of the De la Madrid Sexenio, the import of any product into Mexico required a licence issued by SECOFI. This requirement was consistent with Mexico's economic policy of internal growth and import substitution. Access to the Mexican market for imported products was difficult and they were subject to high custom duties.²¹⁸ The level of imports was, not surprisingly, very low.²¹⁹ With its accession to the GATT in 1986, Mexico adhered to most of the GATT principles in many sectors and incorporated them in its positive law.²²⁰ Mexico adhered to the GATT's *Antidumping Code of*

²¹⁶ *Ibid.*, art. 17. Note that if the land site is undeveloped and the size of the surface exceeds twenty hectares, the transaction requires approval by a resolution of the Commission. (art. 17 (III)b))

²¹⁷ A walk on the shores of the tourist resort areas of Cancun and Acapulco reveals rapidly how much these land trusts have been used, not to mention the *maquiladoras* in the North.

²¹⁸ The duty level on imports, once they were authorized, was on average 27%. Note that they could reach a maximum level of 200 %. (Source: *A New Economic Profile*, *supra*, note 52, at 23).

²¹⁹ In the 1980-1984 period, imports stood at an average of 12 billion \$ U.S. per year. In comparison imports in 1990 were a hefty 32.8 billion \$ U.S. (Source: *Banco de Mexico*)

²²⁰ *Decreto por el que se aprueba el Protocolo de adhesión de Mexico al Acuerdo General Sobre Aranceles Aduaneros y Comercio*, *supra*, note 1. Mexico retained the policy promoting local agricultural production. The protocol assessed that Mexico would keep certain import permits and maintain

1979,²²¹ *Code on Import Licences of 1979*,²²² *Code on Customs Valuation of 1979*,²²³ and the *Regulations against Unfair Trade Practices*.²²⁴ The import licence scheme was practically abolished.²²⁵ Presently, only 3 % of goods require an import licence.²²⁶ These goods are essentially agricultural and food products, such as shrimp, powdered milk, cheese, coffee and wheat in addition to automobile industry products.²²⁷

natural resources restrictions. See R. English, "The Mexican Accession to the GATT", *supra*, note 1.

²²¹ *Decreto de promulgacion del Acuerdo relativo a la aplicacion del Artículo VI del Acuerdo General sobre Aranceles Aduernos y Comercio*, D.O., May 19, 1988.

²²² *Decreto de promulgacion del Acuerdo sobre Prodedimientos para la Tramite de Licencias de Importacion, Adaptado en la Ciudad de Ginerba, Suiza, el 12 abril de 1979*, D.O., April 25, 1988.

²²³ *Decreto de promulgacion del Acuerdo Relativo a la Aplicacion del Artículo VII del Acuerdo General sobre Aranceles Aduernos y Comercio, Adaptado en la ciudad de Ginebra, Suiza, el 12 de abril 1979*, D.O., 21 April, 1988.

²²⁴ *Decreto contra practicas desleales de comercio internacional*, D.O., November 25, 1986; amended by *Decreto por cual se reforma y adiciona el reglamento contra practicas desleales de comercio internacional*, D.O., May 19, 1988.

²²⁵ *Ley del Impuesto General de Importacion*, D.O., February 12, 1988. This law reversed the principle of mandatory import licences in all cases to an exceptional import licence requirement, the rule being free and easy market access.

²²⁶ Compare with 100 % of goods until 1983. In value the remaining 3% represent over 20% of all the Mexican imports. This was agreed upon in the conditions for the Mexican accession to the GATT, which grants Mexico the possibility of keeping the tariffs at a maximum level of 40%. (Source: USITC)

²²⁷ This is explained by the high investments of major car manufacturers such as General Motors, Ford, Chrysler, Nissan and Volkswagen E. T. Siqueiros, "The Legal Framework for the Sales of Goods in Mexico" (1990) 12 Houston J. Int'l. L. 291 at 293. [hereinafter Legal Framework] The importation of cars is possible though since a 1989 Decree liberalized this sector. *Decreto para fomento y modernizacion de la industria automotriz*, D.O., December 11, 1989. On this Decree, see "Mexico's Auto Industry: The Last Bastion of Protectionism Falls?", *supra*, note 161. The industries in this sector are one of the major issues at the final stage of the NAFTA negotiations. [Interview with Canadian Official, International Economic Relations Department, Ministry of Finance, held in Ottawa, February 23, 1992]

As for tariffs, the reforms have also been drastic: import duties have been reduced from a maximum level of 200 % to 20 %, with an average weighted tariff level of 10.4%.²²⁸ The response to these changes was rapidly noticed: imports grew to 24.5 billion \$ U.S. in 1989 and to 32.4 billion \$ U.S. in 1990.²²⁹ In most cases, the required foreign investor's imports for his business operations will neither require a licence nor registration.²³⁰ There are a few other restrictions, such as a ban on certain automobiles, firearms and ivory and quotas in the textile sector allocated by the Chamber of Commerce.²³¹

In addition, the foreign investor is not bound by the *Foreign Investment Law* to supply himself from domestic sources.²³² Mexico has made concrete

²²⁸ In addition to duty, imported goods are subject to a Value Added Tax [hereinafter VAT] of a average rate of 15 % (20 % for luxury items, 0 % for basic foodstuffs). *Ley del impuesto al valor agregado*, D.O., December 29, 1978. [hereinafter *V.A.T. Law*] Note that the imports of a *maquilladora* are, of course, not submitted to either duty or VAT.

²²⁹ Of the 1990 figure, 64.1 % came from the United States, 13 % from the EEC, and 4 % from Japan. Canada represents barely 1 % of the total imports. (Source: *A New Economic Profile*, *supra*, note 52 at 23)

²³⁰ The goods which need such registration or a licence are listed in the "Importers and Exporters Registry" or *Registro Nacional de Importadores y Exportadores* produced by the Ministry of Commerce.

²³¹ Mexico was a contracting party to the *Multifiber International Agreement* before being a member of the GATT. D.O., March 4, 1982. See Legal Framework, *supra*, note 227 at 307. As to Mexico and the United States textile trade, See USITC, *U.S. Imports of Textiles and Apparel under the Multifiber Arrangement: Annual report for 1990*, Publication no 2382, (USITC: Washington, 1991) at C-99.

²³² Though the foreign investor has a general obligation to generate employment and maintain for the first three years of operations a positive foreign exchange balance. *Foreign Investment Law*, *supra*, note 3, art. 5. A specific obligation to buy domestic products imposed on the foreign investor would be contrary to the existing GATT principle that "members must accord to imported products treatment no less favourable than that accorded to like products of origin in respect of all internal requirements affecting their purchase" of article III:4. P.R. Hayden *et al.* (ed.), *Foreign Investment in Canada*, (Prentice-Hall: Scarborough, 1982 (loose-leaf edition)) at 2134. See D.S. MacDonald, "Canadian Industrial Policy Objectives and Article III of the GATT: National Ambitions and International Obligations", (1982) 6 Can. Bus. L. J. 385. See also Canada: Administration of the

efforts to ease the flow of trade by adopting the internationally recognized *Harmonized Import Classification*²³³ and by becoming party to the *United Nations Convention on Contracts for the International Sale of Goods*²³⁴ which stipulates buyer's and seller's rights and obligations when both reside in a country which is a member of the Convention. The foreign investor in Mexico will thus find an environment favourable to external supplies necessary for business.

3) Foreign Exchange Controls

The last element the foreign investor will need to face in the operation of his business are foreign exchange controls. Mexico, until 1982, had a liberal tradition towards foreign exchange, imposing no controls. From 1929, when then there were temporary exchange controls due to the crash, until 1982, no control was exercised.²³⁵ As Mexico was on the verge of bankruptcy, the 1982 crisis

Foreign Investment Review Act. Report February 7, 1984; GATT, IBB, Supp. 30 at 140, L5504. This decision is discussed *supra* in chapter IV, Section A.

²³³ *Ley del impuesto General de importacion*, D.O., February 12, 1988 and the explanatory rules *Reglas generales y complementarias para la aplicacion y interpretacion de la Tarifa del impuesto general de importacion*, D.O., May 20, 1988.

²³⁴ U.N. Doc. A/CONF. 97/18, Annex 1, reprinted in (1980) 19 I.L.M. 668; ratified by Mexico in 1987 and enacted the following year. *Decreto de promulgacion de la Convention de las Naciones Unidas sobre los Contratos de Compraventa Internacional de Mercaderias*, D.O., March 17, 1988.

²³⁵ Exchange controls would have been difficult to enforce anyway. "Most commentators have felt that exchange controls would never work in Mexico. The reason for this is more complicated than the mere situation of an open 2,000 mile border between Mexico and the United States. (...) Rather, the enforcement of exchange controls in Mexico is made difficult by the fact that the country with which Mexico happens to share this long border is the principal defender in the world of free capital movements(...). Even more important, any attempt to control something as ephemeral and fungible as money must come up against this crucial fact: that Mexican society and economy are tightly linked to those of the United States through thousands of personal, familial, professional and business relationships(...) A mere letter or telephone call from Mexico to the United States is sufficient to arrange a purchase of dollars, either as a loan or in exchange for pesos to be paid when

changed that situation as the President Lopez Portillo enacted a Decree establishing a generalized control on all foreign exchange operations.²³⁶ The aim of this Decree was to eliminate the outflow of hard currency by individuals in order to allow the state to respect minimal financial engagements.²³⁷ This Decree was in force less than four months when it was superseded by the *Decreto de Control de Cambio* following the election of President de la Madrid.²³⁸

This Decree reversed the situation from being a generalized control to a scheme of restricted control, creating two foreign exchange markets: a controlled and a free market. The first one is operated by banks, regulated by government and has restricted access. The second is a totally free market responding to the laws of supply and demand. The aim of this dual system is to pump into Mexico's treasury all the foreign exchange possible and then use this hard currency resource where it is the most needed. The free market alternative, also known as *coyote*, eliminates the black market and gives people an alternative way to fulfill their currency needs.

the relative next visits Mexico..." S. Zamora, "Peso-Dollar Economics and the Imposition of Foreign Exchange Controls in Mexico" (1984) 32 Am. J. Comp. L. 99 at 100. [hereinafter Zamora]

²³⁶ *Decreto que establece el control generalizado de cambios*, *supra*, note 70. This Decree was adopted simultaneously to the one nationalizing the Mexican banks.

²³⁷ This action also respected the International Monetary Fund's wishes. S. Zamora, "Exchange Control in Mexico: A Case Study in the Application of IMF Rules" (1984) 7 Houston J. Int'l L. 103.

²³⁸ *Decreto de Cambio*, D.O., December 10, 1982. [hereinafter the Foreign Exchange Decree] This was completed by the *Supplementary Dispositions for Exchange Controls*, D.O., of May 10, October 9 and November 19, 1987. For a comparative analysis of both 1982 decrees, see generally I. Gomez-Palacio, "Mexico's Foreign Exchange Controls - Two Administrations, Two Solutions: Thorough and Benign" (1984) 16 U. of Miami InterAmerican L. R. 267. [hereinafter Gomez-Palacio]

The controlled market works in the following way. The regulations provide that specific types of foreign currency income must be exchanged on the controlled market, such as income from the export of goods,²³⁹ the funds that *maquiladoras* use to cover local costs²⁴⁰ and loans received from foreign banks.²⁴¹ This inflow of foreign currency is allocated, depending on availability, to repayment of debts in foreign currency due to foreign banks,²⁴² for the purchase of merchandise imports,²⁴³ and payment of royalties, technical assistance and other such contractual financial obligations.²⁴⁴ All other commercial transactions are not subject to foreign exchange restrictions. All pure currency operations are done in the free market.

The foreign investor will not find himself particularly restricted by these regulations. Nowadays the difference between the two exchange rates is minimal, being less than 2%.²⁴⁵ All capital operations, investments, remittance of

²³⁹ This does not apply to exports of small value nor to the *maquiladora* industries. Note that the Mexican exporter has a legal obligation to require that exports be paid for in a foreign currency. *Foreign Exchange Decree, supra*, note 238, art. 3. See *Complementary Rules on Exchange Controls Applicable to Exports*, D.O., December 20, 1982.

²⁴⁰ *Ibid.*, art. 2(b). These local costs cover, for example, rent and salary payments. *Doing Business in Mexico, supra*, note 184 at 51.

²⁴¹ *Ibid.*, art. 6. This measure does not apply if the loan is used to repay interest or to finance another foreign currency loan or a specific import as authorized by SECOFI.

²⁴² *Ibid.*, art. 2(c). The loan includes principal and interest and must be registered.

²⁴³ To benefit from the controlled market, imports must meet SECOFI's objectives. Authorized products are listed by SECOFI. Note that the importer is free to use the higher priced free foreign exchange market as well. Gomez-Palacio, *supra*, note 238 at 296.

²⁴⁴ *Foreign Exchange Decree, supra*, note 238, art. 2(d).

²⁴⁵ The difference in between the controlled rate and the free market rate is 45 pesos in a dollar. On the free market, the dollar being valued at close to 2,800 pesos, this represents a difference in value of 1.61 %. (Source: Banco de Mexico)

dividends, payment of royalties and intercompany loans can be done on the free market.²⁴⁶ Travellers are not subjected to any exchange regulations. With confidence in Mexico's economy increasing, especially in the event of a North American Free Trade Agreement, it is most likely that these restrictions will be reduced or simply eliminated.²⁴⁷

B - The Inner-Firm Environment: Fiscal Policy and Intellectual Property Rights Law

1) Overview of Mexico's Fiscal Policy²⁴⁸

Mexico has a modern tax system integrating both income and value added tax [hereinafter VAT]. It is becoming more efficient and fraud is tolerated less than before.²⁴⁹ As a whole, the foreign investor will, with the help of the

²⁴⁶ *Doing Business in Mexico*, *supra*, note 184 at 52.

²⁴⁷ "Exchange controls, even in the most favourable of circumstances, are usually considered undesirable...[though] once imposed, they may take years to remove, since removal of them presupposes the restoration of public confidence that may have been shaken by the imposition of controls in the first place. In the case of Mexico, it is likely that exchange control regulations will be significantly reduced, although certain vestiges of the control may remain." Zamora, *supra*, note 235 at 153.

²⁴⁸ For a complete overview, see E. C. Nicolau, "Mexican Taxes on Foreign Investment and Trade" (1990) 12 *Houston J. Int'l. L.* 265 [hereinafter Nicolau]; F. Sanchez Ugarte, "Taxation of Foreign Investment in Mexico: The North American Perspective", in: *The Dynamics of North American Trade and Investment - Canada, the United States and Mexico*, *supra*, 200 at 166 and especially *Doing Business in Mexico*, *supra*, note 184 at 62 and following.

²⁴⁹ "Historically, Mexico has had low tax compliance and lax enforcement. From 1921 through 1988, the tax authorities brought charges against only two taxpayers for tax irregularities. The situation began changing in 1989, when the Finance's Secretariat tax office brought 49 cases of tax evasion or fraud against taxpayers and obtained convictions in 48 of the cases. Audits are expected to reach 10% of all taxpayers in 1990. Business International Corp., *International Law and Trade - Mexico*, (Int'l. Bus.: London, 1990) That opinion was confirmed by a French Executive, himself of both Mexican and French nationality, Charles Louis Vaudevuy, of the *Société Générale des Eaux*, which invest close to 6 billion dollars U.S. abroad yearly and has been established in Mexico since 1978. [Conference held in Montreal at the law firm Lapointe Rosenstein, June 7, 1991]

1986 reform accelerated by President Salinas in 1989,²⁵⁰ find a favourable fiscal environment for his endeavours.²⁵¹ These reforms form a part of the plan to attract more investment to Mexico. The Mexican corporation will be subject to taxes on its income,²⁵² its assets²⁵³ and to a VAT.²⁵⁴

Corporate taxes stand presently at a maximum rate of 35%, down from 47% in 1988.²⁵⁵ The taxable income is the corporation's gross income less all expenses strictly needed to carry out the company's business.²⁵⁶ Branches, representative offices and agencies of foreign corporations are subject to the same tax as the Mexican corporation on their income gained in Mexico as they are deemed "permanent establishments". The taxes are honoured through a monthly account provisional payment credited against the annual income tax return.²⁵⁷ The Mexican corporation has an obligation to share about 10% of its

²⁵⁰ See A. Ortiz, "Mexico - Boletín sobre la Reforma Fiscal Para 1989" (1989) 5 *Inter-American Legal Materials* 1.

²⁵¹ *Ibid.*, at 13 (para. 8.00).

²⁵² *Ley del impuesto sobre la renta*, D.O., December 30, 1980. [hereinafter *Income Tax Law*]

²⁵³ *Ley del impuesto al activo de las empresas*, D.O., January 1, 1989. [Hereinafter *Tax on Assets or TOA Law*]

²⁵⁴ *VAT Law*, *supra*, note 228.

²⁵⁵ The effective corporate tax rate on profits is a bit higher, 37.8 %, since certain other taxes are not calculated though mandatory as will be explained *infra*.

²⁵⁶ *Income Tax Law*, *supra*, note 252, art. 24. Note that since inflation was very high in Mexico in the 1980's, a special method of calculation of the "taxable income" and of the depreciation of goods was established and new accounting guidelines were issued by the *Instituto Mexicano de Contadores Públicos*. Nicolau, *supra*, note 248 at 274.

²⁵⁷ *Ibid.*, at 278.

profits with its employees.²⁵⁸ This amount is based on the corporation's taxable income, before the payment of income tax and is nondeductible. Since the taxable income base does not take in account this 10% pre-payment, it increases the effective rate of taxation from 35% to 37.8%²⁵⁹

Mexico's fiscal landscape includes a peculiarity: Mexican corporations must pay a 2% tax on their assets [hereinafter TOA]. Nicolau describes the policy underlying this TOA in these terms: "The TOA was established due to the fact that a great number of companies registered in Mexico were filing income tax returns showing losses or absence of revenues. This led the tax authorities to believe that in many cases, income tax was being evaded. The authorities based their belief on the reasonable presumption that it is illogical for a corporation that has been operating at a loss for a number of years to continue to be operating without being liquidated by its shareholders."²⁶⁰ This tax is applied on the fixed, financial and current assets of Mexico and is paid on a monthly provisional basis. This tax is creditable against the income tax if the amount of income tax is higher than the value of the TOA.²⁶¹

All transfers of goods, leases, rendering of services and imports of the corporation are subject to a VAT. The most common rate is 15% of the price for

²⁵⁸ *Income Tax Law, supra*, note 252, art. 26.

²⁵⁹ For example, if the corporation has a taxable income of 1,100 \$, it will distribute 110\$ to its workers and pay 35 % of 1,100 \$ to the Government which means a real taxation rate of 37.8%.

²⁶⁰ Nicolau, *supra*, note 248 at 272.

²⁶¹ *Tax on Assets Law, supra*, note 253, art. 9.

goods and services, 6% for basic products and 0% for foodstuffs and exports.²⁶² The Mexican VAT mechanism works like all others, whereby the corporation pays the government the difference between the VAT received and the VAT charged in the course of business.

Finally, the Mexican corporation is required to withhold tax of third parties in the case of payment of salaries (35% maximum), royalties (15% to 35%), interest (15%) and dividends (0% to 35%). There are no major fiscal incentives given for foreign investors since these have been tried without great results. A few incentives remain for mid-size corporations in the export sector. "The experience shows that the fiscal incentive measures do not attain their objectives and that they are costly in terms of loss of fiscal income. The real stimuli for productive national and foreign investments is the guarantee of a satisfactory macroeconomic environment, which reduces uncertainties and management costs".²⁶³ For Canadians, there is a new tax treaty in force with Mexico that diminishes double taxation effects.²⁶⁴ There is also an Exchange of Information Treaty between the United States and Mexico.²⁶⁵

²⁶² VAT Law, *supra*, note 228, art. 9, 15, 20 and 25.

²⁶³ A.R. Moreno, "L'expérience du Mexique", in: OEDC, *L'imposition et les mouvements internationaux de capitaux - Un colloque réunissant pays de l'OCDE et pays non-membres de l'OCDE*, (OEDC: Paris, 1990) at 70. See also IMF (Fiscal Policy Division), "Politique fiscale et réforme de l'investissement direct extérieur dans les pays en voie de développement" in: *Ibid.*, at 180.

²⁶⁴ Note that this treaty had been in negotiation since 1973. In 1990, an *Exchange of Tax Information Convention* was signed between Canada and Mexico that led to a full bilateral tax treaty. Ministry of Finance (Canada), Information Release 90-057 (April 27, 1990).

²⁶⁵ *Tax Information Exchange Agreement*, D.O., November 9, 1989; reproduced in: (1990) 29 I.L.M. 50.

2) Transfer of Technology Obligations and Intellectual Property Rights²⁶⁶

The transfer of new technologies is essential for Mexico's future. Indeed, third world countries often can not afford either to develop the technologies appropriate for their own conditions or to use the ones that are currently used in developed countries. The issue of transfers of technology has been widely debated in the North\South dialogue and is still at the forefront of the preoccupations of developing countries.²⁶⁷ Mexico had, until very recently, a hostile attitude towards technology transfer contracts with its *Transfer of Technology Law* and endeavoured to keep as much technology as possible used by foreign investors at minimal costs to itself.²⁶⁸ The same was also true, though to a lesser extent, with respect to patents and trade marks and the *Law*

²⁶⁶ See generally USITC, *New Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States - Mexican Relations*, Investigation no. 332-282, (USITC: Washington, 1990) at 6-1 and following.

²⁶⁷ See generally UNCTAD, *Trade and Development in the Least Developed Countries: An Assessment of Major Policy Issues*, (U.N.: New York, 1990), UNCTAD\ITP\TEC\12; UNCTAD, *Trade and Development in the Least Developed Countries: A Compendium of Major Policy Issues*, (U.N.: New York, 1990), UNCTAD\ITP\TEC\12; WIPO, *Licensing Guide for Developing Countries: A Guide for the Legal Aspects of the Negotiation and Preparation of Industrial Property Licences and Transfer Technology Agreements Appropriate to the Needs of Developing Countries*, Publication no 620(E), (WIPO: Geneva, 1977); A. Segal, *Learning by Doing: Science and Technology in the Developing World*, Special Studies in Science, Technology and Public Policy, (Westview Press: Boulder, 1987); M. Fransman & K. King (ed.), *Technology Capability in the Third World*, (MacMillan: London, 1984); P.K. Gosh, *Technology and Policy Development: A Third World Perspective*, (Greenwood Press: Westport, Conn., 1984); M.R. Bhagavan, *Technological Advances in the Third World: Strategies and Prospects*, (Popular Prakashan: Bombay, 1990).

²⁶⁸ The essential aim of the *Transfer of Technology Law* was to adopt in an explicit manner a policy of control over technology in such a way to create greater independence from other countries. This policy was in line with the general policy of "development from within" of import-substitution. M.S. Wionczek *et al.*, *La transferencia internacional de tecnologia: el caso de Mexico*, (Fondo de Cultura Economica: Mexico, 1974).

of *Inventions and Trademarks* regulating these.²⁶⁹ These restrictions led to Mexico being classified amongst the "worst countries in the world" as regards to intellectual property rights in general with the exception of copyrights regulations.²⁷⁰

The President's speech preceding the adoption of the *Transfer of Technology Law* illustrates well the "hard feelings" Mexico had at that time towards contracts involving technology:

"The examination that has been made of contracts or agreements through which domestic industry acquires technology has led to the conclusion that those contracts and agreements have been the channel for the transmission of technology useful to and important to the country's development, but at the same time the technology acquired is often obsolete, inadequate or already available in the country, and moreover that such contracts (...) oblige [the buyer] to acquire obsolete or costly goods at excessive prices, prohibit or limits his exports, curtail his scope for (...) developing technology of his own, intervene in his management (...); and require disputes about the interpretation or the performance of contracts to be brought before foreign courts or tribunals.

Far from stimulating the national economy, these and similar clauses damage it."²⁷¹

²⁶⁹ *Law of Inventions and Trademarks*, D.O., February 10, 1976. See A.C. Hyde & G. R. de la Corte, "Mexico's 1976 Law of Invention and Trademarks" (1980) 12 Case West. J. Int'l. L. 469. The Law was amended in 1987, D.O., January 17, 1987. On these amendments, See J. Delgado, "Highlights of New Regulations for Patent and Trademark Law" (1989) 3 *World Intellectual Property Report* 58. The objective of the Law "was to create a legal framework to stimulate creativity and to prevent multinational companies that generally possess the majority of patents from dominating the domestic market" M. Zellner, "Intellectual Property: Trespassers May Be Prosecuted", (*Business Mexico*, September 1987) at 38.

²⁷⁰ As to the ranking of Mexico, see USITC, *Foreign Protection of Intellectual Property Rights and the Effects on the U.S. Industry and Trade*, Publication no. 2065, (USITC: Washington, 1988), at 3-1. For the ranking in copyrights, see U.S. Department of State, *Country Reports on Economic Policy and Trade Practices*, (U.S. Dept. of State: Washington, 1989) at 766.

²⁷¹ UNCTAD, Trade and Development Board, TD/B/AC.11/13, January 8, 1973.

The *Transfer of Technology Law* imposed a restriction on a vast array of contracts such as licensing, franchising, intellectual property rights and even personal training and hiring. In substance, the law stipulated that any contract whereby intellectual property or technology was involved had to be registered or else the contract would be deemed null, void, and of no effect.²⁷² Any not conforming to the requirements of the Law would not be registered.²⁷³ The Commission responsible for the registration of the contracts had a large discretionary power in the application of the 14 different requirements until the law was adjusted to specify the requirements in 1981 and was slightly liberalized.²⁷⁴ President Salinas, in 1990, changed the Law substantially through regulations in order to allow parties to a contract the right to negotiate at length all its aspects and limiting the grounds for denial of registration by the Commission.²⁷⁵

As for patents and trademarks, they were governed by the *Law of Inventions and Trademarks*, administered by the Mexican Patent and Trademark

²⁷² *Transfer of Technology Law*, *supra*, note 64, art. 11.

²⁷³ *Ibid.*, art. 7. For example, that was the case when royalties of over 3% were required, when restrictions were imposed on sourcing of instruments or basic products, on the management of the business or when the term of the contract exceeded 10 years.

²⁷⁴ *Ley sobre el control y registro de la transferencia de la tecnologia y el uso y explotacion de patentes y marcas*, D.O., January 11, 1982. For a comparative study of this law to the previous, see A. Hyde, "1981 Mexican Transfer of Technology Law" (1983-84) 15 *Lawyer of the Americas* 37.

²⁷⁵ *Reglamento de la ley sobre el control y registro de la transferencia de tecnologia y el uso y explotacion de patentes y marcas*, D.O., January 9, 1990. This was partly in view of Salina's effort to seek negotiations of a FTA with the United States and to harmonize relations since Mexico was on the "Priority Watch List" of the United States subsequently to the implementation of Section 182 of the *Omnibus Trade and Competitiveness Act* of 1988 by the U.S. Secretary of Trade Carla Hills. Two weeks after this new regulation and the promise of a new legislation, Mexico was retrieved from the "Priority Watch List" by the US. See J.A. Soberamis, "La politica mexicana en materia de trespaso tecnologico- Una evaluacion critica del reglamento de la ley" (1990) 40 *Comercio Exterior* 767; USITC, *Review of Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States-Mexican Relations*, *supra*, note 266, at 6-1 and Office of the United States Trade Representative, Press Release, January 24, 1990.

Office. As for patents, the law provided no registration of biotechnological processes, pharmaceutical, medicinal, fertilizer and chemical products. It provided a 14 year patent term as long as the patent was being exploited in the three years following its issuance, in industrial quantities of adequate quality and price.²⁷⁶ Importation of a patented product was not considered exploitation and if these requirements were not met, the term would elapse automatically without review.²⁷⁷

Compulsory licensing of a third party from a patent holder could be ordered by the Mexican Patent and Trademark Office if the patent holder had not satisfied the working requirements, if the exploitation had stopped for 6 months, if the product exploitation did not satisfy the national market or was not exported, in the event that the third party expressed an interest in doing so.²⁷⁸ The decision to issue a compulsory licence would be made after a full hearing of the interested parties by the Mexican Patent and Trademark Office.²⁷⁹

With respect to trademarks, the law explicitly recognized product and service marks and the right to their exclusive use for a five year renewable period after registration with the Mexican Patent and Trademark Office.²⁸⁰ The non-use

²⁷⁶ *Law of Inventions and Trademarks, supra*, note 269, art. 41-42.

²⁷⁷ *Ibid.*, art. 43.

²⁷⁸ *Ibid.*, art. 50.

²⁷⁹ Note however that "Mexican government officials could not recall any such hearing or the granting of any compulsory license" USITC, *Review of Trade and Investment Liberalization Measures (Phase I)*, Publication no. 2275, (USITC: Washington, 1990) at 6-2.

²⁸⁰ *Law on Inventions and Trademarks, supra*, note 269, art. 83, 84 and 112.

of the trademark could lead to the extinction of registration.²⁸¹ The 1987 Amendments to the *Law on Inventions and Trademarks* provided protection without registration for "well known marks" and their derivatives and allowed for objections prior to registration.²⁸²

President Salinas was aware of the fact that in order to improve relations with the United States and to establish a free trade agreement, further changes to these laws were necessary.²⁸³ These were also necessary in order to provide a favourable environment for foreign investors. The previous setting of intellectual property rights described earlier has changed drastically as a result of the new *Law on Promotion and Protection of Industrial Property* which repealed all previous laws and regulations.²⁸⁴ The foreign investor will now find in Mexico the protection similar to what would be accorded in the United States for his intellectual property.²⁸⁵ This is especially true since the law responds to the

²⁸¹ *Ibid.*, art. 117.

²⁸² *Ibid.*, art. 132. Before the 1987 Amendments, once registration was granted, only a trademark owner could only seek cancellation of the registration. See J. Delgado, "Highlights of the New Regulations for Patent and Trademark Law", *supra*, note 269.

²⁸³ A.S. Gutterman, "Changing Trends in the Content and Purpose of Mexico's Intellectual Property Right Regime" (1990) 20 Georgia J. Int'l. & Comp. L. 515 at 524. See also the comment *supra*, at note 275. In the ongoing NAFTA talks, intellectual property is linked to what is happening at the multilateral level in the GATT with the TRIPS negotiations, thus impeding on the progress of the Agreement. Canada wants to wait for the TRIPS to resume and build on that basis in the NAFTA. External Affairs, "North American Free Trade Negotiations, Situation Report no 2", Ottawa, December 1991 at 5.

²⁸⁴ *Law on Promotion and Protection of Industrial Property*, *supra*, note 78, transitory art. 2, repealing the *Law of Inventions and Trademarks*, *supra*, note 269, and the *Law on Control and Registration of Transfer of Technology and the Use of Patents and Marks and its Regulations*, *supra*, note 274. The Regulations of the *Law on Inventions and Trademarks* continued to have effect, pending new regulations and provided that they did not contravene the new law. (Transitory art. 4)

²⁸⁵ "...The fundamental aim of the new Law is to offer in Mexico a protection for industrial property rights similar to the one existing in industrialized countries. With this, the individuals and companies in Mexico will benefit from legal rights comparable to the ones that their competitors

problems that the States perceived in the Mexican intellectual property regime.²⁸⁶

The *Law on Promotion and Protection of Industrial Property* allows for better protection against copies or imitations of patented products, industrial designs, trade secrets, trademarks, copyrights and even denominations of origin. With the abrogation of the *Transfer of Technology Law*, registration of contracts involving intellectual property is no longer required.²⁸⁷ One of the most serious impediments thus disappeared as contracts can be fully negotiated in a secure environment.

Building on existing legislation, the Law reduces the number of items excluded from patent registration: chemical, biotechnical, and pharmaceutical

encounter in other more advanced countries, defending themselves against copies or imitations of their products, fabrication process, trademarks, copyrights, etc." R. V. Gonda, *La nueva ley mexicana de propiedad industrial* (1991) 41 *Comercio Exterior* 1057, at 1057. [hereinafter Gonda] (translation of the author) An American diplomat in Mexico stated that with this new law, "Mexico afforded more protection to patents and intellectual property rights than its American counterpart". [Interview with American diplomat, NAFTA negotiator, *supra*, note 110].

²⁸⁶ See USITC, *Review of Trade and Investment Liberalization Measures by Mexico (Phase I)*, *supra*, note 279, at 6-3, 6-6, 6-10 and 6-15, "perceived changes needed in Mexican Patent Law, Trademarks Law, Copyrights Law, and Trade Secrets".

²⁸⁷ Through this, the government recognizes that more transfer of technology is likely to occur with increased foreign investment than through tight regulations. This is based on the assumption that the 1990's context provides more chances of technology transfers than in the 1970's with the increased globalization and fight for competitiveness in Mexico and in world trade. Gonda, *supra*, note 285, at 1065. Note that in order to ensure such dissemination of the technology, inventions for which patents are solicited will be published 18 months after the patent request was deposited. *Law on Promotion and Protection of Industrial Property*, *supra*, note 78, art. 22. Germany, France, Canada, Spain, The Netherlands and the United Kingdom have similar provisions. Gonda, *supra*, note 285 at 1058.

products can now be registered and patented.²⁸⁸ Patents are granted for a non-renewable period of 20 years, except for pharmaceutical products which can be granted a three year supplementary protection.²⁸⁹ Compulsory licensing of patents has been kept, though it will only be allowed in exceptional circumstances set forth by the law.²⁹⁰ As to trademarks, the existing legal regime, revamped with the 1987 Amendments continues to apply in the new Law. More precise rules have been added which provide for an extended renewable protection period of five to ten years, a reduced obligation to use a registered trademark once its granted registration and an increased protection for internationally recognized trademarks.²⁹¹

Finally, the Law provides exclusive rights upon registration for industrial designs for a period of 15 years,²⁹² for utility models for 10 years,²⁹³ and for appellations of origin for an unlimited period.²⁹⁴ In answer to American wishes, trade secrets are now protected and a quick remedy procedure has

²⁸⁸ *Law on Promotion and Protection of Industrial Property, supra*, note 78, art. 20.

²⁸⁹ *Ibid.*, art. 23.

²⁹⁰ *Ibid.*, art. 70. The mandatory licensing can not be authorized within the first four years of the issuance of the patent neither if the patented product was imported. In any case, a full hearing will be allowed before any action is undertaken. Note that license agreements need to be registered for the sole purpose to have effect against third parties, without any restrictions on its content. *Ibid.*, art. 62 and ff.

²⁹¹ *Ibid.*, art. 89, 95, and Transitory art. 4.

²⁹² *Ibid.*, art. 36.

²⁹³ *Ibid.*, art. 29, 30.

²⁹⁴ *Ibid.*, art. 156, 165. The protection of the appellation may be revoked following the disappearance of the conditions that led to its first recognition.

been established in order to limit possible infringements and resulting damage.²⁹⁵ The Law provides more efficient enforcement of rights through inspections, administrative and penal sanctions.²⁹⁶

The *Law on Promotion and Protection of Industrial Property* is again a total reversal of philosophy: From mandatory registration, stringent rules, low or medium protection, and lax enforcement to the present standards is a long way. Salinas went through this way like a speeding bullet in an unprecedented effort to attract foreign investment and stimulate economic growth. By undertaking such abrupt change, Mexico is adopting industrialized nations' standards in a country where the per capita income is eight times lower. What will be the result of applying a structure of "industrialized laws" in a country which was on the verge of bankruptcy ten years ago? Salinas hopes to achieve better economic development of the country through foreign investment. In some ways, it is like building the frame and body of a car, to wait for the motor to come and then keeping the car keys. This is a major bet for the future based on foreigners and a "new improved Mexico".

This raises questions about the ability of Mexico to assume all these changes.²⁹⁷ Aside from the administrative burden, the reversal of a seventy

²⁹⁵ *Ibid.*, art. 62. See USITC, *Review of Trade and Investment Liberalization Measures by Mexico (Phase I)*, *supra*, note 279, at 6-17.

²⁹⁶ *Ibid.*, art. 203 and ff. The sanctions vary from a fine to six years of imprisonment, without excluding the right to compensatory damages.

²⁹⁷ "...[the] Mexican Patent and Trademark Office (MPTO) does not have the financial resources to expedite its procedures. MPTO officials, as well as Mexican attorneys practising before the MPTO, agree that the office does not have enough resources to perform a wide variety of complex tasks. Eight lawyers are employed in MPTO to perform the analysis and determination (...) [and] are paid approximately one fourth to one fifth as much as junior attorneys in Mexico City patent and

year old trend will probably create social and political upheaval. This reversal implies that the need for change was a result of the inadequacies of the old policy to present day realities. The import substitution policy provided stable economic growth for twenty years, until early 1970. Then, helped by large petroleum discoveries, it continued for another ten years. When the banks stopped lending to Mexico in 1982, import substitution was no longer sustainable. Yet, income distribution remained the same until today. This might have been due to the control that development from within allows on economy and people.

The reforms of intellectual property, import licence, and fiscal laws have opened Mexico to foreign investment and its influences. They demonstrate Mexico's readiness to modify its FDI regime further with NAFTA. The economy will be governed by business, under the new legal framework, and less by government. Up to now, the response of investors has been very good, allowing the GNP to grow faster than the population in 1991. The economic motor Salinas had hoped for is gaining strength. Through this economic success, political and social changes are more likely to occur than they have been in the recent past. A comprehensive North American Free Trade Agreement will most probably bring more foreign investments, get economic motor running, and bring new opportunities to all Mexicans, as we will see in the last chapter.

trademark law firms." The American counterpart has a total staff of about 400 people. USITC, *Review of Trade and Investment Liberalization Measures by Mexico, supra*, note 279, at 6-7.

CHAPTER IV : INVESTMENT REGULATIONS AND FLOWS IN AMERICA

In this chapter, we will examine the current investment patterns between Mexico, Canada and the United States and summarize the investment policies of the United States, Canada and of Chapter 16 of the FTA relating to investment. The presentation of the trade and investment flows in North America shows the economic relationships that link Canada, the United States and Mexico together. It exemplifies the strong economic ties that the United States enjoys with its neighbours and the dependence of both Canada and Mexico on their neighbor. The figures are important since they are the source of each country's specific regulation of FDI and form the basis to NAFTA.²⁹⁸

A - Investment Regulation in America

1) Canada: The Investment Canada Agency

The regulation of foreign investment in Canada has long been a sensitive political issue due to the high degree of foreign ownership in many sectors of the country's economy:²⁹⁹ In the mining sector, FDI now stands at 30%, in

²⁹⁸ The Parties rationale for NAFTA and ambitions for the investment liberalization to occur with NAFTA will be examined *supra*, in Chapter V.

²⁹⁹ See the Gordon Commission Report analysing the level of foreign ownership in Canada and proposing four different means of control, including a central review board. Government of Canada, *Report of the Royal Commission on Canada's Economic Prospects*, (Queen's printer: Ottawa, 1958). The Gray Report concluded that a regulatory scheme was necessary in Canada since there was a very high level of foreign ownership in Canada, reaching 76 % in the energy sector and 90% in some other sectors. Information Canada, *Foreign Direct Investment in Canada*, (Inf. Canada: Ottawa, 1972).

manufacturing at 45% and in wholesale trade at 30%.³⁰⁰ These figures have always fed a strong debate in Canada, as in Mexico, on the effects of foreign investment and its appropriate regulation.³⁰¹ From 1973 to 1984, Canada adopted a restrictive policy on foreign direct investment with the establishment of the Foreign Investment Review Agency [hereinafter FIRA].³⁰² Through FIRA, Canada screened every foreign investment, be it a new investment or an acquisition, regardless of size, allowing only foreign investments of "significant benefit for Canada".³⁰³

FIRA was the object of much criticism from all parties dealing with the agency. Complaints focussed on the length of the process, generally of 12 to 18

³⁰⁰ (Source: Investment Canada)

³⁰¹ See the opinions of H.I. MacDonald, "Nationalism in Canada" in: T.E. Reid (ed.), *Foreign Ownership: Villain or Scapegoat*, (Holt, Reinhart and Winston: Toronto), 1972 at 71; T.F. Franck & K.S. Gudgeon, "Canada's Foreign Investment Control Experiment: The Law, the Context and the Practice" (1975) 50 N. Y. Univ. L. R. 76; D. McDowall, *A Fit Place for Investment ?*, Study no. 81, (Conference Board of Canada: Ottawa, 1984); S. Wex, *Instead of FIRA: Autonomy for Canadian Subsidiaries ?*, (Institute for Research on Public Policy: Montreal, 1984); G. Dewhurst & M. Rudiak, "From Investment Screening to Investment Development: The Impact of Canada's Foreign Investment Review Agency (FIRA) and Investment Canada in Canada's Technological Development" (1986) 11 Can.-U.S. L. J. 149. The similarity between Canada and Mexico with respect to foreign direct investment regulation is not new. J.H. Hodgson, *Las inversiones extranjeras en el desarrollo de Canada y de America Latina* in: R.B. Farrell, *America Latina y Canada frente a la política exterior de los Estados Unidos*, (Fondo de Cultura Economica: Mexico, D.F., 1975) at 56; M. Voghel, *Étude comparative des mesures de contrôle de l'investissement étranger au Mexique, en Australie et au Canada*, *supra*, note 58.

³⁰² *Foreign Investment Review Act*, *supra*, note 58. See J. Turner, "Canadian Regulation of Foreign Direct Investments" (1983) 23 Harv. Int'l. L. J. 333; M. Dewhurst, "The Canadian Federal Government's Policy in Foreign Direct Investment" in: E. Fry & L. Radebaugh (eds.), *Regulation of Foreign Direct Investments in Canada and the United States*, (Brigham University: Provo (Utah), 1984) at 27.

³⁰³ *Foreign Investment Review Act*, *supra*, note 58, art. 2(1). Note that there was an expeditious process for small businesses requiring essentially only registration, a small business being of less than 5 million \$ and employing a maximum of 200 employees in the case of direct acquisition. *Regulations Respecting the Acquisition of Control of Canadian Business Enterprises and the Establishment of New Businesses in Canada*, SOR/83-493, Section 5.

months, its discretionary untransparent screening process, the lack of information, the unclear selection criteria and the fact that foreign investors were required to negotiate with an Agency which in the end, was not the one taking the final decision with regards to the investment proposal. FIRA was considered a discretionary measure impeding the free flow of trade and investments by many of Canada's trading partners.³⁰⁴ The United States brought a formal complaint against the domestic sourcing requirements imposed by FIRA on foreign investors to the GATT in 1982. A GATT panel concluded in the following year that this requirement was contrary to Canada's obligations found in Article III:4 of the GATT and that this policy be modified.³⁰⁵ However, FIRA appears to have been more a "paper tiger" than an "angry Canadian bear" since the average approval rate of investment proposals was 90%. With FIRA, the level of foreign ownership in Canada declined from 37% on average in 1971 to 24% in 1987.³⁰⁶

This trend changed in 1984 with the adoption of the "Open for Business" policy by the newly elected Conservative government and the enactment of the

³⁰⁴ Their were threats of retaliation to FIRA by the United States. J. Abrecht, "Canadian Foreign Investment Policy and the International Politico-Legal Process" in *The Canadian Yearbook of International Law* (1982), (University of British Columbia Press: Vancouver, 1984) at 149.

³⁰⁵ "Administration of the *Foreign Investment Review Act*", Report of the Panel, July 25, 1983, BISD 30th Supp., p. 140 (1982-1983). The local sourcing requirement was not necessary for the effective administration of the *Foreign Investment Review Act* as the article XVII:1(c) allows. However, the requirement by FIRA on the part of a foreign firm operating in Canada to export a minimum of its production was not deemed inconsistent with its GATT obligations.

³⁰⁶ (Source: Investment Canada) Note that it is likely that the existence of FIRA diverted investments to other countries, since investors estimated that they would not pass the test or felt that they were unwelcome. For example, the European Management Forum ranked Canada the least welcoming country for foreign investment out of a total of 28 as a result of a yearly survey, from 1979 to 1983. W.B. Rose, "Foreign Investment in Canada: The New Investment Canada Act" (1986) 20 Int'l. Lawyer 19 at 21.

Investment Canada Act.³⁰⁷ This Act repealed FIRA, replacing it with the "Investment Canada Agency" and a new philosophy.³⁰⁸ The ICA's policy was based on the encouragement of foreign and domestic investment since, as stated in the law, foreign investment is beneficial to Canada.³⁰⁹ The Act abolished the mandatory review process for the establishment of all new Canadian businesses.³¹⁰ A review is required in the case of direct acquisitions of \$5 million or more, indirect acquisitions of over \$150 million or if the investment is in the field of culture.³¹¹

In response to criticism of FIRA, the review process used by Investment Canada was streamlined and given a lower profile, the investor receiving an

³⁰⁷ *Investment Canada Act*, *supra*, note 77. [hereinafter ICA] This new policy was rapidly implemented, the act being adopted in the months following the election of the Tories. See generally Rose, *ibid*.

³⁰⁸ For a comparative study of FIRA and ICA, see M. Heinz Juergen, *Regulation of Foreign Investment in Canada*, (LL. M. Thesis: McGill U., Institute of Comparative Law, 1986); J. Baker, "From FIRA to Investment Canada", in E. Fry & L. Radebaugh (eds.), *Canada-U.S. Economic Relations in the Conservative Era of Mulroney and Reagan*, *supra*, note 302 at 47, J.M. Spence, "Current Approaches to Foreign Investment Review in Canada" (1986) 31 McGill L. J. 507.

³⁰⁹ ICA, *supra*, note 77, art. 2.

³¹⁰ *Ibid*, art. 11(a). The establishment of a new business requires filing a notification with Investment Canada; it will not be reviewed unless the proposed business relates to Canada's "cultural heritage or national identity". *Ibid*, art 15. The publication and distribution of books, film, video, music products have been identified as part of Canada's "national identity". *Investment Canada Regulation*, SOR/DORS 85-611, sched, IV, 119 Can. Gaz. II 3027, 3032-33 (1985), *amended* SOR/DORS 89-69, 123 Can. Gaz. II 130 (1989).

³¹¹ *Ibid*, art. 14(1) a). This measure eliminated 90% of all transactions that had been reviewable under FIRA. This impressive figure is tarnished by the fact that the remaining 10% comprises 90% of the value of the transactional value of investments in Canada, G.C. Glover, D.C. New & M.M. Lacourcière, "The Investment Canada Act: A New Approach to Foreign Investments in Canada" (1985) 4 Bus. Lawyer 83 at 98.

answer forty-five days after the investment proposal was deposited.³¹² The new criterion of selection is that the reviewed investment must be "of net benefit to Canada".³¹³ This criteria has not impeded the successful review in any of the 1317 reviewed transactions subjected to Investment Canada since its creation until 1990.³¹⁴ Since the implementation of the ICA, foreign investments in Canada have increased to a net average inflow of 4.2 billion \$ in the 1986-1989 period, originating mainly from the U.S.³¹⁵

Apart from the centralized review board, the Investment Canada Agency, we find restrictions on foreign ownership exist in Canada in specific sectors of the economy, as is the case in many other countries.³¹⁶ These sectors include agriculture,³¹⁷ fishing,³¹⁸ airlines,³¹⁹ banks,³²⁰ broadcasting and cable

³¹² *Ibid.*, art. 21(1). This period can be extended to a maximum of 75 days, unless the investor agrees otherwise. Note that as with the review in FIRA, "the review process remains a decision based on policy rather than law". E.J. Arnett, "From FIRA to Investment Canada" (1985) 24 Alb. L. R. 1 at 26.

³¹³ *Ibid.*, art. 21. The factors to determine the "net benefit" concept are similar to those of FIRA and leave a large discretionary margin to the Minister responsible for the application of the Act. These factors are the effect of the investment on employment, resources, productivity, technological development, national and international market competitiveness, Canadian participation and "the compatibility of the investment with national industrial, economic and cultural policies". *Ibid.*, art. 20.

³¹⁴ "... up to the end of 1990, 5266 investment proposals had been received. Three-quarters of these were not subject to review, and the 25% that were have been all approved. In some 11 percent of those latter cases, approval was subject to meeting specified performance requirements. Most of these requirements pertain to R&D undertakings in high-technology sectors, Canadian participation in oil and gas sector, and product mandating and production levels in the manufacturing sector." *Challenges of NAFTA, supra*, note 129 at 44. See also Investment Canada, *Annual Report 1990-1991*, (IC: Ottawa, 1991).

³¹⁵ (Source: Statistics Canada)

³¹⁶ An overwhelming majority of countries do not provide national treatment to foreign investors. Business and Industry Advisory Committee to the OECD, *National Treatment: A Major International Investment Issue of the 1980's*, (OECD: Paris, 1982).

³¹⁷ *Western Grain Stabilization Act*, 1985 R.S.C., ch. W-7.

distribution,³²¹ shipping,³²² oil, gas and uranium production.³²³

As a whole, the regulation of FDI in Canada and Mexico show many similar elements. At the outset, it is clear that Mexico had a more restrictive policy with its longstanding 49% maximum foreign participation, its territorial land ownership restrictions and the registration requirements it imposed until a year ago for contracts involving intellectual property. These differences in degree aside, we see that the aims of the *Foreign Investment Law* and of the *Foreign Investment Review Act* are similar. Both laws constitute a control on FDI through a central agency which follows government's policy in order to foster domestic ownership and reap the maximum benefits from FDI. Canada and Mexico lay under the responsibility and discretion of the Executive for the final decision for the review of investment.

Canada does not have, like Mexico, constitutional restrictions on FDI neither are many sectors excluded from foreign participation. Yet, in the key

³¹⁸ *Fisheries Act*, 1985 R.S.C., ch. F-14.

³¹⁹ *Aeronautics Act*, 1985 R.S.C., ch. F-2.

³²⁰ *Bank Act*, 1985 R.S.C., ch. B-1.

³²¹ *Broadcasting Act*, 1985 R.S.C., ch. B-11.

³²² *Canada Shipping Act*, 1985 R.S.C., ch. S-9.

³²³ *Territorial Lands Act*, 1985 R.S.C., ch. F-7; *Canadian Petroleum Resources Act*, 1986 Can. Stat., ch. 45; *Canada Oil and Gas Act*, S.C. 1981, c. 81. The Canadian government's policy on energy through the *National Energy Program (1980)* has been criticized as being a disguised expropriation since the Crown was increasing its share of oil exploration and resource retroactively to "canadianize" the industry. C.J. Olmstead, E.J. Krauland & D.F. Orentlicher, "Expropriation in the Energy Industry: Canada's Crown Share Provisions as a Violation of International Law" (1984) McGill L. J. 439. See also for a description of the the Program E. Mendes, "The Canadian Energy Program: An Example of Assertion of Economic Sovereignty or Creeping Expropriation in International Law" (1981) Vand. J. Trans. L. 475.

sectors of transportation, financial services, mining, energy and agriculture, Canada has imposed restrictions on foreign participation. These sectors are subject to similar restrictions in Mexico. As regards land ownership, a Canadian Province, in the face of growing American land ownership, enacted specific legislation to limit the available lands to foreigners.³²⁴ This legislation was upheld by the Supreme Court of Canada in 1976 as constitutional.³²⁵ Of course, this is much less far reaching than the Mexican exclusions on land ownership. However, these elements show a parallel trend in the regulation of FDI in the two countries. They both share, although to a different degree, the need to centrally regulate FDI on their territory given the strong American presence.

This parallel was preserved with the recent modifications that have occurred in Canada in 1984 and Mexico in 1989. Canada in 1984 has ostensibly liberalized its FDI regime by repealing the *Foreign Investment Review Act* and enacting the *Investment Canada Act*, as did Mexico with the *1989 Regulations*. Both changes substantially liberalized the access to FDI, streamlined the review process and narrowed the discretionary power of the review boards. These parallels are encouraged in part by the world-wide competition to attract foreign investment. Beyond this general trend, this parallel is also the result of an effort to simultaneously control the side-effects and promote the privileged trade and investment relationships they enjoy with the United States. As we will see *infra*, this duality of perspective is present in the FTA and should be reflected upon again in NAFTA as Canada and Mexico share common interests in the

³²⁴ See *Real Property Act*, R.S.I.-P.-E. 1951, ch. 138, promulgated by ch. 40, art. 1, 1972.

³²⁵ *Morgan c. Le Procureur général de la province de l'Île-du-Prince-Édouard*, [1976] 2 R.C.S. 349.

maintenance of a central review agency of FDI.

2) The United States: The "Open-Door" Policy

Foreign investment has been the cause of much less political upheaval in the United States. The United States, until the 1980's, was a strong net exporter of capital and did not have much to fear with respect to foreign influence in their country. This mood prevails as long as foreign investment remains low. An example of how this attitude can change occurred in the early 1970's. As a result of the 1973 oil crisis, petro-dollars were invested in the United States leading to a 38.3% and 22.3% increase in FDI in 1973 and 1974 respectively, compared to a 6% increase on average in the 1962-1972 period. This led to great concern in Congress about foreign ownership and control in the United States which led to a national inquiry into measures affecting foreign investors in the United States. The final report, 27 volumes and 9,000 pages describing all regulations facing foreign investors, concluded that a sufficient number of sectors were appropriately regulated, rendering unnecessary substantial change to the existing policy.³²⁶

Following this report, a Committee on Foreign Investment in the United States [hereinafter CFIUS] was created in order to monitor the flow of foreign

³²⁶ *Foreign Direct Investment Study Act of 1974*, 15 U.S.C. 786 (1982); *Foreign Direct Investment in the United States: Report of the Secretary of Commerce to the Congress in Compliance with the Foreign Investment Study Act of 1974*, (1976).

investment into the U.S.³²⁷ Today, the total stock of foreign investment in the United States is worth 400.8 billion \$US which represents less than 5% of its total value of assets. Japan, with a 16% share of this amount, accounts for 64 billion US\$. Canada has invested 31.5 billion US\$, and Mexico 1 billion US\$ or 0.25% representing 8% and 1% respectively of the total.

In contrast with Canada's policy, the United States has a liberal "open-door policy" policy on FDI and is one of the most open economies with respect to FDI.³²⁸ The theory underlying this absence of regulation is that investment is beneficial to the United States economy.³²⁹ The United States has generally adopted a non-discriminatory treatment for foreign investors.³³⁰ "Foreign nationals and companies are treated as favourably as nationals or companies of the United States with respect to the establishment and operation of enterprises in this country.(...) Further, on the basis of the national treatment principal,

³²⁷ The committee is composed of the Attorney General, the U.S. Trade Representative, the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisers, and the Secretaries of the Treasury, State, Defense, and Commerce Departments. See J. Nichus, "Foreign Investment in the United States: A Review of Government Policy" (1985) 15 Virginia J. Int'l. L. 65.

³²⁸ "The United States has consistently welcomed foreign direct investment in this country. Such investment provide substantial benefits to the United States. (...) We provide foreign investors fair, equitable, and non-discriminatory treatment under our laws and regulations. We maintain exceptions to such treatment only as far as necessary to protect our security and related interests which are consistent with our international legal obligations". International Investment Policy Statement, 19 Weekly Comp. Pres. Doc. 1214 (Sept. 9, 1983), cited in: J. Raby, "The Investment Provisions of the Canada-United States Free Trade Agreement: A Canadian Perspective" (1990) A.J.I.L. 395 at 400. [hereinafter Raby]

³²⁹ See E. M. Graham and P. R. Krugman, *Foreign Direct Investment in the United States*, (Institute for International Economics: Washington, 1989).

³³⁰ The United States has both constitutional and treaty limitations on its capacity to regulate foreign investment. These offer certain guarantees to foreigners. There are Friendship, Commerce and Navigation Treaties [FCN], the OECD *Code of Liberalization of Capital Movements* which have a direct effect in the U.S. legal system and the constitutional guaranties of "due process" and non-discrimination without a compelling interest to act otherwise.

investors from other countries can generally make investments in this country on the same legal terms as American investors."³³¹

The "open-door policy" and national treatment principle do not reflect the whole picture of foreign investment in the United States.³³² In contrast to what the "open-door policy" might appear to be, a number of laws impede or forbid foreign investment in the United States. The most recent exception to this open door policy is also the most important: The "Exon-Florio Amendment" of 1988 which provides the President with broad powers regarding foreign investors.³³³ The Exon-Florio Amendment provides the President with the power to review investments, on a voluntary basis on the part of the investor, on his initiative or following a complaint from a third party, and to take appropriate action to safeguard "national security interests". He may suspend or halt a merger, acquisition or takeover of a U.S. firm by a foreigner.

The CFIUS receives notice of investment from investors on a voluntary

³³¹ H.E. Bale Jr., "The United States Policy Toward Inward Foreign Direct Investment" (1985) 18 Van. J. Trans. L. 199 at 207.

³³² For a critical view of the American policy on FDI and its clarity, see N. Patterson, "Canada-U.S. Foreign Investment Regulation: Transparency vs Diffusion", in: *Regulation of Foreign Direct Investment in Canada and the United States*, *supra*, note 302, at 47. B.M. Fisher, "Canadian Investment in the United States: U.S. Restrictions on Foreign Investment" (1984) 8 Can.-U.S. L. J. 19. [hereinafter Fisher]

³³³ *Omnibus Trade and Competitiveness Act of 1988*, Pub. L. no. 100-418, 102 Stat. 1107 (West Supp. 1989). See J.A. Knee, "Limiting Abuse of Exon-Florio by Takeover Targets" (1989) 23 Geo. Wash. J. Int'l. L. & Econ. 475; M. Sandstrom & C. Coccuza, "The Omnibus Trade and Competitiveness Act of 1988: An Overview" (1989) 3 Rev. Int'l. Bus. L. 65; M. Prichard, "Status of the Omnibus Trade Bill and The Canada-U.S. Free Trade Agreement" (1988) 2 Rev. Int'l. Bus. L. 95.

basis. It can also decide to inquire into an investment itself.³³⁴ It then advises the President of its decision, and he ultimately decides whether or not the investment is contrary to "national security" interests. The notion of "national security" is not defined, leaving great discretion in the implementation of the Act to the Executive. It is used infrequently and each case is evaluated individually.³³⁵

Additionally, many other sectors are forbidden to foreign investors entirely or partially by a string of laws and regulations. These exclusions are sectorial and operate through a fixed maximum level of foreign participation. At the Federal level such restrictions can be found in the fields of transportation,³³⁶ communications,³³⁷ aviation,³³⁸ energy and national

³³⁴ Over half of all investors in the United States, preferring to "play on the safe side", decided to submit their transaction to the review of the CFIUS in 1990. This is explainable since otherwise, the President can intervene *retroactively* and order an investment already made and completed to be divested if found to be contrary to the national security interest of the nation. (Source: U.S. Department of Commerce)

³³⁵ The MAMCO case is a good example of this discretionary power. President Bush issued an order on the basis of the Exon-Florio Amendment February 1, 1990, to the China National Aero-Technology Import and Export Corporation to divest its holdings in MAMCO, a U.S. manufacturer of aircraft components. MAMCO was a "metal basher", fabricating metal components for civilian aircrafts and helicopters designed by the customer, employing himself no engineers. This case involved foreign policy more than economical considerations as "a part of the ongoing love-hate relationship between Washington and Beijing". J. Mendenhall, "Recent Developments: U.S.: Executive Authority to Divest Acquisitions Under the Exon-Florio Amendment- The MAMCO Divestiture" (1991) 32 Harv. J. Int'l. L. 285, at 294. On the concept of "national security", See D.S. Nance & J. Wasserman, "Regulation of Imports and Foreign Investment in the United States on National Security Grounds" (1990) 11 Michigan J. Int'l. L. 926. [hereinafter National Security Grounds]

³³⁶ *Jones Act of 1920*, 46 U.S.C. 802 (1976 & Supp. V 1981).

³³⁷ The Federal Communications Commission may refuse to grant a broadcasting licence on the basis that the corporation is foreign-owned if it finds it to be "in the public interest" to act in this way. Foreign ownership is limited to 20% for telegraph, telephone and telecommunications companies. *Federal Communications Act*, 47 U.S.C. 734 (1976).

resources,³³⁹ banking,³⁴⁰ and defense.³⁴¹ Federal laws aimed at any business conducted in the U.S. may also have serious effects on the foreign investor's investment such as antitrust regulations contained in the *Clayton Act*,³⁴² the *Sherman Act*,³⁴³ or the *Securities Act* for stock participation.³⁴⁴ At the State level, numerous laws and regulations provide incentives to foreign

³³⁸ Limitations on registration of aircraft and foreign participation apply, subject to review by the Civil Aeronautics Board. *Federal Aviation Act*, 49 U.S.C. 1301 (1976 & Supp. V 1981).

³³⁹ Except if a country grants reciprocal rights, no foreign corporation or foreigner may operate in the fields of coal, oil, natural gas and other similar minerals and in no cases in the field of uranium exploitation or atomic energy. *Atomic Energy Act*, 42 U.S.C. 2133, 2134 (1982), *Mineral Leasing Act*, 30 U.S.C. 22 (1982). Restrictions also apply in agriculture. *Agricultural Foreign Investment Disclosure Act*, 7 U.S.C. 3501 (1978). See P. Scarborough, "The Foreign Investor in the United States: Disclosure, Taxation and Visa Laws" (1985) 19 Int'l. Lawyer 85 at 94.

³⁴⁰ *National Bank Act*, 12 U.S.C. 1974. The restrictions imposed are aimed at the nationality of the directors rather than foreign ownership.

³⁴¹ The national defense element is one of the most important barriers to foreign investment in the United States given the "breath taking" scope that this notion has been given in order to halt take-overs. Few foreign firms are involved with classified projects or work, since they are required to have a security clearance for both the firm and all its personal. *Defense Production Act of 1950*, 50 U.S.C.A. App. 2170 (West Supp. 1989). Note that imports and exports are also controlled on the basis of "national security interests", to a point that it has been declared that the nations interest was to diminish controls since it was ultimately weakening U.S. competitiveness. *Trade Expansion Act*, 19 U.S.C. 1862 (1988); See *Panel on the Impact of National Security Control on International Technology Transfer, Committee on Science, Engineering and Public Policy, Balancing the Public Interest* (1987), cited in: *National Security Grounds*, *supra*, note 335 at 926.

³⁴² *Clayton Act*, 15 U.S.C. (1981). This act prohibits direct or indirect acquisition of shares of a company when it would affect or lessen competition in such a way as to incline the creation of a monopoly in a section of the American market.

³⁴³ *Sherman Act*, 15 U.S.C. (1981). This Act is the main antitrust vehicle of the United States and essentially prohibits monopolization by contract, conspiracy or other ways of restraining trade. This law has a wide extra-territorial application which has caused many complaints. J. Davidow, "Extraterritorial Application of U.S. Antitrust Law in a Changing World" (1976) 8 L. & Pol. Int'l. Bus. 895; P.N. Swan, "International Antitrust- The Reach and Efficacy of United States Law" (1984) 63 Oreg. L. R. 177; J.A. Kraft, "Recent Development, Antitrust Law: Extra-Territoriality: In re: Uranium Anti-Trust Litigation" (1988) 21 Harv. J. Int'l. L. 515.

³⁴⁴ *Securities Act*, 15 U.S.C. (1982); *Securities Exchange Act of 1934*, 15 U.S.C. (1981). See Fisher, *supra*, note 332 at 32.

investment and at the same time regulate such investment.³⁴⁵

The American regulations on FDI are barely comparable with those in Mexico. The similarities ends abruptly after common sectors where FDI is regulated, such as transportation services. Apart from this element, the level of restrictions in Mexico and the United States are as incomparable as are their levels of development. This creates an important imbalance between the two countries for the FDI legal environment. The Americans have an "open door policy" imposing a minimum of restrictions on investment *per se* beyond "national security" concerns. Mexico's policy, even though it has been liberalized to a great extent in 1989, is still to control and review investments. The trends in both countries seem to be in opposing directions. With the Exon-Florio Amendment, the United States force upon foreign investors a notification and review procedure. This is done indirectly since the notification process is made on a voluntary basis but the advantages of such notification are forceful incentives. The Mexicans, as we have seen, have undertaken impressive steps to liberalize their existing investment regime and are willing to go further. These diverging trends are not irreconcilable given the imbalance in the investment regime: Many more changes are required before Mexico and the United States reach a similar investment regime. With NAFTA, the Americans will strive to close the existing gap and strike a new balance on access and regulation of FDI.

³⁴⁵ For example, "while 36 States maintain trade and investment promotion offices in Japan, 42 States also have anti-takeover legislation". *Challenges of NAFTA*, *supra*, note 129 at 41. For example, "an Ohio law passed in 1988, in an attempt to help Federal Department Stores fight off Robert Campeau's bid, stated that all foreign takeovers would be postponed until state officials could assess their economic impact and approve the transaction." A similar law was enacted in Wisconsin following the Australian brewer Alan Bond's attempt to takeover Hellman Brewing Company. In both cases, the laws were declared unconstitutional by the courts. Raby, *supra*, note 328 at 440.

3) The Free Trade Agreement: Guarantee of Access to FDI and Preservation of Canada's Identity

In the negotiations leading up to the FTA, investment provisions were a major issue for the United States and a useful bargaining chip for Canada.³⁴⁶ The American negotiation team had high expectations in this regard, as they have often found FIRA and Investment Canada to be serious irritants due to unjustified "paranoia" on the part of Canadians.³⁴⁷ The United States' aim was to remove all hindrances to their investments in Canada. The American policy is in line with their desire to achieve "world investment" liberalization in the GATT's Uruguay Round TRIPs negotiations.³⁴⁸ The Free Trade Agreement was innovative in comparison to existing trade agreements, including provisions liberalizing investments in a binding legal framework.³⁴⁹

³⁴⁶ Raby, *supra*, note 328 at 406. Note that the assessment of the contributions of each Party for investment in the negotiations of the FTA, its results and relevance for NAFTA will be analyzed *infra*.

³⁴⁷ D. Stern, "The Canada/U.S. Trade and Investment frictions: the U.S. View", in: D. Freix *et al.* (eds.), *Canada/United States Trade and Investment Issues* 32 at 59; A. Bale, "Investment Frictions and Opportunities in Bilateral Trade Relations", *ibid.* at 165.

³⁴⁸ See generally Investment Canada, *A Multilateral Investment Accord: Issues, Models and Options*, Working Paper no 8, (IC: Ottawa, June 1991). [hereinafter *Multilateral Investment Accord*]

³⁴⁹ The Bilateral Investment Treaties, the *OECD Codes of Liberalization*, the *U.N. Draft Code of Conduct on Transnational Corporations*, the *International Convention on the Settlement of Investments Disputes* do not deal with investment issues to the same extent as the FTA. *Multilateral Investment Accord*, at 14. The same is true of the *U.S.-Israel Free Trade Agreement* which does not treat investments other than by limiting performance requirements. *Free Trade Area Agreement*, April 22, 1985. Reproduced in: (1985) 24 I.L.M. 653. See generally W.C. Sawyer & R. L. Sprinkle, "U.S. Israel Free Trade Area" (1986) J. W. T. L. 526. For a prospective comparative analysis with NAFTA, see Centros de estudios economicos del sector privado, "el Acuerdo de Libre Comercio Estados Unidos-Israel", (1991) 153 *Actividad Economica* 1.

The Free Trade Agreement investment provisions are founded on the notion of *national treatment*, stipulating that an investor should receive a treatment no less favourable than that accorded to a national of the host country.³⁵⁰ Chapter 16 of the FTA on investment provided significant exception to this general rule. All "measures" existing before the implementation of the FTA non conforming to that principle are safeguarded by a "grandfather clause".³⁵¹ These existing measures can also be amended in the future if they do not increase the level of nonconformity.³⁵² The "grandfather clause" provided some changes to the existing measures, including amendments to the ICA.

The Investment Canada Agency is "grandfathered" in the FTA and it retains its role as a review board for investments. The essential difference is the increased threshold amount over which American investments are reviewed. It has been increased gradually to its present and final level of 150 million dollars for direct acquisitions. Indirect acquisitions are altogether exempt from review.³⁵³ This provision is also applicable to an American selling its Canadian subsidiary

³⁵⁰ *Free Trade Agreement, supra*, note 7, art. 1611. "National Treatment" is defined as "Treatment no less favourable than the most favourable treatment accorded by such province or state in like circumstances to the investors to the Party of which it forms a part." (art. 1604) "Party" includes federal/provincial or state governments and all entities controlled or owned by nationals of either country. For a complete study of Chapter 16 of the FTA, see S.P. Battram and J.T. Kennish, "The Investment Dimension for Canada under the Canada-U.S. Free Trade Agreement" in: Fry and Raudebaugh, *supra*, note 302; S. Hackett, "The U.S.- Canada Free Trade Agreement: An Introduction to the Free Trade Agreement and the Investment Provisions of Chapter 16" (1990) 67 U. Detroit L. R. 283; R.K. Patterson, *Canadian Regulation of International Trade and Investment*, (Carswell: Toronto, 1986) at Part II, Chap. 8-10.

³⁵¹ *Ibid.*, art. 1607. Measure includes laws, regulations, actual practices or published policies. *Ibid.*, art. 1611.

³⁵² *Ibid.*, art. 1607, para. 1(c).

³⁵³ *Ibid.*, note 7, art. 1607 para. 3, para. 5 and Ann. 1607.3

to a third country.³⁵⁴ Subsequent to American demands, amendments to the ICA were made so that it would conform to the prohibition of minimum domestic ownership³⁵⁵ and performance requirements.³⁵⁶

The broader issue of performance requirements was addressed by the FTA which partially restricted them. Trade-related performance requirements, such as minimum export levels, import substitution favouring local sourcing, and minimum domestic content or equity participation can no longer be conditions for entry of investors into either country. This applies to third country nationals if the performance requirement sought is that the investment must "have a significant impact on trade between the two Parties".³⁵⁷ It does not apply to government procurements.

Other important exceptions to the national treatment principle are the public policy exemption and the deliberate exclusion of certain sectors of the

³⁵⁴ *Ibid.*, art. 1607, para 2(b). This provision gives the American firm an advantage over a Canadian firm eager to sell its business since the Canadian is submitted to the review process if the business it sells is worth more than 5 million dollars. *Investment Canada Act, supra*, note 77, art. 14(1).

³⁵⁵ *Ibid.*, art. 1602, para. 2. Minimum domestic ownership requirements have been safeguarded for energy, Investment Canada having published specific guidelines before the FTA. They set a 49% maximum participation rule in uranium mining industries, unless no Canadian partner could be found. Oil and gas industries acquisitions remain under the regular threshold of 550 millions and the review authority of Investment Canada. The Agency can ask undertakings to render the reviewed investment proposal of "net benefit" to Canada. These include minimum domestic ownership and performance requirements. *Ibid.*, Ann. 1607.3, para. 4. M. J. Sheppard and M. Hardwicke-Brown, "The Investment Canada Act: Focus on Investments in Canada's Upstream Oil and Gas Industry" (1991) 30 Alb. L. R. 1 at 51.; See also R. H. Lock, "The Canada\United- States Free Trade Agreement and Trade in Energy" (1988) 9 Energy L. J. 327.

³⁵⁶ *Ibid.*, art. 1602, para. 3.

³⁵⁷ *Ibid.*, art. 1603. It is hard to imagine what type of performance requirement would lead to a significant impact on a 170 billion dollars two-way trade relationship. Raab, *supra*, note 328, at 417.

economy. As for public policy, either country may act contrary to national treatment if the reason for so doing is based on fiduciary, prudential, health, security or consumer protection considerations. Such an exemption is permissible if it applies to all investors and the other party is duly notified in accordance with article 1803 of the Agreement.³⁵⁸ The exact weight and scope of these terms allows leeway in their interpretation.³⁵⁹ As for sectors of the economy, financial services, government procurement, transportation and cultural industries were excluded from national treatment requirements for investments.³⁶⁰ The exception of cultural industries was a *sine qua non* for Canada's ratification of the FTA.³⁶¹

Other investment issues are addressed in the FTA. The sale of Canadian

³⁵⁸ *Ibid.*, art. 1602, para. 9.

³⁵⁹ The European experience illustrates the imagination that States can display when it comes to non-tariff trade barriers using health and safety requirements. An example is the German Brewery Law of 1562 and its application to consumer protection. In this specific case, the 1562 Law required that only natural products be used in the manufacture of beer. Germany refused to allow beer from other countries to be sold in its territory on the basis that they contained chemicals, which was contrary to the 1562 Law and endangered public health. In this case, the European Court of Justice dismissed the German claim. Such cases are frequent and the European Court of Justice's role was central in building the European Community. See J. Boulouis & R.M. Chevalier, *Grands Arrêts de la Cour de Justice des Communautés Européennes*, Vol. 1, 4th Ed., (Dalloz: Paris, 1988). The role and jurisdiction of the FTA's dispute settlement mechanism is, if a comparison has to be made, much narrower. The scope of this provision will depend on the evolution of trade relations between the Parties. See generally T.C. Hartley, *The Foundations of European Community Law*, 2nd ed., (Oxford U. Press: Oxford, 1988).

³⁶⁰ *FTA*, *supra*, note 7, art. 1601 and 2005. The U.S. shipping industry in particular wanted to keep the protectionist measures it enjoys under the *Jones Act*, *supra*, note 336.

³⁶¹ *Ibid.*, art. 2001. The definition of cultural industries in the FTA is consistent with the provision of the ICA which defines "cultural identity\ national heritage", with added terms on radio and television broadcasting. See I. Bernier, "La dimension culturelle dans le commerce international- quelques réflexions en marge de l'Accord de Libre-Échange Canada\États-Unis du 2 janvier 1988" (1987) 25 Can. Year. Int'l. L. 243. This exclusion of the Agreement is one of the elements that the United States want to reassert in NAFTA. [Interview with American diplomat, NAFTA negotiator, *supra*, note 110]

Crown corporations and other government corporations can be restricted to Canadian nationals.³⁶² In case of disagreement on investment, recourse must be had to the dispute settlement mechanism of Chapter 18. Nevertheless, decisions of Investment Canada are not subject to arbitration.³⁶³ This is important as it leaves the evaluation of the investment in light of the "net benefit" test to the discretion of the Minister of International Trade. The right of both Parties to expropriation is recognized as long as it is in the public interest, without discrimination and accompanied by prompt, adequate, and effective compensation.³⁶⁴ The monitoring of investments for statistical purposes is acknowledged.³⁶⁵ Taxation and subsidies are excluded from national treatment, as long as the changes in policy do not constitute discrimination or a disguised restriction of the benefits of Chapter 16 of the FTA.³⁶⁶

The FTA gives insight into what is acceptable in NAFTA. The Americans had strong interests for a liberalization of investment measures in Canada. They first required the elimination of the Investment Canada Agency and of the energy and cultural constraints on investment.³⁶⁷ Canada was ready to liberalize its policy on FDI further but never to that extent. The FTA respected this view. Also,

³⁶² *Ibid.*, art. 1602, para. 5.

³⁶³ *Ibid.*, art. 1603.

³⁶⁴ *Ibid.*, art. 1605. This corresponds to the United States standard for expropriation. The internationally recognized standard is rather a "fair and effective" compensation. On this standard, see *Texaco Overseas Petroleum Company and California Asiatic Oil Company vs. Government of the Arab Republic of Lybia*, *supra*, note 61; S. Gann, "Compensation Standard for Expropriation" (1985) 23 Col. J. Trans. L. 615.

³⁶⁵ *Ibid.*, art. 1606.

³⁶⁶ *Ibid.*, art. 1609. Repatriation of profits is also guaranteed in the same article.

³⁶⁷ Raby, *supra*, note 323 at 404.

the impact of the threshold for review of 150 million dollars is diminished in light of the fact that acquisitions, when they happen, are often made in this size bracket of firms. In 1988, 6.7 billion U.S. dollars were invested by Americans for the acquisition of existing businesses in Canada for a total of 17 acquisitions. This is, on average, 394 million U.S. dollar per transaction which is far above the threshold for review stipulated in the FTA.³⁶⁸ With the FTA Canada gained secure access for its exports in the U.S., the *status quo* on the lax American investment regulations and kept its national economic policy instruments. Such a result would be acceptable to Mexico in NAFTA.³⁶⁹

B - Investment Flows, Trends and Distribution³⁷⁰

1) Trade Flows and Distribution

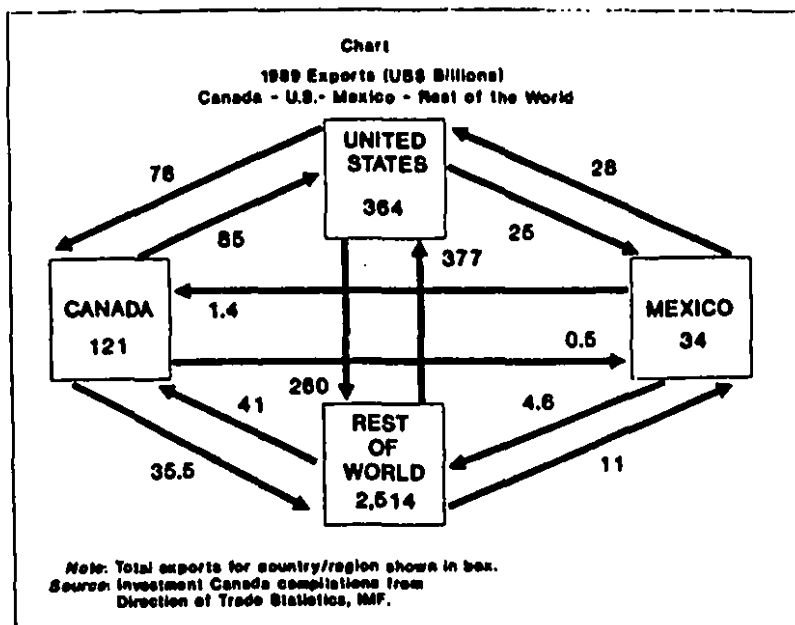
The Chart I below illustrates the trade patterns between Canada, the United States, Mexico and the rest of the world.

³⁶⁸ *Ibid.* at 422. However, in the two years following the implementation of the FTA 90 American firms made direct acquisitions of Canadian companies for 1.6 billion U.S. dollar worth in non reviewable transactions under the new threshold. This means on average below 20 million U.S. dollar per acquisition. In value the bulk of acquisitions made are over the FTA threshold for review. J.E. Payne, "CFTA improves North American Investment", *Business America*, April 8, 1991 at 30.

³⁶⁹ See the discussion on this topic in Chapter V, Section B *infra*.

³⁷⁰ The information for the figures, unless otherwise stated, are taken from the study by Investment Canada, *Challenges of NAFTA*, *supra*, note 129.

Chart I



Not surprisingly, both trade and investment patterns in North America are centred geographically and financially in the United States, as it is the main trading partner of both Canada and Mexico. In 1989, the value of exports between Canada and the United States was 85 and 78 billion US\$ respectively. This represents 70 % of all exports from Canada and 22 % of the exports from the United States, making Canada the principal trading partner of the United States. Between Mexico and the United States, the level of trade was equally significant for Mexico in percentage but not in actual figures. Mexico exported 82% of all of its exports to the United States: an aggregate value of 28 billion US\$.³⁷¹ The United States sold Mexico 25 billion US\$ worth of products which in turn represents 7% of all American exports that year. Of these figures, intra-corporate exchanges between U.S. affiliates accounted for over 40% of all trade for Canada

³⁷¹ Of this figure, the production of the *maquiladoras* accounted for 42% of the total. (Source: USITC)

and 20% for Mexico.³⁷²

The trade figures between Mexico and Canada are in volume thirty-eight times smaller. Mexico accounted for 0.4% of Canada's exports valued at 0.5 billion US\$ and in turn Mexico exported 1.4 billion US\$ worth of products to Canada, representing 4% of Mexico's exports that year.³⁷³ The level of duty on products coming from Mexico is quite low, at an average of 2.4 % for Canada and at an average of 3.6% for the United States. The sectors where the tariffs are higher are most likely to be the ones affected by NAFTA, the workforce being sensitive to such changes.³⁷⁴

³⁷² (Source: U.S. Department of Commerce)

³⁷³ For a detailed comparison of trade relations and the nature of the products exchanged, See Annex I, Tables I, II and III.

³⁷⁴ The full analysis of the economic consequences and virtues of a NAFTA is beyond the scope of this thesis, the author limiting his analysis to the legal challenges imposed by a NAFTA to the FDI regulations of Mexico. With respect to economic consequences of NAFTA, see the studies of USITC, *Economy Wide Modelling of the Economic Implications of FTA with Mexico and a NAFTA with Canada and Mexico*, Preliminary Report on Investigation No. 332-317, (USITC: Washington, February 1992); KPMG Peat Marwick, *The Economic Impact of a Free Trade Agreement with Mexico*, Study prepared for the U.S. Council of the Mexico-U.S. Business Committee, (KPMG: Washington, March 1991); USITC, *Likely Impact of NAFTA on the United States*, *supra*, note 198; Industry, Science and Technology (Canada), *Libéralisation du commerce Nord-Américain - Analyse des incidences par secteur*, (IST: Ottawa, September 1990); IST, *The North American Free Trade Agreement - service Sector Implications for Canadian Services Trade with Mexico*, (Industry, Science and Technology: Ottawa, September 1991); R.J. Wonnacott, *The Economies of Overlapping Free trade Areas and the Mexican Challenge*, (Canadian-American Committee: Toronto, July 1991); Investissement Canada, *The Challenge of NAFTA*, *supra*, note 129; Industry, Science and Technology, *A Study of the Competitiveness of the Mexican Textile and Apparel Industries in a North American Free Trade Context*, *supra*, note 162; Booz-Allen & Hamilton, *Comparative Study of Cost Competitiveness of the Automotive Parts Manufacturing Industry in North America*, *supra*, note 161; *Rules of Origin Issues Related to NAFTA and the North American Automotive Industry*, *supra*, note 161; On this matter, the general opinion is that a NAFTA will create a small but positive effect on the Canadian economy in the short- or medium-term, that this effect will be greater in the United States and also positive, with Mexico gaining the most of all of Parties.

2) Investment Flows and Distribution

Investments follow and complement trade. In 1989, the investment figures were also dominated by the United States. Investments between Canada and the United States were high, Canada having increased its level of FDI in recent years to 31.5 billion US\$. Of a total of 400.8 billion US\$ of foreign investment in the U.S., Canadian investments are mostly in manufacturing (43.3%), finance (28.2%) and petroleum and natural gas (7.9%).³⁷⁵ The same year, Mexico had invested a total of one billion US\$ in the United States and 50,000 US\$ in Canada. In contrast, American investments represented 68% of all foreign investment in Canada: a total value of 68.2 billion US\$. U.S. investments in Mexico have nearly quadrupled in the past ten years reaching 16.8 billion US\$ or 62.8% of all foreign investment in Mexico.³⁷⁶ Chart II illustrates the investment relations between the three countries and the rest of the world. Chart III shows the U.S. foreign direct investment position in Canada and Mexico in 1984 and 1989 by sector, illustrating the significant American presence in each country. This presence is the basis for their high demands for liberalization of FDI in Canada and Mexico.

³⁷⁵ For a complete study of Canada's in- and out-ward investment's, see Investment Canada, *International Investment: Canadian Developments in a Global Context*, (IC: Ottawa, 1991).

³⁷⁶ The importance of American FDI in Mexico is high but it has been decreasing slightly in recent years with the increase of investments originating in the U.K., Japan and Germany.

Chart II

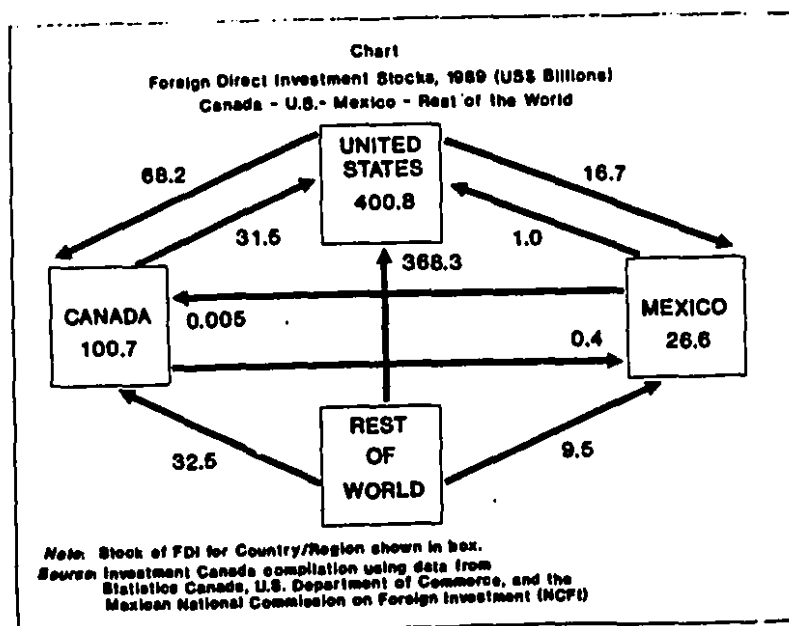


Chart III

U.S. Direct Investment Position in Canada and Mexico, 1984 and 1989

Canada		Mexico		Industry	Canada		Mexico	
1984	1989	1984	1989		1984	1989	1984	1989
percent					US\$ millions			
23.9	16.3	1.5	1.0	Petroleum	11,156	10,912	71	68
44.9	48.4	79.4	82.5	Manufacturing:	20,985	32,324	3,650	5,838
3.5	3.3	9.0	6.6	Food	1,634	2,175	414	466
10.2	9.8	16.2	21.3	Chemicals	4,777	6,580	746	1,505
3.6	3.6	7.2	3.8	Primary and Fabricated Metals	1,672	2,437	332	269
5.3	5.0	4.4	4.5	Machinery, excl. Electrical	2,491	3,316	202	321
3.4	3.3	9.8	6.4	Electrical and Electronic	1,594	2,173	450	451
9.3	11.5	11.0	21.4	Transportation Equipment	4,337	7,673	505	1,518
9.6	11.9	21.8	18.5	Other Manufacturing	4,480	7,970	1,001	1,308
5.2	5.9	9.6	5.6	Wholesale Trade	2,439	3,917	443	395
1.1	1.4	-0.1	0.0	Banking	521	945	-3	0
13.1	17.5	4.2	1.8	Finance, excl. Banks, Ins./ Real Est.	6,139	11,680	195	130
1.5	2.1	-0.6	1.9	Services	705	1,385	-26	138
10.2	8.5	5.8	7.2	Other Industries	4,785	5,684	268	510
100.0	100.0	100.0	100.0	Total	46,730	66,847	4,598	7,079

Source: Compilations by Investment Canada from U.S. Department of Commerce data.

These figures demonstrate the effects of the limitations Mexico has imposed continuously in the petroleum sector, and, more recently, in the banking and financial sectors where U.S. investments total 198 million U.S.\$ or 2.8% of all investments compared with 35.2% of all U.S. investments for these three sectors in Canada. American investments in Mexico are in the manufacturing sector for the most part, with 82.5% of all American FDI, representing in proportion 60% more than what Americans invest in manufacturing in Canada. In percentage, the U.S. investment in food and chemicals in Mexico is twice as high as it is in Canada, reflecting Mexico's greater need in these sectors of its economy. Given the high level of restrictions on foreign ownership in the chemicals sector, the importance of this figure is enhanced. It should be noted that American investment in the automobile sector has tripled in the past five years.³⁷⁷ This high level of investment from the United States in Canada and Mexico demonstrates the close relationship that both countries have had with their neighbour that has led to a potential North American Free Trade Agreement.

³⁷⁷ See USITC, *Rules of Origin issues Related to NAFTA and the North American Automotive Industry*, *supra*, note 161.

CHAPTER V : THE NORTH AMERICAN FREE TRADE AGREEMENT

In this final chapter we will explore the background to negotiations and the rationale for each country's participation in NAFTA. This rationale, in addition to the investment regulations analyzed in the preceding chapter, determine the objectives of each Party with respect to FDI liberalization in NAFTA. We will present each Party's goal with respect to FDI in relation to those of the Parties. Then, after analyzing the issues relating to FDI in NAFTA, we will suggest what a comprehensive NAFTA could include with respect to FDI regulations in Mexico and the legal implications for Mexico. Given the existing laws in each country, we will discuss which solution would best represent the balance of interests between all Parties and, in the end, could foster the economic development of Mexico and continued prosperity for the United States and Canada.

A - The North American Free Trade Agreement: A Challenge from the South

1) Background and Rationale for a NAFTA

In the 1987-1988 period, Canada and the United States successfully negotiated a Free-Trade Agreement which provided for the gradual elimination of tariffs and non-tariff barriers over a ten year period on goods and services, the liberalization of investment provisions, the lessening of cross-border business travel formalities and an impartial procedure for the resolution of trade disputes. The FTA took effect January 1, 1989.³⁷⁸ This Agreement was broad and

³⁷⁸ FTA, *supra*, note 7, art. 2105.

comprehensive, addressing nearly all trade issues between Canada and the United States and leaving the door open for negotiations on unresolved issues, for example the question of subsidies.

The achievement of free trade was a result of balanced and continued interest.³⁷⁹ Canada essentially desired to *secure* access to the market upon which 2 million Canadian jobs depend, by prohibiting discrimination, creating a binding tribunal, harmonizing and facilitating related commercial regulations such as business immigration. The United States also wanted *secure* access to the Canadian market as well as a significant liberalization of Canada's investment policies.

The FTA has played an indirect role in the creation of a possible NAFTA. Though a provision of the FTA stipulates the right of either Party to enter in other free trade agreements, the FTA was designed as a bilateral agreement. The extension of the FTA to other Parties was not included in the Agreement.³⁸⁰ Its aim was limited specifically to trade measures of Canada and the United States.

³⁷⁹ The idea of such free trade for Canada with its neighbour was not new as it was discussed four times before in 1854, 1911, 1925 and 1948. Such is not the case for Mexico in NAFTA. See generally J.L. Granatstein, "L'Éternelle question du libre-échange entre le Canada et les États-Unis", in: Commission Royale sur l'Union économique et les perspectives de développement du Canada, *Les dimensions politiques des rapports économiques entre le Canada et les États-Unis*, vol. 29, (Ministère des Approvisionnements et Services: Ottawa, 1986) at 11; H. Crookwell, *Canadian-American Trade and Investment under the Free Trade Agreement*, (Quorum Books: New York, 1990) at 3.

³⁸⁰ In NAFTA, an accession clause for third Parties should be part of the final agreement. Negotiations are proceeding in that sense. [Telephone interview with a Mexican Official, NAFTA Office, SECOFI, Mexico, held March 26, 1992]

Five years ago, an FTA with Mexico was not even foreseeable.³⁸¹ However, the successful negotiation of the FTA by Canada and the United States provided inspiration for Mexico to pursue the same in light of its new liberalized policies.

At first, when the idea emerged in Mexico, the agreement sought was of a bilateral nature.³⁸² Preliminary studies led to the official endorsement of "a comprehensive bilateral FTA as the best vehicle to strengthen bilateral economic relations and meet the challenges of international competition" in Washington on June 10, 1990 by Presidents Bush and Salinas.³⁸³ This agreement, following the previous example of the FTA, would include the gradual elimination of tariff and non-tariff trade barriers, clear and binding protection of intellectual property rights, the means to expand investment, trade and services and the establishment of a dispute resolution mechanism. Parallel to these talks, it was agreed that discussions would be held on labour and environmental issues.³⁸⁴

³⁸¹ As recently as eight years ago American businessmen in Mexico anticipated that in the future the country would be integrated with Central America through the ALADI. The United States as a Partner did not even appear to be a possibility! See G. B. Blake, "Mexico in the Year 2000", in: J.H. Christman (ed.), *Business Mexico*, (American Chamber of Commerce of Mexico: Mexico, 1984) at 207 and C. H. Lee, "Mexico and Regional Economic Integration", *ibid.* at 213.

³⁸² Canada had been aware of this possibility since the beginning, as it participated as an observer to meetings between the two Secretaries of Trade, Jaime Sierra Puche for Mexico and Carla Hills for the United States. Canada did not show, at first, great interest in the Mexico-U.S. FTA. [Interview with *Frisbie, *supra*, note 110] *The person then acted as the note taker for meetings between the Trade representatives.

³⁸³ The White House, Office of the Press Secretary, *Joint Statement by the Presidents of Mexico and the United States of a Free Trade Agreement*. (no date) The Agreement was formerly proposed to the United States by a letter addressed by President Salinas August 21, 1990.

³⁸⁴ *Ibid.* See *supra*, note 199 and *Response of the Administration to Issues Raised in Connection with the Negotiation of a North American Free Trade Agreement*, Office of the President, May 1st, 1991, at 3-1, 4-1 and ff. The issue of human rights was excluded from any talks, to the disappointment of human rights advocates who perceived these negotiations as a unique opportunity for their improvement. [Speech of Ed Broadbent, President of the Center for Human Rights (Canada), delivered in Montreal, March 17, 1992] See also M. Shupack, "Human Rights and the Mexico-U.S. Free Trade Agreement" (1991) 4 Harv. Hum. Rights L. R. 163.

The American Congress allowed the NAFTA to be negotiated through the "fast-track procedure".³⁸⁵ Congress' approval was linked to the institution of parallel talks on environmental and labour issues.³⁸⁶ The "fast track procedure", once adopted, restricts Congress' role to the approval or disapproval of the trade agreement reached by the President, without any amendment. This is in order to guarantee the other parties to the negotiations that a vote on the agreement will be held within a fixed period of time without amendments. Trade agreements represent a balance of advantages and concessions which must be seen as a whole. The President has until June 1, 1993 to submit a final Agreement for approval by Congress.

The aim of NAFTA is to build an agreement similar in form and scope to the Canada-United-States Free Trade Agreement which is suitable for North America. The FTA would be integrated into NAFTA and thus be repealed. Maintaining two separate agreements would lead to severe legal difficulties in the field of dispute resolution and rules of origins, to name only two potential problem areas. This would result in further complications of the regulatory environment of North American business, a detriment in view of its European competition. For this reason, the main elements of the FTA such as reduction of tariffs, national treatment, government procurement, investment, services, dispute resolution mechanism, countervailing duties and related procedures will be liberalized further

³⁸⁵ *Omnibus Trade and Competitiveness Act of 1988, supra*, note 333, sect. 2902, 2903, May 24, 1991. A first "fast-track" approval had been given before for a Mexico-U.S. Free Trade Agreement. In May, the approval was given for NAFTA and an extended negotiating period. The author was in the offices of SECOFI's NAFTA negotiating team at the time the decision was announced by the Congress. There was great joy and relief for the Mexican team as this was an important step forward.

³⁸⁶ *Response to issues raised with NAFTA to the Congress, supra*, note 192, 384, at 3-1 and 4-1.

or integrated in NAFTA.³⁸⁷ Intellectual property rights will also form part of the final Agreement. The Parties agree that such an Agreement must respect the principles of article XXIV of the GATT relating to the establishment of free trade zones. This provision allows such zones and the exclusion of the most favoured nation principle with respect to third parties to exist.

The Parties are in place for the negotiation of a NAFTA. The present phase of negotiations began in Toronto on June 12, 1991. Since then, after four Presidential encounters, six ministerial meetings and numerous negotiating sessions, great progress has been made. Each party proposed a NAFTA text in December 1991.³⁸⁸ These drafts are now integrated into one formal final draft and will be used as the basis for an agreement. The aim is to reach an agreement before May 1992, since that would be the deadline for Congress to start the "fast track" adoption of the NAFTA. After that time, the American election process will hamper all other activities. However, none of the negotiating teams are willing to let the May 1992 deadline impinge upon the need to achieve a balanced and beneficial agreement.

³⁸⁷ See *Joint Statement by Presidents of Mexico and the United States on Negotiation of a Free Trade Agreement*, *supra*, note 383; Cavitt, *supra*, note 393, at 8; Statements of Ministers Crosbie and Wilson of International Trade in Press releases 90\58, 91\09, 91\11, 91\62, 92\10; J.S. Puche, (Secretary of SECOFI), *El Tratado de Libre Comercio, Mexico-Canada-Estados Unidos*, speech delivered at the inauguration of the *Foro Permanente de Informacion, Opinion y Dialogos, sobre las negociaciones del Tratado de Trilateral de Libre Comercio*, March 1, 1991.

³⁸⁸ At the meeting of the Presidents and of the Prime Minister in December 1991, Mexico and the United States presented texts as a basis for negotiations similar in structure to the one of the Canada-U.S. Free Trade Agreement. Canada had adopted a totally different global sectorial approach. The final NAFTA structure will be based on the Canada-U.S. Agreement. [Interview with Canadian Official, International Economics Department, Ministry of Finance, *supra*, note 227]

The fact that the negotiations are trilateral renders consensus that much more difficult to achieve. In the negotiations leading to the FTA, the bargaining was done face to face, between Canada and the United States. Concessions to the other Party were made on the basis of what the first could offer in return. NAFTA changes the picture by bringing Mexico in the negotiating room. In this context, each Party can be an ally or an adversary. The gains of one do not necessarily correspond to the concessions of the other. This renders the balancing of interests among the three countries much more difficult.

These trilateral regional negotiations are taking place concurrently with the multilateral trade negotiations of the Uruguay Round of the GATT. The evolution of these world negotiations will directly affect the nature of NAFTA. If an agreement is reached in the GATT forum on issues relating to subsidies, trade related investment measures and intellectual property rights, NAFTA might need to be adjusted to correspond with the new international norms.³⁸⁹ The FTA was partially constructed on the basis of GATT as it integrated the GATT's principles in its provisions.³⁹⁰ Moreover, specific provisions integrate GATT's

³⁸⁹ See Statement, *Allocution de l'Honorable Michael H. Wilson, Ministre de l'industrie, des Sciences et de la Technologie, et Ministre du Commerce Extérieur, devant la Chambre de Commerce Canada-Mexique*, Press release no. 91\62, at 5; Cavitt, *supra*, note, 393, at 8. In fact, trilateral negotiations were "on hold" for a while as the Report of the Secretary General of the GATT, Arthur Dunkel, for a proposed solution to the Uruguay Round was being reviewed. Government Procurements, Agricultural subsidies, Intellectual Property Rights and Investment provisions of NAFTA are affected by the on going GATT negotiations [Telephone interview with NAFTA Official, SECOFI, Office of the Chief Negotiator for Mexico, held December 29, 1991]; External Affairs, "NAFTA Negotiations - Situation Report no 2", December 1991 at 5.

³⁹⁰ S. Hackett, "United States-Canada Free Trade Agreement: An Introduction to the Free Trade Agreement and the Investment Provisions of Chapter 16" (1989) 27 U. Detroit L. R. 283 at 285. See also I. Bernier, *L'Accord de Libre-Échange Annoté*, (Y. Blais: Cowansville(Québec), 1990). This monography establishes a cross reference of the provisions of the FTA to the ones of the GATT and the relevant jurisprudence.

main principles into the FTA.³⁹¹ This shows the existing connection between GATT and NAFTA. Though linked, the extent to which these negotiations were intertwined is impossible to determine at the present time.³⁹²

MEXICO'S RATIONALE

The NAFTA negotiations are the direct result of Mexico's change of policy towards the international trade regime, the abandon of its import substitution policy and its subsequent results.³⁹³ This new policy has led to an immediate increase in trade between the United States and Mexico through the booming *maquiladora* industries and increased U.S. investments. Two-way trade between Mexico and the U.S. nearly doubled in two years to reach 53 billion U.S. dollars in 1989. Since 1982, the importance of oil as a percentage of Mexico's export income decreased from 70% to 30%. With this proportional increase of the export of non-oil products, a higher dependence was created on access to the American market. This dependence created a need for Mexico to secure access to this market since income from the world-wide oil market was of declining

³⁹¹ FTA, *supra*, note 7, art. 407, 501, 602 and 807.

³⁹² Comment of C. Grenier, Quebec Deputy Minister of International Affairs, in answer to a question of the audience at the occasion of a conference on NAFTA. [Conference on NAFTA organized jointly by the SDIE, CCIL and the SQDI, held in Montreal, March 4, 1992]

³⁹³ "[facts on U.S.-Mexico trade]...Impetus for negotiations? You may note that some of these basic facts were as true five years ago as they are today. So what has changed to bring us to this day? The short answer is: Mexico itself." Remarks of William H. Cavitt, Director, Office of Canada, U.S. Department of Commerce, *North American Free Trade Negotiations before the Seminar on Business Opportunities in the United States*, Speech Delivered in Montreal, April 15, 1991 at 6. [hereinafter Cavitt] For an account of the unilateral Mexican trade liberalization and the subsequent relations which developed with the United States, see S. Weintraub *et al.* (ed.), *U.S.-Mexico Industrial Integration - The Road to Free Trade*, (Westview Press: Boulder, 1990). The possibility of a free trade agreement between the United States and Mexico had been rarely addressed before given the economic policy. See S. Weintraub, *A Free Trade Agreement between the U.S.A. and Mexico ?*, (Brookings Institution: Washington, 1985).

importance. For Mexico, guaranteed access to its main export market through a Free Trade Agreement was the next logical step for its new policy.³⁹⁴

NAFTA is thus a means of continuing Mexico's economic transformation. Through NAFTA, Mexico will attempt to foster growth in the manufacturing sector which creates jobs and exports, raises competitiveness and attracts foreign investment. Its goals are essentially trade-oriented: to reduce the many obstacles to real free trade that the U.S. presently imposes through sanitary, health and safety norms, quotas, dumping, subsidies investigations and other such commercial legislation.³⁹⁵

Another element favouring NAFTA is the successful framework trade agreement between Mexico and the U.S. that was signed in November 1987.³⁹⁶ The framework agreement implemented a bilateral permanent consultation procedure on various issues such as trade, investment, intellectual property, environment and other issues of concern to both countries. Along with the

³⁹⁴ Especially since in 1990, President Salinas expected great support for investments from the European countries, as this interest was manifested by his participation at the *World Economic Forum (Conférence de Davos)*. However, the unpredicted collapse of the East Bloc diverted nearly all investment interest in that direction. Now, with the NAFTA talks, interests of Europeans and Japanese investors have reappeared. J. Fallows, "The Romance with Mexico", *The New York Review*, November 7, 1991 at 46.

³⁹⁵ J.S. Puche, "Principios para negociar el tratado de libre comercio de America del Norte", (1991) 41 *Comercio Exterior* 653; Oficina de negociacion del tratado de libre comercio, SECOFI, *Tratado de libre comercio: una vision global*, (Mexico, April 1991) (unpublished); see R.C. Siac, *The Use and Abuse of Unfair Trade Remedy Laws: The Mexican-U.S. Experience - The implications for Trilateral Free Trade Negotiations*, (C.D. Howe Institute: Toronto, January 1991) (unpublished). See also a table of U.S. countervailing cases against Mexico in: S. Weintraub, *A Marriage of Convenience*, *supra*, note 401, at 81-82.

³⁹⁶ *Framework Trade and Investment Agreement*, reproduced in: (1988) 27 I.L.M. 438. See G. Smith, "The U.S.-Mexico Framework Agreement : Implications for Bilateral trade" (1989) 20 L. & Pol. Int'l. Bus. 655.

increasing two-way trade, the bilateral commission was successful in strengthening the Mexico-U.S. relationship. As a result of these consultations, bilateral agreements followed in the subsequent years on the aforementioned issues.³⁹⁷ This laid the foundations for talks on further integration.

Finally, Mexico accepted Canada as a part of the deal since President Salinas, with a long term perspective, was of the opinion that it was in the interest of both countries to be part of a same agreement with the United States and not two different agreements. That possibility could lead to a series of bilateral FTA's between the U.S. and other Latin American countries to the detriment of third parties to such agreements. Also, a foreign investor might find that by locating in the U.S. he could reap the benefits of serving three markets rather than two.

UNITED STATES RATIONALE

For the United States, the positive experience of the *maquiladoras*, the desire to secure investments in Mexico and create its own trading bloc was achievable with a North American Free Trade Agreement. The U.S. have found in Mexico's trade proposal great optimism for their economic and political future.³⁹⁸ Economic growth in the United States is predicted by many current

³⁹⁷ *Agreement on Cooperation for the Protection and Improvement of the Environment in the Metropolitan Area of Mexico City*, (1990) 29 I.L.M. 25; *Cooperation Regarding International Transport of Urban Pollution*, (1990) 29 I.L.M. 29; *Trade and Investment Facilitation Talks*, (1990) 29 I.L.M. 36; *Joint Committee for Investment and Trade*, (1990) 29 I.L.M. 40; *Development and Facilitation of Tourism*, (1990) 29 I.L.M. 42; *Exchange of Information with Respect to Taxes*, *supra*, note 265; *Cooperation in Combatting Narcotics Trafficking and Drug Dependency*, (1990) 29 I.L.M. 58.

³⁹⁸ U.S. Department of Commerce, International Trade Administration, *North American Free Trade Agreement- Generating Jobs for Americans*, (U.S. Dept. Commerce: Washington, May 1991), at 3 and ff.

studies as a result of trade liberalization with Mexico. Though some soft sectors will inevitably lose, the overall outcome seems positive.³⁹⁹ The growing significance of American exports to Mexico creates an opening for a comprehensive trade and investment agreements. With NAFTA, the U.S. will enlarge its market opportunities in a country where American goods are fashionable and will secure access for investment in a rapidly growing economy. Benefiting from low labour costs, as the positive *maquiladora* experience proves, will enhance competitiveness at home and abroad. In the long run, a prosperous Mexico will indirectly support American economic growth.⁴⁰⁰

Politically, a stable economic environment in Mexico will reduce illegal immigration, drugs and national security problems in both countries. Problems with illegal immigration show that the U.S. is better off if its 83 million neighbours are satisfied at home.⁴⁰¹ Beyond national interests, extending the U.S. foreign policy through economic ties with Mexico will serve U.S. political interests.⁴⁰²

A NAFTA is also a chance for the United States to "open up" the FTA and renegotiate some of the provisions it finds unsatisfactory with Canada. A

³⁹⁹ See the economic studies cited *supra*, note 374. The key findings of the KPMG Peat Marwick independent study were that a NAFTA would be positive for Mexico and the United States, that it would create jobs in every State and that textiles, apparel, sugar and fruit and vegetables U.S. workers would be the most affected by an Agreement. A return of Mexico to its 1985 protectionist level would hamper the U.S. by reducing the United States income level and competitiveness.

⁴⁰⁰ See *Impact on the U.S. of a F.T.A. with Mexico*, *supra*, note 198, at 2-2 and ff.

⁴⁰¹ S. Weintraub, *A Marriage of Convenience - Relations Between Mexico and the United States*, (Oxford University Press: New York, 1990) at 206.

⁴⁰² Opinion of B. Hamel, *Le nouvel ordre international et la politique commerciale des États-Unis: quelques développements récents*, Cahier de recherche 91-3, Groupe de recherche sur la continentalisation des économies canadienne et mexicaine, (UQAM: Montreal, March 1991).

NAFTA seems to be only the start of a southward expansion of the trade agreement to other Latin American countries for the U.S. By including Canada at the beginning of the process, the door is open to ongoing expansion of the agreement in pursuit of greater markets. Closer continental economic cooperation would provide the Americans with an opportunity to develop their own trading bloc.⁴⁰³

CANADA'S RATIONALE

For its part, Canada had signed a general industrial and tourist cooperation agreement with Mexico in 1979. It did not have a great impact on overall bilateral trade relations.⁴⁰⁴ This lack of trade, beyond Mexico's previous restrictions, is due in part to the lack of knowledge and awareness of Canadians about Mexico for purposes other than tourism. This perception is well illustrated by the comment of Raoul Rodriguez, Director of North America, Asia and Oceania Trade Division of the Mexican foreign Trade Bank (BANCOMEXT), who began a speech by stating: "Many Canadians are probably certain that in Ottawa we are closer to Vancouver than we are to Mexico. In fact, we are closer in this room to the Mexican border than we are, not only to Vancouver, but to Saskatoon. This

⁴⁰³ "Except for Brazil and Mexico, most Latin American countries stand to gain less from free trade agreements (FTAs) with the U.S. than the U.S. stands to gain from FTAs with them. The main incentive for the Latin American countries to form FTAs with the United States may be to attract investment or to halt the spread of new trade restrictions. Latin American countries do probably stand to benefit long-term export benefits from reduced trade barriers among themselves". R. Erzan, A. Yeates, *Free Trade Agreements with the United States - What's in it for Latin America ?*, Working Paper WPS 827, (World Bank: Washington, 1992).

⁴⁰⁴ *Accord entre le Gouvernement du Canada et le Gouvernement des États-Unis du Mexique sur la Coopération Industrielle*. (Mexico, March 7, 1979), reproduced in: S. Pichette, *Le contrôle des investissements étrangers et le transfert de technologie au Mexique*, CETAI, (École des H.E.C.: Montréal, 1981) at Annex 2.

misperception about the distance to Mexico in a way portrays the scarce information that Canadians have on Mexico and Mexicans have on Canada, and the vague notion that prevails on how close we really are to each other."⁴⁰⁵

This misperception is changing rapidly with the possibility of NAFTA in the near future. Mexico's economic opening increased its economic ties with Canada. At the same time that free trade talks between the U.S. and Mexico began, bilateral trade agreements were concluded in the springs of 1990 and 1991 between Canada and Mexico. These agreements provided a legal framework for the increasing ties and also established the basis for closer cooperation.⁴⁰⁶

Canada was more cautious in its approach to NAFTA, announcing on September 24, 1990, that it would "participate in preliminary discussions with Mexico and the United States to establish the basis for subsequent negotiations on a trilateral FTA."⁴⁰⁷ Canada was seen at first as an element of delay by

⁴⁰⁵ [Speech of R. Rodriguez delivered on the occasion of a Seminar on NAFTA organized by the Centre on Trade, Policy and Law held in Ottawa, October 16, 1991].

⁴⁰⁶ *Memorandum of Understanding Regarding the Framework for Trade and Investment Consultations, Memorandum on Combating Narcotics Trafficking and Drug Dependency, Treaty on Mutual Legal Assistance in Legal Matters, Treaty on Extradition, Agreement Regarding Mutual Assistance and Cooperation, Memorandum on Understanding on Forestry Cooperation, Agreement on Agricultural and Livestock Cooperation, Convention on the Exchange of Information/taxes*, Signed in Mexico City, March 16, 1990; *Canada/Mexico Double Taxation Agreement, Film and Television Coproduction Agreement, Memorandum of Understanding Between the Canadian Export Development Corporation and Petroleos Mexicano (Pemex)*, Signed Ottawa, April 8, 1991; in: External Affairs, "Chronology of NAFTA", October 1991. (Agreements not indexed at present time)

⁴⁰⁷ Statement of J. Crosbie, *Le Ministre du Commerce Extérieur annonce que le Canada participera aux négociations sur le libre-échange avec les Etats-unis et le Mexique*, News Release 90/214, September 24, 1990.

both the Mexicans and the Americans.⁴⁰⁸ Mexican negotiators felt unsure of the role Canada would play in the negotiations. Canada and Mexico have common interests, in the field of energy for example, but also compete for the same export market. Mexicans believed that Canada's pursuit of its interests and its desire to preserve the FTA would not make for a strong ally in the negotiation process. With some effort, Canada nevertheless managed to gain its place at the negotiating table.⁴⁰⁹

Canada decided to officially join the negotiations February 5, 1991 to participate fully in the foundation of a North American Free Trade Agreement.⁴¹⁰ This decision was not taken whole-heartedly by Canada: the dominant impression is that it was a choice between the lesser of two evils. Canada is better off as part of the negotiations than as a by-stander.⁴¹¹ Were

⁴⁰⁸ An American diplomat stated baldly that if Canada was to delay the negotiation process of a free trade between the U.S. and Mexico by seeking a NAFTA, the United States might pull out of the negotiations to leave Canada and Mexico to achieve free trade between themselves. [Interview of an American Diplomat, held in Ottawa, May 7, 1991]

⁴⁰⁹ The participation of Canada in the negotiations was not easily granted, as Canadian diplomats "had to kick the door [of the negotiations room] open." [Interviews with Trade Officers of the Canadian Embassy, held in Mexico city, May 21, 1991] Further, the role to be played by Canada at the negotiating table was seriously questioned. R.G. Lipsey, *Canada and the U.S. at the U.S.-Mexico Free Trade Dance: Wallflower or Partner?*, Commentary no. 20, (C.D. Howe Institute: Toronto, August 1990).

⁴¹⁰ Minister of International Trade, *Statement by the Minister for International Trade, John Crosbie, on Canada-U.S.-Mexico Free Trade Negotiations*, Press Release 91\09, External Affairs and International Trade Canada, February 5, 1991.

⁴¹¹ Repeatedly in studies and speeches, one of the stated factors justifying Canada's decision to participate in the trade negotiations was that Canada did not have much choice. See Statement by M. H. Wilson, *Notes for a Speech by the Honourable M. H. Wilson at the Financial Post Conference on North American Free Trade*, International Trade Statement no 91\22, April 25, 1991 at 4; Statement of John Weeks, *Notes for an Address by John Weekes Canada's Chief Negotiator for A North American Free Trade Agreement to the Council of the Americas and the Canadian Manufacturers' Association*, Statement no 91\29, June 3, 1991 at 3; "L'intérêt du Canada...est plus complexe et

Canada to not participate in the Agreement, it would probably lose in terms of investment since establishing an enterprise in the United States would lead to preferential market access for the U.S. based enterprise in the two countries. Further, this precedent could isolate Canada from the southern expansion of the Agreement to the tip of Argentina should this ever happen.⁴¹² It is in Canada's best interest to be a full Party to the Agreement, face the challenge of Mexico and see that its interests are defended.

2) The Objectives of Each Country in NAFTA with Respect to FDI⁴¹³

Canada and the United States have many common interests with regards to a liberalized foreign investment regime in Mexico. The abandonment of its restrictive ownership policy and excluded economic activities in favour of an

indirect", Ministry of Finance, International Economic Relations Division, "Le Canada face à un Accord Commercial Mexique-États-Unis", (Ottawa: July 1990) at 19; Investment Canada, *Les Négociations Canada-E.U.-Mexique sur le Libre-Échange: la justification et la dimension investissement*, (Investment Canada: Ottawa, August 1990) (leaflet) at 1 and 6; M. Hart, *A North American Free Trade Agreement - The Strategic Implication for Canada*, (Center for Trade, Policy and Law: Ottawa, 1990) at 77 and ff.; R. Wonnacott, *U.S. Hub-and-Spoke Bilateral and the Multilateral Trading System*, Commentary 23, (C.D. Howe Institute: Toronto, October 1990); R. Wonnacott, *The Economies of Overlapping Free Trade Areas and the Mexican Challenge*, (Canadian-American Committee: Toronto, 1991). *Contra* R. Grispen, "North American Free Trade Area: A Critical Economic Perspective", (Canadian Center for Policy Alternatives, York U.: North York (Ont.), September 1991) at 9; T. O. Hueglin, "Shouldn't we be Asking Ourselves Why Not ?", (*Options Politiques*: May 1991) at 13.

⁴¹² This approach, qualified as "hub and spoke", would lead to the United States entering into a series of bilateral Free Trade with Latin America countries to the detriment of the continents overall trade. Wonnacott, *The Economies of Overlapping Free Trade Areas and the Mexican Challenge*, *supra*, note 411 at 22 and ff. An accession clause should be included in NAFTA to facilitate this extension. [Telephone interview with Mexican NAFTA official, Mexico, held March 25, 1992]

⁴¹³ The assessment of the interest of the parties is essentially founded on the interviews which were conducted by the author at three different periods of the negotiations and as well on the basis of declarations of scholars and diplomats at various conferences. Access to specific information was denied by all Parties to the negotiation.

open regime is in the interest of both countries, especially the United States. In a peculiar way Mexico and Canada also share an interest in the field of FDI. They both need to preserve control over FDI given the importance, the role played and the dominance of U.S. investment on their territory. Beyond these common grounds, each country has specific interests in the field of investments.

MEXICO

The level of Mexican investment in the U.S. is very low and is negligible in Canada. For that matter, Mexico does not have much to gain in the short or medium term from a greater liberalization of FDI measures existing in the United States and Canada. The U.S. foreign investment regime, though not without restrictions, is incomparable to that of Mexico. In this context, the Mexican negotiators should not aspire to gain more than a "grandfathering" of all the existing measures impeding investments in the U.S. This would be accomplished in the same manner as in the FTA with respect to Canada, thus freezing the maximum level of investment restrictions in the United States in favour of Mexico as it is today.

On the other hand Mexico might seek to obtain from Canada a "grandfathering" of the existing legislation and an extension of the provisions of the FTA beneficial to the United States. The increased threshold for review by Investment Canada would be extended to NAFTA for Mexico's benefit. Given its opening to FDI in response to the Canadian and American demands, Mexico might manage to have the FTA provisions on Canada extended in this way in

NAFTA. This would preserve a single standard of "national treatment" for all three Parties to the NAFTA. Having double standards for Mexico and the United States for FDI in Canada leads to an awkward, possibly discriminatory situation.

Mexico's position on FDI is chiefly defensive. It has stated publically its desire to preserve its constitutional integrity, *i.e.* the Calvo clause and the territorial restrictions. However, as it was the case for Canada in the FTA, a substantive liberalization of its investment provisions is part of the price to pay in order to acquire free access to the lucrative U.S. market for its exports. Thus, the aim of Mexico is twofold. First, it wishes to preserve as much as possible its control over FDI by the "grandfathering" of existing legislation. Even though many restricted sectors will be opened to FDI with NAFTA, this can be accomplished by the regulatory power of the Foreign Investment Review Commission, performance requirements and low levels of investment commanding review. Secondly, it will extort maximum returns out of each concession. Of course, this second aim can be attributed to all Parties involved in NAFTA. Yet, its relative importance for Mexico is greater given the number of concessions that can be given in the field of FDI because of the numerous investment restrictions as described in the preceding chapters.

In the case of the American and Canadian *maquiladoras* Mexico will try to obtain the maximum period of time for their integration in the national economy. During this transition period, it is in Mexico's interest that *maquiladoras* continue to export since they are an important source of foreign currency. This could be fulfilled by maintaining exports requirement and subjecting the production of the *maquiladoras* sold inside the country to regular duties. At the same time, Mexico

will strive to lower the American tax on the value-added of the assembled product and to have the NAFTA rules of origin applied to the *maquiladoras* production. That is an improvement to the present 100% American content requirement to benefit of the Tariff Schedule 9807.00 duty free entry. Applying during the transition period NAFTA rules of origin would enable the integration of Mexican parts in the assembled product without having to pay duty when the product is re-entering the United States. Mexico, however, recognizes that integrating the American and Canadian *maquiladoras* in the national economy in the advent of NAFTA is inevitable after the transitional implementation period.

As to *maquiladoras* operated by non-Party nationals, Mexico wants the existing regime "grandfathered" in NAFTA given their importance to its economy. The existing *maquiladoras* would still be required to export their production. This would preserve one of Mexico's main sources of hard currency. After NAFTA, third party foreign investors would still have the option between a *maquiladora* and "standard" FDI. The advantage of the *maquiladora* for the foreign investor is the absence of requirements that he must meet for its implementation.⁴¹⁴ For Mexico, keeping the *maquiladora* program leaves opportunities to the investor and guarantees a source of foreign exchange.

UNITED STATES

The United States probably has the highest hopes for investment

⁴¹⁴ The absence of requirements is a small advantage compared with access to North American markets with lower American content requirement. Nonetheless, Mexico's position is that the *maquiladora* program should be "grandfathered" in NAFTA.

liberalization in NAFTA. Americans are the largest investors in Canada and Mexico yet they impose the fewest restrictions on foreign investment in their country. The Americans have separate ambitions with respect to investment provisions of NAFTA for each of its neighbours. For Canada, the United States will attempt to make changes to the Chapter 16 of the FTA. The *Investment Canada Act*, grandfathered nearly totally by the FTA, remains an impediment to American investment even though the threshold for review now stands at 150 million dollars. The U.S. is likely to demand a substantial increase of the present FTA threshold for review.⁴¹⁵ The reduction of the scope, if not the abolition, of the cultural industry exclusion to FDI in Canada will be sought as a concession from Canada. The U.S. will also try to obtain more concessions in the energy sector from Canada to reduce the restrictions imposed on American investors.⁴¹⁶

The interests of the United States in Mexico's opening of FDI are far-reaching. The two countries have been distant neighbours for too long. Now the United States wants to seize the unique opportunity that NAFTA provides to gain secure access for American FDI to this market. In this respect, large concessions in the investment regime will be required by the Americans before any agreement be signed. The concessions pursued will be made on the basis of *national treatment* with a minimum of acceptable deviations. Thus the principle of national treatment, a foundation of the FTA, will also be central to NAFTA.⁴¹⁷ The stakes

⁴¹⁵ In 1988, American invested 6.7 billion dollars to acquire existing Canadian businesses. This impressive figure is diminished, to Canada's advantage, by the fact that this amount represented in total only 17 transactions. On average, this means that each transaction was worth 395 million which is well above the current FTA threshold for review. Raby, *supra*, note 328 at 422.

⁴¹⁶ [Interview with R. Frisbie, *supra*, note 110]

⁴¹⁷ FTA, *supra*, note 7, art. 501.

are high for the U.S. given the opportunities that preferential access to the Mexican market would engender. National treatment will be a major issue for Mexico that would require substantial changes in its laws and traditions. Discrimination on the basis of nationality has been enshrined in the Mexican Constitution for the past 75 years with respect to property ownership, energy, mining and other sectors of economic activity.

The goal of the United States is to secure both the access of FDI in Mexico and the reforms that the *1989 Regulations* have undertaken.⁴¹⁸ The *1989 Regulations* can be reversed by a simple presidential decree. Securing the reforms will be realized by amending the Constitution and enacting new law or substantial amendments to the *Foreign Investment Law* in Mexico. These changes would be ensured by the binding nature of NAFTA. In their search for a more secure investment environment, the United States will request that the Calvo Clause of the Mexican Constitution which forbids recourse to foreign tribunals or diplomatic protection in the settlement of private disputes be abolished outright. If disputes arising from investment can not be solved through the independent tribunal to emerge out of NAFTA, then the security surrounding foreign investments simply evaporates.

As for the increased access of American FDI to the Mexican market, the United States will seek the reduction of the number of sectors restricted to foreign investment by the *Foreign Investment Law*. The 141 sectors where investment is controlled or limited by a potential review of the Commission are considered

⁴¹⁸ "Foreign Investment in NAFTA: A U.S. Perspective", (1992) *Business Mexico* 24 (Special Edition).

inconsistent with the restriction of foreign participation in only eight sectors of the U.S. economy. Little consideration is given to the Mexican Constitutional restrictions on foreign investment by the American negotiating team as the Mexican Constitution has been amended over 57 times since 1917.⁴¹⁹ In addition to this general liberalization, specific agreements will need to be hammered out by the negotiators with respect to investments in the financial services, the transport and automobile sectors as the U.S. interest in these sectors is high and the restrictive regulations.⁴²⁰

They will also try to limit the powers of the Foreign Investment Review Commission to a minimum. The Commission's revision powers act as a barrier to the free flow of investment. For that matter, the Americans will try to either abolish the Commission or obtain a very high threshold of review as it was the case in the FTA for Investment Canada. Also, the criteria on which the Commission bases its decisions as stipulated in the *Foreign Investment Law* are unacceptable to the United States. In their present form these criteria are predisposed to favour Latin American countries and are too broad. This needs to be modified if the Commission is maintained.

The Americans will also strive to obtain further liberalization of the foreign investments which are presently admitted to Mexico without review. They are

⁴¹⁹ [Interview with R. Frisbie, *supra*, note 110]; [Interview with Canadian Official, International Economic Relations Department, Ministry of Finance (Canada), held in Ottawa February 23, 1992]. A list of the constitutional amendments is found in: *Constitutions of the Countries of the World (Mexico)*, *supra*, note 19.

⁴²⁰ See the letter to the USITC of the Committee on Ways and Means, U.S. House of Representatives dated August 27, 1991 in: *Rules of Origin Related to NAFTA and the North American Automotive Industry*, *supra*, note 161 at A-2.

presently admitted in reserved economic sectors if they meet six pre-set conditions. One of the major irritants amongst these conditions is the need for a balanced foreign exchange balance during the first three years of operations. Such prerequisites are inconsistent with national treatment.

The provisions of territorial limitations are incompatible with the national treatment principle. It is likely that the American negotiators will ask for full ownership rights in the lands now excluded from foreign ownership. However, this would mean another major constitutional change for Mexico. For this reason the United States are willing to accept a strengthening of the actual Mexican land trust regime. The granting of such ownership or increased rights to American investors would bring more security to the investor doing business in Mexico.

As for the *maquiladoras*, it is in the United States' interest that they become able to sell their production on the Mexican market without any restrictions other than the duty on the value of the unassembled product. This is particularly important in the tightly regulated Mexican automobile market. The duties would be phased out gradually following the phasing out of the duties as scheduled by the Parties to NAFTA. The American operators of *maquiladoras*, with the advent of NAFTA, will naturally integrate themselves to the Mexican economy and continue their operations. However, the Americans want to see the *maquiladora* program discontinued after NAFTA. This would ensure the respect of the principles regarding duty exemptions and the special programs that are now part of the FTA's chapter four on duty provisions.

Finally, again in order to liberalize access to investment and secure the

investors, the U.S. will push for the abandon by Mexico of its foreign exchange regulations to ease free repatriation of profits. The maintenance of non-discriminatory taxation of income will be pursued by the U.S. along with the related measures and exceptions that are part of the FTA.

CANADA

Canada's objective in the field of FDI and NAFTA are twofold. On one hand, it wants to maintain the balance struck with the United States in the FTA. On the other hand it wants to pursue further liberalization of Mexico's FDI restrictions as does the United States. As to the FTA, Canada maintained an asymmetrical situation with regards to the legislation on FDI. Through the "grandfathering" of existing measures on FDI in both countries, Canada assured itself an open and free access for its investments in the United States. This is in contrast with the preservation of the powers of revision, diminished but still existing, of Investment Canada and the cultural and "national identity" exceptions. Both countries kept most of their requirements in the other sectors with restricted access to FDI. This balance is to the advantage of Canada given the guaranteed access to the American market it gained with the FTA and the creation of a binding dispute resolution tribunal. The cultural and "national identity" exceptions were major political issues in Canada and a *sine qua non* condition to the ratification of any free trade agreement. This reality is still present today which places Canada in a defensive position with regards to FDI provisions in relation to the United States.

The vision is different with Mexico as Canada's position is similar to that

of the Americans. Even though the present level of Canadian investment in Mexico is low, it is geared to grow with more liberalization of FDI regulations in presently restricted sectors. Examples of sectors of particular interest to Canada are telecommunications, generation of electricity and the mining sectors. For that matter, it will strive in the same manner as the Americans to have all the legislative changes necessary that would liberalize and secure FDI in Mexico. This includes adhering to the national treatment principle and the abandon of the *Calvo Clause*. The territorial ownership restrictions in Mexico are not an important element of Canada's demands in the negotiations since its interests are low and the trust system is working well. Canada would be satisfied with the maintenance of an enhanced trust mechanism for foreign "ownership" of land in this area.

Where Canadian and the American positions are likely to differ is on the role of the Foreign Investment Review Commission. In the FTA, Canada kept the Investment Canada Agency, all of its regulatory powers, its broad criteria defining the "net benefit" test for review and the exclusive nature of this review by the exclusion of arbitration of the final decision. Canada should not seek to reduce the role of the Commission to a minimum as the Americans are pushing for in the case of Mexico. Canada's demands are more moderate, being a review threshold lower than the Americans and for an emancipation of the criteria to be used in the review process by the Commission. Canada is willing to allow for the discretionary nature of the review process of the Commission as long as it is done in good faith.

B - Foreign Direct Investment Regulations in a NAFTA

1) NAFTA and Foreign Investment Regulations: Issues

An international trade and investment agreement such as NAFTA raises six main issues that must be provided for. They are national treatment, performance requirements, extraterritoriality, investment incentives, dispute settlement and related investment domains. These issues will be regulated by the NAFTA chapter on investment. Provisions on all six issues are not likely to be included as the FTA did not regulate the issues of investment incentives or extraterritoriality.

As for investments themselves, the first core issue in the provisions of a single NAFTA is national treatment. A guarantee that an investor of either Party to the Agreement will benefit from the same treatment as nationals is essential. The possibility of discrimination against Parties would violate the very principle of a liberalized investment regime. Nevertheless, "acceptable deviations" will have to be encompassed in an agreement. These exemptions must be defined in precise terms in order to limit interpretations contrary to the spirit of the accord. This could be accomplished by "grandfathering" existing restrictions, allowing sectorial restrictions or exemptions based on public policy, *i.e.* expropriation or national security.

The second issue is that of performance requirements.⁴²¹ It is a prerequisite that NAFTA delimits to what extent they are permissible and for what purposes. In the case of the FTA, only trade-related performance requirements were prohibited. For Mexico a flexible provision on this issue would ensure a more profitable NAFTA.

The third issue is extraterritoriality.⁴²² What will happen when laws and policies governing the transnational corporation or its internal directives are in conflict with the host countries laws and regulations? Currently, extraterritorial application of laws and policies does not have precise rules as international norms are not yet defined or accepted.⁴²³ The FTA did not deal with this question. An agreement on this is not likely to occur because of the U.S. reluctance to accept this concept although it is relevant with respect to a liberalized investment regime.⁴²⁴

The fourth issue is investment incentives. This touches upon the delicate and broader question of subsidies.⁴²⁵ The difficult issue of subsidies has yet

⁴²¹ See the reflection on performance requirements in a multilateral agreement of Graham and Krugman, *supra*, note 329 at 127.

⁴²² See D.G. Dallemeyer, "Foreign Policy and Export Controls: How Will the Canada-United States Free Trade Agreement Accommodate the Extra-Territorial Application of United States Laws to Canadian Exports of Goods and Technology?" (1989) 19 *Geo. J. Int'l. & Comp. L.* 565.

⁴²³ J.-G. Castel, *Extraterritoriality in International Trade*, (Butterworths: Toronto, 1989).

⁴²⁴ In the FTA, Canada tried to discuss extraterritoriality issues but the United States refused to enter that field. *A Multilateral Investment Accord, supra*, note 348 at 19.

⁴²⁵ Mexico has ceased to subsidize many sectors of its economy following the 1982 crisis and the subsequent reversal of policy. R. C. Siac, "Does Mexico Subsidize Too Much? Perceptions vs Reality", *Commentary*, (C.D. Howe Institute: Toronto, February 1992).

to be resolved in the multilateral forum of the Uruguay Round negotiations or in the FTA itself. This fact will hamper the Parties in dealing with this question at a trilateral level. Nevertheless, Mexico has a large debt to swap for investments and fears of investment displacement are high in the U.S. and Canada.⁴²⁶ Investment incentives includes the difficult question of duty draw backs for re-exported goods. This question was resolved in an unsatisfactory manner as far as Canada is concerned as duty drawbacks have been eliminated gradually in the FTA. It will most probably be addressed once again in NAFTA along with a few investment incentives regulations.

The fifth issue is dispute settlement. This an inevitable question as Parties to the agreement require a means of ensuring their rights. The preliminary issue in that sense is Mexico's Calvo Clause contained in its Constitution. Beyond that, the jurisdiction of the tribunal and the binding effect of its decisions are central to NAFTA. With respect to investment, the analysis will be limited to the elements of the investment scheme that should be included in the settlement of disputes mechanism. The prospective analysis of the arbitration mechanism in itself surpasses the aim of the present study.

The sixth issue is domains related to investment. What can be done with the string of laws of general application which can be applied in a discriminatory fashion? Antitrust laws, tax laws, intellectual property, competition policy, and the monitoring of investments are domains related to investment. The FTA was silent with respect to these provisions and the scope of NAFTA on these is as yet unclear.

⁴²⁶ *Response to Congress, supra*, note 192, 384 at 1-15; *Challenges of NAFTA, supra*, note 129.

When considering potential NAFTA FDI regulations, we will assume that only one agreement will be in force as this is the present aim of all the Parties to the negotiations. The FTA would be repealed since its contents would be integrated into NAFTA. If two separate agreements were kept, serious legal problems would arise with respect to the regime of law applicable for the settlement of disputes and rules of origin. Furthermore in NAFTA specific chapters will address the questions of investments in financial services, the automobile industry and agriculture, areas which were settled or addressed in different parts of the FTA. For that matter, our analysis will be focused on what is likely to be included in the NAFTA's chapter on investment relating to Mexico.

What should be the appropriate legal framework for investments? How could the various interests of Mexico be reconciled with those of Canada and the United States? These elements are all being discussed by the Parties. The next section is a possible answer to these questions based on the profound changes that have shaken Mexico's attitude towards foreign investment through the recent legislative changes previously analyzed, the legal background on investment in Canada and the United States and the lessons that can be learned from the FTA.

2) Solutions: Finding the Right Equilibrium Between Various Interests

To estimate the proper equilibrium between the interests of the Parties with respect to foreign direct investment provisions in an eventual NAFTA, we must first look at the broader picture composing NAFTA. In particular the developmental aspect of such an agreement should be considered due to the

presence of Mexico. The FTA was concluded between two countries which share considerable common bonds and similarities in culture and economy. For Canada, beyond the trade and investment aspects, there was a need that the FTA respect Canadian national identity and culture. This preoccupation is reflected in the investment restrictions on cultural industries in the FTA.

The Mexico-U.S. economic ties are similar in proportion to those between Canada and the U.S. Mexican society and history are as intertwined with the people of the United States as Canada's are with the United States.⁴²⁷ Besides these two common points, NAFTA appears to be a daring challenge to Canada, the United States and Mexico. At stake is the saddling in of a culturally rich but economically underdeveloped country in the industrialized world. Canada and the United States are challenged by the mere fact that integrating the Mexican economy is now rendered possible given the broad common legal and trade policy framework. This combination yields a unique opportunity to build a new economic, regional partnership for common economic growth.

Mexico having unilaterally endorsed in a sweeping way "industrialized country standards" through the leadership of Presidents de la Madrid and Salinas, it is now up to Canada and the United States to recognize the effort and give Mexico a chance. For the United States, this decision makes good "business sense" given the past synergy of the *maquiladoras* and the opportunities present in Mexico. Canada finds limited commercial possibilities in Mexico with NAFTA. Its decision in favour of NAFTA is a bit hard pushed since NAFTA is better than two FTA's for Canada. Trade, not aid, will ultimately endeavour Mexico's development

⁴²⁷ S. Weintraub, *A Marriage of Convenience*, *supra*, note 401 at 11.

and overall continental growth.

In that sense, the challenge lies with Mexico as well. Having reversed its proportion of export income from 70% on oil in 1982 to only 30% in 1990 creates a large dependence on export markets. With oil, the market is world-wide. Given that 80% of all Mexican exports go to the United States, this means that over half of Mexico's export income depends on one single market. This fact leaves few trade policy options opened to Mexico. In between the hope of multilateral concessions, southern regional integration with a stronger Latin American Integration Association, the *statu quo* or a secured, guaranteed access to the United States and Canada markets, the choice in favour of NAFTA appears immediately. With this choice, short-term development possibilities are much higher for Mexico. This might also pave the way for future developing countries of Latin America to join the agreement.

NAFTA, in order to be agreed upon, will need to correspond, at least minimally, with the needs of all Parties. All regulations on foreign investment in Mexico, United States or Canada are in place to ensure the control of specific sectors of the economy and to ensure that foreign investments will be beneficial to the host country. The need for control varies from one country to another. This should be taken into account in NAFTA. Mexico has a greater need for control given its economic situation than does Canada or the United States.

The FTA provisions on FDI are a reflection of the balancing of interests

between Canada and the United States.⁴²⁸ We can see in the FTA that Canada was able to retain the essential elements of its political and economic concerns by "grandfathering" existing restrictions. Culture, energy and review of acquisitions over 150 million dollars are important exemptions from the national treatment principle.⁴²⁹ The review of investments by Investment Canada on the basis of the seven broad criteria of the ICA, which is not subject to appeal, gives Canada an essential instrument for its FDI policy.⁴³⁰ The fact that the Americans accepted these deviations when at first the elimination of the review agency was their goal shows that Mexico has some bargaining power.⁴³¹ Canada's concerns with respect to investment were addressed and Mexico should receive the same attention.

Foreign investment regulations in NAFTA will be successful if Mexico keeps its instruments of national economic policy as Canada did in the FTA. Mexico has to be able to make its internal policy choices within the guidelines established by NAFTA. Foreign investment being one of the essential parts of President Salinas' new economic development policy, Mexico must have the

⁴²⁸ To preserve the existing balance, chapter 16 of the FTA will be maintained overall for Canada and the U.S. in NAFTA. Mexico has few interests in the short and medium term with respect to investment regulations in either country. If changes are to occur, they will essentially result from the negotiations and trade offs that Canada and the United States will accomplish between themselves. The Canadian restrictions on energy and, possibly, culture, could be narrowed. The ceiling for review could be raised if American financial services industries are opened further to Canada. These trade-offs depend on the intricacies of the negotiation process including Mexico's strategic support to one or each other of the Parties. As a result, only minor changes are likely to occur in the investment provisions pertaining to Canada and the United States.

⁴²⁹ See Raby, *supra*, note 328 at 420 and ff.

⁴³⁰ E. A. Safarian, "Direct Investment Strategies and the Canada-U.S. Free Trade Agreement" in: *The Dynamics of North American Trade and Investment*, *supra*, note 200, 147 at 153.

⁴³¹ See the positive evaluation for Canada of the FTA's FDI regulations in light of the position of the parties and its final outcome, by Raby, *supra*, note 328 at 407, 419 and ff.

means to make sure that investments are beneficial to Mexico so that the country does not become a giant *maquiladora*. For that purpose, the Mexican government must retain instruments of national economic policy determination such as the Foreign Investment Review Commission. The fact that the *1989 Regulations* procure only partial openings in some sectors to foreigners, by way of neutral shares or temporary investment trusts without voting rights, that it streamlined rather than abolishing the Commission, demonstrates the will of Mexico to retain some potential minimal control on FDI.

The conclusive FDI regulations in NAFTA should be similar in their approach to the one used in the FTA. It is on that basis that we assess what could be an acceptable balance of interests for all Parties. What we will find in NAFTA is the principle of national treatment, the consequent opening of a majority of restricted sectors and substantial changes to the *Foreign Investment Law*. Also, the review process will be modified, performance requirements will be temporarily allowed, the scope of the dispute resolution mechanism will be defined and related exceptions will be included. Finally, special provisions will deal with the *maquiladoras* to integrate them gradually into the Mexican economy. All these changes will necessarily be executed by legislative amendments and enactments of the Mexican Congress. Regulations susceptible to be modified by a simple Presidential Decree would not be acceptable to Canada or the United States.

NATIONAL TREATMENT AND DEVIATIONS

NAFTA provisions on investment will be based on the *national treatment*

principle. It is the essence of a free trade agreement that an investor, national of one Party, receive a treatment no less favourable than the one given to a national of the host country. All restrictions imposed on foreigners in Mexico by the Constitution and the *Foreign Investment Law* are in direct violation of the national treatment principle. Some limitations on FDI being inevitably acceptable, NAFTA will provide for deviations.

The first limitation is the exclusion of certain economic sectors from the application of the national treatment principle. Mexico has insisted that all constitutional restrictions were non negotiable. This demand should be granted in NAFTA as the petroleum extraction and refining, basic petrochemical industry, electricity, railroads and telegraph services constitute acceptable deviations given Mexico's historic background. These industries are rooted in Mexican nationalism and history.

Though Canada and especially the United States have huge interests in these sectors, Mexico could not endorse an agreement stipulating otherwise. It would be similar in impact to Canada giving away its restrictions on energy and culture in NAFTA or the U.S. allowing free movement of persons. Keeping these industries ensures that Mexico will retain total control over its most precious resource. As compensation, Mexican concessions could be made by opening related domains such as gas distribution, presently restricted to Mexican nationals, and secondary petrochemical products, presently limited to 40% foreign participation, to 100% foreign participation.

Natural resource industries such as mining and mineral refining, fishing, and forestry are limited to a maximum of 34% and 49% of foreign participation under the *1989 Regulations*. Though Mexico has longstanding national interests in these sectors, they could be opened to foreign investors with a provision protecting a minimum level of domestic ownership. The willingness of Mexico to open these sectors is shown by the higher participation allowed through temporary investment trusts by the *1989 Regulations*. These trusts are temporary as Mexico wishes to preserve future domestic ownership of its resources and ensure at least minimum benefits to the country.

A minimum domestic ownership requirement would be acceptable to the other parties as they already exist in Canada and partially in the U.S. These exceptions to national treatment were grandfathered by the FTA. Such a policy in NAFTA for Mexico would be an improvement for foreign investors in comparison to the present temporary investment trusts. After NAFTA, the beneficiaries of these trust would have the opportunity of transforming their certificates for full participation shares at fair market value.

Transportation, aviation and financial service industries are now restricted to Mexican nationals by the *Foreign Investment Law* and the *1989 Regulations*. These sectors should be opened partially by granting limited foreign participation rights. The other Parties both have regulations in these domains to the same effect. The extent of foreign ownership allowed and the precise method of controlling their participation will be determined according to sectoral negotiations. In the case of the financial service industry, foreign investors are likely to be given a specific market share. Although Mexico will preserve domestic ownership, it

maybe will be required to allow higher levels than its counterparts given its technology needs, its desire to attract foreign investors and the maintenance of its constitutional limitations.

These measures fail to cover all the presently restricted sectors. FDI in the car, trucks, firearms, fireworks, river transportation and telecommunications sectors are now limited to foreign ownership rates of 40% and 49%. Foreign participation is unlimited in the fields of construction, drilling, school services, agriculture, newspaper and magazine publishing, legal, accounting and securities services but prior review and authorization of the Commission is necessary before an investment can be made. All these remaining sectors would be opened in NAFTA to 100% foreign participation with a few exceptions.

These exceptions would be provided for the car and truck industry, now limited to 40% foreign participation. The exceptions will be defined in the specific chapter relating to this sector in NAFTA.⁴³² A higher rate of foreign participation is foreseeable but it depends on the agreement reached for this particular sector rather than the own equilibrium of FDI provisions. The same is true for the legal, accounting and securities counselling services and agriculture where 100% FDI is allowed after review from the Commission. The NAFTA sectoral negotiations on services and agricultural matters will determine the admissible level and conditions for FDI.

⁴³² The automobile industry is one of the three major issues where the final negotiations are not progressing satisfactorily as each Parties has opposing views. [Telephone interview with a Mexican NAFTA Official, SECOFI - Mexico, held March 26, 1992]

The liberalization of the previously limited foreign participation sectors poses a problem for the future of the special neutral "N" shares and the temporary investment trusts. Their aim was to allow foreign investment above the prescribed limits without any voting rights for the investor in these sectors. With the allowable foreign ownership in mining, transport, aviation and financial services increasing with NAFTA, part of the temporary investment trusts and the "N" shares of the *1989 Regulations* will become obsolete. The trusts and shares could be transformed into normal shares carrying full voting rights for the investor. If such a transfer would give a higher stake than provided for by the new rules, the normal participating shares could be distributed on a pro rata basis to the investor. The remainder of the shares or trust certificates would still belong to the foreign investor. The system of temporary investment trusts and "N" shares would thus be maintained by Mexico for investments above the minimum domestic ownership level.

These measures mean the ultimate surrendering of Mexico's minority FDI policy. The relinquishing of the longstanding 49% maximum foreign participation rule was begun with the reforms rendered by the *1989 Regulations*. Thus Mexico would be willing to accept these changes, given the elimination of the review in many sectors which has already occurred with the *1989 Regulations*. These measures, with the exception of the preservation of the constitutional limitations, correspond by and large to the objectives of Canada and the United States in NAFTA. As stated before, provisions for a minimum Mexican domestic ownership for the exploitation of natural resources is an acceptable deviation from the national treatment principle since both countries have laws to this effect.

This sectoral liberalization would entrench Mexico's reforms in a binding agreement. It would adjust Mexico's sectoral restrictions to close to what is found in the U.S. and Canada proportionally. An adjustment period might be necessary for the implementation of the new rules in order to let the market adjust. The reduction of one hundred and forty-one restricted sectors to roughly fifteen forms a significant concession on Mexico's part. In return however, concessions with respect to the review process and transfer of technology requirements on the part of Americans and Canadians are essential.

CHANGES IN THE *FOREIGN INVESTMENT LAW*

The *Foreign Investment Law* will not survive NAFTA. A totally new law is now being prepared to adjust Mexico's FDI regime to NAFTA and Mexico's new economic policy. The repeal of the *Transfer of Technology Law* in May 1991 with the enactment of the new *Law on Promotion and Protection of Intellectual Property* demonstrates this possibility. In the new investment law, the main concepts of review and control of FDI would be maintained. The 1989 *Regulations*, curtailed to NAFTA's provisions, would be integrated into the revised law. Again in the 1989 *Regulations* we find the source of balance to the interest of the Parties. They furnish an insight on the extent of Mexico's willingness to modify its policy. These modifications, apart from the opening of the restricted sectors as mentioned before, touch upon the Foreign Investment Review Commission, the review process and the land trusts.

The Foreign Investment Review Commission should be "grandfathered" in NAFTA as Investment Canada was in the FTA. Mexico requires a higher degree

of control on FDI than Canada does. This assertion is made on the basis of Mexico's traditions and on the importance that FDI is to play in Mexico's economic policy and development by bringing technology and capital in the country. The Commission is a useful means for Mexico to make sure that Mexico reaps part of the benefits of the FDI on its territory as it retains the flexibility to implement its economic policy on FDI.

The *1989 Regulations*, by limiting the Commission's discretionary powers, did not modify its ultimate goal. The existence and role of the Foreign Investment Review Commission being assured, what must be addressed by NAFTA are which investments are subject to review, the threshold, the preliminary conditions and the criteria the Commission may base its decision upon in the review process.

Direct acquisitions and the establishment of new businesses should be subject to the review of the Commission as Mexico must make sure that FDI benefits the country. This far-reaching proposal would be tempered by the threshold triggering the review process and the criteria to be used by the Commission. This is possible given the opening of nearly all previously restricted economic sectors to foreigners. The FTA experience where Canada managed to maintain its review board in exchange for high thresholds for review supports this assertion as well.

As for *indirect acquisitions*, Mexico could concede, as did Canada in the FTA, a gradual phasing out of the requirement for review. This would be a useful bargaining chip to compensate for the other deviations from national treatment

that Mexico needs. The absence of review in the case of indirect acquisition would not be a great threat to Mexico's economy. With the exception of the *maquiladoras*, few Mexican corporations have, at the time being, a dominant foreign participation. For this reason, the possibilities of indirect acquisition of a major Mexican corporation are low. Additionally, in the event of an indirect acquisition, the new owner would still be bound by the obligations that the Mexican foreign-owned corporation had undertaken in order to be allowed to operate in Mexico.

In the case of *new business establishments*, two thresholds for review would be possible in NAFTA. An indicator of the threshold level can be found in the *1989 Regulations*. Direct investments in unrestricted sectors of up to 100 million \$US are allowed if five preliminary conditions are met.⁴³³ The first possibility is to preserve the 100 million US\$ level for review. A new business establishment would, however, be required to meet all the existing preliminary conditions with the exception of a balanced foreign exchange. This requirement is the one investors find the hardest to fulfill. American investors will pressure the Administration for the deletion of this condition in NAFTA. Below the threshold, investments would receive automatic approval and benefit from the existing presumption to the effect that the investment fulfills the preliminary conditions. With this first possibility Mexico is assured of a minimum benefit of all investments. Major investments would still be subject to a full review thus providing Mexico flexibility in its approach to FDI.

⁴³³ See *supra*, Chapter 2, Section A (2). The five conditions are external financing of the investment, locating outside overindustrialized areas, maintaining a balanced foreign exchange budget the first three years of operation, generating employment, using adequate technology and observing environmental laws.

The second possibility is to eliminate the preliminary conditions but maintaining a lower threshold triggering review. The exact level will depend on the negotiations as Mexico wants to attract and keep control of foreign investment and Canada and the United States want to have free and secure access for their investments in Mexico. Investments below that level would only be subject to a monitoring provision such as the Canadian notification procedure. This second possibility might be of more interest to Canada and the United States given the absence of preliminary conditions. It still maintains Mexico's options for future investment policies and technology requirements on large investments.

For *direct acquisitions*, the level for review could be of equivalent or higher *proportion* to the level provided for in the FTA for Canada. The 150 million dollar mark for review for direct acquisitions meant that 600 Canadian corporations representing two-thirds of the total assets of the Canadian economy were subject to review in the event of acquisition by an American.⁴³⁴ A threshold level *proportionally* equivalent to the one that Canada has in the FTA would ensure Mexico a safeguard of its economic sovereignty and assets gained over years of protectionism. However, the Americans might succeed in pressuring Canada to raise the current 150 million dollar mark in NAFTA. If this is the case, Mexico will need to fight seriously in the negotiations to preserve a adequate level of review.

The criteria on which the Commission bases its decisions as stated in the *Foreign Investment Law* must be modified. Without modifications, the review

⁴³⁴ This figure might seem very low and a blow to Canada's sovereignty. However, in value most of the direct acquisitions that occur are over that level since that market is the most interesting for mergers and acquisitions. Raby, *supra*, note 328 at 422.

process would be undertaken based on criteria foreign to the nature of a free trade agreement. The criteria have not been modified since 1973. The incompatibilities lie with the central principle of national treatment. Elements of review such as the complementarity of foreign to national investment, the prohibition of investment in fields adequately covered by Mexican business enterprises, the diversification of sources of investment, mandatory local supply sourcing, the need to foster Latin American regional integration, the extent to which the foreign investor is identified with the country's interest are criteria incompatible with free trade.

The other criteria of the Law should be "grandfathered". They are: the effect of the investment on the balance of payments, on employment and training, on competition, productivity, the sources of financing, the contribution to economically less developed zones, technology and development and "the extent to which [the investment] complies with, and contributes to the achievement of national development policy objectives".⁴³⁵ These criteria are in line with what was accepted by the United States in the FTA, with the additional criteria respecting the general effect on the foreign exchange balance of the Mexican economy of the investment. This represents the equivalent of the "net benefit" test for Mexico. With these criteria, the Mexican government keeps the necessary margin to preserve and implement its national policies.

The final element of the *Foreign Investment Law* that will be reformed with NAFTA is the land trust regime. The constitutional exclusion of foreign property ownership in the area 50km along the shores and 100km along borders

⁴³⁵ *Foreign Investment Law, supra*, note 3, art. 13.

is incompatible with the national treatment principle concealed in NAFTA. However, this provision will be "grandfathered" since it can be avoided through the Mexican land trust regime. This regime, described earlier, is working in a satisfactory manner for investors. In order to contribute further to a secure environment for foreign investors, the revamped land trust regime of the *1989 Regulations* would be integrated and improved in the new foreign investment law. An improvement for foreign investors would be the automatic issuance of non-nominative land trusts for an indefinite period. This would require the abolition of the renewable thirty year trust period, of the requirements for a nominative land trust and review by the Commission for land trusts on properties over 20 acres.

This solution is acceptable to all Parties of NAFTA. Mexico could thus avoid politically difficult modifications to its Constitution. Further liberalization of the land trust regime will be beneficial to the country since it will increase the confidence of foreign investors without prejudice to Mexico's control of FDI. For the United States and Canada, these new provisions are acceptable given the past success of these land trusts. The guaranteed and unrestricted right of establishment in the prohibited zone is sufficient for the needs of their investors as it approximates full ownership rights.

PERFORMANCE REQUIREMENTS

Performance requirements are a key issue for Mexico as it wants to retain the benefits of foreign investment as much as it wants to attract it. With clear rules on performance requirement standards, Mexico would ensure that the investment will promote development: transfer of technology, personnel training,

minimum export levels are a few of these elements. Performance requirements would give Mexico a minimum guarantee of benefits for its economy and people. In NAFTA, as in the FTA, a distinction should be made between trade-related performance requirements and other performance requirements.

In the FTA all trade-related performance requirements were banned. With Mexico's level of development being so different from its Partners, trade-related performance requirements are a possibility. They would be enforceable with respect to the investments subject to review by the Commission. These requirements would be granted in NAFTA for a limited period of time, such as the implementation period, in order to give Mexico a better chance to pursue its economic development. At the end of that period, trade-related performance requirements would be banned. The permissible trade-related performance requirements would have to be in line with the GATT provisions. Compulsory minimum domestic sourcing of products, for example, would be contrary to GATT. As a whole, the final outcome of trade-related performance requirements in NAFTA will depend upon the Parties but also upon GATT's Uruguay Round Trade Related Investment Measures' negotiations.

As to the other performance requirements, the former *Foreign Investment Law* and the *Transfer of Technology Law* imposed performance requirements in a non-transparent fashion through the Commission's review of investments and contracts involving intellectual property. The penalties were very stiff in the event of a violation of these laws. These measures have been reduced with the repeal of the *Transfer of Technology Law* replaced by the *Law on Promotion and*

Protection of Intellectual Property. In NAFTA, Mexico should retain its right to impose transfer of technology and local employment requirements for investments subject to review. Mexico has a distinct need for advanced technology because of its development level and the gap created by its previous import substitution policy.

These performance requirements should be acceptable in NAFTA since the trade-related performance requirements would be granted on a temporary basis. Mexico would have sensibly liberalized all sectors of the economy and possibly eliminated the five conditions attached to 100% foreign ownership. The possibility of imposing trade-related performance requirements for a limited period of time would give Mexico a chance to adapt itself to NAFTA. Continued exports are essential for Mexico's economy. As Canada has reserved the right to some performance requirements in the FTA, what was acceptable to the United States in 1988 should still be acceptable four years later. Also, Mexico will find an ally with Canada in defending its right to technology transfers performance requirements. For these reasons, performance requirements will be a part of NAFTA.

EXTRATERRITORIALITY

As to the extraterritorial effect of Antitrust laws, NAFTA, like the FTA, will most probably not address this issue. The Americans are fiercely opposed to entering into negotiations on this matter. Antitrust laws would be omitted from the scope of the agreement, with a small exception with respect to the creation of monopolies which is in line with the FTA provisions. Neither Canada nor Mexico

will be able to achieve a wider compromise on this question because of the strong American opposition. A solution to this for Mexico is the unilateral enactment of a law restraining the extraterritorial application of foreign laws on its territory. Canada did so in 1985 with the enactment of the *Foreign Extraterritorial Measures Act*.⁴³⁶

The only law which has an indirect extraterritorial effect that will be addressed in NAFTA is the *Ley del Impuesto General de Importacion*. The Mexican import licence scheme will need to be relinquished since it contravenes the essence of a free trade agreement. Actually, only 3% of goods imported are submitted to the import licence requirement, representing 20% of the total value of imported goods into Mexico. The restrictions for the most part apply to food, agricultural products, and automobile parts. It is likely that in NAFTA all import licences requirements will be abolished except those relating to agricultural and food products. In those sectors, the United States and Canada have protective measures of their own. The issue of agricultural products as a whole is wider than NAFTA and depends upon the outcome of the GATT and NAFTA's sectoral negotiations.⁴³⁷ In any case, for most of the foreign investors, import licence requirements on food products should not pose major impediments.⁴³⁸

⁴³⁶ *Foreign Extraterritorial Measures Act*, S.C. 1984-85, c. 49.

⁴³⁷ L.T. Kuenzler, "Foreign Investment Opportunities in the Mexican Agricultural Sector", (1992) *Business Mexico* 44 (Special Edition).

⁴³⁸ F.K. Schwedel & K. Haley, "Foreign Investment in the Mexican food System", (1992) *Business Mexico* 48 (Special Edition).

INCENTIVES

As to incentives, the FTA did not address this issue other than by stating that incentives should not be discriminatory or contrary to the spirit of the Agreement. Incentives were not *per se* submitted to national treatment. The inclusion of Mexico in a free trade agreement should not change this situation. The new rules are two-sided as they would also limit Canada's and the U.S.'s ability to promote investments. For that matter, if rules are to be provided in NAFTA with respect to an incentives scheme, they are likely to be minimal as this solution provides flexibility to all Parties unwilling to compromise on this issue. At this time, however, no special regulation on incentive measures is planned in NAFTA. The issue is being discussed at the multilateral level in the TRIM's negotiations of the GATT.

In any event, Mexico has an interest in seeing an extra clause added whereby its debt-for-equity swap program would be "grandfathered". These swaps could eventually be deemed investment incentives contrary to the spirit of the agreement. This would be the case, for example, if a swap to a third country would be judged discriminatory or a disguised restriction on the benefits of the investment provisions of NAFTA. Though a conflict is unlikely, the "grandfathering" of debt-for-equity-swaps would secure Mexico's right to maintain its program. This is an important element for Mexico's future economic development strategy.

DISPUTE RESOLUTION

Disputes relating to investments should be submitted to the trinational tribunal that will emerge from NAFTA.⁴³⁹ A notable exception to this rule would be the stipulation that the decisions of the Commission would not be subject to arbitration or review. This solution would be similar to what was concluded between Canada and the United States in the FTA. It is necessary to ensure fair treatment for investors of either Party in case of dispute, yet also to allow Mexico to exercise its discretion. The Commission must determine on its own which investments are beneficial according to the new criteria. This ensures that Mexico's policy choices can be implemented through the Commission without foreign intrusion into the process. This should be acceptable for all parties to NAFTA as was the case in the FTA.

Under the pressure of American and Canadian demands to establish an effective Tribunal we believe that Mexico will be required to relinquish the Calvo Clause in its Constitution.⁴⁴⁰ The Calvo Clause is completely incompatible with NAFTA since it precludes access to governmental protection to secure private claims and international arbitration. The FTA experience shows the importance of

⁴³⁹ The nature of this tribunal is yet unclear as it is one of the last elements retarding the successful negotiation of NAFTA. [Telephone interview with Mexican Official, NAFTA Office, SECOFI, Mexico, held March 17, 1992]. Analysis of possible dispute resolution mechanism is beyond the scope of this thesis.

⁴⁴⁰ The issue of the arbitration tribunal and the Mexican Calvo Clause is one of the three major points of disagreement in the final stage of negotiations as Mexico refuses to modify its Constitution. Acceptable solutions have yet to be found. [Interview with Mexican NAFTA Official, *supra*, note 432]

an effective binational tribunal for the settlement of disputes.⁴⁴¹ It does not correspond to the modern day reality where international business transactions occur daily and thus require a minimum level of security for the parties to a transaction. In addition, a promise to repeal the Calvo Clause could be a good bargaining chip for Mexico. It would satisfy the demands of the United States and Canada while affecting little change in reality to the legal environment.

The question of a *forum conveniens* for the settlement of international disputes has been the object of many cases in international law, which have emerged alongside the recognition of the sovereignty of States over natural resources within their territory.⁴⁴² The international jurisprudence, with one exception,⁴⁴³ has given little effect to these "Calvo Clauses" as they were considered contrary to international law.⁴⁴⁴ Consequently, abandoning the Calvo Clause will not be dramatic for Mexico from a legal point of view. A constitutional modification to this effect would render possible the creation of an effective and binding trilateral tribunal in NAFTA. It would be surprising if Canada and the United States settle for anything less.

⁴⁴¹ R.P. Parker, "Dispute Settlement in the GATT and Canada-U.S. Free Trade Agreement" (1989) 23 J. World Trade 83.

⁴⁴² See *Texaco-Calciatic*, *supra*, note 61 and the remarks on the New International Economic Order *supra*, note 61.

⁴⁴³ *The Libyan American Oil Company (Liamco) v. Republic of Libya*, reproduced in (1981) 30 I.L.M. 20. On this decision, see P. Rambaud, "Un arbitrage pétrolier : la sentence Liamco" (1980) 26 *Annuaire Français de Droit International* 274.

⁴⁴⁴ See D. Rosenberg, *La principe de la souveraineté permanente des États sur leurs ressources naturelles*, Coll. Bibliothèque de Droit International, (L.G.D.J.: Paris, 1983); B. Stern, "Trois arbitrages, un même problème, trois solutions - Les Nationalisations Lybiennes devant l'arbitrage international" (1980) *Revue de l'Arbitrage* 3.

RELATED EXCEPTIONS

The related exceptions to national treatment will generally follow what was achieved in the FTA. Public policy exemptions from national treatment on the basis of fiduciary, prudential, health, security or consumer protection interests, as states the FTA, will be found in NAFTA. These departures from national treatment are acceptable in as much as they are truly founded on these principles. Clear definitions of what are permissible public policy exemptions will benefit all Parties. This would prevent abuses against Mexico where these standards are sometimes used as non-tariff barriers.

The right to expropriate will be recognized in NAFTA. Though a deviation from the national treatment principle, expropriation is a right inherent to sovereignty. This right was explicitly recognized in the FTA. NAFTA will probably integrate the same elements as in the FTA: the right to expropriate, providing the expropriation is in the public interest, without discrimination and accompanied by prompt, adequate and effective compensation, will be recognized. Given Mexico's past history, rich in expropriations, it is possible that more precise rules on compensation and "fair market value" will be incorporated in NAFTA.

Following the provisions of the FTA, a clause guaranteeing the free transfer of profits, subject to laws of general application on bankruptcy, taxes, criminal offenses and other such provisions will be included in NAFTA. In that respect, the foreign exchange controls which are still in place should be abolished by Mexico. The narrow difference between the controlled and the free market justifies their abolition in itself. Mexico has had a free foreign exchange market for

a long time. The return to free exchange would secure further foreign investors without causing much political upheaval in Mexico. Such a measure would also ensure the free repatriation of profits as demanded by Canada and the United States. A comprehensive NAFTA, after stating the principle of free repatriation, may stipulate some guidelines on foreign exchange controls in Mexico in order to allow temporary controls on the free market when inflation is too high.

The final provisions may also include all the other the elements that were addressed in the FTA. NAFTA would allow monitoring of investments by accumulation of routine information. The exclusion of taxation from the national treatment principle would be in NAFTA in so far as it is non-discriminatory. These measures, being essentially an extension of the FTA provisions to Mexico, would be acceptable to all Parties.

MAQUILADORAS

The *maquiladora* program will be repealed by NAFTA for American and Canadian owners. The 100% export requirement that they require is contrary to a the basic provisions of a free trade and investment agreement. The *maquiladoras* will continue to operate but as normal corporations. Mexico will need to change the law on *maquiladoras* to adjust its provisions so that they are in line with NAFTA's provisions. The aim of these changes would be to submit *maquiladoras* to the same legal regime which prevails for corporations operated by foreign investors who are nationals of a member Party. In order to do this, the necessary amendments would affect the temporary import licence scheme, foreign exchange requirements and domestic sales permissions. The temporary

import licence scheme would have to be repealed because the imported goods the *maquiladora* use will not be subject to any restrictions at the end of the phasing out period.

With NAFTA, American and Canadian *maquiladoras* would also be able to serve the domestic Mexican market. In order to do this, Mexico will have to amend the prevailing regime imposing authorization requirements. As well, foreign exchange requirements would be repealed as the free transfer of profit provision of NAFTA would apply to *maquiladoras*. However, given their nature, the sales on the domestic market would be subject to the same duties as regular exports during a phasing out period. As a whole, these changes would ensure to the existing *maquiladoras* the same treatment as any other corporation, thus aligning them with the principle of national treatment.

An exception to the integration of the *maquiladoras* to the normal Mexican corporate environment will be provided for the *maquiladoras* operating in the car industry. The future of these depends on the specific agreement reached for this delicate sector and the rules of origin provided NAFTA for in the chapter on this sector.

The future of *maquiladoras* operated by third Parties is unclear. Essentially, two contradictory possibilities are now being negotiated between Mexico and the United States. The Mexicans want the program to continue. The "post-NAFTA" *maquiladoras* owned by third parties would possibly benefit from the lower rules of origin but would still be required to export all their production. Their sales on the domestic market, when allowed, would be submitted to the

same duties as regular exports. In turn, the United States wants the *maquiladora* program to be terminated so that all industries would be integrated and be able to serve the Mexican market. The integration of the existing *maquiladoras* of third parties could be more progressive than what was provided for American and Canadian *maquiladoras*. This would prevent further growth of German, Japanese and British *maquiladoras* on the border of the United States.

With such new laws and regulations, all the elements covered by the FTA would be integrated in NAFTA. For Canada and the U.S., bilateral investment provisions of the FTA regulating FDI would not change since chapter 16 of the FTA would be essentially transposed in NAFTA. This is likely to happen if no changes are made to the definition of cultural industries and to the provisions of the FTA on energy. The thoroughly negotiated balance that led to the FTA in 1989 should still be valid today. Canada will devote its best efforts to preserve this balance. Mexico should not interfere at this level because of its defensive position on FDI.

The proposed amendments to Mexico's FDI regulation go much beyond the liberalization of FDI that resulted from the *1989 Regulations*. The opening of 93% of the previously restricted sectors of the economy to foreign participation is a sweeping change. A new law on foreign investment will have to be enacted to integrate these modifications to the existing regime. This is the price that Mexico must pay to enter into a North American Free Trade Agreement since Canada and the United States want secure and guaranteed access to FDI in Mexico.

The aforementioned review thresholds, criteria and performance requirements are useful tools of development for Mexico. Yet at the same time they provide the necessary framework for an acceptable secure and free access to American investors. These new openings by Mexico will definitively seal and confirm Mexico's will to integrate itself into the modern economic system and allow Mexico to continue on its path to economic growth.

CONCLUSION

In conclusion, Mexico's foreign direct investment regulations are a reflection of Mexico's economic policy and a measure of its struggle for development. These regulations aimed, until recently, to restrict foreign investment in Mexico to a minority position and exclude it from many other sectors reserved to the State or Mexican nationals. Following the "guidelines" of the New International Economic Order, most of the restrictions imposed were in the field of natural resources. Mexico wanted through these regulations to preserve its economic sovereignty and reap a maximum of benefits from the exploitation of these resources. The tight FDI regulations and review process achieved this goal as Mexico pursued impressive economic growth on its own.

The surrounding business legal environment, following the same policy, helped in this sense to support Mexico's inner growth. Constitutional territorial limitations, transfers of technology registration obligations and the import licence scheme are a vibrant illustration of this system. All these elements presented serious impediments to foreign investors.

After the 1982 debt crisis and the following stabilization period, Mexico changed its policies as the previous policies were no longer viable. It has done so in an unprecedented effort to adopt norms of industrialized countries and to attract foreign capital and technology in a suffocating economy. Doing so provided a new liberalized legal framework for foreign investors. This is to their advantage as majority participation, less restricted sectors to investment, limited review process and high intellectual property protection provide security and

facility to the entry of foreign investments into Mexico. However, we can perceive from the temporary investment liberalization measures, that Mexico hopes to preserve for the future some of the control and benefits it has enjoyed throughout the period prior to the *1989 Regulations*. This has prevented only a few people from taking advantage of the new openings in Mexico as investment levels reach record highs, especially in the securities-neutral shares market.

Amongst the FDI regulations of Mexico, the *maquiladoras* form a distinct part as, with the 100% export requirement, *maquiladoras* do not interact with Mexican society. For this reason, few limitations are imposed by Mexico upon their establishment. *Maquiladoras* are an integral part of President Salinas' reforms as they now represent the second most important sector, petroleum being first, in the Mexican economy. They also open a window on NAFTA as they represent virtual free trade between the United States and Mexico. This window, with the notable exception of occupational health hazards and environmental standards, gives an optimistic view of future liberalization and integration for the United States and Mexico.

The positive *maquiladoras* experience and the new legal framework implemented by President Salinas have rendered NAFTA possible. The integration of Mexico's economy into those of the United States and Canada through a binding trade agreement is a daring challenge to all Parties involved. A developing, newly industrialized country has modified its policies and laws to then dare two members of the "elite" G-7 group to together liberalize further all their trade and investment relations. The United States reacted positively. Canada, after realizing that its interests would be better served by being part of NAFTA,

decided to join the negotiations. The aim of the negotiations is to finalize one trade agreement which would replace the existing FTA, encompassing the same issues and intellectual property rights.

A NAFTA covering investments is possible if common ground can be reached between all Parties. The overview of the regulation of FDI in Canada and the United States demonstrates the wide differences existing between U.S. and Mexico's FDI regulations and the similarity between to Canada's and Mexico's regulations. The United States has a few sectorial limitations and initiate a review process only when national security could be endangered by an investment. Canada has a central review agency and sectorial limitations. We learn from the FTA's provisions on investment, grandfathering existing limitations to national treatment, that even with the wide differences in the treatment of FDI in Canada and the U.S., the latter have agreed to a binding bilateral FTA with Canada. Of course, the *Investment Canada Act* was liberalized pursuant to the FTA. Yet, the spirit of the Act was preserved as well as Canada's national identity.

Investment liberalization will be a substantial part of the price Mexico will pay to achieve NAFTA. The interests of the United States in this respect are very high since their Mexican investments are also high. This is also true, though to a lesser extent, of Canada. Both countries seek to obtain secure national treatment for their investors in Mexico. Such liberalization will be acceptable to Mexico as long as it retains the necessary elements to implement future policies on FDI and it can ensure that some benefits will stay in Mexico. This could be done by the enactment of a new law on foreign investment, preserving Mexican participation in the sectors restricted by the Constitution, preserving minimum Mexican

participation in natural resource sectors and reserving a narrowed discretionary review process to the Foreign Investment Review Commission. Also, temporary measures such as trade-related performance and foreign exchange requirements would be upheld during the transitional implementation period of the Agreement. However, territorial restrictions would be maintained. The *maquiladoras* and the Calvo Clause would be abolished. The latter is totally incompatible with free trade, the need for security and an independent means for the settlement of disputes.

At the time of writing, NAFTA negotiations are now in their final stage. If they do not result in an Agreement, they will have at least raised awareness on Mexico's geographic and social situation and the numerous commercial possibilities present in this blossoming market. In the event that they lead to a successful and acceptable Agreement, it will set an example and a precedent for other developing countries, willing to pursue economic growth and development through a liberalized trade and investment regime with industrialized countries. This precedent will be the first step for further expansion of the economic liberalization of the Americas. It is hoped that this increased trade and investment, secured by a regional agreement, will ultimately benefit the people by providing them new opportunities and sustainable development for all.

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X - Interviews*

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* This list is not exhaustive as anonymas was sometimes requested. The interviews were conducted in person or by phone inbetween May 1991 and March 1992.

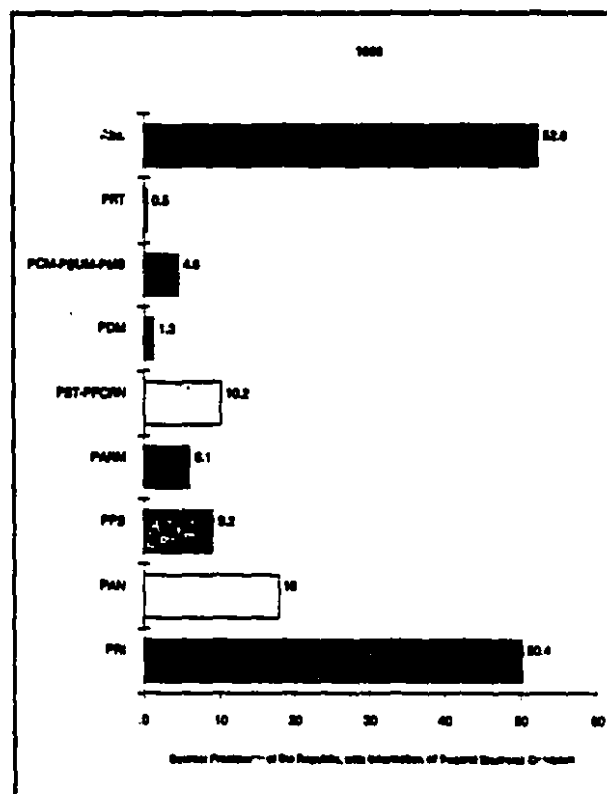
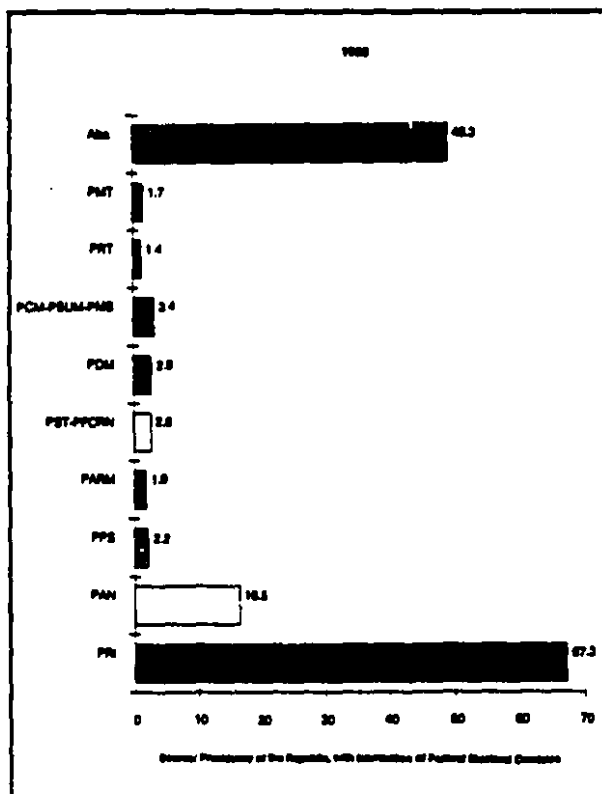
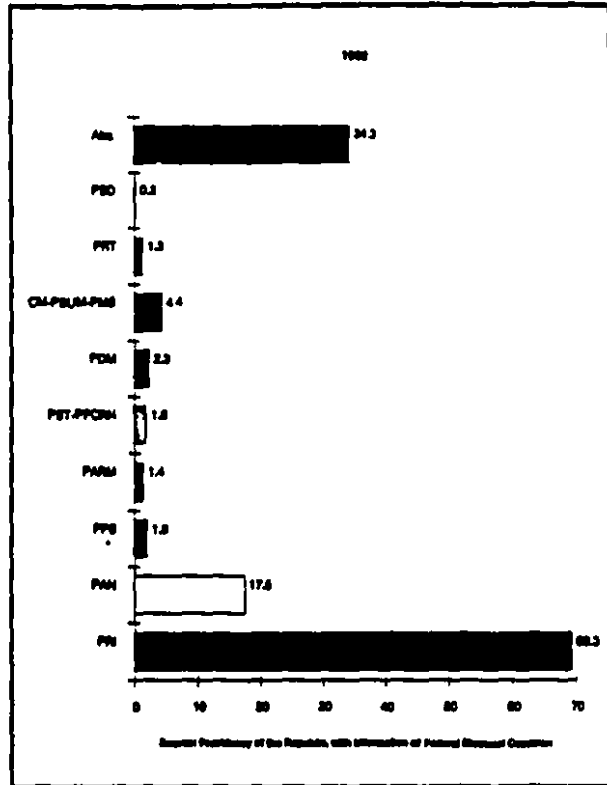
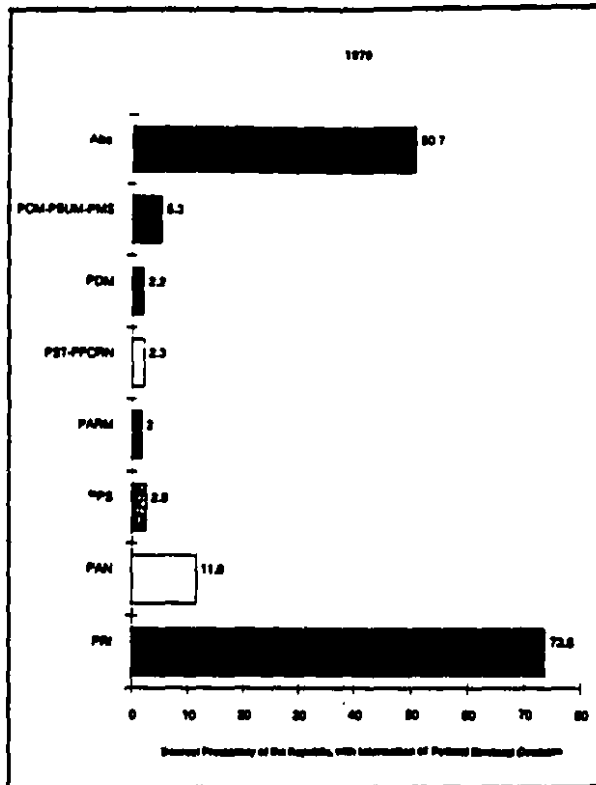
ANNEXES

ANNEX I

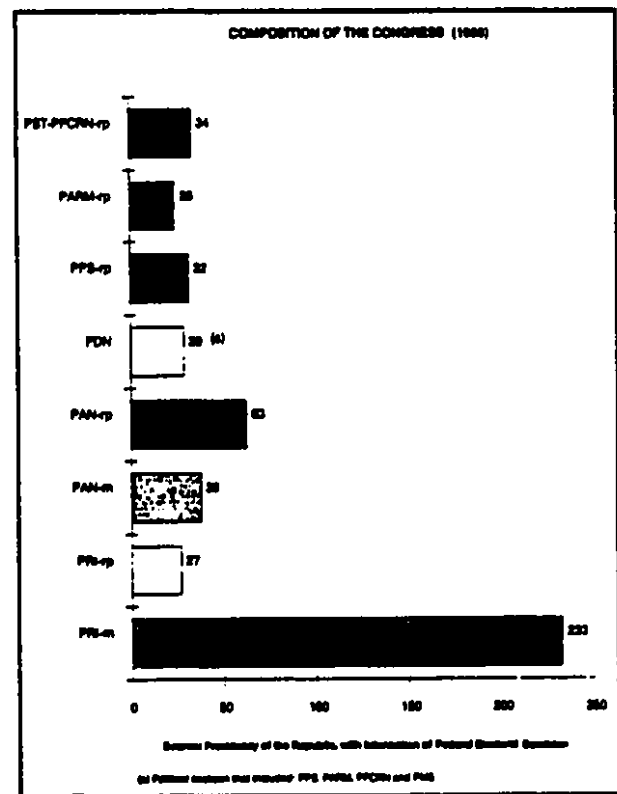
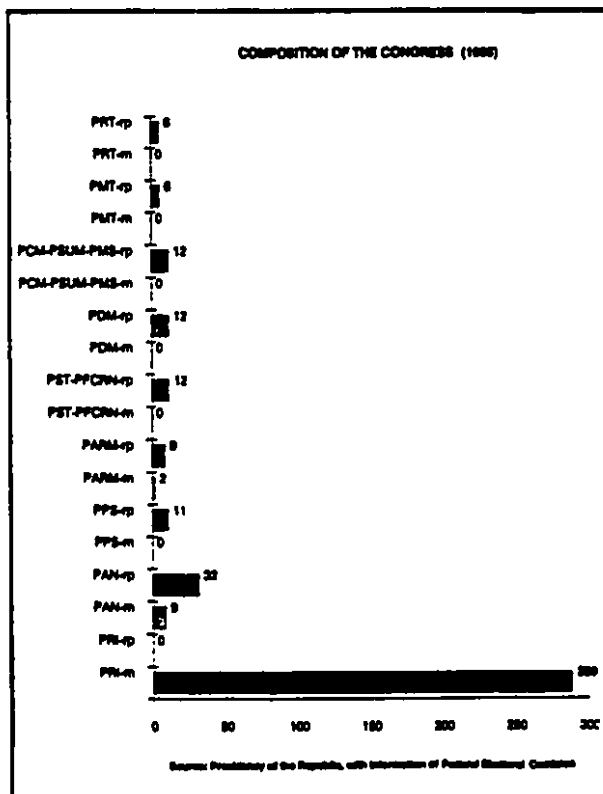
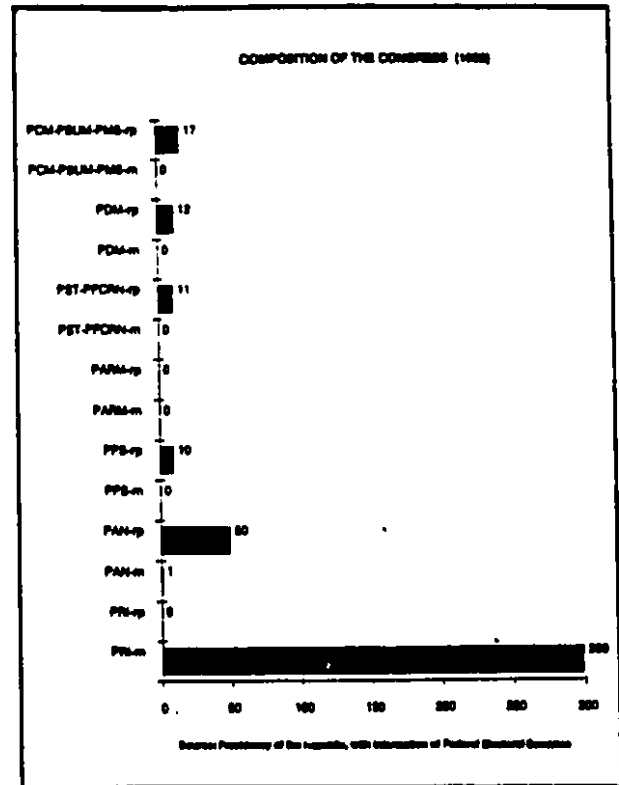
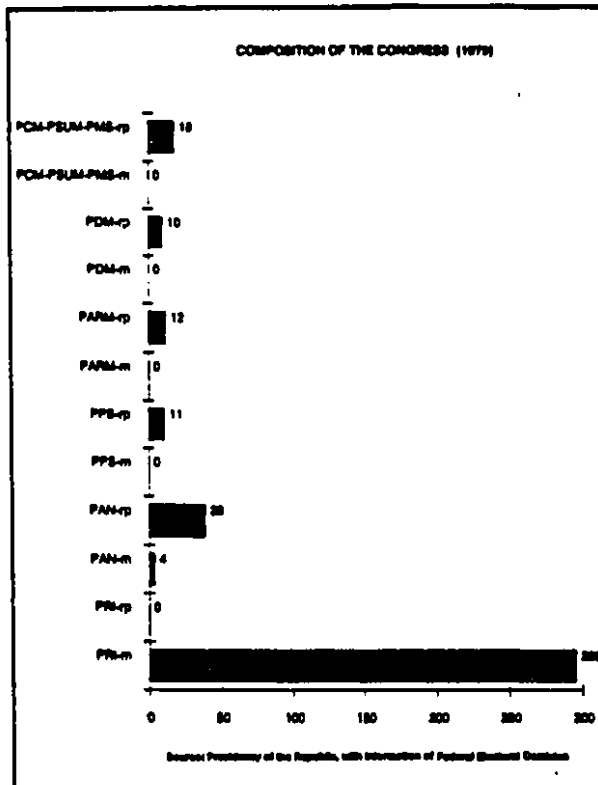
**ELECTORAL RESULTS IN MEXICO
AND COMPOSITION OF THE CONGRESS**

(source: Mexico- A New Economic Profile)

ELECTORAL RESULTS IN FEDERAL ELECTIONS



COMPOSITION OF THE CONGRESS



ABREVIATIONS

Abs: Abstentionism

PCM: Mexican Communist Party

PSUM: Socialist Unified Party of Mexico

PMS: Socialist Mexican Party

PDM: Democratic Mexican Party

PSD: Social-Democratic Party

PFCRN: Cardenist Front of National Reconstruction Party

PARM: Authentic Party of the Mexican Revolution

PPS: Popular Socialist Party

PRT: Revolutionary Party of the Workers

PMT: Mexican Party of the Workers

PST: Socialist Party of the Workers

PAN: National Action Party

PRI: Revolutionary Institutional Party

Note:

Some of these parties have either disappeared, lost their registry or integrated into other political organizations.

ANNEX II

TRILATERAL EXPORTS AND DUTY RATES

(source: *Challenges of NAFTA*)

U.S. Imports and Market Shares from Canada, Mexico and the Rest of the World, by Commodity, 1989

(ranked by Mexican import value)

Commodity Description	Mexican Share of Imports of Commodity	Cdn. Share of Imports of Commodity	Rest-of-World Share of Imports of Commodity	% of All Mexican Imports	Cumulative % of All Mexican Imports	% of All Canadian Imports	% of All Rest-of-World Imports
270900 Petroleum oils, crude	11.41	8.94	79.65	15.06	15.06	3.56	7.90
870323 Automobiles (piston engines > 1500-3000 cc)	3.38	22.75	73.87	5.02	20.08	10.21	8.24
854430 Ignition wiring sets used in vehicles, aircraft, etc.	70.66	5.74	23.59	3.96	24.04	0.10	0.10
980100 Products of U.S. returned after being export, nesoi	10.79	31.73	57.49	3.55	27.59	3.15	1.42
852810 Television receivers, video monitors and projectors	35.55	3.18	61.27	2.89	30.48	0.08	0.36
852990 Parts for television receivers and video monitors	34.87	5.18	59.95	2.35	32.83	0.11	0.29
090111 Coffee, not roasted, not decaffeinated	21.32	0.02	78.67	1.63	34.46	0.00	0.45
870324 Automobiles (piston engines > 3000 cc)	6.13	55.78	38.09	1.40	35.86	3.86	0.65
870821 Safety seat belts for motor vehicles	71.80	12.57	15.63	1.37	37.23	0.07	0.02
710691 Silver in unwrought forms	55.67	35.90	8.43	1.27	38.50	0.25	0.01
840734 Engines, spark-ignition (displacing > 1000 cc)	22.04	46.17	31.79	1.24	39.74	0.79	0.13
870899 Motor vehicle parts nes	5.01	56.05	38.93	1.24	40.98	4.19	0.73
852721 Radio receivers for motor vehicles	24.72	7.41	67.87	1.20	42.18	0.11	0.25
010290 Bovine, live except pure-bred breeding	43.17	56.73	0.10	1.07	43.25	0.42	0.00
030613 Shrimps and prawns, frozen, in shell or not	17.33	0.45	82.22	1.05	44.30	0.01	0.37
847330 Parts & accessories of data processing machines	3.79	14.93	81.28	1.04	45.34	1.24	1.68
854451 Electric conductors (voltage of > 80 but ≤ 1000)	51.57	4.37	44.06	0.91	46.25	0.02	0.05

* Where several subgroups have been aggregated to the 6-digit level, the description of one of the subgroups is applied to the whole.

Source: Compilations by Investment Canada and R.D. Hood Economics Inc. from U.S. Department of Commerce data.

U.S. Imports and Market Shares from Canada, Mexico and the Rest of the World, by Commodity, 1989.

(ranked by Canadian import value)

Commodity Description	Cdn. Share of Imports	Mexican Share of Imports of Commodity	Rest-of-World Share of Imports of Commodity	% of All Cdn. Imports	Cumulative % of All Cdn. Imports	% of All Mexican Imports	% of All Rest of World Imports
870323 Automobiles (piston engines >1500-3000 cc)	22.75	3.38	73.87	10.21	10.21	5.02	8.24
870431 Trucks (gas powered, GVW ≤ 5 tonnes)	63.84	1.63	34.53	5.28	15.49	0.45	0.71
480100 Newsprint, in rolls or sheets	97.67	0.03	2.30	4.98	20.47	0.01	0.03
870899 Motor vehicle parts nes	56.05	5.01	38.93	4.19	24.66	1.24	0.73
870324 Automobiles (piston engines >3000 cc)	55.73	6.13	38.09	3.86	28.52	1.40	0.65
270900 Petroleum oils, crude	8.94	11.41	79.65	3.56	32.08	15.06	7.90
440710 Lumber, coniferous (softwood)	98.85	0.61	0.53	3.23	35.31	0.07	0.00
980100 Products of U.S. returned after being export, nesoi	31.73	10.79	57.49	3.15	38.46	3.55	1.42
470321 Chemical wood pulp (soda or sulphate, coniferous, bleached or semibleached, nes)	96.58	0.04	3.37	2.24	40.70	0.00	0.02
271121 Natural gas, in gaseous state	99.55	0.00	0.45	1.79	42.49	0.00	0.00
271000 Petroleum oils, other than crude	12.16	0.95	86.90	1.77	44.26	0.46	3.13
847330 Parts & accessories of data processing machines	14.93	3.79	81.28	1.24	45.50	1.04	1.68
760120 Aluminum unwrought, alloyed	85.31	0.16	14.53	1.04	46.54	0.01	0.04
710812 Gold in unwrought forms, non-monetary	63.96	7.32	28.72	0.99	47.53	0.37	0.11
854211 Monolithic integrated circuits, digital	9.01	1.44	89.55	0.95	48.48	0.50	2.35
750210 Nickel unwrought, not alloyed	70.50	0.00	29.50	0.92	49.40	0.00	0.10
880330 Aircraft parts nes	30.58	0.66	68.76	0.86	50.26	0.06	0.49

* Where several subgroups have been aggregated to the 6-digit level, the description of one of the subgroups is applied to the whole.

Source: Compilations by Investment Canada and R.D. Hood Economics Inc. from U.S. Department of Commerce data.

Mexican Exports to the U.S. and Duty Rates, 1989

(ranked by export value)

Commodity Description*	Value of Imports from Mexico, by Commodity (US\$ millions)	Mex. Duty Paid as % of Dutiable Imports	Mex. Duty Paid as % of Total Imports	Cdn Duty Paid as % of Dutiable Imports	Cdn Duty Paid as % of Total Imports
270900 Petroleum oils, crude	3,999.14	0.45	0.45	0.42	0.42
870323 Automobiles (piston engines > 1500-3000 cc)	1,334.28	2.50	2.50	0.00	0.00
854430 Ignition wiring sets used in vehicles, aircraft, etc.	1,051.80	5.00	4.97	4.50	0.85
980100 Products of U.S. returned after being export, nesoi	942.25	0.00	0.00	0.00	0.00
852810 Television receivers, video monitors and projectors	768.24	5.00	5.00	4.50	4.50
852990 Parts for television receivers and video monitors	625.34	4.66	4.58	4.28	2.50
090111 Coffee, not roasted, not decaffeinated	434.18	0.00	0.00	0.00	0.00
870324 Automobiles (piston engines > 3000 cc)	372.55	2.50	2.50	0.00	0.00
870821 Safety seat belts for motor vehicles	363.71	3.10	3.10	2.70	0.28
710691 Silver in unwrought forms	337.94	0.00	0.00	4.80	0.00
840734 Engines, spark-ignition (displacing > 1000 cc)	330.38	3.10	3.10	2.62	0.12
870899 Motor vehicle parts nes	329.99	3.09	2.83	2.67	0.24
852721 Radio receivers for motor vehicles	318.41	3.71	3.71	2.90	0.15
010290 Bovine, live except pure-bred breeding	284.23	1.23	1.23	1.28	1.25
030613 Shrimps and prawns, frozen, in shell or not	280.00	0.00	0.00	0.00	0.00
847330 Parts & accessories of data processing machines	276.52	3.90	0.08	0.00	0.00
854451 Electric conductors (voltage of >80 but ≤ 1000)	241.56	5.30	5.27	4.70	3.87
070200 Tomatoes, fresh or chilled	222.32	6.91	6.91	3.07	3.07

* Where several subgroups have been aggregated to the 6-digit level, the description of one of the subgroups is applied to the whole.

Source: Compilations by Investment Canada and R.D. Hood Economics Inc. from U.S. Department of Commerce data.

Canadian Exports to the U.S. and Duty Rates, 1989

(ranked by export value)

Commodity Description	Value of Imports from Canada by Commodity (US\$ millions)	Cdn. Duty Paid as % of Dutiable Imports	Cdn. Duty Paid as % of Total Imports	Mex. Duty Paid as % of Dutiable Imports	Mex. Duty Paid as % of Total Imports
870323 Automobiles (piston engines >1500-3000 cc)	8,979.66	0.00	0.00	2.50	2.50
870431 Trucks (gas powered, GVW ≤ 5 tonnes)	4,645.63	0.00	0.00	0.16	0.16
480100 Newsprint, in rolls or sheets	4,382.85	0.00	0.00	0.00	0.00
870899 Motor vehicle parts nes	3,690.16	2.67	0.24	3.09	2.83
870324 Automobiles (piston engines >3000 cc)	3,392.48	0.00	0.00	2.50	2.50
270900 Petroleum oils, crude	3,132.63	0.42	0.42	0.45	0.45
440710 Lumber, coniferous (softwood)	2,839.02	0.00	0.00	0.00	0.00
980100 Products of U.S. returned after being export, nesol	2,770.70	0.00	0.00	0.00	0.00
470321 Chemical wood pulp (soda or sulphate, coniferous, bleached or semibleached, nes)	1,972.81	0.00	0.00	0.00	0.00
271121 Natural gas, in gaseous state	1,576.06	0.00	0.00	0.00	0.00
271000 Petroleum oils, other than crude	1,555.96	0.84	0.83	1.16	1.15
847330 Parts & accessories of data processing machines	1,089.81	0.00	0.00	3.90	0.08
760120 Aluminum unwrought, alloyed	918.15	0.00	0.00	0.00	0.00
710812 Gold in unwrought forms, non-monetary	868.03	0.00	0.00	0.00	0.00
854211 Monolithic integrated circuits, digital	835.60	0.00	0.00	0.00	0.00
750210 Nickel unwrought, not alloyed	809.44	0.00	0.00	0.00	0.00
880330 Aircraft parts nes	759.98	0.00	0.00	0.00	0.00
760110 Aluminum unwrought, not alloyed	733.24	0.00	0.00	0.00	0.00

Canadian Imports from Mexico, and Canadian Production, by Duty Rate. 1987 and 1989.

Input-Output Commodity Classifications	Canadian Production	Total Imports	Imports from Mexico	Effective Duty rate on Mexican Imports
	1987	1987	1989	1989
	C\$ millions			percent
11600 Alcoholic Beverages Distilled	728	338	10.9	75.5
17500 Textile Containers	0	13	0.0	25.0
18300 Knitted Wear	1,002	972	0.8	25.0
18000 Hosiery	316	39	0.3	24.9
17700 Misc. Textile Fab. Mat. Inc. Rags	85	49	0.1	24.7
15800 Fabric, Woven, Textile Fibres	355	479	1.9	24.4
15900 Fabrics, Broad Woven, Mix & Blends	25	321	0.4	24.2
18400 Clothing	3,936	1,556	6.4	23.7
51000 Fabrics, Impreg. Ex. Rubber-coate	9	192	0.1	23.7
18100 Fabrics, Knitted & Netted, Elastic	0	14	0.2	22.8
14000 Footwear ex. Rubber & Plastic	680	804	4.2	22.7
50200 Watches, Clocks, Chronometers etc.	61	189	0.0	22.4
18200 Fabrics, Knitted, nes.	456	113	1.0	20.7
16700 Narrow Fabrics	103	59	0.0	20.0
15000 Blankets, Bedsheets, Towels & Cloth	176	93	0.3	19.2
7800 Veget. Frozen, Dried & Preserved	508	98	4.0	18.6
11900 Ale Beer, Stout & Porter	2,328	46	4.5	18.1
16800 Lace Fabrics, Bobbinet & Net	7	38	0.0	17.3
17900 Laces and Textile Prod. N.E.S.	198	110	0.0	17.1
30900 Gas Meters and Water Meters	0	12	0.0	16.7
14700 Fabrics, Broad Woven of Cotton	31	339	1.4	15.8
9900 Other Confectionery	425	96	0.0	15.5
17400 Tarpaulins & Other Covers	102	6	0.0	15.2
14300 Luggage	51	98	0.4	14.4
29800 Scissors, Razor Blades, ind. Cutlery	9	46	0.0	14.2
12100 Tobacco Processed, unmanufact.	243	5	0.0	14.0
15700 Tire Yarns	0	17	0.2	13.5
48800 Printing and Other Inks	246	32	0.0	13.0
8200 Pickles, Relishes, Other Sauces	450	41	0.0	12.9
22600 Office and Stationery Supplies	696	304	3.0	12.6
17800 Household Textiles, nes.	352	105	0.5	12.6

Canadian Imports from Mexico, and Canadian Production, by Duty Rate. 1987 and 1989.

Input-Output Commodity Classifications	Canadian Production	Total Imports	Imports from Mexico	Effective Duty rate on Mexican Imports
	1987	1987	1989	1989
	C\$ millions			percent
27400 Power Boilers	0	25	1.1	12.5
40900 Paints & Related Products	1,495	321	0.0	12.5
40500 Film & Sheet, Cellulosic Plastic	0	56	0.0	12.5
33700 Military Motor veh., Motorcycle	266	412	0.3	12.5
47200 Additives for Mineral Oils, nes.	209	112	0.1	12.4
14400 Leather Handbags, Wallets etc.	87	87	0.4	12.4
41500 Toilet Preparations & Cosmetic	1,198	210	0.0	12.0
50500 Plated & Silverware, Cutlery, etc.	15	56	0.1	11.9
47700 Ammunition & Ordnance, Military	0	64	0.0	11.7
38000 Bricks and Tiles, Clay	0	175	0.5	11.6
50600 Brooms, Brushes, Mops & Other Clean.	99	58	2.7	11.6
35600 Gas Ranges & Elec. Stoves, Domestic	243	68	0.1	11.4
50900 Toys and Game Sets	7	491	14.7	11.3
14200 Leather Belting, Shoe Stock	0	19	0.4	11.0
13500 Plastic Pipe Fittings & Sheet	2,530	1,133	2.1	11.0
12600 Tires & Tubes, Trucks & Buses	428	374	0.1	10.7
30100 Heating eq, Warm air ex. Pipes	173	80	0.0	10.5
50700 Bicycles, Children's ch. & Parts	189	149	0.2	10.4
21600 Bldg. Paper	577	55	0.0	10.4
18500 Apparel Accessories & Other Misc.	309	160	1.5	10.3
30400 Com. Appliances, Cook & Warming fo.	67	24	0.2	10.3
38600 Plasters & Oth. Gypsum Basic Prod.	515	18	0.1	10.1
29400 Fittings, Furn. Cabinets & Caskets	2	43	0.0	10.1
25200 Cast & Wrought Iron Pipe & Fitting	142	130	0.6	10.1
21700 Towels, Napkins & Toilet Paper	593	15	0.0	10.0
36900 Batteries	300	186	9.4	10.0
23900 Steel Bars and Rods	1,894	258	0.0	9.9
30600 Forgings of Carbon & Alloy Steel	0	26	0.0	9.9
30800 Pipe Fittings, not Iron & Steel	413	254	0.0	9.9
29300 Builders' Hardware	270	221	1.1	9.9
22400 Facial Tissues, & Sanitary Napkins	419	21	0.0	9.9

Canadian Imports from Mexico, and Canadian Production, by Duty Rate, 1987 and 1989.

Input-Output Commodity Classifications	Canadian Production	Total Imports	Imports from Mexico	Effective Duty rate on Mexican Imports
	1987	1987	1989	1989
	C\$ millions			percent
22500 Paper Containers, nes.	130	35	0.0	9.8
29900 Domestic Equipment, nes.	356	505	0.2	9.8
50400 Jewelry, Findings, met. & Gem Stone	385	363	1.1	9.6
30200 Unit & Water Tank Heaters, Non-electric	27	16	0.2	9.5
20600 Special-Purpose Furniture	594	53	0.0	9.4
36000 Radar Equip. & Related Devices	796	120	0.9	9.4
23800 Steel Castings	177	30	0.0	9.2
35500 Refrig., Freezers & Comb., Domestic	357	73	0.2	9.2
31000 Abrasive Basic Products	286	134	0.5	9.2
15300 Papermakers' Felts	83	14	0.2	9.2
31800 Conveyors, Escal., Elev. & Hoist mac.	598	440	0.1	9.2
31000 Fire Fight. & Traffic Control Equip.	5	77	0.0	9.1
51100 Tiling, Rubber, Plastic	0	111	0.2	9.0
12300 Tobacco Mfg. ex. Cigarettes	163	19	0.0	8.9
35900 Radio & TV Broadcasting & Trans Equip.	759	156	3.9	8.8
22700 Paper End Products	17	92	0.1	8.8
1700 Nursery Stock & Related Mat.	458	161	1.0	8.7
39100 Glass Containers	0	55	0.8	8.6
13100 Rubber Sheetting, Shoe Stock etc.	318	179	0.4	8.5
33900 Oth.Trailers & Semi-Trailers, com.	484	117	0.0	8.5
40800 Pharmaceuticals	2,715	811	0.0	8.5
37200 Enclosed Safety Switches etc.	568	234	2.4	8.5
37000 Wire and Cable, Insulated	1,335	178	4.0	8.4
49700 Aircraft & Nautical Instruments	0	90	0.0	8.3
20700 Misc. Furniture and Fixtures	599	49	0.1	8.3
Total of Above	37,228	16,037	93	
Grand Total*	852,768	139,867	1,694	2.4†

* This table lists the 75 highest duty rates of Statistics Canada's 608 I-O commodity groups. Grand total refers to the total of all 608 classifications.

† Average duty rate of all 608 commodity groups.

Source: Compilations by Investment Canada and R.D. Hood Economics Inc. from Statistics Canada data

Canadian Imports from Mexico, and Canadian Production, by Value, 1987 and 1989

Input-Output Commodity Classifications	Canadian Production	Total Imports	Imports from Mexico	Effective Duty Rate on Mexican Imports
	1987	1987	1989	1989
	C\$ millions			percent
39000 Glass, Plate, Sheet, Wool	558	389	5	0.3
31900 Ind. Trucks, Tractors, Trailers etc.	270	414	5	3.1
38200 Plumb. Eq., Vitreous China, & etc.	125	190	5	4.3
21300 Tissue & Sanitary Paper	184	46	5	4.0
11900 Ale Beer, Stout & Porter	2,328	46	4	18.1
14000 Footwear excl. Rubber & Plastic	680	804	4	22.7
7800 Veget. Frozen, Dried & Preserved	508	98	4	18.6
40400 Plastic Resins & Mat., Not shaped	2,345	1146	4	7.1
37000 Wire and Cable, Insulated	1,335	178	4	8.4
36600 Engines, Marine, Electric Turbin	733	1039	4	5.3
50300 Photographic Equip & Suppl.Incl.Fil.	51	1272	4	0.6
35900 Radio & TV Broadcasting & Trans Equip.	759	156	4	8.8
4300 Gypsum	87	6	3	0.0
25500 Lead, Primary Forms	113	12	3	0.0
4400 Salt	225	28	3	0.0
22600 Office and Stationery Supplies	696	304	3	12.6
32300 Mach. Ind. Specified & Special Pur.	4,802	6243	3	3.4
50600 Brooms, Brushes, Mops & Oth. Clean.	99	58	3	11.6
15200 Fabrics, Broadwoven, Wool, Hair & M.	0	164	3	6.9
36300 Interior Signal, Alarm & Clock Sy.	63	56	3	0.3
7500 Fish Products	2,510	617	2	0.5
28000 Steel Sheet & Strip Coated or Fa.	757	296	2	6.5
37200 Enclosed Safety Switches etc.	568	234	2	8.5
32400 Power-Driven Hand Tools	70	213	2	6.3
1800 Oil Seeds, Nuts and Kernels	1,064	146	2	0.0
13500 Plastic Pipe Fittings & Sheet	2,530	1133	2	11.0
29200 Bolts, Nuts, Screws, Washers etc.	738	428	2	0.4
49900 Misc. Measure & Control Instruments	597	401	2	7.2
15800 Fabric, Woven, Textile Fibres	355	479	2	24.4
35800 Tel & Teleg. Line Apparatus & Equip.	619	722	2	6.7
27600 Beams and Other Struct. Steel	819	134	2	6.8
30700 Valves	277	280	2	7.1
37300 Elec. Light Bulbs & Tubes, etc.	0	181	2	7.4

Canadian Imports from Mexico, and Canadian Production, by Value, 1987 and 1989

Input-Output Commodity Classifications	Canadian Production	Total Imports	Imports from Mexico	Effective Duty Rate on Mexican Imports
	1987	1987	1989	1989
	C\$ millions			percent
34100 Motor Vehicle Engines and Parts	2,902	3,351	249	0.1
34300 Motor Veh. Access. Parts & Assem.	8,099	12,726	244	0.1
25900 Precious Metal & Alloys Prime Fo.	5	109	183	0.0
32900 Office Machines and Equipment	2,015	5,777	145	2.5
35700 T.V., Radio, Record Players	625	2,183	138	3.0
34200 Auxiliary Electric Equipment	335	830	97	0.0
33400 Passenger Automobiles & Chassi.	0	13,083	73	1.4
3800 Crude Mineral Oils	13,048	3,552	49	0.0
32100 Pkg. Mach, Lub. Eq & Oth. Misc. Mach.	740	493	39	1.0
1400 Vegetables, Fresh	1,143	760	39	2.5
59200 Green Coffee	0	369	26	0.0
32600 Refrig & Air Con. Eq, excl. Household	424	873	22	2.0
15600 Yarns, Silk, Fibreglass	873	501	20	7.6
36200 Electronic Equipment Component	1,118	1,759	19	3.2
36800 Elec. Equip. Industrial, ncs.	949	574	18	3.6
26300 Scrap & Waste Materials ncs.	64	485	16	0.0
50900 Toys and Game Sets	7	491	15	11.3
4800 Crude Mineral ncs.	50	136	14	0.0
59300 Tropical Fruit	0	515	14	0.0
1300 Fruits, Fresh, excl. Tropical	349	586	12	0.0
11600 Alcoholic Beverages, Distilled	728	338	11	75.5
17000 Carpeting & Fabric Rugs, Mats, etc.	991	281	10	3.9
36900 Batteries	300	186	9	10.0
36100 Elec. Tubes & Semi-Conductors etc.	0	623	9	4.0
20400 Household Furn. incl. Camp & Lawn	1941	499	9	1.6
59400 Unallocated Imports & Exports	0	12067	8	0.7
37400 Electric Lighting Fixtures etc.	558	318	7	1.6
36700 Transformers & Converters excl. T&T	664	133	7	5.9
18400 Clothing	3,936	1556	6	23.7
24000 Steel Plates, Not Fabricated	556	167	6	7.6
46400 Organic Chemicals, ncs.	0	69	6	3.0
35300 Small Elec. Appliances, Domestic	366	559	6	7.1
7600 Fruit, Berries, Dried, Crystalize	680	438	5	5.2

Canadian Imports from Mexico, and Canadian Production, by Value, 1987 and 1989

Input-Output Commodity Classifications	Canadian Production	Total Imports	Imports from Mexico	Effective Duty Rate on Mexican Imports
	1987	1987	1989	1989
	C\$ millions			percent
50800 Sporting, Fishing & Hunting Equip.	415	415	2	7.9
18500 Apparel Accessories & Other Misc.	309	160	1	10.3
50000 Medical & Related Instruments etc.	583	1074	1	3.4
14700 Fabrics, Broad Woven of Cotton	31	339	1	15.8
34400 Automotive Hardware, excl. Spring	155	320	1	0.0
52100 Household Ornamental Objects & A.	1,265	430	1	6.2
26400 Aluminum & Aluminum Alloys, Cast	1,564	791	1	1.3
39200 Glass Tableware & Houseware, End & nec.	3	101	1	8.2
27400 Power Boilers	0	25	1	12.5
29300 Builders' Hardware	270	221	1	9.9
25000 Steel Pipes & Tubes nec.	426	208	1	4.8
26100 Aluminum Fluorides & Sodium Alum.	0	2	1	0.0
50400 Jewelry, Findings, Met. & Gem Stones	385	363	1	9.6
48000 Phthalic Anhydride	0	8	1	8.1
26600 Copper Alloy Prod. Cast, Roll, ex.	210	107	1	1.3
1700 Nursery Stock & Related Mat.	458	161	1	8.7
18200 Fabrics, Knitted, nec.	456	113	1	20.7
44900 Alcohols and Their Derivatives.	0	69	1	7.6
33500 Trucks, Chassis, Tractors, Com.	8,575	3,378	1	0.0
10500 Nitrogen Function Compounds nec.	0	322	1	0.3
36000 Radar Equip. & Related Devices	796	120	1	9.4
28700 Wire & Wire Rope, of Steel	571	164	1	7.1
38400 Natural Stone Basic Prod, Struc.	3	58	1	1.0
46300 Organo-Inorganic Compounds etc.	0	289	1	6.0
11000 Coffee, Roasted, Ground, Prepared	736	103	1	0.9
52000 Phono Records and Artist Mater.	128	230	1	7.4
Total of Above	87,670	93,871	1,663	
Grand Total	852,768	139,867	1,694	2.4 †

* This table lists the 75 highest dollar value imports of Statistics Canada's 608 I-O commodity groups. Grand total refers to the total of all 608 I-O commodity groups.

† Average duty rate of all 608 I-O commodity groups.

Source: Compilations by Investment Canada and R.D. Hood Economics Inc. from Statistics Canada data.

ANNEX III

ACTIVITIES RESTRICTED TO FOREIGN INVESTMENT AS LISTED IN THE MEXICAN CATALOG OF ECONOMIC AND PRODUCTIVE ACTIVITIES

(source: SECOFI)

**SPECIFIC AND GENERAL FOREIGN
INVESTMENT REGULATIONS BASED UPON
THE MEXICAN CATALOG OF ECONOMIC AND
PRODUCTIVE ACTIVITIES**

FIELD CLASS			REGIME
1111		AGRICULTURE	6
1112		LIVESTOCK AND GAME	6
1200		FORESTRY AND LUMBER ACTIVITIES	
	120011	Forestry	2
	120012	Exploitation Of Forest Nurseries	2
	120030	Collection Of Forest Products	6
	120040	Felling Trees	6
1300		FISHING A/	
	130011	Fishing On the High Seas	5
	130012	Coastal Fishing	5
	130013	Fresh Water Fishing	5
	120020	Growth Of Species	5
2100		CARBON EXPLOITATION	
	210000	Exploitation and/or Profitable Use Of the Mineral Carbon	3
2200		EXTRACTION OF PETROLEUM AND NATURAL GAS	1
2310		EXTRACTION AND/OR PROFITABLE USE OF MINERALS CONTAINING IRON	3
2320		EXTRACTION AND/OR PROFITABLE USE OF MINERALS NOT CONTAINING IRON	3
	232001	Extraction and/or Profitable Use	

FIELD CLASS		REGIME
		Of Minerals Containing Gold, Silver and Other Precious Minerals and Metals
	232002	Extraction and/or Profitable Use Of Mercury and Antimony
	232003	Extraction and/or Profitable Use Of Industrial Minerals Containing Lead and Zinc
	232004	Extraction and/or Profitable Use Of Minerals Containing Copper
	232005	Extraction and/or Profitable Use Of Uranium and Radioactive Minerals
	232006	Extraction and/or Profitable Use Of Other Metallic Minerals Not Containing Iron
2910		EXTRACTION AND/OR PROFITABLE USE OF ROCKS, CLAYS AND SAND
	291003	Exploitation and/or Profitable Use Of Feldspar
	291006	Exploitation Of Gypsum
2920		EXTRACTION AND/OR PROFITABLE USE OF OTHER NON-METALLIC MINERALS
	292001	Extraction and/or Profitable Use Of Barium Oxide
	292002	Extraction and/or Profitable Use Of phosphoric rock
	292003	Extraction and/or Profitable Use Of Fluorite
	292004	Extraction Of Sulfur
	292005	Extraction Of Other Minerals In Order To Obtain Chemicals
	292006	Extraction and/or Profitable Use Of Salt

FIELD CLASS			REGIME
3420	292007	Extraction and/or Profitable Use Of Graphite	5
	292008	Extraction and/or Profitable Use Of other non-metallic minerals	5
		PRINTING, EDITING AND ASSOCIATED INDUSTRIES B/	
	342001	Editing Newspapers and Magazines	6
		BASIC PETROCHEMICALS	
	351100	Manufacturing Basic Petrochemical Products	1
		MANUFACTURE OF OTHER CHEMICALSUBSTANCES AND PRODUCTS	
	352236	Manufacture Of Artificial Explosives and Fireworks	5
	352241	Manufacture Of Secondary Petro chemical Products	4
		PETROLEUM REFINING	1
3530		COKE INDUSTRY, INCLUDING OTHER DERIVATIVES OF CARBON AND PETROLEUM C/	
	354001	Manufacture Of Coke and Other Carbon Derivatives	6
3720		BASIC NON-IRON METAL INDUSTRIES INCLUDING THE TREATMENT OF NUCLEAR FUELS	
	372006	Treatment Of Uranium and Nuclear Fuels	1

FIELD CLASS			REGIME
3822		MANUFACTURE, REPAIR AND/OR ASSEMBLY OF MACHINERY AND EQUIPMENT FOR GENERAL USES WITH OR WITHOUT AN INTEGRAL ELECTRIC MOTOR, INCLUDING WEAPONS.	
	382208	Manufacture Of Firearms and Cartridges	5
3831		MANUFACTURE AND/OR ASSEMBLY OF MACHINERY, EQUIPMENT AND ELECTRICAL ACCESSORIES INCLUDING THOSE FOR THE GENERATION OF ELECTRICAL ENERGY	
	383103	Manufacture Of Parts and Accessories For Electrical Automotive Systems	4
3841		AUTOMOTIVE INDUSTRY	
	384121	Manufacture and Assembly Of Car and Truck Bodies and Trailers	4
	384122	Manufacture Of Car and Truck	4
	384123	Manufacture Of Car and Truck Transmission System Parts	4
	384124	Manufacture Of Car and Truck Suspension System Parts	4
	384125	Manufacture Of Car and Truck Brake System Parts and Accessories	4
	384126	Manufacture Of Other Car and Truck Parts and Accessories	4
3900		OTHER MANUFACTURING INDUSTRIES	
	390002	Minting Coins	1

FIELD CLASS			REGIME
4100		ELECTRICITY	
	410001	Generation and Transmission Of Electrical Energy	1
	410002	Supply Of Electrical Energy	1
5011		CONSTRUCTION	
	501101	Residential or Housing Construction	6
	501102	Non-residential Construction	6
5012		CONSTRUCTION OF URBANIZATION PROJECTS	
			6
5013		INDUSTRIAL CONSTRUCTION AND INSTALLATION	
	501311	Construction Of Industrial Plants	6
	501312	Construction Of Electricity Generation Plants	6
	501321	Construction and Maintenance Of Electricity Conduction Lines and Networks	6
	501322	Construction Of the Means To Conduct Petroleum and Its Derivatives	6
		OTHER CONSTRUCTION	
			6
5014	501411	Mounting or Installing Concrete Structures	6
	501412	Mounting or Installing Metallic Structures	6
	501421	Marine and River Works	6
	501422	Construction Of Routes For Land Transportation	6
	501423	Road Construction	6
		INSTALLATIONS	
5020	502001	Hydraulic and Sanitation Installations In Buildings	6
	502002	Electrical Installations In Buildings	6

FIELD CLASS			REGIME
	502003	Telecommunications Installations	6
	502004	Other Special Installations	6
5030		SPECIAL WORKS	
	503001	Earth Movement	6
	503002	Cement Works	6
	503003	Underground Excavations	6
	503004	Underwater Works	6
	503005	Installation Of Signs and Warnings	6
	503006	Demolition	6
	503007	Construction Of Water Purification or Treatment Plants	6
	503008	Drilling Petroleum and Gas Wells	6
	503009	Drilling Water Wells	6
	503010	Construction Works Not Mentioned Above	6
6230		SALES OF NON-FOOD PRODUCTS TO INDIVIDUALS IN SPECIALIZED ESTABLISHMENTS	
	623050	Specialized Sales Of Liquid Gas Fuel	2
	623087	Specialized Sales Of Firearms, Cartridges and Ammunition	5
7111		RAILWAY TRANSPORTATION	
	711101	Railway Transportation Service	1
7112		AUTO-FREIGHT TRANSPORTATION	
	711201	Transportation Services For Construction Materials	2
	711202	Moving Services	2
	711203	Other Specialized Auto-freight Services	2
	711204	Auto-freight Services In General	2

FIELD CLASS			REGIME
7113		OTHER LAND PASSENGER TRANSPORTATION INCLUDING AUTOMOBILE RENTAL	
	711311	Foreign Passenger Transportation Service By Bus	2
	711312	Urban and Suburban Passenger Transportation Service By Bus	2
	711315	Collective Automobile Transportation Service	2
	711316	Established Route Automobile Transportation Service	2
	711317	Automobile Transportation Service From a Specific Station	2
	711318	School and Tourist Transportation Service	2
7120		WATER TRANSPORTATION	
	712011	Maritime Transportation Service On the High Seas	6
	712012	Coastal Maritime Transportation Service	2
	712013	High Seas and Coastal Towing Service	2
	712021	River and Lake Transportation Service	5
	712022	Internal Port Transportation Service	5
	712023	Tourist Boat rental Service	6
7130		AIR TRANSPORTATION	
	713001	Transportation Service On Mexican Registry Airplanes	2
	713002	Airtaxi Transportation Service	2
7200		COMMUNICATIONS (EXCLUDING SERVICES RENDERED BY THE STATE)	
	720003	Telephone Services	5
	720005	Telegraph Services	1
	720006	Other Telecommunications Services	5

FIELD CLASS			REGIME
8110		CREDIT INSTITUTION, BANKING AND AUXILIARY CREDIT SERVICES	
	811010	Banking	1
	811021		
	811030		
	811022	Funds and Financial Trusts	1
	811041	Credit Unions	2
	811042	General Deposit Warehouses	2
	811043	Financial Rentals	5
	811044	Money Exchanges	2
	811045	Financial Consulting, Development and Commissions	2
8120	811046	Non-banking Services Institutions that grant loans	2
	811047	Other credit institutions	2
		INSTITUTIONAL FINANCIAL SERVICES FOR THE STOCK MARKET	
	812001	Stock brokerage services	2
	812002	Investment Company Services D/	6
	812003	Services Of Companies Operating Investment Companies D/	6
	812004	Stock Market Services	2
		INSURANCE AND BOND SERVICE INSTITUTIONS	
8130	813001	Bond Service Institutions	2
	813002	Insurance Service Institutions	2
	813003	Independent Pension Fund Services	2
9211		EDUCATIONAL SERVICES FOR THE PRIVATE SECTOR	
	921101	Preschool Private Educational Services	6
	921102	Primary School Private Educational	

FIELD CLASS			REGIME
9411	921103	Services Secondary School private Educational Services	6
	921104	Middle School Private Educational Services	6
	921105	High School Private Educational Services	6
	921106	Private Education Services That Combine Preschool, Primary, Secondary, Middle and High School Instruction	6
	921107	Sales and Language Courses Services	6
	921108	Technical Occupational and Artesanal Training Services	6
	921109	Music, Dance and Other Special Private Instruction Sservices	6
	921111	Private Special Education Services	6
		ENTERTAINMENT SERVICES RELATED WITH CINEMA-TOGRAPHY, THEATER, RADIO AND TELEVISION PERFORMED BY THE PRIVATE SECTOR	
	941104	Private Transmission Of Radio Programs	2
	941105	Transmission and Repetition Of Television Programs	2
9510		PERFORMING PROFESSIONAL, TECHNICAL AND SPECIALIZED SERVICES OTHER THAN AGRICULTURE E/	
	951001	Notary Public Services	2
	951002	Legal services	6
	951003	Accounting and Auditing Services	6
	951012	Customs Agency and Representation Services	2

FIELD CLASS			REGIME
9720		CONSTRUCTION RELATED SERVICES	6
9731		LAND TRANSPORTATION RELATED SERVICES	
	973101	Administration Services For Passenger Bus Stations and Auxiliary Services	6
	973102	Administration Services For Buses, Bridges and Auxiliary Services	6
	973105	Vehicle Towing Services	6
	973106	Other Services Related With Land Transportation Not Mentioned Above	6
9732		WATER TRANSPORTATION RELATED SERVICES	
	973203	Administration Of Maritime, Lake and River Ports	2
9733		AIR TRANSPORTATION RELATED SERVICES	
	973301	Air Navigation Services	6
	973302	Airport and Heliport Administration Services	6
9740		SERVICES RELATED WITH FINANCIAL,INSURANCE AND BOND INSTITUTIONS	
	974011	Investment and Value Appraisal Services	6
	974012	Insurance and Bond Negotiation and Agent Services	6
	974013	Pension Consultation Services	6
	974021	Services of Representative Offices Of Foreign Financial Entities	6
	974022	Other Services Related With Insurance and Bond Financial Institutions Not Mentioned Above	6

**APPROVAL SYSTEM BY FIELD OR CLASS OF
ECONOMIC ACTIVITY IN ACCORDANCE WITH
THE MEXICAN CATALOG OF ACTIVITIES
AND PRODUCTS (MCAP)**

- 1: Activities exclusively reserved to the State.
 - 2: Activities reserved to Mexicans.
 - 3: Activities subject to specific regulation in which foreign investment is permitted in up to 34 percent of the capital stock of the companies.
 - 4: Activities subject to specific regulation in which foreign investment is permitted in up to 40 percent of the capital stock of companies.
 - 5: Activities subject to specific regulation in which foreign investment is permitted in up to 49 percent of the capital stock of companies.
 - 6: The Mexican Foreign Investment Commission's prior approval is required for foreign investment to hold a majority interest in these activities.
- A: Excluded from this production is the activity of exploitation of species reserved to fishing cooperatives.
- B: Excluded from this area is the printing of money bills and stamp seals, which is expressly reserved to the Government.
- C: The production of basic oil reserved to the State is excluded from this field.
- D: The companies of fixed rent investing and their

operating companies, with the exception of those in the Government and official foreign offices, financial entities of abroad or groups of foreign persons, either persons or companies.

- E: Companies may permit foreign investment to hold the interest approved by the Mexican Foreign Investment Commission. Those who render person services governed by the Law Regulating Article of the Constitution with respect to professions must be Mexicans.

(2) Published in *The Official Gazette of the Federation* on May 16, 1989.

ANNEX IV

ORIGINS AND LEVELS OF FOREIGN INVESTMENT IN MEXICO

(source: *Challenges of NAFTA*)

Foreign Direct Investment in Mexico: Cumulative Value of FDI in Millions of U.S. Dollars

Years Country	1980	1984	1985	1986	1987	1988	1989	Jan/Nov 1990	Average Annual Growth		
									1980-85	1985-89	1980-89
U.S. % of FDI	5,836.6 69.0	8,513.4 66.0	9,840.2 67.3	11,046.6 64.8	13,716.2 65.5	14,957.8 62.1	16,748.0 63.0	18,650.9 62.8	11.0	14.2	12.4
FRG % of FDI	676.7 8.0	1,125.4 8.7	1,180.8 8.1	1,399.4 8.2	1,446.3 6.9	1,583.0 6.6	1,675.0 6.3	1,830.8 6.2	11.8	9.1	10.6
Japan % of FDI	499.1 5.9	816.0 6.3	895.3 6.1	1,037.5 6.1	1,170.3 5.6	1,319.1 5.5	1,356.0 5.1	1,455.5 4.9	12.4	10.9	11.7
Switzerland % of FDI	473.7 5.6	647.7 5.0	788.9 5.4	823.0 4.8	918.2 4.4	1,004.5 4.2	1,170.0 4.4	1,341.3 4.5	10.7	10.3	10.6
Spain % of FDI	203.0 2.4	369.6 2.9	383.6 2.6	477.3 2.8	603.1 2.9	637.2 2.6	691.0 2.6	691.9 2.3	13.6	15.9	14.6
U.K. % of FDI	253.7 3.0	395.5 3.1	451.9 3.1	556.2 3.3	987.1 4.7	1,754.7 7.3	1,781.0 6.7	1,901.1 6.4	12.2	40.9	24.2
France % of FDI	101.5 1.2	237.3 1.8	248.0 1.7	564.9 3.3	596.1 2.8	748.5 3.1	798.0 3.0	942.4 3.2	19.6	33.9	25.7
Sweden % of FDI	126.9 1.5	230.4 1.8	235.9 1.6	260.5 1.5	297.2 1.4	329.7 1.3	346.0 1.3	349.9 1.2	13.2	10.0	11.8
Canada % of FDI	126.9 1.5	194.8 1.5	229.7 1.6	270.3 1.6	289.6 1.4	323.5 1.3	372.0 1.4	410.4 1.4	12.6	12.8	12.7
Others % of FDI	160.7 1.9	369.8 2.9	374.6 2.6	614.1 3.6	905.9 4.3	1426.1 5.9	1,648.0 6.2	2,109.9 7.1	33.4	65.1	46.7
Total Cumulative FDI	8,458.8	12,899.9	14,628.9	17,053.1	20,930.3	24,087.4	26,587.1	29,684.1	11.6	16.1	13.6

* Revised figures for "Total Cumulative FDI" are incorporated in this table, even though details of the country revisions were not available. Components may not add to totals because of revised totals, and because of rounding errors.

Source: Executive Secretariat of the National Foreign Investment Commission, Mexico.

Foreign Direct Investment in Mexico by Country of Origin

Country of Origin	New FDI - 1990	
	Value (US\$ millions)	% of Total
U.S.A.	1,879.2	60.7
U.K.	101.7	3.3
Germany	163.1	5.3
Japan	120.7	3.9
Switzerland	142.4	4.6
France	177.4	5.7
Spain	10.7	0.4
Sweden	13.3	0.4
Canada	49.5	1.6
The Netherlands	125.1	4.0
Italy	4.6	0.1
Others*	309.3	10.0
Total	3,097.0	100.0

* Includes: Bahamas, Virgin Islands, Cayman Islands, Colombia, Peru, Panama, Venezuela, Lichtenstein, Luxembourg, Belgium, Liberia, Korea, Australia.

Source: Direccion General de Inversion Extranjera (Department General of Foreign Investment)
 Direccion de Estudios Economicos (Department of Economic Studies), Mexico.

U.S. Direct Investment Position in Canada and Mexico, 1984 and 1989

Canada		Mexico		Industry	Canada		Mexico	
1984	1989	1984	1989		1984	1989	1984	1989
percent					US\$ millions			
23.9	16.3	1.5	1.0	Petroleum	11,156	10,912	71	68
44.9	48.4	79.4	82.5	Manufacturing:	20,985	32,324	3,650	5,838
3.5	3.3	9.0	6.6	Food	1,634	2,175	414	466
10.2	9.8	16.2	21.3	Chemicals	4,777	6,580	746	1,505
3.6	3.6	7.2	3.8	Primary and Fabricated Metals	1,672	2,437	332	269
5.3	5.0	4.4	4.5	Machinery, excl. Electrical	2,491	3,316	202	321
3.4	3.3	9.8	6.4	Electrical and Electronic	1,594	2,173	450	451
9.3	11.5	11.0	21.4	Transportation Equipment	4,337	7,673	505	1,518
9.6	11.9	21.8	18.5	Other Manufacturing	4,480	7,970	1,001	1,308
5.2	5.9	9.6	5.6	Wholesale Trade	2,439	3,917	443	395
1.1	1.4	-0.1	0.0	Banking	521	945	-3	0
13.1	17.5	4.2	1.8	Finance, excl. Banks, Ins./ Real Est.	6,139	11,680	195	130
1.5	2.1	-0.6	1.9	Services	705	1,385	-26	138
10.2	8.5	5.8	7.2	Other Industries	4,785	5,684	268	510
100.0	100.0	100.0	100.0	Total	46,730	66,847	4,598	7,079

Source: Compilations by Investment Canada from U.S. Department of Commerce data.

Table .
Main Canadian Companies in Mexico, 1990

Canadian Investor	Mexican Company	Sector
NEI Canada Ltd.	Transformadores Parsons	Industrial
Chempharm Ltd.	Farmaceuticos Lakeside, S.A.	Industrial
Diversey Worlds Holding Inc.	Diversey Mexico, S.A. de C.V.	Industrial
Pharma Investment Ltd.	Cafes Industrializados de Veracruz, S.A. de C.V.	Industrial
Cominco Ltd.	Minera Maria, S.A. de C.V.	Industrial
Moore Corporation Ltd.	Moore Business Forms de Mexico, S.A. de C.V.	Services
Canada Wire and Cable International Ltd Corp.	Industrias Axa, S.A.	Industrial
Philips Trans-America Holdings Corp.	Philips Mexicana, S.A. de C.V.	Industrial
Sapac Corporation Ltd.	Roche Mexicana de Farmacos S.A. de C.V.	Industrial
Noranda Inc.	Grupo Industrial Premenal, S.A. de C.V.	Industrial

Source: Direccion General de Inversion Extranjera, Mexico.

Table 3
Major Foreign Investments in Mexico, 1987

Name of Enterprise	Rank*	Type of Investment	Origin of Capital	Percent Foreign Owned
Chrysler de Mexico	2	Automotive	U.S.A.	99.9
General Motors	3	Automotive	U.S.A.	100.0
Ford Motor Company	5	Automotive	U.S.A.	100.0
Volkswagen de Mexico	8	Automotive	FRG	100.0
Celanese Mexicana	10	Artificial Fibers	U.S.A.	40.0
Kimberly-Clark	12	Paper & Cellulose	U.S.A.	45.0
IBM	14	Electronics	U.S.A.	100.0
Industrias Resistol	17	Petrochemicals	U.S.A.	39.2
Compania Nestle	13	Food	Switzerland	100.0
American Express	22	Financial Services	U.S.A.	100.0
Spicer	29	Auto Parts	U.S.A.	33.0
Ericcson (Mexico)	33	Electronics	Sweden	73.0

* "500 Largest Enterprises in Mexico 1987," Expansion Magazine, August 17, 1990.

Table
Operations of U.S. Affiliates Abroad, 1987

Canada							Industry	Mexico						
Sales	Net Income	Employ.	Wages	Assets	Wage/ Employ.	Net Inc. Employ.		Sales	Net Income	Employ.	Wages	Assets	Wage/ Employ.	Net Inc. Employ.
US\$ millions		thousands	US\$ millions		US\$ thousands			US\$ millions		thousands	US\$ millions		US\$ thousands	
20,704	1,320	35.7	1,446	29,550	40.5	37.0	Petroleum	165	-7	2.4	28	197	11.7	-2.9
81,180	3,624	470.9	12,894	54,697	27.4	7.7	Manufacturing	14,925	829	380.3	1,762	13,334	4.6	2.2
5,407	449	32.9	831	4,494	25.3	13.6	Food	1,596	50	48.5	167	1,083	3.4	1.0
12,362	806	65.5	1,921	10,407	29.3	12.3	Chemicals	3,660	272	65.3	390	3,673	6.0	4.2
4,713	429	39.3	899	5,868	22.9	10.9	Primary and Fabricated Metals	729	45	22.4	99	798	4.4	2.0
6,171	368	40.9	1,299	4,589	31.8	9.0	Machinery excl. Electrical	644	0	18	107	778	5.9	0.0
5,267	228	51	1,261	3,707	24.7	4.5	Electrical and Electronic	1,148	-17	83.7	247	961	3.0	-0.2
34,593	444	133.5	3,964	15,583	29.7	3.3	Transportation Equipment	4,245	213	73.7	383	3,153	5.2	2.9
12,667	900	107.8	2,719	10,049	25.2	8.3	Other Manufacturing	2,903	266	68.7	369	2,888	5.4	3.9
12,689	368	54.4	1,359	8,221	25.0	6.8	Wholesale Trade	1,182	29	9.4	123	834	13.1	3.1
8,872	1,188	30.8	913	40,937	29.6	38.6	Finance, excl. Banks, Ins, Real Estate	124	9	0.5	12	424	24.0	18.0
3,294	193	60.8	839	4,297	13.8	3.2	Services	450	35	14.7	121	354	8.2	2.4
18,476	605	259.7	3,846	13,360	14.8	2.3	Other Industries	1,020	118	34.4	95	1,153	2.8	3.4
145,215	7,298	912.3	21,297	151,062	23.3	8.0	Total/Average	17,866	1,013	441.7	2,141	16,296	4.8	2.3

Source: Compilation by Investment Canada based on U.S. Department of Commerce data.

ANNEX V

**APPLICATION FORM FOR AN INVESTMENT
REVIEWABLE BY THE COMMISSION**

(source: SECOFI)

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9. Projected degree of national integration of company (direct cost/parts' cost)

('000 pesos)

Current
year

19 19 19 19 19

- a. National raw materials, parts & components
- b. Utilized energy, fuel & other materials
- c. Salaries & loans
- d. Depreciation of machinery & equipment
- e. Total national cost
- f. Imported inputs & raw materials

10. Imported inputs Supplier Origin % duty

11. Principal national inputs Supplier

12. Principal clients and relative importance in last year's total sales

Company Products % share

13. Principal competitors in this product area and relative importance as a percentage of national market

Company Products % share

14. Total sales and/or net revenues and profits in the last five years ('000 pesos)

Year National market sales
and/or revenues Export revenue Profits

15. Employment

Current year
(a) 19

Projection next 3 years
(b) 19

(c) 19

(d) 19

Total
(a)+(b)+(c)+(d)

Mexican Foreign

Mexican Foreign

Mexican Foreign

Mexican Foreign

Mexican Foreign

Workers
Technicians^a
Casual workers^a
Subtotal
Administrative employees
Total

^a Specify only those directly involved in the productive process.

16. Company's branches

Full address Major products
produced or traded Operations'
starting date

17. List technology transfer contracts with corporate links, specifying the following details:

Donor	Nationality	% corporate share	Object of contract	Validity	Payment terms	Debt commitments
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18. Foreign exchange budget (\$)

	Current year	19	19	19	19	19
(1) Foreign exchange revenue						
Exports of goods						
Exports of services						
Other earnings						
Total (1)						
(2) Foreign exchange expenditure						
Imports of machinery, equipment & parts						
Imports of raw materials						
Imports of manufactured goods						
Imports of semi-manufactured goods						
Imports of spare parts						
Imports of parts & components						
Foreign interest payments						
Foreign technology transfer payments						
Profit remittances						
Other payments						
Total (2)						
Foreign exchange balance (1)-(2)						

19. List tax or other types of benefit, specify

Legal decree	Nature	Validity	Amount of benefit
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20. List any other authorisations from the CNIE

No of official letter	Date
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21. Agreements accepted and extent to which they were accomplished

22. Name of company representative:

Address:

Telephone:

APPENDICES

One copy of questionnaire

Copy of the federal tax registry

Articles of association

Social statutes

Inscription certificate at the National Register of Foreign Investment

Audited financial statements (balance sheet and profit and loss account) corresponding to the last three financial years

Note: If the company has already applied to the CNIE in the current year, do not complete the basic questionnaire, but refer to previous application.