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FOREIGN DIRECT INVESTMENT IN MEXICO AND THE 1994 CRISIS: A LEGAL PERSPECTIVE

BY

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IN MEMORIAM
TO MY FATHER,
LUIS DEL TORO CALERO

"I WILL CONTINUE YOUR STRUGGLE FOR A BETTER MEXICO."

ABSTRACT

Since the 1994 economic crisis, Mexico's inclusion in the globalization era has been questioned. To discover if Mexico is moving in the right direction, this study has as its objective the examination of the different regulations that, in Mexico, are related to Foreign Direct Investment. These regulations include the 1993 Foreign Investment Law ("*Ley de Inversión Extranjera*"); the Competition Act ("*Ley Federal de Competencia Económica*"); and the North American Free Trade Agreement. The aim of this study is to find out if these regulations are capable of attracting Foreign Direct Investment, which is the most convenient foreign capital flow needed, in order to assist Mexico in its search for economic growth. The importance of the rule of law as an effective instrument to attract FDI is also an element considered in this study.

Finally, this thesis, after the above examination, concludes that Mexico has the potential to overcome its latest economic crisis by using its existing regulations. However, some improvements would benefit its place within the global competition to attract FDI. Most of these improvements are needed at the multilateral level, where Mexico should address the importance that FDI has as a counterbalance to the risks associated with short-term investments. As shown, short-term investments were one of the conditions that provoked the 1994 crisis.

RESUMÉ

Après la crise de 1994, l'insertion du Mexique dans l'ère de la globalisation a été remise en question. Cette thèse étudie les différentes législations relatives aux investissements étrangers directs (telles que la loi sur l'investissement étranger de 1993, la loi sur la concurrence et l'accord ALENA) afin d'apprécier si le Mexique est dans la bonne voie. Le but de cette étude est d'analyser si les législations sont en mesure d'attirer les investissements étrangers directs (IED), ceux-ci étant par ailleurs les capitaux les plus appropriés afin d'assister le Mexique dans sa recherche de développement économique. L'importance de la règle de droit en tant que moyen efficace d'attraction des IED est un autre élément important pris en considération.

Cette thèse conclut que le Mexique possède le potentiel de surpasser sa dernière crise économique à l'aide de sa législation actuelle. Cependant certaines améliorations favoriseraient l'extension des IED face à la concurrence mondiale. La plupart de ces améliorations devraient être effectués à un niveau multilatéral, là où le Mexique devrait mettre en évidence l'importance des IED comme contrepoids aux risques liés aux investissements à court-terme, ceux-ci ayant été un des éléments qui ont provoqué la crise de 1994.

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I. Introduction

Presently, the world is experiencing an unprecedented revival of liberal, free trade theories. Globalization is the word of today. It mirrors the process of economic integration that is occurring worldwide. Markets are no longer isolated, - they are interrelated in such a manner that domestic facts that appear to be circumscribed to a specific territory have important consequences abroad.

Within this context, flows of capital become the main factor in the development of specific countries, regions and even for the globalized world itself. Mexico, as a participant in this movement, has its specific role to play. As said above, globalization implies the interrelation of markets. Hence, any aspect, such as economic developments, regulations and policies, that Mexico experiences will have (and already had) consequences within the global community.

This thesis has as its objective the study of the specific field of Foreign Direct Investment (FDI) in Mexico. FDI is the flow of capital that Multinational Corporations (MNCs), mainly, supply in their operations throughout the world. The study is divided into three chapters and seeks to find the links between economic development and FDI. Also how a country like Mexico can enhance FDI to foster economic growth, thus improving the wealth of its people, will be examined.

In the first chapter, the study includes a description of the different regulations that have ruled FDI in Mexico since its independence until the present day. First, a brief analysis of the different tendencies and rules towards FDI in Mexico throughout its history is included. The reader can see how Mexico has run through a protectionist, suspicious viewpoint applied towards FDI and, later, an open policy of FDI promotion.

In this chapter, the main subject is the law, namely the different regulations that have existed and those that now rule FDI, such as the 1917 Mexican Constitution; the 1973 Law ("*Ley Para Promover la Inversión Mexicana y Regular la Inversión Extranjera*"); the 1989 Regulations ("*Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversion Extranjera*"); the 1993 Foreign Investment Law ("*Ley* *de Inversión Extranjera*"); the Competition Act ("*Ley Federal de Competenci Económica*"); the North American Free Trade Agreement (NAFTA) and their institutions.

The second chapter is not legally-oriented. Its purpose is to explain the circumstances under which Mexico has entered into the era of globalization. First, it analyzes the need for capital flows in Mexico to achieve the necessary economic development. Second, it shows how Mexico has mainly relied on debt to promote economic growth in the past and the resulting consequences on its economy. Third, it examines the recent economic difficulties that Mexico experienced in 1994 after its entry to the globalization process. This chapter demonstrates how reliance in short-term capital flows influenced the 1994 crisis.

The third chapter, focuses on the important role that FDI played in Mexico. It studies the advantages that FDI offers. It compares the effects that FDI produce with those produced by short-term investments and debt. Hence, after demonstrating that FDI as a long-term investment, gives stability to the Mexican economy, the study turns to the different possibilities that Mexico has in the domestic and international arena to enhance FDI. It focuses on the impact that the rule of law has in attracting FDI and evaluates if the present domestic system is sufficient to attract efficient capital to the Mexican market or if more rules, both domestic and international, are necessary.

II. FOREIGN DIRECT INVESTMENT IN MEXICO

A. INTRODUCTION

As a means of understanding the recent developments in the regulation of Foreign Direct Investment (FDI) followed in Mexico, one cannot ignore the history from which it has evolved. Hence, the first part of this study briefly examines the different tendencies and rules that Mexico has had towards foreign investment since its independence in 1821.

Mexico[1] is a representative, democratic and federal republic whose territory covers an area of 1,958,201 km^2 divided into 31 states and the Federal District, with a population in 1994 of 92,202,199. Since its independence from Spain in 1821 until the end of the so-called "Mexican Revolution" in the 1920s, Mexico struggled with invasions, coups d'état and wars. Because of these violent conditions Mexicans did not have the opportunity to think about social, economic and political reforms. It was only during the dictatorship of Porfirio Díaz (1876-1911) that the promotion of foreign investment became a primary government policy and the country flourished with the construction of railroads, some infrastructure, banks, industry and a stable exchange rate. However, there were few beneficiaries and the revolution occurred in 1910.[3]

Thus, it was during the *Porfiriato* that FDI came to Mexico. In a short period of time foreign investment, mainly from American and English capital, dominated the production of the main exporting sectors. It was also during this period that Mexico experienced, for the first time as an independent nation, an economic boom.[4]

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[1] Its official name is *Estados Unidos Mexicanos* (Mexican United States). See *Constitución Política de los Estados Unidos Mexicanos* (Mexican Constitution) signed on February 5, 1917, art. 1. [hereinafter *Constitution*].
[2] Cámara Nacional de Comercio de la Ciudad de México, *Mexico: Data and Statistics Digest 1993*, (Mexico City: CANACO, 1993) at 3.
[3] For more details see J. A. Erfani, *The Paradox of the Mexican State: Rereading Sovereignty from Independence to NAFTA* (London: Lynne Rienner Pub., 1995) at 1-33. See also Colegio de México, *Historia de México* (Mexico: Colegio de México).
[4] Before Díaz the railroad infrastructure was composed of 640 kms, after his government Mexico had 19,289 kms. See L. Meyer, "Desarrollo Político y Dependencia Externa: México en el siglo XX" at W. P. Glade & S. R. Ross, eds., *Críticas Constructivas del Sistema Político Mexicano: Critiques of the Mexican Political System* (Austin, Tx.: Institute of Latin American Studies, Univ. of Texas at Austin, 1973) at 18-24.

From the revolutionary struggle the 1917 Constitution, which remains in force with several modifications[5], emerged. Since this Constitution originated as an agreement among the parties that won the revolution, it departs from the individualist doctrine[6]. It considers human rights not as the basis and object of social institutions, but as a group of individual guarantees (*garantías individuales*) that the State grants to its inhabitants.[7] Furthermore, the 1917 Constitution creates the concept of social guarantees (*garantías sociales*), which are rights that the State grants to certain social classes (contained mainly under articles 123 and 27), and which, as Professor Burgoa states, reflect the fundamental revolutionary aspirations of the wealth of the helpless people, peasants and workers.[8]

Nevertheless, the Mexican economy is, and has been, uneven ever since. It suffers from an extremely inadequate income distribution within society and the different regions and economic sectors. Studies and empirical evidence show this.[9] For example, this sad reality is illustrated in the 1994 survey done by Forbes magazine, which showed that among the richest families in the world, more than twenty were Mexicans[10]. Yet, at the same time, there was a rebellion in the state of Chiapas in which people were struggling, while they were dying of hunger, because they had nothing to lose and everything to gain[11].

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[5] More than 300 until 1995.

[6] Which was the doctrine that dominated the previous Constitution of 1857.

[7] See *Constitution*, art. 1.

[8] I. Burgoa, *El Juicio de Amparo*, 30 ed., (Mexico: Porrua ed., 1992) at 130-31. Regarding the Mexican Revolution, it is important to note that even though the political discourse has been one of a strong sovereign state which finds its origin as a result of the civil war, when one looks to reality the story is different, as one author points: "The [Mexican] state has had remarkable legal-political authority but negligible ability to fulfill the constitutional goals and promises of 1917 - to be the provider of mass society well being." at Erfani, *supra* note 3 at 3.

[9] Fernando Carmona says that the uneven income distribution was at its worst in the 1970s. We think this is more true than that in the 1950s. Since then a process of increasing concentration of income that benefits those who earn income by means of capital has been experienced. See F. Carmona, "Dependencia y Subdesarrollo Económico" at L. Solís, ed., *La Economía Mexicana: Política y Desarrollo*, vol. 2 (Mexico: FCE, 1986) at 460-61. See also P. Aspe & P. E. Sigmund, eds., *The Political Economy of Income Distribution in Mexico* (USA: Holes & Meier Pub., 1984).

[10] See C. Palmeri & K. A. Dolan, "The billionaires: A Tough New World" *Forbes magazine* v. 156:2 (July 17, 1995) at 122-24. In 1994 Forbes magazine identified 24 billionaires in Mexico. In 1995, after the crisis 10 billionaires were identified.

[11] See G. A. Collier, *Ya Basta!: Land and the Zapatista Rebellion in Chiapas* (Oakland, Ca.: Food First, Institute for Food and Development Policy, 1994).

Despite the 1917 Constitution and its "nationalistic" approach towards foreigners[12], FDI after the revolution has been an important factor in the national economy. In the 1940s Mexico initiated the period known as "institutionalized revolution"[13]. During this period the Mexican economy experienced sustained economic development. It was based on a mixed economy in which the State acted in an interventionist manner to provide infrastructure, thus controlling the basic branches of the economy such as oil, railroads and electricity and participating in several other areas in which the private sector could not or would not participate. The private sector was protected and grew because of the Import Substitution Regime.[14] However, FDI entered slowly into the Mexican economy during this period, due to Multinational Corporations (MNCs), which were mainly American, that were also beneficiaries under the protectionist policies. They entered certain areas in which neither the Mexican government nor the private Mexican sector had the capital or knowledge to be competitive, such as chemicals, steel, automobiles and machinery.[15] Nevertheless, Mexico's approach to FDI since the *Porfiriato* has been seen as an attempt of domination, mainly by the U.S., and this sentiment can be observed within the 1917 Constitution.

B. FROM THE 1917 CONSTITUTION TO THE 1989 REGULATIONS

With respect to the regulations of FDI in Mexico, as has been mentioned above, the 1917 Constitution departs from the individualist theory. Article 27 defines private property as a social function and places restrictions on the takeover of some kinds of property by foreigners. Furthermore, the "Calvo Clause"[16] formula was imposed as a

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[12] To understand why Mexicans see foreigners as potential enemies one should study Mexican history. For a brief study of how these feelings contributed to the nationalistic foreign investment rules, see S. W. Fisher, "The Regulation of Foreign Business in Mexico: Recent Legislation in Historical Perspective" (1982) 7 North Carolina J. Int'l. L. & Comm. Reg. 383.

[13] This name comes from the formation in of the PNR (National Revolutionary Party) which is the father of the current PRI (*Partido Revolucionario Institucional*) that has been the party in power since 1930 (or 1928 depending on the scope).

[14] See Meyer, *supra* note 4 at 38-45.

[15] *Ibid.*

[16] The "Calvo Clause" alludes to the thesis held in 1884 by the Argentinean lawyer Carlos Calvo. It is founded on the fact that a foreigner should not have more or less rights or benefits than those bestowed by

restriction on the enjoyment of real property over some assets by foreigners. The Constitution did not contemplate any absolute prohibition on the foreigners' right to hold property, although it was used to affect international interests within the area of natural resources[17]. Article 27, however, simply maintains the civil law concept by which all rights to the Nation's subsoil belongs to Mexico, a principle that was incorporated in the 1783 "*Reales Ordenanzas para la Minería de la Nueva Espana*".[18]

Article 27 of the Constitution states:

> Ownership of the lands and waters within the boundaries of the national territory is vested originally in the Nation, which has had, and has, the right to transfer title thereof to private persons, thereby constituting private property." [further, in the same article we can also see the preeminence of a social influence that, as said before, comes from the revolution, it points:] "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 to ensure a more equitable distribution of public wealth, to attain a well-balanced development of the country and improvements of the living conditions of the rural and urban population." [On regard of the Calvo clause, the same article says:] "Legal capacity to acquire ownership of lands and waters of the Nation shall be governed by the following provisions: I. Only Mexicans by birth or naturalization and Mexican companies have the right to acquire ownership of lands, waters, and their appurtenances, or to obtain concessions for the exploitation of mines or waters. *The State may grant the same right to foreigners, provided they agree before the Ministry of Foreign Affairs*[19] *to consider themselves as nationals in respect to such property, and bind themselves not to invoke the protection of their governments in matters relating thereto; under penalty, in case of noncompliance with this agreement, of forfeiture of*

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law to the citizens of a State. It condemns the diplomatic or armed intervention as a legal means to enforce private reclamations.

[17] One example of this situation was the expropriation of the oil companies in 1938 by President Lázaro Cárdenas. See Erfani, *supra* note 3 at 53-58. It is interesting when she points that :

> [t]he Cárdenas government's use of the principles of international law and of article 27 of the Mexican constitution to justify the oil expropriation to foreign governments also served to mythologize the "powers" of the postrevolutionary nation-state. Legend surrounding the expropriation has it that the Mexican state used its sovereign legal authority to demonstrate its powers over foreign investors.

Ibid. at 55. See also R. González R., *Las Cuestiones Fundamentales de Actualidad en México* (Mexico, SRE [Ministry of Foreign Affairs], 1927).

[18] L. M. Díaz, *Globalización de las Inversiones Extranjeras: Nuevos Aspectos Jurídicos* (Mexico: Themis, 1991) at 39.

[19] *Secretaría de Relaciones Exteriores.*

the acquired property to the Nation. Under no circumstances may foreigners acquire direct ownership of lands or waters within a zone of one hundred kilometers along the frontiers and of fifty kilometers along the shores of the country[20].[21]

The first formal regulations of FDI, besides the Constitution, was the Emergency Decree of 1944[22] that was issued by President Avila Camacho using the extraordinary powers that the Constitution gives to the executive to restrict trade in emergency cases.[23] With this Decree, foreigners needed an authorization issued by the Foreign Affairs Ministry for the takeover of capital invested in a wide range of sectors such as agriculture, livestock, exploitation of forestry resources, real estate and mining concessions.

In 1945 the Mexican government issued a roster of Mexican corporations requiring 51% domestic ownership. In 1947 this was complemented by the creation of an interministerial commission[24] created to supervise the legality of the foreign capital in the country[25]. In 1960 electric power was nationalized. However, it was not until 1973 that the first foreign investment law was enacted in an effort to codify and systematize what had been a confused mass of rules until that time.[26]

It was during this period that the Import Substitution Industrialization was adopted, by which the Mexican State concentrated its efforts on the promotion of local investment and the creation of state enterprises to promote industrialization.[27]

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[20] The so-called *"franja prohibida"* [forbidden zone].

[21] G. H. Flanz & L. Moreno, " Mexico" at A. P. Blaustein & G. H. Flanz, eds., *Constitutions of the Countries of the World*, revised April 1988 (New York: Oceana Pub.: 1996); [emphasis added].

[22] *Decreto que establece la necesidad transitoria de obtener permiso para adquirir bienes a extranjeros y para la constitutción o modificación de sociedades mexicanas que tengan o tuvieren socios extranjeros*, Diario Oficial [hereinafter *D.O.*] July 7, 1944.

[23] *Constitution* art. 131, para. 2. The emergency in this case was the World War II.

[24] This Commission is the predecessor of the National Commission of Foreign Investment created in 1973.

[25] From 1947 to 1953 the interministerial commission adopted twelve general rules, which were mainly related to the legal capacity of foreign investors and the accomplishment of the 1944 Emergency Decree.

[26] See Díaz, *supra* note 18 at 40. See also C. Nadeau, *The Regulation of Foreign Direct Investment in Mexico and the North American Free-Trade Agreement* (LL. M. Thesis, McGill University, 1992) at 14-18.

[27] For a more detailed history of the different measures that the Mexican State adopted before the 1973 statute, see P. E. Sigmund, "The Regulation of Foreign Investment in Mexico and Its Impact on Income Distribution" at Aspe & Sigmund, *supra* note 9, 247 at 249-50. See also Fisher, *supra* note 12 at 390-91, where he says: "The novelty of the Mexican plan for import substitution was that it created protectionist

C. THE LAW TO PROMOTE MEXICAN INVESTMENT AND TO REGULATE FOREIGN INVESTMENT OF 1973[28]

It was not until 1973[29] that the first foreign investment law was enacted. It was formulated under article 73 fr. X of the Constitution, which bestows on Congress the power to legislate matters of commerce[30]. The statute directed, as its name indicates, the promotion of Mexican investment and considered foreign investment as supplementary. It was designed "to avoid the sale of already established Mexican-owned companies to foreign investors" and "to restrict and, in most areas of economic endeavor, to deter foreign investment"[31]. Its purpose was to promote Mexican investment, to regulate foreign investment, to stimulate a just and balanced economic development and to consolidate Mexico's economic independence[32]. "Foreign Investment" was defined as investment made by foreign individuals, entities, and economic units, as well as by Mexican corporate entities which were majority-owned and/or controlled by foreigners[33].

The Mexican government wanted "to protect its ownership structure,...the resources available per unit of labor,...[and] generate mechanisms that guarantee their nationals' exposure to new technologies[34]"[35]. Thus, the 1973 Statute limited four foreign

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barriers to importation of goods while relying on the importation of foreign capital and manufacturing skills as a key to industrialization".

[28] *Ley Para Promover la Inversión Mexicana y Regular la Inversión Extranjera,* D. O. March 9, 1973. [hereinafter *LIMRIE*]

[29] Within the administration of President Luis Echeverría things began to change, "[u]nder Echeverría there was a reexamination of the arguments for and against foreign investment -and more generally of the whole model of stabilized development [*desarrollo* estabilizador] which had dominated the thinking of Mexican policymakers since the early 1950s." at Sigmund, *supra* note 9 at 250.

[30] After three years of criticism about the constitutionality of the Statute, Congress published, in December 1982, an amendment to article 73 of the Constitution.

[31] M. Jauregui, "A New Era: The Regulation of Investment in Mexico" (1993) 1 Mex-U.S. L. J. 41 at 45.

[32] *LIMRIE,* art. 1.

[33] *Ibid.* art. 2.

[34] With regard to the technology sector, before the 1973 law was signed, on December 20, 1972 the Law on the Registration of the Transfer of Technology and Use and Exploitation of Patents and Trademarks was adopted. Its purpose was to review and approve or disapprove proposed new technology contracts and also the *Ley de Invenciones y Marcas* (Inventions and Trademarks Law) D.O. February 20, 1981. For more information about these laws see E. E. Murphy, "The Echeverrían Wall: Two Perspectives on Foreign Investment and Licensing in Mexico" (1982) 17 Texas Int'l. L. J. 135.

[35] N. Lustig, *Mexico: The Remaking of An Economy* (U.S.: Brookings Institution, 1992) at 175.

investment categories: 1) activities reserved for the State[36]; 2) activities reserved exclusively for Mexicans or for corporations with an exclusion of foreigner clause in their articles of incorporation[37]; 3) activities in which foreign investment could not exceed a certain percentage set below the maximum of 49%[38]; and, 4) all remaining activities in which foreign investment was allowed to be no greater than 49%. However, in practice those restrictions were constantly circumvented by establishing a trust (*fideicomiso*) and through the illegal practice of "namelenders"[39].

The 1973 Statute also created both the National Commission of Foreign Investments[40] and the National Registry of Foreign Investments[41]. The Commission had the power to issue general or specific resolutions to regulate the foreign investment[42]. The Commission is composed of the heads of the Ministries of Commerce and Industrial Promotion; Interior; Foreign Affairs; Treasury and Public Credit; Energy, Mines and State Owned Enterprises; and Labor. It holds mandatory monthly meetings. The Executive Secretary is appointed by the president and is in charge of foreign investment in Mexico. The CNIE had discretionary authority to grant exemptions to the 49% limit of foreign investment in those activities mentioned in the fourth category above, when, "in its judgment", it would be advantageous for Mexico, judged on a case-by-case basis. This discretionary power has been seen as a potential source for corruption even though the

[36] *LIMRIE*, art. 4. Such categories are: hydrocarbons; basic petrochemicals; radioactive minerals and nuclear energy; certain mining, electricity, railroads, and telegraph and radiotelegraph communications; and other activities specified by statute.
[37] *Ibid.* includes: radio and television, certain motors carriers, domestic air and sea transportation, forestry, gas distribution, and other activities specified by statute or executive regulations.
[38] *Ibid.* art. 5. It includes: national reserve mining, secondary petrochemicals, automobile components, and other activities specified by statute or executive regulations.
[39] "Prestanombres" or "testaferros" from which Mexican nationals appeared only nominally to be owners of a property.
[40] "*Comisión Nacional de Inversiones Extranjeras*" [hereinafter *CNIE*]; see *LIMRIE*, c. III.
[41] "*Registro Nacional de Inversiones Extranjeras*" [hereinafter *RNIE*]; see *LIMRIE*, c. V.
[42] Which is considered to be an unconstitutional attribution because some resolutions have in fact changed the law without following the legislative procedure required by articles 71 and 72 of the Constitution. "Amongst the most controversial [general resolutions were] those by which the Commission gave itself a veto over 'new establishments', 'new fields of economic activity,' and 'new product lines' undertaken by 'foreign investors,' including previously existing Mexican companies controlled by foreigners." Murphy, *supra* note 34 at 138.

goal it was intended to produce, bargaining power, was successfully achieved.[43] The Registry was established as a watchdog, to monitor activities and keep statistics of the foreign investments direct and indirect. However, its reports were not public. All existing foreign-owned businesses were obliged to register.

Article 13 of the law stated that the Commission would consider a total of 17 criteria to determine the benefit of a proposed foreign investment, to authorize it, or to grant an exception to the 51% national investment requirement. However, broader discretion was permitted[44]. Nevertheless, all these rules failed to produce a healthier economy or promote a more equal income distribution.[45] Furthermore, once a foreign corporation had merged into a 49% basis with a Mexican firm, it "escap[ed] the control of the commission - and judging from the complaints on this score by those interviewed at the Ministry of National Properties, it seems that Mexicanization [was] seen by the regulators as an obstacle to the attainment of the other national goals embodied in the

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[43] To illustrate the bargaining power that the Mexican state had after the entry into force of the 1973 law see the case of "IBM in Mexico" at C. W. L. Hill, *International Business: Competing in the Global Marketplace* (U.S.: IRWIN, 1994) at 195-96.

[44] These were the criteria that foreign investment shall have, under article 13 of the LIMRIE, in order to be considered by the Commission:

I. To be complementary of national investment;

II. It shall not displace national firms that are operating effectively nor direct to fields that are already covered by them;

III. Its positive effects under the balance of payments and, in particular, over the increase of exportations;

IV. Its effects over employment;

V. The occupation and capacitation of Mexican technicians and administrative staff;

VI. The incorporation of local content in the elaboration of products;

VII. The correspondence in which they finance their operations with foreign resources;

VIII. The diversification of the investment sources and the need to promote regional and subregional integration within the Latin-American area;

IX. Its contribution to the development of less developed regions and zones;

X. It shall not imply the creation of monopolies within the national market;

XI. The capital structure of the economic activity branch that has to do with it;

XII. The technological and R&D contribution to the country;

XIII. Its effects over the prices' level and the quality of production;

XIV. Preserve the social and cultural values of the country;

XV. The importance of the activity within the national economy;

XVI. The identification of the foreign investor with the country's interests and its vinculation with foreign economic decision centres; and,

XVII. In general, the proportion in which contributes to the achievement of the objectives and becomes attached to the national development policy.

[45] For examples of the beneficial effects to a small group of families with regard to the policies adopted as a consequence of the 1973 law see Sigmund, *supra* note 9 at 256-57: "*the increasing dominance of a small number of private Mexican industrial groups*".

criteria listed in article 13 and applied by the commission."[46] Thus, the regulations were not effective, since they did not achieve the twin goals of developing the national private sector and producing welfare among the population (with a few exceptions)[47]. It was a law that was not applied evenhandedly and provoked an outlaw situation where the law did not conform to reality. Thus, the opportunity to use the rule of law as an instrument to achieve wealth in Mexico was lost.

The policy towards FDI in Mexico did not shift to a significantly open scheme until 1989. Nevertheless, during the administration of Miguel de la Madrid (1982-88)[48] the CNIE issued the "Guidelines on Foreign Investments and the Purposes of Its Promotion"[49]. In this document it was stated that the 1973 law did not need any changes. However, in accordance with the National Development Plan,[50] the CNIE would promote a policy of selective promotion of sectors[51] that had been targeted as priorities. Nevertheless, this document did not change the perceptions of foreign investors[52].[53]

D. THE 1989 REGULATIONS

Between 1972 and 1982 the average annual increase of the Mexican external debt was 28%. In 1982 the current account deficit reached 16.9% of the Gross Domestic

[46] *Ibid.*, at 255.
[47] See Murphy, *supra* note 34 at 143.
[48] It was during his administration that Mexico was accepted at the GATT in 1986. The agreement was approved by the Senate on October 9, 1986 and published in D.O. on November 26 and 28 of the same year.
[49] *Lineamientos sobre Inversiones Extranjeras y Propósitos de su Promoción*, February 17, 1984 at Comisión Nacional de Inversiones Extranjeras, *Inversiones Extranjeras: Marco Jurídico y su Aplicación* (Mexico: CNIE, 1984).
[50] *Plan Nacional de Desarrollo 1983-1988.*
[51] Sectors included in the National Program of Industrial Promotion and Foreign Trade 1984-88 at *"Areas de Promoción Selectiva Para la Inversión Extranjera Directa"*. See Comisión Nacional de Inversiones Extranjeras, *supra* note 49 at 33.
[52] See R.R. Williams, "Has Mexico Kept the Promise of 1984 ?" (1988) 23 Texas J. Int'l. L. 417.
[53] For more detailed information about this specific period, see J. C. Trevino, "Mexico: The Present Status of Legislation and Governmental Policies on Direct Foreign Investment" (1984) 18 Int'l. Lawyer 285. See also J. Camil, "The Nationalized Banking System and Foreign Debt" (1984) 18 Int'l. Lawyer 323 to observe how President López Portillo nationalized the bank as a response to the crisis of 1982. It is an important chapter on the recent history of Mexico that is not included in this survey because it is beyond the scope of this study.

Product (GDP)[54]. In August of the same year "a group of highly ranked Mexican officials flew to Washington, D.C., to inform the U.S. secretary of the treasury that Mexico could no longer meet its international financial obligations. This announcement marked the beginning of the worst international financial crisis since the world depression in the 1930s"[55], for Latin American countries. This situation spurred the Mexican government to change its foreign investment policy.

After the 1982 debt crisis, the Mexican government realized that foreign investment "had become a necessary precondition for growth. The pursuit of fiscal discipline, deregulation, and the relaxation of foreign trade and foreign ownership limitations were seen as necessary steps to attract significant amounts of foreign investment. [T]he regulatory framework became gradually less restrictive"[56].

In 1986, as a result of Mexico's GATT membership and its entrance into the globalization era, thirty-six petrochemical products were reclassified from basic to a secondary grade. Other economic activities were opened to foreign investment through the National Commission of Foreign Investments' General Resolution that Systematize and Update the General Resolutions[57]. However, it was a highly-criticized method, in Mexico and abroad, which did not give enough confidence and security to foreign investors. Although reform of the 1973 Statute seemed to be essential for President Carlos Salinas'(1988-94) economic strategy, some political considerations were evaluated. Salinas had just started his administration, having been elected in a very suspicious way within an already controversial electoral process. The PRI majority in Congress was not enough to legitimize, in the opinion of an aggressive public, reform of a matter that had been very controversial due to social, historic and security

[54] See J. A. Gurría T., *Flujos de Capital: El Caso de México* (Chile: United Nations, 1994) at 11.
[55] S. Edwards, *Crisis and Reform in Latin America: From Despair to Hope* (U.S.: World Bank, 1995) at 17.
[56] Lustig, *supra* note 35 at 128.
[57] The National Commission of Foreign Investments issued nineteen general resolutions. However, in February 1988 it issued the General Resolution that Systematize and Update the General Resolutions, "*Resolución General que Sistematiza y Actualiza las Resoluciones Generales*" in order to giver coherency and certainty to foreign investors.

Therefore, Salinas' administration chose to take advantage of article 89 fr. I of the Constitution, which bestows the president with the executive regulation power[58].

On May 16, 1989, the Salinas administration published, in the Official Gazette (D.O.), the Regulations for the Law to Promote Mexican Investment and to Regulate Foreign Investment Regulations[59]. These Regulations abrogated all prior regulations governing foreign investment[60].

The 1989 reform established, as a general rule, that "the acquisition by foreigners of the equity or assets of Mexican companies not resulting in foreign participation in excess of [49%] is authorized....Foreign participation in excess of such limit requires the prior authorization of the [CNIE]"[61]. The Commission's foreign investment authorization process was simplified and the requirements standardized. A trust mechanism was introduced to allow temporary foreign investment in restricted sectors for a period of up to twenty years, and the automatic renewal of up to thirty years in the case of real estate trusts. Another trust mechanism was created to encourage the participation of foreign capital in the formation of the financial capital through the Mexican stock exchange, the "neutral investment"[62]. "Corporations could issue neutral shares, which would entitle a foreign investor to a share of equity, but without voting power in the corporation"[63].

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[58] See "Mexico" *Constitution., supra* note 21, art. 89, where the Mexican Supreme law grants the President the power to "promulgate and execute the laws enacted by the Congress of the Union, providing for their exact enforcement in the administrative sphere" this is the so-called reglamentary faculty of the executive which nature is formally executive but materially legislative. We should note that there was a big debate with regard to the possible unconstitutionality of the Regulations that were deemed to be contrary to the principles settled in article 27 of the Constitution. However, the debate no longer has any consequence, besides the historical one. For a very detailed study on this matter see Díaz, *supra* note 18 at 70-79. It was unconstitutional because it was contrary to the 1973 statute and they did not follow the right way to amend the basic principles through the legislative power that the constitution states. Nevertheless, the Regulations gave enough certainty to foreign investors. Official data demonstrates that Mexico received, before 1993, FDI up to US$34, 056. 2 million. See F. Heyfte E., "Capítulo XI del Tratado de Libre Comercio de América del Norte: Inversión" at J. Witker, ed., *El Tratado de Libre Comercio de América del Norte: Análisis, Diagnóstico y Propuestas Jurídicas,* vol. 2 (Mexico: U.N.A.M., 1993) at 61.

[59] "*Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*", D.O. May 16, 1989. In Mexico, Regulations are norms designed to be in compliance with the guidelines of statutes to make them clearer and more effective.

[60] Specifically the CNIE's General Resolution that Systematize and Update the General Resolutions of 1988.

[61] Jauregui R., *supra* note 31 at 46.

[62] "*Inversión neutra*".

[63] Lustig, *supra* note 35 at 129.

In sum, the Regulations differed from the 1973 law in many ways:[64]

a) foreign majority ownership was allowed in all sectors not enumerated;

b) twenty-year trust mechanisms were created to allow foreign ownership in sectors formerly reserved for Mexicans or subject to ownership ceilings;

c) real estate trusts for industrial, tourist or residential purposes in the Restricted Zone were permitted on a thirty-year renewable basis;

d) the concept of neutral investment was introduced. Corporations could issue special shares with pecuniary rights only (series "N") for purchase by trusts[65]. The banks would then issue non-voting certificates which could be bought from the stock market or the banks;

e) it expedited the application the application process, since investment applications were deemed approved if no response was given by the CNIE within 45 days; and,

f) the national registry of foreign investment was simplified.[66]

[64] For more information see F. C. Miranda, "Update on Laws Affecting Business: Mexico" (1992) 7:1 Florida J. Int'l L. 39.

[65] In the Mexican legal system, only banks can be a fiduciary (administrator) of a trust (*fideicomiso*).

[66] See G. L. Sandrino, "The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective" (1994) 27 Vand. J, Transnat'l L. 259. See also J. Camil, "Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model" (1989) 12 Hous. J. Int'l L. 1. For a description of the trends that Mexico had towards FDI from the nineteenth century to the 1989 Regulations see also J. F. Torres Landa R., "The Changing Times: Foreign Investment in Mexico" (1991) 23 N. Y. U. J. Int'l L. & Pol. 801.

E. THE 1993 FOREIGN INVESTMENT LAW

Due to the North American Free Trade Agreement (NAFTA) negotiations, Mexico needed to change its legal regime towards foreign investment in order to adapt its rules with those that, at the time, were being negotiated. Because of Mexico's hierarchy of laws, international agreements, in accordance with the Constitution, are the Supreme Law of the Nation together with federal laws and the Constitution[67]. Thus, the federal law that ruled foreign investment needed to be amended to be in accordance with NAFTA prior to its entry into force. As one OECD publication notes:

> By anchoring the Mexican economy in the North American continent and securing its main export markets, the NAFTA provided the stimulus for the new foreign-investment legislation which entered into force on 28 December 1993[, 4 days before the date of entry into force of NAFTA][68].

On December 27, 1993, the Foreign Investment Law[69] was published in the Official Gazette. This law abrogated the former Law to Promote Mexican Investment and to Regulate Foreign Investment of 1973. However, since Regulations to this Law have not been enacted, the 1989 Regulations are still in force[70].

> In order to enhance economic development [and to make Mexico more competitive in the international investment market], policies concerning foreign investment [within the new law] are mainly directed towards the following basic objectives:
> 1) creation of more and better remunerated jobs;
> 2) allowance of the participation of fresh capital into the economy;
> 3) allowance for higher quality domestic production through increased competition;
> 4) transfer of technology and training of human resources;
> 5) assistance to encourage international competitiveness; and
> 6) contribution to the economy and social programs through the payment of taxes[71].

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[67] Article 133 of the Constitution reads: *"Esta Constitución, las leyes del Congreso de la Unión que emanen de ella y todos los tratados que estén de acuerdo con la misma, celebrados y que se celebren por el Presidente de la República, con aprobación del Senado, serán la Ley Suprema de toda la Unión."* (This Constitution, the laws approved by Congress and all the Treaties that are in accordance with the Constitution, signed by the President, with Senate approval, would be Supreme Law within the Union).

[68] M. F. Houde, "Mexico and Foreign Investment" (1994) 190 OECD Observer 10 at 11.

[69] *Ley de Inversión Extranjera,* D. O. December 27, 1993. [hereinafter *LIE*]

[70] *LIE,* art. fourth transitory.

[71] F. Ciscomani F, *Mexico: Structure and Policy of the Foreign Direct Investment* (Mexico: SECOFI, 1994) at 7.

The Statute is divided into eight titles. Title one establishes the definition of foreign investment and the limits to its participation. Title two focuses on the acquisition of real estate and the creation of trusts. Title three refers to the rules of incorporation and modification of corporations. Title four regulates foreign corporate investment. Title six and seven refer to the organization, functions and structure of the National Commission of Foreign Investments and the National Registry of Foreign Investments. Title eight enumerates the sanctions.

The definition of foreign investment is broad in its scope. It includes the participation of foreign investors in the capital stock of Mexican corporations and in Mexican corporations with a majority of foreign capital, as well as the participation of foreign investors in the activities and acts established by the law[72].

The authorities recognized by the Statute are the National Commission of Foreign Investments, the National Registry of Foreign Investments and the Ministry of Trade and Industrial Promotion.[73]

This act is a definitive statement that there has been an expansion of the official approach concerning foreign investment, from its regulation to promotion. The law now stipulates that foreign investment can participate in any proportion within the capital of Mexican corporations, acquire fixed assets, enter into new economic areas or produce new lines of products, open and operate establishments, and extend or relocate the already established ones, except for what is specifically limited within the same law[74]. Thus, anything not specified, and therefore excluded, is open to investment. The next section of this study, describes the different sectors and rules that conform to these exceptions.

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[72] *LIE,* supra note 69, art. 2, fr. II.

[73] Through its General Direction for Foreign Investment the Ministry of Trade and Industrial Promotion (SECOFI) grants the final economic and legal review of the approvals and recommendations of the National Commission of Foreign Investments.

[74] *LIE*, *supra* note 69, art. 4. See also Hurtado B., *infra* note 97 at 69.

1. Participation of Foreign Investment in Different Economic Sectors

Foreign corporations shall obtain authorization from the Foreign Affairs Ministry[75] so they can register in the Public Registry of Commerce. Any person, natural or juridical that wants to practice any commercial activity within the Mexican jurisdiction needs to be registered.[76]

According to the Constitution of Mexico, and under article 5 of LIE, the following economic activities are reserved to the State because they are deemed to be strategic to the country:

- petroleum and other hydrocarbons[77];
- basic petrochemicals;
- exploitation of radioactive minerals;
- generation of nuclear energy;
- electricity[78];
- radiotelegraphy;
- postal services;
- issuance of bills of exchange;
- minting of coin; and,
- control, supervision and surveillance of ports, airports and heliports.

According to article 6 of the LIE, the following economic activities are reserved for Mexican nationals or Mexican corporations by a foreigners' exclusion clause[79]:

- radio and television broadcast, other than cable;

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[75] The Ministry shall issue the authorization no later than 15 working days after the application.

[76] *LIE*, supra note 69, art. 17. See also Mercantile Corporations General Act, arts. 250 & 251*[Ley General de Sociedades Mercantiles, D. O. August 4, 1934]*.

[77] A decree which reforms several provisions of the Regulatory Law of article 27 of the Constitution in the petroleum area was published in the Official Gazette in May, 1995, and establishes that transport, storage and distribution of gas may be carried out, prior to authorization, by private and social sectors.

[78] Any investor (foreign or Mexican) can participate in the generation and importation of electricity that are not considered public services. See *Resolución General Número 5 que Establece las Reglas Para la Participación de la Inversión Extranjera en las Actividades del Sector de Energía Eléctrica, que no Constituyen Servicio Público*, D. O. September 22, 1993.

[79] Foreigners' exclusion clause is a commitment included in the articles of incorporation to prohibit direct or indirect foreign investment in the company, including a Mexican corporation with a foreigners' admission clause. See *LIE, supra* note 69, art. 2, fr. VII.

- national passengers ground transportation, tourism and loading transportation, excluding courier and packaged goods service;
- urban and interurban automotive transportation on federal highways;
- retail sale of gasoline and liquefied petroleum gas;
- credit unions;
- development banking institutions; and,
- professional and technical services.

Finally, article 7 of the same act states the different percentages in which foreign investors may participate on certain sectors, namely:

- up to 10% in: production cooperatives;
- up to 25% in: national air transportation and aerotaxi transportation; and,
- up to 49% in: financial holding companies, commercial banks, stock brokerage firms, stock exchange specialists, insurance companies, general deposit warehouses, financial surety companies, foreign exchange companies, financial leasing companies; financial factoring companies, limited scope financial institutions, investment companies, manufacturing and commercialization of explosives, artificial fireworks, small arms, cartridges and munitions, publishing and printing national circulation newspapers, cable television, basic telephone, video text services and enhanced switched data services, fishing in internal and coastal waters as well as in the exclusive economic zones, port administration and services of pilotage to ships, navigation companies engaged in commercial exploitation of ships for internal navigation and cabotage, and fuel and lubricants supply for boats, aircrafts and railroad equipment.

However, with the approval of the CNIE, foreign investment may have a majority interest in corporations engaged in the economic activities listed below if the value of the assets of the relevant corporation exceeds the sum to be annually determined by the Commission:

- port services for ships to effect their inland navigation operation;
- shipping companies engaged in the exploitation of ships solely for high seas traffic;
- management of air terminals;

- private education services at the pre-school, primary, secondary, upper-middle, upper and combined levels;
- legal services;
- credit information companies;
- securities classification institutions;
- insurance agents;
- cellular telephone;
- construction of pipeline for transportation of oil and products derived therefrom; and,
- perforation of oil and gas wells.

On the other hand, article 9 of the law specifies that authorization for participation of foreign investment within the capital of Mexican corporations by the Commission is only necessary when the participation is more than 49% in corporations whose assets are more than $85 million pesos in 1996[80] (US$11,486,486 approx.).

2. Real Property

Mexican corporations with a foreign exclusion clause or Calvo Clause can own land for non-residential purposes within the Restricted Zone. Such acquisitions by companies that adhere to the Calvo Clause must be registered with the Foreign Affairs Ministry[81].

However, a foreign investor must still use a trust to acquire real property rights in the Restricted Zone. The Foreign Investment Law extends the period to a fifty-year renewable term, increased from 30 years. The authority in charge of permitting such acquisitions by a fiduciary institution is the Foreign Affairs Ministry. It considers any

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[80] See *Ibid.* arts. 9 & tenth transitory. The amount was revised by interview with Lic. Juan Carlos Alarcón, Secretary of the Director of Metrology and Normalization of the Ministry of Trade and Industrial Promotion (SECOFI)(June 25, 1996) Mexico city.

[81] *Ibid.* art. 10. "...the roots of this restriction can be traced back to 1847 when Mexico lost half of its territory to the United States" F. Orrantia, "Commercial Contracts, Including Joint Ventures, and Real Estate, Under Mexican and United States Law" 951 at Symposium, "Business and Investment Law in the United States and Mexico" (1993) 15 Loyola. L. A. Int'l & Comp. L. J. 909 at 954. For more details on the Mexican legal tradition aspects for real estate transactions see *ibid.* at 951-54.

social and economic impact that the operation may produce for the Nation[82]. If the Ministry does not deny an authorization after thirty working days, it is deemed to have been accepted[83].

3. Neutral Investment

As discussed above, the Mexican government created a new instrument to attract foreign capital to the Mexican market through the 1989 Regulations. This new instrument for investment is the "*inversión neutra*" which gives economic rights to its holders with limited corporate rights[84]. The goal is to capitalize the Mexican Stock Exchange Market and to provide corporations with an alternative market from which to seek financial assistance other than financial credit institutions[85].

However, it also gives speculators a way to make short-term investments other than FDI which, as proven later in this study, creates output, wages and, in general, helps to develop a healthier Mexican economy. Nevertheless, neutral investment, whereby the investor gains no corporate rights or control, gives foreign investors the opportunity to invest in corporations where direct participation in the sectors reserved to the State and/or Mexicans was formerly precluded.

The way in which this form of investment works is simple: A financial institution (fiduciary)[86] issues a "*certificado de participación ordinario*" (certificate of ordinary participation) which is a title of credit (negotiable instrument) issued by a fiduciary institution. These titles of credit represent the right to a proportional part of the rent

[82] This little clause gives broad discretionallity to the Foreign Affairs Ministry, if the objective was such they should have issued some parameters. The discretionallity could produce corruption. Thus, it shall be revoked or ruled.
[83] This is the "*afirmativa ficta*" principle.
[84] *LIE, supra* note 69, art. 19. In Hurtado B., *infra* note 97 at 70 there is a definition of neutral investment as: "a non-participatory financial investment that is not characterized as foreign investment for the purposes of the limitations provided by the law."
[85] J. Alvarez S., "El Régimen Jurídico de la Inversión Extranjera Directa a través de la Inversión Neutra en el Reglamento de la Ley Para Promover la Inversión Mexicana y Regular la Inversión Extranjera" (1989) 2 Ars Juris 19 at 20-21.
[86] See *supra* note 65.

produced by stocks, rights or goods that the fiduciary institution holds[87], which in this case are the shares "N" that integrate the fiduciary patrimony.[88] The issuance is made on the Mexican Stock Exchange Market where foreign investors can acquire them. The neutral investment is neither Mexican nor foreign[89].

Furthermore, the Foreign Investment Law opens the possibility for foreign participation in the capital of financial institutions such as commercial banks, financial groups and brokerage houses, constituted by "A" or "B" shares, which are otherwise reserved for Mexicans. However, this is subject to the previous opinion of the Ministry of Finance and Public Credit and the National Stock Commission and authorization of SECOFI.[90]

The principal objective of the neutral investment regime, which was to attract foreign investment, was realized. In January 1994, investment in the stock exchange market was at US$3,173.3 million. However, in January 1995, portfolio investment dropped to US$-187.6 million, indicating a capital flight of exceptional proportions.[91] Thus, Mexico's reliance on portfolio investment without raising a significant amount of FDI at the same time to counterbalance it provoked a financial crisis in Mexico. Under similar circumstances this could happen in any country at any time.[92]

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[87] *Ley General de Títulos y Operaciones de Crédito*, D. O. August 27, 1932. [Titles and Operations of Credit Act], art. 228. See also chapter V-Bis of the same law called "*De los Certificados de Participación*".
[88] Alvarez S., *supra* note 85 at 24.
[89] *Ibid.* at 24. See also *LIE, supra* note 69 art. 18.
[90] *Ibid.* art. 20. See also the CNIE's resolution number 3, *Resolución General Número 3 que Establece Criterios y Mecanismos Especiales Para la Aplicación de Diverssas Disposiciones del Reglamento de la Ley Para Promover la Inversión Mexicana y Regular la Inversión Extranjera en Relación con la Inversión Neutra,* D. O. August 9, 1990, modified by resolution published on April 1, 1992.
[91] Source: SECOFI, *Evolución de la Inversión Extranjera en México*, (Mexico: SECOFI, February 1995).
[92] For more information regarding neutral investment see also Nadeau, *supra* note 25 at 40-43.

4. The "*Comisión Nacional de Inversiones Extranjeras*" - A new approach

As previously discussed, the CNIE was and still is the authority in charge of resolving the procedence of foreign investment. However, as the new Act gives foreign investors a wider range of participation within a deregulation regime, the Commission's revisable investments are the only ones settled under articles 8 and 9 of the Act. The law does not establish any proceedings in which due process rights are guaranteed and thus, is unconstitutional. It also gives the Commission overly-broad discretionality. On the other hand, the authority to issue general resolutions is still in the law and, as noted before, this is a legislative faculty, although it has not been brought before the Supreme Court because of the individualistic nature of the *Juicio de Amparo,* Mexico's constitutional control system.[93]

As a consequence of Mexico's insertion into the globalization era, the Commission's criteria, used to authorize a specific foreign investment, decreased from 17 items to four[94]. However, there is still a certain amount of discretionality, which remains objectionable and subject to extra legal influences.

The Commission also has the power to prevent foreign investment for national security reasons[95]. Moreover, in order to give foreign investors more certainty and to assure a healthier market, the Commission can only impose requirements that do not distort international trade.[96] Hence, performance requirements are no longer permitted.

At this point, it is important to note that the significant changes made to the Foreign Investment Rules were part of a general strategy by the Mexican State that had as

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[93] See R. Pérez M., "La Nueva Legislación Mexicana sobre Inversión Extranjera: Aspectos Conceptuales" (1995) 9 Cuadernos de Posgrado - ENEP Acatlán 89 at 112-13,

[94] See *supra* n. 44 for the previous criteria. The new criteria that the CNIE has to take into account, accordingly to *LIE, supra* note 69, art. 29:

I. The impact over labor and its capacitation;

II. The technological contribution;

III. The fulfillment with the environmental rules, and

IV. In general, the contribution to increase the competitiveness of the Mexican productive plant.

[95] *Ibid.*, art. 30.

[96] *Ibid.*, art. 29. This rule is to avoid the use of performance requirements that, as has been seen, were an important part of the Mexican policy towards foreign investment to achieve bargaining power. See also Hill, *supra* note 43 at 212.

its primary goal the entry into force of NAFTA so as to insert Mexico in the global competition for capital[97]. As J. A Erfani points out:

> In anticipation of NAFTA....the Mexican government under the Salinas administration passed two laws curtailing executive authority to regulate commerce and private property. In 1991[[98]], the government enacted a stringent new law, the Industrial Property Act, to protect intellectual property, including that of foreign firms. Moreover, in 1993 the government passed a Foreign Investment Law that, among other things, eliminated government-imposed performance requirements on firms and opened up more sectors of the Mexican economy to foreign investors.[99]

Finally, as one can observe from reading the Foreign Investment Act, foreign investors who wish to invest in Mexico's market, within any sector that is not excluded, can do so by opening a Mexican branch office or as a subsidiary.[100]

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[97] For a summary of the different rules that change in Mexico regarding the implementation of NAFTA, see D. Hurtado B., "Summary of Recent Legislative and Administrative Developments in Mexico" (1994) 2 U.S. - Mex. L. J. 65. The LIE was used also as a negotiating instrument in the NAFTA negotiations. It was a "product of the President's economic plan and the passage of this Act by Congress, at the same time the NAFTA negotiations began. Indeed, this law was a very important tool fro Mexico's passage of the NAFTA by the Mexican Congress and assisted the passage by the United States Congress and the Canadian Parliament." L. Perera, "New Legal Framework for Foreign Investment in Mexico" (1994) 2:29 San Diego Justice J. 42 at 42.

[98] *Ley de Fomento y Protección de la Propiedad Industrial*, D.O. June 27, 1991.

[99] Erfani, *supra* note 3 at 177.

[100] To explore this topic, see J. Camil, "Joint Ventures, Shareholders Agreements and Mexican Investment Law" at Symposium, *supra* note 81 at 956-962.

F. The North American Free Trade Agreement: the Entrance of Mexico into the Globalization Era

The North American Free Trade Agreement,[101] signed by Canada, Mexico and the U.S., entered into effect on January 1, 1994. NAFTA's "objectives are much more expansive than trade alone: The agreement is [also] designed to remove barriers to investment among the three countries"[102]. NAFTA's chapter XI deals with investment, services and related matters. NAFTA was a precursor in the integration of investment within a bilateral or multilateral economic agreement. This implies that all three parties recognized that investment was necessary to complement the dynamics of the three economies and that the ties between trade and investment is very strong[103].[104]

According to Daniel Price[105], a U.S. negotiator of the investment chapter, barriers to investment should be construed as barriers to trade, which is why it was considered essential to create a specific chapter that governed issues related to investment. He notes that the objectives of chapter 11 are to "...establish a secure investment environment through the elaboration of clear rules of fair treatment of foreign investment and investors, remove barriers to investment by eliminating or liberalizing existing restrictions, and [to] provide an effective means for the resolution of disputes between an investor and the host government"[106].

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[101] *North American Free Trade Agreement Between the Government of the United States of America, the Government of Canada and the Government of the United Mexican States*, Dec. 17, 1992, Can.-Mex.-U.S., 32 I. L. M. 296-456 & 605-800 [hereinafter *NAFTA*]. In Mexico, the agreement is called *Tratado de Libre Comercio* and it is usually known as TLC.

[102] S. Weintraub, *NAFTA What Comes Next?* (Washington, D.C.: Center for Strategic and International Studies, 1994) at xxi. See also Business Law Symposium, "Foreign Investment in Mexico: Rules, Regulations, and Implementation by Regulatory Agencies" (1993) 15 Loyola L.A. Int'l & Comp. L. J. 935 at 947 where Gregorio Estrella says something that is still a reality: "Currently NAFTA's effect on Mexico remains unclear."

[103] Actually Multinational Corporations (MNCs) are the main subjects that contribute FDI phenomenon and they are also one of the big world traders.

[104] See F. Heftye E., "Capítulo XI del Tratado de Libre Comercio de América del Norte: Inversión" at J. Witker, ed., *El Tratado de Libre Comercio de América del Norte: Análisis, Diagnóstico y Propuestas Jurídicas*, v. 2, 55 (Mexico: U.N.A.M., 1993) at 62.

[105] D. M. Price, "An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement" (1993) 27:3 Int'l Lawyer 727.

[106] *Ibid.* at 727.

In article 1102, following the spirit of the entire agreement in other areas[107], NAFTA obliges the three parties to provide national treatment to investors from the other parties, and in article 1103 it obliges them to provide most-favored-nation treatment to investors within the North American market.[108] Furthermore, any party has the right to be given the better of the two treatments (MFN or National)[109].

NAFTA, founded under article XXIX of GATT[110] as a free trade area, is defined as:

> a group of two or more customs territories in which the duties and other restrictive regulations of commerce....are eliminated on substantially all the trade between the constituent territories in products originating in such territories[111].

The parties are committed to do everything possible to remove all potential obstacles to free trade and, as in the case of NAFTA, to encourage investment. Therefore to achieve these goals NAFTA follows the principles of national and most-favored nation treatment (MFN)[112] even though within the multilateral context regional agreements are the most important exception to the MFN principle on which GATT is founded[113]. This exception is due to the recognition that such agreements can promote faster economic integration; paragraph four of article XXIV of GATT says: "the purpose of a customs union or of a free trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories"[114].

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[107] See *NAFTA, supra* note 101 arts. 301, 308, 1003, 1202, 1203, 1405, 1406 & 1703.

[108] See G. C. Hufbauer & J. Schott, *NAFTA: An Assessment*, revised edition (Washington, D.C.: Institute for International Economics, 1993) at 80.

[109] *NAFTA supra* note 101, art. 1104.

[110] *General Agreement on Tariffs and Trade*, 30 October 1947, Can, T. S. 1947 No. 27, 55 U. N. T. S 187, T. I. A. S. No. 1700 [hereinafter *GATT*].

[111] *Ibid.*, art. XXIV. 8(b).

[112] The most favored-nation treatment promotes non-discriminatory access to markets, transparency and welfare increasing conduct of international trade policies. It is the cornerstone of the GATT system (article I). It is complemented by the national treatment obligation, which is also a non-discrimination principle, stated at article III of GATT.

[113] Recently, there has been a big discussion about the convenience of the celebration of Regional Economic Agreements instead of continuing the globalization process through the use of the already existing multilateral agreement (GATT). As this topic departs from the issue of this work, there is a very good dissertation by M. J. Trebilcock & R. Howse, *The Regulation of International Trade* (London: Routledge, 1995) at 90-96.

[114] *GATT supra* note 110, art. XXIV.

1. NAFTA and the Foreign Investment Law

Although NAFTA "strongly reinforces Mexican economic reforms designated to improve the investment climate in [the] country"[115], chapter XI had to be implemented within the Mexican legal system. In order to do that the Salinas administration considered that the 1973 law was obsolete and decided to send a foreign investment bill to Congress, which became the Foreign Investment Act of 1993, previously discussed, as well as other laws to be discussed later on this study.[116]

The liberalization of the current national legislation should apply to investments outside North America. However, the only instance where NAFTA provides more extensive liberalization to North American investors is in the realm of foreign equity caps. As seen above, article 1102 provides that NAFTA investors can have 100% equity participation in Mexican companies outside the strategic areas[117]. Thus, where foreign participation is subject to ceilings under the 1993 Act, NAFTA investors will eventually have full access.

However, even though investments, other than the strategic areas, are permitted on a 100% basis and without any prior authorization, any investment that exceeds the limit that the CNIE imposes under article 9 of the Foreign Investment Act[118], and certain

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[115] Hufbauer & Schott, *supra* note 108 at 79.

[116] At the beginning of the Salinas administration the attitude towards foreign investment changed from a selective promotion to a permanent and liberalized promotion. In the *Plan Nacional de Desarrollo* (PND) 1989-94 it was established that the foreign direct investment is beneficial to Mexico because of the following reasons: 1. creates direct and indirect permanent well paid jobs; 2. provides the country with fresh resources for a healthier financing of corporations; 3. provides modern technologies to the industrial plant and enforces the exportation efforts of Mexico. See Programming and Budget Secretariat (SPP), *Plan Nacional de Desarrollo 1989-1994* (Mexico: SPP, 1989) at 88.

[117] *NAFTA supra* note 101, art. 1101 says that: "A Party has the right to perform exclusively the economic activities set out in Annex III and to refuse to permit the establishment of investment in such activities" and according to Annex III, the economic activities are the same as covered under article 5 of the Foreign Investment Law. It is important to mention that if the State gives any concession under any of these activities this does not imply that the State resigns to control them, thus, the principle of national treatment does not apply. See *Ibid.*, Annex III, ss. 1 & 2.

[118] See *supra* note 80.

activities referred to in Annex I & II of NAFTA,[119] are excluded. Article 1111[120] is very clear on this issue:

> Nothing in Article 1102 [National Treatment] shall be construed to prevent a Party from adopting or maintaining a measure that prescribes special formalities in connection with the establishment of investments by investors of another Party, such as a requirement that investors be residents of the Party or *that investments be legally constituted under the laws or regulations of the Party*, provided that such formalities do not materially impair the protections afforded by a Party to investors of another Party and investments of investors of another Party pursuant to this Chapter.[121]

Hence, within the *formalities constituted under the laws* of Mexico the requisite of previous authorization of the CNIE within certain sectors provided by the Foreign Investment Law are present. Nevertheless, once a sector has been liberalized it cannot be restricted in the future, even if it was a totally restricted sector before NAFTA.

Nevertheless, the ceiling set on article 9 of the Foreign Investment Law is different for the NAFTA Parties. In accordance with Annex I it will be US$25 million until 1997; US$50 million in the year 2000; US$75 million in 2003 and US$150 million after the year 2003.[122]

With regard to the subjects that are protected under NAFTA's chapter 11, the Parties' individuals and corporations are covered. With regard to corporations, if they are controlled by nationals different from the NAFTA Parties, it is necessary that they engage in substantial entrepreneurial activity[123] to avoid the use of NAFTA as an instrument to

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119 That are in conformance with articles 6 and 8.

120 "Under Article 1111, member nations may adopt or maintain measures that prescribe special formalities regarding the establishment of investments by investors of another nation. For example, a nation may require that investors be residents of that nation, or that investments be constituted under the laws and regulations of the nation. Special measures may be prescribed as long as the formalities do not impair the substance of the benefits given under Chapter Eleven. [It] also allows a member nation to require investors to provide routine business information concerning investments in its territory for statistical or informational purposes". R. Sandoval, "Chapter Eleven: Investments Under the North American Free Trade Agreement" (1994) 25 St. Mary's L. J. 1195 at 1198.

121 *NAFTA supra* note 101, art. 1111 [emphasis added].

122 *Ibid.* Annex I [I-M-4].

123 *Ibid.* art. 1113. In the first part of this article there is another exception for corporations that are deemed as from a Party but are controlled by non-party nationals if the party does not have diplomatic relations with that Nation or adopts or maintains measures to prohibit transactions with that Nation. The U.S. government has gone so far that they are trying to impose such a restriction to the other two parties of

constitute ghost corporations that do not operate in the North American market.[124] However, under the Foreign Investment Act of 1993 any foreign investor could be subject to the law[125].

The definition of investment[126]in NAFTA is broader than in the Foreign Investment Law. It is closer to the one settled on under Bilateral Investment Treaties (BITs)[127]. In fact, chapter XI of NAFTA is like a BIT inserted into a trade agreement.[128] It contains not only the participation of corporations but also refers to the transfer of assets between a parent and its subsidiary, intellectual property, real estate and the like. However, as one author points out, it is not a conceptual definition, it just enlists various activities. This creates confusion because there could be other activities that are not included.[129]

NAFTA with the Helms-Burton Act. However, this article does not give grounds to the U.S. to do such a thing.

[124] See Heftye E., *supra* note 104 at 64.

[125] See *LIE, supra* note 69, art. 2, fr. II & III.

[126] See *NAFTA, supra* note 101, art. 1139.

[127] "[T]he term 'investment' means any kind of asset invested by an investor of one Contracting Party in the territory of the other Contracting Party and in particular, though *not exclusively*, shall include:

> (I) any movable and immovable property and any other related property rights;
> (ii) shares, stock, bonds and debentures or any other form of participation including minority or indirect participation in a company or a business enterprise;
> (iii) claims to money, and claims to performance under contract having a financial value;
> (iv) any intellectual property rights, including rights with respect to copyrights, patents, trademarks, trade names, industrial designs, trade secrets, good will as well as know-how;
> (v) business concessions conferred by law or under contract, including concession rights to search for, cultivate, extract or exploit natural resources;
> (vi) rights, conferred by law or under contract, to undertake any economic and commercial activity.

Agreement between the Government of Canada and the Government of the Republic of Hungary for the Promotion and Reciprocal Protection of Investments, in force November 21, 1993, art. I(b) [emphasis added].

[128] For more information regarding BITs see P. B. Gann, "The U. S. Bilateral Investment Treaty Program (1985) 21 Stan. J. Int'l L. 373. See also M. R. Reading, "The Bilateral Investment Treaty in ASEAN: A Comparative Analysis" (1992) 42 Duke L. J. 679.

[129] V. C. García Moreno, *La Inversión en el TLC (Capítulo XI)* (Professor of International Law in the National Autonomous University of Mexico -U.N.A.M.) [unpublished].

2. Performance Requirements[130]

Performance requirements are controls that host countries impose on the subsidiaries of multinational corporations(MNCs) on the basis that acceptance of such preconditions helps them to maximize the benefits of FDI and minimize its risks[131]. As already seen, the Foreign Investment Law prohibits any performance requirements [132]. Nonetheless, NAFTA negotiators inserted a specific provision prohibiting the following performance requirements for an investment of a Party and even a non-Party in its territory[133] in an exclusive manner:[134]

> (a) to export a given level or percentage of goods or services;
> (b) to achieve a given level or percentage of domestic content;
> (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
> (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
> (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
> (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
> (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

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130 "The prohibition on performance requirements [in NAFTA] serves two goals: First, it eliminates trade distortions that arise from imposing such requirements. Hence a Party is prohibited from imposing such requirements even on its own investors. Second, it ensures a degree of entrepreneurial autonomy: souring and sales decisions are based on the investor's judgment, not by the dictates of the host government." Price, *supra* note 105 at 729.

131 Hill, *supra* note 43 at 212, where he also says that the most common performance requirements are: "related to local content, exports, technology transfer, and local participation in top management."

132 See *supra* note 96. Art. 29 of *LIE* says in its last paragraph "The Commission, in deciding whether an application is appropriate, may only impose requirements that do not distort international trade." the English version extracted from R. H. Folsom, M. W. Gordon & J. A. Spanogle, *International Business Transactions: A Problem-Oriented Coursebook*, 3d ed. (St. Paul, Minn.: West Pub. Co., 1995) at 999.

133 *NAFTA supra* note 101, art. 1106. 1.

134 See Ibid. art. 1106. 5.

Along with this rule, NAFTA also prohibits the receipt or continued receipt of an advantage on compliance of certain performance requirements similar to those mentioned above[135]. However, there are some exceptions. It is permitted to condition an advantage on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory[136]. Other exceptions, covered in Annex I, are in the communications sector[137], the automotive industry[138], the *Maquiladora* sector[139], and the transportation sector[140]. In addition, there are exceptions with respect to export promotion and foreign aid programs[141], procurement by a Party or a state enterprise[142], and requirements imposed by an importing Party relating to the content of goods necessary to qualify for potential tariffs or preferential quotas[143]. Furthermore, there are some restrictions that are permitted to protect the environment[144], health, national security[145] and social concerns[146].

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[135] *Ibid.* art. 1106. 2., They are: "(a) to achieve a given level or percentage of domestic content; (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory; (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows; (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings."

[136] *Ibid.* art. 1106. 4.

[137] *Ibid.* Annex I [I-M-10]; [I-M-12]; [I-M-14]; [I-M-17].

[138] *Ibid.* [I-M-33].

[139] *Ibid.* [I-M-34]; [I-M-36]; [I-M-37]. See *infra* chapter II for further explanation.

[140] *Ibid.* [I-M-77].

[141] *Ibid.* art. 1108. 8 (a). Prohibitions settled under article 1106(1)(a), (b) and (c), and (3)(a) and (b) do not apply.

[142] *Ibid.* art. 1108. 8(b). Prohibition settled under 1106(1)(b), (c), (f) and (g), and (3)(a) and (b) do not apply.

[143] *Ibid.* art. 1108. 8(c). Prohibition settled under 1106(3)(a) and (b) do not apply.

[144] *Ibid.* art. 1106. 6. With regard to the environmental protection it should be noted that article 1114 does a declaration in favour of the environment besides the Environmental Side Agreement signed by the three Parties. Since this matter escaped from the scope of this survey, note that the provision under article 114, which says:

> Nothing in this Chapter shall be construed to prevent a party from adopting, maintaining or enforcing any measure otherwise consistent with this chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.
>
> The parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party

Finally, performance requirements that impede a firm ~~to~~ from appoint ing the management it wishes are not permitted. However, it is permitted to require that a majority of the board of directors, or any committee thereof, be of a particular nationality, providing that the measure does not materially impair the ability of the investor to exercise control over the investment.[147] Mexico specifically has some other exceptions that apply to this prohibition within production cooperative corporations[148], in the manufacture and commercialization of explosives, firearms, cartridges, munitions and fireworks corporations[149], religious services[150], air transportation[151], and water transportation[152].

3. Transfers

Traditionally, Mexico has followed the practice of not restricting the transfer of profits by MNCs operating within its territory, Mexico left the final decision of whether to reinvest its profits or not to foreign investors, in this way removing suspicious transfers of funds from parents to subsidiaries.[153] In general, NAFTA reaffirms this principle by establishing that "[e]ach Party shall permit all transfers relating to an investment of an investor of another Party in the territory of the Party to be made freely and without

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has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.

[145] *Ibid.* art. 1106. 2.

[146] *Ibid.* art. 11006. 4. This article could be construed as one of the few social development clauses inserted in NAFTA. Different from the Treaty of Rome, which in article 92(3) gives the Commission the discretionary power to exempt prohibited state aids in three areas: (1) aid for very depressed regions; (2) to promote the execution of an important project of common interest or to remedy a serious disturbance in a Member State's economy; and, (3) in regional and sectorial aid. NAFTA on the other hand, does not create any institution to foster social development in areas that need help, such as the cohesion fund in the EU. For more information on this topic, see Dr. H. Niemeyer, "State Aids and European Community Law" (1993) 15 Michigan J. Int'l L. 189. See also Hufbauer & Scott, *supra* note 108 at 105-109, where they discuss the necessity of NAFTA to create a fund to finance regional development "to deal with the problems created in the wake of expanded North American commerce [if not] ..the idea of freer trade would be discredited."

[147] *NAFTA supra* note 101, art. 1107.

[148] *Ibid.* Annex I [I-M-7].

[149] *Ibid.* Annex I [I-M-39] & [I-M-52].

[150] *Ibid.* [I-M-53].

[151] *Ibid.* [I-M-55] & [I-M-57].

[152] *Ibid.* [I-M-78].

[153] Heftye E., *supra* note 104 at 76.

delay[,]..in a freely usable currency at the market rate of exchange prevailing on the date of the transfer..."[154].

However, a Party may, as an exception, prevent a transfer through the non-discriminatory application of its laws relating to:

a) bankruptcy, insolvency or the protection of the rights of creditors;

b) issuing, trading or dealing in securities;

c) criminal or penal offenses;

d) reports of transfers of currency or other monetary instruments; or

e) ensuring the satisfaction of judgments in adjudicatory proceedings.[155]

At this point is important to note a rule contained in NAFTA that is of particular importance to this study. This rule authorizes a Party to restrict or prevent transfers when it experiences serious balance of payments difficulties and adopts or maintains economic policies consistent with International Monetary Fund (IMF) consultations.[156]

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[154] *NAFTA supra* note 101, art. 1109.

[155] *Ibid.*

[156] *Ibid.* art. 2104 "Balance of Payments". This matter is very important within the discussion on the third chapter of this survey.

4. Expropriation

States have the internationally respected right[157] to take property, provided that it is on behalf of a public purpose[158].[159] However, if a takeover is made, compensation shall be paid.[160] While the description of this issue is relatively simple, in practice it raises a lot of questions. For example, what is considered as public purpose? how shall the compensation be determined? and, when it shall be paid?

Internationally, the Charter of Economic Rights and Duties of States says:

> Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.
> Each State has the right: ...
> To nationalize, expropriate or transfer ownership of foreign property, in which case *appropriate compensation* should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned [as is the case on NAFTA] that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.[161]

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[157] "Today, it appears that the right of a state to expropriate foreign property for a public purpose related to its internal needs, is recognized by customary international law. However, expropriation measures that are arbitrary or discriminatory or which are motivated by considerations of a political nature unrelated to the internal well being of the taking state are illegal and invalid for restitution or, if not possible, compensation."
"What amounts to expropriation and what measure of compensation must be paid under international law are questions that have not yet been settled." H. M. Kindred, *et al., International Law: Chiefly as Interpreted and Applied in Canada*, 5th ed. (Canada: Edmond Montgomery Pub., 1993) at 549.

[158] See *Constitution, supra* note 21, art. 27

[159] *NAFTA supra* note 101, art. 110 says that "[n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment, except:
(a) for a public purpose;
(b) on a non-discriminatory basis;
(c) in accordance with due process of law and [with international law]; and
(d) [through compensation].."
However, "public purpose" is not defined and this could produce problems in the future.

[160] See R. H. Folsom. M. W. Gordon & J. A Spanogle, *International Business Transactions: A Problem Oriented Coursebook*, 3d ed. (St. Paul, Minn.: West Pub. Co., 1995) at 1019-20.

[161] *Charter of Economic Rights and Duties of States*, GA Resolution 3281 (XXIX), U.N. GAOR, 29th Sess., Supp. No. 31, U.N. Doc. A/9631 (1974), 50, art. 2. [emphasis added].

However, it has also been recognized, mostly by developed nations, that whenever there is an injury to its nationals by a State, the State has the right to protect its citizens, giving rise to the "diplomatic protection" institution.[162]

NAFTA states that compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place and shall be paid without delay and be fully realizable.[163] Thus, NAFTA is the first multilateral treaty involving developed and developing countries that adopts "Hull Doctrine ideals and consensual international arbitration mechanisms as the standard means for determining compensation."[164] This is an extremely significant shift in Mexican policy. Traditionally, developing countries, led by Mexico, have opposed the fair market value standard and have advocated one of compensation appropriate to the circumstances giving rise to the expropriation, as in the U.N. Charter.[165]

Not only has Mexico changed its policy under NAFTA, but also with respect to foreign and national investors in general, although the changes were made specifically for NAFTA[166]. The Expropriation Act[167] does not distinguish between foreign and national

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[162] See Daly, *infra* note 168 at 1161-66.
[163] *NAFTA supra* note 101, art. 1110.
[164] Daly, *infra* note 168.
[165] Traditionally the U.S. scope has been that of "adequate, effective, and prompt compensation", known as the Hull formula in honor of Cordell Hull (U.S. Secretary of State). However, the Third Restatement of the Foreign Relations law of the United States 712 (1987) does not take entirely the Hull formula, it says:
A State is responsible under international law for injury resulting from:
(1) a taking by the state of the property of a national of another state that
(a) is not for a public purpose, or
(b) is discriminatory, or
(c) is not accompanied by a provision for just compensation;

For compensation to be just under this subsection, it must, in the absence of exceptional circumstances, be in an amount equivalent to the value of the property taken and be paid at the time of taking, or within a reasonable time thereafter with interest from the date of taking, and in a form economically usable by the foreign national;
(2) a repudiation or breach by the state of a contract with a national of another state
(a) where the repudiation or breach is
(I) discriminatory; or
(ii) motivated by non-commercial considerations, and compensatory damages are not paid; or
(b) where the foreign national is not given an adequate forum to determine his claim of repudiation or breach, or is not compensated for any repudiation or breach determined to have occurred; or
(3) other arbitrary or discriminatory acts or omissions by the state that impair property or other economic interests of a national of another state.
[166] See name of the decree at *infra* n. 167.

investors, except in the case of the Calvo Clause[168]. It establishes that the compensation shall include commercial value and it shall be paid within a year after the expropriation decree.[169]

5. Dispute Settlement

NAFTA does not create any autonomous institution with authority over the governments of the Parties. It is expressly provided that no Party shall allow for enforcement of the Agreement by domestic legal proceedings involving a private right of action[170]. Hence the dispute settlement system[171], to protect the rights of investors against possible violations of the Agreement by a State, has been indispensable. It is of such importance that one author states:

> The long-term success or failure of [NAFTA] will depend in large on the effectiveness of its dispute settlement system. In the highly politicized world of international trade law, a system that can resolve disputes and promote compliance with legal obligations will go far in advancing NAFTA's substantive goals of economic integration. A weak or underutilized system, on the other hand, is likely to undermine NAFTA's legitimacy and inhibit further progress toward hemispheric integration.[172]

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[167] *Ley Federal de Expropiación*, D. O. December 22, 1993. It was reformed from the previous law that was in force since 1936 on the *Decreto que Reforma, adiciona y deroga disposiciones de diversas leyes relacionadas con el Tratado de Libre Comerco de América del Norte* (Decree which reforms, adds, and derogates several laws related with NAFTA).

[168] Which in words of Justine Daly has been "[o]ne of the underlying reasons for the strained foreign investment relations that Mexico has experienced with traditionally capital-exporting states.." J. Daly, "Has Mexico Crossed the Border on State Responsibility fro Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico after the NAFTA" (1994) 25 St. Mary's L. J. 1147 at 1149.

[169] See Pérez M., *supra* note 93 at 106-07.

[170] A. de Mestral & J. Winter, "Dispute Settlement Under the North American Free Trade Agreement and the Treaty of European Union" (1994) 17 J. European Integration 235.

[171] With regard to the dispute settlement procedure issue we shall note that NAFTA has three main dispute settlement systems, one general which is stated under chapter 20, one for the matters relates with antidumping and countervailing duties (AD/CD) on chapter 19, and the last one, and most important for this work, included in chapter 11 on investments.

[172] D. S. Huntington, "Symposium on the North American Free Trade Agreement: Settling Disputes Under the North American Free Trade Agreement" (1993) 34 Harv. Int'l L. J. 407.

The dispute settlement system in chapter 11 has been described as the cornerstone of the investment provisions of NAFTA[173]. It is a mechanism that assures equal treatment among investors of the Parties in accordance with international reciprocity and due process before an impartial tribunal.[174] It has no precedent in any previous multilateral agreement[175].

Traditionally, Mexico has not favoured settling disputes with investors within an international forum. However, with its entrance into the competition[176] to attract FDI, it was necessary for Mexico to accept the use of arbitration as an instrument to settle disputes with foreign investors rather than resorting to the national courts where investors might fear bias[177]. Furthermore, the use of arbitration is an alternative way to avoid the use of power-oriented methods by home state governments and, by these means, to protect the Calvo Clause objective, which is to avoid foreign states intervention in the manner of diplomatic protection[178]. It is also an alternative dispute resolution method which promises flexibility, confidence, speed and neutrality[179].

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[173] Heftye E. calls it the *piedra angular* (cornerstone) of chapter 11 which has as its objective that investors use arbitration to protect their rights, S*upra* note 104 at 84.

[174] *NAFTA supra* note 101, art. 1115.

[175] D. Gantz, "Resolución de Controversias en Materia de Inversiones Extranjeras en el TLCAN" at *infra* note, 179 at 151.

[176] See as an example of the actual competition worldwide J. Atik, "Investment Contests and Subsidy Limitations in the EC (1992) 32 Va J. Int'l L. 837. See also C. Gray & W. Jarosz, "Law and Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe" (1995) 33:1 Colum. J. Transnat'l L. 10. See also E. Bradley, "India's Quiet Economic Revolution" (1994) 29 Colum. J. World Bus. 7. See also B. C. Potter, "China's Equity Joint Venture Law: A Standing Invitation to the West for Foreign Investment" (1993) 14 U. Pa. J. Int'l Bus. L.

[177] Traditionally, in the past conflicts between investors and States were settled in conformance with the national laws. However, as a consequence of the pressures that MNC's, nowadays the tendency to use alternative methods (*i.e.*, arbitration) is very common. See D. Wippman, "Dispute Resolution" (1992) 7:1 Florida J. Int'l L. 93 for an explanation of recent developments of arbitration in Latin America as an alternative dispute resolution procedure.

[178] "The Calvo Doctrine, named after the famous Argentine jurist, Carlos Calvo, encompasses two basic concepts: (1) the requirement of absolute equality of the treatment of aliens with the treatment of nationals, meaning that aliens have resort to local remedies, and (2) the policy of nonintervention of the alien's state of nationality." extracted from J. Daly, *supra* note 168 at 1150. However, as the same author points out that "[b]ecause Mexico has agreed to the Chapter Twenty dispute resolution procedures, which are a form of diplomatic protection, any future Mexican administration could not attempt to reject diplomatic protection or assert the Calvo Doctrine without being in breach of the NAFTA." *Ibid.*, at 1187.

[179] J. Witker, "Panorama General de Solución de Controversias en el Comercio Internacional Contemporáneo" at J. Witker, ed. *Resolución de Controversias Comerciales en América del Norte* (Mexico: U.N.A.M., 1994) 17.

Investors[180] can initiate chapter 11 procedures when a State has breached an obligation covered under chapter 11, related to State enterprises[181] or Monopolies[182], and that a specific investor has suffered loss or damage due to that breach.[183]

The affected investor may submit the claim for arbitration six months after the events giving rise to the claim, prior to consultation or negotiation[184], under the ICSID Convention[185] or the UNCITRAL Arbitration Rules[186]. However, to exercise this right to

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[180] Only the investors have the right to claim, not the investments. Hence, as provided by article 1117, an investor has the right to claim if a breach affects its investments in a corporation of the breaching Party in which the investor has ownership or control.

[181] If they breach their obligation *NAFTA* supra note 101, art. 1503(2) states:

> Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under Chapter Eleven...and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges.

[182] *Ibid.* art. 1502(3)(a) states:

> Each party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately-owned monopoly that it designates and any government monopoly that it maintains or designates: acts in a manner that is not inconsistent with the Party's obligations under this Agreement wherever such a monopoly exercises any regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charges.

[183] *Ibid.* art. 1116.

[184] *Ibid.* art. 1118.

[185] *International Centre for Settlement of Investment* Disputes 17 U.S.T. 1270; T.I.A.S. 6090, 575 U.N. T.S. 159. Only when the U.S. is the investor or the Party because it is the only NAFTA Party which is a party in the World Bank's International Centre for the Settlement of Investment Disputes. It is important to mention what one author says about the ICSID Convention in order to understand its origin:

> [The] ICSID was established over 25 years ago under a multilateral convention, prepared by the World Bank, known as the 1965 Washington Convention or the ICSID Convention. In accordance with this Convention, ICSID provides facilities for the conciliation and arbitration of legal disputes arising out of an investment between a member country of ICSID and a national of another member country. The World Bank sponsored the establishment of ICSID in the belief that the availability of a dispute settlement machinery of this kind could help to promote increased flows of international investment. The jurisdiction of ICSID tribunals is based on the mutual consent of the parties to the dispute. Membership of ICSID does not by itself imply acceptance by the state of such jurisdiction. Consent of the host state to submit a dispute to ICSID or the actual submission of a dispute to ICSID deprives the state of the investor from exercising diplomatic protection in his favour until such time as the host state fails to comply with the award rendered against it. Furthermore, ICSID tribunals apply, in the absence of agreement by the parties on applicable law, the law of the host state and such rules of international law as may be applicable. And the host state may require the foreign investor, as a condition of the state's acceptance of ICSID's jurisdiction, to

an arbitration proceeding, the investor must first waive the right to initiate or continue a proceeding before any court or administrative tribunal under the law of any Party[187], except proceedings for an injunctive, declaratory or other extraordinary relief not involving the payment of damages.[188] The right to initiate an arbitral proceeding under chapter 11 lapses after three years[189]. Overall, the dispute settlement procedure in chapter 11 has been recognized as a very effective and modern system by jurists from the three different Parties.[190] It will be interesting to see how it will work in practice.

The arbitral award is enforceable only between the parties and with respect to the particular case[191]. NAFTA gives a period of time prior to full enforcement of the award[192]. If a Party fails to comply with the award the affected Party may initiate a panel procedure under chapter 20 or may seek enforcement under the ICSID Convention, the New York Convention[193] or the Inter-American Convention[194].[195]

> exhaust local remedies. In member countries, ICSID tribunal awards have the finality of decisions of their national courts and are not subject to review by such courts. The World Bank covers the cost of ICSID's Secretariat which charges the parties to a dispute only the actual cost of the proceedings including a per diem fro the arbitrators. Since it was opened for signature in 1965, over 120 countries have signed the ICSID Convention. Of these, 110 countries have also ratified the ICSID Convention and have thus become members of ICSID. The member countries include some 80 developing countries.

I. F. I Shihata, *Legal Treatment of Foreign Investment: "The World Bank Guidelines"* (The Netherlands: Martinus Nijhoff Pub., 1993) at 98 note 68.

186 United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, December 15, 1976.

187 Article 26 of the ICSID Convention says: "[a] Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."

188 See *NAFTA supra* note 101, arts. 1121 & 1122.

189 *Ibid.* arts. 1116(2) & 1117(2).

190 See The Joint Working Group of the American Bar Association, the Canadian Bas Association, and the Barra Mexicana, "Report on Dispute Settlement Procedures in the North American Free Trade Agreement" (1993) 27:3 Int'l Lawyer 831.

191 *NAFTA supra* note 101, art. 1136.

192 120 days in ICSID Convention cases; three months within ICSID Additional Facility Rules and Uncitral Arbitration Rules cases. *Ibid.*, art. 1136(3).

193 *Convención sobre el Reconocimiento y Ejecución de las Sentencias Arbitrales Extranjeras,* D. O. June 22, 1971.

194 *Convención Interamericana sobre eficacia extraterritorial de las Sentencias y Laudos Arbitrales Extranjeros,* D.O. August 28, 1987. (Panama Convention)

195 For more information regarding the different applicable rules under these Conventions see J. A. Silva S. & V. C. García M., "Sobre el Tratado de Libre Comercio entre Canadá, EE. UU. y México" (1993) 4 Boletín de la Facultad de Derecho (Universidad Nacional de Educación a Distancia -Spain) 233.

One Mexican lawyer has said, regarding arbitration, that it "is currently the best way to settle controversies that have their origin in international trade...Nonetheless although the recognition and enforcement of a foreign arbitral award is not a complex matter in Mexico City, this is not the case in the rest of the country because judges are not used to having to recognize and enforce them."[196] Hence, enforcement, even under NAFTA could still be a difficult task to overcome in these undeveloped (juridical and economical) areas of Mexico. However, if a Party does not fulfill its obligations after an award has been reached under chapter 11, the investor still has the right to ask its State to initiate chapter 20 proceedings.[197]

Finally, it is important to mention that a resolution against a decision of the CNIE for which an investment is not accepted could not be challenged within the dispute settlement proceedings, nor under the dispute system of chapter 20[198].

G. Competition Law as the Last Regulatory Scheme in an Era of Deregulation

> [I]t is widely agreed that international markets, as domestic ones, cannot simply be left to themselves. They need a coherent regulatory framework ensuring that the expected benefits of the market economy are not undermined by the behavior of governments and private actors and that common goods and public interests are safeguarded.[199]

In Mexico as other countries, such as Canada and the U.S., antitrust legislation is considered to be within the "national interest" rules, which means that these countries believe that competition and its regulation protects values and interests deemed as

[196] L. Pereznieto C., "Resolution of an International Transaction Under Mexican Conflict of Laws Principles" (1992) 7:3 Florida J. Int'l L. 427 at 432.
[197] *NAFTA supra* note 101, arts. 1136, 2008, 2020, 2022.
[198] *Ibid.* Annex 1138. 2
[199] L. A. W. Hunter & S. M. Hutton, "Where There Is a Will, There Is a Way: Cooperation in Canada-U.S. Antitrust Relations" (1994) 20 Can.-U.S. L. J. 101 at 110. See also A. Haagsma, "An International Competition Policy as a Means to Create an Open Global Market Place" at J. F. Beseler & N. Williams, *Anti-dumping and Anti- Subsidy Law* (London: European Community, 1986) at 412 where he states this declaration of an official of the European Commission's Directorate General of Competition: "[t]rade is not liberalized by the absence of competition rules but precisely by their active enforcement."

important for domestic and international reasons. Moreover, within the new market contestability theory competition rules become more important to foster efficient markets and to compete for investment, avoiding the existence of barriers to entry or any other competition-distortive behaviour produced by governmental or private action. [200]

However, competition policies are authority acts and as such they have to be regulated by rules of law to avoid discretionality. This is a basic principle in the theory of law, and furthermore, is one of the principles in which the effectiveness of law has been sustained.

1. MNCs and Competition Law

Host governments, as is the case of Mexico, are worried about the power of MNCs operating or willing to operate in their market because of the MNCs' enormous economic power[201]. A MNC can use the funds of its parent company to subsidize its costs and achieve enough market power to monopolize the market or act in an anticompetitive manner.[202]

This does not mean that antitrust or competition laws should be construed as measures to protect the national market; their aim is to protect the competitive process, not competing firms. The main goal of these laws is consumer protection rather than other social goals such as the creation or maintenance of jobs or the protection of small and middle enterprises. For these other purposes there are different rules and policies. However, indirectly, competition laws could have political goals, such as the disconcentration of economic power by private or governmental enterprises; otherwise, such firms would justify their anticompetitive behaviour on the basis that there is no regulation of business practices.[203]

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[200] See D. P. Fidler, "Competition Law and International Relations" (1992) 41 I. C. L. Q. 563 at 565-70. *See* also T. J. Schoenbaum, "The Concept of Market Contestability and the New Agenda of the Multilateral Trading System" (1996) 11 ASIL Insight 1.

[201] However, competition policy was not a significant concern of Mexico for most of its history. See Newberg, *infra* note 210.

[202] Hill, *supra* note 43 at 207.

[203] See H. M. Blake, "In Defense of Antitrust" (1965) 65 Colum. L. R. 3.

Therefore, competition laws, directly and indirectly, shall produce the following results[204]:

a) better products;

b) decrease production costs;

c) more and better services; and,

d) decrease of prices for consumers.

On the other hand, the effects that antitrust policy should have on the market-place are[205]:

a) a better income distribution within the market;

b) an increase of the budget for research and development of products;

c) consumer welfare;

d) a more rational use and distribution of resources; and,

e) the decrease of monopoly's power.[206]

Hence, preservation of competition is a means to obtain the goals of antitrust laws, which are, among other things, consumer welfare, the promotion of low prices, choices among products and innovation. Competition should also be preserved because it provides society with the maximum output that can be achieved at any given time with the resources available.[207] Thus, competition laws can be viewed as one of the last counterbalance instruments that States (and society in general) have to regulate the conduct of firms, especially the powerful MNCs.

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[204] O. Carrillo, "El Capítulo XV: Política en Materia de Competencia, Monopolios y Empresas de Estado" at J. Witker, *El Tratado de Libre Comercio de America del Norte: Análisis, Diagnóstico y Propuestas Jurídicas*, vol. 2, (Mexico: U. N. A. M., 1993) 210-11.

[205] *Ibid.*

[206] On the contrary, R. Bork, suggests that antitrust policy has drawn away from its objective in four different ways:

> a) moving away from the ideal of free market towards the regulated market;
> b) tearing from political decision by democratic process to the political choice by courts;
> c) concerning about group welfare instead of general welfare; and,
> d) moving from the ideal of liberty and reward according to merit to one of equality of outcome and reward according to status.

R. H. Bork, *The Antitrust Paradox* (N.Y.: Basic Books Inc., 1978) at 418.

[207] *Ibid.* Although competition should not be understood as the perfect competition model but in a more realistic way, considering every potential and actual element that could play within it, as in a real life market. The type of business behavior that antitrust laws shall promote is that of productive efficiency, the one which creates wealth.

2. The *Ley Federal de Competencia Económica*[208]

Since 1917 the Mexican Constitution has been concerned with the protection of competition within the Mexican market. However, it was not until this decade that it developed a competition or antitrust act. The Mexican Constitution says:

> In the United Mexican States there shall be no monopolies or restrictions to free competition [*estancos*] of any kind, nor exemption from taxes under the terms and conditions provided by law. Equal treatment shall be given to prohibitions under the guise [*título*] of protection to industry
>
> Consequently, the law shall punish severely and the authorities shall prosecute every concentration or cornering in one or a few hands of articles of prime necessity for the purpose of obtaining a rise in prices; every act or proceeding which prevents or tends to prevent free competition in production, industry or commerce, or services to the public; every agreement or combination, in whatever manner it may be made, of producers, industrialists, merchants, and common carriers, or those engaged in any other service, to prevent competition among themselves and to compel consumers to pay exaggerated prices; and in general, whatever constitutes an exclusive an undue advantage in favor of one or more specified persons and to prejudice of the public in general or of any social class.[209]

With regard to the "*Ley Federal de Competencia Económica*"[210] (Federal Act Governing Economic Competition), former Mexican President Carlos Salinas de Gortari (1988-94) said:

> Modernizing Mexico's economy is not an end in itself but rather is the best strategy for making sustained and permanent improvements to the living conditions of all Mexicans.... The present administration is meeting this challenge by, aiming other things, promoting competition in the manufacturing sector and creating a system of economic regulations capable of encouraging competitiveness, creativity and participation by all Mexicans in the production and marketing of goods and services.[211]

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208 *Ley Federal de Competencia Económica*, published in D. O. on December 24, 1992 [came into force on June 23, 1994] [hereinafter *LFCE*].

209 *Constitution*, art. 28. at Flanz & Moreno, *supra* note 21 at 32.

210 For more information regarding this Act, see J. A. Newberg, "Mexico's New Economic Competition Law: Toward the Development of a Mexican Law of Antitrust" (1994) 31 Colum. J. Transnat'l L. 587.

211 Speech by Carlos Salinas, Congress of Mexico, 17 December 1992.

On the same basis, the *"Ley Federal de Competencia Económica"* has as its object: *"....sentar las bases de una política de competencia y no solo una política antimonopolio: el objetivo es proteger al proceso de competencia en forma integral...."*[212]

Therefore, the objectives of the *"Ley Federal de Competencia Económica"* are[213]:

- to promote the economic efficiency;
- to avoid monopolic practices; and,
- to protect the competitive process and the freedom of individuals within the economic activities.

The LFCE establishes as non-authorized practices the "absolute monopolic practices" and "relative monopolic practices"[214]. The absolute monopolic practices are considered as null (*nulidad absoluta*). Thus, anybody has the right to ask for their invalidation. Such practices would not have any juridical effects because they are considered to be anticompetitive practices. These practices, known as horizontal practices, are: monopolies, the formation of cartels, agreements for the division or share of markets and manipulation of public auctions. Such horizontal practices should not be named as monopolistic practices because, in *stricto senso,* they are not monopolies, *i.e.*, sole actors, but oligopolies, since it involves the action of more than one economic agent (Art. 9). As such, they should be referred as oligopolic practices[215].

On the other hand, there are the "relative monopolic practices", which are not always anticompetitive. To be considered anticompetitive, these practices have to gain substantial market power. They are known as vertical practices.

The LFCE defines the "relative monopolic practices" as: *"...los actos, contratos, convenios o combinaciones cuyo objeto o efecto sea o pueda ser desplazar indebidamente*

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[212] Presidencia de la Republica. *Iniciativa de la Ley Federal de Competencia Economica.* In English: (to settle the basis of a competition policy and not only an antimonopoly policy: the objective is to protect the competition process in an integral manner).
[213] P. García Villegas S. C., *Análisis Jurídico y Económico de la Ley Federal de Competencia Económica* (LL. B. Thesis, National Autonomous University of Mexico, 1994).
[214] *LFCE supra* note 208, arts. 8 & 9.
[215] See *supra* note 204 at 173.

a otros agentes del mercado, impedirles substancialmente su acceso o establecer ventajas exclusivas en favor de una o varias personas"[216]

To prove that there is a "relative monopolic practice" the authority in charge of the inquiry has to find:[217]

- that the actor has the potential to develop substantial market power beyond the relevant market; and,
- that it affects goods or services on the relevant market.

For the determination of the relevant market:

- the possibility to substitute the good or service for others, (national or international origin) considering the technological possibilities, if the consumers have substitutes and the length of time for the substitution;
- the distribution costs of the good;
- the costs and the possibilities for the consumers to go to other markets; and,
- the federal, local and international normative restrictions that could limit the access to the consumers to another supply sources or the access of the supplier to alternative clients.

For the determination of the substantial market power in the relevant market:

- the participation in that market and if it can fix or set prices unilaterally or to restrict the supply in the relevant market without any possibility of the competitors to counteract such a market power;
- the existence of barriers to the entry;
- the existence and power of competitors; and,
- the recent behavior.

The relative monopolic practices that the law classifies are vertical division of markets, restrictions to the selling price, tied selling, exclusivity contracts, denied trade and boycott.

[216] *LFCE supra* note 208, art. 10. In English: (the acts, contracts, convenants or combinations of which the objective or effect is or could be to displace *unduly* to other market agents, substantially prevent their access or establishes exclusive advantages to one or more persons).
[217] *Ibid.* arts. 11, 12 & 13.

a) Mergers and Acquisitions

Mergers are the other practice that the LFCE regulate and, as this is a typical mode of entry for MNCs, it is of the interest to this. They are known as "*concentraciones*" and are regulated in chapter III of the Act. Notice of "*concentraciones*" must be given to the *"Comisión Federal de Competencia Económica"*[218] (Commission) before they occur. Mergers (concentraciones) are defined as:

> ...a merger with or acquisition of control over another firm, or any other act joining together companies, associations, stockholders, business partnerships, trusts companies or assets in general, which is carried out between competitors, suppliers, customers, or any other economic agents, whose purpose or effect is to diminish, harm or impede competition with respect to identical or substantially similar goods and services...[219]

The Commission shall consider where the following thresholds meet to determine if a merger should be sanctioned: a) the relevant market; and, b) the potential competitors, the market power and the degree of concentration of the relevant market[220]. If the Commission finds that the merger produces an anticompetitive behaviour, then it could act in one of two ways: 1) it could condition the merger according to the Commissions discretion; or, 2) it could order the partial or total disconcentration, the termination of the control or the suppression of the acts[221].

Nevertheless, mergers and acquisitions do not necessarily imply anticompetitive behaviour and, furthermore, with the increasing appearance of MNCs within the

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[218] Which is an administrative autonomous body, disconcentrated from the Ministry of Commerce and Industrial Development (SECOFI). It is authorized to: "conduct investigations initiated at the request of interested parties or.... by itself, of competition law violations [;] issue administrative rulings and asses penalties for such violations[;] render advisory opinions regarding competition law questions; and participate in the negotiation of international agreements regarding competition policy." Newberg, *supra* note 210 at 587-88.

[219] *LFCE supra* note 208 art. 16 in its original version says: *"se entiende por concentración la fusión, adquisición del control o cualquier acto por virtud del cual se concentren sociedades, asociaciones, acciones, partes sociales, fideicomisos o activos en general que se realice entre competidores, proveedores, clientes o cualesquiera otros agentes económicos."*

[220] *Ibid.* art. 18.

[221] *Ibid.* art. 19.

globalization of markets, corporations merge to be more efficient and more able to compete in the national market as well as in the international one[222].

However, there are some cases in which notice of acquisitions or mergers shall be given to the Commission before they occur, and wait for its approval to register in the Public Register of Trade[223] if so required. The threshold tests that the merger or the acquisition shall meet are:

a) if the transaction is worth over US$30 million' approximately (12 million times the basic minimum wage applicable within the Federal District[224]); b) if the acquiring firm acquires more than 35% of the assets or shares of a target firm with assets or annual sales in excess of the amount mentioned before; or c) two or more of the parties to the transaction have assets or annual sales in excess of US$129 million approximately (48 million times the basic minimum wage applicable within the Federal District) and the transaction entails the acquisition of capital or assets in excess of the same amount[225].[226]

The Commission has a 45 day period upon the reception of the notification and if it does not issue a resolution within that period, the inaction is deemed as an affirmative resolution.[227]

b) Sanctions

Sanctions are established in a specific chapter of the LFCE under articles 35 to 38. In Mexico it is necessary, under the LFCE, that the anticompetitive act have an effect on the market-place. This is not true under the Competition Act in Canada.

The Commission shall consider, through the imposition of a fine, the gravity of the anticompetitive act, the damage caused, the signs of intentionality, the participation of

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[222] See García Villegas S. C., *supra* note 213 at 145.

[223] *Registro Público de Comercio.*

[224] The *salario mínimo vigente en el Distrito Federal* is 21 pesos per day. The sums are subject to changes in the minimum wage and to currency fluctuations of course.

[225] See Newberg, *supra* note 210 at 594-95. *LFCE supra* note 208, art. 20.

[226] The notification must include the relevant legal documents for the transaction, the most recent financial statements of the parties, and any other information necessary for the analysis of the transaction. See *Ibid.*, art. 21.

[227] The President of the Commission could extend the period up to 60 more days in exceptional complex cases. *Ibid.* art. 21.

the transgressor in the market, the size of the affected market, the length of the practice, the reincidence or antecedents of the transgressor and its economic capacity.[228]

Hence, monopolic activities are not an offense in and of themselves, even though they have a lucrative effect. However, it is an offense if the lucrative effect is obtained by means of monopolic activities because in a monopolic market the gains are anticompetitive and they are superior to the normal gains in a competitive market.

Under Mexican legislation, anticompetitive actions are not criminal offenses *per se,* as is the case in Canada and other countries. The Commission, after administrative proceedings, shall establish the sanction in accordance with the law it considers appropriate.

Under this procedure the Commission resolves the claims that are presented by the affected Party(ies).[229] . The Commission, in a plenary session, [230] is the authority that makes the final resolution on a majority vote basis.

After receiving the claim, the Commission has to notify the possible transgressor of the inquiry, attaching copies of the claim. The defendant has 30 days to answer the claim or what he finds to be his by rights attaching the necessary proof. After the evidentiary stage, the Commission sets a period of 30 days for hearings, which can be either oral or written. Once the records ("*expediente*") are integrated, the Commission shall dictate a resolution within 60 days.[231]

After this procedure, the Commission's resolution could impose a sanction if it finds that the defendant is guilty of predatory pricing as a "relative monopolic practice", The sanction could consist of:

a) suspension, correction or suppression of the practice;

b) the partial or total disconcentration;

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[228] *Ibid.* art. 36.

[229] When its a case of relative monopolic practices or mergers, only the affected persons or the Commission itself have the right of action to initiate an inquiry. On the other hand, when it is an absolute monopolistic practice any person or the Commission have the right.

[230] Composed by five commissioners as the *Reglamento Interior de la Comisión Federal de Competencia,* published in D. O. October 12, 1993. (Interior Regulation of the Federal Commission of Competition) establishes on its article 14.

[231] *LFCE supra* note 208, art. 33.

c) a fine not exceeding the equivalent of 7,500 times the minimum wage in force on the Federal District of Mexico if the evidence is false;

d) a fine not exceeding the equivalent of 375,000 times the minimum wage in the case of absolute monopolic practices ;

e) a fine not exceeding the equivalent of 225,000 times the minimum wage for relative monopolic practice;

f) a fine not exceeding the equivalent to 225,000 in the case of unauthorized mergers or acquisitions, and 100,000 if no notification is made with regard to the merger or acquisition; and,

g) a fine not exceeding the equivalent of 7,500 times the S.M.D.F. to the individuals who participate directly in the monopolic practice, on behalf of juridical persons (firms).[232]

c) Remedies

In Mexico the authority in charge of the proceedings against anticompetitive behavior is the Federal Commission of Competition, formed by five commissioners who are designated by the President and who must be experts in antitrust law. This state organ is an administrative organ which is disconcentrated from the Ministry of Commerce and Industry Promotion[233]. In administrative law a disconcentrated organ is an authority which has technical and operative autonomy to dictate its resolutions, but depends on a Ministry for its budget and hierarchy.

Thus, the proceedings before the Commission are administrative, not judicial. It is formally an administrative authority which has material judicial (quasi-judicial) functions.

The Commission is authorized to:[234]

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232 Like the administrator, share holders, executives or any person within a firm that makes an anticompetitive practice.

233 *Reglamento Interior de la CFCE*, art. 3.

234 J. A. Newberg, "Mexico's New Economic Competition Law: Toward the Development of a Mexican Law of Antitrust" (1994) 31 Colum. J. Trans. L. 587., pp. 590.

a) conduct investigations initiated by interested parties or by the Commission on its own initiative;

b) issue administrative rulings and assess penalties for such violations;

c) give advice regarding competition law questions; and,

d) participate in the negotiations of international agreements to which competition matters are subject.

After a resolution has been reached by the plenary session of the Commission, the affected person has the right to interpose the remedy of reconsideration [235] before the same authority (the Commission), as in every administrative proceeding.

This remedy has to be interposed within 30 days after the notification of a resolution. With regard to this right, the law does not specify the different resolutions that the Commission could reach. Hence, one should understand that the parties have the right to interpose by using the reconsideration remedy against any of these resolutions[236].

The remedy, if admitted, has the effect of revoking, modifying or confirming the claimed-against resolution. The judgment will contain the settlement of the claimed-against action, the legal foundation and the resolution's aims. The remedy should be in writing, directed to the President of the Commission, and should contain the claimed-against facts with the necessary proofs attached.[237]

The immediate effect of the interposition of the remedy is the suspension of the resolution's execution. If necessary, a guarantee has to be given before the suspension of the execution to attest to the possible damages that the suspension could cause to a third party.[238]

The Commission has 60 days after the interposition of the reconsideration remedy to notify the party regarding the resolution of a remedy. If the Commission does not receive a resolution within this period it shall be understood that the party confirms the claimed-against act or resolution. This last provision, contained in the last paragraph of article 39, is very onerous. It is contrary to the legal principle contained in the Mexican

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[235] 'Recurso de Reconsideracion', *LFCE supra* note 208, art. 39.

[236] See García Villegas S. C. *supra* note 213 at 167.

[237] *LFCE supra* note 208, art. 39, para. 2.

[238] *Ibid.* art. 39, para. 3.

Constitution's article 16 (*prinicipio de legalidad*), which states that every resolution of an authority needs foundation and motivation if it affects an individual and his or her possessions, family, and other rights. Thus, this provision is unconstitutional because it is not in accord with the Constitutional guarantee.

However, any individual affected by an authority act founded under this provision can ask for the protection by the Supreme Court of Mexico's "*Juicio de Amparo*", the Mexican constitutional judicial control system.

One might speculate that this provision was enacted so that after the final resolution of the Commission, individuals could use the "*Juicio de Amparo*" as a last resort. And if the objective is to expedite the proceedings, it will not do so; in fact, the proceedings will be lengthened as parties secure their rights under "*Juicio de Amparo*". Furthermore, the fact that it is unconstitutional undermines the Commission.

In addition, under the resolution of the reconsideration remedy a party has the right to interpose the supreme remedy in Mexico, the "Juicio de Amparo", that in this case is the "*Amparo indirecto or bi-instancial*". This gives the parties two chances to interpose the "*Juicio de Amparo*", first, against the administrative act of reconsideration and second, against the law itself.

Another available remedy, in this case a civil remedy, is for the benefit of the economic agents who have suffered damage or prejudice as a consequence of the anticompetitive behaviour. They can initiate a civil trial to obtain compensation and recover the losses and correct the prejudices that occurred by means of the anticompetitive behavior.[239] This trial is conducted in a regular court, which may award damages of up to double the amount established by the Commission, though the judge is not legally bound to do so.

[239] *Ibid.* art. 38.

H. Other Rules Affecting FDI

Observing the description and examination of these rules, two important conclusions can be drawn: 1) that Mexico has shifted from its former state-oriented, protectionist policy toward FDI; and, 2) that this shift is permanent, construed as the permanency that the law (federal laws) and international obligations (NAFTA, GATT & OECD membership) give.

1. Domestic Level

This character can also be seen in several other different acts and laws enacted by the Mexican government and after NAFTA, as a natural consequence of it.

Among them are the following:

- Promotion and Protection of Industrial Property Law[240]; This new law

> affects several areas: (1) it significantly broadens patent protection, [chemicals and pharmaceuticals]; (2) it extends the term of patent protection to 20 years commencing from the date of filing the patent application, or to 14 years commencing from the date of issuance; (3) it extends the term of trade mark registrations from five years to ten years; and (4) it increases sanctions for improper disclosure of trade secrets" [241]

- Mexican Federal Copyright Law[242];
- General Law of Ecological Equilibrium and Environmental Protection[243];
- International Trade Law[244]; and,
- Decree for the Development and Operation of the Maquiladora Industry for Exportation[245].

Along with these laws, and in accordance with its NAFTA obligations within the Investment chapter, Mexico has already liberalized the following sectors:

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240 *Ley de Fomento y Protección a la Propiedad Industrial*, published in D. O. on June 22, 1991.

241 D. H. Badiola, "Summary of Recent Legislative and Administrative Developments in Mexico" (1994) 2 U. S. - Mex. L. J. 65 at 66. For more information, see R. E. Neff, "Mexican Copyright protection: Proposals for Better Legislation and Enforcement" (1994) 2 U. S. - Mex. L. J. 51.

242 *Ley Federal de Derechos de Autor*, D. O. December 31, 1956 [amended in 1991].

243 *Ley General de Equilibrio Ecológico y la Protección al Ambiente*, published in D. O. January 28, 1988.

244 *Ley de Comercio Exterior*, published in D.O. on July 27, 1993.

245 *Decreto para el Fomento y Operación de la Industria maquiladora de Exportación*, published in D.O. on December 22, 1989.

The Mexican Navigation Act (D.O. Jan. 4, 1994) provides that Mexican shipping companies can be 100% foreign-owned. Such companies may register and flag vessels as Mexican, but on-board personnel must be Mexican by birth. The *Airport Infrastructure Law* governs the privatization of airports. The limit on foreign participation is 49% with the possibility of 100%. On May 11, 1995 the *Law Regulating Article 27 of the Mexican Constitution* was amended to permit foreign and private sector participation in transportation, storage and distribution of natural gas. On May 12 of the same year, article 28 of the Constitution was amended to remove railroad services as a strategic activity. Finally, the *Federal Telecommunications Law* (June 7, 1995) ends the TELMEX monopoly and allows grants of concessions in satellite communications to companies that can have up to 49% foreign equity. Thus, the following sectors are no longer reserved to the State: satellite communications, railroads and control, inspection and surveillance of maritime and inland ports and airports. [246]

2. International Level

Mexico will continue to foster an international promotion of free trade and investment policy. As a means to attract more capital flows and promote exports and domestic investment abroad, Mexico has already signed different free trade agreements and BITs and is in the process of negotiating others.

With regard to the free trade agreements, Mexico signed one with Chile (D.O. January, 1, 1992), who at this moment is being considered to be a member of NAFTA. Mexico has also signed agreements with Bolivia[247]and one with Costa Rica[248] and, finally, one with Colombia and Venezuela[249]. Furthermore, Mexico is presently negotiating a free trade agreement with Nicaragua on one side and, on the other, a multilateral agreement

[246] See Goodrich, Riquelme y Asoc. *Mexico: Business Opportunities and Legal Framework* (Mexico: Goodrich, Riquelme y Asoc., 1995).

[247] *Tratado de Libre Comercio entre los Estados Unidos Mexicanos y la República de Bolivia* (D. O. Decemebr 28, 1994).

[248] *Tratado de Libre Comercio entre los Estados Unidos Mexicanos y la República de Costa Rica* (D. O. June 21, 1994).

[249] *Tratado de Libre Comercio entre los Estados Unidos Mexicanos y las Repúblicas de Colombia y Venezuela* (D. O. December, 16, 1994).

with Guatemala, Honduras and El Salvador. In South America, Mexico is negotiating free trade agreements with Ecuador and Peru. With Mercosur, Mexico is bringing up to date its agreements with the region.[250]

With regard to other regions, Mexico is in the process of negotiations with the European Union to sign a free trade agreement[251]. Presently, Mexico has signed BITs[252] with Spain[253] and Switzerland[254].

[250] See *Programa de Política Inustrial y Comercio Exterior* (D. O. May 31, 1996) at 148.
[251] See *Ibid.*, at 148.
[252] In Spanish it is known as *Acuerdos para la Promoción y Protección Recíproca de Inversiones* (APPRIs).
[253] *Acuerdo para la Promoción y Protección Recíproca de Inversiones entre los Estados Unidos Mexicanos y el Reino de Espana* (D. O. Decemebr 20, 1995).
[254] *Acuerdo para la Promoción y Protección Recíproca de Inversiones entre los Estados Unidos Mexicanos y la Confederación Suiza* (D. O. Decemeber 20, 1995).

III. FDI AND THE CRISIS OF DECEMBER 1994

The above examination of the main rules that govern FDI in Mexico has provided the juridical basis needed to better understand the direction that Mexico has chosen to take in order to enhance its economy. The second part of this study focuses on Mexico's reliance on foreign investment to achieve the economic growth necessary for the welfare of its people. Beginning with a discussion of Mexico's need for capital and then the crises of 1982 and 1994, the role that FDI has played in this process and its role in the future is shown.

A. The Need For Capital in Mexico

The 1995-2000 National Development Pian[255] recognizes the importance of FDI for Mexico. The Plan's goal is to rely on foreign investment as an instrument of support for Mexico's development and to avoid the risks derived from excessive dependence on short-term foreign investment.[256] In addition to the PND, there is also the Mexican government's decree entitled the "Industrial Policy and Foreign Trade Program"[257], which is the regulation of the PND within specific sectors[258].

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[255] *Plan Nacional de Desarrollo 1995-2000*, D. O. May 31, 1995, [hereinafter *PND*].

[256] *Ibid.* at 145. "*Inversión y Ahorro Externo*". To achieve this goal, the Plan states that the next things shall be accomplished:

a) Stability and certainty within the financial and economic evolution of the country, through fiscal, monetary, financial and currency exchange policies;

b) A stable real exchange rate, in accordance with an expansion of exports and a balanced current account in the balance of payments financiable in the short term;

c) A stable and attractive real yield to both, foreign and national investors;

d) That the National investment receives the same treatment than that of foreign investment to avoid, on one hand, that foreign investment receives subsidies at the expense of the national economy and, on the other hand, that investment would not be attractive to foreign investors;

e) To procure that foreign resources are oriented towards productive direct investments, eliminating rule barriers that, without any juridical justification, exist for foreign participation in the productive activity;

f) Promote conditions that encourage long term investments, to discourage the flight of capitals; and,

g) To give juridical security and certainty to direct foreign and national investment.

[257] *Programa de Política Industrial y Comercio Exterior*, published in D.O. on May 31, 1996; [hereinafter *PPICE*]. It is important to mention that this Program sates that the policies that Mexico shall follow through the next years shall be:

1) Macroeconomic stability and financial development;

2) Creation and improvement of infrastructure and human resources;

As Cárdenas has written: "Mexican economic development has been closely connected to the foreign sector through must of its history. From colonial times to the present, the export sector has been instrumental in either promoting economical growth or creating recessions and crises in the balance of payments. and composition."[259]

1. National Conditions

Mexico needs high rates of economic growth to recover from the accumulated residues of the past years' lack of growth to be able to confront the growth of the population and improve employment opportunities[260]. According to the Ministry of Commerce and Industrial Promotion, Mexico's economy needs to grow at an average annual rate of at least 5%.[261] The necessary growth can only be achieved if the rates of investment are up to 24% of the gross national product[262].[263]

Because of the protectionist system that reigned in Mexico before the 1990s, the industrial sector did not grow sufficiently. Some public services such as telecommunications, transport, basic petrochemical goods, gas and electricity have not

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3) Promotion of production chains;
4) Improvement of the technological infrastructure;
5) Economic Deregulation;
6) Exports promotion;
7) International Trade negotiations; and,
8) Competition.

Ibid. at 37 " *II. Objetivos y Estrategias de la Política Industrial*" (Objectives and Strategies of the Industrial Policy).

[258] From the joint treatment of trade and industrial policy that the PPICE assumes, we shall imply that the Mexican state, in accordance with the recent international trend, recognizes the importance that investment has for trade in an interrelated basis, as already seen before.

[259] E. Cardenas, "Contemporary Economic Problems in Historical Perspective" in D. S. Brothers & A. E. Wick, eds., *Mexico's Search for a New Development Strategy* (U.S.: Westview Press, 1990) at 1.

[260] By the end of the present century estimations said that Mexico will have 105 million inhabitants, thus an estimated 1.5 million jobs must be created annually to cover that population and to give employment to the presently unemployed. L. Solís, "Social Impacts of the Economic Crisis" at Brothers & Wick, *supra* note 259 at 46.

[261] *PPICE, supra* note 257 at 34.

[262] *Producto Interno Bruto (PIB).*

[263] The rate is given in the *PPICE, supra* note 257 at 4.

been strong enough to meet the current requirements of the economy.[264] Thus, investment flows are necessary in order to create and expand Mexico's infrastructure and permit economic development in the future.[265]

Furthermore, as will be discussed later, within the globalization context, the volatility of the financial market is an unavoidable reality; thus, it is necessary for Mexico to become more economically stable to attract long-term investments and to promote internal revenue.[266] This will achieve the macroeconomic stability needed to attract future FDI. Mexico, like many other developing countries, does not have enough internal revenue, thus foreign investment becomes necessary to make up for the shortfall [267].

Another important sector that Mexico needs to develop is technology[268]. In order to compete on an international level, Mexico needs capital in the area of research and development (R&D) to create comparative advantages and participate in the global economy from a better position. In order to achieve these goals, Mexico's Foreign Investment Law promotes the establishment of MNCs, which are the main economic source of technological knowledge. Furthermore, with the new Protection and Promotion of Industrial Property Act[269] and NAFTA[270], intellectual property rights now enjoy greater

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[264] That is the main reason why the new legal regime including the Foreign Investment Law and NAFTA allow foreign investment in such sectors.

[265] On regard of this specific point and to show its importance, I will transcribe a paragraph from president Zedillo's speech before the Senate on January 3, 1995 when he announced a program to overcome the crisis of 1994. He said: "*El crecimiento y el empleo exigen que el país construya una infraestructura adecuada. Debemos reconocer con toda honestidad que el país todavía arrastra importantes carencias en materia de infraestructura que limitan su potencial de crecimiento y de generación de empleos. Debemos reconocer con igual honestidad que el gobierno federal no cuenta con los recursos suficientes para emprender por sí solo la edificación de la infraestructura para un desarrollo integral y equilibrado entre las regiones del país.*" (Growth and Employment demand that Mexico builds an adequate infrastructure. We shall honestly recognize that the country is still carrying on significant lacks of infrastructure that limit our potential growth and the creation of jobs. We shall honestly recognize too, that the federal government does not have enough resources to build the necessary infrastructure by itself for an integral and equilibrated development among the country regions.)

[266] See *PPICE, supra* note 257 at 38. 4.

[267] See J. A. Gurría T., *Flujos de Capital: El Caso de México* (Chile: United Nations, 1994) at 11.

[268] See *PPICE, supra* note 257 at 79 "*III. 4. Mejoramiento de la Infraestructura Tecnológica para el Desarrollo de la Indsutria*" (Improvement of the Technological Infrastructure for the Development of the Industry).

[269] *Ley de Fomento y Protección de la Propiedad Indsutrial,* see *supra* note 240.

[270] Most of the time the direct sale of intellectual property rights from foreign firms is not common. When this happens the best way to attract the new technologies to an economy is through FDI. Within this context, NAFTA enhances the establishment of FDI and thus, the transference of technology.

protection. Thus, transfer of technology arrangements should grow as well. It will also be necessary to promote the establishment of new machinery and equipment to create core advantages in the Mexican economy, thus allowing Mexico to compete in the international arena[271].

Due to its current account deficit, Mexico had to devalue its currency in 1994 and with this, inflation became another problem from which the national economy suffers. Hence, it is necessary to reduce this deficit in order to reactivate its economic growth.[272] There is also the huge external debt that Mexico has been accumulating throughout its history, which is around US$100, 000 million just in the public sector[273].

Finally, it has been said that Mexico's need for foreign investment to complement its national investment is now necessary in order to correct the current account[274] deficit, which was caused, according to one author, by private investment growing faster than its capacity to generate savings.[275] Whatever the reason: "The key task of Mexican economic policymakers in the 1990s is to promote the restructuring and growth of the Mexican economy while keeping inflation under control. Investment, generated both from domestic savings and from foreign sources, will be the primary engine of growth."[276] In sum,

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[271] Frequently, industrial machinery and equipment directly embody the new technologies. Thus, being the necessary means to assimilate them (the new technologies). Furthermore, with its use, labor is capacitated to use the most advanced machinery and equipment and permits future development of industrial technologies. See *PPICE*, *supra* note 257 at 96.

[272] See Ernesto Zedillo, "*Mensaje a la Nación Pronunciado por el Presidente Ernesto Zedillo Ponce de León el 3 de Enero de 1995*" at *Acuerdo de Unidad Para Superar la Emergencia Económica* (Mexico: Senate LVI Legislature, 1995).

[273] Source: Banco de México, *Indicadores del Sector Externo*, vol. 167 (Mexico City: Bank of Mexico, June 1996) at 71.

[274] "current account" is "[t]he first great account of the balance of payments, which includes imports and exports of merchandise, service payments, such as insurance, tourism, transportation and payment of income such as interests and dividends." Cámara Nacional de Comercio de la Ciudad de México, *Mexico: Data and Statistics Digest 1993* (Mexico City: CANACO, 1993) at 355.

[275] Different from the current account deficit that was caused in the past when there were very little national savings. See Gurría T., *supra* note 267 at 19. It is also important to mention that within the 1989-1993 period foreign investment in the manufacturing sector declined form 67% to 49%; on services it increased from 32% to 49%, and finally, the agriculture sector has been stagnated at levels around 1%. *Ibid.*

[276] G. C. Hufbauer & J. J. Schott, North American Free Trade: Issues and Recommendations (Washington, D.C.: Institute for International Economics, 1992) at 19.

Mexico continues to have many economic problems: a low Gross Domestic Product, an increasing inflation, a large external debt and a current account deficit[277].

2. The Competition for FDI

The flows of capital world wide have grown quickly as is the case with trade. During 1980 to 1992, FDI grew at an annual rate of 12.5%[278]. However, the competition to attract new FDI is fierce for both developed[279] and developing countries[280]. Furthermore, with the entry of China, India and the Eastern European countries into the competition to attract FDI, Mexico's efforts to attract capital flows[281]must be redoubled. In 1993, China attracted almost 40% of the FDI destined for developing countries and Latin America, as a whole, in second place attracted only 28%.[282]

Competition can also be seen in the area of exports promotion. Developed nations spend great amounts of capital to promote exports[283]. Mexico, on the other hand, has two main programs to promote exports, the *Maquiladora*[284] program and the Temporary Imports to Produce Export Goods Program (PITEX)[285]. However, as a result of NAFTA these programs will change by the year 2001[286].

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[277] It is interesting to note that almost the same problems have existed since the 1980s. To compare it see A. Maddison, "Comparative View of Mexico's Adjustment and Growth Problems" in *supra* n. 259 at 28-41.

[278] See *PPICE, supra* note 257 at 12.

[279] *Ibid.* within the same period developed countries attract 78% of that FDI.

[280] *Ibid.* however some developing countries had annual rates of FDI attraction bigger than the world average, specifically the Southeast Asian countries growth was higher to 16%. In 1993 those countries attracted 67% of FDI within the developing world.

[281] See *supra* note 176.

[282] See *PPICE, supra* note 257 at 15.

[283] Canada being the one that spends the most. See *Ibid.* at 127.

[284] For more information about *maquiladoras* see Nadeau, *supra* note 26 at 44-57; where *maquiladoras* are defined 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." See also G. C. Hufbauer & J. J. Scott, *North American Free Trade: Issues and Recommendations* (Washington, D.C.: Institute for International Economics, 1992) at 91-105.

[285] *Programa de Importación Temporal para Producir Artículos de Exportación.*

[286] In accordance with NAFTA's Annex 401 Mexico's reserve list and Art. 19 of the *Decreto para el Fomento y Operación de la Industria Maquiladora de Exportación*, D.O. December 22, 1989 where it is stated that the *Maquiladora* industry will be allowed to introduce its products completely within the Mexican market after seven years (since 1994, after the entry into force of NAFTA).

Thus, Mexico must be more competitive, realizing that relative comparative advantages are no longer the basis for competition and that markets become more interrelated every day. Mexico must compete more effectively against developed and developing countries to attract the necessary foreign capital to achieve economic growth. The concept of competition is now broader, as it is now understood to include the efficiency of a market in adapting itself to the contestable markets theory[287]. The goal is improved market contestability in order to attract more efficient investment flows[288]. Thus, Mexico should become an active promoter of the insertion of competition rules within the multilateral trade agenda, namely the WTO and the OECD.

3. Conclusion

The conditions explained above are important factors considering the course that the Mexican economy has taken in the past and is still taking today. Chief among them is Mexico's need for capital to promote national growth. Nevertheless, methods of raising capital have changed. From stimulating private (national and/or foreign) investment in the country to the reliance on loans by commercial international banks to foster public spending. The next part of this study will follow this phenomenon through the most recent economic crises Mexico has suffered. Finally, the last chapter explores the possibilities that FDI offers to Mexico in order to collaborate in the growth of Mexican economy and presents the possible legal instruments that can be used to attain that goal.

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[287] The theory of contestable markets was advanced by William J. Baumol..in 1982. He argues that the optimal form of industrial organization is a perfectly contestable market characterized by costless entry and exit. In such a market the entrant would encounter no obstacles in terms of production techniques or perceived product quality relative to the incumbent. Thus, entry would be judged simply on the basis of the incumbent's prices.
Schoenbaum, *infra* note 288 at 1.

[288] See T. J. Schoenbaum, "The Concept of Market Contestability and the New Agenda of the Multilateral Trading System" (1996) 11 ASIL Insight 1.

B. The Debt Crisis

For three decades, from 1940 to 1970,[289] the Mexican economy had a stable and sometimes rapid growth, based principally on a mixed economy in which the State had a planning role[290]. However, in the 1970s, some developments undermined Mexico's economy[291]. "At the end of the 1980s, Mexico was going through particularly difficult economic circumstances: high inflation of close to 160 percent annually, a public sector deficit of 16 percent of GDP, a large external debt representing almost half of GDP, low growth rates, and a lack of competitiveness in the country's productive plant."[292] In August 1982 Mexico announced that it could not fulfill its international financial obligations[293]. The main cause was the extraordinary amounts of foreign borrowing between 1975 and 1982 from commercial banks[294]. Nevertheless, there were other factors, such as the increase of world real interest rates, the decline of commodity prices[295], the recession in the U.S.[296], along with capital flight[297] after the first signs of economic crisis appeared, for example, the overvaluation of the peso.

It was during the administrations of Presidents Luis Echeverría and José López Portillo (1970-1982) that the government asked for huge amounts of funding from

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[289] See L. Solís, *La Economía Mexicana*, vols., 1 & 2, (Mexico: Fondo de Cultura Económica, 1973) for a detailed survey on the Mexican economy within this period.

[290] It was under the import substitution system that Mexico grew for a long time. However, the Mexican companies were not competitive and, furthermore, they were not job creation activities.

[291]
> First, excessive protectionism and generalized government control greatly encouraged rent-seeking activities and created a rigid economic structure unable to react rapidly to changing world economic conditions[, and s]econd.....the combination of increasing burdens on public sector budgets and inefficient tax systems reduced government's ability to provide social services efficiently and generated an increasing degree of inequality. Third, as a result of weak public finances structures...[it was] forced to rely on inflationary financing as a way to bridge government expenditures and revenues. And fourth,...exports were greatly discouraged...

S. Edwards, *Crisis and Reform in Latin America: From Despair to Hope* (U.S.: World Bank, 1995) at 1-2. See also J. A. Erfani, *infra* note 301 at 59-125.

[292] P. Aspe A., "Responding to Transformations in the Developing World" in Boughton & Lateef, *infra* note 333 at 127.

[293] In words of Sebastian Edwards, "[t]his announcement marked the beginning of the worst international financial crisis since the world depression in the 1930s." Edwards, *supra* note 291 at 17.

[294] Due to the policy of commercial banks to lending to developing nations after the oil shock in 1973.

[295] Edwards, *supra* note 291 at 22.

[296] See Hoagland, *infra* note 305.

[297] A total of US$2,958 million went out of Mexico in 1980 and US$10,914 million in 1981. Erfani, *infra* note 301 at 144.

international and commercial banks to finance the public expenditures[298] and to promote the oil industry[299], in which new oil reserves were found. The government accepted the idea that Mexico needed to attract capital in order to supplement domestic savings and finance higher rates of capital accumulation. The problem was that the government centered it within flows from multilateral institutional and foreign commercial banks and did not give private flows a significant role[300].

> However, "the public foreign debt crisis of 1982 was not only a vestige of the Echeverría and López Portillo borrowing and spending years. The debt crisis was also linked to the stabilizing growth strategy, which had fostered an economically powerful private financial sector insistent, by the early 1980s, on siphoning public credit off into dollar accounts rather than employing it in productive investment."[301]

Moreover, Mexico's production of exportable goods declined along with the increasing number of imports that Mexico's industry needed.[302] Also, as much as four-fifths of the deficit in the current account was because of the growing deficit in debt servicing[303].

Thus, in September 1982, the banks were nationalized in Mexico[304], after closing the foreign exchange markets and freezing some US$12 billion time deposits in Mexican

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[298] State-owned enterprises jumped from 175 in 1971 to 458 in 1976. Current public expenditures grew from 8% of GNP during 1996-1972 to 10.7% in 1973-75. Federal government expenditures went from 41 billion pesos in 1971 to 145 billion in 1975. Erfani, *infra* note 301 at 129.

[299] There was a discovery of large oil reserves in the late 1970s and the government borrowed with the future oil revenues guarantee. However, oil prices dropped dramatically in 1981-82 and Mexico faced a debt crisis.

[300] See Edwards, *supra* note 291 at 46. See also Erfani, *infra* note 301 at 129, where he points out that the extreme spending of the government was financed mainly through the contraction of loans from foreign commercial banks.

[301] J. A. Erfani, *The Paradox of the Mexican State: Rereading Sovereignty from Independence to NAFTA* (London: Lynne Rienner Pub., 1995) at 128, further ahead at 132 he says with regard to the crisis cause the "[m]assive foreign public borrowing to finance public spending in combination with private sector investment slowdowns and capital flight eventually led to the contradictory economic policies after 1973 [including the nationalization of banks] and then to dire economic crisis in 1976 [and 1982]."

[302] In fact, the import substitution program did not work to alleviate Mexico's balance of payments problem. It only replaced imports of consumer goods with imports of machinery, capital goods and basic grains. P. E. Sigmund, "The Regulation of Foreign Investment in Mexico and Its Impact on income Distribution" at P. Aspe & P. E. Sigmund, *The Political Economy of Income Distribution in Mexico*, eds., (New York: Holmes & Meier Pub.) 247 at 250.

[303] See Erfani, *supra* note 301 at 143-151. To acknowledge certain problems regarding the nationalization of banks in Mexico, see also J. Camil, "The Nationalized Banking System and Foreign Debt" in Brinsmade, *infra* note 305 at 323 - 329.

[304] Mainly to attack capital flight that was flowing from the private banks dollar accounts.

banks[305]. Then the unthinkable happened: the government announced a moratorium on the payment of its foreign debt until the end of 1984[306].[307] At the same time, for the first time in recent Mexican history, the Mexican Central Bank announced implementation of the exchange controls system[308] which changed by decree on December 13, 1982 into a simpler, partial one[309].

However, after realizing that it was not only a short-term financial crisis, but also a structural debt crisis, the IMF announced delivery of an emergency package of $5 billion dollars.[310] Due to it nature and origin, the 1982 crisis could be considered as irregular because most of the indebtedness of Mexico (and the other Latin American countries) was owed to commercial banks. Thus, it was not only a matter of restructuring the debt with government creditors. Mexico also had to consider the restructuring of commercial bank credits[311]. This gave origin to the participation of the IMF, the official creditors and commercial bank creditors to build a framework for the restrcturing of the debt.

On August 27, 1983, Mexico signed an agreement with the IMF and the commercial banks to reschedule its debt. Nevertheless, the damage was already done. A

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[305] A. C. Hoagland, "Overview: Perspective from an American Lawyer in Mexico" in L.L. Brinsmade, *et al., Symposium: Doing Business in Mexico: The impact of its Financial Crisis on Foreign Creditors and Investors* (1984) 18 Int'l Lawyer 285 at 287.

[306] Another contradictory measure that the government took to face the crisis was the use of quantitative trade restrictions during 1982-84 with the consequence of a reduction in imports of intermediate inputs, hurting its economy by reducing the level of economic activity and growth. See Edwards, *supra* note 291 at 32.

[307] To acknowledge the devastating economic and social effects that the crisis had during this period see Hoagland, *supra* note 305 at 287- 295.

[308] Its principal guidelines were: (a) all payments to be made by residents of Mexico to nonresidents were subject to the authorization of the appropriate authorities; (b) no payment in foreign currency was authorized within Mexico and obligations in foreign currency payable in Mexico had to be paid in Mexican currency; (c) all foreign currency received by residents in Mexico was required to be converted into Mexican currency at the applicable rate of exchange; (d) the import and export of Mexican and foreign currency required the prior authorization of the appropriate authorities; and (e) different rates of exchange were established taking into consideration different kinds of transactions.

F. A. Vázquez P., "Legal Aspects of Mexican Exchange Controls" in Brinsmade, *supra* note 305 at 310.

[309] *Ibid.* at 312 - 321.

[310] See Edwards, *supra* note 291 at 19-20. However it was until December 1982 that the IMF gave final approval to the $4 billion loan during the beginning of Miguel de la Madrid's *sexenio.*

[311] "This was a new problem and one which the international banking, regulatory and legal communities addressed reasonably well, considering that there were very few precedents available in the early years of the crisis". R. Reisner, "International Debt: Focus on Mexico: A Panel" (1988) 82 Am. Soc. Int'l L. Proc. 478 at 479.

foreign funds reduction of about 40% between 1981 and 1983 in all of Latin America and a major turnaround in the trade balance were consequences.[312] Government obligations increased in real value due to currency devaluations, making it impossible to pay the debt off. In fact, studies showed that it was not possible for Mexico and some other Latin American[313] countries to pay even the interest on the debt in the short-term[314]. Hence, the idea was to condition the entrance of new money and the restructuring and reduction of debt to structural reforms, which at the same time produces a faster recovery and sustainable growth.[315]

1. The IMF "conditions"

It was not until 1989, with the Brady Plan[316], that the crisis was confronted in all of Latin America in a more homogenous and effective way. Before that[317], Mexico had already reached a stand-by agreement[318] with the IMF in order to forestall its US$97.6 billion debt obligation.[319]

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312 *Ibid.* at 23.

313 The Latin American countries affected by the debt crisis were Argentina, Brazil, Bolivia, Chile, Costa Rica, Colombia, Dominican Republic, El Salvador, Ecuador, Honduras, Haiti, Guatemala, Guyana, Jamaica, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay and Venezuela.

314 These studies suggest that "[a] typical major debtor needed financing in the form of new money for about five years to experience some recovery in real consumption...and in real income." Edwards, *supra* note 291 at 32.

315 *Ibid.*

316 In March 1989, U.S. Secretary of the Treasury Nicholas Brady announced a new initiative based on voluntary debt reduction. "He proposed to exchange old debt for new, long-term debt with a lower face value...Typically, principal payments on these new securities were backed by thirty-year, zero-coupon U.S. Treasury Bills, with interest payments subject to rolling three-year guarantees." S. Edwards, *The Evolving Role of the World Bank: The Latin American Debt Crisis* (Washington, D.C.: World Bank, 1994) at 4. See also H. Reisen, *Debt, Deficits and Exchange Rates: Essays on Financial Interdependence and Development* (Great Britain: OECD, 1994) at 55-65.

317 On July 22, 1986.

318 "A stand-by agreement is a negotiated arrangement. Usually an IMF delegation will visit the country on a fact-finding mission and begin negotiations which often can stretch out over an extended period. The negotiated terms are then embodied in a letter of intent. Failure to meet the performance criteria identified in the letter of intent usually will result in inability to receive funds under the agreement." A. B. Sander, "International Debt: IMF-Mexico Stand-By Agreement -*Letter from Gustavo Petriccoli, Mexican minister of Finance to Jacques de Larosiere, Managing Director IMF*" (1987) 28 Harv. Int'l L. J. 157 at 157.

319 In its letter of intent Mexico first compromised "to reduce its public spending deficit by increasing revenues and by decreasing public expenditures on goods and services...... [t]he agreement also takes a partial step toward moving the Mexican economy in the direction of more free trade." Sander, *supra* note 318 at 158.

The efforts to reduce the consequences of the crisis were varied. After basing growth on public expenses some efforts were made to cut public expenditure[320] which, together with the huge indebtedness, were the main causes of the crisis. In Mexico during the de la Madrid[321] administration, a stabilization program that combined fiscal and credit constraints along with an exchange rate anchor and income policies was made with the support of labor unions and representatives of the private sector[322]. Along with these stabilization measures Mexico's program went further. It privatized several state-owned companies[323], deregulated economic activities, reformed its legal system and entered into negotiations with many countries to promote trade via free trade agreements and to open its economy.[324]

This occurred with the worldwide recognition that the debt crisis and the economic problems that the region was experiencing were not only a short-run liquidity problem, but also that the structuralist theory was no longer effective in a globalized world. It was evident that as a region they needed to rely on openness, freer markets, deregulation and privatization policies.[325]

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[320] more than 20% during 1982-86. Edwards, *supra* note 291 at 26.

[321] President Miguel de la Madrid H. (December 1, 1982 - November 30, 1988).

[322] called the "*Pacto de Solidaridad Social*" signed on December 1987. See Edwards, *supra* note 291 at 39. With it, inflation was reduced from 159% in 1987 to 8.6% in 1993.

[323] not only to generate the so badly needed capital, but also as a larger strategy shifting Mexico's economy to a market-oriented one. The financial sector, including banks was liberalized later in 1990 with the publication in D. O. of the *Ley de Instituciones de Crédito* on July 19, 1990; and the amendment of articles 25, 26, 28 & 73 fr. X of the Constitution (which enter into force on June 28, 1990). See F. Borja M., *El Nuevo Sistema Financiero Mexicano* (Mexico: Fondo Cultura Económica, 1991).

[324] For an inside view of these period, see Cardenas, *supra* note 259 at 17-23. See also M. de María y Campos, "El Cambio Estructural en la Evolución Reciente de la Economía Mexicana" in M. de la Madrid H. *et al.*, *Cambio Estructural en México y en el Mundo* (Mexico: Fondo de Cultura Económica, 1987) at 93, where he states some of the measures that the de la Madrid administration took in order to achieve a structural change of Mexico's economy, such as: a) the rationalization of protection; b) the integral export promotion program; c) the fiscal and financial stimulation to employment policies; d) the substitution of a defensive policy towards foreign investment to one of selective promotion; e) the impulse for he incorporation of modern technologies and the development of Mexico's own technology; and, f) a new scheme of negotiation and insertion within the international arena, based on bilateral actions, as well as on regional and multilateral ones (GATT & NAFTA).

[325] Edwards, *supra* note 291 at 48. "Enrique Iglesias refers to this phenomenon as the emergence of a "trend toward convergence" and identifies four fundamental components: (a) macroeconomic stability, (b) trade openness, (c) poverty alleviation, and (d) a reduced role for government"

Adoption of these policies were the precondition imposed by the multilateral institutions (IMF, World Bank & U.S. Treasury) for assistance.[326] Nevertheless, the important point is that these institutions indeed impose certain conditions in order to release funds. These conditions were, namely: Trade liberalization[327], exchange rate action, tax reform[328], financial reform[329], public enterprise reform[330] and privatization[331].[332] In this way the IMF and the World Bank tried to condition the loans with stabilization programs and with the protection of growth[333].

The macroeconomic stabilization programs were structured upon the following strategies[334]:

1) Reducing the burden of the foreign debt. This was done by: debt-equity swaps; debt-conversion schemes; debt restructuring and voluntary debt-reduction agreements with commercial banks in a consensual manner.[335]

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[326] There has been a discussion as whether these policies were freely adopted or not. Sebastian Edwards says that these institution played a role but "they do not deserve central billing in the process". Edwards, *supra* note 291 at 55; also the ex-director of the World Bank Group from 1981 to 1986 A.W. Clausen has said that "[t]he two Bretton Woods institutions are in the best position in the world to extol the virtues *-in a non- "conditional" way-* of the advantages of liberalizing economic regimes." A. W. Clausen "Establishing a Vision for Promoting Economic Development" in Boughton &. Lateef, *infra* note 333 at 70. See also T. Killick, "Adjustment and Economic Growth" in Boughton & Lateef, *infra* note 333 at 146-158, where he studies the conditionality within the reform process.

[327] In an IMF evaluation Mexico reached the following achievements until 1993 in this area: "Major since 1985; coverage of non-tariff barriers reduced from 90 to 17 percent; tariff range 0-20 percent; tariff average 13 percent. Edwards, *supra* note 291 at 63.

[328] *Ibid.* "Fiscal adjustment since 1985; tax reforms; improved tax administration." See also Aspe. *supra* note 292 at 129, where he says: "The main elements of the tax reform were the reduction in the number of taxes and in tax rates, the widening of the taxpayer base, and the strict enforcement of fiscal laws to fight fiscal evasion."

[329] *Ibid.* "Since 1986; capital account open; no credit allocation; banks already privatized."

[330] Even though that the World Bank prior to the crisis support with loans the operation of state-owned enterprises. See D. Babai, "El Banco Mundial y el FMI: Apoyo o Rechazo al Papel del Estado? in R. Vernon, ed., *La Promesa de la Privatización: Un desafío para la política exterior de los Estados Unidos* (Mexico: Fondo de Cultura Económica, 1992) 261 at 261-268.

[331] *Ibid.* "Major; 100 state owned enterprises already sold; forty t be privatized through 1996." In December 1982 there were 1,125 paraestatales, in December 1988 there were 449. Erfani, *supra* note 301 at 163. P. Aspe A. (former Minister of Finance of Mexico) says that the number of state-owned enterprises in 1982 was of 1,155 and decreased by the end of 1994 by more than 80%. See Aspe, *supra* note 292 at 130.

[332] Edwards, *supra* note 291 at 57.

[333] "A new concern....is the need to design adjustment programs that avoid adverse distributional effects." M. Singh, "The IMF and the World Bank in an Evolving World" in J. M. Boughton & K. S. Lateef, eds., *Fifty Years After Bretton Woods: The Future of the IMF and the World Bank (Proceedings of a conference held in Madrid, Spain September 29-30, 1994* (Washington: IMF & World Bank Group, 1995) 35 at 39.

[334] See Edwards, *supra* note 291 at 69-114.

2) Reducing the public sector deficit. This was done by: tax reforms; expenditure cuts; and, privatization of state-owned enterprises.[336]

3) Implementing consistent domestic credit policies.

4) Designing exchange rate policies consistent with anti-inflationary efforts.

5) Giving credibility to the programs, by assuring that reforms would be sustained through time.[337]

The second part of the restructuring plan was to create instruments by which the debt would be disaggregated, enabling commercial banks to use their debt as a financing instrument and, thereby solving the problem of the huge debt owed to them by Mexico[338]. This, as will be seen later, was one of the contributing causes for the last crisis in Mexico.

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[335] As a result of the agreements made between Mexico and the commercial banks "no bank [had] a preferred position, ... no bank [was] to get out of its loans before every other bank [was] out of its loans, and any bank was paid in advance of any other bank, [Mexico became obliged] to make sure that every other bank was paid a pro rata share of the amount owed to it." Reisner, *supra* note 311 at 480.

[336] See E. Laris A., "El Cambio Estructural en la Industria Paraestatal" in de la Madrid H., *supra* note 324 at 159-166.

[337] Even though along with all these measures the government created a palliative poverty program "solidaridad" is "needless to say [that] the economic and social costs of the policies were substantial. They included acute reduction in real wages, deterioration in basic social indicators such as nutrition and health, loss of human capital, deterioration in income distribution and the consequent impoverishment of the middle classes" Cárdenas, *supra* note 259 at 17-8. It is also important to note that the standard of living of Mexicans has decreased since the financial crisis of 1982. For some data regarding these, see L. Solís, "Social Impact of the Economic Crisis" at D. S. Brothers & A. E. Wick, eds., *Mexico's Search for a New Development Strategy: Proceedings of a Conference Sponsored by the Ford Foundation and the Economic Growth Center of Yale University* (U.S.: Westview Press) at 44-52.

[338] See Reisner, *supra* note 311 at 479-80.

C. THE DECEMBER 1994 CRISIS

After successfully managing the 1980s crisis in Mexico by following the restructuring program from the IMF, World Bank and U.S. Treasury, the country was seen as an example for indebted countries as to what and how policies should be performed in order to achieve economic growth[339]. Moreover, Mexico became the "golden boy" of economic reform, structural adjustment and privatization.[340]

Apparently Mexico was doing very well in dealing with the debt crisis and shifting into a healthier economy. Inflation was reduced from 160% in 1987 to 8.1% in 1993, and GDP grew annually at an average rate of 2.9% in real terms[341]. Its foreign debt decreased with the help of the IMF and World Bank restructuration programs, reducing it by over US$7 billion in principal debt and an annual average reduction in transfers to the rest of the world, from 1990 to 1994, of more than $4 billion a year, allowing Mexico to regain access to voluntary capital markets. Tax reform, the renegotiation of the external debt and the privatization process allowed Mexico to reduce its consolidated public debt from 64% of GDP in 1988 to 22% in 1994.[342]

However, Mexico's economic growth was not sufficient[343]. It grew only an average of 2.9% between 1990-94[344]. Along with this, Mexico developed a huge current

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[339] See Clausen, *supra* note 326 at 89, where he mentions Mexico as one of the success stories together with Chile and China. He even called them "role models" for economic development. See also C. H. Chandler, "El Caso de los Estados Unidos" in de la Madrid H., *supra* note 324 at 55-61, where he (President of Eastman Kodak Co. and president of the Exports Committee of the Reagan's administration) stands out the reform process of the Mexican economy.

[340] See C. C. Lichtenstein, "The Mexican Crisis: Who Should be a Country's Lender of Last Resort" (1995) 18 Fordham Int'l L. J. 1769.

[341] A survey from the G-7 group says that during the 1988-92 period growth recovered at an annual average rate of 3.5% by year. Furthermore the ratio of fiscal balance to Gross Domestic Product declined to only -1.5% in 1991 and a surplus of 0.5% in 1992 from -16% in 1986-87. See M. Yoshitomi, "Main Issues of Macro-Economic Coordination: The Peso, Dollar and Yen problems" in S. Ostry & G. R. Winham, *The Halifax G-7 Summit: Issues on the Table* (Halifax, Canada: Centre for Foreign Policy Studies, Dalhousie University, 1995) 35 at 37.

[342] See Aspe A., *supra* note 283 at 129-131.

[343] As earlier as in the 1990s, some Mexican specialists have already pointed out that Mexico needed an annual average growth of 1.8% just to provide employment to the already 4 million unemployed workers at that time. Furthermore, to recover the 1981 level of per capita income, additional growth average should be of more than 3% annually. See L. Solís, "Social Impact of the Economic Crisis" in Brothers & Wick, *supra* note 259 at 48.

[344] Edwards, *supra* note 291 at 297.

account deficit[345], which was one of the determining factors of the 1982 debt crisis. The business sector felt the reduction of expenditures and faced the need to attract capital from other sources, such as foreign capital[346]. Moreover, interest rates increased in the U.S., which had bad consequences for the Mexican economy, including capital flight[347].

Mexico's currency was overvaluated because of the enormous flows of foreign capital. When a country's currency is overvaluated FDI becomes reluctant because of the danger of a devaluation[348]. Thus, the FDI decrease in Mexico prior to the crisis, together with the decrease and exit of short-term investments, resulted in pressure on Mexico's balance of payments. [349]

Evidently, the misalignment of the peso could not be sustained indefinitely and in December 20, 1994 the Mexican government announced a 53 cent adjustment in the exchange rate of the peso vis-à-vis the U.S. dollar[350]. Thus became a huge devaluation later on even though Mexican officials denied it[351].At that time the exchange rate was a "virtually fixed exchange rate regime"[352], keyed to the dollar since 1992.

With the devaluation came the increased flight of capital, which had already started, and now became bigger, triggering a new crisis which appeared to be as bad (or worse) than that of 1982. The Mexican government announced that the devaluation was to

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345 More than 7% of GDP in 1993 and 1994.

346 See International Finance Corporation (Economics Department), *Prospects for the Business Sector in Developing Countries* (Washington, D.C.: World Bank, 1989) at 1-10.

347 Other effects on real interest rates increase are: less exports, domestic interest rates rise, payments of debt service increase, and real commodity prices fall as investors try to shift their portfolios from commodity-related financial instruments. See C. E. Petersen & T. G. Srinivasan, "Effects of a Rise in G-7 Real Interest Rates on Developing Countries" in D. Vines & D. Currie, eds., *North-South Linkages and International Macroeconomic Policy* (U.S.: Cambridge University Press, 1995) 313 at 321.

348 *Ibid.* at 13-15.

349 For an economic approach of how devaluations affect the balance of payments see J. Pitchford, *The Current Account and Foreign Debt* (London: Routledge, 1995) at 45-57.

350 See Foreign Broadcast Information Service (FBIS), Daily Reports, "Government Announces Devaluation of Peso" (21 December 1994) FBIS-LAT-94-245.

351 Carlos Sales, chairman of the Senate Treasury Commission said that the expansion of the peso exchange rate was temporary and not a devaluation. See Foreign Broadcast Information Service (FBIS), Daily Reports, "Peso Devaluation Not to Affect Foreign Investment" (23 December 1994)FBIS-LAT-94-247. See also Foreign Broadcast Information Service (FBIS), Daily Reports, "People Urged Not to Buy Dollars Out of Panic" (23 December 1994)FBIS-LAT-94-247; where José Madariaga (president of the bankers association) also denied the devaluation.

352 Yoshitomi, *supra* note 341 at 38.

be only a corrective measure[353]and that it would not effect foreign investment. However, on December 28, 1994, the Mexican public was already aware of the effects[354].

1. Short-term foreign investment as a cause of the 1994 crisis

Paradoxically, the debt crisis and the programs to fight against it, together with other circumstances[355], had itself occasioned the 1994 Mexican crisis. As a consequence of the adjustment on its economy and its need of capital, Mexico attracted an extraordinary amount of foreign capital. Thus, foreign exchange became overabundant, overvaluating the real exchange rate[356].[357] Mexico had a fixed exchange rate before the 1990s. However, in the 1990s it widened the band and the currency became overvaluated. The narrow band exchange rate, "which at endpoints of the band mimics a fixed rate"[358], could not stand the pressure that large capital outflows caused to Mexico's balance of payments.[359]

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353 by Foreign Relations Secretary José Angel Gurría. See Foreign Broadcast Information Service (FBIS), Daily Reports, "Peso Devaluation Not to Affect Foreign Investment" (23 December 1994)FBIS-LAT-94-247.

354 Foreign Broadcast Information Service (FBIS), Daily Reports, "Article Warns Against Adverse Effects of Devaluation" (28 December 1994) FBIS-LAT-94-249. In a specialized economic newspaper one author said that the adverse effects were:

> [I]mmediate panic among investors, who will enter the foreign exchange market and deplete international reserves [thing that happened], prompting an increase in domestic interest rates [also happened], which will be hiked in an effort to prevent a flight of capital and to restore balance within the financial sector. In turn, this hike in interest rates will increase the price of money and the cost of domestic public and private debt payments, which will exacerbate the payment problems faced by those seeking credit and bank loans [which also happened].

355 political factors like the Chiapas rebellion, and the murder of the official Party's presidential candidate and General Secretary together with the use of exchange rate policy as an anti-inflationary tool which also provoke an over-abundance of foreign exchange, and the issuance of short-term debt by the government.

356 See Edwards, *supra* note 316 at 8. Along with the exchange rate pressures it also provokes a loss of international competitiveness.

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> The exchange rate is one of the most important prices in an economy, and it is vitally important to have it properly aligned. Only with a realistic exchange rate can businessmen direct resources into competitive sectors, making it possible for countries to lift themselves into the virtuous cycle in which high investment and high growth go together.

International Finance Corporation, *supra* note 346 at 12.

358 Holden & Rajapatirana, *infra* note 383 at 31.

359 See *Ibid.* at 30-31.

Due to its current account deficit, caused by the overvaluated peso and domestic liberalization[360], Mexico needed more capital. The problem was that it was financed by large capital inflows[361]. Nevertheless, no corrective measures were taken[362] even though, prior to the crisis, World Bank staff had already pointed out the danger of relying on massive inflows of foreign capital[363]. They said that Mexico's

> current account deficit remains very high...Underlying the large current account deficit has been a fall in private domestic saving, indicating that foreign capital inflows have in effect financed an increase in domestic consumption[, furthermore,] productivity growth has so far been insufficient to offset the loss of external competitiveness implied by the peso appreciation...[and] with current account deficits of over $20 billion supported by even higher levels of foreign capital inflows, Mexico is vulnerable to foreign capital volatility.[364]

The majority of that foreign capital was in the form of short-term investment[365] not FDI[366]. Furthermore, the rebellion in Chiapas, in January 1994; the murder of PRI's presidential candidate, Luis Donaldo Colosio M., in March 1994[367]; and the murder of PRI's General Secretary, José Francisco Ruíz Massieu[368], cause fear on foreign investors[369]

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360 See Yoshitomi, *supra* note 341 at 37-40.

361 As S. Edwards says: "[w]hile large current account deficits can take place for a limited period of time, they cannot be maintained in the long run. This is a matter of arithmetic. A current account deficit of the magnitude of Mexico's would eventually require that the country devote 100 percent of its GNP to pay interest (and dividends) to foreign holders of Mexican securities." Edwards, *supra* note 291 at 329 (footnote 5); see also appendix 9-1 at 314-317 "The Simple Economics of Current Account Sustainability".

362 it appears to be because an electoral year was coming and because of personal interests of former President Carlos Salinas to contend for the presidency of the World Trade Organization.

363 and not only the World Bank, but also some analysts, like Duff and Phelps of Chicago in 1993 when they said that Mexico was not entirely a safe place to invest so the investments should be made in a short-term basis rather than in a long-term one. See Moisés, *infra* note 381 at 56.

364 World Bank, *Trends in Developing Economies 1994* (Washington, D.C., World Bank, 1994) in Edwards, *supra* note 291 at 298.

365 "Private portfolio capital flows are becoming increasingly important as a source of external finance for developing countries..." Petersen & Srinivasan, *supra* note 347 at 313.

366 In the 1990s capital markets have been used to finance developing countries more than ever. "For 1992 alone, international portfolio investment in emerging markets was more than US$19 billion, which exceeds net loans from international commercial banks, and is more than three times the level achieved in 190." J. Glen & B. Pinto, *Debt or Equity? How Firms in Developing Countries Choose* (Washington, D.C.: World Bank, 1994) at 3.

367 The Stock Exchange Market plunged from a record high of 2,881 points on February 2, 1994 to 1,957 on April 20 as a result of Colosio's assassination. See Mexico -Country Report (London: The Economist Intelligence Unit, 1994) at 18.

368 Later the former president's brother, Raúl Salinas, was charged for this murder.

369 It should be mentioned that a group of U.S. mutual funds managers (Weston Forum) pressured the Mexican government not to raise peso interest rates so (along with other causes) the Mexican government "followed a policy of targeting peso nominal interest rates, by determining a maximum yield on domestic

and they started to take out their investments, which resulted in major declines in the stock of international reserves held by Mexico's central bank from US$30 billion in February 1994 to US$5 billion in December.[370] "By mid-December speculators sensed that the Bank of Mexico was in a weak position. Those who were better informed massively sold pesos and attacked the Bank of Mexico's international reserves. By then it was too late, as the very low level of international liquidity had left Mexico with very little room for maneuvering."[371]

It also appears that not only short-term foreign investments caused the crisis. Domestic short-term investments also flew at the first signs of a possible devaluation. In an IMF report, it is said that "[t]he available data [at that time] show that the pressure on Mexico's foreign exchange reserves during 1994, and in particular just prior to the devaluation, came not from the flight of foreign investors or from speculative position-taking by these investors, but from Mexican residents"[372]. However, while Mexican investors were an important factor in the crisis, the main cause was a profound one; a structural one. Domestic capital flight was just one of the causes that influenced the devaluation. The crisis went beyond the sole devaluation.

What is not clear is why Mexico did not impose exchange controls to deal with the crisis. The IMF Agreement allows a country to do so if it has a temporary exchange crisis[373]. If the exchange controls are imposed on capital movements, IMF members are free to restrict capital flows within its jurisdiction. The answer is given by Cynthia C. Lichtenstein, who says: "[b]ecause to do so would violate the new rules of the game of what [is called] "the internationalized capital markets". The possibility that one might

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currency treasury securities (CETES), above which the Treasury would not sell them." Edwards, *supra* note 291 at 299.

370 See *Ibid.* at 298-99. "Higher interest rates in the United States during 1994 also contributed to the reduction in capital flows into Mexico."

371 *Ibid.* at 299-300.

372 C. Chandler, "The IMF Ties Peso Crisis to Mexican Investors" *The Washington Post* (21 August 1995) A17, col. 4. "The report indicates that Mexican residents' net sales of domestic stocks and bonds and other peso-denominated assets may have totaled as much as US$4.7 billion in December, accounting for more than two-thirds of the US$6.7 billion decline in Mexico's reserves of dollars and other stable currencies that month."

373 *Articles of Agreement of the International Monetary Fund,* Art. IV, 60 Stat. 1401, 3 Bevans 1351 (1945), (1994, as amended). in I. F. I. Shihata, *Legal Treatment of Foreign Direct Investment: "The World Bank Guidelines"* (Netherlands: Martinus Nijhoff Pub., 1993) at 81-82.

impose exchange controls precludes one from access to these capital markets because the last thing that any mutual fund manager can tolerate is the possibility that he or she might not be able to quickly dump a holding and shift elsewhere."[374]

Figures prepared by public and private sectors indicated that as of September 1994 the country had capital account deposits amounting to US$17.2 million, a balance of payments deficit of US$22 billion and capital flight totaling more than US$10 billion, causing a foreign exchange deficit of US$15 billion covered by the central bank's reserves.[375] Moreover, before the crisis an OECD publication warned that the Mexican economy was relying too much on temporary (hot) flows such as portfolio investment and that Mexico was dependent on short-term capital inflows "vulnerable to quick reversal in the event of change in investor sentiment"[376]

Henceforth, one should question why short-term foreign investments were the main type of inflows that came to Mexico. The answer could be influenced by various factors. However, this study will focus on one, which is the restructure of debt program followed by Mexico. As Domingo Cavallo pointed out in the late 1980s[377], it was frightening the accumulation of debt by governments as a result of the obligatory refinance of foreign debt. Moreover, it was frightening to see that along with this accumulation debt process there were sophisticated financial activities which attract a big number of minds which rather than being focused on productive procedures, were focused on what seems to be a big speculative bubble.[378]

On one hand, because of its promotion of macroeconomic policies[379], Mexico had high interest rates which did not help to promote internal savings[380] but which did promote

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[374] Lichtenstein, *supra* note 340 at 1775.
[375] See "Article Warns Against Adverse Effects of Devaluation", *supra* note 354.
[376] Reisen, *infra* note 421 at 208. In a table he demonstrates this by showing Mexico received net inflows of US$8.5 billion in 1990 to US$22.7 billion in 1992; where cool(FDI) accounted for US$2.6 billion in 1990 toUS$6.2 billion in 1992, however hot inflows (portfolio investment and short-term bank flows) accounted for US$5.9 billion in 1990 to US$16.6 in 1992.
[377] In a conference held in Mexico city on June 1987.
[378] See D. Cavallo, "Perspectivas desde los Países en Desarrollo" in M. de la Madrid H. *et al.*, *Cambio Estructural en México y en el Mundo* (Mexico: Fondo Cultura Económica, 1987) at 29-32.
[379] After the Mexican crisis, it has been recognized, finally, that even though macroeconomic stability is necessary for the economic growth of a country it is not sufficient. See Holden & Rajapatirana, *infra* note 383 at 38-39.

the entry of short-term foreign investment[381], creating a deficit in the current account[382].[383] On the other hand, because of some of the instruments used to restructure the debt, such as debt-equity swaps, along with the fall in interest rates in the U.S., Mexico became a large recipient of foreign capital inflows, which sometimes were seeking the best short-term returns[384]. Finally, the last reason for the large inflows of short-term foreign investment was the recent liberalization. An important part of the short-term investment came through the neutral investment channel which fosters portfolio investment[385], and which was incorporated into the Mexican legal system in 1989.[386]

As Mexico was experiencing foreign exchange volatility, long-term financing was difficult to obtain. Therefore, businesses cut investments relying on internally generated funds and short-term foreign investment. In accordance with a World Bank study, businesses have three main sources of funds: a)internal sources; b) loans; c) funds raised form capital markets in the forms of bonds and equity; and, d) FDI[387]. Only in 1987 did Mexican companies raise over US$3 billion in the securities markets[388]. By 1992, 50% of the foreign investment was in the stock exchange market[389]. Therefore, it is clear what source of funds businesses in Mexico were choosing.

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[380] It is important to mention that developing countries such as Mexico are natural importers of foreign capital due to their real investment needs, which are larger if compared with their national income and their level of domestic (internal) savings. See F. Z. Jaspersen, A. H. Aylward & M. A. Sumlinski, *Trends in Private Investment in Developing Countries: Statistics for 1970-94* (Washington, D.C.: World Bank, 1995).
[381] In the 1989-90 period, short-term investment came into the country for a total of US$4, 383 million. and the FDI was around US$7,000 million. Source: SECOFI. See E. G. Moisés, "Panorama Reciente de la Inversión Extranjera" (1995) 9 Cuadernos de Posgrado -ENEP Acatlán 51.
[382] even though its current account deficit was intermediate to low from 1980 to 1993 in accordance with World Bank data.
[383] See P. Holden & S. Rajapatirana, *Unshackling the Private Sector: A Latin American Story* (Washington, D.C.: World Bank, 1995) at 14.
[384] See *Ibid.* at 34.
[385] "which are place through the capital market without entrepreneurial commitment, are relatively short-term and made only for the sake of capital yield..." J. Voss, "The Protection and Promotion of Foreign Direct Investment in Developing Countries: Interests, Interdependencies, Intricacies" (1982) 31 I. C. L. Q. 686 at 686.
[386] In March 1991 SECOFI informed that 74.9% of the foreign investment was channeled to the stock market in the form of neutral capital. See Moisés, *supra* note 381 at 54.
[387] See International Finance Corporation, *supra* note 346 at 21-24.
[388] *Ibid.* at 22.
[389] Moisés, *supra* note 381 at 54.

a) Market-Based Debt Reductions

The most common financial instrument[390] used in Latin America, including Mexico, after the 1980s crisis to attract foreign investment was the "debt-equity swap"[391]. It has a two-functioned nature: on the one hand, it allows a company to pay less than the real full cost of an investment and, on the other, it is a debt management tool, allowing debtor countries' governments to retire its foreign debt at a discount[392].[393]

The benefits of relying on debt-equity swaps for the economy are not very clear[394]. Often they do not result in additional foreign investment but just exchange one type of liability for another (producing higher domestic debt). They are inflationary because most of the time[395] they require the issuance of local currency or local debt if the investment is additional, or cost foreign exchange if it is not.[396] As some authors have pointed out:

> A naive view, ... sees this as a transaction that simultaneously cancels some of the country's external obligations and generates a capital inflow. This is a misleading picture on both sides. The obligation has not been canceled through a swap - it has been exchanged for a different obligation. Moreover, there has been no capital inflow: any investment by the firm that makes the swap is in effect being financed by the country's domestic savings, not by externally supplied resources.[397]

A debt-equity swap is not beneficial when it is additional, or causes "round tripping". Round tripping occurs when a firm that engages in a swap finds a way to take out of the country an equivalent amount of capital as the one it contracts with the swap.[398]

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[390] also called "Market-Based Debt Reduction Instruments".
[391] by them "debtor countries permit private investors to redeem public foreign debt for equity shares in new or existing companies" J. Bergsman & W. Edisis, *Debt-Equity Swaps and Foreign Direct Investment in Latin America* (Washington, D.C.: World Bank, 1988) at v.
[392] Its capacity to reduce foreign debt is very limited.
[393] International Finance Corporation, *supra* n. 346 at 24-26.
[394] That is why Mexico suspended its issuance in 1987. Nevertheless there still are some in operation since then.
[395] exception is made when they are "additional".
[396] International Finance Corporation, *supra* n. 346 at 25-26.
[397] S. Claessens, I. Diwan, K A. Froot & P. R. Krugman, *Market-Based Debt Reduction for Developing Countries* (Washington, D.C.: World Bank, 1990) at 31. See also Bergsman & Edisis, *supra* note 391 at 5-6.
[398] *Ibid.* at 31.

"Additionality" is a problem if the debt-equity swap finances an investment that would have taken place in any case, that is, with or without the swap.[399] In sum, the market-based instruments used to restructure debt are not solutions to debt problems, nor are they the best means to attract capital. They "can worsen the liquidity problems of debtor countries while providing little real long-term debt relief......Extensive debt reduction through a purely voluntary market-based approach is neither desirable nor feasible."[400]

"In Mexico [US]$1.3 billion of debt were converted into equity during 1986 and 1987",[401] while FDI in 1986 was about USD$-49.5 million.[402] Hence, one can observe that the use of swaps should only be incremental; "swaps can never substitute for fundamental changes in the overall investment climate that would be necessary for [Mexico] to reach its potential [to attract] foreign [direct] investment"[403] In fact, after the crisis, foreign bank analysts said that the Mexican debt increased, due to the devaluation and the foreign debt swap programs, from 36.5% of GNP in 1994 to 64% in 1995[404].

The other short-term investment instrument that caused the crisis was the issuance of short-term debt by the Mexican government as "sterilized intervention"[405] to avoid the break-down of the economy caused by hot capital flows. It did not work. As one author says:

> Short-term debt represents a true danger under free capital mobility. In these circumstances rumors, "news", or (temporary) losses in confidence can result in very massive redemptions of government debt, generating serious liquidity problems.[406]

This kind of remedy was the last cause of the crisis. In order to finance the increased external deficit on Mexico's current account, the government issued short-term

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399 *Ibid.*
400 *Ibid.* at 44.
401 International Finance Corporation, *supra* note 396 at 25.
402 Bergsman & Edisis, *supra* note 391 at 3.
403 *Ibid.* at 5.
404 See Foreign Broadcast Information Service (FBIS), Daily Reports, "Foreign Debt to Swell Under Devaluation, Debt Swaps" (10 February 1995) FBIS-LAT-95-028. "[I]n nominal terms the foreign debt has increased by 20.16 percent, jumping from $85,435 billion to $102,659 billion."
405 See Reisen, *infra* note 421 at 205-227.
406 Edwards, *supra* note 291 at 302.

dollar-indexed treasury securities[407]. Thus, once the confidence in the Mexican economy began to decline, the short-term investments slowed and the liquidity of the central bank was not sufficient when compared with the amount of the short-term external debt. [408] Hence, the Bank of Mexico ran out of reserves and the devaluation occurred.[409]

In sum, Mexico's reliance on foreign capital inflows caused an overvaluation of the real exchange rate. Furthermore, because of the short-term nature of the foreign investment, Mexico's economy became highly-sensitive, which, together with an unsustained growth on one hand and the exchange rate policies on the other[410], resulted in a shortage of capital reserves. Later, with the issuance of short-term debt, these circumstances precipitated the crisis. Thus, one of the core problems was the short-term nature of the overwhelming flow of foreign capital into the Mexican market.

The viewpoint of a Mexican specialist on the two different approaches that Mexico had taken to improve its economy bears repeating. The debt-based system before the 1980s, and the short-term foreign investment (including market-based debt reduction) system after the 1980s crisis resulted in the 1994 crisis. He says:

> In the past five years, perhaps the restructuring has made some time to solve the liquidity problem, but unless we find a way to solve the underlying international trade problems, rescheduling is no solution at all. We cannot continue rescheduling forever while the total amount of debt increases annually. If we are to continue borrowing to service part of the debt, I think that we will find no solution. I think that the debt crisis has become a crisis because it is regarded only as a debt crisis, instead of being placed in a broader context of its relationship with international trade, international investment, etc. Unless we are able to develop some kind of solution that takes this broader context into account, the debt crisis will never be solved. The current approach is rather like treating a

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407 called "*tesobonos*".

408 To acknowledge the consequences from a legal perspective, see D. N. Darrow, P. V. Darrow, D. A. Doetsch, M. Jauregui R. & M. Nader S., "Restructuring Strategies for Mexican Eurobond Debt" (1995) 16 Nw. J. Int'l L. & Bus. 117.

409 See Yoshitomi, *supra* note 341 at 38.

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> [o]vervalued exchange rates have often been supported by businessmen who rely on imported raw materials, especially if there are also tariffs on manufactured imports, an by those who have contracted debts in foreign exchange. The evidence suggests [as is the case of Mexico] that the apparent benefits from overvaluation are illusory. What is more, overvalued exchange rates make investors reluctant to commit funds when devaluation can severely reduce their value or increase debt service costs.

International Finance Corporation, *supra* note 346 at 17.

> patient for his fever rather than his illness. If we focus our attention on the fever, the ill person may become a corpse in a very short time.[411]

To prevent the sick person from becoming a corpse, Mexico had already taken some steps, such as its entrance into GATT, the signing of NAFTA and the reform of its foreign investment rules, among others. However, as seen in this chapter there are still some steps to take. Mexico needs to attract more efficient capital to the country to avoid bad experiences such as the last two crises. The next chapter explores the different options that Mexico has in order to attract FDI as the most effective means to promote growth, in contrast with debt and short-term investments.

[411] F. A. Vázquez P., in Brinsmade, *supra* note 305; 482 at 483.

IV. AN ALTERNATIVE SCHEME TO ENHANCE (LONG-TERM) FOREIGN DIRECT INVESTMENT

"En su etapa actual de desarrollo, México requiere del uso complementario del ahorro externo, el cual debe dirigirse a la inversión productiva más que a la obtención de altos rendimientos de corto plazo, para evitar que el retiro repentino de los capitales del exterior ponga en peligro la estabilidad financiera y el crecimiento económico sostenido."[412]

Developing countries have several options to attract foreign capital with which to supplement domestic savings and investment. These countries have the choice to borrow abroad[413] or to attract foreign direct investment and portfolio investment.[414] It appears to be that the safest choice is FDI. Kieler Studien says:

> [I]t is widely acknowledge that debt inflows involve higher risks for the recipient country than FDI. Debt-service schedules are fixed ex ante and are typically not related to the country's ability to pay....In sharp contrast, the payment of dividends to foreign investors is closely related to the host country's economic performance. The servicing of non-debt creating capital inflows is more flexible because FDI provides for risk sharing between the host country and foreign investors.[415]

This final chapter focuses on the importance that FDI has on developing countries, such as Mexico, as a means to promote growth. As this study's viewpoint is a legal one, it examines the relationship between the rule of law, FDI and how a country can attract more FDI than other than through capital flows such as short-term investment and debt, which are problematic when economic growth relies on them. Finally, it examines the latest international developments in this area and how they could benefit Mexico.

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412 *Plan Nacional de Desarrollo 1995-2000*, D. O. May 31, 1995 at 144. In English: Within its current development stage, Mexico needs the complementary use of foreign capital, which shall be directed to productive investment more than to the attainment of short-term high yields, to avoid that abrupt take offs of foreign capital threat the financial stability and sustainable economic growth.

413 See L. Taylor, *Foreign Resource Flows and Developing Country Growth* (U.N.: World Institute fro Development Economics Research -WIDER, 1991) for a thorough survey on the effects of debt financing in developing countries.

414 See K. Studien, *Debt versus Equity Finance in Developing Countries: An Empirical Analysis of the Agent-Principal Model of International Capital Transfers* (Germany: J.C.B. Mohr Tubingen, 1989), where he does an analysis of the two main choices (debt and FDI) from both perspectives, the firm and the host country.

415 *Ibid.* at 1.

A. FDI AS A LONG -TERM INVESTMENT REMEDY

FDI is the transfer of resources, including intellectual property and management, in return for claims on all or part of the future profits, from a foreign firm to a host country. Hence, it is both an industrial and a financial phenomenon[416].[417]

On one hand, as noted before, lending from commercial banks has proven to be a heavy burden for Mexico. Mexicans suffered a decrease in their standard of living because of the debt service requirements. Hence, Mexico needs to share the risks of financing its economic growth with the agents of FDI, the MNCs, and not only through loans and short-term investments. As one author says, there are three main reasons why heavy reliance on bank finance is undesirable:

> 1. [It] entails variations in debt service requirements that only accidentally correspond to changes in the borrower country's ability to service debt;
> 2. [It] requires repayment regardless of the performance of the borrowers' macroeconomies or specific projects or programs, and hence shifts risk only through default; and,
> 3. [It] provides lenders with no stake in the outcome of the borrowers' macroeconomies or specific projects or programs, and, hence does not give any responsibility for the selection or execution of programs or projects to the suppliers of capital.[418]

On the other hand, financing economic growth and the current account deficit through portfolio investment has some bad consequences. First, in comparison with FDI, "it is not possible for direct foreign investors to sell a plant in an exchange market". Second, "if [a] global bond fund or the equity emerging markets fund manager determines that...Mexico no longer seems able to add performance to the fund or even will substantially detract, the *tesobonos* [bonds] in the bond fund are dumped on the

[416] See Lessard, *infra* note 418 at 131. He also says that the financial contribution of FDI includes "(1) the capital provided by the foreign firm, (2) the risks assumed by the foreign firm, and (3) the improved economic performance of the project or enterprise due to the incentives provided by the ownership/contractual structure." *Ibid.* at 132.

[417] The most common used definition for FDI is the one made by the IMF as: "Investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor's purpose being to have an effective voice in the management of the enterprise." International Monetary Fund, *Balance of Payments Manual* 408 (Washington: IMF, 1977) at 136

[418] D. R. Lessard, "The Financial Component of Foreign Direct Investment: Implications for Developing Countries" in Robinson, *infra* note 425; 131 at 147.

market as are the shares of Mexican companies."[419] Hence, the central bank would have to use its reserves to defend the peso and the country's reserves flow out "as quickly as they were added by the portfolio investors."[420]

FDI brings the following benefits to host countries:[421]

a) a source of foreign finance so needed after the breakdown of commercial bank lending;

b) contributes to development, transferring technology[422] and know-how[423], as well as the promotion of a more efficient share of risk than other means to attract capital;

c) creates jobs[424];

d) creates welfare;[425]

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419 Lichtenstein, *supra* note 340 at 1774.

420 *Ibid.*

421 See H. Reisen, *Debt. Deficits and Exchange Rates: Essays on Financial Interdependence and Development* (Great Britain: OECD, 1994) at 66. See also J. M. Grieco, "Foreign Investment and Development: Theories and Evidence" in Moran, *infra* note 428 at 35-37, for a description of the "Proponents of Foreign Direct Investment School".

422 One of the theories that explains why MNC transfer technologies to developing countries is the "Product-Cycle Theory" by Raymond Vernon, which says that "[t]he optimal location in the world to produce a product changes as the market for the product matures." Hence, after a product has been developed maturity costs increase and production has to shift [within the technology] to less developed markets. Hill, *infra* note 425 at 133-136. See also J. Saúl Lizondo, "Inversión Extranjera Directa" (1995) 9 Cuadernos de Posgrado -ENEP Acatlán 59 at 66.

423 See R. McCulloch, "New Perspectives on Foreign Direct Investment" in K. A. Froot, ed., *Foreign Direct Investment* (Chicago: University of Chicago Press, 1993) 37 at 38-41, where she explains why firms engage in FDI instead of exporting, licensing and other modes of entry.

424 Mexico needs the creation of new 1,200 per month to surpass the current deficit in job creation. See R. Llanos Samaniego, "En 10 anos se podría abatir el déficit de empleo, díce el CCE" *La Jornada* (17 July 1996) LARIOS. HTM. However, there is a discussion on the effects on jobs that FDI could have when it is made in the form of Mergers or Acquisition with domestic companies. See McCulloch, *supra* note 423 at 47-8. Nevertheless, and in accordance with Michael Porter's theory of the "stages of competitive development" labor is the first endowment or factor that attract FDI. "After all, economic development is characterized by the steady accumulation of physical and human capital, which produces the sequential pattern of dynamic comparative advantage in any market-based, growing economy." Ozawa, *infra* note 427 at 34.

425 However, it should be noted that the Hecksher-Ohlin-Samuelson Model says that with international trade (and here we include the movement of capital) both parts (host country and the MNC) will experience an increase in their aggregate welfare. "[I]t has been demonstrated....that, while aggregate welfare would be improved by foreign investment, the welfare of the nationals in the country receiving the investment might not change or might even decline." R. S. Eckaus, "A Survey of the Theory of Direct Investment in Developing Countries" in R. D. Robinson, ed., *Direct Foreign Investment: Costs and Benefits* (New York: Praeger, 1987) 111 at 115. See also C. W. L. Hill, *International Business: Competing in the Global market* (Illinois: Irwin, 1994) at 118-119 & 129-133, where there is a definition of the Heckscher-Ohlin Theory which says: "Countries will export those goods that make intensive use of locally abundant factors of production and import goods that make intensive use of locally scarce factors of production."[including capital as a factor of production].

e) substitutes financial aid, loans and portfolio investment as means to attract capital[426], and finally,

f) creates growth[427].

Despite the potential benefits of FDI, the other side of the coin, that is the opposite view held by the *dependence* school [or dependency theory], says that FDI has the following negative effects on host countries' economy: "[MNCs] soak up local capital for their projects rather than bring in many new resources; that they use inappropriate technologies developed in response to the labor/capital proportions in the home country; and that they drive domestic producers out of the market"[428], concentrating income and increasing foreign indebtedness.[429] Nevertheless, the empirical data shows that they were more further away from reality than the pro-FDI advocates even though the debate has not ended[430].

Another relevant issue with regard of FDI is its potential power to respond to improved government policies[431]and other factors, making it more attractive for countries. FDI responds to factors such as: (a) geographic location; (b) natural resources; (c) market size; (d) labor and other factor supply[432]; (e) regulations and the enforcement of law; and, (g) macroeconomic policies. Hence, a country could attract or repel FDI depending on how these factors are developed.[433] Along with these factors, one should also consider the "coping capacity" of a country, that is, "the ability to exploit and indeed

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[426] See G. T. Ellindis, "Foreign Direct Investment in Developing Countries and Newly Liberalized Nations" (1995) 4 Detroit C. L. J. Int'l L. & Pract. 299 at 306-308.

[427] it seems to be a direct relationship between investment and growth and between the latter and welfare. In fact, World Bank studies assume a linear relationship between investment and growth. This is the "incremental capital-output ratio" (ICOR). See Easterly, *infra* note 443 at 8. See also T. Ozawa, "Foreign Direct Investment and economic development" (1992) 1:1 Transnat'l Corporations 27, where he explains how FDI play a crucial role to facilitate economic growth in developing countries with explicit reference of the Japan's and Southeast Asian's experiences.

[428] T. H. Moran, "The Future of Foreign Direct Investment in the Third World" in T. H. Moran, *et al., Investing in Development: New Roles for Private Capital?* (New Brunswick, U.S.: Transaction Books, 1986) 3 at 4. This survey is also important to notice the importance that FDI would play after the debt crisis.

[429] See Grieco, *supra* note 421 at 37-39 for a description about the *dependentista* approach.

[430] For data during the 1980s D. J. Encarnation & L. T. Wells, "Evaluating Foreign Investment" in Moran, *supra* note 428 at 61-85. See also M. Grieco, *supra* note 421 at 44-56.

[431] Reisen, *supra* note 421 at 66.

[432] including the cost of some services such as infrastructure.

[433] Reisen, *supra* note 421 at 71.

create opportunities [as a result] of the collaborative synergism between the state and society, and of their joint ability to take advantage of the MNCs' assets for national development"[434], and its influence on the decision of MNCs to invest in a defined market.[435]

Another issue that appears to influence a MNC's decision to invest directly in a country is because the opportunity for portfolio diversification[436] in order to reduce risks and increase average returns[437]. It seems that MNCs choose FDI in the absence of reliable stock markets or other channels to acquire foreign equity (like debt-equity swaps)[438]. Hence, for Mexico it appears encouraging that FDI could be a way to steadily replace short-term investments and its risks[439]. In the end, short-term investors, like FDI investors, are interested only in the direct benefits they receive from the payment of cash dividends.[440]

In conclusion, as economies become interrelated, countries should enhance their created assets and lower their costs of doing business in order to attract foreign investment into their markets. In the case of Mexico the aim should be to attract FDI to promote economic growth, to foster its competitiveness and to diminish and prevent the causes and effects of the last crisis, respectively.

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[434] S. Chan & C. Clark, "Do MNCs Matter for National Development? Contrasting East Asia and Latin America" in S. Chan, ed., *Foreign Direct Investment in a Changing Global Political Economy* (New York: St. Martin's Press, 1995);166 at 180. This author also states that "a tradition of domestic cooperation enhances effectiveness in recruiting and leveraging MNCs fro national development." *Ibid.* at 181.

[435] which shall not be understand as the possibility of conditioning FDI to performance requirements.

[436] See Saúl Lizondo, *supra* note 422 at 61-61.

[437] In fact, as M. G. Gilman says some authors believe in the ability of MNCs' management "to be able to operate across national frontiers and exchange control procedures in order to maximize their profits form a currency fluctuation, or to protect themselves from its consequences." M. G. Gilman, *The Financing of Foreign Direct Investment* (Great Britain: Frances Pinter Pub., 1981) at 13.

[438] Eckaus, *supra* note 425 at 121-22.

[439] See chapter II.

[440] See T. L. Hazen, "The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law" (1991) 70 North Carolina L. Rev. 137.

B. FDI'S ROLE AFTER THE CRISIS

After the devaluation of the peso, Mexico has suffered because of the decrease in domestic private investment. However, in the long term the devaluation[441] could promote the export-oriented industries which will help create a positive balance of payments. For this to happen Mexican firms need investment capital. As World Bank officials said: "as countries move to restructure their economies in the adjustment phase [we are again in an adjustment phase], a recovery in private investment, particularly in the tradable goods sectors, is critical for restoring overall capital formation and growth."[442]

Moreover, as a World Bank survey[443] shows, FDI is a separate factor of production which complements domestic capital. It has been demonstrated that the marginal product of FDI's capital is higher if the ratio to foreign and domestic capital is lower. Hence, more FDI "implies a higher marginal product of domestic capital, so it will imply a higher growth rate."[444] On the same basis, and in accordance with the "stages theory of competitive development"[445], FDI fosters two "factor endowments" in an economy: labor and efficient capital. These factors are necessary for a country to enhance its comparative advantages and, later, to create growth and achieve competitiveness[446]. Once FDI has promoted trade, a country receives more hard-currency, which in turn contributes to the formation of domestic savings[447]. With the 1994 crisis and the misalignment of the peso, the Mexican government inadvertently stopped the process of growth driven by the previously-opened economy.

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441 In contrast, as seen above, overvaluation of exchange rates are "beneficial only in the short run. The lower growth of exports due to the overvaluation, lowers overall growth and reduces investment in the longer run." Chhiber, Dailami & Shafik, *infra* note 442 at 7.

442 A. Chhiber, M. Dailami & N. Shafik, "Reviving Private Investment in Developing Countries: Major Themes" in A. Chhiber, M. Dailami & N. Shafik, *Reviving Private Investment in Developing Countries: Empirical Studies and Policy Lessons* (Amsterdam: North Holland, 1992) 1 at 3.

443 W. Easterly, R. King, R. Levine & S. Rebelo, *How Do National Policies Affect Long-Run Growth?: A Research Agenda* (Washington, D.C.: World Bank, 1992).

444 *Ibid.* at 23.

445 created by Michael Porter. "Its basic thesis is that four broad attributes of a nation shape the environment in which local firms compete, and that these attributes promote or impede the creation of competitive advantage. These attributes are": factor endowments; demand conditions; relating and supporting industries; firm strategy, structure, and rivalry. Hill, *supra* note 425 at 137-144.

446 One should not forget that FDI is mainly introduced by MNCs which, at the same time are the main actors in international trade.

447 At this stage the country's factor endowments shift from low-skilled labor to a more capital abundant economy.

FDI can be scared away not only by foreign exchange difficulties, but also by the underlying reasons for the need for capital. Thus, FDI is not attracted if its capital inflows are going to finance consumption or capital flight instead of profitable investment as was the case before the crisis.[448]

The current task is to attract the needed capital to promote private investment. The safest way of doing this is through FDI in the form of joint ventures, mergers or acquisitions between domestic firms and MNCs[449], as well as licensing agreements, management contracts, franchising and turnkey projects[450]. Whereas the cause is at the same time the effect, FDI can help stabilize the exchange rate. At the same time, MNCs need stable exchange rates to engage in long-term investments.[451] Even though, it appears that restrictions on capital transfers are more important for MNCs than exchange rate volatility when considering entry to a market[452].

This approach (the export-oriented one) becomes very real within the NAFTA context. While Mexico, Canada and the U.S. created the North American market, MNCs will need access to it to avoid tariffs or other barriers to entry[453]. Mexico could become an important recipient of FDI seeking to enter the North American Free Trade Zone if its comparative advantages to its two partners are taken into account [454]. Thus, FDI will

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[448] See D. J. Goldsbrough, "Investment Trends and Prospects: The Link with Bank Lending" in Moran, *supra* note 428 at 173-186. See also Edwards, *supra* note 291 at 302, where he points out the necessity of a country like Mexico to gain productivity while stabilizing its economy. If not its consequences are awful, as Mexicans have experienced.

[449] However, it should be noted that parent companies will experience some difficulties when contributing loans to the capital of Mexican subsidiaries. See H. S. Engle, "International Developments: Mexico - Devaluation of the Mexican New Peso" (1995) 22:3 J. Corporate Taxation 273.

[450] See C. P. Oman, "New Forms of Investment in Developing Countries" in Moran, *supra* note 428 at 131.

[451] Unstable exchange rates are attractive for short-term investments where, if successful, they can obtain a big return speculating against a currency that is unstable. To understand how this hypothesis works, see Gilman, *supra* note 437 at 23-35.

[452] in accordance with a survey made in the U.S. by C. D. Wallace. See Wallace, *infra* note 464 at 148-172.

[453] See C. Green, *Canadian Industrial Organization and Policy*, 3d. ed. (Canada: McGraw-Hill, 1990) at 128-132; for an analysis of how tariffs influence FDI attraction.

[454] including the devaluated peso.

collaborate with its capital to foster the export-oriented Mexican sector.[455] One should take into account that:

> The competitiveness of countries is becoming increasingly dependent upon their ability to create new assets; but in order to do so, firms domiciled in one country may need to extend their markets and their supply capabilities into other countries that offer the greatest commercial opportunities.[456]

Moreover, the Mexican government has already stated this in the "Emergency Economic Plan" that followed the 1994 crisis. With regard to the external account, Mexico will need to reduce the "trade deficit...to [US]$3bn - 3bn while the current account shortfall fell to [US]$14bn. This was to be financed by [US]*$8bn of foreign direct investment*, [US]$5bn in loans from commercial banks and $1bn in other net capital inflows, such as portfolio investment."[457]

Hence, FDI could make three main contributions to the future of the Mexican economy: a) to foster export-oriented sector[458]; b) to balance the deficit in the current account; and, c) to promote economic growth[459]. Another factor that Mexico needs to cultivate is its international competitiveness[460] and FDI could play a role in it.[461]

For this to happen, Mexico needs a different approach towards FDI, which seems to have been already taken, not to consider as foreign aid, but to recognize the nature of

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455 In fact, just before the crisis the export sector was doing very well and NAFTA appeared to contribute. In the first nine months there was a positive growth of 2.9%. Mexico - Country Report, (London: Economist Intelligence Unit, 1994) at 16.

456 Dunning, *infra* note 469 at 15.

457 Mexico -Country Report (London: The Economist Intelligence Unit, 1st. quarter, 1995) at 18. [emphasis added]. In fact, within the first four-month period of 1996, Mexico had a surplus on its trade balance with North America of US$4,506 million. See O. Martínez Nicols, "Genera 80 de los ingresos por exportaciones y capta 60 de la IED" *El Economista* (17 July 1996) AE11071.HTM.

458 By fostering the export-oriented sector Mexican companies are beneficiaries of its development if they are integrated in a productive chain within the sector. See *PPICE supra* note 257.

459 At last, "[d]eveloping a long-lasting relationship with foreign investors bolsters a country's reputation and credit worthiness. This serves to encourage further foreign investment which increases the flow of hard currency into the country due to the initial capital outlays and potential tax revenues generated through domestic taxation regimes." Ellindis, *supra* note 426 at 307.

460 In accordance with the World Economic Forum Mexico is in the 46th place in international competitiveness below economies such as India, Brazil, Colombia and Argentina. See R. Migueles, "Sigue México a la Zaga" *Reforma* (18 July 1996) RNEG0004.HTM.

461 For a descriptive survey about the relation between trade and FDI in developing countries and its impact on competitiveness, see Agosin & Prieto, *infra* note 475.

the investment as one which acknowledges the private investor's desire to make a profit. MNCs collaborate with an economy as a means of increasing domestic savings; they should not be held responsible for any shortage of capital and the resulting economic hardship it would provoke. Doing so would open recently close wounds[462].[463] The process of economic growth should be one in which all the participants within the market should collaborate (national, foreigners, government, etc.), each one playing its respective role.

C. The Rule Of Law And FDI

Investment laws are very important factors for MNC's market entry decisions[464]. Therefore, the importance of BITs becomes obvious as a means to revert distortive host investment laws. In Mexico, with the 1993 law and NAFTA, this is no longer of concern to direct investors. Moreover, it is now accepted that rules and government policies[465] which create incentives for MNCs are effective in doing so. However, and seen above[466], incentives that are trade distortive should be avoided.[467]

> It is now accepted that "state and market can play a mutually supportive rather mutually exclusive role in the [economic growth process]. The state, through its subsidies [permitted by international law] to domestic producers and its recruitment of MNCs as carriers of production assets, can promote and foster comparative advantage. However, in the final analysis the state cannot itself create and sustain such advantage. That task has to be fulfilled by the private sector, which has to be ready, eager, and able to respond to the market signals and the government's incentive programs."[468]

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[462] Mainly after the effects of the latest crisis experienced by our country.

[463] See C. R. Kennedy, "Relations Between Transnational Corporations and Governments of Host Countries: A Look to the Future" (1992) 1:1 Transnat'l Corporations 67, where he calls for attention on the potential risk of the debt crisis remedies that could renew the expropriations era.

[464] In the C. D. Wallace survey it is the fourth most critical factor. See C. D. Wallace, "Foreign Direct Investment in the Third World: U.S. Corporations and Government Policy" in C. D. Wallace, *Foreign Direct Investment in the 1990s: A New Climate in the Third World* (Netherlands: Martinus Nijhoff Pub., 1990) at 157.

[465] which are (or shall be) always created by rules of law.

[466] See discussion in NAFTA.

[467] For general information on the effectiveness of incentives see S. Guisinger, "Host-Country Policies to Attract and Control Foreign Investment" in Moran, *supra* note 428 at 157-172.

[468] Chan & Clark, *supra* note 434 at 181.

In fact, the discussion of whether the allocation of economic activities should be determined entirely by the market forces is useless. Governments should take coordinated actions with the economic agents and help the markets to work efficiently[469]. Mexico should adopt this approach and take advantage of it as well in order to avoid risks, thereby enhancing the efficiency of capital markets within its capabilities.

Indeed, in order to prevent or fight against market failures[470], governments have laws and policies. As an example, consider that the overvaluation of the Mexican currency was a risk produced by a market failure. The government can and should seek, in coordination with the private sector, policies to avoid such risk that affects both the country and the investors.

> [B]ecause the economic welfare of countries is ultimately the responsibility of the Governments of those countries, it may be argued that, in a very real sense, national administrations compete with each other to ensure that their macroeconomic and organizational strategies and policies are such as to provide their wealth creators with the maximum possible incentives to sustain and advance their competitiveness, *vis-à-vis* their foreign rivals.[471]

However, the problem is to find out how and where government policies and regulations came into the marketplace. Where? The answer is in the macroeconomic field. This means that governments are responsible to assure a fair level of economic certainty to the economic agents by means of low inflation, competitive market, *healthy balance of payments*, among other factors. Also necessary is the efficient allocation of a country's scarce resources[472], such as capital in the case of Mexico within this study.

How? is the most difficult question. It is important to underscore that in any case States should not oblige producers of wealth to act against their own interests; they should act in a manner consistent with the upgrading performance of the economic agents

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469 See J. H. Dunning, "The Global Economy, Domestic Governance, Strategies and Transnational Corporations: Interactions and Policy Implications" (1992) 1:3 Transnat'l Corporations 7. He says that governments should reappraise their "domestic macro-organizational strategies" meant as "the actions taken by Government to optimize the modality by which the resources and capabilities within their jurisdiction are created, upgraded and allocated among different uses, and the efficiency at which these are deployed for any given use." *Ibid.* at 8.

470 See Dunning, *supra* note 469 at 15-20.

471 *Ibid.* at 21.

472 There is disagreement as to the effectiveness of governments in playing this role. See Dunning, *supra* note 469 at 23. Notwithstanding this, a positive posture towards it can be assumed.

as if they were acting in a perfect market without failures.[473] One of the ways to do so is by setting up an institutional and legal framework so that markets can efficiently perform their function. Mexico has already done this with the issuance of the *Ley de Inversión Extranjera* and its partnership with Canada and the U.S. in NAFTA, as well as with the other free trade agreements that it has signed.[474] However, within the multinational sphere there are still some important measures to account for in order to create the most attractive environment for MNCs and foster the entry of efficient capital to Mexico.[475]

Besides foreign investment laws, there are two other topics which one would like to mark as important areas in which government could play an enhancing role. Governments can first guarantee a stable, competitive exchange rate; and second, provide the legal and institutional arrangements related to competition policy. Both are competitiveness-enhancing measures and necessary conditions for healthy economic growth.

With regard to competition laws the new approach within the Mexican system has already been described. Some issues must be addressed. First, MNCs are naturally attracted to concentrated markets[476]. Hence, "stimulating competition would be the core policy measure to maximize the welfare gains from the presence of [MNCs] in domestic markets."[477] Second, the competition rules should be applied in a non-discriminatory

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473 See Dunning, *supra* note 469 at 34.

474 Remember the study made in chapter I of this survey with regard to the development made by Mexico in the area of FDI regulations.

475 Besides this statement, other types of government intervention are described by M. R. Agosin & F. J. Prieto, "Trade and Foreign Direct Investment Policies: Pieces of a New Strategic Approach to Development?" (1993) 2:2 Transnat'l Corporations 63 at 66, as follows: "there is an important role for government intervention in identifying industries with long-run promise, steering investment resources in their direction, acting to complete or create markets and investing in the creation of complementary assets in which the private sector is likely to under-invest."

476 See C. R. Frischtak, "From Monopoly to Rivalry: Policies to Realize the Competitive Potential of Transnational Corporations" (1992) 1:2 Transnat'l Corporations 57.

477 *Ibid.* at 57. See also J. M. Grieco, "Summaries of Recommendations - Foreign Investment and Development: Theories and Evidence" in T. H. Moran, *et al.*, *Investing in Development: New Roles for Private Capital?* (New Brunswick, U.S.: Transaction Books, 1986) 21 at 22, where within a list of recommendations he makes this one on regard of competition:

"Developing countries should can greatly enhance their prospects for receiving substantial gains from foreign capital if they undertake policies consciously aimed at fostering competition among foreign firms, between foreign firms and national enterprises, and between imports and goods locally produced by foreign enterprises."

manner to both nationals and multinationals. The role for the rule of law and government should be to set a framework establishing the limits for acceptable effective market conduct and deter, at the same time, anticompetitive behaviour.[478] Third, as MNCs are difficult to view in a narrowly-defined market, the harmonization of competition rules[479] should be raised within the WTO and more specifically within NAFTA[480] recognizing that markets are no longer defined by only domestic factors.

1. Recent developments in the international arena

Presently, investment is seen as an important factor to achieve the interrelation of markets; to give more velocity to the globalization[481] process[482]. This has been seen as the

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[478] See Frisctak, *supra* note 476.

[479] Harmonization of competition laws has been described as "...the effect of reducing and narrowing the divergence among jurisdictions in the scope of regulations, criteria of illegality, measures to be taken, and enforcement procedure." M. Kurita, "Recent Developments of Competition Policy in Japan and their Implications for International Harmonization of Competition Laws" in C. J. Cheng, L.S. Liu & C. K. Wang, *International Harmonization of Competition Laws* (Netherlands: Martinus Nijhoff Pub., 1995) at 362; or in other words, as the Director of Investigations and Research of Canada says:

> [I]t does not imply identical rules across jurisdictions but simply denotes a greater convergence and coherence of underlying principles, statutory rules, enforcement practices and analytical methods across jurisdictions. The aim of harmonization should be to promote a level of compatibility among the basic objectives and rules concerning competition under which business enterprises -both domestic and foreign- will operate, without compromising a nation's fundamental right to regulate conduct in its own territory.

R. Feltham, S. A. Salen, R. F. Mathieson & R. Wonnacott, *Competition (Antitrust) and Antidumping Laws in the Context of the Canada - U.S. Free Trade Agreement: a study for the Committee on Canada - United States Relations* (Canada: Chamber of Commerce, 1991) at 105.

[480] "Given that anti-competitive behavior can be expected to take place across jurisdictions with increasing frequency, the challenge to antitrust enforcement in a global marketplace will be to secure greater enforcement co-operation and harmonization of competition policy." G. N. Addy, "International Harmonization and Enforcement Cooperation: The Canadian Experience" in Cheng, *supra* note 479 at 400. See also A. W. Hunter & S. M. Hutton, "Where There is a Will, There is a Way: Cooperation in Canada-U.S. Antitrust Relations" (1994) 20 Can. - U.S. L. J. 101, to see recent efforts towards harmonization within NAFTA.

[481] Globalization is characterized by the next facts related with this survey:
a)"International trade in both goods and services is growing faster than domestic output in most countries and certainly in the world economy as a whole;
b) Foreign Direct Investment is growing faster than national investment;
c) International financial flows are growing at a much faster rate than domestic financial transactions;
d) International trade, investment and finance are all occurring at the same time and through the same agent, the transnational corporation." M. R. Agosin & F. J. Prieto, *supra* n. 475 at 64.

[482] During the 1980s, FDI increased at around 30% annually in the world (more than three times the rate of world exports and four times as world GDP). Brittan, *infra* note 485.

third stage within the international linkage among countries, which is led by MNCs[483]. As Sir Leon Brittan[484] has written:

> Investment is recognized for what it is: a source of extra capital, a contribution to a healthy external balance, a basis for increased productivity, additional employment, effective competition, rational production, technology transfer, and a source of managerial know-how.....capital is recognized as a scarce resource that no country can afford to drive away.[485]

Within the international arena there is a tendency of viewing FDI as an issue of public policy. There have been developments in the regulation of the financial activities of MNCs at both the national and international levels. The OECD has developed guidelines[486], as has the World Bank[487]. GATT[488] has already included investment in its forum and, at the regional level, NAFTA has a chapter which rules investment issues.

This is because of the nature of a MNC's behavior. Its economic activity is "potentially footloose in its location"[489], hence, they respond to factors that influence their costs and revenues by entering or exiting a market with an outstanding speed.[490] This creates more competition to attract MNCs to markets that need their capital[491], technology, management and other assets which States lack or have not entirely developed. In order to attract them, States have to develop or foster their assets (factor endowments) or comparative advantages in order to be attractive for MNCs and their capital (as in the case of Mexico).

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483 See S. Ostry, "The Domestic Domain: The New International Policy Arena" (1992) 1:1 Transnat'l Corporations 7.
484 Vice-President of the European Commission.
485 L. Brittan, "Investment Liberalization: The Next Great Boost to the World Economy" (1995) 4:1 Transnat'l Corporations 1 at 2.
486 *Declaration on International Investment and Multinational Enterprises*, Paris: OECD, June 1976.
487 *Guidelines on the Treatment of Foreign Direct Investment*, International Bank for Reconstruction and Development: September 21, 1992.
488 See T. H. Moran & C. S. Pearson, "Do TRIPS Trip Up Foreign Investment? An International Business Diplomacy Perspective" in C. D. Wallace, ed., *Foreign Direct Investment in the 1990s: A New Climate in the Third World* (Netherlands: Martinus Nijhoff Pub., 1990) 28 at 28-60.
489 Dunning, *supra* note 469 at 13.
490 *Ibid.*
491 In fact, developing countries have become a very attractive host of FDI during the 1990s. Over half of the world FDI goes to developing countries. Brittan, *supra* note 485 at 3.

2. Lack of a Multinational Agreement in FDI

Globalization and the world's economy have successfully achieved growth sustained by the institutional framework created after World War II. These institutions are the IMF/World Bank for financial cooperation and the GATT for trade cooperation[492]. Nevertheless, there is no binding multilateral agreement for the third kind of economic activity, namely investment[493].[494] "Developing a broad framework for international investment would help stabilize the global economic system while giving direction and coherence to the regulatory environment facing transnational business."[495]

Furthermore, a multilateral investment agreement would help to avoid a repetition of the struggle experienced by MNCs, host countries and home countries during the 1970s, when expropriations and confrontations between host countries and MNCs were common[496]. However, there is a forum for dispute settlement on FDI matters created by the World Bank, the ICSID, to which, as stated before, Mexico is not party[497].

Presently, the rules for FDI are so diverse that to follow or enforce them is almost impossible. On the one hand, we have binding rules[498], such as the domestic investment laws; bilateral investment treaties (BITs); regional agreements, such as NAFTA and the EC[499]; and finally, one limited multilateral agreement, GATT's Trade Related Investment

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[492] GATT did not came to life with the Havana Charter in 1948. The proposed ITO (international Trade Organization) came to be the actual WTO since 1995.
[493] Even though that, as seen above, investment (and MNCs) is a main factor for trade development.
[494] For a survey regarding the different multilateral efforts done before 1978 including the Havana Charter, The U.N. initiatives and OECD Code of Liberalization of Capital Movements and Declaration on International Investment and Multinational Enterprises, see K. W. Grewlich, *Direct Investment in the OECD Countries* (Netherlands: Sijthoff & Noordhoff Int'l Pub., 1978) at 73-104.
[495] J. M. Kline, "International Regulation of Transnational Business: Providing the Missing Leg of Global Investment Standards" (1993) 2: 1 Transnat'l Corporations 153 at 153.
[496] *Ibid.* See also C. R. Kennedy Jr., "Relations between Transnational Corporations and Governments of Host Countries: A Look to the Future" (1992) 1:1 Transnat'l Corporations 67, where he states "a resurgence of expropriation could be expected to occur, since an increased need for external capital could trigger a radical response within developing countries if [MNCs], both industrial and financial, are perceived as being responsible for the capital shortage and any resulting economic hardship." *Ibid.* at 70.
[497] In order to attract FDI as long-term investments and in accordance with chapter 11 of NAFTA, Mexico should become part of it.
[498] The binding nature of these rules are reinforced with dispute settlement procedures to make them effective.
[499] See *Treaty Establishing the European Economic Community*, March. 25, 1957, art. 67, 298 U.N.T.S. 3, 42, where it is established one of the pillars of the now European Union, the free movement of capital.

Measures (TRIMs)[500]. On the other hand, there are several non-binding (soft law) regulations concerned with FDI. The 1976 OECD's Declaration on International Investment and Multinational Enterprises[501]; the World Bank's Guidelines on the Treatment of Foreign Direct Investment[502]; the UNCTAD's Code on Restrictive Business Practices; the United Nations' Consumer Protection Guidelines; the United Nations' Code of Conduct on Transnational Corporations[503]; and, the ILO's Tripartite Declaration on TNCs and Social Policy.[504]

With regard to domestic laws, there are now substantive similarities among different investment regimes for FDI throughout the world. Although they are different, their standards and procedures are similar. Due to the current shift that the world has

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[500] By which no GATT Member shall apply any trade related investment measure that is inconsistent with the national treatment principle or the obligation of general elimination of quantitative restriction. See *Agreement on Trade Related Investment Measures* (April 15, 1994), art. 2. Furthermore, TRIMS provides an "illustrative list" of TRIMS which are contrary to GATT this list includes "local content, sourcing, and some trade balance requirements and import and export restrictions". Nevertheless, it does not contain measures "such as technology transfer requirements." M. J. Trebilcock & R. Howse, *The Regulation of International Trade* (London: Routledge, 1995) at 292.

[501] OECD, *Declaration on International Investment and Multilateral Enterprises*, Publication No. 37.431 (1976) See W. H. Witherell, "The OECD Multilateral Agreement on Investment" (1995 4:2 Transnat'l Corporations 1 at 4; in which he does a brief exposition of this instrument:

> Adopted in 1976, [it] contains four distinct elements woven into balanced overall package of instruments designed to address key issues for international cooperation. The Declaration is a political undertaking, supported by legally-binding Decisions of the OECD Council, that provides active follow-up procedures covering notification, policy monitoring, review and consultation.
>
> The four elements of the Declaration are as follows:
>
> - a ***National Treatment*** instrument provides that OECD members should treat foreign-controlled enterprises operating in their territories no less favorably than domestic enterprises in like situations;
> - ***Guidelines for Multinational Enterprises*** that establishes voluntary standards of conduct representing the collective expectations of OECD governments as to the behaviour of such enterprises;
> - an instrument on ***Investment Incentives and Disincentives*** that encourages transparency and provides for consultation and review; and,
> - an instrument on ***Conflicting Requirements***, designed to avoid or minimize the imposition by OECD governments of conflicting requirements on TNCs and providing a forum for consultation.

See also Grewlich, *supra* note 494 at 88-90 for an analysis of the binding/non-binding nature of this "Declaration".

[502] See I. F. I Shihata, *Legal Treatment of Foreign Investment: "The World Bank Guidelines"* (Netherlands: Martinus Nijhoff Pub., 1993).

[503] *Code of Conduct on Transnational Corporations*; U.N. ESCOR, June 2, 1983, Doc. E/C.10/1983/S/5. (19833). For information about this Code and FDI, see C. T. Ebenroth & J. Karl, "International Investment Contracts and the Debt Crisis" (1988) 22:1 Int'l Lawyer 179.

[504] See Kline, *supra* note 495.

experienced towards the interrelation of markets within the globalization era, principles that were once irreconcilable are starting to become homogenous throughout the world.[505]

Within this array of agreements, codes of conduct and domestic rules "[n]o agreed global framework on FDI principles exist[506] to help gather and channel these disparate elements into a supportive structure for transnational business policy."[507] And this, as the same author explains later:

> [M]ay lead enterprises to opt for short-term gains that can result from unresponsive or even abusive behaviour in relation to public policy goals and needs. Lacking an applicable set of transnational business standards, disappointment and frustration from unmet or misplaced expectations could again make national policy makers suspicious of [MNC] actions.[508]

Nevertheless, after years of proposals for a multilateral agreement to regulate FDI[509], the issue of negotiating more FDI issues has been tabled for future WTO negotiations. Furthermore, the OECD is working on a Multilateral Investment Agreement (MAI) of a free-standing nature[510] so as to permit non-OECD members be part of it.[511]

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[505] See M. G. Geist, "Toward a General Agreement on the Regulation of Foreign Direct Investment" (1995) 26: 3 L. & Pol. Int'l Bus. 673 at 686-717, where he makes a study of legal structures that rule FDI in different countries. (United States, Canada, United Kingdom, Portugal, Poland, Japan, South Korea, Thailand, Argentina, Mexico and Nigeria)

[506] The International Court of Justice has already noted this important lack on the multinational level, it has said:

> Considering the important developments of the last half century, the growth of foreign investments and the expansion of the international activities of corporations .... and considering the way in which the economic interests of states have proliferated, it may at first sight appear surprising that the evolution of law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane.

Belgium v. *Spain*, 1970 I.C.J. Rep. 3, at 47-48 [better known as the Barcelona Traction case] transcripted from M. A. Geist, "Toward a General Agreement on the Regulation of Foreign Direct Investment" (1994) 26:3 L. & Pol. Int'l Bus. 673 at 673.

[507] Kline, *supra* note 495 at 161.

[508] *Ibid.* at 163.

[509] See T. L. Brewer, "International Investment Dispute Settlement Procedures: The Evolving Regime for Foreign Direct Investment" (1995) 26: 3 L. & Pol. Int'l Bus. 633.

[510] There are workshops organized for non-members as part of the dialogue. The chairman of the MAI Negotiating Group, Mr. Frans Engering, said: "accession by non-Members to MAI would certainly not be a matter of 'take it or leave it', but would be the result of negotiations with each country on the terms of its accession, including its agreed list of reservations." OECD, *OECD Letter, Vol. 5/5*, June 1996 at 4.

[511] The process started in May 1995 and it shall be finished by May 1997. According to the comuniqué of the OECD Council at Ministerial level of May 21-22 OECD members have reaffirmed the commitment to reach the Agreement in 1997. See OECD, *OECD Letter, Vol. 5/6*, July 1996 at 10. See also News Report, "OECD Goes to Work on Investment Agreement" (1996) 181:1 Journal of Accountancy 28.

One important issue that arises, however, is which of these organizations is better suited for this task. Perhaps they should work together and reach a final agreement within the WTO[512] forum because it is more representative and customarily a negotiating forum.[513]

> In its progress report to Ministers, the MAI Negotiating Group says that since talks began last September, key building blocks of the Agreement have been defined, such as investment protection, national treatment, Most favoured Nation treatment, and transparency. Mechanisms for achieving standstill and rollback of existing restrictions and resolving state-to-state disputes have also been outlined.[514]

Even though Mexican domestic law is governed, in general, in accordance with the existing multilateral regulations[515], the Mexican authorities should play an active role in the preparation, negotiation and adoption of the MIA in order to procure and even playing field for Mexico as a host country and to promote the principles already addressed in its laws for the protection of MNCs' rights.

Moreover, in relation to the 1994 crisis, Mexico should address the problem of how to keep short-term speculative capital under control within the multilateral forum (namely the OECD) and give more certainty to the capital markets, besides the

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[512] The WTO Commission has proposed to start a debate about common rules designed to nurture and encourage FDI within its organization. *See* Updates, "FDI Rules Needed" (1995) 35:4 Business Europe 3.

[513] See T. L. Brewer & S. Young, "Towards a Multilateral Framework for Foreign Direct Investment: Issues and Scenarios" (1995) 4:1 Transnat'l Corporations 69. With regard to the representation issue of the WTO versus the OECD this author says that, however, this is true, "[t]he relatively small size and industrial-country bias of OECD's membership, though, is changing: Mexico has joined, the Republic of Korea has indicated an interest in joining, and several countries of Central and Eastern Europe are likely to become members in the coming years." *Ibid.* at 75. See also Witherell, *infra* note 515. See also W. H. Witherell, "Investment, Services, Taxation and Competition" (1995) 30:1 Business Economics 29 in regard to the forum, he shares the two institution position:

> The choice of the OECD as the forum for negotiation would not foreclose the agreement being transferred elsewhere at a later stage, e.g., to the WTO if and when it appears that the broader membership of that organization is ready to accept the high standards of liberalization and investment protection that would be the objectives of this agreement. Participation of other like-minded non-OECD Member countries in such an agreement would enhance its effectiveness by enlarging its sphere of influence.

Ibid. at 30.

[514] OECD, *OECD Letter, Vol. 5/6*, July 1996 at 10.

[515] As an example, the OECD Declaration and Decisions on International Investment and Multinational Enterprises and its Codes of Liberalization of Capital Movements and Current Invisible Operations provide for: a) national treatment, before and after establishment; b) repatriation of profits, dividends, rents and the proceeds of liquidated investments; c) transparency of regulations; and, d) a mechanism of consultation to deal with complaints. Mexican rules also consider these issues. See W. H. Witherell, "The OECD Multilateral Agreement on Investment" (1995) 4:2 Transnat'l Corporations 1.

encouragement of FDI as long-term investments. This is a point that needs further development so as to build a proposal of a possible legal regime to govern FDI with the participation of host countries, home countries and the different sectors within them (academic, governments and investors).[516]

Finally, it should be remembered that the Mexican crisis of 1994 was not solely a domestic problem; it had international causes and international effects[517]. Hence, it is in the interest of the global community to find a solution.[518]

> If anyone doubt[s about] the systemic importance [of an agreement in this matter], they need only have watched markets around the world over the last few days, and observed the co-movements of markets in other countries with the markets in Mexico...[519]

3. Protection Against Risks[520]

Enterprises that decide to go abroad face, on the one hand, an increase in opportunities, such as access to larger markets, diversification of their portfolios, higher

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[516] To illustrate the necessity for it:
"*...markets have become more volatile in recent years, causing investors to focus increasingly on near-term performance....the proliferation of short-term derivative instruments has exacerbated this problem. As investors demand superior near-term results, corporate managers feel compelled to shore up current earnings, often at the expense of investing for the future.*" T. L. Hazen, "The Short-Term / Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law" (1991) 70 North Carolina L. Rev. 137 at 137.

[517] Markets worldwide started to come down. This phenomenon was called the "*efecto tequila*".

[518] See L. H. Summers, "Our Mexican Challenge" (1995) 26: 4 L. & Pol. Int'l Bus. 979, where he relates how the U.S. had the necessity to help Mexico stopping the crisis effects to stop the worlds markets disbalance. See also L. C. Buchheit, "Cross-Border Lending: What's Different This Time?" (1995) 16 Nw. J. Int'l L. & Bus. 44.

[519] *Ibid.* at 980. See also for a proposal form the short-term investors part R. Macmillan, "Towards a Sovereign Debt Work-out System" (1995) 16 Nw. J. Int'l L. & Bus. 57, where he concludes that "[d]espite numerous popular arguments that the nation state is becoming obsolete because capital and trade flows make border irrelevant [with which I do not agree], *the legal structure is far from supranational.* Numerous commissions and quasi-courts exist, but with the notable exception of the Court of Justice in the European Union, these are either subject to political influence so that the rule of law is weak ...or they are specialized tribunals (like the World Trade Organization)." at 106; from this point he proposes a system to protect creditors in the case of a crisis.

[520] Risk is defined by Gilman, *supra* note 437 at 80 as follows: "as the return and capital gains on foreign-currency assets are denominated in [host] currency, the increasing amount of home currency used to finance a given of foreign-asset accumulation will increase proportionately the expected variance of the return and capital gains in the home currency."

rates of return and lower costs. On the other hand, doing business in an international framework market presents risks, such as devaluation, monetary restrictions, expropriations, nationalization, civil wars. "The vulnerability of some of the largest potential investment projects to major contractual changes is sufficiently great that special guarantees may be needed to enable the projects to be launched in the first place."[521]

Hence, to improve the investment climate, it is necessary to protect foreign investors against risks. The way in which the guarantees can be offered are as diverse as law permits. They can be offered by states concluding international agreements, by the signing of BITs between importing and exporting-capital countries, or in the form of a multilateral agreement. They can also be extended by the home country to its own investors or by the home state to specific foreign investors.[522]

a) Multilateral Investment Guarantee Agency

Mexico needs to foster FDI, more than it has done since the last two crises, to reach an optimal rate of growth. The global community still lacks a multinational legal instrument to guarantee investors against some existing non-commercial risks. This additional element could add to the already existing ones in order to improve the flows of FDI.

Recently, Mexico has experienced several social, political and economic difficulties. The murder of Colosio and Ruíz Massieu, the Chiapas rebellion[523], the increasing disparity in income distribution and the 1994 crisis, among others[524], have made the already hard quest for a better Mexico into an extremely difficult one. Such

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[521] Moran, *supra* note 428 at 16.

[522] See Fatouros, *infra* note 539 at 70-128 for a legal description about the development and history of the different instruments that had been used until the 1960s. As an example of nationally-sponsored insurance agencies nowadays there is the U.S. Overseas Private Investment Corporation (OPIC). See *Overseas Private Investment Corporation Act*, 22 U.S.C.A 2191-2200b.

[523] which has both a social and political connotation.

[524] like the crisis on the financial system which has a debt burden problem with its creditors as well as with its debtors. See R. A. Karaoglan & M. Lubrano, "Mexico's Banks After the December 1994 Devaluation - A Chronology of the Government's Response" (1995) 16 Nw. J. Int'l L. & Bus. 24.

risks obviously frighten foreign investors; even short-term investors are doubtful about investing in an environment such as this one.

> Among the factors that could cause larger flows of investment to developing nations, improvement of the investment climate and reduction of perceptions related to political risks are fundamental prerequisites. In this context, the creation of the Multilateral Investment Guarantee Agency (MIGA) comes as a major policy initiative that has considerable potential to remove barriers t international investment and give a new vigor to the development process.[525]

The Multilateral Investment Guarantee Agency[526], sponsored by the World Bank, was created in 1988. Its objective is to "encourage the flow of investments for productive purposes *member countries*, thus supplementing the activities of the [World Bank] and other international development financial institutions"[527]and complementing government-sponsored and private investment guarantee programs[528]. The risks against MIGA insures are: currency transfer limitations, expropriation, war and civil disturbance, and breach of contract involving host nation and investor[529], plus additional risks such as terrorism and kidnapping on a case by case evaluation basis.[530] In guaranteeing an investment, MIGA must consider the economic soundness of the investment and its contribution to development in the host country. They should also be new projects of a medium or long-term nature.[531] Moreover, MIGA considers whether the investment conditions in the host country include the availability of fair, equitable and non-discriminatory legal protection for the investor[532]. North American investors have this treatment guaranteed by NAFTA.[533]

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525 I. F. I. Shihata, "Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Investment Guarantee Scheme" (1987) 21 Int'l Lawyer 671 at 694.

526 World Bank, *Convention Establishing the Multilateral Investment Guarantee Agency*, opened for signature October 11, 1985, 24 I.L.M. 1598 (came into force April 12, 1988) [hereinafter *MIGA*]. See also I. F. I. Shihata, *MIGA and Foreign Investment: Origins, Operations, Policies and Basic Documents of the Multilateral Investment Guarantee Agency* (Netherlands: Martinus Nijhoff Pub., 1988) for a detailed survey of this institution.

527 *MIGA*, art. 2.

528 Comeaux & Kinsella, *infra* note 532 at 40.

529 like joint venture agreements, agreements for favorable tax treatment, among others.

530 See Shihata, *supra* note 526.

531 See *MIGA*, art. 12(d).

532 Risk insurance is not only available from MIGA, but also from a number of sources including nationally-sponsored insurance agencies like OPIC in the U.S. and private insurers. See P. E. Comeaux &

MIGA was created in response to the 1980s crisis and is founded on the idea that "the heavily indebted countries needed to rely more on private enterprise and foreign private investment, an expandable growth resource that would not compound their debt problems."[534] It fills the gaps against non-commercial risks that private investment insurance does not cover[535]. It has both developed and developing country members.

Mexico has not take advantage of the international effort made to alleviate the distrust of investors to engage in long-term projects where potential non-commercial risk is perceived[536]. It seems that Mexico has not joined MIGA because some people think this will give Mexico a "risky" image. Whereas, they do not think that not joining MIGA worsens it.[537]

b) Exchange risks (Devaluation)

The IMF allows a country to establish exchange controls if it is suffering a temporary exchange crisis, as was Mexico's case in the 1994 crisis. Although Mexico has historically been very respectful towards an exchange control policy[538] even after the last crisis, exchange control is not against international law.

N. S. Kinsella, "Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance" (1994) 15: 1 N. Y. L. Sch. J. Int'l & Comp. L. 1.

[533] important for NAFTA investors. See *NAFTA supra* note 101, c. 11.

[534] Multilateral Investment Guarantee Agency, *MIGA: The Mission and the Mandate* in http://www.miga.org/mandate.htm.

[535] "Insurance agencies are often unable or unwilling to provide the type of coverage that foreign investors need...., for example, [private insurance] is often limited by restrictive eligible criteria. In addition, types of coverage offered by private insurers often exclude currency transfer and war risks, and are short term (1-3 years)." Multilateral Investment Guarantee Agency, *Introduction*; at http://miga.org/prof001.htm. See also G. T. Ellindis, "Foreign Direct Investment in Developing Countries and Newly Liberalized Nations" (1995) 4 Detroit C. L. J. Int'l L & Prac. 299 at 18-21.

[536] By July 31, 1996, Mexico had not joined MIGA nor had it considered fulfilling membership requirements. Source: http:www.worldbank.org/. Other countries that are in the same position are: Cuba, Iceland, Liechtenstein, Andorra, Monaco, Austria, Netherlands Antilles, Chad, Liberia, Central African Republic, Iraq, Iran, Afghanistan, Somalia, Thailand, Brunei, Australia, New Zealand, North Korea, among others. See MIGA, *MIGA Annual Report 1995* (Washington, D.C.: MIGA, 1995).

[537] Interview with Dr. Oscar Santamaría, Mexican Trade Commissioner in Montreal (BANCOMEXT); July 24, 1996, Montreal, Canada.

[538] In its recent history it was only established after the debt crisis to avoid the already astonishing capital flight that the economy was suffering due to the crisis. See C. R. Valencia V. & R. Sánchez-Mejorada V., "Fundamentals of doing business with Mexico: After the Exchange Control" (1983) 14 St. Mary's L. J.

Nevertheless, "[t]he existence, or possibility of future imposition, of exchange controls constitutes a major obstacle to [FDI]"[539], and foreign investors are reluctant to enter a market if there are no guarantees that could absorb the risk or ameliorate it. The MIGA's coverage of currency inconvertibility includes restrictions of currency transfers outside of the host country as well as excessive delays to inacquiring foreign exchange caused by the host government, and deterioration in conditions governing the conversion and transfer of local currency. The insurance consists of the payment of a compensation from the losses the investor suffered because of these causes. Nevertheless, devaluation is not covered.[540]

> Insurance programs provided by developed nations and the World Bank [MIGA] do not provide protection against the devaluation of the host nation's currency. Investors must look to the private insurance market to obtain coverage for such risks. Companies such as Lloyd's of London, Citicorp International Trade Indemnity, and American International Underwriters provide such coverage.[541]

Devaluation of currency incurs legal problems because monetary depreciation erodes the value of the currency, together with legal rights and obligations.[542] "Continuous monetary instability affects all legal institutions, including law and order in the economic field, taking into account the delays of the law and legal uncertainties."[543]

Hedging against exchange risks is not an easy task for firms. The most common method is the use of forward contracts. However, for FDI investors the contract period is not long enough[544], thus making it costly. Along with this practice there are other

683. See also S. Zamora, "Exchange Control in Mexico: A Case Study in the Application of IMF Rules" (1984) 7 Houston J. Int'l L. 103.

[539] A. A. Fatouros, *Government Guarantees to Foreign Investors* (New York: Columbia University Press, 1962) at 49.

[540] See Comeaux & Kinsella, *supra* note 532 at 41.

[541] G. T. Ellindis, "Foreign Direct Investment in Developing Countries and Newly Liberalized Nations" (1995) 4 Detroit C. L. J. Int'l L. & Prac. 299 at 315

[542] See E. Hirschberg, "The Legal Aspects of Devaluation of Currency in Modern Times" (1982) 87 Commercial L. J. 183.

[543] *Ibid.* at 183.

[544] Commonly "the forward market for maturities longer than six months is usually thin in any currency." Gilman, *supra* note 437 at 18.

instruments, such as forward options[545], currency swaps[546], exchange repurchase agreements and risk guarantee agencies.[547] In Mexico, before the crisis, in 1991, the Bank of Mexico authorized broker-dealers to offer a limited form of currency exchange contracts, which hedged against expected devaluations of the peso[548].

However, devaluation is an ordinary risk (commercial) that has to be faced by every businessman investing abroad or even domestically. What MNCs can protect against is the possibility of the imposition of an exchange control as a consequence of devaluation.

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[545] Also called "forward exchange" where two parties agree to exchange currency and execute a deal in the future.

[546] defined by Hill as "the simultaneous purchase and sale of a given amount of foreign exchange for two different values." Hill, *supra* note 425 at 265.

[547] See Gilman, *supra* note 437 at 18-20. See also Hill, *supra* note 425 at 262-66.

[548] This was the beginning of a series of future options which as we have seen create instability on capital markets and should be raised within the multilateral forum. See M. H. O'Donoghue & E. Barbará de Parres, "Mexico Faces the Question of Swaps" (Nov. 1994) Int'l Financial L. Rev. 19.

V. CONCLUSIONS

In conclusion, FDI indeed has the potential power to contribute to the economic development of Mexico. Moreover, it helps to reduce the negative effects that other capital flows have on the economy, namely loans from commercial banks and short-term investments. Nevertheless, it is also clear that to take advantage of FDI flows Mexico needs to create a more stable economic environment. This implies a sound macroeconomic policy, and most importantly a fair distribution of income which, in my opinion, is the biggest problem that Mexico has - and has been unable to solve throughout its history.

Realizing that the rule of law plays an influential role on FDI and after analyzing the different rules that in Mexico regulate FDI, one could note that Mexico is on the right path. Domestic regulations are in conformity with international standards and they have already proven to be efficient in the attraction of foreign capital in the form of direct investment.

However, in relation to the 1994 crisis, Mexico should address the problem of how to keep short-term speculative capital under control within the multilateral forum (namely the OECD) and give more stability to the capital markets, besides the encouragement of FDI as long-term investments. This is a point that needs further development so as to build a proposal of a possible legal regime to govern FDI with the participation of host countries, home countries and the different sectors within them (academic, governments and investors). I hope this study might in some way help to raise the subject for further negotiations within the multilateral organizations.

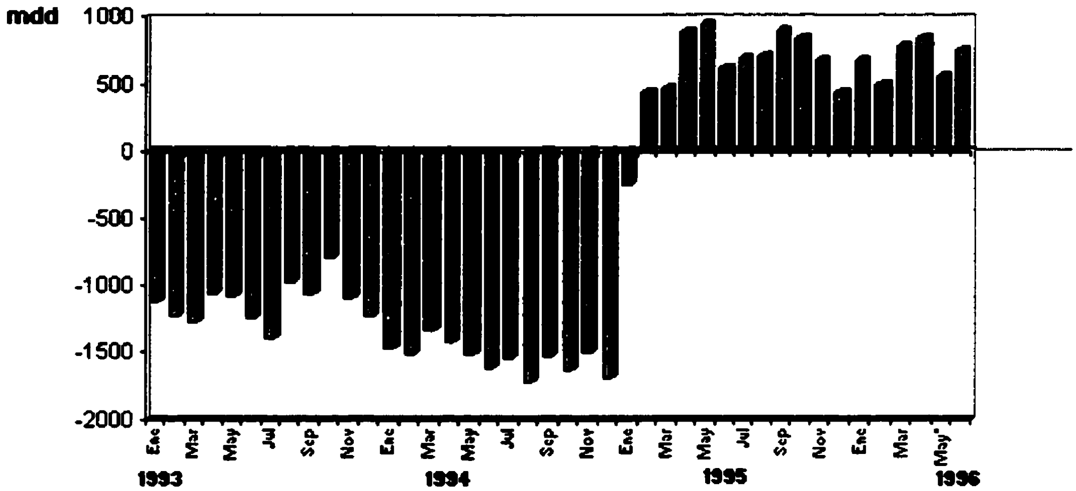
Furthermore, Mexico needs alternative methods to foster FDI. The most important is that which has been mentioned above. Second, and due to its lack of an internationally accepted risk guarantee institution, Mexico should become a member to the Multilateral Investment Guarantee Agency. Its entrance could have a positive impact on MNCs and thus, attract more FDI. Third, Mexico should also become a member of the International

Centre for Settlement of Investment Disputes (ICSID), thus giving more certainty to foreign investors.

Finally, accepting that the "contestable markets" theory has the potential to rule the globalization process in the next century, Mexico needs to actively participate within the multilateral forum, promoting the principles that have already been adopted in its domestic competition law. It should also reach agreements with its trade and investment partners to create clear and internationally-accepted competition rules to prevent distortive private and public behaviour within its markets, namely the North American market and those which could be developed in the future as a consequence of trade and investment agreements.

ANNEX I

TRADE BALANCE (U.S. MILLION OF DOLLARS)



Balanza Comercial Mensual
(millones de dólares)
Trade Balance (U.S. millions of dollars)

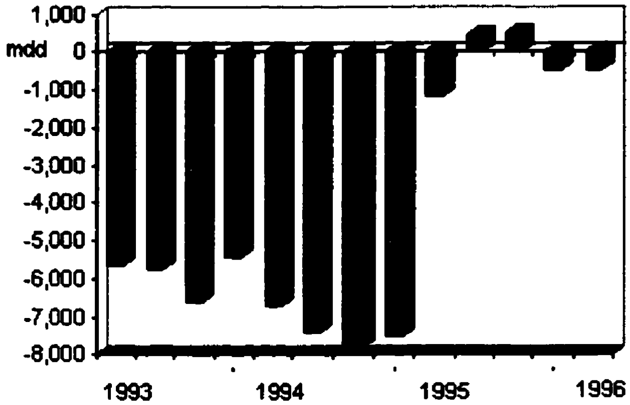
1996	Ene	Feb	Mar*	Abr*	May*	Jun	Jul	Ags	Sep	Oct	Nov	Dic
mdd	673	491	778	842.5	557.7	749						

1995	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
mdd	-250	436	461	890	943	609	693	708	909	837	675.4	433.8

Source: SCHP-BANXICO-INEGI

ANNEX II

CURRENT ACCOUNT (MILLIONS OF DOLLARS)



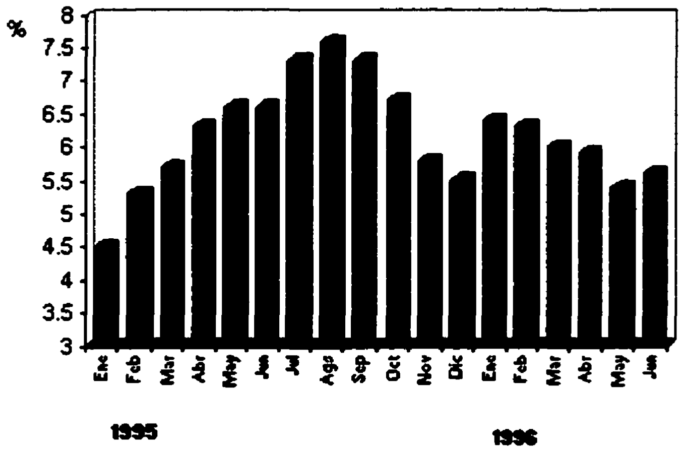
Cuenta Corriente
(millones de dólares)
Current Account (millions of dollars)

	1993				1994				1995				1996
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
MD	-5,661	-5,742	-6,569	-5,426	-6,709	-7,393	-7,831	-7,487	-1,177	467	512	-456	-462

Source: Banco de México (Mexico's central bank)

ANNEX III

GENERAL UNEMPLOYMENT RATE



Tasa de Desempleo Abierto General (41 areas urbanas)
General Unemployment Rate (41 urban areas)

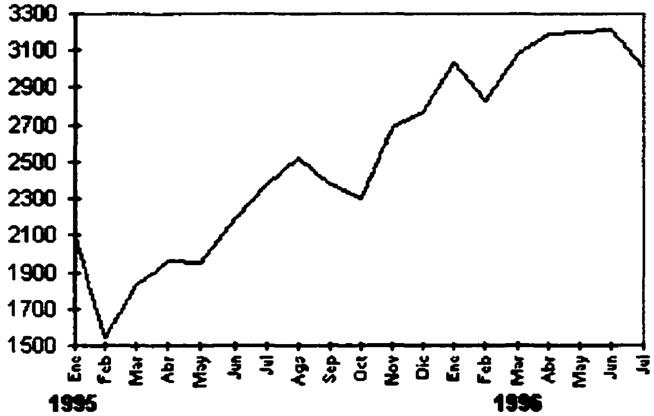
%	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
1995	4.5	5.3	5.7	6.3	6.6	6.6	7.3	7.6	7.3	6.7	5.8	5.5
1996*	6.4	6.3	6.0	5.9	5.4	5.6						

Source: Banco de México.

ANNEX IV

MEXICAN STOCK MARKET INDEX

1878=100



Indice de Precios y Cotizaciones de la Bolsa Mexicana de Valores
(fin de periodo)
Mexican Stock Market Index (close)

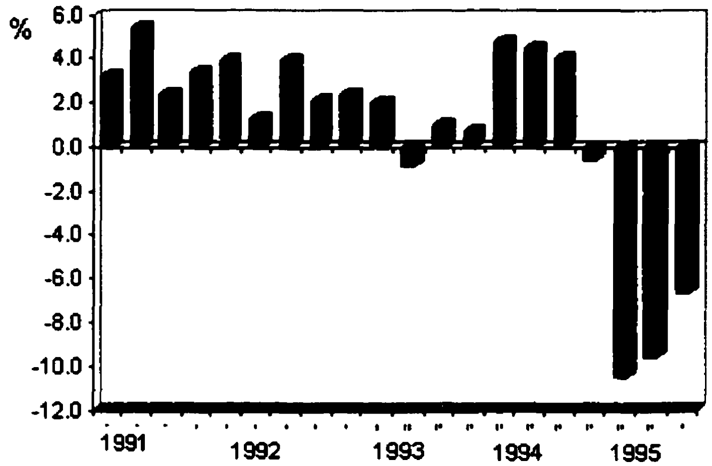
1996	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
Indice	3034.7	2833.0	3081.0	3187.0	3206.0	3211.0	3007.0					

1995	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
Indice	2094.0	1549.0	1833.0	1960.5	1945.1	2196.0	2375.2	2517.0	2381.5	2302.0	2689.0	2778.0

Source: Mexican Stock Exchange Market (*Bolsa Mexicana de Valores, S.A. de C.V.*)

ANNEX V

REAL GROSS DOMESTIC PRODUCT - GDP (ANNUAL RATES OF CHANGE)



PIB REAL

Base 1980=100 (tasas anuales reales de crecimiento)

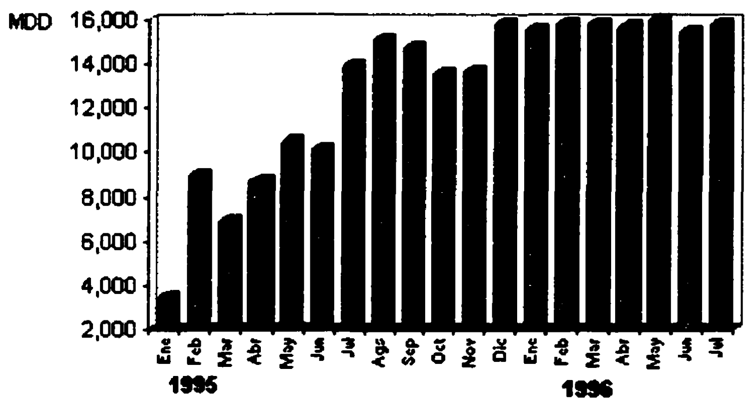
Quarterly Real GDP Base 1980=100 (annual rates of growth)

	1991				1992				1993				1994				1995			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
%	3.2	5.4	2.4	3.4	3.9	1.3	3.9	2.1	2.4	2.0	-0.8	1.0	0.7	4.8	4.5	4.0	-0.6	-10.5	-9.60	-6.63

Source: INEGI.

ANNEX VI

INTERNATIONAL RESERVES (MILLIONS OF DOLLARS)



Reservas Internacionales
(Millones de dólares)
International Reserves (millions of dollars)

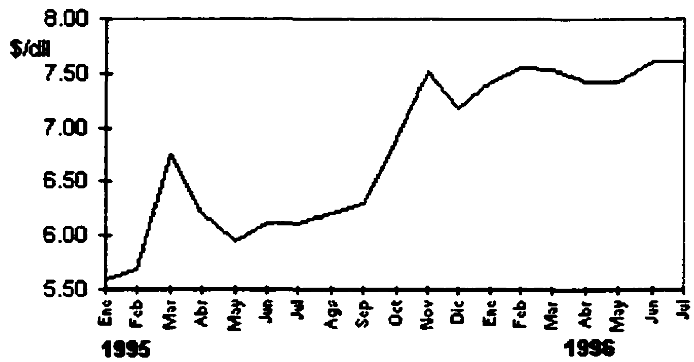
1996	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
MDD	15,484	15,780	15,798	15,642	15,955	15,402	15,805					

1995	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
MDD	3,483	8,978	6,850	8,705	10,438	10,082	13,867	15,073	14,699	13,496	13,594	15,741

Source: Banco de México.

ANNEX VII

AVERAGE INTERBANK EXCHANGE RATE (pesos per dollar)



Tipo de Cambio Interbancario Promedio
(pesos por dólar, a la venta, 48 horas)
Average Interbank Exchange Rate (pesos per dollar)

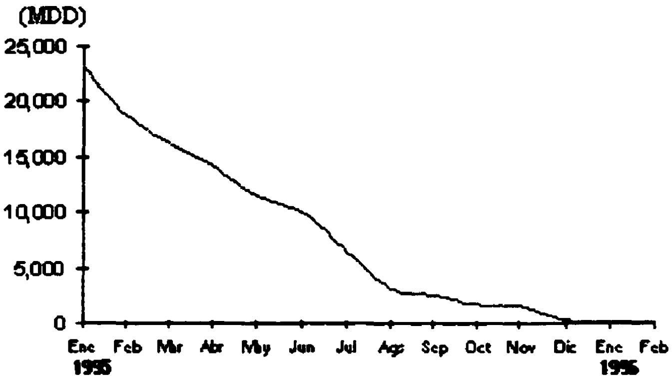
1996	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
$/dll	7.43	7.56	7.53	7.42	7.43	7.60	7.6					

1995	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
$/dll	5.60	5.68	6.75	6.20	5.95	6.12	6.12	6.20	6.31	6.89	7.51	7.17

Source: Banco de México.

ANNEX VIII

TESOBONOS (MILLIONS OF DOLLARS)



Tesobonos en poder del público

(Millones de dólares)

Tesobonos (millions of dollars)

1996	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
MMD	30	0										

1995	Ene	Feb	Mar	Abr	May	Jun	Jul	Ags	Sep	Oct	Nov	Dic
MMD	23,074	18,748	16,168	14,189	11,511	9,959	6,443	3,173	2,566	1,742	1,588	245

Source: Banco de México & Minitry of Finance (*Secretaría de Hacienda*).

ANNEX IX

FDI IN MEXICO
(millon dollars)

COUNTRIES AND REGIONS	1994 Value	1994 Part. %	1995 Value	1995 Part. %	1996 [1/] Value	1996 [1/] Part. %	Accum. 1994-1996 Value	Accum. 1994-1996 Part. %
TOTAL	**8,382.3**	**100.0**	**10,403.5**	**100.0**	**3,003.6**	**100.0**	**21,789.4**	**100.0**
North America	**4,345.7**	**51.8**	**6,424.1**	**61.7**	**2,002.6**	**66.7**	**12,772.4**	**58.6**
Canada	205.3	2.4	803.7	7.7	413.4	13.8	1,422.4	6.5
U.S.	4,140.4	49.4	5,620.4	54.0	1,589.2	52.9	11,350.0	52.1
European Union	**1,845.4**	**22.0**	**1,819.8**	**17.5**	**685.6**	**22.8**	**4,350.8**	**20.0**
Germany	118.6	1.4	345.9	3.3	399.1	13.3	863.6	4.0
Austria	0.2	0.0	0.1	0.0	0.0	0.0	0.3	0.0
Belgium	13.3	0.2	59.9	0.6	3.4	0.1	76.6	0.4
Denmark	2.3	0.0	8.0	0.0	7.1	0.2	17.4	0.0
Spain	114.0	1.4	96.4	0.9	16.2	0.5	226.6	1.0
Finland	1.0	0.0	3.4	0.0	-0.2	-0.0	4.2	0.0
France	66.2	0.8	117.1	1.1	21.6	0.7	204.9	0.9
Greece	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Netherlands	395.2	4.7	1,042.1	10.0	37.8	1.3	1,475.1	6.8
Ireland	1.0	0.0	0.7	0.0	19.7	0.7	21.4	0.0
Italy	9.0	0.1	0.0	0.0	1.6	0.0	10.6	0.0
Luxembourg	11.9	0.1	10.8	0.1	-2.6	-0.0	20.1	0.0
Portugal	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.0
United Kingdom	1,096.4	13.1	112.8	1.1	147.1	4.9	1,356.3	6.2
Sweden	16.2	0.2	22.6	0.2	34.8	1.2	73.6	0.3
Selected Countries	**2,165.5**	**25.8**	**2,119.2**	**20.4**	**281.2**	**9.4**	**4,565.9**	**21.0**
Netherland Antilles	495.5	5.9	78.7	0.8	22.9	0.8	597.1	2.7
Bahamas	17.3	0.2	70.9	0.7	1.4	0.0	89.6	0.4
Bermudas	0.2	0.0	-1.3	-0.0	2.4	0.0	1.3	0.0
Cayman Islands	154.9	1.8	90.8	0.9	6.4	0.2	252.1	1.2
South Korea	6.6	0.0	141.1	1.4	44.6	1.5	192.3	0.9
Chile	2.1	0.0	1.3	0.0	6.6	0.2	10.0	0.0
China	1.4	0.0	6.9	0.0	-0.3	-0.0	8.0	0.0
Philippines	0.0	0.0	6.1	0.0	0.0	0.0	6.1	0.0
India	340.2	4.1	1,301.7	12.5	0.0	0.0	1,641.9	7.5
Japan	735.7	8.8	207.5	2.0	50.6	1.7	993.8	4.6
Panama	318.1	3.8	103.3	1.0	0.5	0.0	421.9	1.9
Singapore	-0.5	-0.0	12.6	0.1	18.9	0.6	31.0	0.1
Switzerland	56.5	0.7	68.0	0.7	112.9	3.8	237.4	1.1
Taiwan	3.6	0.0	2.7	0.0	1.1	0.0	7.4	0.0
Uruguay	30.8	0.4	8.8	0.0	6.9	0.2	46.5	0.2
Virgin Islands	3.1	0.0	20.1	0.2	6.3	0.2	29.5	0.1
Other Countries	**25.7**	**0.3**	**40.4**	**0.4**	**34.2**	**1.1**	**100.3**	**0.5**

Up to May 31, 1996.
Source: SECOFI. Dirección General de Inversión Extranjera.

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