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ARTICLES

FOREIGN INVESTMENT IN MEXICO: MEXICO WELCOMES FOREIGN INVESTORS

"Pobre de México, tan lejos de Dios, y tan cerca de Estados Unidos."

Porfirio Díaz[1]

I. Introduction

Mexico's Foreign Direct Investment (FDI) policy has undergone many changes in recent years. The purpose of this paper is to give the reader an understanding of Mexico's FDI policies. First, by analyzing the legal changes that have taken place, and then by determining if these changes are consistent with the country's political and economic realities.

This paper is divided into three sections. The first section gives a brief historical overview of Mexico's FDI policy. The second section is an analysis of the latest FDI legal modifications and their impact on foreign investors. The last section is an analysis of the likely political and economic results of FDI policies in Mexico, and the prospects for success of these policies.

II. Historical Overview

A. *Foreign Direct Investment in Mexico*

The polemics of the foreign investment debate began early in the last century. In its incipient stages, the debate was between liberals who advocated for free trade, and protectionists who favored industrialization by closing the domestic market imports. At the end of the nineteenth century, liberals gained an upper hand and as a result, Mexico entered into an age of unprecedented economic growth.[2] However, the policies of free trade failed to provide equal

1. President of Mexico, 1876-1880 and 1884-1911. His quote refers to the condition of Mexico, a developing country, sharing a common border with the United States, the most developed country in the world. It is often used to describe both the blessings and misfortunes of Mexico due to this proximity to the United States.

2. According to Leopoldo Solis, "During the Díaz regime, the growth of a market

benefits to all Mexicans. Wealth was concentrated in a few people, while the majority of Mexicans lived in extreme poverty. Foreign investors were notoriously present within the Profirist elite and were blamed for many of Mexico's economic illnesses at the commencement of the Revolution in 1910.[3] As a result of the 1910 Revolution and the subsequent change of power, dramatic transformations occurred. The most transcendental change being the enactment of a new constitution which imposed severe limitations on foreign investors.[4]

After the revolution, Mexico's political instability, economic problems,[5] confiscations, and nationalization reduced the importance of FDI in Mexico.[6] The constitutional restrictions on FDI, along with the lack of confidence in the country, reduced the flow of FDI. Foreign investment did not begin to increase again until after the beginning of World War II.[7] At the same time, the Mexican government, acknowledging the danger of the war, decreed a State of Emergency, and the executive branch governed with extraordinary powers.[8]

Once the war was over, the emergency powers decree was repealed, and the old FDI rules were revived by the way of a presidential accord.[9] These provisions placed certain economic areas off-

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economy stimulated the economic expansion . . . one main reason being the railroad lines . . . ." LA REALIDAD ECONÓMICA MEXICANA: RETROVISIÓN Y PERSPECTIVAS 47 (1981); For a complete discussion on Mexico's economic growth, see HISTORIA MODERNA DE MÉXICO. EL PORFIRIATO: VIDA ECONÓMICA (Daniel Cosio Villegas ed., 1965).

3. 2 JOHN H. COATSWORTH, EL IMPACTO ECONÓMICO DE LOS FERROCARILES EN EL PORFIRIATO 95-114 (1984).

4. This is explained on the political grounds of former excessive exploitation of Mexico's natural and human resources by alien owners. For more details of pre-revolutionary conditions see COSIO VILLEGAS, *supra* note 2, and COATSWORTH, *supra* note 3.

5. *See generally* 10 ENRIQUE KRAUZE, ET AL. HISTORIA DE LA REVOLUCIÓN MEXICANA: LA RECONSTRUCCIÓN ECONÓMICA (1977); JAMES WILKIE, THE MEXICAN REVOLUTION: FEDERAL EXPENDITURE AND SOCIAL CHANGE SINCE 1910 (1967).

6. *See* LORENZO MEYER, MÉXICO Y LOS ESTADOS UNIDOS EN EL CONFLICTO PETROLERO 1917-1942 (1972). One of the main events was Mexico's nationalization of its oil industry, mostly in the hands of foreign owners.

7. FDI changed from $1.4 billion in 1914 to $411 million in 1937. However, the trend had been reversed by the time World War II began. Gary B. Pitts, *American Investment in Mexico,* 2 HOUS. J. INT'L L. 261, 262 (1980).

8. On the side of foreign investment, the Executive was especially worried that:

> ". . .[T]he state of war had originated an important flow of foreign capital, which fearing the war, can be used easily to accumulate, acquire, and speculate with specific goods, estates, and firms, with damage to the distribution of national property and seriously limit participation of Mexicans in the economic development of Mexico." DIARIO OFICIAL DE LA FEDERACIÓN (Mexico City, June 29, 1944).

9. Oscar Ramos Garza in MÉXICO ANTE LA INVERSIÓN EXTRANJERA: LEGISLACIÓN, POLÍTICA Y PRÁCTICAS 383-389 (1974), presents twelve regulations enacted by the Interministerial Joint Commission—a remainder of the June 29, 1944 Decree—which set the policies that regulated FDI during 1945-1973.

limits to foreign investors altogether, and established limitations on foreign ownership of Mexican.

FDI increased during the 1960's, and continued its surge in the late 1970's. During this period, Mexico experienced high rates of growth. The eighties, however, revealed the weak economic basis of the country, and proved economic projections of sustained growth to be too optimistic.[10] As of 1989, the economic crisis still persisted, and new approaches to foster development emerged.

Net FDI in Mexico increased from $3.1 billion in 1971 to $10.2 billion by 1985.[11] FDI increased even if one does not take into account foreign remittances, royalties, financing, and interests paid to parent companies.[12] Contrary to the world's trend, the U.S. remains Mexico's largest foreign investor reaching $15.1 billion in 1986. Total sales of U.S. affiliates in Mexico were $15.6 billion.[13]

B. *Mexico's Economic Development*

In the years after World War II, Mexico adopted a policy of Industrial Substitution of Imports (ISI). Industrialization and protectionism were seen as supplementary policies.[14] ISI policies were successful during the 1950's and 1960's. By the 1970's, however, the picture for ISI had changed dramatically. Until 1982, Mexico's economy had experienced negative economic growth. Measured in GNP terms, Mexico's steady high rate of economic growth was well above its annual demographic growth. In one sense, despite continuing inequalities, most Mexicans were sharing in Mexico's economic boom. However, behind the mask of the "economic miracle," there were a number of contradictory policies. In 1982,

10. Mexico's external revenues increased fourfold from the mid-1970's to 1982 due to the discovery and exploitation of huge oil reserves. However, when the oil prices began to decline, so did the government's revenues. *See* EL SISTEMA ECONÓMICO MEXICANO (Rogelio Montemayor ed., 1982)

11. NACIONAL FINANCIERA, LA ECONOMÍA MEXICANA EN CIFRAS 336 (1986).

12. According to Banco de México, total U.S. FDI in 1987 reached almost 2.2 billion (new investments + reinvestment of retained earnings + credits and loans from parent co.). BANCO DE MÉXICO, INFORME ANUAL 1987, at 135 (1986). Critics argue that there is indeed a negative capital flow as multinationals circumvent controls and remit too high fees for royalties and licensing and that much of the incoming FDI is only reinvestment of retained earnings which are obtained in the local economy.

13. U.S. DEP'T OF COMMERCE, U.S. DIRECT INVESTMENT ABROAD: OPERATIONS OF U.S. PARENT COMPANIES AND THEIR FOREIGN AFFILIATES, REVISED 1986 ESTIMATES (1989) at table 3, assets abroad, and table 6, sales abroad.

14. BELA BALASSA, THE PROCESS OF INDUSTRIAL DEVELOPMENT AND ALTERNATIVE DEVELOPMENT STRATEGIES (1980). The author distinguishes two stages in the import-substitution-industrialization process: the first is oriented to substitute final consumer goods, and the second to intermediate and somewhat more sophisticated intermediate goods. He also finds that ISI policies transform protection against export of manufactured goods, discourages production, and encourages consumption by the way of exchange rate and commercial policies.

Mexico entered into an economic crisis of unprecedented dimensions which still persists.

1. *Policy of "Desarrollo Estabilizador"*

From the 1950's until the 1970's,[15] the Mexican economy experienced high rates of growth. This era was known as *desarrollo estabilizador*, or "stabilizing development" period. It was predicated on the implementation of an economy revolving around the state with increased support to private enterprise through subsidies and cheap credit. During these years, the industrial sector grew at higher rates than the rest of the economy.[16] The focus of the ISI policies gradually changed from consumer goods toward intermediate and capital goods. The policy emphasized an inward orientation using protective tariffs and other barriers to FDI,[17] along with monetary and fiscal policies, to strengthen and encourage domestic economic development.

However, by 1970 the model was exhausted, or at least required a conscious rethinking. Because it no longer provided enough jobs, it presented serious distortions to the rest of the economy, and was sustained by massive external borrowing to cover the perennial deficits in public finances.

2. *Emergence of Contradictory Policies*

From 1970 to 1976, the policy of "shared development," *desarrollo compartido*, aimed to keep the economy growing and to decrease the inequalities that had been aggravated in the 1960's. The basic difference was that shared development wanted to reduce and rationalize the burden of the commercial policy,[18] to increase industrial efficiency, and to diversify exports (particularly manufactured products) in order to strengthen Mexico's position in the international marketplace. Little could be done since the government could not really enforce their policies. The reason being that their

15. Gerardo Bueno, *Política Comercial y de Desarrollo en el Contexto de las Relaciones Norteamericanas, in* MEDIO SIGLO DE FINANCIAMIENTO Y PROMOCIÓN DEL COMERCIO EXTERIOR DE MÉXICO: ENSAYOS CONMEMORATIVOS (1987). Gerardo Bueno divides Mexico's contemporary economic history in two main periods. The first covers from early 1950's to 1973. Here the macroeconomic policies were consistent, the economy experienced long term stability, and inflation presented low rates of increase. The second great period covers 1973 to present. The second period is characterized by a constant switching of policies and macroeconomic wrongdoing. Macro variables are more complex and unbalanced. Within these two divisions there are also sub-divisions that usually cover six year periods.

16. *See* SOLIS, *supra* note 2, at 79-81.

17. Tariff measures are taxes levied on goods crossing borders. Non-tariff barriers are hidden measures to obstruct free trade such as imposition of quotas and sanitary controls.

18. For a purely economic view see FRANKLIN R. ROOT, INTERNATIONAL TRADE AND INVESTMENT 120 (1978).

implementation was not backed by workers and industrialists who argued that more time was needed to compete efficiently in the international markets.

To make things even more difficult, the political situation found authorities favoring expansionist policies, resulting in higher government expenditures to be financed by inflationary taxes. Higher inflation in Mexico weakened the *peso's* exchange rate. But the government had made the exchange rate a political cause difficult to sustain.[19]

Inflation, increasing public sector deficits, and external account imbalances, forced Bank of Mexico to devalue the Mexican *peso* for the first time in more than twenty years. September of 1976 marked the end of an era of stable economy and began to set the environment of economic decline. In that month, Mexico asked the International Monetary Fund (IMF) to support its international obligations. The IMF was able to help, but requested a number of changes in Mexico's economic policies. The Mexico-IMF Agreement obliged Mexico to decrease the government's deficits, increase interest rates to savers, keep the *peso's* parity in equilibrium, reduce inflation, and generate an economic recession to keep the domestic variable under control.[20]

The agreement had a duration of three years, but it was abruptly ended by Mexico when it consolidated the exploitation of its enormous oil resources. Mexico's policy makers discarded IMF and instead chose foreign bankers eager to lend. At that time, bankers offered favorable terms of financing and extensive borrowing ensued.[21]

Mexico launched an ambitious process of development based upon future oil earnings. With domestic and foreign confidence high, coupled with massive investment and borrowing, Mexico's GNP increased more than 36% between 1978 and 1981.[22] Prospective oil revenues created an illusion of vast Mexican wealth,[23] leading to a reformulation of Mexico's economic development, with oil as the leading sector. From the oil sector would come foreign earnings to improve ISI performance and to promote efficiency. Opti-

19. For an analysis of the sources and policy options at the time, see Gerardo Bueno, *El Desarrollo de la Economía Mexicana, in* OPCIONES DE POLÍTICA ECONÓMICA EN MÉXICO DESPUÉS DE LA DEVALUACIÓN (1977).

20. *Id.*

21. According to former Finance Minister David Ibarra (1977-1982), "Bankers sat waiting in line to offer the best deals without political constraints." Multilateral agencies (IMF, Inter-American Development Bank) could offer better deals but usually they tied their financing to strict guidelines.

22. MONTEMAYOR, *supra* note 10.

23. The illusion of a vast Mexican oil wealth, simply awaiting to be tapped, is best reflected in the remarks of President José López Portillo: "[W]e have to learn to administrate the abundance of wealth generated by oil revenues."

mistic economic planners predicted a picture of extraordinary growth based upon increasing oil prices.[24] Unfortunately, domestic and foreign factors played against Mexico's policies.

Since 1981, it has been apparent that oil prices would not continue to increase. On the contrary, oil prices began to decline sharply. Because President José López Portillo was personally and politically committed to keeping the *peso*-dollar parity, measures to deal with the impending economic crises were postponed.[25]

Shortly thereafter, foreign economic policy became a matter of great concern in Mexico and abroad. Political opposition charged the government that Mexico's economic policy had been dictated by IMF and that the country's sovereignty was in danger. This politically charged situation has prevailed in Mexico since 1982, when crisis transformed to recession.[26] In this context, the newly elected President Miguel De la Madrid took office in December 1982 and presented an economic program to rapidly address the economic problem.

III. LEGAL FRAMEWORK OF MEXICO'S INVESTMENT LAWS

A. *Mexico's General Legal Framework*

In theory, the Mexican legal system presents striking similarities to its U.S. counterpart.[27] This is no coincidence, since most of the provisions of the Mexican Constitution[28] were heavily influ-

24. This is an oversimplification of the economic strategy. Sound economists led by Mr. Jose Luis de Oteiza, then Minister of Parastatal Industry, supported the argument of a leading sector as a tool to expand national economic benefits. In the case of PEMEX, the government's oil enterprise, the strategy was designed to overcome the traditional primary products model provided that PEMEX would require many foreign industrial and manufactured supplies be substituted by Mexican producers, thus enhancing production and welfare.

25. It was López Portillo who made the infamous statement before the Mexican Congress: "I will defend the peso [exchange rate] as a dog." For an extensive bibliography—both in Spanish and English—that reviews Mexico's economy during 1976-1982, see René Villarreal, *De la Industrialización Substitutiva a la Petodependencia Externa y Desustitución De Importaciones, in* EL SISTEMA ECONÓMICO MEXICANO (Rogelio Montemayor ed., 1982).

26. While there have been plenty of works regarding foreign economic policy making in industrialized countries, there are few works for developing countries both in general and particular issues. The case of Mexico is no exception. There are few studies about foreign economic policy, and in those few existing, scholars tend to consider just one aspect, such as trade policy, commercial policy, or export promotion. *See generally* Sofía Méndez Villareal, *La Dimensión de la Política Exterior Mexicana,* and Bela Balassa, *Medio Siglo de Financiamiento y Promoción, in* CUADERNOS DEL POLÍTICA EXTERIOR MEXICANA (1986).

27. *See generally,* G. S. MARGADANT, AN INTRODUCTION TO THE HISTORY OF MEXICAN LAW (1981); C. W. ANDERSON, THE POLITICAL ECONOMY OF MEXICO (1963).

28. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS, *Diario Oficial,* February 1, 1917 [hereinafter CONST.]. References to the Mexican Constitution are to the Constitution of 1917, signed at Queretaro on January 31, 1917. The Constitution of 1917 has been subject to numerous amendments.

enced by the U.S. Constitution.

Similar to U.S. federal structure, federal power in Mexico is divided into executive, legislative, and judicial branches.[29] Moreover, the enactment of laws is the prerogative of the legislature.[30] However, the Mexican Constitution itself empowers the executive "to promulgate and execute the laws . . . [of] Congress providing for their exact enforcement in their administrative sphere."[31] This power is exercised in the form of regulations (*reglamentos*), issued by the executive branch to "explain the elaborate" on the meaning of the enacted laws.[32] Since most statutes are actually explained and supplemented in this manner, this power to interpret the laws, normally exercised by the courts in the United States, provides the Mexican federal executive with a powerful tool to dictate the direction of the laws without the need for its congress to enact additional legislation.[33] The Mexican Constitution is the supreme law of the land,[34] and the laws enacted by congress cannot contravene it. Below the congressionally-enacted laws are the regulations issued by the executive branch which may not contravene the law that they are supposed to explain.[35]

B. *Presidential Role in Lawmaking*

It is important to bear in mind the role of the executive branch in the lawmaking process of Mexico. Because of the peculiar political system, the President has real power not balanced by the judicial or legislative branches. The Constitution allows both congress (either the Senate or the Chamber of Deputies) and the executive branch to introduce laws to congress.[36] However, congress rarely presents initiatives to deal with the pressing issues in the political agenda.[37] Most of the important policies are formulated within the

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29. CONST. art. 49.
30. *Id.*, art. 73.
31. *Id.*, art. 89.
32. *See generally* H. WRIGHT, FOREIGN ENTERPRISE IN MEXICO: LAWS AND POLICIES (1917).
33. It should be noted that the role of the judiciary in Latin America in general does not enjoy the prestige and independence that the judiciary enjoys in Anglo-American countries. *See generally* K. KARST, LAW AND DEVELOPMENT IN LATIN AMERICA 92 (1975).
34. CONST. art. 133.
35. Underneath a *Reglamento*, in legal hierarchy, is the Executive Decree (Decreto), also used by the executive branch to explain a law or a regulation. At times, a decree can become a sort of seminal law where no legislation exists at all. Ministries are also empowered to issue administrative rulings (*acuerdos*), whose goal is to clarify issues over which the Ministry is in charge. An administrative ruling may be repealed by any other regulation.
36. The state legislatures are also empowered to introduce legislation to Congress. CONST. art. 71.
37. According to Lorenzo Meyer (scholar at El Colegio de México), almost 95% of all initiatives are presented by the Executive branch. *See also* MEXICO'S POLITICAL

different ministries of the executive branch. Once these initiatives are reviewed by the Office of the President, they are submitted to congress, where they are likely to be approved. In the past, congress served as a rubber stamp for the President,[38] but that may no longer hold true as new political parties emerge and congress becomes increasingly independent.[39]

C. *Constitutional Underpinnings of Mexico's Foreign Investment Regulation*

Compared to the U.S. Constitution, the Mexican Constitution is very long,[40] and quite detailed.[41] Several provisions regulating foreign investment and ownership of Mexico's resources are included in the Constitution itself.[42] In addition, the Constitution mandates that the State is to control the economy,[43] and to do so is to assure a "more just distribution of income and wealth."[44]

1. *The "Calvo Clause"*

Under the "Calvo Clause"[45] of Article 27, any foreigner[46] who acquires property in Mexico agrees not to invoke the protection of his government in relation to the acquired property, and to have

STABILITY: THE NEXT FIVE YEARS (Roderic A. Camp ed., 1986), and POLITICS IN MEXICO (George Philip ed., 1985).

38. Article 73 enumerates those areas in which Congress may create legislation. Article 89 enumerates the prerogatives of the President to create and to formulate policies oriented to clarify and keep the public administration working smoothly. These new formulations cannot be opposed to those enacted by Congress.

39. In the 1988 presidential elections, Mexico's ruling party, the PRI, officially won only 50.8% of the popular vote amidst widespread charges of electoral fraud by the opposition. Currently in the House of Deputies, the PRI has 260 seats, with the PDR (a coalition of seven smaller parties) holding 110, and the conservative Partido de Acción Nacional (PAN) with 130. In the Senate, the PRI holds 60, and the opposition holds four seats. Article 135 of the Constitution requires a two-thirds vote of each chamber to enact a constitutional amendment. This means that the PRI will probably have to form a coalition with another political party to change the Constitution. For more details, refer to POPULAR MOVEMENTS AND POLITICAL CHANGE IN MEXICO (Joe Foweraker & Ann L. Craig eds., 1990).

40. The Mexican Constitution consists of 136 articles. Several articles are longer than the entire U.S. Constitution, making the Mexican Constitution more like a legal code by U.S. standards. By contrast, the brevity of the U.S. Constitution prompted Chief Justice John Marshall to comment ". . . this is a *constitution* we are expounding [and not a legal code]." McCulloch v. Maryland, 17 U.S. 316, 406 (1989).

41. The Mexican Constitution contains provisions in the field of investment, ranging from the requirement of worker's entitlement to profit sharing, CONST. art. 123(A)(IX), to the minimum number of vacation days that workers are entitled per year. *Id.* art. 123 (B)(III).

42. Particularly in art. 27 and 28, discussed *infra* notes 46-53.

43. CONST. art. 25(I).

44. *Id.*

45. Named after the 19th century Argentinean diplomat, Dr. Carlos Calvo. *See* DONALD R. SHEA, CALVO DOCTRINE AND CLAUSE (1955).

46. A foreigner is one that is not Mexican by birth or naturalization. CONST. art. 27(I).

such disputes settled in Mexico under Mexican law.[47] The penalty for a foreign investor who seeks protection of his government regarding property in Mexico is the forfeiture of property to the Mexican State.[48] These limitations also apply to Mexican corporations with foreign shareholders.[49]

2. *Geographical Limitation: The Restricted Zone*

Due to well known historical reasons,[50] the Mexican Constitution provides for special limitations regarding foreign ownership of real property in a "restricted zone," extending for 100 kilometers from the borders, or 50 kilometers along the shores of the country.[51] Direct ownership by foreigners of property located in this area is forbidden.[52]

3. *Economic Activities Limited to the State*

The Mexican Constitution reserves several economic activities exclusively for the State, thus excluding private participation, whether by Mexicans or by foreigners, including the operation of railroads, electricity generation and transmission, telegraphs, petroleum and basic petrochemicals, and nuclear industries.[53]

D. *The New Foreign Investment Law (FIL), and its Current Reglamento*

The Foreign Investment Law of 1973[54] (FIL) and its new regulation issued in 1989[55] (FIL Regulation), dramatically changed the outlook for foreign investment. Since the FIL and the FIL Regulation were promulgated at radically different economic and political periods,[56] it is to be expected that there will be tensions between the

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47. *Id.*
48. *Id.*
49. *Id.* These restrictions also apply to Mexican companies in which foreign investors participate.
50. Namely, the loss of the territory that now makes the Southwest to the United States between 1836 and 1847, as well as many other cover interferences by the U.S. in Mexico's internal affairs. *See* Josefino Zoraida Vazquez, *Los Primeros Tropiezos, in* 3 HISTORIA GENERAL DE MÉXICO 80 (1976).
51. CONST. art. 27(I).
52. *Id.* However, foreigners can own property indirectly through a trust.
53. CONST. art. 27(IV), and art. 28(V).
54. Ley Para Promover la Inversión Mexicana y Regular la Inversión Extranjera [Law to Promote Mexican Investment and to Regulate Foreign Investment], DIARIO OFICIAL DE LA FEDERACIÓN [D.O]., March 9, 1973 [hereinafter FIL].
55. Reglamento de la Ley Para Promover la Inversión Mexican y Regular la Inversión Extranjera [Regulation of the Law to promote the Mexican Investment and Regulate the Foreign Investment], D.O., March 15, 1989 [hereinafter FIL Regulation].
56. The FIL was promulgated during the presidency of Luis Echeverria with the goal of expanding the control and direct participation of the State in the economy. By contrast, the FIL Regulation of 1989, issued by the current presidency of Carlo Salinas de Gortari with part of a program fully committed to the opening of Mexico to the

two.[57]

In addition to the economic activities reserved for the State by the Constitution, the FIL includes a classification of new activities. These are: radio and television, transportation industries, forestry, and gas distribution. All activities are reserved for Mexicans and foreign investment is excluded.[58]

The FIL allows foreign participation of up to 49% in the sectors not reserved for the State or for Mexican nationals, provided that foreigners do not acquire control of the business.[59] The National Commission on Foreign Investment was given authority to authorize higher percentages in specific instances,[60] but exceptions to the forty-nine percent ownership limitations were not generally granted.[61]

The FIL Regulation liberalizes treatment of FDI by allowing foreign investment in any proportion, without previous authorization, for those activities not explicitly reserved for the State or for Mexican nationals.[62] However, the following conditions need to be satisfied: the investment must not exceed one hundred million dollars (1989);[63] the investment is made outside Mexico's main industrial areas;[64] and the investor maintains a balance in foreign currency operations for the first three years of operations.[65]

1. *FDI in the "Restricted" Zone*

With respect to the constitutional prohibition of direct foreign investment in the restricted zone, the FIL allows foreign participation in this zone through a trust. A Mexican credit institution, acting as the trustee, can retain the legal title, and the foreign investor can retain the equitable interest.[66] Investment is restricted to indus-

world markets, was enacted while Mexico was still struggling to emerge from one of its harshest economic crisis of recent times. *See* OPPENHEIMER & CO., INC., PROSPECTUS THE MEXICO ADVANTAGE FUND app. (1990).

57. *See infra* discussion on the constitutionality of the FIL Regulation, at 25.

58. FIL, art. 4(a)-(e), and the supplement to the FIL Regulation: Reglamento Específica y General Para la Inversión Extranjera Directa Con Base en la Classificación Mexicana de Actividades Económicas y Productos.

59. *Id.* art. 5.

60. *Id.*

61. Although this may appear to be carte blanche for the executive, by allowing the Foreign Investment Commission the discretion to permit majority control of business by foreign investors, exceptions to the 49% limitation on foreign ownership were rarely granted. Only 100 to 150 such exceptions were given up to 1984. Camil, *Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model*, 12 HOUST. J. INT'L. L 1, 5, n. 5 (1989).

62. FIL Regulation, art. 5.

63. *Id.* art. 5(5). In 1989, this amount was 100 million dollars.

64. *Id.* art. 5(III). These areas include the metropolitan areas of Mexico City, Monterrey, and Guadalajara.

65. *Id.*, art. 5(III), and art. 28(I)(b)(iii).

66. FIL, art. 18.

trial or tourist operations, with a maximum trust duration of thirty years.[67] Equitable title can be acquired without government permit.[68] This allows for transferability of equitable interest, but title can only be "nominative," and not to the "bearer."[69]

2. *FDI Through Trusts*

The FIL Regulation allows the creation of trusts, without government authorization, provided that foreigners do not acquire control of a business through such trusts, or that foreign ownership does not exceed forty-nine percent.[70] The FIL Regulation also authorizes "bearer" shares to be acquired through a trust.[71] In addition, a trust may be renewed, upon the same conditions as the original,[72] and the equitable interest may be transferred.[73]

3. *FDI in Areas Previously Limited to Mexican Investors*

The FIL Regulation also allows for temporary foreign investment in areas restricted by the FIL. These include air and sea transportation and gas distribution[74] through a trust. Foreign ownership may be in any percentage, but only in cases where the Mexican business has an extreme financial need, or are in need of new capital.[75] These temporary trusts have a maximum duration of twenty years.[76]

4. *Registration and Permits Requirements*

Acquiring real property not located within the restricted zone may be done without government authorization.[77] Leases for up to 10 years[78] may be similarly acquired.

The FIL requires that all foreign investors, Mexican corporations, and trusts with foreign participation be registered.[79] Entities who do not register cannot pay dividends, and all agreements entered into by non-registered investors are void.[80] However, one of the major innovations of the FIL Regulation is that it has a built-in mechanism to force the bureaucracy to act. Any solicitation and

67. FIL, art. 20.
68. FIL, art. 22.
69. FIL, art. 21.
70. FIL Regulation, art. 10.
71. *Id.* art. 13-14.
72. FIL Regulation, art. 20.
73. *Id.* art. 21.
74. FIL, art. 4.
75. FIL Regulation, art. 23.
76. *Id.* art. 26(I)(a).
77. *Id.* art. 36.
78. FIL Regulation, art. 37.
79. FIL, art. 23.
80. FIL, art. 27.

permit required that is requested, if not approved within forty-five working days, is deemed to have been approved.[81] Similarly, any registration request not acted upon within twenty working days is also deemed to be duly registered.[82] These requirements indicate that there is a design to have most of the requests submitted to be approved, and to assure the foreign investors that the federal bureaucracy will not delay their business planning.

IV. EFFECTS OF THE NEW FIL REGULATION

A. *Additional Activities Open to Foreign Investors*

The new regulations open up nearly two thirds of the Mexican economy to foreign investors.[83] Activities explicitly open to foreigners without any ownership limitations include the following: agriculture and cattle raising;[84] newspaper and magazine publications; residential and industrial building;[85] drilling of oil wells; private educational services;[86] legal and accounting services; most activities related to air and ground transportation;[87] and insurance services.[88]

However, several important activities including most fishing activities, mining, and automobile manufacturing, only allow a minority (less than fifty percent) FDI participation. The FIL Regulation apparently allows one-hundred percent foreign ownership in any activity not listed above.[89] These non-enumerated activities include most of the manufacturing industries[90] and tourism, which

81. FIL Regulation, art. 2.

82. FIL Regulation, art. 51.

83. *Declaration of Commerce Secretary Jaime Serra Puche*, UPI, May 28, 1989, *available in* LEXIS, Nexis Library, UPI File.

84. Article 27(IV) of the Constitution prohibits ownership of rural lands by corporations, and article 27(XV) limits the amount of agricultural and pasture land that may be owned by individuals. Presumably these limitations remain in place. CONST. art. 27.

85. Indeed, the government is seeking foreign participation to build, finance, and operate a "superhighway" from Mexico City to Acapulco. Robert Graham *Mexico; Dealing with the Pack*, FIN. TIMES, Oct. 12, 1989, at I.

86. The U.S. reader may find surprising that this provision has caused some controversy in Mexico. *See* Leonardo Saavedra, *Inversiones Extranjeras en Educación!*, EL DÍA, May 15, 1989. Article 3 of the Constitution does dictate that education "shall be designed to develop harmoniously all the faculties of the human being, and to foster . . . love for the Motherland." Critics, however, are skeptic that foreign institutions will be able to carry out this mandate.

87. Mexico has already sold the state-owned Mexicana Airlines to foreign investors. M. D. Baer *Politically and Economically, He Has to Walk a Tightrope*, CHRISTIAN SCI. MONITOR, Dec. 14, 1989, at 19.

88. Mexico is currently seeking to sell up to 49% of state-owned Aseguradora Mexicana (Asemex), the largest Mexican insurer, to foreign investors. *Mexico Seeks Foreign Investment in Insurance firm*, REUTERS, Feb. 14, 1990, *available in* LEXIS, Nexis Library, Rueter File.

89. FIL Regulation, art. 5.

90. Planning and Budget Minister Ernesto Zedillo announced: "curbs have not been placed on foreign investment in Mexico's tow largest state-owned steel companies. Under the new regulations of foreign investment law, these companies could be 100% foreign-owned." *Steel Privatization in Mexico*, MINING J., Mar. 16, 1990, at 214. Mex-

may represent the most promising field for U.S. investment in Mexico.[91]

B. *Bureaucratic Expediency*

The FIL Regulation requires that any application submitted for foreign investment approval[92] or for foreign investment registration[93] be deeded approved if not answered within forty-five days. This will serve to expedite the process by eliminating the bureaucracy. Indeed, it seems to be designed to force the bureaucracy to give a de facto approval.[94]

V. CONSTITUTIONALITY OF MEXICO'S FOREIGN INVESTMENT REGULATIONS

The constitutionality of FIL Regulation has been widely debated.[95] Such a debate would have been unheard of a few years ago. The debate indicates the emergence of significant political opposition[96] and perhaps an indication of the loosening of the PRI's grip on power.

The FIL, after listing those economic sectors reserved for the State[97] and for Mexicans only,[98] explicitly states that foreign ownership for those activities not included in the classification be limited to only forty-nine percent.[99] The National Commission for Foreign Investment has the power to increase the percentage of foreign ownership only in specific circumstances, and only if in the best interest of the country.[100]

The FIL Regulation takes the opposite approach, by allowing

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ico is determined to privatize Altos Hornos and Sicartsa, either on debt-for-equity swaps, or by outright selling. Both are heavily in debt.

91. Indeed, a foreign company recently acquired an edible oils and past factory from Conasupo, the state-owned producer and distributor of basic foodstuffs. *Unilever to Buy Mexico City Firm*, L.A. TIMES, Feb. 26, 1990, at D2, col. 1.

92. FIL Regulation, art. 2.

93. *Id.*, art. 51.

94. According to Commerce Secretary Jaime Serra Puche, prior to these regulations, the approval process generally took 365 working days, meaning a year-and-a-half wait. *Foreign Investment, More Mexican Foreign Investment Reform Needed to Attract Investor, Analysts Say*, DAILY REP. FOR EXEC., May 17, 1989, *available in* LEXIS, Nexis Library, DREXEC File.

95. *See* L. Saavedra, *Inversiones Extranjeras en la Educación!*, EL DÍA, May 24, 1989; Jorge Camil, *Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model*, 12 HOUST.J. INT'L L. 1, 13, n. 111 (1989); V.C. García Moreno, *Reglamento de la Ley Sobre Inversión Extranjera; Breve Analysis, in* ACADEMIA MEXICANA DE DERECHO INTERNACIONAL PRIVADO, XII SEMINARIO NACIONAL DE DERECHO INTERNACIONAL PRIVADO (1989).

96. *See supra* note 54, on Mexico's present political situation and results in the last presidential elections.

97. FIL, art. 4.

98. *Id.*

99. *Id.*, art. 5.

100. *Id.*

foreign investment in any proportion and in any area not expressly limited by the FIL Regulation.[101] Therefore, a good argument can be made that the FIL has abdicated the government mandate of controlling foreign investment.[102] In addition, the FIL Regulations, by allowing investment in areas that the FIL has designated open to only Mexican investors, even if on a temporary basis, and only through a trust,[103] may also be deemed to be contravening the FIL itself.

The effects of having either a Law or a Regulation contravene the Constitution is a problematic area of Mexican Law for which there does not exist a satisfactory answer. While in the U.S. it is the prerogative of the judiciary to declare laws and regulations unconstitutional, in Mexican jurisprudence, only an aggrieved party has standing to raise such challenge. With regards to the FIL and the FIL Regulation, a Mexican investor may have standing to raise such a challenge. However, the FIL Regulation does open up new fields of the economy to Mexican investors. As a result, it is unlikely that a Mexican investor will be deemed to be aggrieved. In addition, a judicial determination will affect only the rights of the aggrieved party, and not the law itself,[104] but only when five such decisions have been rendered in the same issue, and no contrary decision has been rendered. The precedent established is only controlling as to the judicial branch of government, which in essence means that the law being challenged will stand as is.

For the above reasons, it is safe to assume that the question of whether or not the FIL Regulation is unconstitutional will remain an esoteric argument relevant only as a point of academic interest.

VI. TAX CONSIDERATIONS

A. *Mexican Investment Incentives*

A typical method of attracting foreign investment[105] is the promotion of tax saving incentives:[106] "Tax incentives of one form or

101. FIL Regulation, art. 5.

102. FIL, article 1 describes the objective of the law as to ". . . promote Mexican investment and to regulate foreign investment for stimulating a just and equilibrated development, and to consolidate the political independence of the country."

103. *See supra* discussion on temporary investment.

104. CONST. art. 107(II).

105. *See generally* George E. Lent, *Tax Incentives in Developing Countries, in* READINGS ON TAXATION IN DEVELOPING COUNTRIES 363, 364 (Richard M. Bird & Oliver Oldman eds., 1975) (originally published in RIVISTA DI DIRITTO FINANZIARIO E SCIENZA DELLE FINANZE 29 (March 1970)).

106. "When establishing new plants overseas, multinational firms are often offered substantial investment incentives by host countries. Examples of the types of subsidies offered by host countries include reduced tax rates in the early years of operation, cash grants, subsidized loans, and labor training grants. These subsidies have become a widespread practice in both developed and developing countries, and play an important

another are part of the arsenal of virtually all developing as well as developed countries for mobilizing and directing capital for new investment."[107] From the earliest years "industrialists [in Mexico] have been given significant tax concessions."[108] Although most laws regulating investments usually do not specify a distinction as to foreign or domestic capital, they are generally aimed at the attraction of capital from abroad.[109]

Traditionally, the tax incentives in Mexico were available only to Mexicans or Mexican majority-owned companies.[110] However, with Mexico's open-arms approach to foreign investment,[111] Mexico has opened new terrain for these foreign investments. In accordance with its goals, Mexico has extended foreign investors several tax concessions. Included in these concessions are tax credits for selected industries and geographical locations within Mexico. In addition, the government, in promoting its goals of employment, investment, and development of geographical areas, has provided fiscal assistance to *maquiladoras*,[112] the fishing industry,[113] industrial operations,[114] shipping enterprises,[115] and mining.[116]

Addressing the geographical advantages, the tax incentives are in the form of free zones[117] and regional areas.[118] In the free zones, special incentives are available in the form of up to one-hundred percent reduction of import duties on machinery, equipment, spare parts, and raw materials for a maximum of ten years from the time operations begin.[119] Further, as part of the National Industrial Development Plan, Mexico is divided up into three zones for tax

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role in efforts to secure foreign investment." Eric W. Bond & Larry Samuelson, *Tax Holidays as Signals*, 76 AM. ECON. REV. 820 (1986).

107. LENT, *supra* note 105, at 363.

108. "Beginning in 1941, exemptions from the payment of all major forms of taxation for periods varying from five to ten years were granted to new enterprises and to others deemed necessary for the development of manufacturing in Mexico." ROGER D. HANSEN, POLITICS OF MEXICAN DEVELOPMENT 49 (1971); "The fiscal assistance granted for many years by the Mexican government has obviously been a most important aspect in Mexico's industrial development." Alonso V. Aguilar & William F. Kryzda, *Tax Incentives for Industrial Investments, in* 1 DOING BUSINESS IN MEXICO 26-1, 26-2 (Joseph J. Norton et al. eds., 1990).

109. LENT, *supra* note 105, at 364.

110. 2 INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION, TAXATION IN LATIN AMERICA 67 (Supp. No. 80, 1990); *See also* 4 MEMBERS OF THE FOREIGN TAX LAW ASS'N, TAX LAWS OF THE WORLD, MEXICO 20 (1986).

111. *See supra* note 56.

112. TAXATION IN LATIN AMERICA, *supra* note 110, at 211.

113. *Id.* at 70.

114. *Id.* at 73.

115. *Id.* at 77.

116. *Id.* at 76.

117. *Id.* at 71.

118. *Id.* at 76.

119. TAX LAWS OF THE WORLD, MEXICO, *supra* note 110, at 23.

purposes:[120]

> ZONE I is a zone of preferential incentives and is divided into two sub-zones. Zone I-A is aimed at industrial port development in four port cities. Zone I-B is aimed at industrial urban development consisting of seven cities with development potential.
>
> ZONE II is composed of state priority zones. Included in this zone are cities designated by each state governor as priority locations for industrial activity. No incentives, and even restrictive policies, are applied to this zone.
>
> ZONE III is a restrictive zone and consists of two subzones. Zone III-A, a zone of controlled growth, consists of Mexico City and its surrounding area. Zone III-B, a zone of consolidation, consists of all areas where two cities have overlapping influence.[121]

Within these regional zones, tax credits are provided at various rates to investors in order to offset any or all tax liability.[122]

The typical tax incentives granted by Mexico are in the form of tax credits known as Certificados de Promoción Fiscal (CEPROFI). These credit certificates are valid for five years and may be used for the payment of most federal taxes.[123] The credits available are for costs incurred in the construction or installation of facilities, or the acquisition of equipment and machinery.

Other credits may be acquired for certain types of business activities. There are two categories where an investor may acquire additional credits. Category I—industrialization of food and dairy products for human and animal consumption; manufacture of capital goods for various industries; and manufacture of machinery, equipment, and transportation equipment. Category II—industrialization and manufacture of nondurable consumer goods; durable consumer goods; and intermediate goods.[124] Additionally, tax credits can be acquired through the creation of new jobs,[125] the acquisition of equipment or machinery manufactured in Mexico,[126] or

120. John E. Tarbox, *An Investors' Introduction to Mexico's Maquiladora Program*, 22 TEXAS INT'L L.J. 109, 130 (1986).

121. *Id.*

122. Within Zone I, incentives range from twenty to forty percent; in Zone II, fifteen to forty percent; and in Zone III, zero to thirty percent. The different percentages of tax credit incentives available are dependent on the type of industries involved. TAXATION IN LATIN AMERICA, *supra* note 110, at 74.

123. TAX LAWS OF THE WORLD, MEXICO, *supra* note 110, at 20. The current income tax rate for corporations is thirty-five percent. TAXATION IN LATIN AMERICA, *supra* note 110, at Tax Chart.

124. Tarbox, *supra* note 120, at 130-31 (citing DOING BUSINESS IN MEXICO, § 16.07[1][b] (S. Lefier ed. 1986)).

125. "This incentive is '20 percent of the general annual minimum salary for the corresponding economic zone, multiplied by the number of jobs directly generated by such investment.' " *Id.*

126. "Incentives can also be acquired in any zone and for any activity involving the

"investment in a new industry, particularly a small industry."[127]

B. *United States Tax Considerations*

Mexico and the United States operate their tax systems independent of one other and there is no tax treaty between the two countries.[128] Thus, the starting point for the treatment of foreign earned income in the United States is the Internal Revenue Code.

The Foreign Tax Credit provided to a taxpayer is "the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country."[129] "If the foreign tax due on a given amount of income is equal to, or greater than, the United States tax due on that income, then the U.S. Treasury collects nothing."[130] This type of situation would be ideal, for there truly is a tax incentive. However, if the tax paid to the foreign government is less than the tax due to the United States, then the U.S. Treasury imposes a tax liability for the difference, thus removing any incentive initially created by the Mexican measures. Therefore, the attractiveness of the Mexican tax incentives are neutralized by the U.S. tax system.[131]

Mexico seeks for the adoption by the U.S. of a tax-sparing approach—a method that is applied by numerous industrialized nations. The investor in a tax-sparing approach receives the full credit of the tax he would have paid to the Mexican treasury had Mexico not granted a tax incentive. By this method, the investor truly receives a tax benefit as a result of investing in Mexico.[132]

As the integration of North American proceeds, the United States, Mexico, and Canada must seek equitable solutions to the

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acquisition of registered machinery and equipment manufactured in Mexico. This incentive is five percent of acquisition cost." *Id.*

127. "A 'small industry' is one whose total assets are not over 200 times the annual minimum wage in Mexico City." PITTS, *supra* note 7, at 292.

128. TAXATION IN LATIN AMERICAN, *supra* note 110, at 83. However, on November 9, 1989, the two governments signed a treaty to exchange tax information. This has been seen as the potential starting point of a full tax treaty between the United States and Mexico. *Mexico and U.S. Exchange Tax Information*, 13 L.A. LAW., 15 (1990).

129. I.R.C. § 901(b)(1) (1988).

130. Gregory C. Shaffer, Note, *An Alternative to Unilateral Immigration Controls: Toward a Coordinated U.S.-Mexico Binational Approach*, 41 STAN. L. REV. 187, 211 (1988).

131. *Id.* at 211-12. "[T]he investment program subsidizes the U.S. Treasury rather than direct foreign investment." *Id.* at 212.

132. Japan and the United Kingdom have signed tax-sparing treaties with certain developing nations. "This form of tax-sparing occurs when a developing country reduces or eliminates taxes as part of an investment-incentive program. The developed country will recognize this program by *granting credit for the amount that would have been taxed if there had been no tax incentive.*" *Id.* at 217 (citing Anthoine, *Provisions in Tax Laws of Developed Countries Bearing Upon Private Direct Investment in Developing Countries, in* U.S. TAX'N & DEVELOPING COUNTRIES 71 (R. Hellawell ed. 1980) (emphasis added)).

problem of double taxation.[133] In making its decisions on taxation of foreign investments, the government of the United States should consider the consequences on Mexico's tax incentives so as not to neutralize any of these incentives.[134] "The [United States] must establish a tax-sparing agreement by which it forgoes taxing the newly exposed tax base in order to make the tax cut effective."[135]

VII. ANTICIPATED IMPACT OF THE NEW FDI POLICIES

A. *Will Mexico Succeed?*

Mexico's new foreign investment laws clearly meet with the approval of the U.S.,[136] even though most of Mexico's economy is now open to foreigners.[137] Some in the U.S. think that Mexico is not going far enough to resolve its economic problems.[138]

Only time will tell if success will be forthcoming, but success cannot be expected overnight. Complaints about the lack of progress so far[139] simply miss the point. The stated goal that the Mexican leadership seeks to accomplish is long term economic stability.[140] The pace of investment cannot exceed that of the regular business planning, and much investment may simply take the form of debt for equity swaps.[141]

Some areas of the economy are already benefitting. Inflation has been dramatically decreased,[142] and the stock market rise of

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133. Glenn P. Jenkins, *The Taxation of foreign investment income in Canada, the United States and Mexico*, 44 LAW & CONTEMP. PROBS. 143 (1981).

134. *Id.* at 159.

135. *Id.*

136. The U.S. trade representative remarked, "We are extremely admiring of the manner in which the Salinas administration has opened up Mexico, brought down tariffs, and have permitted foreign investment." *Address of Carla Hills, U.S. Trade Representative Before the National Association of Manufacturers*, FED. NEWS SERVICE, April 4, 1990, *available in* LEXIS, Nexis Library, FEDNEW File.

137. *Id.*

138. Conservative elements in the U.S. are urging that Mexico eliminate subsidies in general, and allow foreign investment in any sector. *See From the U.S. Mexico: Friendly advice on ending the Farm Crisis*, HERITAGE FOUND. REP., February 12, 1990, at 1.

139. Jorge Castañeda, a Mexican commentator, complains that last year imports increased by 57%, while exports grew only by 15%. Also, during the past year, there was actually a decrease of foreign investment. Jorge Castañeda, *A 'Deal' to Give Away the Store*, L.A. TIMES, April 2, 1990, at B7.

140. The Mexican President declared to a joint session of the U.S. Congress: "A new world awaits us on the threshold of the 21st century, open to the boldness of the imagination." *Address by Carlos Salinas de Gortari, President of Mexico to the Joint Session of the U.S. Congress*, FED. NEWS SERVICE, Oct. 4, 1989, *available in* LEXIS, Nexis Library, FEDNEW File.

141. Last year, the state-owned Mexicana del Cobre, one of the country's largest copper producers, was acquired for $1.36 million of public sector debt. *Mexico's Dilemma*, MINING J., Sept. 22, 1989, at 235.

142. Inflation has been reduced from 160% in 1987 to 17% in 1989. *The Year's 25 Most Fascinating Business People*, FORTUNE, Jan. 1, 1990, at 62.

sixty-eight percent for 1989[143] is an indication of investor optimism. The budget deficit of sixteen percent of GDP in 1987 is expected to come down to 1.6% in 1990.[144] For the first time in ten years, the economy has grown faster[145] than the population of Mexico.[146] If this economic growth rate is sustained, coupled with the decrease in new births,[147] Mexico may indeed be able to overcome some of its economic woes.

B. *Who Will Share in Mexico's Success?*

If Mexico achieves an economic boom, as the authors believe it will, the profits will not be distributed equally. Indeed, the traditional imbalances of Mexico's distribution of wealth may be accentuated. Privatization no doubt will open many avenues of opportunities for investment, and it may help to repatriate some of the $80 billion plus dollars that have fled Mexico.[148] Liberalization of foreign investment regulations will allow foreign capital to take advantage of Mexico's economic opportunities.

To date, the Mexican workers have taken the brunt of the new economic policies. In August of 1989, Army troops occupied the Cananéa copper mine, the largest mine in Mexico, sending 4,000 workers on strike. As the government ends the subsidies to state-run enterprises, or outright sells them to private investors, these enterprises will be forced to be competitive by world standards. The prices of raw material will also rise to world-wide competitive levels, and both public and private enterprises will be tempted to achieve cost reductions at the expense of the Mexican worker. If the population continues to grow, and immigration to the U.S. cur-

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143. *Id.*

144. *Farming Looms as the Next Crisis: Food Import Bill Soars as Culturated Land Shrinks*, LATIN AM. WKLY. REP. (Latin Am. Newsl.), Feb. 8, 1990, at 10.

145. GDP increased by 3% in 1989. *The World: How Latin America's Economies Look After a Decade's Decline*, N.Y. TIMES, Feb. 11, 1990, at 3.

146. According to Carlos Jarque, president of the National Institute for Geographic Statistics, the Mexican population (estimated at 85 million), has grown at an annual rate of 2.2 percent during the past decade. *Results of Mexican Census Expected to Be Bleak*, REUTER LIB. REP., March 30, 1990, *available in* LEXIS, Nexis Library, LIBYRPT File.

147. Mexico's fertility rate has declined from 6.8 children per woman in 1960-65 to 3.6 in 1985-90. Ben J. Wattenberg, *Lower Birth Rates Spell a Brighter Future for the Third World*, U.S. NEWS & WORLD REP., Dec. 18, 1989, at 23.

148. Mexican officials commented that the "Mexican government expects to attract greater foreign investment and partially recover some $84 billion in expatriated capital." *Mexico: Expects Greater Foreign Investment after Debt Talks* INTER PRESS SERVICE, February 6, 1990, *available in* LEXIS, Nexis Library, INPRES File. In fact, it is estimated that Latin Americans have invested an estimated $326 billion dollars *in the U.S. alone.* This is more than Mexico, Brazil and Argentina owe their creditors. *A Chasm of Misery: Latin America's Rich and Poor Have Become Separate, Weary Societies*, TIME, Nov. 6, 1989, at 64.

tails, then the overall bargaining position of the Mexican worker will be significantly diminished.

Similar problems in the agricultural sector[149] may prompt the President to take steps to privatize the agricultural sector.[150] Indeed, conservative commentators are already advising Mexico to take this course of action.[151]

C. *Will the Present Political System Survive?*

Paradoxically, the sectors that are now bearing the burden of the new economic policies are the ones that placed President Salinas de Gortari in power and have been the pillars of the PRI's success.[152] The main beneficiaries of the new policies, the upper middle class and the entrepreneurial elite, have traditionally not been supportive of the PRI. A decrease in the State involvement in the economy may in effect be seen as a sign of weakness. This trend, coupled with unrest of labor unions, the discontent in the agrarian sector, and the galvanization of strong political opposition, may lead to the unraveling of the entire political system.[153] Under this scenario of uneven wealth distribution and labor unrest, it is possible that come the next presidential election in 1994, the PRI will have achieved some of its economic goals, but ironically may not have the ability to deliver the vote and keep itself in power.

D. *Where is Mexico Headed?*

With one third of the economy remaining "off hands" to foreigners, and the majority ownership requirements still in existence, Mexico still pursues a highly nationalistic economic policy. However, if the current measures are successful, it may be a powerful incentive to continue the privatization of Mexico. Paradoxically, if success is not achieved, the remaining controls of the economy may be blamed, and a market driven economy will result.

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149. The Revolution of 1910 achieved its goal of distribution of land at a very high economic price, with farm productivity generally decreasing dramatically. In 1989, agricultural goods accounted for 7.4%, or $1.4 billion of total imports—an increase of 86.6% over 1988. *See* Latin Am. Newsl., *supra* note 144.

150. *Id.*

151. As a solution to the farm crisis, the Heritage Foundation is urging Mexico to cease state ownership of land (presumptively to avoid the system of ejidos and communal lands, an integral part of the current "revolutionary government"); to eliminate subsidies to food producers, and to lift price controls or foods; to allow foreign investment in the agricultural sector; and to stop using "agrarian reform" as a political tool, rather than economic tool. HERITAGE FOUND. REP., *supra* note 138.

152. Traditionally, the PRI has depended on formal and informal organizations of poor peasants, organized labor, and other urban poor to deliver the vote.

153. Opposition leaders, such as Cuahutemoc Cárdenas, believe that this economic reform effort is no more than an attempt by the PRI to perpetuate itself in office under a new guise, at a time of changing circumstances. Robert Graham, *Mexico: Dealing with the Pack*, FIN. TIMES, Oct. 12, 1989, at 1.

Already, the writing on the wall is visible in Mexico's most "nationalistic" industry—oil. Plans have already been announced for PEMEX to form ventures with domestic and foreign corporations.[154] In addition, the government has reduced the number of "basic petrochemicals" from which foreigners are excluded[155] and the new regulations allow foreigners to engage in perforation of oil wells.[156] In a similar manner, the executive branch has the ability to continue its privatization programs without the need for any additional legislation.

E. *A Return to Pre-revolution Economic Policies?*

Porfirio Díaz[157] relied on private investment, both foreign and domestic, to achieve development for an economically stagnated Mexico.[158] During the Porfiriato, the economy did grow at an impressive rate,[159] and foreign capital did pour in.[160] The resulting disparities in wealth distribution led to results only too well known.

The current situation is reminiscent of the Porfiriato period. The differences being that, only now, President Salinas de Gortari and his U.S.-educated technocrats no longer feel the need to carry the baggage of nationalistic rhetoric, and believe that in this age of world-wide democracy, Mexico will be able to deal with the United States on equal terms. Perhaps the Mexican state has finally matured and feels confident, or maybe Mexico believes that these are different times.[161]

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154. PEMEX announced that it is negotiating for 1.3 billion dollars in foreign investment credit, with U.S. and Japanese multinational companies, and 27 million dollars in domestic investment. The loan will be repaid "in kind"—that is with feedstocks. Leslie A. Layton, *PEMEX Peddles a Petrochemicals Push*, CHEMICAL WEEK, Feb. 28, 1990, at 9.

155. Mining and Basic Industry Under-Secretary Alfredo Elias Ayub announced that the government reduced the number of basic petrochemicals (reserved exclusively for the state) from 34 to 20, and thus allowed foreign participation of up to 40% on those "secondary petrochemical." *Mexican Government Eases Restrictions on Investment in Petrochemicals Sector*, DAILY REP. FOR EXECUTIVES (Bureau of Nat'l Aff., Washington D.C.), Aug. 16, 1989.

156. FIL Regulation, Supplement "Regulación Específica y General Para la Inversión Extranjera Directa con Base en la Classificación Mexicana de Actividades Económicas y Productos" de Acuerdo con la Dirección General de Estadística de la Secretaría de Programación y Presupuesto.

157. *See supra* note 1.

158. *See generally* E.F. Hurtado, *Private Enterprise and Government in Mexican Development, in* MEXICO'S RECENT ECONOMIC GROWTH, THE MEXICAN VIEW (M. Urquidi trans., 1967).

159. *See supra* note 2 and accompanying text.

160. Indeed, by the turn of the century, foreign investors controlled over one half of the wealth of the country. *Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model*, 12 HOUS. J. INT'L L. 1, 12, n. 5 (1989).

161. Foreign capital accounted for only 11% of Mexico's total investment in 1980-85. This figure is small compared with figures for Brazil (37%) and Spain (40%). Fernando Sanchez Ugarte, under-secretary of Industry and Foreign Investment, declared that the objective of Mexico is to raise foreign investment to 15% or 20% in the next

In any case, the short term problems can be fatal to the Mexican experiment with free market. Free flow of goods and capital[162] will result in prices for commodities eventually reaching parity with those elsewhere in the world. However, the free flow of Mexico's excess labor resources into the United States will likely not become a reality in the near future. The lack of an adequate state welfare infrastructure as a safety net to take care of the poor will most likely lead to even more pronounced wealth distribution differences and to increasing social unrest.

However, the present program can succeed and bring economic and political stability to Mexico. To achieve success, Mexico needs to continue to cut its subsidies and its costly involvement in economic activities. These can be transferred from the government to the private sector and eventually be channeled directly to the more needy segments of the population.[163]

VIII. CONCLUSION

The direction that the new Mexican leadership is pursuing is unmistakable. The clear objective is the privatization and modernization of Mexico's economy and drastic retreat from the state controlled economic policies of the past. As both foreign and domestic investors accept the new changes as a lasting reality, Mexico will experience tremendous increases in FDI and in repatriation of capital. These changes will probably succeed in bringing economic prosperity for the country. However, severe problems with wealth distribution loom in the horizon, and these changes may contribute to the unraveling of the present political system.

Given the dramatic course of world events, resulting in popular insurrections around the world, President Salinas de Gortari should be commended for anticipating these problems, and trying to spare Mexico some of the pain that other countries have suffered in the road to achieve social and economic freedom. Whether or

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few years. *New Rules to Entice Foreign Capital: Doubling Annual Inflow Over Next Six Years the Target*, LATIN AM. REGIONAL REP.: MEXICO & CENTRAL AM. (Latin Am. Newsl., London), Aug. 17, 1989, at 2.

162. Talks of a U.S.-Mexico free trade agreement were announced after President Salinas returned from Europe, convinced that it was in the best interest of the Americas to form an "Europe-like" trading block. *A Common Market for the Americas*, CHI. TRIB., Apr. 2, 1990 at 12.

163. For example, the government is trying to sell the Cananea mining operations hoping this will save $500 million dollars a year in subsidies. Graham, *supra* note 153, at 1.

not these initiatives will help Mexico to avoid social unrest remains to be seen.

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