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# THE LIBERALISATION OF FINANCIAL SERVICES IN MEXICO AND ITS RELATION WITH NAFTA, MEFTA AND GATS

*Gerardo Vazquez Gomez\**

## I. INTRODUCTION

**I**NTERNATIONAL trade is a tool for encouraging economic growth between nations. Its influence has been increasing, and as a result the world has reached a higher level of interdependence. In general, the prosperity of many nations has increased significantly in the last decades.<sup>1</sup> Thus, there is more competition, more availability of places to invest, buy, or sell, and consequently, consumers have more choices. Trade is allowing countries to focus on what they do best, which yields more products or better services.<sup>2</sup>

Mexico is a natural hub for trade and investment. It sits in a strategic geographical position because it shares 2000 miles of border with the largest market in the world. It is located at the center of the American continent, having coasts on the Pacific and the Atlantic Oceans. Mexico has become, particularly in the last ten years, the natural commercial bridge between North and South America, between America and Europe, and between Asia and America. Mexico took advantage of its location and today “enjoys preferential access to 850 million consumers in thirty-two countries,” primarily because of Mexico’s participation in a network of

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1. John Jackson, Address at the Conference of the Law of International Trade and Economics Relations of the A.B.A.’s Section of International Law and Practice (October 29, 2003) (Jackson comments that “one big problem of the trading system is that it does not address fair distribution[;] smaller countries are at a disadvantage in many ways before the big economies”). It is interesting to note that 50% of the world’s trade is located in countries that have 10% of the world population, 30% in countries that have 50% of the world population, and 1% in countries that have 40% of the world population. See also WORLD BANK, GLOBAL ECONOMIC PROSPECTS 2005: TRADE, REGIONALISM AND DEVELOPMENT 8 (2005). World trade growth averaged 10.2% in 2004, reflecting an increase in industrial production and investment activity.
2. JOHN JACKSON, THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMICS RELATIONS 15 (2d ed. 2002).

free trade agreements.<sup>3</sup>

Among this network of trade agreements, the most important to Mexico are the North American Free Trade Agreement (NAFTA), which just had its ten-year anniversary on January 1, 2004, and the Mexico-European Free Trade Agreement (MEFTA), which came into force on July 1, 2002. As a result of these agreements, Mexico has achieved important relative preferences with respect to its competitors in foreign markets. In addition, with respect to multilateral trade in services, and specifically financial services, Mexico is bound to the General Agreement on Trade in Services (GATS).

In theory, Regional Trade Agreements (RTAs) like NAFTA and MEFTA must go beyond the World Trade Organization (WTO), as required by article XXIV of the General Agreement on Tariffs and Trade (GATT) and article V of the GATS.<sup>4</sup> However, this does not always happen, as Stephenson pointed out:

[I]t is clear that the multilateral discipline require that all RTAs encompassing services be more ambitious in their objectives and go well beyond the GATS in terms of liberalization. The difficulty arises in interpreting what is involved in 'going beyond' in a precise manner, as there is a lack of clarity with respect to the kind of barriers that an RTA should be expected to eliminate.<sup>5</sup>

In addition, the WTO Secretariat has acknowledged that "it is difficult to establish to what degree a large number of RTAs achieve a deeper level of integration than the WTO."<sup>6</sup>

In a recent study, the Organization for Economic Cooperation and Development (OECD) observed that, first, "regional trade agreements can complement, but cannot substitute for, coherent multilateral, rules and progressive multilateral liberalisation," and second, "in some particularly

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3. Luis de la Calle Pardo, *The Importance of Foreign Direct Investment in the Economic Development of Mexico*, in OECD GLOBAL FORUM ON INTERNATIONAL INVESTMENT: NEW HORIZONS AND POLICY CHALLENGES FOR FOREIGN DIRECT INVESTMENT IN THE 21ST CENTURY (November 2001), at <http://www.oecd.org>.

4. This situation brought up the question of implementing GATS article V, which allows members to enter into regional agreements to liberalize trade in services as long as they get a "GATS-plus" (do not raise the overall level of trade barriers to WTO members who are not party to them and cover substantially all trade sectors).

5. Sherry M. Stephenson, *Regional Versus Multilateral Liberalization of Services*, 1 WORLD TRADE REV. 204 (2002).

6. A recent OECD study (2002) assessed:

[T]o what extent provisions included in RTAs going beyond to WTO commitments. The study focused on tariffs. . . , services, labour mobility, trade facilitation. . . in APEC, NAFTA, MERCOSUR and the EU. The conclusion was that in many respects *RTAs have not progressed too much beyond the GATT/WTO Agreements* and that it was very difficult to determine whether RTAs represented an improvement in terms of liberalization of trade. (emphasis added).

WTO SECRETARIAT, WORLD TRADE REPORT 2003 54, available at [http://www.wto.org/english/news\\_e/pres03\\_e/pr348\\_e.htm](http://www.wto.org/english/news_e/pres03_e/pr348_e.htm) (last visited Sept. 17, 2004) [hereinafter WTO REPORT 2003].

sensitive areas, regional initiatives *have been no more successful—and in some cases less successful—than activity at the multilateral level.*<sup>7</sup> In the specific case of financial services, the OECD stated that “*while the GATS has achieved a higher level of bound liberalisation in financial services than that found in most RTAs, the development of the GATS Understanding on Commitments in Financial Services took advantage of insights gained in financial market opening at the regional level.*”<sup>8</sup> That being said, it is of considerable relevance to know, from a legal perspective, whether each RTA has gone beyond the WTO agreements.

In this regard, this article discusses how the liberalization of financial services has occurred in Mexico since NAFTA came into force in 1994; what its implications and connections with NAFTA, MEFTA, and GATS have been; and to what extent NAFTA and MEFTA have achieved positive results beyond the GATS in such liberalization. Earlier research by Stephenson<sup>9</sup> took notice of what has been achieved in NAFTA in comparison to GATS (2002). First, this paper updates recent effects; second, it examines the previous analyses; and third, it examines such liberalization in the context of the new MEFTA and legislative reforms that increased foreign participation in Mexico’s financial system.

It can be argued that the liberalization of financial services in Mexico has been strikingly fast. In just the past ten years, from 1994 to 2004, foreign participation in the Mexican banking system has risen remarkably from 5 to 80 percent as measured by the share in total assets of foreign banks. Regulation on entry into the financial market of financial services has experienced changes, significantly diminishing entry barriers. This liberalization has been achieved mainly through three steps.

The first step was by way of NAFTA, where the liberalization process in financial services began. For example, NAFTA stated that no foreign bank can have more than 1.5 percent market share, and it will gradually increase the aggregate foreign market share limit in banking from 8 to 15 percent. The aggregate foreign investment is limited to 30 percent.

The second step was the Mexican Congress’s approval of legislative reforms in the financial sector, which were published in the Official Diary on February 15, 1995. The market share limit in individual holdings was increased from 1.5 to 6 percent, and the aggregate foreign market share limit was increased from 8 to 25 percent. The aggregate foreign investment is limited to 49 percent. The transitional implementation projected once in NAFTA, step-by-step during a period of six years for financial services until 2000, was changed when the Mexican peso crashed, and the financial system collapsed at the end of 1994. Even though Mexico was entitled (by way of paragraphs 9, 10, 11, 13, and 14 of section B and paragraph 1 of section C of the Schedule of Mexico, Annex VII of NAFTA)

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7. OECD, REGIONALISM AND THE MULTILATERAL TRADING SYSTEM 20 (OECD, Doc. No. 222003031E1, 2003).

8. *Id.* at 11.

9. Stephenson, *supra* note 5, at 193.

to establish market share limits on U.S. and Canadian banks in the event of any financial crisis, the contrary happened because the Mexican Congress eliminated more barriers to foreign investment.

In 1999, the third step occurred when Congress approved a measure allowing foreign economic agents to own 100 percent of the capital stock of Mexican banks.<sup>10</sup> This was due to the view that foreign banks could play a positive role in the capitalization and rescuing of troubled national banks. Since then, foreign institutions have been merging with and buying domestic banks. Most notable are the entrance of the American and European conglomerates such as Citibank, HSBC, Scotiabank, and Banco Bilbao Viscaya. These banks have injected significant capital into the financial system.

This paper is divided into six sections. After this introduction, section II begins with a brief overview of the current Mexican trade economy and its network of free trade agreements. Section III will briefly look into the recent history of the Mexican economy and its financial system. Section IV will focus on the background of NAFTA and its general impact on Mexico, looking at the positive and negative effects. In addition, it will examine the implications of the new commercial relationship between Mexico and the European Union. Section V will compare some of the common objectives of the liberalization of trade in services and specifically in financial services among NAFTA and GATS. It will examine how and to what extent NAFTA and MEFTA have gone beyond GATS. Finally, section VI summarizes key points and provides some conclusory observations.

## II. MEXICO AS THE NATURAL HUB IN THE INTERNATIONAL TRADE SYSTEM

Mexico is situated in a unique and strategic geographical location. It has become the commercial bridge between North, Central, and South America in addition to serving as a link between America and Europe and America and Asia. Furthermore, Mexico shares 2000 miles of border with the largest market in the world and is the third largest recipient of Foreign Direct Investment (FDI) in the world (behind China and Brazil).

Mexico is the eighth largest trading power in the world and is the largest trading power in Latin America, with 43 percent of the region's exports and 38 percent of total imports.<sup>11</sup> It has emerged as the second largest export market for U.S. goods and has displaced Japan as the second largest trading partner. Mexican exports to the United States have grown twice as fast as exports from the rest of the world, and it has "increased its share in total U.S. imports from 6.8 percent in 1993 to 11.4

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10. Published on Jan. 19, 1999, in the Mexican Official Diary, *available at* <http://dof.terra.com.mx/>.

11. BANCOMEXT, *THE MEXICAN BANK FOR FOREIGN TRADE, INDUSTRIAL COSTS IN MEXICO 2001: A GUIDE FOR FOREIGN INVESTORS* (6th ed. 2001) [hereinafter *BANCOMEXT STUDY*].

percent in September 2001.”<sup>12</sup> A recent OECD study shows that in the last twenty years:

Mexico moved away from specializing in primary goods towards a greater specialization in manufacturing products such as motor vehicles, consumer electronics and computer equipment. This is in marked contrast to Argentina, Brazil and Chile which continue to specialize in primary products. . . Mexico’s pattern of specialization, which follows a similar path to that of the US and the EU and which is highly dependant on access to FDI or other forms of partnership, may be the result of Mexico’s participation in the NAFTA and its increased market integration within North America.<sup>13</sup>

Paiva Abreu comments that “Mexico is by far the most important trading economy in Latin America: its total trade in 1999 was 45% of total Latin American trade, representing almost three times total trade from the second important trading nation: Brazil, and 80% more than total Mercosur trade.”<sup>14</sup> With these numbers (the total trade for Mexico in 1999 was U.S. \$278 billion, whereas Brazil accounted for U.S. \$98 billion), it is possible to see the important role Mexico is playing in the context of international and regional trade.<sup>15</sup>

Mexico is currently pursuing its economic model of development based on free trade agreements, privatization, and openness to foreign investment.<sup>16</sup> In addition to NAFTA, MEFTA, and the Free Trade Agreement with the European Association of Free Commerce, Mexico has concluded several trade agreements with the following countries: Bolivia, Venezuela, Colombia, the North Triangle (composed of Guatemala, Honduras, and El Salvador), Chile,<sup>17</sup> Israel,<sup>18</sup> Costa Rica, Uruguay, Peru, Ecuador,

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12. De la Calle Pardo, *supra* note 3, at 2.

13. WTO REPORT 2003, *supra* note 6, at 63.

14. Marcelo de Paiva Abreu, *Latin America and Caribbean Interest in the WTO, in TRADE NEGOTIATIONS IN LATIN AMERICA* 21 (Diana Tussie ed., 2003). Mercosur’s total trade was about 45% of total trade in all other Latin American and Caribbean economies, Mexico excluded. Mercosur’s 1999 GNP represented 48.7% of total GNP of the region (of which Brazil accounts for 33.9%, Mexico 24%, the Andean Community as a whole 16.7%, and Chile 4%).

15. BANCOMEXT STUDY, *supra* note 11, at 22.

16. *Id.* at 23. Between 1994 and 2000, Mexico received more than \$74 billion of FDI, placing itself among the leading countries recipients of FDI development (after China and Brazil).

17. *Id.* at 31. From 1991 to 1999, the trade between Mexico and Chile grew 458% and in 2000 it was around US \$369 million. Thus, Mexico has become the most dynamic partner for Chile’s products. The favourable commercial performance between Mexico and Chile brought about negotiation in order to extend and to deepen the coverage of the Economic Complementation Agreement subscribed in 1991. Because it only considered the liberalization of trade in goods, the new agreement included services, investment, controversy solution, governmental purchases, and copyrights.

18. *Id.* at 33; the agreement negotiated with Israel is the first trade agreement that Mexico has negotiated with a Middle East nation. For Mexican exporters, Israel represents a potential market with annual imports that surpass US\$30 billion. In 1999, the bilateral commerce between Mexico and Israel increased to US\$169 million. The current trade between Mexico and Israel is complementary. It will also stimulate trade and investment among these countries “because Israel and Mex-

Brazil, Trinidad and Tobago, Belize, Panama, Dominican Republic, and Nicaragua.<sup>19</sup> More recently, President Vicente Fox visited Japan's Prime Minister Junichiro Koizumi during the first week of October 2003, in order to sign the final points of a free trade agreement.<sup>20</sup> Mexico has partial agreements with various countries in South America, including Belize, Peru, Ecuador, Brazil, and Uruguay. Mexico is also participating in the constitution of the Free Trade Area of the Americas (FTAA).<sup>21</sup>

Mexico broke its protectionist past and since the 1980s has sought to attract foreign investment and to incorporate technology transfer. In addition, Mexico has achieved the removal of trade barriers; the gradual reductions in tariffs; the elimination of performance requirements; the establishment of rules of expropriation, compensation, and dispute settlement mechanism; and the remittance of capital abroad.

A good example of the new changes used to attract foreign investment is the case of expropriation in NAFTA. Chapter 11 (the Investment Chapter) abolishes the Calvo Doctrine.<sup>22</sup> Named after the Argentinean international law expert Carlos Calvo, the doctrine states that foreigners are limited to the same treatment given to nationals. Mexico has surrendered this historic legal principle in order to provide more legal certainty and predictability to foreign investors. This is important because NAFTA party banks and investors will be protected by the due process and fair compensation from any act of expropriation, nationalization, or any act of the state that could affect them in any form.<sup>23</sup> Mexico, like other Latin American countries, has suffered military interventions several times throughout its history as an independent country, making this legal prin-

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ico are the only countries with preferential access to US, Canada and the EU, with which both countries have already signed free trade agreements." *Id.*

19. Joseph J. Norton, *Doing Business Under the FTAA Reflections of a U.S. Business Lawyer*, 6 *NAFTA: L. & BUS. REV. AM.* 431 (2000) (negotiations will continue on course to sign free trade agreements with Singapore).
20. *Pigs May Fly*, *THE ECONOMIST*, Oct. 18, 2003, at 56. The agreement is important for both countries, but for different reasons. Mexico's trade deal has turned it into one of the most open trading nations, as well as struggling to overcome their problems in its economy due to the increasing high competition from China. One way of doing this is by getting more access to the Japanese market. For Japan, Mexico would be its second free trade agreement, after Singapore. The farm products are the main obstacles. Pork already accounts for 10% of Mexico's exports to Japan. Japanese officials complain in turn at Mexico's reluctance to lower its tariffs on steel.
21. WTO REPORT 2003, *supra* note 6, at 48. Forty-three percent of the world merchandise trade "now occurs under the umbrella of preferential trade agreements," and "this share will increase as more RTAs are negotiated in the future." *Id.*
22. PAUL HASTINGS ET AL., *NORTH AMERICAN FREE TRADE AGREEMENT: SUMMARY AND ANALYSIS* (1993); North American Free Trade Agreement (NAFTA), *opened for signature* Dec. 8, 1992, U.S.-Can.-Mex., 32 I.L.M. 289 (entered into force Jan. 1, 1994), available at <http://www.nafta-sec-alena.org> [hereinafter NAFTA].
23. KRISTA N. SCHEFER, *INTERNATIONAL TRADE IN FINANCIAL SERVICES: THE NAFTA PROVISIONS* 257 (1999). The political and economic situation for Mexico before NAFTA was uncertain and NAFTA brought credibility to the Mexican market as a stable financial market.

ciple justified.<sup>24</sup> Historically, Mexico and other Latin American governments tried to limit diplomatic interventions of other countries toward nationals who were living or investing in these countries. The Mexican government, for example, refused to hear private claims for compensation under any law but its own. The Calvo Doctrine led to much dissatisfaction among foreign investors, as these investors had to accept the risk of uncompensated nationalizations if they brought assets into Mexico.<sup>25</sup> It is important to bear in mind that in the case of trade in financial services, Mexico, like most other Latin American countries, are not net exporters, but rather net importers of financial services; consequently, it is understandable why, in the beginning of the trend of liberalization, these countries were reluctant to liberalize trade in services.<sup>26</sup>

### III. BRIEF HISTORICAL OVERVIEW OF THE MEXICAN ECONOMY

From 1950 to 1970, Mexico had a stable economy with low inflation. The increase in oil prices in 1973 brought several economic benefits to the country as a result of significant growth in export revenues. However, as Norton suggests, "Much of the exuberance was rooted in the country's estimation of its national control of petroleum resources in light of rocketing oil prices in 1970's . . . Mexico, as did most Third World countries, held to an economic policy of import-substitution industrialisation and severe restrictions on foreign direct investment."<sup>27</sup>

This temporal situation incited a false feeling of welfare in the country. Mexican state-owned companies and the Mexican government itself had borrowed more from foreign banks than any other developing country in the world. The external debt quadrupled between 1976 and 1982. In the meantime, the government faced a large deficit and expanded programs, such as investing huge amounts in health and education.<sup>28</sup>

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24. The French invasion in 1863 and the U.S. invasion in 1847 (when Mexico was forced to sign the Guadalupe Hidalgo Treaty). In this treaty, Mexico lost more than half of its territory: California, Texas, Arizona, and New Mexico, with the last invasion in 1914 by the U.S. Navy in the Port of Veracruz.
  25. SCHEFER, *supra* note 23, at 210. It is noteworthy that the GATS/WTO rules on services and financial services do not deal with the topic of expropriation, although customary international law says that expropriation should be based on non-discriminatory principles.
  26. However, the countries that have unilaterally liberalized their financial sector, like Mexico, have experienced gains in the efficiency in the sector. Inter-American Development Bank, *Financial Integration, in BEYOND BORDERS: THE NEW REGIONALISM IN LATIN AMERICA* 105 (2002), available at [http://www.iadb.org/res/publications/pubfiles/pubbb-2002e\\_7384.pdf](http://www.iadb.org/res/publications/pubfiles/pubbb-2002e_7384.pdf) [hereinafter *Financial Integration IADB Doc*].
  27. JOSEPH J. NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMIES 265 (2000).
  28. THOMAS DALSGAARD, *The Tax System in Mexico: A Need For Strengthening the Revenue-Raising Capacity* 8 (OECD, Working Paper No. ECO/WKP(2000)6, 2000) available at <http://www.oecd.org/dataoecd/14/11/1884584.pdf> (last visited Sept. 12, 2004). With respect to fiscal policies, the Mexican Government was extremely dependant on oil revenues and the expenditures were high. After the cri-



The overvalued currency policy was implemented. Speculation on the peso's devaluation spurred further cycles of devaluation and massive transfers of money outside the country.<sup>29</sup> When oil prices fell and the world interest rate rose, however, the downward capital market revaluation of Mexico was inevitable, thus putting the country into crisis. One crisis arose in 1982 when the government declared a suspension of payments on the foreign debt, imposed exchange controls, and devalued the peso.<sup>30</sup> These acts resulted in the cessation of inflows of foreign private capital.<sup>31</sup>

The government passed a decree nationalizing the banking system (with the exception of Citibank), but the measure functioned as more than a nationalization. It was an expropriation because the owners were already Mexican nationals. Many experienced bankers who did not approve of the measure left their positions, and those employees who stayed often did not have the necessary training. In addition, high inflation and high interest rates increased the costs of bank funds, which resulted in many in the private sector pulling their capital resources out of bank instruments and putting them into governments bonds.<sup>32</sup>

The process of modernization in Mexico started in the 1980s with President Miguel De La Madrid, who encouraged privatization. Norton writes, "[T]he government permitted 34 per cent of non-voting shares to be sold to private Mexican buyers . . . Mexico had embarked upon a broad trade programme, including reduction of the use of import licences [and] major tariff cuts."<sup>33</sup> The government announced that the country was joining GATT, and subsequently it joined the Mexico-U.S. Commercial Framework Agreement on Trade and Investment, signed on November 1987 (predecessor to NAFTA).<sup>34</sup> During the late 1980s, Mexico started to modify its commercial, civil, and property laws. The respect of human rights began to be part of the daily agenda, and the path to democracy began to emerge.

During President Salinas de Gortari's presidency, the government laid the foundation of today's Mexican economy. A strong commitment to liberalization and privatization existed,<sup>35</sup> and several reforms helped the

sis, the Government was looking to increase the tax base and engaged in the issue of tax evasion.

29. SCHEFER, *supra* note 23, at 98.

30. Lee C. Buchheit, *A Lawyers Perspective on the New International Financial Architecture*, 14 J. INTL. BANKING L. 225 (1999), reprinted in *THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE* (R. Lastra ed., Kluwer Law Int'l, 2001). Virtually all lending to emerging market borrowers ceased. The existing credits to these countries were subjected to repeat rescheduling throughout the 1980s.

31. HAL S. SCOTT & PHILIP A. WELLONS, *INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATIONS* 1137 (6th ed. 1997).

32. NORTON, *supra* note 27, at 265.

33. *Id.* at 266.

34. *Id.*

35. *REGULATORY REFORM IN MEXICO: ENHANCING MARKET OPENNESS THROUGH REGULATORY REFORM* 20 (OECD, 1999), available at <http://www.oecd.org/dataoecd/44/57/2507154.pdf>. In 1994, Mexico's accession to the OECD was instru-

economy, including the liberalization of deposit and lending rates, the elimination of the mandatory requirement for commercial banks to hold long-term commercial paper to maturity, and the elimination of reserve requirements. Norton has drawn attention to the fact that legislative changes were very important, such as the Law for the Regulation of Financial Groups, which allowed a single holding company to provide a variety of financial services (i.e. banking, brokerage, and insurance services).<sup>36</sup> Also, the eighteen state-owned banks became totally privatized.

Toward the end of 1994, Mexico faced another strong economic crisis, its consequences later known as the Tequila Effect. Within the country, many argued that the crisis was due to clearly incompetent management of the Government, *el error de diciembre* (the December mistake). Maysami writes:

[T]he exchange rate crisis that shook Mexico at the end of December 1994 was made possible, if not inevitable, by policy mistakes stretching back several years. Among the underlying weaknesses were an overvalued real exchange rate, declining central bank reserves, and an unstable structure of domestic and external debt.<sup>37</sup>

In December 1994, the Foreign Exchange Commission (FEC) abandoned the exchange rate regime and tried to stabilize the foreign exchange market by raising the upper limit. The FEC later changed this policy, however, to ensure the establishment of a freely floating exchange rate system.<sup>38</sup> The Mexican government devalued the peso 15 percent against the dollar, and two days later allowed the peso to float. It subsequently fell 50 percent in one month. In 1994, Mexico's government spent U.S. \$20 billion to protect the peso. Because reserves were reduced to U.S. \$6 billion, the real interest rates reached high levels, causing serious difficulties for financial intermediaries and for debtors in general. A large number of investors withdrew their money, and consequently the reserves in Mexico disappeared.<sup>39</sup> Once the crisis began, the Mexican government tried to handle it quickly by implementing several programs, such as minimizing the inflationary effects of the devaluation, encouraging constitutional and legislative reforms,<sup>40</sup> promoting competitiveness in the private sector, and establishing a coherent floating exchange rate regime.

At this point, the second step in the liberalization of financial services came into place in Mexico. Congress approved and published the legisla-

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mental in the extension of NAFTA's investment commitments to non-NAFTA countries.

36. NORTON, *supra* note 27, at 267.

37. R.C. Maysami & J.J. Williams, *National Policy and Structural Reform: Pillars of Stable Mexican Economic Growth*, 7 J. INT'L BANKING L. 174, at 174-75 (2001).

38. THE BANKING AND FINANCIAL STRUCTURE IN THE NAFTA COUNTRIES AND CHILE 161 (George M. von Furstenberg ed., 1997).

39. *Id.*

40. Maysami & Williams, *supra* note 37, at 2 (this reform also includes the amendment to allow private investment in railroads and satellites).

tive reforms in the Official Diary on February 15, 1995.<sup>41</sup> Among the reforms, it is noteworthy that, in the banking system, the individual holding market share limit was increased from 1.5 to 6 percent, and the aggregate foreign market share limit was increased from 8 to 25 percent, and the aggregate foreign investment was limited to 49 percent. Thus, the initial implementation once projected by NAFTA (step-by-step during a period of six years for financial services until 2000) was suspended when the Mexican peso crashed and the financial system collapsed at the end of 1994. Even when Mexico was entitled (according to the paragraph 9, 10, 11, 13, and 14 of section B and paragraph 1 of section C of the Schedule of Mexico, Annex VII of NAFTA)<sup>42</sup> to establish market share limits on U.S. and Canadian banks in the event of financial crisis, the contrary happened as more barriers to foreign investment were eliminated by the Mexican Congress. An important key issue is the soundness of a macroeconomic policy framework "which promotes growth by keeping inflation low, the budget deficit small, and the current account sustainable."<sup>43</sup> When Mexico promulgated the legislative reforms in 1995, however, it did not have any of these. In addition the financial system was in serious need of capitalization, and the legislative reforms came to encourage foreign participation.

Mexico's crisis had several factors in common with the Asian crisis of 1997, among other common factors we can observe that a weak banking system, excessive leverage, "inter-bank funding, especially in foreign currencies, moral hazard, weak central banks, underdeveloped securities markets and inadequate legal structures, are mostly related to law-based failures."<sup>44</sup> The banking system was too weak when Mexico joined NAFTA. There were several reasons for this weakness, among which were erroneous economic policies. When the banking system was privatized, the banks were focused mainly on lending to the government and state-owned companies in order to subsidize Mexico's scandalous deficit, lack of proper management in the banks, lack of transparent procedures when the privatization itself was carried out, and lack of moral solvency and technical acumen of the people in charge of the banks.

The International Monetary Fund (IMF), together with the U.S. government, has played an important role in helping the Mexican government deal with the crisis. It is interesting to note that the IMF has violated its internal rules by granting Mexico a loan equal to seven times its quota, in addition to exhibiting unprecedented speed in its negotiation.<sup>45</sup> Mexico received considerable support because, at that moment, it

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41. The following laws were modified: (1) Credit Institutions Law (*Ley de Instituciones de Credito*); (2) Securities Market Law (*Ley del Mercado de Valores*); and (3) Financial Groups Law (*Ley para Regular las Agrupaciones Financieras*).

42. NAFTA, *supra* note 22, 32 I.L.M. at 289.

43. NORTON, *supra* note 27, at 11.

44. *Id.* at 11-12.

45. JEFFREY D. SACHS, *Do We Need an International Lender of Last Resort?*, Frank D. Graham Lecture, Princeton University 2 (Apr. 1995), <http://www.earthinstitute.columbia.edu/about/director/pubs/intllr.pdf>.

was illiquid but solvent. As Sachs points out, "Not many countries share a 2,000 mile border with the IMF's largest shareholder."<sup>46</sup>

Guillermo Ortiz, ex-minister of Finance, said that the Mexican (1994-1995) and Asian (1997) crises had similarities because, in both cases, they caught many by surprise: investors suddenly changed their wills, there was generally good progress in the economy, and the banking systems expressed signs of problems before the crisis.<sup>47</sup>

In 1994, political and criminal events had an adverse effect on market expectations. These events included the kidnapping of an important banker, the assassination of presidential candidate Donaldo Colosio, the accusations and resignation of the Deputy Attorney General, and the hostility of the Zapatista Movement in Chiapas.

To face the economic crisis, the government, along with Banco de Mexico and labour sectors, agreed to sign the Unity Agreement to Overcome the Economic Emergency (*Acuerdo de Unidad para Superar la Emergencia Economica*). The government also took some other actions, such as keeping inflation under control.<sup>48</sup> The Exchange Stabilization Fund (*Fondo de Estabilizacion Cambiaria*) helped the economic program.<sup>49</sup> Foreign financial authorities and international organizations, such as the IMF, assisted with the creation of this fund to help the Mexican economy.

In the financial sector, other programs were implemented, such as the Immediate Support Agreement to Banking Sector Debtors (*Acuerdo Inmediato a los Deudores de la Banca, ADE*), later known as the Savings Protection Fund (FOBAPROA), whose successor is the Institute for the Protection of Bank Savings (IPAB).<sup>50</sup> Thus, when the Mexican banks experienced trouble in 1995, they submitted to the control of FOBAPROA and were subsequently sold, with most of them being acquired by foreign banks (i.e. Citibank, HSBC, Banco Bilbao Vicaya, Scotiabank, and others).

The fund allocated to rescuing Mexico contained more U.S. \$52 billion. The United States arranged a U.S. \$9 billion credit line at the Federal Reserve. The United States then exchanged U.S. \$20 billion for pesos with Mexico for three to five years. Mexico agreed to pay a fee for the

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46. *Id.*

47. Guillermo Ortiz Martinez, *What Lessons Does the Mexican Crisis Hold for Recovery in Asia?*, FIN. & DEV., June 1998, at 6 (1998).

48. *Rescuing the Sombrero*, THE ECONOMIST, Jan. 21, 1995, at 18.

49. News Brief, IMF, *IMF Executive Board Set to Consider Stand-By Credit for Mexico*, (June 15, 1999), available at <http://www.imf.org/external/np/sec/nb/1999/NB9929.htm>.

50. OECD DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS, COMMITTEE ON COMPETITION LAW AND POLICY, *MERGERS IN FINANCIAL SERVICES 191* (OECD, Doc. No. DAFFE/CLP(2000), 2000), available at <http://www.oecd.org/dataoecd/34/22/1920060.pdf>. In Mexico, the protection of bank deposits is almost complete but it will progressively be dismantled until 2005 when only deposits up to approximately US\$110,000 will be protected.

exchange and set aside oil revenues as security.<sup>51</sup> The IMF lent Mexico U.S. \$17.8 billion,<sup>52</sup> and some members of the Bank for International Settlements lent U.S. \$10 billion, with U.S. \$3 billion lent by commercial banks and U.S. \$1.5 billion lent by the Bank of Canada.<sup>53</sup>

The Mexican economy is currently progressing. The government has made repayments to the IMF, and inflation and interest rates are declining. Exports are increasing (in only ten years Mexican exports have grown from U.S. \$31 billion to U.S. \$136 billion).<sup>54</sup> The external deficit is small. There has been a strong increase in net international reserves since 1996.<sup>55</sup> Trade and current account balances have improved. The peso has recovered. Foreign reserves have risen. And the stock market has also recovered.<sup>56</sup> One of IMF's arguments discusses the remarkable progress that Mexico has accomplished in reestablishing macroeconomic stability, the government unveiled a medium-term program—the National Program to Finance Development (PRONAFIDE).<sup>57</sup>

The third step in the liberalization of financial services in Mexico occurred in 1999 when the Congress approved a measure that allowed foreign participants to own 100 percent of the Mexican banking system.<sup>58</sup> According to the Initiative of the Executive and the debates in the Mexican Congress, this reform resulted from the continuous urgency to attract more capital and modern technologies, more competition, and efficiency and productivity in the financial system, which was still without significant strength.<sup>59</sup>

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51. *Quick or Quagmire?*, THE ECONOMIST, Jan. 21, 1995, at 95. The condition was the change in policies on everything from immigration and labour laws to policy towards Cuba.
  52. *The Funds Sums*, THE ECONOMIST, Feb. 11, 1995, at 10; Press Release, IMF, IMF Approves US\$17.8 Billion Stand-By Credit for Mexico (Feb. 1, 1995).
  53. SCOTT & WELLONS, *supra* note 31, at 1201.
  54. BANCOMEXT STUDY, *supra* note 11, at 15. The exports of Mexico have grown significantly. In only four years, Mexican exports to the United States have grown 142%, to the European Union 40%, to Latin America 113%, and the Asian Tigers (South Korea, Taiwan, Singapore, and Hong Kong) 191%. Exports also represent the most dynamic sector of the economy and the first creator of employment. In the last few years, export growth has contributed half of the increase of gross domestic product. Since 1994, exports have been increased to 124.8%. Mexico has diversified its exports in all sectors. Regarding imports, in only five years, Mexico increased its imports to 79%. In 1999, total imports to Mexico increased 13% in relation to 1998 and 32% more than in 1997.
  55. News Brief, IMF, Camdessus Welcomes Advance Repayment of Loans by Mexico, Positive Developments in Mexican Economy, (Jan. 15, 1997), available at <http://www.imf.org/external/np/sec/nb/1997/nb9701.htm>.
  56. News Brief, IMF, IMF Board Releases US\$2 Billion for Mexico: Sets Schedule for Remaining US\$8.7 Billion (June 30, 1995), available at <http://www.imf.org/external/np/sec/nb/1995/nb9516.htm>.
  57. News Brief, IMF, IMF Staff Views Favorably Mexican Medium-Term Program (June 3, 1997), available at <http://www.imf.org/external/np/sec/nb/1997/NB9710.HTM>.
  58. Published Jan. 19, 1999, in the Official Diary, Ministry of Interior (Secretaria de Gobernacion), available at <http://dof.terra.com.mx>.
  59. Reasons for the Legislative Reform to the Credit Institutions Law presented by the Executive, published Jan. 19, 1999, in the Official Diary, Ministry of Interior (Secretaria de Gobernacion), available at <http://dof.terra.com.mx>.

Since 1999, foreign institutions have been merging with and buying domestic banks. Most notable are the entrances of the American and European conglomerates such as Citibank, Banco Bilbao Viscaya, and, more recently, HSBC. These banks have injected significant capital into the financial system. Because of these investments, Mexico has the deepest foreign bank participation in Latin America, accounting for 50 percent in 2000, 74 percent in 2002, and more than 80 percent in 2004.<sup>60</sup> The entry of foreign banks has caused significant positive changes in the banking sector, such as giving borrowers and investors access to new financing and investment, increasing efficiency and productivity, increasing competition, and decreasing interest rates charged by banks. This is also the current view of Mexico held by the IMF and the OECD. According to the OECD Economy Survey of Mexico:

[T]he financial sector has experienced an increase in efficiency and profitability, a system-wide re-capitalisation and an overall clean-up of balance sheets . . . Today, the Mexican banking system is increasingly solid and as profitable as in the rest of the OECD counterparts; and the supervision and regulatory frameworks are close to best practices.<sup>61</sup>

Similarly, the IMF's Financial System Stability Assessment on Mexico concluded that "given the large participation of strong foreign banks, the still low participation of banks in financial intermediation, and the recent strengthening of capital, the banking system, should not become a source of problems."<sup>62</sup> The OECD Survey also suggests, however, that there are some points that still need improvement, such as facilitation in the collection of bad loans (bankruptcy procedures), and the low level of credit to

60. See *Financial Integration IADB Doc.*, supra note 26, at 108; see also IMF, MEXICO: FINANCIAL SYSTEM STABILITY ASSESSMENT 13 (IMF Country Report No. 01/192, 2001); see also Aaron Tornell, Frank Westermann, & Lorenza Martinez, *NAFTA and Mexico's Less-than Stellar Performance* 8 (National Bureau of Economic Research, Working paper 10289, Feb. 2004), available at <http://www.nber.org>; see also *The Difference a Name Makes*, FIN. TIMES, May 6, 2004, at 14 ("Almost 90 per cent of Mexican banking assets are now [2004] in foreign banks"); see also Romina Roman Pineda, *Mexico: A Mine of Gold for Foreign Banks*, EL UNIVERSAL, May 3, 2004, at 1. Mexico has become one of the most profitable markets for the foreign banks (Citibank, HSBC, BBV and Scotiabank), with bank profits in Mexico surpassing those obtained elsewhere in Latin America, Africa, and Japan. HSBC just obtained profits 63% larger than the prior year. For this reason, Banco Bilbao Viscaya Argentaria and Scotiabank have acquired 99% of the shares of the Mexican banks Bancomer and Inverlat.

61. OECD, *Economic Survey of Mexico 2002*, in POLICY BRIEF 5 (March 2002), <http://www.oecd.org/dataoecd/41/18/2068882.pdf> [hereinafter *Economic Survey of Mexico*]. OECD also admits:

[T]he banking system scores poorly on some indicators. Labour productivity is relatively low, and further policy action is needed to facilitate the collection of bad loans. . . new bankruptcy procedures are yet to be fully tested and the exercise of credit guarantees still faces high legal costs, slow proceedings and poor enforcement at local level.

*Id.*

62. International Monetary Fund, Mexico, Financial System Stability Assessment, October 2001, IMF Country Report No. 01/92, at 6.

the private sector for small- and medium-sized enterprises and individuals.<sup>63</sup>

#### IV. MEXICO UNDER NAFTA AND MEFTA

The effects of NAFTA have been particularly interesting. NAFTA had both positive and negative points. It has created a market with 360 million people. At the time it was implemented it was the largest market in the world. Of course, it has been disregarded in some areas, but it is important to bear in mind that this is still an ongoing process. This opportunity was promising for Mexico, which was the weakest party in the agreement. The Secretariat of the WTO in the World Trade Report for 2003 said that Mexico has benefited from NAFTA. On the contrary, others say that such benefit has not been realized as advocates promised.

##### A. NEGATIVE EFFECTS OF NAFTA

Critics have long contended that NAFTA does not benefit Mexico. It is argued that “the United States obtained from Mexico the total opening of its market in services, while keeping its own market closed by means of horizontal barriers to the free circulation of service workers.”<sup>64</sup>

As a matter of fact, the United States can apply its laws extra-territorially in that the treaty extended to Mexico certain US legal concepts. Such as investments, intellectual property, competition and antitrust law, labour law, environmental law, the traffic of drugs, illegal immigration and even the administration of justice. The euphemism used by the U.S. was “convergence of values.”<sup>65</sup>

It is necessary to consider that the free circulation of services workers is the most controversial of the modes of supply services, not only in NAFTA but also in GATS and many others agreements.<sup>66</sup> At the multi-lateral level, liberalization has been slow. NAFTA represents an important small step towards negotiations for the liberalization of the free circulation of persons. With respect to the extension of legal concepts, Mexico has greatly benefited from the trade north because the rule of law concept has become better understood and consequently more aptly applied. Since then, important changes have been made in Mexican laws, such as the Foreign Investments Law and the Credit Institutions Law. As a result, the predictability and legal certainty in the judiciary has increased significantly since NAFTA came into force.

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63. *Economic Survey of Mexico*, *supra* note 62, at 5.

64. Durval de Noronha Goyos, *MERCOSUR v FTTA*, 1998 INT'L TRADE L. & REG. 20, 21.

65. *Id.* at 22.

66. OECD, *Service Providers on the Move—Labour Mobility and the WTO General Agreement on Trade in Services*, in POLICY BRIEF (Aug. 2003), <http://www.oecd.org>; see also Gary Hufbauer & Tony Warren, *The Globalization of Services: What Has Happened? What are the implications?* (Inst. for Int'l Econ., Working Paper 99-12, 1999), available at <http://www.iese.com>.

Another negative effect of NAFTA could be the discrimination against third parties that frustrate the attainment of multilateral objectives built on non-discrimination. These third parties engender a degree of trade diversion and the application of numerous rules of origin and differing standards that could make international trade more complex and costly. Furthermore, the overlapping of these agreements risks undermining the transparency of trading rules, which are some of the fundamental principles of the WTO.<sup>67</sup>

Others have commented that NAFTA, as negotiated and consequently implemented, was one of the main reasons for the Mexican crisis. Maysami and Williams write:

As a result of the NAFTA model, Mexico became a client state of the US designed to buy services, industrial and agricultural products and to produce huge trade deficits to be financed with speculative borrowings by the financial sector. In 1994 this bizarre situation caused the accumulation by Mexico of an enormous trade deficit of the value of US \$19 billion which in turn caused the liquidity crisis in Mexico at the beginning of 1995 and the massive devaluation of the peso.<sup>68</sup>

However, as previously discussed, the Mexican banking system was already in trouble several years before NAFTA came into force. In fact, the banking system was too weak when Mexico joined NAFTA. There were several reasons for this weakness, such as erroneous economic policies, a centralized focus by the privatized banking system on lending to the government and state-owned companies in order to subsidize its scandalous deficit, lack of proper management in the banks, lack of transparent procedures when the privatization itself was carried out, and the lack of moral solvency and technical acumen by those in charge of the banks.

## B. POSITIVE EFFECTS OF NAFTA

The Secretariat of the WTO commented in November 2003:

Participation in RTAs, particularly the NAFTA, has exposed Mexican producers to foreign competition and subjected them to strong pressure to increase productivity. Average productivity per worker, in the manufacturing sector, which accounted for an average 21 per cent of total GDP during 1996 – 2000, increased at an average rate of 6.8 per cent in the period 1990 – 2001. At the same time, preferential access to the huge North American market has granted certain Mexican producers the demand base, capital, and technology necessary to exploit economies of scale and sustain productivity gains. . . FDI inflows into Mexico, which averaged \$3.9 billion from 1990 to 1993, trebled in the period 1994 to 1999 and reached \$25 billion in 2001.<sup>69</sup>

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67. WTO REPORT 2003, *supra* note 6, at xvi.

68. See Maysami & Williams, *supra* note 37, at 2.

69. See WTO REPORT 2003, *supra* note 6, at 63.



One of the advantages of NAFTA is that most of the sectors have been implemented step-by-step (although this was not possible in the financial services as has been seen). This process of implementation implies that some sectors are considered more important than others, and after a reasonable period of time those sectors will be liberalized. NAFTA's fifteen-year phase-in sounded reasonable, as it was planned to prevent serious disruption by allowing the markets to adapt to the changes gradually.

Between 1994 and 1998, the annual growth average of the total trade between Mexico, the United States, and Canada has been 12 percent above the growth in the global goods trade (9 percent).<sup>70</sup> In only five years, total trading between the three nations increased 75 percent (nearly U.S. \$227 billion) to achieve U.S. \$500 billion in 1998. Also, it should be noted that in 1995 Canada became the second market for Mexican products.<sup>71</sup>

Mexico has become the second most important trade partner for the United States.<sup>72</sup> After five years, bilateral trade between both nations increased by almost 120 percent, from U.S. \$88.1 billion in 1993 to over U.S. \$187 billion in 1998. In the same year, Mexican exports to the United States increased by U.S. \$103 billion, an increase of 143 percent compared to 1993. The growth rate of Mexican exports to the United States has been superior to the average of those from the rest of the world. Over one dollar out of each ten that the United States spends abroad is spent on Mexican products.<sup>73</sup> Thus, "Mexico's exports alone have tripled since 1994, with Mexico recently displacing Japan as the second largest supplier of goods and services to the United States."<sup>74</sup> Thus, we can think that NAFTA effectively has succeeded in stimulating trade and investment.

Mexico has benefited greatly from NAFTA. For this reason, and because of the European Union's success in its economic integration, President Vicente Fox is trying to strengthen this integration. From the beginning of his administration, President Fox proposed a plan to expand NAFTA to a North American Common Market, as a North American

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70. Among other advantages, NAFTA provides abundant opportunities for local interest groups. The so-called rules of origin are designed to safeguard originating goods with preferential treatment against non-originating goods, such as the goods imported from other non-members countries. In other words, it limits the benefits of the agreement to producers of the member states only. Marise Cremona, Remarks at the Class of Regional Economic Integration, International Economic Law Course, Centre for Commercial Law Studies, Queen Mary College, University of London (Apr. 28, 2003).

71. BANCOMEXT STUDY, *supra* note 11, at 26. Mexican exports to Canada increased at a rate of 12% from 1994 to 1998, reaching more than five billion dollars.

72. See Gabrielle Marceau & Cornelis Reiman, *When and How Is a Regional Trade Agreement Compatible with the WTO?*, 28 *LEGAL ISSUES OF ECON. INTEGRATION* 123 (2001).

73. See BANCOMEXT STUDY, *supra* note 11, at 28.

74. See Jennifer E. Harman, *Mexican President Vicente Fox's Proposal for Expanding NAFTA into a European Union-Style Common Market—Obstacles and Outlook*, 7 *L. & BUS. REV. AM.* 207, 208, 212 (2001).

replica of the European Union. However, such suggestion has not been developed by the United States and Canada.<sup>75</sup> In general, the trade among NAFTA parties has increased significantly. Mexico has become Canada's largest trading partner as well as its eighth largest exporter market, and Canada is Mexico's second largest market for sales.<sup>76</sup>

Another important advantage for NAFTA is that, from the point of view of coherent legal structure, it is more integrated and its enforceability is more effective.<sup>77</sup> The WTO is still fragmented into three parts with disciplines applying to goods in Part I (GATT), another applying to services in Part II (GATS), and an agreement applying to intellectual property rights in Part III (Trade-Related Aspects of Intellectual Property Rights, or TRIPS). In contrast, NAFTA has incorporated investments and technical barriers to trade that apply to both trade in goods and trade in services alike in only one body.<sup>78</sup>

### C. THE MEXICAN-EUROPEAN FREE TRADE AGREEMENT (MEFTA) AND ITS IMPLICATIONS FOR NAFTA.

MEFTA represents significant implications for NAFTA Members and NAFTA in general. Holbein and Ranieri write: "The European Union (EU) is the United States' largest aggregate trading partner and Mexico is its second largest national trading partner. Any agreement that eliminates trade barriers and improves market access between these two crucial trading partners potentially has major implications for U.S. business."<sup>79</sup> Mexico has become a bridge between the EU and the United States and Canada and vice-versa. Therefore, enterprises coming from commercial partners of Mexico would now be able to establish operations in Mexico in order to take advantage of its preferential access to U.S., Canadian, European, and Latin American markets.<sup>80</sup>

The EU represents an attractive opportunity for Mexico because it is the largest and most integrated trade arrangement in the world bound into a customs union that is committed to political and economic integration.<sup>81</sup> It is home to more than 400 million people (now with the enlarge-

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75. *Id.* at 208.

76. *Id.* at 213.

77. The RTAs generally have a more effective and sophisticated dispute-settlement procedure. For example, see the powerful case of chapters 11 and 20 of NAFTA. NAFTA, *supra* note 22, chs. 11, 20, 32 I.L.M. at 639, 693.

78. See Stephenson, *supra* note 5, at 193.

79. THE EU-MEXICO FREE TRADE AGREEMENT xviii (James R. Holbein & Nick W. Ranieri eds., Transnational Publishers, 2002) [hereinafter MEFTA TRADE IN SERVICES AGREEMENT].

80. *Id.* at 23; see also *Bilateral Trade Relations*, European Commission Trade Doc, at 1, available at <http://www.europa.eu.int/comm/trade/bilateral>. Mexico's imports from EU are engines, autos (specific arrangements for cars include a tariff cut from 20% to 3.3% with the tariff disappearing in 2003), textiles, machinery and equipment, construction machinery and equipment, telecommunications equipment, medicines, and milk. In turn, Mexico exports to EU oil, auto parts, avocado, cut flowers, fruits, juices, honey, coffee, silver, copper, and steel.

81. MEFTA TRADE IN SERVICE AGREEMENT, *supra* note 79, at 21.

ment to twenty-five countries), and has a gross domestic product of over U.S. \$7 trillion, making it the world's second largest economy behind the United States.<sup>82</sup> Until 1975, links between Mexico and the EU were mainly focused on historical and cultural ties. A First Framework Cooperation Agreement was signed in September 1975 and renewed in October 1980. In the late 1990s, because of structural changes, modernization processes, and trade liberalization in Mexico (including Mexico's participation), political, economic, and commercial cooperation with the EU improved considerably, resulting in this commercial agreement. During 1993, the EU's trade with Mexico registered an accumulated growth of 4.7 percent, and the EU became the second largest investor in Mexico. From 1994 to 1998, accumulated Foreign Direct Investment in Mexico was U.S. \$41.2 billion, with 21 percent constituting EU investment. The main investors were the United Kingdom (32 percent), the Netherlands (30.5 percent) and Germany (19 percent).<sup>83</sup>

The EU found Mexico and NAFTA extremely attractive. Among other factors, this attraction resulted from the economic growing rate of the NAFTA parties. A study by the Centre for Policy Studies showed that NAFTA economies are growing at a rate twice that of the EU. Between 1992 and 2000 Mexico had a 38 percent increase in jobs while the United States and Canada had a 13 percent increase. During the same time period, the EU only experienced a 3 percent increase in employment.<sup>84</sup>

The EU and Mexico signed three legal instruments (collectively known as MEFTA):

Economic Partnership, Political Co-ordination, and Co-operation Agreement (Global Agreement); Interim Agreement to the Global Agreement (Trade in Goods Agreement); and Final Act of the Global Agreement (Trade in Services Agreement).<sup>85</sup>

With respect to comparing the MEFTA and NAFTA, it can be said that MEFTA will stimulate trade by liberalizing almost all trade by 2007, a bit earlier than NAFTA in some areas. Moreover, MEFTA has negotiated tariffs lower than those that existed within NAFTA.<sup>86</sup> In NAFTA, member parties "are not required to give up a portion of their sovereignty. . . with the possible exception of Chapter 11 arbitration."<sup>87</sup> In turn, the EU has supranational authorities where they share common policies.

As for services, most of the sectors were negotiated, such as telecommunications, energy, tourism, and financial services, although certain sub-

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82. Casey Burges, *An Anglo-NAFTA Union: Does it Make Sense?*, 8 L. & BUS. REV. AM. 685, 686 (2002).

83. BANCOMETX STUDY, *supra* note 11, at 91; *see also* *Bilateral Trade Relations*, European Commission Trade Doc (July 2000), at <http://www.europa.eu.int/comm/trade/bilateral>.

84. Burges, *supra* note 82, at 693.

85. Alberto de la Pena, *Free Trade Agreement between Mexico and the European Union*, 7 L. & BUS. REV. AM. 369, 371 (2001).

86. MEFTA TRADE IN SERVICES AGREEMENT, *supra* note 79, at 23.

87. Burges, *supra* note 82, at 689.

sectors, such as audio-visual, maritime sabotage, and air transport, are explicitly excluded. It should still be considered to have "substantial sectoral coverage" according to article five of GATS.<sup>88</sup>

MEFTA has gone beyond the commitments of GATS (as will be seen in the last section of this paper relating to financial services). The agreement's objectives include the progressive and reciprocal liberalization of trade in services (not exceeding ten years). For example, the financial services sector was practically liberalized when the MEFTA Trade Services Agreement came into force. Article 12, paragraph 4, subparagraph (e) of the Trade in Service Section of MEFTA states the general rule:

No Party shall maintain or adopt the following measures: . . .  
 (e) limitations on the participation of foreign capital in the terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.<sup>89</sup>

The exceptions, some of which will be described in the last section of this paper, are described in the list of reservations set out in Annex I of the Trade in Service Agreement of MEFTA.<sup>90</sup> This liberalization was consistent with the previous rule adopted by Mexico (discussed in the third section of this paper) when Congress approved in 1999 the allowing of foreign economic agents to own 100 percent of the capital stock of Mexican banks.<sup>91</sup>

It is worth mentioning that in the services sector, the EU will clearly benefit more than Mexico. This disparity is due to the EU's *net-exporter* nature of services and financial services. European banks and insurance companies, like their U.S. and Canadian counterparts, are authorized to establish and operate directly on the Mexican territory.<sup>92</sup> In return, Mexican banks will have similar access to the EU.<sup>93</sup> However, as Mexico is not a *net-exporter* in financial services, this potential market cannot be exploited (in the short or medium term) in such a manner as the one in industrial products and manufacturing where the Mexican competitive advantage lies.

The future of MEFTA will depend on the future integration of the FTAA.<sup>94</sup> They might interact and complement each other, converting Mexico into the trade hub between the Americas and Europe.

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88. Proposal for a Council Decision on the Community Position within the EC-Mexico Joint Council on the Implementation of articles 3, 4, 5, 6 and 12 of the Interim Agreement, EUR. PARL. DOC. (COM(2000) 9 final/4) 6 (2000) [hereinafter Communication from the European Commission 2000].

89. MEFTA TRADE IN SERVICES AGREEMENT, *supra* note 79, at 428.

90. Article 17 of the MEFTA Trade Services Agreement will permit the Members the elimination of the remaining discriminations within three years of the entry of the Agreement.

91. Reforms to the Foreign Investments Law and other Laws, published Jan. 19, 1999, in the Official Diary, available at <http://dof.terra.com.mx/>.

92. Communication from the European Commission 2000, *supra* note 88, at 5.

93. MEFTA TRADE SERVICE AGREEMENT, *supra* note 79, at 415.

94. De la Calle Pardo, *supra* note 3, at 379.

V. NAFTA, MEFTA, AND GATS AND THEIR CONNECTION WITH THE LIBERALIZATION OF FINANCIAL SERVICES IN MEXICO

In a very interesting study, the OECD observes that “WTO-consistent preferential [regional] trade agreements can complement but cannot substitute for coherent multilateral rules and progressive multilateral liberalisation” and that “[i]n some particularly sensitive areas, regional initiatives *have been no more successful – and in some cases less successful – than activity at the multilateral level.*”<sup>95</sup> In the specific case of financial services, the OECD stated that “*while the GATS has achieved a higher level of liberalisation in financial services than that found in most RTAs, the development of the GATS Understanding on Commitments in Financial Services took advantage of insights gained in financial market opening at the regional level.*”<sup>96</sup> Thus, it is legally relevant to know to what extent each RTA could go beyond WTO Agreements.<sup>97</sup> Stability and liberalization constitute two of the main objectives that bilateral, regional, and multilateral agreements share and promote.<sup>98</sup> This section will assess to what extent NAFTA and MEFTA have exceeded services trade in relation to GATS.

Stability is an important element for international trade in order to guarantee security, credibility, and predictability. These key factors give both investors and consumers in general the vision of market opportunities. Although GATS has contributed in many ways to this goal of credibility and predictability, it is acceptable to say that:

GATS scores rather poorly. . . and . . . the possibility allowed for under the GATS of including commitments in national schedules

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95. United States Embassy—Tokyo, Japan, *Ministers at OECD Call for New WTO Trade Negotiating Round*, available at <http://japan.usembassy.gov/e/tp-ec0092.html> (May 16, 2001); OECD, *Regional Trade Agreements* (2003), available at [http://www.oecd.org/document/62/0,2340,en\\_2649\\_34145\\_31839102\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/62/0,2340,en_2649_34145_31839102_1_1_1_1,00.html) (last visited Sept. 12, 2004).

96. *Economic Survey of Mexico*, *supra* note 63, at 7.

97. It should be noted that NAFTA, like many other RTAs, is inconsistent in some degree with GATS, and consequently brings incompatibility and uncertainty to the world trade system. It has been generally recognized that “the lack of clarity of Art. V of GATS (and Art. XXIV of GATT) and the ambiguities surrounding this provisions leave the compatibility of RTA’s largely uncertain.” See Sherry M. Stephenson, *GATS and Regional Integration*, in *GATS 2000: NEW DIRECTIONS IN SERVICES TRADE LIBERALIZATION* 509 (Pierre Sauve & Robert M. Stern eds., 2000). See also Luis Abuggatas et al., *Liberalization of Trade in Services: Options and Implications*, in *TRADE NEGOTIATIONS IN LATIN AMERICA* 91 (Diana Tussie ed., 2003). See N.E. Scott, *Compatibility of EU Regional Trade Agreements with WTO rules in the Post Uruguay Round* (1996 Int’l Trade L. & Reg.). Regarding the compatibility between RTAs and WTO agreements it should be noted that the case *Turkey- Restrictions on Imports of Textile and Clothing Products*, WT/DS34/R, has been a landmark because it is the first one which gives a substantial meaning to article XXIV and the conditions that must be fulfilled in order to make the RTA compatible with the WTO rules (although this is related directly with GATT, the same principles might be applied in the future for GATS).

98. See Stephenson, *supra* note 5, at 187 (NAFTA Agreement has become a prototype for many developing countries to join the wave of services trade liberalization).

that are bound at a more restrictive level than the “status quo” (or less than actual regulatory practice) means that effectively service providers are not necessarily provided with accurate information on market access possibilities through this multilateral instrument.<sup>99</sup>

A good example is article XXI of GATS, which states that “A Member (referred to in this Article as the ‘modifying Member’) may modify or withdraw any commitment in its Schedule, at any time after three years have elapsed from the date on which that commitment entered into force, in accordance of the provisions of this Article.”<sup>100</sup> NAFTA and MEFTA, on the contrary, have gone notoriously beyond GATS because they provide the status quo provision<sup>101</sup> in a more predictable way for the treatment of existing trade in services. With respect to the Financial Services Chapter, article 1404 states as follows:

No Party may adopt any measure restricting any type of cross border trade in financial services by cross border financial services of another Party that the Party permits on the date of entry into force of this Agreement, except to the extent set out in Section B of the Party’s Schedule to Annex VII.

In the same sense, Article 12 (3) of the MEFTA states: “No party may adopt new measures for the establishment and operation of financial services supplier of the other party, which are more discriminatory than those applied on the date of entry into force of this Decision.”<sup>102</sup>

Regarding liberalization, although GATS has made good efforts and considerable positive changes in the services trade, it still falls short in the liberalization of services markets. Stephenson argues that “most specific commitments scheduled by both developed and developing countries are in fact ‘stand-still bindings’ and do not enlarge market access for service providers, committing the government concerned only to maintain the current level of access.”<sup>103</sup>

In contrast, NAFTA and MEFTA improve such legal framework. NAFTA includes a clause requiring that the better of either Most Favoured Nation or National Treatment status be given to a service provider from a Member (Standard of Treatment: articles 1405 and 1406 in the case of Chapter of Financial Services of NAFTA, and in the same

99. *Id.* at 191.

100. General Agreement on Trade in Services (entered into force Jan. 1995), in *WORLD TRADE ORGANIZATION, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS*, art. XXI, at 301 (Cambridge University Press UK, 2003).

101. This provision means actual regulatory practice, and it gives the promise to the parties involved that they will not go back, withdraw or decrease their current commitments or regulatory practice.

102. Joint Council Decision No. 1 Covering Trade in Services, Investments and Related Payments, Protection in Intellectual Property Rights and Dispute Settlement; *MEFTA TRADE IN SERVICES AGREEMENT*, *supra* note 79, at 428-29.

103. See Stephenson, *supra* note 5, at 192 (both the limited number of sectors included in national schedules as well as the limited number of overall commitments, particularly by developing countries, testify to the lack of success of the GATS).

sense articles 14 and 15 of MEFTA).<sup>104</sup> Article 1205 of NAFTA, titled Local Presence, is beneficial for all Members because it allows service providers to determine the most efficient way to carry out their trade. Specifically, article 1205 provides: "No Party may require a service provider of another party to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border provision of a service."<sup>105</sup> Article 1210 paragraph 3 and article 1111 of NAFTA set forth further requirements.<sup>106</sup> Article 1210, titled Licensing and Certification, provides:

1. With a view to ensuring that any measure adopted or maintained by a Party relating to the licensing or certification of nationals of another Party does not constitute an unnecessary barrier to trade, each Party shall endeavour to ensure that any such measure . . . 3. *Each Party shall, within two years of the date of entry into force of this Agreement, eliminate any citizenship or permanent residency requirement set out in its Schedule to Annex I that it maintains for the licensing or certification of professional service providers of another Party.* Where a Party does not comply with this obligation with respect to a particular sector, any other Party may, in the same sector and for such period as the non-complying Party maintains its requirement, have sole recourse to maintaining an equivalent requirement set out in its Schedule to Annex I, reinstating:
  - (a) Any such requirement at the federal level that it eliminated pursuant to this Article; or
  - (b) On notification to the non-complying Party, any such requirement at the state or provincial level existing on the date of entry into force of this Agreement.
2. The Parties shall consult periodically with a view to determining the feasibility of removing any remaining citizenship or permanent residency requirement for the licensing or certification of each other's service providers.<sup>107</sup>

Article 1111, titled Special Formalities and Information Requirements, provides:

1. Nothing in Article 1102 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

104. *Id.* at 198. See also MEFTA TRADE IN SERVICES AGREEMENT, *supra* note 79, at 428, 429; NAFTA, *supra* note 22, art. 1405, 32 I.L.M. at 657, stating as follows: Each party shall accord to Investors of another party treatment no less favourable than that it accords to its own investors, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of financial institution and investment in financial institution in its territory.

105. NAFTA, *supra* note 22, 32 I.L.M. at 289.

106. Stephenson, *supra* note 5, at 198.

107. See NAFTA, *supra* note 22, 32 I.L.M. at 289.

impair the protections afforded by a Party to investors of another Party and investments of investors of another Party pursuant to this Chapter.<sup>108</sup>

A. COMPARING FINANCIAL SERVICES COMMITMENTS UNDER NAFTA, MEFTA, AND THE SCHEDULE OF SPECIFIC COMMITMENTS OF MEXICO (ANNEXED TO ITS SCHEDULE TO THE GATS)<sup>109</sup>

First, it should be stated that the main objectives of NAFTA are to reduce or completely eliminate economic barriers and promote economic integration among the NAFTA Members, to promote the development of a key legal framework needed to improve security for investments, and to facilitate the free flow of goods and services.<sup>110</sup> Chapter fourteen was a central priority of the U.S. and Canadian negotiators.<sup>111</sup> However, from the Mexican point of view, this chapter has been a sensitive area. For the first time in fifty years, Mexico will permit financial institutions from other NAFTA countries to establish and wholly own Mexican subsidiaries to provide banking, insurance, and securities services. It should be noted that NAFTA establishes a transition phase for each financial service sector to the year 2000.<sup>112</sup>

NAFTA establishes two basic principles guiding the investment in the financial service sector:

1. Commercial presence and cross Border Services: Financial Services providers of a NAFTA country may establish banking, insurance and securities operations, as well other types of financial services in any other NAFTA Country. Each country may determine the juridical form in which those services provided in its own country may take. Each country must permit its residents to purchase financial services in the territory of another NAFTA country, although the country does not have to allow solicitation activities by such providers in its own territory. Also, a country may not impose new restrictions on the cross-border provision of financial services in a sector.

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108. *Id.*

109. *Schedules of Commitments and Lists of Article II Exemptions*, Feb. 26 1998, WORLD TRADE GATS/SC/56Suppl.3, available at [http://www.wto.org/english/tratop\\_e/serv\\_e/serv\\_commitments\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm), at 3 [hereinafter *Schedule of Commitments*].

110. See NAFTA, *supra* note 22, chs. 1 & 2, 32 I.L.M. at 297-98; see also HASTINGS, *supra* note 22.

111. It is worth mentioning that the Canada-United States Free Trade Agreement (CUSFTA) was the first trade agreement ever to include provisions on financial services, as both countries have been net-exporters of financial services. This explains as well why the United States and Canada were putting pressure on Mexico in opening its market in financial services. ERIC MILLER, FINANCIAL SERVICES IN THE TRADING SYSTEM: PROGRESS AND PROSPECTUS 2 (IADB, Occasional Paper No. 4, 1999), available at <http://www.iadb.org>.

112. See JOHN H. JACKSON ET AL., LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS; CASES, MATERIALS AND TEXT 868 (4th ed. 2002); see also NAFTA, *supra* note 22, ch. 14, 32 I.L.M. at 657.



2. Non-Discriminatory Treatment: each NAFTA country will provide both national treatment and most favoured nation treatment to other NAFTA financial services providers operating in its territory. This means treatment no less favourable than that accorded by a party to its own investors, financial services providers, and financial institutions in like circumstances. A NAFTA country may satisfy the requirement of national treatment even though it may treat financial services providers of another party differently from domestic financial services if it accords equal competitive opportunities.<sup>113</sup>

The guiding principle of NAFTA regarding financial supervision is reserved to the host country. However, “regulators are permitted to negotiate bilateral agreements leading to regulatory and supervisory harmonization.”<sup>114</sup>

On the other hand, Mexico signed the WTO/GATS. Mexico’s commitments are annexed to its Schedule to GATS. Specific commitments are made according to the four modes of supply for each services sector: (1) cross border supply; (2) consumption abroad; (3) commercial presence; and (4) free movement of natural persons.<sup>115</sup> Mexico’s commitments set up some deviations from the non-discrimination and national treatment principles. For example, foreign institutions must obtain authorization from the Ministry of Finance. Additionally, foreign institutions should remain under effective control of Mexican holders. Finally, foreign investment by governments is not permitted.

Mexico has accepted a higher degree of liberalization of cross-border trade in Financial Services with NAFTA and MEFTA Members rather than with GATS Members.<sup>116</sup> The following chart will help illustrate this point.

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113. See NAFTA, *supra* note 22, ch. 14, Arts 1403, 1404, 1405, 1406.

114. *Financial Integration IADB Doc*, *supra* note 26, at 105 (2002), available at [http://www.iadb.org/res/publications/pubfiles/pubbb-2002e\\_7384.pdf](http://www.iadb.org/res/publications/pubfiles/pubbb-2002e_7384.pdf).

115. *Schedule of Commitments*, *supra* note 109, at 3.

116. It is worth mentioning that in the Financial Services Agreement of GATS (1997) most of the Latin American countries did not make commitments in the banking and insurance sector in the mode 1, 2 and 4. This is because such Governments still wanted to have strict control over cross-border flows capital and regulatory controls. See Sherry M. Stephenson, *Multilateral and Regional Services Liberalization by Latin America and the Caribbean*. OAS Trade Unit/Ser.D/XXII SG/TU/TUS-9, 1st ed. March 2001, at 10.

NAFTA <sup>117</sup>	MEFTA	GATS
<p>Commercial Banks (Instituciones de Banca Múltiple) and Holding Companies (Sociedades Controladoras) During the transition phase (1994-2000) Mexico will gradually increase the aggregate foreign market share limit in banking from 8 percent to 15 percent. During the transition phase (1994-2000), no foreign bank can have more than 1 1/2 percent market share, nor a foreign securities dealer more than 4 percent. Aggregate foreign investment up to 30 per cent of common stock capital, Initial limits on foreign investment in foreign financial affiliates but none after 1st January 2000: "Aggregate foreign investments in holding companies and in commercial banks are limited to 30 percent of common stock capital ("<i>capital ordinario</i>"). These percentage limits do not apply to investments in foreign financial affiliates as such term is defined in, and subject to terms and conditions under, Sections B and C of this Schedule" (In other words, these limits shall be removed at the end of the transition period: After 1st January 2000).<sup>118</sup></p>	<p>The general rule is described in the Article 12 paragraph 4 subparagraph (e) of the Trade in Service Section of MEFTA which states that:<sup>119</sup>          "No Party Shall maintain or adopt the following measures:          (e) limitations on the participation of foreign capital in the terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment."          The exceptions are described in the list of reservations set out in Annex I of the Trade in Service Agreement of MEFTA and are as follows:<sup>120</sup>          Commercial Banks          This activity is restricted to established commercial banks. Foreign investment by persons exercising governmental functions is not allowed.          In accordance with the applicable financial legislation, representative offices of banking institutions are excluded from this activity</p>	<p>Commercial Banks          Foreign Investors may hold up to 40 percent of common stock capital, Limit on individual holding is a percentage of capital stock or up to twenty percent with authorization from the Ministry of finance (SHCP), Effective Control by Mexicans must be required:          "This activity is restricted to multiple banking institutions. Foreign investors may hold up to 40 per cent of common stock capital and up to 100 per cent of the additional capital representing 40 per cent of non-voting common stock capital. Foreign investment by artificial persons exercising governmental functions is not allowed. The limit on individual holdings is 5 per cent of capital stock or up to 20 percent of capital stock with authorization from the SHCP. Effective control of the enterprise by the Mexican shareholders is required."<sup>121</sup>          Mode 1 Unbound</p>

117. NAFTA, *supra* note 22, Annex VII, Schedule of Mexico § A, 32 I.L.M. at 770.

118. *Id.* Schefer points out as well that the legal text states clearly, "*Se requiere que el control efectivo de la empresa lo mantega los inversionistas mexicanos*" - "that is, effective control of investment must remain with Mexican investors." In addition, no individual may hold more than 5% of the capital stock of a commercial bank without special permission from the Secretary of Finance. See SCHEFER, *supra* note 23, at 116.

119. NAFTA, *supra* note 22, Annex VII, Schedule of Mexico § B(16), 32 I.L.M. at 774.

120. MEFTA TRADE IN SERVICES AGREEMENT, *supra* note 79, at 428.

121. *Id.* at 455. It is important to mention that such Reservations shall be reviewed by the Special Committee on Financial Services established under art. 23, with the view to propose to the Joint Council their modification, suspension and elimination (art. 17(2) of MEFTA) and no later than three years following the entry into force of the Agreement, the Joint Council shall adopt a decision providing for the elimination of substantially all remaining discrimination. That decision shall contain a list of commitments establishing the level of liberalization, which the Parties agree to grant each other (art. 17(3) of MEFTA). *Id.* at 429.

<p>Cross Border purchases of financial services in Mexican pesos not allowed: "In order to avoid impairment of the conduct of Mexico's monetary and exchange rate policies, cross-border financial service providers of another Part shall not be permitted to provide financial services into the territory of Mexico. . . and residents of Mexico may not purchase financial services from cross-border financial service providers of another Party, if such transactions are denominated in pesos."<sup>122</sup></p>		
<p>Insurance Companies (Instituciones de Seguros) U.S. and Canadian insurance firms can own 100 percent of Mexican Insurance companies by the year 2000: however, making the investment through a joint venture with a Mexican insurer will avoid the aggregate and individual market share caps: "Aggregate Foreign Direct Investments (FDI) in insurance companies must be less than 50 percent of paid-in capital ("<i>capital pagado</i>") (or limited to 49 per cent) in Mexican firms and no limits on FDI for foreign Financial affiliates after 2000."<sup>123</sup></p>	<p>Insurance Companies General rule: see Commercial Bank section above. Reservation: Established insurance companies may carry out insurance and insurance-related services. Foreign investors may hold up to 49 percent of the paid up capital. Foreign investments by governments and official agencies are not allowed. Effective control of the enterprise by the Mexican shareholders is required. This percentage limit does not apply to investments in foreign financial affiliates as such item is defined in, and subject to terms and conditions under the Affiliates Section.<sup>124</sup></p>	<p>Insurance Companies Foreign direct investment up to 40 percent; limit on individual holdings up to 20 percent with authorization. Effective controls must be by Mexicans: "Foreign investors may hold up to 40 per cent of the paid-up capital and up to 30 per cent of non-voting paid-up capital. Foreign investment by governments and official agencies is not allowed. The limit on individual holdings by foreign investors is 10 per cent of paid-up capital or up to 20 per cent of paid-up capital with authorisation from the Ministry of Finance and Public Credit (SHCP). Effective control of the enterprise by the Mexican shareholders is required."<sup>125</sup> Mode 1 Unbound</p>

122. *Schedule of Commitments*, *supra* note 109, at 3.

123. NAFTA, *supra* note 22, Annex VII, Schedule of Mexico § B(8), 32 I.L.M. at 774.

124. MEFTA TRADE IN SERVICES AGREEMENT, *supra* note 79, at 454.

125. *Schedule of Commitments*, *supra* note 109, at 1.

<p>Securities Firms (Casas de Bolsa) Securities Specialists (Especialistas Bursátiles) Aggregate FDI are limited to 30 percent of capital in Mexican Securities Firms Initial limits on FDI until 1999</p> <p>No Limits on FDI for foreign firms and Individual holdings:</p> <p>During the transition phase (1994-2000) The limit for securities activities by foreigners will increase from 10 percent to 20 percent.</p> <p>“Aggregated FDI in securities firms and securities specialist are limited to 30 percent of capital (“capital social”) and individual foreign investment are limited to 10 percent of capital, while individual investments by Mexicans may, with approval from the <i>Secretaria de Hacienda y Credito Publico</i> (Ministry of Finance), rise to 15 percent of capital. These percentage limits do not apply to investments in foreign financial affiliates as such term is defined in and subject to terms and conditions B and C of this Schedule”<sup>126</sup> (In other words, these limits shall be removed at the end of the transition period: After 1st January 2000).</p>	<p>General rule: see Commercial Bank section above.</p> <p>Reservation:</p> <p>Established securities firms and established securities specialists may carry (establishment and cross border). Foreign investment by persons exercising governmental function is not allowed.</p>	<p>Securities firms and securities specialists may carry this activity and FDI may hold up to 40 percent, limit on individual holding up to 20 percent and the Effective control of the enterprise by the Mexican shareholders is required:</p> <p>“Securities firms and securities specialists may carry out this activity. Foreign investors may hold up to 40 per cent of the common stock capital and up to 100 per cent of the additional capital representing 40 per cent of the non-voting common stock capital. Foreign investment by artificial persons exercising governmental functions is not allowed. The limit on individual holdings is 10 per cent of the capital stock or up to 20 per cent of the capital stock with authorization from the SHCP. Effective control of the enterprise by the Mexican shareholders is required.”</p> <p>Mode 1 Unbound</p>
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126. NAFTA, *supra* note 22, Annex VII, Schedule of Mexico, 32 I.L.M. at 770.

<p>General Deposit Warehouses (Almacenes Generales de Deposito)          Financial Leasing Companies (Arrendadoras Financieras)          Financial Factoring Companies (Empresas de Factoraje Financiero)          Bonding Companies (Instituciones de Fianzas)          Aggregate FDI are limited to 49%, No limits on DFI for foreign firms and individual holdings:          "Aggregate foreign investments in general deposit warehouses, financial leasing companies, financial factoring companies and bonding companies must be less than 50 percent of paid-in capital ("capital pagado"). These percentage limits do not apply to investments in foreign financial affiliates."<sup>127</sup> In other words, these limits shall be removed at the end of the transition period: After 1st January 2000.</p>	<p>General rule: see Commercial Bank section above.          Reservation:          General Deposit Warehouses (Establishment and cross border) Foreign investors may hold up to 49 per cent of the paid-up capital. Foreign investments by persons exercising governmental functions are not allowed. Effective control of the enterprise by the Mexican shareholders is required. This percentage limit does not apply to "investments in foreign financial affiliates" as such term is defined in the Affiliates Section.          Financial Leasing          General rule: see Commercial Bank section above.          Reservation:          (Establishment and cross border) Established Financial Leasing companies may carry out financial leasing activities. Foreign investors may hold up to 49 percent of the paid-up capital. Foreign investments by persons exercising governmental functions are not allowed. Effective control of the enterprise. . . This percentage limit does not apply to "investments in foreign financial affiliates" as such term is defined in Affiliates Section.          Financial Factoring          The same as Financial Leasing</p>	<p>Financial Leasing          Foreign direct investment up to 49 per cent of paid up capital, limit on individual holdings of 10 per cent of paid up capital and Effective controls for Mexicans is required.          "Financial leasing companies may carry out financial leasing activities. Foreign investors may hold up to 49 per cent of paid-up capital and up to 30 per cent of non-voting paid-up capital. Foreign investment by artificial persons exercising governmental functions is not allowed. The limit on individual holdings is 10 per cent of paid-up capital. Effective control of the enterprise by the Mexican shareholders is required."<sup>128</sup>          General Deposit Warehouses          Foreign direct investment up to 49 percent of paid up capital, limit on individual holdings of 10 percent of paid up capital and Effective controls for Mexicans is required.          "Foreign investors may hold up to 49 per cent of the paid-up capital and up to 30 per cent of the non-voting paid-up capital. Foreign investment by artificial persons exercising governmental functions is not allowed. The limit on individual holdings is 10 per cent of the paid-up capital. Effective control of the enterprise by the Mexican shareholders is required."</p>
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127. *Id.* However, it should be mentioned that Mexico has set out in Annex VII of NAFTA some ambiguous reservations regarding the establishment of commercial banks, where the Mexican Authorities could use enormous discretion, consequently affecting the freedom of establishment to other NAFTA Parties.

128. *Schedule of Specific Commitments, supra* note 109.

<p>Credit Unions (Uniones de Credito) Financial Agents (Comisionistas Fiancieros) Foreign Exchange Firms (Casas de Cambio)  “Foreign investments in credit unions, financial agents and foreign exchange firms are not allowed. This limitation does not apply to investments in foreign financial affiliates as such term is defined in, and subject to terms. . .”<sup>129</sup></p>	<p>General rule: see Commercial Bank section above.  Reservation:  Foreign Exchange Firms  Established commercial banks and established foreign exchange firms may carry out this activity.  (Establishment and cross border) Foreign investors may hold up to 49 percent of the paid-up capital. Foreign investments by persons exercising governmental functions are not allowed. Effective control of the enterprise by the Mexican shareholders is required. This percentage limit does not apply to “investments in foreign financial affiliates” as such term is defined in Affiliates Section.</p>	<p>Foreign Exchange Firms  FDI may hold up to forty-9 percent of the paid-up capital, limit on individual holding is 10 percent of the paid up capital and Effective Control of the enterprise by the Mexican Shareholders is required:  “Foreign exchange firms may also carry out this activity. Foreign investors may hold up to 49 per cent of the paid-up capital and up to 30 per cent of the non-voting paid-up capital. Foreign investment by artificial persons exercising functions of authority is not allowed. The limit on individual holdings is 10 per cent of the paid-up capital. Effective control of the enterprise by the Mexican shareholders is required.”<sup>130</sup></p>
<p>Source: Stephenson, (Columns of NAFTA and GATS)<sup>131</sup></p>	<p>Source: Annex I of the MEFTA Trade in Services Agreement<sup>132</sup></p>	

## VI. SUMMARY AND CONCLUDING REMARKS

Mexico has achieved its position as a trade hub in the international and regional trade system. It is the only member of NAFTA to secure a free trade agreement with the EU. This privileged position makes Mexico a platform for utilizing tariff reductions for goods and service providers, thereby seeking to expand its market in services to both Europe and North America.

The process of modernizing Mexico started in the 1980s with President Miguel De La Madrid when the government announced that the country was joining the GATT, and continued when it joined the Mexico-U.S. Commercial Framework Agreement on Trade and Investment in November 1987 (predecessor to NAFTA). During the late 1980s, Mexico started to modify its commercial, civil, and property laws.

The liberalization of financial services in Mexico has occurred primarily in the last ten years. The total assets of foreign banks rose remarkably from 5 to 80 percent. Regulation of entry into the financial market of financial services has changed, diminishing entry barriers significantly. This liberalization has been achieved through three different steps. The

129. *Id.* at 7.

130. *Id.* at 5.

131. Stephenson, *supra* note 5, at 200, *see also* NAFTA, *supra* note 22, Annex VII, Schedule of Mexico; *Schedule of Commitments*, *supra* note 109, at 1.

132. MEFTA TRADE IN SERVICES AGREEMENT, *supra* note 79.

first occurred when NAFTA came into force, and the second occurred when the Mexican Congress approved legislative reforms in the financial sector in February 1995. The transitional implementation once projected by NAFTA changed when the financial system collapsed in the end of 1994. The third step occurred in 1999 when Congress approved a provision allowing foreign economic agents to own 100 percent of the capital stock of Mexican banks. Since then, foreign institutions have been merging with and buying domestic banks. These include Citibank, HSBC, and Banco Bilbao Viscaya. Although it could be argued that the Mexican financial system is now controlled by foreign investors, it should be said as well that it has achieved the main benefits of trade liberalization in financial services: namely, more competition, efficiency, and productivity, and better financial intermediation. However, there are still some points that need to be improved, such as the collection of bad loans and the low level of credit to the private sector for individuals and small- and medium-sized enterprises.

Regarding NAFTA, Mexico's exports and trade have tripled since 1994, with Mexico replacing Japan as the second largest supplier of goods and services to the United States. Thus, NAFTA has succeeded in stimulating trade and investment for Mexico. However, in the services sector, the United States, Canada, and the EU (with MEFTA) will clearly benefit more than Mexico. This is due to their *net-exporter* nature of services, specifically in regard to financial services. European banks and insurance companies are authorized to establish and operate directly on Mexican territory like their U.S. and Canadian counterparts. Because Mexico is not a *net-exporter* in financial services, this potential market will not be able to be exploited (in the short or medium term) like the market in industrial products and manufacturing.

Although there is a lack of clarity with respect to how far or to what extent RTAs have to exceed GATS, it should be stated that with respect to the liberalization of financial services, NAFTA and MEFTA have generally gone beyond the multilateral rules in services (as has been shown in the table in the preceding section of this paper). NAFTA and MEFTA have gone beyond GATS in this sector because they are economic integration agreements which meet the relevant tests of GATS article V. Those tests include: (1) covering of substantially all sub-sectors (no mode of supply is *a priori* excluded from coverage); (2) providing for absence or elimination of any discrimination between or among the parties in the covered sub-sectors, through gradual elimination of existing discriminatory measures (for example, three years in financial services in accordance to article 17 of MEFTA Trade Agreement in Service) or providing new or more discriminatory measures at the entry into force of the agreement or within a reasonable time frame (although, as a result of the legislative reforms on financial services in 1999, many sub sectors were already open); and (3) not raising (nor lead to the raising of) the overall level of barriers to the trade in services on non-parties Members of the

WTO in the covered sectors and sub sectors. Moreover, equality of treatment of the services suppliers of other WTO Members established within the territory of any of the parties to the Agreements will not be affected (according to articles V:4 and V:6 of the GATS) .

In NAFTA and MEFTA, the percentage of foreign participation in financial services is notoriously higher than GATS, and the effective control of investment enterprises is not required to be by Mexicans shareholders, as in GATS.<sup>133</sup> Furthermore, in NAFTA and MEFTA, National Treatment and Most Favoured Nation are unconditional principles, whereas in GATS, National Treatment is not a general obligation, but rather the result of specific commitments subject to numerous exceptions.

A similarity between the three agreements is that all contain a “prudential carve out” to ensure that the liberalization does not risk supervision and prudential regulation. Also, in NAFTA and MEFTA, the services liberalization has been easier to achieve because there are a limited number of participants with similar objectives. However, it is worth mentioning that neither GATS, MEFTA, nor NAFTA guarantee cross-border trade for financial services,<sup>134</sup> as Paragraph 13 of Annex VII of NAFTA clearly shows,<sup>135</sup> where there are ambiguous reservations regarding the establishment of commercial banks. Consequently, Mexican authorities could use enormous discretion, affecting the freedom of establishment to other NAFTA parties.<sup>136</sup>

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133. Stephenson, *supra* note 5, at 199.

134. *Id.*

135. Paragraph 13 of Section B of Annex VII: Reservations, Specific Commitments and Other Items, states:

Following the transition period, acquisition of a commercial bank established in Mexico, or of the assets or liabilities thereof, by an investor of another Party will only be authorised by Mexico, *subject to reasonable prudential considerations on a case-by-case basis*, if the sum of the capital of the acquired commercial bank and the capital of any foreign commercial bank affiliate already controlled by the acquiror would exceed four percent of the aggregate capital of all commercial banks in Mexico.”

NAFTA, *supra* note 22, Annex VII, Schedule of Mexico § B(13), 32 I.L.M. at 774 (emphasis added).

136. The Ministry of Finance has the power to plan, co-ordinate, evaluate and supervise the country’s banking system. It’s a fact that “discretionary power constitutes an exceptional situation to the principle of law by which the administrative authority applies or does not apply the general rule established in a legal provision.” In the case of Mexico when the Authority grants the concession of a bank or any financial service provider it is based in its discretionary power. See G. Reyes, *Rules and Discretionary Power in Relation to Troubled Banks: Case Studies: Mexico, in THE REFORM OF LATIN AMERICAN BANKING SYSTEMS: NATIONAL AND INTERNATIONAL PERSPECTIVES* 153 (Ernesto Aguirre and Joseph Norton eds., 2000).





# **Draft Codes**

