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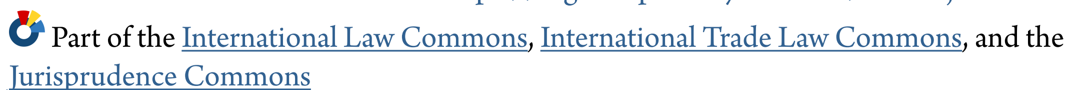
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NAFTA AND THE REGULATION OF FINANCIAL AND OTHER SERVICES

LINDA POWERS*

I. INTRODUCTION

This discussion will be an overview with a few selected highlights of some of the key issues and key areas of new business in the service sectors which are being opened up by the North American Free Trade Agreement ("NAFTA").[1] The service sectors are highly regulated sectors and trade negotiations in those sectors are subject to many complex regulatory provisions.

I will comment on the following questions: What is NAFTA? What is it doing? What is it not doing? I will then comment on the architecture of the Agreement so that you can find the specific provisions of interest to you or your clients. I will then describe a couple of the key service sector areas and where we are in the process. I will also suggest a few things you might want to watch that will be ongoing.

Why did we put such an effort into and give such a priority to NAFTA? The General Agreement on Tariffs and Trade ("GATT")[2] is important, but NAFTA is of special importance. The American economy has become much more export dependent than most people realize. We have not had great economic growth in recent years, but seventy percent of that growth has come from exports. Canada is our single largest export market. Mexico is our third largest export market, after Japan. On manufactured exports, Mexico has recently moved into second place.

Not only is Mexico number three (or number two for manufactured goods) in volume, it is also our fastest growing market. Mexico today has about 80,000,000 consumers. They are expected to have 100,000,000 by the turn of the century and they are already today, even with lower income levels, buying more per capita from us than Europe is buying.

NAFTA is important for several reasons. From a business perspective, one of the key factors in structuring business operations is rationalizing

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1. Oct. 7, 1992 draft, U.S.-Can.-Mex. [hereinafter NAFTA].

2. Apr. 10, 1947, 55 U.N.T.S. 194, *reprinted in* BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 3 (Stephen Zamora & Ronald A. Grand eds., 1990).

operations. From a U.S. government perspective, rationalizing is a way to contribute as much benefit to the U.S. economy as possible. We have realized that rational business decisions mean that some business operations need to move offshore. It is far better that they move offshore to Mexico than that they go to Asia, which is where they have been primarily moving, because operations in Mexico use a higher percentage input of U.S. parts and components. Thus, the U.S. economy retains vastly more benefit from the rationalized operation if business operations move to Mexico rather than to Asia.

Also, immigration pressures are important. We all know what kind of social costs and difficult decisions the United States is facing in this area. Immigration pressures are an undeniable reality. The more that we can do to help economic growth in Mexico, the more we can relieve those pressures in the United States.

II. WHAT IS NAFTA?

NAFTA is a free trade area only; it is not a common market. We are not aiming to develop the full spectrum of common internal policies that the European Community has developed, such as a common company law, a common social policy, a labor policy, and an agricultural policy. We are not aiming for common policies, just a free trade area.

While GATT appears to be a trading block, NAFTA is not. It is not a trading block for several reasons. One is because we would like to see NAFTA gradually extend to as many participants as possible. It has already been announced that every other country in this hemisphere, when it reaches the same level of growth and adopts trade policies similar to Mexico, is welcome to join. The rationale is that if we can extend beyond a regional level, so much the better. Frankly, if all one hundred countries in the GATT process were ready to participate in such a deal today, we would be thrilled. So, it is not an exclusive club; it has no common external policies. We are not developing common tariffs externally, vis-a-vis, non-NAFTA countries.

III. ARCHITECTURE OF THE AGREEMENT

All of you who are thinking of doing work on NAFTA will be delighted to know that the document runs 1000 pages for the text and annexes, and another 900 pages for the tariff schedules. That will take thousands of hours to go through. You can be assured that your clients will not do it. If you want to amaze and impress your friends on the cocktail circuit or dazzle your client without billing thousands of hours, the one document that you want to get is the summary prepared by the three NAFTA countries.[3] This is a descriptive document, not a legally operative

3. Description of the Proposed North American Free Trade Agreement (Aug. 12, 1992) (prepared by the governments of Canada, Mexico, and the United States, on file with the *New Mexico Law Review*).

document. It gives a summary of NAFTA, chapter by chapter. It is about seventy-five pages long, and every word was negotiated by the three countries. And, as it says, it was "prepared by the governments of" with heavy involvement from the lawyers of each country. There is enough detail in here that you can sound like an expert, but it is written in plain English, only seventy-five pages long.

The architecture of NAFTA is as follows. The Investment Chapter, Chapter 11, applies to all sectors across the board. It involves all goods and services, except financial services. The other two chapters dealing with service industries are the Cross-Border Trade in Services, Chapter 12, and Financial Services, Chapter 14. To determine which chapter has the relevant provisions, you must determine how the business proposes to enter the Mexican market. This may be done by means of setting up an establishment or by cross-border transactions from their operations in the United States. Thus, an American business may establish a Mexican subsidiary or a representative office, send the goods across the border, or send their service personnel across the border to provide the service.

The Investment Chapter discusses market access by means of an establishment for all services other than financial services as well as goods. The Financial Services Chapter, Chapter 14, is self-contained; it contains both investment provisions and cross-border provisions for financial services. The principles of the Investment Chapter use the same building blocks as in any trade agreement, whether bilateral or under GATT. The market access provision concerns the right to establish a presence.[4] The national treatment provision provides that if you do go to Mexico, you get treated the same as Mexicans.[5] A transparency provision states that you are entitled to know what the rules are that apply to you and you are entitled to get timely administrative assistance.[6] A temporary entry provision allows senior managers to go in.[7] A rule of origin section identifies which service companies are eligible for these benefits.[8] There is also a dispute resolution provision.[9]

The thrust of the Investment Chapter, is that you must be allowed to set up a presence if you want to. The thrust of Chapter 12 on Cross-Border Trade in Services is that you cannot be required to establish a presence in order to do business in a country if you do not want to. The combined concept is that the choice should be a business decision, unimpeded by barriers or rules that put artificial distortions into the decisionmaking process. The business should make a free decision about whether it goes the establishment route or the cross-border route. That same principle is in the Financial Services Chapter.

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4. NAFTA, *supra* note 1, art. 1101.
5. *Id.* art. 1102.
6. *Id.* art. 1411.
7. *Id.* art. 1603.
8. *Id.* annex 1603.
9. *Id.* arts. 1115-36.

There are a couple of differences in the principles applied in the general Investment Chapter and those applied in the Financial Services Chapter. The reason is that, although we have had international trade rules on goods for decades, there have not been binding international multilateral rules on service trade before now. GATT only covers goods. Even when a principle is long established, like national treatment, the development of a body of precedents through a body of dispute resolution cases in the services context will be necessary.

Under the national treatment principle, the standard is treatment no less favorable than that accorded a domestic person in like circumstances.[10] In a service business which is highly regulated, there inevitably will be many kinds of small differences in treatment. It will need to be sorted out which of those are significant and amount to a denial of comparable treatment and which of them do not. In the Financial Services Chapter, the formulation of the standard is spelled out as equality of competitive opportunity.[11] NAFTA considers national treatment in a de facto way, even if the black letter rules are identical. The important issue is whether there is equality of competitive position or not. As lawyers, you can predict plenty of work needs to be done to explain what that principle is going to mean.

Another aspect of national treatment is how this principle applies in a country like the United States, which is a federal structure and has differing rules at the state level. Under the Investment Chapter, national treatment applies generally, and under the Financial Services Chapter, the national treatment principle applies to what we call subnational units, such as states and localities. There is a different standard in the Investment Chapter than in the Financial Services Chapter. In the Investment Chapter, the standard for the state level is most favored state treatment.[12] Whatever the best treatment any given state in the United States gives to any party in the United States is what the Mexican/Canadian parties are entitled to as well. In the financial services context, it is a home state rule.[13] When a financial firm from either Mexico or Canada comes into a given state, they take on the character of a firm from that state. So, if they go to the state next door and the state next door treats its own resident firms better than people from all of the other forty-nine states, that Mexican or Canadian financial firm still gets the same treatment as its home state. There frequently is a distinction drawn between a state's treatment of its own residents versus people from other states or outside the country. The demarcation becomes one between residents of that state versus persons from anywhere else. Thus, there are two different standards in the two different chapters.

Another difference between the two chapters is the standard on the rules of origin. Which service firms are entitled to benefit from these?

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10. *Id.* art. 1102.
11. *Id.* art. 1405.
12. *Id.* art. 1102(3).
13. *Id.* art. 1405(4).

There are two options for standards. The nationality of a service firm can be judged based upon where it is incorporated, or alternatively on the basis of its ultimate parentage. For example, consider the Deutsche Bank USA; is it a U.S. bank or a German bank? Under the place of incorporation standard, it is a U.S. bank, entitled to all of the benefits of NAFTA. Under the ultimate parentage test, it is a German bank, not entitled to any of the benefits of NAFTA.

In the general services chapter, Cross-Border Trade in Services (Chapter 12), the standard selected is the place of incorporation.[14] The United States considers this appropriate because we want subsidiaries of U.S. firms in Europe to be treated the same as if they were indigenous European firms. This is in our bilateral investment treaties. Unfortunately, in the Financial Services Chapter, we were unable to get Canada to agree with that. Canada insisted on an ultimate parentage test. Thus, in the Financial Services Chapter, each of the three countries will select which standard it is going to use.[15] The United States and Mexico will still use the place of incorporation standard; thus, it will only be Canada which will use the ultimate parentage test.

IV. OTHER AREAS OF PARTICULAR ECONOMIC SIGNIFICANCE

A. *Financial Services*

Today, the Mexican market is fairly closed and very underdeveloped. U.S. financial firms cannot set up their own operations and they can only invest up to thirty percent in a Mexican operation as shareholders. The opportunities are very limited now, but the financial market in Mexico is expected to grow tremendously over the coming decade. Commercial and consumer finance are expected to experience explosive growth. The trade flows between the United States and Mexico, which have nearly quadrupled since 1986, will continue to grow. Therefore, the whole range of financial services will grow. Insurance coverage will also grow. Only one in five Mexican persons has any insurance on their automobiles. Only half of the Mexican population has any pension coverage. It is a completely undeveloped market and the incomes are rising quickly enough that there will be tremendous opportunity in this area.

NAFTA will open up all of these financial sectors over a relatively short transition period of six years. In banking and securities, the phase-in of this market access will be done by gradually phasing in the amount of market share that was allowed to U.S. and Canadian enterprises. The six year period I am anticipating begins January 1, 1994.

In the case of insurance, the phase in will be even faster. Majority ownership will be permitted by 1998. A whole new category of financial

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14. *Id.* art. 1213(2).
15. *Id.* art. 1416.

firms will be created in Mexico through their implementing legislation. They do not today have any of the commercial or consumer finance companies that do such huge business in the United States. As part of this deal, there will be tremendous opportunity in this area.

B. Telecommunications

Telecommunications[16] is a fantastic market which is expected to grow fifty percent a year in the coming years. It is already growing at the rate of fifty percent a year in Mexico. Telecommunications can be divided into several categories. There is basic telecommunications, such as the basic telephone service. These are the public networks. Then there is the enhanced or value-added telecommunications services, on-line data services, voice mail, electronic mail, and intra-corporate communication networks.

NAFTA does not open up the basic telecommunications services to foreign investment, but this is not what American companies are interested in anyway. That is not where the business opportunity lies. For basic telecommunication, the Agreement will ensure that U.S. telecommunications firms get access to and use of those public voice telephone networks at a reasonable cost and on a non-discriminatory basis. Such access is necessary to provide voice mail and electronic mail. If you get the access to use, you get the right to start providing all of the value-added services. In addition, there are disciplines put on the monopoly in Mexico on the basic telephone service to separate the basic telephone service activity from any enhanced telecommunications service activity that will be competing with the U.S. and Canadian firms. The purpose is to eliminate any cross-subsidization. On intracorporate communications, companies will have the ability to operate their own internal intracorporate networks, which they cannot do today. Today, these networks have to be operated for them by a local company. Lastly, firms will have the right to connect up to the public network system whatever kind of equipment they wish. The only remaining requirement will be that the equipment cannot do harm to the network.

C. Land Transport

Annex 1212 of NAFTA deals with land transportation. Trucking is very important, especially in a state like Texas. That is going to phase in fairly quickly over a couple of years also.

V. APPROVAL PROCESS

In the United States, the text of NAFTA has been given to Congress. This is the same semi-final text that came out to the public. We have taken the first critical, legally operative step of the congressional approval process. We have recently sent the formal notification to Congress of

16. *See id.* ch. 13.

our intent to sign the Agreement. That notification of intent to sign started the running of a ninety day calendar period, during which time Congress gets to read this 1000 page agreement to look for major problems. Congress should not have major problems because we have been consulting with them every step of the way. But if they do, we will see if anything can be done about it. At the end of that ninety day period, which is December 17, 1992, we will sign. At that point, when the three countries have signed, that agreement is locked in stone regardless of what administration is in office. Then the implementing legislation will be drafted. It must go to Congress by the spring of 1993, being delivered before the expiration of fast-track authority on midnight of May 31, 1993. Then Congress has a ninety day legislative period, which starts running when we submit the implementing legislation to them for a vote.

COMMENTS ON FINANCIAL SERVICES, OTHER SERVICES, AND TEMPORARY ENTRY RULES

THOMAS HEATHER*

I will attempt to give a brief review of the current Mexican banking industry, and its preparations regarding the North American Free Trade Agreement ("NAFTA").[1] The bottom line is that NAFTA will bring increased competition to the industry.

The 1980s was an exceptional decade for Mexico. Although some call it the "Lost Decade" in terms of economic growth, it was certainly not lost in terms of very necessary economic reform. Mexico outlived an economic model based upon three concepts; namely, public sector spending as the basic promoter of growth, a protected inward-looking industry, and a surprising lack of adaptability to growing external circumstances. This economic model culminated with the September 1982 nationalization of Mexico's commercial banks.

It was time to introduce a new order in the economy through fiscal discipline, a structural opening, a restructuring and debt reduction exercise of Mexico's public sector indebtedness, and a redefinition of the state's role in the economy. The results have been very positive. There has been a very substantial reduction of the public sector deficit, from almost 17% of gross domestic product ("GDP") in 1982 to 1.5% in 1991. In 1992, Mexico is expecting a budget surplus for the first time in modern history. This surplus excludes total income from the privatization process. There has been a dramatic decrease of total public sector indebtedness, from approximately 121% of GDP in 1982 to an expected 40% this year. Inflation has been curbed from a high of almost 160% to a low of 10% this year.

The administration has a very clear agenda as to its priority of reducing inflation in order to achieve a stable economy and constant growth and thus become competitive with the American and Canadian economies. Mexico has had real sustained economic growth averaging 3.8% for the last three years, and although the projections of 5.5% for this year have been adjusted, there is a basis to expect a reasonably healthy 3% growth. There has been a unilateral opening of the economy through liberalization of trade and investment. Current account deficits were more than balanced with the inflow of capital, both from capital repatriation by Mexicans averaging at four billion dollars for the past eighteen months, and from foreign investment. This has led to an accumulation of foreign reserves of approximately eighteen billion dollars.

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1. Oct. 7, 1992 draft, U.S.-Can.-Mex.

Part of Mexico's overall strategy has been to redefine the government's role in the economy through deregulation and deprivatization. In 1982, Mexico had 1,155 state owned enterprises; today it has approximately 220, with the number continuing to decrease. The banking industry witnessed major adjustments. The number of banks was reduced from sixty-eight to eighteen. More importantly, all of Mexico's commercial banks are now the responsibility of the private sector. Obviously, when you have a selling process that brought the government proceeds of more than $12.2 billion and investors paying on the average four times book value, the new bankers feel they are entitled to some protection before the sector is opened under NAFTA. I believe, however, that attitudes are now moving toward embracing more and better competition, and that the banking laws have been modified to address this changing environment.

The concept of financial groups or universal banking based upon the European model was adopted only two years ago. Thus, the Mexican government allows diverse financial services activities to be conducted under a common financial services holding company. Foreign investment was allowed basically on the same basis as was available to Mexicans. In 1991, the government promulgated new capitalization rules, conforming to those recommended under the Basle Committee on Banking Regulation and Supervisory Practices.[2] The net capital, as a percentage of risk-weighted assets, must reach eight percent by January 1, 1993.

There has been a deregulation of former mandatory reserve requirements and liquidity coefficients and restrictions on interest rates, due mainly to the tremendous reduction in the government's demand for credit. There has also been movement in the quarterly loan portfolio classifications of the banks. There are five risk-level categories, and reclassification of at least eighty percent of each bank's loan portfolio is required every three months. Under current guidelines, by January 1, 1993, all banks must have their loan portfolio appropriately reserved.

It is also important to mention a redefinition of the central bank's role as enforcer of these provisions. The central bank is strictly applying capital adequacy and loan loss reserve standards, and exceptions generally are not allowed. The hope is to produce a very strong capitalized financial system to meet growing competition.

With NAFTA on the horizon, Mexican banks are defining new strategies. Alliances are being pursued, which include equity investments by foreign banks. There has already been Canadian and Spanish investment in Mexican banks. Eight of the Mexican financial groups have established broker-dealers in New York, California, and Texas under their investment banks. Two of the Mexican banks have wholly-owned subsidiaries that operate banks in the United States, and nine have New York agencies or branches. It has also been reported in *El Financiero*, that Boncomer,

2. Ministry of Finance and Public Credit, Directive of May 20, 1991.

S.A. is also apparently considering taking initial steps to establish fifty locations in four American states by 1995.

Credit card and mortgage loans, absent during the 1980s, have also boomed. The year 1991 showed an increase of 130% over 1990. The first nine months of 1992 show an even greater increase. It is true, however, that the Mexican private sector continues to be generally underdeveloped and under-banked with respect to its financial requirements. NAFTA will result in increased economic activity and in greater demand for financial services, all within a context of greater competition. Competition has been increasing every year. Mexican banks have been competing not only with each other, but also with American and European institutions, in the corporate market, in advisory services, in government finance, and in high net worth individual banking.

The recent rules enacted by the central bank to curb monetary growth by requiring limitation of funding in dollars for Mexican banks will foster even more competition in light of the high Mexican peso rate of borrowing. Through September of 1992 alone, the Mexican private and public sectors have floated six billion dollars' worth of debt issues. Prior to the Mexican stock market decline or adjustment of this summer, there were seven billion dollars worth of equity issues placed through multi-jurisdictional offerings. The main advisory work for these offerings was performed by American firms.

Mexican bankers are obviously aware of this competition, but in general there is a feeling that the extensive branch networks of the Mexican banks, the stronger capital base, the knowledge of specific industry and geographic diversification of customers and services, together with substantial investment in technology, will give them a competitive edge.

In sum, NAFTA will produce more competition in the banking industry, which will benefit both the consumer and the economy. Just a few years ago, the underlying philosophy was that because we were Mexican we had a right to our place in business. Today we have to earn our place in business. NAFTA will define the rules for continued orderly competition and development. America and Mexico must keep in mind that not only are their economies intertwined, but that they share a common border of more than 3,000 kilometers. They may also be concerned with the economic well-being of Eastern Europe, Taiwan, and South America, but it is an unavoidable fact that they must work together and give substantial attention to their own economic and political relationship.

COMMENTS ON THE REGULATION OF FINANCIAL AND LEGAL SERVICES IN MEXICO UNDER NAFTA

STEPHEN T. ZAMORA*

September 1, 1992, passed without any observance of the ten-year anniversary of the expropriation of the banks in Mexico. On September 1, 1982, President José López Portillo nationalized the banks in Mexico and imposed a system of strict exchange controls.[1] This dark period in Mexican financial history has been all but ignored in the wave of enthusiasm surrounding NAFTA. Ten years later, the government has sold the same banks back to the Mexican private sector, at a total sale price of 124 billion dollars. There are no longer any exchange controls to speak of between the two countries, other than those imposed by the United States on currency transactions.[2] These liberalizations do not negate the fact that Mexican domestic financial markets have developed in an autarchical fashion, notwithstanding the linkages that Mexican banks may have to the outside world via credit arrangements.

The prospect of increased integration of financial services under NAFTA must be considered against a background of severe restrictions against foreign bank operations in Mexico. The partial opening of Mexican financial markets to foreign financial institutions is a welcome development, but the Financial Services Chapter of NAFTA contains numerous qualifications, and a staged process of liberalization,[3] that demonstrate the concern of the Mexican government in proceeding cautiously in this area. Because the financial system lies at the heart of all economic activity, this caution is well deserved.

Increased financial integration between Mexico, the United States, and Canada brings together three disparate banking systems. In many respects, the United States and Mexico could not be more dissimilar when it comes to their banking systems. The United States has 12,000 banks; Mexico has, eighteen. Mexico has a highly concentrated banking environment, in which the largest six banks control a majority of the assets and deposits of the banking system. The U.S. banking system is splintered by the McFadden Act[4] and other federal laws and regulations.

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1. *See generally* Stephen T. Zamora, *Peso Dollar Economics and the Imposition of Foreign Exchange Controls in Mexico*, 32 AM. J. COMP. L. 99 (1985).

2. *See* Currency Transactions Reporting Act, 31 U.S.C.A. §§ 5311-26 (1992) (adopted as part of the Bank Secrecy Act, 12 U.S.C. § 1829(b) (1988)).

3. *See* North American Free Trade Agreement, Oct. 7, 1992 draft, U.S.-Can.-Mex., annex VII [hereinafter NAFTA] (schedule of Mexico).

4. 12 U.S.C. § 24 (1988).

Another difference between the American and Mexican financial systems has to do with the role of financial intermediation.[5] The United States is a country of debtors, with numerous credit-providing institutions aggressively seeking to extend many varieties of credit to those debtors, both for business and for personal use. Mexico, on the other hand, is a country of concentrated capital in which consumer and business credit is expensive and at times hard to get. As a result, Mexican owned corporations—even the largest corporations—tend to be controlled by small groups of families and individuals. In Mexico, if you want to start a computer company in your garage, it has been more difficult than in the United States to raise venture capital. The banks may have money to lend, but interest rates are expensive and a great deal of credit is earmarked for public sector financing and for major corporations.

Because of these differences, Mexico represents an attractive market for U.S. banks. Increased entry into Mexican financial markets will not occur without difficulties, however. Mexican laws regulating banking and securities differ from U.S. regulations. Certain types of sophisticated credit arrangements are not available under Mexican law.[6] The principal effect of NAFTA on the financial system of Mexico may have more to do with creating a climate for legal reform of domestic laws, in order to "modernize" Mexican banking, than with the entry of relatively few foreign financial institutions.

I would also like to make a more general comment about financial services in NAFTA. Trade in services is not like trade in goods. To provide a level trading field in goods, all you have to do is reduce tariffs, eliminate quotas, and enforce rules of origin and protections against non-tariff barriers. Once imported goods enter the country, they take on a "domestic" character—that is, they mingle with domestically produced goods and conform to whatever laws may apply to their use. In the case of services, on the other hand, we are talking about a more intrusive entry into the domestic legal environment. The introduction of foreign-owned or foreign-managed services implies continuing activities that take place within the domestic legal system of the host country, a legal system created primarily to deal with local rather than international concerns. This may mean greater pressure on changes in the domestic legal system, as the foreign entity pushes for harmonization of host country laws to conform to the foreign investor's home regulatory environment. Thus, the request for a "level playing field" involves more than just ease of entry; it also has to do with the fairness of continuing application of host country laws that may never have been designed with foreign participants in mind.

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5. Financial intermediation by banks has been much less important in Mexico than in the United States. U.S. bank deposits represent about 55% or 60% of gross national product ("GNP"), a clear demonstration of the importance of banks in our economy. In Mexico, bank deposits are about half the U.S. figure—only 30% of GNP.

6. For a discussion of the need for reform of commercial laws that affect banking in Mexico, see John Rogers, *Mexican Corporate Banking in a North American Market*, 9 MEX. TRADE & L. REP. 9 (1992).

Some of the restrictions on entry of foreign banks in Mexico under NAFTA deserve particular mention. For instance, from the time NAFTA takes effect, foreign banks will be allowed to establish subsidiaries in Mexico, as long as the total capital of all of those subsidiaries does not exceed eight percent of the total capital of all Mexican commercial banks, and the individual capital of any one bank does not exceed 1.5% of the total capital of Mexican banks.[7] I have heard U.S. bankers in Mexico express some concern that this limitation may create problems due to the capital limitation. Banks interested in the Mexican market will try to establish banks at the highest (1.5%) level, in order to support their commercial lending programs in Mexico. Suppose ten American and Canadian banks apply for subsidiary status, each at the maximum level. Because of the eight percent total market limitation, the government would be forced to be selective in granting entry, because the entry of five banks would virtually fill the eight percent quota. NAFTA is silent on any criteria that might be used in such a process of selection. The banks that are closed out of the process are sure to complain.

American bankers have also complained that U.S. and Canadian banks will not be allowed to establish branches in Mexico, but may only do business through subsidiaries. The use of foreign branches is more economical, since capital and accounting costs can be reduced. The Mexican response is that U.S. and Canadian subsidiaries will be allowed to branch throughout Mexico (which allows nationwide branch banking), whereas Mexican banks are not allowed to branch across state lines in the United States, due to the limitations of the McFadden Act. Should the McFadden Act be abrogated in the future, it would be appropriate for the United States to ask Mexico to lift the ban on foreign bank branches. NAFTA, of course, establishes minimum levels of liberalization; Mexico can always liberalize restrictions to a greater extent than NAFTA requires.

Finally, I would point out that continued restrictions on trade in legal services, even after the entry into force of NAFTA, runs counter to the notion of market integration. Under NAFTA, all three NAFTA countries are to adopt rules to permit foreign legal consultants from NAFTA countries to operate in their territories,[8] and must eliminate citizenship restrictions on the granting of professional licenses.[9] Thus, U.S. lawyers can hope to practice as foreign legal consultants in Mexico, and may even be allowed to pursue Mexican law degrees in order to become practitioners of Mexican law.

American law firms have also been allowed to establish offices in Mexico, under foreign investment permits granted by the Ministry of Trade (Secretaría de Comercio y Fomento Industrial). To date, however, such permits have been granted only on the condition that the foreign

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7. *See* NAFTA, *supra* note 3, annex VII, schedule B, ¶¶ 2 & 5 (Schedule of Mexico).

8. *Id.* annex 1201.5(B).

9. *Id.* art. 1210(3). Article 1210(3) requires NAFTA parties to eliminate citizenship or permanent residency requirements for licensing or certification of professional service providers within two years after the entry into force of NAFTA.

law firm not attempt to employ lawyers who practice Mexican law. As a result, the few U.S. law firms in Mexico can only practice foreign law, and must refer all Mexican law questions to outside counsel. NAFTA leaves this rule intact, stating merely that "Mexico will adopt measures regarding the practice of foreign legal consultants in the territory of Mexico, including matters related to association with and hiring of lawyers licensed in Mexico."[10]

This is a serious limitation, because many law firms would prefer to establish offices in Mexico that can render the most efficient service possible. Many international transactions involve a simultaneous analysis of American, Mexican, and international laws and regulations. It is both arbitrary and inefficient to draw rigid lines to separate them, and to prohibit a law firm from hiring the best personnel possible—American or Mexican—to serve a client's needs. No such limitation exists, as far as I can tell, on the operations of U.S.-based accounting firms in Mexico. In short, lawyers are not willing to submit themselves to foreign competition in the same way that other sectors are being required to do. It is reasonable and necessary to adopt rules to protect the public from irresponsible or unprofessional practitioners of law, and the NAFTA governments are correct to control the provision of legal services to their citizens. Such protection, however, does not require undue restrictions that limit foreign competition.

10. *Id.* annex VI.

DISCUSSON OF THE REGULATION OF FINANCIAL SERVICES UNDER NAFTA

QUESTION: What do the provisions of NAFTA have to say about the licensing of attorneys? Specifically, what kind of licensing process is involved and how will it affect the recognition of credentials on both sides of the border?

ANSWER, *Ms. Powers*: I would break down the negotiations concerning legal services into three aspects. The first aspect concerns the rights of American lawyers to practice as foreign legal consultants in Mexico. The second concerns the right to practice as a fully admitted local lawyer advising on Mexican law as well as home country law. The third concerns partnership-affiliation type arrangements.

The key items to be accomplished in trade negotiations were the right to practice as a foreign legal consultant and the right to have partnership and affiliation arrangements with local lawyers, so that you can provide a "one-stop-shop" law firm in Mexico. I personally believe, and the input from the industry was consistent with this, that the issue of getting admitted as a Mexican lawyer was less of an issue. We tried very hard to get the partnership affiliations. I think that the provisions are fairly adequate to start off with, at least on the right to practice as foreign legal consultants. The United States has a dozen or so states that allow foreign legal consultants to be admitted and to practice in America.

Mexico will likewise allow foreign legal consultants to practice there. In neither country does this right cover the entire territory, but in both countries it covers all of the major markets; Mexico City, Los Angeles, etc. That part is not so bad. The first process will be to try to make those provisions better.

The second process is really the critical one. Mexico absolutely insisted that U.S. lawyers could not have the right to freely structure law firm arrangements in Mexico, that there had to be an equal number of Mexican partners as U.S. partners there, or that they had to have fifty percent or more of the equity in the firm. We could not get a satisfactory situation on that, so what we have is an on-going process. One year from now the parties, the government, and the negotiators will meet to negotiate again about forms of affiliation and partnership law firm arrangements. I am assuming that the American Bar Association will probably want to gear up in a big way and it may be possible to have input through that.

The third point concerns admission to practice Mexican law. Each country is maintaining the current situation, which is national treatment. To be admitted to practice American law, Mexican lawyers have to go through the same qualifications as U.S. lawyers and vice versa. In the annex on professional services there is a process set up to encourage

movement towards doing something similar to what the European Community has already done, which is mutual recognition of elements of your qualification requirements.

QUESTION: What are some of the other professional service changes that will be the result of NAFTA, for example accounting?

ANSWER, *Ms. Powers*: Accounting and engineering are the other major changes. Frankly, the accountants seem to be the best of all of the professions at developing consensus across borders. They have been very active with their counterpart organizations and they are moving towards mutual recognition of their qualifications. Similarly, a process has been set up in regard to engineers for the two countries to begin working out special arrangements for mutual recognition, in their case for temporary licenses.

QUESTION: What will be the impact of NAFTA on the newly privatized Mexican banks? Was it wise for Mexico to allow the inclusion of financial services in NAFTA?

ANSWER, *Mr. Heather*: As I mentioned before, the Mexican banks are now the responsibility of the private sector. I believe that in the recently concluded banking convention, which was in September of 1992, there were two clear indications. First, Mexican banks have to comply with the government guidelines issued by the Central Bank. Second, lowering inflation is the main target for the government for this year. The Mexican banks have been preparing themselves for competition. There are also issues as to capitalization—can they meet the capitalization rules? More money has to be poured into the banks even after the very substantial investments are made. All in all, I believe it was wise to include financial services. It is a fact of life that international capital markets are there and I think NAFTA will benefit the industry, the consumer, and the economy in general. The inclusion of financial services was a very necessary part of NAFTA.

ANSWER, *Mr. Zamora*: I also think it would be unfortunate to create a free trade agreement in goods without having agreements on something as important as financing, including trade financing, etc. But I do think, again, in moving Mexico from a closed system to a much more open system, the other partners in NAFTA need to be aware of the legitimate need within Mexico to provide a strong domestic banking system in and of itself, rather than to presume that we should simply be able to rush in because of the large size of our financial institutions.

ANSWER, *Ms. Powers*: Very briefly, I would like to say it was good for Mexico to include this both for its own interests and for American interests. Why for their own interest? Remember, it is not a situation of excess capacity in finance in Mexico; rather, it is a situation of a shortage of capacity that could very well become a bottleneck to their development. So yes, the newly privatized banks are going to grapple with the new competition. Mexico needs the additional finance capacity

which the banks will develop and, with technology, they will become more competitive. From a political standpoint, the American perspective is that if there were no financial services agreement, there would have been no NAFTA.

QUESTION: Does the telecommunications agreement foresee cable television as a value-added service for basic telecommunications?

ANSWER, *Ms. Powers*: That kind of mixes the issues. Basic telecom is voice telephone service. Cable television will be opened up under NAFTA for the first time for investment by American companies. It will be a big business opportunity.