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## **Liberation of Foreign Investment Policies in Mexico: Legal Changes Encouraging New Direct Foreign Investment**

Charles T. DuMars

*University of New Mexico - Main Campus*

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# LIBERALIZATION OF FOREIGN INVESTMENT POLICIES IN MEXICO: LEGAL CHANGES ENCOURAGING NEW DIRECT FOREIGN INVESTMENT

CHARLES T. DuMARS\*

## I. INTRODUCTION

The nations of Mexico and the United States are drawn together by numerous economic, political, and historical forces. While our common history as developing nations of the new world is significant and immigration policies are likewise critical, the most significant force pulling us together is our growing economic interdependence. This economic interdependence is reflected in the extensive changes over the past three years in Mexico's foreign investment laws. These changes cannot be understood in a vacuum. They make sense only in a historical context and with an understanding of the economic forces that have shaped them. This article begins by exploring Mexico's debt crisis and its current economic position in the world economy. This discussion is followed by a review of the history leading up to the current foreign investment laws. These laws are examined in detail, with particular emphasis on the Maquiladora program. This article also explores Mexican environmental and labor laws as they relate to the Maquiladora program.

## II. MEXICO'S ECONOMIC CRISIS AND ITS RESPONSES

Mexico's foreign debt problems can generally be traced back to the oil price increases of 1973-74 and 1979-80 when oil prices were forced to new heights by the Organization of Petroleum Exporting Countries ("OPEC"). The inflated prices generated large and unexpected trade surpluses for many countries which export oil. These countries typically handled the large surpluses by depositing substantial amounts of money in international banks. While Mexico was not among the countries who benefitted directly from the trade surpluses,<sup>1</sup> the international banks found developing countries with stable governments, like Mexico, to be attractive borrowers. During the period from 1970 to 1980, unfortunately, Mexico

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\* J.D., University of Arizona; Professor of Law, University of New Mexico School of Law; of Counsel, Sheehan, Sheehan & Stelzner, P.A., Albuquerque, New Mexico. The author wishes to extend special thanks to Madonna N. Bixby, Associate, Sutin, Thayer & Browne, Albuquerque, New Mexico, for her help in the preparation of this article.

1. See UNITED STATES INTERNATIONAL TRADE COMMISSION, REVIEW OF TRADE AND INVESTMENT LIBERALIZATION MEASURES BY MEXICO AND PROSPECTS FOR FUTURE UNITED STATES — MEXICAN RELATIONS 1-2 n.16 (1990) (Pub. 2275) [hereinafter REVIEW OF TRADE AND INVESTMENT]; JOINT ECONOMIC COMMITTEE, ECONOMIC REFORM IN MEXICO: IMPLICATIONS FOR THE UNITED STATES (1988) [hereinafter ECONOMIC REFORM IN MEXICO].

used most of its borrowed funds for purposes that were not conducive to economic development.<sup>2</sup>

President Portillo used much of this new revenue to create para-state industries<sup>3</sup> when the private sector would not step in to meet demands within the country. These industries were created not only to fill manufacturing voids, but also to stimulate local economies by creating employment in regions where the local economies needed help. The para-state industries were subsidized by money borrowed from other nations and from foreign, private sector banks. These foreign loans were guaranteed *sub silentio* by Mexico's anticipated future oil profits.

The increases in government spending during this period far outdistanced increases in Mexico's revenues. The Mexican government responded to the growing deficit largely through additional borrowing and monetary expansion.<sup>4</sup> Portillo's policies were brought to their knees by the typical calamities that befall nations that increase the money supply by placing borrowed capital into banks to stimulate growth or that use borrowed capital to subsidize state industries. The increased money supply, coupled with low interest rates, led to inflation. The inflation led to higher wages and more money in the pockets of Mexican citizens. The policy of artificially increasing the money supply and putting more pesos in the pockets of Mexicans created a disparity between the Mexican official value of the peso and the value of the peso on the international money market. Speculators in the international money market viewed the Mexican economy as weak and valued the peso very low. Mexico steadfastly refused to allow the peso to float and reflect its low international exchange rate.<sup>5</sup> Mexican citizens who had large amounts of pesos could simply go to the national bank, buy dollars with their pesos, and travel to the United States to spend them.

The international monetary community did not believe that this exchange rate imbalance could continue indefinitely and considered a devaluation of the peso to be inevitable. Mexicans who feared the devaluation of the peso converted their pesos into dollars and then redeposited them into banks in the United States. This capital flight from Mexico to the

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2. See UNITED STATES INTERNATIONAL TRADE COMMISSION, THE EFFECT OF DEVELOPING COUNTRY DEBT SERVICING PROBLEMS ON U.S. TRADE (1987) (Pub. 1950) [hereinafter THE EFFECT OF DEVELOPING COUNTRY DEBT SERVICING PROBLEMS].

3. Para-state industries are industries in which the government may have majority or minority ownership. Para-state entities may be organized as decentralized entities or trusts. The government also increased spending on subsidies and other aid to domestic industries, which accounted for 61% of all government spending in 1975. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 1-2. The result was an increase in the fiscal deficit from 2.2% of the gross domestic product in 1969 to 10.0% in 1975, and 17.2% in 1982. *Id.*

4. While this was a seemingly cavalier response to the growing deficit, it is likely that the Mexican government's actions were fed by expectations that oil revenues would increase dramatically in the future when new reservoirs discovered in the 1970's were developed. *Id.* Instead, oil prices declined, and the government's monetary expansion led to inflation and overvalued currency. These factors, in turn, caused balance of payments problems and capital flight in anticipation of peso devaluations. *Id.*

5. D.O., *Exchange Control Decree* (Dec. 13, 1982).

United States and other countries with a stable currency occurred at an alarming rate. In order to curb this capital flight and to protect the dollars that remained in the Mexican Federal Reserve Bank, President Lopez Portillo, just prior to leaving office in 1982, nationalized the banks<sup>6</sup> and imposed exchange controls.<sup>7</sup> This action left his successor, Miguel de La Madrid, the unhappy task of facing declining oil prices, an \$86 billion foreign debt, an exchange rate that was inconsistent with reality, and exchange controls on currency in a country with a 2,000 mile border adjoining a neighboring country where foreign currency was readily obtainable on the free market.

Conditions were worsened by the fact that the United States adopted very conservative fiscal policies which increased the value of the dollar. Because Mexican loans were denominated in dollars, the American fiscal policy had the effect of increasing the debt value of Mexican loans. A world recession further reduced demands for Mexican exports and limited Mexico's opportunity to acquire foreign currency. Also, other developing countries adopted conservative economic policies, which had the effect of increasing interest rates on Mexico's loans.<sup>8</sup>

President Madrid began to move away from the economic isolationism policies of previous administrations. He removed the Portillo exchange controls and established a three tier system for exchanging pesos at the Mexican banks designed to encourage capital investment and to gradually allow the peso to float. For the average Mexican citizen, allowing free market exchanges of pesos resulted in incredible devaluations. The peso dropped from a rate of 28 pesos to the dollar in 1981 to 2,850 pesos to the dollar in 1990.

Mexico was forced to admit it could not pay its foreign debts without additional loans. In August of 1982, Mexico announced that it could not make its scheduled debt payments and turned to the World Bank and the International Monetary Fund ("IMF") for short-term help.<sup>9</sup> The help was given, and Mexico experienced a brief improvement in its economy. By 1984, however, the debt had still risen to \$97 billion.<sup>10</sup> The additional banking help and the concessions that were made by creditors

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6. D.O., *Decree Nationalizing the Banks of Mexico* (Sept. 2, 1982).

7. *Id.* The Mexican peso trades under three exchange rates: (1) the controlled rate, which is set by the central bank and applies to most exports and imports, debt payments, and maquiladora expenditures; (2) the official free rate, which is determined by and applies to transactions of commercial banks; and (3) the private free rate, which is used for most other transactions. Since 1989, the peso has remained approximately equal to the two free rates, probably as a result of government devaluation of the peso at a rate of approximately one peso per dollar per day.

8. In addition to the expanding deficit, three other events in the early 1980's made it difficult for Mexico to repay its loans: (1) the worldwide recession, which reduced the demand for Mexico's exports; (2) the adoption of conservative monetary policies by many developed countries to stop inflation within their own systems, which had the financial effect of raising interest rates paid by Mexico without actually changing the rates; and (3) the substantial appreciation of the U.S. dollar, which effectively increased the value of Mexico's debts because most of Mexico's loans are denominated in U.S. dollars.

9. THE EFFECT OF DEVELOPING COUNTRY DEBT SERVICING PROBLEMS, *supra* note 2, at 21-23.

10. *Id.* at 23-26.

were given on the condition that Mexico make fundamental economic policy changes. These changes included promises from Mexico to reduce tariffs, liberalize laws restricting foreign investment, reduce public spending, reform the tax system, divest state-owned enterprises, and reform domestic price controls.<sup>11</sup> All of these measures made life even more difficult for the Mexican people.

In 1985, the IMF suspended its agreement with Mexico after the Mexican government increased spending and exceeded anticipated fiscal deficits. Mexico's economic problems were further compounded by the major earthquake in Mexico City in the fall of 1985 and by the dramatic decreases in export revenues when oil prices fell substantially in 1986.

Mexico again asked for help in 1986. The IMF, the World Bank, and commercial banks responded by entering into major new agreements with Mexico. In exchange, Mexico promised certain reforms in its economic policies, including reduction of trade restrictions and liberalization of foreign investment.<sup>12</sup> After Mexico began implementing the promised reforms and liberalizing its import trade regime, Mexico decided to reapply<sup>13</sup> for membership in the General Agreement on Tariffs and Trade ("GATT").<sup>14</sup>

Mexico's first significant act of modern trade reform was its entry into GATT, an international trade administrative body.<sup>15</sup> Membership in GATT involves appointment of a working body to review the application of accession and to submit recommendations to the GATT Council. A working body was appointed for Mexico in February of 1986, and by August of 1986, Mexico had become the 92nd Contracting Party in GATT.<sup>16</sup> Because Mexico was able to accede to GATT as a developing

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11. ECONOMIC REFORM IN MEXICO, *supra* note 1.

12. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 1-3 n.17.

13. In November of 1985, President Miguel de la Madrid announced formal actions to apply for membership in the General Agreement on Tariffs and Trade during the Tokyo Round. Application was made on January 16, 1979. D.O. (Nov. 25, 1985).

14. Among the rebuilding efforts following World War II was an attempt by the Western allies to charter the International Trade Organization ("ITO") to standardize international trade rules. The ITO failed to be ratified, but from it came an agreement to a more general set of commercial trade policies. This agreement became known as the General Agreement on Tariffs and Trade ("GATT"). It is not binding on its members, but it acts as a guideline for international trade practices.

15. GATT discussions reflected a realization by both developing and developed countries that the world trading system needed updating. This realization was generally a response to increased protectionism, greater use of nontariff trade barriers, and a worldwide economic slump. Mexico was both a new GATT member and a developing country at the time of these debates. It assumed a moderate role in the negotiations.

16. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-1. At that time, Mexico was the world's 13th largest economy and the largest market economy outside of GATT. Mexico had first tried to join GATT in 1979. President Lopez Portillo, perhaps bowing to political and economic pressures, announced in 1980 that Mexico would delay its entry into GATT. Sources of opposition were varied. The intellectual left feared that Mexico would lose its autonomy if it became a GATT member; CANACINTRA, an organization of small manufacturers, maintained that joining GATT would not improve employment or the distribution of wealth; labor unions felt that joining GATT would result in lost jobs. *Id.* In addition, increasing oil prices fueled the belief that the need to liberalize manufactured trade rather than continue import substitution should be postponed. *Id.* When oil prices fell in mid-1981, the Mexican economy collapsed, and Mexico began looking for long-term alternative solutions to its economic problems. *Id.*

country, it was entitled to the special treatment afforded developing countries.<sup>17</sup> Mexico was also allowed to continue to exercise sovereignty over its natural resources and to retain the priority status of its agricultural section in economic and social policies.<sup>18</sup>

As part of its contribution to GATT, Mexico agreed to: (1) bind its entire tariff schedule to a maximum level of fifty percent *ad valorem*; (2) limit surtaxes applied to general tariffs in nine sectors and reduce the surtax to zero in eight years; (3) conform to Article VII of the General Agreement in its customs valuation procedures and eliminate its official pricing system by December 1987; and (4) gradually eliminate its import permit requirements.<sup>19</sup> Mexico would not agree to eliminate its various additional charges on imports.<sup>20</sup>

Negotiations between the United States and Mexico culminated in a four part understanding reached in 1987. The "Framework of Principles and Procedures for Consultation Regarding Trade and Investment Relations" ("Bilateral Accord") was the first formal bilateral mechanism governing commercial relations between the two countries. The Bilateral Accord included four parts: (1) statement of principles; (2) consultive mechanism; (3) data exchange; and (4) Immediate Action Agenda. The most significant of these elements was the establishment of a means by which the two countries could consult and negotiate on trade issues, trade disputes, and trade barriers.<sup>21</sup> The Bilateral Accord also set into motion negotiations on the Immediate Action Agenda in the areas of textiles, agriculture, steel, electronics, products, investment matters, technology transfer (intellectual property rights protection), and service industries.<sup>22</sup> The Bilateral Accord is generally viewed as a turning point in improvement of the historically strained relations between the United States and Mexico.<sup>23</sup>

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17. GATT, PROTOCOL FOR THE ACCESSION OF MEXICO TO THE GENERAL AGREEMENT ON TARIFFS AND TRADE, in BASIC INSTRUMENTS AND SELECTED DOCUMENTS (1985-1986). REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-1. A developing country does not have to extend to a developed country reciprocity of a negotiated concession. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-1 n.7.

18. GATT, *supra* note 17, at 4.

19. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-2.

20. If these duties are still in effect by the end of December 1990, the contracting parties will review the matter. *Id.* at 2-2.

21. *Id.* at 2-3.

22. *Id.* at 2-3 to 2-4.

23. From January of 1988 through July of 1989, four consultations and three plenary sessions under the 1987 Bilateral Accord were held. Topics of discussion and negotiation included the United States' interest in loosening restrictions on the Mexican electronics sector to permit increased exports and foreign investment, the exchange of investment data, a discussion of Mexico's investment regulations relating to small business, improving Mexican patent and copyright laws, a discussion of agriculture, and review of Mexico's computer industry guidelines. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-4. Less formal dialogue was conducted in areas such as intellectual property rights, insurance, investment data exchange, motor carriers, and general policy cooperation and coordination. *Id.* In August of 1989, the United States Department of Agriculture and the Mexican Ministry of Agriculture and Water Resources agreed to create five binational technical groups to promote cooperation and aid commerce: (1) technical and administrative programs; (2) improvement of marketing; (3) inspection and research; (4) data collection; and (5) coordination of research programs. *Id.*

Two sectoral accords have been reached since the Bilateral Accord was signed in 1987. The first covered steel and alcoholic beverages.<sup>24</sup> The second, effective January 1, 1988, was the Textile Agreement.<sup>25</sup> The possibility of inclusion of services and intellectual property agreements in GATT received heated discussion. While the United States was a proponent of the inclusion of services<sup>26</sup> and sought protection for intellectual property, Mexico pushed for technology transfer concessions for developing countries.

Mexico also argued that the world economy should enhance the economic development of developing countries by: (1) recognizing that equal treatment among unequal partners cannot occur; (2) including labor intensive services and labor flows, preferential arrangements for developing countries, and procedures for speeding up transfers of technology to developing countries; and (3) recognizing that certain laws and regulations relating to the development interests of developing countries are not barriers to trade in services.<sup>27</sup>

On the intellectual property issue, developing countries argued for the importance of access to new technology to promote industrial development. Developing countries believed that rising costs connected with increased standards and enforcement measures relating to intellectual property would restrain their economic development. The developed countries' objections to inclusion of intellectual property was based on the belief that new technological innovations, such as computer software and pharmaceutical products, should be protected from piracy and imitation.<sup>28</sup>

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24. The United States agreed to a one time increase of 12.4% in Mexico's steel quotas, and Mexico agreed to restrict exports of finished steel during the period between 1985 and 1990. *Id.* at 2-5. Mexico agreed to: (1) limit exports of certain steel wire products which had not been subject to earlier restrictions; (2) eliminate import quotas and, as a new GATT member, eliminate all official steel reference prices as of December 1987; and (3) eliminate import quotas on certain products such as alcohol, flowers, and agricultural products, and lift annual quotas on imports of beer and wine. *Id.*

25. The Textile Agreement raised United States import quotas on Mexican textile and apparel products. Mexico was permitted to supplement textile exports to the United States by six percent each year for four subsequent years. In exchange, Mexico agreed to lower trade barriers to United States exports of yarns and white goods (*e.g.*, bleached cotton and linen fabrics) and phase out import license requirements for all garments and textiles (except for carpets, tapestries and used clothing). The Textile Agreement also imposed controls on Mexico's exports of cotton, wool, and manmade fiber textiles and apparel to the United States through 1991. *Id.*

26. On the services issue, developing countries feared that developed countries would demand unrequited concessions of the developing countries even before developed countries offered any concessions in the more traditional GATT areas of tariff reductions and market access. Developed countries also approved of the fact that the services issue raised the likelihood of increased movement of labor across borders. While developed countries agreed that greater freedom of movement for professional and skilled workers was required if GATT covered the services area, they disagreed with the developing countries' call for increased mobility because of a conflict with most immigration laws.

Among its various proposals relating to the inclusion of services, Mexico argued that any accord in services should generally aim to increase the production, productivity, employment, and service-related exports of developing countries.

27. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-9 n.79; UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, URUGUAY ROUND PAPERS ON SELECTED ISSUES 99-101 (1989).

28. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-9 n.67.

Mexico argued that intellectual property rights must be balanced against public and economic interests. It proposed special measures for developing countries, including shorter terms for patents, legal aid for countries to improve their intellectual property systems, and increased availability of financial resources so that developing countries could modify their current patent and trademark systems.<sup>29</sup> While it may seem unusual that developing countries are concerned about patent protection and intellectual property rules, these changes are important because the lack of protection of patents and intellectual property in these countries is a major deterrent to technology transfer.<sup>30</sup>

External pressures from membership in GATT, failure of short-term economic fixes to slow inflation, and rising interest rates forced Mexican interest groups to take cooperative actions to deal with the crisis. This cooperative action was reflected in the 1987 Economic Solidarity Pact ("Pact"). This Pact was an agreement among government, labor, business and other economic interests. Its purpose was to implement reforms and achieve economic policy objectives, and its major policy objective was to reduce the inflation rate.<sup>31</sup> To meet its objectives, the Pact called for price and wage freezes, reductions in spending and the public sector deficit, divestiture of many of Mexico's state-owned ventures, and relaxation of Mexico's restrictions on foreign investment.<sup>32</sup> The Pact, which was later renamed the Pact for Stability and Economic Growth, was scheduled to remain in effect through July of 1990.<sup>33</sup>

The Mexican government and private debtors also were able to retire some of the country's debt by engaging in debt-equity swaps. Under this arrangement, Mexico acquired several billion dollars of debt at a discount in exchange for pesos that were required to be invested in Mexico. These swaps allowed Mexico to buy back its own debt at a discount and obtain foreign investment at the same time. The investors also benefitted from the swaps because the discount they gave the government was smaller than the discount they received when they bought debt on the secondary debt market.<sup>34</sup>

Foreign debt decreased overall from \$107.4 billion in 1987 to \$96.3 billion in September of 1989.<sup>35</sup> During the period between 1987 and 1989, private sector debt decreased by almost \$10 billion.<sup>36</sup> These figures reflected

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29. *Id.* at 2-10.

30. The pirating of pharmaceuticals, computer software, cassette tapes, and other easily copied products has made foreign industry understandably reluctant to bring state-of-the-art technology to these countries if their research investment can be lost without any remedy in the host country.

31. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 1-3.

32. ECONOMIC REFORM IN MEXICO, *supra* note 1.

33. Mexico's economy has improved significantly since the country began making reforms under the Pact. Its inflation rate fell from almost 160% in early 1988 to less than 20% in 1989. The government's fiscal deficit decreased from 16.1% of the gross domestic product in 1987 to approximately 6.3% in 1989, and it is expected to decrease further in 1990. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 1-3.

34. *Id.* at 1-4.

35. *Id.*

36. *Id.*



investors' renewed confidence in the Mexican economy.<sup>37</sup> One major factor in this confidence was a new debt agreement, called the Brady Plan, which was negotiated in 1989. The Brady Plan allowed reductions in principal and interest and the granting of new loans to developing countries, which limited public sector spending, encouraged foreign investment, and minimized subsidies to domestic industries.<sup>38</sup>

Mexico reached a preliminary new debt agreement with its commercial creditors under the Brady Plan in July of 1989. The agreement gave banks three alternatives: (1) reduce the principal on outstanding Mexican loans by 35% with a rate of interest equal to the London Interbank Offer Rate ("LIBOR") plus 13/16% collateralized with U.S. Treasury Bonds; (2) reduce interest on outstanding loans to 6.25%, collateralized in the same manner; or (3) make new loans in the amount of 25% of the current debt with an interest rate equal to LIBOR plus 13/16%.<sup>39</sup> Maturity rates under the first two options were increased from twenty to thirty years, and the amortization period for new money under the third option was placed at fifteen years, with a seven year grace period.<sup>40</sup>

The reduction in the debt owed to banks approving the first two options was estimated by the Mexican government to be approximately \$14.75 billion, and banks made available \$1.5 billion in new loans under the third option between 1990 and 1992. In addition, Mexico estimated its external debt to be \$93.6 billion in the spring of 1990, representing a decline of \$2.7 billion since the fall of 1989.<sup>41</sup> While there was virtually no change in 1988, public sector debt fell almost \$1.7 billion, to \$78.3 billion, during the first quarter of 1989.<sup>42</sup>

During his October 3, 1989 visit to the United States, Mexican President Salinas and President Bush signed the "Understanding Between the Government of the United Mexican States and the Government of the United States of America Regarding Trade and Investment Facilitation Talks" ("TIFTs"). While building on the 1987 Bilateral Accord, the TIFTs also established a negotiating process for expanding trade and investment opportunities.<sup>43</sup> The TIFTs were a significant step in bilateral commercial relationships between the two countries because they: (1) provided for

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37. "Mexicans began to repatriate the assets they had sent abroad in the early and mid-1980's. The Government reported a return of over \$2.5 billion in private capital in 1989 alone." REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 1-4; see also SECRETARIAT DE HACIENDA Y CREDITO PUBLICO, THE RENEGOTIATION OF MEXICO'S EXTERNAL DEBT 20 (1990) [hereinafter HACIENDA].

38. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 1-4.

39. HACIENDA, *supra* note 37, at 10; AMERICAN EMBASSY, MEXICO, ECONOMIC TRENDS REPORT (Nov. 1989) [hereinafter ECONOMIC TRENDS REPORT].

40. HACIENDA, *supra* note 37, at 10. Creditor governments also agreed to reschedule \$2.6 billion of interest and principal payments scheduled to come due over the next three years. The International Monetary Fund made \$3.6 billion available to Mexico over three years. The World Bank agreed to three development loans and an energy sector loan totalling \$1.96 billion and to provide additional loans between 1990 and 1992. Japan agreed to lend Mexico \$2.05 billion. Spain agreed to provide \$4 billion to Mexico in credits and investment. ECONOMIC TRENDS REPORT, *supra* note 39.

41. HACIENDA, *supra* note 37, at 14.

42. AMERICAN EMBASSY, MEXICO, FOREIGN INVESTMENT CLIMATE REPORT 2 (June 1989).

43. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 2-6.

comprehensive trade and investment negotiations; (2) focused on specific products as well as cross-sectoral issues such as services, intellectual property rights, technology, and investment; (3) provided for binational, rather than separate, teams of government experts to gather, review, and analyze information before negotiations begin; and (4) established a timetable to guide talks through various stages.

### III. THE FOREIGN INVESTMENT LAW OF MEXICO - ORIGIN AND CURRENT TERMS

While numerous problems have been cited as root causes for the Mexican revolution of the early 1900's, scholars generally agree upon four primary causes. One cause was the explosive population growth of persons of Indian and Spanish heritage who were locked out of the political decisionmaking process by the dictatorship of Porfirio Diaz.<sup>44</sup> A second cause was the Diaz laissez faire economic policy of encouraging foreign investment by permitting major industries to exploit labor.<sup>45</sup> A third cause was the policy which allowed unlimited foreign ownership of real property and resulted in the removal of campesinos from the lands they had traditionally farmed.<sup>46</sup> A fourth cause was the perceived exploitation of the poor by the Catholic Church and its consistent alignment with the wealthy. This final cause is not germane to this article and is not discussed.

A new Mexican constitution was drafted in 1917 when the revolution ended. One of the major goals of the constitution was to prevent the recurrence of the social evils that lay at the heart of the revolution. Article 27 nationalized the water, mineral, and land resources in the name of the Mexican state and required states to obtain a permit for the use of these resources. It also created a restricted zone near the seacoast and the borders of the country where foreign ownership was prohibited. Article 123 made labor law constitutional law by establishing extensive rights for workers. The 1917 Constitution also contains the famous "Calvo Clause,"<sup>47</sup> which requires foreigners doing business in Mexico to waive their right to assert their status as foreigners as a defense to legal actions.

In the years following the revolution, Mexico began to function as a socialist country by allocating its resources and pursuing social justice through direct government intervention. In the late 1930's, President

44. R. HERGET & J. CAMIL, AN INTRODUCTION TO THE MEXICAN LEGAL SYSTEM 14-15 (1978).

45. *Id.* at 13.

46. *Id.*

47. CONSTITUCION POLITICA DE LOS ESTADOS UNIDOS MEXICANOS, art. 27, par. I (as amended January 6, 1960). The Calvo Clause is:

The doctrine stated by the Argentine jurist, Carlos Calvo, that a government is not bound to indemnify aliens for losses or injuries sustained by them in consequence of domestic disturbances or civil war, where the state is not at fault, and that therefore foreign states are not justified in intervening, by force or otherwise, to secure the settlement of claims of their citizens on account of such losses or injuries. Such intervention . . . is contrary to the principle of state sovereignty.

BLACK'S LAW DICTIONARY 186 (5th ed. 1979).

Lazaro Cardenas nationalized the American oil companies and created Petroleos Mexicanos ("PEMEX"), a state-owned and state-operated petroleum development company. President Cardenas was considered a national hero for standing up to the United States, and he continues to hold an important place in Mexico's history.

During World War II, Mexico increased its sales of goods in the world market, taking up the slack while other countries were running their industrial war machines. Even after the war, Mexico achieved steady growth. It boasted a stable currency and took great pride in its stable banking industry. Because of the stability of the Mexican economy, foreign investment in Mexico continued into the late forties and early fifties. While there was skepticism from the political left as to the propriety of allowing foreign investment, there was no outright hostility. It was not until the arrival of President Luis Escheverria in the early 1970's that there was a major policy shift condemning direct foreign investment. Mexico adopted a policy of import substitution to strengthen its industries by excluding imports and forcing Mexican citizens to purchase goods made in Mexico. According to theory, exclusion of imports would create a market demand within the country to which Mexican industries would respond.<sup>48</sup> The import substitution policy was accompanied by "The Law to Promote Mexican Investment and to Regulate Foreign Investment of 1973."<sup>49</sup> This law placed certain industries, such as petrochemicals and utilities, exclusively within the control of the state<sup>50</sup> and set a maximum of forty-nine percent or less equity ownership by foreigners in virtually all businesses in Mexico.<sup>51</sup>

This policy of "Mexicanization" of industries continued relatively unchanged until the early 1980's when a number of resolutions were passed which were designed to promote foreign investment and to attract the badly needed capital to pay off the extensive foreign debt. These resolutions included the February 17, 1984 guidelines promulgated by the Foreign Investment Commission. These guidelines were never published in the *Diario Oficial* and therefore were not changes in law. They did, however, suggest that majority foreign ownership in thirty-three selected activities falling within nine general areas was encouraged and that there was no need to "Mexicanize" (have fifty-one percent Mexican owned stock) after organization in these areas.<sup>52</sup> The resolutions of September 2, 1986 relaxed the majority ownership requirement in certain small and medium-sized firms, provided that foreign investors were willing to risk

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48. ECONOMIC REFORM IN MEXICO, *supra* note 1, at 5.

49. D.O., *The Law to Promote Mexican Investment and Regulate Foreign Investment* (Mar. 9, 1973).

50. *Id.* art. 4(a).

51. *Id.* art. 5(d).

52. The nine industrial areas of activities were: (1) manufacture of non-electric equipment and machinery; (2) manufacture of electric machinery and appliances; (3) the machine tools industry; (4) the electronics industry; (5) transportation equipment and materials; (6) the chemical industry; (7) other manufacturing industries (including medical and photographic equipment and new high technology materials); (8) biotechnology; and (9) the hotel industry.

their capital to obtain temporary, majority-like control, and provided this majority control was phased out over a ten year period.<sup>53</sup> Also, in 1986, there was an increase in permissible foreign participation in certain petrochemical industries.<sup>54</sup> On February 3, 1988, the Foreign Investment Commission streamlined its procedure for review of foreign investment applications and allowed acquisition of up to forty-nine percent of the equity interest of a firm without prior approval, as well as expansion of additional equity interests by existing investors without Foreign Investment Commission approval.<sup>55</sup>

The major Foreign Investment Law breakthrough came under the leadership of the current President of Mexico, Carlos Salinas de Gotari. These regulations are called "The Regulations of the Law to Promote Mexican Investment and Regulate Foreign Investment."<sup>56</sup> They repeal all existing regulations, resolutions, and decrees, but do not modify the law itself. The stated intent of the regulations is to increase the volume of investment capital and also to accelerate the flow of investment capital by simplifying and clarifying foreign investment procedures and providing secure and clear legal rules for investment.

The regulations contain a table of business activities that are regulated in varying degrees by the government of Mexico. These include: (1) activities exclusively carried out by the state; (2) activities exclusively for Mexican citizens; (3) activities limited to thirty-four, forty, and forty-nine percent foreign ownership; and (4) activities that have no percentage limit on foreign investor control (unclassified activities).

These regulations are complex and only the most significant provisions are discussed here. The areas of greatest interest to the foreign investor are the unclassified activities. In these activities, there is automatic approval of 100% foreign investment. The Foreign Investment Commission automatically approves up to 100% ownership in unclassified industries if the following conditions are met:

- (1) The investment in fixed assets during the preoperative period does not exceed the peso equivalent of 100 million dollars;
- (2) The project is funded with foreign capital;
- (3) The project, if industrial, is not in Mexico City, Guadalajara, or Monterey;
- (4) The project anticipates that accumulated foreign exchange flows will be, at a minimum, in balance over the first three years of the project;
- (5) The project anticipates creation of permanent jobs and establishes

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53. General Resolutions Nos. 14 and 15.

54. General Resolution No. 15, art. 1 §§ A(1), A(2).

55. For a list of the 36 basic petrochemicals that were reclassified as secondary and the remaining 34 basic petrochemicals, see FOREIGN INVESTMENT BARRIERS OR OTHER RESTRICTIONS THAT PREVENT FOREIGN CAPITAL FROM CLAIMING THE BENEFITS OF FOREIGN GOVERNMENT PROGRAMS 2-5 (Pub. 2212) (1989).

56. D.O., *The Regulations of the Law to Promote Mexican Investment and Regulate Foreign Investment* (May 16, 1989).

worker training programs and personnel development programs; and (6) The project employs technologies adequate to meet environmental requirements.<sup>57</sup>

Upon filing of the necessary papers to begin a *new* business, approval is automatic if the Foreign Investment Commission does not respond within forty-five days of the date of the application.<sup>58</sup> Until May 16, 1992, if an existing company is *acquired* by a foreign investor in an unclassified area, approval of the acquisition is not necessary if the above criteria are met and if the investor agrees to increase the fixed assets of the company by at least thirty percent.<sup>59</sup> Otherwise, acquiring a majority ownership of an existing company requires Foreign Investment Commission approval.

The regulations of May 1989 also allow foreign investors, with the approval of the Foreign Investment Commission, to acquire rights, by means of a twenty year trust, of up to 100% ownership in certain classified activities if there is a finding of economic benefit and if the activity is not exclusively reserved for Mexicans or the state.<sup>60</sup>

The new regulations also allow foreigners to access the Mexican stock market through use of a trust. Essentially, through a trust which is usually controlled by a Mexican bank, foreign investors are allowed to own certificates of participation in funds which are comprised of Mexican companies traded on the market. The participation rights reflect control only over the economic rights of the stock.<sup>61</sup>

While thirty year trust ownership of real estate in the restricted zones was common prior to May of 1989, the new laws set out specific criteria for the trusts that are designed to guarantee their validity.<sup>62</sup> In addition, real estate trusts can be extended for an additional thirty years.<sup>63</sup> Renewal is automatic if the beneficiaries remain the same and hold the property on the same terms. Trust approval is expedited under the new law. Approval is automatic after forty-five days from the date of the application if the Secretariat of Foreign Relations takes no action on the matter. If, by acquisition, new and productive investments are to be made in tourism-related activities in the restricted zone, foreign investors may also now acquire beneficial rights in existing Mexican trusts holding interests in real property in the restricted zone. Other changes in Mexico's foreign investment regime include regulations opening up the petrochemical industry on August 14, 1989,<sup>64</sup> the banking industry in December of 1989,<sup>65</sup> and the insurance industry on January 3, 1990.<sup>66</sup>

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57. *Id.* title 2, art. 5.

58. *Id.* title 1, art. 2.

59. *Id.* art. 5.

60. *Id.* art. 26.

61. *Id.* arts. 13-15.

62. *Id.* art. 17.

63. *Id.* art. 20.

64. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 5-10 n.76.

65. See D.O., *Decree by Which Several Provisions of the Regulatory Law of Banking and Credit Public Service are Amended, Enlarged, and Revoked* (Dec. 27, 1989).

66. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 5-11.

One area of foreign investment which was grounded in liberal principles of foreign investment policy was the offshore assembly industry, or Maquiladora program. This program, though liberal in focus, antedated many of the current changes. It was established in 1965 as a part of New Mexico's border industrialization program.<sup>67</sup> It was designed to offset the impact of the loss of the Bracero program that sent seasonal workers to the United States.<sup>68</sup> Initially, the program was limited to a twenty kilometer strip along the border; however, it has been expanded throughout Mexico.<sup>69</sup> The program is simple in concept. It allows parts of items to be imported into Mexico for assembly and then returned to the United States after assembly, with a United States duty paid only on the value added by assembly. In order to ensure that the finished products are returned to the United States, a bond is required in the amount of the duty which would have to be paid if the product is not re-exported to the United States.<sup>70</sup> United States legal provisions allow for duty-free re-entry of the assembled products and preferential duty-free treatment to goods from developing countries, such as Mexico.<sup>71</sup>

The program's success is based on three major factors. First, labor costs for assembly in the United States are high. Second, labor costs in Mexico are extraordinarily low in comparison to costs in the United States because of a currency exchange rate favorable to United States businesses and because of the differences in the standard of living between the two countries.<sup>72</sup> Third, Mexico holds a comparative advantage with respect to transportation costs over potential competitors in Asia and other parts of the world. While these other nations can also provide an abundant supply of inexpensive labor, the distance to that labor supply is great when compared with the distance to Mexico.

Since its inception, the maquila industry has provided great benefits to the Mexican economy. It has provided both employment and much needed foreign currency, particularly during the last decade. As a source of foreign exchange, it ranks second only to petroleum. The growth of the maquila program has been phenomenal. In 1965, there were twelve maquilas. As of August of 1989, there were 1,699 maquilas employing 433,682 workers in Mexico.<sup>73</sup> Maquilas are involved in numerous light industries, including textiles, apparel, furniture, and electronics parts.

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67. The term maquiladora comes from the Spanish word "maquila," which was the amount of corn that farmers used to pay a miller for his services. See Tarbox, *An Investor's Introduction to Mexico's Maquiladora Program*, 22 TEX. INT'L L.J. 109 (1987).

68. The Bracero, or Mexican Labor Program, allowed migrant Mexican workers to enter the United States on a temporary basis from 1942 through 1964. See UNITED STATES INTERNATIONAL TRADE COMMISSION, *THE USE AND ECONOMIC IMPACT OF TSUS ITEMS 806.30 AND 807.00 8-1* (Pub. 2053) (1988).

69. D.O., *Decree for Development and Operation of the Maquiladora Industry* (Dec. 22, 1989) [hereinafter *Maquiladora Decree*].

70. *Mexican Law on In-Bond Processing Plants* art. 23.

71. These provisions are HTS 9802.00.60 and HTS 9802.00.80.

72. For example, the average Mexican wage rate in U.S. dollars declined from \$2.96 per hour in 1980 to \$1.37 per hour in 1987. See THE EFFECT OF DEVELOPING COUNTRY DEBT SERVICING PROBLEMS, *supra* note 2, at 8-10.

73. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 84 n.107.

Maquilas even perform such tasks as sorting coupons and molding china from freeze-dried clay powder. Foreign exchange from the industry has gone from \$772 million in 1980 to \$2.3 billion in 1988.<sup>74</sup> Foreign exchange earnings in 1989 were anticipated at approximately \$3 billion.<sup>75</sup>

The majority of the maquila firms are from the United States; however, Mexican companies have participated, as have European countries. Japanese firms have moved into the market with fifty-eight firms in 1989. The majority of the Japanese operations are located in Baja, California.<sup>76</sup>

The maquila program was first expressly authorized through the Secretary of Commerce and Industrial Development in 1971. On paper, the overall process of operating a maquila is straightforward, but historically it has been cumbersome in application. Much of the bureaucratic red tape has been changed by the new regulations discussed below. In general, a business submits an application to operate as a maquila describing the nature of the operation, its location, its expected employment, and other relevant information. A license is then issued by the Mexican government and work begins. A maquila can import capital equipment for use in its business operations without paying a duty. Raw materials imported for assembly may also be imported without duty, but they must be utilized during a specific time period and re-exported as part of a finished product. The maquila can be a Mexican corporation or it can be 100% foreign-owned. It can be Mexican-owned with United States management, or the maquila may simply be a Mexican company that has subcontracted to assemble a product without foreign management. Maquilas can be established for all industries except those exclusively reserved for the state.

The allowing of 100% foreign ownership of maquilas is an express exception to the Foreign Investment Law.<sup>77</sup> This exception received formal approval by General Resolution Number 92 of the Foreign Investment Commission in 1984. Eighty percent of the maquilas operate near the border, and those within the prohibited zone hold property through a Mexican bank as trustee. From the outset, foreign ownership was allowed because the industries that brought in parts for assembly did not compete in the Mexican market by selling their products in Mexico; rather, they re-exported their goods for sale outside the country. As a result, the entire output of the maquila had to be returned to the foreign state. In 1983, the regulations were changed to allow maquilas to sell up to twenty

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74. American Chamber of Commerce of Mexico. Although the Mexican value added tax accounts for around 24% of the total value of maquiladora production, local content comprises only about 1.7% on average for the industry. MARTIN, DROUGHT, AND TORRES, INC., II(1) MAQUILAMEX BRIEFS 3 (March 1990).

75. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 88 n.113.

76. This figure includes all maquiladoras with Japanese participation, whether it be minority, majority or wholly-owned. EMBASSY OF MEXICO FACT SHEET: MEXICO'S MAQUILADORAS: FACTS AND FIGURES table 1, at 6.

77. 1984 General Resolution No. 2, issued by the National Foreign Investment Commission ("CNIE").

percent of their production in the Mexican market under certain conditions, including compliance with an established foreign currency budget, technology transfer, domestic content requirements, and proof that Mexican producers cannot meet existing demand.<sup>78</sup> Very few maquilas meet this rigorous criteria. In April of 1988, only fifteen maquilas were authorized to sell products in the Mexican market.<sup>79</sup>

The process of liberalization of the maquila industry began in 1986 with the decision to allow regional offices of the Secretary of Commerce and Industrial Development ("SECOFI") (rather than the Mexico City office) to approve maquila applications in most areas of maquila operation. On February 3, 1988, the Foreign Investment Commission streamlined the process even more. It repealed preexisting regulations and made sweeping changes. Prior to these reforms, it was impossible to acquire an existing maquila business without approval of the Foreign Investment Commission unless it was already at least seventy-five percent foreign-owned. Under the new regulations, an existing Mexican-owned maquila can be acquired or leased into a new economic activity without prior approval of the Foreign Investment Commission, provided the assembled products are exported or provided to another maquila. The regulations also extend the 100% foreign ownership exception to textiles and apparel products.<sup>80</sup>

Article 6 of the May 16, 1989 regulations expressly provides that no prior authorization of foreign participation in existing maquiladora enterprises is required. This article formally confirms the liberalization measures extended by the 1988 resolution discussed above.

On December 23, 1989, the "Decree for the Development and Operation of the Maquiladora Industry for Exportation" became law. It replaced the 1983 decree mentioned above, and it made significant changes in the operation of maquilas.<sup>81</sup> For example, there is now "one stop shopping" for maquila approval. One office within SECOFI is now authorized to approve all aspects of maquila operation, including program approvals and registration with the National Maquila Industry Registry, the Foreign Investment Commission, the Secretariat of Foreign Relations, the Federal Taxpayers Registry, the National Fund for Workers Housing Institute, and the Mexican Social Security Institute. Previously, nine different agencies had to approve a maquila. Local SECOFI offices can perform this service, and travel to Mexico City is no longer necessary.<sup>82</sup>

Previously, maquila licenses were valid for only two years. After two years, a license had to be renewed or operations had to be suspended. Now, maquila licenses are valid for an indefinite period.<sup>83</sup> Also, replacement of capital equipment was difficult because old equipment had to

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78. D.O., *The Decree for the Development and Operation of the In-Bond Export Industry* art. 12 (Aug. 15, 1983); see also *Maquiladora Decree*, *supra* note 69, art. 13.

79. E. ECHEVERRIA-CARROLL, *MAQUILAS, ECONOMIC IMPACTS AND FOREIGN INVESTMENT OPPORTUNITIES: JAPANESE MAQUILAS - A SPECIAL CASE*, 4 Research Monograph, Bureau of Business Research, Graduate School of Business, University of Texas, Austin (1988).

80. 1988 General Resolution § V.

81. *Maquiladora Decree*, *supra* note 69, art. 3, § VII.

82. *REVIEW OF TRADE AND INVESTMENT*, *supra* note 1, at 5-1 n.133.

83. *Maquiladora Decree*, *supra* note 69, art. 7.



be re-exported and importation of certain capital goods was difficult. Now, the law provides for automatic replacement of machinery and equipment. Telecommunications and computer equipment fall within this duty-free importation category.<sup>84</sup> Another significant change is the ability to bring trucks, trailers, and containers across the border. These may remain in the country for three months, thus avoiding difficult loading and unloading requirements at the border.<sup>85</sup>

Access to the Mexican market has also been substantially liberalized. Under the new decree, a maquila may sell into the Mexican market an amount equal to fifty percent of its total export sales during the preceding year.<sup>86</sup> These Mexican market sales cannot reduce existing sales; they must be in addition to the previous level of exports. Thus, a company can sell into the Mexican market only if it increases its overall production. It cannot sell into the domestic market in excess of one-third of its current production.<sup>87</sup>

Under the new decree, virtually all of the cumbersome preconditions for sale into the Mexican market have been removed. A maquila need only show its ability to maintain a positive foreign currency account. A positive currency account exists if the maquila's expenditures of foreign currency in Mexico on labor, operating expenses, supplies, etc., exceed the value of imports used in production.<sup>88</sup>

One of the main goals of the liberalization measures in the maquila industry is to make the industry a part of the overall economy of the country. To achieve this goal, the Mexican government has offered tax breaks to encourage the use of local Mexican materials in sales into the Mexican market. The duty structure also promotes the use of local materials. For example, when a maquila sells into the Mexican market, duties must be paid on the imported product.<sup>89</sup> One option is to simply pay a duty based on tariff rates applicable to the final product as though it had been imported in finished condition into the country. A second option is to include local materials (local content) and pay duty only on the value of the imported components, which is usually less than the tariff rate on the overall product. The local content requirements, which must be met to get the more favorable tariff rates, are based upon a percentage of the overall cost of the parts going into the product. These amounts are two percent the first year, three percent the second year, and four percent each year after that.<sup>90</sup>

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84. *Id.* art. 10, § II.

85. *Id.* art. 10, § IV.

86. *Id.* art. 20.

87. *Id.*

88. "This is not the same concept as a foreign trade balance since maquila exports are considered transfers, not sales transactions and are not counted in Mexico's trade statistics." REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 5-17 n.140.

89. *Maquiladora Decree*, *supra* note 69, art. 22.

90. "Local content in the maquila industry averages around 1.7%." REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 5-17 n.142.

The new law replaces the previous organization for support of the maquila industry with a new work group that operates out of SECOFI and has as its mission streamlining and supporting maquila operations. This is a vast improvement over pre-existing conditions where numerous offices had jurisdiction over the maquila industry.

#### IV. EXCHANGE CONTROLS FOR MAQUILADORAS

Under Articles 2 and 5 of the Exchange Controls Decree,<sup>91</sup> and Articles 42 through 45 of the Complementary Exchange Control Rules,<sup>92</sup> companies which operate under maquiladora status must pay for all operating expenses incurred by the company in pesos. The pesos must have been exchanged for dollars at the controlled market rate of exchange. All payments made for wages, lease payments, procurement of goods or services, taxes, insurance and bond premiums, or interest are subject to this rule. The requirement also applies to other operating expenses in Mexico. This restriction does not apply to the acquisition of fixed assets or to rental payments if the purpose of the payment is to repay a foreign currency loan obtained from a foreign banking institution to finance the facility.<sup>93</sup>

Article 47 of the exchange control rules also requires that federal or local taxes be paid with pesos obtained under the controlled market. This phrase has been interpreted to include all taxes paid by a maquiladora, regardless of the originating event. Authorities have allowed peso tax refunds to a maquiladora to be used to pay for operating expenses, provided the tax was originally paid with pesos generated from the sale of dollars at the controlled market rate.

#### V. ENVIRONMENTAL CONSIDERATIONS FOR FOREIGN INVESTORS OPERATING IN MEXICO

##### A. *Air and Water Quality in General*

As noted above, Mexico is a country that faces substantial economic challenges as it struggles to cope with the devalued peso and inflation. In addition to the above challenges, Mexico City labors under intense air pollution problems because it has millions of motor vehicles and over 100,000 local industries. Some calculate that residents of Mexico City breathe in over six million tons of toxins. Mexico likewise faces serious air and water quality problems at its border with the United States. To date, Mexico's response to this problem has been vocal but indirect. In addition to conducting investigations of these ecological problems, Mexico has created elaborate plans, commissions, and subagencies to address these problems.

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91. D.O. (Dec. 20, 1985).

92. D.O. (May 11, 1987).

93. *Id.* art. 47.

Mexico's first major steps toward solving pollution problems included amendments to its constitution and the creation, in January of 1972, of the Subsecretary of Environmental Improvement under the Secretariat of Health and Assistance. These acts were followed by the creation of the more powerful position of Secretariat of Urban Development and Ecology ("SEDUE") in December of 1982. This position was further refined and focused with the creation of the Subsecretary of Ecology and its further bifurcation into Directorates of Air Pollution and Water Pollution. Notwithstanding the creation of these positions and agencies, the results of Mexico's attempts to control pollution problems have been mixed at best because the various agencies have languished from a lack of financial resources and overlapping jurisdiction.

On December 23, 1987, the Mexican legislature passed a new law relating to environmental protection in Mexico titled the "General Law of Ecological Equilibrium and Environmental Protection" ("Environmental Law").<sup>94</sup> The law is massive. It is divided into six headings and subdivided into twenty-six chapters containing a total of 194 articles.

The Environmental Law is described in its first articles as a regulatory law interpreting the diverse constitutional provisions relating to the preservation and restoration of the ecological equilibrium, including the protection of the environment. Its basic objectives are to: (1) define general ecological principles and establish the instruments for their application; (2) achieve an ecological order; (3) preserve, restore, and improve the environment; (4) protect the wilderness and aquatic flora and fauna; (5) promote rational enjoyment and use of natural resources; (6) promote the preservation of quality air and control pollution of the air, water and soil; (7) promote cooperation between the federal government, federal entities, and municipalities in this area; (8) promote the coordination of the various subagencies and entities of the Federal Public Administration; and (9) encourage the society as a whole to share responsibility for the protection of the environment.

Article 3 of the Environmental Law defines thirty terms, including: "environment," "protected natural areas," "rational use of resources," "ecological criteria," "ecological imbalance," "ecological emergencies," and "ecological regions." The article also underscores the necessity of decentralizing the duties required for its application and coordinating the actions of federal, state, and municipal levels of government.

Title 4 of the Environmental Law, titled "Environmental Protection," is divided into seven chapters. The first three chapters refer to the prevention and control of atmospheric contamination (Articles 110-116), the prevention and control of water pollution of aquatic ecosystems (Articles 117-133), and soil contamination (Articles 112-115). The law also addresses nuclear contamination, noise pollution, thermal and light energy pollution, and other forms of contamination, such as visual contamination.

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94. D.O., *The General Law of Ecological Equilibrium and Environmental Protection* 149 (Jan. 28, 1988) [hereinafter *Environmental Law*].

With respect to environmental protection, the Environmental Law assigns responsibility not only to SEDUE, but also to other agencies, including the Secretaries of Health, Agriculture, Water Resources, Commerce and Industrial Growth, Energy, Mines and Para-state Industry, Interior, Fishing, Transportation and Communication, Employment and Social Work, and the National Commission of Nuclear Safety. It also encourages societal participation in diverse tasks associated with environmental protection.<sup>95</sup> Although the Environmental Law became effective March 1, 1988, the new environmental legislation will require legislation to define its parameters.<sup>96</sup> Until the new regulations are adopted, the original regulations established in the early 1970's remain the law. One encouraging event from an environmental standpoint is the passage of new regulations regarding disposal of hazardous wastes. It is not yet clear, however, whether local laws will be passed to make the suggestions for decentralization suggested by Article 6 become a reality.

### *B. Environmental Requirements for Maquiladoras*

As stated above, companies operating in Mexico under maquiladora status normally import all of their raw materials and supplies into Mexico on a temporary, duty-free basis. Therefore, they are required to export from Mexico both the hazardous waste they generate from imported hazardous or non-hazardous raw materials and all other hazardous wastes derived from such imported materials.<sup>97</sup> Non-hazardous waste derived from imported materials may be disposed of in Mexico only if approval is obtained from the Mexican Customs Department.<sup>98</sup> Disposal of hazardous waste derived from imported materials in Mexico is absolutely barred.<sup>99</sup> Mexican customs and maquiladora regulations,<sup>100</sup> however, do acknowledge that a certain amount of wastes are consumed during the manufacturing process, and they allow a shrinkage factor to be applied to the total amount of waste that must be exported.

In addition to these requirements, all maquiladoras must comply with the following environmental licensing, registration, and reporting requirements:

1. *Environmental Operating License.* All manufacturing plants must obtain a license from the Secretary of Urban Development and Ecology covering all aspects of their manufacturing activities.<sup>101</sup>

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95. See *Environmental Law*, *supra* note 94, arts. 157-59 ("Social Participation"); *id.* arts. 189-94 ("Popular Outcry").

96. Telephone conversation with Diputada Maria Esparanza Moreljos Borja (Dec. 7, 1987). Ms. Moreljos Borja expressed serious doubts with respect to the ability of authorities to apply the new law.

97. D.O., *The Regulations of the General Law of Ecological Equilibrium and Environmental Protection in Connection with Hazardous Waste* art. 55 (Nov. 25, 1988) [hereinafter *Hazardous Waste Regulations*].

98. *Id.*

99. *Hazardous Waste Regulations*, *supra* note 97, art. 55.

100. *Maquiladora Decree*, *supra* note 69, art. 15.

101. *Environmental Law*, *supra* note 94, art. 28.

2. *Environmental Impact Statement.* The application for an Environmental Operating License must be accompanied by a statement concerning the potential impact of the company's operations on the environment. This statement may result in the requirement of a full environmental impact study, if authorities believe it is warranted.<sup>102</sup>

3. *Residual Water Discharge Registration.* Water discharges from a production plant must be registered with SEDUE.<sup>103</sup> Residential water discharges are exempt from this requirement.

4. *Hazardous Waste Generator Registration.* Plants that generate any waste considered to be hazardous under the applicable technical standards must register with and obtain a generator's permit from SEDUE.<sup>104</sup>

5. *Ecological Bill of Lading.* The importation, exportation, transportation, and handling of any hazardous raw materials, hazardous products, or hazardous waste must be carried out in accordance with "Ecological Bills of Lading" which must be obtained for every shipment.<sup>105</sup>

6. *Storage of Hazardous Materials.* Hazardous raw materials or waste materials must be stored in facilities which comply with special requirements set forth in the regulations.<sup>106</sup>

7. *Reporting and Record Keeping Requirements.* Regular reporting of changes that affect the environment must be reported. Changes in the information provided to SEDUE in the applications for any of the licenses or registrations listed above must also be reported to SEDUE. A permanent physical inventory of all hazardous materials in the possession of a company at any given time must be kept and must be made available for inspection by SEDUE. Companies that generate hazardous waste must file biannual reports with SEDUE.<sup>107</sup>

## VI. LABOR ISSUES FOR MAQUILADORAS

Labor relations in Mexico are governed by Article 123 of the Mexican Constitution of 1917, as well as the Federal Labor Law ("FLL") and its derivative statutes.<sup>108</sup> The FLL contains detailed provisions concerning the minimum working conditions and rights which must be afforded by an employer to its work force. These provisions are not waivable by the employee.

The FLL established individual and collective labor relationships. An individual labor relationship is created automatically when a person is hired to perform a task subject to the control of the employer, whether on a temporary basis or for an indefinite time period.<sup>109</sup> A collective

102. *Id.*

103. *Hazardous Waste Regulations*, *supra* note 97, art. 8.

104. *Id.*

105. *Id.* art. 45.

106. *Id.* arts. 14-15.

107. *Id.* art. 8.

108. D.O., *Federal Labor Law* (Apr. 1, 1970) [hereinafter *Federal Labor Law*]; *see also* CONSTITUCION POLITICA DE LOS ESTADOS UNIDOS MEXICANOS art. 123.

109. *Federal Labor Law*, *supra* note 108, art. 20.

relationship exists when the work force is organized into a labor union and the employer executes a collective bargaining agreement with the union.<sup>110</sup>

The issue of labor relations in Mexico is incredibly complex and steeped in Mexican history. The following is only a brief summary of a few of the key issues concerning individual labor entitlements and labor unions.

#### A. *The Strength and Influence of Labor Unions in Mexico*

The strength and influence of labor unions in Mexico varies widely from state to state and city to city. In certain states, such as Tamaulipas, and certain cities, such as Mexico City and surrounding areas, an agreement with a union is virtually inevitable. In states such as Chihuahua, however, only a small percentage of companies have collective bargaining agreements with unions. Collective bargaining agreements which do exist were entered into without coercion.

Unions in Mexico are voluntary organizations, and the FLL divides them into several categories:

1. *Trade Unions.* These unions organize workers of a specific trade, occupation or craft.
2. *Enterprise Unions.* These unions organize workers of a specific company or firm.
3. *Industry Unions.* These unions organize workers of a specific type of industry.
4. *National Industry Unions.* These unions organize workers of a specific type of industry existing in two or more states.<sup>111</sup>

Unions freely form federations or confederations at the local and federal levels. Federations of unions (called "centrals") may be classified as traditional, moderate, or radical. Traditional federations are affiliated with the ruling political party, the Institutional Revolutionary Party ("PRI"). The famous Mexican Congress of Workers ("CTM") is the best example of a moderate federation. It forms part of the Labor Congress. The more radical or independent unions, which are usually affiliated with more radical political parties, are concentrated in certain southern states of Mexico. It is estimated that of the approximately 14.2 million people that comprise the work force, 6.3 million are organized in unions, and 5.9 million of these union members are part of federations within the more moderate Labor Congress.<sup>112</sup>

Unions are permanent associations of at least twenty workers who seek to defend their mutual rights and interests. Unions must be certified by the corresponding Labor Conciliation and Arbitration Board ("Labor Board").<sup>113</sup> The FLL recognizes not only organized unions, but also

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110. *Id.* art. 356.

111. *Id.* art. 360.

112. See DE REGIL, *UNIONS IN MEXICAN LABOR POLICY AND PRACTICE*, BUREAU OF NATIONAL AFFAIRS (1985).

113. *Federal Labor Law*, *supra* note 108, arts. 355-56.

coalitions of workers, which are temporary associations of any number of workers that have banded together for the defense of mutual rights and interests. Although only unions may execute collective bargaining agreements,<sup>114</sup> a coalition does have the right to strike under certain circumstances.<sup>115</sup> Not every worker may be a union member. Workers who are considered to be white collar employers ("*empleados de confianza*") may not be members of the union.<sup>116</sup>

The FLL establishes minimum benefits and minimum working conditions to be met for all workers, regardless of whether they are organized. Therefore, in many areas of Mexico, there is little incentive for the employees to unionize if the employers follow the FLL.

### B. *The Labor Relationship*

Under the FLL, when a person is hired to carry out a task under the control of the employer, a labor relationship arises, unless the relationship is only for one specific task or for a specified time period. Once a labor relationship is created, the employee can only be terminated for cause.<sup>117</sup> If no justifiable cause can be found for the termination, the employer pays a severance payment in lieu of litigation in the administrative labor courts.

If a company's workers form a union, they may request that the company enter into a collective bargaining agreement setting forth the terms and conditions of employment for the company's employees. The white collar employees may receive the benefits of this agreement even though they cannot belong to the workers union.<sup>118</sup> If there is no union, terms and conditions of employment are embodied in individual employment contracts. If no written employment contract exists, the protections of the FLL presumptively apply and form an implied contract between the employer and the employee.<sup>119</sup>

While varying circumstances dictate different quantum of severance payments for an employee's termination, a typical amount is the sum of three months wages plus twelve days wages for each year the employee has worked.<sup>120</sup> In addition, if a terminated employee brings an action against his employer and the Labor Board determines that the employee was terminated without just cause, the employer may be held liable for the payment of an additional twenty days wages for each year worked.<sup>121</sup> On the other hand, if a properly documented cause for termination exists, the employer may terminate the employee without liability, unless the

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114. *Id.* art. 388.

115. *Id.* art. 440; CONSTITUCION POLITICA DE LOS ESTADOS UNIDOS MEXICANOS art. 123, § XVIII.

116. *Federal Labor Law*, *supra* note 108, art. 363.

117. *Id.* art. 47.

118. *Id.* art. 184.

119. *Id.* art. 21.

120. *Id.* art. 50.

121. *Id.*

employee has worked for more than fifteen years, in which case wages of twelve days per year worked must be paid.<sup>122</sup>

While wages paid in the maquila program are higher than in most other employment sectors and peso amounts paid are much higher than in previous years because of inflation, the standard of living of Mexican workers has declined dramatically, and they continue to lose purchasing power.<sup>123</sup> Indeed, the monthly cost of a subsistence food basket for a typical Mexican blue collar worker is more than he can afford. A maquila worker in Juarez, at the highest salary available, earns 27.5% less than his minimum subsistence requirements.<sup>124</sup>

To encourage workers to stay, the average maquila operator pays its employees a package of forty-three percent of the salary amount in the form supermarket coupons, savings funds, punctuality bonuses, production bonuses, and seniority bonuses, in addition to wages.<sup>125</sup> Nevertheless, worker turnover and the inability of workers to meet the minimum subsistence needs remains a serious problem. Although there is a shortage of trained persons in the maquila industry, the average maquila worker in Juarez earns only 54% of what is needed to meet subsistence needs. This includes incentives, bonuses, and other supplemental pay packages.

## VII. PROSPECTS FOR FUTURE FOREIGN INVESTMENT

Although foreign investment in Mexico has increased greatly over the past ten years, direct foreign investment is only a minor part of the overall gross investment picture. Foreign direct investment is less than ten percent of the total gross fixed investment and less than five percent of the gross domestic product. Sixty-three percent of the cumulative foreign investment was from the United States.<sup>126</sup>

The United States is Mexico's number one trading partner, and negotiations are underway for the development of an extensive bilateral trade agreement between the two countries. Mexico has substantially reduced its ownership of para-state companies and has liberalized its trade policies to allow foreign competition, thereby strengthening its own industries. It has liberalized the rules for direct foreign investment and has made tremendous strides in controlling inflation and restructuring international debt.

Mexico is a nation of tremendous natural resources. It contains a surface area of 764,000 square miles and is the thirteenth largest country in the world. It ranks eleventh in world population with an estimated population of 84 million, and it has a labor force of over 27 million.<sup>127</sup> The Mexican literacy rate is high, and per capita income is \$2,080.00 a

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122. *Id.* art. 162.

123. Sander & Mendoza, *Compensation Overview*, TWIN PLANTS NEWS 34-37 (May 1990).

124. *Id.* at 34.

125. *Id.* at 35.

126. REVIEW OF TRADE AND INVESTMENT, *supra* note 1, at 5-2.

127. *Id.* at xi.



year. Mexico is the world's leading producer of silver and it produces many other raw minerals. Mexico has the world's fourth largest oil reserves, and it is proximate to the massive United States market.<sup>128</sup>

On the down side, one-half of Mexico's population is under the age of fifteen, and the minimum wages, plus bonuses in the booming industries such as the maquila industry, are insufficient to meet subsistence needs. Furthermore, Mexico faces stiff labor competition from other nations facing worse financial circumstances. Mexico also has a backlog of severe environmental problems that it must address. Even so, it is apparent that Mexico is committed to encouraging direct foreign investment and participating as a positive player in the world economic community. Success will depend on Mexico's ability to promote foreign investment, strengthen its industries, and utilize its comparative advantages in the labor market to acquire technology and develop a sound financial base. With the foreign investment law changes promoted by President Salinas de Gotari, Mexico is making a good start in this direction.

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128. Manufacturing and commerce, including domestic wholesale and retail services and international trading services, make up the largest sectors of Mexico's economy. Within these sectors, petroleum and refined petroleum products represent Mexico's largest single industry and produce the greatest percentage of Mexico's foreign exchange. Mexico currently produces approximately 2.5 million barrels per day of crude petroleum and exports approximately one-half of its production. The second largest producer of foreign exchange are the maquiladoras.

Mexico's gross domestic product was \$176.7 billion in 1988, or approximately \$2,116 per capita, compared with \$19,646 per capita in the United States. This represents a modest growth of 1.1% over 1987. The gross domestic product for 1989 was projected to be 1.5%. *Id.*