Mexican Law

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I. The Mexico-European Community and Member States Economic Partnership, Political Coordination, and Cooperation Agreement

A. MEXICO AND ITS NETWORK OF INTERNATIONAL TRADE AGREEMENTS

Mexico has historically had a culture of staying behind its borders. However, in the late 1980s that all changed; since then, Mexico has had an active participation in the execution of international trade and bilateral investment agreements. For over forty years, Mexico followed a traditional protectionist model of import substitution as a method to foster internal growth. This strategy seemed adequate until it showed drawbacks and limitations: Reduction in competition generated perfect conditions for monopolies (with no effective antitrust policy until the 1992 enactment of the Federal Law of Economic Competition). Recurrent crises that began in 1976 slowed Mexico's economic expansion. Mexico had grown heavily dependent on oil exports and was thus forced to default on foreign loans. The country had no option but to reorganize its trade and industrial policies to allow a full deregulation of its economy. As recent economic achievements show, these hard decisions have paid off, including Mexico becoming the nation with the single largest network of

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international trade agreements. This economic redirection has thus involved significant deregulation coupled with liberalization policies and a new competition framework.

As a significant event in the changes being discussed, Mexico signed the General Agreement on Tariffs and Trade (GATT)[1] in 1985, agreeing to implement world standards on trade liberalization and a constant reduction of tariffs. In 1990, Mexico was a founding member of the European Bank for Reconstruction and Development (EBRD). Progress down this path accelerated in 1991 when Mexico began negotiations leading to the execution in 1993 of the North American Free Trade Agreement (NAFTA)[2] by and between Mexico, the United States, and Canada. In 1991, Mexico and Chile executed a complementary commercial agreement, which was further replaced by a free trade agreement (FTA) in 1999. In 1993, Mexico was the first Latin-American member of the Asia-Pacific Economic Cooperation Forum (APEC), which seeks to establish a free trade area by 2010 for the economies of the APEC's developed members and by 2020 for developing countries. In January 1994, the NAFTA became effective. Four months later, Mexico joined the Organisation for Economic Cooperation and Development (OECD) and also acted as a founding member of the World Trade Organization (WTO).

Along with those important achievements, Mexico has also entered into FTAs with Bolivia (1995); Costa Rica (1995); Venezuela and Colombia (1995) (collectively the "group of three"); the Interim Accord with the European Community (1997); Nicaragua (1998); the Expansion to the Economic Complementation Accord executed with Uruguay (1999); Israel (2000); the European Community and its member states (2000); and Guatemala, Honduras, and El Salvador (2000) (the North Triangle). Additionally, Mexico is currently negotiating trade pacts with Singapore, Japan, South Korea, and MERCOSUR (Argentina, Uruguay, Paraguay, and Brazil). In early November 2000, Mexico finalized negotiations with the countries making up the European Free Trade Area (Liechtenstein, Switzerland, Norway, and Iceland).[3] Likewise, Mexico is a promoter for the Free Trade Area of the Americas, expected to be launched by 2004.

In addition to these important developments, Mexico has a growing network of bilateral investment treaties with several countries, including many European countries.[4] One key development concerns a recent Mexican Supreme Court of Justice landmark decision[5] which held that international treaties were superior to federal laws and subordinate only to the Mexican Constitution. This decision changes the former interpretation that federal laws and international treaties had identical value. The core reason to sustain the new finding lies in the fact that international undertakings are assumed by a Mexican state but simul-

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1. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. *See also The Adhesion Protocol of Mexico to GATT*, MEXICAN FEDERAL OFFICIAL GAZETTE, Nov. 26, 1986.

2. North American Free Trade Agreement, *opened for signature* Dec. 8, 1992, U.S.-Can.-Mex., 32 I.L.M. 605 [hereinafter NAFTA]. *See also* MEXICAN FEDERAL OFFICIAL GAZETTE, Dec. 20, 1993.

3. *See* MEXICAN FEDERAL OFFICIAL GAZETTE, June 29, 2001.

4. Mexico has executed 15 Bilateral Investment Treaties; 13 of which have been executed with member states of the European Community.

5. Precedent No. LXXVII/99 (Plenary session of the Mexican Supreme Court of Justice). "International Treaties. They are hierarchically located above Federal Laws and immediately thereafter the Mexican Constitution." Amparo en revisión 1475/98, Sindicato nacional de Controladores de Tráfico Aéreo, May 11, 1999. Unanimity of 10 votes (absent Justice José Vcente Aguinaco Alemán). Ponente: Justice Humberto Román Palacios. Legal Secretary: Antonio Espinoza Rangel.

taneously commit all Mexican authorities before the international community. In this context, Mexico's president is authorized by article 133 of its constitution[6] to sign international treaties, but in order to become effective, they must be ratified by the Senate. Thus, this significant decision sends a clear message to the international community that Mexico is prepared to enforce commitments that have been entered into with other nations.

Within this environment, it is essential to describe what the commercial relationship with the European Community (EC) really is. Mexico has started a new commercial-political cooperation stage synchronizing the phenomenon of globalization and keeping the path of free market economy through regional integration. Mexico and the EC and its member states are not blind to the importance of commercial diversification, market presence, and market access. The new relationship with Europe is not just another FTA; rather, it constitutes an instrument that creates new momentum for cooperation in other areas. Commerce with Europe, as perceived by Mexico and the EC, involves more than the simple exchange of goods and services and creates a tool for cooperation in politics, human rights, democratic principles, culture, technology, and other areas.

The bottom line is that Mexico and the European Union (EU) established a free trade area on July 1, 2000.[7] The EU imported over $843 billion worth of goods in 1999. The EU is Mexico's second largest trade partner and second largest source of foreign investment. However, the EU's trade participation in Mexico decreased from 10.9 percent in 1990 to 6.8 percent in 1999. In part, this reflects the fact that the EU has a smaller share of a much larger pie as Mexico's total trade exploded over the past decade. The decline is also a result of many preferential trade agreements that Mexico and the EU have with third countries.

Mexico has positioned itself as a global hub for international trade. The FTA with the EU will guarantee preferential access for Mexican products to the largest market in the world. The EU-Mexico FTA will also create strategic alliances between Mexican and European companies to promote the transfer of technologies. The more favorable business climate will increase foreign capital investments in Mexico.

The recently implemented FTA is part of a much broader agreement signed in December 1997 called the Economic Partnership, Political Coordination, and Cooperation Agreement.[8] This so-called global agreement meets the EU objective to have an agreement that promotes greater social equality in Mexico and a political system that is genuinely democratic, pluralist, and respectful of human rights. This agreement regularizes the political dialogue between the EU and Mexico, including broad coverage of cooperation on drug trafficking, money laundering, health, and the environment. The agreement has just recently been ratified by all the member states of the EU and replaces the Interim Agreement on Trade and Trade-Related Matters, which was ratified in late 1998 and is now subsumed within the global agreement.

6. Constitución Política de las Estados Unidos Mexicanos [Mexican Constitution] art. 133.

7. Decision No. 2/2000 of the EC/Mexico Joint Council of 23 Mar. 2000 (FTA in goods), 2000 O.J. (L/157) (entered into force July 1, 2000), *available at* www.europa.eu.int/comm/trade/bilateral/mex.htm [hereinafter EC-Mexico FTA].

8. Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and its Member States and the United Mexican States, 2000 O.J. (L/276) (entered into force Dec. 8, 1997), Eur.-Mex., *available at* www.europa.eu.int/comm/trade/bilateral/mex.htm [hereinafter Mexico-EC and MS Agreement].

B. A Free Trade Agreement with the European Community: A Common Misunderstanding

It is usual to read in the media that Mexico executed an FTA with the EC. This assertion involves two misleading ideas. First, as explained later, the Mexico-EC and Member States Treaty on Economic Partnership, Political Coordination, and Cooperation Agreement and its joint decisions are not merely an FTA.[9] This treaty involves several other topics and areas that go beyond commercial matters, such as political coordination and cooperation. Second, the EC lacks legal standing as an independent agent. Neither the Maastricht (1993) nor the Amsterdam treaties (1997) provide the EC any legal status. It has long been argued that it would be desirable vis-à-vis third countries to grant legal existence to the EC to give it even more credibility and legal standing abroad.

It is important to recall that the EC was created with the Treaty on European Union (TEU),[10] signed in Maastricht on February 7, 1992, although it came into effect on November 1, 1993. The nature of the EC is largely debated. For some authors it is only a way of describing supranational and intergovernmental cooperation instruments while for others it is a truly international organization. For some, it is the path to follow to reach the common objective set forth in the preamble of the EC treaty of attaining an "ever closer Europe for the people of Europe," and it is a preliminary step to the creation of a structure closer to a federal or confederate state.[11]

The TEU modified the constitutive treaties[12] and provided a new legal structure to the treaty system by creating a full *acquis communataire*. The EC is an interaction of supranational and intergovernmental forces, which has been explained as a structure resting on three pillars, like a Greek Parthenon. On the one hand, the EC rests under the first community pillar, which sustains the union consisting of the European and Coal and Steel Community (ECSC), the European Economic Community (EEC), and the European Atomic Energy Community (EAEC) and reinforces its federal or supranational nature.

On the other hand, there are two types of intergovernmental cooperation reflected in the second and third pillars. The second pillar deals with matters related to common foreign and security policy. The third pillar currently deals with police and judicial cooperation in criminal matters.[13] These matters are not subject to the federal/supranational nature of the

9. A free trade area seeks free circulation of merchandise among its partners without foreign common protection. A customs union seeks free circulation of merchandise, too; however, that freedom is protected from foreign markets through a common foreign tariff. Finally, a common market clusters the elements above and adds common policies in agriculture, transportation, coordination in social and fiscal areas, among other things. *See* Araceli Mangas Martín & Diego J. Liñán Nogueras, Instituciones y Derecho de la Unión Europea (1st ed. 1996).

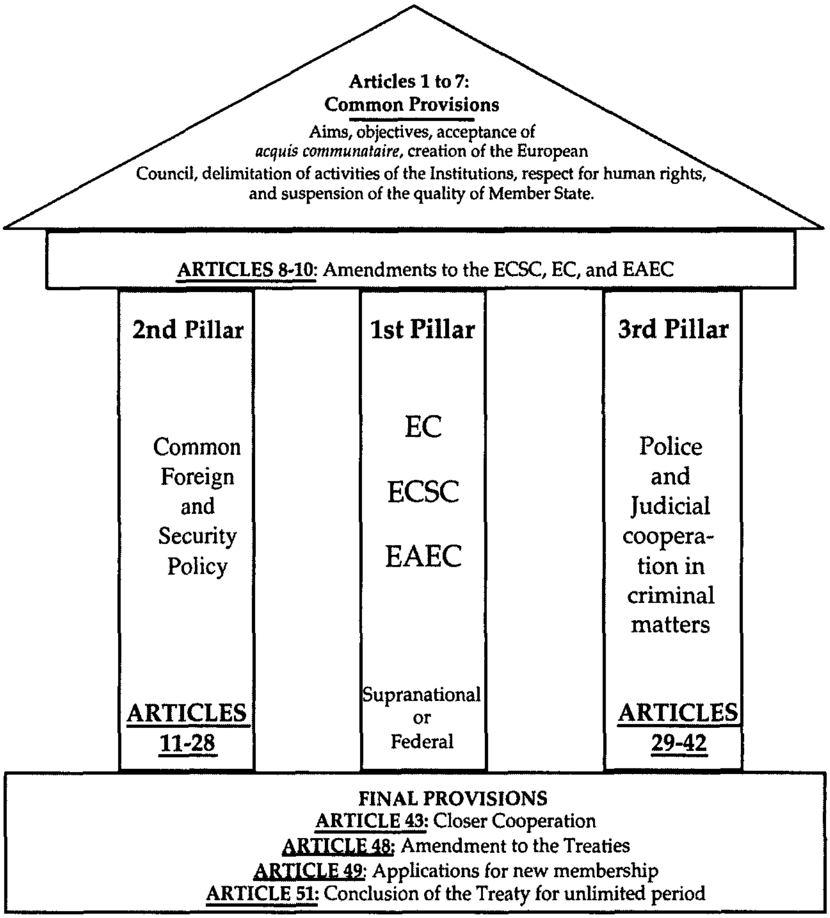
10. Treaty on European Union, 1992 O.J. (C 191) [hereinafter TEU].

11. *See* T. C. Hartley, The Foundations of European Community Law (4th ed. 1998).

12. Constitutive treaties refer to the following instruments: (1) European and Coal and Steel Community or Treaty of Paris, which was signed in Paris, France on Apr. 18, 1951 and came into effect on July 25, 1952; (2) European Economic Community or Treaty of Rome, which was executed in Rome on Mar. 25, 1957 and came into effect on January 1, 1958; and (3) European Atomic Energy Community, which was signed in Rome and came into effect on the same day as the EEC. It is important to remark that even though the EEC and the EAEC were both signed in Rome, only the former is widely known as the Treaty of Rome.

13. The TEU was further amended by the Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, O.J. (C 340) 86 [hereinafter Treaty of Amsterdam]. The third pillar was re-denominated from "Cooperation

institutions[14] of the EC; therefore, they must be dealt with as means of intergovernmental cooperation whereby the member states have not delegated any kind of sovereignty in such institutions. The following chart best describes this:



in the Fields of Justice and Home Affairs" to "Provisions on Police and Judicial Cooperation in Criminal Matters."

14. TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Nov. 10, 1997, O.J. (C 340) 173. Article 7 (ex-article 4) provides that there are only five institutions of the European Community: (1) a European Parliament, (2) a Council, (3) a Commission, (4) a Court of Justice, and (5) a Court of Auditors.

There is no known development granting legal standing to the EC itself. This issue did not appear in the agenda of the topics to be discussed in an intergovernmental conference held in Nice in December 2000, which focused on major amendments to the constitutive and EU treaties. One expectation was for a possible change in the complicated structure of those treaties into one single body or, even better, to incorporate them into a constitution. If that had been the case, then an obvious step would have been to grant full legal standing to the EC. Other items that were expected to be discussed were the expansion of the EC, the inclusion of a human rights charter, and a full reform of the institutions to generate a greater community. Additionally, another important topic in the agenda was the enlargement of the EC and its representation in the corresponding institutions.

C. Importance of Executing a Treaty with the European Community and the Member States

Economic growth makes Mexico a strategic region for investment and the development of trade relations. With its stabilization and structural and political adjustment policies, Mexico has created the conditions for development and growth. The EC is Mexico's second trading partner after the United States (although with a significant difference between first and second place), and Mexico is considered by the EC as its largest Latin-American export market. Given that both Mexico and the EC are open to trade globalization, both have an interest in strengthening relations and further refining the complementary nature of their economies. Mexico seeks to diversify its sources of supply, technologies, goods, services, and capital. On its part, the EC is trying to consolidate and improve its trading and technological position in Latin America, which has a strong consumer potential and whose presence decreased before the execution of the NAFTA. Significantly, Mexico's NAFTA membership makes it a natural two-way springboard into the two largest economic zones in the world. This is an alternative not otherwise available, considering the huge stumbling blocks that the United States and the EC face in order to have a direct liberalized trade relationship.

The Mexico-EC and MS agreement has as an underlying objective of mutual recognition of the importance of market access. The EC acknowledged the great impact of losing economic and political presence in Latin America while Mexico cannot allocate its full economic expectations to the North American market. Mexico has acknowledged that a diversified economy, enhanced through a network of regional trade agreements, will allow it to penetrate other markets under beneficial conditions. On the other hand, it will position the country as an attractive place for foreign direct investment and will create badly needed jobs.

As mentioned before, Mexico has gone through a modernization and liberalization process of its economy. Mexico achieved unprecedented progress by reducing its customs' duties within the GATT framework. It currently applies average aggregate customs tariffs of 10.6 percent. Today, Mexico is the fourteenth world economy and the EC's second largest trading partner in Latin America after Brazil. In addition, Mexico alone represents 35 percent of the exports of the Latin American region. The EC is Mexico's second trading partner after the United States, which makes up around 75 percent of Mexico's foreign trade.

One of the EC's main concerns about Latin America was that its participation in Mexico's total trade decreased from 11.4 percent in 1990 to 6.1 percent in 1996 after the NAFTA came into force. In gross numbers, the EC's exports were reduced by 39 percent, and it was predictable that this figure would be further eroded if not reversed by a commercial treaty with Mexico.

The above data is in sharp contrast with the presence of the EC through foreign direct investment. As figures show, the EC's direct investment in Mexico has rapidly increased in the last decade. As a result, the EC's share of total direct investment rose from 6 percent in 1993 to 19 percent in 1996 but remains quite modest compared with the United States' share. Currently, the EC's foreign direct investment represents approximately 22 percent of Mexico's total investment, second only to the United States.

On the other hand, we must highlight that contrary to the situation of MERCOSUR, Mexico complements the agricultural products needed in the European market. Approximately 85 percent of Mexican agricultural products go to the United States, although Mexico is simultaneously an important importer of agricultural products. Thus, this agreement was seen as a twofold opportunity for Europe: On one hand, Mexico is a great importer of agricultural products and market access is ensured to the EC, but on the other hand, Mexico complements the EC's agricultural products (mainly peas, coffee, beer, and natural honey).

D. Brief Historical Overview of the Mexico-European Community and Member States Relationship

The commercial and political relationship between Mexico and the EC is not recent. In the 1960s, Mexico decided to formalize diplomatic relations with the then-EEC[15] and thus established a diplomatic mission in Brussels. Notwithstanding the foregoing, the starting point for the institutional relationship between Mexico and the EEC occurred in 1975 through the Economic and Commercial Cooperation Agreement, signed in Luxembourg,[16] which may be considered a second generation agreement. Both Mexico and the EEC granted each other most-favored-nation status, and they sought to conduct projects on economic and commercial cooperation. This agreement was not as successful as expected, and it achieved limited results. Despite this fact, it was renewed in 1980. Subsequently in 1987, Mexico and the EEC signed an agreement allowing the exchange of notes related to textile commercial interchange.[17] In 1988, an accord seeking to establish a delegation of the EC in Mexico was signed and then inaugurated at the end of 1989.[18]

In Luxembourg, Mexico and the EEC signed a third generation agreement, which was named the Cooperation Scheme Agreement (1991).[19] The aim of this agreement was to

15. The EEC further changed its name after the Maastricht Treaty or TEU, which entered into force in 1993. Since one of the aims of the Union was to foster closer links towards a common market, the economic reference disappeared and was changed to European Community.

16. Agreement between the United Mexican States and the European Economic Community, July 15, 1975, 1975 O.J. (L 247); *see also* Europa en México, Revista de la Delegación de la Comunidad Europea en México, Año 1, Número 2, 2000.

17. Agreement Allowing the Exchange of Notes Related to Textile Commercial Interchange, Mexico-EEC, 1987; *see also* Europa en México, Revista de la Delegación de la Comunidad Europea en México, Año 1, Número 2, 2000, *available at* www.europa.eu.int.

18. *Id.*

19. Third Generation Agreement, Mexico-EEC, Apr. 26, 1991; *see also* Europa en México, Revista de la Delegación de la Comunidad Europea en México, Año 1, Numero 2, 2000, *available at* www.europa.eu.int.

increase cooperation in the areas of commerce, investment, industry, finance, technology and science, public health, the fight against illegal drugs, tourism, environment, public administration, and culture. This agreement went further than the 1975 agreement, especially given its focus on the promotion and entrepreneurial cooperation for the development of small and medium enterprises. One of the main shortcomings was that the 1991 agreement did not establish real privileges in commercial and investment matters.[20] Its main advantages can be summarized in the fostering of entrepreneurial cooperation and the intensification of a political dialogue.

On May 2, 1995, in Paris, Mexico and the EC signed a solemn joint declaration in which the parties agreed to further develop their relationship. Thus, the goal was the conclusion of a new economic, political and commercial agreement that would be favorable to the development of the exchange of goods, services, and investments on the basis of progressive liberalization and reciprocal benefits, consistent with WTO rules.[21]

On December 8, 1997, the full legal regime of relationships between the EC and Mexico evolved positively with the execution of two different legal instruments: (1) the Economic Partnership, Political Coordination, and Cooperation Agreement executed between the EC and its member states and the United Mexican States (Mexico-EC and MS Agreement) and (2) the Interim Agreement related to Commerce and Related Matters executed between the EC and the United Mexican States (Interim Agreement).[22]

The Mexico-EC and MS Agreement marked the first time that the EC had negotiated an agreement of this kind with a Latin American country. This agreement needed to be ratified by the Mexican Senate, the European Parliament, and the fifteen constitutional authorities of the member states. The Mexico-EC and MS Agreement is a mixed accord since part of the agreement belongs to the absolute competence of the EC while other areas remain within the member states' jurisdictions. The Mexico-EC and MS Agreement mainly consists of three chapters: political, cooperation, and commercial matters.[23]

The political chapter sought to increase the intensity of the political dialogue through contacts, exchange of information, and consultation. This dialogue must be kept at the highest political level of the parties. This chapter also includes the convenience of implementing a political dialogue with the European Parliament. One of the most controversial issues is the inclusion of a democratic clause, which is a proviso of a reciprocal nature and is commonly included in all agreements executed by the EC. This clause allows suspension of the Mexico-EC and MS Agreement for lack of compliance with democratic principles and human rights.[24]

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20. *See Europe in Mexico*, MAGAZINE OF THE DELEGATION OF THE EUROPEAN COMMISSION IN MEXICO, Year 1, No. 1, 1999.

21. *Id.*

22. An excellent work regarding the explanation of the Global and Interim Agreement is found in the paper submitted by Elsa Guadalupe Ortega López called *The Evolution of the EC-Mexico Relation: The New Economic Partnership, Political Coordination and Cooperation Agreement.* This paper was submitted by the author as a partial fulfillment of the requirements of the master's degree in European legal studies. Bruges, May 1998.

23. *Europe in Mexico, supra* note 20, at 16–19.

24. *Id.*

The chapter dealing with cooperation identifies more than twenty different possibilities of cooperation and an evolving clause allowing the possibility through mutual consent of the parties to develop other sectors not identified in the Mexico-EC and MS Agreement. Cooperation ranges from industrial and entrepreneurial issues to combined combat against illegal drugs, money laundering, environment, and the fight against poverty.[25]

Finally, the Mexico-EC and MS Agreement sets forth a mutual liberalization and preferential commercial treatment. Liberalization includes rules on commercialization of goods (tariff phase-out periods) and services; progressive and reciprocal abolishment of rules restricting movements of capital and foreign investment; government procurement; cooperation and coordination in competition topics to avoid distortion of competition affecting commerce between Mexico and the EC; adequate protection of intellectual property; and the adoption of a dispute settlement mechanism compatible with WTO provisions. Likewise, the Mexico-EC and MS Agreement creates an institutional mechanism, the Joint Council, which is entrusted with the decision-making and supervision activities of the agreement. The Joint Council will consist of representatives of Mexico, the Commission for the European Communities, and the member states. The Joint Council will be chaired alternately by Mexico and the EC as provided for in its internal regulations.[26]

The Interim Agreement provided a fast-track way to commence negotiations toward trade liberalization without having to wait for ratification of the Mexico-EC and MS Agreement. Since the Interim Agreement involved commercial areas subject to the exclusive competence of the EC, the ratification process would be reduced only to the European Parliament and the Mexican Senate. The Mexican Senate ratified the Interim Agreement on April 23, 1998, while the European parliament did so on May 13, 1998. The Interim Agreement entered into force on July 1, 1998. Along with the Interim Agreement, the parties agreed to the terms of a joint declaration related to services, capital movements, and intellectual property. They agreed to negotiate such items on a parallel basis with the liberalization of trade in goods.[27]

The negotiations between the EC member states and Mexico that led to the conclusion of the Mexico-EC and MS Agreement and certain decisions issued by the Joint Council commenced on July 14, 1998, when the Joint Council of the Interim Agreement was established. Subsequently, there was one preparatory meeting held from September 30 through October 2, 1998, to establish the agenda and nine rounds of negotiations that ended on November 25, 1999. This process of negotiation can best be summarized as follows:[28]

25. *Id.*

26. *Id.*

27. *Id.*

28. The information herein provided was obtained from the Web site of the Ministry of Commerce and Industrial Development (SECOFI) at www.secofi-snci.gob.mx/Negociación/UniónEuropea/Avances_neg/avances_neg.htm. We should not lose sight of the fact that during the entire negotiation the Mexican government kept a "side room" to have the corresponding feedback of the industrial, agricultural or commercial sector involved.

Date and Place of the Round	Main Content of the Negotiation
1. November 9–13, 1998 (Mexico)	Proposals on trade of goods, rules of origin, safeguards, technical standards, unfair practices, services, capital movements and payments, competition, government procurement, intellectual property, and dispute settlement.
2. January 18–22, 1999 (Brussels)	Advance in the drafting of legal texts, especially in matters related to competition, intellectual property, government procurement, and standards. Parameters for liberalization were set forth.
3. March 8–12, 1999 (Brussels)	Exchange of lists regarding tariff reduction and specific rules of origin. Important advance in the text of the rules of origin, standards, competition, intellectual property, and dispute settlement mechanism. Agreement to cover all sectors in the rendering of services.
4. April 12–16, 1999 (Mexico)	Analysis of drafts on market access, sanitary measures, and dispute settlement. The EC expressed to Mexico its desire to review the restrictions to agricultural products entering the EC.
5. May 17–21, 1999 (Brussels)	Competition and intellectual property groups finalized discussion of technical matters. In agricultural products, the parties exchanged information about the core products to be covered. Standards, government procurement, services, and investment had an important advance in the discussion.
6. June 16–22, 1999 (Mexico)	Important subjects were discussed: market access, rules of origin, services, and capital movements. The EC demanded "NAFTA parity" and reiterated its offer to eliminate eighty-two percent of the tariffs at the entry into force of the agreement and the rest by the year 2003. Mexico counter-offered with some gradual liberalization to finalize by the year 2007.
7. July 19–23, 1999 (Brussels)	Safeguards, sanitary and phytosanitary measures, customs cooperation, and dispute settlement items were concluded at the technical level. Positions in rules of origin kept narrowing their distance. Government procurement reached an important stage to agree to its final text.
8. October 7–15, 1999 (Mexico)	The safeguard chapter was concluded and important advances in agriculture, fisheries, services, capital movements, and payments were made. The EC submitted important suggestions in rules of origin regarding the automotive sector.
9. November 18–25, 1999 (Brussels)	A final agreement was reached.

E. General Overview of the Mexico-EC and Member States Agreement

On March 20, 2000, the Mexican Senate approved three international instruments: (1) the Mexico-EC and MS Agreement[29] signed in Brussels on December 8, 1997; (2) the decision of the Joint Council regarding the Economic Partnership, Political Coordination, and Cooperation Agreement,[30] executed between the United Mexican States and the EC and its member states and signed in Brussels on February 23, 2000 (the decision on the EC-MS competence); and (3) the Joint Decision of the Interim Agreement over Commerce and Commerce Related Matters executed between the United Mexican States and the EC[31] and signed in Lisbon on February 24, 2000 (the decision on the EC competence). Those instruments came into effect on July 1, 2000, except for the commercial part of the decision on the EC-MS competence, which became effective on October 1, 2000. Currently, such instruments are in full force and effect since all formalities have been finally and duly complied with by all signatory parties.

The decision on the EC-MS competence covers aspects of shared competence. This decision covers topics related to commerce in services, investment, intellectual property, and dispute settlement. On the other hand, the decision on the EC competence covers subjects of the EC's specific competence, where no intervention of the member states is necessary. This decision deals with free circulation of goods, government procurement, competition matters, consultation mechanisms in intellectual property, and dispute settlement.

The Mexico-EC and MS Agreement[32] includes eight titles divided into sixty articles. Title I deals with the scope of the agreement and provides a clear commitment for the respect for democratic principles and fundamental human rights as set forth in the Universal Declaration of Human Rights.[33] This agreement aims to strengthen the relationship of the parties on a reciprocal basis and common interest. To that end, the Mexico-EC and MS Agreement will reinforce commercial and economic relations through commercial liberalization in accordance with WTO rules and will reinforce and broaden cooperation. It forms the basis for the FTA that is analyzed in section F.

Political dialogue is dealt with in title II.[34] In this part, the parties agreed to institutionalize a more intense political dialogue based on democratic principles and respect of human rights, including all bilateral and international common interests within the context of the international organizations to which the parties belong. This dialogue will be carried on in accordance with the "Joint Declaration of Mexico and the European Union on Political Dialogue"[35] contained in the final act, which is part of this agreement. The ministerial

29. Mexico-EC and MS Agreement, *supra* note 8.

30. Decision of the Joint Council regarding the Economic Partnership, Political Coordination and Cooperation Agreement, Feb. 23, 2000; the commercial part of this decision was published in the Mexican Federal Official Gazette on Sept. 30, 2000, and became effective October 1, 2000, *available at* www.se.gob.mx (international treaties).

31. Joint Decision of the Interim Agreement over Commerce and Commerce Related Matters, Mex.-EU, Feb. 24, 2000.

32. Mexico-EC and MS Agreement, *supra* note 8.

33. Universal Declaration of Human Rights, G.A. Res. 217 A, U.N. GOAR, 3d Sess., 483d plen. mtg., U.N. Doc. A/RES/217 A, *available at* www.un.org/Overview/rights.html.

34. Mexico-EC and MS Agreement, *supra* note 8, tit. II.

35. Joint Declaration of Mexico and the European Union on Political Dialogue, *available at* www.se.gob.mx (international treaties).

dialogue in the joint declaration will be provided within the Joint Council set forth in its article 45. Title III provides for commercial aims.[36] Its main objective is to provide a framework to foster the development of the exchange of goods and services, including a bilateral, preferential, progressive, and reciprocal liberalization of goods and services. This liberalization will take into account the sensitivity of specific products and service sectors in accordance with appropriate WTO rules.

Regarding trade in goods, the Joint Council will decide the measures and calendar for the bilateral, progressive, and reciprocal liberalization of tariff and non-tariff barriers as stated in WTO rules and article XXIV of the GATT, taking into account the sensitivity of specific products.

Such decision will take into account, among other things, the following: (1) scope and phase-out periods; (2) custom fees and any other measures of equivalent effect and quantitative and non-quantitative restrictions over imports and exports; (3) national treatment and prohibition of tax discrimination; (4) antidumping and countervailing duties; (5) safeguard and surveillance measures; (6) rules of origin and administrative and customs cooperation; and (7) technical regulations, sanitary and phytosanitary measures, and mutual acknowledgment of labeling, certification, and so on.

Exceptions to the freedom of transit of goods will be justified on the basis of public morality; public policy or security; protection to the life and health of human beings, animals, and plants; protection of industrial, intellectual, and commercial property; and so on. The Joint Council will decide on the necessary measures for the reciprocal and progressive liberalization of commerce on services as stated in the appropriate WTO rules, especially in article V of the General Agreement on Trades and Services[37] as adopted by the parties. Those measures will enter into effect as soon as adopted.

Capital and payment movements are covered in title IV.[38] This title aims to set forth a framework for the progressive and reciprocal liberalization of the capital and payment movements between Mexico and the EC without prejudice to other applicable provisions of this agreement and other international agreements. The Joint Council will adopt the corresponding measures to reach the objectives above in the form of a decision. This decision will include the definition, content, extension, and nature of the concepts included in this title. National treatment principles and the scope and transition periods of the liberalization are to be agreed. The decision may include a clause allowing the parties to restrict such freedom because security and public order, public health and defense, or difficulties for exchange or monetary policy reasons exist. Title V aims to set forth the objectives in government procurement, competition, intellectual property, and other provisions related to commerce.[39] Regarding government procurement, the parties will agree upon the gradual and reciprocal liberalization of specific government procurement markets. The Joint Council will decide on an appropriate provisions-and-deregulation calendar. Such decision will decide on scope, nondiscriminatory access to the agreed markets, value of the thresholds, and transparent legal procedures, including clear challenge procedures and use of information technology.

36. Mexico-EC and MS Agreement, *supra* note 8, tit. III.

37. General Agreement on Trade in Services, Sept. 27, 1994, 1994 WL 761795 (GATT), art. 5 [hereinafter GATS].

38. Mexico-EC and MS Agreement, *supra* note 8, tit. IV.

39. *Id.*, tit. V.

The parties agreed to take appropriate steps to avoid distortions and restrictions of competition that could affect the commerce between Mexico and the EC. The Joint Council will provide the cooperation and coordination mechanisms before the competent authorities to apply their competition laws. This cooperation will include reciprocal legal assistance, notification, consultation, and exchange of information to ensure transparency in the application of competition policies and laws. The Joint Council will decide on the following issues: (1) accords among companies, decisions of associations of enterprises, and cooperative practices among commercial entities; (2) any abuse of the dominant position by one or more economic agents; (3) mergers among companies; (4) state monopolies of commercial character; and (5) public companies and those that have been granted exclusive or special rights.

The parties reinforced the great importance that they accord to intellectual property rights (copyrights, including software programs and data basis and connected rights; and rights related to patents, industrial designs, geographical indications, and so on, as defined in the Paris Agreement on Intellectual Property Protection and Confidential Information, article 10*bis*). The parties commit themselves to establishing appropriate measures to ensure adequate and effective protection, in accordance with the strictest international standards, including effective means to that effect. Thus, the Joint Council will decide on a consultation mechanism and the kinds of measures to be adopted, consistent with the multilateral relevant intellectual property conventions.

Title VI expresses the will of the parties on cooperation.[40] The Joint Council will establish a regular dialogue toward intensifying cooperation through exchange of information, periodic dialogue on the evolution of cooperation, and surveillance of sector agreements established in the Mexico-EC and MS Agreement. The parties will also explore the possibility of entering into new agreements.

There are specific aims on industrial cooperation, investment promotion, financial services, small and medium enterprises, technical regulations and conformity evaluation, customs cooperation, and information issues. Furthermore, the Mexico-EC and MS Agreement sets forth the objective of cooperating on the following sectors: agriculture, mining, energy, transportation, tourism, statistics, public administration, the fight against illegal drugs, money laundering, and control of chemical precursors. There are also rules aiming to cooperate in science and technology, education and formation, culture, audiovisual sector, information and communication, environmental and natural resources, fisheries, social matters, and means to avoid and supersede poverty and regional cooperation. There are also statements about cooperation on refugees, human rights and democracy, consumer protection, data protection, and health. Of significance is the fact that the Mexico-EC and MS Agreement sets forth in article 43 an evolution clause, which establishes the possibility that the parties may expand the title on cooperation through mutual consent. Those resources needed to implement the policy on cooperation will be provided by the parties, and therefore, the parties will endorse the European Investment Bank to allow continued support for activities in Mexico.

Title VII sets forth the institutional framework.[41] The Mexico-EC and MS Agreement provides for the creation of a Joint Council entrusted with the application of this agreement.

40. *Id.*, tit. VI.
41. *Id.*, tit. VII.

The Joint Council will meet at the ministerial level at regular intervals and every time that circumstances so require. It will examine all main aspects arising out of the scope of this agreement and any other bilateral or international matters of mutual interest. The Joint Council consists of members of the government of Mexico and members of the council of the EU and of the European Commission. The members of the Joint Council may send representatives in accordance with the internal regulations to be established by the Joint Council.

The presidency of the council will be alternately chaired by a member of the Mexican government and a member of the council of the EU in accordance with the provisions of its internal regulations. In order to reach the objectives of the Mexico-EC treaty and its member states agreement, the Joint Council will be entitled to make decisions in those cases established in the agreement. The decisions to be adopted will be binding and the parties will take the necessary measures to adopt them. The Joint Council will also be entitled to make the pertinent recommendations. Decisions and recommendations will be adopted with the previous agreement between both parties.

The Joint Council will be assisted in its task by a joint committee composed of representatives (high officers) of the government of Mexico and by members of the council of the EU and of the European Commission. The internal regulations of the Joint Council will determine the obligations of the joint committee. It is expressly set forth that the Joint Council may delegate any of its authority to the joint committee. The joint committee will meet once a year, alternating between Brussels and Mexico City at the date agreed by the parties. The presidency of the joint committee will be alternately held by a representative of each one of the parties. The joint committee may also decide the creation of any other special committee to help it in the implementation of its duties. The Joint Council will decide on the establishment of a specific procedure for the solution of commercial controversies regarding commerce, compatible with pertinent WTO provisions.

The parties agreed to secure an elevated protection degree in respect of personal data and any other form of information.[42] Likewise, the parties will agree on a clause on national security. Therefore, the parties are entitled to take measures required to avoid the disclosure of information contrary to the essential interests of their security, the production and marketing of weapons, as long as they do not alter conditions of competition for matters other than exclusive military ends. In addition, the parties agreed to take measures to be considered essential to guarantee its security in cases of severe internal disturbance that can endanger social peace. The final act contains joint and unilateral declarations made concurrent with the signature of the Mexico-EC and MS Agreement. Double Taxation Treaties will still be applicable. This agreement is applicable in the territory of Mexico and the EC.[43] If one of the parties breaches its obligations in accordance with the Mexico-EC and MS Agreement, it may adopt the appropriate measures. Previously, and except for cases of

42. Note the recent safe-harbor mechanism established between the United States and the EU on this issue. To the extent that U.S. companies do business with Europe through Mexican partners, it will be important for all concerned to pay attention to the safe harbor guidelines and their counterparts in Mexican law.

43. Currently, there are 15 member states composing the EC. It is expected that in the following 10 years the EC's expansion could reach up to 25 member states. The conditions of accession set forth by the TEU (1993), as amended by the Treaty of Amsterdam (1997), provide that the acceding countries must adopt the *acquis communataire*. Therefore, a question that must be resolved is whether an enlargement of the EC will automatically incorporate those countries to the benefits/obligations of the Mexico-EC and MS Agreement, at least in those areas of exclusive competence of the EC.

special urgency (substantial breach), it must provide the Joint Council all useful information to review the situation in order to reach an acceptable solution within thirty days. The parties commit to choose those measures that disturb as little as possible the proper functioning of this agreement. Those measures will be notified immediately to the joint committee and will be subject to consultations within the Joint Council, if the parties so agree.

The Mexico-EC and MS Agreement is drafted in double counterparts in the following languages: Spanish, German, Danish, French, Finnish, Greek, English, Italian, Dutch, Portuguese, and Swedish, each one being equally authentic. This agreement was subject to ratification in accordance with the constitutional procedures of each of the parties. It is currently in full effect.

F. THE EU-MEXICO FREE TRADE AGREEMENT MARKET ACCESS COMMITMENTS

Mexico and the EU established a free trade area on July 1, 2000.[44] As a result of this new agreement, Mexico has the potential to increase its exports of manufactured goods and agricultural products to the EU. The EU should also increase exports of goods and services to Mexico and increase its direct foreign investment in Mexico as well. The EU-Mexico FTA will also create strategic alliances between Mexican and European companies to promote the transfer of technologies. The more favorable business climate will increase foreign capital investments in Mexico.

1. *Tariff Elimination*

Tariffs will be reduced immediately and then eliminated entirely between Mexico and the EU on the most ambitious schedule ever negotiated by either party.[45] The two trading partners recognized the asymmetry between Mexico and the EU in the staging of tariff elimination: 92.8 percent of bilateral trade in goods involves industrial products. While the EU already had zero duties on 60 percent of industrial exports from Mexico, this figure rose to 82 percent as of July 1, 2000. The EU will reduce all tariffs on Mexican industrial goods to zero by 2003; 52 percent of European industrial goods will enter Mexico duty-free by 2003, and the rest will face a maximum duty of 5 percent. Mexico will complete tariff elimination for EU goods in 2007.

2. *Automotive Sector*

A major goal for Europeans was enhanced market access to the Mexican automotive sector. European cars will enter the Mexican market under the same conditions as or better than those of NAFTA cars. Mexico agreed to eliminate its automotive decree, which has several restrictive regulations, by January 1, 2004.[46] Mexican tariffs were reduced from 20 percent to 3.3 percent and will be eliminated by 2003. EU vehicles imported by companies that are not established in Mexico will also benefit from the preferential treatment guaranteed under the agreement. Mexico has established a tariff rate quota (TRQ) for auto-

44. The full agreement is available in all EC languages on the DG Trade Web site at http://europa.eu.int/comm/trade/bilateral/mexico/fta.htm. *See also* Communication from the Commission to the Council and the European Parliament Accompanying the Final Text of the Draft Decisions by the EC-Mexico Joint Council, COM(2000)9, Jan. 18, 2000. *See* Speech/99/184 from 24 Nov. 1999.

45. EC-Mexico FTA, *supra* note 7.

46. *See* Communication from the Commission to the Council and the European Parliament Accompanying the Final Text of the Draft Decisions by the EC-Mexico Joint Council, COM(2000)9, Jan. 18, 2000.

mobiles being imported from Europe. This means that for the first two and a half years, Mexico will permit up to 14 percent of its automobile imports to come from the EU with special low tariffs (the in-quota tariff). Mexico will allocate up to 10 percent of its imports to EU firms already established in Mexico and the remaining 4 percent to EU firms new to Mexico. The tariffs on these in-quota cars from the EU will be identical to tariffs under the NAFTA: 3.3 percent for 2000, 2.2 percent for 2001, and 1.1 percent for 2002.[47] After 2002, there will be a zero duty, and from 2003 to 2006, there will be a single 15-percent quota for established or new firms. Mexico will still accept auto imports from the EU above this quota level, but they will be subject to a 10-percent duty. This TRQ will be abolished by 2007.

The Mexican auto industry will certainly benefit from this agreement as well. Mexico has been exporting about one million cars a year, primarily to the North American market, since tariffs to the EU have been 7 percent. This duty fell July 1, 2000 under the FTA to 3.3 percent and will fall to zero by 2003 as long as Mexican content is adequate. For the first three years of this agreement, local content must be at least 50 percent, based on the value added by Mexican producers. This is a bit stricter than the NAFTA rule, which assigns all the value of an auto part to Mexico if the imported components for that part have been significantly transformed in Mexico.[48] After the third year, the local content requirement will rise to 60 percent. This was one of the more difficult issues in the negotiation because Mexico had wanted a requirement for 30-percent local content.

As automobile manufacturers choose Mexico as an export platform for their vehicles, look for investment in Mexico to skyrocket. Already, Volkswagen, which produces in Mexico the popular Beetle for export to the United States and the EU, will increase its investment in Mexico by U.S.$1 billion, having decided to earmark a third of its worldwide investment budget to Mexico over the next five years. Volkswagen exports 300 new Beetles to the EU daily and imports one-third of its vehicle parts from Germany. Tariffs on these parts are due to be cut by more than half to 4 percent by 2005, significantly reducing the cost of production. DaimlerChrysler is also planning to invest U.S.$1.2 billion to solidify its production of its successful PT Cruiser, which is manufactured exclusively in Mexico. After a fifteen-year hiatus, Renault is planning a return to Mexico with an investment of U.S.$400 million in conjunction with its merger partner Nissan. Peugeot is also considering an investment in Mexico.

3. *Agriculture*

In the agricultural sector, 95 percent of Mexican agricultural exports will receive preferential access to the EU by 2007. Quantitative restrictions will be removed under the agreement. The agreement provides for much faster access for European products entering Mexico (four years) than Mexican access to Europe (seven years). Some of the products, such as grains, meat, milk products, potatoes, some fruits, and sugar, were excluded from coverage.[49] These products are covered by a European agricultural policy known for its export subsidies, intervention prices, and non-tariff trade barriers, which would put national products at a serious competitive disadvantage. With the exception of bananas, Mexican export products won favorable access to Europe. Many products are included in tariff elim-

47. The tariff elimination schedule is available at http://europa.eu.int/comm/trade/bilateral/mexico/fta.htm.
48. NAFTA, *supra* note 2.
49. EC-Mexico FTA, *supra* note 7.

ination periods (three periods: 2003, 2008, or ten years) or in tariff rate access quotas greater than ever before in history.

Agriculture has only represented 6 percent of Mexico's trade with the EU. Even though a significant number of important agricultural products were excluded from the EU-Mexico FTA, there will be ample opportunity for investment in Mexican agriculture due to increase of exports to the EU. These investments will be located throughout Mexico. The states of Nuevo Leon, Veracruz, Tamaulipas, and San Luis Potosi will benefit from the large quota negotiated for orange juice concentrate. The Mexican states of Michoacan and Guerrero will see their avocado exports increased. Exports of coffee will rise considerably from the states of Veracruz and Chiapas. The flowers from the states of Morelos and Mexico as well as the federal district are now on an equal footing with flowers from Colombia and various countries from Africa. Finally, the highly efficient tomato production from Baja California, Sonora, Sinaloa, and Yucatan can now enter the EU duty-free. One estimate has Mexican agricultural exports to the EU increasing tenfold over the next decade. Mexico has opened its economy to selected agricultural exports that were high on the EU priority list, including beer, certain vegetables, fruits and fruit juices, liquors and spirits (vodka, cognac, certain whisky, gin), cut flowers, tomatoes, and tobacco. Tariffs on certain wines have been reduced from 20 percent to 15 percent, although the agreement has quality wines (above $5 in value) becoming duty free by 2003.

Tariff quotas are identified in category 6.[50] Quotas will be managed in accordance with the conditions mentioned in the annex, on the basis of specific export documents issued by the exporting party. Import licenses will be issued by the importing party automatically within the agreed limit on the basis of export certificates issued by the other party.

4. *Sanitary and Phytosanitary Issues*

The tariff package will be complemented by provisions on sanitary and phytosanitary measures (SPS) with the establishment of a special committee to address and solve possible problems in this area. In this regard, Mexico has also committed itself to promptly resolve an outstanding SPS issue related to pig-meat products from the EU. The special committee will meet once a year to exchange information, identify and facilitate a solution to access problems, and promote equivalent standards between the EU and Mexico.

5. *Safeguards*

Safeguards may be established for a maximum period of three years to temporarily help a sector that is facing serious difficulties due to imports between the EU and Mexico. In all safeguard cases, compensation is required, although retaliation is permitted in the event of a failure to agree on the compensation package. In order to bring a safeguard action, products must be entering in such increased quantities and under such conditions as to cause or threaten to cause serious injury or serious disturbance in any sector of the economy or difficulties that could bring about serious deterioration in the economic situation of a region of the importing party. The safeguard action must have clear elements progressively leading to their elimination within one to three years. No safeguard can be placed on products previously subject to safeguards until three years after their expiration.

50. *Id.*, Category 6.

6. *Critical Shortage*

The parties have agreed to permit export restrictions or export customs duties in the event that tariff reductions or elimination of quantitative restrictions lead to a critical shortage or threat of a shortage of foodstuffs or other products essential to the importing party. Such measures may be applied to address a shortage of essential quantities of domestic materials supplied to a domestic processing industry during periods when the domestic price of inputs is held below the world price as part of a governmental stabilization plan. Such measures may also apply when shortages lead to re-export to a third country of a product against which the exporting party maintains export customs duties or export prohibitions or restrictions and the situation gives rise or is likely to give rise to major difficulties for the exporting party.

7. *Standards*

In most areas, the WTO agreements and rules provide the basic level of commitment. For example, the WTO Agreement on Technical Barriers to Trade provides the basis for the standards commitments. The EU and Mexico have agreed to establish a standards committee to promote cooperation regarding information exchange over standards systems and solutions to access problems related to technical standards. Similarly, a subcommittee on sanitary and phytosanitary standards will meet annually to exchange information, identify and solve access problems, and promote equivalent standards between the EU and Mexico.

8. *Government Procurement*

This agreement provides to EU providers access to the Mexican procurement market, which is essentially equivalent to that given to U.S. and Canadian producers under the NAFTA, including key EU priorities of petrochemicals (PEMEX), electricity (CFE), and construction.

9. *Textiles and Apparel*

Production of textiles and apparel for export to the United States has skyrocketed under the NAFTA. While much of that involves U.S. fabric, the EU has offered Mexico good access to its market as long as the fabric is of Mexican or EU origin. This should be a significant plus for the growing Mexican textile industry. The EU's tariff on Mexican clothing of 11.5 percent is being phased out over four years with duty-free exports in 2003. Meanwhile, Mexico is opening its market to EU apparel. As of July 1, 2000, the Mexican tariff of 35 percent was lowered to 20 percent. This will be reduced to five percent by 2003 and then phased out by 2007.

10. *Rules of Origin*

The general structure and provisions of the EC standard protocol were followed in this agreement. As a result, over 90 percent of the rules of origin follow the EC harmonized rules, simplifying the movement of goods between Mexico and Europe. The EU agreed to a transition rule for vehicles, engines, and garments so that the Mexican industries could adapt to the new standards.

Some rules were simplified, including those for some auto parts and electromechanical appliances.[51] For some chemicals, auto parts, and machinery, the rules were adapted to reflect the lack of raw materials or components in Mexico. Over 95 percent of Mexican exports will obtain rules of origin benefiting national production sectors. Sectors to be

51. *Id.*

emphasized include textiles, transportation and auto parts, electronics, footwear, chemicals, and plastics. While the EU will benefit from enhanced access to the Mexican market, the NAFTA rules of origin will prevent a flood of European agricultural and industrial products from entering the U.S. market duty-free through Mexico. For companies to gain preferential access to the EU for production in Mexico, a certain proportion of the product must be produced in Mexico (or the EU).

Most products are subject to the EU standard harmonized rules of origin. However, for some products this was deemed too restrictive due to Mexico's lack of production in certain products. For these goods, a more liberal rule of origin was adopted. Firms operating in Mexico that plan to export to the EU need to examine the product specific rule of origin required by the EU for preferential access under this agreement.

11. *Services*

Both Mexico and the EU viewed the services agreement as an important goal. They took an ambitious approach that provides for progressive liberalization of most services sectors beyond the basic commitments made in the WTO's General Agreement on Trade in Services (GATS)[52] within ten years. The GATS is embodied in part B as a separate package of commitments from those covering goods trade.

Several major services sectors will be covered, including financial services, telecommunications, distribution, energy, tourism, and environment. However, audiovisual, air transport, and maritime transport services are excluded from coverage. The liberalized treatment is equivalent to NAFTA treatment. European banks and insurance companies will be authorized to establish operations in Mexico like U.S. and Canadian firms.

12. *Investment*

The agreement is based upon the commitments established in the WTO Agreement on Trade-Related Investment Measures.[53] The parties agreed to begin immediately to progressively liberalize payments related to investments. Further liberalization of bilateral rules concerning investment and related payments will begin in three years. Mexico has concluded thirteen bilateral investment treaties with EU member states to mesh with the investment commitments of the FTA.[54]

Investment in Mexico has averaged about U.S.$11 billion per year since the start of the NAFTA. The new trade opportunities due to the agreement with Europe should significantly increase this level of investment. Besides the major increase in investment in the automotive sector described above, other sectors will also see significant inflows of capital. For example, Moulinex, a brand name producer of small appliances, has decided to close its plant in France and consolidate all of its production of irons to the state of Guanajuato in Mexico.

12. *Dispute Resolution*

The primary dispute settlement mechanism will continue to be the WTO Dispute Settlement Understanding (DSU).[55] To assist on issues related only to the specific commitments under the FTA, the parties agreed to create a dispute resolution mechanism with clear and quick procedures.

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52. GATS, *supra* note 37.

53. Agreement on Trade-Related Investment Measures, Sept. 27, 1994, 1994 WL 761642 (GATT).

54. *Supra* note 4.

55. Understanding on Rules and Procedures Governing the Settlement of Disputes, *available at* www.wto.org.

Under this system, the parties to the dispute will first hold consultations before the general committee. The committee has thirty days to issue its decision. At this point, the parties may request the establishment of an arbitration panel. Once the panel has issued its decision, both Mexico and the EU reserve their rights to appeal the panel's decision to the WTO. If the panel's decision is not implemented, then the parties have the right to temporarily suspend comparable benefits until the panel's decision has been implemented.

G. Expected Impact of the Free Trade Agreement

Both Mexico and the EU expect significant increases in their exports. Mexico should see an increase in the availability of consumer goods and services. Mexico expects to receive substantial new and profitable investment. Mexico has positioned itself as a global trade hub. Companies from all over the world should establish operations in Mexico to take advantage of its preferential access to U.S., Canadian, European, and Latin American markets. This agreement should help to broadly diversify the products traded between Mexico and Europe and increase trade volumes substantially. Currently, Mexico's primary imports from Europe are autos, textile machinery and equipment, construction machinery and equipment, telecommunications equipment, medicines, and milk. Mexico's primary exports to Europe are oil, auto motors and parts, coffee, silver, copper, and steel-laminated products. Under this agreement, the EU has obtained the same treatment as Mexico's NAFTA partners.

U.S. firms should not lose sales to Mexico. However, it is likely that the U.S. share of imports into Mexico might fall as a growing Mexico buys more products from the now cheaper EU. The U.S. Department of Commerce is developing a list of the few instances where the EU has negotiated tariffs lower than those that exist within the NAFTA. While the government of Mexico is under no obligation to accelerate tariff reductions under the NAFTA to match these lower levels, this will probably happen with pressure from the U.S. business community.

The bigger question is what will happen to U.S. sales to the EU. The reality is that the EU MFN tariff is already zero for about 60 percent of current Mexican exports to the EU. However, Mexico will have a tariff advantage on several important products, including motor vehicles, as listed in the following table. It is too early to tell how much trade diversion will take place because of these tariff preferences.

Product	Current EU MFN Tariff	Duty to Mexico	Tariff Elimination
Motor cars and vehicles	10%	3.3%	2003
Plastic manufactures	6.5%	0	Immediate
Nucleic acid and salts	6.5%	0	Immediate
Chemical products	6.5%	0	Immediate
Titanium pigments	6%	3.1%	2003
Aluminum articles	6%	3.1%	2003
Motorcycles	6%	3.1%	2003
Plywood Sheets	7%	3.7%	2003

From the point of view of U.S. firms, particularly the automotive firms that already have significant operations in Mexico, their share of overall sales to the EU is not likely to fall. What might change is the location of certain production. U.S. firms might move some production to Mexico to meet the EU rules of origin. Of course, if the sales to the EU rise fast enough from Mexico, the sales from the U.S. to Mexico of U.S.-made components for this production might increase more than the loss of sales directly to the EU.

H. Conclusion

The Mexico-EC and MS Agreement, its joint decisions, and the new FTA are an important step to consolidate the network of commercial and political agreements that Mexico has negotiated since the mid 1980s. Mexico cannot rely only on its American network for economic and trade growth, especially the NAFTA. For Europe, it is a new comeback to the American continent where it had lost hold. Mexico is changing not only from a commercial point of view but also from a political one. A newly elected democratic president has taken office (December 1, 2000), which reinforces Mexico's new direction of a market economy with a human face.

Human rights and democratic principles will continue to be a paramount objective of Mexico. Mexico signed this agreement not only for what the EC currently represents but also for what it will become. Market access is a priority and Mexico and the EC and its member states are aware of that. This agreement represents a new stage in Mexico's future that, even though started almost four decades ago, has achieved real momentum at the very end of the twentieth century. This is the start of a significant chapter in cross-Atlantic relationships, and specific results must await implementation and identification of new issues for further thoughts and evaluation.

The EU-Mexico FTA offers U.S. and Mexican firms the opportunity of increasing sales into the large EU market. Indeed, one can expect joint ventures of U.S. and Mexican companies that develop production within Mexico to meet the EU rules of origin for preferential access. These products would have content from both Mexico and the United States but would have a tariff advantage compared with products either coming directly from the United States or from other parts of the world. The key to benefiting from this FTA is a careful assessment of the rules of origin as they apply to specific products.

One may expect that the Mexico-EU agreements will have a ripple effect and that there will be more of these instruments signed with other nations in the hemisphere. However, as in the case of the NAFTA, Mexico has taken the lead while others might soon follow (at least they have expressed their will to do so). The diplomatic, political, and social impacts in the United States and Europe will have a critical role in the timing for all those new deals to come to fruition.

II. Rate Protection in Mexican Toll Road Finance

A. Background

In the early 1990s, Mexico promoted a rapid expansion of toll highways around the country. Most of the highway projects were financed through loans from Mexican banks, but at least three highways were financed through the placement of bonds in the international market. The concessions for most of such highways permitted toll increases to be effected in accordance with increases in Mexico's National Consumer Price Index (NCPI), and when the Mexican economy collapsed in early 1995 after a sharp devaluation of the Mexican peso in December 1994, inflation rose sharply with a corresponding increase in tolls on most of the newly financed highways. The impact on users of the roads caused some political difficulties for the Mexican government as well as concerns for the Mexican banks that had been involved in financing many of the road projects and were suffering severe pressures due to rising levels of non-performing loans in general, caused by the collapse of the economy.

The government decided in late 1997 to (1) revoke many of the concessions that had been granted to builders and operators of the highways that were financed by bank loans, (2) take over operation of such roads, and (3) issue government bonds to the banks through a new trust called FARAC, in exchange for their highway loans.[56] Although this rescue of the bank-financed roads provided some relief for the lending banks by removing problematic loans from their portfolios, it nevertheless caused the banks to record some losses by reason of the forced exchange of their loans for FARAC bonds. The rescue was followed by a reduction of tolls on many of the rescued roads.

The government elected not to include the highways financed by international bond offerings within its rescue package because this would have required the government to spend several hundred million dollars to acquire or prepay all of the bonds. The government did not attempt to offer FARAC bonds in exchange for international bonds. In general, the international bond documentation did not permit the bond payment terms to be amended without the consent of 100 percent of the bondholders, which would have been difficult to achieve, given the widely dispersed nature of the holders. As a consequence, the tolls on the securitized roads continued to be indexed to rises in the NCPI. Although in some cases the tolls are relatively high in relation to other toll roads, the quality of such roads also seems to be higher. The evidence from elasticity studies suggests that a reduction of tolls would create a risk that the roads would not generate sufficient revenues to cover all of the debt service on the bonds.

B. Government Challenges to Toll Structures

After the 1997 rescue was carried out, the Mexican government began to resist further toll increases on securitized roads. In the case of the Mexico City-Toluca road, the concessionaire and the operator were instructed by the bondholders to give effect to toll increases in accordance with the bond documentation, but the Mexican Ministry of Communications and Transport (the *Secretaría de Comunicaciónes y Transportes* or SCT) objected to such increases, claiming that tolls were already too high and asserting in early 1999 that the SCT's express authorization was required for each toll increase. This came as a surprise to the bondholders, who had been assured at the time the Toluca bonds were issued that such authorization was not required.

The Toluca bonds were issued in 1992, shortly after the Toluca highway concession was amended to provide expressly that tolls could be increased in accordance with any increase in the NCPI of 5 percent or more, or every six months (whether or not the NCPI increase during the six-month period equaled 5 percent or more). The amended concession required only that the toll increase be registered with the SCT along with the related evidence of

56. Diario Oficial de la Federación, Aug. 27, 1997, first section, at 35.

the NCPI increase. The offering circular for the international bonds contained a reference to the concession amendment and also specified that toll increases in accordance with NCPI rises would not require authorization from the SCT.

The intent or effect of the SCT's communications to the Toluca trust and bondholders since early 1999 is still in doubt. Was the SCT saying that the statements in the offering circular were incorrect or that it was in effect partially expropriating the trust's claim to the toll collection rights under the amended concession? To date, the SCT has failed to clarify its intent in this regard. In either event, the bondholders recently increased their pressure on the concessionaire and operator of the road to go ahead and effect the required toll increases, notwithstanding communications from the SCT.

A trust agreement[57] to which the concessionaire and operator are parties requires them to carry out the toll increases that the technical committee for the trust (controlled by the bondholders) instructs them to effectuate as long as the increases are justified by rises in the NCPI. The concessionaire and the operator have evidently failed to comply with such instructions because they are concerned that the SCT will retaliate by revoking the concession—a step that does not appear to be justified by the terms of the concession title as amended.

C. Implications of the Government's Position

The government's position has disturbing implications for the future of toll highway finance in Mexico and, indeed, for any future financing of Mexican infrastructure projects that may be premised on government assurances on rate protection. Mexico's needs for financing of water projects, gas distribution systems, and electric power projects are all likely to require some form of rate protection as one of the elements necessary to assure investors (including those providing debt financing) of the financial viability of the projects. If the proposals made in early 1999 by the Zedillo administration to privatize the electric power generation and distribution systems in Mexico, through changes to the Mexican constitution and related laws, obtain the approval of the incoming Mexican Congress in the next few months—as is now generally expected—then such privatizations may nevertheless be hampered by difficulties in obtaining financing for the private power projects that will then be legally permitted to be built. Such difficulties could be exacerbated by investor concerns over whether the Mexican government will honor commitments as to rate protection that are likely to be essential parts of the new concessions to be issued or whether it will later give in to political concerns over public reactions to unpopular toll or rate increases and prevent them from being carried out.

Of course, this problem is not unique to Mexico. Many countries, including a number of industrialized countries as well as developing countries, are faced with the challenge of how to turn over to the private sector various areas of activity that was formerly controlled by the government to reduce government expenditures and achieve greater efficiencies in such sectors without engendering political problems due to market-driven rate or toll in-

57. Trust agreement formalized in Public Deed No. 65, 113 (Oct. 5, 1990), granted before Mr. Ignacio Soto Borja, Notary Public No. 129 of the Federal District of Mexico, amended and restated pursuant to Public Deed No. 59,934 (June 17, 1992), granted before Mr. Francisco Javier Arce Gargollo, Notary Public No. 74 of the Federal District of Mexico.

creases. Mexico's problem is a special one in that by becoming a party to the NAFTA in 1994, it is being forced to accelerate the modernization of its infrastructure to compete more effectively in a dramatically new international trade environment.

In this context it is important that Mexico have modern and efficient new highways to speed the delivery of raw materials, equipment, and parts to its producers, and for the delivery of its export products to their markets, in the United States in particular. However, the fact that the income levels of the users of such highways are generally not as high as in more industrialized countries creates political pressures against relatively high tolls. Government subsidization of tolls, as in the case of the rescued roads, is one way of keeping tolls down to more widely affordable levels, but that requires the expenditure of scarce government resources that may be better devoted to areas in which the private sector has less experience, such as education and social services.

D. Conclusion

The new administration of Vicente Fox Quesada, which took office on December 1, 2000, will be forced to study this problem and come to decisions quickly in order to ensure that Mexico receives the new infrastructure finance it urgently needs to achieve its goals for growth in trade and industrial production. Although the issue of rate protection is a difficult one, it will have to be addressed in a way that gives assurances to investors and lenders that new highway and other infrastructure projects are financially viable while at the same time addressing the potential concerns of users.

III. Project Finance and Federal Guarantees Provided for Infrastructure Projects in Mexico

A. Introduction

Project finance has perhaps been one of the major tools used in the past decades to promote investment in significant infrastructure projects. Although project finance was initially conceived and used in developed countries, it has certainly turned into an indispensable tool for emerging economies in financing public works. Mexico is no exception.

In implementing project finance structures in Mexico, the Mexican government has developed a credit facility used as a guarantee, specifically designed to decrease financial and cash flow risks.[58] The mechanism has proven to benefit several projects related to public services and the investment on infrastructure, which was otherwise unbearable for the government. In this section, we briefly explain the mechanics and benefits of this structure because it has been implemented in several wastewater treatment facilities projects.

B. Project Finance and Associated Risks

Project finance is a term used mainly to describe the organization of financing, equity investment, and allocation of risks in major, capital-intensive infrastructure standalone pro-

58. The mechanism has been elaborated through Banco Nacional de Obras y Servicios (Banobras) by way of implementing several rules issued by the Ministry of Finance and Public Credit. There is no specific law or rule creating the mechanism, but rather the use and interpretation under different public and private laws, such as the *Ley de Coordinación Fiscal* and Regulations to Article 9 thereof and the *Ley General de Títulos y Operaciones de Crédito*.

jects. That is, there is limited recourse, if any, in the financing of the project. Therefore, viability of these standalone projects is based on the expected revenue stream arising from the operation of the facilities. These types of projects involve a wide array of areas such as construction and operation of power facilities, construction and operation of sewage systems and wastewater treatment plants, toll toads, pipelines, telecommunications, and others.

There is no question about the benefits generated by project finance, especially to emerging economies: (1) governments at federal and local levels are able to promote the investment in infrastructure; (2) the private sector, which is better prepared to develop such projects, participates in same; and (3) the population at hand receives the benefits associated with these projects (for example, electricity, means of communication, healthier environment, public services, and so on).

The success of infrastructure projects, as mentioned, is based on well assessed revenue streams. However, there are many risks associated with project financing, especially when the project is located in an emerging economy. The *main risks* associated with project financing in emerging economies are political risks (such as expropriation, war, civil unrest, lack of convertibility of currency, and breach of contracts by governmental entities), regulatory risks (lack of clear laws and regulations, underdeveloped legal regimes, slow and corrupt judicial systems, constant changes in law, and so on), economic or financial risks (such as purchase power capacity, convertibility of currency, devaluation, interest rates, and imposition of tariffs), market risks (such as lack of sales once the facility is operating, and lack of payment), supply risks (such as shortage of supply in essential products), construction risk (that is, failure to complete construction or defects in same), operation risk (that is, ability to maintain the facilities operating in order to ensure cash flows), and credit risk (that is, ability to obtain additional financing if required).

Some would say that the art of project financing resides precisely in the identification of each risk, mitigation of the risks to the extent possible, and allocation of the risks to the entities better suited to undertake such risks. By way of example, risks may be mitigated through insurance, contractual obligations, contingent credit lines, and letters of credit.

C. Mexican Government-Sponsored Projects Mitigating Cash Flow Risks

It has become evident in Mexico that the government is not the best entity suited to promote and invest in infrastructure projects. Simply put, the government is no expert in the construction and operation of the country's infrastructure needs. It is, however, responsible for providing the means to direct and promote such investments. That is precisely what the Mexican government has done in the past years.

Government-sponsored projects at a federal level are the most successful since the track record shows that the government honors its obligations. In these projects, cash flow risks are mitigated by a country risk evaluation. For instance, Mexico has increased its creditworthiness rating, and investors are therefore more likely to invest in Mexico than in other countries with lower ratings.

In order to promote infrastructure investment, the Mexican government has issued and amended a number of regulations that provided clear rules applicable to these projects. Procurement laws and regulations have been updated, bid processes have been made much more transparent, and the structuring of the projects has been made with the close aid and participation of the private sector.

This regulatory modernization, however, has taken place at a federal level. Local governments continue to have underdeveloped laws, confusing and in many cases contradicting regulations, and lack of knowledge on the structuring of projects. In addition, local governments are concerned with political issues rather than development and, most importantly, are not necessarily creditworthy. Needless to say, local infrastructure projects are difficult to promote but also present interesting business opportunities.

There is, however, a mechanism that mitigates to a great extent credit and market risks associated with project financing at state and municipal levels.[59] This mechanism consists of a guarantee of cash flows based on the relevant Mexican tax structure.

D. Mexican Tax Pool

The referred structure is based on a tax sharing system created by the Mexican government through the *Ley de Coordinación Fiscal*, or Tax Coordination Law (TCL), enacted in 1978.[60] The basic concept is that the federal government has created a pool of federal taxes collected by the central government and in some instances by local governments. The pool arises from the fact that various local governments are unable to collect certain taxes, primarily on sales and income, and are furthermore unable to obtain enough resources from such taxes to bear all public expenses.

The pool of taxes is distributed in an equitable manner among the different states and municipalities. The amount allocable to each state and or municipality is called a *participación*, or quota, and is delivered to such entities on a monthly basis. The quota allocable to each state depends on a specific formula, which takes into consideration, among other things, direct and indirect density of population and taxes collected and contributed by such state (see Chart A, p. 953). Article 9 of the TCL provides that quotas may not be attached nor used as collateral for a specific purpose except for payment of municipal or state obligations
in favor of the federal government, banking institutions operating in national territory, and individuals or entities of Mexican nationality. Using quotas as collateral, however, requires a prior authorization from the local congress and registration thereof with the Registry of Obligations and Loans of States and Municipalities kept by the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público* or SHCP). Municipal obligations may only be registered when such obligations are jointly guaranteed by the corresponding state government.

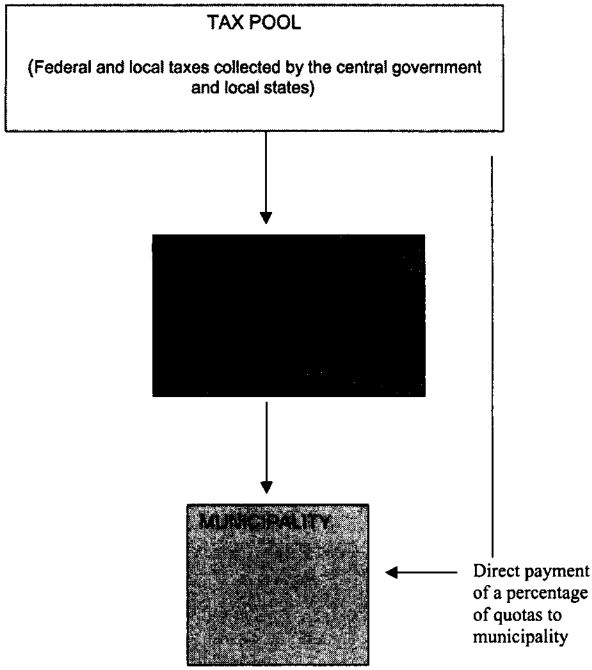
E. Quotas as Collateral

In order to promote investment in infrastructure projects, Mexico has allowed states and municipalities to use their corresponding quotas as collateral in projects sponsored by local authorities. The structure is used for financing the construction and operation of facilities, reducing the risks of non-payment of compensation for operating and or managing facilities, financing other urban infrastructure projects engaged by government owned utilities and municipalities, and supporting the private sector in obtaining financing both in national and international markets.

Projects sponsored by local authorities have little chance for success given, among others, the low creditworthiness of the entities and the lack of sophistication and political risks

59. *See Ley de Coordinación Fiscal*, art. 9 (Mex.).
60. *Ley de Coordinación Fiscal* (Tax Coordination Law), D.O. 27 de diciembre de 1978 (Mex.).

CHART A



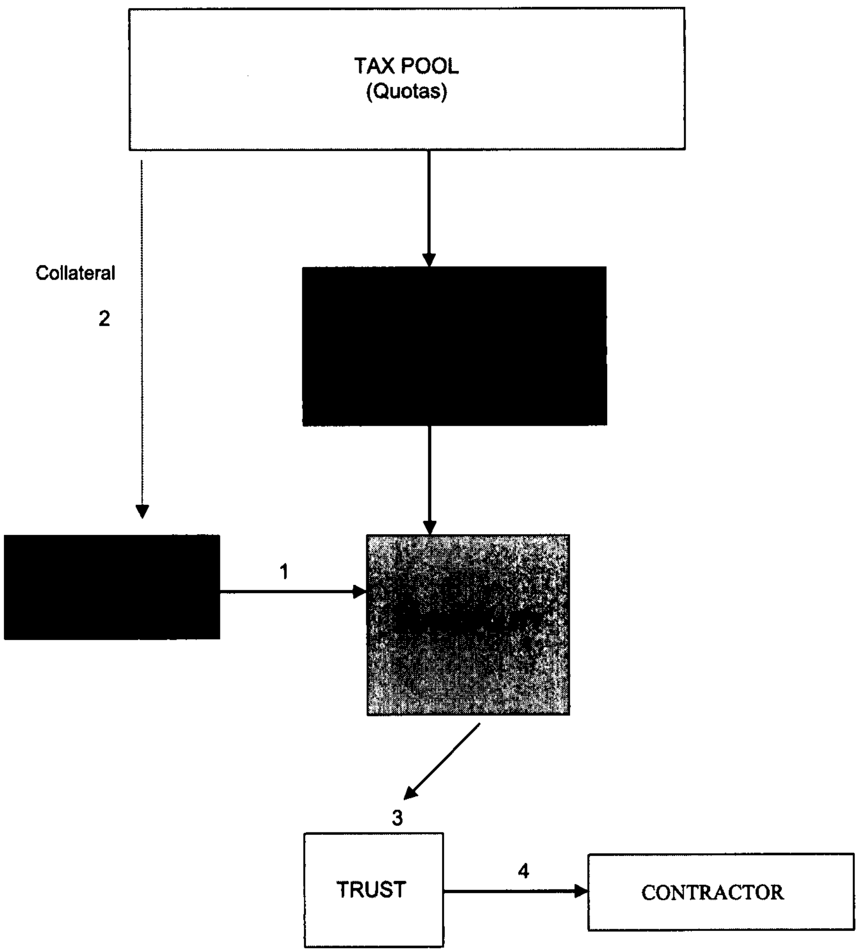
associated thereto. By way of guaranteeing payment to contractors through the creation of collateral over quotas, the private sector is assured that, upon compliance with all of its obligations, payment will come. This mechanism lowers the risks associated with project finance because revenue streams (the only source of payment) are assured by local authorities. Collateral over quotas, however, is not directly for the benefit of contractors; rather, it is created through a mechanism in which the sponsor obtains a contingent line of credit for payment of services and in case such line of credit is used and not reimbursed, then quotas are used as guarantee. A trust mechanism is generally used to ensure the automatic use of proceeds (see Chart B, p. 954).

1. *Nature of Contingent Revolving and Irrevocable Lines of Credit*

In order to promote private investment in local government-sponsored projects, a secured line of credit is obtained. The line of credit is irrevocable in order to ensure that upon using the quotas as collateral, the same will not be revoked. Lines of credit are regulated by the General Law of Credit Instruments and Operations (*Ley General de Títulos y Operaciones de Crédito*)[61] as revolving credit agreements.

61. *Ley General de Títulos y Operaciones de Crédito* (Credit Law) (Mex.). Title 2, Chapter IV of the Credit Law regulates credit operations. *See id.* arts. 291–310.

CHART B



1. A contingent revolving line of credit is opened in favor of a municipality.
2. The municipality, with the prior authorization by the state Congress and with the joint obligation of the state, uses quotas as collateral in favor of a lender.
3. The right to draw on the line of credit is effected as a trust (the contractor is appointed as beneficiary).
4. Failure to pay directly to a contractor enables the contractor to use the proceeds from the line of credit through the trust. Failure to pay the lender matures the guarantee, and the lender may collect from quotas.

Under this type of credit agreement, a borrower is allowed to disburse totally or partially the principal amount of the credit and to make partial payments thereto during the term of the agreement. These payments will replenish the principal amount of the credit and may thus be disbursed again by the debtor. Unless otherwise agreed, the full amount of the credit may be withdrawn by the borrower at any time in immediately available funds. Pursuant to the Law of Credit Instruments, these credit facilities may be extinguished for the following reasons:

- the borrower disburses the full amount of the credit, unless it is a revolving credit;
- expiration of the term or, when there is no specific term, at any time with prior notice to the borrower;
- when the credit is denounced (that is, restricted) by the creditor under the terms of article 294 of the Law of Credit Instruments (irrevocable lines of credit, however, may not be denounced);
- lack or loss in value of guarantees provided, unless the guarantees are substituted;
- suspension of payments or bankruptcy of any party to the credit agreement; and
- dissolution/liquidation of borrower.

2. *Entities Providing Lines of Credit*

While all commercial banks authorized to operate in Mexico provide these types of credit facilities, most are reluctant to open irrevocable lines of credit in favor of governmental entities. The reason is that collecting from quotas may prove burdensome and will certainly damage their relationship with local governments. However, the *Banco Nacional de Obras y Servicios Públicos, S.N.C.* (Banobras), a Mexican development bank owned by the federal government, does provide this facility.

As a federal development bank, Banobras renders banking services oriented to promote and finance projects within the objectives of the national development program (issued by each presidential administration). Therefore, Banobras assists the federation, states, and municipalities in urban development, infrastructure, and public services. Among other specific objectives, Banobras finances and renders technical assistance to municipalities in implementing urban development projects. Thus, Banobras is the ideal entity to provide these types of credit facilities.

3. *Banobras's Role in Issuing a Line of Credit*

In pursuing its purpose, Banobras has promoted the concept of the *irrevocable contingent line of credit* to grant security to private investors that municipalities will pay the corresponding compensation agreed to in public works or services contracts. The idea in this case is that most municipalities lack the financial strength to attract participation of the private sector in infrastructure projects. Therefore, certainty of payment creates incentives for the private sector for participating in such projects.

Banobras's lines of credit are intended to provide for an alternate source of payment by municipalities to service providers or any other long term contractors and reduce commercial risk on the operations. Banobras's lines of credit have also been specifically designed to cover tariff payments on wastewater treatment plants. In these cases, Banobras opens a line of credit in favor of a municipality or in favor of a specific municipal utility, usually equal to three or six months of tariff payments (depending on each project). This amount is adjusted periodically to reflect inflation. The municipality and the state government guarantee payment to Banobras of any disbursed amounts by using the quotas they are entitled to receive from the SHCP as collateral.

The main advantages of the Banobras' Lines of Credit are that they allow local governments to promote infrastructure projects with the participation of the private sector and, thus, allocate less state resources to the project; provide security to the private sector in allowing public services through concessions or service contracts, including finance institutions by ensuring that a corresponding municipality or utility will have resources to pay the corresponding tariffs; create a contingent source of funds to cover cash liquidity problems, and pay the respective contractor; provide immediate liquidity to the projects; and efficiently cover risks and reduce costs for funding the projects.

Banobras's lines of credit have been used to (1) finance the construction and/or operation of public works, (2) reduce risks on non-payment of compensation to the contractors that operate and/or manage the facilities, (3) finance other urban infrastructure projects engaged by utilities or municipalities, and (4) support the private sector in obtaining financing both in the national and international markets.[62] Thus, Banobras's lines of credit have benefited state governments, municipalities, and the private sector in developing infrastructure projects—especially those related to wastewater treatment plants.

4. *Operation of the Line of Credit*

For Banobras to issue a line of credit in favor of a municipality or utility, Banobras will first analyze the financial strength of the corresponding entity and determine if it has the capacity to pay according to its own cash flows. Banobras will usually work closely with the entity in structuring the project, including the issuance of the corresponding bid, drafting of the service contract or concession, and issuing the rules for the supervision of the works. Once Banobras endorses the project, it then authorizes the opening of the line of credit in favor of the entity. The entity must follow a specific procedure, which includes local congress authorization, as explained below, to contract the line of credit.

When the line of credit is contracted, the entity then assigns the right to disburse on the line of credit to a trust specifically created for this purpose and appoints a contractor as the beneficiary of the trust. This structure ensures prompt use of the line of credit by the contractor since no instruction will be required from the entity to disburse. If within the term of the specific contract the entity is unable to pay the corresponding compensation, the trust triggers the line of credit to pay such compensation to the contractor. The entity is then obligated to pay Banobras the corresponding amounts disbursed under the line of credit.

Once the entity pays, the line of credit is replenished. However, in the event the entity does not pay in time, Banobras is then entitled to draw on payment from quotas allocated to the municipality or the state government by the SHCP. Payment through the drawing of quotas replenishes the line of credit.

5. *Procedure Required for Municipalities or Entities to Contract a Line of Credit and Guarantee Credits with Quotas*

Pursuant to the Mexican Constitution, states or municipalities may not obtain credits except to the extent they are destined to productive public investments, including those

62. *See Linea Contingente y Pendiente para Proyectos de Infraestructura Hidraulica*, issued by Banobras (on file with author).

credits obtained by public agencies or bodies such as utilities, and in this case to the extent permitted by local law.[63]

On a local basis, the credits and the granting of guarantees with quotas are to be authorized by a local congress. Once the local congress authorizes the credit, the specific entity is free to negotiate the terms of the line of credit within the limits set forth in the corresponding congressional decree.

Pursuant to the regulations in article 9 of the TCL,[64] registration must meet the following requirements:

- that the obligations be paid within Mexico and in Mexican currency, for payment of public investments or contingent obligations pursuant to the terms authorized by the local congress, up to the amounts so authorized and included in the corresponding state budget;
- that in the event the obligation is evidenced in a negotiable credit instrument (*título de crédito*), language be included restricting circulation only within Mexico;
- that the local congress have previously authorized the use of quotas corresponding to the state or municipality as collateral;
- that quotas to be received by the state or municipality be sufficient to guarantee payment of the respective obligations;
- that recent fiscal and financial information of the state or municipality be published in a local and national newspaper; and
- that the corresponding state or municipality not be in default on other debt owed to other development banks.

Once the aforementioned conditions are met, the SHCP makes the corresponding notations in the registry. Any amendment to the obligations shall be registered only if the formalities followed for initial registration are met.

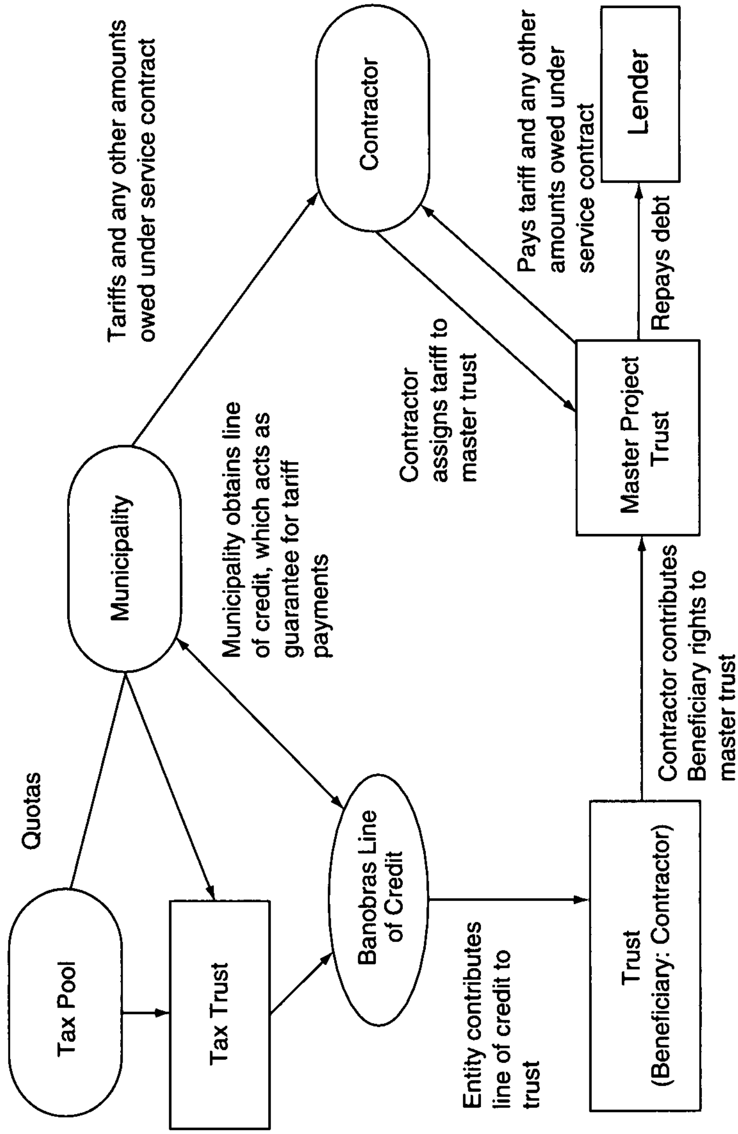
Article 11 of the TCL regulations provides that registration of the obligations grant creditors the right to collect from quotas in case of breach. For this purpose, the creditor must inform the SHCP of the failure of payment, which will be confirmed by such ministry. The SHCP shall then pay any corresponding amounts, making the deduction from any quota corresponding to the state or municipality. Although not specifically contemplated in the TCL or its regulations, state governments will usually grant to the SHCP a power of attorney allowing the SHCP to pay an entity such as Banobras the outstanding amounts of state obligations breached. For such purpose, the state's quotas are used.

Currently, the payment structure is being changed nationwide in order to transfer all quotas to a master trust, which then makes the corresponding payments. In this manner, the SHCP only has the obligation to pay the quotas to such trust, thus avoiding unnecessary confrontation with states or municipalities. It is the trust that makes the corresponding allocation through specific irrevocable instructions given by states or municipalities. Although not perfect, this mechanism has served as the basis to finance many projects (see Chart C, p. 958).

63. *See* Constitución Política de las Estados Unidos Mexicanos [Mexican Constitution] art. 117, § VIII.

64. *Reglamento del Articulo 9 de la Ley de Coordinación Fiscal en Materia de Obligaciones y Emprestitos de Entidades Federativas y Municipios*, D.O. 7 de julio de 1982 (Mex.).

Chart C
Usual Project Structure



F. Conclusion

Through the creation of the line-of-credit mechanism and using quotas as collateral to back up local government-sponsored projects, many infrastructure projects that would otherwise have been unbearable due to financial costs have been successfully promoted by Mexican local governments. The line of credit effectively reduces financial risk, thus attracting national and international financing to projects. The opportunities are ripe for multiple projects to benefit from this financing structure, considering the dire infrastructure needs that Mexico has in many areas nationwide.