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Mexican Foreign Investment Laws: An Overview

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MEXICAN FOREIGN INVESTMENT LAWS: AN OVERVIEW

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I. INTRODUCTION

Mexico represents one of the most successful cases of market economy development in Latin America.[1] This development began during the administration of President Miguel de la Madrid and has continued during the presidency of Carlos Salinas de Gotari.[2] Initiatives to develop a market economy have included the Solidarity Plan,[3] the privatization of the economy,[4] tax reform,[5] a restructuring of debt,[6] and the enactment of intellectual property laws.[7]

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1. *See* Gary Hector, *Why Mexico is Looking Better*, FORTUNE, Jan. 15, 1990, at 135.

2. President de la Madrid served from 1982 until 1988. The current President, President Salinas, has served since 1988. Juanita Darling, *Profile: On the Ground Floor of Mexico's Privatization*, L.A. TIMES, Sept. 10, 1991, at 3, col. 1.

3. The Solidarity Plan began in early 1988 as an agreement between the government, the business community and organized labor to reduce the high inflation rate. Statisticians placed Mexico's inflation rate between 100% and 160% during 1987. Under the plan, the government agreed to limit spending, business agreed to limit price increases, and organized labor agreed to limit its wage demands. The Solidarity Plan was partially responsible for the reduction in inflation to 18% in 1988. Inflation increased slightly to 20% for 1989 and was measured at 27% in 1990. Most importantly, the Solidarity Plan brought together key sectors of the Mexican economy, something thought impossible by many observers. *See* Harold D. Skipper, Jr., *Mexico City; World Insurance Reform*, BEST'S REVIEW—PROPERTY-CASUALTY INSURANCE EDITION, Feb. 1990, at 76.

4. The privatization of the economy has been an ongoing process throughout the Salinas Administration. By the end of 1989, Mexico was in the process of denationalizing approximately 800 businesses. Included in the process of privatization are the country's telephone companies, airlines, copper and steel industries, and banking systems. Hector, *supra* note 1, at 135.

5. Mexico's tax laws are being restructured, following closely the Reagan Administration's reforms of the early 1980s. Income taxes have been reduced from 42% to 35% for corporations, and the overall tax structure has been greatly simplified. Francisco Gil Diaz, *Mexico's Internationally Competitive Tax System*, BUSINESS MEXICO, Jan./Feb. 1992.

6. The Brady Plan was proposed in March 1989 by U.S. Secretary of the Treasury Nicholas Brady. Under the plan, Brady proposed debt restructuring and debt-service reductions for third world debtors. U.S.-Mexico Relations, DEP'T ST. BULL., July 1989, at 73-75.

On February 4, 1990, Mexico rescheduled $48.1 billion of its $93.6 billion medium- and long-term debt. It was the first country to do so under the Brady Plan. This reduced Mexico's annual interest to $1.1 billion and freed up $1.45 billion. Most importantly, Mexico's debt rescheduling signalled to the financial world that Mexico would continue to act responsibly to pay its debts and stabilize its economy. *Mexican Debt: To Him That Hath Not*, ECONOMIST, Apr. 27, 1991, at 82.

7. The most recent initiative has been the enactment of new intellectual property laws. On June 27, 1991, the Mexican Congress enacted the Law on the Development and Protection of Intellectual Property, which repealed all earlier intellectual property laws and regulations, including those concerned with technology transfer. *Ley para Desarrollo y Protección de Propiedad Intelectual*, D.O., June 27, 1991. The 1991 Intellectual Property Law brings Mexico's intellectual property laws in line with those

Reform also has come in the area of foreign investment. On May 16, 1989, the government liberalized its foreign investment laws by issuing new regulations[8] to the 1973 Law to Promote Mexican Investment and to Regulate Foreign Investment. However, the law itself has remained unchanged.[9] While the 1989 Regulations were designed to provide more clarity to foreign investment rules and to open up a wider range of investment opportunities, they did not make all of the changes desired by the international business community. By leaving the 1973 Foreign Investment Law intact and reworking regulations,[10] the government retained the flexibility to expand or restrict the investment opportunities as the Mexican economy changes.[11]

This Article will discuss the development of Mexican foreign investment laws and regulations over the past two decades, beginning with a discussion of the 1973 Foreign Investment Law and continuing with a discussion of the 1989 Regulations. It will also address how the international business community has responded to the 1989 Regulations. The article concludes with a discussion of how foreign investment in Mexico may be

of the United States and many of the Western European nations. John McKnight & Carlos Muggenburg, *The New Look in Mexico's Intellectual Property Protections*, TEX. LAWYER, July 29, 1991, at 13.

8. *Reglamento do la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, D.O., May 16, 1989, *translated in* GONZALEZ VARGAS BRYAN & GONZALEZ BAZ BRYAN, FOREIGN INVESTMENT IN MEXICO: A SUMMARY OF LAWS AND REGULATIONS CURRENTLY IN FORCE (1991) [hereinafter Translation of 1989 Regulations]. For ease of reference, these regulations shall be referred to as the 1989 Regulations.

9. *Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, D.O., Mar. 9, 1973, *translated in* MEXICAN NATIONAL COMMISSION OF FOREIGN INVESTMENT, FOREIGN INVESTMENTS: JURIDICAL FRAMEWORK AND ITS APPLICATION (1984) [hereinafter Translation of 1973 Law]. For ease of reference, the law shall be referred to as the 1973 Foreign Investment Law or 1973 Law.

10. *Id.* The limitations of Mexico's willingness to open up its economy to free trade becomes apparent when contrasting the 1989 regulations to more recent legislation. For example, in the area of intellectual property legislation, the Mexican government has gone a long way to please the international pharmaceutical industry, which gained substantial protection under the 1991 Intellectual Property Law. *IP Law Passed, Parallel Imports an Issue*, BUS. LATIN AM., July 15, 1991, at 225-26.

While gaps remain in the 1991 Intellectual Property Law with respect to certain industries, e.g., computer software, these gaps may be filled when regulations to the 1991 Intellectual Property Law are issued. These new regulations are projected to be issued in the first half of 1992. Alfredo Rangel, Address Before the 17th Annual International Business Law Institute (Nov. 15, 1991).

11. Dionisio J. Kaye, *Mexico: Liberalizing Foreign Investment*, 4 TEMP. INT'L & COMP. L.J. 79, 90 (1990).

affected by the proposed North American Free Trade Agreement.

II. THE FOREIGN INVESTMENT LAW OF 1973 AND ITS APPLICATION

A. *Foreign Investment Before 1973*

Over the past century, Mexican foreign investment strategies have reflected Mexico's prevailing economic situation. The first attempt at a foreign investment strategy started during the era of President Porfirio Diaz (1880-1910) and lasted through the end of the 1920s. This strategy discouraged government intervention in favor of free market development.[12] It required exploiting natural resources to develop local infrastructure.[13]

By the end of the 1920s, the Great Depression and the political chaos brought about by the Mexican Revolution forced the government to lessen or eliminate foreign control of its basic industries.[14] These policies were strengthened during World War II, when a presidential decree gave the government the authority to control the participation of foreign companies in domestic businesses.[15]

After World War II, Mexico's economy expanded dramatically, particularly in the export of primary products.[16] Tc diversify the economy, the government followed a version of the then-popular import-substitution theories.[17] These theories called for developing, producing and manufacturing certain intermediate and capital goods in order to lessen imports and build the local infrastructure necessary to produce world-class goods in the future.[18] To achieve these goals, the government moved to protect local industry. One example of this policy was the subsidization of automobile parts manufacturers who, because of government local-content policies, had an oligopoly in selling to the large foreign automobile assemblers in Mexico.[19]

12. PETER MORICI, TRADE TALKS WITH MEXICO: A TIME FOR REALISM 20 (1991).
13. *Id.*
14. *Id.* at 17-20.
15. *See* Kaye, *supra* note 11, at 79.
16. MORICI, *supra* note 12, at 17-20.
17. *Id.*
18. *Id.*
19. *See* Jorge Camil, *Mexico's Auto Industry: The Last Bastion of Protectionism Falls?*, 12

By the early 1970s, it had become clear that import-substitution policies alone were insufficient to solve Mexico's economic problems.[20] The government instead began to promote the development of export-oriented products and capital goods. To increase its exports, Mexico needed foreign assistance to improve technology, invest in new industries, and manufacture goods for export.[21]

B. 1973 Foreign Investment Law

To meet these goals, the Mexican Congress passed the 1973 Foreign Investment Law.[22] Under early interpretations of the 1973 Law, all foreign investment had to be registered with the government in order to receive government protection and avoid civil penalties.[23] The purpose of the law was "to promote Mexican investment and regulate foreign investment in order to stimulate a just and balanced development and consolidate the country's economic independence."[24] The key to balanced development under the 1973 Law was the granting of certain commercial activities only to the Mexican state and to Mexican citizens and companies.[25]

The 1973 Law also required that foreign investment in other Mexican corporations not exceed 49%.[26] Exceptions to the 49% rule were made only when the government deemed a particular foreign investment as critical to the development of certain economic or fiscal policies.[27] These criteria generally were designed to protect Mexican industries and workers while recognizing the value of investments in high-technology, high-quality markets.

HOUS. J. INT'L L. 191 (1990) (discussing the Mexican government's regulation of its auto industry).

20. *See* MORICI, *supra* note 12, at 19.

21. *Id.* at 19-21.

22. Translation of 1973 Law, *supra* note 9.

23. *Id.* chs. 5, 6.

24. *Id.* art. 1.

25. *Id.* art. 4.

26. *Id.* art. 5.

27. *Id.* art. 13. These exceptions were made only after the Mexican Foreign Investment Commission examined certain criteria and characteristics of the investment. The criteria for analyzing a particular foreign investment are enumerated in article 13 of the 1973 Law:

> I.—That it [the foreign investment] be complementary to national investment;
>
> II.—That it should not displace national business enterprises that are

The 1973 Law was designed to reflect flexibility on the part of the Mexican government.[28] It established what Professor Michael W. Gordon described as the "operational code," the unwritten, unknown rules which govern the actions of a government.[29] The "public code," according to Professor Gordon, is a government's established, written law.[30]

Accordingly, Mexico's operational code was the Foreign Investment Commission's case-by-case authorization under article 13 of the 1973 Law; its public code was its law permitting only 49% foreign investment. However, a foreign investor could exceed the 49% rule by convincing the Foreign Investment Commission that a particular investment met some or all of the seventeen characteristics found in article 13.[31] Because

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operating satisfactorily, and that it should not enter fields that are adequately covered by such enterprises;

III.—Its positive effect on the balance of payments and, especially, on the increase of Mexican exports;

IV.—Its effects on employment, taking into account job opportunities created and wages paid;

V.—The employment and training of Mexican technical and management personnel;

VI.—The incorporation of domestic inputs and components in the manufacture of its products;

VII.—The extent to which it finances its operations with resources from abroad;

VIII.—The diversification of sources of investment and the need to foster Latin American regional and subregional integration;

IX.—Its contribution to the development of the relatively less economically developed zones or regions;

X.—That it should not enjoy monopolistic position in the domestic market;

XI.—The capital structure of the branch of economic activity involved;

XII.—Its contribution of technology and its assistance in the country's technological research and development;

XIII.—Its effect on price levels and quality of production;

XIV.—That it should respect the country's social and cultural values;

XV.—The importance of the activity in question in the context of the country's economy;

XVI.—The extent to which the foreign investor is identified with the country's interest and his connection with foreign centers of economic decision; and

XVII.—In general, the extent to which it complies with, and contributes to the achievement of national development policy objectives.

Id.

28. *See* Kaye, *supra* note 11, at 81.

29. Michael W. Gordon, *Of Aspirations and Operations: The Governance of Multinational Enterprises by Third World Nations*, 16 U. MIAMI INTER-AM. L. REV. 301, 325-40 (1984).

30. *Id.*

31. *Id.*

of its flexibility, Mexico's operational code resulted in a degree of uncertainty for potential foreign investors.

The operational code in Mexico has tended to differ with changing economic conditions. When the economy was strong or when an election was approaching, the Foreign Investment Commission tended to take a tougher view of the article 13 criteria. Other times, particularly when the economy was weak, the Commission approved investments that it might have rejected earlier.

The flexibility of the 1973 Foreign Investment Law worked reasonably well until 1982, when the Mexican economy took a sudden and sustained fall due to failing petroleum prices.[32] This resulted in a substantial increase in Mexico's external debt, higher inflation, substantial capital flight, and a 0.5% decline in the GNP in 1982 and 5.3% decline in 1983.[33] By the end of 1983, the Foreign Investment Commission began to gradually relax Mexico's foreign investment policies.[34] It is in this environment that the 1989 Regulations were issued.

III. The 1989 Regulations to the 1973 Foreign Investment Law

A. *Background*

On May 16, 1989, President Salinas issued new regulations to the 1973 Foreign Investment Law.[35] The 1989 Regulations repealed all existing administrative regulations and decrees, as well as the general resolutions of the Foreign Investment Commission.[36] The government, however, decided to leave the 1973 Foreign Investment Law intact because it considered the law a flexible instrument capable of adapting to the economic conditions in the country.[37]

The 1989 Regulations represent one of the general mechanisms used by the de la Madrid and Salinas Administrations to

32. David B. Hodgins, Comment, *Mexico's 1989 Foreign Investment Regulations: A Significant Step Forward, But Is It Enough?*, 12 Hous. J. Int'l L. 361, 362 (1990).

33. Ignacio Gómez-Palacio, *The New Regulation on Foreign Investment in Mexico: A Difficult Task*, 12 Hous. J. Int'l L. 253, 253 (1990).

34. Jorge Camil, *Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model*, 12 Hous. J. Int'l L. 1, 2 (1989).

35. Translation of 1989 Regulations, *supra* note 8, at 5.

36. *Id.* Transitory Articles; *see also* Kaye, *supra* note 11, at 82.

37. Kaye, *supra* note 11, at 81.

combat the ills besetting the Mexican economy.[38] Additionally, it is apparent that the 1989 Regulations had two other purposes: to increase the level of foreign investment in Mexico and to replace government debt with private equity.

Simply put, the 1973 Law and the old regulations had not brought sufficient foreign capital into the country. A 1989 report in the *U.S. Department of State Bulletin* stated that Mexico's laws and regulations discouraged foreign investment.[39] Besides the general restrictions, investors were turned away by the arbitrary and complicated procedures established by the Foreign Investment Commission.[40] Investors did not know whether their proposed investments would be approved and often faced arbitrary changes after their applications had been approved.

The 1989 Brady Plan, however, countered this uncertainty by conditioning debt reductions and restructuring on the liberalization of Mexico's foreign investment laws and regulations.[41] This restriction made sense given that Mexico could no longer obtain borrowed funds to fuel its economy. Consequently, the 1989 Regulations were an attempt to move Mexico's emphasis away from borrowed funds and government debt and toward increased foreign investment in the private sector to build private equity.[42]

B. *Overview of the 1989 Regulations*

1. *Classified Economic Activities*

An appendix to the 1989 Regulations sets out six classifications of activities that either limit the scope of foreign investment or require Foreign Investment Commission approval before an investment can exceed 49%.[43] The first classification consists of activities reserved to the state, such as extraction of petroleum, natural gas, and uranium; the manufacture of petrochemical products and refinement;[44] and the minting

38. *See supra* notes 3-7.
39. DEP'T STATE BULL., *supra* note 6, at 73.
40. *See supra* text accompanying notes 28-31.
41. DEP'T STATE BULL., *supra* note 6, at 73.
42. Camil, *supra* note 34, at 9-12.
43. Translation of 1989 Regulations, *supra* note 8, art. 5, at 23-25. The appendix to the 1989 regulations classifies the economic activities.
44. *Id.* at 77-88

of coins.[45]

The second classification consists of activities reserved to Mexicans citizens. These include forestry; retail trade in liquified petroleum gas; cargo, surface and some high seas transportation; some credit and insurance services; radio and television broadcasting; and notary services.[46] The third classification includes coal, iron and sulfur exploration and extraction.[47] In this classification, foreign investment is permitted up to 34% of corporate capital.

The fourth classification governs the automotive industry and the manufacture of secondary petrochemical products.[48] Foreign investment in these activities is permitted up to 40% of the corporate capital. The fifth classification includes fishing; telephone services; and extraction of non-ferrous metallic ores, rocks, clay and sand.[49] In this classification, foreign investment is permitted up to 49% of corporate capital.

The final classification of activities consists of agriculture; cattle raising; print shops and magazine publications; construction and installation services; private education; legal, accounting and financial services.[50] Foreign investment in these activities requires prior approval of the Foreign Investment Commission for more than 49% foreign ownership.

The classified activities account for only a third of all possible investment activities.[51] Outside of these classifications, foreign investment is permitted up to 100%. Investors may therefore completely avoid the administrative discretion provided by the 1973 Law and the old regulations.[52] This is true even for classified activities, as foreigners may participate up to 100% through a trust mechanism in which a Mexican bank is the direct owner of the shares and the foreign investor is the beneficiary.[53]

45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.*
51. Rangel, *supra* note 10.
52. Translation of 1989 Regulations, *supra* note 8, art. 5, at 23-24.
53. Translation of 1989 Regulations, *supra* note 8, art. 23, at 33-34. The trust mechanism cannot be utilized for activities reserved exclusively to the state. For nearly twenty years, the trust mechanism has been popular for the acquisition of property rights that were restricted under the 1973 Law—property within 100 kilo-

2. Investment in Unclassified Activities Through New Companies

Under the 1989 Regulations, if a foreigner organizes a new company that does not participate in any classified activity, there is no approval requirement for 100% foreign investment if the investor meets a series of criteria defined in the 1989 Regulations.[54] These requirements are (1) the amount of investment in the pre-operational stage may not exceed the peso equivalent of $100,000,000; (2) the funds for the investment must come from abroad unless the foreign investor already has operations in Mexico, in which case the investment can come from the Mexican assets of the foreign investor; (3) the enterprise created by the foreign investment must maintain a balanced foreign currency budget for the first three years of the investment; (4) industrial or manufacturing enterprises must not be located in areas designated for controlled growth, such as Mexico City, Guadalajara and Monterrey; (5) the enterprise must create jobs on an ongoing basis and establish ongoing human resources training programs; and (6) the enterprise must utilize appropriate technologies and abide by the environmental laws of the country.[55]

3. Investments in Unclassified Activities Through Established Mexican Companies

Foreign investment in established Mexican companies that participate in unclassified activities is less restrictive under the 1989 Regulations. Prior to 1989, foreign investments in existing Mexican companies, without Foreign Investment Commission approval, was limited to acquisition of a total of 25% of the capital or 49% of the fixed assets of the enterprise.[56]

The 1989 Regulations allow the acquisition of up to 100% of the shares of an existing Mexican company without authorization so long as all provisions associated with newly-formed companies are met. The foreign investor must also invest in new fixed assets equivalent to at least 30% of the net value of

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meters of the borders or 50 kilometers of the sea coasts. *See also infra* text accompanying notes 66-70.

54. Translation of 1989 Regulations, *supra* note 8, art. 5, at 23-24.

55. *Id.*

56. Translation of the 1973 Law, *supra* note 9, art. 8. Leasing of the business enterprise or its essential assets also constituted the acquisition of assets. *Id.*

fixed assets in the company, and the paid-up, capitalized stock at the date of acquisition of the shares must increase by 20% the additional investment in fixed assets.[57] Essentially, in this provision, Mexico is attempting to bring fresh money, talent, and technology into some of its existing companies by requiring that investors also have an equity stake in the company itself.

4. *Foreign Investment Commission Authorizations*

While the 1989 Regulations do not change the requirements for Foreign Investment Commission authorization in cases which do not meet the requirements for unclassified activities, they do simplify the registration process and reduce the time needed to obtain a Commission decision.[58] All documents requiring authorization must be submitted to the Commission's Executive Secretary who, after obtaining the complete file, must submit the program to the Commission for resolution within thirty business days.[59] The Commission thereupon has an additional thirty business days in which to send its resolution to the Foreign Ministry, which will then have fifteen business days to arrive at its resolution.[60] Overall, the maximum delay for obtaining investment approval is seventy-five business days.[61] If no resolution is issued after any of the mentioned time periods have elapsed, the investment project is deemed authorized.[62]

5. *Temporary Foreign Investment*

The 1989 Regulations provide for a form of foreign investment in activities that, in the past, were reserved exclusively to

57. Translation of 1989 Regulations, *supra* note 8, transitory art. 6, at 24-25. It is necessary to submit a program to the Foreign Investment Commission. Within sixty business days following the investment, whether it is in a new company or an existing Mexican company, the Mexican company must submit to the Commission: a detailed description of the economic activities the company intends to develop and the geographic location of the establishments it may open and operate, a schedule of investment and financing, a schedule for employment creation, a production and sales schedule, an export and foreign currency budget, a three-year Mexican supplier development program, and a summary description of the technology to be applied in the business. *Id.* art. 61, at 59.

58. *Id.* art. 2, at 21-22.

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

Mexicans or limited to 49% foreign investment. This form of investment is the temporary trust,[63] which may exist for no more than twenty years.[64] The trustee must establish a technical committee, which is to consist of at least as many Mexicans as foreigners.[65]

Foreign investment through a temporary trust requires Foreign Investment Commission approval. It is designed to assist Mexican companies that are in financial distress or require significant new capital investment.[66] Commission authorization will be granted only if Mexican companies can prove to the satisfaction of the Foreign Investment Commission that they have made sufficient and reasonable attempts to interest Mexican investors; the evidence presented to the Commission shows that existing Mexican investors have waived their preferential rights; and the foreign investors will either contribute cash or assume the debts of the company.[67]

6. *Expansion of Existing Foreign Investment*

Prior to the 1989 Regulations, it was difficult for wholly owned foreign companies to expand their existing operations or acquire larger office or plant space without pressure from the government to "Mexicanize." The general rule now is that Foreign Investment Commission authorization is not needed so long as the additional investment meets the requirements established for investment in newly authorized companies.[68] These investments also are subject to the program submission requirements.[69] Investments in new fields of activity or new products require the satisfaction of the terms applicable to investments in established Mexican companies.[70]

7. *Acquisition and Lease of Real Estate*

The Foreign Investment Commission can also authorize foreign investors to invest only by acquiring rights to a trust. The investor acts as a beneficiary to a trust fund composed of

63. *Id.* art. 23, at 33-34.
64. *Id.* art. 26, at 35-37.
65. *Id.*
66. *Id.* art. 23, at 33-34.
67. *Id.* art. 24, at 35.
68. *See id.* art. 28, at 37-39.
69. *Id.*
70. *Id.* art. 29, at 39-40; *see supra* text accompanying notes 58-59.

shares of a company with an "exclusion of foreigners clause."[71] The trust property can be located within the restricted zone so long as the investment involves new productive investments in tourist or industrial activities.[72]

8. Neutral Investments

Perhaps the greatest single area of foreign investment in Mexico in recent years has been through its stock exchange, Bolsa de Valores. The 1989 Regulations assist this investment by creating a new type of stock called neutral shares or "Series "N."[73] This mechanism allows foreign investors to acquire beneficial rights to type A shares, those which can be owned only by Mexicans, through a trust, which allows the investors to share in the gains and dividends but not the voting rights.[74] Neutral shares can be issued only by companies that will use their proceeds to establish new activities or expand existing activities.[75] Commission authorization is required for the issuance of neutral shares.[76]

IV. Foreign Investment Regulations: An Investor's Response

The 1989 Regulations are an attempt to clarify the foreign investment rules and to reduce the scope of government discretion in the application of the 1973 Foreign Investment Law.[77] They also increase the availability of foreign investment opportunities by opening up investments which, until 1989, had not been available to foreign investors since the early 1970s.[78]

The initial response to the 1989 Regulations did not live up to the expectations of the Salinas Administration. In the year and a half after the announcement of the 1989 Regulations, investors exhibited a wait-and-see attitude.[79] Many long-term

71. *Id.* art. 12, at 27.
72. *Id.*
73. *Id.* arts. 13-15, at 27-29.
74. *Id.*
75. *Id.* art. 14, at 28.
76. *Id.* art. 13, at 27-28.
77. *Id.* at 5.
78. *Id.*
79. Charles W. Thurston, *Mexico Surprised by Flood of Investors; 1991 Outlays Hit $14 Billion*, J. Com., Dec. 17, 1991, at 1A.

investors remembered that Mexico nationalized its banking industry in 1982, only to privatize it again in 1991.[80] This, coupled with the decision of the Salinas Administration not to repeal the 1973 Foreign Investment Law, caused some investors to wonder whether President Salinas had the political clout to further open up foreign investment.

Investors' timid response to the 1989 Regulations may also be due to President Salinas' unstable political foundation. Salinas won the presidency in 1988 with a slim majority, and a substantial number of Mexicans believe that Salinas' Institutional Revolutionary Party (PRI) "stole" the election from the Democratic Revolutionary Party (PRD) and its candidate, Cuauhtemoc Cardenas.[81] Since Salinas is constitutionally limited to one six-year term, many have questioned whether his reforms will survive the 1994 presidential elections, especially if the PRI is defeated.

The Salinas Administration, however, was strengthened by the results of the 1991 Mexican congressional elections, in which the PRI won 61.4% of the vote and 320 seats in the 500-member Chamber of Deputies.[82] Coming in a poor third was the left-leaning, anti-business PRD with less than 9% of the vote and only forty-one seats in the Chamber.[83] Thus, the PRD's support on the presidential level did not translate into congressional power and it now appears that the economic progress in Mexico over the past three years has helped the popularity of President Salinas.[84]

In 1990, direct foreign investment increased to $5 billion; it increased to $8.32 billion during the first nine months of 1991.[85] This increase was a result of many factors, only one of which was the 1989 Regulations. President Salinas' economic reforms, particularly in the area of privatization, coupled with the start of the North American Free Trade Agreement negotiations between the United States, Canada and Mexico, were

80. Hodgins, *supra* note 32, at 370.

81. Andrew Reding, *Mexico Under Salinas: A Facade of Reform*, 6 WORLD POL'Y J. 685, 686-87 (1989).

82. George W. Grayson, *Mexico Routs Anti-Business Left*, J. COM., Sept. 3, 1991, at 4A. The center-right National Action Party (PAN) was second with 17.7% of the vote and 89 seats in the legislature. *Id.*

83. *Id.*

84. *Id.*

85. *See generally* Thurston, *supra* note 79.

probably the most significant factors in increasing investor confidence.[86]

The bulk of the new direct investment seems to be coming from existing large investors such as General Motors, Chrysler, Ford, Hewlett-Packard and Southwestern Bell.[87] Much of this investment is to retool existing manufacturing plants, some recently privatized, in order to prepare for the North American Free Trade Agreement and reduce costs during the U.S. economic downturn.[88] In addition to the $8.3 billion in direct investment, an additional $5.1 billion has gone in the Mexican stock market during the first nine months of 1991.[89]

Despite the growth in foreign investment in Mexico, there are still some areas of concern among foreign investors. The Japanese still remain skeptical investors.[90] Japanese direct investment in 1991 was less than $400 million, which is less than 5% of the total foreign investment.[91] European investment grew, but remains steady, as a percent of all investment.[92]

Even among American investors, concern continues over the lack of key Mexican infrastructure. This is true not only for transportation and communications, but also for the supply of basic components needed for industry. One example is printed circuit boards (PCB's). While Mexico successfully recruited the personal computer and auto-assembly industries, it was not until the late 1980s that Mexico developed a capability for double-sided and multilayered PCB's. The failure to provide such basics, when compared with its Asian competitors, has weakened Mexico in the eyes of investors, even when it competed favorably on labor, location and other investor variables.

Mexican labor also is a matter of concern for foreign investors. While Mexico can compete favorably on labor rates, and Mexican workers have been shown to be very efficient,[93] the Salinas Administration has done little to reform its labor laws,

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86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.*; *see also* Susan W. Sanderson & Robert H. Hayes, *Mexico—Opening Ahead of Eastern Europe*, HARV. BUS. REV., Sept.-Oct. 1990, at 32.
90. Thurston, *supra* note 79.
91. *Id.*
92. *Id.*
93. Sanderson & Hayes, *supra* note 89, at 40.

which allow employees to "vest" after thirty days and provide some very onerous provisions for unjust dismissal.[94] Additionally, required fringe benefits constitute, on average, 70% of base payroll.[95]

Foreign investors also find the 1989 Regulations to be ponderous and difficult to read in some sections and too simplistic in others. An example of over simplicity is article 61, which asks investors to provide plans dealing with economic activities and geographic location, job creation, production and sales, export and foreign currency balance, supply plans and technology descriptions.[96] However, the regulations do not specify the level of detail to be provided.

V. The Impact of the North American Free Trade Agreement

Finally, many foreign investors are waiting to see how the North American Free Trade Agreement (NAFTA) will develop before making their critical investment decisions. With discussions underway, it is difficult to comment definitively on how NAFTA will affect foreign investment in Mexico. It is possible, however, to offer an educated analysis on how NAFTA might affect this important area by analyzing the Canada-United States Free Agreement (CFTA).

A. Local Content Rules

One key concern in the NAFTA negotiations will be the level of local content required under the agreement. The CFTA sets a 50% local-content rule for automobiles.[97] This means that 50% of the value added to automobiles through raw materials and labor must come from either the United States or Canada to take advantage of the tariff reductions provided by the agreement.[98] Mexico is said to favor a 50% local content, while the U.S. wants 60-70%[99] Ford and Chrysler both support the U.S. government because they already have made

94. *See* Price Waterhouse, Doing Business in Mexico 69-82 (1984).

95. *Id.*

96. Translation of 1989 Regulations, *supra* note 8, art. 61, at 59.

97. *United States-Canada Free Trade Agreement: Hearings Before the Subcomm. on Trade of the House Comm. on Ways and Means*, 100th Cong., 2d Sess. 36-37 (1988) [hereinafter *FTA Hearings*] (summarizing the Canada-U.S. Free Trade Agreement).

98. *Id.*

99. *Bush Bulls Ahead on Free Trade with Mexico*, Bus. Wk., Feb. 24, 1992, at 46, 47.

large investments in Mexico.[100] Canada, however, favors a local content of 50%.[101]

The impact of the local content rules may influence foreign investment in two related ways. First, a higher local content requirement may force U.S.-headquartered automakers to look to Mexico for components and assembling in order to preserve and enhance their position in the lucrative U.S. and Canadian markets. This could result in large increases in foreign investment in Mexico. On the other hand, lower local content requirements may create a rush of Asian investment in Mexico so that the Mexican components could help qualify their products as "North American." Of course, other industries will also have to look at local content rules in making investment decisions.

B. Foreign Investment Requirements

Another key issue will be the extent to which Mexico, under NAFTA negotiating pressure, will accept the liberal foreign investment requirements contained in the CFTA. Chapter 16 of the CFTA, which concerns foreign investment outside the financial sector,[102] sets out four basic rules governing foreign investors.

First, each party must treat investors of the other party, in like circumstances, at least as favorably as its own investors with respect to the establishment of new businesses; the acquisition of existing businesses; and the conduct, operation, and sale of business enterprises located in its territory.[103] Neither party can require investors to sell investments by reason of their nationality, nor can it require their own nationals to hold a minimum level of equity in investments made by investors of the other country.[104]

Second, neither party, when permitting or regulating an investment in its territory, may impose or enforce trade-distorting measures.[105] Trade-distorting measures include those that require an investor to export a specified amount of goods;

100. *Id.*
101. *Id.*
102. *FTA Hearings, supra* note 97, at 44-46.
103. *Id.* at 44.
104. *Id.*
105. *Id.*

to substitute locally produced goods for imports; or to buy, or give preferential treatment to, locally-produced goods.[106]

Third, neither party may expropriate a foreign investor's holdings unless such expropriation is in accordance with generally accepted standards of international law. These standards require, among other things, payment of prompt, adequate and effective compensation at the fair market value of the expropriated properties.[107]

Finally, neither party may prevent an investor from transferring profits or earnings from an investment.[108] Article 16 of the CFTA does allow all existing restrictions to be grandfathered so long as they are not made more restrictive.[109] However, the open market theme of article 16 contradicts Mexico's more restrictive 1973 Foreign Investment Law and the 1989 Regulations. Therefore, the extent to which Mexican foreign investment law will survive NAFTA negotiations remains uncertain.

C. *Constitutional Conflicts*

The third major concern for the NAFTA negotiations is the degree to which Mexico will open up its petroleum and mining industries. Article 27 of the Mexican Constitution reserves to Mexicans all sub-soil rights and has been the constitutional basis for many of the restrictions in the 1973 Law and 1989 Regulations.[110] Neither the United States nor Canada seems willing to ask Mexico to change its Constitution, but they will seek to clarify how article 27 applies to key sub-soil rights, especially petroleum and mining.[111]

Article 27 was the basis of Mexico's nationalization of the petroleum industry.[112] While, in all probability, NAFTA will not cause Mexico to reverse the nationalization of its oil industry, Mexico must decide how it will define that nationalization. The November, 1990, meeting between Presidents Bush and Salinas indicates that Mexico's position is flexible. At that

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106. *Id.*

107. *Id.*

108. *Id.* There are limited exceptions, e.g., limitations on dividend payments set by bankruptcy laws.

109. *Id.*

110. MEX. CONST. art. 27.

111. MORICI, *supra* note 12, at 85.

112. MEX. CONST. art. 27.

meeting, they agreed, in principle, to a $5.6 billion loan to increase exploration and drilling projects. These projects, which will be completed by U.S. companies, fall under the description of "pure service" contracts, but because they give U.S. corporations an equity stake in drilling projects they are not far from being "risk service" contracts, the method used by Ecuador and other Latin American countries to permit equity-type investment in the government-owned oil sector.

In the mining area, the government recently enacted a regulation interpreting the law on foreign investment in mining.[113] This regulation recognizes the need for working capital and advanced technology to improve the mining sector and, particularly, its need to export.[114] It allows foreign investors to create commercial companies to obtain mining concessions.[115] These companies can be up to 49% foreign-owned.[116] If a foreigner wants to invest in excess of 49%, this regulation allows companies to issue "F" shares, which are held in trust and entitle their holders only to monetary rights.[117] They can be issued only for periods up to twenty years.[118]

The United States and Canada probably will not ask Mexico to abolish its foreign investment laws and regulations. But Mexico may be asked to apply them differently to its North American trade partners. Obviously, the best situation for the United States and Canada would be for Mexico to meet the chapter 16 rules while retaining its foreign investment laws and regulations against the rest of the world. If this is not possible, it is likely that the North American nations will demand that Mexico reach an accord on issues such as national treatment, performance requirements and free technology transfers. The most important issue to the United States and Canada will not be the adoption of chapter 16 of the CFTA, but what foreign investment regulations Mexico will grandfather in.

In sum, NAFTA negotiations likely will result in further positive changes in Mexico's foreign investment laws and regula-

113. *Reglamento sobre La Ley de Mineria en relación de Inversión*, D.O., Sept. 27, 1990, *translated in* Translation of 1989 Regulations, *supra* note 8, at 101.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

tions. Nevertheless, Mexico is not likely to abolish its 1973 Foreign Investment Law due to political and cultural considerations. Politically, it would be difficult for President Salinas, or any other Mexican president, to open Mexico's borders in an unrestricted fashion. Culturally, Mexicans tend to view their government as playing a major role in business. Peter Morici perhaps said it best when he suggested that Mexico may be closer to the Japanese model of syndicate capitalism than to the American model of atomistic capitalism.[119] This is attributed to Mexico's long tradition of the government playing "rector" to the domestic economy.[120] Morici believes that the concept of the Mexican government as a rector is a "cultural affection" and not merely a policy matter.[121] Foreign investment laws, regulations and policies must be considered within that context.

VI. Conclusion

There are some very good economic reasons for Mexico to open its foreign investment regime, especially to its North American partners. The issue, however, may be fought on political and cultural, rather than economic, grounds. It is one thing for Mexico to liberalize its foreign investment regime. It is quite another thing for Mexico to further open its economy to the United States of America, which many Mexicans perceive has dominated and repressed it in the past. Mexico would prefer to maintain the flexibility of the 1989 Regulations and to continue to adjust its "operational code" according to political and economic changes. The United States and Canada, however, will insist that Mexico liberalize its foreign investment laws and regulations. Trade between Mexico and its northern neighbors will increase whether or not NAFTA becomes a reality. However, the Mexican rules on foreign investment are unlikely to change in the near future unless NAFTA becomes a reality.

119. Morici, *supra* note 12, at 93-94.

120. A rector is a ruler or governor. In addition, rectors also oversee public and private universities. Webster's Unabridged Dictionary 1510 (2d ed. 1983). Thus, they can be compared to the American chairman of the board in the sense that they provide strategic direction but step back from day-to-day activities.

121. Morici, *supra* note 12, at 20.