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Centre for Commercial Law Studies
Queen Mary College, University of London

**THE MEXICAN EXPERIENCE WITH FINANCIAL SECTOR
LIBERALIZATION AND PRUDENTIAL STRUCTURAL REFORM**

by

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**THE MEXICAN EXPERIENCE WITH FINANCIAL SECTOR
LIBERALIZATION AND PRUDENTIAL STRUCTURAL REFORM**

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Abbreviations

- ABM**, Asociación de Bancos de México (Mexico's Banks' Association)
- AD/CVD**, Antidumping and Countervailing Duties
- AFORES**, Administradoras de Fondos para el Retiro (Retirement Funds Managers, Mexico)
- AFI**, Alliance for Financial Inclusion
- ALADI**, Asociación Latinoamericana de Integración (Latin American Integration Association)
- AML**, Anti-Money Laundering
- APEC**, Asia Pacific Economic Co-operation.
- Art/Arts**, article/articles
- BANAMEX**, Banco Nacional de México, S. A.
- BANCOMEXT**, Banco Nacional de Comercio Exterior (National Bank of Foreign Trade, Mexico)
- BANSEFI**, Banco del Ahorro Nacional y Servicios Financieros (Bank of National Savings and Financial Services, Mexico).
- BANXICO**, Banco de México (Central Bank of Mexico)
- BCBS**, Basel Committee on Banking Supervision
- BBA**, British Bankers' Association
- BCCI**, Bank of Credit and Commerce International SA
- BIS**, Bank for International Settlements
- BBV**, Banco Bilbao Vizcaya
- BBVA**, Banco Bilbao Vizcaya Argentaria
- CAS**, Country Assessment Strategy
- CC**, Comisión Cambiaria (Foreign Exchange Commission, Mexico)
- CFTA**, Canada – USA Free Trade Agreement
- CGAP**, Consultative Group for Assisting the Poor
- CGFS**, Committee on Global Financial System
- CNBV**, Comisión Nacional Bancaria y de Valores (Banking and Securities National Commission, Mexico)
- CNIE**, Comisión Nacional de Inversión Extranjera (Foreign Investment National Commission, Mexico)

CONDUSEF, Comisión Nacional para la Defensa de los Usuarios de los Servicios Financieros (National Commission for the Defense of the Users of the Financial Services, Mexico).

CONEVAL, Consejo Nacional de Evaluación de la Política de Desarrollo Social (Evaluation of Social Development Policy National Council, México)

CONSAR, Comisión Nacional del Sistema de Ahorro para el Retiro (Retirement Funds System National Commission, Mexico)

CPSS, Committee on Payment and Settlement Systems

CTF, Counter Terrorism Financing

CUSFTA, Canada-USA Free Trade Agreement

DOF, Diario Oficial de la Federación (Official Gazette of the Federation, Mexico).

DSB, Dispute Settlement Body

DSU, Dispute Settlement Understanding

EBRD, European Bank for Reconstruction and Development

EC, European Community

ECEX, Programmes for Foreign Trade Companies

ECJ, European Court of Justice

ELD, Escuela Libre de Derecho (Free School of Law, Mexico)

EU, The European Union

EWS, Early Warning System

FATF, Financial Action Task Force

FELABAN, Federación Latinoamericana de Bancos (Latin American Banks' Federation)

FDI, Foreign Direct Investment

FOBAPROA, Fondo Bancario de Protección al Ahorro (Savings Protection Banking Fund, México, 1990-1998)

FOGADE, Fondo de Garantía de los Depósitos Bancarios ([Bank] Deposits' Guarantee Fund, Mexico).

FONAES, Fondo Nacional de Apoyo para Empresas en Solidaridad (National Support Fund for Enterprises in Solidarity, México)

FSA, Financial Services Authority (UK)

FSAP, Financial Services Action Plan

FSF, Financial Stability Forum

FSAPWB, Financial Sector Assessment Program, program of the WB and IMF

FSLC, Financial Sector Liaison Committee, committee of the WB and IMF

FTA, Free Trade Agreements

FTAA, Free Trade Area of Americas

GAAP, Generally Accepted Accounting Principles

GATT, The General Agreement on Trade and Tariffs

GATS, The General Agreement on Trade in Services

GFC, Global Financial Crisis (started in 2008)

GDP, Gross Domestic Product

G5, The Group of Five

G7, The Group of Seven

G8, The Group of Eight

G10, The Group of Ten

G20, The Group of Twenty

G22, The Group of Twenty Two

G33, The Group of Thirty Three

HSBC, Hong-Kong Shanghai Banking Corporation

IAIS, International Association of Insurance Supervisors

IADB, Inter-American Development Bank

IADI, International Association of Deposit Insurers

IASC, International Accounting Standards Committee

ICSID, International Centre for the Settlement of Investment Disputes

IFAC, International Federation of Accountants

IFA, International Financial Arrangement

IFC, International Finance Corporation

IFI, International Financial Institution

IIF, Institute of International Finance

IMSS, Instituto Mexicano del Seguro Social (Social Security Mexican Institute, Mexico)

IMF, International Monetary Fund

IOSCO, International Organization of Securities Commission

IPAB, Instituto para la Protección del Ahorro Bancario (Institute for the Protection of Savings in Banks)

IPMA, International Primary Market Association

JF, Joint Forum on Financial Conglomerates

LIC, Ley de Instituciones de Crédito (Banking Law, Mexico)

MEFTA, The Mexican-European Free Trade Agreement

MFN, Most Favored Nation

MXN, Mexican Pesos

NAFIN, Nacional Financiera (National Financier, Mexico)

NAFTA, The North American Free Trade Agreement

NCA, Basel II or New Capital Agreement

NIFA, New International Financial Architecture

NT, National Treatment

OECD, Organization for Economic Co-operation and Development

PEMEX, Petróleos Mexicanos (Mexican Oils, Mexico)

PND, Plan Nacional de Desarrollo (National Development Plan, Mexico)

PSE, Plan Sectorial de Economía (Sector Programme of Economy, Mexico)

PAN, Partido Acción Nacional (National Action Party, Mexico)

PRD, Partido de la Revolución Democrática (Democratic Revolution Party, Mexico)

PRI, Partido Revolucionario Institucional (Institutional Revolutionary Party, Mexico)

PROCAPTE, Programa de Capitalización Temporal de la Banca (Temporary Programme for the Capitalization of the Banking Sector, Mexico)

PRONAFIDE, Programa Nacional de Financiamiento del Desarrollo (Financing Development National Programme, Mexico)

RTA, Regional Trade Agreement

ROSC, Reports on Observance on Standards and Codes

SAR, Sistema de Ahorro para el Retiro (Retirement Savings System, Mexico)

SME, Small and Medium Enterprises (in Mexico, PyMEs: Pequeñas y Medianas Empresas)

SIEFORES, Sociedades de Inversión Especializadas en Fondos para el Retiro (Investment Societies Especialized in Retirement Funds, Mexico)

SOFIPOS, Sociedades Financieras Populares (Popular Financial Institutions, Mexico)

SOFOMES, Sociedades Financieras de Objeto Múltiple (Múltiple Object Financial Societies, Mexico)

SOFOLLES, Sociedades Financieras de Objeto Limitado (Limited Object Financial Societies, Mexico)

SHCP/Hacienda, Secretaría de Hacienda y Crédito Público (Secretary of the Treasury and Finance, Mexico)

TELMEX, Teléfonos de Mexico (Mexican Telephones, Mexico)

TRIPS, Trade-Related Aspects of Intellectual Property Rights (of the World Trade Organization)

UDI, Unidad de Inversión (Investment Unit, Mexico)

UK, The United Kingdom of Great Britain and Northern Ireland

UNAM, Universidad Nacional Autónoma de México (National Autonomous University of Mexico)

UNCITRAL, United Nations Commission of International Trade Law

USA or US, United States of America

USD, Dollars of the United States of America

WB, The World Bank

WTO, World Trade Organization

WWII, World War II

CONTENTS

Acknowledgements.....	3
Abbreviations	7
Abstract.....	18
INTRODUCTION	19
CHAPTER 1: OVERVIEW OF MEXICO'S RECENT POLITICAL ECONOMIC HISTORY AND OF ITS PATH TOWARD ECONOMIC MODERNIZATION AND FINANCIAL LIBERALIZATION (INCLUDING POLITICAL CONFRONTATIONS)	32
1.1 RECENT HISTORICAL AND POLITICAL BACKGROUND AND CONTEXT OF MEXICO'S ECONOMIC MODERNIZATION	33
1.1.1 Introduction	33
1.1.2 General Political-Economic Background and Context of Pre-NAFTA Mexico	33
1.1.3 Background and Context of Mexico's Early 1980s Economic Crisis	38
1.1.4 Political Confrontations Regarding Free Market Policies.....	43
1.1.5 Mexican Political Parties' Attitudes Surrounding NAFTA's Negotiation and Approval	44
1.1.6 Political-Economic Context of the Beginnings of the NAFTA Era.....	46
1.2 THE MEXICAN PRE-NAFTA FINANCIAL SYSTEM.....	49
1.2.1 Expropriation of the Mexican Banks.....	49
1.2.2 The Years of Government-Owned Banks	52
1.2.3 Commercial Banks' Re-privatization.....	53
1.3 THE POST-NAFTA MEXICAN FINANCIAL SYSTEM	55
1.3.1 The Mexican Crisis of 1994: The "Tequila Effect" and the Response to the Impact on the Crisis through the Financial Services Liberalization, Support Programs and Regulatory Measures	55
1.3.2. Tax Policy.....	63
1.3.3 FDI	64
1.3.4 Other Structural Reforms in the Post-NAFTA Financial System.....	66
1.3.5 Mexico as a Natural Hub in the International Trade System	67
1.3.6 Regulatory Framework in the Post-NAFTA Financial System.....	70
1.3.7 Universal Banking	72
1.3.8 Prudential Regulation in the Post-NAFTA Financial System	73
1.3.9 Pension System in the Post-NAFTA Financial System.....	73
1.3.10 IPAB in the Post-NAFTA	74
1.3.11 The Mexican Stock Exchange	75
1.3.12 Foreign participation and Affiliates of Foreign Financial Entities in the Post-NAFTA Financial System	75
1.3.13 SOFOMES created in the Post-NAFTA Financial System.....	76
1.3.14 Mexico's Challenge	77

1.4 G20 AND ITS ROLE IN THE ARCHITECTURE OF THE MEXICAN FINANCIAL SYSTEM	79
1.4.1 Introduction.....	79
1.4.2 Mexico and G20	80
1.4.3 G20's Assessment of Mexico's Institution Building in Its Financial System.....	89
1.4.4 Conclusions	93
1.5 CLOSING REMARKS	94

CHAPTER 2: MEXICO'S ACCESSION TO THE MULTILATERAL REGIONAL AGREEMENTS: GATT, GATS/WTO, THE MEXICAN POLITICAL DEBATE REGARDING ITS ACCESSION, AND CROSS BORDER FINANCIAL SERVICES. 95

2.1 THE VARIOUS FRAMEWORKS AND THE PECULIAR MEXICAN APPROACH	96
2.1.1 Background.....	96
2.1.2 Multilateral Integration: Global Trade Agreements	98
2.1.3 Regional Integration.....	99
2.1.4 Bilateral Integration	99
2.1.5 Unilateral Approach: The Mexican "Bottom up Approach", Unilateral Framework or Autonomous Liberalization; Is It More Important than Multilateral and Regional Liberalization?	100
2.1.6 Overlapping Membership in RTAs: The Current Case of Mexico.....	101
2.1.7 The "Mexican vision" and International Development Law	103
2.1.7.1 Developed and Developing Countries	103
2.1.7.2 Duty to Cooperate, Solidarity, the Right to Development and the Mexican Vision.....	103
2.1.7.3 Qualification as a Developing Country.....	105
2.1.8 Common Objectives with Respect to Liberalization of Trade in Services Trade on These Various Frameworks: Transparency, Stability and Liberalization.	105
2.1.9 Political Confrontation in Mexico Regarding its Accession to GATT.....	106
2.1.10 Some Observations to These Various Frameworks	113
2.2 CROSS-BORDER FINANCIAL SERVICES: GATS AND ITS FINANCIAL SERVICES AGREEMENT.....	116
2.2.1 Introduction.....	116
2.2.2 Historical Growth and Development of GATT, GATTS and WTO	119
2.2.3 Common Objectives of GATS and Other Services Agreements; NAFTA and MEFTA: Transparency, Stability and Liberalization	120
2.2.4 Trade in Services and Developing Countries.....	123
2.2.5 GATS and Trade in Services	124
2.2.6 Barriers to Trade in Services.....	125
2.2.7 Assessing GATS and the Development of Cross Border Trade in Financial Services	126
2.2.8 Some Observations to GATS.....	131
2.2.9 GATS and NT	133
2.2.10 Arguments against the Liberalization of Financial Services and the Possibility of Generating Financial Crises.....	133

2.2.11 Arguments in Favor of the Liberalization of Financial Services	137
2.2.12 Financial Services Liberalization: NAFTA Parties and MERCOSUR	138
2.2.13 Liberalization Commitments of Developing Countries in GATS	139
2.2.13.1 Africa	141
2.2.13.2 East Europe	141
2.2.13.3 Latin America and Mexico	142
2.2.13.4 Some Observations to the Commitments.....	142
2.3 A COMPARISON WITH THE EUROPEAN UNION AS AN EXAMPLE OF PROPER SEQUENCING IN FINANCIAL LIBERALIZATION	145
2.3.1 Banking and Financial Markets in Europe.....	145
2.3.2 Assessment.....	148
2.4 CHAPTER CONCLUSIONS AND CLOSING REMARKS	151
CHAPTER 3: MEXICO’S DOMESTIC EFFORTS TO DEREGULATE AND TO PROMOTE FINANCIAL INCLUSION.....	153
3.1 INTERNATIONAL FINANCIAL REGULATION HARMONIZATION AND LIBERALIZATION THROUGH INTERNATIONAL ORGANIZATIONS.....	154
3.1.1 Introduction.....	155
3.1.2 Banking Regulation	155
3.1.3 Basel Accord and BCBS	155
3.1.4 IOSCO.....	156
3.1.5 Basel II - The Emergence of the New Regulation of Banking: The Privatization of the Regulation?.....	157
3.1.6 Mexico’s Successful Implementation of International Financial Standards at Unilateral Level: The Bottom-up approach to prudential liberalization....	157
3.1.7 Basel III and its Implementation in Mexico	164
3.1.8 Balance between Liberalization and Competition with Financial Supervision and Regulation	167
3.2 FINANCIAL INCLUSION IN MEXICO	170
3.2.1 Some background information	170
3.2.2 Concentration of the Banking Sector.....	171
3.2.2.1 Whether Concentration in the Banking Sector is Good.....	171
3.2.2.2 Recent History of Banking Concentration in Mexico.....	172
3.2.2.3 Mexico’s Banking Concentration Levels.....	173
3.2.3 Ambiguity of the Terms Used in Discussing Financial Inclusion	173
3.2.4 Identifying the Problem in Mexico and Its Size	176
3.2.5 The Chief cause of Financial Exclusion in Mexico: Poverty	181
3.2.6 Legal and Institutional Framework to address Financial Inclusion.....	184
3.3 CHAPTER CONCLUSIONS AND CLOSING REMARKS.....	189

CHAPTER 4: MEXICO'S POSITION ON NAFTA AND ITS LIBERALIZATION OF FINANCIAL SERVICES INCLUDING INVOLVEMENT IN THE DISPUTE SETTLEMENT PRACTICE RELATING TO GATS/WTO AND NAFTA. 191

4.1 MEXICO'S POSITION ON NAFTA	192
4.1.1 Introduction.....	192
4.1.2 Mexico under NAFTA.....	192
4.1.3 Alleged Disadvantages for Mexico.....	193
4.1.4 Advantages for Mexico.....	195
4.2 NAFTA AND FINANCIAL SERVICES	201
4.2.1 Objectives, Regulation Sources and Definition	201
4.2.2 Rules of Origin	204
4.2.3 Common and Shared Objectives with Respect to Liberalization of Trade in Financial Cross Border Services, Transparency, Stability and Liberalization..	204
4.2.4 Commercial Presence and Cross Border Services	205
4.2.5 NT and MFN.....	206
4.2.6 Transparency (GATS Art. III and NAFTA Art.1411).....	208
4.2.7 Progressive Liberalization	209
4.2.8 Market Access.....	210
4.2.9 Staffing.....	211
4.2.10 Investment in Financial Institutions	212
4.2.11 Reservations and Commitments	213
4.2.12 Exclusions	215
4.2.13 Administration and Dispute Settlement	216
4.2.14 Provisions Regarding Access to Mexico.....	218
4.2.15 Establishment of Financial Institution Subsidiaries in Mexico.....	218
4.2.16 Special Restrictions and Powers.....	219
4.2.17 Capital and Asset Limits	220
4.2.18 Banks, Securities, Insurance.....	220
4.2.19 Other Financial Services	220
4.2.20 Cross-Border Insurance Services in Mexico	221
4.2.21 Provisions Regarding Access to Canada	222
4.2.22 Provisions Regarding Access to the USA	223
4.3 NAFTA, MEFTA, GATS/WTO AND THEIR CONNECTION WITH THE LIBERALIZATION OF FINANCIAL SERVICES IN MEXICO.	225
4.3.1 What Can NAFTA Learn from EU?	229
4.3.2 NAFTA and Other RTA	230
4.3.2.1 Mexico and FTAA	231
4.4 MEFTA AND ITS IMPLICATIONS FOR NAFTA.....	233
4.4.1 Mexico and EU	233
4.4.2 Implications for NAFTA.....	236
4.4.3 Benefits of MEFTA	239
4.4.3.1 Trade in Goods.....	239
4.4.3.2 Trade in Services.....	240
4.4.3.3 How Does EU Investors Access the NAFTA Market?.....	241
4.4.3.4 NAFTA's Rules of Origin	241

4.4.3.5 Comparison between NAFTA's and MEFTA's Rules of Origin....	241
4.5 DISPUTE SETTLEMENT PRACTICE RELATING TO GATS/WTO, NAFTA AND MEFTA.....	243
4.5.1 Dispute Settlement in Services	243
4.5.2 Dispute Settlement in Services under GATS/WTO: Security and Predictability	243
4.5.3 The Jurisprudence of the WTO	245
4.5.4 Other General Interpretative Principles.....	248
4.5.5 The Rule of <i>Stare Decisis</i> in GATS/WTO.....	249
4.5.6 The Dispute Settlement under NAFTA Rules.....	251
4.5.7 The Financial Services Case Presented before Chapter 14 of NAFTA: Fireman's Fund Insurance Company	254
4.6 CHAPTER CONCLUSION AND CLOSING REMARKS.....	254
CHAPTER 5: MEXICO TWO YEARS AFTER THE ONSET OF THE 2008 GLOBAL FINANCIAL CRISIS AND THE SUCCESS OF ITS BOTTOM UP APPROACH TO PRUDENTIAL LIBERALIZATION	258
5.1 INTRODUCTION	259
5.2 EARLY STAGES OF THE CRISIS.....	260
5.2.1 A Made-in-USA Crisis.....	260
5.2.2 Mexico's Early Resistance and the Success of its Bottom-up Approach to the Prudential Liberalization	261
5.2.3 Early Effects on Mexico.....	263
5.2.4 Mexico's Early Measure to Face the Crisis.....	264
5.3 AFTERMATH FOR MEXICO AS OF 2009... ..	266
5.3.1 Impact on the Economy's Growth.....	266
5.3.2 Impact on Private Companies that Gambled with Derivatives.....	266
5.3.3 The CitiGroup-BANAMEX Issue	267
5.4 SYSTEMIC CRISIS PREVENTED AND FASTER ECONOMIC RECOVERY ACHIEVED	268
5.4.1 Zero Bank Failures in Mexico.....	268
5.4.2 Faster and Larger than Expected Growth in 2010.....	268
5.4.3 Key Factors of the Resilience of the Mexican Financial System and the Fast Economic Recovery: the Success of the Bottom-up Approach to the Prudential Liberalization	269
5.4.3.1 Learning from Past Crises.....	269
5.4.3.2 Structural Reforms	270
5.4.3.3 Economic Liberalization in General	271
5.4.3.4 Financial Prudential Liberalization in Particular	272
5.4.3.5 Savvy and Courageous Leadership.....	273
5.5 CHAPTER CONCLUSION AND CLOSING REMARKS	273
CHAPTER 6: CONCLUSIONS.....	275

APPENDIX 1:	Comparison of Arts. 27 and 28 of the 1857 and 1917 Mexican Constitutions.....	287
APPENDIX 2:	Excerpts of the 1982 and 1983 Amendments to the Mexican Constitution.....	289
APPENDIX 3:	G-20 and its Role in the Architecture of the Mexican Financial System	292
	3.1 Background, History and Development.....	292
	3.2 Mandate and Objectives.....	300
	3.3 Members and Structures.....	301
	3.4 Mexico and G20.....	302
	3.5 G20's Assessment of Mexico's Institution Building in Its Financial Sector.....	300
	3.6 Some observations and conclusions.....	315
APPENDIX 4:	A Comparison with EU as an Example of Proper Sequencing in Financial Liberalization... ..	316
	1. Introduction.....	316
	2. Banking and financial markets in Europe	323
	3. Financial integration in Europe.....	324
	4. Assessment.....	327
	5. Regional integration.....	327
	6. European Court of Justice.....	329
	7. The Financial Services Action Plan.....	330
	8. The Process towards Mutual Recognition	331
	9. Mutual Recognition.....	331
	10. Minimum Harmonization.....	332
	11. Home Country Control.....	333
	12. Host Country Control.....	334
	13. Assessment.....	335
	14. Conclusions.....	338
APPENDIX 5:	Gambling with Derivatives Burned Mexican Companies	339
APPENDIX 6:	The BCCI Affair and the <i>Three Rivers District v. Governor and Company of the Bank of England</i> Case.....	344
	Bibliography.....	362

Abstract

The Mexican Experience with Financial Sector Liberalization and Prudential Structural Reform

After WWII, the Mexican government took increasingly the control over the economy including the banking sector in 1982. By 1985, a worsening economic crisis forced the government to begin a process of economic liberalization. The 1994-1995 financial crisis prompted efforts to develop a sound prudential framework for Mexico's financial system. Toward this goal, liberalization in financial services is vital for developing countries to make their build financial systems viable and their economies stronger. Related economic legal reform scholarship indicates that safe and sound financial markets are built upon the effective implementation of key "international prudential standards". In 1995, Mexico started to work domestically, from the "bottom-up", in financial sector reform, while applying step by step international prudential standards and opening unilaterally the sector to foreign investment, even ahead of the liberalization agreed in NAFTA.

NAFTA's and MEFTA's innovative chapters on financial services, with their various dispute resolution mechanisms, are examples of Mexico's commitment to promoting high levels of cooperation at the bilateral, regional and hemispheric levels. At the global level, as part of G20, Mexico has promoted a financial system reform approach that continues liberalization with financial stability and sustainable economic development. This thesis argues that Mexico's case demonstrates that financial liberalization and related structural reform need to be integrated in a coherent and coordinated policy manner, and be effected in an enlightened country-specific (bottom-up) and sequenced manner. This must be applied within a wider financial stability framework combined with sustainable, equitable economic policies consistent with a country's particular developmental stage.

Fifteen years after Mexico began its financial liberalization agenda, the Global Financial Crisis has demonstrated that such a process can deliver a stronger and more stable financial system. Mexico should therefore not backtrack on its commitment to the prudential liberalization of its financial sector but use the crisis as a basis for further meaningful reform and policy readjustment to create further substantial and sustainable liberalization and regeneration longer term.

INTRODUCTION

According to modern economic development scholarship, liberalization in financial services is vital for developing countries, such as Mexico, as it can assist them in building viable financial systems and developing stronger economies. Related economic legal reform scholarship, indicates further that, to develop robust yet safe and sound financial markets, a country should build these markets upon a structural foundation rooted in “international prudential financial standards.”

International prudential financial standards have been created over the past two decades, during which the international financial community has been devising consensus on international standards and codes of conduct to achieve financial stability and develop robust financial systems. This consensus has taken the form of pronouncements by such bodies as the BCBS, IASC/IASB, IOSCO, IAIS, JF, and FSF.¹

This dissertation centers on Mexico (a leading developing economy and a member of the G20) as a country case study in the attempt to create a viable “prudential liberalization” framework respecting its domestic financial sector. It argues that Mexico is a case in which law and related institutional framework have been fundamental to economic development generally, and in which an effective financial sector is essential to economic growth.

The 1994 Mexican crisis caused a fundamental re-evaluation of the role of financial law and institutions with the consequent development, for the first time, of a comprehensive framework of internationally acceptable “international prudential financial standards” delineating minimum requirements for financial stability.²

¹ See BCBS, “Report on the Supervision of Banks’ Foreign Establishments – Concordat” (Sep. 1975); BCBS, “International Convergence of Capital Measurement and Capital Standards” (Jul. 1998); C. Felsenfeld & G. Bilali, *The Role of the Bank for International Settlements in Shaping the World Financial System*, 25 U. PA. J. INT’L ECON. L. (2004) at 945; and D. Alford, *Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry*, 10 DICK. J. INT’L L. REV. 189 (1992) at Ch. III.

² See Douglas Arner, *The Mexican Peso Crisis: Implications for the Regulation of Financial Markets*, LAW & BUSINESS REVIEW OF THE AMERICAS 4 (1996) at 28-69; and See DOUGLAS ARNER, FINANCIAL STABILITY, ECONOMIC GROWTH AND THE ROLE OF LAW (2007) at 2.

Law has a role in both financial stability and financial market development, both of which, in turn, are important for economic growth. The current international financial system was developed as a response to the risks inherent in financial liberalization, domestic restructuring and globalization of finance.

IFI's Financial sector legal reform efforts that are part of the so called NIFA,³ mandated by the G7 (which include the WB and the IMF),⁴ have not formally and systematically considered how, within the context of an overall legal infrastructure and policy approach and framework, the financial sector reform efforts should fit into, and support, the economic and social development.⁵

Thus, in addition to the application of international best practices, the improvement of substantial legal and judicial framework, societal cognizance of, and adherence to, rules and their enforcement should also be encouraged.⁶ Likewise, fundamental legal changes are to be introduced in a measured, sequenced and sustainable manner consistent with the country's particular stage of economic, financial, and even political development, including its relative level of market and regulatory sophistication.

Such was Mexico's case, as shown in Chapter I. As a response to its 1980s and (mostly) 1994-95 crises, Mexico has been the leading Latin American country in efforts to develop a sound prudential framework for its financial sector, keeping an eye toward evolving "international prudential financial standards" yet working domestically from the bottom-up.

³ Beginning in the mid 1990s, G7 (today G8) began to focus on "international financial architecture." The first use of the specific terminology "New International Financial Architecture" is often attribute to Michael Camdessus, former managing director of the IMF, who first began regularly to use this term in 1998 (e. g., Michael Camdessus, "Toward a New Financial Architecture for a Globalized World," address at the Royal Institute of International Affairs, London, May 8, 1998).

⁴ See George Walker, *A New International Architecture and the Financial Stability Forum*, ESSAYS IN INTERNATIONAL FINANCIAL LAW & ECONOMIC LAW 24 (1999).

⁵ This author is in no way arguing that G7/G8's efforts and IFI implementation, dissemination and assessment over the past decade have been without merit but suggesting that these efforts and directions are not sufficient, inasmuch as they deal with an incomplete picture of a developing country's longer-term economic and social developmental requirements, which can be facilitated through the financial sector's legal development. See J. J. NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMIES (2000).

⁶ See J. J. Norton, "Taking Stock of the "First Generation" of Financial Sector Legal Reform" (WB Law & Development Working Paper Series 4, 2007).

Simultaneously over the past three decades, the international financial community has been in the process of devising a consensus on international standards and codes of conduct to achieve financial stability and to develop robust financial systems. This consensus takes the form of minimum standards in the form of soft law, with compliance being achieved through the force of example. The pronouncements are made by such bodies as the BCBS, IASC/IASB, IOSCO, IAIS, JF, and FSF.⁷

Trade-financial services liberalization agenda and the prudential standards-structural reform agenda have largely been driven on separate policy paths and by differently motivated sets of diverse domestic, regional and international bureaucrats. It is with much irony that any real policy and practical linkage between these two interrelated but most often disconnected agendas has only arisen briefly in times of prior financial crises, and perhaps more so now on a sustained basis in light of the current GFC (2008-2010).

International agreements on trade-financial services liberalization (WTO/GATS, NAFTA, and MEFTA) focus on opening domestic boundaries to allow the provision of financial services at both cross-borders and local levels. The financial sector reform needed at the domestic level to implement commitments undertaken internationally mainly emphasizes competitiveness and greater concern for financial stability. In terms of self-fulfilling crises, financial liberalization makes attacks possible and exposes underlying financial vulnerabilities to the vagaries of international capital markets.⁸

Defining the nexus between trade liberalization and safety and soundness concerns for financial markets and institutions is a major cooperative challenge for trade and financial authorities at the multilateral, regional and domestic level. Moreover, the issue of proper sequencing in financial service liberalization is critical.

⁷ For discussion of soft law and its role, see G. Bertezolo, *The European Union Facing the Global Arena: Standard-Setting Bodies and Financial Regulation*, 34(2) ELR 257 (2009); T. Meyer, *Soft Law as Delegation*, 32 FORDHAM INTERNATIONAL LAW JOURNAL (2009) at 888; P. VERDIER, *Transnational Regulatory Networks and their Limits*, 34 YALE JOURNAL OF INTERNATIONAL LAW (2009) at 113; A. HAMANN & H. FABRI, *Transnational Networks and Constitutionalism*, 6 INTERNATIONAL JOURNAL OF CONSTITUTIONAL LAW (2008) at 481; S. PICCIOTO, *Constitutionalising Multilevel Governance?*, 6 INTERNATIONAL JOURNAL OF CONSTITUTIONAL LAW (2008) at 457.

⁸ See Norton, "Taking...", *op. cit.*, at 30.

It seems to this author that the primary emphasis needs to be placed on the “maturing of the internal financial system and market,” which includes broadening access to the financial system and linking the prudential and financial sector reform side to the IMF and WB reform efforts, and to the above mentioned international financial standards-setters such as the BC, before wholesale external liberalization takes place.⁹

The sequencing of reforms is not a mechanical process but one that should be customized and fine-tuned on a country-by-country basis. Legal reform should be approached from a made-to-order, not a ready-made, perspective. Improper sequencing (i.e., liberalization that precedes strengthening of financial reforms) has been a critical underlying factor in many financial crises.

Proper sequencing is important as a country tries to broaden its financial system in a meaningful, fair and equitable¹⁰ manner to make it accessible to those who are presently excluded from it.¹¹

Financial inclusion “is present in the discussions about the future of financial regulation, and it is acknowledged as a component of financial and socio-economic stability as it provides opportunities for those who are not economically privileged.”¹²

⁹ See *id.*, at 30.

¹⁰ See *id.*; and CGAP, GOOD PRACTICE GUIDELINES FOR FUNDERS OF MICROFINANCE, 2nd ed.; Microfinance Consensus Guidelines (CGAP 2006): “With an estimated three billion of the world’s population “excluded” (in terms of practical effect, not necessarily by intent) from the financial sectors of their respective countries—leaving them without any financial “lifeline” or any effective means to access the financial sector, and without the prospects of wealth creation over time—the importance of getting this next generation of financial sector reform right cannot be overstressed”.

¹¹ See Norton, “Taking...”, *op. cit.*, at 34. See also GERARD CAPRIO, PATRICK HONOHAN, and JOSEPH E. STIGLITZ, eds., FINANCIAL LIBERALISATION: HOW FAR, HOW FAST? (2001). The problems that arose from the failure of proper sequencing of reforms in Thailand in the 1990s are illustrative here.

¹² AFI & CNBV, REPORTE DE INCLUSIÓN FINANCIERA 1 [1ST REPORT ON FINANCIAL INCLUSION] (2010) at 10 [hereinafter 1ST REPORT ON FINANCIAL INCLUSION IN MEXICO]. Along similar lines, the WB has said that, “Recent development theory sees the lack of access to finance as a critical mechanism for generating persistent income inequality, as well as slower growth. Without inclusive financial systems, poor individuals and small enterprises need to rely on their own limited savings and earnings to invest in their education, become entrepreneurs, or take advantage of promising growth opportunities. Financial sector policies that encourage competition, provide the right incentives to individuals, and help overcome access barriers are thus central not only to stability but also to growth,

Domestic banking sectors and financial systems in some developing countries have had a reputation of serving better the government and the upper classes at the expense of excluding significant portions of the population and their developmental needs.

Studies referred by the WB on financial inclusion would seem to indicate that is as true about Mexico as it is about other developing economies in Latin America.¹³ Nevertheless, a closer analysis of more recent empirical data, in light of a wholesome understanding of Mexico's broader cultural and economic contexts, shows that the issue of financial inclusion in Mexico goes beyond what can be accomplished through deregulation and competition.¹⁴

Notwithstanding the above, it is also to be kept in mind that, as the WB itself acknowledges, "certain regulatory prudential measures aimed at financial stability can restrict the degree to which banks can serve small borrowers."¹⁵ Therefore, "A reform approach to financial sector policy that explicitly recognizes the importance of access can help ensure that financial development also makes financial systems more inclusive."¹⁶

A point of reference for proper sequencing of liberalization of financial services could be the one shaped by the EU, which has created an internal market characterized by the abolition of obstacles to the free movement of the four freedoms. The EU has come up with one of the most complex regulatory and

poverty reduction, and more equitable distribution of resources and capacities" (WB, FINANCE FOR ALL? POLICIES AND PITFALLS IN EXPANDING ACCESS (2008) at ix [hereinafter FINANCE FOR ALL?].

¹³ See A. Kumar, T. Beck, C. Campos, and S. Chattapadhyay, "Assessing Financial Access in Brazil" (WB Working Paper No. 50, 2005); available at:

www.wam.umd.edu/~soumya/Docs/Assessing%20Financial%20Access%20in%20Brazil.pdf#search='world%20bank%20and%20access%20to%20financial%20services'. See also T. M. Solo and A. Manroth, "Access to Financial Services in Columbia: The Unbanked in Bogotá" (WB Policy Research Working Paper No. 3834, Feb. 2006) at:

www.wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/01/31/000016406_20060131090049/Rendered/PDF/wps3834.pdf; and J. Caskey, C. Ruíz Durán and T. Solo, "The Unbanked in Mexico and the USA" (WB Policy research Working Paper 3835, Feb. 2006); available at: www.wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/01/26/000016406_20060126162730/Rendered/PDF/wps3835.pdf.

¹⁴ See *infra* Chapter 3, 3.2 Financial Inclusion in Mexico.

¹⁵ FINANCE FOR ALL? at 144.

¹⁶ *Id.*

supervisory schemes in the world, namely FSAP, and it includes all main domains of domestic and sophisticated cross-border financial services.¹⁷

Although BCBS, IOSCO and other involved IFAs and IFIs have attempted to provide generally applicable core prudential standards and principles on various aspects of a sound banking and financial system, these standards and principles have largely emanated from industrialized countries, such as the EU and the US, and have not taken into consideration that the existing financial systems in most developing countries and emerging economies have tended to serve better some segment of society excluding others.

Further, as previously discussed, the general assumption of liberalization of financial services is that this liberalization is, by definition, good for development. Again, this assumption is most often shaped by the industrialized countries (e.g., through WTO and GATS).¹⁸

The interaction between international prudential financial standards and WTO/GATS has not been sufficiently addressed. Both developed and developing countries should consider carefully *ex ante* the implications of financial crises, as well as the efforts of WTO and, more directly, GATS and its component negotiations on financial services.

In the present extensive debate on the role of the architecture of the international financial system in both preventing and responding to financial crises, as well as preserving financial stability, the interplay of the IMF, WB, and WTO/GATS has not been properly addressed.¹⁹

Liberalization and competition bring important economic benefits in the context of supporting financial development, economic growth and poverty reduction.²⁰

¹⁷ Chapter 2 discusses briefly this topic.

¹⁸ See Norton, "Taking..." *op. cit.*, at 37.

¹⁹ *Id.*, at 30. In the same sense, see ARNER, FINANCIAL..., *op. cit.*, at 13.

²⁰ See ARNER, FINANCIAL..., *op. cit.*, at 440: "Competition in financial markets, as in other segments of a market economy, is important for proper market functioning and efficiency of resource allocation. Unlike many other markets, however, financial markets (especially those related to banking) as noted throughout this volume, carry a number of externalities, both positive and negative. Financial markets

Research and experience suggest that a liberalized and competitive financial sector supports increased economic growth. As said before, at the same time, financial liberalization brings with it certain risk that need to be addressed appropriately.

Most importantly, recent research indicates that financial liberalization without appropriate sequencing and development of a legal and regulatory framework to reduce risks actually can increase the risk of financial crisis.²¹ However, it should be considered as well that financial liberalization leads to more stable markets in the long term.²²

While the literature is generally incomplete and inconclusive to date, there is some positive effect of capital account liberalization on growth, especially for developing countries, though crises seem to be larger in emerging economies if the capital market opens first, rather than the domestic financial sector. Further, equity market liberalization appears to decrease both output and consumption growth volatility, indicating that equity market liberalization is good for both global markets and individual markets.²³

In looking at liberalization, international best practice suggests that in building a competitive financial sector, countries like Mexico have used multilateral and

generally benefit from foreign participation and competition. At the same time, however, open capital markets can also have negative consequences if a proper institutional framework does not exist. Nonetheless, one of the best ways to generate competition is to allow foreign participation. Empirical research supports the idea that foreign financial intermediaries have a positive role in financial stability and development.”

²¹ See *id.*, at 412. See also M. Goldstein and P. Turner, “Banking Crises in Emerging Economies” (BIS Economic Paper No. 46, Oct. 1996); and W. White, “What Have We Learned from Recent Financial Crises and Policy Responses?” (BIS Working Paper No. 84, Jan., 2000). A result of the research generated by BIS and IMF after the crises has been to link financial liberalization with financial crises around the world over the past century. Another important link is that between financial liberalization and especially competition, and financial sector development and economic growth, while at the same time reducing risk of financial crisis. Weak “domestic financial systems” have been suggested to be a significant underlying cause of 1990s crisis when coupled with liberalizations without appropriate prior and /or concurrent restructuring. Though according to some research financial liberalization is followed by more pronounced boom-bust cycles in the short run, in the long run it leads to more stable markets.

²² G. Kamisnky and S. Schmuker, “Short-Run Pain Long-Run Gain: The Effects of Financial Liberalization” (IMF Working Paper , WP/03/34, Feb., 2003)

²³ H. Edison, M. Klein, L. Ricci and T. Sloek, “Capital Account Liberalization and Economic Performance: Survey and Synthesis” (NBER Working Paper No. 9100, 2002). See also G. Bekaert, C. Harvey and C. Lunblad, “Does Financial Liberalization Spur Growth?” (NBER Working Paper No. 8245, 2001).

regional arrangements such as WTO/GATS, NAFTA and MEFTA to reinforce progress and encourage competition and prudential liberalization.

However, in addition to risks, foreign participation often raises also a number of difficult internal political issues in many economies, such as the case of Mexico and historically, often resulting in efforts to block –at some point- such participation. Today, foreign participation in the Mexican case is dealt with largely through multilateral (WTO), regional (NAFTA) and bilateral (MEFTA) negotiations.

As said before, Mexico has been domestically proactive and has fostered high levels of cooperation on the bilateral, regional, hemispheric and global levels. It is worth-noting Mexico's efforts to coordinate financial sector liberalization with prudential supervision enhancement through the common treaty framework of NAFTA, particularly through its innovative Chapter 14 on financial services and its vanguard dispute resolution mechanisms, which is one of the more advanced set of rules in financial services liberalization.

Of present and long-term significance are Mexico's current efforts as part of G20 Leaders and Finance Ministers groupings to develop a financial system reform approach that continue liberalization, while promoting financial stability and sustainable economic development. While the 1982 Mexican Sovereign Debt default did not result in any imposed conditionality on financial sector reform but focused on macroeconomic reforms, Mexico began to initiate major economic reforms in the late 1980s.²⁴

The tough financial situation resulting from Mexico's 1994 crisis brought about important prudential financial sector reform that linked it to IMF, WB reform efforts, and to the aforesaid international financial standards-setters such as the BCBS. Even as a pioneer emerging economy,²⁵ Mexico became proactive in these processes and was innovative in its approaches following a bottom up approach.

²⁴ See NORTON, FINANCIAL SECTOR ..., *op. cit.*, at 265.

²⁵ Here "emerging economies" refers, according to "related terminology used by the IMF ,to market-based economies in the process of moving to "developed" status through integration into the global economic and financial system. See ARNER, FINANCIAL..., *op. cit.*, at 17.

Simultaneously Mexico executed successfully such prudential financial standards into multilateral (WTO/GATS), regional (NAFTA) and bilateral (MEFTA) contexts.

The onset of the 1994 Mexican financial crisis signaled the return of a sort of financial crises not seen since before the establishment of the Bretton Woods system. The design of the Bretton Woods system was to eliminate the possibility of such financial crises in the future.²⁶ Financial crises in emerging economies over the past fifteen years highlight the dangers inherent in financial liberalization without the adequate domestic restructuring in the context of participation in the increasingly globalized financial system.²⁷

In reviewing case studies of financial crises in the 1990s, one can get a number of important lessons, such as the Mexican case has shown. First, becoming full participants in the international financial system, while at the same time maintaining both domestic and international financial stability, requires careful domestic restructuring as part of any process of liberalization. Throughout financial crises, liberalization without appropriate restructuring has been followed often by crises, which have sometimes had international or even global impact.

Second, the policies and systems advocated by Bretton Woods and other IFI during the 1990's did not adequately take into account the risks inherent in financial liberalization and likewise provided insufficient guidance on the necessary requirements to be implemented domestically in the context of restructuring. Third, developments in one country are no longer restricted to its own borders in today's increasingly globalized financial system, and consequently there is a need to readdress the Bretton Woods system and to have in place a proper NIFA.²⁸ Fourth, all these systems, whether domestic or international, need to be based upon transparent, rule-based structures.²⁹

²⁶ The Bretton Woods system was successful in many ways. However, following the break-up of the fixed exchange rate system in 1973, the gradual return to free movement of capital, and the increasing reintegration of financial systems, the stage was set for a return to the sort of crises common during the 19th and 20th centuries. See *id.*, at 16.

²⁷ See *id.*, at 6.

²⁸ See *id.*

²⁹ *Id.*, at 35.

That is why the degree of liberalization of services, and specifically the liberalization of financial services, has generated a significant debate among the main emerging economies in connection with full liberalization against lesser degree of liberalization. Mexico, in particular, has adopted a liberal approach over the last seventeen years, and the financial system has evolved toward almost full financial services liberalization. Nevertheless, this faced strong opposition within Mexico and generated significant political debates and criticism coming from the major political parties (PRD and PAN) and from other political forces in the country.

Mexico started to strengthen its financial system back in the mid 1990's after the Tequila Crisis by linking strongly to international prudential financial standards. This author argues that adhering to those international standards, in addition to other economic and social reforms, has helped financial stability and financial markets development, both of which in turn have been significant for economic growth in the country.

From the perspective of this author, each country's situation is *sui generis*, and international prudential financial standards have not been designed as instruments for development and access by themselves. As Joseph Stiglitz has emphasized, there is a need to contemplate various political, economic, social and cultural facets of development as well.³⁰ Thus, this paper argues that financial sector reform needs to be one of many other broader objectives for the sound economic development of a particular developing country.

Therefore, this work takes into account the stage in which Mexico became innovative in its bottom up approach to linking to international standards.³¹ Mexico has enlightened the implementation of those international financial standards at

³⁰ See JOSEPH STIGLITZ, *GLOBALIZATION AND ITS DISCONTENTS* (2002); and Joseph Stiglitz, "Whither Reform Ten Years of the Transition" (keynotes address at the WB annual conference, Apr. 28-30, 1999).

³¹ See Norton, "Taking..." *op. cit.*, at 33. Purely top-down legal reform is not viable in the long-term much has to come from the bottom up. Active and fully committed country participation is needed from the very beginning. Keeping in mind that each country represents an individual case, nations may need to adopt solutions that correspond to their different levels of development and their different needs, especially in relation to the financial sector. This means that the initiative for conducting and construing reform in a broader developmental context should rest primarily with the involved country.

unilateral level, which have been executed successfully externally into a multilateral (WTO/GATS), regional (NAFTA) and bilateral (MEFTA) context.

This work is organized in six chapters. Chapter 1 gives account of Mexico's gradual economic liberalization over the past three decades, during which it transformed its almost fully state-controlled economy into a more free-market economy, eventually becoming also an active part of the WTO regime. It also gives account of the liberalization of its financial system over the last two decades, having NAFTA as a clear turning point. In light of its 1994 crisis, Mexico is an example of how financial liberalization can be devastating if not accompanied by the strengthening of the financial market institutions, especially adequate supervision and regulation.

Chapter 2 examines the history and growth of GATS and financial services liberalization, the GATT/WTO institution, its development and relationship with RTA's agreements, as well as the liberalization commitments among developing countries in GATS, together with an investigation on how trade regulations in financial services might affect prudential and other types of regulation in financial services.

Specifically, Chapter 2 discusses the worldwide development as assisted by universal, rule-based, non-discriminatory and equitable multilateral trading with meaningful trade liberalization. In this sense the study shows the benefits of the development of multilateral, regional, bilateral and unilateral liberalization.

Mexico's accession to multilateral and RTAs (GATT, WTO/GATS), the development of the cross border financial services, the multilateral framework and the Mexican policy debate surrounding it, are also discussed in Chapter 2. As part of the aforesaid, Chapter 2 addresses the specific question of whether the Mexican bottom up approach, unilateral framework or autonomous liberalization is more important than the multilateral and regional liberalization.

Chapter 2 also takes into account briefly how the EU has been an example of proper and interesting sequencing of liberalization of financial services, which has

created an internal market characterized by the abolition of obstacles to the free movement of the four freedoms.

Chapter 3 focuses on Mexico's domestic efforts to deregulate and its unilateral implementation of international principles and standards. Given the additional challenge that developing economies face regarding financial inclusion, and the role that deregulation can play in favor of inclusion, this chapter examines and documents the legal and institutional framework of Mexico's ongoing efforts to promote financial inclusion.

Chapter 4 evaluates NAFTA. It documents the political debates that surrounded its adoption and existence from the leftist parties in Mexico, and analyzes its advantages and disadvantages for Mexico. It specially analyzes its chapter on financial services, as well as the different principles on trade in financial services such as NT, MFN treatment, market access, proportionality, harmonization and mutual recognition. It also explores what NAFTA can learn from the EU, and from the different FTA that Mexico has signed with other countries such as Japan.

Chapter 4 also analyzes the bilateral framework such as the MEFTA and its provisions, as well as the dispute settlement practice relating to those three frameworks (GATS/WTO, NAFTA and MEFTA). The principles of interpretation are examined including the one financial service case study presented before chapter 14 of NAFTA.

The manuscript of this work was submitted for supervisory review in early 2008 and is intended to speak primarily as of June 2008. In the process of revision, however, the major intervention of the GFC occurred and has brought into question the efficacy of various perceived "conventional wisdom" on global and domestic financial liberalization, on the international financial regulatory/supervisory standards³² that have evolved over the past two decades, and on the globalization processes generally. Accordingly, a Chapter 5 on "Mexico Two Years after the Onset of the 2008 Global Financial Crisis" was added.

³² See Communiqué of the International Monetary and Financial Committee of the Board of Governors of the IMF, (IMF Press Release No. 08/240, Oct. 11, 2008).

It is noteworthy how, in spite of the negative impact the crisis has have on several key elements of the Mexican economy, the Mexican financial system has shown a unprecedented strength and solidity. This whole phenomenon is examined in Chapter 5, which concludes that Mexico should not backtrack on its commitment to “prudential liberalization” as to its financial sector but should use this crisis as a springboard for further meaningful reform and policy readjustments as to meaningful and sustainable “prudential liberalization.”

The concluding Chapter 6 draws together Mexico’s three decade journey and in connection therewith provides some modest policy reform recommendations.

The methodology used in this work has been the analysis of primary sources, such as International Treaties like GATS, GATT, WTO, NAFTA, MEFTA etc., court cases, WTO and NAFTA cases as well as Mexican law, reports and other documents by Mexican governmental agencies (SHCP, CNBV, BANXICO, CONDUSEF, etc.) and secondary sources.

CHAPTER 1:

OVERVIEW OF MEXICO'S RECENT POLITICAL ECONOMIC HISTORY

AND OF ITS PATH TOWARD ECONOMIC MODERNIZATION

AND FINANCIAL LIBERALIZATION

(INCLUDING POLITICAL CONFRONTATIONS)

1.1 RECENT HISTORICAL AND POLITICAL BACKGROUND AND CONTEXT OF MEXICO'S ECONOMIC MODERNIZATION

1.1.1 Introduction

This section explores the general background and context of the liberalization of financial services in Mexico in the 1990s. Having NAFTA (1994) as a clear threshold, it explores the further legislative reforms that allowed for increased foreign participation in the Mexican banking sector and the financial system in general. Lastly it reports on the shape of the financial system in the NAFTA era.

1.1.2 General Political Economy Background and Context of Pre-NAFTA Mexico

“The Mexican economy lived isolated since the 1930’s decade up to the middle of the 1980’s.”³³ Throughout all this span of time Mexico was ruled by a single political party, PRI, which from the presidency controlled the three branches of the federal government, of the local state governments, and even the municipal governments.³⁴

Mexico’s path toward economic liberalization in general is very much the history of PRI’s positions on these issues up until 2000, when a different political party, PAN won the presidential elections and took over the executive branch of the Mexican government. PRI’s position on economic policies and models has swayed from left to center-left to center back to left over the past decades and continues to have ambiguous positions on matters of political economy.³⁵

³³ Edna Jaime Treviño, “La lógica de la reforma económica,” LUIS RUBIO (coord.) POLÍTICAS ECONÓMICAS DEL MÉXICO CONTEMPORÁNEO [ECONOMIC POLICIES OF CONTEMPORARY MEXICO] (2001) at 53. See also Robert E. Herztein and Joseph P. Whitlock, *Regulating Regional Trade Agreements— a Legal Analysis*, PATRICK F. J. MACRORY, ARTHUR EDMOND APPLETON, and MICHAEL G. PLUMMER, eds., THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS,” Vol. 2 (Feb. 2005) at 220: “Mexico remained a basically closed economy... up until the mid-1980s.”

³⁴ Mexican constitutional scholar Jorge Carpizo used the term “Mexican Presidentialism” to refer to the quite unlimited power (both *de iure* and *de facto*) that the peculiar kind of presidential system in Mexico bestowed to presidents, in spite of the constitution’s formal separation of powers and apparent “checks and balances.” See generally JORGE CARPIZO, EL PRESIDENCIALISMO MEXICANO, [THE MEXICAN PRESIDENCIALISMO] 9TH ed., (1989).

³⁵ Some political commentators have referred to this phenomenon as “a wide center”, but except for the more centrists Salinas and the Zedillo administrations (1988-2000), PRI has been characterized more by center-left and leftist positions. Furthermore, after coming on third place in the 2006 presidential election, below the leftist coalition lead by PRD, PRI’s new and current leadership (as of

The roots of Mexican economic Statism are found in the Mexican Revolution and the federal constitution it begot in 1917. Unlike the 1857 federal constitution, which was a classical liberal constitution that protected private property and restricted the government's attributions, the 1917 constitution has been dubbed a "social constitution." What that actually means for all practical purposes is that individual rights are restricted in favor of greater attributions for the state (or, more realistically, the government) to be able to assist better (allegedly) under-privileged classes.

A comparison of some samples of the most relevant portions of the two articles that touch on elements of political economy shows the aforesaid shift and the economic doctrine that dominated Mexico during most of the 20th century.³⁶

Between 1935 and 1940 (the presidential administration of Lázaro Cárdenas) government "took an increasing role as chief factor in the economic dynamic of the country."³⁷ Between 1941 and 1951 Mexico was forced to substitute imports due to WWII, which restricted maritime transportation and therefore imports from overseas, and which forced the USA to limit its exports. Although when the war was over the reasons that justified the import substitution policy had ceased, Mexico did not abandon it.³⁸

The accession of Miguel Alemán to the Mexican presidency (1946), right after WWII ended, marked the onset of the economic model of import substitution, whose first stage lasted up until 1956-1958, when the "stabilizing development" started during the second half of the presidential administration of Adolfo Ruiz Cortines.³⁹

2010) has moved the party's stand (and voting behavior in the Legislative branch) from center to left, consistently opposing any structural reform that would change the *status quo* constructed by PRI during its Statist era.

³⁶ See Appendix 2: Excerpts of the 1982 and 1983 Amendments to the Mexican Constitution.

³⁷ Roberto E. Blum, "Las políticas económicas y la transformación política de México," [Economic Policies and the Politic Transformation in México] in RUBIO, *op. cit.*, at 32.

³⁸ *Id.*

³⁹ See MARTÍN CARLOS RAMALES OSORIO, INDUSTRIALIZACIÓN POR SUSTITUCIÓN DE IMPORTACIONES (1940-1982) Y MODELO "SECUNDARIO-EXPORTADOR" (1983-2006) EN PERSPECTIVA COMPARADA [Industrialization by Substitution of Imports (1940-1982) and "Secondary-Exporter" Model (1983-2006) in Comparative Perspective], at Chapter 2 (2.1); available at:

<http://www.eumed.net/libros/2008c/434/Modelo%20primario%20exportador%20e%20inicios%20de%20la%20industrializacion%20sustitutiva.htm>). The second stage of the "substitution of imports" policy took place during the "stabilizing development" era (1956-1970) and was characterized by an

A significant legislative step increasing governmental control of the economy was given with the “Law on Attributions of the Federal Executive in Economic Matters,” promulgated in December 30, 1950. In the 9th edition of *EL PRESIDENCIALISMO MEXICANO*,⁴⁰ Jorge Carpizo explained that the objective of this law was to allow the president “to intervene in the different facets of the economic process: production, distribution and consumption.”⁴¹

This new law that legalized thorough governmental intervention in the economy was reckoned positive by Carpizo and other UNAM scholars. Andrés Serra Rojas (professor of Administrative Law) praised the law saying it constituted “the most important legislative document on state interventionism in Mexico, aside, of course of the corresponding articles of the constitution.”⁴² Likewise, Antonio Martínez Baez (Secretary of Economy when the law was issued) said that “because of its purposes of the highest public interest,” the said law should “exist permanently.”⁴³

The most significant legislative step toward taking over full control of the economy was the set of constitutional amendments required to furnish, *post facto*, with constitutional grounds López-Portillo’s expropriation of the Mexican private banks in September, 1982. The amendments, promulgated in February 3, 1983, moved the contents of Art 25 (inviolability of mail) and Art 26 (inviolability private

increase in commercial protectionism, which extended beyond 1970 throughout the whole 1970s. Author Martín C. Ramales Osorio quotes Nora Lustig saying: “Industrialization during the fifties and sixties occurred within a domestic market overly protected by tax and non-tax barriers. The proportion of the imports that required previous permits increased from 28% in 1956 to more than 60% in average during the sixties, and around 70% in the seventies.” (RAMALES OSORIO, *op. cit.*, at chapter 2 (2.2.); available at:

<http://www.eumed.net/libros/2008c/434/Desarrollo%20estabilizador%20y%20profundizacion%20de%20la%20industrializacion%20sustitutiva.htm>.

⁴⁰ The 9th ed., cited in this work, was printed in Dec. 1989, right before the economic modernization process. However, it seems to be a mere reprint from a much earlier edition since it does not reflect any of the debates taking place in the late 1980’s.

⁴¹ CARPIZO, *op. cit.*, at 135.

⁴² *Id.* Citing ANDRÉS SERRA ROJAS, *DERECHO ADMINISTRATIVO* [Administrative Law], México (1974); Vol. II, at 301.

⁴³ *Id.*, at 135-136. Citing Fernando Zamora, *Fundamentos constitucionales de la intervención estatal en materia económica* [Constitutional Foundations of the State Intervention in Economic Matters], in *LA CONSTITUCIÓN DE 1917 Y LA ECONOMÍA MEXICANA* [THE 1917 MEXICAN CONSTITUTION AND THE MEXICAN ECONOMY] (1958) at 214.

homes by the army in times of peace), one small paragraph each, to end of Art 16, in order to fill such articles with an entirely new content.⁴⁴

It is worth highlighting that, as Luis Pazos has repeatedly pointed out, most of the concepts introduced to the Mexican constitution by the 1983 amendments to Arts 25 and 26 were taken from the Soviet and Cuban constitutions.⁴⁵

Art 28 was also amended as of February 3, 1983, although it had already been amended as of November 17, 1982, shortly after the presidential expropriation of the Mexican private banks. The November 1982 amendment added a fifth paragraph to Art 28 (on the prohibition of monopolies) that said:

It is also an exception to what is provided in the first part of the first paragraph of this Article the rendering of the public service of banking and credit. This service shall be rendered exclusively by the State through institutions, in the terms that the corresponding statute establishes, which shall also determine the guarantees that would protect the interests of the public and the functioning of those in support of the policies of national development. The public service of banking and credit will not be object of concession to particulars.⁴⁶

The February 3, 1983, amendment of Art. 28 went far beyond. The new text rearranged what was already contained but also added several new provisions. Such amendments (many of which are still in the Mexican constitution in spite of the economic liberalization experienced since 1985) show the profound influence Statist ideas have in Mexico and the consequent belief that the government should control the economy.

Carpizo wrote that the government-owned sector had “grown in an impressive way,” and that there was “intervention in a very ample range of activities that are

⁴⁴ See Appendix 2: Excerpts of the 1982 and 1983 Amendments to the Mexican Constitution.

⁴⁵ See, for instance, Luis Pazos, “Las falsas políticas de austeridad del gobierno mexicano” [The False Austerity Policies of the Mexican Government] (Jun. 3, 1985). Originally delivered at the Mexican Forum of The Center for Strategic & International Studies of Georgetown University; available at: <http://www.uaca.ac.cr/actas/1987feb/lpazos.htm>.

⁴⁶ DOF (Nov. 17, 1982) at 7-8; available at: http://www.diputados.gob.mx/LeyesBiblio/ref/dof/CPEUM_ref_097_17nov82_ima.pdf.

ultimately controlled by the executive.”⁴⁷ As of 1970 there were 247 government-owned entities distributed in five sectors: a) farming, forest and fishing; b) industrial; c) communications and transportation; d) social welfare; and e) financial, commercial and other services. As of 1974 there were 351 government controlled entities, and as of June 1976, there were 511.⁴⁸

The industries and economic activities that were under direct control of the Mexican president were: social security,⁴⁹ electrical power, railways and various train companies, one airline, airports, federal roads and bridges, the Mexico City underground transportation, the phone monopoly, port services, oil, housing, forests and fertilizers, and the iron and steel industry.⁵⁰

Carpizo’s 1989 edition of his book fails to account for the Mexican president’s control over the banking sector that resulted not only from the expropriation of the Mexican banks⁵¹ but also from the amendment of constitutional Art 28. Therefore, the liberalization of the banking sector was going to require amending once again the constitution to remove the restriction contained in Art 28, fifth paragraph.⁵²

The high point of Statism described above was the prelude of the collapse of the Mexican economy in the early 1980s, which eventually forced the Mexican government to start, albeit hesitantly, the transition toward liberalization.

1.1.3 Background and Context of Mexico’s Early 1980s Economic Crisis.

The period between 1954 and 1970 is known in Mexican economic history as the “stabilizing development” (*desarrollo estabilizador*), which was characterized by significant and steady economic growth, low inflation and steady exchange rate.⁵³

⁴⁷ CARPIZO, *op. cit.*, at 151.

⁴⁸ *Id.*, at 151-152.

⁴⁹ In Mexican labor law and custom, social security comprehends more than payments after retirement and in case of accidents, including also full medical coverage, child-care, vacationing, sports, entertainment and shopping facilities.

⁵⁰ CARPIZO, *op. cit.*, at 151-152.

⁵¹ See *infra* 2.1. Expropriation of the Mexican Banks.

⁵² See *infra* 2.3. Commercial Banks Re-privatization.

⁵³ See Juan Ramírez Marín, *Banco de México (BANXICO)* [Bank of Mexico (BANXICO)], 87 QUORUM LEGISLATIVO (Oct-Dic 2006), at 206. Luis Pazos highlights the role of Antonio Ortiz Mena at SHCP in keeping low inflation during the time he held that office, which covered the better part of

However, the economic benefits did not reach all the population but primarily urban middle classes.

Such unequal distribution of the benefits of economic growth and stability brought about social discontent that included protests from labor unions (railroads, telephone, rural teachers, PEMEX, medics, etc.), which were strongly repressed by the government.⁵⁴

Upon his accession to the presidency of Mexico in 1970, Luis Echeverría Álvarez adopted an economic model that put on the federal government the primary burden of providing the growing population with education, health services, housing, and employment. In order to achieve that, public expense was increased, “including the social expense, in order to achieve the so much desired Echeverrian ‘shared development’; namely, the double Keynesian goal of full-employment and distributive fairness.”⁵⁵

Consequently, in 1972 the Mexican government increased public spending “to expand production, decrease unemployment and improve the distribution of income”.⁵⁶ Such public spending was paid by the expansion of the monetary supply by BANXICO (which continued through 1975).⁵⁷ In addition to that, in 1973 the government’s budget increased taxation on commercial income.

Furthermore, the government had to resort to borrow money from the domestic (59%) and foreign (41%) markets. In order to finance itself, government also

the Stabilizing Development. Ortiz was in charge of SHCP during the presidential administrations of Adolfo López Mateos (1958-1964) and Gustavo Díaz Ordaz (1964-1970). During those 12 years between 1958 and 1970, the average GDP was 6.2%, and the average annual inflation was 2.6%, which at some points was lower than that of the USA. This was due, according to Pazos, to fiscal discipline, low foreign debt, and free prices. See Luis Pazos, “Desarrollo estabilizador ¿Secreto de Ortiz Mena?” (May 15, 2007); available at: <http://www.asuntoscapitales.com/default.asp?id=3&ids=2&idss=8&ida=2046>. Also, between 1952 and 1960, BANXICO was directed by Rodrigo Gómez who “declared himself along his administration, as a staunch enemy of inflation, since it not only has negative effects over the distribution of the income, but also ends stopping investment and economic growth” (Ramírez Marín, *op. cit.*). Ramírez Marín highlights the role of BANXICO’s prudent monetary policy in achieving economic growth and stability.

⁵⁴ See RAMALES OSORIO, *op. cit.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ “The monetary mass grew at an average inter-annual rate of 18.2% during 1971-1975” (*id.*).

resorted to increase in 1% the “*encaje legal*,” the obligatory reserve that private banks had to keep in deposit at BANXICO.⁵⁸

Such measures caused inflation, which turned negative the real interest rates paid by banks to the saving public. Credit for the private sector became unavailable from the domestic banking sector, so it had to turn to foreign indebtedness. Between 1971 and 1976 the public deficit was multiplied 9.3 times, and the government’s foreign indebtedness 4.3 times.

Yet the goals for which all that increase in public spending was made were not achieved. Growth during the same years was 5% in average, “insufficient to solve the problems of unemployment and sub-employment... Rather than coming close to the economy of full-employment it moved away from it.”⁵⁹ Moreover, the Echeverría administration ended with a devaluation (August 1976) of the Mexican currency of almost 100%, the first devaluation in 22 years (since the onset of the “stabilizing development” in 1954).

OPEC’s 1973 oil embargo and the consequent raise in oil prices did not benefit Mexico significantly. Mexico’s oil production that year represented merely 1% of the totality of the world’s oil production, and its proven reserves of oil were only 0.6% of the world’s proven reserves.⁶⁰

⁵⁸ See *id.* The *encaje legal* was first used during WWII as an instrument to control the extraordinary and significant influx of foreign currency in order to prevent that influx to cause inflation. Thus, it was not originally meant to become a source of financing of public spending. It started to be used as a means of financing public spending with moderation during the “stabilizing development” (when there was another extraordinary influx of foreign currency), and started to be abused in the 1970s (see Ramírez Marín, *op cit.*, at 205-207).

⁵⁹ See RAMALES OSORIO, *op. cit.*

⁶⁰ See Lorenzo Meyer Cosío, *El auge petrolero y las experiencias mexicanas disponibles. Los problemas del pasado y la visión del futuro* [The Oil Boom and the Available Mexican Experiences. The Problems of the Past and the Vision of the Future], in FORO INTERNACIONAL [International Forum], Vol. XVIII, No. 72 (Apr-Jun, 1978) at 581; available at: <http://www.lorenzomeyer.org/Articulos-Revistas/27.pdf>. During the 1960s domestic demand of oil products increased while oil exploration, exploitation and production activities lagged behind up until the early 1970s. In order to avoid an energy crisis, exploration activities were intensified in the early 1970s (see CENTRO DE ESTUDIOS DE LAS FINANZAS PÚBLICAS [Center for Public Finance Studies], Cámara de Diputados, H. Congreso de la Unión [Center for Public Finances Studies, Chamber of Representatives, H. Congress of the Union] (herein after CEFP), “Evolución y perspectiva del Sector Energético en México, 1970-2000” [Evolution and Perspective of the Energy Sector in Mexico, 1970-2000] (Dic. 2001) at 15; available at: <http://www.cefp.gob.mx/intr/edocumentos/pdf/cefp/cefp0512001.pdf>.

It was until 1974 (when that embargo ended) that the exploitation of oilfields discovered back in 1972 made it possible for Mexico to start exporting oil again that year (1974). Further exploration and discoveries between 1974 and 1978 resulted in a significant increase in Mexico's proven oil reserves in the late 1970s.⁶¹

In 1976, José López-Portillo won the presidential election, without having to compete against any opposition candidate, and was inaugurated on December of that year. Under his leadership, one of the objectives of PEMEX's 1977-1983 administration and its exploration policy was to prove abroad "that Mexico counted with reserves and production capacity large enough as to become an important exporter of crude oil, while that would facilitate at the same time the firm's and the country's access to international loans," having the oil reserves as backup.⁶²

By 1979 it was proven that Mexico possessed 5% of the oil world reserves and 3% of the gas world reserves.⁶³ In light of Mexico's improved oil reserves and production capacity, the 1979 (or second) oil crisis (triggered at the wake of the Iranian Revolution) brought unprecedented economic benefits to Mexico as a result of a significant growth in export revenues.⁶⁴

It was that 1979, at the wake of the discovery of one of the most important oilfields in the world (Cantarell, off the coast of the southeastern State of Campeche), that López-Portillo uttered his famous statement: "We have to get used to manage abundance."⁶⁵

⁶¹ See CEFP, *op. cit.*, and ENRIQUE CÁRDENAS, LA POLÍTICA ECONÓMICA EN MÉXICO, 1950-1994 [The Economic Policy in Mexico, 1950-1994] (1996) at 108.

⁶² *Id.*, at 16.

⁶³ See GERARDO GIL VALDIVIA & SUSANA CHACÓN DOMÍNGUEZ (COORD.), LA CRISIS DEL PETRÓLEO EN MÉXICO [The Oil Crisis in Mexico] (Apr. 2008) at 35; available at: http://www.foroconsultivo.org.mx/libros_editados/petroleo.pdf; and CÁRDENAS, *op. cit.*, at 109.

⁶⁴ See CÁRDENAS, *op. cit.* "Between 1977 and 1981 the economy grew at an average annual rate of 7.8%, while inflation grew 24.2% in annual average during that term. The boom came from two fundamental sources: a big expansion of public investment in all areas, especially in those related with the export of oil... Secondly, both the larger availability of international funding and the oil export themselves made easier the access to growing amounts of foreign loan, which made it easy the growth of both public and private spending" (*op. cit.*).

⁶⁵ See Rubén Cortés, "Así nació Cantarell, así se está muriendo" [Thus Cantarell was Born, thus It Is Dying], in LA RAZÓN [The Reason] (Mar. 10, 2010); available at: <http://www.razon.com.mx/spip.php?Art.26232>. See also Blum, *op. cit.*, at 35.

However, as Norton suggests, “much of the exuberance was rooted in the country’s estimation of its national control of petroleum resources in light of rocketing prices in 1970’s, and Mexico held to an economic policy of import substitution industrialization and severe restrictions on foreign direct investment.”⁶⁶

The exuberance was mistaken to be permanent or at least steady for the medium term. This incited false feelings of welfare about Mexico both in the Mexican government and in international banks (mostly from the USA). During the second half of the 1970s such banks over-lent money to Mexican government-owned companies and to the federal government itself.

Mexico borrowed from foreign banks more money than any other developing country, and such banks did not count with enough information about their economies, balance of payments positions, investment flows, aggregate external debt and international reserves.⁶⁷

The Mexican Government became extremely dependent on the large revenues from oil sales (that resulted from OPEC oil embargo) to cover its increasingly high expenditures, which included public health and education programs. It also adopted an overvalued currency policy. Speculation on the peso’s devaluation spurred further cycles of devaluation and massive transfers of money out of the country.⁶⁸

The Mexican government’s foreign debt had quadrupled between 1976 and 1982. Thus, when oil prices fell and international interest rates rose, the downward capital market revaluation of Mexico was inevitable, thus putting the country into a serious crisis in 1982. That year the Mexican government declared a suspension of payments of its foreign debt, devalued the peso against the USA Dollar, imposed

⁶⁶ NORTON, FINANCIAL SECTOR..., *op. cit.*, at 265. On López-Portillo’s import substitution policy, see RAMALES OSORIO, *op. cit.*, at Chapter 2 (2.3.); available at: <http://www.eumed.net/libros/2008c/434/Desarrollo%20compartido%20auge%20petrolero%20y%20a%20gobierno%20de%20la%20industrializacion%20sustitutiva.htm>.

⁶⁷ See Thomas Dalsgaard, “The Tax System in Mexico: A Need For Strengthening the Revenue-Raising Capacity” 8 (OECD, No. ECO/WKP 6, (2000); available at <http://www.oecd.org/dataoecd/14/11/1884584.pdf>; and Arner, *The Mexican ...*, *op. cit.*, at 51.

⁶⁸ See K. N. SCHEFER, INTERNATIONAL TRADE IN FINANCIAL SERVICES: THE NAFTA PROVISIONS, 1st ed., (2000) at 98; and Dalsgaard, “*The Tax...*,” *op. cit.*

foreign currency exchange control,⁶⁹ and expropriated all the private banks.⁷⁰ These acts resulted in the cessation of inflows of foreign private capital.⁷¹

It has been observed rightly that the “policies followed from early 1970s to early 1980s were, at best, contradictory and erratic, plunging the country into economic crisis in 1976 and again in 1982.”⁷² So, after decades of varying degrees of protectionism, state-controlled economy, and about a decade of nationalization and government control of all kinds of companies of all kinds of sectors, a growing bureaucracy, and fiscal indiscipline, Mexico was left in a deep economic crisis with uncontrolled inflation, and a big and growing foreign debt.⁷³

⁶⁹ Both the expropriation of the private banks and the foreign currency exchange control came hand in hand and were announced at the same time. As explained below (see *infra* 2.1. The Expropriation of the Mexican Commercial Banks), one of the reasons for the expropriation of the banks argued in the presidential decree was that it was necessary in order for the state to be able to “adopt the necessary measure oriented to correct domestic disruptions.” One of such measure was the imposition of a foreign currency exchange control regime. “The austerity and adjustment actions in matters of economic policy that had been applied to restrain the crisis had not rendered results mainly because of the amount of the flight of capitals” (Eduardo Turrent, “Historia sintética de la banca” [Synthetic History of the Banking Sector] at 17; available at: <http://www.banxico.org.mx/sistema-financiero/material-educativo/basico/%7BFFF17467-8ED6-2AB2-1B3B-ACCE5C2AF0E6%7D.pdf>).

⁷⁰ See ABM, “La banca en México: Breve síntesis de grandes transformaciones 1982-1996” [Banking in Mexico: Brief Synthesis of Big Transformations 1982-1996] at paragraph 3; available at: http://www.abm.org.mx/banca_mexico/historia.htm; and Lee C. Buchheit, *A Lawyers Perspective on the New International Financial Architecture*, 14 J. INTL. BANKING L. 225 (1999). Virtually all lending to emerging market borrowers ceased. The existing credits to these countries were subjected to repeat rescheduling throughout the 1980s.

⁷¹ See HAL S. SCOTT & PHILIP A. WELLONS, *INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATIONS*, 6th ed. (1997) at 1137.

⁷² Herztein and Whitlock, *op. cit.*, at 218.

⁷³ Although the state of affairs described was exacerbated during the twelve years between 1970 and 1982, similar policies were followed by most Mexican presidents during the 20th century. What Luis Pazos (Professor of Political Economy at ELD) wrote in 1991 about the recent economic history of Ibero-America was certainly true of Mexico: “Most of the economic policies implemented in the 20th century in Ibero-American countries have been inspired in the protectionist and over-regulation that Adam Smith condemned and in the Marxist theories that leads also to over-regulation and state monopolies” (LUIS PAZOS, *DEL SOCIALISMO AL MERCADO [From Socialism to Market]*, 1st ed., (Mexico, 1991), at 155. Furthermore, he adds a few paragraphs later that:

Over the last four decades, a large number of intellectuals, progressive priests, liberation theologians and third-world politicians, devoted themselves to defend the benefits of de centrally planned system or socialism. Many of them started from Marxist theses such as class struggle, income concentration, surplus-value and exploitation, to propose solutions the Ibero-America’s social problems.

Other intellectuals, in a veiled way, under the semantics of structuralism, peripheral capitalism, dependency theory, and the deterioration of exchange terms, presented solutions in more complete and “scientific” ways, but arrived to the same conclusions of the Marxists.

During the last four decades, that is, after the WWII, those theories were the ones that had more influence in Latin American governments (*id.*, at 157).

As a result of the grave economic crisis left behind by José López Portillo (1976-1982), Miguel De la Madrid Hurtado's presidential administration (1982-1988) faced the first package of structural adjustment measures imposed by WB and IMF, which marked the onset of so-called "neo-liberalism" in Mexico.⁷⁴ However, the only significant achievement of the De la Madrid administration was Mexico's accession to GATT in 1986.

1.1.4 Political Confrontations Regarding Free Market Policies

The influence and power that the so-called neo-liberals and technocrats gained within PRI by the latter part of the De la Madrid administration provoked the creation of a dissenting faction within that party, by its leftist members, self-named *Corriente Democratizadora* (Democratizing Bloc). This faction explicitly opposed free market policies and reforms, including economic liberalization. By 1988, the so-called Democratizing Bloc seceded from PRI and joined leftist opposition parties to form an electoral alliance that eventually became the PRD party.

Ever since, PRD and other smaller leftist parties that have followed or still follow PRD's former presidential candidates (formerly Cuauhtémoc Cárdenas, and more recently Andrés Manuel López Obrador) have presented steadily a strong opposition against free market economy and FTAA, NAFTA and WTO,⁷⁵ both in their discourse and their voting behaviour in the Legislative branch.

PRI then swung without too much opposition within toward a more market center position under the influence of its presidential candidate, Carlos Salinas de Gortari, who held the Secretary of Programming and Budgeting during the De la Madrid administration. PRI's candidate, Salinas, officially won the 1988 presidential election, amidst allegations of electoral fraud against PRD, which came second in the election's official results.

⁷⁴ See also PAZOS, DEL SOCIALISMO..., *op. cit.*, at 158-159. Politicians and public servants that followed free market policies started to be called, rather derogatorily, "neo-liberals" and/or "technocrats;" although the term "technocrat" was applied more specifically to people with postgraduate studies in foreign universities.

⁷⁵ See Gustavo Castro Soto, "Las perspectivas para México en el nuevo sexenio 2006-2010" [Mexico's Perspectives in the new administration 2006-2010], (Jan. 24, 2007); available at:

The Salinas administration (1988-1994) brought about a first generation of free market policies and structural reforms. In his First Presidential Report to the Legislative branch (September 1989), then President Salinas said:

The crisis showed us that a larger State is not necessarily a more capable Estate; a State that owns more is not a fairer Sate. The reality is that, in Mexico, more State meant less capacity to respond to the social demands of our fellow countrymen and, at the end, more weakness of the State itself. While the public sector's activity was increasing, the attention to problems of potable water, health, rural investment and food, housing, environment and justice decreased. The State was expanding while the welfare of the people was falling down.⁷⁶

Although the process of reducing the number of state-owned companies was started back in the De la Madrid Administration, “the larger and most controversial privatizations were carried out during the government of president Carlos Salinas... It was during this... that the privatization of the commercial banks was carried out between 1989 and 1990.”⁷⁷ Other changes needed to adapt Mexico for NAFTA were achieved by the Salinas administration.⁷⁸ A significant one was the autonomy of BANXICO, and making its chief mandate to fight inflation.⁷⁹

1.1.5 Mexican Political Parties' Attitudes Surrounding NAFTA's Negotiation and Approval

A Mexico-US Commercial framework Agreement on Trade and Investment (predecessor to NAFTA) was signed in November 1987.⁸⁰ Then, in March 1990, a newspaper leaked information about a meeting between USA and Mexico government officials to explore the possibility of a bilateral FTA.

⁷⁶ Carlos Salinas de Gortari, “Primer Informe de Gobierno” [First Presidential Report] (1989) at 28; available at: www.diputados.gob.mx/cedia/sia/re/RE-ISS-09-06-17.pdf.

⁷⁷ Turrent, *op. cit.*, at 23.

⁷⁸ See generally LUIS PAZOS DE LA TORRE, HACIA DÓNDE VA SALINAS [Where Is Salinas Heading] (1989).

⁷⁹ See “EXPOSICIÓN DE MOTIVOS DE LA INICIATIVA DE DECRETO POR EL QUE SE REFORMAN LOS ARTÍCULOS 28, 73 Y 123 DE LA CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS, ENVIADA AL H. CONGRESO DE LA UNIÓN POR EL EJECUTIVO FEDERAL” [Exposition of Motivation of the Bill to Amend Art.s 28, 73, and 123 of the Political Constitution of the Mexican USA, Sent to the H. Congress of the Union by the Federal Executive]; available at:

http://www.banxico.org.mx/tipo/disposiciones/Constitucion/expmot_art28.html.

⁸⁰ See *id.*

In June 11, 1990, presidents Carlos Salinas and George Bush announced officially in Washington their intention of starting the negotiation process toward a bilateral FTA. Both presidents presented notices to their respective congresses in August of that same year. In February 1991, Canada joined the project, and negotiations officially started for a regional trilateral FTA between the nations of the northern part of the American continent.⁸¹

That same 1991, Mexico had an intermediate federal election (to renew the Legislative branch) that put the prospects of NAFTA's approval at the forefront of the wider public debate.⁸² Ten political parties took part in that 1991 election. Four small extreme leftist parties, Partido del Frente Cardenista de Reconstrucción Nacional (PFCRN), Partido del Trabajo (PT), Partido Revolucionario de los Trabajadores (PRT) and Partido Popular Socialista (PPS), questioned the very legitimacy of the federal government to negotiate and sign NAFTA.⁸³

PAN, PRD and Partido Auténtico de la Revolución Mexicana (PARM) did not question the legitimacy of the negotiations but the way in which NAFTA was negotiated. PAN proposed to get the Legislative branch involved in order to remedy the lack of representativeness. PRD and PARM (both leftist parties) proposed a public debate in order to increase citizen participation.⁸⁴ PRI was the ruling party and therefore supported the process as was carried out.

In the summer of 1991, three years after the highly contested presidential election of 1988 (in which, at best, PRI won by a narrow margin over the leftist PRD), the intermediate federal election saw a significant recovery of PRI, who won 61.4% of popular the vote. PAN came second with 17.7%, and PRD third with 8.26%.

⁸¹ Silvia Narváez, *El tratado de libre comercio de América del Norte (TLCAN) y la problemática del sindicalismo trinacional* [The North American Free Trade Agreement (NAFTA) and the Problema of Trinational Unionism], REVISTA NUEVA ANTROPOLOGÍA [New Anthropology Magazine] XVIII 059 (Apr., 2001) at 94-95; available at: <http://www.juridicas.unam.mx/publica/librev/rev/nuant/cont/59/cnt/cnt5.pdf>.

⁸² Lincoln Bizzózero, *Los partidos políticos de Canadá y México y el Tratado de Libre Comercio de América del Norte* [The Political Parties of Canada and Mexico and the North American Free Trade Agreement], INTEGRACIÓN LATINOAMERICANA [Latin American Integration] 204 (Oct. 1994) at 17 and 18.

⁸³ See *id.*, at 18.

⁸⁴ *Id.*

The seven small parties (including the leftist PARM, PFCRN, PPS, PRT, and PT) got, together, only 13% of the popular vote, although in the 1988 election most of them were part of the leftist coalition lead by PRD which came close to winning (or arguably won) the presidential election.⁸⁵

PRI's CTM defined its position until after the election (August 19, 1991), endorsing the federal government's economic policy and economic liberalization, as long as workers' and labor unions' rights were not compromised nor the standard of living of workers. CTM's position statement on NAFTA also posed "the need to provide training programs in order to increase productivity, and proposed a revision of the educational system that would make it possible to train young people in priority technical areas for the new economic activities."⁸⁶

Notwithstanding the above, CTM's Secretary of Education acknowledged that the first stage of the commercial liberalization "had provoked negative experiences that was necessary to correct by means of the modernization of the productive plant, the introduction of new technologies and new ways of labor organization."⁸⁷ Aside from this, CTM's attitude toward NAFTA was generally positive.⁸⁸

In 1993, NAFTA was ratified by the Mexican Senate with PRI's and PAN's Senators the vote in favor, while PRD Senators voted against.

1.1.6 Political-Economic Context of the Beginning of NAFTA Era

NAFTA entered into effect on 1st January 1994, but was accompanied by the armed uprising the "Zapatista Army" guerrilla in the south-eastern state of Chiapas that

⁸⁵ *Id.*, at 17. Of the parties mentioned only one, PT, survives as a separate party, as the rest have merged with PRD.

⁸⁶ CTM, COMITÉ NACIONAL [National Committee], *La CTM ante el Tratado de Libre Comercio, 19 de agosto de 1991* [The CTM before the Free Trade Agreement, August 19, 1991], CTM ÓRGANO DE ORIENTACIÓN DE LOS TRABAJADORES [CTM Orientation Entity of the Workers] No. 2014 (Aug 28, 1991) at 12-13. Cited in Narváez, *op. cit.*, at 95-96.

⁸⁷ PABLO PASCUAL MONCAYO y RAÚL TREJO DELABRE, *LOS SINDICATOS MEXICANOS ANTE EL TLC* [Mexican Labor Unions before the Free Trade Agreement] (1993) at 26. Cited in Narváez, *op. cit.*, at 96.

⁸⁸ See Narváez, *op. cit.*, at 96-97.

very same day. Zapatistas enjoyed the sympathy of leftist parties (PRD and its smaller “satellite” parties), organizations, and intellectuals, as well as the alleged (unofficial) support of another PRI faction that, under the leadership of Manuel Camacho Solis, later left that party to join PRD.

Noticeably, among the chief issues denounced and opposed by the Zapatistas and their supporters were precisely NAFTA and other “neo-liberal” policies and reforms carried out by the Salinas administration. The significance of the date of the uprising must not be underestimated. It was the starting date of NAFTA⁸⁹ and the beginning of year of presidential elections (upcoming later in the summer) in which voters were going to decide whether Mexico should continue on a path toward free market economics or go back to Statism.

Salinas’s first choice for a successor as president (by way of PRI’s candidacy)⁹⁰ was Luis Donaldo Colosio Murrieta, who had been in charge of the Secretary of Social Development. But Colosio was assassinated during the presidential campaign, in March 23, 1994. Among the many theories of why Colosio was murdered, a popular one (although as unproved yet as any other thesis advanced so far) alleges that he had the intention of departing from “neo-liberalism” (a matter that also remains unproved).

Whatever the truth about Colosio’s assassination is, the very existence of such a theory confirms the significance and intensity that confrontations about free markets have had in recent Mexican political and economic history.

Ernesto Zedillo Ponce de León, who had been in charge of SHCP and was perceived as committed to continuing the changes toward a free market economy, became PRI’s candidate in place of Colosio. Zedillo won the presidential election, amid fears of further violence and turmoil, and thus due in part to the population’s

⁸⁹ An immediate effect of the Zapatista uprising was to scare away foreign investment that had been already committed to move to Mexico, even if it was just temporarily. The intention of the Zapatistas of damaging the Mexican economy under the NAFTA cannot be underestimated.

⁹⁰ On the “meta-constitutional” power of the Mexican president to appoint his successor under PRI’s “Mexican Presidentialism,” see CARPIZO, *op. cit.*, at 190-197.

desire for peace and stability, but also thanks to the economic improvement (both perceived and real) Mexico had achieved by the end of the Salinas administration.

Not even a month into the Zedillo administration (inaugurated on 1st December, 1994), the infamous “Tequila Crisis” was unleashed.⁹¹ The sudden devaluation of the Mexican currency, followed by an overnight exponential increase in interest rates, quickly hit large segments of the general population who had various kinds of debts (from credit cards to residential mortgages) rendering them unable to pay their debts and thus losing their assets and credit eligibility. Firms with loans in dollars struggled to pay and had to lay-off a significant number of employees (at all levels), bringing about a sudden and sizeable increase in unemployment.

An imaginable consequence of the economic crisis in the political debate arena was to blame it on the so-called “neo-liberal” policies and reforms. In spite of that, the Zedillo administration (1994-2000) upheld the reforms made by his predecessors and continued on a path toward free market economy. Fiscal discipline was maintained (although at the expense of an increase in the consumer tax from 10% to 15%); and BANXICO continued to fight and keep inflation under control.

By 1995, NAFTA started to bear fruits, as the surplus with the USA grew due to the rise of Mexican exports to that country (due in part to the devaluation of the Mexican Peso). Maquiladora investments, manufacturing jobs and exports were the main source of economic growth.⁹² During the Zedillo administration six more FTA were signed.⁹³ This was possible because Zedillo still had political control over the Legislative branch, as his party (PRI) had the absolute majority in both chambers, and “presidentialism” was still the ruling principle in Mexican practical politics.

In spite of the deep and long-felt aftermath of the 1994 crisis, and its being blamed on free market policies and reforms (both of which were still very much alive

⁹¹ For more on the 1994 Crisis, see *infra* 3.1. The Mexican Crisis of 1994: The “Tequila Effect” and the Response to the Impact on the Crisis through the Financial Services Liberalization, Support Programs and Regulatory Measures.

⁹² See LUIS PAZOS DE LA TORRE, HISTORIA SINÓPTICA DE MÉXICO [Sinoptic History of Mexico], (2008), at 153.

⁹³ FTA G3 (between Mexico, Colombia and Venezuela, 1995); FTA México-Costa Rica (1995); FTA Mexico-Bolivia (1995); FTA Mexico-Nicaragua (1998); FTA Mexico-Chile (1999); MEFTA (2000); FTA Mexico-Israel (2000).

by the time of the 2000 presidential election), the centrist PAN won the presidential election with Vicente Fox Quezada as candidate, embracing and giving continuity to the market program of his predecessors. PRI came second in the election, and PRD and its satellite allied parties came third.

The cyclic end-of-presidential-term currency devaluation was prevented for the first time in 30 years in the 2000 presidential transition, thanks to the preventive line of credit to protect the Mexican currency (often referred to as financial “bullet-proofing”)⁹⁴ achieved in 1999.⁹⁵

During the Fox administration (2000-2006), foreign public debt was reduced by SHCP, as well as the government’s deficit, albeit a comprehensive tax reform was aborted by the legislative branch.⁹⁶ BANXICO continued fulfilling its mission of fighting inflation quite successfully with the executive branch’s cooperation; both imports and exports grew; and three more FTA were signed⁹⁷ plus the Mexico-Japan EPA.

1.2 THE PRE-NAFTA MEXICAN FINANCIAL SYSTEM

1.2.1 Expropriation of the Mexican Banks

Before 1974, banks in Mexico were specialized banks in that they provided limited services and/or served only a limited slice of users of financial services, according to the type of service each bank provided.

In order to promote the development of the banking sector and a more efficient use of their resources, a 1974 legal amendment created the innovative figure of what was called *banca multiple* [multiple banking] (also known internationally as universal banking) whereby banks were to render multiple financial services (or all

⁹⁴ From the Spanish *blindaje financiero*.

⁹⁵ See CNN-Expansión, “Acontecimientos económicos, tipo de cambio, PIB, empleo 1994-2009” [Economic Events, Exchange Rate, GDP, Employment 1994-2009]; available at: <http://www.cnnexpansion.com/media/2009/07/08/acontecimientos.pdf>.

⁹⁶ *Id.*

⁹⁷ FTA Mexico-TN (Triángulo del Norte [North’s Triangle], between Mexico, El Salvador, Guatemala and Honduras, 2001); FTA Mexico-Uruguay (2004).

of them) to all kinds of users, increasing flexibility and risk diversification.⁹⁸ The process of mergers to create the new multiple banking banks started in December 1976, along with the inauguration of the López-Portillo administration.⁹⁹

More legislative changes to the regulation of the banking sector came in 1978 aiming to establish effectively “multiple banking” banks, firms “authorized to exercise the following operations: deposit-taking, savings, financial intermediation, mortgages and trust.” As part of the new legislation, it was prohibited for independent specialized institutions to render the abovementioned services that were now reserved to banks.¹⁰⁰

The six years of the López-Portillo presidential administration (1976-1982) witnessed drastic changes in the shape of the Mexican financial system, from the early days of the newly legally recognized financial groups,¹⁰¹ and the establishment and consolidation of the figure of “multiple banking” banks to the expropriation of that newly developed banking sector.

On September 1st, 1982, during his overly dramatized Sixth (and last) Presidential Report to the Mexican Congress, López-Portillo announced what he called “the nationalization of the private banks,” which was in fact an expropriation or even a confiscation, rather than a nationalization, since the banks’ owners were Mexicans. Ironically, one of the two private banks that was not expropriated was Citibank, the one single foreign bank in Mexico back then.¹⁰²

⁹⁸ See CASE STUDY: THE CASE OF MEXICO, at 2.

⁹⁹ See Turrent, *op. cit.*, at 14.

¹⁰⁰ *Id.*, at 15-16.

¹⁰¹ Another feature to highlight about the Mexican financial system in the early 1970 was that most banks were usually part of a “financial group” along with another or other companies providing other financial services such as mortgage companies, financing societies, etc. Such financial entities were controlled by the same holding and often shared a brand-name. In December 1970, a new legal provision imposed on them “the obligation of following a coordinated financial policy and establishing a system of reciprocal guarantees in case of losses.” What had been so far informal financial groups started to acquire official recognition over the next five years. By December 1974, there were 15 financial groups (created around a bank) officially recognized (see *id.*, at 13-14).

¹⁰² See *id.*, at 18; and WENDY DOBSON and PIERRE JACQUET, FINANCIAL SERVICES LIBERALIZATION IN THE WTO (1998) at 273. The Mexican Government expropriated 58 of the 60 private banks. The two private banks that were not expropriated were Citibank, and “Banco Obrero” [Labor Bank] owned by the powerful Confederación de Trabajadores de México (CTM) [Confederation of Workers of Mexico]. CTM has been and is still the most numerous confederation of labor unions in Mexico. In 1947 the CTM leadership decreed that all its members would be members of PRI, and thus the CTM

According to the expropriation decree, the expropriation was due to the following reasons:

...private banks had acquired excessive profits by rendering a public service by government-concession;¹⁰³ they had created monopoly phenomena according to their interests with the public's money; in order for credit not to continue to be in the high strata of society and to make it come timely and affordably to the larger part of the people; to facilitate the getting out of the economic crisis that had been aggravated by the lack of direct control of the State over the financial system; to maintain public peace and to be able to adopt the necessary measures oriented to correct domestic disruptions.¹⁰⁴

In the wording of governmental discourse, the main argument was that the expropriation was necessary because bankers were *saca-dólares* ("dollar-drainers"), and/or helping other individuals who were dollar-drainers, who by causing such a flight of capitals away from Mexico were responsible of the economic crisis. A dollar-drainer was whoever moved their USA dollars abroad from Mexico (to avoid the economic crisis).

People protecting their private property against the effects of the economic crisis were labeled as traitors. López-Portillo claimed to have a "little list" of the *saca-dólares* who were hurting the Mexican economy. That list, however, was never made public; perhaps because it was not that little and included members of his own administration.¹⁰⁵

became one of PRI's "three sectors" (the labor sector). The expropriation decree also exempted the representation offices of foreign banks in Mexico (see Turrent, *op. cit.*).

¹⁰³ "Public service" is a technical term in Mexican Administrative Law. In this technical sense, a public service is a "juridical-administrative institution in which the entitled one is the State and whose end is to satisfy in a regular, continuous and uniformed manner public needs of essential, basic or fundamental character; it is concretized through individualized provisions which may be supplied directly by the state or by particulars by means of concession. Because of its nature, it shall always be subject to norms and principles of public law... Characteristics. They are created and organized by the State by means of laws emanated from the Legislative Power; they must be continual, uniform, regular and permanent; they always suppose a work of public interest; they satisfy the general interest opposing the particular; they satisfy material, economic, safety and cultural needs; they can be for profit or non-profit... (DICCIONARIO JURÍDICO MEXICANO [Mexican Legal Dictionary], 5th ed., (1992) at 2906. As already referred above, the 28th Art of the Mexican constitution is the one that lists the activities that are regarded as "public service".

¹⁰⁴ Turrent, *op. cit.*, at 17.

¹⁰⁵ See John P. Cogan, Jr. *Privatization of the Mexican Banking System: Quetzalcoatl and the Bankers*, 23 ST. MARY'S L.J. 753 (1991-1992) at 758.

The banks' expropriation came hand-in-hand with the "generalized currency exchange control," announced in the same paragraph of the same Sixth Presidential Report, right after the banks' nationalization. The "reckonings" presented to justify such currency exchange control were summarized as follows:

Austerity actions and adjustments in matters of political economy that had been applied to contain the crisis had not rendered results chiefly because of the amounts of capital flights. The economic crisis that had been suffered at least since the middle of 1981 had been caused by two phenomena: contraction of the foreign markets for Mexico's export products, and the unavailability and higher cost of foreign credit.¹⁰⁶

As explained above,¹⁰⁷ along with the expropriation and in order to furnish it with constitutional grounds, amendments to the constitution were required. Those amendments went beyond the expropriation of the existing private banks establishing an absolute prohibition for the private sector to engage in banking activities.¹⁰⁸ A total of 49 private commercial banks were expropriated.¹⁰⁹

1.2.2 The Years of Government-Owned Banks

Government's close control over the banking sector (itself a means of controlling the financial system, and the economy in general) was effective immediately after the expropriation. In September 4, the government announced measures ruling the interest rates banks would be paying and the currency exchange rates applicable to banking operations.¹¹⁰

Although decreed by López-Portillo, it was the De la Madrid administration which had to indemnify the banks and organize the government's management of the government-owned banks, an unprecedented situation in Mexico. By the time of the expropriation De la Madrid was already president elect but was not consulted by López-Portillo about the expropriation, a decision with which De la Madrid disagreed.

¹⁰⁶ Turrent, *op. cit.*, at 17-18.

¹⁰⁷ See *supra* 1.2. General Political Economy Background and Context of Pre-NAFTA Mexico.

¹⁰⁸ See Appendix 2: Excerpts of the 1982 and 1983 Amendments to the Mexican Constitution.

¹⁰⁹ *Id.*, at 21.

¹¹⁰ See Turrent, *op. cit.*, at 18-19. For the adverse results of these measures see *id.*, at 19.

Once in office, De la Madrid did not overturn the expropriation but merely allowed for up to 30% of the shares to be owned by private investors, in order to promote competitiveness.¹¹¹

The experienced bankers disapproved of the expropriation and were let go from their positions. Although De la Madrid appointed prestigious professionals to head the expropriated banks (or so the official history claims),¹¹² the newly created bankers still lacked experience and proper training¹¹³ and had little margin to maneuver since, for all practical purposes, all the banks were centrally managed by BANXICO through its strict regulations and controls.

Another change was the re-structuring of the banking sector by means of “a careful process of mergers,” which reduced the number of banks from 60 in 1982, to 19 in 1985. Six of those banks had national presence, seven were multi-regional, and six more were regional.¹¹⁴

1.2.3 Commercial Banks’ Re-privatization

As discussed above, the economic liberalization hesitantly begun by De la Madrid was sped up and expanded during the Salinas administration (1988-1994), and not without much political controversy.¹¹⁵ Even more controversial was the re-privatization of the commercial banks carried out between 1989 and 1990, which required a constitutional amendment to remove the addition made back in 1982 and 1983 that made banking an activity reserved to the government.¹¹⁶ Once the constitutional amendment was passed, all of the 18 banks owned by the government by 1990 were auctioned and sold between 1990 and 1992.¹¹⁷

¹¹¹ See *id.*, at 21. It has to be recognized that De la Madrid moderated the extent and full effects of the banks expropriation by re-privatizing, not long after, the banks’ financial and non-financial subsidiaries. See also NORTON, FINANCIAL SECTOR..., *op. cit.*, at 266.

¹¹² See Turrent, *op. cit.*

¹¹³ See NORTON, FINANCIAL SECTOR..., at 27.

¹¹⁴ See Turrent, *op. cit.*, at 22.

¹¹⁵ See *supra* 1.4. Political Confrontations Regarding Free Market Policies.

¹¹⁶ Regrettably most of the Statist (and even Socialists) content introduced to the Mexican Constitution back in 1982 and 1983 remains to this day.

¹¹⁷ See Christopher R. Rowley, *Searching for Stability: Mexico’s 1995 Banking System Reforms*, in L. AND BUSINESS REVIEW OF THE AMERICAS (Summer 1998) at 30. Market penetration was very low. In

The buyers were Mexican individuals and strong Mexican economic groups, which paid a total USD\$12.4 billion.¹¹⁸ The pressure on the re-privatized banks, whose purchasers were trying to recover their investment, increased significantly the lending, which from 1991 to 1994 grew at an average annual rate of 23.7%, more than 8 times the average annual rate of growth of real GDP.¹¹⁹

The newly privatized banks were nevertheless the product of the old financial system, and after the privatization authorities failed to strengthen the prudential controls, increase their supervision, and establish criteria for lending or for evaluating portfolio risk.¹²⁰

The Salinas administration was committed with liberalization and privatization,¹²¹ including the liberalization of deposit and lending rates, elimination of the mandatory requirement for commercial banks to hold long-term commercial paper to maturity and the elimination of reserve requirements. Norton has drawn attention to some important legislation such as the Law for the Regulation of Financial Groups, which allowed a single holding company to own several financial entities, providers of various financial services (e. g. banking, securities brokerage, and insurance).¹²²

Mexico there was one branch bank per every 18 000 people while in the USA had one per every 4 000 people.

¹¹⁸ See Saturnino E. Lucio, *The Effect of NAFTA on the entry of Foreign Banks in Mexico and in the USA*, JERRY HAAR and KRISHNAN DANDAPANI, eds., *BANKING IN NORTH AMERICA: NAFTA AND BEYOND*, 1st ed., (1999) at 184.

¹¹⁹ See DOBSON and JACQUET, *op. cit.*, at 268.

¹²⁰ See Fernando Montes-Negret & Luis Landa, "Interest Rate Spreads in Mexico during Liberalization" (WB paper, Jul. 1999).

¹²¹ OECD, "Regulatory Reform in Mexico: Enhancing Market Openness through Regulatory Reform (1999) at 20; available at: www.oecd.org/dataoecd/44/57/2507154.pdf. In 1994, Mexico's accession to the OECD was instrumental in the extension of NAFTA's investment commitments to non-NAFTA countries.

¹²² See NORTON, *FINANCIAL SECTOR...*, *op. cit.*, at 268. At the same time, and even prior, of NAFTA negotiation process, most of the Mexican domestic reforms were made, which "paved the way for a smooth NAFTA". Although the privatization was complete, the Mexican banks were considered as less developed than those of the NAFTA partners.

1.3 THE POST-NAFTA MEXICAN FINANCIAL SYSTEM

1.3.1 The Mexican Crisis of 1994: The “Tequila Effect” and the Response to the Impact on the Crisis through the Financial Services Liberalization, Support Programs and Regulatory Measures

The Mexico’s 1994 crisis, whose consequences would be dubbed later as the “Tequila Effect,” has been attributed to several causes. Domestically, some attributed the crisis to the government’s incompetent handling, which was why it was dubbed “*el error de diciembre*” (“December’s Mistake”). Yet, the 1994 crisis was actually due to policy mistakes stretching back over several years.¹²³ Among the weakness were: the real appreciation of the peso, a very large current account deficit by massive (portfolio) capital inflows, and the slow growth of productivity (between 1988 and 1994).

Real growth averaged 2.8% (significantly lower than Chile), productivity growth was almost flat until 1993, export expansion was low, real wages barely reached their 1980 level, the declining trend in private savings, poverty and income distribution continued to be a serious problem,¹²⁴ declining central bank reserves and an unstable structure of external debt.¹²⁵

Paradoxically, right before the crisis, the media, financial institutions such as WB and IMF, and financial experts were talking about the "Mexican Miracle." During this period there was a significant contrast between Mexico's achievement in terms of

¹²³ See MONTES-NEGRET & LANDA, *op. cit.* While improved supervision was extremely important and necessary, it was not sufficient to address these problems of incentive. Neither did it address the implicit high cost of a deficient legal framework and weak, slow, costly and often corrupt judicial and enforcement mechanisms. The basic foundations for sound financial intermediation are: 1) Proper screening and licensing of new entrants; 2) Properly capitalized banks; 3) Sound banking practices and procedures; 4) An adequate legal framework; 5) Adequate judicial practices and enforcement mechanisms; and 6) Strong supervision, regulation and enforcement. Of these six basic elements, the Mexican financial liberalization process omitted the first five, and was deficient in the last. That was partially responsible for the post-liberalization crisis that erupted in December 1994.

¹²⁴ See HERMAN SAUTTER and ROLF SCHINKE, eds., *STABILIZATION AND REFORMS IN LATIN AMERICA: WHERE DO WE STAND?* (1996) at 70. In the same sense see George Bratsiotis and Wayne Robinson, “Economic Fundamentals and Self-fulfilling Crises: Some Evidence from Mexico” (University of Manchester working paper). See also JAN JOOST TEUNISSEN, ed., *CAN CURRENCY CRISES BE PREVENTED OR BETTER MANAGED? LESSONS FROM MEXICO* (1966).

¹²⁵ See R. C. Maysami & J. J. Williams, *National Policy and Structural Reform: Pillars of Stable Mexican Economic Growth*, 7 *J. INT’L BANKING L.* (2001) at 174-75.

reform policies and economic results. For Sautter such excessive optimism was due to an exaggerated faith in market-oriented reforms and the US administration efforts to persuade the public of the benefits of NAFTA.¹²⁶

In December 1994, the Mexican CC¹²⁷ abandoned the exchange rate regime and tried to stabilize the foreign exchange market by raising the upper limit. The CC would change later this policy, however, to ensure the establishment of a freely floating exchange rate system.¹²⁸ The Mexican Government devalued its currency 15% against the USA Dollar and two days later let the Peso float freely. Subsequently, it fell 50% in one month.

In 1994, Mexico's government spent USD\$20 billion to protect the peso. Because reserves were reduced to USD\$6 billion the real interest rates reached high levels causing serious difficulties to financial intermediaries and to debtors in general. A large amount of investors withdrew their money; consequently the reserves in Mexico disappeared.¹²⁹

Some, like Sautter, say that when the crisis began, instead of taking corrective measures consistent with the new external circumstances, the government tried to maintain the same exchange rate by using large amounts of dollar-linked short term debt (*Tesobonos*) making the economic situation especially vulnerable to speculative attacks. When the attack happened, the government's belated reaction was to try to widen the exchange rate.¹³⁰

Others, like Slover, point out that the government responded quickly in arranging the support and liquidity packages to stem the massive outflow of capital. Even

¹²⁶ See SAUTTER and SCHINKE, *op cit.*, at 74. Among others talking about the "Mexican Miracle" were also investment bankers, mutual fund managers and financial reporters such as Bear Stearns and Co's: "we expect a strengthening of the peso in the coming months, creating very high dollar on Cetes;" J. P. Morgan "We view Mexico as investment grade risk. We do not regard Mexican debt to have predominantly speculative characteristics." See also VALERIANO F. GARCIA, BLACK DECEMBER: BANKING INSTABILITY, THE MEXICAN CRISIS AND ITS EFFECT ON ARGENTINA (1997).

¹²⁷ The Mexican government's Foreign Exchange Commission is an authority comprised by the autonomous BANXICO and the executive branch of the federal government represented by SHCP.

¹²⁸ See GEORGE M. VON FURSTENBERG, THE BANKING AND FINANCIAL STRUCTURE IN THE NAFTA COUNTRIES AND CHILE (1997) at 161.

¹²⁹ *Id.*

¹³⁰ See SAUTTER and SCHINKE, *op. cit.*, at 69.

more, the regulators were able to constrain the growth of impaired institutions successfully without resorting to inflationary financing to resolve banks.¹³¹

In any case, the fact remains that the Mexican Government tried to handle quickly the crisis by implementing several programs such as minimizing the inflationary effects of the devaluation, and encouraging constitutional and legislative reforms¹³² to promote competitiveness in the private sector.

In response to the crisis, the Mexican government also made significant progress¹³³ in the following areas, identified by a special G10 Working Party as key for a robust financial system:¹³⁴ 1) sound and well-developed legal and judicial system;¹³⁵ 2) accounting practices and disclosures techniques;¹³⁶ 3) stakeholder oversight and institutional framework;¹³⁷ 4) market structure that favors free competition and promotes the efficient use of resources and the maximization of returns; 5) financial regulatory and supervisory system designed to support and enhance market functioning, rather than displacing it, by promoting the integrity of the market infrastructure and fostering the efficient operation of the financial system;¹³⁸ and 6) financial safety net designed to minimize moral hazard.¹³⁹

The new good accounting practices and disclosure technique applied in Mexico made it then possible for the markets to see clearly the financial condition of the

¹³¹ See Thomas W. Slover. *Tequila Sunrise: Mexico Emerges from the Darkness of Financial Crisis*, ESSAYS IN INTERNATIONAL FINANCIAL & ECONOMIC LAW 15 (1998) at 51.

¹³² See Maysami & Williams, *op. cit.*, at 2. Among others reform includes the amendment to allow private investment in railroads and satellites.

¹³³ See Slover, *op. cit.*, at 51.

¹³⁴ See G10, "Financial Stability in Emerging Market Economies" (Apr. 1997); Slover, *op. cit.*, at 53. The international community gave BANXICO its approval when it was invited to the meeting of the Board of Governors of the BIS in Sep. 1996.

¹³⁵ *Id.*, at 74. This includes: well defined property rights and contract law, market contracts easily enforceable in practice, ability to pledge and seize collateral and well developed bankruptcy code.

¹³⁶ See *id.* For example, information on the creditworthiness of financial institutions made publicly available on a regular and frequent basis.

¹³⁷ See *id.* For example, capital adequacy requirements commensurate with risk, replacement of management for poor performance, etc.

¹³⁸ See *id.*, at 75. Independence from political interference in daily supervision, and appropriate accountability to achieve these clearly defined objectives: conduct supervision on a consolidated basis, verification of information on risk management and internal control systems and on asset quality by regular examinations or external audits, adherence to norms established by international consultative bodies (such as BCBS), and strategy for addressing financial insolvency.

¹³⁹ See *id.*, at 76. For example: Explicit rather than implicit deposit insurance paid for by banks and targeted especially towards protecting small depositors, appropriate allocation of losses among stakeholders, stringent conditionality for the use of public money.

Mexican banks as well as monitor the activities of the Mexican financial regulatory authorities. Likewise, by reducing barriers to market entry, a market structure to promote free competition was also created.¹⁴⁰

The second step toward financial services liberalization in Mexico was the legislative changes passed by Congress and promulgated on February 15, 1995.¹⁴¹ Among the changes were, the share limit for banks from 1.5% in individual holding market to 6% and in aggregate foreign market from 8% to 25% while the aggregate foreign investment was limited to 49%.

The initial implementation once projected by NAFTA (step-by-step during a period of six years for financial services until 2000)¹⁴² was suspended when the Mexican peso crashed and the financial system collapsed at the end of 1994.

Although Mexico was entitled (according to the paragraph 9, 10, 11, 13 and 14 of Section B, and paragraph 1 of the Section C of the Schedule of Mexico, Annex VII of NAFTA)¹⁴³ to establish market share limits to US and Canadian banks in any event of the financial crisis, instead of that the Mexican Congress removed more barriers to foreign investment.

Nevertheless, other key factors necessary to promote economic growth, such as a sound macroeconomic policy framework that keeps inflation and budget deficit low, and a sustainable current account,¹⁴⁴ were not present at the time of the said 1995 legislative changes.

¹⁴⁰ See Slover, *op. cit.*, at 52.

¹⁴¹ The following laws were modified: Ley de Instituciones de Crédito (Banking Law), Ley del Mercado de Valores (Stock Exchange Law), Ley para Regular las Agrupaciones Financieras (Financial Groups Law).

¹⁴² See MACARIO SCHEITINO, EL TRATADO DE LIBRE COMERCIO: QUE ES? Y COMO NOS AFECTA? [THE NORTH AMERICAN FREE TRADE AGREEMENT WHAT IS IT? AND HOW DOES IT AFFECT US?] (1994) at 47. NAFTA's 15-year phase-in is reasonable, as it may prevent financial instability by allowing the markets to adapt gradually to the changes.

¹⁴³ NAFTA, 32 I.L.M. at 289.

¹⁴⁴ NORTON, FINANCIAL SECTOR..., *op. cit.*, at 11.

The USA and IMF played a key role helping the Mexican government to deal with the crisis. IMF even violated its internal rules by granting Mexico a loan equal to seven times its quota, which was unprecedented in its negotiation speed.¹⁴⁵ This is explained partly because, although illiquid, Mexico was no insolvent, and partly because, as Sachs points out, “Mexico has the luck to share 2000 miles border with the IMF’s largest shareholder.”¹⁴⁶

In 1994 political and criminal events had an adverse effect on market expectations that forced investors to reconsider their investments and jeopardized Mexico’s spending policies. The first major event was political, namely, the uprising of the Zapatista National Liberation Army, which took place the same day NAFTA entered into force (1st January 1994).

The second major event was criminal with political implications, namely, the assassination of presidential candidate Luis Donaldo Colosio. The day after that tragic event, the Mexican market fell 22 points and the country was exposed to large losses in foreign exchange reserves due to investors’ panic.¹⁴⁷

Other events were the accusations and resignation of the Deputy Attorney General. Lastly, in September 1994, PRI’s general secretary José Francisco Ruiz Massieu was assassinated, putting into question again Mexico’s political stability.

Another measure used by the executive branch of the Mexican federal government, along with BANXICO, to deal with the 1994 crisis was to negotiate a unity agreement with the labor sectors (*Acuerdo de Unidad para Superar la Emergencia Economica* [Unity Agreement to Overcome the Economic Emergency]), which included keeping inflation under control.¹⁴⁸ The economic program was

¹⁴⁵ See Jeffrey D. Sachs, “Do We Need an International Lender of Last Resort?” (Frank D. Graham Lecture, Princeton University, Apr. 20, 1995) at 2; available at: <http://www.stern.nyu.edu/~nroubini/asia/AsiaHomepage.htm>.

¹⁴⁶ See *id.*

¹⁴⁷ See WB, *Mexico, Country Overview*, TRENDS IN DEVELOPING ECONOMICS (1996). See also J. J. Norton, *The Mexican Peso Crisis and the Future of Financial Integration in the Americas* in J. J. NORTON, MADS ANDENAS and M. FOOTER, eds., THE CHANGING NATURE OF INTERNATIONAL LAW IN THE TWENTY FIRST CENTURY (1998), at Ch. 12. See also Slover, *op. cit.*, at 38, and Arner, *The Mexican...*, *op. cit.*, at 27.

¹⁴⁸ See *Rescuing the Sombrero*, THE ECONOMIST (Jan. 21, 1995) at 18.

supported by the *Fondo de Estabilizacion Cambiaria* [Exchange Stabilization Fund],¹⁴⁹ which was established with foreign financial authorities and international organizations, such as IMF, to lend support to the Mexican currency.

In the financial sector, other programs were implemented such as the *Acuerdo Inmediato a los Deudores de la Banca* [Immediate Support Agreement to Banking Sector Debtors], which was later transformed into FOBAPROA and finally into IPAB.¹⁵⁰ Thus, the Mexican banks that became insolvent in 1995 were put under the control of FOBAPROA and were sold afterwards. Most of them were bought by foreign banks (Citibank, HSBC, BBV, Scotiabank, etc.).¹⁵¹

Another important financial program to deal with the effects of the 1994 crisis was PROCAPTE,¹⁵² designed to help banks in need of improving capitalization levels and increasing depositors' confidence and to help them prevent a direct impact on the money supply and on the overall fiscal stance of the government.¹⁵³

Another measure taken to deal with the crisis was the creation of the UDI (inflation-indexed units of account), which helped banks to restructure significant portions of their loan portfolios, in order to increase the likelihood of their loans to continue to perform in light of high inflation and interest rates.¹⁵⁴ In other words, UDIs were used to relieve debtors and as a means for bank users to save their money protected against inflation.

¹⁴⁹ See IMF, "IMF Executive Board Set to Consider Stand-By Credit for Mexico" (News Brief No. 99/29, Jun. 15, 1999); available at: <http://www.imf.org/external/np/sec/nb/1999/NB9929.htm>.

¹⁵⁰ See OECD Directorate for Financial, Fiscal and Enterprise Affairs, Committee on Competition Law and Policy, "Mergers in Financial Services" (OECD, Doc. No. DAF/CLP (2000) 191; available at: <http://www.oecd.org/dataoecd/34/22/1920060.pdf>. In Mexico, starting in 2005, bank deposits are protected up to approximately USD\$110,000, before then protection used to be unlimited.

¹⁵¹ See Slover, *op. cit.*, at 38. BBV purchased Grupo Financiero Probursa (holder of Multibanco Mercantil Probursa), Grupo Financiero Cremi, and Banco de Oriente; Bank of Nova Scotia purchased Grupo Financiero Inverlat; HSBC purchased Grupo Financiero Bital. Years later, when BBV became BBVA, it purchased Grupo Financiero Bancomer.

¹⁵² See Javier Gavito, Aaron Silva & Guillermo Zamarripa, *Mexico's Banking Crisis: Origin, Consequences, and Countermeasures*, FURSTENBERG, *op. cit.*, at 236. In 1995 five banks applied for PROCAPTE, which issued MXN\$6 billion Pesos worth of convertible debentures. The following year, June 1996, four banks left PROCAPTE.

¹⁵³ See Arner, *The Mexican...*, *op. cit.*, at 27. This program also gave help to those banks whose capitalization levels fell below the internationally accepted standard of 8% of risk weighted assets and was intended to use for banks that were facing short-term capital needs.

¹⁵⁴ See *id.*, at 28. In the same sense see Gavito, Silva & Zamarripa, *op. cit.*, at 237.

The fund to rescue Mexico amounted to more than \$US 52 billion Dollars. USA arranged a USD\$9 billion credit line from the Federal Reserve, and later agreed to exchange USD\$20 billion for MXN for 3 to 5 years. Mexico agreed to pay a fee for the exchange and set aside oil revenues as collateral.¹⁵⁵ IMF lent USD\$17.8 billion.¹⁵⁶ Some members of the BIS lent USD\$10 billion Dollars. Another USD\$3 billion were loaned by commercial banks, and USD\$1.5 billion by the Bank of Canada.¹⁵⁷

Mexico was able to repay IMF.¹⁵⁸ Inflation and interest rates declined and exports increased (only in ten years Mexican exports grew from USD\$31 to USD\$136 billion).¹⁵⁹ External deficit was small, and there was a strong increase in the net international reserves in 1996.¹⁶⁰ Trade and current account balances improved as well, the Mexican Peso recovered, foreign reserves rose and the stock market also recovered.¹⁶¹

In 1997 Claudio Loser was able to write: “Mexico has made remarkable progress in re-establishing macroeconomic stability and the Mexican government has unveiled a medium-term program... PRONAFIDE.”¹⁶²

In the second quarter of 1995 Mexico also regained access to the international capital markets, only five months after the December 1994 devaluation. This situation makes a contrast with the seven years that took capital markets to be negotiated after the 1982 crisis.¹⁶³

¹⁵⁵ See *Quick or Quagmire?*, THE ECONOMIST (Jan. 21, 1995) at 95. The condition was the change in policies on everything from immigration and labor laws to policy towards Cuba.

¹⁵⁶ See *The Funds Sums*, THE ECONOMIST (Feb. 11, 1995) at 10; and IMF, “IMF Approves US \$17.8 Billion Stand-By Credit for Mexico” (Press Release, Feb. 1, 1995).

¹⁵⁷ See SCOTT & WELLONS, *op. cit.*, at 1201. See also Slover, *op. cit.*, at 53.

¹⁵⁸ See STEPHEN J. RANDALL and HERMAN W. KONRAD, NAFTA IN TRANSITION (1995) at 135.

¹⁵⁹ See BANCAMEXT, INDUSTRIAL COST IN MEXICO 2001, 6th ed. (2001) at 15 [hereinafter BANCAMEXT STUDY].

¹⁶⁰ See IMF, “Camdessus Welcomes Advance Repayment of Loans by Mexico, Positive Developments in Mexican Economy” (News Brief No. 97/1, Jan. 15, 1997); available at: <http://www.imf.org/external/np/sec/nb/1997/nb9701.htm>.

¹⁶¹ See IMF, “IMF Board Releases USD\$2 Billion for Mexico: Sets Schedule for Remaining USD\$8.7 Billion” (News Brief No. 95/16, Jun. 30, 1995); available at: <http://www.imf.org/external/np/sec/nb/1995/nb9516.htm>.

¹⁶² See IMF, “IMF Staff Views Favorably Mexican Medium-Term Program” (News Brief No. 97/10, Jun. 3, 1997); available at: <http://www.imf.org/external/np/sec/nb/1997/NB9710.HTM>.

¹⁶³ See Slover, *op. cit.*, at 53.

The third step in the liberalization of financial services in Mexico was given in 1999, when its Congress amended the banking law allowing for a 100% of foreign investment in Mexican banks.¹⁶⁴ According to the Executive's Bill and the debates in the Mexican Congress, the motivation of the proposed amendment was the continuing and urgent need to attract more capital and modern technologies, and to promote competition, efficiency and productivity in the Mexican financial system, which was still vulnerable.¹⁶⁵

As a result of the amendments to the banking law, foreign banks started to purchase Mexican banks. Most notable is the entrance of American and European banking conglomerates such as Citibank,¹⁶⁶ HSBC and BBVA. These banks injected significant amounts of capital into the Mexican financial system. As a result, Mexico became the country with the largest foreign bank participation in Latin America, accounting for 50% in 2000, to 74% in 2002 and more than 80% in 2004.¹⁶⁷

The entry of foreign banks into the Mexican financial system brought about significant positive changes in Mexico's banking sector including, higher efficiency, the use of cutting edge technology, improved productivity, more competition, and lower interest rates.¹⁶⁸

¹⁶⁴ See DOF (Jan. 19, 1999).

¹⁶⁵ See *id.*

¹⁶⁶ See Romina Román Pineda, *Citigroup gana 700 mmd* [Citigroup earns USD\$700 Billion], EL UNIVERSAL (Oct. 18, 2005); available at: <http://www.eluniversal.com.mx/finanzas/47955.html>.

¹⁶⁷ See *Financial Integration IADB Doc., op. cit.*, at 108; IMF, MEXICO: FINANCIAL SYSTEM STABILITY ASSESSMENT (2001); and Romina Román Pineda, *Mexico: A Mine of Gold for Foreign Banks*, EL UNIVERSAL (May 3, 2004) at 1. Mexico has become one of the most profitable markets for the foreign banks (Citibank, HSBC, BBV and Scotiabank), with bank profits in Mexico surpassing those obtained elsewhere in Latin America, Africa, and Japan. Only HSBC obtained profits 63% larger than the previous year. See also MEXICO UPDATE (publication of the Mexican Embassy in the UK, Oct. 2005) at 4. Currently the only large commercial bank that remains under controlled of Mexican nationals is BANORTE. In September 6, 2005, THE BANKER awarded BANORTE as "Bank of the year." BANORTE has cut costs including an 8% reduction of personnel, and its management has improved profitability. BANORTE has also grown in loan portfolio by 18%, and its share price increased 80 during 2004. BANORTE's stock is currently the ninth most active stock in the Mexican Stock Exchange.

¹⁶⁸ See Carlos Palomares, *The Globalization of Financial Services: Implications for Competition in the North American Market*, HAAR and DANDAPANI, *op. cit.*, at 119. Before the entrance of the foreign banks to Mexico, poor service was notorious. The technology penetration has also helped to improve efficiency. In 1992, Mexico had 4500 bank branches, Canada 7500 and USA 68000. In that time there 1 ATM per 21 000 people. In Contrast, Canada and USA had 2700 people per ATM. Today, the Technology innovation recognizes as well that the majority of the consumers will be doing their banking remotely.

By 2002, the OECD Economy Survey said the following about Mexico:

Today, the financial sector has experienced an increase in efficiency and profitability, a system wide re-capitalization and an overall clean up of balance sheets today. The Mexican banking system is increasingly solid and as profitable as in the rest of the OECD counterparts; and the supervision and regulatory frameworks are close to the best practices.¹⁶⁹

IMF's Financial System Stability Assessment of Mexico concluded that, given the large participation of strong foreign banks, the "still low participation of banks in financial intermediation, and the recent strengthening of capital, the banking system, should not become a source of problems."

Along with the aforesaid policies taken in response to the 1994 financial crisis, the Mexican financial authorities adopted important measures in the prudential regulation and supervision arenas to enhance security and transparency, thus rendering a more robust and sound financial system.

Among such measures were: a) improved disclosure by financial institutions' in order to promote transparency for the benefit of the investors, b) strengthened mechanisms of internal control, c) the establishment of credit bureau to help risk management, d) improved asset-valuation methods, encouragement of the use of market valuation of the investment portfolio, e) new regulations for loan portfolios classification and, f) strengthened functions for rating agencies.¹⁷⁰

1.3.2 Tax Policy

The Mexican government applied stricter tax rules that were likewise more strictly enforced. Many called that "tax terrorism". Among the tax reforms passed by Congress, the most significant were: i) corporate tax rate raise from 34% to 35%; ii) domestic withholding tax rate raise from 35% to 40%; iii) net capital gains tax raise

¹⁶⁹ See OECD, *Economic Survey of Mexico 2002*, POLICY BRIEF 5 (Mar. 2002); available at: <http://www.oecd.org/dataoecd/41/18/2068882.pdf> [hereinafter 2002 OECD ECONOMIC SURVEY OF MEXICO]. According to this document, nevertheless, there are still areas that need improvement, e. g. collection of bad loans (bankruptcy procedures), and the low level of credit to the private sector for SME as well as for individuals (id., at 5).

¹⁷⁰ See Gavito, *et al.*, *op. cit.*, at 237.

from 30% to 40%; iv) a new 5% tax to dividends distributed by corporations and remittances to head offices by branches; v) new taxation scheme that shifted the tax base for USA-owned *maquiladoras* (in bond companies).

SHCP toughened many rules including the strengthening of its legal audit and confiscatory powers under Art 42-A of the Income Tax Law, which enables unlimited access to the amount and type of information; tougher penalties for non-compliance by external auditors, who became liable for any failure to disclose taxpayers' omissions; and the criminalization of tax evasion.

1.3.3 FDI

After the 1994-1995 crisis, Mexico created new investment opportunities¹⁷¹ and provided more certainty, predictability and legal security for national and international investors. One example is the amendment of the Foreign Investment Law,¹⁷² which establishes procedures, defines legal entities and binds the country's economic sector to NAFTA. Amendments to the said law in 1996 extended rights held by partner countries under NAFTA to investors worldwide.

In 1999 more amendments provided legal certainty, strengthened open foreign investment and eliminated investment performance requirements. Except for the areas prohibited by the Mexican Constitution, foreigners are allowed 100% participation in Mexican companies.¹⁷³ Summing up, although Mexico is still halfway in some areas of investments,¹⁷⁴ noticeable progress has been made.

All corporations must be registered at the Ministry of Economy. The CNIE and National Foreign Registry are empowered to record, evaluate and register foreign

¹⁷¹ See CLYDE W. BARROW, SYLVIE DIDOU-AUPETIT and JOHN MAELLA, *GLOBALIZATION, TRADE, LIBERALIZATION, AND HIGHER EDUCATION IN NORTH AMERICA: THE EMERGENCE OF A NEW MARKET UNDER NAFTA* (2003).

¹⁷² See J. J. Norton & David W. Banowsky, *Secured Financing Issues for International Lenders: Bridging the Gap between the Civil and Common Law through Asset-backed Securitisation Lessons From and Respecting Argentina and Mexico*, NORTON & ANDENAS, *op. cit.*, at 308.

¹⁷³ See Maysami & Williams, *op. cit.*, at 5.

¹⁷⁴ See BANCAMEXT STUDY at 21. The USA is the main source of FDI in Mexico. Between January 1994 and December 1998, companies with American capital invested more than USD\$24.7 billions. Mexico's total FDI during 1999 was USD\$11 millions, it is worth mentioning that three quarters of total was assigned to the manufacturing industry. It was also installed mainly in the central region state of the country.

investments. Normally, investments applications of less than 394 million pesos in fixed assets are approved automatically but other require approval from the CNIE, e.g. energy, telecommunications and controlling stock holding in companies related to governments activities (sector to be considered strategic). There are also economic activities reserved exclusively for Mexican citizens such as retail sales of gasoline, non-cable radio and television services, credit unions, savings and loan institutions.¹⁷⁵

Important changes have also happened in the area of the property. The law now permits foreign investment in residential land within 100 kilometers of Mexico's border and 50 kilometers of the coastline via trust arrangements. These allow the trustee to use and control land through a 50 years renewable investment trust without any rights or entitlements. Also, the concept of neutral investment permits foreigners to participate in all domestic companies, through non-voting shares.

The most popular forms of juridical person is the corporation (including its variable capital variety). The latter is popular because of its flexibility in subsidiaries. Branches of foreign corporations as well as partnerships and joint ventures are permissible.

Nevertheless, branches have disadvantages because they cannot own real estate nor deduct expenditures for royalties, interest or fees that are paid to the parent company. The formation of branches consumes more time and expenses, they are more restricted than corporations, and are not privileged with limited liability status.¹⁷⁶

The promotional arm of the Mexican government associated with the FDI is BANCOMEXT.¹⁷⁷ This development bank is in charge of promoting and financing foreign trade, also acting as a matchmaker between Mexican companies or Mexican

¹⁷⁵ See Maysami & Williams, *op. cit.*, at 6.

¹⁷⁶ *Id.*

¹⁷⁷ The Representative Office of BANCOMEXT in London also operates as a Trade Commission of the Mexican Embassy and its main objective is to promote Mexican exports and investment opportunities to the UK and the Republic of Ireland. See www.bancomext.com. Interview with Ms. Elena Espinosa-Wingate, Commercial Counselor and Head of BANCOMEXT-London, (Feb. 19 2003); and www.promexico.gob.mx.

exporters and foreign importers and investors. It also has expert services of some 36 offices located all over Mexico and 41 offices overseas.

Moreover, it organizes Trade Missions and individual visits to Mexico, sends a list of appropriate suppliers, and provides advice and information on all aspects of importing from Mexico. It is worth mentioning that the Mexican Government avoids using tax incentives to promote FDI, preferring instead to stimulate exports through several development programs, for example the programs for foreign trade companies (ECEX).

The *maquiladora* program is the most successful FDI strategy to promote Mexican exports. *Maquiladoras* must be registered with the National Maquiladoras Industry Registry in order to receive special customs exemptions. These companies temporarily export intermediate goods (either in the form of raw materials, machinery, parts or equipment) duty free and subsequently, the final goods are re-exported or sold domestically.¹⁷⁸

Related with scope of the protection against unfair foreign trade, it is interesting to point out that Mexico has begun using similar laws to the famous Section 301 of the USA Trade Code, against such unfair practices of other nations. Mexico has supplanted Canada as the fourth most active user of these laws.¹⁷⁹

1.3.4 Other Structural Reforms in the Post-NAFTA Financial System

The reforms Mexico has implemented, which have focused on economic and financial liberalization, have enabled the economy to take advantage of the benefits of globalization. The reforms included trade and capital account liberalization, increased private sector participation in key sectors of the economy, tax reforms, and changes in labor market structures. Capital market liberalization and pension market reform have transformed a closed economy into an open, market driven one.¹⁸⁰

¹⁷⁸ See Maysami & Williams, *op. cit.*, at 7.

¹⁷⁹ See M. C. Beverly, *Impact of international Trade Law on National Law-Making in Western Hemisphere*, NAFTA: LAW AND BUSINESS REVIEW OF THE AMERICAS Vol. III, No. 4 (Autumn 1997), at 11.

¹⁸⁰ See José A. Gurría, *Mexico: Recent Developments, Structural Reforms and Future Challenges*, FINANCE & DEVELOPMENT (Mar. 2000) at 4.

The Senate of the Mexican Congress approved the new Commercial Reorganization and Bankruptcy Act in April 2000. The new legal framework is intended to maintain a balance among firms and their creditors in order to protect both entities' legal rights. The Federal Institute of Reorganization and Bankruptcy Specialist was also created, which co-ordinates the provision of technical support in reorganization cases.

In recognizing that the Mexican economy is linked with international markets, this new law includes a Cross-Border Insolvency Chapter, based on the UNCITRAL Model of Insolvency. The role of the judges in the insolvency process has been revised, keeping their functions as the main operators.¹⁸¹

Later, the Mexican Congress approved reforms that created a new legal framework for granting collateral and established an expeditious judicial process for executing judgments against security interest, known as the Miscellany of Secured Lending reforming the Commerce Code, General Law of Negotiable Instruments and Credit Transactions and Credit Institutions Law.¹⁸²

Also, in 1997 then President Zedillo sent the Congress a bill of amendments to the banking legislation such as reducing moral hazard incentives, by creating a new bank deposit insurance fund, called FOGADE, FOBAPROA and later IPAB, enforcing debt payment by making it easier and faster for banks to collect payment or take control of collateral, all of which was aimed to lead the country out of its financial problems.¹⁸³

1.3.5 Mexico as a Natural Hub in the International Trade System

Mexico enjoys a unique and strategic geographical location being the commercial bridge between North and Central and South America, a link between America and Europe and between America and Asia.

¹⁸¹ See Maysami & Williams, *op. cit.*, at 7.

¹⁸² See *id.*

¹⁸³ See TIMOTHY KESSLER, GLOBAL CAPITALS AND NATIONAL POLITICS: REFORMING MEXICO'S FINANCIAL SYSTEM (1999) at 124.

A 2003 OECD study showed that over the previous 20 years, Mexico had moved forward from specialization in primary goods to greater specialization in manufacturing products such as motor vehicles, consumer electronics and computer equipment, in marked contrast to Argentina, Brazil and Chile, which continue to specialize in primary products.¹⁸⁴

In 2008, “Mexico was the 16th largest exporter of goods in the world, and the 38th largest exporter of services products,”¹⁸⁵ with destinations that included USA, Canada, Germany, Spain and Brazil.¹⁸⁶ In 2009, Mexico was the 15th trader (exporter and importer) in world merchandise trade.¹⁸⁷

In Latin American trade with the USA, while Brazil is the largest economy in the region, it accounts for only 10.4% of USA trade with Latin America. That is below Mexico, who in 2009 “composed 11.7% of total U.S. merchandise trade (exports plus imports)” and was “the largest Latin American trade partner, accounting for 58% of the region’s trade with the United States... By contrast, the rest of Latin America together makes up only 8.3%.”¹⁸⁸

Over the last 20 years, Mexico has pursued an economic model of development based on FTA,¹⁸⁹ privatization and openness to foreign investment.¹⁹⁰ In addition to NAFTA, MEFTA and the FTA with the European Association of Free Commerce, Mexico has FTA with: Bolivia, Venezuela, Colombia, the North Triangle

¹⁸⁴ See WTO SECRETARIAT, WORLD TRADE REPORT 2003, at 54; available at: http://www.wto.org/english/news_e/pres03_e/pr348_e.htm [hereinafter WTO REPORT 2003].

¹⁸⁵ For 2008 data see WB, “Mexico Trade Brief” (World Trade Indicators 2009/10) at 2; available at: http://info.worldbank.org/etools/wti/docs/Mexico_brief.pdf [hereinafter “Mexico Trade Brief 2009/10”].

¹⁸⁶ *Id.*

¹⁸⁷ WTO, INTERNATIONAL TRADE STATISTICS 2010 (2010) at 13; available at: http://www.wto.org/english/res_e/statis_e/its2010_e/its2010_e.pdf.

¹⁸⁸ J. F. Hornbeck, “U. S. – Latin America Trade: Recent Trends and Policy Issues” (Congressional Research Service Report for Congress, Jun. 25, 2010) at 3 and 4; available at: <http://www.fas.org/sgp/crs/row/98-840.pdf>. This source explains that “Mexico’s high figure again reflects an evolving trade liberalization dating to the mid-1980s and its historical ties with the U. S. economy” (at 5).

¹⁸⁹ See Victor Mallet y Anna Fifield, FINANCIAL TIMES (November 18, 2005).

¹⁹⁰ See BANCOMEXT STUDY at 23. Between 1994 and 2000, Mexico received more than USD\$74 billion in FDI, becoming a leading recipient country of FDI development (after China and Brazil). For the role FTA played in helping Mexico to cope with the 2008 GFC and to recover from its effects faster than expected (as of 2010), see *infra* Chapter 5, 5.4.3.3 Economic Liberalization in General.

(Guatemala, Honduras, and El Salvador), Chile,¹⁹¹ Israel,¹⁹² Costa Rica, Uruguay, Peru, Ecuador, Brazil, Trinidad and Tobago, Belize, Panama, Dominican Republic, Nicaragua,¹⁹³ and Japan. Mexico also has partial agreements with Belize, Peru, Ecuador, Brazil and Uruguay.

As a result of the above, as of 2010, Mexico was “the only country with preferential access to two-thirds of the world’s gross domestic product.”¹⁹⁴

In addition to its many FTA, Mexico has adopted legislative changes remove old barriers or discouraging factors to foreign investment, as is the case of expropriation in NAFTA’s Chapter 11 (on Investment), which abolishes the Calvo Doctrine.¹⁹⁵ Named after the Argentinean international law scholar Carlos Calvo, the doctrine states that foreigners are subject to the same treatment as nationals.

Like other Latin American countries, throughout its history Mexico suffered several military interventions making this legal principle justified.¹⁹⁶ Historically, Mexico and other Latin American governments have tried to limit the intervention that foreign governments may have in favor their nationals living or investing in these countries.

The Mexican government, for example, refused to hear private claims for compensation under any law but its own. “The Calvo Doctrine” led to much

¹⁹¹ See *id.*, at 31.

¹⁹² See *id.*, at 33; and Ulises Díaz, *Mexico fails to take advantage of the agreement negotiated with Israel*, REFORMA (Jul. 12, 2010) at 5.

¹⁹³ See J. J. Norton, *Doing Business Under the FTAA Reflections of a USA Business Lawyer*, 6 NAFTA: L. & BUS. REV. AM. (2000) at 431.

¹⁹⁴ Adam Thomson, *Car Exports Power Mexico to Recovery*, FINANCIAL TIMES (Oct. 18, 2010); available at: <http://www.ft.com/cms/s/0/d958d532-dad2-11df-a5bb-00144feabdc0.html#axzz1Cq2iZXoN>.

¹⁹⁵ See PAUL, HASTINGS, JANOFSKY & WALKER, NORTH AMERICAN FREE TRADE AGREEMENT: SUMMARY AND ANALYSIS (1993); and NAFTA, 32 I.L.M. 289.

¹⁹⁶ The French invasion in 1863; US invasion in 1847 when Mexico was forced to sign the “Guadalupe Hidalgo Treaty.” In this Treaty, Mexico was force to give way more than a half of its territory: California, Texas, Arizona, New Mexico, Colorado, etc.). The last invasion was in 1914 by the USA Navy in the Port of Veracruz.

dissatisfaction among foreign investors, as they had to accept the risk of uncompensated nationalizations if they brought assets into Mexico.¹⁹⁷

It is noteworthy that in the case of trade in financial services, Mexico, like most other Latin American countries, is not a net exporter but a net importer. It is therefore understandable why at the beginning of the trend of liberalization these countries were reluctant to liberalize trade in services.¹⁹⁸

Consequently, Mexico surrendered this historic legal principle in order to provide more legal certainty and predictability to foreign investors. NAFTA parties' banks and investors are protected by due process and fair compensation from any act of expropriation, nationalization or any act of the prince that could affect them.¹⁹⁹

1.3.6 Regulatory Framework in the Post-NAFTA Financial System

SHCP is the primary authority regulating and supervising financial services in Mexico with the following responsibilities: establishment of credit limits and capital reserves requirements, assessment of national and international banking transactions in order to monitor the systemic risk, interpretation of financial laws and supervision of bank holding companies.²⁰⁰

Along with SHCP, CNBV²⁰¹ and BANXICO regulate banking activities and other and financial intermediaries in Mexico. In its Institutional Program, CNBV outlined the four principles of improvement: prudential regulation, supervision, market self-regulation and corrective actions.²⁰²

¹⁹⁷ See SCHEFER, *op. cit.*, at 257 (1999). The GATS/WTO rules on services and financial services do not deal with the topic of expropriation, although customary international law says that expropriation should be based on non-discriminatory principles.

¹⁹⁸ See IADB, *Financial Integration*, BEYOND BORDERS: THE NEW REGIONALISM IN LATIN AMERICA (2002) at 102. However, the countries that have unilaterally liberalized their financial sector, like Mexico, have experienced gains in the efficiency in the sector.

¹⁹⁹ See SCHEFER, *op. cit.*, at 257. The political and economic situation of Mexico before NAFTA was uncertain and NAFTA brought credibility to the Mexican market as a stable financial market.

²⁰⁰ See DOBSON and JACQUET, *op. cit.*, at 273.

²⁰¹ In 1995 the National Banking Commission and National Securities Commission merged to form the CNBV.

²⁰² See Slover, *op. cit.*, at 45. Under this program, the CNBV consolidated macro supervision scheme to lead Mexico towards a real universal banking scheme through the management and coordination of on-site inspections and off-site monitoring of financial institutions and to assist in the evaluation's

BANXICO (Mexico's central bank) has been autonomous since 1994. It issues the official Mexican currency (the Mexican Peso) and has the constitutional mandate of keeping its purchasing power (fighting inflation). It also has the mandate of promoting the healthy development of the financial system, for which it has the power to impose penalties against financial institutions, including civil monetary penalties and suspension of operations in foreign currencies, gold and silver.

It is also responsible for holding the reserves of and acting as a clearing house for financial institutions. It is also responsible for imposing penalties on financial institutions, including civil monetary penalties and suspension of operations in foreign currencies, gold and silver.²⁰³

Financial groups are governed under the rules set forth in the Law of Financial Groups, enacted in 1990. Three different types of structures are permitted for financial groups. The first two types must be headed by either a bank or a brokerage firm and must offer leasing, factoring, foreign exchange and mutual fund management services.

In the third and most common type, each firm is headed by a holding company and may include a bank, a brokerage house and a leasing company. More than one mutual fund and insurance company are allowed to operate in each holding company, subject to the requirement that they serve different markets. Regardless of the model chosen, financial conglomerates must receive authorization from the SHCP in order to establish a financial group and then from the appropriate regulator.²⁰⁴

management of funds, capital adequacy, asset quality, profitability and organization. This scheme changed the methods used by on-site inspections, where previously the inspectors were stationed inside of the financial institutions. With the new system the inspectors stationed outside of the financial institutions carry out regular on-site inspections. Off-site inspections have been strengthened through the Financial Analysis System (SAF), which is a database that electronically receives the financial information that institutions must provide to the CNBV. This information allows the off-site inspectors to create individual, comparative and sector analyses concerning the performance of financial institutions and consequently develop early warning mechanisms that make it possible to detect, in a timely manner, any wrong behavior risky enough to lead to critical levels.

²⁰³ See Slover, *op. cit.*, at 14.

²⁰⁴ See DOBSON and JACQUET, *op. cit.*, at 273.

Mexican law provides for two kinds of banks: commercial and development banks. Commercial banks render services such as savings, mortgage, deposit-taking, loans and credits. Commercial banks are authorized by SHCP hearing BANXICO's recommendations.

Development banks play a large role in the Mexican Economy. They are established by their respective organic laws for special objectives such as promotion of foreign trade, housing, industrial and agricultural development. The main development banks are NAFIN and BANCOMEXT. Foreigners are not allowed to own stock of development banks.

1.3.7 Universal Banking

The universal banking model is one of the main products of the deregulation process and is followed by a large number of nations around the world.²⁰⁵ A universal banking model ranges from offering all financial services through the same organization (or financial group, as is the case in Mexico) with different entities, to the possibility of a single institution performing different financial services (for example Germany).

As mentioned above, universal banking (known in Mexico as *banca múltiple* [multiple banking]) was adopted in Mexico back in 1974, as well as the creation of financial groups that provided an assortment of broader financial services in addition to banking services.²⁰⁶ Yet, the 1982 expropriation of commercial banks isolated the banking activity and made it exclusive to the government. Thus, Mexican financial groups were able to offer an assortment of financial services, except for those peculiar to the banking activity.

Upon the re-privatization of commercial banks and the updating of the legislation regulating financial groups universal banking was again allowed to private banking

²⁰⁵ See Harry M. Makler, *Regional Integration and Trends in Financial Services*, HAAR and DANDAPANI, *op. cit.*, at 21.

²⁰⁶ See *supra* 2.1. Expropriation of the Mexican Banks.

corporations, as well as their participation in financial groups that offer a wide variety of financial services under the same brand.

SHCP is the authority in charge of planning, coordinating, evaluating and supervising Mexico's banking system. Discretionary power constitutes an exceptional situation to the principle of law by which the administrative authority applies or does not apply the general rule established in a legal provision.²⁰⁷ In Mexico, the power to grant a bank concession is discretionary.

1.3.8 Prudential Regulation in the Post-NAFTA Financial System

BANXICO instructed commercial banks to increase their capital to risk weighted asset ratio to 8% by 1993. However, the poor risk management, the exchange rate management and the non-performing loans were the main causes of the peso crisis and the increase of the capital to risk did not help too much.

After the crisis, CNBV enforced strict rules to protect banks against losses from non-performing loans. Since 1995, financial institutions have been required to maintain reserves equal to the largest of either 60% of non-performing loans or 4% of their entire portfolio. To date Mexico also applies internationally recognized GAAP.²⁰⁸

1.3.9 Pension System (Retirement Savings System) in the Post-NAFTA Financial System

Since 1997, retirement funds are privately managed by AFORES (Retirement Savings' Managers). Nevertheless, the federal government's IMSS is still in charge of enforcing the social security system, which includes collecting the fees coming from the employer and the employee (withheld from his salary by the employer). Each worker has an individual account to which all the fees collected are deposited,

²⁰⁷ See G. Reyes, *Rules and Discretionary Power in Relation to Troubled Banks: Case Studies: Mexico*, E. AGUIRRE and J. J. NORTON, *THE REFORM OF LATIN AMERICAN BANKING SYSTEMS: NATIONAL AND INTERNATIONAL PERSPECTIVES* (2000) at 153.

²⁰⁸ See DOBSON and JACQUET, *op. cit.*, at 273; Slover, *op. cit.*, at 46. The application of the GAAP responds to the request to improve the quality of information provided to markets by banks and to improve overall transparency in the financial system. For example, the financial statements before the adoption of the GAAP were different from the USA Especially, in the area of valuation of fixed assets, definition of non-performing assets and the treatment of interest income on loans.

which is a significant departure from the “common pool” of the previous system. AFORES invest the workers’ retirement savings in special investment funds, strictly regulated, known as SIEFORES (Specialized Investment Societies in Retirement Funds). Workers have the right to choose the AFORE that will manage their retirement savings and, within that AFORE, the SIEFORE in which they want those funds to be invested. The authority that supervises the SAR (Retirement Savings System) is the CONSAR (National Commission of the Retirement Savings System).²⁰⁹

Firms from the USA and Canada are allowed to invest in, thus be stockholders of, AFORES on a basis consistent with NAFTA.

1.3.10 IPAB in the Post-NAFTA Financial System

The Mexican government created FOBAPROA in 1990 as a response to the need of liquidity that followed the devaluation of the Mexican currency.²¹⁰ IPAB is the successor of FOBAPROA,²¹¹ as of January 20, 1999. Its purpose is establishing a guarantee system for people who have bank deposits or who have given loans or credit to financial institutions and of regulating the supports given to financial institutions for the protection of depositors.

IPAB is expected to accelerate the recovery of the financial system and lay the groundwork for better supervision over financial institutions through the promotion of market discipline and the efficiency and capitalization of the banking system.²¹²

²⁰⁹ See *Ley del Instituto Mexicano del Seguro Social* [Mexican Social Security Institute Law], and *Ley de los Sistemas de Ahorro para el Retiro* [Savings for Retirement Systems Law]. See also Slover, *op. cit.*, at 42. AFORES are financial institutions devoted exclusively to manage individual retirement savings accounts and to channel these funds into the corresponding sub-accounts, as well as to administer specialized retirement mutual funds called SIEFORES. During his presidential administration, Ernesto Zedillo launched the new pension system so that the domestic saving rate would increase and diminish reliance on foreign capital.

²¹⁰ DOF Jul. 18, 1990. FOBAPROA was a trust set up by the federal government and managed by BANXICO as fiduciary.

²¹¹ The IPAB is a legal entity with its own budget and legal capacity, operating under a Board of Directors integrated by BANXICO, SHCP, CNBV, and a General Secretary. See *Ley de Protección al Ahorro Bancario* [Bank Savings Protection Law] (DOF, 1st Jun. 2001).

²¹² See *id.*; and DOBSON and JACQUET, *op. cit.*, at “Appendix B: Mexico.” According to the law, whenever a financial institution is liquidated, it enters into suspension of payments under bankruptcy laws. IPAB will pay the guaranteed liquid obligations due according to procedures specified in the law. It also manages the deposit insurance sale of assets through its banking support system.

1.3.11 The Mexican Stock Exchange

The Mexican Stock Exchange was established in 1894, but was practically ignored until the 1970s when market capitalization rose. Nevertheless, it has suffered significant setbacks as resulting from the 1982 crisis, the 1987 stock market crash, and the 1994-1995 crisis.²¹³

The Mexican Stock Exchange is regulated by the *Ley del Mercado de Valores* [Stock Exchange Law]. It is own and operated by a corporation whose shareholders must be securities brokers or stock capitalists. It has an auction hall divided into two trading floors, one for capital markets, including an intermediate market for trading shares, a derivatives market for trading of futures, warrants and options, and the other floor for money market for trading of debt instruments.²¹⁴

Starting in 1999, trading is electronically conducted from the brokers' offices while the derivatives market is operated on a trading floor.²¹⁵

1.3.12 Foreign Participation and Affiliates of Foreign Financial Entities in the Post-NAFTA Financial System

According to the Mexican law the affiliates of foreign financial institutions are Mexican corporations which are authorized to operate as financial institution, and whose capital stock is owned by a foreign financial institution that has been legally established as such in a foreign country. The foreign financial institution must be from a country with which Mexico has signed a treaty that provides for the establishment of foreign affiliate in Mexico.²¹⁶

²¹³ See also IADB, *Financial...*, *op. cit.*

²¹⁴ See *Ley del Mercado de Valores* [Stock Exchange Law].

²¹⁵ See DOBSON and JACQUET, *op. cit.*, at "Appendix B: Mexico." The equity market is still highly concentrated with a few firms accounting for the majority of the shares. In 1995 one company had almost one-quarter of capital of the stock market and between 20 percent and 40 percent of daily trading. The fact of the market concentration is because there are just few public firms considered marketable. Only 19 of 190 stocks companies were marketable in 1996. One of these firms, TELMEX, accounted for almost half of the total foreign equity investment.

²¹⁶ See LIC.

In the same sense, an affiliate holding company as the foreign financial institution must hold at least 51 percent of the capital stock. An affiliate, a foreign financial entity and affiliate holding company are terms that apply to entities in a NAFTA country, which permits affiliate of foreign financial entities to operate in Mexico. In order to have an affiliate, the foreign financial institution must perform in their countries of origin the same activities authorized for the affiliate in Mexico. Mexican legislation regulates affiliates operations.

As it has been said earlier in the first section of this chapter, there were basically three steps towards liberalization of financial services in Mexico: 1) NAFTA, 2) the legislative reforms of 1995, and the 3) the legislative reforms of 1999. According to the Reforms of 1999 the permissible foreign ownership for both NAFTA and non-NAFTA firms entering the sector was increased to 100%.

1.3.13 SOFOMES created in the Post-NAFTA Financial System

On July 18, 2007, amendments to various provisions of the financial legislation were promulgated²¹⁷ establishing new regulations for financial leasing and factoring companies, as well as creating a new form of financial entity called SOFOMES. The aim of the amendments was to facilitate lending, financing and factor in transactions, permitting these activities to be carried out by SOFOMES, without the necessity of obtaining authorization from the Mexican federal government.

SOFOMES may have as their principal activity the continuous and professional offering of loan transactions, leasing and/or financial factoring. Additionally, the decree eliminates restrictions on foreign investment in relation to financial leasing and factoring companies, so that the corporate capital of the new SOFOMES may be comprised up to 100% by foreign investment.

From a tax perspective, SOFOMES will enjoy, in general terms, the same tax treatment that SOFOLES enjoy, with the decree establishing that interest generated

²¹⁷ Amendments were made to the General Law of Credit Instruments and Operations, the General Law of Credit Organizations and Auxiliary Activities, the Foreign Investment Law, the Income Tax law, the Value Added Tax Law and the Tax Code, among others.

from financial leasing and factoring activities of SOFOMES will not cause the imposition of Mexican Value Added Tax (IVA).

1.3.14 Mexico's Challenge

Mexico recognizes the importance of a robust financial system as an engine to promote economic growth²¹⁸ and that there is plenty of room for improvement. According to the G10's Working Party on "Financial Stability in Emerging Market Economies," there is still an inadequate bankruptcy system. A robust financial system includes a well-defined bankruptcy laws in order to take possession of collateral. The 1995 bankruptcy law was so inefficient that they provided many debtors with virtual immunity from collection efforts.²¹⁹

Taking into account the severe financial crisis of the 1982 and 1994, Mexico represents a significant example where financial liberalization can be devastating if it is not accompanied by strengthening of financial market institutions, especially an adequate supervision and regulation.²²⁰

Hence, is true now that recently Mexico has made important developments in its financial laws as well as its regulatory and supervisory system.²²¹ However, the fact

²¹⁸ This has been shown by empirical results. The main contributors are specially the banking sector and the equity market variables to GDP. See José De Gregorio and Pablo E. Guidotti, *Financial Development and Economic Growth*, 23 WORLD DEVELOPMENT 3 (Mar. 1993) at 433-448. See also B. R. Johnston and Ceyla Pazarbasioglu, "Linkages between Financial Variables, Financial Sector Reform, and Economic Growth and Efficiency" (IMF Working Paper WP/95/103, 1995); R. G. King and R. Levine, "Financial Indicators and Growth in a Cross-Section of Countries" (WB Working Paper WPS 819, 1992); and Hans J. Blommestein & Michael Spencer, *Sound Finance and the Wealth of Nations*, FURSTENBERG, *op. cit.*

²¹⁹ See Slover, *op. cit.*, at 56.

²²⁰ See Blommestein & Spencer, *op. cit.*, at 6.

²²¹ In 2001, several important changes were introduced in several laws including *Ley de Instituciones de Crédito* (Banking Law); *Ley para Regular las Agrupaciones Financieras* (Financial Groups Law); *Ley del Mercado de Valores* (Stock Exchange Law); *Ley General de Organizaciones y Actividades Auxiliares de Crédito* (Organizations and Credit Auxiliary Activities Law); *Ley General de Instituciones y Sociedades Mutualistas de Seguros* (Insurance and Mutual Insurance Companies Law); and *Ley de la Comisión Nacional Bancaria y de Valores* (CNBV's Law). New laws were also promulgated such as *Ley de Sociedades de Inversión* (Investment Funds Law); *Ley Orgánica del Banco del Ahorro Nacional y Servicios Financieros* (BANSEFI's Organic Law); *Ley de Ahorro y Crédito Popular* (Popular Savings and Credit Law); *Ley para Regular las Sociedades de Información Crediticia* (Law to Regulate Credit Information Companies). In 2002, *Banrural* (the development bank that lent to the agricultural sector) was liquidated. A new entity called *Financiera Rural* (Rural Financier) was created, not as a bank but as a facilitator of credit to that sector. Improvements were introduced to the Development Banks' Organic Laws as well as to the Pension System Law. The

remains that there are still pending tasks, such as to break from old practices of banking supervision, which have allowed formal compliance without addressing the crucial issues of bank, solvency, profitability and competition.²²²

Additionally, in some cases the regulators in Mexico forgot his role of watchdog and played only as supporters of financial institutions. This was the case of a drug-cartel which successfully bought a bank in 1995, and surprisingly it was until 19 months later when the fraud was discovered. Also, the involvement of Mexican banks in many laundry operations raised a lot of doubts.²²³

Summarizing, Mexico began the liberalization process slowly in the 1970s; this liberalization combined with serious macroeconomic disorders took the country into a financial crisis in 1982. Again in 1990s the government continued encouraging liberalization when in 1994 it faced another crisis. Fortunately, with USA and international financial institutions combined with a better regulatory and supervisory mechanism the effect was much less than the prior crises.

With the overlapping negotiations in unilateral, multilateral, regional and bilateral instruments raises the question of what will be the most appropriate forum for liberalization of services of developing countries, such as Mexico. The discussion in Chapters III and IV suggests that for some services sectors, especially financial services, the most appropriate level for liberalization of developing countries is the regional or bilateral arena. Consequently, at regional level it is where governments should focus its negotiation efforts. However, it should be

government also enacted the Law on Transparency and Competition for Guaranteed Credits. In 2003, changes were introduced to the Guarantee Law; the Law Regulating Credit Information Companies, and the regime on Money Laundering and Terrorism Financing. See WTO, S/FIN/M/46, 29 Oct. 2004, (04-4602), Committee on Trade in Financial Services, "Report of the Meeting Held on 28 September 2004," Note by the Secretariat.

²²² See Blommestein & Spencer, *op. cit.*, at 56.

²²³ The CNBV discovered in 1998 that the Juárez drug cartel had obtained indirectly a license from SHCP in April 1995 to purchase a bank. The real owners of the banks were discovered after regulators had detected a fraud at the bank 19 months later. See also Leslie Crawford, *Mexico Drug men "Bought Bank"*, FINANCIAL TIMES (Mar. 17, 1998). In the same sense, see Slover, *op. cit.*, at 56. In 1998, USA prosecutors ("Casablanca Operation") discovered a vast drug money-laundering scheme involving 12 of 19 largest banks. Most recently, on 6th October 2005, the USA Treasury published a list of 11 companies and one currency exchange company directly linked with northern Mexico drug lords (see http://news.bbc.co.uk/hi/spanish/latin_america/newsid_4164000/4164678.stm).

considered as well together with some other circumstances, such as the political context and the definition of national interests.

1.4 G20 AND ITS ROLE IN THE ARCHITECTURE OF THE MEXICAN FINANCIAL SYSTEM

1.4.1 Introduction

Aiming to achieve financial stability, G20 has played a significant role in the construction of the current global financial architecture in general, and in the evolution of the Mexican financial system in particular. As shown in what follows, since G20's inception, Mexico has adopted a proactive role, both domestically and externally, in sketching and adopting measures that portray the current global financial architecture.²²⁴

The main issue discussed in the first G20 Finance Ministers' and Central Bank Governors' Meeting was crises prevention and resolution. Among other things, G20 members agreed back then to:

...implement the emerging international consensus on policies to reduce countries' vulnerability to financial crises, including through appropriate exchange rate arrangements, prudent liability management, private sector involvement in crisis prevention and resolution, and adoption of codes and standards in key areas including transparency, data dissemination, market integrity, and financial sector policy.²²⁵

By 2001, crisis prevention and resolution still remained as a main issue, and G20 concluded that the adoption of "the best practices embodied in international standards and codes also will help support strong, stable growth and reduce the risk of future financial crises."²²⁶ Accordingly, it continued promoting the adoption of international standards and codes, and the assessments under one or both of the

²²⁴ For the background, history, development, mandate, objectives, members and structure of G20, see Appendix 3.

²²⁵ G-20, *Communiqué*, "G-20 Finance Ministers and Central Bank Governors Meeting," (Montreal, Oct. 25, 2000) at paragraph 7.

²²⁶ G-20, *Communiqué*, "G-20 Finance Ministers and Central Bank Governors Meeting", (Ottawa, Nov. 16-17, 2001) at paragraph 5.

IMF/WB-led FSAPWB and Reports on Observances with ROSCs, which had been implemented on a voluntary basis by the majority of G20 members.

1.4.2 Mexico and G20

On 2003, under Mexico's leadership, G20 followed up discussion on such issues as crises prevention and resolution, globalization, and the interdiction of terrorist financing. Additionally, a major step was taken to reach a consensus to solve financial crises: Mexico announced that it had included collective action clauses in an international bond with the purpose of restructuring debts in case the debtor is unable to carry out its commitments.

Eventually other G20 countries and smaller developing countries such as Brazil, Korea, and South Africa followed this example.²²⁷ Endeavouring to achieve UN's "Millennium Development Goals" was another resolution of 2003, at the "Monterrey Consensus," which concerns and involves Mexico.²²⁸

In 2004, G20 members Brazil, Korea, Mexico, and Turkey, together with private sector creditor groups, including IFF and IPMA, issued the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets." In that document it is reaffirmed "the importance of an international financial architecture that sets incentives for pursuing sustainable policies and prudent risk-taking."²²⁹

On 2004, two mid-term issues were also discussed in 2004, regional economic integration and demography and growth. On regional integration, a subject matter in which Mexico has played and continues to play a key role, G20 concluded that "regional cooperation and integration can be important steps for national economies in opening up to global trade and financial flows and in achieving gradual improvements in competitiveness."²³⁰

²²⁷ See G20, *THE GROUP OF TWENTY: A HISTORY* (2008) at 32 [hereinafter, *THE GROUP OF TWENTY*].

²²⁸ UN Conference on Financing for Development held in March, 2000, in Monterrey, México.

²²⁹ G20, *Communiqué*, G20 Finance Ministers and Central Bank Governors Meeting, (Berlin, Germany, Nov. 20-21, 2004) at paragraph 3.

²³⁰ *Id.*, at paragraph 6.

...policy challenges differ greatly among countries in the short-term. Countries that will encounter aging problems first need to integrate to the labour force a larger part of their working-age population, expand individual working life, and implement life-long learning. Countries that will experience a rise in the working age population before the problematic impact of aging becomes apparent should increase investment in human-capital and infrastructure while pursuing prudent fiscal policies.²³¹

By 2005, another issue concerning Mexico became the focus of G20, namely, the importance migrant remittances have for developing countries to reduce poverty and promote economic development. Therefore, G20 urged the international community to improve remittance services.

The subject matter of G20's 2006 Annual Meeting was "Building and Sustaining Prosperity," with the aim of promoting global development and growth, based upon open trade.²³² It was recognized that "maintaining a strong world growth and containing inflation will require on-going adjustments to monetary and fiscal policies while ensuring appropriate exchange rate flexibility and structural reform."²³³

President Calderón's administration (inaugurated on December 1, 2006) has follow suit promoting fiscal discipline and giving continuity, in coordination with BANXICO, to the fight inflation, and to maintaining sound and prudential monetary and exchange policies, even in spite of the strong antagonism of the opposition political parties. This on-going antagonism has been the reason why structural reforms have not been achieved, as the Legislative branch is controlled by the leftist opposition parties, chiefly PRI and PRD.²³⁴

On 2007, under the leadership of South Africa, G20 followed up on the 2005-2006 Bretton Woods Reform discussion. The statement "Reforming the Bretton Woods Institution" was intended to strengthen the "credibility, effectiveness and

²³¹ *Id.*, at paragraph 7.

²³² G20, *Communiqué*, G20 Finance Ministers and Central Bank Governors Meeting, (Melbourne, Australia, Nov. 18-19 2006) at paragraph 5 [hereinafter MELBOURNE 2006 G20 COMMUNIQUÉ].

²³³ *Id.*, at paragraph 4.

²³⁴ Although PRI has been commonly branded as a "broad center" party (comprising both left and right groups), as a result of the 2006 federal election (in which the more extremist leftist PRD came second in votes), a new party president was elected, Beatriz Paredes Rangel, who immediately steered the party's positions to the left, both in its discourse and in its votes at the Legislative branch.

legitimacy of IMF and WB.”²³⁵ Consequently, G20 insisted that the reform should enhance the representation of dynamic economies, many of which were emerging market economies, whose importance in the global economy had increased.

Thus, although a creation of the G7, the G20 developed as an autonomous, informal group,²³⁶ firstly, then to become (due to the September 2008 USA financial crisis) a permanent summit, quickly repeated to become a permanent feature of international political life.²³⁷

As a result, G20 meetings are no longer forums merely for finance ministers and central bank governors, but a summit of its member’s leaders. “G20 leaders still meet with their finance ministers by their side, and thus far only ministers of tourism (from all members but America) and ministers of labour seem ready to join the G20 governance game.”²³⁸

Mexico’s participation in the Bretton Woods institutional system, through G8 (from which G20 sprung), dates back to 1989. Mexico started participating in G8 summit governance at the leaders’ level in 1989, did so again in 2003 and has done so continuously since 2005. It has participated as an equal at the ministerial level, starting with the Global Health Security Initiative since 2001, and at the official level in the Heiligendamm Process since 2007.²³⁹

Mexico has been a full member of the G20 at all levels from the start, but with the very recent emergence of an inner pentarchy, replacing the troika, as the steering group for the G20 summits and thus system, Mexico is not a member of this inner

²³⁵ G-20, *Communiqué*, G-20 Finance Ministers and Central Bank Governors Meeting, (Kleinmond, Cape Town, South Africa, Nov. 17-18, 2007) at paragraph 14.

²³⁶ PETER I. HAJNAL, *THE G8 SYSTEM AND THE G20: EVOLUTION, ROLE AND DOCUMENTATION* (2007), at 156.

²³⁷ John Kirton, “Why the World Needs G8 and G20 Summitry: Prospects for 2010 and Beyond,” (paper prepared for the Center for Dialogue and Analysis on North America (CEDAN), Tecnológico de Monterrey [Monterrey Institute of Technology] (ITESM), Mexico City Campus, Mexico City, Mar. 11-12, 2010. Draft of Apr. 8, 2010), at 3.

²³⁸ *Id.*

²³⁹ *Id.*, at 4. At the leaders level, Mexico has participated in 4 summits (1989 Paris Dinner, 2003 Lyon Outreach, 2005 G8 plus Five, and 2007 Major Economies Forum/Meeting Summit on Climate Change. At ministerial level Mexico has participated 3 times: Global Health Security Initiative 2001, 2005 Gleneagles Dialogue on Clean Energy and Climate Change, and 2007 Heiligendamm Process/Heiligendamm-L’Aquila Process (*id.*, at 14).

grouping.²⁴⁰ A 2003 G20 assessment of Mexico's Institution²⁴¹ building in its financial system, deemed Mexico's case a positive example regarding liberalization on institution building.²⁴²

As already mentioned above, in 2003 and under its leadership, Mexico announced that it had included collective action clauses in an international bond with the purpose of restructuring debts in case the debtor is unable to carry out its commitments, an example that other G20 countries and smaller developing countries followed later.²⁴³ In 2004, Mexico was one of the G20 members that, together with private sector creditor groups, issued the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets."

In November 2006, G20 recognized that, "maintaining a strong world growth and containing inflation will require ongoing adjustments to monetary and fiscal policies while ensuring appropriate exchange rate flexibility and structural reform."²⁴⁴

President Calderón's administration (inaugurated on December 1, 2006) has followed suit promoting fiscal discipline and giving continuity, in coordination with BANXICO, to the fight inflation, and to maintaining sound and prudential monetary and exchange policies, even in spite of the strong antagonism of the opposition political parties and pundits.

The great "Made-in-USA" financial crisis that erupted in September 2008, inevitably affected the Mexican economy especially, because of its strong dependence on the USA's economy. Income was affected because of the crisis effect on Mexico's exports of manufacture and oil, USA tourism to Mexico, remittances of migrant workers.²⁴⁵

²⁴⁰ *Id.*

²⁴¹ Institution understood as the rules, enforcement mechanisms and organizations that shape the functioning of markets.

²⁴² See G20, Case Study: The Case of Mexico. Globalization: The Role of Institution Building in the Financial Sector;" available at: <http://www.banxico.org.mx/tipo/publicaciones/seminarios/XII-Mexico.pdf> [hereinafter CASE STUDY: THE CASE OF MEXICO].

²⁴³ THE GROUP OF TWENTY, at 32.

²⁴⁴ MELBOURNE 2006 G20 COMMUNIQUÉ at paragraph 14.

²⁴⁵ See Víctor M. Godínez, *México y el G-20* [Mexico and G20], ANÁLISIS POLÍTICO [Political Analysis], (May 2010) at 5; available at:

As a result, the Calderón administration (2006-2012) has participated actively in G20's pursuit of durable solutions to the global crisis. As of 2010, Mexican efforts are focused on following up fiscal and monetary measures aimed at restraining global crisis consequences.²⁴⁶

At the London 2009 G20 meeting, Mexico supported, among other measure, the enforcement of international coordination to make information available on a timely basis, in order to be able to design global strategies that allow for the prevention and resolution of financial institutions' bankruptcies.²⁴⁷ Mexico implemented this measure by creating the Council of the Financial System Stability.²⁴⁸ It was the first emerging economy to adopt this measure, which most developed countries had already implemented.²⁴⁹

In the speech to introduce this act, President Calderón said:

With this council we are generating a privileged forum to strengthen the coordination and exchange of information between the country's financial authorities which will allow us to act in a faster and more accurately manner, when risks for financial systems are detected, and also will allow us to comply with commitments proposed to reinforce national finances and also contribute to the international effort in accordance with commitments acquired at G20.²⁵⁰

The concern for finding and applying durable solutions to the global crisis is not restricted to Mexico but constitutes one of the most frequent discussions in international forums such as G20.²⁵¹ In this regard, anti-cyclical policies,²⁵² reform

http://www.fesmex.org/common/Documentos/Ponencias/Paper_Mexico_y_el_G20_Victor_Godinez2010.pdf

²⁴⁶ See *id.*

²⁴⁷ See President Calderón's speech at the signing of act that created the Mexican Council of Financial System Stability (Jul. 29, 2010); available at:

<http://www.presidencia.gob.mx/index.php?DNA=42&Contenido=58992>.

²⁴⁸ DOF, Jul. 29, 2010.

²⁴⁹ See <http://www.cnnexpansion.com/economia/2010/07/28/mexico-economia-calderon-estabilidad-cnn>.

²⁵⁰ See President Calderón's speech at the signing of the act that created the Mexican Council of Financial System Stability, *op cit.*

²⁵¹ It is worth highlighting that Mexico's participation in G5 as coordinator has opened a more effective dialogue with G8 and G20.

of financial institution and market liberalization were measures implemented by Mexico, in some cases, even before they were proposed by G20 as a reaction to global crisis²⁵³.

Mexico has adopted a proactive role in proposing issues to be discussed by G20, such as: 1) Coordinating developed and emerging economies and IMF, WB and, in general, international financial organisms; 2) Rebuilding the international financial structure; 3) Implementing a “Green Fund” to address climate change; and 4) Committing to achieving the United Nations Millennium Development Goals.²⁵⁴

Along with Germany, Mexico coordinates G20’s Working Group, which is in charge of the “Reinforcement of international cooperation and promotion of financial markets integrity,” the following purposes: follow up and develop proposals to strengthen regulatory cooperation of institutions and financial markets, strengthen negotiation and resolution of international effects of financial crisis, elaboration of proposals to protect global financial system from illicit activities and strengthen cooperation between international agencies.²⁵⁵

Mexico has also endeavoured to increase the involvement of the emerging economies in the decision making and the implementation of international economic and financial guidelines. Together with Argentina and Brazil, Mexico has promoted the voice and vote reform of IMF and WB moving the deadline from 2013 to 2011.²⁵⁶

On January 13-14, and upon Mexico’s invitation, G20’s Sherpas met at the Mexican Foreign Ministry to discuss the group’s rules of operation. “Among other issues, they discussed their positions on the group’s rotating presidency; the scope,

²⁵² Ten anti-cyclical measures were issued by President Felipe Calderón Hinojosa on March, 2008, among which are tax incentives for punctual taxpayers registered with an electronic signature, 3 percent reduction in Income Tax and Flat Rate Business Tax to increase company’s liquidity and simplification of foreign trade procedures and reduction of duties.

²⁵³ See Godínez, *op. cit.*, at 6.

²⁵⁴ See *id.*, at 7.

²⁵⁵ See G20 Working Group on Reinforcing International Cooperation and Promoting Integrity in Financial Markets (WG2) Final Report, March 27, 2009, available at http://www.g20.org/Documents/g20_wg2_010409.pdf.

²⁵⁶ See Godínez, *op. cit.*, at 8.

frequency and timing of the summits, support structures and the relationship with the meetings of the finance ministers and Central Bank governors.”²⁵⁷

On March 12, in the context of the delivery of his paper *Why the World Needs G8 and G20 Summitry: Prospects for 2010 and Beyond*,²⁵⁸ Prof. John Kirton (University of Toronto) said that “Mexico is called to occupy a very important role in G20, above all as a communication bridge between developed and developing nations.”²⁵⁹ Likewise, Kirton highlighted the interest demonstrated by Mexico in updating the so-called ‘international architecture’.²⁶⁰

On May 15, 2010, under “Global Issues” in the V EU-Mexico Joint Statement:

On global economic and financial issues, both sides stressed the importance of the multilateral trading system of the World Trade Organization and an ambitious and balanced outcome of the Doha Development Round as soon as possible. Both sides agreed on the need for the G20 to deliver on existing commitments and to set ambitious goals for the future to get a stronger, more balanced and more sustainable growth. They shared similar views about the priorities to pursue in this context, notably on supporting global recovery; ensuring a consistent implementation of financial market reforms and strengthening international financial institutions, among others. From its side, the EU welcomes and supports hosting the G-20 Summit in 2012. The EU is committed to make a strong contribution to this Summit.²⁶¹

At the summit, President Calderón said that although the strategy of recovering growth (at the expense of fiscal stability) generally work for those countries that adopted it, “there are certain consequences that are starting to be paid which,

²⁵⁷ “The G20 Sherpas Meet in Mexico to Discuss the Group’s Rules of Operation” (Foreign Ministry press release, Jan. 15, 2010); available at:

http://portal3.sre.gob.mx/english/index.php?option=com_content&task=view&id=400&Itemid=9

²⁵⁸ Kirton, *Why...*, *op. cit.*

²⁵⁹ “Mexico será protagonista del G-20: experto” [Mexico will be a protagonist of the G-20 Says Expert], EL ECONOMISTA [The Economist] (Mar. 12, 2010); available at:

<http://eleconomista.com.mx/sociedad/2010/03/12/mexico-sera-protagonista-g-20-experto>

²⁶⁰ *Id.*

²⁶¹ Council of the European Union, “V EU-Mexico Summit Comillas (Cantabria, Spain) 16 May 2010, Joint Statement;” available at:

http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/er/114464.pdf.

paradoxically, are becoming one of the main inhibitors of growth.”²⁶² He said that it is fundamental that those G20’s developed countries that have decided to keep their expansive fiscal policies and have not yet a solid recovery, “start to make credible and real fiscal adjustments that would generate in the markets certainty and trust.”²⁶³

Along those lines, President Calderón also warned at the summit that “economies with growing deficit and public debt are in the process of becoming one of the larger obstacles for the development of the world economy.”²⁶⁴ He also alerted about the dangers, for future growth, of the permanence of expansive policies and its high deficits, as public debt in industrialized countries is at levels never seen before (83% of the GDP in the USA, 68% in the UK, and 73% in Germany), the implications of which must be analyzed.²⁶⁵

President Calderón also urged the drafting of new clear rules for the financial markets to eliminate uncertainty and provide a rout map toward recovery. He called for an agreement for the regulation of markets, in order to reduce “systemic risks for the global financial system and, at the same time, to promote world economic recovery.”²⁶⁶ He called for higher capital requirements for activities that generate systemic risks, for the strengthening of international cooperation among supervisors, as well as designing joint measures to identify non-cooperating jurisdictions.²⁶⁷

He expressed that Mexico “backs the proposal accumulated at the G20 Summit to face the problems associated to financial institutions of systemic importance.”²⁶⁸ Following suit, he announced he would be sending the Legislative branch “a bill that

²⁶² *Urge Calderón al G-20 a aprobar nuevas reglas para mercados financieros*, [Calderón Urges G20 to Approve New Rules for Financial Markets] EL FINANCIERO EN LÍNEA [The Financial Online] (Jun. 27, 2010); available at:

<http://www.elfinanciero.com.mx/ElFinanciero/Portal/cfpages/contentmgr.cfm?docId=270387&docTip o=1&orderby=docid&sortby=ASC>.

²⁶³ “México advierte ajustes en naciones G20” [Mexico Advises Adjustments in G20 nations] (Jun. 28, 2010); available at <http://www.cnnexpansion.com/economia/2010/06/28/brasil-y-mexico-advierten-por-recortes>.

²⁶⁴ *Urge Calderón...*, *op. cit.*

²⁶⁵ *Id.*

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ *Id.*

includes a resolution framework for the bankruptcy of banks, based on the best international practices.”²⁶⁹

After South Korean President Lee Myung-bak state visit to Mexico on July 2, 2010, a joint communiqué was issued by Mexico and the Republic of Korea stating:

The Mexican leader reiterated his disposition to work closely with Korea and support his work as G20’s President in turn, looking forward to the upcoming Summit of Leaders to be hold next November in Seoul. Both leaders reckoned that G20 must continue adding efforts to ensure the economic recovery, the fulfilment of its commitments in financial regulation and supervision, to promote a comprehensive reform of the international financial institutions, and to adopt the measure needed to promote a vigorous, sustainable and balanced growth. Likewise, they fully concurred on the need for the G20 to push the development agenda in order to share the benefits of economic development and to contribute to the fulfilment of the Development Millennium Objectives. President Lee expressed his satisfaction for the decision that Mexico leads and be host of the G20’s Leaders Summit in 2012.²⁷⁰

It is worth highlighting G8’s concern for what became the top priority early in President Calderón’s administration, namely, “the drug trafficking and transnational crime that is proliferating in Mexico and infecting the Caribbean, North America, Africa and even distant Europe itself.”

G8 has appropriately listed the above as its “fourth security priority... the new multi-faceted, non-state security challenge coming from vulnerable states.”²⁷¹ This is consistent with the frequent appeals President Calderón has made to the international community to cooperate with the Mexican government in its war against drug cartels whose criminal activity is carried out across borders.

²⁶⁹ *Id.*

²⁷⁰ “Comunicado Conjunto México-República de Corea en ocasión de la Visita de Estado a México del Presidente Lee Myung-bak [Mexico-Republic of Korea Joint Communiqué on Occasion of the state Visit to Mexico of President Lee Myung-bak] (Jul. 2, 2010); available at: http://www.sre.gob.mx/ctsocial/contenido/comunicados/2010/jul/cp_202.html

²⁷¹ Kirton, *Progress...*, *op. cit.*, at 6.

1.4.3 G20's Assessment of Mexico's Institution Building in Its Financial System.²⁷²

Mexico's case has been considered a positive example regarding liberalization on institution building. Hereby a brief reference to some milestones in the development of the Mexican financial system that eventually lead to the adoption of the prudential financial standards that have contributed to its recent sustainable financial stability in accordance with the consensus reached by G20.²⁷³

As developed above, the foundations of the current Mexican financial system are found in the legislative changes that took place in the 1970s and 1980s.²⁷⁴ A 1975 Stock Exchange Law provided the legal framework for the expansion of securities operations and strengthened the regulatory role of the National Securities Commission.²⁷⁵ Another innovation (introduced in the 1978) was the issuing of federal government bonds known as *Certificados de la Tesorería* or CETES. Other financial instruments were created in the late seventies, such as the non-bank paper and convertible securities.

The road to liberalization was hindered by the 1982 expropriation of the Mexican private banks and the consequent government management of all the banking activity.²⁷⁶ Such "financial repression" affected in several aspects of the Mexican economy, externally and domestically.²⁷⁷ By the late 1980s, Mexico started a process of radical economic transformation.²⁷⁸ Among the main steps taken were the deregulation of the financial sector, its internationalization, and the re-privatization of the commercial banks.²⁷⁹

²⁷² Institution refers here to the rules, enforcement mechanisms and organizations that shape the functioning of markets.

²⁷³ See CASE STUDY: THE CASE OF MEXICO, at 1.

²⁷⁴ See *supra* 2.1. Expropriation of the Mexican Banks.

²⁷⁵ See *id.*

²⁷⁶ See *supra* 2.1. Expropriation of the Mexican Banks; and 2.2. The Years of Government Owned Banks.

²⁷⁷ See *id.*, at 3.

²⁷⁸ See *supra* 1.4. Political Confrontations Regarding Free Market Policies.

²⁷⁹ See *supra* 2.3. Commercial Banks' Reprivatization; and 3. The Mexican Post-NAFTA Financial System.

Deregulation was mainly focused on reducing limits to banks maintaining the supervision and regulation of their activities in order to make more efficient their services and operation but yet subjecting them to strictly necessary regulations.²⁸⁰

One of the most important institutional paradigm changes derived from the signing of NAFTA in 1993. The purpose of this agreement was to create an environment that promoted the opening of the financial sector to foreign investment. In accordance with the terms and obligations assumed under NAFTA, Mexican Congress modified financial regulations in order to allow foreign financial institutions the establishment of fully-owned subsidiaries in Mexican territory.²⁸¹

The opening of the Mexican economy derived from NAFTA intended to balance competition and financial stability through gradual modifications in the countries' applicable regulations in order to adjust them to the guidelines provided by NAFTA. Nevertheless, Mexico drafted certain conditions to NAFTA to guarantee the gradual transition to foreign access; such provisions mainly limit the amount of capital and assets that foreign investors are allowed to hold from the total capital of all financial institutions in Mexico²⁸².

Although origins of economic crisis in Mexico in 1994 are extremely complex; such situation forced Mexico to implement unanticipated measures in an attempt to stabilize the country's banking system.²⁸³ In 1994 Mexico had an important amount of foreign investment considerably conformed by liquid and short term equity and debt portfolio investments that may be quickly withdrawn that allowed Mexico to support the large deficit of its current accounts.²⁸⁴

On this kind of scenario, countries normally reduce their deficit adjusting its monetary and fiscal policy or its exchange rate. Though, Mexico permitted a significant inconsistency between its monetary and fiscal policy and its exchange rate

²⁸⁰ See *id.*, at 4.

²⁸¹ See *id.*, at 7; and *supra* 3. The Post-NAFTA Financial System.

²⁸² See Rowley, *op. cit.*, at 34-35.

²⁸³ See *id.*

²⁸⁴ See *id.*, at 37.

system forcing Mexico to either, raise interest rates or devalue peso; however making a decision was complicated due to upcoming presidential election.

Domestic political events in Mexico caused an increasing withdraw of large amounts of foreign investment and, as a reaction, several actions were taken in order to stop the outflow of capital, such as depreciating the MXN, securing short-term credit agreement with the USA and Canada, and increasing rates on short-term CETES.²⁸⁵

Finally, Mexico was forced to completely devalue its currency on December 22, 1994 leading Mexican economy to recession²⁸⁶. As we may notice, the fundamental problem was not liberalization *per se*, crisis was a result of a combination of diverse factors, external, domestic, economic and political; specially the fact that ideal liberalization conditions did not exist at that time (i.e. stable macroeconomic environment, adequate timing and sequencing of domestic and capital account liberalization, a financially sound banking system)²⁸⁷.

Notwithstanding the abovementioned crisis, Mexico continued with its financial liberalization process presumably due to Mexico acknowledged the benefits of liberalization and because the process of institutions building was difficult to revert since international efforts were involved in this process.²⁸⁸

Since 1995, BANXICO adopted a gradual disinflation process and in 2001 finally introduced a formal specific inflation framework including: 1) Consolidation of the autonomous monetary authority; 2) Reiteration of price stability as the fundamental objective of the monetary policy; 3) Announcement of short and medium term inflation targets; 4) A permanent analysis of all potential sources of inflationary pressures; 5) An emphasis on transparency and communication with society; and 6) An improved framework for central bank accountability.²⁸⁹

²⁸⁵ See *id.*

²⁸⁶ See *id.*

²⁸⁷ CASE STUDY: THE CASE OF MEXICO at 9.

²⁸⁸ See *id.*, at 10.

²⁸⁹ See *id.*, at 11.

Also, Mexican efforts after the crisis focused on two aspects: maintaining the integrity of the financial system and establishing adequate policies to ensure correct operation of the financial system in an increasingly liberalized environment. Consequently, the Congress passed a financial reform in December 1998 pursuing those aspects.²⁹⁰

Of the other measures taken during this period, it is worth highlighting the aforementioned reformation of the pension system²⁹¹ and the passing of the bankruptcy and secured lending legislation by the federal Legislative branch in 2000.

In addition, supervisory and regulatory frameworks were strengthened to accomplish with applicable best international practices.²⁹² Legislative amendments approved between 1995 and 2000 strengthened the financial system and improved the operation of financial markets, thus achieving strength in banks' financial conditions, higher efficiency in banking system and foreign participation in the domestic banking system that promoted competition capitalizing banking system.²⁹³

Among the aforesaid legislative amendments are changes to banking law and the financial groups law, aimed at strengthening their corporate governance by introducing timely risk identification mechanisms and creating an audit committee. Likewise, the Rules of Capitalization Requirements for Multiple Banks were amended in order to accelerate the process of homologation between banking regulation and international standards by simplifying processes and establishing uniform criteria with CNBV, as well as eliminating certain discretionary faculties of financial authorities.²⁹⁴

Amendments to the Miscellany on Credit Collateral were made in order to promote bank lending by reducing transaction costs, interest rates, and risks related with lending operations. An act for Credit Information Institutions was passed to regulate the establishment and operation of credit information companies,

²⁹⁰ See *id.*, at 13.

²⁹¹ See *supra* 1.3.9 Pension System (Retirement Savings System) in the Post-NAFTA Financial System.

²⁹² See *id.*, at 14.

²⁹³ See *id.*

²⁹⁴ See *id.*, at 17.

establishing transparency regulations for the proper operation of such companies and providing secrecy in financial matters.²⁹⁵

In order to improve financial inclusion and promote creation of SME the following laws were passed: the Federal Mortgage Association's statute, Popular Savings and Credit Law, BANSEFI's statute, and the statute of Financiera Rural.²⁹⁶

Concerning the Mexican Stock Exchange, it has been affected by diverse problems, such as low firms controlled by a small group of investors and the fact that the domestic debt is dominated by public sector instruments. As a result, Congress approved important reforms to the Stock Exchange Law and the Mutual Funds Law with the intention of promoting development of the stock market by establishing provisions under transparency and efficiency principles. In general, these laws establish the new basis for corporate governance in this regard.²⁹⁷

1.4.4 Conclusions

Mexico's importance and relevance in the global economic and financial scene, even as emerging economy, is attested by its participation in G20, even since the inception of its predecessors. Although such importance and relevance was first made apparent in a painful way (on occasion of its 1994 crisis), the 2008 "Made in USA" crisis proved that Mexico learned the lessons from its past crises and has been dutiful, ever-since, in reforming its regulatory and institutional framework, in order to be protected against the risks inherent in liberalization and a growing involvement in the globalized economy.

The above also shows, on the other hand, the benefits that membership in G20 has given Mexico, especially when sound free market economics approaches are still harshly repudiated by a significant portion of Mexico's political players, as well as other regional leaders.

²⁹⁵ See *id.*, at 18.

²⁹⁶ See *id.* For a development of the question of financial inclusion in Mexico and the role of these institutions see *infra* Chapter 3, 2 Financial Inclusion in Mexico.

²⁹⁷ See *id.*, at 19.

Moreover, the positive balance of Mexico's participation in G20 has encouraged a more active role on the part of Mexico, who has become a leading member, both by voice (proposals) and by example (compliance). This has been increasingly the case over the second half of the first decade of the 21st century, which makes noteworthy the impetus that President Calderón and his economic cabinet has brought to the Mexico-G20 relationship and the positive fruits it has borne.

1.5 CHAPTERS CONCLUSION'S AND CLOSING REMARKS

During the 20th century, Mexico took various paths in search of economic growth and development in general. For decades, the Mexican government focused and committed all its efforts on increasing its intervention and control over ever increasing areas of the economy, which entailed (in addition to central planning of the economy) protectionism, inflation, and over-regulation to the extreme of micro-management of several firms, industries and whole sectors. Eventually, the interventionist model was exhausted and Mexico was left broke as a result of it. This came to pass during De la Madrid administration (1982-1988) whose economic advisors were successful in persuading the decision makers that the only way to face the economic emergency was to move in the direction of liberalization of the economy. The change was not going to be welcome by many. Illegitimate interests and complacency, as well as ideological dogmatism, fostered resistance to the economic reforms required, in spite of the severity of the crisis.

A first a quite modest step given by the Mexican government in the direction of economic reform (multilateral liberalization) was Mexico's accession to the GATT, as will be seen in the next chapter, as a measure aimed primarily towards curbing hyperinflation and opening foreign markets for Mexican products which in turn would provide the Mexican economy with an income of American Dollars urgently needed to be able to face the country's foreign debt. Liberalization started to bear modest first fruits which provided the Mexican decision makers (within and without the government and its political party) with sufficient element to encourage them in furthering the liberalization agenda up to the point of being willing to negotiate and enter into a regional free trade agreement that included the largest market and most powerful nation of the world.

CHAPTER 2:

MEXICO'S ACCESSION TO THE

MULTILATERAL REGIONAL AGREEMENTS:

GATT, GATS/WTO,

THE MEXICAN POLITICAL DEBATE

REGARDING ITS ACCESSION,

AND CROSS BORDER FINANCIAL SERVICES

2.1 THE VARIOUS FRAMEWORKS AND THE PECULIAR MEXICAN APPROACH

2.1.1 Background

International trade is a tool to promote economic growth among the nations. As its influence has increased, the world has become more interdependent. The prosperity of the nations involved in international trade has increased significantly over the last decades, in general.²⁹⁸ As a result there is more competition, more freedom as to where to invest, buy or sell and, consequently, consumers have more choices. Trade allows countries to focus on what they can do best, thus resulting in better products and services.²⁹⁹

Liberalization of financial services has been affected in various ways: unilaterally, bilaterally, regionally, and/or multilaterally. This situation seems to have created duplicity of functions. The international trade system has had to develop such different tools to reduce dysfunctions, thus making a fairer play for the participants, allowing them to choose the most appropriate way for themselves. It is argued for instance that RTAs can help positively the world trade system when they go beyond multilateral rules, enhancing further liberalization.³⁰⁰

For purposes of this work, the primary frameworks for liberalization are multilateral or global (e. g. GATS/WTO), regional (e. g. NAFTA), and bilateral (e. g. MEFTA),³⁰¹ though the unilateral framework has played an important role in trade liberalization of financial services as shown in this chapter.

²⁹⁸ See WB, *Global Economic Prospects Report, Trade, Regionalism and Development* (2005) [hereinafter WB 2005 GLOBAL ECONOMIC PROSPECTS REPORT]. According to this report, world trade growth averaged 10.2% in 2004, reflecting an increase in industrial production and investment activity. Addressing the Conference of the Law of International Trade and Economic Relations of the A.B.A.'s Section of International Law and Practice (Oct. 29, 2003), John H. Jackson commented that "one big problem of the trading system is that it does not provide fair distribution smaller countries are at a disadvantage in many ways before the big economies". It is interesting to note that fifty percent of the world's trade is located in countries that have ten percent of the world population, thirty percent in countries that have fifty percent of the world population, and one percent in countries that have forty percent of the world population (see JOHN H. JACKSON, *THE WORLD TRADE SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMICS RELATIONS* (2002) at 15.

²⁹⁹ Cf. JACKSON, *op. cit.*, at 15.

³⁰⁰ WB 2005 GLOBAL ECONOMIC PROSPECTS REPORT.

³⁰¹ There is also a unilateral liberalization, which is when a country by itself takes domestic actions in order to remove barriers to foreign investment and capital access.

It is also worth mentioning the relationship between regional integration and development. It has been recognized that there is a close link between regional integration and development. Since then, many developing countries have been focusing on regional and bilateral agreements as a strategic framework to leverage their standards of living and development, such as Mexico's case with NAFTA.

The duality of regional rules versus multilateral rules has arisen, developed and is still a topic of some debates³⁰² together with the issue of compatibility between RTAs and the multilateral rules such as GATS/WTO.³⁰³ The overlapping membership in RTAs adds more complexity and uncertainty.

Most developing countries are involved in several trade agreements, which produce what is called "a spaghetti bowl." An average Latin American country belongs to seven agreements which have their different rules of origin, tariff schedules and periods of implementation, all of which complicates matters in the international arena and in the domestic procedures of every country.

Such overlapping of treaties may run counter to the primary objective of RTAs quoted in Arts. XXIV of GATT and V of GATS, which is not to raise barriers to the trade of third countries but to facilitate trade among members.

For Mexico and other developing countries it is important to know to what extent liberalization of services has been adequate as well as determine whether those various frameworks might duplicate or triplicate the same functions. If this were the case, then, it should be known how to co-ordinate those frameworks in order to maximize complementariness instead of antagonism.

³⁰² See Report of the Panel on *Turkey - Restrictions on Imports of Textile and Clothing Products*, WT/DS34/R). See also GABRIELLE MARCEAU and CORNELIS REIMAN, WHEN AND HOW IS A REGIONAL TRADE AGREEMENT COMPATIBLE WITH THE WTO (2001).

³⁰³ In the specific case of NAFTA for example, the lack of compatibility between RTAs within the WTO rules could be due to several reasons; one of them is the uncertainty surrounding the issue of NAFTA vs. GATT/WTO priority. According to Art. 103 of NAFTA, such FTA is superior to GATT. Yet, from the point of view of international public law, WTO has a superior hierarchy.

2.1.2 Multilateral Integration: Global Trade Agreements

Multilateral liberalization is one of the pillars of the strategy towards liberalization. Between 1983 and 2003, it accounted for 25% of the share of total tariff reduction whereas regional had 10%.³⁰⁴ Collectively considered, it can represent a kind of fortress to some countries (especially the small ones) in which they can achieve significant results, such as market access for agricultural products and reduction of subsidies by developed countries.³⁰⁵

GATT/WTO represents an example of multilateral economic integration and liberalization. GATT was never organization as such, neither with regulatory nor jurisdictional powers. The countries were called “contracting parties” due to the nature of agreement without international legal personality. It was until the Uruguay Round (1986-1004) that WTO was established as its successor.

The Marrakesh Agreement (April 15, 1994) contains the institutional framework for this organization. The WTO Ministerial Conference, comprised by representatives of all its members, gathers every two years.³⁰⁶ This multilateral integration is explained in Chapter 2 along with the analysis of GATS.

Countries in the process of joining WTO must first introduce domestic reforms in their core trade policies, laws, regulations, institutions, and policies that affect trade and investment. Mexico, for instance, from being a protectionist country moved to one of the most liberalized in just 15 years (1985-2000).

Interestingly, the countries that have benefited the most from joining WTO are the ones that used it as a tool to support their reform program. China, for example, throughout the fifteen years of accession negotiations focused on locking in domestic

³⁰⁴ See WB 2005 GLOBAL ECONOMIC PROSPECTS REPORT at XVI.

³⁰⁵ See *id.*, at XVI. WB states that RTAs cannot be an alternative to multilateral liberalization. According to this Report the gains for all developing countries from the RTAs cannot be fraction of those from full multilateral liberalization. On the other hand, the same Report accepts that if one of the partner countries is a high income and large economy the countries signing the first trade agreement may benefit individually and substantially, but those benefits will decrease as new countries sign additional agreements. This is the case of Mexico in NAFTA that has benefited substantially, but this will be reduced as new developing countries would join the Agreement.

³⁰⁶ See H. VAN HOUTTE, THE LAW OF INTERNATIONAL TRADE, 2nd ed., (2002) at 39.

reforms that reduced state controls over production and increased competitiveness in key areas of its industry.³⁰⁷

2.1.3 Regional Integration

This work focuses mainly on NAFTA as a model of RTA.³⁰⁸ NAFTA established free trade between USA, Canada and Mexico. It is an improved extension of CUSFTA (August 12, 1992). Regarding regional integration, NAFTA³⁰⁹ created a 360 million people market, the largest market in the world when it was first implemented. Although it has been disregarded in some areas, it is important to bear in mind that it is still an ongoing process.

2.1.4 Bilateral Integration

Bilateral integration will be analyzed through MEFTA. Bilateral agreements are attractive due to the weaknesses and disadvantages of the multilateral system mentioned above. In the specific case of the MEFTA, EU represented an attractive opportunity for Mexico because it is the largest and most integrated trade arrangement in the world bound into customs unions which are committed to political and economic integration.³¹⁰

³⁰⁷ See WB, "Trade Progress Report: Focus on Country Trade Policy" (Document 21718, Mar. 1, 2005) at 11.

³⁰⁸ See Robert Devlin and Lucio Castro "Regional Banks and Regionalism: A New Frontier for Development Financing" (paper for the "Conference on Financing for Development: Regional Challenges and the Regional Development Bank" at the Institute for International Economics, IADB, Feb. 19, 2002) at 20.

³⁰⁹ See Frederick Abbott, *The North American Integration Regime and its Implications for the World Trade System*, J. H. H. WEILER, ed., *THE EU, THE WTO AND THE NAFTA TOWARDS A COMMON LAW OF INTERNATIONAL TRADE?* (2000) at 176. NAFTA does not have legal personality in the international field and is not a member of the WTO, by contrast the EU has legal personality and is a member of the WTO. Interestingly, the Member States of the EU are also members of the WTO. If the EU votes, it represent all its Member States. If a Member State votes individually, then each Member State votes, and consequently there is no separate vote by the EU. This framework produces a complex legal situation for the WTO members outside the EU which seek to determine responsibility for EU and Member State compliance with the WTO.

³¹⁰ MEFTA (TRADE IN SERVICE AGREEMENT) at 21.

The home of more than 400 million people (now with the enlargement of 25 countries), with a GDP of over 7 trillion, EU is the world's second largest economy after the USA.³¹¹

2.1.5 Unilateral approach: The Mexican “Bottom up Approach”, Unilateral or Autonomous Liberalization; Is It More Important than Multilateral and Regional Liberalization?

Autonomous liberalization has accounted for most of the reductions in border protection over the last 20 years. Several reforms of developing countries such as Mexico, Brazil, China, Argentina and India were primarily unilateral reforms carried out to increase the productivity of the domestic economy. It has been used for most of the countries to liberalize their trade since 1980s.

An examination of tariff reduction by developing countries found that neither regional trade agreements nor multilateral agreements were the driving force in the liberalization. Autonomous liberalization accounted for 66% of the liberalization, while multilateral agreement 25% and regional agreements only 10%.³¹²

Most recently, over the last six years, 31 countries have implemented important reforms, lowering their MFN tariffs by 4% or more. Such is the case of India, Egypt, Chile and Mexico. The reforms were focused mainly on trade policy: exchange rate reforms, tax policy reforms and liberalization of domestic markets.³¹³

Unilateral reform or autonomous liberalization has many advantages: a) promote global competitiveness by lowering costs of inputs, b) increase competition from imports to drive productivity to growth and c) integrate the national economy into the global economy. Also having low barriers minimize the risks of trade diversion (when RTAs exist) and promote trade with other markets.³¹⁴

³¹¹ Casey Burges, *An Anglo-NAFTA Union: Does it Make Sense?*, 8 L. & BUS. REV. AM. (2002) at 685-686.

³¹² See WB 2005 GLOBAL ECONOMIC PROSPECTS REPORT at 42.

³¹³ See WB, “Trade Progress Report...,” at 9.

³¹⁴ See WB 2005 GLOBAL ECONOMIC PROSPECTS REPORT at XVI.

Unilateral liberalization has been greatly influenced by RTA's such as NAFTA, in the case of Mexico. In this case, and in attempt to comply with NAFTA obligations, Mexico had to amend several financial and commercial internal laws and regulations, producing in Mexico further autonomous liberalization.³¹⁵

As it has been said before, purely top-down legal reform is not viable in the long-term as much has to come from the bottom up. Especially regarding prudential financial standards, active and fully committed country participation is needed from the very beginning.

Keeping in mind that each country represents an individual case, nations may need to adopt solutions that correspond to their different needs and levels of development. This means that the initiative for conducting and construing reform in a broader developmental context should rest primarily on the country involved.³¹⁶

In the case of México, it is interesting how its 1994 crisis brought about a fundamental re-evaluation of the role of financial law and institutions with the consequent development, for the first time, of a comprehensive framework of internationally acceptable standards delineating minimum requirements for financial stability, which is analyzed in Chapter 3.³¹⁷

2.1.6 Overlapping Membership in RTAs: The Current Case of Mexico

The explosion of many economic integration agreements has created a complex web (or "spaghetti bowl"³¹⁸), which complicates matters in the international trade system and in the domestic procedures of each country. For example, customs agents report that this "spaghetti bowl" reduces transparency and delays considerably the process of goods through customs offices. And the bigger the delays are in trade and customs, the smaller the role of trade in the GDP.³¹⁹

³¹⁵ See *infra* Chapter 3.

³¹⁶ See Norton, "Taking...", *op. cit.*, at 33.

³¹⁷ See ARNER, FINANCIAL..., *op. cit.*, at 2.

³¹⁸ See Devlin and Castro, *op. cit.*, at 7.

³¹⁹ See WB 2005 GLOBAL ECONOMIC PROSPECTS REPORT at XIII. Customs agents have reported that it complicates the matters and thus takes longer to process goods covered by preferential agreements.

During the last 20 years Mexico has been actively involved in the negotiating RTAs.³²⁰ Mexico's trade liberalization is supported by a rich network of 12 RTAs covering America, Europe, Middle East and Asia,³²¹ and has inspired many developing countries in the region to join the wave of trade liberalization.³²²

However, Mexico is an example of some of the problems that overlapping RTAs can produce:

- 1) Members of the Central American Common Market have signed a free trade agreement with the Dominican Republic covering services, even when they do not have such provisions among themselves.
- 2) Colombia and Venezuela have agreed on the elimination of barriers to services trade between each other in the context of the Andean Community but have not agreed to the same objective in the context of the Group of the Three Treaty they signed with Mexico.³²³
- 3) Members of the Central American Common Market are now negotiating with Chile at the same time that they are finalizing a services agreement among one another.³²⁴

Such multiple rules may run counter to the primary objective of RTAs expressed in Arts. XXIV of GATT and V of GATS, which is not to raise barriers to the trade of third countries but to facilitate trade among members, resulting in net trade diversion.³²⁵

³²⁰ See Mexico Unit, "UK Trade & Investment Document," at 16; available at: www.uktradeinvest.gov.uk. Mexico also plays a central role in OECD, APEC and WTO. Mexico has signed more RTAs than any other country in the world, which has placed it in a privileged position as one of the biggest exporters worldwide and one of the main receivers of FDI.

³²¹ Lecture by Ambassador Fernando de Mateo (Permanent Representative for Mexico at the WTO Conference, Tuesday 12th Apr. 2005, Canning House, London). For more information regarding statistics see also www.economia.gob.mx, Mexico offers a preferential access to more than 1 billion consumers in 43 countries (77% of the GDP).

³²² Sherry M. Stephenson, *Regional versus Multilateral liberalization of services*, WORLD TRADE REVIEW (2002) at 188. NAFTA-type has inspired the following FTA: CARICOM, the Group of Three Agreement (G3, between Mexico, Colombia and Venezuela. However, in Nov. 2007, Venezuela withdrew of the group) and FTA between Mexico and Bolivia, Mexico and Costa Rica, Mexico and Nicaragua, Chile and Mexico, Chile and Canada, Chile and Central America, Mexico and the Northern Triangle (Honduras, Guatemala and el Salvador).

³²³ Venezuela has withdrawn from Group of Three in 2008.

³²⁴ *Id.*, at 524.

³²⁵ *Id.*

2.1.7 The “Mexican Vision” and International Development Law

2.1.7.1 Developed and Developing Countries

There is a close link between regional integration and development. As a result, many developing countries, like Mexico are focusing on regional and bilateral agreements as strategic frameworks for leveraging their standards of life and development.³²⁶

Within international law international development law has been added, which focuses on the position of developing countries. It is important to point out that there are two basic principles of international development law:³²⁷ 1) Developing countries have a right to development; and 2) Developed and developing countries have a duty of solidarity.

2.1.7.2 Duty to Cooperate, Solidarity, the Right to Development and the Mexican Vision

There is a duty of solidarity and cooperation in the development process.³²⁸ Such duty is shared among developed and developing countries. In this context, countries should act in good faith and help the countries that need it more. In other words, it is the unity of action towards a common end: the development of all nations.³²⁹

This rule has been stated in many international agreements. The most important is the Declaration on the Right to Development of 1986. Does this mean that rich countries ought to help poor countries?³³⁰ Is the right to development a kind of human right or an economic right? Rich countries have not yet accepted the right to

³²⁶ WB, Global Economic Report 2005, at XV [hereinafter GLOBAL ECONOMIC REPORT 2005].

³²⁷ See VAN HOUTTE, *op. cit.*, at 37.

³²⁸ See WB, RESPONSIBLE GROWTH FOR THE NEW MILLENNIUM: INTEGRATING SOCIETY, ECOLOGY AND THE ECONOMY (2004) at 3 and 19 [hereinafter RESPONSIBLE GROWTH]. Today, 80 percent of global GDP goes paradoxically to only to 20 percent of the world's people and 70 percent of the world's poor live in rural areas and in the world's poorer regions, the majority of the population is dependant on agricultural activities.

³²⁹ RUMU SARKAR, DEVELOPMENT LAW AND INTERNATIONAL FINANCE, 1ST ed., (1999) at 57.

³³⁰ GLOBAL ECONOMIC REPORT 2005, at viii. Poverty remains high, with 2.7 billion people living on less than USD\$2 a day.

development as a binding norm of international law; however, they grant aid or trade³³¹ preferences on a voluntary basis.³³²

As Wolfensohn has stated, we live in a “world out of balance... and it is time to restore it to the way we use it;” with six billion people living on earth, one billion own 80% of global GDP, while another billion survives on less than USD\$1 a day. In the Millennium Development Goals, world leaders agreed to cut poverty by half by 2015, setting targets for health, education, and equal opportunities for women, environment and preservation of the forest and oceans.³³³

The former Mexican President Vicente Fox also proposed the “Mexican vision” on priority issues regarding the Millennium Goals, such as the connection between sustained development, security and human rights and the reduction by half of extreme poverty in the world by 2015.³³⁴

This statement represents one of the world’s main objective; the urgency and the need to link sustained development, security, human rights with the reduction of poverty, which would provide a minimum level of a sound economic development of a particular developing country.

At the Monterrey and Johannesburg meetings, developing countries agreed to strengthen governance, create a positive investment climate, build transparent legal and financial system and fight corruptions. Developed countries agreed to support

³³¹ *Id.*, at 11. Developed countries have transferred large amounts of capital into developing countries. Since 2000, the central banks of some of the largest developing countries have increased their foreign reserves by more than 80%. Taken as a group the reserves of Mexico, Brazil, China, India and Turkey represent more than 45% of developing country reserves.

³³² In the case *Nicaragua v. USA* the International Court of Justice stated that international aid is “rather unilateral and voluntary”, so that it could stop when the rich country decides.

³³³ James D. Wolfensohn, “A New Global Balance; The Challenge of Leadership” (address to the WB Board of Governors, Dubai, United Arab Emirates, Sep. 23, 2003) at 6. Interestingly, developing countries are growing faster than rich countries. China with 1.3 billion people, will achieve most of the Millennium Development Goals, India is on track, however, countries like Sub-Saharan Africa is going in the opposite direction, where one of six children will die before they reach the age of five, many from AIDS. Wolfensohn says that; “part of the reason (why not all developing countries are moving forward) ... is because there is still too much cronyism and corruption. In nearly every country, it is a matter of common knowledge where the problems are and who is responsible. Frankly, there is not enough bold and consistent action against corruption, particularly at the higher levels of influence.

³³⁴ Participation of Vicente Fox (then president of Mexico) at the General Assembly of United Nations (Sep. 14-15, 2005), MEXICO UPDATE (Oct. 2005) at 3.

these efforts by enhancing capacity building, increasing aid and opening their markets for trade.³³⁵

However, there is a strong paradox and rhetoric in this issue, since “the aid today is at its lowest level ever. It has fallen from 0.5% of GDP in the early 1960s to about 0.22% today. And this is at a time when incomes in developed countries have never been higher.”³³⁶ Developing countries have a right of development, and developed countries could help greatly acting without delay to stop the famine, disease and chaos that have been spreading within the developing world.

2.1.7.3 Qualification as a Developing Country

The differentiation between developing and developed countries is usually based on economic and social parameters (e. g. GDP, national product per capita, and level of literacy). The “preferential treatment for developing countries depends on auto-selection.”³³⁷ In other words, a country presents itself as a developing country and is usually accepted as such.

2.1.8 Common and Shared Objectives with Respect to Liberalization of Trade in Services on These Various Frameworks: Transparency, Stability and Liberalization

Has trade liberalization in financial services been more successful in the form of the RTA or multilateral liberalization? GATS Art. V states that regional trade agreements must go further in their market access liberalization than the multilateral system. However, it does not specify how far they should go.

These different frameworks (multilateral, bilateral and regional) contain similar disciplines with respect to trade in services and especially to financial services,

³³⁵ Wolfensohn, *op. cit.*, at 7.

³³⁶ *Id.*, at 9.

³³⁷ See VAN HOUTTE, *op. cit.*, at 38.

sharing and overriding the same objectives such as: transparency, stability and liberalization.³³⁸

2.1.9 Political Confrontations in Mexico Regarding Its Accession to GATT

“From the late 1940s until the mid 1970s, the basic thrust of [Mexican] trade policy was the use of high tariffs and import-substituting industrialization...”³³⁹ In the 1970 and through the mid 1980s trade protectionism increased even more. Notwithstanding the above, Mexico started to participate in the capacity of “active observer” at the multilateral commercial negotiations known as the Tokyo Round.³⁴⁰

During almost the whole term of the Tokyo Round, Luis Echeverría Álvarez was President of Mexico (1970-1976), and José López-Portillo headed SHCP. An Office for Trade Negotiations and Tariffs was established at SHCP during the early stages of the Tokyo Round, as well as an inter-ministerial commission for the same topics, formally presided by López-Portillo.³⁴¹

In 1978 USA issued “emphatic invitations” for Mexico “to join GATT before the end of the Tokyo Round (1973-1979) and to open up its economy”.³⁴² Mexico “assumed certain commitments in principle, and its representatives believed it was only logical for Mexico to negotiate accession in order to receive improved market access as a result of GATT membership.”³⁴³ When López-Portillo became president of Mexico (December, 1976), he maintained the “incipient interest in GATT.”³⁴⁴

³³⁸ Stephenson, *Regional...*, *op. cit.*, at 189 and 193. Earlier research by Stephenson took notice of what had been achieved in NAFTA in comparison to GATS (2002). Unlike GATT, GATS only has two disciplines of general application: the MFN and the transparency, the other two basic provisions with respect to NT and market access are of specific application and apply to service sector negotiated in the national schedules of commitments

³³⁹ Herztein and Whitlock, *op. cit.*, at 218.

³⁴⁰ See Jaime Álvarez Soberanis, *El ingreso de México al GATT: La problemática de nuestra adhesión* [Mexico's Accession to the GATT: The Problems of Our Joining], 36 BOLETÍN MEXICANO DE DERECHO COMPARADO (Sep.-Dic., 1979) at 683; available at:

<http://www.juridicas.unam.mx/publica/librev/rev/boletin/cont/36/art/art1.pdf>

³⁴¹ Herztein and Whitlock, *op. cit.*, at 220.

³⁴² *Id.*

³⁴³ *Id.*

³⁴⁴ *Id.*

On January, 1979, López-Portillo's Ministry of Commerce sent to Director General of GATT the letter of intent required to join expressing, among other things:

...that Mexico would accept accession only insofar as three basic principles were upheld: that it should be recognized as a "developing country," that it be allowed to implement the measures required to achieve the aims of its economic and social development policies, and that its commitments during the Tokyo Round be considered part of the concessions give for GATT accession.³⁴⁵

On January 29, a Working Group was established to negotiate with the Mexican authorities to examine its application to join GATT under Art. XXXIII and to submit recommendations to the Council.³⁴⁶ On October 26, the protocol of accession was ready, yet "an acrimonious debate involving government officials, politicians, academics, public intellectuals and business leaders, among others, on the merits of GATT accession that continued throughout 1979 and early 1980," sidelined the very successful negotiations.³⁴⁷

In April 1979, the Colegio Nacional de Economistas (CNE) [National Bar of Economists], during its Third Annual Conference and in the presence of then President López-Portillo, "expressed concerns over the consequences of Mexico's entre into GATT, chief among them that it would represent a threat to the sovereign management of trade and industrial policy and provoke serious dislocations in the Mexican economy."

One month later, speaking through the national media, the CNE stated that:

...accession to GATT should be postponed indefinitely given that the national economy was not ready for increased foreign competition, and that the existing trade policy instruments were adequate to combat the prevailing anti-export bias. In arguments reminiscent of those used some thirty years earlier by Finance Minister Beteta,³⁴⁸ the CNE also

³⁴⁵ *Id.*

³⁴⁶ WTO, "Minutes of Meetings: Held in the Centre William Rappard on 29 January 1979", available at <http://gatt.stanford.edu/bin/object.pdf?90430205>.

³⁴⁷ Herztein and Whitlock, *op. cit.*, at 221.

³⁴⁸ Referring to Ramón Beteta Quintana (1901-1965), who headed SHCP during the Miguel Alemán presidential administration (1946-1952).

claimed that the GATT was ineffective in dismantling protectionism and did not deal effectively with the needs of developing countries.³⁴⁹

Likewise, in the legal academic realm, essays and articles were published by UNAM (usually leftist in its ideological affiliations) opposing *a priori* (in spite of claims to the contrary) Mexico's accession to GATT. Ricardo Méndez-Silva, for example, writes:

Mexico's accession or not to the... [GATT] has, in any case, positive and negative aspects that need to be pondered carefully in order to arrive to a balance of costs and benefits that would translate in a rational decision, free of emotions and aprioristic labelling. At the national level, the discussion has been impregnated with stereotypes: those who defend the accession represent the conservative current and those who oppose it represent the progressive one. Above ideological varnishes, it is convenient to go into a technical analysis of the dispositions of the GATT, their extent and the incompatibilities there are with respect to the Mexican development policies.

At any rate, the author wants to express from these initial words that this study starts and concludes in a position that it is at the same time the premise and conclusion: the non-convenience [*sic*] of Mexico's accession to the GATT.³⁵⁰

One of the three facets of Méndez-Silva's position against Mexico's accession to GATT (under the subheading "The Conditioning Framework") was that during the 1970s the USA had:

...significant setbacks... in its political and economic strategies... [and] experienced a loss of valuable geopolitical and geoeconomical pieces... the Middle-East... Afghanistan... Pakistan... Yemen... Iran... [all of which] point in the direction of an undermining the North American [USA] influence and, on the other hand, although not in an automatic manner, in benefit of the Soviet preponderance. The chief fear of the USA in this conflictive effervescence is that a chain reaction would be produced that affects Saudi Arabia, which is one of its chief partners in the region and the chief oil exporter of the world. Thus, in the background of these political readjustments is the danger of the

³⁴⁹ Herztein and Whitlock, *op. cit.*, at 221.

³⁵⁰ Ricardo Méndez-Silva, *The non Accession of Mexico to the GATT*, 36 BOLETIN MEXICANO DE DERECHO COMPARADO (Sep-Dic, 1979) at 747; available at: <http://www.juridicas.unam.mx/publica/librev/rev/boletin/cont/36/art/art3.pdf>

suspension of the supply of oil or its reduction in the medium term for circumstances that not quite unforeseeable.³⁵¹

One paragraph of two sentences and five lines is devoted to the decrease in USA exports, before going back to the thesis of the USA pretention “to avoid cracks in its immediate sphere of action” and its search for “fundamentally energetic self-sufficiency.”³⁵² In the same paragraph Méndez-Silva calls dangerous “The idea—in principle ethereal or exotic— of building a North American Common Market that has as engine axis the USA and that includes Canada and Mexico as supply sources of oil and gas, raw materials and, in the case of Mexico, of low-cost manpower.”³⁵³

Other objections Méndez-Silva raised under this sub-heading were that the GATT “consecrates, in spite of institutional make-up..., a capitalist development model;” that the Dollars Mexico would get from oil sells would be recovered by the USA by means of its exports to Mexico;³⁵⁴ and those who wished to ignore that would rather “fall to the promise of the world markets longingly await for the Mexican products.”³⁵⁵

The anti-capitalist theme is the most prevalent in the article referred, with statements as the following:

...the accession to the GATT would close dangerously the circuit of influence of the financial and commercial world institutions of capitalism, as the Mexican State hands over to this instances, faculties connected with the conduction of its economy that ought to be handled according to the national interests and needs and not adjusted to

³⁵¹ *Id.*, at 748.

³⁵² The oil theme is repeated again a few paragraphs later: “It is necessary to notice that almost none of the OPEC countries is member of the GATT, what leads to some issues of interests. The Agreement is in practice the anti-model of the OPEC, which by means of the its members’ concerted policies has meant the most important questioning of a whole international trade system that used to function upon the premise of low-cost primary articles and industrial products of high price (*id.*, at 753).

³⁵³ *Id.*

³⁵⁴ This argument is repeated a few paragraphs later saying: “I deem suspicious that in the moment en which the Mexican State finds itself in the possibility of getting an important influx of foreign currency, with which it could decrease in the medium term its indebtedness indexes and gradually recover its faculties in the direction of its financial and monetary policy, it is being pressed to place itself in a system of world trade that would suck out the income coming from the oil sales” (*id.*, at 750).

³⁵⁵ *Id.*

prefabricated models that pursue the free circulation of the capital and merchandizes according to the interests of the industrialized countries. A reflection that is worth commenting, is the one that notices the danger of the “privatization of the State,” which is an objective pursued by all transnational strategy that attempts to debilitate the traditional sovereign attributes of the State, that are still a break or at least de-accelerant element to the world projection of supercapitalism (Juan María Alponete, *UnoMásUno*, 7th April).³⁵⁶

Under the subheading “Specific Clarifications”, Méndez-Silva raised the argument that Mexico did not have products to export,³⁵⁷ and that it was not in shape to start competing at world level.³⁵⁸ Under the subheading “Normative and Political Incompatibility”, Méndez-Silva argues that the principle of non-discriminatory treatment, “at first sight could appear the incarnation of justice, postulates a factual situation of inequality, since it is not possible to treat in the same conditions countries that are in different degrees of development”.³⁵⁹

Under the subheading “Minimum Basis of Negotiation,” Méndez-Silva outlines the approach he recommends to take regarding the USA’s invitation to adhere to the GATT, namely: 1) To postpone the accession to the GATT or join only as observer or with a conditioned membership;³⁶⁰ 2) In case that is not possible, to submit the accession process to a more or less long process of adjustments; 3) To request that the principles of equality and reciprocity be not applied strictly; 4) To detect clearly the diverse policies and available subsidizing measures, established to foment the development of industrial branches and of regions in order to prevent that the guidelines of the GATT force their dismantlement;³⁶¹ 5) To apply the Mexican

³⁵⁶ *Id.*, at 750. Likewise, the very last paragraph of this article is devoted to capitalism: “It is true that Mexico finds itself within a capitalist model, both in its domestic system of mixed economy and in its main international relationships. However, this conditioning should not give place for a deeper linkage with the USA, which already exercises over Mexico a dangerous influence due to the mere weight of the economic disparity. The decision should be the strengthening of the autonomy through the overcoming of the regional, sector and social unbalances” (*id.*, at 762).

³⁵⁷ See *id.*, at 754.

³⁵⁸ See *id.*, at 754-756.

³⁵⁹ *Id.*, at 756-757.

³⁶⁰ At this point Méndez-Silva refers to “The close opposition that has been manifested in Mexico, which has joined the labour and business sectors in a strange combination of interests, backed up by academics, journalists and even an important wing of the government,” (*id.*, at 760) as a justification for his first recommendation.

³⁶¹ The reason offered for this recommendation is: “Mexico lacks exporting capacity, and that the economy oriented over the last years toward import substitution demands the redefinition to the outside, with the aid of state stimuli to exports” (*id.*, at 760).

system of customs valuation, which allows the use of official prices; 6) To ensure the freedom of the Mexican State to purchase in any place, preferably in national territory, without applying the damaging notion of equality between nationals and foreigners;³⁶² 7) To guarantee that Mexico will be able to continue using its regime of licenses prior to the imports.³⁶³

CNE's and UNAM's arguments above mentioned were echoed by the powerful Congreso del Trabajo (CT) [Labor's Congress]. The, chief organization of the Mexican labour movement,³⁶⁴ stated, by means of a study, that the entrance of Mexico to the GATT would hurt the autonomy of the national State; that it would compromise the sales of oil products.³⁶⁵ This latter argument was repeatedly denied by the Minister of Commerce, who expressed that oil sales would continue to be sold by means of separate agreements.³⁶⁶

Opposition to joining the GATT also came from SME, whose spokesperson said:

...joining the GATT will benefit the exporting groups, where big national and transnational capital predominates, while abandoning a protectionist policy and opening the domestic market to the manufacturing products of the GATT's partners would damage noticeably the less powerful firms.³⁶⁷

Luis Pazos, a long-time advocate of free trade and market economics, observed back then that detractors of the GATT in the business sector "were those who had made big fortunes taking advantage of that fictitious economy of protectionism."³⁶⁸ The industrials taking the anti-GATT position were those associated in, and represented by, the National Chamber of the Transformation Industry

³⁶² *Id.*, at 761.

³⁶³ See *id.*, at 760-761.

³⁶⁴ The "Labor's Congress" comprises practically all the labor unions in Mexico.

³⁶⁵ *El ingreso de México en el GATT provoca críticas internas* [Mexico joining the GATT provokes criticisms within], UNOMASUNO (Nov. 8, 1979); available at:

http://www.elpais.com/articulo/economia/MEXICO/ORGANIZACION_MUNDIAL_DEL_COMERCIO/OMC/ingreso/Mexico/GATT/provoca/criticas/internas/elpepico/19791108elpepico_22/Tes

³⁶⁶ *Id.*

³⁶⁷ *Id.*

³⁶⁸ Luis Pazos, *El GATT: ¿es de derecha o de izquierda?* [The GATT: Is It Right or Left?], REVISTA NOVEDADES (Nov. 8, 1979).

(CANACINTRA). This chamber said that joining the GATT would be harmful for Mexico therefore it should wait 20 years to make that decision.³⁶⁹

Along the lines of arguments already referred above, several other critics of joining the GATT said to the media that, “An inefficient industrial stripe and which has captive the domestic market will be put in the tight-rope of unequal competition, bankruptcy, or disappearance, which... would provoke more unemployment and deep social conflicts.”³⁷⁰

On the other hand, in his newspaper and magazine writings to the general public, Pazos stated clearly that joining the GATT implied no danger, if by danger we understand unemployment and bankruptcy, and not an increased competition and more efficiency in our private and state-owned firms.³⁷¹ He also wrote that the industrials’ and economists’ groups that opposed the GATT were not interested on improving the Mexican living standards; that they just wanted “to keep their interests and secure their power on the political economy.”³⁷²

There was opposition also of some members of the presidential cabinet,³⁷³ notably from the Secretary of National Patrimony and Industrial Promotion, José Andrés de Oteyza, whose secretary was in charge of the administration of the oil sales income, a position of political and economic power he was not willing to lose.³⁷⁴ Finally, giving in to the pressure, López-Portillo instructed his Minister of Commerce to communicate to the Director General of GATT his decision, “after consultations at the national level, to postpone the accession of Mexico to GATT,”³⁷⁵ on May 16, 1980. Mexico remained, nevertheless, an observer at some of the GATT sessions.³⁷⁶

³⁶⁹ Luis Pazos, *Los Antigattistas* [The Antigattists], REVISTA NOVEDADES (Feb. 21, 1980).

³⁷⁰ *El ingreso de México...*, *op. cit.*

³⁷¹ Pazos, *El GATT...*, *op. cit.*

³⁷² Pazos, *Los antigattistas*, *op. cit.*

³⁷³ See Sergio Berumen, “Los sexenios económicos en México y su inmersión en la globalización” [The economic presidential administrations in Mexico and its immersion in globalization], available at: http://www.cem.itesm.mx/dacs/publicaciones/proy/n7/investigacion/in_sberumen.html.

³⁷⁴ See Pazos, *Los antigattistas*, *op. cit.*

³⁷⁵ GATT’s Director-General’s receipt and transcription of Mexico’s communication (May 16, 1980); available at: <http://gatt.stanford.edu/bin/object.pdf?90970467>. For a detailed analysis of this decision see Dale Story, *Trade Politics in the Third World: A Case Study of Mexican GATT Decision*, 36 INTERNATIONAL ORGANIZATION (1982) at 767-794. Story examines “this critical decision... from two perspectives: a left-leaning foreign policy, and domestic constrains in the Mexican political system. Major foreign policy factors were a growing resentment of USA dominance combined with a

2.1.10 Some Observations to These Various Frameworks

The liberalization of trade and the liberalization of financial services have been affected in a variety of ways: unilaterally, bilaterally, regionally, and/or multilaterally. This situation seems to have created duplicity of functions. However, it is suggested that the international trade system has had to develop such different tools in order to reduce dysfunctions in the world's trading system and thus making a play fairer for all the participants, allowing them to choose the most appropriate way.

In the case of Mexico and its RTAs, they are the more likely to encourage world trade efficiency if their primary effect is to create new investment and trade rather than to divert existing trade (of course after unilateral liberalization, which is the most successful framework).

Developing countries wishing to harness to trade to their development strategy should see each framework as one of the elements in the four pillars strategy that includes: unilateral, bilateral, regional and multilateral liberalization. The GATT/WTO represents an example of multilateral economic integration and liberalization. Multilateral integration accounts for 25% of the aggregate liberalization. Collectively considered, it can represent a kind of fortress to some countries (especially the small ones) where they could achieve significant results.

Firstly, they have to introduce domestic reforms in their core trade policies, laws, and policies that affect trade and investment. Mexico, for instance, from being a protectionist country moved to one of the most liberalized in just 20 years (specially, in financial area). Thus, multilateral framework has played an important role in the liberalization of trade.

preference for conducting relations with the USA on a bilateral basis. Internal political pressures reflected the continued reform of the Mexican political system at the upper levels and the relative autonomy of some elite groups from the state. López-Portillo's decision did not constitute an outright rejection of trade liberalization. However, the decision could have international repercussions in 'politicizing' USA-Mexican trade relations, in slowing trends toward freer trade (especially in Latin America), and in strengthening multilateral organizations like UNCTAD in which Third World countries exercise considerable power" (*id.*, at 767, abstract); available at:

<http://journals.cambridge.org/action/displayAbstract?fromPage=online&aid=4281296>

³⁷⁶ One example was the International Dairy Products Council (Sep. 1980); see the corresponding report, available at: <http://gatt.stanford.edu/bin/object.pdf?92220508>.

Since 1990, there has been a new wave of regionalism, the “South-South” agreements have shifted to “North-South” agreements, which link up commercially with industrialized countries in reciprocal trade. This is seen in NAFTA, Canada’s FTA with Costa Rica and Chile, and Japan’s with Mexico and Singapore. RTAs can help sensitive domestic constituencies to liberalize and maintain lower tariffs.

Additionally, as the case of Mexico in NAFTA, RTAs help as an incubator for developing country producers to learn to trade with RTA partners without facing global competition. In the positive effect mentioned “first-mover advantage”. Countries may need to maximize their benefits through moving first and engage in North South agreement as in the case of Mexico in NAFTA.

The results in the statistics of the WB Global Economic Report 2005 provide some justification for developing countries’ pursuit of RTA with the developed countries if they do so exclusively or at least get a first mover advantage by getting there first.

Also, developing countries can negotiate faster RTAs than multilateral agreements assuming that successive governments will try to change the commitments once implemented. This is especially important in Mexico, where the new party tried to change some of its predecessors’ policies.³⁷⁷ Also RTAs can be used as leverage to facilitate domestic reforms.

Summarizing, regional framework or RTA’s has been functioning as an “axis” in the world trading system, since it has been the tool on which depend and which influence the other frameworks. Paraphrasing has become the most powerful integrating device which fosters the rest of the frameworks.

Unilateral framework constitutes the best strategy to achieve development for the developing countries. The fact is that it has accounted for most of the reductions in border protection in the last 20 years. Several reforms of developing countries such

³⁷⁷ For some examples of how PAN tried to change some things done by PRI, see *infra* 1.13.

as Mexico, Brazil, China, Argentina and India were primarily unilateral reforms that were carried out to increase the productivity of the domestic economy. In this way, the autonomous liberalization accounts for 66% of the liberalization, while multilateral agreement 25% and regional agreements only 10%.

Open Regionalism represents a good option to solve this situation. It is recognize it as a device through which regionalism can be used to accelerate the progress toward global liberalization. This concept looks to assure that RTAs will in practice be building blocks for further liberalization rather than stumbling blocks that delay such progress. This applies as well in the case of the trade in financial services.³⁷⁸ This concept has been adopted as a principal of the APEC, whose members account for about half of world trade (USA, Japan and China among others).

Since it was recognized that there is a close link between regional integration (RTA) and development, many developing countries have been focusing on regional and bilateral agreements as strategic framework to leverage their standards of life and development, as was the case of Mexico with NAFTA.

In the Monterrey consensus developing countries agreed to strengthen governance, create a positive investment climate, build transparent legal and financial system and fight corruption. Developed countries on their part agreed to support these efforts by enhancing capacity building, increasing aid and opening their markets for trade.

Additionally is it worth mentioning that these different frameworks (multilateral, bilateral and regional) contain similar disciplines with respect to trade in services and special to financial services, sharing and overriding the same objectives such as: transparency, stability and liberalization.

³⁷⁸ Fred Bergsten, Institute for International Economics, iie.com/publications/wp/1997/97-.htm.

2.2 CROSS BORDER FINANCIAL SERVICES: GATS AND ITS FINANCIAL SERVICES AGREEMENT

2.2.1 Introduction

Cross-border trade in Financial Services is a tool to increase possibilities to conduct cross-trade business in order to make stronger markets and stronger economies. Liberalization of services and especially in financial services can help countries to build more robust and efficient financial systems by introducing international practices and standards and by opening the markets to foreign competition.³⁷⁹

However, the developing countries and emerging economies were not keen, at the beginning, on opening³⁸⁰ their markets to the foreign financial services because they were afraid that this openness would damage their whole economic sector, trade in services, and especially trade in financial services like banking is of special concern; “banking is treated as special, it has to do with control of economy...foreign control of the banking system would be at the very last, a symbolic surrender of economic sovereignty...the GATS has had recognized it.”³⁸¹

Even more, the liberalization of this sector could bring some dangerous consequences as it may be a threat to domestic financial services companies, the undermining of prudential controls, the increased volatility of capital flows,³⁸² and the threat of the general financial system stability. In other words, such liberalization carries the risk of leading to banking and financial crises.

³⁷⁹ STIJN CLAESSENS & MARION JANSEN, eds., *THE INTERNATIONALIZATION OF FINANCIAL SERVICES: ISSUES AND LESSONS FOR DEVELOPING COUNTRIES* (2000) at 2.

³⁸⁰ In the case of goods, states protect their domestic industry by imposing tariffs and quantitative, restrictions on service industry. They differently operate in the case of services, because of their intangible nature.

³⁸¹ Banking and financial systems are crucial for any country for achieving the following goals: 1) maintaining a sound and efficient payment system, 2) controlling liquidity of the banking system which is the base for a price stability, 3) regulating the allocation of financial resources in specific industry, 4) controlling cross-border capital flows and 5) promoting competition in Banking services at competitive prices. See Art Alcausin Hall, 21 *NEW YORK LAW SCHOOL NEW YORK LAW JOURNAL OF INTERNATIONAL & COMPARATIVE LAW* 41 (2001) at 2.

³⁸² These instruments can contribute to volatility if investors flee at signs of uncertainty or trouble as happened during the Mexican 1994 crisis.

For these reasons, developing countries are still reluctant to accept a new regime for liberalization of international trade especially in financial services,³⁸³ with some exceptions as Singapore.³⁸⁴ Many developing countries argued that the liberalization of trade had benefited mainly the developed countries, with 64% of the direct benefits.³⁸⁵ It is also worth noting that USA and Germany governments had strong protection policies against foreign trade in the 19th century, like Japan and Korea.³⁸⁶

Developing countries argue that such liberalization has largely benefited the developed economies of the north.³⁸⁷ They claim that northern countries opened their markets only when it was convenient, maintaining trade barriers and restrictions when it was not.

Notwithstanding the above, developing countries have continued to make big efforts in liberalization, mainly because the USA, the WB and the IMF have been encouraging them, as in the following example: during the past decade 60 developing countries have reduced trade restrictions and 20 of the top 24 industrialized countries have raised them.³⁸⁸

Some tried to explain that international services transactions had common trade properties and that the liberalization of services and the financial reform could be beneficial to developed and developing countries alike.³⁸⁹ However, this issue is still unsolved due to the fact that although many have argued in favor of such

³⁸³ Victor Murinde, *General Agreement on Trade in Services: Financial Services Issues: Part 1*, 14 INTERN. BANKING AND FINANCIAL LAW (1995-1996).

³⁸⁴ J. N. Bhagwati, *International Trade in Services and its Relevance for Economic Development*, ORIO GIARINI, ed., THE EMERGING SERVICE ECONOMY (1987) at 26.

³⁸⁵ Interestingly now 20 of the most liberal countries in terms of world trade are developing countries. See D. N. Goyos, *MERCOSUR v. FTAA*, INTERNATIONAL TRADE LAW & REGULATION (1998) at 1.

³⁸⁶ John Kay, *Justice in Trade is not simply a moral question*, FINANCIAL TIMES (Jun. 26, 2003).

³⁸⁷ FINANCIAL TIMES (Sep. 16, 2003) at 22.

³⁸⁸ See Beverly, *op. cit.*, at 11. The USA has emphasized that while being competitively weak in the manufactured goods sector, they are strong in the field of services, including financial services, shipping, information, computers and telecommunications. Services account for 70% of the jobs in that country.

³⁸⁹ Wendy Dobson, *Further Financial Services Liberalization in the Doha Round?*, INTERNATIONAL ECONOMICS POLICY BRIEFS PB02-8 (Aug. 2002) at 1. Also, it has been argued that there is a strong link between developing countries' long term growth and financial reform. The Deputy Treasury Secretary Kenneth Dam, has suggested that developing countries can transform their domestic financial sectors into "engines of growth."

liberalization many others, like the OXFAM Report³⁹⁰ have opposed or at least they state that such liberalization should be designed in a different way.

As a result, the liberalization of the international trade³⁹¹ and especially the internationalization of the financial services has become very important as it is one of the sectors which has grown significantly in the last 15 years,³⁹² partly due to the enormous growth in world trade, the significant increase in the foreign direct investment, the financial deregulation, new telecommunication technology and sophisticated changes in financial innovation.³⁹³ Thus, it is important to determine whether the benefits of the liberalization of financial services exceed their potential costs for a developing country such as Mexico.

Among the main benefits one can find providing a legal framework that reassures foreign institutions investing for the long term and providing a source of external pressure for change and transparency.³⁹⁴ In addition to the liberalization of financial services, and in a parallel and complementary framework, there has been a general and international attention to the requirements of sound financial systems.

As Norton points out:

³⁹⁰ The OXFAM Report has argued that the systematic financial crisis is related in many ways to the liberalization of the financial services (see OXFAM, *RIGGED RULES AND DOUBLE STANDARDS: TRADE, GLOBALIZATION AND THE FIGHT AGAINST POVERTY*, at Ch. 8 [hereinafter *RIGGED RULES AND DOUBLE STANDARDS*]).

³⁹¹ Protectionism can be expensive as it generally raises prices and makes other countries retaliate by raising their own trade barriers. The WTO Secretariat argues “that’s exactly what happened in the 1920s and 30s with disastrous effects” (see WTO, “10 Benefits of the WTO trading system” at 6 to 11; available at: http://www.wto.org/english/thewto_e/whatis_e/t0ben_e/t0b00_e.htm).

³⁹² See *id.*, at 225. See also Hall, *op. cit.*, at 3. The fastest-growing sector of the world economy is that of services. Annual trade in services has tripled to \$1.2 trillion or one quarter of total world trade. Specifically, the banking industry has grown at more than 20% per year, which is twice as fast as world trade. Between 1960 and 1990 branch assets of foreign located in the USA grew from USD\$3.5 billion to USD\$378.8 billion. However, as a group, developing countries are running a deficit in their services trade of about USD\$33 billion, only five have a surplus. The USA by contrast has a surplus of USD\$80 billion.

³⁹³ See *id.* According to Murinde, GATS provides further impetus to NAFTA’s chapter on trade in financial services, especially in the perspective of telecommunications. NAFTA includes rules on trade in services affecting telecommunications, such as investment; US-based firms are expected to invest new resources in Mexico’s value-added network data services market, estimated grow to USD\$100 million by 1995. Trade in Financial Services is likely to grow steadily in the next decade as its reliance on telecommunications increases, within the provisions of both the GATS and NAFTA.

³⁹⁴ See Dobson, *op. cit.*, at 3.

...to develop agreed minimum principles and standards necessary to be implemented in order to encourage and improve confidence in and viability of domestic financial institutions, to minimize systematic risk as is the case of the Basel Committee on Banking Supervision...the International Organization of Securities Commission (IOSCO).³⁹⁵

Also, the liberalization of trade and financial services in trade means more transactions and more trade which denotes a possibility for more disputes to arise. Consequently, WTO members should be able to use efficiently the Dispute Settlement in the WTO.³⁹⁶

2.2.2 Historical Growth and Development of GATT/WTO

GATT was never intended as an international organization, however, it was *de facto* acting as an organization with neither regulatory nor jurisdictional powers. GATT was functioning as follows: the contracting parties had regular meetings (like international conferences) and through these meetings they exercised their jurisdictional powers.

After 1960, the administration was given to the GATT Council composed of representatives of the contracting parties. GATT continued until the Uruguay Round (1986-1994)³⁹⁷ when WTO was finally created and took over its institutional role.³⁹⁸ Nevertheless, GATT as a treaty still exists.³⁹⁹

WTO was created and is regulated by the Marrakesh Agreement of April 15, 1994.⁴⁰⁰ The WTO Ministerial Conference, composed of representatives of all member states, meets at least once every two years. The General Council conducts

³⁹⁵ J. J. NORTON, *FINANCIAL SECTOR REFORM IN EMERGING ECONOMIES* (2000) at 16.

³⁹⁶ WTO, "10 Benefits...", *op. cit.*, at 3. Before WWII, countries were not able to bring disputes to an international organization. These rules included the obligation for members to submit their disputes to the Panels and Appellate Body of WTO and consequently not to act unilaterally.

³⁹⁷ See Goyos, *op. cit.*, at 2. Interestingly, during the Uruguay Round, and for the first time, the European Community and Japan resisted the pressure from the USA. Traditionally the USA has supported multilateralism. However, in this Round there was a radical change in the position of its trade policy introduction, turning now towards regionalism.

³⁹⁸ See VAN HOUTTE, *op. cit.*, at 39.

³⁹⁹ See, JACKSON, *op. cit.*, at 59.

⁴⁰⁰ Philip Ruttley, *The WTO Financial Services Agreement*, *JOURNAL OF INTERNATIONAL FINANCIAL MARKETS* (1999) at 2.

the functions of the Ministerial Conference in the period between the two conferences. The administrative body is known as the WTO Secretariat. Other bodies are: Council of Trade in Goods, Council of Trade in Services, Council of TRIPS, Dispute Settlement Body, and Trade Policy Review Body.⁴⁰¹

Even if it is true that WTO panels have been gathering a huge amount of jurisprudence and that the Appellate Body's comments have given interesting guidelines thus making positive progress in the certainty and predictability of the world trade system, the fact still remains that from a developing country's point of view the consistent violation of GATT's basic rules and principle of non-discrimination by developed countries increases instability.⁴⁰² One would say that it is still in some ways a weak organization. As the very Pascal Lamy said, "WTO is a medieval institution."⁴⁰³

2.2.3 Common Objectives of GATS and Other Services Agreements; NAFTA and MEFTA: Transparency, Stability and Liberalization

The OECD observes that WTO consistent preferential regional trade agreements can complement, but cannot substitute for, coherent multilateral rules and progressive multilateral liberalization and that in some particularly sensitive areas, regional initiatives have been no more successful –and in some cases less successful– than activity at the multilateral level.

⁴⁰¹ VAN HOUTTE , *op.cit.*, at 41.

⁴⁰² See SILVIO BORNER, ed., *INTERNATIONAL FINANCE AND TRADE IN A POLYCENTRIC WORLD* (1988) at 102. Perhaps unintentionally, the GATT has encouraged developed countries to abuse discriminatory quantitative import restrictions.

⁴⁰³ See Larry Elliot, *THE GUARDIAN* (Aug. 2, 2004). Unfortunately, developing countries waited a long time for US and EU cut farm support. The WTO as a multilateral authority would have been shattered in some way. Developing Countries consolidated the strong negotiating position they established in Cancun, Brazil, India and China were leading. Metaphorically can be said that despite the mobile phones and the laptops, the way the WTO does business could be referred to the "Catholic Church" of six or seven centuries ago. The way that a small group of influential players hold the fate of the meeting in their hands, secret negotiations, difficult rules that are just few aware. It is just like medieval popes when Europe was divided up into princedoms all of which shared the same faith and owed allegiance to the Pope. Now, the world is divided into princedoms that owe allegiance to the "free trade god." Geneva has its own articles of faith and a court for prosecuting wrongdoers. Its aim, like that of Rome, is to embrace the world. WTO needs to refresh structures and thinking. The reality gap has to be closed between the way the global trading system operates in theory and the way it operates in practice.

In the specific case of financial services, an OECD study shows that while GATS has achieved a higher level of liberalization in financial services than is found in most RTAs, the development of GATS Understanding on Commitments in Financial Services took advantage of insights gained in financial market opening at the regional level.⁴⁰⁴ Having said that, relevant results should be known to what extent RTAs could go beyond GATS/ WTO Agreements.⁴⁰⁵

In this context, OECD study points out that GATS has gone beyond most RTAs in financial services, a situation that is considered inaccurate in the case of NAFTA and MEFTA as examined below in Chapter 4. What is more, the main aim of GATS is the promotion of transparency through Arts. III, V, VI, VII, VIII and IX.

Nevertheless, and paradoxically, the practice has been short in its achievements. The fact that countries have had to schedule all the information in national commitments has made it impossible to get information on services not included in such commitments. Moreover, when any of the four modes of services sectors is declared “unbound”, it turns the area into a blind point, since there is no more legal obligation to show transparency or disclose any regular practice.

Stability and liberalization are also the main objectives of all bilateral, regional and multilateral agreement shares and promotion.⁴⁰⁶ Stability is an important element for the international trade in order to guarantee security, certainty, credibility and predictability. These key factors give the investors and consumers in general, the vision of market opportunities.

⁴⁰⁴ See OECD, “Regionalism and the Multilateral Trading System” (Doc. No. 222003031P1, 2002) at 20 [hereinafter OECD STUDY 2002].

⁴⁰⁵ It should be noted that NAFTA, like many other RTAs, is inconsistent in some degree with GATS and consequently brings incompatibility and uncertainty to the world trade system. The lack of clarity of Art. V of GATS (and Art. XXIV of GATT) has been generally recognized and the ambiguities surrounding these provisions leave the compatibility of RTA’s largely uncertain. See Sherry M. Stephenson, *GATS and Regional Integration*, PIERRE SAUVÉ & ROBERT M. STERN, eds., *GATS 2000: NEW DIRECTIONS IN SERVICES TRADE LIBERALIZATION* (2000), at 509. See also Luis Abugattas Majluf & Sherry M. Stephenson, *Liberalization of Trade in Services: Options and Implications*, DIANA TUSSIE, ed., *TRADE NEGOTIATIONS IN LATIN AMERICA* (2003) at 91. See N. E. Scott, *Compatibility of EU Regional Trade Agreements with WTO rules in the Post Uruguay Round*, INT’L TRADE L. & REG. (1996).

⁴⁰⁶ See Stephenson, *GATS...*, *op. cit.*, at 187 (NAFTA Agreement has become a prototype for many developing countries to join the wave of services trade liberalization).

Although GATS has contributed in many ways to this road of credibility and predictability, the fact remains that service providers are not necessarily equipped with accurate information about market access possibilities through this multilateral agreement.⁴⁰⁷ A good example is Art. XXI of GATS, which allows any country to modify or withdraw any commitment already given:

A Member (referred to in this Article as the “modifying Member”) may modify or withdraw any commitment in its Schedule, at any time after three years have elapsed from the date on which that commitment entered into force, in accordance of the provisions of this Article.⁴⁰⁸

On the contrary, Art. 1404 NAFTA state as follows:

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

In the same sense, Art. 12 (3) of the MEFTA says that:

No party may adopt new measures as regards to the establishment and operation of financial services supplier of the other party, which are more discriminatory that those applied on the date of entry into force of this Decision.⁴⁰⁹

Thus, NAFTA and MEFTA have gone notoriously beyond GATS in this issue by providing the *status quo* provision⁴¹⁰ in a more predictable way for the treatment of existing trade in services binding the parties, so that no new restrictions can be introduced.⁴¹¹ Some argue that GATS services schedules have been useful in that very few disputes have arisen in this area. Yet, it should be noted that sometimes either the service providers are not aware of the content of such commitments or the

⁴⁰⁷ See Stephenson, *Regional...*, *op. cit.*

⁴⁰⁸ See GATS/WTO THE LEGAL TEXTS at 301.

⁴⁰⁹ “Joint Council Decision No. 1 Covering Trade in Services, Investments and Related Payments, Protection in Intellectual Property Rights and Dispute Settlement,” MEFTA TRADE IN SERVICES AGREEMENT, at 428-29.

⁴¹⁰ This provision means actual regulatory practice, and it gives the promise to the parties involved that they will not go back, withdraw or decrease their current commitments or regulatory practice.

⁴¹¹ See NAFTA DOCUMENTS SUPPLEMENT (1994) at 577, 601 and 615 [Hereinafter NAFTA DOCUMENTS SUPPLEMENT].

commitments are not used as an effective tool for pursuing trade policy interest due to the fact that most services commitments are below *status-quo* levels.⁴¹²

GATS in liberalization of services has made a good step forward, Yet it is still half way as there is a limited number of sectors included in national schedules as well as a limited number of overall commitments especially by developing countries.⁴¹³ The NAFTA and EU experiences also demonstrate deeper integration than GATS in financial services.

2.2.4 Trade in Services and Developing Countries

Services is the fastest growing component of the global economy. Even in developing countries, the services sector grew faster than manufacturers in the 1990s. The main services such as financial, communications, transportation, retail and professional business have been improving notably the whole developing economies.⁴¹⁴

However, it is clear that the comparative advantage in services belongs to developed countries, and therefore the returns to extension of orderly trade rules to services enabling services transactions to expand will accrue to the developed rather than the developing countries.

Developing countries tend to see the economic arguments advanced by developed countries in favor of services trade as deceitful, because developed countries used to have their services sector heavily regulated and protected against external competitors, and in the case of USA even against inter-state competition.⁴¹⁵

⁴¹² See GATS/WTO THE LEGAL TEXTS at 301. See also Stephenson, *Regional...*, *op. cit.*

⁴¹³ See GATS/WTO THE LEGAL TEXTS at 301. See also Stephenson, *Regional...*, *op. cit.* One exception is the telecommunications area with the adoption of the four protocols where countries have made a lot of sector binding.

⁴¹⁴ RESPONSIBLE GROWTH at 63.

⁴¹⁵ See Bhagwati, *op. cit.*, at 27.

For most of developing countries, such as Mexico, their advantage remains in the goods sector. In other words, in the services versus goods issue, the developed countries want to swap concessions on services against concessions on goods.⁴¹⁶

Also, most developing countries have no comparative advantages in services such as banking and insurance since they are net-importers of such services. However, the fact remains that there are still some countries that can find some comparative advantages in some services such as South Korea, India and Pakistan, where there are some skills with software, data being transmitted in overseas locations for engineering, medical, and a host of other skilled services (long distance services).⁴¹⁷

As a result of liberalization in services in general, competition increases and thus improves. Competition is the most effective instrument to lower average costs and increase quality and variety of services. Interestingly, only Latin American countries have been approaching recently developed countries in their degree of competition in financial services and telecommunications.⁴¹⁸ Also, data point out that countries that have fully liberalized trade and investments in finance and telecommunications have grown on average 1.5% faster than other countries over the past decade.⁴¹⁹

2.2.5 GATS and Trade in Services

Trade in services in the global and legal trade system was a recent development since it was not included in GATT until 1986, when USA negotiated the inclusion of services in the Punta del Este Ministerial Declaration. In the declaration it was agreed that trade in services would not be placed within the legal framework of GATT, but that GATT practices and procedures would nevertheless apply to them.

This means that all of GATT's jurisprudence and regulation that is applicable will be implemented into the GATS arena.⁴²⁰ The main problem in addressing trade in

⁴¹⁶ *Id.*, at 31.

⁴¹⁷ *Id.*

⁴¹⁸ See RESPONSIBLE GROWTH at 64. In financial services after developed countries in liberalization are: 1) Latin American Countries, 2) Europe and central Asia, 3) Middle East and Central Asia, and 4) East Asia.

⁴¹⁹ *Id.*, at 64.

⁴²⁰ See Joel P. Trachtman, *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis*, 34 COLUM. J. TRANSNAT'L L. (1995) at 44.

services, as opposed to trade in goods, is locating the service geographically and consequently jurisdictionally.⁴²¹ GATS was born in 1993, and it was said that it would fill the gap left in the 1947 GATT, since back then services were not a significant component of the world trade.⁴²²

2.2.6 Barriers to Trade in Services

In GATT there are tariffs and non-tariffs barriers. In contrast, the barriers to trade in services are intangible, usually in the form of government regulation. That is why it is difficult to provide quantitative measures of commitments to liberalize services trade as it is done for goods.⁴²³ Although trade in goods is also subject to national regulation, this must be compatible with GATT as long as it is not discriminatory.⁴²⁴

With respect to services, barriers have three dimensions: barriers to competition, barriers against foreign entry to provision of services, and regulatory barriers affecting the performance of the service sector. The regulation on services is mainly in finance and telecommunications, and takes the form of licensing requirements and prudential restrictions.

Interestingly, regarding services WB states that the policies in 2005 in developing countries are more restrictive than those in the developed ones. In South Asia, the index of liberalization in financial services was three, while in the developed world was eight. In the telecommunications sector, the most liberal are Latin America together with developed countries and by contrast Middle East and North Africa keep the least liberal approach.⁴²⁵

⁴²¹ Trachtman, *Trade...*, *op. cit.*, at 44.

⁴²² Office of the USTR, "GATT Uruguay Round: Progress Report" 6 (Dec. 14, 1988). Cited in Trachtman, *Trade...*, *op. cit.*, at 52.

⁴²³ See PETER GALLAGHER, *GUIDE TO THE WTO AND THE DEVELOPING COUNTRIES* (2000) at 49.

⁴²⁴ See GATS/WTO THE LEGAL TEXTS, GATT 47 at 427. Part II, Art. III. See also Trachtman, *Trade...*, *op. cit.*, at 46. The production of process of goods is not subject to national regulation to the importing country (as long as the process takes place abroad). The General Agreement on Tariff and Trade Dispute Settlement Panel Report on USA Restrictions on Imports of Tuna, 30 I.L.M. 1594, 1603 (1991). It distinguishes the regulation of tuna as a product, which is permitted under Art. III of GATT, from regulation of the production process by which the tuna is caught, which is not authorized under Art. III and must be justified. See Trachtman, *Trade...*, *op. cit.*, at 46.

⁴²⁵ WB, "Trade Progress Report..." *op. cit.*, at 9.

2.2.7 Assessing GATS and the Development of Cross Border Trade in Financial Services

The term liberalization as applied to financial services refers to “market opening,” that is the removal of restrictions on market entry for foreign service-providers. WTO decides which market access should be distinguished from capital account liberalization or convertibility, which refers to the freedom with which capital inflows and outflows (short term debt and equity, portfolios flows, commercial bank lending and bonds) of varying maturities are allowed to move across borders, and which are within the scope of the IMF. Central to the success of both concepts is “domestic liberalization” known as well as “financial reform,” which refers to the process of deregulation.⁴²⁶

This thesis distinguishes three types of financial liberalization:

1. Domestic financial deregulation, which allows market forces to work by eliminating controls of lending and deposit rates and on credit allocation, and reducing the role of the state in the domestic financial system.
2. Capital account liberalization as has been said aims at removing capital controls and restrictions on the convertibility of the currency.
3. Internationalization of financial services, whose objective is to eliminate discrimination in treatment between foreign and domestic financial services providers and the removal of barriers to the cross-border provision of financial services.⁴²⁷

This work focuses on the latter, the elimination of discrimination in treatment between foreign and domestic financial services providers and the removal of barriers to the cross-border provision of financial services.

⁴²⁶ Dobson, *op. cit.*, at 2. Deregulation has several dimensions: a) the withdrawal of government intervention through privatizing state-owned banks, for example freeing key prices like interest rates to be market-determined, b) the freeing of restrictions on intrasectorial activities so that banks can offer insurance, this was the situation in the US for many years. c) Strengthening of domestic financial institutions and markets to increase the efficiency of services, for example cheaper financing. The three concepts (market opening, capital account liberalization and domestic liberalization) do not necessarily need to move together (e.g. Chile reformed its domestic financial market in the late 1970s, opened its capital account in 1980, experienced a financial crisis and reversed its capital account).

⁴²⁷ See CLAESSENS & JANSEN, *op. cit.*, at 3.

The financial services sector has been one of the most difficult to negotiate. In 1995, negotiations were made, but USA withdrew of them. In April 1997, negotiations were re-activated and successfully ended. The main trading countries agreed to include financial services on a permanent and MFN basis in GATS and 70 WTO members improved their commitments on market access and NT.⁴²⁸

In December 1997, WTO members signed the Financial Services Agreement that established a framework for future liberalized market access for financial services providers.⁴²⁹ Seventy-one WTO members adhered to this agreement and it is said that around 95% of the world's financial services markets are affected by the new agreement.⁴³⁰

Together with the BCBS, IOSCO⁴³¹ and GATS, this can be seen an international effort (encouraged mainly by the G7 countries)⁴³² to build up a comprehensive, sound and safe international financial system, which is essential to be followed by all the countries, especially by those which have suffered domestic crises with international implications, such as the case of Mexico (tequila crisis).

In its Art. I, (Scope and Definition)⁴³³ GATS defines trade in services as follows:

1. This agreement applies to measures by members affecting trade in services.
2. For the purposes of this agreement, trade in services is defined as the supply of a service:
 - (a) from the territory of one member into the territory of any other member (cross-border supply);⁴³⁴

⁴²⁸ Rosa Maria Lastra, *Cross Border Trade in Financial Services*, DOUGLAS D. EVANOFF, JOHN RAYMOND LABROSSE, and GEORGE G. KAUFMAN, eds., INTERNATIONAL FINANCIAL INSTABILITY: GLOBAL BANKING AND NATIONAL REGULATION, Vol. 2, (2007) at 428.

⁴²⁹ Although some countries made some reservations, like Mexico, to this Agreement, the trend moves clearly to the Liberalization of the financial services. The GATS also envisages that the commitments to liberalize the services will take initially the form of changes of domestic legislation, such as maximum foreign ownership limitations, restrictions on the establishment of local representations, restrictions on the type of legal business.

⁴³⁰ This Agreement came into force on schedule on March 1, 1999. See P. Ruttley, *op. cit.*, at 1.

⁴³¹ IOSCO along with IASC are developing internationally acceptable accounting standards. See NORTON, FINANCIAL SECTOR..., *op. cit.*, at 19; and IOSCO, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (Sep 1998).

⁴³² See *supra* Chapter 1, 1.4 G20 and its Role in the Architecture of the Mexican Financial System.

⁴³³ See GATS/WTO THE LEGAL TEXTS at 286. Part I, Art. I.

- (b) in the territory of one member to the service consumer of any other member (consumption abroad);⁴³⁵
- (c) by a service supplier of one member, through commercial presence in the territory of any other member (commercial presence);⁴³⁶
- (d) by a services supplier of one member, through presence of natural persons of a member into the territory of any other member (movement of individuals).⁴³⁷

GATS aims to enhance the predictability and to provide transparency under the principles of progressive liberalization. The GATS framework is as follows: a) Rules and obligations specified in the articles of the agreement, b) Annexes on specific sectors and subjects including an annex on financial services, and c) National schedules of market access and NT commitments and list of MFN exemptions.⁴³⁸

GATS Art. II requires that members “accord immediately and unconditionally to services and service suppliers of any other Member, treatment no less favorable than that it accords to like services and service suppliers of any other country”.⁴³⁹ This obligation is referred to as the MFN requirement. Under the MFN obligation, all countries must allow service providers from different countries non-discriminatory access to their markets.

Also, there are specific obligations related to market access (Art. XVI)⁴⁴⁰ and NT (XVII).⁴⁴¹ They apply only to services that are registered in the Schedule of Commitments of countries. Such limitations might be horizontal (cross-sectoral) or sector specific and are listed for each of the modes of supply. Art. XVIII offers the

⁴³⁴ This includes international transportation, the supply of a service through mail or telecommunications. In the financial area, this would cover domestic consumer taking a loan, buying insurance or securities in another country.

⁴³⁵ This relates to the movement of the consumer as well of the movement of his property. In finance it would cover consumers buying for example insurance while they are traveling abroad.

⁴³⁶ This is when legal entities of one WTO Member have presence in other WTO Member, such as corporations, joint ventures, representatives’ offices or branches, in banking would be when a bank wants to establish a branch or subsidiary.

⁴³⁷ In the case of natural persons who are themselves suppliers.

⁴³⁸ See GATS/WTO THE LEGAL TEXTS at 287 Art. II. See also WTO, OPENING MARKETS IN FINANCIAL SERVICES AND THE ROLE OF THE GATS (1997) at 4 [hereinafter OPENING MARKETS IN FINANCIAL SERVICES].

⁴³⁹ *Id.*, at 5.

⁴⁴⁰ *Id.*

⁴⁴¹ *Id.*

possibility for countries to inscribe additional commitments not dealt either under Art. XVI (market access) or XVII (NT). As a result, some countries have made their specific commitments in accordance with the Understanding on Commitments in Financial Services - an optional text containing a formula approach to the scheduling of commitments.⁴⁴²

Nonetheless as mentioned above, “the process of liberalization of the GATS still will be slow and still is a halfway,”⁴⁴³ and Art. XIX recognizes that fact.⁴⁴⁴ The members will enter successive rounds of negotiation (beginning no later than in five years) with the view to achieve progressively higher levels of liberalization.⁴⁴⁵ Thus, the best part of this liberalization is still to come, hopefully for the benefit for all members, taking into special consideration emerging and developing countries.⁴⁴⁶

GATS is governed by three core principles: MFN, non-discrimination,⁴⁴⁷ NT, and market access.⁴⁴⁸ The agreement prohibits a range of policies that restrict market access.⁴⁴⁹ GATS Art. III also sets up transparency rules. These rules require from all members establishing inquiry points to provide specific information on laws, regulations and administrative practices affecting services covered by GATS.⁴⁵⁰

Art. VI (domestic regulation) require members to establish disciplines guaranteeing that qualification requirements, technical standards and licensing

⁴⁴² See GATS/WTO THE LEGAL TEXTS at 298 and 299 Art. XVI and XVII and Opening Markets in Financial Services, *op. cit.*, at 4.

⁴⁴³ See ROSS CRANSTON, PRINCIPLES OF BANKING LAW, 2nd ed. (2002) at 436.

⁴⁴⁴ See GATS/WTO THE LEGAL TEXTS at 300.

⁴⁴⁵ See OPENING MARKETS IN FINANCIAL SERVICES at 4.

⁴⁴⁶ See SCHEFER, *op. cit.*, at 349. The liberalization process has to take into account national policy objectives and in particular each member’s level of development.

⁴⁴⁷ See *id.*, at 248. Art. II of the GATS states that each Member shall accord immediately and unconditionally services and service suppliers of any other Member treatment no less favorable than it accords to like services and service suppliers of any other country.

⁴⁴⁸ See Will Martin & L. Alan Winters, *The Uruguay Round: A Milestone for the Developing Countries*, WILL MARTIN & L. ALAN WINTERS, THE URUGUAY ROUND AND THE DEVELOPING COUNTRIES (1996) at 93. An exception of MFN, as seen in *supra* Chapter 2, are the RTAs (Art. V of GATS). The MFN in GATS is subject to a “negative list” which it applies to all services except those listed by each country member. NT and Market access are determined by a conditional positive list approach which only applies to sector’s listed in a country schedule and to measures not exempted.

⁴⁴⁹ See GATS/WTO THE LEGAL TEXTS at 208. Part III, Art. XVI.

⁴⁵⁰ See *id.*, at 298. Part III, Art. XVI

procedures are based on objective and transparent criteria and should not be more burdensome than necessary and do not constitute a restriction on supply.⁴⁵¹

Art. XI prohibits members from applying restrictions on international transfers and payments for current transactions relating to activities for which specific commitments have been made. Art. VII (recognition)⁴⁵² allows the establishment of procedures for mutual recognition of licenses, education or experience granted by a particular member.

Art. VIII covers rules governing monopolies and exclusive service suppliers and other business practices restraining competition. GATS allows monopoly or oligopoly for supply on services providing that governments ensure that firms do not abuse their power market to nullify commitments.⁴⁵³

Art. XIV gives similar exceptions that were found in GATT, providing members with the legal cover to make measures safeguarding public morals, order, health, security, consumer protection and privacy. It also includes violating NT if they are forced to ensure equitable or effective collection of direct taxes or violating MFN if it results from a double taxation agreement.⁴⁵⁴

In the case of bilateral negotiations being unsuccessful members will opt for arbitration and the retaliation will be allowed when members do not comply with arbitration. The WTO Dispute Settlement mechanism will be solving disputes relating to GATS, GATT and TRIPS.⁴⁵⁵

The Annex on Financial Services⁴⁵⁶ enables members to take prudential measures for investor protection and the integrity of the financial system. However, this exemption should not be used as a means of avoiding a member's commitments.

⁴⁵¹ See *id.*, at 292. See also Martin and Winters, *op. cit.*, at 96.

⁴⁵² See GATS/WTO THE LEGAL TEXTS, at 292. Art. VII; and Martin and Winters, *op. cit.*

⁴⁵³ *Id.*, at 293 (Art. VIII).

⁴⁵⁴ See *id.*, at 297 (Art. XIV).

⁴⁵⁵ See Martin and Winters, *op. cit.*, at 96.

⁴⁵⁶ CRANSTON, *op. cit.*, at 435.

Therefore, carve out means that priority is given to the goods of bank regulation over the demands of competition and liberalization. Beside Arts. XVI, XVII and XVIII, more specific commitments can be made in accordance with the Annex on Financial Services that complement the basic rules of GATS.

As mentioned earlier, paragraph 2(a) of the Annex recognizes that countries may take measures for prudential reasons (e. g., *Fireman's Fund Insurance Company v Mexico* case in NAFTA). Likewise, Art. XII allows countries to introduce restrictions of a temporary nature in the event of serious balance of payments and external financial difficulties subject to consultation with WTO members.⁴⁵⁷

The right of establishment could be implemented in either a branch (not separately incorporated) or a separately incorporated subsidiary. This difference has important consequences for regulatory, bankruptcy and tax purposes. A subsidiary will be treated as a local person, with its own legal personality, and automatically receive NT.

On the other hand, from a regulatory perspective, a branch will have the regulation and supervision of the home office and will have the advantage of taking the home office's capital. Finally, for bankruptcy purposes and in the event of failure, the subsidiary is a different legal person.

2.2.8 Some Observations to GATS

According to OXFAM, GATS represents in sum a singular and unique framework because it establishes the right of corporate service providers to locate in another country and to provide services to the citizens of that country. According to its report this was the central demand of the USA, the EU and the big corporate groups during the Uruguay Round. Consequently, this constitutes a "huge extension of investors' rights and a potential curtailment of policy sovereignty for developing countries."⁴⁵⁸

⁴⁵⁷ See GATS/WTO THE LEGAL TEXTS, at 295 (Art. XII).

⁴⁵⁸ In the same sense, WTO Services Division Director David Hartridge said: "Without the enormous pressure generated by the American financial services sector like American Express and Citicorp,

OXFAM also says that one of the reasons for the current imbalance in the global trade in services is that global markets for labor are far more restricted than global markets for financial services to the detriment of developing countries. Therefore developing countries have concentrated on the mode d), because labor is the area where they have the greatest comparative advantage. Yet, since labor markets are subject to the greatest restrictions on trade, there is a striking disparity between the development of global and mobile financial markets and immobile labor markets.⁴⁵⁹

OXFAM's argument of the GATS central demand of the corporate groups being true is certainly right. It should be said as well that it was like that when GATS was initially launched. Nevertheless, later on, negotiations increased the attention and interest in developing countries reaching the point that they are now key players in the current negotiations.⁴⁶⁰

To sum up, on one hand GATS is a landmark achievement and on the other it is a half way the road, although as well it is considered in some ways a failure. It is a landmark because it has created a multilateral treaty in a new area and a failure because of the limited commitments.

Regarding GATS transparent rules, it has been short in its achievements. Scheduling the national commitments or declaring "unbound" any of the four modes of services sectors, turns the area into a blind point, since there is no more legal obligation to show transparency, especially, as it has happened often, with the sensitive areas.

there would have been no services agreement" (RIGGED RULES AND DOUBLE STANDARDS at 226 and 228).

⁴⁵⁹ At the present services provided through transnational corporations established in other countries account for about 33 % of the global services trade, compared with 1% through the transfer of labor (*id.*, at 228).

⁴⁶⁰ Between March 31, and 30 October 2003, 39 Members have submitted initial offers, of them a significant number are developing countries: Argentina; Bahrain; Bolivia; Bulgaria; Canada; Chile; China; Chinese, Taipei; Colombia; Czech Rep; EC; Fiji; Guatemala; Hong Kong, China; Iceland; Israel; Japan; Korea; Macao, China; Mexico; New Zealand; Norway; Panama; Paraguay; Peru; Poland; Senegal; Singapore; Slovak Republic; Slovenia; Sri Lanka; St Christopher & Nevis; Switzerland; Thailand; Turkey; Uruguay (see: http://www.wto.org/english/tratop_e/serv_e/s_negs_e.htm).

This lack of transparency is a serious shortcoming in trade in services. A negative list approach could have been a better solution for market access and NT. Without clear rules of transparency, the negotiations will remain driven by powerful export interest.

Moreover, GATS' impact could have been better if the *status quo* had been bound to all sectors. Market access is heading for the right direction. However, the positive list approach was wrong and mainly because developing countries' influence in the negotiations, in the end, provided a counterproductive effect, due to slowing down the free trade and limiting the value of GATS to governments seeking to liberalize. Market Access and NT should have been a general obligation with the negative list instead of the current positive approach.

2.2.9 GATS and NT

NT is one of the cornerstones of GATS, and means that a host country ought to treat foreign services no less favorably than (like) domestic services and service suppliers. In contrast with GATT, NT in GATS is negotiable among parties (the parties only commit to the extent they actually want, such as specific sectors and supply modes).

2.2.10 Arguments against the Liberalization of Financial Services, and the Possibility of Generating Financial Crises

Liberalization in services and specifically in financial services is more complicated than any other kind of liberalization.⁴⁶¹ Among the arguments against liberalization is national pride and the avoidance of foreign economic domination, a need to allow time for local services to mature, rapid capital flight, the presence in the banking system of large non-performing loans, and domestic regulators having limited the ability to monitor a more complex financial system.

⁴⁶¹ See RESPONSIBLE GROWTH at 67. Liberalization in services is more complicated than liberalization in goods. Privatization without competition and proper regulation may get nothing else than passing from public monopoly into private monopoly, ending without improvement in services. Thus, should be carry out proper regulation in all liberalization.

Developing countries have been dominated in many ways throughout the history and as a result they have been reluctant to continue opening their markets. Even some developed countries, members of the OECD such as Canada, USA, Japan and Australia, have restricted foreign banks and investments at some point of their history.⁴⁶²

The experiences of countries that have deregulated and opened their financial markets show that the states were affected by financial crises. One of the analyses of banking crises worldwide found that in 18 of 25 cases studied, financial liberalization has occurred sometime in the previous 5 years.⁴⁶³

In this context, financial liberalization may have helped to create crisis in some countries because the combination of trade and financial liberalization may be explosive⁴⁶⁴ and lead to a rapid increase in consumption of durable consumer goods and this will have dangerous effects on savings and the balance of trade.⁴⁶⁵

However, it is thought that such crises could be seen as the price that countries have to pay for the growth process.⁴⁶⁶ Then, more than delaying the crisis, the attention should be paid on how to handle it and take the correct measures to diminish its effects, as has been the example of the Mexico crises of 1994.

A weak institutional financial framework makes liberalization more likely to lead to a banking crisis as well as excessive free trade or competition.⁴⁶⁷ OXFAM has correctly stated that such systematic financial crises are related in many ways to the

⁴⁶² See CRANSTON, *op. cit.*, at 428.

⁴⁶³ See DOBSON and JACQUET, *op. cit.*, at 8.

⁴⁶⁴ Sigal Ribon and Oved Yosha, "Financial Liberalization and Competition in Banking: An Empirical Investigation" (Working Paper no. 2399, Tel Aviv University, Oct. 1999). Israel Banking system lost power market as a consequence of its financial liberalization, despite the fact that the market remains highly concentrated. In the same sense, see also Slover, *op. cit.*, at 8. Financial liberalization can contribute to financial instability during transition period by increasing the exposure to credit and foreign exchange risks, especially when is taken in a risky macroeconomic environment.

⁴⁶⁵ See MIGUEL URRUTIA, ed., FINANCIAL LIBERALIZATION AND THE INTERNAL STRUCTURE OF CAPITAL MARKETS IN ASIA AND LATIN AMERICA (1988) at 3. In the same sense Dobson, *op. cit.*, at 8.

⁴⁶⁶ In the same sense, see Eswar S. Prasad, Kenneth Rogoff, Shang-Jin We and M. Ayhan Kose, Effects of Financial Globalization on Developing Countries: Some Empirical Evidence (IMF Occasional Paper, 220) at 25.

⁴⁶⁷ BBV surprised observers with its offer of \$4.1 billion for Mexican bank Bancomer, the Spanish giant and other big banks (HSBC and Citibank) have gradually acquired Mexico's banks since the country's banking system crashed in 1995 after a financial crisis.

liberalization of the financial services,⁴⁶⁸ mainly because the financial sector has some characteristics that do not fit very well into the “competition and market economy structure.”

For example, excessive competition in the financial sector could bring lower profits and thus make the financial institutions lower their safety standards, stimulate imprudent behavior, which in the end could trigger a domino effect. In other words, liberalization in financial services is different from other services in the sense that over the top competition is and should be counterbalanced by prudential reasons.⁴⁶⁹ Therefore in this area there is a tension between competition and prudential supervision, which will be examined later in this chapter.

Moreover, effective regulation is essential to ensure that the poor have access to basic services.⁴⁷⁰ WB recommended to developing countries in financial services to get “gradually opened.”⁴⁷¹ For example, in the case of China’s financial sector, it is suggested that “financial markets be opened gradually to allow regulations and institutional developments to precede liberalization.” As a result, China could avoid destabilizing financial losses by state banks that were saddled with poor portfolios as efficient foreign banks entered the market.⁴⁷²

In developing countries trade liberalization follows financial liberalization and also a higher GDP growth. Financial and trade liberalization leads to faster growth, but also higher probabilities of crises. In fact most of the developing countries, such as Mexico and South Korea, in their process of liberalization have experienced boom-bust cycles.⁴⁷³

⁴⁶⁸ See RIGGED RULES AND DOUBLE STANDARDS at 225.

⁴⁶⁹ Mahmood Bagheri and Chizu Nakajima, *Optimal Level of Financial Regulation under the GATS: A Regulatory Competition and Cooperation Framework for Capital Adequacy and Disclosure of Information*, JOURNAL OF INTERNATIONAL ECONOMIC LAW (2002).

⁴⁷⁰ See *infra* Chapter 3.

⁴⁷¹ RESPONSIBLE GROWTH at 66.

⁴⁷² *Id.*

⁴⁷³ See Aaron Tornell, F. Westermann and L. Martinez, “The Positive Link between Financial Liberalization Growth and Crises” (National Bureau of Economic Research Working paper 10293, 2004) at 31.

The financial liberalization in South Korea for example, generated rapid growth, high savings and large capital inflows into direct and capital market investments. It is thought that the lack of liberalization in many developing countries is one of the most important reasons why they have been prevented from growth and absorption of capital.⁴⁷⁴

In addition to the liberalization factor, the impact of instability of developing countries was “aggravated by the increasingly close linkages and mutual dependencies that had developed between developed and emerging economies.”⁴⁷⁵ In other words, the world has become more and more interconnected and any financial problem in any country would have in short or medium term some or strong side effects in the others.

Another reason why some developing countries are reluctant to accept trade liberalization in services and financial services is that it would involve adopting the WTO/ TRIPS agreements, which means adopting USA style patent and copyright laws that one said are to be protective of western companies. For example, developing countries would have to pay more for drugs, software and videos. That’s why for some developing countries the costs on balance probably outweigh the gains from trade liberalization in services.⁴⁷⁶

Developing countries consider that it is inconsistent and a strong paradox to preach the benefits of free trade and then maintain the highest subsidies and barriers

⁴⁷⁴ See also Manuel Agosin, Isabelle Grunberg, Mark Mobius, et al, “Perspectives on International Financial Liberalization,” (United Nations Development Program discussion paper, 1998) at 20. The authors state that Mexican Crises was not due to financial liberalization, but the lack of it. Mexico pursued a fixed exchange rate regime that resulted in a large current account deficit financed by capital inflows. It was widely recognized that the exchange rate regime and the current account deficit were the destabilizing factors to the Mexican crisis as has been studied in Chapter 1 of this work, not capital inflows. A floating exchange rate allows current accounts positions to be redressed and introduce currency risk for investors, forcing them to examine the merits of potential investments and ensuring a more efficient allocation of resources. Exchanges rates are only after all prices. Price risk is inherent in any market and is essential in transmitting changes in markets conditions.

⁴⁷⁵ See WALKER, INTERNATIONAL..., *op. cit.*, at 276 and 277. Between 1980 and 1996 almost two third of all IMF members had experienced an important financial problem. Problems in any emerging market could not be more ignored, since one quarter of all industrial countries’ exports had been purchased by developing countries by 1990 and between 1991 and 1994 developing countries have received 40 percent of global inflows of foreign direct investment. See also J. J. Norton, *Asian Contagion and Latin America*, AGUIRRE and NORTON, REFORM..., *op. cit.*, at 291.

⁴⁷⁶ See Robert Hunter-Wade, FINANCIAL TIMES (Aug. 11, 2005).

for goods in which they have a comparative advantage,⁴⁷⁷ for example the case of the agricultural sector where the USA⁴⁷⁸ and EU still keep a high level of protection.⁴⁷⁹

The Mexican example has shown that a way of preventing crises is implementing proper judicial reform, prudential regulation and improving contract enforceability. Authorities must focus on what to do after the crises (such as proper prudential regulation) instead of trying to stop them. Delaying an inevitable crisis will make the effects worse.⁴⁸⁰

Mexico's 1982 and 1994 financial crises are a good example of how financial liberalization can be devastating when not accompanied by the strengthening of the financial market institutions, especially by an adequate supervision and regulation.⁴⁸¹

Lastly, among the policy responses to counteract such financial crises by the G7 and subsequent groups such as G10, and according to Walker, in order to enhance the construction of the "new international financial architecture", the following are worth mentioning: market transparency, market supervisory and regulatory factors, proper corporate governance, accountancy and audit standards, insolvency procedures improving prudential standards.⁴⁸²

2.2.11 Arguments in Favor of the Liberalization of Financial Services

The presence of foreign banks provides access to foreign savings, lower financing costs, technical transfer as well as increased competitiveness, efficiency and diversity of the financial sector.⁴⁸³ What is more, open financial sector makes it possible for

⁴⁷⁷ See FINANCIAL TIMES (Sep. 16, 2003) at 22. The expectations of the WTO's ministerial meeting in Cancun were never high but the collapse of the talks confounded even the pessimists.

⁴⁷⁸ See THE INDEPENDENT (Nov. 16, 2005) at 37. On this, President Bush offered at the United Nation to end all US agricultural and industrial subsidies, if the others did so too. Also in this context, Jagdish Bhagwati argues in his DEFENSE OF GLOBALIZATION that the greater trade freedom should move at the optimal pace, not the fastest. He believes that the costs of going to fast are often overestimated and says that powerful lobbies in USA have pushed, disgracefully for over rapid opening markets prior to the WTO entry.

⁴⁷⁹ See Wolfensohn, *op. cit.*, at 10.

⁴⁸⁰ See Tornell, Westermann and Martinez, *op. cit.*, at 31.

⁴⁸¹ See Blommestein & Spencer, *op. cit.*, at 6.

⁴⁸² WALKER, INTERNATIONAL..., *op. cit.*, at 282. The most important papers were the Halifax Summit in 1995, the Denver Summit in June 1997, the G7 Cologne Financial Ministers Report in June 1999.

⁴⁸³ Dobson, *op. cit.*, at 4.

better macroeconomic policies and regulation and efficient international allocation of resources.

In this sense, GATS and other WTO agreements related to the trade in financial services, in terms of liberalization and regulation, contribute to a process of production of optimal level of financial regulation (mandatory disclosure of information and capital adequacy).⁴⁸⁴

2.2.12 Financial Services Liberalization in NAFTA Parties and MERCOSUR

NAFTA's Chapter 14 binds the parties to provide: a) Access to the financial service providers of the other party; and b) Better NT or MFN to the other parties' financial institution providers, cross border financial service providers and eligible investors. Nevertheless, the cross border branching is subject to national discretion as it is in the case of Mexico which has reservations in Annex VII.⁴⁸⁵

Within the range of the NAFTA there are no tariffs on trade, although individual external tariffs are sustained. What it means is that the three countries form a free trade union but not a customs union. Chapter 14 of the pact and its Annexes deal with the financial services and obtain unqualified NT but they do not require any harmonization or impose mutual recognition like the case of the EU. What they allow is the autonomy of the member countries as far as regulation is concerned.⁴⁸⁶

MERCOSUR was started by Argentina, Brazil, Paraguay and Uruguay in 1991, and now constitutes the third biggest trade market in the world. The assumptions of the treaty were to establish an internal market by the year 1994 with the incorporation of common external tariff and free movements of labor, goods, services and capital, which were supposed to liberalise the market gradually.

⁴⁸⁴ Bagheri and Nakajima, *op. cit.*, at 509.

⁴⁸⁵ See CRANSTON, *op. cit.*, at 433. For the liberalization of financial services among NAFTA parties, see *infra* Chapter 4.

⁴⁸⁶ See GEORGE A. WALKER, *EUROPEAN BANKING LAW: POLICY AND PROGRAMME CONSTRUCTION* (2007) at 61.

Similarly to GATS and NAFTA, MERCOSUR fosters both the intercontinental and local trade.⁴⁸⁷

2.2.13 Liberalization Commitments of Developing Countries in GATS

The negotiations in 1995 resulted in an interim agreement and the final permanent agreement was finally achieved on 12th December 1997. A total of 56 schedules of commitments representing 70 WTO countries were annexed to the fifth protocol of GATS.⁴⁸⁸ Section 5 of the Annex of GATS states that two broad categories of financial services are covered by GATS: banking and other financial services, and insurance with insurance related services. Banking relates to all traditional services.

The commitments were: no restrictions apply to both market access and NT is for high-income countries 25% and for low and middle-countries is 7%. These numbers could show how far GATS is from getting free total global trade.⁴⁸⁹ Also, high income countries accepted commitments covering 45% of their services sector and low and middle income countries scheduled only about 12%.⁴⁹⁰

Generally, developing countries were reluctant to make offers with only 16.2% of sectors in developing countries listed and 6.9% listed with no policy exemption. It was the “aristocracy of developing countries”⁴⁹¹ that was willing to make GATS commitments, which listed 40 percent of total sectors.⁴⁹² This reluctance to liberalize stands in contrast to the liberal commitments made by the developed countries, most of which had a clear interest in exporting financial services.

⁴⁸⁷ See *id.*

⁴⁸⁸ See Ying Qian, “Financial Services and GATS - Analysis of the Commitments Under the GATS at the WTO” (paper in the Liberalization and Internationalization of Financial Services Conference, May 10, 1999) at 1.

⁴⁸⁹ See Martin and Winters, *op. cit.*, at 104. The Committee on Trade in Financial Services looks at the status of acceptance of the Fifth Protocol whether the Members who participated in the financial services negotiations in 1997 have ratified their commitments. It also looks at the classification of financial services and at developments in financial services trade. See for example, WTO, S/FIN/M/46, Oct. 29, 2004, (04-4602), Committee on Trade in Financial Services, “Report of the Meeting Held on 28 Sep. 2004; note by the Secretariat.

⁴⁹⁰ See GALLAGHER, *op. cit.*, at 49.

⁴⁹¹ Surya Subedi, “The Law of Foreign Investment in a Changing World: The Challenge of Reconciling the Competing Principles” (Distinguished Shihata Conference 2005). Among this aristocracy are: Brazil, China, India, South Korea and Mexico.

⁴⁹² For the list of all financial services commitments and MFN exemptions see: http://www.wto.org/english/tratop_e/serv_e/finance_e/finance_commitments_e.htm. See also Martin and Winters, *op. cit.*

The format of the schedule is as follows: “none” means that a member binds itself to not having any measures that violate market access or NT for specific sector or mode of supply. “Unbound” means that no commitment is made for any specific sector or mode of supply, and “other” implies that restrictions are listed and consequently bound for a mode of supply or sector.

Low and middle-income countries, mainly eastern European, made the highest number of specific commitments, with more than 300 sectors or modes of supply: the Czech Republic, Hungary and the Slovak Republic. In market access the high-income countries were more liberal, 60% of commitments for the high-income group imply no restrictions as compared to 45% for low-income ones. In the same context, developed countries were keen on setting limitations on residency requirements whereas developing countries focused more on ownership requirements.

What is more, a comprehensive WTO study has found that members’ governments have made more commitments in financial services than any other except tourism. However and paradoxically, the number of limitations maintained on market access and on NT is higher than any other sector.⁴⁹³ This is a mirror which reflects on one hand, the importance for developing countries of the foreign banking investments and on the other, still shows some fears about prudential regulation and reservations about systemic risk.

Another study shows that GATS commitments were driven by self-interested politicians granting protection or liberalization to special interests. Also, the absence of an own export interest took developing countries into a more restrictive bondage in their commitments in comparison with previous practice.⁴⁹⁴ In his study Mattoo points out that a government’s decision to liberalize may be affected by the economic

⁴⁹³ See OPENING MARKETS IN FINANCIAL SERVICES; and Qian, *op. cit.*, 3.

⁴⁹⁴ See Phillip Harms, Aaditya Mattoo *et al.*, “Explaining Liberalization Commitments in Financial Services” (WB Policy Research paper 2999, Mar. 2003), at 2. For example, India used to issue 15 licenses every year for new foreign bank branches, but in the commitments under GATS is bound to issue only 12 licenses.

environment, especially the macroeconomic stability and the quality of prudential regulation.

The WTO study shows that the commitment coverage in general is more comprehensive among developing countries compared to other groups, but the African countries such as Sierra Leona Malawi, Mozambique and Gambia have made all banking and other financial services commitments.⁴⁹⁵ Moreover, 80 percent of the limitations on the market access have been taken in banking and other financial issues. 60 percent of the measures were made in Mode 3; by contrast, there were few limitations scheduled in Mode 1 and 2.⁴⁹⁶

2.2.13.1 Africa

Sierra Leona Malawi, Mozambique and Gambia have made commitments on all banking services and other financial services.⁴⁹⁷ This is worth noting since they are in the category of the least developing countries. Specifically Sierra Leona which has covered all financial services in its schedule without exclusions.⁴⁹⁸ Also, for these countries domestic factors have played significant role to determine their GATS commitments, for instance macroeconomic policies and prudential regulations have slowed down liberalization and the need to protect domestic markets imposed certain limitations in commitments.

2.2.13.2 East Europe

Easter European countries made the highest number of specific commitments (with more than 300 sectors or mode of supply), mainly the Czech Republic, Hungary and Slovak Republic. These countries liberalized their insurance sector equally to or better than their banking sector, indicating increasing sophistication of their economies, which requires more internationalization of insurance services.⁴⁹⁹

⁴⁹⁵ See Qian, *op. cit.*, at 3.

⁴⁹⁶ See *id.*

⁴⁹⁷ See *id.*

⁴⁹⁸ See *id.*

⁴⁹⁹ See *id.*, at 4.

2.2.13.3 Latin America and Mexico

It is worth noting that members in Latin America tend to have higher probability to impose requirements of discrete licensing or economic need test compared to other members. The additional probability is near to 30% for the insurance sector and 7 above in the banking sector.⁵⁰⁰ Mexico signed WTO/GATS and its commitments are annexed in its Schedule to GATS.

Specific commitments are made according to the four modes of supply for each services sector: (1) cross border supply, (2) consumption abroad, (3) commercial presence and (4) free movement of natural persons.⁵⁰¹ Mexico's commitments set up some deviations from the non-discrimination and NT principles, for example, foreign institutions must obtain authorization from SHCP. Additionally, foreign institutions should remain under effective control of Mexican holders, and foreign investments by governments are not permitted.

Mexico has accepted a higher degree of liberalization of cross-border trade in financial services within NAFTA and MEFTA members rather than with other GATS members.⁵⁰²

2.2.13.4 Some Observations to the Commitments

In general, member governments have made more commitments in financial services than in any other sector except tourism. However, the number of limitations kept on market access or on NT is higher than in several other sectors. Member countries preferred commercial presence to cross-border supply.

Also, members tend to have more liberal commitments in banking sector than the insurance sector. For example in Latin America it is more likely to have very liberal

⁵⁰⁰ See Qian, *op. cit.*, at 3.

⁵⁰¹ GATS SCHEDULE OF COMMITMENTS MEXICO, at 3.

⁵⁰² See Sherry M. Stephenson, "Multilateral and Regional Services Liberalization by Latin America and the Caribbean" (OAS Trade Unit/Ser.D/XXII SG/TU/TUS-9, 1st d. Mar. 2001) at 10. It is worth mentioning that in the Financial Services Agreement of GATS (1997) most of the Latin American countries did not make commitments in the banking and insurance sector in the mode 1, 2 and 4. This is because such governments still wanted to have strict control over cross-border flows capital and regulatory controls.

commitments in banking sector and at the same time remain closed in the insurance sector.⁵⁰³ The fact that eastern European countries were among the major players in the process of GATS commitments is mainly because they had previously liberalized their legal frame-works to become recipients of foreign investments, especially in the banking sector.⁵⁰⁴ This legal reform emerged as a result of the harmonization programs that were taken towards the enlargement of the EU.

According to IADB “Financial liberalization makes a financial system function better”. The empirical evidence available, albeit scarce and fragmented, suggests that “the effects of internationalizing the banking system are positive, since banking systems increase their competitiveness and efficiency in particular when foreign banks comes from a more developed country.”⁵⁰⁵ On whether the presence of foreign banks reduces credit volatility there is controversy.⁵⁰⁶ According to IADB, some economists claim that foreign banks are more prone to react to shocks in the host economy given their ability to “substitute local assets with alternative investments abroad that are not easily available for local banks.”⁵⁰⁷

On the other side, it is argued that, because of their access to external funds and consequent increased liquidity,⁵⁰⁸ and the incentive they have to protect their reputation, foreign banks are able to stabilize local deposits. Likewise, the competitive pressure that the entry of foreign banks may generate can lead to measures that guarantee future stability through more aggressive provisioning standards and higher capital ratios.⁵⁰⁹ This was the actual case with Mexico’s financial liberalization experience.

⁵⁰³ See Qian, *op cit.*, at 15.

⁵⁰⁴ See IADB, *Financial...*, *op. cit.*, at 109. Eastern European Countries and Latin America were the major recipients of international capital flows to the banking sector between 1990 and 1998. In Latin America the foreign ownership grew notably between 1994 and 2001.

⁵⁰⁵ IADB, *Financial...*, *op. cit.*, at 112.

⁵⁰⁶ IADB refers to L. G. GOLDBERG, *When Is U. S. Banking Lending to Emerging Markets Volatile?* Staff Reports 119, Federal Reserve Bank of New York (2001); and J. CRYSTAL, G. DAGES, AND L. G. GOLDBERG, *Does Foreign Ownership Contribute to Sounder Banks in Emerging Markets? The Latin American Experience.* Staff Reports 137, Federal Reserve Bank of New York (2001).

⁵⁰⁷ IADB, *Financial...*, *op. cit.*, at 112.

⁵⁰⁸ See L. G. Goldberg, *The Competitive Impact of Foreign Commercial Banks in the USA*, R. ALTON GILBERT, ed., *THE CHARGING MARKET IN FINANCIAL SERVICES* (1992).

⁵⁰⁹ IADB refer to Crystal, Dages and Goldberg, *op. cit.*

In addition to the above, IADB refers to the tendency of foreign banks to follow the more stringent prudential practices of their home countries, which “leads domestic banks as well as supervisors to adopt international standards in order to ease competitive pressure coming from the depositors searching for the safest institutions.”⁵¹⁰ Therefore, foreign banks can be a stabilizing factor because they help to improve the regulatory environment.⁵¹¹

Therefore, on balance, the positive effects of financial services liberalization in the host country out-weight the risk argued above.

Regarding liberalization commitments, in the final agreement (GATS) there is no strong correlation between a member’s actual level of economic or financial sector development and its commitments in the banking sector. GATS has been less successful in the introduction of competition through Mode 3- commercial presence.

Some members showed greater probability in applying restrictions through minority equity and discretionary licensing to protect the position of incumbents. Also, more advanced members tend to withdraw from more liberal commitments in Mode 3 compared to other Modes, perhaps due to the need to protect domestic companies.⁵¹²

This work agrees in general that future liberalization in services would need to take into account also the causes and effects of the financial crises. Nevertheless, since interests of WTO members in liberalizing trade services under GATS lie in long term, short-term concerns should not nullify the long term benefits from liberalization.⁵¹³ However, it is also recognized that there cannot be a complete liberalization of financial services, because this would bring the risk of systemic instability providing financial legal framework it is strong.

⁵¹⁰ IADB, *Financial...*, *op. cit.*, at 122.

⁵¹¹ See Phillip Harms, Aaditya Mattoo *et al* “Explaining Liberalization Commitments in Financial Services,” at 3. For example, in the South Korean case, when they had a liberalization crisis, the government decided to end restrictions on foreign presence, as part of the adjustment program negotiated with the IMF.

⁵¹² See Qian, *op. cit.*, at 17.

⁵¹³ See GALLAGHER, *op. cit.*, at 49.

2.3 A COMPARISON WITH THE EU AS AN EXAMPLE OF PROPER SEQUENCING IN FINANCIAL LIBERALIZATION

Because of NAFTA's benefits for Mexico and the EU's success in economic integration, the Fox administration in Mexico (2000-2006) tried to deepen regional integration.⁵¹⁴ From its beginning, the Fox administration proposed to expand NAFTA to a North American Common Market, as a copy in North America of the EU.⁵¹⁵ However, the proposal has not been followed up by USA and Canada.⁵¹⁶

The example set by the EU continues to be relevant in connection with Mexico's bottom-up approach to liberalization. For this reason, this section will analyze the EU's financial integration and as a comparison of proper sequencing in financial Liberalization.

2.3.1 Banking and Financial Markets in Europe

One of the activities of the EU is the creation of an internal market characterized by the abolition of obstacles to the free movement of the four freedoms mentioned above. In the *Gaston Schul* case, the Court stated that "the aim of the treaty is to eliminate all obstacles to intra community trade in order to merge the national markets into a single market bringing about conditions as close as possible to those of a genuine domestic market."⁵¹⁷

⁵¹⁴ See TARDANICO and ROSENBERG, *op. cit.*, at 257.

⁵¹⁵ See DANIEL LEDERMAN, WILLIAM MALONEY & LUIS SERVEN, LESSON FROM NAFTA FOR LATIN AMERICAN AND THE CARIBBEAN (2005) *op. cit.*, at 177. Lederman *et al* present some important lessons from the EU experience: The accession of Portugal and Spain (1986) was accompanied by a boom in FDI. Between 1980 and 1992, investment inflows rose by a factor of eight in Spain and a factor of six in Portugal. However, the boom was temporary because by the mid 1990s the ratio of FDI to GDP was the same as in the years prior the accession. The reallocation was not an automatic result of accession to EU. In the case of Greece, on the other hand, its accession (1981) was not accompanied by any important changes in FDI, a fact that was attributed to its poor domestic policy during those years and to the lack of structural reforms in strategic sectors such as banking, financial services and foreign investments in general. This suggests that if Mexico had not been sufficiently prepared with proper legal and judicial reform, NAFTA would not have been as beneficial as planned.

⁵¹⁶ See Jennifer E. Harman, *Mexican President Vicente Fox's Proposal for Expanding NAFTA into a EU-Style Common Market—Obstacles and Outlook*, 7 L. & BUS. REV. AM. (2001) at 208.

⁵¹⁷ Case 15/81 *Gaston Schul Douane Expeditie BV v. Inspecteur der Invoerrechten en Accijnzen, Roosendaal* (1982) ECR 1409, paragraph. 33.

Upon laying the foundations for the EU, its creators skilfully used already existing international agreements such as GATT, but also moved a few steps forward. The main ideas and operational procedures of GATT initially inspired the “founding fathers” of the EU, but their vision improved the scope of GATT regarding market integration.

The Treaty of Rome provided the platform for the integration in services (Art. 59), the rights of establishment (Art. 52), free movement of capital (Art. 67) and free movement of workers (Art. 48).⁵¹⁸ In 1992 the Treaty on the EU changed the name from the European Community to EU, with its scope covering, among others, provisions on justice and home affairs.⁵¹⁹

The ECJ passing a verdict on the *Van Binsbergen* case announced that "specific requirements imposed on the person providing the service cannot be considered incompatible with the treaty where they have as their purpose the application of professional rules justified by the general good - in particular rules relating to organization, qualifications, professional ethics, supervision and liability which are binding on any person established in the state in which the service is provided."⁵²⁰

Thus, non-discrimination regulation may be protected under certain circumstances, even though the regulation differs from that imposed by other member states and even though it imposes differential burdens on persons than other member states. The ECJ invalidated here the Dutch residence requirement.

The goal of the EU in financial services was to create a legislative framework that would allow greater integration of financial markets without sacrificing the public policy interests of each member state regarding prudential rules, market stability and consumer protection. The new way of looking on the goods and services in general led to reconsidering the idea's implementation into the financial services area which applied a parallel principle of home country control.

⁵¹⁸ Treaty of Rome Arts. 59, 52 and 48.

⁵¹⁹ J. P. Trachtman, *International Trade in Financial Services under GATS, NAFTA and the EC*, 34 COLUM. JOURNAL TRANSNATIONAL L. (1995) at 59.

⁵²⁰ *Id.*

In spite of the initial economic obstacles that EU encountered in the late 1970s and early 1980s, further advancement followed gradually to end up with the establishment of the internal market by 1992, founded on the judgement of the European Court of Justice in *Cassis de Dijon* of 1979.⁵²¹

The EU's regulatory and supervisory schemes include all the main domains of domestic and cross-border financial services. The programme itself results from different approaches to multinational cooperation in the institution's history and gradual development from ideas of full harmonization, which was supposed to impose entire collections of fixed standards on all of the fields listed in General Programmes falling under the original EEC Treaty, to notions of the *mutual recognition* of agreed standards, which stressed the importance of outlining common minimum standards for all the members in important areas.⁵²²

The EU experience is important because in some countries financial sectors were competitive prior to the single market while in others they were heavily regulated with a major part in hands of the government.⁵²³ To sum up, the EU is a good example of the liberalization in the financial services as a single market.⁵²⁴ Yet, some still believe that the EU is "still a fragmented market,"⁵²⁵ and that in practice it has brought a heterogeneous integration across both, sectors and countries.⁵²⁶

In spite of Schefer's opinions, she also acknowledges that one of the EU's most outstanding achievements was to call into being one single market for banking and

⁵²¹ See WALKER, *EUROPEAN...*, *op. cit.*, at 40.

⁵²² See *id.*, at 11.

⁵²³ See CLAESSENS & JENSEN, *op. cit.*, at 5. For example, Italy, Portugal, Greece, and Spain were heavily regulated.

⁵²⁴ See Trachtman, *International...*, *op. cit.*, at 59. The EU's single passport idea has become greatly exported to other regions, such as NAFTA and MERCOSUR. This objective has been achieved since the Second Banking Directive (SBD) in 1989.

⁵²⁵ See SCHEFER, *op. cit.*, at 261. Schefer and Rogers consider that despite the liberalization in the provision of banking services the integration of the banking market in the EU is far from complete. Also Wijsenbeek a European Parliament deputy from Netherlands said: "Possibly in response to the advent of the monetary union, there was a mergers of financial institutions...however the banking sector is still a highly fragmented market...even the largest European banks do not account for more than one or two per cent of the total volume of banking services at Union level." See also Arthur Rogers, "EU Parliamentarians Weigh Changes to Allow Freer Cross-Border Banking Activity" (70.20 BNA Banking Rep 826; 18 may 1998).

⁵²⁶ See IADB, *Financial...*, *op. cit.*, at 106. While the banking sector deepened its integration process, retail banking remained fragmented and strongly localized. Securities market led to deeper integration but insurance faced obstacles due to legal barriers.

financial services, on which the whole community economic and financial is based. One particular difficulty here is to stabilize the market both at a local and regional level trying to foster the market access within the internal system at the same time.

Appropriate supervision and monitoring are necessary to lessen the vulnerability of the financial sector which is subject to instability due to the interdependence with other members' economies. The organization has been gradually working on the issues of ensuring both the access and the control over it. While doing so, it evolved its approach from the full harmonization to the mutual recognition and minimum harmonization.⁵²⁷

2.3.2 Assessment

Although EU's regulatory and supervisory schemes are of the most advanced in the world FSAP, while evaluating the program and appreciating its achievements, one cannot forget that some issues concerning further development, present frame and substance, together with its successful termination, may demonstrate a few problems. To be fully recognized as an efficient financial scheme it has to address some general integration issues as well as specific financial ones to avoid partial evaluation diminishing its importance or pertinence.⁵²⁸

One of main differences between the EU and NAFTA is that NAFTA is open to any new members. Also, within the range of NAFTA there are no tariffs on trade, although individual external tariffs are sustained. That means that in NAFTA the three countries form a free trade union but not a customs union.

Chapter 14 of NAFTA and its annexes deal with the financial services and ordain unqualified NT but they do not require any harmonization or impose mutual recognition. What they allow is the autonomy of the member countries as far as regulation is concerned.⁵²⁹

⁵²⁷ See WALKER, EUROPEAN..., *op. cit.*, at 12.

⁵²⁸ *Id.*, at 11.

⁵²⁹ *Id.*

As Cranston correctly points out, the aim in the EU is to have a single market in financial services that allows establishing branches in other EU member states and providing financial services across borders. Thus through mutual recognition a bank established in one member state has a “single passport” to establish branches or to provide services in other member state.⁵³⁰ A single license is thus sufficient for the whole EU, instead of each member state requiring its own license.

As said earlier, this directive gave the idea of home country control and minimum harmonization as opposed to full harmonization of regulatory rules. Home country control means that the primary responsibility for regulatory oversight of banking institutions resides with the institutions’ home country supervisors.⁵³¹

The same is with the principle of “freedom of establishment,” which flows from EU Treaty Rights and provides any financial institution in the EC with conducting permitted services in another EC member country. This has become known as the single banking license.

Therefore, the principle of mutual recognition entails recognition by all member states of all of the other member states’ banking laws and regulations.⁵³² This was designed to encourage free trade in financial services without having to harmonize banking laws among all the member states, and its impact has been remarkable.⁵³³ In this sense, participants’ national laws do not have to be fully harmonized and home rules are accepted to govern cross border provisions.

The adoption of minimum harmonization and mutual recognition outside the EU is problematic because its implementation is premised upon a transfer of sovereign

⁵³⁰ See CRANSTON, *op. cit.*, at 433. The passport does not apply to a bank based outside the EU the third country bank must incorporate a “subsidiary” in the Community and be licensed in at least one jurisdiction.

⁵³¹ See IADB, *Financial...*, *op. cit.*, at 112.

⁵³² See WALKER, *EUROPEAN ...*, *op. cit.*, at 199.

⁵³³ OECD, *THE OECD REPORT ON REGULATORY REFORM Vol. I (1997)* at 79 [hereinafter *THE OECD REPORT ON REGULATORY REFORM*].

authority from member states to the EU Commission and such compromise of national sovereignty is impossible to achieve in other contexts.⁵³⁴

In this context, the EU Single Passport idea has become attractive for other foreign banks, such as the USA banks, which having a subsidiary in Europe allow them to use the single passport within the 25 countries.⁵³⁵ However, if the USA bank sets up just a branch, this single passport benefit would not apply.⁵³⁶

EU financial integration has brought the following benefits: a) greater exposure to international competition, b) improved efficiency in financial intermediation, c) more efficient capital utilization, d) development of the financial industry itself and e) better fiscal discipline.⁵³⁷

When establishing any regional trading scheme or treaty, a conflict between easy market access and control inevitably emerges. Together with disappearing current national market levels and diminishing technical and consumer protection to ensure market entry to new incumbents, applicable control mechanisms may be remarkably diminished or completely withdrawn from.

Given the lack of central body exercising its surveillance within the regional integration system, the European Community Treaty faces a strategy void in the matter of supervision. As financial market is extremely susceptible to insecurity, the market regulation is influenced at national or host levels.⁵³⁸

An interesting and complex case involving licensing, regulatory, supervisory and consumer protection issues in the context of the integration of a single EU financial market (and of globalization, for that matter) is that of BCCI which eventually

⁵³⁴ See Jane Kaufman Winn, *National Treatment v. Reciprocity in International Banking: USA and European Community*, J. J. NORTON, CHIA-JUI CHENG, and I. FLETCHER, eds., INTERNATIONAL BANKING OPERATIONS AND PRACTICES: CURRENT DEVELOPMENTS (1994) at 9.

⁵³⁵ The single passport idea is better understood now with the new enlargement.

⁵³⁶ Because the branch is just an office of the parent bank without legal entity and thus it would not be liable, while the subsidiary held a separate legal entity.

⁵³⁷ IADB, *Financial...*, *op. cit.*, at 106.

⁵³⁸ See WALKER, EUROPEAN..., *op. cit.*, at 345.

derived in the *Three Rivers District v. Governor and Company of the Bank of England* litigation.⁵³⁹

2.4 CHAPTER CONCLUSIONS AND CLOSING REMARKS

Liberalization in services in general promotes competition, which is the most effective instrument to lower average costs and increase the quality and variety of services. Latin American countries have been recently coming close to developed countries' levels of competition in some services (such as telecommunications).

From the perspective of the trading system and an examination of tariff reduction by developing countries found that neither regional trade agreements nor multilateral agreements were the driving force in the liberalization. Autonomous liberalization or bottom up approach accounted for 66% of the liberalization, while multilateral agreement 25% and regional agreements only 10%. So unilateral is the most successful way to liberalize. Most recently, over the last six years, 31 countries have implemented important reforms, lowering their MFN tariffs. Such is the case of India, Egypt, Chile and Mexico. The reforms were focused mainly on trade policy.

Unilateral reform or autonomous liberalization has brought many advantages, among them, to promote global competitiveness by lowering costs of inputs, increase competition from imports to drive productivity to growth and integrate the national economy into the global economy.

⁵³⁹ See Appendix 6: *Three Rivers District v. Governor and Company of the Bank of England*. It should be highlighted from the outset that this case falls outside the scope and object of this thesis. The litigation known as *Three Rivers District v. Governor and Company of the Bank of England* (the Three Rivers case for short), was originated by a law suit filed by ex-depositors of the Bank of Credit and Commerce International (BCCI) accusing the Bank of England of insufficient surveillance over BCCI, which resulted in losses of about 10 billion Sterling Pounds for around 6,000 depositors in Britain (including the Three Rivers District Council, Hertfordshire, the Western Isles Council and other authorities in Scotland), after the Bank of England closed down BCCI in July 5, 1991. BCCI SA was incorporated in Luxembourg but had its headquarters in London. Most of BCCI branches in the UK belonged to another corporation called BCCI Overseas, incorporated in Cayman. Back then, the Bank of England was the supreme financial authority in the UK. Yet, because the banks were not incorporated in the UK, it was allegedly unclear whose responsibility was the supervision of the said banks that, nevertheless, had branches and their headquarters in the UK. BCCI was therefore able to exploit the loopholes thus begetting what seems to be the biggest financial scandal in history.

Interestingly, unilateral liberalization has been greatly influenced by RTA's such as NAFTA, in the case of Mexico. In this case, and in attempt to comply with NAFTA obligations, Mexico had to amend several financial and commercial internal laws and regulations, producing in Mexico further autonomous liberalization. As it has been said before, purely top-down legal reform is not viable in the long-term as much has to come from the bottom up. Especially regarding prudential financial standards, active and fully committed country participation is needed from the very beginning.

Keeping in mind that each country represents an individual case, nations may need to adopt solutions that correspond to their different needs and levels of development, as the case of México that will be seen in the next chapter. This means that the initiative for conducting and construing reform in a broader developmental context should rest primarily on the country involved. In the financial sector, the presence of foreign banks provides access to foreign savings, lowers financing costs, enables the transfer of knowledge and technology, and increases the competitiveness, efficiency and diversity of the sector. An open financial system makes it allows better macroeconomic policies and regulation and efficient international allocation of resources. GATS and other WTO agreements pertaining trade in financial services contribute to a process of production of optimal level of financial regulation.

However, developing countries argue that northern countries have opened their markets only when it has been convenient to their interests, while developing countries have made big efforts in liberalization. Also, for some developing countries, deregulation has been associated with financial crises. A weak institutional financial framework makes liberalization more likely to give way to financial crises. Attention should be paid on how to handle the crises and take the correct measures to diminish its effects.

Mexico signed WTO/GATS and its commitments are annexed to its Schedule to GATS. Specific commitments are made according to the four modes of supply for each services sector related: (1) cross border supply, (2) consumption abroad, (3)

commercial presence and (4) free movement of natural persons.⁵⁴⁰ Mexico's commitments set up some deviations from the non-discrimination and NT principles, for example, foreign institutions must obtain authorization from SHCP, and governmental foreign investment is not permitted.

To sum up, GATS is a good step forward in financial services liberalization but is still half way, as there is a limited number of sectors included in national schedules as well as a limited number of overall commitments, especially by developing countries, such as Brazil and Mexico. NAFTA and the EU experience have demonstrated deeper integration than GATS in financial services. EU's FSAP is one of the most complex regulatory and supervisory schemes in the world and includes all the main domains of domestic and sophisticated cross-border financial services.

This author agrees that liberalization in financial services needs to take into account also the causes and effects of financial crises. Therefore there cannot be a full liberalization of financial services because of the risk of systematic instability. Competition must be limited at some point in favor of prudential regulation, as will be seen in the section.

As next chapter shows as well, Mexico's latest approach to liberalization in financial services (after the 1994 crisis) is an example of the aforesaid. Within less than two decades, Mexico went from a government owned banking sector to a liberalized, yet stable and solid, financial system that has been successful in weathering the GFC. This success in stability and resilience has come, nevertheless, at the cost of limiting competition and consequently the ability to achieve a much sought-after financial inclusion.

⁵⁴⁰ Schedule of Commitments Mexico, at 3.

CHAPTER 3:
MEXICO'S DOMESTIC EFFORTS TO DEREGULATE
AND TO PROMOTE FINANCIAL INCLUSION

3.1 INTERNATIONAL FINANCIAL REGULATION, HARMONIZATION AND LIBERALIZATION THROUGH INTERNATIONAL ORGANIZATIONS

3.1.1 Introduction

Institutions, committees and bodies such as IMF, WB, OECD, BIS, BCBS, IOSCO, IAIS, CPSS, CGFS,⁵⁴¹ oversee the international financial system, promoting monetary stability and currency support, and generating common standard rules and regulations in these areas,⁵⁴² and are therefore concerned with the harmonization of financial standards, which can indirectly bring about liberalization.⁵⁴³

3.1.2 Banking Regulation

Governments must regulate banks in order to protect banks' depositors and shareholders, and to provide a safe financial system in general limiting their exposure to risk, thus preventing potential economic or political crises. There are various forms of protection such as deposit insurance, guarantees to shareholders that come and minimum capital requirements for banks (a percentage of their assets) in order to provide with sufficient backup in case of unexpected losses or public panic.⁵⁴⁴

3.1.3 Basel Accord and BCBS

The main international banking committee is the BCBS, created in 1974 as a response to the Bank Herstatt failure⁵⁴⁵ to be forum for regular consultation among banking regulatory authorities from Belgium, Canada, France, Germany, Italy, Japan,

⁵⁴¹ IOSCO was founded with the mission of organizing meetings of securities regulators for wealthy countries (see <http://www.iosco.org>, www.bis.org, www.imf.org, www.worldbank.org, www.oecd.org, www.iais.org). Information produced by the BCBS is provided through the BIS (www.bis.org). EU has also established directives that harmonize the financial regulation among its member states and addresses the issue of regulatory responsibility as shown in this chapter.

⁵⁴² See WALKER, INTERNATIONAL..., *op. cit.*, at 272. As a result of the 1980s and 1990s crises (especially those of Asia, Mexico, and other Latin American countries), the wealthiest countries gathered to enhance and coordinate international economic policy, thus creating G7 comprised by Japan, Canada, France, USA, UK, Germany and Italy.

⁵⁴³ See Mörner Anna, *Financial Services and Regional Integration: A Comparative Snapshot*, 7 LAW AND BUSINESS REVIEW OF THE AMERICAS (fall 2001).

⁵⁴⁴ Thomas Oatley, *The Dilemmas of International Financial Regulation*, REGULATION Vol. 23, No. 4, at 36.

⁵⁴⁵ See WALKER, INTERNATIONAL..., *op. cit.*, at 27.

Luxembourg, the Netherlands, Sweden, Switzerland, UK and USA. It has issued several important documents on banking supervision and regulation,⁵⁴⁶ and represents one of the most successful models for technical cooperation in the complex and sensitive area of finances.⁵⁴⁷

Although initially focused almost exclusively on cross-border supervisory issues (beginning with its 1975 First Concordat), BCBS has also produced a number of common regulatory standards in areas such as capital adequacy, financial derivatives, financial conglomerates, operational and interest rate risk management, electronic banking and bank systems and controls.⁵⁴⁸

Its most significant achievement is perhaps its “1997 Core Principles for Effective Banking Supervision,” which created a full regulatory and supervisory model for national and internationally active banks, as well as for those within G10 and non-G10 countries. This also became the main model for the production of core principles in a number of other key financial areas including securities, insurance, and payment and settlement.⁵⁴⁹

3.1.4 IOSCO

The most important body in the securities area is IOSCO. Originally setup as a North American conference forum (1974) for organizing meetings of securities regulators, it subsequently converted into a full international regulatory organization in 1983. It established a Secretariat in Montreal Canada in 1986; and in 1987 was formed under Quebec law as a not-for-profit organization.⁵⁵⁰

IOSCO has a large direct membership (with over 130 participating countries and national supervisory agencies). It operates through a complex committee structure which includes its President’s Committee, an Executive Committee, an Emerging

⁵⁴⁶ See J. J. NORTON, *DEVISING INTERNATIONAL BANK SUPERVISORY STANDARDS* (1995) at XXV. BCBS rules are known as “soft law.” These are regulations which have non-legal characterization. In other words, they exist outside the officially recognized formal legal sources such as treaties.

⁵⁴⁷ See Walker, *International Banking...*, *op. cit.*, at 26.

⁵⁴⁸ See NORTON, *DEVISING...*, *op. cit.* Yet, BCBS is noted for its legal and procedural informality.

⁵⁴⁹ WALKER, *INTERNATIONAL...*, *op. cit.*, at 26.

⁵⁵⁰ Trachtman, *International...*, *op. cit.*, at 43.

Markets Committee and a Technical Committee (which parallels the BCBS in the banking area) as well as four regional committees (Asia-Pacific, Interamerican, Africa/Middle East and Europe). IOSCO has issued a large number of documents in specific securities and exchanges and subsequently market related areas.

3.1.5 Basel II - The Emergence of the New Regulation of Banking: The Privatization of the Regulation?

Some new features of the new paradigm of regulation (from the implementation of the New Basel Capital Accord) have arisen, such as delegation of duties to informational intermediaries. These intermediaries are risk rating agencies and account professionals who have the task of monitoring and enforcing regulatory goals.

This situation remains complex since the regulatory incorporation of private sector elicits new questions of public policy, as well as the question whether informational intermediaries should be subject to more extensive regulatory systems and regulators should focus on regulating professional bodies which hold the key to good governance and implementation of substantive regulation.⁵⁵¹

3.1.6 Mexico's Successful implementation of International Financial Standards at Unilateral Level: The Bottom-up approach to prudential liberalization

The adoption, by the Mexican financial groups that owned banks, of the GAAP and BCBS principles from 1994 and onwards, strengthened and made them attractive to foreign firms. Those changes are analyzed by comparing banking indicators and by comparing the international and the Mexican banking regulatory principles.

The internationalization of the Mexican financial system, in general, and of its banking sector in particular, is a relatively recent phenomenon, which came as an aftermath of the 1994-95 financial crisis. This was part of a reorganization strategy for the recovery of the financial system, justified as a measure to secure the public's

⁵⁵¹ See Mahmood Bagheri, *Informational Intermediaries and the Emergence of the New Financial Regulation Paradigm*, 24 (11) THE COMPANY LAWYER (2003).

deposits and recapitalization of the existing banks, many of which were in trouble. It was necessary in order to make possible the bailout of the banking sector.

Allowing foreign capital to invest in larger proportions in Mexican banks quickly changed the distribution of shares between Mexican and foreign capital. On December 1996 (right before the new regulation on foreign investment came into effect) only 7% of the total shares of Mexican banks were in hands of foreigners. Just three months later, by March 1997, 17% of shares were owned by foreigners.

As of June 2008, 19 of 32 Mexican private banks were controlled by foreign capital, including the most important private banks: Bancomer, BANAMEX, and (then) Banca Serfin. Chart 2 shows the Chronology of the first wave of acquisitions and mergers of private Mexican banks by foreign firms.

Chart 2		
Chronology of Mergers and Acquisitions of Mexican Banks by Foreign Firms⁵⁵²		
Date	Foreign Bank	Mexican Bank
May 30th, 1995	BBV	Banco Mercantil Probusa
August 9th, 1996	BBV	Banca Cremi and Banco Oriente
March 18th, 1997	Santander	Grupo Financiero Serfin
May 16th, 1997	Santander	InverMexico and Banco Mexicano
August 27th, 1997	Citibank	Banca Confia
May 8th, 1997	Santander	Grupo Financiero Serfin
March 30th, 2000	Nova Scotia Bank	Grupo Financiero Inverlat
June 29th, 2000	BBVA	Grupo Financiero Bancomer
May 17th, 2001	Citibank	Grupo Financiero Banamex
December, 2002	HSBC	Grupo Financiero Bital

At the same time (January 1997), new accounting principles were adopted, which modified some concepts such as loans and overdue accounts. Market to market value

⁵⁵² See Bubel and Skelton (2002) and <http://woodstockinst.org>

analysis was introduced; and inflationary effects were taken into account in bank accountings. One of their aims is to provide clear and accurate information the markets. It is believed that GAAP rules contributed to accelerate the internationalization of bank management practices in Mexico, as they made it possible to compare Mexican banks against their international counterparts.

In this way the financial system was concentrated and capitalized between 1998 and 2003. The financial system reached systemic stability due to a reduction in competition among the banking institutions. The analysis on the intermediaries' financial performance is done by implementing profit and banking operation indicators. Particularly, the profit analysis is made by means of financial margin estimation and the total interest, while the operational analysis is done based on administrative costs over assets ratio.

The bank loans to the private sector and the unpaid credits of Mexican banks decreased after the internationalization. This is relevant since the origins of the banking crisis of 1994-95 are related to inappropriate policies related to credit expansion and unsuitable accounting practices. Starting in 1998, housing commercial loans and delinquent loans were reduced.

Mexican banks have been ever since more risk adverse in the long run. Therefore, financial globalization brought, as benefits to the Mexican economy, greater systemic stability, higher profitability and efficiency for banks, and most likely better authorization practices and higher loan repayment rate.

In México, the regulation and risk management practices are differentiated according to the type of financial intermediation activity. The difference in Mexico assumes that the intermediaries carry on their activities in a very specialized approach so as to guarantee the stability and performance of the financial system performance, which justifies the existence of institutional practices and specialized regulation for banking intermediaries as well as for non banking intermediaries, in addition to the existent common practices for any other institutions. (See Chart 3).

Chart 3

REGULATION AND RISK MANAGEMENT IN MEXICO⁵⁵³		
Institution type	Risk Management Memoranda	Issued by
Commercial banks	1423	CNVB
Development banks	1473	CNVB
Securities Brokers	10-247	CNVB
Insurance companies	S-11.6	CNSF
Retirement funds	51-1	CONSAR
All	31 BANXICO guideline to operate in the derivatives market	BANXICO

Bank management in Mexico adopted gradually and increasingly the definitions and development of international practices, especially after the 1994-1994 crisis. At the regulatory level, the globalization of the Mexican financial system started in 1994 with the implementation of BCBS (1988) recommendations, which imposed international standard to measure the solvency and performance of Mexican banks.

Internationally, the creation of new financial instruments and the risk position enlargement in the markets throughout the 1990s led to better risk management. Toward that end, BCBS rules were updated in November 2005. Although originally meant to be regional, BCBS's recommendations have reached global dimensions in practice. Ever since, management practices and bank risk regulations have been influenced by Basel II, which is recognized by more than 130 countries, including Mexico, as well as by IMF and WB. The Mexican financial system had no trouble adopting Basel II, since its regulation has been very strict after the "Tequila Crisis."

⁵⁵³ KPMG (2005).

Chart 4

BASEL AGREEMENTS INSTRUMENTATION IN MEXICO			
Date	Basel	Mexico	Contents
July 1998	Capital Agreement		Capital measures and standards to acquire international convergence.
July 1994		Rules on capitalization requirements (SHCP) Memorandum 2019/95 (BANXICO)	This regulation aim to assure a given "regulatory capital" which would face the banks duties regarding the economic crises.
Sept. 1995			The 31 requirements to participate in the derivative market are presented and it intend to minimize insolvency risks and the financial system liquidity.
June 1999	First document		First consultancy document. The new agreement consists in three core principles: minimum capital requirement, supervision process and effective market discipline implementation.
Nov. 1999		Memorandum 1423 (CNBV)	Prudential dispositions in terms of integral risk Management.
Jan. 2001	Second document		Second consultancy document. Internal methodologies are emphasized, into market disciple supervision. It is more flexible and induces to better risk management.
Feb. 2001		Memorandum 1480 (CNBV)	Methodology used by commercial banks to evaluate the given loans.
Oct. 2002	Third Quantitative Impact study (QIS)		Technical orientation on the quantitative impact study to estimate the impact of the new agreement in the given loans.
Nov. 2002	Third document	Memorandum 1506 (CNBV)	Prudential dispositions for internal control.
April 2003			Third consultancy document. Reform recommendations regarding regulation and supervision of the financial system, emphasizing quality management and banking risk administration.
June 2004	New Capital Agreement or Basel II		Important recommendations focused on measurement and control including financial risks (liquidity, interest rate, exchange rate) as well as operative risks. It is of remarkable importance the politics, processes and procedures evaluations for the risk management.
July 2004		Modifications C-1423 (CNBV)	Prudential dispositions in terms of integral risk Management Basic principles related to this management and mechanisms that allow activities that involve risk levels linked to the net capital and operative capacity. Derogation of the C-1423.

Ever since, Mexican regulation has aimed to reduce information asymmetry problems and improve risk management. Specially, information problems are confronted by implementing early warning systems and market discipline. The adoption of these systems aims to detect and prevent capitalization problems and banks' insolvency. Market discipline changes seek the homologation of the information must be revealed and published by the banks to analyze their solvency and financial situation.

The Mexican directives on risks (CNBV 2004a and 2004b) are in agreement with BCBS's principles. The purpose is to have time series to analyze the mentioned events via financial modelling. Regarding credit risk, the guidelines allow grading the portfolio by the types of credit it contains and also establishes methodologies to define risk estimations and the possibility to implement internal methodologies. This regulation became compulsory in Mexico in 2007.

In order to guarantee that banks are duly capitalized (which is necessary to protect the public that trusts their savings or investments to their hands), and to promote financial stability (which is also necessary to promote economic development), Mexican financial authorities and the ABM agreed to adopt the New Capital Agreement (NCA) stated by Basel II.

The aim of the BCBS is to elaborate a new agreement for the adequate capital ratio in the banks. In order to strengthened them and assure stability, by means of adopting of risk management practices more strict and precise. This effort was officially stated in the document entitled "International Measures and Capital Standards convergence, reviewed framework" which contains the principles and standards usually named as Basel II or NCA.

Among Basel II core purposes are the establishment of principles and standards, to reflect with precision and sensitivity the effects on the banks capital due to the risks that the intermediaries face. Such as: credit risk, market risk and operational risk.

The NCA has three core principles. Principle 1 is “Minimum Capital Requirement.” For credit risk, four aspects are considered: 1) Standard simplified focus; 2) Standard focus; 3) Basic internal qualification focus; and 4) Advanced internal qualification focus. For the operational risk, four focuses are also taken in account: 1) Basic indicator focus; 2) Standardized focus; 3) Alternative Standardized focus; and 4) Advanced Measurement focus.

Principle 2 is “Supervision process” and refers to a higher independency level and institutional autonomy. The supervisor may request the banks to maintain a capitalization level above the minimum. Principle 3 is “Effective use of market discipline” and encourages the implementation of best practices when information is revealed, so that the market and society have the tools to evaluate the banks’ financial condition.

Mexican financial authorities considered the following key points to implement Basel II: 1) All financial institution had to implement at least the Standard Focus when calculating credit risk of capital requirement. As for the operational risk, banks had to adopt the Basic Indicator Focus with the option of using the Standard method or the Alternative Standard method. Regarding market risk, banks may use the internal model to determine the risk value. 2) Communication channels with external financial entities were established, in order to coordinate the transitions to Basel II. 3) The following chronogram was considered to implement the NCA in Mexico, in order to operate synchronized with the best international standards and thus embrace a healthy and progressive development.

Chart 5

SUBJECT	DATE
Principle 1: “Minimum Capital Requirement”	
a. by credit risk	
Standard focus	January 2007
Basic internal qualification focus	January 2007
Advanced internal qualification focus	January 2008
b. by operational risk	
Basic indicator focus	January 2007
Standardized focus	January 2007
Alternative Standardized focus	January 2007
Principle 2: “Supervision process”	
Adoption of Principle 2	January 2007
Principle 3: “Effective use of market discipline”	
Adoption of principle 3	January 2007

3.1.7 Basel III and Its Implementation in Mexico

“At its 12 September 2010 meeting, the Group of Governors and Heads of Supervision, the oversight body of the BCBS, announced a substantial strengthening of existing capital requirements,”⁵⁵⁴ in response to the global financial crisis. Immediately upon that announcement, both BANXICO and CNBV “expressed confidence that the banks would meet the new requirements ahead of time.”⁵⁵⁵

In a press communiqué, BANXICO said:

For the particular case of Mexico, the new accord will not represent as profound changes and those that the banks of other countries will have to face. This, because, after the 1994-1995 financial crisis in Mexico, a new and very demanding regulatory framework was established in the

⁵⁵⁴ BIS, “Group of Governors and Heads of Supervision announces higher global minimum capital standards” (Sep. 12, 2010); available at: <http://www.bis.org/press/p100912.htm>

⁵⁵⁵ Adam Thomson & Jonathan Wheatley, *Mexico and Brazil confident on capital rules*, FINANCIAL TIMES (Sep. 13, 2010); available at: <http://www.ft.com/cms/s/0/0a5fa210-bf66-11df-965a-00144feab49a.html>.

area of capitalization, both for the amounts of required capital, as for the quality demanded for such capital. It is for this that banks in our country will not have to make extraordinary efforts to fulfill with the new regulatory parameters.

This is also why the country's credit institutions [banks] will be able to meet the new demands before the end of the international transition period, which goes up to 2019.

It is pertinent to point out that the decisions made in the country in the past on bank capitalization were appropriate, as they made possible that our credit institutions were not contaminated by the deterioration of the foreign banking systems. This is confirmed by the fact that the new global regulatory framework is close to the one applied in Mexico.

[SHCP, CNBV and BANXICO] will work on the implementation in our country of the new accord with the intent of starting its public discussion during the first semester of 2011.⁵⁵⁶

In fact, Mexico's banks were so very well capitalized by the time Basel III was announced, that as of August 2010, the Mexican banking sector "had a capital ratio index of 13 per cent, a calculation that used similar methodology to that of the new Basel requirements."⁵⁵⁷

3.1.8 Balance between Liberalization and Financial Supervision and Regulation.⁵⁵⁸

Liberalization is understood as the "freedom to engage in economic activity at home and/or abroad, a freedom subject to institutional and policy constraints needed to guarantee public interests at large."⁵⁵⁹ Such constraints are the object of financial regulation and supervision, and one of the larger public interests it aims to guarantee is financial stability.

⁵⁵⁶ BANXICO, "Comunicado de prensa: Estableció hoy el Comité de Basilea para Supervisión Bancaria estándares más Exigentes a Nivel Mundial" [Press Communiqué: The Basel Committee for Bank Supervision Established Today More Demanding Standards at World Level] (Sep. 12, 2010) at 2; available at:

<http://www.banxico.org.mx/informacion-para-la-prensa/comunicados/miscelaneos/boletines/%7B082605CD-1EC1-29AC-795A-9ED990B1E939%7D.pdf>.

⁵⁵⁷ Thomson & Wheatley, *Mexico...*, *op. cit.*

⁵⁵⁸ Trachtman, *International...*, *op. cit.*, at 59.

⁵⁵⁹ Victor Ognitsev, "Economic Liberalization as a Driving force of Globalization: Experiences of Countries in North and Central Asia" (United Nations Conference on Trade and Development, Sep. 29, 2005) at 4.

History proves that both poles are necessary and should coexist in order to have a healthy and prosperous global economy. For instance, the 2008 financial crisis was due to excessive borrowing, lending and investment, principally in the context of the market for subprime residential mortgages in the USA; such excesses impacted globally in every market and asset class.⁵⁶⁰ Before that, the Asian Financial Crisis of 1997 and 1998, caused mainly by improper regulatory systems in real estate; the collapse of the Long Term Capital Management (“LTCM”), the world’s largest and most famous hedge fund by 1998, among others.

As a response to the global financial crisis, in April 2008, FSF issued a report on regulatory reforms including the following areas: (i) prudential oversight, especially capital, liquidity and risk management; (ii) transparency and valuation; (iii) role and uses of credit ratings; (iv) authorities’ responsiveness; and (v) arrangements for dealing with financial stress.⁵⁶¹ In October of 2008, FSF reaffirmed the regulatory reforms proposed in April, but also focused on:

- (1) international interaction and consistency of emergency arrangements and responses;
- (2) mitigation of pro-cyclicality, including in the context of capital, loan-loss provisioning, compensation and valuation / leverage;
- (3) addressing the scope of financial regulation to emphasize currently unregulated aspects; and
- (4) better integrate macroeconomic oversight and prudential supervision.⁵⁶²

In accordance to the abovementioned proposals, on November 15, 2008, G20 issued the Declaration Summit on Financial Markets and the World Economy in which Finance Ministers and Central Bank Governors analyzed the causes of the global crisis and established common actions and principles for reform of financial markets, such as: (i) Strengthening Transparency and Accountability; (ii) Enhancing Sound Regulation; (iii) Promoting Integrity in Financial Markets; (iv) Reinforcing International Cooperation; and (v) Reforming International Financial Institutions.⁵⁶³

⁵⁶⁰ Douglas W. Arner, “The Global Credit Crisis of 2008: Causes, Consequences and Implications for Financial Regulation” (Asian Institute of Financial Law Working Paper No. 3) at 1.

⁵⁶¹ *Id.*, at 24.

⁵⁶² *Id.*, at 25

⁵⁶³ G-20, *Communiqué*, “Declaration Summit on Financial Markets and the World Economy,” (Nov. 15, 2008).

Therefore, liberalization of financial services should never mean the elimination of prudential regulation and supervision aimed at preventing systemic instability and, therefore, at the preservation of the liberalized financial system. Prudential regulation aimed at the preservation of the financial system by preventing systemic instability must be maintained even if in some cases it can bring about consequences reckoned as anticompetitive.⁵⁶⁴

GATS Art. VI endorses such criterion.⁵⁶⁵ According to GATS, a member may eventually discriminate or restrict market access if it is done for prudential reasons. However, this shall not be used as a means for avoiding the member's commitments or obligations under the agreement.⁵⁶⁶

*Fireman's Fund v. United Mexican States*⁵⁶⁷ was "the first case under the NAFTA to be heard under Chapter Fourteen, devoted to cross-border investment in Financial Services,"⁵⁶⁸ and serves as a good example of how financial services freedom is to be limited in favor of prudential regulation.

In October 2001, Fireman's Fund Insurance Company [hereinafter Fireman's Fund], a USA corporation that sells personal and fire insurance, filed a notice of arbitration against Mexican government. Fireman's Fund claimed that Mexico violated Arts. 1102, 1105, 1110 (Chapter 11) and 1405 (Chapter 14) by facilitating the purchase of debentures denominated in MXN and owned by Mexican investors, but not the purchase of debentures denominated in USD and owned by Fireman's Fund; despite both series were issued at the same time and for USD\$50 million.⁵⁶⁹

⁵⁶⁴ Mahmood Bagheri and Chizu Nakajima, at 518.

⁵⁶⁵ Together with Art. VI. Also Arts. XIV, II, XVII recognize the right of the member states to regulate financial services. See GATS/WTO THE LEGAL TEXTS.

⁵⁶⁶ Hamid Mamdouh, "The GATS and Financial Services" (class presentation, 2005) at slide 7. Typical prudential measures are: (i) Capital adequacy ratios and solvency margin requirements; (ii) Requirements for preserving asset quality; (iii) Liquidity ratios; (iv) Control of market risk; (v) Check of management controls; and (vi) Fit and proper tests for members of the board of directors.

⁵⁶⁷ For analysis of this case, see *infra* Chapter V.

⁵⁶⁸ *Fireman's Fund v. Mexico* –Award, ICSID Case No. ARB(AF)/02/01 (Redacted Version), at paragraph 1; available at http://www.naftalaw.org/Disputes/Mexico/Fireman/FiremansFund-Mexico-Final_Award.pdf [hereinafter *Fireman's Fund v. Mexico*]

⁵⁶⁹ US DEPARTMENT OF STATE, *Fireman's Fund v. United Mexican States*, available at: <http://www.state.gov/s/l/c5817.htm>.

Fireman’s Fund claimed that expropriation under NAFTA includes deprivation of the use and value of its investment, so Mexico, by permanently depriving Fireman’s Fund of the use and value of its investment expropriated it within the meaning of Art. 1110 of NAFTA, and that it did not receive fair market value for its investment (USD\$50 million).⁵⁷⁰

On the other hand, Mexico contended that emergency measures taken by its government to handle the crisis, and contested by Fireman’s Fund, concerned prudential measures authorized by Chapter Fourteen of NAFTA, particularly Art. 1410.⁵⁷¹ In other words, Mexico argued that all the measures it took to handle the crisis were actually “reasonable measures for prudential reasons” covered by the understanding of Art. 1410 (Exceptions) of the NAFTA.

The Tribunal expressed that the Fireman’s Fund’s claims brought under Arts. 1102, 1105, and 1405 of NAFTA were not within its competence, so it would only know of Art. 1110 and, thus, Fireman’s Fund’s allegation related to the expropriation suffered.⁵⁷²

Furthermore, the Tribunal noted that the article invoked by Mexico is entitled “Exceptions”, thus it provides that measures usually prohibited in Part Five of NAFTA (e.g. comprising Chapter eleven and Chapter fourteen) would not be transgressing of it if they meet the requirements of “reasonable measure taken for prudential reason”.⁵⁷³

The claimant leveled as argument that if a mean is unfavorable, it cannot be treated as reasonable and thus, it is included under the regulations of the NAFTA. Mexico declared that Claimant misunderstood Art. 1410 and should not bring the claim of discrimination under Chapter Fourteen as it is obviously exempted from it.

Finally, the Tribunal concluded that the exception applied to all regulations of Part Five “Investments, Services and Related Matters” of the NAFTA relevant to

⁵⁷⁰ See *Fireman’s Fund v. Mexico* at 103, 106, and 107.

⁵⁷¹ *Id.*, at 120.

⁵⁷² *Id.*, at 143, 147.

⁵⁷³ *Id.*, at 159.

Financial Services comprising the NT article (Art.1405) according to Art. 1410(1), allowed to implement sensible measures of a prudential character even though their effect could be biased. Hence, the Tribunal refused to treat a measure discriminatory in effect as by that fact unreasonable.⁵⁷⁴

Having being a chief negotiator of the Financial Services Chapter of the NAFTA as a representative of the United States, Olin L. Wethington wrote in his book FINANCIAL MARKET LIBERALIZATION that Art. 1410(1) (a), bypassing NT and other obligations, ensures the right to apply reasonable measures in order to protect the security and stability of the financial system, even though the implementation of the tool can be discriminatory.⁵⁷⁵

Wethington emphasizes that exceptions include only sensible measures, e. g. connected with capital adequacy, loan loss reserve requirements, cash reserve and liquidity requirements. But, focusing on Mexico, he adds that the exempted means cannot be utilized as a disguise for discriminating USA or Canadian incumbents or for making discretionary judgments as to granting licenses and assessing particular firm applications.⁵⁷⁶

⁵⁷⁴ *Id.*, at 161-162.

⁵⁷⁵ *Id.*, at 163.

⁵⁷⁶ *Id.*, at 164.

3.2 FINANCIAL INCLUSION IN MEXICO

3.2.1 Some background information

One complaint raised against the shape the Mexican private banking sector took after the reforms carried out between 1995 and 2006, and the changes those brought about, is that it was a highly concentrated sector that lacked enough competition, which consequently discouraged or even excluded potential users.⁵⁷⁷

This was one of the motivations for changes made to the LIC between 2007 and 2008, which allowed smaller specialized banks (“niche banks”) to be authorized with smaller requirements and for banking operations to be carried out by means of non-banking agents on behalf of the banks. The complaint decreased in frequency and intensity after the said changes but has not ceased to be a favorite theme of leftists, and anti-market, anti-globalization voices, who blame the problem on the re-privatization of banks and on allowing foreign firms to control them.⁵⁷⁸

⁵⁷⁷ At the time of NAFTA's negotiation only 8% of the Mexican population had a checking account and there were an average of 18,500 people per banking branch in Mexico as opposed to approximately 2,000 people per branch in the USA and Canada. See Cally Jordan, *Financial Services Under NAFTA: The View From Canada*, in 9 REVIEW OF BANKING AND FINANCIAL SERVICES (Mar. 24, 1993), at 52, n.43. Cited in Eric J. Gouvin, *Banking in North America: The Triumph of Public Choice over Public Policy*, 32 CORNELL INTERNATIONAL LAW JOURNAL (1998), at 14; available at: http://assets.wnec.edu/78/cornell_international.pdf.

⁵⁷⁸ See, for example, the heavily editorialized rendering of a news-clip published by leftist magazine PROCESO. Under the title “IPAB Calls Upon Banks to Reactivate Loans,” the magazine opens the news report saying: “Due to the great banking concentration and the low amount of loans toward firms in Mexico, ...[IPAB] urged banks to a greater opening-up to competition.” (“Llama IPAB a la banca a reactivar el crédito,” PROCESO (Jun. 10, 2010); available at: <http://www.proceso.com.mx/rv/modHome/detalleExclusiva/80228>.) Nevertheless, the actual speech of María Teresa Fernández Labardini (IPAB's Executive Secretary), referred by PROCESO as source, contains no reference whatsoever to “banking concentration” (speech available at: http://www.ipab.org.mx/foro_estabilidad_economica/documentos/presentaciones_ok2/DiscursoMTFL.pdf). Likewise, the reference to competition is not an “urge” to “open up,” but a matter of fact statement that, “being a common objective of financial authorities and the sector, it is important for banks to grant loans, come close to the client to compete and return to the traditional manner of doing the receiving and lending business.” A few paragraphs later, the speech touches again on competition saying. In order Unlike the implication that PROCESO's news-clip conveys the speech implies that there are competition conditions that are not being exploited by the competitors. IPAB acknowledges that “banking credit to the non-financial private sector grew at an average rate of 16%” between 2004 and 2009, but notices that as of March 2010, it was contracted by 6.1%. The real problem that IPAB addressed in this speech (and that other financial authorities have been addressing between 2009 and 2010) is the underdevelopment of the Mexican banking sector.

Therefore, before addressing directly the question of financial inclusion in Mexico, the question of whether Mexico's concentration and competition levels are acceptable is addressed.

Much is being said and written on the subject of "financial inclusion" (broadly speaking), but the several terms used and their varying meanings are so ambiguous, that the lack of uniformity hinders accurate academic discussion on what the problem is, what are its causes, and therefore how to solve it. The way in which the issue is defined or understood determines the approach taken and the suggestions made to tackle the problem.

This hindrance to proper research is first shown and analyzed, followed by the identification of a more circumscribed understanding of the problem in Mexico's peculiar case, which is supported by data generated by Mexican authorities that have worked more (and more recently) on the issue.⁵⁷⁹

Lastly, the legal and institutional frameworks in which the challenge of financial inclusion is being addressed in Mexico's particular case is identified, and the actions that have been (and continues to be) carried out by the Mexican government according to it, are explained and its results reported.

3.2.2 Concentration in the Banking Sector

3.2.2.1 Whether Concentration in the Banking Sector is Good

According to the Federal Reserve of the USA, unlike other sectors of the economy, over-competition in the banking sector may generate unstable and fragile systems during economic crises.⁵⁸⁰ In fact, oligopolistic banking systems are more stable

⁵⁷⁹ Shortly before submitting this work to revision more data relevant for the matter of financial inclusion was released, most of which was used to shape this section but not necessarily quoted.

⁵⁸⁰ See WILLIAM GRUBEN and ROBERT MCCOMB, "Privatization, Competition, and Supercompetition in the Mexican Commercial Banking System" (Research Department Working Paper (US) 99-04; Federal Reserve Bank of Dallas, 2009).

since the presence of numerous competitors encourages riskier behaviors and lower levels of credit prudence.⁵⁸¹

Increasing competition may lead to a natural concentration on the profitable clients, consequently turning uneconomic to provide services to less profitable clients, when more resources have to be destined to beat competitors. In fact, PricewaterhouseCoopers recently concluded that “A very aggressive competition policy and social inclusion are mutually exclusive.”⁵⁸²

There are studies that demonstrate the positive relationship between consolidation and competition.⁵⁸³ In the EU banking deregulation and the promotion of transnational financial services generated a larger banking concentration that had as a result more competition in the sector.⁵⁸⁴

3.2.2.2 Recent History of Banking Concentration in Mexico

At the time of the “Tequila Crisis” (1994), there were 19 banks in Mexico. By 1996, after the amendments made to open unilaterally the financial sector to foreign investment, there were 40 private banks. By 2002, the number decreased to 32.⁵⁸⁵ Yet, at the end of 2010, there were 41 banks in Mexico.⁵⁸⁶ Therefore Banking concentration in Mexico has decreased over 15 years following the “Tequila Crisis.”

⁵⁸¹ NICOLA CETORELLI and PIETRO F. PERETTO, “Oligopoly Banking and Capital Accumulation,” (Federal Reserve Bank of Chicago Working Paper No. 2000-12).

⁵⁸² BBA, “Promoting financial inclusion – The work of the Banking Industry” (2000). Citing PricewaterhouseCoopers, “The breaking wave” (Feb. 2000). According to BANXICO, there is evidence that during the period between the re-privatization and the 1994 crisis, “an intense competition was generated in all the segments of the banking market. As was to be expected, this larger competition induced a decrease in the indexes of banking concentration at least in three realms: deposits, loans, and securities” (Turrent, *op. cit.*, at 29).

⁵⁸³ Edward P. Gardener, B. Moore Molyneux, and L. A. Winters, *The Impact of Single Market Programme on EU Banking: Select Policy Experiences for Developing Countries*, CLAESSENS and JANSEN, *op. cit.*

⁵⁸⁴ Xavier Vives, *Lessons from European Banking Liberalization and Integration*, CLAESSENS and JANSEN, *op. cit.*

⁵⁸⁵ Gerardo Esquivel, “Competencia en el Sector Bancario en América Latina,” at 5; available at: http://www.segib.org/upload/File/Gerardo_Esquivel.pdf

⁵⁸⁶ See CNBV, “Padrón de Entidades Supervisadas”(2010); available at: <http://www.cnbv.gob.mx/Bancos/Paginas/PadroneEntidadesSupervisadas.aspx>.

The figures above do not take into account other entities that are legally authorized to render basic financial services under the regulation and supervision of CNBV such as government development banks and popular thrift and loan entities.

3.2.2.3 Mexico's Banking Concentration Levels

Mexico banking concentration levels are within the international average. Countries such as Germany, Belgium, Denmark, Spain, France, the Netherlands, Sweden and Uruguay, among others, have much more concentrated banking systems than Mexico.⁵⁸⁷ As of 2006, "Of 105 countries for which data on bank concentration were available for 2005, 85 had three-firm concentration ratios above 50%, 53 above 75%, and 31 above 90%."⁵⁸⁸

As of October 2007, BANXICO's assessment of the Mexican banking sector was that:

The most visible tendency has been toward the entrance of a larger number of participants in the market. The authorization of new multiple banks⁵⁸⁹ has derived largely from a deliberate policy adopted by the authorities in order to allow the conformation of new banks looking for a very desirable end: to induce more competition in the sector. With that it is sought not only to reduce the fees of services but also to narrow the margins of intermediation.⁵⁹⁰

3.2.3 Ambiguity of the Terms used in Discussing Financial Inclusion

WB bank uses interchangeably and synonymously the terms "financial inclusion," "access to finance," "inclusive financial systems," "access to financial services," "broad access to financial services," and "improving access,"⁵⁹¹ but the meaning of

⁵⁸⁷ See

<http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:20696167%7EpagePK:64214825%7EpiPK:64214943%7EtheSitePK:469382,00.html>. The document referred is no longer available on this link which now contains updated data.

⁵⁸⁸ Kevin Davies, "Banking Concentration, Financial Stability and Public Policy"; available at <http://www.rba.gov.au/publications/confs/2007/davis.pdf> (based on WB data, 2006).

⁵⁸⁹ "Banca multiple" is the technical terms used by Mexican law to refer to private banks which render multiple services to a variety of users.

⁵⁹⁰ Turrent, *op. cit.*, at 36; available at: <http://www.banxico.org.mx/sistema-financiero/material-educativo/basico/%7BFFF17467-8ED6-2AB2-1B3B-ACCE5C2AF0E6%7D.pdf>.

⁵⁹¹ FINANCE FOR ALL? at ix, 1-2, 7-8, and 21-24, 27, 28.

such terms is at best ambiguous. In WB's literature these terms refer sometimes merely to "improving the degree to which financial services are available to all at a fair price,"⁵⁹² or the "absence of price and non-prices barriers in the use of financial services."⁵⁹³

In other instances such terms refer merely to having "an account with a financial institution,"⁵⁹⁴ while other times they mean actually getting loans and other financial services and products,⁵⁹⁵ and even having financial services "available when and where desired, and products... tailored to specific needs."⁵⁹⁶

Taking a different approach, the BBA has used a better and more realistic explanation. For the BBA, "promoting financial inclusion" involves four elements: 1) Trying to make sure that an assortment of appropriate financial services is available for all; 2) Helping people to understand those services and to have access to them; but also, 3) Acknowledging the solutions have to be profitable (otherwise they

⁵⁹² *Id.*, at 28.

⁵⁹³ *Id.*, at 22 and 27.

⁵⁹⁴ *Id.*, at ix.

⁵⁹⁵ *Id.*, and: "One of the important channels through which finance promotes growth is the provision of credit to the most promising firms... Many firms, particularly small ones, often complain about lack of access to finance" (at 7); and: "Access to finance, and the institutional underpinnings associated with better financial access, favorably affects firm performance along a number of different channels. Improvements in the functioning of the formal financial sector can reduce financing constraints for small firms and others who have difficulty in self-financing or in finding private or informal sources of funding. Research indicates that access to finance promotes more start-ups: it is smaller firms that are often the most dynamic and innovative. Countries that strangle this potential with financial barriers not only lose the growth potential of these enterprises but also risk missing opportunities to diversify into new areas of hitherto unrevealed comparative advantage. Financial inclusion also enables incumbent firms to reach a larger equilibrium size by enabling them to exploit growth and investment opportunities. Furthermore, greater financial inclusion allows firms the choice of more efficient asset portfolios as well as more efficient organizational forms, such as incorporation" (at 7-8). Among some of the definitions of financial inclusion recently attempted by "different initiatives," the 1ST REPORT ON FINANCIAL INCLUSION IN MEXICO lists the following: "Financial inclusion means having access to a set of financial products and services that include credit [loans], savings, payment system, pensions, as well as financial education and consumer protection." It adds under such definition that "The products and services have to be attainable, of high quality, and available within physical and sustainable proximity" (1ST REPORT ON FINANCIAL INCLUSION IN MEXICO at 14).

⁵⁹⁶ *Id.*, at 22. Several pages below the cited statement, WB qualifies it saying that, "Of course this does not mean that all households and firms should be able to borrow unlimited amounts at prime lending rates or transmit funds across the world instantaneously for a fraction of 1 percent of the amount" (at 27). Along similar lines, another of the definitions listed by the 1ST REPORT ON FINANCIAL INCLUSION IN MEXICO for financial inclusion says it is, "Universal and continuous access of the population to diversified financial services, adequate and formal, as well as the possibility of using them according to the needs of the users to contribute to their development and wellbeing" (at 14).

will not work);⁵⁹⁷ and 4) Acknowledging that some people will opt to exclude themselves.⁵⁹⁸

Meanwhile, the AFI and the Mexican government refer to “access to financial products and services” as merely “a first component of financial inclusion,”⁵⁹⁹ thus giving the impression that for them “financial inclusion” comprehends more ambitious state of affairs than the one described by WB’s concept of “financial inclusion” and “access to finance”. Nevertheless, a few pages further into the document cited, the 1ST REPORT ON FINANCIAL INCLUSION IN MEXICO contradicts its own earlier statement by adopting as working definition the following:

Financial inclusion refers to the access and use of a portfolio of financial products and services that reaches the majority of the adult population with clear and concise information in order to satisfy the growing demand, under an appropriate regulatory framework.⁶⁰⁰

There is a fundamental hindrance for proper research and discussion on “access to financial services”, namely, the very meaning and reach of the terminology used by the specialized literature. “Access to finance”, “financial inclusion,”⁶⁰¹ “bankarization,”⁶⁰² “financial penetration,”⁶⁰³ “depth of the financial systems,”⁶⁰⁴ and

⁵⁹⁷ WB also mentions, albeit rather marginally, this element: “Efforts to improve inclusion should also make business sense, translate into profits for the providers of these services, and therefore have a lasting effect”, FINANCE FOR ALL?, at 22.

⁵⁹⁸ BBA, “Promoting Financial Inclusion...,” *op. cit.*, at 1. It is a better defined and more realistic explanation because: 1) It acknowledges (albeit tacitly) that a financial system cannot achieve, in and of itself, the state of affairs described by other organizations as financial inclusion; but that it can only help trigger the motion toward (promote), to make sure *some* financial services are *available* for all, even if some people exclude themselves from the financial system. 2) In connection with the later, it acknowledges that people’s culture and education are crucial factor in the broad phenomenon of financial exclusion. 3) It acknowledges that lack of profitability is another crucial factor in the phenomenon of financial exclusion which is a burden that cannot be forced upon financial institutions.

⁵⁹⁹ 1ST REPORT ON FINANCIAL INCLUSION IN MEXICO at 10. AFI & CNBV acknowledge in this document that “there is no universal definition of financial inclusion” (*id.*, at 6, 10 and 14).

⁶⁰⁰ *Id.*, at 14.

⁶⁰¹ Financial inclusion is the terminology used by the AFI and the CNBV (see 1ST REPORT ON FINANCIAL INCLUSION IN MEXICO at 6, 10, etc.). The British FSA has used the language of “financial exclusion” (cf. FSA, IN OR OUT? FINANCIAL EXCLUSION: A LITERATURE AND RESEARCH REVIEW 2000).

⁶⁰² From the Spanish Word *bancaizar*. According to FELABAN, “Bankarization is the ability of the population to use the set of financial services without obstacles to prevent it” (FELABAN, ¿QUÉ SABEMOS SOBRE BANCARIZACIÓN EN AMÉRICA LATINA? UN INVENTARIO DE FUENTES DE DATOS Y LITERATURA [What Do We Know about Bankarization in Latin America? An Inventory of Data Sources and Literature] (Mar. 2007) at 2). FELABAN’s comprehensive, far reaching and unrealistic

microfinance,⁶⁰⁵ are terms used loosely and ambiguously by the specialized literature to refer broadly to overlapping phenomena and policy objectives.

This lack of accuracy results in a hindrance to identify accurately the problem to be addressed, its dimensions, the state of affairs pursued as objective, and consequently the paths to achieve that state of affairs.

3.2.4 Identifying the Problem in Mexico and Its Size

The ambiguity shown above has been true about the discussion on financial inclusion in Mexico. Upon the publication of WB's FINANCE FOR ALL?, one of Mexico's leading financial newspapers, EL FINANCIERO, printed a rather sensationalist front-page headline and subsequent column according to which the WB stated that the Mexican private banking sector was excluding 75% of the Mexican population.⁶⁰⁶ Nevertheless, a careful reading of FINANCE FOR ALL?, and its sources demonstrates that assertion is, not just inaccurate and outdated, but plainly false.

Firstly, WB has never conducted any survey or study to measure financial inclusion in Mexico. WB merely resorts to the data provided by the local

meaning of "bankarization" here echoes one of the meanings ascribed by WB to the term "financial inclusion" (FINANCE FOR ALL?).

⁶⁰³ AFI & CNBV, 1ST REPORT ON FINANCIAL INCLUSION IN MEXICO at 7; and *Dictamen de la Cámara de Diputados* [Lower House's Assessment of the Bill of amendments to the LIC] (under "I. Actividades de banca y crédito" [Banking and Lending Activities])

⁶⁰⁴ See Gonzalo Castañeda Ramos & Clemente Ruiz, *Avances y los asuntos pendientes para la profundización de los servicios financieros en México* [Advances and Pending Issues for the Deepening of Financial Services in Mexico], SECRETARÍA GENERAL IBEROAMERICANA (CUMBRE IBEROAMERICANA), LA EXTENSIÓN DEL CRÉDITO Y LOS SERVICIOS FINANCIEROS: OBSTÁCULOS, PROPUESTAS Y BUENAS PRÁCTICAS [Credit and Financial Services Extension: Obstacles, Proposals and Good Practices] (2006) at 99; and FINANCE FOR ALL? at 147. Likewise, the Mexican government's development bank BANSEFI uses this terminology: "Formal financial systems are characterized by lack of depth, leaving the majority of the population without access to financial services" (see <http://www.BANSEFI.gob.mx/BANSEFI/Paginas/English.aspx>).

⁶⁰⁵ This term is used, for instance, by the Consultative Group to Assist the Poor (www.cgap.org), and the OECD. Moreover, the use of this terminology is not limited to proper financial institutions (recognized as such and thus regulated by governments).

⁶⁰⁶ Alicia Salgado, *Excluyente, la banca en México, dice el BM* [Excluding, the [private] Banking Sector in Mexico, Says WB], EL FINANCIERO (Nov. 15, 2007) at 1 and 4: <http://www.elfinanciero.com.mx/ElFinanciero/Portal/cfpages/contentmgr.cfm?docId=90077&docTipo=1&orderby=docid&sortby=ASC>). The figure appears in FINANCE FOR ALL? at 34, Box 1.3, but it is taken out of context and mistakes the information provided in the source, as it will be shown below. In the document entitled "Plan Estratégico 2008 – 2012" [Strategic Plan 2008 - 2012], BANSEFI quotes a similar figure (26% of the Economically Active Population) without citing any source, in spite of the fact that CONDUSEF has used BANSEFI's information to contradict the aforesaid, as documented later in this chapter.

governmental agencies of each country. Accordingly, WB acknowledges the limitations and frailty of the information used in FINANCE FOR ALL? Hereby some examples:

Much less is known about how inclusive financial systems are and who has access to which financial services... Better data are needed to advance research on financial inclusion, and significant efforts have recently been made in this direction.⁶⁰⁷

Ideally, one would like to have census data on the number and characteristics of households that have a bank account or an account with a bank-like financial institution. In the absence of census data, one would at least like to have survey-based measures that are representative of the whole population and of important subgroups, again collecting information about the types of financial services they are consuming, in what quantities, and at what price, as well as complementary data on other characteristics of the household that might affect or be affected by their financial service use.⁶⁰⁸

...surveys prepared by or for the World Bank in India, Brazil, Colombia, and Mexico (Box 1.3), though even these are not always representative of the whole country and are not consistent across different countries.⁶⁰⁹

To date, however, survey-based data are quite limited both in terms of the number of countries that are covered and the amount of information collected about the respondents. The data are often not comparable across countries because the surveys use different definitions. Only a handful of the large and long-established Living Standard Measurement Surveys (LSMS) surveys sponsored by the World Bank cover financial services, and even these provide limited financial information... Different surveys have different primary objectives... Findings based on surveys of individuals cannot easily be compared directly with those from surveys of households. Different survey methodologies and their impact on the quality of information gathered are the subjects of an ongoing research effort at the World Bank.⁶¹⁰

Along similar lines, FELABAN explains that:

⁶⁰⁷ FINANCE FOR ALL? at 26-27.

⁶⁰⁸ *Id.*, at 30.

⁶⁰⁹ *Id.*

⁶¹⁰ *Id.*, at 30, and 33.

The availability of data on bankarization comparable across Latin American countries is very limited, which itself imposes important restrictions in the ability to perform analysis on the issue. The existent data come, in its majority, from polls made at a worldwide level by the multilateral institutions of Washington, particularly the World Bank. The regional polls focused on the particularities of Latin America are extremely scarce. Some studies at country level have more ample information, but because each study follows a different methodology, the data are in general not compatible across countries.⁶¹¹

Secondly, the 75% of the exclusion figure posted in Box 1.3 of FINANCE FOR ALL?,⁶¹² and publicized by EL FINANCIERO, cites as source the 2006 WB's Policy Research Working Paper 3835,⁶¹³ which in turn refers as source a 2002 "National Poll of Financial Services" by the Mexican "National Institute of Geography, Statistics and Informatics" (INEGI).

In spite of the poll's title, the figure cited by WB refers to a poll restricted to Mexico City's Metropolitan Area with a sample of 1,500 individuals. Moreover, that poll also reported that 48% of the people polled did have a bank account, not just the 25% so much publicized. The 25% figure refers only to those individuals who had a bank account that was not a mandatory bank account associated with a housing loan.

From the above it becomes clear that the data published by FINANCE FOR ALL? is an improper extrapolation of an outdated statistical estimation of individuals (rather than households) who actually use banking services in Mexico City, rather than updated hard data of the number of the households that have access to financial services in general (or even exclusively *banking* services), even if they are not currently account holders, or if for whatever reason they opt voluntarily to exclude themselves from the financial system.

A couple of private firms carried out surveys after 2002 (the year of INEGI's poll used by WB) which rendered very different results:

⁶¹¹ FELABAN, *op. cit.*, at 3.

⁶¹² FINANCE FOR ALL? at 34.

⁶¹³ Caskey *et al*, *op. cit.*, at 32-47.

At a national level, the GEA-ISA opinion poll on the banking sector performed on January 2005, says that... the 70% of the population above 18 years old has some type of relationship with a bank (34.4% credit-card holders, 9.9% checking/investing accounts, 9.2% savers, 9.4% payroll deposit account holders, 7.5% users).⁶¹⁴

Later that year (October 2005), another prestigious private polling firm, carried out a “National Household Poll on Banking Services in Mexico” which reported that 49.3% of people polled was users of at least one banking service.⁶¹⁵

More recent and comprehensive data published by CONDUSEF (the Mexican authority in charge of the defense and protections the users of financial services) indicates that as of 2007, 82.1% of the population of Mexico had their financial services needs covered by 10,861 offices of financial entities. Of that total number, 9,451 offices belong to the private banking industry and 1,410 to BANSEFI’s “People’s Network”.⁶¹⁶

This has been the result of a 21.4% increase in the number of offices and/or branches of financial entities between 2002 and 2007, that is 1 664 more offices/branches that cover 33 more municipalities than in 2002. Thus, 1 447 municipalities had not yet presence of the private banking industry (as of 2007), which meant 14.1 million people or 4.2 million households.⁶¹⁷

The most recent data available has come from a 2009 SHCP “Survey on The Use of Financial Services”, and reports that 57% of Mexico’s population are actual users of financial services: 48% are users of traditional deposit services (savings account, checking account, and payroll account with a debit card); 27% are users of traditional

⁶¹⁴ Castañeda Ramos & Ruiz, *op. cit.*, at 126 (note 7).

⁶¹⁵ Consulta Mitofsky:

http://www.consulta.com.mx/interiores/99_pdfs/12_mexicanos_pdf/mxc_NA051006_ServiciosBancarios.pdf

⁶¹⁶ The “People’s Network” is comprised by popular thrift and credit societies that are supported by BANSEFI.

⁶¹⁷ CONDUSEF, “Presencia de la banca a nivel geográfico, 2002-2007: Una visión general” [Presence of The Banking Sector at Geographical level, 2001-2007: A General Vision], (Apr. 2008) at 1-5.

loan services (personal or payroll loan, credit card, house mortgage, car loan); 12% are users of insurance services.⁶¹⁸

The obvious discrepancy between the data reported by CONDUSEF in 2008 (82.1% of Mexico's population having access to financial services) and that reported by the SHCP in 2009, is explained by the difference in each of these governmental authorities' concept of access to financial services and therefore of what they are reporting. To be more accurate, the 2009 SHCP's survey is talking about actual users of financial services. The criticism to the SHCP's data would then be that it does not account for voluntary exclusion.

On the other hand, CONDUSEF is reporting the percentage of the population that lives in areas with physical/geographical access to a branch or office of a financial institution in general, not just private banks. The criticism to this approach would be that it focuses only on potential physical access, which would seem to ignore the major cause of involuntary exclusion from financial services in Mexico, namely, poverty.⁶¹⁹

Nevertheless, when studied as a whole, CONDUSEF's understanding of the problem, approach and information becomes all the more relevant and useful, precisely because it highlights the role economic underdevelopment plays and the

⁶¹⁸ SHCP, "Encuesta sobre Uso de Servicios Financieros 2009" [2009 Survey on The Use of Financial Services]. Cited in Alejandro Werner Wainfeld (Undersecretary of SChP), "10º Aniversario de la CONDUSEF: Los beneficios de la información, la transparencia y la competencia" [CONDUSEF's 10th Anniversary: The Benefits of Information, Transparency and Competition], (Apr. 2009) at 2 (http://www.shcp.gob.mx/SALAPRENSA/sala_prensa_presentaciones/aww_presentacion_condusef_22042009.pdf). The cited document claims that as a result of the legislation introduced to promote people's access to information on financial institutions, products and services, enforced by CONDUSEF, competition has increased and "access to financial services has improved significantly over the last 5 years". The point of comparison is the above multi-cited 25% figure published by WB. The media report of the cited presentation quotes the Undersecretary saying that WB's data from 5 years earlier is half of what the 2009 survey found, thus concluding that financial access has been doubles in Mexico over the last five years (see *México duplica usuarios de servicios financieros* [Mexico Doubles Financial Services Users] in EL ECONOMISTA [The Economist] (Apr. 22, 2009): <http://eleconomista.com.mx/notas-online/finanzas/2009/04/22/mexico-duplica-usuarios-servicios-financieros>). In light of the analysis made on WB's information, it is obvious that this claim is grossly exaggerated and ungrounded.

⁶¹⁹ Paulina Beato, *Introducción*, SECRETARIA GENERAL IBEROAMERICANA, *op. cit.*, at 104.

public policies the executive branch of Mexican Government is using to address that particular factor.⁶²⁰

3.2.5 The Chief Cause of Financial Exclusion in Mexico: Poverty

CONDUSEF explains the absence of offices/branches in or near population centers as due to economic underdevelopment of the places where that phenomenon exists. “The more the relative development is, the larger presence of banks also is, and the smaller the economic activity, the smaller the presence of banks is, which indirectly perpetuates the ballasts for economic integration and growth.”⁶²¹

Consequently, when and where there has been improvement in economic variables, financial inclusion has improved as well. According to CONDUSEF:

The penetration of almost all of the “savings, consumer loan, and housing loans instruments, as well as the handling of accounts and means of payment with cards, has been growing rapidly over the last years, in the same measure in which inflation has been reduced, unemployment levels are stable, and the *per capita* income recovers gradually and the effects provoked by the external shocks derived from the behavior of the international economy are ameliorated.”⁶²²

Accordingly, CONDUSEF identifies inequality of income as “one of the chief factors that limit the possibilities of individuals and their families to develop socially and economically.” Therefore, “we ought not be surprised that the offer of banking services also keeps a close correlation with the proportion of the available income.”⁶²³

⁶²⁰ By no means this claim denies the presence of other barriers to financial inclusion in Mexico, including those (few) that can be overcome by means of regulatory liberalization (as will be addressed below), and those that pertain more to voluntary rather than involuntary exclusion.

⁶²¹ CONDUSEF, *op. cit.*

⁶²² *Id.* Similarly, WB says that, “There is little disagreement that the ability of financial service providers to reach a broad clientele is highly dependent on macroeconomic environment,” among other variables. Furthermore, “Theoretical and empirical research has confirmed that macroeconomic instability is an important obstacle to effective intertemporal contracting. Fiscal imbalances in particular generate high and variable inflation, often making the future value of money so uncertain (and difficult to hedge) for both suppliers and demanders that long-term financial contracts simply do not exist. Households will not give up control over their savings for longer time-periods in unstable macroeconomic environments, and financial institutions will not commit beyond short-term contracts given funding uncertainties. (FINANCE FOR ALL?, at 146).

⁶²³ CONDUSEF, *op. cit.*

CONDUSEF reports that “68% of the households not covered by bank branches have income below two minimum salaries (MS),⁶²⁴ while the households making more than seven MS that aren’t covered by the banks are just the 4.8%,” and concludes that “the larger the proportion of households with income of two MS or less, there is also a smaller presence of banks or, even, the absolute absence of the traditional banking service.”⁶²⁵

At this point it is worth highlighting that, according to CONEVAL (the Mexican Government’s commission in charge of measuring poverty), households that have an income of two MS or less are in situation of poverty. Poverty is defined there as “not having an income enough to satisfy their food, educational, health, housing, transportation, clothing, and foot-ware expenses.”⁶²⁶ Consequently, people in poverty have no use for financial services since they have no money to save, no assets to use as collateral for loans (which makes them ineligible for a mortgage from a commercial bank), and no money to use insurance services.⁶²⁷

⁶²⁴ The current MS in Mexico is equivalent to approximately USD\$4.00 a day (USD\$120.00 monthly), as of 2010.

⁶²⁵ *Id.*

⁶²⁶ CONEVAL, “Informe ejecutivo de pobreza en México 2007” [2007 Executive Report on Poverty in Mexico] (Jun. 2007) at 3 (<http://www.coneval.gob.mx/contenido/normateca/2328.pdf>). CONEVAL’s methodology comprehends three levels of poverty: 1) Food poverty (inability of a household to afford a basic set of nutritional food even if spending its whole income); 2) Poverty of capabilities (in addition to food poverty, the inability of a household to afford health and education expenses, even if spending its whole income); and 3) Poverty of assets (in addition to 1 and 2, the inability of a household to afford clothing, housing, and transportation, even if spending its whole income (*id.*)).

⁶²⁷ Sources are practically silent on whether the cashing of remittances from abroad (mostly from Mexican migrant workers in USA) are among the financial services considered in their measurements. Yet, in light of CONEVAL’s working definition of poverty, it is quite unlikely that people in the said condition are recipients of this kind of money transfers. According to BANXICO’s information on household remittances during 2008, the average monthly income per household was USD\$346.00, which more than USD\$100.00 (or 43.33%) above the poverty line (this data already reflects, by the way, a decrease in 3.6% decrease in 2008 as a result of the crisis in the USA). In light of CONDUSEF’s analysis of on the economic underdevelopment of the areas without presence of financial institutions, the presence of that kind of money influx would by itself bring about more economic activity and development and thus attract financial institutions. Moreover, according to BANXICO’s report, 95.9% of the remittances were sent via electronic transfers, and 2.4% via money orders, which means that the recipients have access to, and actually use, financial services. Only 1.7% of the remittances were done using “other instruments,” which likely implies non-financial services means. See BANXICO, “Las remesas familiares en 2008” [Family remittances in 2008] (Jan. 27, 2009); available at: <http://www.banxico.org.mx/documents/%7BB7CBCFAF-AB7D-BE65-F78F-6827D524C418%7D.pdf>.

As of 2008, CONEVAL estimated that 47.4% of the population in Mexico was in poverty.⁶²⁸ That means that only 52.6% of Mexico's population is potentially user of financial services, which is close to the 57% figure of actual users of financial services reported in early 2009 by SHCP (which reports the state of affairs as of 2008). This reasonably confirms that the chief cause of financial exclusion in Mexico is poverty.⁶²⁹

Exclusion due to poverty cannot be solved by the private sector of the financial system alone, neither solely by means of its liberalization. Alluding to the BBA's understanding of financial inclusion it has to be acknowledged that solutions have to be profitable or they will not work.⁶³⁰ Along the same lines, WB acknowledges that, "Efforts to improve inclusion should also make business sense, translate into profits for the providers of these services, and therefore have a lasting effect."⁶³¹

Therefore, the role the private financial sector in Mexico and its regulatory framework can play in promoting financial inclusion of people in poverty is very limited, if not practically inconsequential. Accordingly, the primary approach of the Executive branch of the Mexican Government has been a comprehensive programme delineated in the PND (National Development Plan).

⁶²⁸ CONEVAL, "Evolución de la pobreza en México" [Evolution of Poverty in Mexico] (2009) at 7 (<http://www.diputadosfederalespan.org.mx/lxi/campanas/foroEco2010/1234.pdf>).

⁶²⁹ There of course are other factors that have been identified as barriers to financial access that are very much present in Mexico. Nevertheless, poverty is often behind or somehow related to some of such other obstacles. Lack financial education and culture is clearly one of those obstacles in which poverty is involved (see Beato, *op. cit.* at 11; and Castañeda & Ruiz, *op. cit.*, at 124). According to CONEVAL, "The educational level of the head of household strongly influences the difficulty to overcome the poverty circle"; and only "26.7% of the heads of household in poverty of assets have more basic education" (CONEVAL, "Executive Report...", *op. cit.*, at 4-5). Lack of financial education and culture is connected with another obstacle to financial inclusion, namely high levels of informality with the consequent excessive use of cash instead of the payment instruments offered by the financial system (see Beato, *op. cit.*; and Castañeda & Ruiz, *op. cit.*). This is not to deny, nevertheless, that there is still in Mexico a need of institutional development and regulatory reform.

⁶³⁰ BBA, *op. cit.*

⁶³¹ FINANCE FOR ALL?, at 22. A recent measure of the Legislative branch of the Mexican Government (controlled by parties that favor governmental interventionism and disfavor market approaches) intended to favor low-income people in their use of banking services has been to mandate BANXICO to regulate (even re-regulate) the fees private banks are allowed to charge to account-holders and other kind of users for various services and penalties.

3.2.6 Legal and Institutional Framework to Address Final Inclusion

The Mexican Constitution (Art. 25) mandates that the ruling of the national development corresponds to “the state” (meaning government), in order to guarantee it is comprehensive and sustainable, among other things.⁶³² Furthermore, “The State will plan, conduct, coordinate, and orient the national economic activity...”⁶³³

Art. 26, section A, further mandates the government to organize a “democratic planning system of the national development”, for which therefore there has to be “a national development plan [PND] to which the programs of the Public Federal Administration shall obligatorily subject”.

Therefore, no serious discussion on the regulation of fairness and inclusion in the Mexican financial system and its role in economic development can ignore the PND,⁶³⁴ which is part of the Mexican legal frame-work.

Within “Axis 2. Competitive and Employment-generating Economy”, and under the subheading (2.2) entitled “Efficient Financial System”, the PND says:

It is to be reminded that the families of lesser income are also the most vulnerable, due to the fragility of their income and to the fact that along with their assets such income is often more affected by extreme climatic events. To count with financial instruments designed for the needs of these forgotten segments of the population entails improvements in the wellbeing, the equality and even the economic growth.⁶³⁵

Then in the strategy section, the PND appoints the development banks (government owned and managed banks) as primarily responsible of achieving the inclusion of the lower classes into the financial system:

⁶³² For the updated official text of the Mexican Constitution, see <http://www.ordenjuridico.gob.mx/Constitucion/cn16.pdf>

⁶³³ Art. 25, second paragraph.

⁶³⁴ For PND’s official text, see <http://pnd.calderon.presidencia.gob.mx/>.

⁶³⁵ PND, 2.2. “Efficient Financial System,” at 99.

Strategy 2.4. Focusing the actions of the Development Banks on addressing the population in priority sectors that are un-addressed by the private financial sector...

...It will correspond to the development banks to conduct the enlargement of the credit given toward strategic sectors that still have limited access to financing: the SME, infrastructure, housing for low income individuals and rural producers of medium and low income...⁶³⁶

Accordingly, the 2007-2012 “Economy Sector Program”⁶³⁷ lists as 10th of its “10 Challenges and Priorities”:

10. To encourage a more strengthened social banking sector with a larger social capital, especially for the sector of the population that is excluded of the commercial financial sector by means of the implementation of public policies that support the strengthening of popular⁶³⁸ thrift and credit institutions that promote the economic development of communities and small scale firms.⁶³⁹

In order to deepen the social banking sector, the PSE lists the following actions (under Strategic Line 1.2.3):

- a) To diversify the social banking sector, fomenting the creation and development of the solidarity boxes,⁶⁴⁰ and other thrift and credit cooperative societies; of popular financial societies; of trusts and other associative entities that would promote popular savings and credit.

⁶³⁶ PND, Axis 2 (“Competitive and Job-Generating Economy”), Objective 2 (“To Democratize the Financial System without Jeopardizing The System’s Solvency as A Whole...”), Strategy 2.4.

⁶³⁷ “Sector Programs” derive from the PND.

⁶³⁸ In Mexican political and policy contexts, the term popular refers mostly to lower socio-economic classes or otherwise marginalized segments of the population.

⁶³⁹ Diagnostic of the Economy Sector / Characteristics of the Economic Context / Competitiveness / 10 Challenges and Priorities.

⁶⁴⁰ “The Solidarity Boxes are a peculiar organizational system of thrift and/or loan entities for low-income population, primarily rural, that does not have access to formal financial services. Its objective is to reach out peasants, and indigenous people, and social sector groups in urban areas with quality financial services, above all those who subsist in micro regions of extreme marginality. FONAES [National Support Fund for Enterprises in Solidarity] implements support mechanisms to allow for the incorporation and transformation of the Solidarity Boxes into Popular Thrift and Credit Entities, within the current legislation on the subject” (FONAES, “Cajas solidarias”: <http://www.fonaes.gob.mx/index.php/banca-social/cajas-solidarias>). The use of the word “box” to refer to this type of entities is borrowed from the popular “cajas de ahorro” (literally “savings boxes”) or *cajas de ahorro y préstamos* (thrift and loaning boxes), they are similar to thrift banks, although according to Mexican legislation they are not considered banks or “credit institutions” (*instituciones de crédito*) as the LIC denominates private banks.

- b) To incentivize the territorial diversification of the entities that constitute the social banking sector, in order to bring close popular saving and credit instruments of the scarce resources population.
- c) To contribute to the capitalization and strengthening of the social banking sector, fomenting their utilization as instances for the dispersion of the resources of the federal social programs, for the revolving of such aids, and for the transfer and payment of the remittances coming from migrants.
- d) To press on the growth of the deposits of remittances by means of solidarity boxes and to lower the cost of such remittances.
- e) To stimulate the use of the resources liberated due to the lowering of the cost of remittances in profitable productive projects that bring about the rooting of the rural population in their communities.
- f) To increase the resources for the consolidation and promotion of micro-financers that help productive projects in the most needful areas, in order to favor the support new entrepreneurs.
- g) To carry out business accompaniment and strengthening for the entrepreneurs obtaining a micro-credits.

The primary development bank involved in this strategy is BANSEFI. Originally created as a National Savings Patronage (Patronato del Ahorro Nacional, PAHNAL), in June 2002 was transformed into BANSEFI with the mandate of completing and giving depth to the Mexican financial system, so that financial products and services can be offered to the majority of the population, particularly those with lower income, in competitive conditions and with more security and legal certainty.⁶⁴¹

⁶⁴¹ See the first paragraph of BANSEFI's website's introduction:
<http://www.BANSEFI.gob.mx/BANSEFI/Paginas/BANSEFI.aspx>.

According to Art. 2 of the act that transformed PAHNAL into BANSEFI, this bank “shall render banking and credit services... supporting the national development policies... procuring the adequate development of the popular thrift and credit sector...”⁶⁴² Likewise, according to Art. 3 of BANSEFI’s statute, its mission is:

...to promote saving, financing, and investment among the integrating parties of the Sector, to offer financial instruments and services among them, as well as to channel financial and technical support necessary to encourage saving habits and the healthy development of the Sector, and in general the national and regional development of the country.

Toward this end, among other policies and actions, BANSEFI:⁶⁴³

- Does not charge commissions and offers the best interest rates of the market, and allows for opening accounts with small amounts of money.
- Serves the Popular Thrift and Credit Organizations as second floor development bank, with services that allow them to improve their income, reduce their costs, and make efficient their processes, as well as widen the variety of services they render to the partners and clients.
- Temporarily coordinates the funds that Mexican Government is giving to the Popular Thrift and Credit sector in order to facilitate its transformation and to position it as a strategic component of the financial system; as well as to strengthen the operation and functioning of the popular thrift and credit organizations, with the end of promoting their viability in the mid and long terms. These aids are being funded by multilateral organism, particularly WB, and the Multilateral Fund of Investments managed by the IDB.

According to CONDUSEF’s studies, BANSEFI and the People’s Network⁶⁴⁴ are helping significantly to improve financial inclusion.⁶⁴⁵ As of 2009, 1 623 branches

⁶⁴² “Decree whereby the National Savings Patronage, Decentralized Organism of the Federal Government Is Transformed into the Bank of National Saving and Financial Services, Development Bank Institution.”

⁶⁴³ See <http://www.BANSEFI.gob.mx>.

⁶⁴⁴ *La Red de la Gente* (The People’s Network) is a commercial alliance between BANSEFI and the intermediaries of the Popular Sector that enables distributing financial products and services to the

of the People's Network covered 700 municipalities, which places it as the second largest financial network in the country, and the first in municipal coverage.⁶⁴⁶

In light of the above, CONDUSEF reckons at another study that:

The role that the People's Network has played along with BANSEFI, has being determining, not just in terms of the larger and more varied offer of financial products, among other equally important services, but also in terms of the level of effective geographical coverage, and the effort to bankarize the population.⁶⁴⁷

The [thrift] boxes attached to the People's Network –many of which are in process of authorization—are aimed fundamentally to the low-resources population, which is also the group that does not have, or has less, financial services accessible to them, both from a geographic as well as a practical point of views, due to the design and cost of the products that the market offers.⁶⁴⁸

Many of these popular thrift boxes make it possible for people to have access, among other financial services, to thrift accounts with minimal amounts to open and deposit; saving programs to acquire social interest⁶⁴⁹ housing loans; cashing of remittances send by their relatives abroad...⁶⁵⁰

Achieving a more inclusive financial system in Mexico will take more time but also the improvement of the general economic conditions of the population that is currently excluded. Therefore, there is little that can be achieved by means of financial liberalization, especially if prudential regulation is kept as a priority.

low-income population. As of 2009, there are 182 intermediaries of the Popular Sector in alliance with BANSEFI.

⁶⁴⁵ See CONDUSEF, "Presence of the Banking...", *op. cit.*, at 3.

⁶⁴⁶ As of 2007, 1 410 branches of the People's Network covered 625 of the municipalities and were able to supply the needs of 70.4 million people. Some of such branches were the exclusive suppliers of financial services at 269 municipalities with 4.4 million inhabitants (See CONDUSEF, "Presence of the Banking...", *op. cit.*, at 3).

⁶⁴⁷ *Id.*, at 43.

⁶⁴⁸ CONDUSEF, "Comentarios a la Cobertura Geográfica del Sistema Bancario y de la Red de la Gente y BANSEFI en 2006" [Commentaries to The Geographical Coverage of the Banking Sector, and the People's Network, and BANSEFI in 2006], at 67.

⁶⁴⁹ "Social interest" refers in Mexico, and in this context, to the lowest income (or "most affordable") type of housing.

⁶⁵⁰ *Id.*

3.3 CHAPTER CONCLUSIONS AND CLOSING REMARKS

The homologation of Mexico's accounting regulatory standards with those of the BCBS, and their implementation made Mexican financial groups attractive to foreign banks, which purchased almost all of them. As a result the Mexican financial system achieved higher systemic stability as a whole, and Mexican banks achieved higher profitability, efficiency, and better practices. Regulatory framework improvements strengthened the Mexican banking sector. Operative risk management and credit risk management, the publication of banks' information, plus market discipline became essential to the Mexican financial system.

Chapter 5 documents the way in which the Mexican financial system that resulted after the latest reforms has proved to be a solid and stable one in the midst of the GFC.

Thanks to the bottom up approach to the prudential liberalization in México, bank management adopted gradually and increasingly the definitions and development of international practices, especially after the 1994-1994 crisis. At the regulatory level, the globalization of the Mexican financial system started in 1994 with the implementation of BCBS recommendations, which imposed international standard to measure the solvency and performance of Mexican banks.

Internationally, the creation of new financial instruments and the risk position enlargement in the markets throughout the 1990s led to better risk management. Toward that end, BCBS rules were updated in November 2005. Ever since, management practices and bank risk regulations have been influenced by Basel II, which is recognized by more than 130 countries, including Mexico, as well as by IMF and WB. The Mexican financial system had no trouble adopting Basel II, since its regulation has been very strict after the "Tequila Crisis." This, since several Mexican directives (for example on risks, CNBV 2004a and 2004b) are in complete agreement with BCBS's principles.

For the particular case of Mexico, the new Basel III will not represent as profound changes and those that the banks of other countries will have to face. This, because,

after the 1994-1995 financial crisis in Mexico, a new and very demanding regulatory framework was established in the area of capitalization, both for the amounts of required capital, as for the quality demanded for such capital. It is for this that banks in México will not have to make extraordinary efforts to fulfill with the new regulatory parameters. This is also why banks will be able to meet the new demands before the end of the international transition period, which goes up to 2019. It is pertinent to point out that the decisions made in the country in the past on bank capitalization were appropriate, as they made possible that our credit institutions were not contaminated by the deterioration of the foreign banking systems. This is confirmed by the fact that the new global regulatory framework is close to the one applied in Mexico.

In fact, Mexico's banks were so very well capitalized by the time Basel III was announced, that as of August 2010, the Mexican banking sector "had a capital ratio index of 13 per cent, a calculation that used similar methodology to that of the new Basel requirements.

Concerning financial inclusion, although liberalization can help promoting financial inclusion, the extent of that help is limited when the chief cause of exclusion is poverty. A liberalization that would attempt to solve this kind of financial exclusion would need to compromise on prudential standards allowing for high risk operations. Therefore, that kind of exclusion is to be addressed by other public policies (as is the case in Mexico) that do not put in risk the financial system.

NAFTA was Mexico's most significant step toward liberalization in services in general and in financial services in particular. Therefore, next chapter is devoted to taking a closer look from the point of view of the Mexican liberalization agenda in the late 20th century.

CHAPTER 4:

**MEXICO'S POSITION ON NAFTA AND
ITS LIBERALIZATION OF FINANCIAL SERVICES INCLUDING
INVOLVEMENT IN THE DISPUTE SETTLEMENT PRACTICE
RELATING TO GATS/WTO AND NAFTA**

4.1 MEXICO'S POSITION ON NAFTA

4.1.1 Introduction

This chapter addresses the advantages NAFTA has brought to Mexico and the alleged disadvantages that some critics have raised against it. Secondly, it explains the relevant aspects of NAFTA for trade in financial services.

This chapter also analyzes and compares some of the common objectives of liberalization in trade in services, and specifically in financial services, among NAFTA, EU and GATS. Moreover, it shows how financial services are not completely amenable to some of the trade disciplines found in GATT, such as prohibition of quantitative restrictions, MFN treatment, NT and reduction of tariffs. Thus, though regulatory barriers can be compared to quantitative restrictions, yet, they cannot be eliminated.⁶⁵¹

A comparison is then made between some of the common objectives of liberalization of trade in services, and specifically in financial services, in NAFTA, EU and GATS. It also examines to what extent NAFTA has gone beyond GATS but not as far as the EU. Lastly, this chapter examines the dispute settlement mechanism en NAFTA y GATT/WTO.

4.1.2 Mexico under NAFTA

NAFTA is the most important among Mexico's FTA network. When it was first implemented, NAFTA created a 360 million people market, the world's largest market when it was first implemented. This was a promising opportunity for Mexico, the weakest party in the agreement.

Mexico is a natural hub for trade and investment. It is situated in a strategic geographical position as it shares 2000 miles border with the largest market in the world. It is located in the center of the American continent between the Pacific and

⁶⁵¹ See Trachtman, *Trade...*, *op. cit.*, at 41.

the Atlantic oceans. It has become a commercial bridge between the northern and the southern parts of America, between America and Europe, and Asia and America.

Taking advantage of its location and as a result of its network of FTA, as of 2010 Mexico enjoyed “preferential access to one billion consumers in 44 countries,”⁶⁵² and has achieved important relative preferences in trade in services with respect to its competitors. WTO’s 2003 World Trade Report said that Mexico benefited in general terms from NAFTA, as shown below. But some say the success has not been as promised by its advocates.

4.1.3 Alleged Disadvantages for Mexico-

NAFTA critics have long contended that such FTA does not benefit Mexico. Goyos, for instance, argues that the USA obtained from Mexico total opening of its market in services, while keeping its own market closed by means of horizontal barriers to the free circulation of service workers.

The USA is certainly the largest exporter of services,⁶⁵³ and getting the Mexican market was a priority for the negotiators.⁶⁵⁴ However, free circulation of workers was not allowed in NAFTA, keeping Mexico without the opportunity of exercising its highest potential: the skills of its workers.

Yet, it must be pointed out that free circulation of services workers is the most controversial of the modes of services supply not only in NAFTA but also in GATS and many other agreements.⁶⁵⁵ At the multilateral level, there has been a very slow progress in this liberalization. NAFTA represents an important small step towards negotiations in the liberalization of the free circulation of persons.

⁶⁵² See The NAFTA Office of Mexico in Canada, “FTA’s Signed by Mexico;” available at: <http://www.nafta-mexico.org/ls23al.php?s=501&p=3&l=2>.

⁶⁵³ See WTO Report 2010, at 29.

⁶⁵⁴ See Goyos, *op. cit.*, at 3. The Mexican service sector it is estimated at US \$146 billion.

⁶⁵⁵ See OECD, *Service Providers on the Move -- Labour Mobility and the WTO General Agreement on Trade in Services*, POLICY BRIEF (Aug. 2003). See also Gary Hufbauer & Tony Warren, “The Globalization of Services: What Has Happened? What are the implications?” (OECD Paper, Oct. 1999). See also PAZOS, *LIBRE COMERCIO...*, *op.cit.*, at 216 and 221. Pazos stated, a year before NAFTA was launched, that such an agreement would help to ease economic pressures in Mexico, which would imply a substantial reduction in the flow of illegal immigrants to the US.

Goyos also says that USA can apply its laws extra-territorially in a way that the treaty extended onto Mexico certain legal concepts, such as investments, intellectual property, competition and antitrust law, labor law, environmental law, the traffic of drugs, illegal immigration and even the administration of justice. He calls as euphemism: “convergence of values”.⁶⁵⁶

Mexico has been greatly benefited with the trade north - south, since the concept of “rule of law” has been more understood and consequently applied. Since then, Mexican legislation (e. g. the foreign investment and banking laws) have been improved, and consequently, the predictability and legal certainty in the judiciary has increased significantly since NAFTA came into force.

Another argued disadvantage of NAFTA is that it discriminates unduly against third parties and frustrates the attainment of multilateral objectives built on non-discrimination, which engenders a degree of trade diversion and the application of numerous rules of origin and differing standards that could make international trade more complex and costly. The overlapping of these agreements may also undermine the transparency of trading rules, some of the fundamental principles of the WTO.⁶⁵⁷

Other antagonists of NAFTA claim that, as negotiated and then implemented, it was one of the main causes of the 1994 Mexican crisis. They argue that as a result of the NAFTA model, “Mexico became a client state of the USA designed to buy services, industrial and agricultural products and to produce huge trade deficits to be financed with speculative borrowings by the financial sector.”⁶⁵⁸

But Mexico’s liquidity crisis and consequent currency’s devaluation at the end of 1994 and the beginning of 1995⁶⁵⁹ cannot be blamed on NAFTA since, as seen in Chapter 1, they were the result of the multiple weaknesses of an immature financial system which predated NAFTA.

⁶⁵⁶ *Id.*, at 4.

⁶⁵⁷ See WTO REPORT 2003 at xvi; and WTO REPORT 2010 at 28. Mexico’s trade value in 2010 reached USD\$230 billion.

⁶⁵⁸ See Maysami & Williams, *op. cit.*, at 2.

⁶⁵⁹ See *id.*

4.1.4 Advantages for Mexico

As of 2001 (seven years after NAFTA started), Mexico's exports to the USA grew twice as fast as its exports to the rest of the world.⁶⁶⁰ As of 2003, WTO commented:

Participation in RTAs, particularly the NAFTA, has exposed Mexican producers to foreign competition and subjected them to strong pressure to increase productivity. Average productivity per worker, in the manufacturing sector, which accounted for an average 21% of total GDP during 1996-2000, increased at an average rate of 6.8% in the period 1999-2001.⁶⁶¹

Preferential access to the North American market has granted Mexican producers a demand base, and the capital and technology necessary to exploit economies of scale and sustain productivity gains.

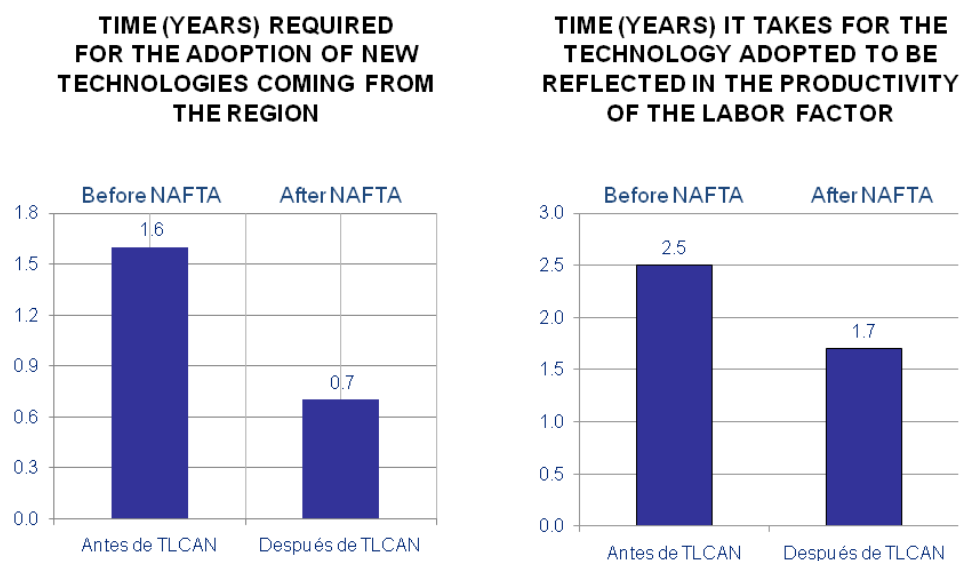
Regarding access to new technologies, and the time it takes for such technologies to be reflected in the productivity of the labor factor, a 2005 WB-Stanford University publication⁶⁶² shows the improvements that NAFTA has brought about.

⁶⁶⁰ See De la Calle Pardo, *op. cit.*, at 2.

⁶⁶¹ See WTO REPORT 2003, at xvi and 63.

⁶⁶² LEDERMAN, MALONEY & SERVEN, *op cit.* Graphic elaborated (in Spanish) and provided by Dr Jaime Serra Puche.

NAFTA & THE ADOPTION OF NEW TECHNOLOGIES



Source: Daniel Lederman, William F. Maloney & Luis Serven, *Lessons from NAFTA for Latin America and the Caribbean Countries: A Summary of Research Findings* (WB 2003).

The above confirms, at least in Mexico's case, that integration encourages productivity growth either through trade or foreign investment, and that global and regional integration grant productivity gains.⁶⁶³ As a whole, global integration can bring about larger gains because it involves larger markets and thus results in larger comparative advantages that would generate larger potential gains.

FDI inflow into Mexico, which averaged USD\$3.9 billion between 1990 and 1993, trebled in the period 1994-1999 and reached \$25 billion in 2001.⁶⁶⁴ According to a WB-Stanford University publication, "without NAFTA Mexican exports would have been 50% less, and the FDI to Mexico 40% less."⁶⁶⁵ Based on that publication, Mexican economist and former Secretary of Commerce, Dr Jaime Serra Puche, elaborated the following chart showing the how different Mexican exports and FDI to Mexico would have been without NAFTA.⁶⁶⁶

⁶⁶³ See LOPEZ CORDOVA ERNESTO, REGIONAL INTEGRATION AND PRODUCTIVITY: THE EXPERIENCES OF BRAZIL AND MEXICO (2003). Mexico's more aggressive stance with NAFTA seems to have paid-off at least as far as productivity is concerned. Tariff reduction undertaken during the agreement appears to have had a sizeable positive impact on productivity growth, which added to already substantial gains reaped during the period of non-preferential liberalization.

⁶⁶⁴ *Id.*

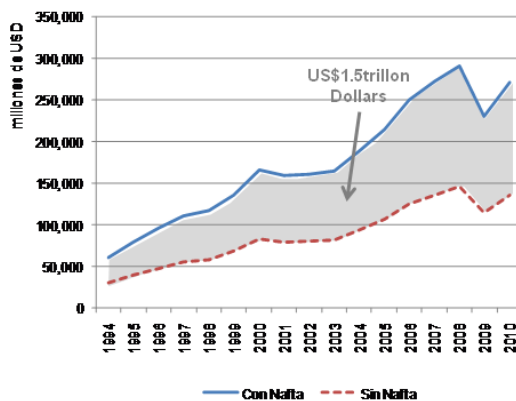
⁶⁶⁵ See LEDERMAN, MALONEY & SERVEN, *op. cit.*

⁶⁶⁶ The chart is not published but was kindly provided by Dr Serra Puche upon personal request.

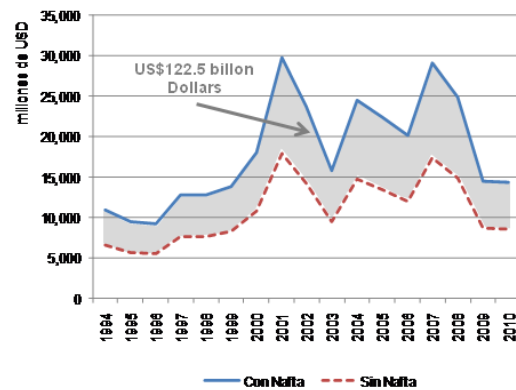
NAFTA RESULTS FOR MEXICO (1994-2010)

According to Lederman, et. al. (WB, 2003), without NAFTA Mexican exports would have been 50% less, and the FDI to Mexico 40% less.

TOTAL MEXICAN EXPORTS WITH (SOLID BLUE) AND WITHOUT (DOTTED RED) NAFTA*



FDI TO MÉXICO WITH (BLUE) AND WITHOUT (RED) NAFTA*



* Exports up to November, 2010, and FDI up to 3rd trimester, 2010.

Source: Daniel Lederman, William F. Maloney & Luis Servén, *Lessons From NAFTA for Latin America and the Caribbean Countries: A Summary of Research Findings* (WB 2003).

1

In the midst of the dramatic decline in world trade in 2009, in which the global GDP output fell by 2.3%, the Mexican economy remained steady as its exports and imports oscillated only by 2% and 1% respectively from 2005 to 2009.⁶⁶⁷ The WTO system of trade regulation prevented another descent into protectionism that so exacerbated economic conditions in the 1930s.⁶⁶⁸

One of the advantages of NAFTA was its gradual implementation for most of sectors in Mexico. This means that some sectors were reckoned more sensitive and therefore were liberalized after a reasonable time. NAFTA's 15-year phase-in sounded reasonable, as it was meant to prevent serious disruption by allowing the markets to adapt gradually to the changes.

Between 1994 and 1998, the annual average growth of the total trade between Mexico, USA and Canada was 12%, above the growth in the global trade in goods

⁶⁶⁷ See WTO Report 2010, at 28.

⁶⁶⁸ *Id.*, at 20.

(9%).⁶⁶⁹ In only five years, total trading between the three nations increased 75% (nearly USD\$227 billion) to achieve half a trillion USD in 1998. In 1995 Canada became the second market for the Mexican products.⁶⁷⁰

Although the GFC hit severely the NAFTA region, by November 2010:

...the Flows of the Mexico-Canada trade increased 39% compared to last year, resulting in USD\$27.4 billion ... a value that surpassed in 13.4% the trade level observed before the international crisis started (in November 2008 bilateral trade was USD\$24.1 billion).⁶⁷¹

During the NAFTA era, bilateral trade between Mexico and Canada “has grown almost 7 times... equivalent to an average annual growth rate of 12.6% between 1993 and 2010.”⁶⁷² In 2010, “Mexico kept its position as Canada’s 3rd largest trade partner in the world.”⁶⁷³ “Mexico is the 5th largest export market for Canadian products with a value of USD\$7.8 billion... 655% higher than sales recorded in 1993,” in spite of a 9.8% contraction since 2008, due to the financial crisis.⁶⁷⁴

Regarding Mexican Exports to Canada:

By November 2010, Mexico kept its position as the 3rd greatest supplier for the Canadian market (5.5%), only exceeded by imports from the United States (50.5%) and China (11%). Exports of Mexican products to Canada in this period totaled USD\$19.6 billion, 651% more than exports registered in 1993 (USD\$2.6 billion). The average annual growth rate of exports from Mexico to Canada was 12.6%.⁶⁷⁵

⁶⁶⁹ Marise Cremona (remarks at the Class of Regional Economic Integration, International Economic Law Course, Centre for Commercial Law Studies, Queen Mary College, University of London, Apr. 28, 2003). Among other positive points for NAFTA are that provides abundant opportunities for local interest groups. The rules of origin are designed to safeguard originating goods with preferential treatment against non-originating goods, such as the goods imported from other non-members countries. In other words, it limits the benefits of the agreement to producers of the member states.

⁶⁷⁰ See BANCOMETX STUDY at 26. Mexican exports to Canada increased at a rate of 12% from 1994 to 1998, reaching more than USD\$5 billion.

⁶⁷¹ The NAFTA Office of Mexico in Canada, “Mexico-Canada Trade and Investment” (Jan. 2011) at 1; available at: http://www.economia-snci.gob.mx/sic_php/pages/files_varios/pdfs/Can_Nov10.pdf.

⁶⁷² *Id.*

⁶⁷³ *Id.*

⁶⁷⁴ *Id.*

⁶⁷⁵ *Id.*

As for trade between Mexico and the USA, Mexico has become one of the most important partners of the USA.⁶⁷⁶ In 2001 Mexico replaced Japan⁶⁷⁷ as the second largest supplier of (non-oil) goods and services to the USA.⁶⁷⁸ Twelve years after NAFTA, trade between both nations had increased by almost 120%, from USD\$88.1 billion in 1993, to over USD\$187 billion in 2005. The same year, Mexican exports to the USA increased to USD\$103 billion, an increase of 143% compared to 1993.

The growth rate of Mexico's exports to the USA has been superior to the average of those from the rest of the world.⁶⁷⁹ In 2009, Mexico was the third largest supplier of goods imports to the USA (USD\$176.5 billion).⁶⁸⁰ Total Mexican exports of goods to the USA reached USD\$229.65 billion in 2010, while USA's total exports of goods to Mexico that year reached USD\$163.32 billion.⁶⁸¹

Contrary to the antagonists' forecasts, NAFTA has not only not made Mexico's trade more dependent on the USA but has actually helped decrease the proportion of trade between the USA and Mexico compared to trade with other countries, as shown in the following chart:⁶⁸²

⁶⁷⁶ See MARCEAU & REIMAN, *op. cit.*, at 28.

⁶⁷⁷ See Harman, *op. cit.*, at 207, 208, and 212. Mexico took over Canada's place as non-oil supplier of the USA, just behind China.

⁶⁷⁸ Harman, *op. cit.* at 212.

⁶⁷⁹ At New Orleans summit (Apr. 22, 2008) President Calderón stated that 1 of 5 jobs in Mexico are related to exports to the USA within NAFTA, and that the annual growth rate of bilateral trade between both nations is of at least USD\$10 billion (see REFORMA, Apr. 23, 2008). A 2010 BANCOMEEXT press-release informs that as of August 2010, Mexican exports to the USA reached a record level of USD\$20.269 billion, USD\$5.208 billion more than the same month in 2009, which means an increase of 34.6%, whilst Mexican imports from the USA, USD\$14.228 billion, 28.5% more than August 2009 (BANCOMEEXT, "Exportaciones record de México a EU" [Record Exports from Mexico to USA] (Oct. 15 2010); available at:

<http://www.bancomext.com/Bancomext/secciones/sala-de-prensa/noticias/exportaciones-record-de-mexico-a-eu.html>).

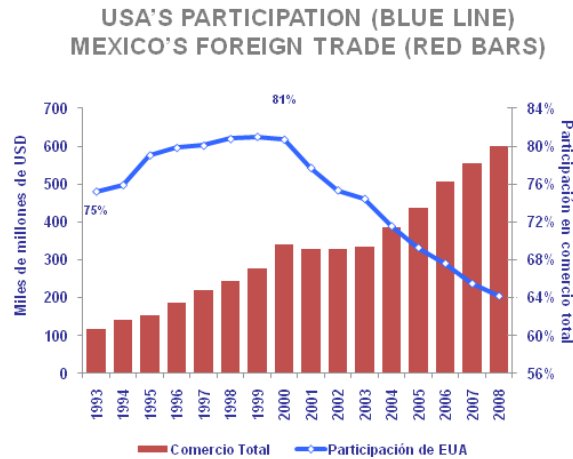
⁶⁸⁰ Office of the United States Trade Representative, "North American Free Trade Agreement (NAFTA);" available at: <http://www.ustr.gov/trade-agreements/free-trade-agreements/north-american-free-trade-agreement-nafta>.

⁶⁸¹ U. S. Census Bureau, "Trade in Goods (Imports, Exports and Trade Balance): 2010;" available at: <http://www.census.gov/foreign-trade/balance/c2010.html#2010>.

⁶⁸² Chart kindly provided by Dr Jaime Serra Puche.

NAFTA & Mexico's Dependence on the USA

USA's participation in Mexico's foreign trade has decreased after NAFTA



Source: BANXICO.

Mexico's exports also display strong structural change, evolving from petroleum to machines. Trade diversion has not been an issue and risks may have been even further reduced by MEFTA.⁶⁸³

Lastly, from the point of view of ad coherent legal structure, NAFTA is more integrated and its enforceability is more effective.⁶⁸⁴ WTO for example, is still fragmented into three parts with disciplines applying to goods in Part I (GATT), another applying to services in Part II (GATS), and Agreement applying to intellectual property rights (TRIPS) in Part III. In contrast NAFTA have incorporated investments, technical barriers to trade that apply to both trade in goods and trade in services alike, etc. in only one body.⁶⁸⁵

⁶⁸³ See Devlin and Castro, *op. cit.*, at 22. See also A. Krueger, "Trade Creation and Trade Diversion under NAFTA" (Working Paper 7429, National Bureau of Economic Research, 1999); and A. Krueger, *NAFTA's effects: A Preliminary Assessment*, WORLD ECONOMY (Jun. 2000).

⁶⁸⁴ RTAs generally have a more effective and sophisticated dispute-settlement procedure. For example, see NAFTA's Ch. 11 and 20.

⁶⁸⁵ See Stephenson, *Regional...*, *op. cit.* at 193.

4.2 NAFTA AND FINANCIAL SERVICES

4.2.1 Objectives, Regulation Sources, and Definitions

NAFTA's main objectives are: 1) To reduce or completely eliminate economic barriers and promote economic integration among NAFTA members; 2) To promote the development of a key legal framework needed to improve security for investments; 3) To facilitate the free flow of goods and services.⁶⁸⁶

Mexico's objectives in financial services in NAFTA are: 1) To expand its economic growth by linking its economy to the USA economy in a way that provides its products favored access to the USA market; 2) To encourage flows of foreign capital into Mexico, thereby providing its industry with the resources necessary to enhance Mexico's economic performance; 3) To contribute to the economic efficiency and facilitate the globalization of its financial sector.⁶⁸⁷

NAFTA's Chapter 14 was a priority for USA and Canada negotiators,⁶⁸⁸ while for Mexico it was a sensitive issue. For the first time in 50 years, Mexico was going to allow foreign financial institutions (in this case, from NAFTA countries) to be established in its territory and wholly own Mexican banks, insurance companies, and companies rendering securities services. Accordingly, NAFTA established a transitional phase for each financial service through the year 2000.⁶⁸⁹

NAFTA'S Chapter 14 contains the main body of the treaty's financial services rules: the regulated financial institutions from each country, investments in financial institutions by investors from another party country, and cross border trade in

⁶⁸⁶ See PAUL, HASTINGS, JANOFSKY & WALKER, *op. cit.*; NAFTA at Ch. 1 and 2.

⁶⁸⁷ See OLIN L. WETHINGTON, *FINANCIAL MARKET LIBERALIZATION: THE NAFTA FRAMEWORK* (1994).

⁶⁸⁸ See Eric Miller, "Financial Services in the Trading System: Progress and Prospectus" (IADB Occasional Paper No. 4, 1999) at 2. The CUSFTA was the FTA ever to include provisions on financial services, as both countries have been net-exporters of financial services. This explains as well why USA and Canada put pressure on Mexico to open its market in financial services.

⁶⁸⁹ See JOHN H. JACKSON, WILLIAM J. DAVEY, ALAN O. SYKES, *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS; CASES, MATERIALS AND TEXT*, 4th ed. (2002), at 868; and NAFTA, Ch. 14, 32 I.L.M. at 657.

financial services.⁶⁹⁰ Still, numerous matters connected with financial services are ruled by other chapters. Sometimes this is because one chapter refers to another or other chapters.⁶⁹¹ Likewise, some provisions of the treaty outline conditions applicable to all of its chapters.⁶⁹²

Some of the regulations and conditions of the financial services chapter of the previous CUSFTA were transferred to NAFTA and are cross-referred.⁶⁹³

NAFTA also imposes on its members the obligation of ensuring that their laws and regulations conform to the general standards of Chapter 14, including the measures of any state, province or local government.⁶⁹⁴

NAFTA lays on their members duties connected with measures (for instance provisions, laws and other regulations) embracing the means of any state, province or local authorities in a NAFTA country. Specifically, NAFTA countries are bound to abide by overall regulations and norms outlined in the chapter – among them NT, MFN treatment, market access, cross-border services, and integrity principles.⁶⁹⁵

Generally speaking, a NAFTA country may not implement a state or province regulation that is in opposition to the country's obligations, unless the applied measure was exempted and incorporated into a special list.⁶⁹⁶ All three countries used their rights to except some of the measures associated mainly with market entry and cross-border service supplies. Some 'exemptions' allow a NAFTA country to apply measures incompatible with the agreed norms of the treaty. These refer chiefly to means taken for 'prudential' reasons⁶⁹⁷

⁶⁹⁰ NAFTA Art. 1401(1).

⁶⁹¹ See *id.* Arts. 1401(2), 1412(2), 1414, 1415, 1416.

⁶⁹² See *id.* Arts. 105, 201, 1101, chs. 20, 21, 22.

⁶⁹³ NAFTA, Art. 1401(4), annex 1401.4.

⁶⁹⁴ *Id.* Art. 1401(1); see also, Art. 1409(1).

⁶⁹⁵ *Id.*, Art. 1401(1). See also *id.* Arts. 105, 201(2), 1409(1)

⁶⁹⁶ *Id.*, Art. 1409; The reservations taken by each NAFTA country with respect to the financial services chapter are set out in annex VII and in annexes to several specific articles of Chapter 14.

⁶⁹⁷ NAFTA, Art. 1410. Mexico applied successfully this exception to protect its financial system. See *infra* 5.8. The Financial Services Case Presented before Chapter 14 of NAFTA: Fireman's Fund Insurance Company.

Concerning the compatibility between NAFTA and WTO, the great majority of the NAFTA obligations are compatible with the WTO parties' obligations. However, there is one GATS provision could be contrary to WTO, that is GATS's MFN obligation of Art. II,⁶⁹⁸ which is a basic GATS obligation. Nevertheless, it has been subject to a legitimizing exception for FTAs and customs unions.⁶⁹⁹

NAFTA sets out special definitions. "Financial services" means any service of a financial nature, whether or not provided by a regulated financial service provider.⁷⁰⁰ "Financial services" also covers all services "incidental or auxiliary" to services of a financial nature, the services provided by government related entities are excluded from the agreement.⁷⁰¹ Financial institution is any entity authorized to do business and regulated as a financial institution under the laws of any NAFTA country.⁷⁰²

NAFTA differentiates between a 'financial service providers' which can be subject to regulation but not necessarily, and 'financial institutions' which need to be regulated. In light of the various regulatory policies among the three member countries, companies involved in specific kinds of financial activities, such as factoring or leasing, may be considered as regulated 'financial institutions' in one NAFTA country and as unregulated 'financial service providers' in another.

NAFTA defines 'investment' as any participation in any kind of business, if that participation means that the owner of such business is entitled to obtain a share in the income or profits of the business. It also comprises any equity investment and all types of property.⁷⁰³

⁶⁹⁸ SCHEFER, *op. cit.*, at 343.

⁶⁹⁹ Art. II of GATS states that members of the agreement may legitimately offer each other more favorable treatment than that they each offer other WTO Members as long as the requisite degree of market integration is foreseen. (WTO, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, Art. XXI, at 301 (2003) [Hereinafter GATS/WTO THE LEGAL TEXTS]).

⁷⁰⁰ *Id.* Art. 1416. See also Kenneth Bachman, Scott N. Benedict, Ricardo A. Anzaldúa, *Financial Services under the North American Free Trade Agreement: An Overview*, 28 INT'L L (1994) at 293.

⁷⁰¹ *Id.* Art. 1401(3), 1410(3).

⁷⁰² NAFTA Art. 1416. It also distinguishes between financial services providers which may or not be regulated and financial institutions which must be regulated.

⁷⁰³ *Id.*, Arts. 1139, 1416.

4.2.2 Rules of Origin

To be able to take advantage of NAFTA's financial services regulations, financial entities and investors must meet specific requirements of 'rules of origin' cross-referred to from Chapter 12 on Cross-Border Trade in Services. Under these requirements a NAFTA country may deny benefits when the financial institution or the financial provider is owned or controlled by nationals of a non-NAFTA country and has no substantial business activities in the territory of a NAFTA country.⁷⁰⁴

Likewise, a NAFTA country may deny benefits to a financial entity if the investment is controlled by nationals of a non-NAFTA country with which the NAFTA country does not have diplomatic relations or trade restrictions exist.⁷⁰⁵ Canada may additionally deny benefits to any investment which is not ultimately controlled by nationals of NAFTA country.⁷⁰⁶

4.2.3 Common Objectives with Respect to Liberalization of Trade in Financial Services on These Various Frameworks: Cross Border Services, Transparency, Stability and Liberalization

NAFTA, like GATS and other RTAs, establishes basic principles guiding investment in financial services such as: commercial presence, cross border services, non-discriminatory treatment, progressive liberalization, transparency, stability, protection of privacy, competition rules, movement of natural persons, movement of capitals, the general exceptions, and prudential exceptions.

4.2.4 Commercial Presence and Cross Border Services⁷⁰⁷

Financial Services providers of a NAFTA country may establish banking, insurance and securities operations, as well as other types of financial services in any other

⁷⁰⁴ *Id.*, Art. 1211.

⁷⁰⁵ *Id.*, Art. 1211 (1)(a).

⁷⁰⁶ NAFTA, annex VII (B)(2) Canada.

⁷⁰⁷ *Id.*, Art. 1404.

NAFTA country. This is known as “mobility of provider.”⁷⁰⁸ Each country may determine the juridical form that the services providers should take.

Each country must permit its residents to purchase financial services in the territory of another NAFTA country, which is known as “mobility of consumer,”⁷⁰⁹ although the country does not have to allow solicitation activities by such providers in its own territory.⁷¹⁰

There is also an obligation known as “standstill” by virtue of which a country may not impose new restrictions on the cross-border provision of financial services in a sector.⁷¹¹ This means that a NAFTA country may maintain the measures it had before NAFTA came into force to regulate cross-border services and mobility of providers but may not adopt any new measure increasing restrictions, unless there is an exception clearly specified in the reservations.⁷¹²

Some of the standstill rule exemptions are: 1) Canada right to impose more restrictive means on cross-border trade in securities after NAFTA;⁷¹³ 2) A similar reservation by the USA concerning Canada;⁷¹⁴ and 3) A specific obligation assumed by Mexico to free particular cross-border insurance services.⁷¹⁵

All three countries opted for subsequent liberalization of financial services across the borders with the inclusion of insurance services and negotiations due to no later than January 1, 2000.⁷¹⁶

In the case of Cross-Border services in GATS,⁷¹⁷ members must explicitly indicate the types of services that they commit to allow into their markets by this

⁷⁰⁸ *Id.*, Art. 1004(1).

⁷⁰⁹ *Id.*, Art. 1404. The only restriction is that should fulfill the rules of origin requirements.

⁷¹⁰ *Id.*, Art. 1402(2). NAFTA permits each country to adopt its own definition of doing business.

⁷¹¹ *Id.*, Art. 1004(1). Among the important exceptions to the standstill obligation are reservations by Canada permitting it to adopt more restrictive measures affecting cross-border trade in securities after NAFTA entered into force.

⁷¹² *Id.*

⁷¹³ *Id.*, annex VII(B)(1)-Can.

⁷¹⁴ *Id.*, annex VII(B)-USA.

⁷¹⁵ *Id.*, annex VII(A)-Mex.

⁷¹⁶ NAFTA, annex 1404.4.

⁷¹⁷ GATS/WTO THE LEGAL TEXTS Art. I.

means. NAFTA coverage of cross-border trade, while only binding the parties not to worsen their present practices, is an unconditional requirement for them.

In their GATS Schedules of Specific Commitments, Canada and USA committed to ensure that WTO Member financial services suppliers are permitted to deliver their services by means of cross-border supply methods. Thus, NAFTA obligations are compatible with WTO obligations in this area.

Mexico left its GATS commitments for cross-border supply modes unbound for banking service delivery. Thus, Mexico may restrict other WTO Members' banks from engaging in cross border trade to the extent it sees fit. In the case of NAFTA, however, Mexico is obliged to offer party banks access to its market through cross-border supply.

For non-NAFTA member banks, these obligations could result in disadvantages. The fact that Mexico did not include cross-border supply within the scope of its GATS commitments is legitimate; consequently, there is no actual violation of a non-party's WTO rights caused by this competitive inequality.⁷¹⁸

NAFTA allows consumer movement. NAFTA members adopted a rule to let their citizens obtain financial services from any financial services supplier within the territory of another NAFTA state that meets the requirements of the principle of rules of origin.⁷¹⁹ Moreover, NAFTA members ought to allow their citizens and residents located outside their territory to procure financial services from NAFTA financial service suppliers located outside that territory as well.

4.2.5 NT and MFN

NAFTA's financial services chapter binds its member states to grant financial institutions, cross-border financial service suppliers and investors from other NAFTA countries, NT as well as MFN treatment.⁷²⁰

⁷¹⁸ See SCHEFER, *op. cit.*, at 347.

⁷¹⁹ *Id.*, Art. 1404(2).

⁷²⁰ NAFTA, Art. 1405, 1406.

NT principle requires awarding investors, their investments, and financial entities of other NAFTA states, treatment no less favorable than it does to its own national incumbents under similar conditions.⁷²¹ This requirement is met by NAFTA's countries' provisions that guarantee tantamount comparative chances to institutions, investors and their investments from other NAFTA states.⁷²²

A NAFTA country may satisfy the requirement of NT even though it may treat financial services providers of another party differently from domestic financial services if it accords equal competitive opportunities.⁷²³

MFN regulation⁷²⁴ binds NAFTA countries to secure to investors, their investments and financial entities of other NAFTA countries treatment no less propitious than it gives to investors, their investments and financial incumbents from any other state under similar conditions.

The effect of requiring each NAFTA country to provide both above mentioned treatments is to require the better of the two in any situation where one or the other is more favorable.

⁷²¹ *Id.*, Art. 1405(1)-(4).

⁷²² *Id.*, Art. 1405(5).

⁷²³ *Id.*, Art. 1405 (5).

⁷²⁴ MFN represents both advantages as well as disadvantages. It should be said that MFN clause provides that advantages extended to third state are automatically extended to the beneficiary state as a right and are not subject. One of the best examples of a reciprocal unconditional MFN clause is found in Article (1) of GATT and is considered one of the cornerstones of the current international trading system. In favor of MFN it can be said that without it governments may be tempted to form particular discriminatory international groupings. These special grouping can cause misunderstanding and disputes because the countries resent the exclusion. MFN could both lessen tensions among nations and inhibit government temptation to rely on short-term policies that could result in creating more tension. However, it has been seen as a debatable issue in the world trade history system and some have argued that has caused problems to some countries creating an unequal treatment. Hornbeck, for example points out that MFN is giving privileges and advantages to some countries involved in the network, generating in some way some discriminations against the countries excluded of the treatment, for example, Russia had not been a party to one important convention on the past, this is the Brussels Sugar Convention and Russia protested vigorously against the countervailing duties imposed by the U.S.A. and the U.K. It is worth turning as well to the history of the clause and to the early assertions which were made concerning its character and purpose, so we find that its original function was not to secure advantages but to insure against discrimination. See Stanley K. Hornbeck, *The Most Favored Nation Clause*, *The American Journal of International Law*, Vol. 3, No. 3 (Jul, 1909) at 629. See ANDREW PAUL NEWCOMBE. *LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT*, 2009, Kluwer Law International BV The Netherlands, at 198-199. See also JACKSON, *op. cit.*, at 157.

The guiding principle of NAFTA regarding financial supervision is reserved to the host country affair. However, regulators are permitted to negotiate bilateral agreements leading to regulatory and supervisory harmonization.⁷²⁵

Mexico signed WTO/GATS and its commitments are annexed to its Schedule to GATS. Specific commitments are made according to the four modes of supply for each services sector related: (1) cross border supply, (2) consumption abroad, (3) commercial presence and (4) free movement of natural persons.⁷²⁶ Mexico's commitments set up some deviations from the non-discrimination and NT principles, for example, foreign institutions must obtain authorization from SHCP, and governmental foreign investment is not permitted.

4.2.6. Transparency (GATS Art. III and NAFTA Art. 1411)

Drafted with the conviction that visibility reduces protectionism, GATS Art. III provision on transparency has as goal that each WTO Member's laws and regulations affecting trade in services are made public and available to interested persons. Specifically, the article states that members shall publish promptly and, at the latest by the time of their entry into force, all relevant measures of general applications which pertain to the operation of this Agreement.

In addition to publishing their measures, WTO members shall promptly, and at least annually, inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws, regulations or administrative guidelines which specifically affect trade in services covered by their specific commitments.

A comparison of the requirements of GATS Art. III with the parallel provision in NAFTA Chapter 14 reveals no exclusivity in fulfilling the obligations of each treaty. The requirements of publications of new measures and the establishment of information centers to distribute detailed information are also present in the NAFTA.

⁷²⁵IADB, "Financial Integration," at 105.

⁷²⁶Schedule of Commitments Mexico, at 3.

However, NAFTA Art. 1411 is not only more detailed than the GATS Art. III, it is also targeted at involving all interested persons in the rule-making processes of the NAFTA Parties - not just persons of NAFTA Parties. GATS obligation is phrased in terms of government-to-government (that is, member-to-member) notification.

Thus, assuming that private persons will maintain vigilant watch over the implementation of the treaty requirements, NAFTA has a higher potential for achieving non-discrimination in domestic measures. Art. 1411 begins, for instance, by requiring that notice of proposed measures of “general application” be published in order to allow an opportunity for such persons to comment on the measure.

This idea of allowing for comments on proposals before a rule is made suggests (without an explicit requirement) that the rule makers of the party take the comments into consideration before deciding whether to enact the proposed rule.⁷²⁷

4.2.7 Progressive Liberalization⁷²⁸

The GATS that came into effect in 1995 was a framework agreement. Even with the additional commitments that have since come into effect, GATS is not an instrument that completely covers the international service trade. Knowing that it was only a good first step, GATS was agreed on and signed by the members on the condition that further liberalizations were to be negotiated in the future. Together Art. XIX through XXI of GATS are a clear symbol of this open-endedness.

Comprising Part IV (Progressive Liberalization) of GATS, these provisions set out the framework requirements of future negotiating rounds in the services sectors. Starting no later than in 2000, and “periodically thereafter”, the members shall enter into successive rounds of negotiations, with a view to achieving a progressively higher level of liberalization.

The schedules of specific commitments completed by each member at the end of the Uruguay Round, the Second Protocol, and/or the Fifth Protocol are the basis on

⁷²⁷ See SCHEFER, *op. cit.*, at 158-171.

⁷²⁸ See GATS/WTO THE LEGAL TEXTS Arts. XIX-XXI and NAFTA Art. 1404.

which further developments in financial services are to proceed, while the existing commitments may be withdrawn or modified.¹⁶²

NAFTA Chapter 14 is more complete than was the GATS Annex on Financial Services. Yet, since NAFTA did not accomplish all that the negotiators had hoped it would, its parties also provided for further attempts to liberalize their financial service markets in “two of Chapter Fourteen’s Annex Provisions”.

In Annex 1404.4 there is an obligation to consult on further liberalization of cross-border trade in financial services. Annex 1413.6 also requires consultations on certain provisions of Mexico’s commitments. Neither of these NAFTA provisions would have an adverse effect on a non-Party, WTO Member.

4.2.8 Market Access

A NAFTA state is bound to allow individuals and enterprises from other NAFTA countries to set up financial institutions in its area and to expand their functioning throughout its territory.⁷²⁹ NAFTA restricts this advantage to ‘financial service providers’, which means that, to be entitled to this, an entity needs to be involved already in performing business connected with financial services.⁷³⁰

NAFTA states may limit cross-border subsidizing of financial institutions, which permits member states to demand individual incorporation for financial incumbents in their territory, forbidding through this a direct cross-border branching.⁷³¹ Yet, NAFTA members have decided on discussing the possibility of direct bank

¹⁶² See SCHEFER, *op. cit.*, at 158: “... it becomes clear from the Preamble and Art. XIX [GATS] that there is no obligation to liberalize trade in services immediately, but that liberalization should be achieved progressively in successive rounds of negotiations. The liberalization process has to take account of national policy objectives and in particular each member’s level of development. In addition, special concessions are made to developing country members ... The adherence to the principle of progressive liberalization of trade in services was clearly reaffirmed by all WTO members at the Singapore Ministerial Conference in December 1996 [footnote omitted]. Full liberalization of trade in financial services was therefore certainly not the aim of Uruguay Round negotiations and should not realistically be expected to be achieved by December 12, 1997 ... Each round of negotiations is, however, due to achieve some important improvements so as to increase the general level of commitments without reducing the liberalization already reached today.”

⁷²⁹ *Id.*, Art. 1403.

⁷³⁰ *Id.*, Art. 1403(5).

⁷³¹ *Id.*, Art. 1403(4).

branching across NAFTA country borders if and when the USA permits Mexican- and Canadian-controlled USA banks to extend cross-state by subsidiaries or branches to include all the area of the USA.⁷³²

One of the limitations on market access of NAFTA is that it restricts cross border branching of financial institutions. In other words, NAFTA member will require separate incorporation for financial institutions in its territory (by subsidiaries).⁷³³ Nevertheless, the members have agreed to re-negotiate cross border branching throughout the time.⁷³⁴ These general principles of market access are in connection with the specific commitments and reservations made from every NAFTA country in its annexes. All these form an integral part of the Agreement.

Thanks to the broad range of NAFTA's financial services chapter it deals with new sorts of financial services that may be non-existent so far. According to the regulation of that chapter, NAFTA countries have consented to allow entry into its market to all regulated financial institutions from another NAFTA country provided its services are authorized in the territory of the country of origin.⁷³⁵

In addition, NAFTA countries have agreed to let regulated financial institutions from other NAFTA countries to pass the information for data processing into and out of the country of origin's area, given that such a transfer is demanded in the regular conduct of business of these entities.⁷³⁶

4.2.9 Staffing

Chapter 14 severely restrains each country's capability to apply residency or nationality requisites on financial institutions. Therefore, no NAFTA state is permitted to demand from a financial institution being under control of persons from

⁷³² *Id.*, Art. 1403(3).

⁷³³ *Id.* Art. 1403(4).

⁷³⁴ *Id.* Art. 1403(3).

⁷³⁵ *Id.*, Art. 1407(1).

⁷³⁶ *Id.*, Art. 1407(2).

other NAFTA country to hire personnel of any specific nationality as “senior managerial or other essential personnel”.⁷³⁷

It is also forbidden to impose requirements on a simple majority of the board of directors of financial institutions to be comprised of a country’s own citizens or/and residents.⁷³⁸ The USA reserved the right to maintain citizenship and residency requisites in relation to national bank presidents subject to the current law.⁷³⁹

4.2.10 Investment in Financial Institutions

Chapter 14 includes, by cross-reference, some regulations of Chapter 11 (on investment).⁷⁴⁰ These provisos, among other things, allow each NAFTA country to introduce particular demands (like incorporation, residency requisites for investors or information requirements) in relation to investments by investors from other NAFTA countries, under condition that these demands do not weaken the essence of the profits of the treaty.⁷⁴¹

These regulations establish numerous other rights and duties. For instance, a NAFTA state is not allowed to nationalize or dispossess of ownership, either directly or indirectly, the property of an investor from another NAFTA country except: 1) When done for a public purpose; 2) On NT and MFN grounds; or 3) In agreement with rules of due process of law.⁷⁴²

If an expropriation happens anyway, the investor must be remunerated at a fair market value, verified and paid meeting particular criteria. These criteria need to take into consideration the timing of assessment and payment, the payment of interest, the currency in which the payment is made, going-company value, and other issues determining the fair value of the enterprise.⁷⁴³

⁷³⁷ *Id.*, Art. 1408(1).

⁷³⁸ *Id.*, Art. 1408(2).

⁷³⁹ *Id.*, annex VII(A)-USA.

⁷⁴⁰ *Id.*, Art. 1401(2). This provision incorporates Arts. 1109 through 1111, 1113, 1114, and 1211 into the financial services chapter.

⁷⁴¹ *Id.*, Art. 1111.

⁷⁴² *Id.*, Art. 1110(1).

⁷⁴³ *Id.*, Art. 1110(1)-(6).

NAFTA states also agreed to allow investors from other NAFTA countries to make transfers directly connected with the investments (such as dividends, apportions of profits, interests and other payments) in the currency they select.⁷⁴⁴

This duty is subordinate to applicable bankruptcy and securities laws, criminal laws regulating currency transfers, laws regarding the satisfaction of judgments, emergency balance of payments means and provisions connected with the safety, soundness, integrity or financial responsibility of financial service providers.⁷⁴⁵

Concerning environmental issues, NAFTA countries decided that environmental regulations should not be forgone or renounced to draw, maintain or facilitate investment.⁷⁴⁶ The investment chapter grants investors a right to a special dispute resolution mechanism for investor-state arguments connected with investments.⁷⁴⁷

4.2.11 Reservations and Commitments

Taking into account all the provisions included in NAFTA, and in the financial services chapter in particular, one has to notice the importance of numerous exemptions opted for by the three NAFTA countries. These exemptions reconcile differences in legislations, aims and negotiation privileges between NAFTA countries.

From the practical point of view the division of the exemptions from the main text of the agreement allowed many regulations to be expressed explicitly, as a declaration of general rules. This move can facilitate the future enlargement of the NAFTA by easing access to the treaty by subsequent countries.⁷⁴⁸

Annex VII provides for the chief exemptions to Chapter 14 which constitute two kinds. Firstly, all the countries have kept the right to apply already existing means that are not compatible to Arts. 1403 (setting up the financial institution), 1404

⁷⁴⁴ *Id.*, Art. 1109(1), (2).

⁷⁴⁵ *Id.*, Arts. 1109(4), 1410(4).

⁷⁴⁶ *Id.*, Art. 1114(2).

⁷⁴⁷ See *id.*, Arts. 1414, 1415, ch. 20.

⁷⁴⁸ See NAFTA, Art. 2204.

(across border trade), 1405 (NT), 1406 (MFN), 1407 (new financial services and data processing), and 1408 (personnel employment).⁷⁴⁹ To be reserved, a regulation needs to have been existent on the date of entry into life of the Agreement (January 1, 1994).⁷⁵⁰

Mexico did not reserve any restrictions as to national measures under Chapter Fourteen. Local authorities' regulations already in place, that are inconsistent with NAFTA, may be exempted without any particular need to enumerate them on a specific list.⁷⁵¹

The second group of exemptions comprises country-by-country arrangements as to reservations related to specific regulations, which are enlisted in every country's section B to annex VII. Like the exemptions enumerated in section A, the exemptions enlisted in section b of annex VII may be used only against particular regulations of the chapter, to be specific Arts. 1403 through 1408.

Yet, section B reservations are not restrained to already existing means.⁷⁵² Interestingly, the ones which are the longest and most thorough belong to Mexico and determine stipulations and requirements by which Mexico agrees to allow entry to its financial markets to USA and Canadian financial institutions.

⁷⁴⁹ *Id.*, Art. 1409(1).

⁷⁵⁰ *Id.* Art. 2203.

⁷⁵¹ *Id.*, Art. 1409(1)(a)(iii).

⁷⁵² *Id.*, Art. 1409(2).

4.2.12 Exclusions

Art. 1410 states that nothing in the part of the NAFTA, including the financial services chapter, shall be interpreted as regulation refraining a NAFTA country from applying measures for ‘prudential’ reasons or in search of monetary and credit related or exchange rate resolutions.⁷⁵³ This proviso is crucial and embraces various regulatory notions and aims. Above all, it exempts from a number of chapters of the NAFTA sensible means applied or kept for prudential regulatory reasons.

This so called ‘carve-out’ guarantees that each member country has the elasticity to control and oversee financial institutions and financial markets. Prudential measures may be means employed for the security of investors and depositors, or to sustain the integrity of financial institutions, or to guarantee the security and steadiness of a NAFTA country’s financial system.⁷⁵⁴

An independent chapter includes a related exemption which applies to the whole NAFTA in general. In particular, Art. 2104 excepts from the regulations employed for balance of payments reasons, if the NAFTA country introducing them undergoes a grave crisis in this area, and provided the measures are compatible with IMF actions. This exemption is subordinate to numerous terms which change according to whether the balance of payments means is connected with across borders trade in financial services or not.

Other reservations of Chapter Fourteen recognizes NAFTA countries’ authorities’ freedom to decide on their public retirement and statutory social security plans or any activity or service with the guarantee of utilizing the financial expedients of a government or a governmental body.⁷⁵⁵

Eventually, other chapters of NAFTA include exemptions that may be implemented in the financial services area under some conditions. Art. 2102, for

⁷⁵³ *Id.* Art. 1410(1), (2).

⁷⁵⁴ *Id.* Art. 1410(1).

⁷⁵⁵ *Id.* Arts. 1401(3), 1410(3).

instance, excepts means regarded as crucial by a NAFTA state to protect national security.⁷⁵⁶ NAFTA also excludes issues of taxation, which are mainly managed by two-sided tax settlements.⁷⁵⁷

4.2.13 Administration and Dispute Settlement

NAFTA is superintended by a body called a Free Trade Commission.⁷⁵⁸ This Commission on its part is propped by a NAFTA Secretariat.⁷⁵⁹ NAFTA also appoints various committees and working panels on numerous matters, all being under the surveillance of the Free Trade Commission.⁷⁶⁰

Among the latter is the Financial Services Committee comprised of financial services regulatory experts from each of the NAFTA countries.⁷⁶¹ The main responsibility of the Financial Services Committee is to oversee the application of the financial services chapter, dealing with the financial matters addressed by any NAFTA state and part taking in financial services dispute settlement proceedings.

The dispute settlement process is considered by all countries as crucial matter that involves national sovereignty. Dispute settlement issues are contained in chapters 11 (investment), 19 (antidumping and countervailing duty questions), 20 (administration and general approach to dispute resolution), and various other provisos.

The resolution process for financial services is similar to the one used for other parts of NAFTA. Yet, some differences exist. The process entails a number of stages. In the first place, a NAFTA state may ask for consultations with one or more NAFTA countries on any problem related to financial services.⁷⁶² These talks are supposed to be carried out by appointed entities regulating financial services. A

⁷⁵⁶ *Id.* Art. 2102.

⁷⁵⁷ *Id.* Art. 2103.

⁷⁵⁸ *Id.* Art. 2001.

⁷⁵⁹ *Id.* Art. 2002.

⁷⁶⁰ *Id.* Arts. 2001(2)(d), 2001(3), annex 2001.2.

⁷⁶¹ *Id.* Art. 1412, annex 1412.1.

⁷⁶² *Id.* Art. 1413.

participation of other regulatory entities is allowed at the request of a NAFTA country.⁷⁶³

If consultations do not achieve the expected success, a NAFTA state may resort to the Free Trade Commission to help resolve the debate.⁷⁶⁴ The Commission may apply various tools to reach a compromise - additional consultations, hearings, working groups or counselors, provide recommendations, and utilize arbitration and employ other available operations to ensure the maximum satisfaction for both of the sides while resolving the matter.⁷⁶⁵

If the parties are not content with the result achieved by the Commission, a NAFTA country may demand the designation of an arbitral panel to hear the arguments of the debate.⁷⁶⁶ Each panel should be composed of five impartial experts selected from a group of arbitrators, which group is nominated by each party according to the principles contained in the agreement.⁷⁶⁷ Independent groups of financial experts and other experts are designed to serve the purpose of resolution.⁷⁶⁸

In the case of financial services disputes all five arbitrators may be chosen from the roster of financial experts, provided all involved countries agree. If the countries do not agree on this matter, there exists a possibility of selecting experts from both financial arbitrators' roster and non-financial arbitrators group.⁷⁶⁹ If the line of defense of a defendant country entails prudential regulation or monetary policy, then the panel needs to be comprised of financial experts obligatorily.⁷⁷⁰

The mediation panel submits its initial and final reports to the Free Trade Commission, which decides on the final settlement together with the disputing parties. Usually, the Commission oversees implementing of the panel's recommendations.⁷⁷¹ Yet, it is not the rule. If the advice of the panel is not

⁷⁶³ *Id.*

⁷⁶⁴ *Id.* Arts. 1414, 1415, 2003, 2004, 2006, 2007.

⁷⁶⁵ *Id.*

⁷⁶⁶ *Id.* Art. 2008.

⁷⁶⁷ *Id.* Arts. 2009, 2010, 2011.

⁷⁶⁸ *Id.* Arts. 1414(1), 2009.

⁷⁶⁹ *Id.* Art. 1414(4).

⁷⁷⁰ *Id.* Art. 1414(4)(ii).

⁷⁷¹ *Id.* Arts. 2016, 2017, 2018.

followed, the dominant party may reciprocate through refusing profits in the financial services sector that equilibrate the losses in the affected area.⁷⁷²

4.2.14 Provisions Regarding Access to Mexico

The financial Services chapter and associated annexes, in particular annex VII, ensures an easier access to Mexican financial markets for USA and Canadian financial services entities. The regulations will enter into force by the means of new laws, provisions and interpretations and other measures introduced by SHCP and its subsidiary commissions such as CNBV and CNSF.

4.2.15 Establishment of Financial Institution Subsidiaries in Mexico

American and Canadian financial services suppliers and investors conducting business in their countries may ask to set up or purchase Mexican governed financial institutions to engage in ‘alike’ activities in Mexico. When it comes to some kinds of financial services, like foreign exchange, bonding and general deposit warehouse services, the requests may be made at once after entering into life of the Treaty.

When a USA or Canadian investor legitimately sets up or procures a bank or securities enterprise in Mexico, that investor acquires a right to establish a ‘financial group holding company’ subordinate to Mexican law and can extend the scope of his activities to other sorts of financial services under the same conditions as national Mexican investors.⁷⁷³

Taking advantage of the Mexican financial group organizational system, qualified USA and Canadian investors may create or purchase supplementary Mexican enterprises involved in the complete scope of financial services activities allowed under Mexican law, comprising banking, securities, insurance, factoring, leasing, bonding, and warehousing, among others. Moreover, according to Mexican law, financial services entities branched through a financial group may have the same name and sell their products through the agency of any other enterprise in the group.

⁷⁷² *Id.* Art. 1414(5). Compare *id.* Art. 2019.

⁷⁷³ *Id.* annex VII(C)(5)-Mex.

4.2.16 Special Restrictions and Powers

In Annex VII, Mexico restricted the right to employ various terms and stipulations on financial services suppliers and investors pursuing access to Mexico. Therefore it may require from an investor to be already involved in providing the same type of financial service in its home NAFTA country.⁷⁷⁴ Mexico may prevent investors from possessing more than one financial entity of each kind in Mexico.⁷⁷⁵

Moreover, Mexico can require from a financial entity (other than an insurance company), which is supposed to be set up or purchased in Mexico by an investor from another NAFTA country, to be completely owned by that investor.⁷⁷⁶

Investing in Mexican insurance companies is exempted from the above requirement because Mexican provisions have for a number of years allowed alien insurance companies to access joint venture enterprises or make significant minority investments in Mexican insurance entities. Other regulations concerning insurance companies and included in the financial services annex of Mexico maintain the same privilege.

Mexican financial services enterprises owned by investors of other NAFTA state are granted the same powers, and are subordinate to the same restrictions and provisions, as national companies, with a few exclusions, among them being the ones related to the capital and asset limits though applying only for a definite period of time and not to all kinds of financial services. Mexican financial services companies owned by investors from other NAFTA countries may be prevented from setting up branches, affiliations and agencies outside Mexico.⁷⁷⁷

⁷⁷⁴ *Id.* annex VII(B)(14)(a)-Mex. This is in addition to the more general requirements that an investor meet the rule of origin test to benefit under the Financial Services Chapter and that a company be engaged in financial services in its home NAFTA country to be considered an eligible “financial service provider” or “financial institution”. *See supra* notes 12, 17-23, 29-30 and accompanying text.

⁷⁷⁵ NAFTA, *supra* note 1, annex VII(B)(14)(b)-Mex.

⁷⁷⁶ *Id.* annex VII(B)(12)-Mex.

⁷⁷⁷ *Id.* annex VII(B)(12)-Mex.

4.2.17 Capital and Asset Limits

A unique particular type of financial institution called SOFOLES will be subservient to restrictions grounded on the amount of their assets, not their capital.⁷⁷⁸ Control capital requisites (and sometimes asset restrictions) efficaciously restrict the extent of a Mexican financial institution's transactions.⁷⁷⁹ Thanks to that, these restrictions are frequently called 'market share limits'.

4.2.18 Banks, Securities, Insurance

For banks owned by investors from NAFTA countries, the whole industry capital limit started at 8% in 1994 and was meant to increase to 15% by 1999.⁷⁸⁰ The sole-institution capital limit was meant to be 1.5% through year 1999.⁷⁸¹

For securities brokers owned by investors from NAFTA states, the whole industry capital limit increased from 10% in 1994 to 20% in 1999. The sole-institution capital limit was 4% through year 1999. As to bank branches, Mexico was entitled, until the year 2004 and under some circumstances, to freeze or expand for three years the whole industry capital limit of alien investor securities enterprises under a safeguard regulation.⁷⁸²

For insurance the whole capital limit increased from 6% in 1994 to 12% in 1999.⁷⁸³ The sole-institution capital limit was 1.5% through 1999.⁷⁸⁴ Both limits ceased to be applicable in January 1, 2000.⁷⁸⁵ Separate measure and application of capital limits could be imposed on life and health insurance and to casualty and other kinds of insurance.

⁷⁷⁸ *Id.* annex VII(B)(8)-Mex.

⁷⁷⁹ *Id.* annex VII(B)(1)-(7)-Mex.

⁷⁸⁰ *Id.* annex VII(B)(5)-Mex.

⁷⁸¹ *Id.* annex VII(B)(2)-Mex.

⁷⁸² *Id.* annex VII(B)(9)-Mex.

⁷⁸³ *Id.* annex VII(B)(6)-Mex.

⁷⁸⁴ *Id.* annex VII(B)(2)-Mex.

⁷⁸⁵ *Id.* annex VII(B)(9)-Mex.

4.2.19 Other Financial Services

The same whole capital limits on Mexican factoring and leasing firms owned by investors from another NAFTA state were applicable to securities brokerage firms, until the year 2000.⁷⁸⁶ Such firms were not, nevertheless, subordinated to individual capital limits.⁷⁸⁷ Among those not subject to any restrictions in this matter were warehousing, bonding, foreign exchange and mutual funds management companies.

Mexico allowed by its regulations to establish SOFOLES which are mandated to involve in lending and other types of bank-like activities except for deposit-taking. Under NAFTA Mexico permitted USA and Canadian non-bank investors to set up SOFOLES in its territory, offering conditions no less favorable than it offers to its national Mexican companies as to providing consumer, commercial or mortgage lending or credit card services.⁷⁸⁸

Until 2000, NAFTA imposed on these alien-possessed SOFOLES the whole, but not individual, limits grounded on their assets, not on their capital.⁷⁸⁹ The total assets of such companies cannot surpass 3% of the total assets of all banks and limited-scope financial entities in Mexico.⁷⁹⁰ The limit is calculated without taking into consideration lending by limited-scope branches of automobile manufacturers, which are not subordinate to this restriction.

4.2.20 Cross-Border Insurance Services in Mexico

NAFTA bound Mexico to allow USA and Canadian companies to supply some cross-border insurance services so far banned by Mexican regulations. To be specific, Mexico agreed on the insurance of tourism-related risks in Mexico (with an exception of risks of liability to third parties) and associated intermediary services, if procured through physical mobility of the consumer without requesting in Mexico by the provider.

⁷⁸⁶ *Id.* annex VII(B)(5)-Mex.

⁷⁸⁷ *Id.* annex VII(B)(2), (5)-Mex.

⁷⁸⁸ *Id.*, annex VII(B)(2)-Mex.

⁷⁸⁹ *Id.* annex VIII(B)(8)-Mex.

⁷⁹⁰ *Id.*

Mexico, as well, agreed to let Mexican consumers obtain from USA and Canadian companies the following: insurance of shipments of goods in international transit to or from any NAFTA country from point of origin to final destination; insurance of the vehicle transporting such goods (including vehicles used in maritime shipping, commercial aviation, and space launching and freight, including satellites) during the period of its use in such transportation, provided that such vehicle is licensed and registered outside Mexico; and related intermediary services.

Mexico keeps the right to other restrictions on across border insurance services in accordance with the law current at the time of signing NAFTA.⁷⁹¹

4.2.21 Provisions Regarding Access to Canada

Canada has reserved fewer restrictions and assumed fewer new obligations than Mexico under the financial services chapter. Generally, it granted Mexican companies and investors the same benefits already in place for USA investors under CUSFTA.

Canada allows Mexican investors to set up affiliate financial institutions in its territory and excludes them from some of the regulations of the so-called 10/25 investment rules applicable to aliens, under which no investor may possess 10% of the capital of any national-wide Canadian financial institution, and non-nationals in total may not own more than 25% of such capital.

NAFTA allows Mexican and USA investors to have a control over Canadian financial institutions affiliates (Schedule II subsidiaries) without those limits. These settlements subordinate USA, Mexican, and national Canadian investors alike, to 10% limit on investments in Canadian largest nation-wide financial institutions. Yet, NAFTA excepts USA and Mexican investors from the restriction on the 25% total investments by non-Canadians in nation-wide institutions.⁷⁹²

⁷⁹¹ *Id.*, annex VII(A)-Mex.

⁷⁹² *Id.*, annex VII(C)(1)-Can.

Moreover, Canada has decided on exempting Mexican-controlled bank branches from the requisite of acquiring Canadian ministry of Finance approval before establishing supplementary affiliations in Canada.⁷⁹³

What Canada did not agree on is covering Mexico with the provisions of CUSFTA in term of all financial services. Additionally, Canada also reserved some restrictions under the financial services chapter related with securities regulation, reinsurance, and any current incompatible local measures.⁷⁹⁴

4.2.22 Provisions Regarding Access to the USA

The USA has made significantly more reservations under the financial services chapter compared to Canada.⁷⁹⁵ What is more, the USA was allowed, up to January 1, 1995, to exclude existing incompatible means operating in forty-four states.⁷⁹⁶ Juxtaposing NAFTA and CUSFTA, it becomes clear that USA did not make too much further advancement in giving new possibilities for Canadian financial services providers' functioning.⁷⁹⁷

USA did not assume the obligations to spread out all the financial services regulations of the CUSFTA to Mexico, either. Unlike the Canadian government securities under the CUSFTA, USA has not awarded the Mexican government securities the status of being 'bank eligible' in accordance with the Glass-Steagall Act.⁷⁹⁸

NT and MFN principles of the chapter on financial services should nevertheless be applicable in Canadian and Mexican investors' involvement in any subsequent

⁷⁹³ NAFTA, *supra* note 1, annex VII(C)(2)-Can.

⁷⁹⁴ NAFTA, annex VII(A), (B)(1)- Can., Art. 1409(1), annex 1409.1.

⁷⁹⁵ See *id.*, annex VII(A)-USA

⁷⁹⁶ *Id.*, Art. 1409(1), annex 1409.1.

⁷⁹⁷ See CFTA, Art. 1403(3), annex 1403.3.

⁷⁹⁸ *Id.*, Art. 1702(1). See also IADB, *Financial...*, *op. cit.*; and David Hale, *The World's Banking Superpower*, FINANCIAL TIMES, at 21. The Glass-Steagall act established in 1933 that the banking and securities sectors should keep separate. This took the US regulatory industry in different direction than its counterpart Mexico and Canada which were pursuing a Universal Banking. The US is the world's banking superpower.

financial services freeing that may take place in the USA. This may comprise, for instance, multi-state subsidizing and the Glass-Steagall Act reform.

In relation to it, it is noteworthy to mention that Mexico and Canada have opted to review the manner of market access allowed for financial services companies – together with permitting direct, across border affiliating rather than merely individually incorporated branches (with an exception of revisiting Mexico’s market entry restrictions) – at the same time at which USA decides to let Canadian and Mexican banks to extend their operating multi-state throughout all of the USA.⁷⁹⁹

Eventually, USA has committed itself to Mexico, though not fully, in relation to the Glass-Steagall Act matters.⁸⁰⁰ USA agreed to release Mexican financial entities from provisions of the Glass-Steagall Act and connected limitations for a period of five years, given that while establishing the entity before NAFTA came into life it purchased: 1) A Mexican bank with USA transactions, and 2) A Mexican securities company that possesses or controls a USA securities company.⁸⁰¹

The allowed activities of the USA securities subsidiary need to be restricted to those in which it was involved in on the date of purchase, and the USA branch is not permitted to extend its operations through acquisition in the USA for five years.⁸⁰² This limited five-year disclaimer would seem to favor only a few Mexican banks that became subsidized with Mexican securities companies (and their USA securities transactions) while privatizing Mexican state-owned banks in 1991 and 1992.⁸⁰³

⁷⁹⁹ NAFTA, Art. 1403(3), annex 1403.3.

⁸⁰⁰ *Id.*, annex VII(C)-USA

⁸⁰¹ *Id.*

⁸⁰² *Id.*

⁸⁰³ *Id.*

4.3 NAFTA, MEFTA, GATS/WTO AND THEIR CONNECTION WITH THE LIBERALIZATION OF FINANCIAL SERVICES IN MEXICO

Although RTAs such as NAFTA and MEFTA should go beyond GATS in terms of liberalization (at least theoretically, according to GATS Art. V), it has been recognized that there is a lack of clarity as to how far or to what extent this should be achieved.⁸⁰⁴ Even more, OECD states in a study that the liberalization of financial services in GATS has been more ambitious than most RTAs, including NAFTA.⁸⁰⁵

This section argues that in achieving financial integration NAFTA has gone beyond GATS, but less ambitious than the EU. In doing so, it explored how this integration in financial services has been achieved, through the different principles of NT, market access and MFN in NAFTA.

The difficulty arises in interpreting what exactly means ‘to go beyond,’ as there is a lack of clarity with respect to the kind of barriers that RTA should be expected to eliminate.⁸⁰⁶ Also, the WTO Secretariat has acknowledged that, “it is difficult to establish to what degree a large number of RTAs achieve a deeper level of integration than the WTO.”⁸⁰⁷

The OECD study observed that RTAs can complement but cannot substitute for multilateral rules and progressive multilateral liberalization, and that in some particularly sensitive areas, “regional initiatives have been no more successful – and

⁸⁰⁴ This situation brought up the question of implementing GATS Art. V, which allows members to enter into regional agreements to liberalize trade in services as long as they get a “GATS-plus” (do not raise the overall level of trade barriers to WTO members who are not party to them and cover substantially all trade sectors).

⁸⁰⁵ An important OECD study (2002) assessed: “To what extent provisions included in RTAs going beyond to WTO commitments. The study focused on tariffs..., services, labor mobility, trade facilitation... in APEC, NAFTA, MERCOSUR and the EU. The conclusion was that in many respects *RTAs have not progressed too much beyond the GATT/WTO* Agreements and that it was very difficult to determine whether RTAs represented an improvement in terms of liberalization of trade” (WTO REPORT 2003 at 54, emphasis added).

⁸⁰⁶ See Stephenson, *Regional...*, *op. cit.*, at 204.

⁸⁰⁷ See OECD STUDY 2002 at 54; and WTO REPORT 2003.

in some cases less successful – than activity at the multilateral level.”⁸⁰⁸ Addressing financial services in particular it stated that:

...while the GATS has achieved a higher level of liberalization in financial services than that found in most RTAs, the development of the GATS Understanding on Commitments in Financial Services took advantage of insights gained in financial market opening at the regional level.⁸⁰⁹

Yet it is still of considerable relevance to know, from a legal perspective, to what extent each RTA has gone or not beyond WTO Agreements.⁸¹⁰

Two of the main objectives that bilateral, regional and multilateral agreements share and promote are: stability and liberalization.⁸¹¹

Stability is an important condition in international trade in order to guarantee security, credibility and predictability. These key factors give investors and consumers in general the vision of market opportunities. Although GATS has contributed in many ways to this road of certainty, credibility and predictability, it is also evident that GATS scores rather poorly in general.

For example, the possibility allowed for under GATS of including commitments in national schedules that are bound at a more restrictive level than the *status quo* (or less than actual regulatory practice) means that effectively service providers are not

⁸⁰⁸ *Id.*

⁸⁰⁹ See OECD STUDY 2002.

⁸¹⁰ It should be noted that NAFTA, like many other RTAs, is inconsistent in some degree with GATS, and consequently brings incompatibility and uncertainty to the world trade system. It has been generally recognized that “the lack of clarity of Art. V of GATS (and Art. XXIV of GATT) and the ambiguities surrounding this provisions leave the compatibility of RTA’s largely uncertain.” See Stephenson, *GATS...*, *op. cit.*, at 509. See also Abugattas Majluf & Stephenson, *op. cit.*, at 91. See Scott, *op. cit.* Regarding the compatibility between RTAs and WTO agreements it should be noted that the case *Turkey- Restrictions on Imports of Textile and Clothing Products, WT/DS34/R*, has been a landmark because it is the first one which gives a substantial meaning to Art. XXIV and the conditions that must be fulfilled in order to make the RTA compatible with the WTO rules (although this is related directly with GATT, the same principles might be applied in the future for GATS).

⁸¹¹ See Stephenson, *GATS...*, *op. cit.*, at 187 (NAFTA Agreement has become a prototype for many developing countries to join the wave of services trade liberalization).

necessarily provided with accurate information on market access possibilities through this multilateral instrument.⁸¹²

In this context, Art. XXI of GATS⁸¹³ states that:

1. (a) A Member (referred to in this Article as the “modifying Member”) may modify or withdraw any commitment in its Schedule, at any time after three years have elapsed from the date on which that commitment entered into force, in accordance of the provisions of this Article.

NAFTA and MEFTA, on the other hand, have gone notoriously beyond GATS because they provide the *status quo* provision⁸¹⁴ in a more predictable way for the treatment of existing trade in services binding the parties, so that no new restrictions can be introduced.⁸¹⁵

With respect to its financial services chapter, NAFTA’s Art. 1404 states:

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

In the same sense, MEFTA Art. 12 (3) says that: “No party may adopt new measures as regards to the establishment and operation of financial services supplier of the other party, which are more discriminatory than those applied on the date of entry into force of this Decision.”⁸¹⁶

⁸¹² *Id.*, at 191.

⁸¹³ General Agreement on Trade in Services (entered into force Jan. 1995), in WORLD TRADE ORGANIZATION, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, Art. XXI, at 301 (Cambridge University Press UK, 2003) [Hereinafter WTO legal texts].

⁸¹⁴ This provision means actual regulatory practice, and it gives the promise to the parties involved that they will not go back, withdraw or decrease their current commitments or regulatory practice.

⁸¹⁵ See NAFTA DOCUMENTS SUPPLEMENT at 601 and 615.

⁸¹⁶ Joint Council Decision No. 1 Covering Trade in Services, Investments and Related Payments, Protection in Intellectual Property Rights and Dispute Settlement; MEFTA TRADE IN SERVICES AGREEMENT, *op. cit.*, at 428-29.

Regarding liberalization, although GATS has made a good try and introduced a lot of positive changes in services trade, it is still short in the liberalization of services markets. Stephenson points out that:

...most specific commitments scheduled by both developed and developing countries are in fact “stand-still bindings” and do not enlarge market access for service providers, committing the government concerned only to maintain the current level of access.⁸¹⁷

On the other hand, NAFTA and MEFTA improve such a legal framework. NAFTA includes a clause requiring that the better of either MFN or NT should be given to a service provider from a member (Standard of Treatment: Art. 1405, and 1406 in the case of the chapter of financial services of NAFTA and in the same sense Art. 14 and 15 of MEFTA).⁸¹⁸

Art. 1205 of NAFTA⁸¹⁹ is also beneficial for all members because it allows service providers to determine the most efficient way to carry out their trade:

Art. 1205: Local Presence

No Party may require a service provider of another party to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border provision of a service.

Art. 1210 paragraph 3 and 1111 of NAFTA say that:⁸²⁰

Article 1210: Licensing and Certification⁸²¹

1. With a view to ensuring that any measure adopted or maintained by a Party relating to the licensing or certification of nationals of another

⁸¹⁷ See Stephenson, *op. cit.*, at 192 (both the limited number of sectors included in national schedules as well as the limited number of overall commitments, particularly by developing countries, testify to the lack of success of the GATS).

⁸¹⁸ *Id.*, at 198. See also MEFTA TRADE IN SERVICES AGREEMENT, *op. cit.*, at 428, 429; NAFTA, Art. 1405, 32 I.L.M. at 657, stating as follows:

Each party shall accord to Investors of another party treatment no less favorable than that it accords to its own investors, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of financial institution and investment in financial institution in its territory.

⁸¹⁹ NAFTA, *id.* 23, 32 I.L.M.

⁸²⁰ Stephenson, *op. cit.*, at 198.

⁸²¹ See NAFTA, *op. cit.*, 23, 32 I.L.M. at 602.

Party does not constitute an unnecessary barrier to trade, each Party shall endeavor to ensure that any such measure:

...

3. *Each Party shall, within two years of the date of entry into force of this Agreement, eliminate any citizenship or permanent residency requirement set out in its Schedule to Annex I that it maintains for the licensing or certification of professional service providers of another Party.* Where a Party does not comply with this obligation with respect to a particular sector, any other Party may, in the same sector and for such period as the non-complying Party maintains its requirement, solely have recourse to maintaining an equivalent requirement set out in its Schedule to Annex I or reinstating:

(a) Any such requirement at the federal level that it eliminated pursuant to this Article; or

(b) On notification to the non-complying Party, any such requirement at the state or provincial level existing on the date of entry into force of this Agreement.

4. The Parties shall consult periodically with a view to determining the feasibility of removing any remaining citizenship or permanent residency requirement for the licensing or certification of each other's service providers.

...

Art. 1111: Special Formalities and Information Requirements⁸²²

1. Nothing in Article 1102 shall be construed to prevent a Party from adopting or maintaining a measure that prescribes special formalities in connection with the establishment of investments by investors of another Party, *such as a requirement that investors be residents of the Party or that investments be legally constituted under the laws or regulations of the Party*, provided that such formalities do not materially impair the protections afforded by a Party to investors of another Party and investments of investors of another Party pursuant to this Chapter.

4.3.1 What Can NAFTA Learn from EU?

NAFTA pursued different objectives than those pursued by EU. NAFTA'S economic integration is lower and the financial systems are different, however, it includes the following:

⁸²² *Id.*

- 1) Clearly defined long-term aims beyond sectoral efficiency, including economic development, and global competitiveness;
- 2) Recognition that minimum harmonization of regulatory frameworks and cross border financial activities require reform of public administration, specially tax treatment, banking and insurance legislation and joint supervision of securities markets, in order to make the “single passport” system reliable; and
- 3) Commitment to a considerable degree of fiscal harmonization and economic coordination, to avoid financial crisis that would affect financial integration.⁸²³

Unfortunately, there is still a long way to go because: a) NAFTA lacks the political will to enforce legislative programs similar to the EU; b) The heterogeneity of domestic regulatory institutions and the persistence of fiscal imbalances; c) The lack of recognition of foreign regulations constraining the “home country control” principle; d) The threat of currency differences (currency risk).⁸²⁴ Nevertheless, some corporate groups are pushing for harmonizing regulations and institutional arrangements for information sharing across countries.

4.3.2 NAFTA and Other RTA

Creating a FTAA is a complex issue. MERCOSUR may not be able to join NAFTA because, for USA, NAFTA and other similar ones derived from Uruguay Round and involving the WTO have a lower hierarchy than federal law. In Latin America, as in Europe and the majority of the countries, treaties have a higher precedence than local laws. This does not occur in the USA; consequently this might produce a conflict of application or rules.⁸²⁵

The USA has been pressing to make NAFTA join MERCOSUR,⁸²⁶ and in some occasions it has tried to create the FTAA. Nevertheless, there is still resistance from

⁸²³ IADB, *Financial...*, *op. cit.*, at 108.

⁸²⁴ *Id.*, at 107. Countries towards a harmonization should move toward adopting a common regime.

⁸²⁵ Goyos, *op. cit.*, at 5.

⁸²⁶ MERCOSUR has become the third wealthiest regional trading organization, following EU and NAFTA. It is expanding its membership and trading relationships within Latin America and beyond, including the aforesaid regional trading blocs. It is therefore poised to provide its members of the Southern Cone states of Brazil, Uruguay, Argentina, and Paraguay, along with associated members Chile and Bolivia, with the ability to broaden their natural economic base beyond their geographic

MERCOSUR.⁸²⁷ According to Goyos, an FTAA structured along the NAFTA model:

...would have a most destructive impact on the agricultural sector of all MERCOSUR economies (which represents approximately 28% of the collective GDP) in view of the subsidies in place in the USA and Canada...for the service sector, would be equally damaging to MERCOSUR countries, as a result of the infamous one-way quota system in place in NAFTA. Thus it seems that for the MERCOSUR countries, it would be better to stay away out of FTAA.⁸²⁸

4.3.2.1 Mexico and FTAA⁸²⁹

USA used to be the one interested in signing FTAA, mainly because of the expansion of their services sector, government procurement, and tightening rules to protect investment and intellectual property. USA was quick to stress that the Cancun fiasco did not spell the end of its efforts to get FTAA signed.⁸³⁰

In Cancun, many Latin American countries joined G21, a new group of developing countries led by China, India and Brazil. This group pushed hard for more ambitious agricultural reform by rich countries while defending high farm tariffs in poor countries.

frontiers to many other nations (see Jorge M. Guira, *MERCOSUR: The Emergence of a Working System of Dispute Resolution*, 6 NAFTA: LAW AND BUSINESS REVIEW OF THE AMERICAS (2000).

⁸²⁷ MERCOSUR, created by the Asuncion treaty (March 26, 1991), started operating from 1 January 1995, integrating its four members: Argentina, Brazil, Paraguay, and Uruguay. It is started operation as a free trade zone and a customs union as a first stage. In general, its goals are: free circulation of goods, services and production factors; creation of a common external duty and adoption of a common commercial policy vis-à-vis third countries, co-ordination of macroeconomic and other sectorial policies; commitment of the associated countries to harmonize their legislation in the pertinent areas so as to strengthen the integration process. It is the most important commercial undertaking ever carried out in South America, embracing a population of 200 million, a GNP of near one trillion USD and an estimated trade volume for 1994 of USD\$112,600 millions. Unlikely previous attempts at regional economic integration, which never really materialized, MERCOSUR has excellent chances of achieving long-term success. It is important to take into account that these figures will increase as from 1995 due to integration. The market will then appear highly attractive to investors both inside and outside the free trade zone. MERCOSUR created an external common duty between 0 and 20 per cent for almost 9,000 products. Also, each of the member countries provided a list of products which will not be freely traded (about 200 per country) in an effort to protect certain sensitive industries.

See J. F. Norman and J. A. Pezzuti, *MERCOSUR: Recent Developments*, INTERNATIONAL TRADE LAW AND REGULATION (1995). See also Jorge M. Guira, *MERCOSUR as an Instrument for Development*, 3 NAFTA: LAW AND BUSINESS REVIEW OF THE AMERICAS (Sum. 1997).

⁸²⁸ Goyos, *op. cit.*, at 5. See also Guira, *MERCOSUR as an Instrument...*, *op. cit.*.

⁸²⁹ For more detail analysis of this see Witker, *op. cit.* at 75.

⁸³⁰ See THE ECONOMIST, Oct.18, 2003, at 55.

Today FTAA is almost stagnant due to the opposition of Venezuela's president Hugo Chávez and Bolivia's president Evo Morales. Both presidents see FTAA as means for the USA to take legally complete control of the political and economic systems of the region. In addition, the presidents of Argentina and Brazil, Luis Ignacio Lula Da Silva and Néstor Kirchner, respectively, state that the agreement should provide a real and true free trade, consequently, agricultural and other subsidies by the USA must end.⁸³¹

These subjects, who at that time had all the attention from the nations that wanted to enter the FTAA, are in the author's opinion a way to present to everybody the span and dimensions of the treaty on commerce that is being discussed. It is worth emphasizing that during all the negotiation summits has never been any opacity on the debate.

Similarly, the role that the FTAA plays is of vital importance as "the Latin American countries developing in general and countries especially, face the great challenge to solve not just a transmission, but three great processes of change, that interlace in the equation State-region-globalization;"⁸³² and for that reason it is extremely important to retake all previous commercial treaty experiences to be able to develop all the acquired abilities and to implant new models that, in consequence, increase the efficiency of the treaty to include more strengths than defects.

It is therefore noticeable that FTAA retakes as a precedent base the NAFTA document, especially the chapters on the solution of controversies and the subject of intellectual property. As far as the arbitration of controversy solving is concerned, NAFTA treaty regulations are outstanding as they "establish a system by means of which individual investors or in representation of a company can seek protection from violations on the part of a government, state companies or monopolies before a court of international arbitration."⁸³³

⁸³¹ Witker, *op. cit* at 75.

⁸³² *Id.*, at 159.

⁸³³ *Id.*, at 175.

In this sense, one of the great innovations that were introduced within the NAFTA is the “right conferred to the investors to initiate arbitration trial versus a State, right that traditionally corresponded to the States.”⁸³⁴ However, as mentioned above, these single experiences serve as a framework of reference and in this sense there is a need to grasp other significant experiences of the NAFTA, in order to present a more effective system in the dispute resolution.

4.4 MEFTA AND ITS IMPLICATIONS FOR NAFTA

4.4.1. Mexico and EU

EU is the second largest commercial power in the world as it brings together around one fifth of world trade. It is comprised by 25 countries with a total population of around 400 million, and has a GDP of over 7 trillion.⁸³⁵ EU is Mexico’s second commercial partner and its second source of FDI.⁸³⁶

The advantages of MEFTA are numerous. Mexico represents a strategic partner for EU because of the potential of its market and its privileged position.⁸³⁷ For Mexico, MEFTA gives it the opportunity to diversify its products, increase the supply of goods and services and balance its international relations, as well as bigger exports, better technology transfer, more competitiveness, enterprise efficiency and creation of more and better jobs.

MEFTA is comprised by three documents:

⁸³⁴ *Id.*, at 177.

⁸³⁵ Burges, *op. cit.*

⁸³⁶ European Commission, “Trade. Mexico;” available at: <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/mexico/>. In 1998 trade between Mexico and EU was over USD\$15.6 billion, 6% more than in 1997. Exports to EU were almost USD\$4 billion and imports USD\$11.7 billion. In the first semester of 1999 the total trade was of USD\$8.9 billion, showing a growth of 18% as compared to the same period of 1998. EU market remained the second destination for Mexican merchandise exports in 2006, which reached USD\$13.3 billion, representing 5.4% of Mexico’s total exports. It also remained as the second source of imports into Mexico, reaching US\$29 billion. See “Mexico-European Union: Seven Years of a Successful Trade Relationship;” available at: <http://www.economia-snci.gob.mx>.

⁸³⁷ As of 2008, MEFTA has represented for Mexico in commerce USD\$59.6 billion (40.5 billion Euros), 18% more than the one of 2007, and 222% more than that of 1999 (see *op. cit.*).

- 1) Decision 2/2000 of the Joint Council of the Interim Agreement of Commerce and Issues Related to the Commerce between Mexico and the EU that entered into force on July 1, 2000;⁸³⁸
- 2) Agreement of Economic Association, Political Understanding and Cooperation between Mexico and the EU, came into force on 1st October 2000; and
- 3) Decision of the Joint Council of the Agreement of Economic Association, Political Understanding and Cooperation between Mexico and the EU came into force on 1st March 2001.

MEFTA covers all goods originating in the parties' territories,⁸³⁹ classifying such goods in the following categories:⁸⁴⁰ 1) Industrial products that include all type of goods; 2) Fisheries; and 3) Agricultural goods. Fisheries and agricultural goods were subject to specific regulations having a gradual reduction of customs duties until 2010.⁸⁴¹ According to De la Pena, they were the most complex ones in the negotiations because the Agricultural Common Policy in the EU which implemented subsidies of the exports threatened the Mexican sector.⁸⁴²

According to MEFTA, around 82% of the Mexican goods are allowed to enter the EU duty-free. This however, does not include many of Mexico's top agricultural tariff reductions. For Mexico, manufacturing is the sector that is most likely to benefit from MEFTA, particularly the local auto industry. Meanwhile the EU investments will mostly go into locally-based European manufacturers seeking to export to the USA market.

EU has been highly interested in maintaining trade with Latin America. Negotiations to liberalize trade between the EU and MERCOSUR started in 1991. Right after signing the Treaty of Asuncion, the Ministers of Foreign Affairs of

⁸³⁸ Decision 2/2000 of the Joint Council of the Interim Agreement of Commerce and Issues Related to the Commerce between Mexico and the EU, CE-MX 3854/00 DG E V1.

⁸³⁹ *Id.*, Art. 9 at 16.

⁸⁴⁰ *Id.*, Art. 10 at 22.

⁸⁴¹ During the VI Joint Council, both parts reaffirmed their interest on moving toward negotiations as previewed in MEFTA on the revision clauses on this regard. See VI Joint Council 8436/09 (Presse 79); available at:

http://www.economia.gob.mx/swb/work/models/economia/Resource/420/1/images/Consejo_conjunto_140509_comunicado_conjunto_final.pdf

⁸⁴² See Alberto De la Pena, *Free Trade Agreement between Mexico and the European Union*, 7 L. & BUS. REV. AM. (2001), at 373.

MERCOSUR's four member states met in Luxembourg with representatives of the EU in order to explain the objectives of the Southern Cone regional bloc.

Regarding trade, both parties agreed to work together as to increase and diversify commercial exchange.⁸⁴³ Both parties main intention was to prepare the gradual tariff and non-tariff liberalization and the creation of the inter-regional association.

According to the text of the agreement this task will be fulfilled by analysis of the commercial relations with third parties. In this sense particular attention was given to the agreements reached by MERCOSUR with Chile and Bolivia and with the other States of ALADI (Latin American Integration Association) and the actual negotiation with NAFTA.

Regarding EU, MERCOSUR representatives paid special attention to the special treatment agreements reached by EU and African and Asian developing countries - the identification of sensitive products. This includes, in particular, agricultural and other primary products.

EU is concentrating its efforts on negotiating the reduction and further elimination of non-tariff barriers instead of tariff barriers. It is well known that EU, and in particular countries such as France, the Netherlands, Belgium and Denmark, are very protectionist regarding the agricultural sector and are not willing to remove all their protectionist measures.

But although there is a clear intention to free the trade between both regional blocs, the agricultural sector has greatly influenced the negotiations⁸⁴⁴. That EU wanted to start talking about non-tariff barriers, instead of tariff barriers as expected by MERCOSUR, also contributed to the stagnation of the latter negotiations.⁸⁴⁵

⁸⁴³ This was reaffirmed by the VI Joint Council 8436/09 (Press 79) celebrated in Prague on May 14, 2009. It was recognized that there has been a qualitative and essential change on their bilateral relations, and their decision to establish a Strategic Association. See VI Joint Council, at:

http://www.economia.gob.mx/swb/work/models/economia/Resource/420/1/images/Consejo_conjunto_140509_comunicado_conjunto_final.pdf

⁸⁴⁴ Decision 2/2000 of the Joint Council of the Interim Agreement of Commerce Art. 10 *Id. at.* 22

⁸⁴⁵ G. Biazi, "Trade liberalization Negotiations between the EU and Mercosur" (International Trade Law and Regulation, 2000) at. 2.

4.4.2 Implications for NAFTA

MEFTA has significant implications for NAFTA members and NAFTA in general.

The EU is the largest aggregate trading partner and Mexico is its second largest national trading partner. Any Agreement that eliminates trade barriers and improves market access between these two crucial trading partners potentially has major implications for USA business.⁸⁴⁶

Mexico has become a bridge for EU to USA and Canada and vice-versa. Consequently, enterprises from Mexico's commercial partners are now able to establish operations in Mexico to take advantages of its preferential access to USA, Canada, European and Latin American markets.⁸⁴⁷

EU represents an attractive opportunity for Mexico because it is the largest and most integrated trade arrangement in the world bound into a customs union that is committed to political and economic integration.⁸⁴⁸

Until 1975, links between both parties were mainly focused on historical and cultural ties. A First Framework Cooperation Agreement was signed in September 1975 and renewed in October 1980. In the late 1990s, as a result of structural changes, modernization process and trade liberalization in Mexico (including Mexico's participation), political, economic and commercial cooperation with the EU improved considerably ending up in this commercial agreement.

From 1993, EU's trade with Mexico registered and accumulated growth of 4.7%. The EU became the second largest investor in Mexico. During 1994 - 1998, accumulated FDI in Mexico was USD\$41.2 billion of which 21% was EU

⁸⁴⁶ THE EU-MEXICO FREE TRADE AGREEMENT xviii (James R. Holbein & Nick W. Ranieri eds., Transnational Publishers, 2002) [hereinafter MEFTA TRADE IN SERVICES AGREEMENT].

⁸⁴⁷ *Id.*, at 23. See also BILATERAL TRADE RELATIONS at 1. Mexico's imports from EU are engines, autos (specific arrangements for cars include a tariff cut from 20% to 3.3% with the tariff disappearing in 2003), textiles, machinery and equipment, construction machinery and equipment, telecommunications equipment, medicines, and milk. In turn, Mexico exports to EU oil, auto parts, avocado, cut flowers, fruits, juices, honey, coffee, silver, copper, and steel.

⁸⁴⁸ MEFTA (TRADE IN SERVICE AGREEMENT) at 21.

investment. The main investors were: UK (32%), the Netherlands (30.5%) and Germany (19%).⁸⁴⁹

Mexico and NAFTA were extremely attractive to EU. This was, among other factors, a result of the economic growing rate of NAFTA parties:

A study by the Centre for Policy Studies Showed that NAFTA economies are growing at a rate twice that of the EU. Between 1992 and 2000 Mexico had a 38 percent increase in jobs while the USA and Canada had a 13% increase. During the same period, the EU only experienced a 3 percent increase in employment.⁸⁵⁰

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

1. Economic Partnership, Political Co-ordination and Co-operation Agreement (Global Agreement)
2. Interim Agreement to the Global Agreement (Trade in Goods Agreement)
3. Final Act of the Global Agreement (Trade in Services Agreement)⁸⁵¹

Regarding the similarities and differences between MEFTA and NAFTA it can be said that MEFTA stimulated trade by liberalizing almost all trade by 2007, a bit earlier than NAFTA in some areas. Even more, MEFTA has negotiated tariffs lower than those within NAFTA.⁸⁵² In NAFTA, members “are not required to give up a portion of their sovereignty... with the possible exception of Chapter 11 arbitration,”⁸⁵³ while EU has supranational authorities which share common policies.

In the services sector,⁸⁵⁴ most of the sub-sectors were negotiated, such as telecommunications, energy, tourism and financial services, although certain sub-sectors for example: audio-visual, maritime cabotage, and air transport are

⁸⁴⁹ BANCOMEXT STUDY at 91. See also BILATERAL TRADE RELATIONS.

⁸⁵⁰ Burges, *op. cit.*, at 693.

⁸⁵¹ DE LA PENA, *op. cit.*, at 371.

⁸⁵² MEFTA TRADE IN SERVICES AGREEMENT at 23.

⁸⁵³ *Id.*, at 689 and 697. NAFTA’s Chapter 11 has been strongly criticized, because “it has had the effect of eroding national sovereignty by allowing corporations to challenge laws and regulations...and when an awards granted in favour of an investor the payment comes directly from the treasury of the offending nation, meaning that taxpayer are footing the bill.”

⁸⁵⁴ In 2008, trade in services represented for Mexico 3.267 billion Euros on exportations, and 4.764 billion Euros on importations. See Relación México–Unión Europea bajo el TLCUEM [Mexico-EU relationship under MEFTA] at <http://www.economia-bruselas.gob.mx/#>

explicitly excluded. It should still be considered to have “substantial sectoral coverage” according to Art. V of GATS.⁸⁵⁵

MEFTA has gone beyond the commitments of GATS, as it has set out as an objective the progressive and reciprocal liberalization of trade in services (not exceeding 10 years). For example, the financial services sector was practically liberalized when the MEFTA Trade Services Agreement came into force. Art. 12 paragraph 4 sub paragraph (e) of the Trade in Service Section of MEFTA states the general rule:⁸⁵⁶

No Party shall maintain or adopt the following measures:

...

(e) limitations on the participation of foreign capital in the terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment...

The exceptions are described in the list of reservations set out in the Annex I of the Trade in Service Agreement.⁸⁵⁷ This liberalization was consistent with the one previously adopted by Mexico, when in 1999 its legislative branch approved that foreign economic agents were allowed to own 100% of the capital stock of Mexican banks.⁸⁵⁸

In the services sector, EU benefits more than Mexico due to its *net-exporter* nature of services and financial services. European banks and insurance companies are authorized to operate and establish directly in Mexican territory like their USA and Canadian counterparts.⁸⁵⁹

Mexican banks have similar access to EU⁸⁶⁰ but, since it is not a *net-exporter* in financial services, this potential market is not likely to be exploited (at least in the

⁸⁵⁵ Proposal for a Council Decision on the Community Position within the EC-Mexico Joint Council on the Implementation of Arts. 3, 4, 5, 6 and 12 of the Interim Agreement, EUR. PARL. DOC. (COM(2000) 9 final/4) 6 (2000) [hereinafter Communication from the European Commission 2000].

⁸⁵⁶ MEFTA Trade in Services Agreement at 428

⁸⁵⁷ Art. 17 of the MEFTA Trade Services Agreement will permit the Members the elimination of the remaining discriminations within three years of the entry into force of the Agreement.

⁸⁵⁸ DOF (Jan. 19, 1999); available at: <http://dof.terra.com.mx/>.

⁸⁵⁹ Communication from the European Commission 2000, *Id.* at 5.

⁸⁶⁰ MEFTA Trade in Services Agreement, *Id.* at 428.

short and medium term), as the one in industrial products and manufacturers where the Mexican competitive world advantage lays.

The future of the MEFTA might depend on the future integration of FTAA.⁸⁶¹ It might interact and complement each other, converting Mexico into the trade hub between the Americas and Europe.

4.4.3 Benefits of MEFTA⁸⁶²

There are many reasons why EU investors look towards Mexico to do business. Among the main ones are the following:

- Low wages in Mexico
- As of 2009, Mexico was the 10th exporter and importer in the world (excluding intra-EU trade).⁸⁶³
- The USA is its largest trading partner.
- Due to its network of FTA, as of 2010 Mexico enjoyed “preferential access to one billion consumers in 44 countries,”⁸⁶⁴
- Mexico has become a natural platform for trade and investment, strengthened by its strategic geographic position.
- Mexico is the only country in the world with free trade access to NAFTA market and EU markets.

4.4.3.1 Trade in Goods⁸⁶⁵

The most basic achievement of MEFTA is the permanent elimination of all tariffs among the partners according to a rapid phase-out schedule. Only the most sensitive products are subject to a long phase-out.

⁸⁶¹ De La Calle Pardo, *op. cit.*, at 379.

⁸⁶² Unless otherwise noted, this section is taken from Goodrich, Riquelme y Asociados, “Benefits For Investors Under The Mexico-European Union Free Trade Agreement,” available at: <http://goodrichriquelme.com/PDF/MEFTA2004.pdf>.

⁸⁶³ See, WTO, “Trade Profiles: Mexico;” available at: <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=MX>.

⁸⁶⁴ See The NAFTA Office of Mexico in Canada, “FTA’s...,” *op. cit.*

⁸⁶⁵ Unless otherwise noted, this section is taken from Goodrich, Riquelme y Asociados, *op. cit.*

Industrial products account for more than 90% of the total bilateral trade in merchandise. In this case, the liberalization covers the entire range of products and is implemented progressively over a transitional period of 7 years. All tariffs are eliminated by 1 January 2007.

On 1 July 2000, date of entry of MEFTA, EU eliminated tariffs on 82% of the Mexican industrial products, while Mexico liberalized tariffs on 48% of EU industrial products, and eliminated the 1999 tariff increases on EU footwear and certain textile products (dismantling from 25%-35% to 10%-15%).

On 1 January 2003, EU liberalized customs duties on all Mexican industrial products, while Mexico eliminated tariffs on an additional 5% of EU industrial products (to total 52% of the same), and ensured that the remaining 48% of the EU industrial products were subject to a maximum tariff of 5%.

4.4.3.2 Trade in Services⁸⁶⁶

The service markets of both parties are to be progressively liberalized within a period of no more than 10 years, that is, by the year 2011. The agreement covers all services including: financial (allowing all EU banks and insurance companies to directly operate in Mexico), telecommunications, distribution, energy, tourism, and environmental services. The only exceptions are audiovisual, maritime cabotage and air transportation services.

From the date of entry, the parties agreed not to introduce new restrictions on EU or Mexican investors.

The relevant provisions for services ensure investors that: no restrictions on the number of operations or services provided in the other party's territory will be introduced; full enjoyment of NT at equivalent conditions; treatment of MFN will be granted, surpassing the benefits bestowed on third parties.

⁸⁶⁶ *Id.*

4.4.3.3 How Do EU Investors Access the NAFTA Market?⁸⁶⁷

Any EU company may benefit from the existence of NAFTA and MEFTA, by combining the rules of origin of each treaty. Products with content from both Mexico and EU have a tariff advantage for import into the USA and Canada compared with products either coming directly from the EU or from other parts of the world.

Preferential access to USA and Canada for Mexican production requires that a certain proportion of the finished product contains regional components (Mexico, US, or Canada). The key is the correct combination of the rules of origin provided for in each of NAFTA and MEFTA.

4.4.3.4 NAFTA's Rules of Origin⁸⁶⁸

NAFTA requires that all non-originating components undergo a shift of tariff classification. As such, the classification of the non-NAFTA components imported into Mexico must be different from the tariff classification of the finished product to be exported.

NAFTA provides two different types of valuations to determine the NAFTA content of the products: 1) Valuation based on the ex-works price of the finished product; and 2) Valuation based on the cost of the non-originating component.

Non-originating components can be 40% to 50% of the ex – works price of the finished product. There is no limit as to the percentage of regional (NAFTA) components to be included in a finished product.

⁸⁶⁷ *Id.*
⁸⁶⁸ *Id.*

4.4.3.5 Comparison between NAFTA's and MEFTA's Rules of Origin⁸⁶⁹

The two basic rules of origin provided for in both agreements: 1) The non-originating components must be transformed into a different tariff classification in order to qualify as an originating product, i.e., a tariff shift must take place; and 2) There is a quantitative non-regional limitation of an average of 40% to 60% of the total ex-works price of the finished product

The basic difference is the method of valuations of regional content. In MEFTA, the applicable rules of origin are determined by tariff classification per individual component. In NAFTA, the rules of origin may be determined by a percentage of the ex-works price of the finished product or the cost of the non-originating component.

All finished products that comply with the NAFTA rules of origin are not subject to USA or Canadian import duties on their export from Mexico. However, from 1 January 2001, NAFTA required Mexico to grant the same tariff treatment to all non-NAFTA components, which are destined to be exported to the NAFTA region.

Consequently, all non-originating NAFTA components, incorporated into finished products to be exported to the USA and Canada, are subject to Mexican import duties, and the corresponding 15% Value Added Tax. To minimize the impact of such obligation, Mexico implemented Sector Promotion Programs, which objective is to grant a preferential ad-valorem tariff to non-NAFTA components to be incorporated into finished products to be exported anywhere in the world.

As such, the Sector Promotion Programs eliminate import duties on some of the non-NAFTA originating components, and reduce the remaining ones to a maximum duty of 5%.

Mexico offers major benefits for all EU investors that desire to access the NAFTA region free of duties. The key lies in the correct combination of the rules of origin

⁸⁶⁹ *Id.*

provided for in MEFTA and NAFTA, together with the applicable Mexican domestic trade program, such as the *maquiladora* and the Sector Promotion Program.

Lastly, it should be noted that Mexico has a privileged position as a free trade partner, being the only country in the world, which is a member of both the NAFTA free trade area and the EU trading block.

4.5 DISPUTE SETTLEMENT PRACTICE RELATING TO GATS, NAFTA AND MEFTA

One of the issues that raised controversy in the GATT was its dispute settlement procedure, which was one of a kind. Some claimed that the system should aim at immediate problem resolution through settlements, obfuscation, carrying threats from the position of power, etc. Others underlined the importance of outlining the general long-term goals like text interpretation foreseeability and unchangeability.⁸⁷⁰ Today, WTO's dispute settlement is responsible for the resolution of disputes under GATS, GATT and TRIPS.⁸⁷¹

4.5.1 Dispute Settlement in Services

The Dispute Settlement Understanding (DSU) is the member dispute mechanism and it applies to disputes under any WTO Agreements. The dispute settlement process consists of three stages: 1) bilateral consultations, 2) adjudicative process before the panel and in case of the appellate body and 3) implementation and enforcement under surveillance of the DSB.

⁸⁷⁰ See John H. Jackson, *Dispute Settlement and the WTO: Emerging Problems*, 1 J. INT'L ECON. L. 329 (1998) at 168-177. Although GATT was in a way marginalized by some as being only a catalyst for a settlement negotiation, in fact the institution was intended to replace the International Trade Organization and the Charter of the latter opted for the creation of a thorough dispute settlement mechanism employing a lifelike use of arbitration and, under some circumstances, appealing to the World Court.

⁸⁷¹ MARTIN and WINTERS, *op. cit.*

4.5.2 Dispute Settlement in Services under GATS/WTO: Security and Predictability

The DSU provides certainty, security and predictability to the multilateral trading system.⁸⁷² In order to provide such predictability in the interpretation of GATS and in general all the WTO Agreements, the panels and the Appellate Body have been applying the customary rules of treaty interpretation described in Arts. 31 to 33 of the Vienna Convention.⁸⁷³

In this sense, the rules that have been applied by other International Courts such as the International Court of Justice in the public international law arena are the same that the panel and the Appellate Body have been applying for the dispute settlement procedure of GATS and other WTO Agreement.

Principles such as “good faith” in accordance with the ordinary meaning of the terms in their context and in the light of their “object” and “purpose” (Art. 31 of the Vienna Convention) have been ratified under the Art. 3.2 of the DSU. In the same sense, the Panels and Appellate Body of the WTO expressively have quoted several times Arts. 31, 32 and 33 of the Vienna Convention when interpreting the agreements of the WTO: GATT, GATS and TRIPS.⁸⁷⁴

Related to the preamble’s language of the texts we have the *US-Section 301-310 of the Trade Act of 1974*,⁸⁷⁵ regarding the “textual” interpretation - a representative case is the *Japan – Taxes on Alcoholic Beverages*,⁸⁷⁶ “subjective intention” is shown by the International Court of Justice in the Territorial Dispute (Libyan Arab Jamahiriya vs. Chad).⁸⁷⁷

⁸⁷² Wolfgang Weiss, *Security and Predictability under WTO Law*, WORLD TRADE REVIEW (2003) at 183.

⁸⁷³ The Vienna Convention expresses customary international law on the interpretation of treaties entered into by states and therefore is binding to non-parties of the Vienna Convention.

⁸⁷⁴ Regarding Art. 31 was in the case *US –Standards for Reformulated and Conventional Gasoline* (35 ILM (1996) 603). WT/DS2/AB/R para 6, 7. Also, *US-Section 301-310 of the Trade Act of 1974*, para. 7.22.

⁸⁷⁵ Para 7.22. *US-Section 301-310 of the Trade Act of 1974*.

⁸⁷⁶ *Japan – Taxes on Alcoholic Beverages* WT7DS8/AB/R pp11-12.

⁸⁷⁷ *Territorial Dispute (Libyan Arab Jamahiriya vs. Chad)* ICJ Reports 1994, 6 at 21f., para 41.

The “preparatory work” interpretation (*travaux préparatoires*) has been used for the Panels and Appellate Body as a supplementary means of interpretation as Art. 32 of the Vienna Convention stated.⁸⁷⁸

4.5.3 The Jurisprudence of the WTO

1998 was a year of great success for WTO’s dispute settlement procedures. In comparison to the GATT, there were four times more cases brought there and quite a big number of settlements reached. It may point to a real concord of procedures imposed and settlements complying with them. It may also mean that governments enjoy high predictability of the settlement outcomes which see eye to eye with the rules.

What is more, the general feeling among the member states considering compliance with the finalization and formal adoption of the official panel reports is extremely positive. The issue may only be if, in the light of international law, the country is bound to obey the WTO rules when it is required to do so by the panel, or if it can provide a kind of compensation employing other trade measures.⁸⁷⁹

Another positive aspect in this respect has been a continuously growing number of cases brought by developing countries both against trade super-powers and other developing nations. The improvements introduced in the text of the GATT/WTO treaty and mentioned above together with the possibility to appeal to an Appellate Body affected the whole worldwide trade system. The Appellate Body visibly indicated that rules of the GATT and WTO are in absolute concordance with the general international law.

Moreover, the reports prepared by the Body, which proves to keep being rather independent and neutral, have been thoroughly thought and worked on to such an

⁸⁷⁸ Daya Shanker, *The Vienna Convention on the Law of Treaties, The Dispute Settlement System of the WTO and the Doha Declaration on the TRIPS Agreement*, 36 (4) JOURNAL OF WORLD TRADE (2002) at 731.

⁸⁷⁹ See JACKSON, *op. cit.*, at 180.

extent that they are followed by legal institutions in judicial systems of numerous nations.⁸⁸⁰

Being more analytical and rule-oriented than they tended to be earlier in the GATT, the Appellate Body has been demonstrating higher respect towards the rulings of national governments and as a consequence has been manifesting cautiousness in hastening to adopt new interpretations of the treaty language. As a result, it may contribute to better understanding and acknowledgement of the WTO mechanisms on the global scale.⁸⁸¹

The world trade system largely benefited from the improvements of dispute settlement procedures as one can see on the bases of cases brought and won by some countries against other which carefully made use of the dispute settlement mechanisms.

Yet, another interesting point, in the evolution of the process, is allowing governments to hire private attorneys in order to obtain an expertise complying with the regulations if they are not able to have one on their own. Certain limitations on this practice has been introduced but the general move has been in favor of this procedure, though some preventive measures towards avoiding the conflict of interests and information confidentiality should be taken.⁸⁸²

Being appreciated, as it is, the WTO will have to be up-to-date with changing situations, issues and problems in today's fast moving world of economy not to get marginalized in terms of international relations. Giving the upper hand to bilateral or regional arrangements and treaties can have a detrimental effect on combined effort expected under the multilateral scheme. For example, the treaty will have to handle with time some its rule vagueness or lack of precise regulations.⁸⁸³

This may be done either by introducing some changes to the Uruguay Round treaty text or working out a completely new document, which is quite a tricky issue.

⁸⁸⁰ *Id.*, at 181.

⁸⁸¹ *Id.*, at 182.

⁸⁸² *Id.*, at 183.

⁸⁸³ *Id.*, at 184.

If the members wished for the treaty text alterations, they would encounter numerous problems. Having tried to maintain a balance, the member states, in the Uruguay Round, opted for inserting laws which would restrain institutions from intrusion into sovereignty.

Thus, clauses of Art. IX and X constitute a collection of restrictions as to what can be done as a result of the membership of the WTO. For instance, it is clearly said that new liabilities, even agreed on by majority, cannot be imposed on members.⁸⁸⁴

In addition, there is a necessity of obtaining three-fourths of the votes to reach the conclusion of new text interpretation. Putting aside the restrictions, one could note a fact that it is extremely inviting to try at least and alter all the rules which contain disparities or vagueness in the course of the dispute settlement process. However, in Art. 3, paragraph 2 of the Dispute Settlement Understanding, legislators reserved themselves a way out of this inconvenient scenario.

According to the document, recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements. In other words, the system cannot be overeager to change the regulations dramatically. In comparison, the GATT rules were written in such an ambiguous and imprecise language that it was much easier to shift and exchange the ideas covered by it.⁸⁸⁵

WTO can take various paths to improve its rules as a way of developing the system itself. Some of them may be adapting the two-thirds scheme for amendment introduction, taking small steps of reform in the course of practice under the resolution, avoiding national ratifications while agreeing on amendments considering both alterations in the text of the treaty and decisions reached by the DSB, using the 'consensus rule' in some aspects of it and others not necessarily, or encouraging the members to refrain themselves from blocking in cases of crucial national interest non-existence if the text ceased to be inconsistent with any of the current rules of the WTO together with its clauses.

⁸⁸⁴ *Id.*, at 185.

⁸⁸⁵ *Id.*, at 186.

Other paths could focus on forwarding the proposals for the plurilateral agreements by an ample number of members or keeping the door open for the accession by any other member, bearing the burden of the introduction and maintenance costs by the acquiescing members, etc. What is important is the fact that employing some or all of these means could facilitate the improvement of the WTO's works and avoidance of deadlocks while debating in the future disputes.⁸⁸⁶

4.5.4 Other General Interpretative Principles

Regarding other principles of interpretation, Panels and Appellate Body have been applying the “principle of effectiveness” which means that a treaty interpreter must give meaning and effect to all the terms of the treaty. In other words, “all applicable provisions have to be read in a way that gives meaning to all of them harmoniously, and all the parts and its sections should be interpreted as a whole.”⁸⁸⁷

The principle of deference is also understood by the Appellate Body in the case *EC – Measures Concerning Meat and Meat Products (Hormones)*, in which it stated that interpretation was being made in deference to the sovereignty of states (*in dubio mitius*). “If the meaning of a term is ambiguous, that meaning is to be preferred which is less onerous to the party assuming an obligation or which interferes less with the territorial and personal supremacy of a party.”⁸⁸⁸

Regarding the dynamic interpretation, the Appellate Body said that the interpretation of the WTO Agreements and rules was not rigid or inflexible that it could not consider variable circumstances. In the case *US – Import Prohibition of Certain Shrimps and Shrimp Products* it stated regarding the term “natural resources” in Art. XX (g) that GATT is not “static” in its content or reference but is rather by definition, evolutionary, and their interpretation cannot remain unaffected by the subsequent development of law.”⁸⁸⁹

⁸⁸⁶ *Id.*, at 188.

⁸⁸⁷ Weiss, *op. cit.*, at 186.

⁸⁸⁸ In this case the Appellate Body referred to the ICJ Jurisdiction *EC – Measures Concerning Meat and meat Products (Hormones)*/WT/Ds26/AB/R, WT/DS48/AB/R para 154. To The ICJ cases we have the ICJ Reports 1974, 253 at 267 para 44: *Nuclear Test Case (Australia vs. France): Access of Polish War Vessels to the Port of Danzig* (1931).

⁸⁸⁹ *US – Import Prohibition of Certain Shrimps and Shrimp Products*, para. 130.

4.5.5 The Rule of *Stare Decisis* in GATS/WTO

Related to the subsequent practice and the binding effects of the panel and Appellate Body reports it is understood that the WTO shall be guided but not bound by its own decisions. The authority of its previous decisions is only declaratory.⁸⁹⁰ The foregoing consideration agrees with Art. 31(3)(b) of the Vienna Convention which states that any subsequent practice in the application of a treaty shall be taken into account. However, the precedents have a persuasive power. In other words, panels and Appellate Body have to consider in some way previous reports.

Paraphrasing, panels and Appellate Body have to give certain degree of deference to previous GATT/WTO panel or Appellate Body reports. This is because previous reports create expectation among WTO, mainly for the countries who participate systematically as third parties (as the case of the USA, the E.U. and China). In case a panel decides to deviate from previous reports, such deviation has to be justified.

4.5.6. The Dispute Settlement under NAFTA Rules

NAFTA's integration has been much less ambitious than the EU and the methods chosen for the dispute resolution is another example of that idea. The European Court of Justice has characteristic similar to the judicial processes and the NAFTA dispute processes are more related to arbitral processes.⁸⁹¹ Financial disputes in NAFTA will be solved under Chapter 20 (general disputes NAFTA provisions) unless they involve a financial investment dispute which will use Chapter 11 (investment provisions).

NAFTA has given high priority to arbitration and mediation to settle disputes, regulated by the ICSID Convention rules, which were altered to end up with

⁸⁹⁰ See Appellate Body, *Japan – Taxes*, pp 13f. Also, *US – Restrictions on Import of Tuna, WT/DS29/R*, PARA.3.74.

⁸⁹¹ However, NAFTA's chapters 19 and 20 are more judicial than similar processes in GATT. See Michael Wallace Gordon, *NAFTA and the Financial Dispute Resolution*, J. J. NORTON AND NORBERT HORN, *NON-JUDICIAL DISPUTE SETTLEMENT IN INTERNATIONAL FINANCIAL TRANSACTIONS* (2000) at 209. See also GARY HORLICK, *WTO & NAFTA RULES AND DISPUTE RESOLUTION: SELECTED ESSAYS ON ANTIDUMPING, SUBSIDIES AND OTHER MEASURES* (2003). After WWII, international trade law became a matter of primary interest, which resulted in creating brand new international and national provisions as well as spiking political involvement in case-law and personnel decisions.

appointing three arbitrators. It means that each party is allowed to choose one arbitrator and the third one is appointed as a result of an agreement between the two.

Because the arbitrators are not obliged by any NAFTA or other treaties to be of the nationality of any of the parties, there is a likelihood that neither of them will be the national of the opponent in the matter. If there is no concord as to the third mediator, the one who takes decision is the Secretary-General who has a choice of 45 arbitrators chosen by the parties and one more time the nationality does not play an important role here. Furthermore, there is a need to ensure the unbiased opinion of the panelists with regard to compensation scheme adopted.

NAFTA does not contain any compensation regulations. According to the ICSID Convention, the mediators calculate the expenses incited by the proceedings and they are restrained by the ICSID Administrative Council. Additionally, as provided by Art. 1132 of the NAFTA, a panel may appoint experts to report in writing on the matter handled by the panel. It may do so at the request of the disputing party or as a result of its own initiative.⁸⁹²

Chapter 11 provides for arbitration requests in case of investor's conviction about a party's transgressing of the NAFTA regulations. The panel's decision is obligatory, though no specific times to arrive at it are outlined, which can make the entire process a long one.⁸⁹³

AC/CVD disputes solutions under Chapter 19 are binding and each party has to comply with the panel's decision. Chapter 20, though not providing for the automatic adoption of the panel's final report, takes a reasonably shorter time to

⁸⁹² See *id.* In light of NAFTA and its Chapter 19, the arbitrators' fees, and travel and lodging expenses, as well as the overall expenses of the panel shall be divided equally between the parties. NAFTA emphasizes that a panel's decision is binding.

⁸⁹³ See *id.*, at 2-7. As has been early significant step on the path for investor-state arbitration improvement was the ICSID. However, the restrictions it imposed contributed to the search of other ways to resolve the disputes on in investment field. Another could be an agreement debated on within the Organization for Economic Co-operation and Development (OECD) to include the regulations and dispute resolution system as more satisfactory to advanced countries and investors. One of the drawbacks, however, is the fact that it would apply only to the members of the pact in question.

come at a conclusion and permits retaliation in case of one disputant's avoidance to fulfill its obligations resulting from the arbitrators' decision.⁸⁹⁴

4.5.7 The Financial Services Case Presented before Chapter 14 NAFTA: Fireman's Fund Insurance Company⁸⁹⁵

Grupo Financiero Bancrecer, S. A. de C. V. (hereinafter GF BANCRECER) was one of the Mexican financial groups re-privatized in the early 1990's.

On August 29, 1995, GF BANCRECER's shareholder's assembly issued two series of subordinated debentures that would be convertible into stock in GF BANCRECER. One series was to be in MXN and the other in USD. Each series of debentures were to be in the amount of USD\$50,000,000. The funds were destined to capitalize GF BANCRECER's bank, which was also its main subsidiary.

The MXN series was purchased entirely by various Mexican investors. The USD series was purchased in its entirety by Fireman's Fund Insurance Company (hereinafter FIREMAN'S FUND), a firm incorporated under the laws of the State of California, that has as its principal business the provision of insurance of various kinds, including accident, fire and other types of personal and business insurance.

In 1997, GF BANCRECER's bank faced financial troubles, so Working Group was formed with representatives of entities of the Mexican government for the purpose of carrying out an indemnification and capitalization program for the financial group's bank. As a result of such program, the Mexican instructed the purchase of the MXN debentures by FOBAPROA but not so the USD debentures.

FIREMAN'S FUND, met with representatives of the Mexican government to discuss the measure and to seek a similar treatment of their USD debentures, which did not happen.

⁸⁹⁴ See Gary Horlick, *WTO and NAFTA Rules, op. cit.*, 4-15.

⁸⁹⁵ All the information in this section is taken from *Fireman's Fund v Mexico* - AWARD ICSID Case (International Centre for the Settlement of Investment Dispute) No- ARB (AF)/02/01 Date of dispatch to the parties 17 July 2006; available at: http://www.economia.gob.mx/work/snci/negociaciones/Controversias/Casos_Mexico/Fireman/Fireman.htm.

FIREMAN'S FUND then sued Mexico under NAFTA's Chapter Fourteen, pursuant to the applicable provisions of NAFTA's Chapter Eleven, particularly those in Section B thereof, which comprises Art. 1115 through 1138. FIREMAN'S FUND alleged that Mexico had violated, to its detriment, Art. 1102, 1105, 1110 and 1405 of NAFTA, and requested that the claims set forth to be submitted to arbitration under the Additional Facility Rules of the ICSID.

FIREMAN'S FUND alleged that the Mexican government violated NAFTA's Art. 1110, as it deprived it of its investment property in GF BANCRECER by resorting to prejudicial treatment, therefore banning FIREMAN'S FUND from the use and worth of its investment; and by compensating FIREMAN'S FUND to alleviate and make up for the loss, as obliged by the article referred.

FIREMAN'S FUND claim was for the Tribunal to grant it indemnification for the complete worth of its investment, which was estimated in USD\$50 million, together with interest grounded on a 90-day LIBOR rate, and additionally, 4% from the day of the acquisition up to the time of requital increasing per annum.

Mexico took the stand that all the challenged measures were "reasonable measures for prudential reasons" covered by the understanding of Art. 1410 (Exceptions). Fireman's Fund rejected that all the measures fell under the article in question, and also argued that the means were not "reasonable".

This was the first case touching the issue of cross-border investment in financial services within NAFTA. Having different regulatory principles as to securities transactions, insurance and banking, NAFTA's member states were aware of the fact that investor-state arbitration for the provisions interpretation could not take place. Still, cross-border investments in financial institutions were to be fostered and incumbents – protected from expropriation by the NAFTA.

The matter was addressed by the arbitration panel (Tribunal) who decided that the dispute indeed entailed investing in a financial institution. The Tribunal pointed since Art. 1410 is entitled "Exceptions", it lists all the means banned from

implementation under “this Part” (e.g. comprising Chapter Eleven and Chapter Fourteen) which cannot be treated as transgressing of the NAFTA if it meets the requirements of “reasonable measure taken for prudential reason.”

FIREMAN’S FUND argued that if a means is unfavorable it cannot be treated as reasonable and thus falls under the general regulations. Mexico answered that FIREMAN’S FUND misunderstood Art. 1410 and should not bring the claim of discrimination under Chapter Fourteen as it is obviously exempted from it.

The Tribunal concluded that the exception applied to all regulations of Part Five (“Investments, Services and Related Matters”) of the NAFTA relevant to Financial Services comprising the NT article (Art.1405) and as such, according to Art. 1410(1), allowed the implementation of sensible measures of a prudential character even though their effect could be biased. Hence, the Tribunal refused to treat a measure discriminatory in effect and by that fact unreasonable.

After having been a negotiator of NAFTA’s financial services chapter on behalf of the USA, Olin L. Wethington wrote in his book FINANCIAL MARKET LIBERALIZATION⁸⁹⁶ that Art.1410(1)(a), bypassing the NT and other obligations, ensures the right to apply reasonable measures in order to protect the security and stability of the financial system, even when the implementation of the tool may be discriminatory.

Wethington emphasizes that exceptions include only sensible measures connected with capital adequacy, loan loss reserve requirements, cash reserve and liquidity requirements; and that the exempted means cannot be utilized as a disguise for discriminating USA or Canadian incumbents or for making discretionary judgments as to granting licenses and assessing particular firm applications.

Another controversy was whether Art.1410 (1) was a self-judging provision. Yet, in the Tribunal’s view that was not the case as the article allows the state-party to

⁸⁹⁶ *Op. cit.*

defend before an unbiased panel or committee if the Tribunal finds a measure in question to make an expropriation thus violating Art. 1110.

The soundness of the defense is to be addressed by the Financial Services Committee or by the arbitral tribunal. As the Tribunal found out that in this case the measures did not constitute expropriation under the NAFTA, the debate over the means being reasonable or discretionary is purely academic.

The Tribunal decision concluded as follows:

- (a) Reject FFIC's claim to find the Mexican government guilty of violating Art. 1110 of the NAFTA by expropriating FFIC's investment.
- (b) Reject FFIC's claim for compensation for the complete worth of its investment.
- (c) Assume that all parties shall bear their own costs and cover 50% of the costs of the Tribunal.

4.6 CHAPTER CONCLUSIONS AND CLOSING REMARKS

NAFTA has become the most important FTA of Mexico's FTA network. At the time of its implementation, NAFTA created the world's largest market. This was a promising opportunity for Mexico, the smallest and weakest of the three parties, as it gained preferential access to one billion consumers in 44 countries.

In addition to the economic benefits, there have been also intangible benefits for Mexico from NAFTA. One worth highlighting is a more intentional adoption of the principles of the rule of law in Mexican legislation and institutions. Consequently, predictability and legal certainty in the judiciary system has increased significantly since NAFTA came into force. This has been reflected in improvements made to legislation such as the Foreign Investment Law and the Banking Law.

Some have argued that NAFTA was one of the main causes of the 1994 Mexican crisis. However, Mexico's liquidity crisis and consequent currency devaluation at the end of 1994 and the beginning of 1995 cannot be blamed on NAFTA since, as seen in Chapter 1, they were the result of weaknesses in an immature Mexican financial system which predated NAFTA. In the case of Mexico, NAFTA integration

encouraged productivity growth through both trade and foreign investment, and that global and regional integration resulted in productivity gains.

Regarding financial supervision in NAFTA it should be noted that it is reserved for the host country affair, however, regulators are permitted to negotiate bilateral agreements leading to regulatory and supervisory harmonization. In relation to market access, NAFTA states that it may limit cross-border subsidizing of financial institutions, thus allowing member states to demand individual incorporation for financial incumbents in their territory, and thereby forbidding a direct cross-border branching. Nevertheless, NAFTA members have decided to discuss the possibility of direct bank branching across NAFTA country borders if and when the USA permits Mexican- and Canadian-controlled US banks to extend cross-state by subsidiaries or branches throughout the entire USA.

Interestingly, due to the broad range of NAFTA's financial services chapter, it deals with new types of financial services that may be currently non-existent. Furthermore, NAFTA (Art. 1407) states that countries consent to allow all regulated financial institutions from another NAFTA country to enter into their markets provided that their services are authorized in the territory of the country of origin.

Regarding prudential measures NAFTA has proven its maturity through the Fireman's Insurance Company (arbitration case related to), NAFTA (Art. 1410). Arbitrators of this case recently stated that nothing on the part of NAFTA, including the financial services chapter, shall be interpreted as a regulation refraining a NAFTA country from applying measures for 'prudential' reasons or in search of monetary and credit-related or exchange rate resolutions. This provision has been crucial. Above all, it allows exemptions in a number of chapters of NAFTA for sensible means applied or kept for prudential regulatory reasons. This so called 'carve-out' guarantees that each member country has the elasticity to control its financial institutions.

NAFTA pursued different objectives than those pursued by EU. NAFTA has a lower level economic integration and different financial systems, however, NAFTA should take important lessons from the EU. These include the recognition that a

minimum harmonization of regulatory frameworks and cross-border financial activities require reform of public administration, especially tax treatment, banking and insurance legislation and joint supervision of securities markets in order to make the “single passport” system reliable as it is in the EU. Nevertheless, there is still a long way to go, because NAFTA lacks the political will to enforce legislative programs similar to the EU.

MEFTA has had significant implications for NAFTA, since the EU became its second largest national trading partner. Any agreement that eliminates trade barriers and improves market access between these two crucial trading partners potentially has major implications for US businesses. Mexico has become an important export bridge for the EU to the USA and Canada and vice-versa. Consequently, enterprises from Mexico’s commercial partners are now able to establish operations in Mexico to take advantage of its preferential access to US, Canada, European and Latin American markets. In this sense, the EU represents an opportunity for Mexico because it is the largest and most integrated trade arrangement in the world that is bound into a customs union and is committed to political and economic integration.

It is worth mentioning that MEFTA has gone beyond the commitments of GATS, with the objective of the progressive and reciprocal liberalization of trade in services (not exceeding 10 years). The financial services sector in Mexico was practically liberalized, as seen in Chapter 1, when the MEFTA Trade Services Agreement came into force. It is clear that in the services sector and more specifically in the financial services sector, the EU benefits more than Mexico due to its *net-exporter* nature of services and financial services. European banks and insurance companies have been authorized to operate and establish themselves directly in Mexican territory like their US and Canadian counterparts. Mexican banks have similar access to the EU, however, since Mexico it is not a *net-exporter* in financial services, this potential market is not likely to be exploited (at least in the short and medium term), as much as the market for industrial products and manufacturing where the Mexican competitive advantage lays. Consequently, Mexico offers major benefits for all EU investors that desire access to the NAFTA region free of duties. The key lies in the correct combination of the rules of origin provided for in MEFTA and NAFTA,

together with the applicable Mexican domestic trade program, such as the *maquiladora* (In bond) and the Sector Promotion Program.

Macro-economically the Mexico has made a significant recovery since the 1994-1995 (tequila crisis) and since NAFTA came into force, as charts have shown, however, in 2008 it was hit severely by the GFC. Throughout the more than two years that have elapsed since the onset of the GFC, the Mexican economy and its financial system have shown resilience that calls for an explanation. Mexico has passed the final test and graduated. The next chapter shows that this can be largely accredited to Mexico's "bottom-up" approach to the prudential liberalization of its financial system.

CHAPTER 5:

**MEXICO TWO YEARS AFTER THE ONSET OF
THE 2008 GLOBAL FINANCIAL CRISIS AND
THE SUCCESS OF ITS BOTTOM-UP APPROACH
TO PRUDENTIAL LIBERALIZATION**

5.1 INTRODUCTION

The saying goes that when the USA catches a cold, Mexico gets pneumonia; and that actually used to be the case. Not long ago, even fifteen or merely ten years ago, a crisis like the “made-in-USA” GFC unleashed in 2008 (2008 GFC) surely would have drowned Mexico into deep financial trouble and economic crisis. Yet, unlike the 20th century, the biggest global financial crises since the 1930s did not produce that outcome.

To be sure, Mexico was severely hit by the 2008 GFC, yet throughout the more than two years that have lapsed since the onset of the GFC, the Mexican economy and its financial system have shown resilience that calls for an explanation.⁸⁹⁷ This chapter shows that this has been largely one of the fruits of Mexico’s “bottom-up” approach to the prudential liberalization of its economy, in general, and of its financial system in particular.

⁸⁹⁷ This situation is not exclusive of Mexico but shared by other Latin American emerging economies that also learned their lessons from past crises and have applied doses of sound prudential financial and fiscal behavior. See chiefly WB, GLOBALIZED, RESILIENT, DYNAMIC. THE NEW FACE OF LATIN AMERICA AND THE CARIBBEAN (Oct. 2010); available at: http://siteresources.worldbank.org/INTLAC/Resources/AnnualMeetingsLACOutlookReport_01Oct10_ENG.pdf; John Paul Rathbone, *Latin America: No Longer The Man with a Moustache and a Guitar*, FINANCIAL TIMES (Nov. 22, 2010); available at: <http://www.ft.com/cms/s/2/43677f8c-f658-11df-846a-00144feab49a.html#axzz168PvyMz1>; and Gideon Rachman, *Is Globalization on the Retreat in 2011?*, FINANCIAL TIMES (Jan. 3, 2011); available at: <http://www.ft.com/cms/s/0/74a54ade-1773-11e0-badd-00144feabdc0.html#axzz1A5Chwk00>. See also Constantino Hevia, “Emerging Market Fluctuations; What Makes the Difference?” (WB, Policy Research Working Paper, Development Research Group, Macroeconomics and Growth Team, WPS4897, (Apr. 2009); P. FAJZYLBER & J. H. LÓPEZ, eds., REMITTANCES AND DEVELOPMENT: LESSONS FROM LATIN AMERICA (2008); WB, “World Bank Praises Latin America’s Resilience in Global Financial Crisis, Washington” (Jul. 6, 2009) at 1; available at: <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/0,,contentMDK:22238812~pagePK:146736~piPK:146830~theSitePK:258554,00.html>. See also OECD, 2009 Economic Survey of Mexico. On Brazil’s case see Marcos Valadao and Nara Galeb Porto, *Brazilian Response to International Financial Crises, The Pre-Salt Discoveries by Petrobras and the New Free Trade Areas in the Cities of Brazil*, LBRA (Sum 2009); and *Brazil takes off*, THE ECONOMIST (Nov. 14th 2009) at 15.

5.2 EARLY STAGES OF THE CRISIS

5.2.1 A Made-in-USA Crisis

The 2008 GFC was originated in the USA and exported to the rest of the world in the form of “toxic assets” derived from its subprime mortgage market.⁸⁹⁸ The downturn was originally related to the weakening of the subprime mortgage market in the USA, especially during 2005 and 2006, but spread to the inter-bank market and other financial markets.⁸⁹⁹

This crisis resulted from an unprecedented period of excessive borrowing, excessive lending and excessive investment incentivized by a series of significant economic and regulatory factors.⁹⁰⁰ However, excessive borrowing and lending were prevalent in all assets globally, including commercial real estate, corporate lending (mergers, acquisitions and private equity transactions), commodities and international equities. This broad based excessive borrowing and lending were fueled by excessive investment from a wide range of investors around the world.⁹⁰¹

The combination of excessive lending, excessive risk in the USA mortgage market, in addition to the lack of transparency, proper prudential regulation and supervision in the financial markets became the perfect storm to produce the crisis first in the USA, later in Europe and Japan, then to affect seriously most of the emerging economies and developing countries. On September 18, 2008, the international financial system was on the precipice of collapse and global credit markets practically stopped working for the following four weeks.⁹⁰²

⁸⁹⁸ See Arner, “The Global...,” *op.cit.*, and Stephen Labaton, *Geithner: Regulators Part of the Problem*, THE NEWS (Aug. 7, 2009) at 15.

⁸⁹⁹ See OECD, “2009 Economic Policy Reforms: Going for Growth.” at 18.

⁹⁰⁰ Angel Gurría, “From the Financial crisis to the economic downturn –Restoring growth is a key challenge” *op. cit.*, at 4

⁹⁰¹ See Arner, “The Global...,” *op. cit.*, at 1.

⁹⁰² See Daniel Tarullo, “Banking on Basel” (2008).

5.2.2 Mexico's Early Resistance and the Success of its Bottom-up Approach to Prudential Liberalization

It took some time for the 2008 GFC to hit Mexico and other Latin American and Asian countries. According to Manuel Sánchez, Deputy Governor of BANXICO, this was due to “the reasonably good economic performance of various countries in Asia and Latin America..., the application of prudent fiscal and monetary policies and the endeavors made to improve financial regulation and supervision.”⁹⁰³

Deputy Governor Sánchez also reported that, “when the first symptoms of the global financial crisis appeared, the majority of the analysts reckoned that the Mexican economy was in a more solid position than in previous episodes of financial turbulence.” It was therefore reckoned that “the magnitude of the impact of the international crisis over the economy was going to be smaller than what has been finally observed.”⁹⁰⁴

According to the OECD Economic Survey of Mexico 2009, the financial sector looked relatively sound at the onset of the crisis, and its limited exposure to foreign assets and liabilities reduced vulnerabilities to shocks. Conservative lending policies practices helped contain credit demand and avoided housing bubbles.⁹⁰⁵

The above confirms that Mexico's bottom-up approach to prudential liberalization of its financial sector was crucial in delaying and reduce the magnitude of the impact of the 2008 GFC in Mexico in the short term, and to prevent worse consequences in the medium and long term. Mexico was indeed much better prepared to face this crisis than ever before since at least the Mexican Revolution (1910).

⁹⁰³ Manuel Sánchez, “Impacto de la crisis internacional en México, respuesta de política y perspectivas” [Impact of the International Crisis in Mexico, response of policy and perspectives] (Speech, Nov. 19, 2009), at 1; available at: <http://www.bcr.gob.sv/uploaded/content/category/2106364632.pdf>. See also Manuel Sánchez, “Mexico's Economic Outlook: Challenges and Opportunities” (remarks at the Center for Hemispheric Policy; University of Miami, Feb 5, 2010), at 4; available at: <http://www.banxico.org.mx/publicaciones-y-discursos/discursos-y-presentaciones/discursos/%7B90A0BE2B-F2C3-0118-02A5-2EDDA1894287%7D.pdf>.

⁹⁰⁴ Sánchez, “Impacto...”, *op. cit.*, at 2-3.

⁹⁰⁵ OECD, 2009 Economic Survey of Mexico, at Ch. 1.

One example of prudential financial regulation, that according to Deputy Governor Sánchez grounded the reckoning above quoted and that certainly protected the Mexican financial system, is the Mexican regulation that strictly limits the operations that banks can carry-out with related parties, including their holdings,⁹⁰⁶ which prevented the latter to communicate the effects of their “toxic assets” (those linked to the USA subprime mortgage market) to the former.

Another example of prudential regulation and oversight is found in the fact that “banks in Mexico did not have “toxic assets.”⁹⁰⁷ Likewise, as of 2008 it was recognized that Mexico was “the number one of Latin America in bank’s financial stability with 14.1 in per cent age of capital to total assets in 2008.”⁹⁰⁸

Thanks to the bottom up approach to the prudential liberalization in México, Bank management adopted gradually and increasingly the definitions and development of international practices, especially after the 1994-1995 crisis. At the regulatory level, the globalization of the Mexican financial system started in 1994 with the implementation of BCBS recommendations, which imposed international standard to measure the solvency and performance of Mexican banks.

Internationally, the creation of new financial instruments and the risk position enlargement in the markets throughout the 1990s led to better risk management. Management practices and bank risk regulations have been influenced by Basel II, which is recognized by more than 130 countries. The Mexican financial system had no trouble adopting Basel II, since its regulation has been very strict after the “Tequila Crisis.” This, since several Mexican directives (for example on risks, CNBV 2004a and 2004b) are in complete agreement with BCBS’s principles (See Chapter 3).

⁹⁰⁶ *Id.*, at 3.

⁹⁰⁷ Sánchez, “Impacto...”, *op. cit.*, at 3. See also Fidler, Wheatley and Thomson, *Latin America...*, *op. cit.*

⁹⁰⁸ See Fidler, Wheatley, and Thomson, *Latin America...*, *op. cit.*

5.2.3 Early Effects in Mexico

Notwithstanding the above, the crisis still hurt Mexico. In the autumn of 2008, investors withdrew 22.19 billion dollars from the Mexican Stock Exchange and the federal government's bond debt market.⁹⁰⁹ Likewise, at the end of 2008 Mexico's prospects for economic growth in 2009 were notably downgraded to zero,⁹¹⁰ or even "to slip marginally into negative territory."⁹¹¹

The crisis was transmitted to emerging economies, including Mexico, by multiple channels,⁹¹² but two shocks in particular were of considerable magnitude: the demand shock and the financial shock.⁹¹³ According to BANXICO's Deputy Governor Sánchez, the main channel of transmission to Mexico was the reduction in the rhythm of world economic activity and in the prices of raw materials and commodities, which caused a drop in its income of foreign currency (chiefly USA Dollars) coming from the export of goods and services, especially to the USA.⁹¹⁴

The shortage of USA currency in Mexico, plus the environment of greater risk aversion prevailing in the international markets that rarified the debt and foreign exchange markets, brought about a devaluation of the Mexican Peso against the Dollar. This hurt private Mexican companies that had derivate operations in USA

⁹⁰⁹ See *Foreign Investors Withdrew \$22.19 Billions from the Country*, LA JORNADA (Dec. 18, 2008).

⁹¹⁰ As of Oct. 20, 2008, "Merrill Lynch reduced its 2009 economic growth forecast for Mexico to 0.9 percent from 1.9 percent" (Jens Erik Gould, *Merrill Lynch Cuts Mexico 2009 Growth Forecast to 0.9 Percent*, Bloomberg (Oct. 20); available at:

http://www.bloomberg.com/apps/news?pid=newsarchive&sid=afCNXp2HFjgg&refer=latin_america.

By early January 2009, then SHCP Secretary Agustín Carstens announced that the Mexican economy was not going to grow at all in 2009 as a result of the recession in the USA. (David Luhnnow, *U. S. Recession Stymies Mexico's Growth for 2009*, THE WALL STREET JOURNAL (Jan. 9, 2009); available at: <http://online.wsj.com/Art/SB123146808512567033.html>. See also Erwan Quintin and Edward Skelton, *How Much Will the Global Financial Storm Hurt Mexico?* SOUTH WEST ECONOMY (Nov-Dec 2008) at 1.

⁹¹¹ Stephen Fidler, *Going South*, FINANCIAL TIMES (Jan 9, 2009); available at:

<http://www.ft.com/cms/s/0/c75e5054-ddb9-11dd-87dc-000077b07658.html#axzz19eO9eNMR>.

⁹¹² On the impact on emerging economies in general and on the Mexican economy in particular, see Sánchez, "Impacto...", *op. cit.*, at 1-5.

⁹¹³ *Id.*, at 9.

⁹¹⁴ *Id.*, at 3. The author further explains that Mexico's peculiarities have increased the impact of this shock, that is, that 80% of Mexico's exports of manufactured goods (which account for 80% of Mexico's total exports) are purchased by the USA. See also Manuel Sánchez, "Mexico's Economic Outlook: Challenges and Opportunities" (Remarks at the Conference "Latin America 2010: Economic, business and Trade Forecast". Center for Hemispheric Policy. University of Miami. Feb. 5, 2010), at 1-2; available at: <http://www.banxico.org.mx/publicaciones-y-discursos/discursos-y-presentaciones/discursos/%7B90A0BE2B-F2C3-0118-02A5-2EDDA1894287%7D.pdf>.

Dollars, thus increasing the demand of that currency causing a further devaluation of the Mexican Peso.⁹¹⁵

The rarified debt and foreign exchange markets also caused “an increase in the long term interest rates, a drastic decrease in securities indexes... an increase in the margins of sovereign risk,” and a shortage of foreign financing for Mexican companies.⁹¹⁶

5.2.4 Mexico’s Early Measures to Face the Crisis

In October 2008, the Mexican government announced various tax stimuli aimed at mitigating the effects of crisis and the global recession on Mexico, including an increase in public investment for 2009.⁹¹⁷

By January 9, 2009, upon the announcement that Mexico’s prospects of growth for that year were downgraded to zero,⁹¹⁸ President Calderón announced 25 measures to face the global crisis, to prevent outright recession and layoffs, to help households’ and SME’s economy, and to promote competitiveness in general, investment in infrastructure, and transparency in public spending.⁹¹⁹

At this point is worth highlighting commentary THE WALL STREET JOURNAL’s commentary, about the Mexican government having “more tools at its disposal to confront a recession than at any time in recent memory.”⁹²⁰ It is further explained that, “Past Mexican governments were too indebted to ramp up public spending in times of crisis and usually had to resort to belt-tightening.

⁹¹⁵ See Sánchez, “Impacto...” *op cit.*, at 4. For more on the negative effects that derivative operations had for Mexican companies, see *infra* 3.2. Impact on Private Companies that Gambled with Derivatives.

⁹¹⁶ *Id.*

⁹¹⁷ See *id.*, at 5.

⁹¹⁸ See Gould, *op. cit.* This source reported also that during the last few months of 2008 job losses were starting to pick up, “with more than 250,000 workers cut from manufacturing payrolls during the last few months of 2008.

⁹¹⁹ See *id.*

⁹²⁰ Sánchez, “Impacto...,” *op. cit.*

This time, the government is on solid enough ground to boost spending in areas such as infrastructure.”⁹²¹ This was made possible due to economic liberalization reforms that implied abandoning the Statist economic model, without losing prudential input over the economy.

Likewise, in addition to the measures taken to stimulate economic activity, the autonomous BANXICO and the federal government took several measures aimed at normalizing and preserving the sound functioning of the Mexican financial system.⁹²² As for the monetary policy, BANXICO, in its capacity of autonomous monetary authority, “decided to start a cycle of monetary relaxation as a measure that would help to mitigate the unfavorable effects of the adverse international context.”⁹²³

Regarding currency exchange policy, an early measure (October 2008) to backup the provision of liquidity in USA Dollars was an agreement between BANXICO and the Bank of the Federal Reserve of the USA that established a temporary currency exchange mechanism. Likewise Mexico applied for a flexible line of credit with the IMIF, which was approved in April 2009.⁹²⁴

Domestically, BANXICO was instructed to carry out extraordinary sales of USA Dollars in order to satisfy the demand of that currency by private companies and to provide liquidity. Between October and December 2008, BANXICO auctioned \$18.227 billion USA Dollars of its international reserve.⁹²⁵ Additionally, sales of USA Dollars were to be made whenever the Mexican Peso would devalue more than 2% compared to the previous day, in order to prevent excessive volatility in the currency exchange market.⁹²⁶

In order to provide liquidity in MXN for the domestic market, BANXICO allowed for mechanism of liquidity at a lower interest rate and allowing for a wider

⁹²¹ *Id.*

⁹²² See *id.*, at 5-6, and 9.

⁹²³ *Id.*

⁹²⁴ *Id.*, at 6-7.

⁹²⁵ See *id.*; and Mario Reyna Cercero, Diana Salazar Cavazos & Hector Salgado Banda, “The Yield Curve and its Relation to Economic Activity: An Application to Mexico” (BANXICO Research Paper No. 2008-15, Dec. 2008).

⁹²⁶ Sánchez, “Impacto...,” at 6.

range of assets to be taken as collateral by commercial banks in order to acquire loans from it.⁹²⁷ Other measures were applied by SCHP and BANXICO “toward unlocking certain markets after the aggravation of the crisis.”⁹²⁸

5.3 AFTERMATH FOR MEXICO AS OF 2009

5.3.1 Impact on the Economy’s Growth

By April 2009, the imported economic disturbance was aggravated by the measures the Mexican government had to take in order to prevent the spreading of the swine (or AH1N1) flu epidemic (according to international standards and commitments within the World Health Organization), and the role both played immediately and directly in the contraction of tourism in particular and the services sector in general.⁹²⁹

In spite of the several measures taken in several fronts (which certainly helped to ameliorate the worst effects of the crisis), Mexico still “experienced a harsh economic downturn.” According to official data, “the economic contraction started during the second quarter of 2008 and probably ended in the same quarter of 2009. During this five-quarter period, per-capita GDP plummeted by approximately 10%, a fall similar to the one observed in the first half of 1995...”⁹³⁰

5.3.2 Impact on Private Companies That Gambled with Derivatives

The crisis has brought to public light the role of financial derivatives in keeping the global financial system in a constant state of volatility. This, however, was not a new experience for the Mexican economy. These financial instruments were a key factor in triggering the Mexican currency crisis in 1995. This time, the derivatives

⁹²⁷ *Id.*, at 7.

⁹²⁸ *Id.* The author lists five more measures dealing with governmental securities, bonds, swaps, etc. See, for instance, José Manuel Arteaga, *Se emiten bonos de deuda por 2 mil mdd* [Bonds Worth USD\$2 Billion Are Issued], EL UNIVERSAL (Dec. 19, 2008); available at: <http://www.eluniversal.com.mx/finanzas/68241.html>.

⁹²⁹ Sánchez, “Mexico’s...,” *op. cit.*, at 4. See also OECD, 2009. Economic Survey of Mexico 2009. The OECD 2009 [hereinafter OECD 2009. Economic Survey of Mexico 2009].

⁹³⁰ Sánchez, “Mexico’s...,” *op. cit.*, at 1. See also OECD, Economic Survey of Mexico 2009, Ch. 4.

transactions undertaken by the Mexican corporations intensified the effects of the recession in Mexico.⁹³¹

The volatility in developed countries' financial markets was not seen as a threat to Mexico's financial stability until early October 2008, when international investor's quest for liquidity and safety led them to reduce their exposure in emerging markets.⁹³² The peso reached a six –year high against the dollar in early August but then began to fall.

On October 8, this weakening intensified as the peso dropped by 13.8% in one day. The fall was exacerbated when several large Mexican companies started selling Pesos to cover speculative bets on the exchange rate. Mexico had not experienced such currency depreciation since the Tequila Crisis.⁹³³

5.3.3 The Citi Group-BANAMEX Issue

Another problem originated in the USA with which Mexican financial authorities had to deal with was the USA government's ownership of CitiGroup (owner of Mexican bank BANAMEX) after the being bailed-out. According to Art. 13 of the Mexican banking law, no governmental entity shall own stocks in Mexican banks.

SHCP concluded that Citigroup did not have to sell its shares in BANAMEX. Opposition political parties (leftist) reacted by initiating a constitutional controversy before the Mexican Supreme Court.⁹³⁴ The resolution of this case needs to take into account NAFTA.

⁹³¹ BANXICO, "Financial System Summary Report" (Jul. 2009) at 5.

⁹³² Hevia, *op. cit.*

⁹³³ See Quintin and Skelton, *op. cit.*, at 13.

⁹³⁴ See Horacio Jiménez, Ricardo Gómez and Juan Arvizu, *Oposición lleva a la Corte caso Banamex* [Opposition Takes Banamex Case to Court], ELUNIVERSAL (Mar 24, 2009), at front page; available at: <http://www.eluniversal.com.mx/primer/32687.html>; *Debe Corte decidir si Banamex-CitiGroup violó la ley: Beltrones* [Court Ought to Decide whether Banamex-Citigroup Violated the Law: Beltrones], EL UNIVERSAL (Mar. 24, 2009); available at: <http://www.eluniversal.com.mx/notas/586106.html>.

5.4 SYSTEMIC CRISIS PREVENTED AND FASTER ECONOMIC RECOVERY ACHIEVED

5.4.1 Zero Bank Failures in Mexico

The year 2009 was bad for Mexico; nevertheless a systemic crisis was prevented.⁹³⁵ As of December 31, 2010, not a single bank in Mexico had failed nor were there any troubled Mexican banks. Meanwhile, twenty five banks failed in 2008 in the USA, 140 in 2009, and 157 in 2010,⁹³⁶ that is, a total of 322 failed banks in the USA since the beginning of the crisis. This is noteworthy given the high dependence of the Mexican economy on the USA's economy.

While early analyses attributed this to the relatively small size of the Mexican banking system,⁹³⁷ the fast recovery of the economy and further research and analysis has shown that the explanation is found on the structural prudential reforms undertaken over the last 25 years: the bottom-up approach to prudential liberalization.

5.4.2 Faster and Larger than Expected Growth in 2010

As of November 2009, BANXICO's Deputy Governor Sánchez estimated that Mexico's growth for 2010 would be of approximately 3%, "conditioned on the magnitude and speed" of the recovery expected in the USA, and therefore with the reservation that if the demand of Mexican manufactured goods were to be smaller than the analysts' forecast then the recovery of the Mexican economy would be slower.⁹³⁸

⁹³⁵ See RICARDO PAEZ DE BARROS, FRANCISCO H. G. FERREIRA, JOSÉ R. MOLINAS VEGA, and JAIME SAAVEDRA CHANDUVI, MEASURING INEQUALITY OF OPPORTUNITY IN LATIN AMERICAN AND THE CARIBBEAN (2009) at 1; available at: http://siteresources.worldbank.org/LACEXT/Resources/258553-1222276310889/Book_HOI.pdf.

⁹³⁶ Marcy Gordon, *Regulators Close Banks in Ga., Fla., Ark., Minn.*, YAHOO FINANCE (Dic. 17, 2010); available at: <http://finance.yahoo.com/news/Regulators-close-banks-in-Ga-apf-3911928937.html?x=0&.v=7>.

⁹³⁷ See for instance Fidler, Wheatley and Thomson, *Latin America...*, *op. cit.*

⁹³⁸ Sánchez, "Impacto..." *op. cit.*, at 9.

Nevertheless, in spite of the lack of recovery in the USA in 2010 (whose growth was downgraded to 2.5%),⁹³⁹ Mexico's economic growth was estimated to be 5% for 2010.

According to BANXICO, as of September 24, 2010:

- Production and manufacture exports were keeping “a good growing pace,” although it could decrease as a result of the moderation in the economic activity of the USA.”⁹⁴⁰
- Private demand continued “to be lagging behind, with depressed investment and consumption still below levels prior to the crisis.”⁹⁴¹
- The currency's exchange rate was in relatively stable levels, while long term interest rates had reached historically low levels.⁹⁴²
- Inflation was lower than expected by both the market and the central bank, which estimated that it would stay below the floor of its own forecast,⁹⁴³ and expected to reach a 3% inflation rate by the end of 2011.⁹⁴⁴

5.4.3 Key Factors of the Resilience of the Mexican Financial System and the Fast Economic Recovery

5.4.3.1 Learning from Past Crises

A special report by THE ECONOMIST highlights that, after the early 1980s crisis, “policymakers abandoned the protectionism and fiscal profligacy that had brought hyperinflation and bankruptcy. In their place they adopted the market reforms... (opening up their economies to trade and foreign investment, privatization and

⁹³⁹ See The Financial Forecast Center, “U. S. Gross Domestic Product GDP Forecast” (Jan. 1, 2011); available at: <http://www.forecasts.org/gdp.htm>.

⁹⁴⁰ BANXICO, “Anuncio de Política Monetaria” [Announcement on Currency Policy] (Sep. 24, 2010) at paragraph 2; available at: <http://www.banxico.org.mx/informacion-para-la-prensa/comunicados/politica-monetaria/boletines/%7BE1969E22-0202-5FCE-3CB0-B02C66B029E1%7D.pdf>

⁹⁴¹ *Id.*

⁹⁴² *Id.*

⁹⁴³ *Id.*, at paragraph 3.

⁹⁴⁴ *Id.*, at paragraph 4. BANXICO acknowledges in the cited document that its monetary policy has “a most powerful ally” in the fiscally responsible policy of the federal government.

deregulation).”⁹⁴⁵ Along the same lines, in *The New Face of Latin America: Globalised, Resilient, Dynamic*, WB says past crises have immunized the region, so that during this financial crisis, while advanced economies caught pneumonia, Latin America “only got a cold”.⁹⁴⁶

5.4.3.2 Structural Reforms

According to THE ECONOMIST, Latin America weathered the [2008-2009] recession partly thanks to good fortune but also to sound policies including “flexible exchange rates, inflation-targeting by more or less independent central banks, more responsible fiscal policies and tighter regulation of banks, as well as social policies aimed at the poor.”⁹⁴⁷ Since the late 1980s, Mexico has been intentional in pursuing fiscal discipline and fighting inflation, and shortly after (1994) amended its constitution to bestow autonomy to BANXICO.⁹⁴⁸

Along similar lines, BANXICO’s Deputy Governor Sánchez has compared the difference of contexts between past Mexican crisis and the 2008 GFC. Past Mexican crisis were homegrown crises “typically linked to major macroeconomic and financial disequilibria, in the form of high fiscal deficits, large current account imbalances and fragile financial intermediaries,” plus a fixed exchange rate, all of which “eventually led to a speculative attack on the currency.”⁹⁴⁹

Unlike those crises, the 2008 GFC hit a Mexican economy that enjoyed “sound macroeconomic fundamentals, including a solvent fiscal position, a floating

⁹⁴⁵ Michael Reid, *A special report on Latin America. So near yet so far: A richer, fairer Latin America is within reach, but a lot of things have to be put right first*, THE ECONOMIST (Sep. 9, 2010); available at:

http://www.economist.com/node/16964114?story_id=16964114&CFID=149231776&CFTOKEN=97833347.

⁹⁴⁶ See Rathbone, *op. cit.*

⁹⁴⁷ Reid., *op. cit.*

⁹⁴⁸ See *supra* Chapter 1, 1.1.4 Political Confrontations Regarding Free Market Policies; 1.1.6 Political-Economic Context of the Beginnings of the NAFTA Era; 1.3.6 Regulatory Framework in the Post-NAFTA Financial System; and Chapter 1, 1.4.3 G20’s Assessment of Mexico’s Institution Building in Its Financial System.

⁹⁴⁹ Sánchez, “Mexico’s...,” *op. cit.*, at 4.

exchange rate system, and an independent central bank committed to price stability.”⁹⁵⁰

5.4.3.3 Economic Liberalization in General

The role of economic liberalization in general (primarily international free trade) in protecting the Mexican economy against the worst effects of the crisis and in making possible a faster and larger recovery is also identified by experts and commentators.

Miguel Mancera Aguayo, former General Director and then Governor of BANXICO (1982-1998) mentions the larger diversification of Mexican exports along with BANXICO’s high international reserves and the system of floating exchange rate among the reasons for the better position Mexico had to weather the 2008 GFC.⁹⁵¹ Likewise, the F

INANCIAL TIMES said that “thanks to its trade links with Asia, Latin America’s economies were broadly unhurt.”⁹⁵²

As an example of the above, in the beginning of 2009, 50 transnational corporations moved their main operations from the USA, Europe and Asia to Mexico, with investments worth USD\$100 billion Dollars.⁹⁵³

Another notable example is found in the car industry. As of September 2010, Mexico’s car exports had reached “1.4 million units, up 71.2per cent on last year and 10.5 per cent on 2008, the best year on record.”⁹⁵⁴ Volkswagen, Ford, Chrysler (including Fiat) and Nissan have made significant investments in production plants in Mexico between 2008 and 2010, moving production, and even design, modeling and engineering, from Europe, Japan, the USA and South America to Mexico.⁹⁵⁵

⁹⁵⁰ *Id.*

⁹⁵¹ See Miguel Mancera Aguayo, *Crisis económicas en México, 1976-2008* [Economic Crises in Mexico, 1976-2008], ESTE PAÍS [This Country] (Jan. 2009); available at: <http://www.cnnexpansion.com/economia/2009/01/13/crisis-economicas-en-mexico-19762008>.

⁹⁵² Rathbone, *op. cit.*

⁹⁵³ Jorge Ramos Pérez, *Mexico it is not suffering like Europe due to the crisis*, EL UNIVERSAL (Apr 29, 2010).

⁹⁵⁴ Thomson, *Car...*, *op. cit.*

⁹⁵⁵ *Id.*

This investment has been attracted to Mexico, not only because of the affordable labor costs, but also because “Mexico’s 40-odd trade agreements with other countries had made it both cheap for manufacturers to import materials and to export finished vehicles, in particular to the USA and Canada via” NAFTA. Thus, Mexico has preferential access to two-thirds of the world’s GDP.⁹⁵⁶

5.4.3.4 Financial Prudential Liberalization in Particular

As a response to its early 1980s and 1994 financial crises, Mexico re-evaluated the role of financial law and institutions, which consequently lead to the development for the first time, of a sound and comprehensive prudential framework of internationally acceptable standards delineating minimum requirements for financial stability,⁹⁵⁷ yet working from the bottom-up domestically with innovative financial sector reform approaches. Likewise, in attempt to comply with NAFTA obligations, Mexico amended several financial and commercial internal laws and regulations.⁹⁵⁸

Regulation changes strengthened the Mexican banking system as well as strict monitoring from the financial authorities. Mexico empowered its financial system through building its markets upon a solid and structural foundation rooted in “international prudential financial standards,” as well as promoting the above mentioned “prudential liberalization” framework while respecting its domestic financial sector.

Deputy Governor Sánchez confirms that another difference between past crises and the way Mexico dealt with the 2008 GFC, is “the construction of a strong regulatory and supervisory framework together with openness to foreign investment,” which has yielded a solid banking system.⁹⁵⁹ Likewise, the credibility earned by prudent financial policymaking over the past two decades may have helped Mexico weather the current financial storm without devastating effects.⁹⁶⁰

⁹⁵⁶ *Id.*, quoting words by Lorenza Martínez at the Mexican Secretary of Economy.

⁹⁵⁷ See ARNER, *FINANCIAL...*, *op. cit.*, at 2.

⁹⁵⁸ *Id.*

⁹⁵⁹ Sánchez, “Mexico’s...,” *op. cit.*, at 4

⁹⁶⁰ See Quintin and Skelton, *op. cit.*, at 2.

5.4.3.5 Savvy and Courageous Leadership

Beyond political courtesies, BANXICO Governor's assessment and endorsement of President Calderón's performance in dealing with the crisis highlights that, in addition to proper policies, successfully weathering the crisis required both savvy and courage:

It would be obtuse to skimp on the merits of [the federal government's] fiscal policy when today is amply acknowledged that Mexico knew how to foresee in a timely manner the strong adjustment that would follow after the global crisis. Not all the governments of the world had, in the most acute moments of the crisis, the political will to defend a strong fiscal policy, even at the expense of misunderstandings and criticism. Fiscal strength which is indispensable to preserve in order to give continuity to an accelerated economic recovery without inflationary pressures, just as the one we have observed during 2010... Ten years ago it would have been unimaginable that the Federal Government would finance itself, as it is now, at 30 years maturity term with a fixed rate, in pesos, of only 7.23%.⁹⁶¹

5.5 CHAPTER CONCLUSION AND CLOSING REMARKS

The 2008 GFC was an important test to the modernization process started by Mexico 25 years ago. As IDB's chief economist Santiago Levy said about the 2008 GFC, it "may have been the final exam and the graduation party" after Latin America's lengthy education in getting macroeconomic policy right.⁹⁶²

Today Mexico is much better equipped to deal with adverse economic shocks today than at any point in its recent history.⁹⁶³ It has managed to reduce greatly its vulnerability to homegrown shocks and to insulate its banking and financial system from the 2008 GFC, mainly thanks to the "prudential liberalization" of its economy in general and of the financial system in particular.

⁹⁶¹ BANXICO, "Anuncio..." *op. cit.*

⁹⁶² Reid, *op. cit.*

⁹⁶³ See Quintin and Skelton, *op. cit.*, at 10.

Likewise, financial globalization brought benefits to the Mexican economy, which may be summarized as greater systemic stability, banks efficiency and better authorization practices as well as higher credit repayment rates. Notwithstanding, further structural reforms are urgently needed in areas such as education, tax-collection, energy, labor, competition, communications and commercial diversification.⁹⁶⁴ Therefore Mexico should not only not back-track from the reforms already achieved but should apply the same approach of prudential liberalization exemplified in financial services to those other areas that need reforms.

⁹⁶⁴ See Roberto Salinas León, “Amenazas presentes” [Current Threats] (Jan. 5, 2011); available at: <http://ipea.org.mx/2011/01/amenazas-presentes/>. In this column Dr Salinas summarizes a lecture by Roger Pardo, former Deputy Adjunct Secretary of Defense, in a visit to Mexico City (late 2010), in which Pardo “recommends reforms that will allow to place the institutional basis of a society of free and responsible citizens,” as the way to deal with the “multifaceted threat that is presented in the weakness of the [Mexican] State, the institution and the civil society, independently of the violence and the war against drugs cartels.” Among the reforms recommended stand out an energy reform that allows investment in the sector, “while still allowing on the service we demand;” tax reform; and a tariff reform that would identify Mexico as “the bridge and strategic base of inter-American commerce.”

CHAPTER 6:
CONCLUSIONS

More than 35 years of increasing governmental control over the entire spectrum of the economy in Mexico, coupled with fiscal indiscipline and inflationary policies, only served to generate severe consecutive and ever-increasing downward-spiraling crises. The magnitude of the “tequila crisis” made it inevitable for the Mexican government to start a slow and initially hesitant departure from the earlier policies that led to the crises, and reluctantly to adopt liberalization and other market based economic policies (Chapter 1).

Today, Mexico has not only overcome its systemic crises but has become, even as an emerging economy, an important and relevant actor in the global economic and financial scene. The way Mexico weathered the 2008 “Made in the USA” crisis, which resulted from its regulatory and institutional framework reforms, attests to this. The previous crises have immunized Mexico, so that during this GFC, while advanced economies caught pneumonia, Mexico “only got a cold” (Chapter 5).

Another testimony to Mexico’s importance and relevance in today’s globalized economy is its participation in the G20, even since the inception of its predecessors. Moreover, the positive balance of Mexico’s participation in the G20 has encouraged it to take a more active role, thus becoming a leading member based on Mexico took the first steps towards economic reform (most notably the accession to GATT), the latest GFC showed that Mexico’s country-specific bottom-up approach to legal reforms towards the prudential liberalization of the economy generally is bearing very palpable fruits, most notably in the financial sector (Chapters 3 and 5).

The reform to the legal framework gave the Mexican financial system the strength and stability that has enabled it to avoid the likely disasters that a crisis like the GFC could have easily brought about under the previous legal framework. In and of itself, this proves the merits of the Mexican bottom-up approach to prudential liberalization in the highly sensitive and specialized realms of markets and finance (Chapters 1 and 5).

The current favorable state of affairs of the Mexican economy in general, and more specifically the resilience shown by its financial system after the GFC, are not fortuitous nor due to isolated causes, rather the aggregate result of the various legal

and economic reforms undertaken over the last 25 years. These reforms began with the GATT and were followed by the structural reforms of the early 1990s (notably the independence of BANXICO in 1994), NAFTA and WTO (1994), the opening of the financial sector (1995-1999), and the several FTA's entered into with various nations and regions, including MEFTA in 2000 (Chapters 1, 2, and 5).

An examination of tariff reduction by developing countries found that neither regional trade agreements nor multilateral agreements were the driving force in the liberalization. Autonomous liberalization or a "bottom up approach" accounted for 66% of the liberalization, while multilateral agreements and regional agreements accounted for 25 and 10% respectively (Chapter 2). Thus, unilateral liberalization has become the most successful way to liberalize in many countries.

Interestingly however, Mexico has been applying this approach under two unique circumstances: firstly, it has been implemented within a democratic environment (in China, for example, although they also are pursuing a bottom up approach, the communist party continues to decide who will rule the country); and secondly, through the adoption of internal structural prudential reforms (e.g. amending several internal financial, investment and commercial laws and regulations) undertaken over the last 25 years and through step by step in its implementation of international financial principles (Chapters 1, 3 and 5). This is not a defect inherent in the approach, rather a necessary result of the other political obstacles that Mexico has had to overcome and which have been aggravated by popular opinion and objection to economic liberalization throughout these years. In other words, both Mexican authorities and population in general were finally persuaded that this was the only path to follow in order to achieve the goal of economic progress and legal certainty and predictability. These are the reasons why this model should be followed by other countries of similar financial structure and level of economic progress.

As has been stated, purely top-down legal reform is not viable in the long-term as much has to come from the bottom up. Especially regarding prudential financial standards, active and fully committed country participation is needed from the very beginning (Chapter 1) since has to be analyzed properly its level of implementation and commitment in each country, taking into account that every nation represents an

unique case. As such each authority may need to adopt solutions that correspond to their different needs and levels of development, as has been successful in the case of Mexico (Chapters 2, 3 and 5).

In addition to economic modernization and resilience, Mexico has reaped other expected benefits from liberalization in financial services. In general liberalization of services increases competition and consequently improves such services. Competition is the most effective instrument to lower average costs and increase quality and variety of services. The presence of foreign banks in Mexico has provided access to foreign savings, lowered financing costs, and increased competitiveness, efficiency and diversity (Chapter 2 and 3). Transfer of knowledge was an additional benefit of early stages of its liberalization of the Mexican financial system, with the influx of experienced bankers from abroad and the adoption and implementation of relevant international standards and regulations (Chapter 3).

On the other hand, the expected level of growth in financial inclusion as a result of financial liberalization has, as of yet, not been achieved in Mexico. This is due to several factors, the chief of which is the high level of poverty. Financial liberalization alone cannot solve the problem of financial exclusion, nor can private banks, especially when prudential standards are given priority. With its country-specific bottom-up approach to financial reform, Mexican law consistently mandates the pursuit of financial inclusion to the development banks and other governmental programs and institutions. Therefore, private banks have not been forced to compromise prudential standards for the sake of financial inclusion (Chapter 3).

A palpable benefit of social significance for the lower classes that has begun to be more readily recognized, and that is related to financial inclusion, is the amount of money made available by private banks for financing housing. This financing has grown steadily over the last four years, albeit moderately. It is true, however, that “social interest” (low-income) housing has comprised the smallest proportion of these loans and that it has not grown proportionately. This confirms the underlying conflict between adhering to relevant prudential standards and achieving increased financial inclusion, since the low-income segment is the one with the highest

proportion of payment delays and defaults and generally has a higher risk (Chapter 3).⁹⁶⁵

Some have argue that financial liberalization has only benefited developed countries while developing countries have been left vulnerable to unnecessary but inevitable financial crises. Mexico's case, however, proves that this is not necessarily true, provided that proper sequencing and compliance with relevant prudential regulations are observed. On the contrary, financial liberalization has to be credited with rescuing the Mexican financial system from its 1994-1995 crisis (Chapters 1 and 3). This crisis put NAFTA's Chapter 14 (FFIC's v Mexico) to the test and passed successfully when it confirmed a nation's right to apply prudential criteria (Fireman's case), further confirming NAFTA's and MEFTA's superiority over GATS and the WTO (Chapter 1, 3, 4 and 5).

Due to the bottom-up approach to prudential liberalization in Mexico, bank management gradually and increasingly adopted the definitions and development of international practices, especially after the 1994-1995 crisis (Chapters 1 and 3). At the regulatory level, the globalization of the Mexican financial system started in 1994 with the slow implementation of BCBS recommendations by Mexican authorities (CNBV and SHCP), which imposed international standards to measure the solvency and performance of Mexican banks (Chapter 3).

Internationally, the creation of new financial instruments and the risk position enlargement in the markets throughout the 1990s led to better risk management. Management practices and bank risk regulations have been influenced by Basel II, which is recognized by more than 130 countries, including Mexico. The Mexican financial system had no trouble adopting Basel II, since its regulation has been very strict after the "Tequila Crisis." This, since several Mexican directives (for example

⁹⁶⁵ See BANXICO, "Reporte sobre el sistema financiero a junio de 2010" [Report on the Financial System as of June 2010] (Nov. 2010), at 46-47; available at: <http://www.banxico.org.mx/dyn/publicaciones-y-discursos/publicaciones/informes-periodicos/reporte-sf/%7BDC37ACB-26F0-020D-145B-5CF397D62E68%7D.pdf>. Furthermore, another recent BANXICO document indicates that the low dynamism in loans "seems to reflect chiefly problems in the demand" not the supply. See BANXICO, "Crecimiento económico: ¿Pausa o cambio de rumbo?" (Nov. 4, 2010), at 18; available at: <http://www.banxico.org.mx/publicaciones-y-discursos/discursos-y-presentaciones/presentaciones/%7BF4638876-217B-8699-D92F-9C6498AF3E9F%7D.pdf>.

on risks, CNBV 2004a and 2004b) are in complete agreement with BCBS's principles (Chapters 3 and 5).

For the particular case of Mexico, the new Basel III will not represent as profound changes as those that the banks of other countries will have to face. This, is because, after the 1994-1995 financial crisis in Mexico, a new and very demanding regulatory framework was established in the area of capitalization, both for the amounts of required capital, as well as for the quality demanded for such capital. It is for this reason that banks in Mexico will not have to make extraordinary efforts to comply with the new regulatory parameters (Chapter 3).

This is also why banks will be able to meet the new demands before the end of the international transition period, which goes until 2019. It is pertinent to point out that the past decisions made in Mexico on bank capitalization were appropriate and allowed its credit institutions to avoid being contaminated by the deterioration of the foreign banking systems (Chapter 5). This is confirmed by the fact that the new global regulatory framework is close to the one applied in Mexico. In fact, Mexico's banks were so well capitalized by the time Basel III was announced, that as of August 2010, the Mexican banking sector already had a capital ratio index of 13 percent, a calculation that used similar methodology to that of the new Basel requirements (Chapter 3 and 5).

NAFTA is the most important among Mexico's FTA network. When it was first implemented, NAFTA created a market of 360 million people, the world's largest market at the time of implementation. This was a promising opportunity for Mexico, the weakest party in the agreement. Mexico, as a natural hub for trade and investment is situated in a strategic geographical position and today enjoys preferential access to one billion consumers in 44 countries (Chapter 3 and 4). As seen in the macroeconomics charts (Chapter 4), Mexico has benefited greatly with north-south trade, since the concept of "rule of law" has been better understood. Since then, Mexican legislation (e. g., the foreign investment and banking laws) has been improved, and consequently, the predictability and legal certainty in the judiciary system has increased significantly since NAFTA came into force in 1994.

Some argued that NAFTA was one of the main causes of the 1994 Mexican crisis. Nevertheless, Mexico's liquidity crisis and consequent currency devaluation at the end of 1994 and the beginning of 1995 cannot be blamed on NAFTA since, as seen in Chapter 1, they were the result of weaknesses in an immature Mexican financial system which predated NAFTA. On the contrary, NAFTA integration encouraged productivity growth through both trade and foreign investment, and that global and regional integration resulted in productivity gains.

A noteworthy legal principle of NAFTA is that financial supervision is reserved for the host country; however, regulators are permitted to negotiate bilateral agreements leading to regulatory and supervisory harmonization.

Interestingly and due to the broad range of NAFTA's financial services chapter it deals with new types of financial services that may be currently non-existent. According to the regulation of that chapter (Art. 1407 (1) of NAFTA) countries consent to allow all regulated financial institutions from another NAFTA country to enter into their market provided that their services are authorized in the territory of the country of origin. Regarding prudential measures NAFTA has proven its maturity through the Fireman's Insurance Company case (Chapter 4). This so called 'carve-out' has guaranteed that each member country has the elasticity to control its financial institutions and financial markets. Prudential measures were for the security of investors and depositors, to sustain the integrity of financial institutions, or to guarantee the security and steadiness of a NAFTA country's financial system as happened regarding Mexico in the Fireman's Insurance case (Chapter 4).

NAFTA pursued different objectives than those pursued by the EU. NAFTA a lower level of economic integration and different financial systems, however, NAFTA should take important lessons from the EU. These include the recognition that a minimum harmonization of regulatory frameworks and cross-border financial activities require public administration reform, especially tax treatment, banking and insurance legislation and joint supervision of securities markets in order to make the "single passport" system reliable as it is in the EU. Nevertheless, there is still a long way to go, because NAFTA lacks the political will to enforce legislative programs similar to the EU. MEFTA has had significant implications for NAFTA, since the

EU is the largest aggregate trading partner and Mexico is its second largest national trading partner. Any agreement that eliminates trade barriers and improves market access between these two crucial trading partners potentially has major implications for US businesses. Mexico has become an important export bridge for the EU to the USA and Canada and vice-versa.

It is clear that in the services sector, the EU benefits more than Mexico due to its *net-exporter* nature of services and financial services. European banks and insurance companies are authorized to operate and establish themselves directly in Mexican territory like their US and Canadian counterparts. Mexican banks have similar access to EU, however, since Mexico is not a *net-exporter* in financial services, this potential market is not likely to be exploited (at least in the short and medium term), as much as the market for industrial products and manufacturing where the Mexican competitive advantage lies. Consequently, Mexico offers major benefits for all EU investors that desire access to the NAFTA region free of duties. The key lies in the clever and correct combination of the rules of origin provided for in MEFTA and NAFTA, together with the applicable Mexican domestic trade program, such as the *Maquiladora program* (In bond) and the Sector Promotion Program (Chapter 4).

Although the year 2009 was bad for Mexico, a systemic crisis was prevented. As of December 31, 2010, not a single bank in Mexico had failed nor were there any troubled Mexican banks. Meanwhile, 25 banks failed in the USA in 2008, and in 2010 a total of 322 banks had failed in the USA since the beginning of the crisis. This is noteworthy given the high dependence of the Mexican economy on the US economy. While early analyses attributed this to the relatively small size of the Mexican banking system, the fast recovery of the economy and further research and analysis have shown that the explanation is found in the structural prudential reforms undertaken over the last 25 years and the bottom-up approach to prudential liberalization through the adoption of international financial principles (Chapters 1, 3 and 5).

The achievements of the legal reform that liberalized the financial sector provide a stronger foundation for the several additional economic reforms that Mexico requires those already planned, those not yet planned but expected, and those that will

eventually become apparent to be required. This will be in addition to the adjustments required by the changes already adopted. Among such plans, the establishment of a customs union continues to be a major goal of the Mexican government, albeit following the failed attempts by the Fox presidential administration. The example provided by the EU then continues to be relevant in connection with Mexico's country-specific and bottom-up approach to prudential liberalization.

The one arguable disadvantage of Mexico's approach has been the relatively slow pace with which liberalization has been incrementally achieved, which is why it has taken 25 years for liberalization to bear any recognizable fruits. However, this is not a defect inherent in the approach, rather a necessary result of the other obstacles that the Mexican political situation has created (aggravated idiosyncrasies) including objections to market economics in general and economic liberalization in particular throughout these years (Chapters 1, 2, and 4).

The practical impossibility of transitioning immediately or more quickly from the fully government-controlled and closed economy of the 1980s to a more liberalized economy creates the danger of stepping back from the partial reforms already achieved, especially during the earlier stages, due to the political opposition faced throughout this process. When, for example, the 1994-1995 crisis hit the then recently re-privatized banks, opponents of liberalization exploited the occasion to specifically blame re-privatization *per se*,⁹⁶⁶ and to more generally blame the support for market economic policies and reforms carried out in the early 1990s.

Although that cross-roads highlighted one of the chief advantages of a bottom-up approach (since Mexico spontaneously and unilaterally allowed foreign banks to control Mexican banks although the NAFTA's provisions provided that to be scheduled much later), it also demonstrates that the reforms achieved were vulnerable to partisan national politics and the shifts in voters' mood (Chapter 1). As of 2010, much of the political and academic debate on the political economy in

⁹⁶⁶ As mentioned above (see *supra* Chapter 1, 1.2 The Mexican Pre-NAFTA Financial System), one of the factors involved in the 1995 banks' crisis was the lack of specific banking experience of the new bankers. Nevertheless that is not a defect of re-privatization *per se* but an inevitable result of lacking people with such experience after a decade of government controlled banks.

Mexico continued to be filled with voices opposing the current economic model and arguing return to the 1980's model or other versions of Statism. The danger therefore continues to exist of Mexico ending the transition toward economic liberalization and leaving this proves unfinished and incomplete or even to regress (Chapters 1, 3 and 5).

This risk increases as another presidential election approaches in 2012 and with the effects of the global financial crisis, which many continue to blame on globalization and economic liberalization. These remain strong opinions within large portions of the Mexican population.⁹⁶⁷

The danger should not be underestimated especially since the articles of the Mexican constitution that were added and modified in 1983 to give almost unlimited powers to the government to control the economy (Arts 25, 26 and 28)⁹⁶⁸ are still part of the fundamental law. Consequently, there is a legal need to restrain any upcoming head of state (and even a majority in the legislative branch) from claiming and using (or abusing) such powers to undo 25 years of economic prudential liberalization. In light of the fragile state of the reforms achieved to date, it is urgent that they are given permanence by reflecting them in Mexico's Constitution (Chapter 1, Appendix 1 and 2).

One factor that has given some degree of domestic validation to Mexico's economic reforms has been the "indigenous" and unique or original source of several of the policies and measures undertaken within a democratic and peaceful environment, as opposed to being perceived as having been imposed from abroad or by authoritarian dictator or political party. This has gradually (and only recently) become a more prevalent feature of Mexico's approach to prudential liberalization.

⁹⁶⁷ On November 18, 2010, UNAM's rector José Narro Robles "urged the governments to change the economic and social models in order to prevent the poverty and inequality that affect humanity from continuing to become more acute." He even stated that, "México is one of the countries more affected throughout the crisis." The statements were made in the context of the 2010 "World Summit of Local and Regional Leaders," organized by Marcelo Ebrard, governor of the Federal District of Mexico (Mexico City), who has already expressed his desire to contend for the presidency in 2012 as candidate of the leftist PRD. See *Narro Urges City Mayors to Change the Social and Economic Models*, LA JORNADA (Nov. 19, 2010) at 34.

⁹⁶⁸ See *supra* Chapter 1, 1.1.2 General Political Economy Background and Context of Pre-NAFTA Mexico.

This is exemplified by the leading role that Mexico, in both policy statements and by actual example, has taken among emerging economies, particularly in such contexts as the G20.

The next logical step for Mexico is to formally incorporate a political economic doctrine into its Constitution that is consistent with the economic liberalization reforms already achieved over the last 25 years. Even though many of the ideas underlying these reforms date back to decades of global discussion and experience, Mexico's specific approach to economic liberalization has been largely the product of indigenous reflection, reception, adaptation and implementation, with close attention to Mexico's manifold particularities and specificities.

Reversing the aforementioned 1983 constitutional amendments would reset sensible boundaries to government involvement and interference with the economy, and thereby restore the rule of law in this most sensitive area of national identity, as well as give its citizens (both individually and collectively) permanent legal certainty and predictability over their economic activities and development. Proper prudential liberalization requires that a government protect the interests of market users and the general public, with necessary adjudication and penalization steps being taken where the legal process has been abused or misapplied.

One critical issue that must still be corrected (which goes beyond reversing the 1983 constitutional amendments) is limiting the government's power to expropriate assets other than land and its accessions (Art. 27). Currently, Mexico's government can expropriate companies as a whole, or all of their assets, apart from real-estate property (land and its accessions), which goes beyond the spirit of the same article in the 1857 Mexican Constitution.

This unlimited power of expropriation "for the public benefit" generates another vulnerability to the rule of law, legal certainty and predictability which can damage productive investment in Mexico, as was demonstrated throughout the 20th century and most painfully with the expropriation of the banks in 1982.

Achieving the degree of rule of law and legal certainty within Mexico as proposed above can only further strengthen its financial system, in particular, and its economy in general, and, with this, the quality and maturity of its legal and institutional framework.

Finally, the experiences gained with prudential financial sector liberalization can be applied to structural reforms in other key sectors that urgently require intervention, such as education, fiscal policy, labor, energy, agriculture, telecommunications, and scientific and technological research and development, among others. An enlightened country-specific and bottom-up approach to prudential liberalization and structural reform could still achieve much more.

This specific, and almost uniquely, Mexican approach to financial sector reform has been a key factor in securing the reforms achieved to date and, which can, if continuously applied and supported, generate further achievements in the future.

APPENDICES
APPENDIX 1:

Comparison of Arts. 27 and 28 of the 1857 and 1917 Mexican Constitution

1857 CONSTITUTION⁹⁶⁹	1917 CONSTITUTION
<p>Art. 27. The property of the persons cannot be occupied without his consent, but for cause public utility and prior indemnity. The law shall determine the authority that ought to make the expropriation and the requirements with which this must be verified.</p> <p>No civil or ecclesiastic corporation, whatever its character, denomination or object may be, shall have legal capacity to acquire in property or to administrate by itself real estate, with the sole exception of the buildings destined immediate and directly to the service or object of the institution.⁹⁷⁰</p>	<p>Art. 27. The property of the lands and waters comprehended within the national territory corresponds originally⁹⁷¹ to the Nation, which has had and has the right to transmit their dominion to the particulars, constituting the private property.</p> <p>This shall not be expropriated but for cause of public utility and by means of an indemnity.</p> <p>The Nation shall have in all time the right to impose to private property the modalities that the public interest dictates as well as to regulate the exploitation of the natural resources susceptible of appropriation, in order to make an equitable distribution of the public wealth and to look after its conservation. With this objective measures will be dictates to fraction large estates...⁹⁷²</p> <p style="text-align: center;">...</p> <p>V.-The Banks duly authorized, according to the law of the institutions of credit, may have capitals imposed upon urban and rural properties according to the prescriptions of such laws, but shall not have in property or administration, more real estate than those entirely necessary for the direct object.</p> <p style="text-align: center;">...</p>

⁹⁶⁹ Available at: <http://www.juridicas.unam.mx/infjur/leg/conshist/pdf/1857.pdf>.

⁹⁷⁰ Written in the context of the Mexican Reformation War (between Liberals and Conservatives) the objective of this Art. was primarily to prevent the Roman-Catholic Church from hoarding (directly or through a private corporation) lands that were not put to work and which therefore became economically idle. They were called “goods in dead hands”.

⁹⁷¹ *Originariamente* in the original text in Spanish. The term is different from the term “original” as it means that the property of the land etc., was originally of “the Nation”, but that it continues to be ultimately property of “the Nation”.

⁹⁷² *Latifundios* in the original text in Spanish.

Art. 28. There shall be no monopolies nor embargos or prohibition of the free sale of products,⁹⁷³ nor prohibitions for the protection of the industry. They are exempted solely, those relative to the minting of currency, mail, and the privileges that, for a limited time, the law grants to the inventors or improvers of an artifact.

Art. 28. In the Mexican United States there shall be no monopolies; nor embargos or prohibitions of the free sale of products of any kind;⁹⁷⁴ nor prohibitions for the protection of the industry; except only the ones relative to the minting of currency, the mail, telegraphs and radiotelegraphy, the issuing of bills by means of one single Bank which the Federal Government shall control, and the privileges that for a certain time are granted to the authors and artists for the reproduction of their works, and the ones that, for the exclusive use of their inventions, are granted to inventors and improvers of an artifact.

...

⁹⁷³ *Estancos* is the one word used in the original text in Spanish translated here as “embargos or prohibitions of the free sale of products,” according to the meaning number 3 given by the Spanish Royal Academy (http://buscon.rae.es/draeI/SrvltConsulta?TIPO_BUS=3&LEMA=estanco).

⁹⁷⁴ *Id.*

APPENDIX 2:

Excerpts of the 1982 and 1983 Amendments to the Mexican Constitution

Art 25:

It corresponds to the State the governing of the national development to guarantee that it be comprehensive, that it strengthens the Sovereignty of the Nation and its democratic regime and that, by means of the promotion of the economic growth and the employment and a fairer distribution of income and wealth, it may allow the full exercise of the liberty and dignity of the individuals, groups and social classes, whose security this constitution protects.

The State shall plan, conduct, coordinate and orient the national economic activity, and shall carry out the regulation and promotion of the activities that the general interest requires in the framework of liberties this Constitution grants.

...

The public sector shall be in charge, exclusively, the strategic areas appointed in the Art. 28, fourth paragraph of the Constitution, maintaining always the Federal Government the property and control over the entities to be established.

Likewise it will be able to participate, by itself or with the social and private sectors, according to the law, to boost and organize the priority areas of the development.

Under the criteria of social fairness and productivity the firms of the social and private sectors of the economy shall be supported and boosted, subjecting them to the modalities that the public interest dictates and to the use, in general benefit, of the productive resources, looking after their conservation and the environment.

...

The law shall encourage and protect the economic activity carried out by particular and shall provide the conditions so that the development of the private sector

contributes to the national economic development, in the terms that this Constitution establishes.⁹⁷⁵

Art 26:

The Estate shall organize a system of democratic planning of the national development that gives solidity, dynamism, permanence and equity to the growth of the economy for the independence and the political, social and cultural democratization of the Nation.⁹⁷⁶

Art 28:

...
...
...

The laws shall set the basis to fix maximum prices to the articles, materials or products that are considered necessary for the national economy or the popular consumption, as well as to impose modalities to the organization of the distribution of those articles, materials or products, in order to prevent that unnecessary or excessive intermediations provoke insufficiency in the supply, as well as the increase in the prices. The law shall protect the consumers and shall propitiate their organization for the better looking after their interests.

They are not monopolies the functions that the State exercises in an exclusive manner in the strategic areas to which this precept refers: minting of currency, mail, telegraphs, radiotelegraphy and the communication via satellite; the issuing of bills by means of one single bank, decentralized organism of the Federal Government, oil and the other hydrocarbons; basic petro-chemistry; radioactive minerals and generation of nuclear energy; electricity; railroads, and the activities that would expressly mark the laws that the Congress of the Union issues.

⁹⁷⁵ DOF, Feb. 3, 1983 at 4; available at:
http://www.diputados.gob.mx/LeyesBiblio/ref/dof/CPEUM_ref_102_03feb83_ima.pdf.

⁹⁷⁶ *Id.*

It is also an exception to what is provided in the first part of the first paragraph of this article the rendering of the public service of banking and credit. This service shall be rendered exclusively by the State through institutions, in the terms that the corresponding statute establishes, which shall also determine the guarantees that would protect the interests of the public and the functioning of those in support of the policies of national development. The public service of banking and credit will not be object of concession to particulars.⁹⁷⁷

The State shall count with the organism and enterprises that it may required for the efficacious handling of the strategic areas of which it is in charge and in the activities of priority character where, according to the laws, it would participate by itself or with the social and private sectors.

...
...

The State, submitting itself to the laws, shall be able, in cases of general interest, grant concessions for the rendering of public services or the exploitation, use and taking advantage of the goods of the Federation's dominion, but for the exceptions that the same prevent. The laws shall set the modalities and conditions to secure the efficiency of the rendering of the services and the social utilization of the goods, and shall avoid concentration phenomena that are contrary to the public interest.

The submission to regimes of public service shall stick to what is provided by the Constitution and shall only be carried out by means of law.

Subsidizes shall be able to be granted to priority activities, when they were general, of temporary character and not affecting.

⁹⁷⁷ Except for a change in the capitalization of the word "Art." in the first sentence, this paragraph remained without change from the November 1982 amendment.

APPENDIX 3:

G20 and Its Role in the Architecture of the Mexican Financial System

Aiming to achieve financial stability, G20 has played a significant role in the construction of the current global financial architecture in general, and in the evolution of the Mexican financial system in particular. As shown in what follows, since G20's inception, Mexico has adopted a proactive role, both domestically and externally, in sketching and adopting measures that portray the current global financial architecture.

1. Background, History and Development.

During the 1980s, trade liberalization (GATT and, subsequently, WTO), domestic capital markets liberalization and the opening of capital accounts (first in industrial economies and later in emerging economies) brought about an exponential increase in cross-border capital flow and, in general, an increasingly integrated global economy. “Much of this increase was again due to the growing importance of emerging markets, and importantly reflected the unprecedented additional momentum provided by the transition of largely closed centrally-planned economies to open market economies.”⁹⁷⁸

Consequently,

While it had been possible for major industrial countries to address most global economic problems among themselves—through the G-5 or subsequently the G-7—during the 1970's and even to a large extent during the 1980s, this had become increasingly difficult by the late 1990s, as the weight of the G-7 countries in the global economy declined, owing largely to the rapid growth of emerging economies, especially those in Asia.⁹⁷⁹

Likewise:

The increasing interdependence of all countries stemming from the on-going expansion of cross-border trade and capital flows, and the parallel rise in the exposure of countries to economic and financial shocks emanating from far beyond their borders, underscored the importance of

⁹⁷⁸ See G20, *THE GROUP OF TWENTY: A HISTORY* (2008), at 9. Hereinafter, *THE GROUP OF TWENTY*.

⁹⁷⁹ *Id.*

broadening the scope of international economic and financial co-operation.⁹⁸⁰

These ‘tectonic’ shifts in the global economy,⁹⁸¹ plus the late 1990s crises in emerging economies,⁹⁸² motivated the launching of a new international group.⁹⁸³ In the wake of the 1997 Asian crisis (at the APEC leaders’ summit, Vancouver, November 1997), the idea sprung of organizing “a special meeting of finance minister from around the world to examine and debate the problems besetting the global economy and, where possible, to seek a consensus on solutions.”⁹⁸⁴

⁹⁸⁰ *Id.*, at 11.

⁹⁸¹ *Id.* Elsewhere, the same document reiterates that “While the establishment of the G-20 was a direct response to the global repercussions of the economic and financial crisis in Asia, it also gave tangible recognition to the marked changes to the international economic landscape that had occurred over the preceding decades. Emerging countries had become important economic powers. Moreover, owing to the increasing integration of economies and markets through globalization, domestic developments in these countries could have significant repercussions far beyond their borders” (at 16).

⁹⁸² See “Origins” at http://www.g20.org/about_what_is_g20.aspx. According to THE GROUP OF TWENTY, “The main motivation for launching a new international group was the crisis in emerging economies that had begun in Thailand in mid 1997, and which widened and intensified through the next two years, touching other important Asian economies, before spreading to Russian and Latin America” (at 9). Notwithstanding the above, the same document mentions later that, “At the 1995 Halifax G-7 Summit, the support of a number of emerging and smaller industrial economies was sought to help strengthen the international financial architecture in the wake of the Mexican peso crisis. In addition to urging the establishment of a new standing procedure, and encouraging work on an IMF quota increase, G-7 leaders looked beyond the traditional G-10 group of industrial countries to “other countries with the capacity to support the [international financial] system” to lend funds to the IMF in case of emergencies” (at 10). The same document states that among the several factors underlying the expanding crisis, a most important one is that, “the development of supervisory and regulatory systems in many emerging economies had not kept pace with the challenges posed by the opening of capital accounts and with the liberalization of domestic financial sectors” (at 11).

⁹⁸³ John Kirton observes that G8’s and G20’s have in common that both “came from a shock to the international order that none of the existing international institutions could adequately address. Both flowed from made-in-America financial shocks — the G8 from Nixon’s end of the gold-dollar link on August 15, 1971, and the G20 from the failure of Lehman Brother on September 15, 2008.” There are however also dissimilarities: “The G8’s seminal shock was a conscious, controlled, narrowly targeted, state-delivered one from a still hegemonic USA. The G20’s was from an unconscious, uncontrolled, untargeted shock from non-state actors within America, spreading with unpredictable speed and scope to damage most of the world. Moreover, the G8 was born from multiple shock across many interlinked domains... The G20, in contrast, sprang from a shock in the single sphere of finance, both for its first summit in November 2008 and for its first finance ministers’ meeting in December 1999 before. The G8 was thus created to guide global order overall. The G20 was created to react in a single, economic sphere (John Kirton, *Why the World Needs G8 and G20 Summitry: Prospects for 2010 and Beyond*, (paper prepared for the Center for Dialogue and Analysis on North America (CEDAN), Tecnológico de Monterrey [Monterrey Institute of Technology] (ITESM), Mexico City Campus, Mexico City, March 11-12, 2010. Draft of April 8, 2010), at 2-3.

⁹⁸⁴ THE GROUP OF TWENTY, at 12.

As a result, a G22 (also known as the Willard Group) met at Washington, DC,'s Willard Hotel, in April 1998, "to examine the functioning of the international financial system."⁹⁸⁵

The group – which characterized itself as 'Finance Ministers and Central Bank Governors from a number of systematically significant economies' – was originally conceived as a one-time meeting to resolve global aspects of financial crisis in emerging-market economies.⁹⁸⁶

The countries invited to attend, in addition to G7 members,⁹⁸⁷ were 15 important economies. Only 11 of those attended. They met again (as an extension of the first meeting) on the margins of the fall 1998 meetings of WB and IMF (5 October 1998), with four more countries joining the group (thus completing the 15 countries): Argentina, Australia, Brazil, China, Hong Kong, India, Indonesia, Malaysia, Mexico, Poland, Russia, Singapore, South Africa, South Korea and Thailand.⁹⁸⁸

G22's work:

... Helped to provide direction and support to international financial institution, such as the IMF, in their efforts to promote reforms aimed at strengthening domestic and international financial markets. These included greater disclosure and transparency, adoption of internationally-accepted standards and codes, and development of a framework for crisis solution.⁹⁸⁹

It "also contributed to the G7 initiative announced by finance minister and governors in October 1998 to examine arrangement for co-operation among international regulatory and supervisory bodies."⁹⁹⁰

After various proposals, discussed among G7 countries through the autumn of 1998, on how to carry forward G22's work, by early 1999, G7 agreed "to hold follow-up seminars on international financial architecture, involving a much larger group of 33 countries."⁹⁹¹ G33 thus succeeded G22, comprised by G22 plus Belgium, Chile,

⁹⁸⁵ *Id.*, at 12-13.

⁹⁸⁶ PETER I. HAJNAL, *THE G8 SYSTEM AND THE G20: EVOLUTION, ROLE AND DOCUMENTATION* (2007) at 151.

⁹⁸⁷ Canada, France, Germany, Italy, Japan, UK, and USA.

⁹⁸⁸ See HAJNAL, *op. cit.* See also, *THE GROUP OF TWENTY*, at 13.

⁹⁸⁹ *THE GROUP OF TWENTY*, at 14.

⁹⁹⁰ *Id.*

⁹⁹¹ *Id.*, at 14-15.

Côte d'Ivoire, Egypt, Morocco, the Netherlands, Saudi Arabia, Spain, Sweden Switzerland, and Turkey.⁹⁹²

G33 met twice in 1999 for ad hoc seminars, at Bonn, Germany, in March, and at Washington, DC, in April. “Issues covered at these seminars included improving prudential oversight of financial markets; strengthening financial systems, especially in emerging-market economies; and encouraging the adoption of policies to better protect the most vulnerable.”⁹⁹³ “The proposals made by the G22 and G33 to reduce the world economy’s susceptibility to crises showed the potential benefits of a regular international consultative forum embracing the emerging-market countries.”⁹⁹⁴ Likewise:

It was hoped that an international consensus would coalesce around G-7 proposals under consideration ahead of the 1999 Cologne Summit that were aimed at strengthening and reforming the international financial institutions, as well as financial markets in industrial and emerging economies.⁹⁹⁵

In spite of being reckoned successful, both advanced and emerging economies were dissatisfied “with the ad hoc nature” of G22 and G33 processes. “There were also concerns about the number of participants at the G-33 seminars, which made it difficult to have a meaningful informal dialogue among key countries on important economic and financial issues.”⁹⁹⁶ G7 also realized “the merit in engaging systemically important emerging-market economies in a regular informal dialogue,” because the growing importance of these countries “in the global economy and their vulnerabilities had been exposed by earlier crisis.”⁹⁹⁷

Therefore, after the second G33 seminar (April 1999) discussion on a replacement of the G33 began. Then Canada’s finance minister Paul Martin championed the idea of

⁹⁹² HAJNAL, *op. cit.*, at 151.

⁹⁹³ THE GROUP OF TWENTY, at 15.

⁹⁹⁴ G20 [Australian Chair] 2006). Cited in HAJNAL, *op. cit.*, at 151-152.

⁹⁹⁵ THE GROUP OF TWENTY, at 15.

⁹⁹⁶ *Id.*, at 16.

⁹⁹⁷ *Id.*

broadening the international architecture beyond G7 or G10, arguing that emerging economies had to “be at the table and be part of the solution.”⁹⁹⁸

Proposals were discussed until “a consensus emerged that a distinct ‘G-X’ needed to be created as a forum for debate among systemically important advanced and emerging economies.”⁹⁹⁹ In their June report to the 1999 Cologne G8 summit, on strengthening the international financial architecture, G7 finance ministers recommended the establishment of G20.

During August and early September 1999, G7 solved important issues such as “the mandate of the new Group, its membership, and how it would be integrated “within the framework of the Bretton Woods institutional system” as called for by G-7 ministers in the June 1999 communiqué.”¹⁰⁰⁰ The establishment of G20 was confirmed by the G7 finance ministers and central bank governors in their joint communiqué in September 1999.¹⁰⁰¹ That was the official birth of G20.

The main issue discussed in the first Finance Ministers’ and Central Bank Governors’ Meeting was crises prevention and resolution. Among other things, G20 members agreed back then to:

...implement the emerging international consensus on policies to reduce countries’ vulnerability to financial crises, including through appropriate exchange rate arrangements, prudent liability management, private sector involvement in crisis prevention and resolution, and adoption of codes and standards in key areas including transparency, data dissemination, market integrity, and financial sector policy.¹⁰⁰²

By 2001, crisis prevention and resolution still remained as a main issue, and G20 concluded that the adoption of “the best practices embodied in international standards and codes also will help support strong, stable growth and reduce the risk

⁹⁹⁸ Paul Martin, Interview conducted by Candida Tamar Paltiel, G8 Research Group, (Ottawa 18 November 2001). Available at www.g8.utoronto.ca/g20/interviews/Martin011118.pdf. Cited in THE GROUP OF TWENTY, at 17.

⁹⁹⁹ THE GROUP OF TWENTY, at 18.

¹⁰⁰⁰ *Id.*

¹⁰⁰¹ See HAJNAL, *op. cit.*, at 152.

¹⁰⁰² G-20, *Communiqué*, “G-20 Finance Ministers and Central Bank Governors Meeting,” (Montreal, 25 October, 2000) at paragraph 7.

of future financial crises.”¹⁰⁰³ Accordingly, it continued promoting the adoption of international standards and codes, and the assessments under one or both of the IMF/WB-led FSAPWB and Reports on Observances with ROSCs, which had been implemented on a voluntary basis by the majority of G-20 members.

Upon the attacks to the USA on September 11, 2001, which were perceived as an attack to all of its members intended to shake global economic confidence and security, G20 incorporated “terrorism” to the issues to be discussed and address by the group. G20 thus affirmed:

We are committed to combating terrorism by cutting off its financial sources. There should be no safe havens for the financing of terrorism. To this end, we have agreed on an Action Plan to deny terrorists and their associates access to our financial systems. We call on other countries to take similar steps.¹⁰⁰⁴

G20 members also agreed on the implementation of UN conventions, and supporting surveillance and voluntary self-assessments through the IMF, the FATF, and other international organisms.

On 2003, under Mexico’s leadership, G20 followed up discussion on such issues as crises prevention and resolution, globalization, and the interdiction of terrorist financing. Additionally, a major step was taken to reach a consensus to solve financial crises: Mexico announced that it had included collective action clauses in an international bond with the purpose of restructuring debts in case the debtor is unable to carry out its commitments. Eventually other G-20 countries and smaller developing countries such as Brazil, Korea, and South Africa followed this example.¹⁰⁰⁵ Endeavouring to achieve UN’s “Millennium Development Goals” was another resolution of 2003, at the “Monterrey Consensus,” which concerns and involves Mexico.¹⁰⁰⁶

¹⁰⁰³ G-20, *Communiqué*, “G-20 Finance Ministers and Central Bank Governors Meeting”, (Ottawa, 16-17 November 2001) at paragraph 5.

¹⁰⁰⁴ *Id.*, at paragraph 13.

¹⁰⁰⁵ THE GROUP OF TWENTY, at 32.

¹⁰⁰⁶ UN Conference on Financing for Development held in March, 2000, in Monterrey, México.

In 2004, G20 members Brazil, Korea, Mexico, and Turkey, together with private sector creditor groups, including IFF and IPMA, issued the “Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets.”

We reaffirmed the importance of an international financial architecture that sets incentives for pursuing sustainable policies and prudent risk-taking. In this regard, we welcomed the results achieved between issuing countries and private-sector participants on “Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets.” Such principles, which we generally support, provide a good basis for strengthening crisis prevention and enhancing predictability of crisis management now, and as they further develop in future.¹⁰⁰⁷

On 2004, two mid-term issues were also discussed in 2004, regional economic integration and demography and growth. On regional integration, a subject matter in which Mexico has played and continues to play a key role, G20 concluded:

We agreed that regional cooperation and integration can be important steps for national economies in opening up to global trade and financial flows and in achieving gradual improvements in competitiveness. We agreed that G20 countries, as systemically important economies, have a special responsibility in their regions. We undertake to play a leading role in advancing regional and global integration.¹⁰⁰⁸

...policy challenges differ greatly among countries in the short-term. Countries that will encounter aging problems first need to integrate to the labour force a larger part of their working-age population, expand individual working life, and implement life-long learning. Countries that will experience a rise in the working age population before the problematic impact of aging becomes apparent should increase investment in human-capital and infrastructure while pursuing prudent fiscal policies.¹⁰⁰⁹

By 2005, another issue concerning Mexico became the focus of G20, namely, the importance migrant remittances have for developing countries to reduce poverty and promote economic development. Therefore, G20 urged the international community to improve remittance services.

¹⁰⁰⁷ G-20, *Communiqué*, G-20 Finance Ministers and Central Bank Governors Meeting, (Berlin, Germany, 20-21 November 2004) at paragraph 3.

¹⁰⁰⁸ *Id.*, at paragraph 6.

¹⁰⁰⁹ *Id.*, at paragraph 7.

By 2006, G20's the subject matter of the Annual Meeting was "Building and Sustaining Prosperity." The aim being to promote global development and growth, based upon open trade.¹⁰¹⁰ It was recognized that "maintaining a strong world growth and containing inflation will require ongoing adjustments to monetary and fiscal policies while ensuring appropriate exchange rate flexibility and structural reform."¹⁰¹¹

President Calderón's administration (inaugurated on December 1, 2006) has follow suit promoting fiscal discipline and giving continuity, in coordination with BANXICO, to the fight inflation, and to maintaining sound and prudential monetary and exchange policies, even in spite of the strong antagonism of the opposition political parties. This ongoing antagonism has been the reason why structural reforms have not been achieved, as the Legislative branch is controlled by the leftist opposition parties, chiefly PRI and PRD.¹⁰¹²

On 2007, under the leadership of South Africa, G20 followed up on the 2005-2006 Bretton Woods Reform discussion. The statement "Reforming the Bretton Woods Institution" was intended to strengthen the "credibility, effectiveness and legitimacy of IMF and WB."¹⁰¹³ Consequently, G20 insisted that the reform should enhance the representation of dynamic economies, many of which were emerging market economies, whose importance in the global economy had increased.

On November 14-15, 2008,

...the leaders of the world's 20 systemically significant countries held their first summit in Washington DC in response to the great made-in-America financial crisis that had erupted in full force two months before. Within six months of their Washington gathering they met again, on April 1-2, 2009, in London. A mere six months later, they met for a third time, on September 24-25, 2009, in Pittsburgh. There they

¹⁰¹⁰ G-20, *Communiqué*, G-20 Finance Ministers and Central Bank Governors Meeting, (Melbourne, Australia, 18-19 November 2006) at paragraph 5.

¹⁰¹¹ *Id.*, at paragraph 4.

¹⁰¹² Although PRI has been commonly branded as a centre party (comprising both left and right groups), as a result of the 2006 federal election (in which the more extremist leftist PRD came second in votes), a new party president was elected, Beatriz Paredes Rangel, who immediately steered to the left the party's positions, both in the discourse and in its votes at the Legislative branch.

¹⁰¹³ G-20, *Communiqué*, G-20 Finance Ministers and Central Bank Governors Meeting, (Kleinmond, Cape Town, South Africa, 17-18 November 2007) at paragraph 14.

proclaimed that their summit would become a permanent institution, to serve as the primary centre of global economic governance for the indefinite future, long after the crisis that had created it had passed.¹⁰¹⁴

Thus, “although a creation of the G7, the G20... developed as an autonomous, informal group,”¹⁰¹⁵ firstly, then to become (due to the September 2008 USA financial crisis) a permanent summit, “quickly repeated to become a permanent feature of international political life.”¹⁰¹⁶ As a result, G20 meetings are no longer forums merely for finance ministers and central bank governors, but a summit of its member’s leaders. “G20 leaders still meet with their finance ministers by their side, and thus far only ministers of tourism (from all members but America) and ministers of labour seem ready to join the G20 governance game.”¹⁰¹⁷

2. Mandate and Objectives.

As stated at its inaugural meeting by the ministers and central bank governors, G20:

...was established to provide a new mechanism for informal dialogue in the framework of the Bretton Woods institutional system, to broaden the discussion on key economic and financial policy issues among systemically significant economies and promote co-operation to achieve stable and sustainable world economic growth that benefits all.¹⁰¹⁸

As a result of the September 2009 Pittsburgh summit (the third meeting in a row within a year after the 2008 “Made in USA” crisis) and G20’s decision to become a permanent institution, it proclaimed its mission was “to serve as the world’s premier, permanent forum for international economic cooperation”¹⁰¹⁹ From the Pittsburgh

¹⁰¹⁴ Kirton, *Why the World needs...*, *op. cit.*, at 1.

¹⁰¹⁵ HAJNAL, *op. cit.*, at 156.

¹⁰¹⁶ Kirton, *Why the World needs...*, *op. cit.*, at 3.

¹⁰¹⁷ *Id.*

¹⁰¹⁸ G20, *Communiqué*, “G-20 Finance Ministers and Central Bank Governors Meeting,” (Berlin, 15-16 December, 1999) at paragraph 2. For the development and summary of the discussions on the mandate, see THE GROUP OF TWENTY, at 18-19.

¹⁰¹⁹ John Kirton, *Progress through Partnership: Prospects for the 2010 Muskoka-Toronto Summits* (June 24, 2010), at 1: available at: <http://www.g7.utoronto.ca/evaluations/2010muskoka/kirton-prospects-100624.pdf> .

Summit, G20 Finance Ministers were tasked “to take forward work in the following areas:”¹⁰²⁰

- Framework for Strong, Sustainable, and Balanced Growth
- Strengthening the International Financial Regulatory System
- Modernizing our Global Institutions to Reflect Today's Global Economy
- Reforming the Mandate Mission, and Governance of the IMF
- Reforming the Mission, Mandate, and Governance of Our Development banks
- Energy Security and Climate Change
- Strengthening Support for the Most Vulnerable
- Putting Quality Jobs at the Heart of the Recovery
- An Open global economy

3. Members and Structure.

G20 country members are G8 country members plus Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, Turkey, and the Council Presidency and the President of the European Central Bank, who together represent the 20th member, namely, the EU. There are also ex-officio participants: the managing director of the IMF, the President of WB, and the chairpersons of the IMF, and Financial Committee and Development Committee of the IMF and WB.¹⁰²¹

The G20 represents all the regions of the world. Together, its members comprise two-thirds of the world’s population and generate approximately 90% of global gross domestic product. Their combined economic clout and broadly representative membership give the G20 greater legitimacy and potential greater influence than the G8 commands.¹⁰²²

Members interact as equals without legal binding decisions; speeches are intended to be spontaneous; and the staff is not permanent but provided by the chairing country.

At the Sherpa Meeting 1, in Mexico City (January 12, 2010), the consensus on membership and participation was that:

¹⁰²⁰ See http://www.g20.org/about_faq.aspx#2_Why_was_the_G-20_set_up. For the full elaboration of each of these areas, see *Leaders’ Statement: The Pittsburgh Summit* (September 24-25, 2009); available at: <http://www.pittsburghsummit.gov/mediacenter/129639.htm>.

¹⁰²¹ See HAJNAL, *op. cit.*, at 152.

¹⁰²² *Id.*

G20 should have 20 country member participants, the 19 with the chair each year being allowed to invite 1-2-3- guests as its choice, but only for that year. The European Union (EU) was seen in a special category as far as regional organizations were concerned.¹⁰²³

4. Mexico and G20

Mexico's participation in the Bretton Woods institutional system, through G8 (from which G20 sprung), dates back to 1989:

Mexico started participating in G8 summit governance at the leaders' level in 1989, did so again in 2003 and has done so continuously since 2005. It has participated as an equal at the ministerial level, starting with the Global Health Security Initiative since 2001, and at the official level in the Heiligendamm Process since 2007.¹⁰²⁴

Mexico has been a full member of the G20 at all levels from the start, but "with the very recent emergence of an inner, replacing the troika, as the steering group for the G20 summits and thus system, Mexico is not a member of this inner grouping."¹⁰²⁵ A 2003 G20 assessment of Mexico's Institution¹⁰²⁶ building in its financial sector, deemed Mexico's case a positive example regarding liberalization on institution building.¹⁰²⁷

As already mentioned above, in 2003 and under its leadership, Mexico announced that it had included collective action clauses in an international bond with the purpose of restructuring debts in case the debtor is unable to carry out its commitments, an example that other G20 countries and smaller developing countries followed later.¹⁰²⁸ In 2004, Mexico was one of the G20 members that, together with

¹⁰²³ Kirton, *Progress through Partnership...*, *op. cit.*, at 8.

¹⁰²⁴ Kirton, *Why the World needs...*, *op. cit.*, at 4. At leaders level, Mexico has participated in 4 summits (1989 Paris Dinner, 2003 Lyon Outreach, 2005 G8 plus Five, and 2007 Major Economies Forum/Meeting Summit on Climate Change. At ministerial level Mexico has participated 3 times: Global Health Security Initiative 2001, 2005 Gleneagles Dialogue on Clean Energy and Climate Change, and 2007 Heiligendamm Process/Heiligendamm-L'Aquila Process (*id.*, at 14).

¹⁰²⁵ *Id.*

¹⁰²⁶ Institution understood as the rules, enforcement mechanisms and organizations that shape the functioning of markets.

¹⁰²⁷ See "G20 Case Study: The Case of Mexico. Globalization: The Role of Institution Building in the Financial Sector;" available at: <http://www.banxico.org.mx/tipo/publicaciones/seminarios/XII-Mexico.pdf>

¹⁰²⁸ THE GROUP OF TWENTY, at 32.

private sector creditor groups, issued the “Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets.”

In November 2006, G20 recognized that, “maintaining a strong world growth and containing inflation will require ongoing adjustments to monetary and fiscal policies while ensuring appropriate exchange rate flexibility and structural reform.”¹⁰²⁹ President Calderón’s administration (inaugurated on December 1, 2006) has followed suit promoting fiscal discipline and giving continuity, in coordination with BANXICO, to the fight inflation, and to maintaining sound and prudential monetary and exchange policies, even in spite of the strong antagonism of the opposition political parties and pundits.

The great “Made in USA” financial crisis that erupted in September 2008, inevitably affected the Mexican economy especially, because of its strong dependence on the USA’s economy. Income was affected because of the crisis effect on Mexico’s exports of manufacture and oil, USA tourism to Mexico, remittances of migrant workers.¹⁰³⁰ As a result, the Calderón administration (2006-2012) has participated actively in G20’s pursuit of durable solutions to the global crisis. As of 2010, Mexican efforts are focused on following up fiscal and monetary measures aimed at restraining global crisis consequences.¹⁰³¹

At the London 2009 G20 meeting, Mexico supported, among other measure, the enforcement of international coordination to make information available on a timely basis, in order to be able to design global strategies that allow for the prevention and resolution of financial institutions’ bankruptcies.¹⁰³² Mexico implemented this measure by creating the Council of the Financial System Stability.¹⁰³³ It was the first

¹⁰²⁹ G-20, *Communiqué*, G-20 Finance Ministers and Central Bank Governors Meeting, (Melbourne, Australia, 18-19 November 2006) at paragraph 14.

¹⁰³⁰ See Víctor M. Godínez, “México y el G-20” [Mexico and the G-20] in *Análisis Político* [Political Analysis], (May 2010) at 5; available at http://www.fesmex.org/common/Documentos/Ponencias/Paper_Mexico_y_el_G20_Victor_Godinez2010.pdf

¹⁰³¹ See *id.*

¹⁰³² See President Calderón’s speech at the signing of act that created the Mexican Council of Financial System Stability (July 29, 2010); available at

<http://www.presidencia.gob.mx/index.php?DNA=42&Contenido=58992>

¹⁰³³ DOF, July 29, 2010.

emerging economy to adopt this measure, which most developed countries had already implemented.¹⁰³⁴

In the speech to introduce this act, President Calderón said:

With this council we are generating a privileged forum to strengthen the coordination and exchange of information between the country's financial authorities which will allow us to act in a faster and more accurately manner, when risks for financial systems are detected, and also will allow us to comply with commitments proposed to reinforce national finances and also contribute to the international effort in accordance with commitments acquired at G20.¹⁰³⁵

The concern for finding and applying durable solutions to the global crisis is not restricted to Mexico but constitutes one of the most frequent discussions in international forums such as G20.¹⁰³⁶ In this regard, anti-cyclical policies,¹⁰³⁷ reform of financial institution and market liberalization were measures implemented by Mexico, in some cases, even before they were proposed by G20 as a reaction to global crisis¹⁰³⁸.

Mexico has adopted a proactive role in proposing issues to be discussed by G20, such as: 1) Coordinating developed and emerging economies and IMF, WB and, in general, international financial organisms; 2) Rebuilding the international financial structure; 3) Implementing a "Green Fund" to address climate change; and 4) Committing to achieving the United Nations Millennium Development Goals.¹⁰³⁹

Along with Germany, Mexico coordinates G20's Working Group, which is in charge of the "Reinforcement of international cooperation and promotion of financial markets integrity," the following purposes: follow up and develop proposals to strengthen regulatory cooperation of institutions and financial markets, strengthen

¹⁰³⁴ See <http://www.cnnexpansion.com/economia/2010/07/28/mexico-economia-calderon-estabilidad-cnn>

¹⁰³⁵ See President Calderón's speech at the signing of the act that created the Mexican Council of Financial System Stability, *op cit.*

¹⁰³⁶ It is worth highlighting that Mexico's participation in G5 as coordinator has opened a more effective dialogue with G8 and G20.

¹⁰³⁷ Ten anti-cyclical measures were issued by President Felipe Calderón Hinojosa on March, 2008, among which are tax incentives for punctual taxpayers registered with an electronic signature, 3 percent reduction in Income Tax and Flat Rate Business Tax to increase company's liquidity and simplification of foreign trade procedures and reduction of duties.

¹⁰³⁸ See Godínez, *op. cit.*, at 6.

¹⁰³⁹ See *id.*, at 7.

negotiation and resolution of international effects of financial crisis, elaboration of proposals to protect global financial system from illicit activities and strengthen cooperation between international agencies.¹⁰⁴⁰

Mexico has also endeavoured to increase the involvement of the emerging economies in the decision making and the implementation of international economic and financial guidelines. Together with Argentina and Brazil, Mexico has promoted the voice and vote reform of IMF and WB moving the deadline from 2013 to 2011.¹⁰⁴¹

On January 13-14, and upon Mexico's invitation, G20's Sherpas met at the Mexican Foreign Ministry to discuss the group's rules of operation. "Among other issues, they discussed their positions on the group's rotating presidency; the scope, frequency and timing of the summits, support structures and the relationship with the meetings of the finance ministers and Central Bank governors."¹⁰⁴²

On March 12, in the context of the delivery of his paper *Why the World Needs G8 and G20 Summitry: Prospects for 2010 and Beyond*,¹⁰⁴³ Prof. John Kirton (University of Toronto) said that "Mexico is called to occupy a very important role in G20, above all as a communication bridge between developed and developing nations."¹⁰⁴⁴ Likewise, Kirton highlighted the interest demonstrated by Mexico in updating the so-called 'international architecture.'¹⁰⁴⁵

On May 15, 2010, under "Global Issues" in the V EU-Mexico Joint Statement:

On global economic and financial issues, both sides stressed the importance of the multilateral trading system of the WTO and an ambitious and balanced outcome of the Doha Development Round as

¹⁰⁴⁰See G20 Working Group on Reinforcing International Cooperation and Promoting Integrity in Financial Markets (WG2) Final Report, March 27, 2009, available at http://www.g20.org/Documents/g20_wg2_010409.pdf.

¹⁰⁴¹ See Godínez, *op. cit.*, at 8.

¹⁰⁴² "The G20 Sherpas Meet in Mexico to Discuss the Group's Rules of Operation" (Foreign Ministry press release), January 15, 2010; available at: http://portal3.sre.gob.mx/english/index.php?option=com_content&task=view&id=400&Itemid=9.

¹⁰⁴³ *Op. cit.*

¹⁰⁴⁴ "Mexico será protagonista del G-20: experto" [Mexico will be a protagonist of the G-20], in *El Economista* [The Economist] (12 March, 2010); available at:

<http://eleconomista.com.mx/sociedad/2010/03/12/mexico-sera-protagonista-g-20-experto>.

¹⁰⁴⁵ *Id.*

soon as possible. Both sides agreed on the need for the G20 to deliver on existing commitments and to set ambitious goals for the future to get a stronger, more balanced and more sustainable growth. They shared similar views about the priorities to pursue in this context, notably on supporting global recovery; ensuring a consistent implementation of financial market reforms and strengthening international financial institutions, among others. From its side, the EU welcomes and supports hosting the G-20 Summit in 2012. The EU is committed to make a strong contribution to this Summit.¹⁰⁴⁶

In advance of G20's IV Summit (June 26-27, 2010), a June 25, 2010, communiqué by the Presidential office, announced:

President Felipe Calderón shall ratify Mexico's role as key performer in the multilateral consensus mechanisms at global level and the commitment of his Government to contribute to international economic stability. He shall also address the overdue need of achieving sustainable and balanced world growth, as well as moving forward in the agenda of reforming international institutions in favour of developing countries. He shall reiterate the need to promote an open commercial system, free of protectionist measures, as key factors for economic recovery and the recovery of Mexico's exporting activity.¹⁰⁴⁷

At the summit, President Calderón said that although the strategy of recovering growth (at the expense of fiscal stability) generally work for those countries that adopted it, "there are certain consequences that are starting to be paid which, paradoxically, are becoming one of the main inhibitors of growth."¹⁰⁴⁸ He said that it is fundamental that those G20's developed countries that have decided to keep their expansive fiscal policies and have not yet a solid recovery, "start to make credible and real fiscal adjustments that would generate in the markets certainty and trust."¹⁰⁴⁹

¹⁰⁴⁶ Council of the EU, "V EU-Mexico Summit Comillas (Cantabria, Spain) 16 May 2010, Joint Statement;" available at:

http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/er/114464.pdf .

¹⁰⁴⁷ "President Calderón Will Participate in the IV Summit of Leaders of the G20" (communiqué, June 25, 2010); available at: <http://www.presidencia.gob.mx/?DNA=85&Contenido=58035>.

¹⁰⁴⁸ "Urge Calderón al G-20 a aprobar nuevas reglas para mercados financieros," [Calderón Urges G20 to Approve New Rules for Financial Markets] in *El Financiero en Línea* [The Financial Online] (June 27, 2010); available at:

<http://www.elfinanciero.com.mx/ElFinanciero/Portal/cfpages/contentmgr.cfm?docId=270387&docTip o=1&orderby=docid&sortby=ASC>.

¹⁰⁴⁹ "Mexico advierte ajustes en naciones G20" [Mexico advises adjustments in G20 nations] (June 28, 2010); available at <http://www.cnnexpansion.com/economia/2010/06/28/brasil-y-mexico-advierten-por-recortes>.

Along the same lines, President Calderón also warned at the summit that “economies with growing deficit and public debt are in the process of becoming one of the larger obstacles for the development of the world economy.”¹⁰⁵⁰ He also alerted:

..about the dangers, for future growth, of the permanence of expansive policies and its high deficits, as public debt in industrialized countries is at levels never seen before –of 83 per cent of the GDP of the USA, 68 per cent in the UK, and 73 percent in Germany,— the implications of which must be analyzed.¹⁰⁵¹

President Calderón also urged the drafting of new clear rules for the financial markets to eliminate uncertainty and provide a rout map toward recovery. He called for an agreement for the regulation of markets, in order to reduce “systemic risks for the global financial system and, at the same time, to promote world economic recovery.”¹⁰⁵² He called for higher capital requirements for activities that generate systemic risks, for the strengthening of international cooperation among supervisors, as well as designing joint measures to identify non-cooperating jurisdictions.¹⁰⁵³

He expressed that Mexico “backs the proposal accumulated at the G20 Summit to face the problems associated to financial institutions of systemic importance.”¹⁰⁵⁴ Following suit, he announced he would be sending the Legislative branch “a bill that includes a resolution framework for the bankruptcy of banks, based on the best international practices.”¹⁰⁵⁵

After South Korean President Lee Myung-bak state visit to Mexico, on July 2, 2010, a joint communiqué was issues by Mexico and the Republic of Korea stating, among other things:

The Mexican leader reiterated his disposition to work closely with Korea and support his work as G20’s President in turn, looking forward to the upcoming Summit of Leaders to be held next November in Seoul. Both leaders reckoned that G20 must continue adding efforts to ensure the economic recovery, the fulfilment of its commitments in financial regulation and supervision, to promote a comprehensive reform of the

¹⁰⁵⁰ “Urge Calderón...,” op. cit.

¹⁰⁵¹ *Id.*

¹⁰⁵² *Id.*

¹⁰⁵³ *Id.*

¹⁰⁵⁴ *Id.*

¹⁰⁵⁵ *Id.*

international financial institutions, and to adopt the measure needed to promote a vigorous, sustainable and balanced growth. Likewise, they fully concurred on the need for the G20 to push the development agenda in order to share the benefits of economic development and to contribute to the fulfilment of the Development Millennium Objectives. President Lee expressed his satisfaction for the decision that Mexico leads and be host of the G20's Leaders Summit in 2012.¹⁰⁵⁶

Although G8 agenda item, it is worth mentioning this group's concern for what became the top priority early in President Calderón's administration, namely, "the drug trafficking and transnational crime that is proliferating in Mexico and infecting the Caribbean, North America, Africa and even distant Europe itself." G8 has appropriately listed the above as its "fourth security priority... the new multi-faceted, non-state security challenge coming from vulnerable states."¹⁰⁵⁷ This is consistent with the frequent appeals President Calderón has made to the international community to cooperate with the Mexican government in its war against drug cartels whose criminal activity is carried out across borders.

5. G20's Assessment of Mexico's Institution Building in Its Financial Sector.¹⁰⁵⁸

Mexico's case has been considered as a positive example regarding liberalization on institution building. For purposes of presenting a complete landscape of the institution building process in Mexico, it is deemed convenient a brief reference to the diverse periods of Mexican financial system for a correct analysis of the immediate perspective and steps to be followed in order to adjust such system to prudential financial standards that lead Mexico to an economic growth and sustainable financial stability in accordance with consensus reached by G-20.¹⁰⁵⁹

Significant reforms were approved from the early seventies to 1988, where financial liberalization finds its grounds. One of the most innovative reforms was the

¹⁰⁵⁶ "Comunicado Conjunto México-República de Corea en ocasión de la Visita de Estado a México del Presidente Lee Myung-bak [Mexico-Republic of Korea Joint Communiqué on Occasion of the state Visit to Mexico of President Lee Myung-bak] (July 2, 2010); available at: http://www.sre.gob.mx/csocal/comunicados/2010/jul/cp_202.html

¹⁰⁵⁷ Kirton, *Progress through Partnership...*, *op. cit.*, at 6.

¹⁰⁵⁸ Institution refers here to the rules, enforcement mechanisms and organizations that shape the functioning of markets.

¹⁰⁵⁹ See "*G-20 Case Study: The Case of Mexico*", *Globalization: The Role of Institution Building in the Financial Sector*, at 1, available at <http://www.banxico.org.mx>

amendment to Credit Institutions Law in 1974; by virtue of which specialized banking was transformed into universal banking allowing new multi-service banks to provide different kind of services increasing flexibility and risk diversification.¹⁰⁶⁰

In 1975 a Security Markets Act regulated the legal framework for expansion of securities operations, and strengthened the regulatory role of the National Securities Commission.¹⁰⁶¹ Also, introduction of Treasury Certificates (CETES) in 1978 reinforced the measures adopted during this period. Other financial instruments were created in the late seventies, such as the non-bank paper and convertible securities. This liberalization process was interrupted in September 1982 with banks nationalization as a measure against critical Mexico's debt crisis. Such "financial repression" affected in diverse aspects of the Mexican economy, externally and domestically.¹⁰⁶²

During late eighties, Mexico started a process of radical transformation of the economy from high trade rates, foreign trade restrictions and high levels of regulation to a deregulation and opening to international trade system. As a result, the main steps followed were deregulation of the financial sector, internationalization of the financial sector and privatization of commercial banks. Deregulation was mainly focused on reducing limits to banks maintaining the supervision and regulation of their activities in order to make more efficient their services and operation but yet subjecting them to strictly necessary regulations.¹⁰⁶³

In June 27, 1990, a Constitutional reform abolished government's exclusive right to provide banking and credit services. The major reasons that urged the Congress to approve such reform were the modification of Mexican society in its complexity, plural expression and culture diversity; in other words, economic crisis aggravated social backwardness making necessary a modification in accordance with the current

¹⁰⁶⁰ See *id.*, at 2.

¹⁰⁶¹ See *id.*

¹⁰⁶² See *id.*, at 3.

¹⁰⁶³ See *id.*, at 4.

social situation in Mexico in order to make the country competitive in an increasingly globalized context.¹⁰⁶⁴

In this scenario, in August 1993, Congress approved a Constitutional reform granting autonomy to the BANXICO. The main purpose of this reform was to establish the basis for price stability and as a consequence reinforce purchasing power of the national currency, as well as controlling inflation levels.¹⁰⁶⁵

One of the most important institutional paradigm changes derived from the signing of NAFTA in 1993. The ratio of this agreement was creating an environment that promotes the opening of the financial sector to foreign investment. In accordance with the terms and obligations assumed under NAFTA, Mexican Congress modified financial regulations in order to allow foreign financial institutions the establishment of fully-owned subsidiaries in Mexican territory.¹⁰⁶⁶

The opening of the Mexican economy derived from NAFTA intended to balance competition and financial stability through gradual modifications in the countries' applicable regulations in order to adjust them to the guidelines provided by NAFTA. Nevertheless, Mexico drafted certain conditions to NAFTA to guarantee the gradual transition to foreign access; such provisions mainly limit the amount of capital and assets that foreign investors are allowed to hold from the total capital of all financial institutions in Mexico¹⁰⁶⁷.

“After the effective date of NAFTA, large numbers of foreign banks applied for permission to enter the Mexican financial services market. (...) Although Mexico was one of the most underbanked economies in the world and ‘desperately in need of more financial services’ the individual and aggregate capital limits imposed by

¹⁰⁶⁴ See FERNANDO HEGEWISCH DÍAZ INFANTE, DERECHO FINANCIERO MEXICANO [Mexican Financial Law], Porrúa, México, 3rd ed. (2004) at 9.

¹⁰⁶⁵ See “G-20 Case Study: The Case of Mexico”, Globalization: The Role of Institution Building in the Financial Sector, at 6, available at <http://www.banxico.org.mx>

¹⁰⁶⁶ See *id.*, at 7.

¹⁰⁶⁷ See Christopher R Rowley, “Searching for Stability: Mexico’s 1995 Banking System Reforms” in NAFTA: LAW AND BUSINESS REVIEW OF THE AMERICAS, Vol IV, No. 3 (Summer 1998), at 34, 35.

NAFTA limited what might have been greater foreign investment by preventing most foreign banks from pursuing retail banking in Mexico”.¹⁰⁶⁸

Although origins of economic crisis in Mexico in 1994 are extremely complex; it is worth to overview a brief landscape as context of later financial development in Mexico issues. “Such situation forced Mexico to implement unanticipated measures in an attempt to stabilize the country’s banking system”.¹⁰⁶⁹ In 1994 Mexico had an important amount of foreign investment considerably conformed by liquid and short term equity and debt portfolio investments that may be quickly withdrawn that allowed Mexico to support the large deficit of its current accounts.¹⁰⁷⁰

On this kind of scenario, countries normally reduce their deficit adjusting its monetary and fiscal policy or its exchange rate. Though, Mexico permitted a significant inconsistency between its monetary and fiscal policy and its exchange rate system forcing Mexico to either, raise interest rates or devalue peso; however making a decision was complicated due to upcoming presidential election. Also, a lot of political and national events generated an increasing withdraw of large amounts of foreign investment from Mexico and, as a reaction, several actions were taken in order to stop the outflow of capital, such as depreciating peso, securing short-term credit agreement with the USA and Canada, and increasing rates on short-term CETES.¹⁰⁷¹

Another measure adopted by Mexico was to increase the issuance of debt instruments denominated “tesobonos” instead of increasing interest rates, reducing government expenses or devaluating peso. “Tesobonos guaranteed an investor’s repayment in pesos sufficient to cover the dollar value of its investment, thus protecting the investor in the event of devaluation.”¹⁰⁷² The issuance of tesobonos left Mexico’s foreign currency reserves vulnerable in case of an outflow of foreign capital.¹⁰⁷³

¹⁰⁶⁸ See *id.*, at 36.

¹⁰⁶⁹ See *id.*

¹⁰⁷⁰ See *id.*, at 37.

¹⁰⁷¹ See *id.*

¹⁰⁷² See *id.*, at 38.

¹⁰⁷³ See *id.*

Finally Mexico was forced to completely devalue its currency on December 22, 1994 leading Mexican economy to recession¹⁰⁷⁴. As we may notice, the fundamental problem was not liberalization *per se*, crisis was a result of a combination of diverse factors, external, domestical, economic and political; specially the fact that ideal liberalization conditions did not exist at that time (i.e. stable macroeconomic environment, adequate timing and sequencing of domestic and capital account liberalization, a financially sound banking system).¹⁰⁷⁵ Notwithstanding the abovementioned crisis, Mexico continued with its financial liberalization process presumably due to Mexico acknowledged the benefits of liberalization and because the process of institutions building was difficult to revert since international efforts were involved in this process¹⁰⁷⁶.

Since 1995, BANXICO adopted a gradual disinflation process and finally in 2001 introduced a formal specific inflation framework including the following: **(i)** consolidation of the autonomous monetary; **(ii)** authority; **(ii)** reiteration of price stability as the fundamental objective of the monetary policy; **(iii)** announcement of short and medium term inflation targets; **(iv)** a permanent analysis of all potential sources of inflationary pressures; **(v)** an emphasis on transparency and communication with society; and **(vi)** and improved framework for central bank accountability.¹⁰⁷⁷

Also, Mexican efforts after the crisis focused on two aspects: maintaining the integrity of the financial system and establishing adequate policies to ensure correct operation of the financial system in an increasingly liberalized environment. Consequently, the Congress approved a financial reform in December 1998 following those aspects.¹⁰⁷⁸

¹⁰⁷⁴ See *id.*

¹⁰⁷⁵ “G-20 Case Study: The Case of Mexico”, Globalization: The Role of Institution Building in the Financial Sector, at 9, available at <http://www.banxico.org.mx>.

¹⁰⁷⁶ See *id.*, at 10.

¹⁰⁷⁷ See *id.*, at 11.

¹⁰⁷⁸ See *id.*, at 13.

From such reform, three items are particularly relevant: (i) deposit coverage was limited to an amount equivalent to 400,000 UDI's¹⁰⁷⁹ per person and per financial institution; (ii) Institute for Bank Deposit Insurance ("IPAB" per its acronym in Spanish) was created for managing the new deposit insurance scheme, restructuring programs for banks that receive its support and to administrate and sale assets acquired through several banking-support programs; and (iii) limits to foreign ownership in financial system allowing foreign investment up to 100% in Mexican financial holdings¹⁰⁸⁰.

Another measures were taken during this period, being especially relevant the amendment of the pension system based on an individual capitalization system in 1997 and the Congress approval of the bankruptcy and secured lending legislation in 2000. In addition, supervisory and regulatory frameworks were strengthened to accomplish with applicable best international practices¹⁰⁸¹.

Reforms approved from 1995 to 2000 strengthened the financial sector in Mexico and improved operation of financial markets achieving strength in banks' financial conditions, higher efficiency in banking system and foreign participation in the domestic banking system that promoted competition capitalizing banking system.¹⁰⁸² In 2000, for the first time in 70 years the elected President did not represented PRI and no political party held a majority in Congress. These circumstances derived into a political equilibrium that became a new institutional arrangement reflected in the reforms approved since then to the present. As a result, significant reforms were approved to strengthen institutional framework and combat remaining problems in the financial system, such as:¹⁰⁸³

- Credit Institutions Law and the Financial Groups Law

¹⁰⁷⁹ UDIS are units of account with constant real value; its daily value depends on fluctuations in Mexican Consumer Price Index.

¹⁰⁸⁰ "G-20 Case Study: The Case of Mexico", Globalization: The Role of Institution Building in the Financial Sector, at 13, available at <http://www.banxico.org.mx>.

¹⁰⁸¹ See *id.*, at 14.

¹⁰⁸² See *id.*

¹⁰⁸³ See *id.*, at 17, 18.

Main objectives of these laws is to strengthen credit institutions' corporate governance and broaden the offered services by introducing timely risk identification mechanisms and creating an audit committee.

- Amendment to the Rules of Capitalization Requirements for Multiple Banking Institutions

Purposes of this reform are to accelerate the process of homologation between banking regulation and international standards by simplifying processes and establishing a uniform criteria with the CNBV, as well as eliminating certain discretionary faculties of financial authorities.

- Amendments to the Miscellany on Credit Collateral

This reform intends the promotion of bank lending by reducing transaction costs and interest rates, which will reduce risks related with credit operations and decrease interest rates.

- Credit Information Institutions Law

It regulates the establishment and operation of credit information companies by establishing transparency regulations for the proper operation of such companies and providing secrecy in financial matters.¹⁰⁸⁴

Also, for purposes of increasing access of the population to financial services and promote creation of small and medium companies it was proposed to increase these institutions autonomy, and an improved accountability process. In this regard, Congress passed the following laws: Organic Law of the Federal Mortgage Association, Popular Saving and Credit Law, Organic Law of the Bank of National Savings and Financial Services, and the Organic Law of Financiera Rural.¹⁰⁸⁵

¹⁰⁸⁴ See *id.*, at 18.

¹⁰⁸⁵ See *id.*

With respect to Mexican Stock Exchange, it has been affected by diverse problems, such as low firms controlled by a small group of investors and the fact that the domestic debt is dominated by public sector instruments. As a result, Congress approved important reforms to the Securities Market Law and to the Mutual Funds Law with the intention of promoting development of the securities market by establishing provisions under transparency and efficiency principles. In general, these laws establish the new basis for corporate governance in this regard.¹⁰⁸⁶

6. Some observations and Conclusions

Mexico's importance and relevance in the global economic and financial scene, even as emerging economy, is attested by its participation in G20, even since the inception of its predecessors. Although such importance and relevance was first made apparent in the painful way (on occasion of its 1994 crisis), the 2008 "Made in USA" crisis proved that Mexico learned its lessons from its crisis and has been dutiful, ever-since, in reforming its regulatory and institutional framework, in order to be protected against the risks inherent in liberalization and a growing involvement in the globalized economy.

The above also shows, on the other hand, the benefits that membership in G20 has given Mexico, especially when sound free market economics approaches are still harshly repudiated by a significant portion of Mexico's political players, as well as other regional leaders.

Moreover, the positive balance of Mexico's participation in G20 has encouraged a more active role on the part of Mexico, who has become a leading member, both by voice (proposals) and by example (compliance). This has been increasingly the case over the second half of the first decade of the 21st century, which makes noteworthy the impetus that President Calderón and his economic cabinet has brought to the Mexico-G20 relationship and the positive fruits it has borne.

¹⁰⁸⁶ See *id.*, at 19.

APPENDIX 4:

A Comparison with EU as an Example of Proper Sequencing in Financial Liberalization.

1. Introduction.

The foundation of the European Community was the Coal and Steel Community Treaty of Paris, which dates back to 1952. The EU is the response to the two wars that affected Europe in the 20th century, and the preservation of the peace as a supreme value. The Treaty of Rome was signed establishing the European Economic Community and at the same time the European Atomic Energy Community.¹⁰⁸⁷

The Treaty of Rome tried to achieve an ambitious economic integration that included the area of services,¹⁰⁸⁸ free movement of capital, right of establishment,

¹⁰⁸⁷ See The Rt Hon The Lord Cockfield PC, *The European Union, Creating the Single Market*, (Wiley Chancery Law 1994) at 5. The Preamble of the Treaty of Paris is as follows: “CONSIDERING that world peace can be safeguard only by creative efforts commensurate with the dangers that threaten it” and therefore:

“RESOLVED to substitute for age old rivalries the merging of their essential interests; to create by establishing an economic community, the basis for a broader and deeper community among peoples long divided by bloody conflicts; and to lay the foundations for institutions which will give direction to a henceforth shared.”

¹⁰⁸⁸ See GEORGE A. WALKER, *EUROPEAN BANKING LAW: POLICY AND PROGRAMME CONSTRUCTION* (2007) at 9:

“The Treaty of Rome which tried to regulate the operations of banks and banking itself faced obstacles in the light of lack of any particular regulations resulting from a course of action void related with monitoring and ensuring provisions for the financial market. The treaty included many development provisions comprising areas such as competition law, agricultural policy, improvement and implementation of atomic energy resources, however, the financial field was deprived of similar legislation. In fact, there existed a number of general principles that could be derived from chief aims and regulations of the pact but they present minor aid in establishing a thorough scheme for financial market supervision and regulation.

Closer superintendence over and complex legislation concerning banking and national markets in Europe have been worked on and created over decades of the European Community functioning. The superintendence in question aims at thorough monitoring of financial markets conduct by means of financial instruments or regulative rules while the legislation is a set of provisions having as an objective managing and constraining the risks undertaken by banks and other financial organizations. By the way of addition, brought to life under Maastricht Treaty, the European Union is a successor of numerous European communities operating over years in Europe among them being the European Community, the European Coal and Steel Community and the European Atomic Energy Community. Supplementary powers were granted to it in reference to Common Foreign and Security Policy and Home Affairs and Justice Policy as well.

Constituting one of the largest regional areas for trade, industry and commerce, the institution had to come up with regulations to establish a firm financial system within it. As the underlying principle of the institution functioning is an immediate or obligatory right to access the internal market for all the interested parties which would ensure no

and free movement of persons. In 1992, the treaty established the European Union to encompass the European Community.¹⁰⁸⁹

The targets of the EU are described in the Art. 2 of the Treaty of Rome:¹⁰⁹⁰ the establishment of the common market and an economic and monetary union and, in

inside borders with the guarantee of free goods, persons, services and capital movement, equilibrium of ensuring the complete cross-border entry and at the same time applying essential scope of the market control should be carefully maintained. The internal market, although being more limited than the common market which on its part was supposed to be founded on the ground of Art 2, was intended to be gradually introduced by the end of December 1992 as an embodiment of Arts. 15, 26, 47(2)s, 49, 80, 93 and 95, however with the avoidance of dismissing other regulations of the pact – Art 14(1) (ex 7a).¹⁰⁸⁸ The European Union comprises of a free trade area (FTA) and customs union (CU) which are founded on the common market (CM) ensuring free flow of labour, capital, goods and services. It also aspires to form an economic and monetary union (EMU) and intends to reach complete political union with time as well. Considering the existence of the EU, one has to notice that it actually started as interaction and joint operation between partakers at a specific time. Though it was initially constrained to dealing with the common coal and steel industries management, it soon expanded its operation to atomic energy, general goods and services, economic monetary issues handling ending with shared regulations on justice, home affairs and defence.”

¹⁰⁸⁹ Treaty of Rome Complete text, See <http://europa.eu.int/abc/obj/treaties/en/entoc053.htm>

[Hereinafter Treaty of Rome]

¹⁰⁹⁰ See WALKER, EUROPEAN..., *op. cit.*, at 68:

“To implement the new order the treaty initiators created a number of legislative and executive institutions to help the whole process go on, the main ones being the European Parliament, the Council, the Commission, the Court of Justice and the Court of Auditors. The European Parliament is composed of the representatives of the member states chosen in direct elections in the respective country for five-year terms. The representatives then hold the executive power of implementing the new regulations. The President and officers of the Parliament are selected from amidst its members. The members of the Commission are allowed to witness the Parliament’s meetings and take an active part in them. The Commission is obliged to answer any member’s or Parliament’s questions orally or in a written manner. Voting procedure depends on the absolute majority and the quorum is included in the Rules of Procedure and agreed on by the Parliament. Every year, the Parliament is bound to discuss the Commission’s general report in open session. The Commission may be asked to step down on an essential motion by two-thirds majority votes after a three-day discussion.

The Council acts as the coordinator of the member states general economic policies and may attribute to the Commission executive powers to impose accepted regulations. The council comprises representatives of each member states on ministerial level with competences of acting on behalf of their governments. The Presidency is passed on at six-month intervals. The council meets at the entreaty of its president, a member state or the Commission. Voting is based on a majority, although in the cases listed by the treaty a qualified majority may be employed. In terms of voting, an interesting concept is that Council members may act on behalf of others. The Council may as well ask the Commission to prepare studies and make research on the rules governing committees under the Treaty, fix salaries, allowances and pensions for the Commission and the Court. As far as the Commission is concerned, it is a body responsible for guaranteeing new regulations implementation, providing recommendations and stating opinions plus supporting the adoption of provisions by the Council and the European Parliament. Within a month from the opening of the European Parliament, it presents an annual report which includes the Community activities. The entity consists of 20 members chosen on the basis of their knowledge and competence as well as independence and capability of acting for the good of the entire Community for five-year renewable terms. Members are

general, the elimination of tariffs and non-tariffs barriers.¹⁰⁹¹ Also, Art. 23(1)¹⁰⁹² states that the EU is based in part on a Customs Union where custom duties are prohibited between member states. Also the EC prohibited the non-tariff barriers (quantitative restrictions).

One of the activities of the EU is the creation of an internal market characterized by the abolition of obstacles to the free movement of the four freedoms mentioned above. In the case *Gaston Schul* the Court stated that “the aim of the treaty is to eliminate all obstacles to intra community trade in order to merge the national markets into a single market bringing about conditions as close as possible to those of a genuine domestic market.”¹⁰⁹³

While laying the foundations for the EU, its creators skilfully used then existing international agreements such as the GATT, however they moved a few steps forward. It is a fact the main ideas and operational procedures of the GATT initially inspired the “founding fathers” of the EU but their vision extended the scope of the GATT with regard to integration market security. As said before, the GATT was the result of the Conference held from 1st to 22nd July 1944 at Breton Woods in New Hampshire with an aim to establish new trade and monetary pact to be due to after the WWII.¹⁰⁹⁴

required to step down from any other position for the time of working for the Commission and the President is chosen by common concurrence and accepted by the Parliament. The body proceeds on the majority of votes.

The creation of the bodies mentioned above is one of the distinguishing features of the European regional agreement and outstands among others. This line of thinking is followed to include the common financial market, specifically in terms of banking, insurance and investment funds. On 5th November 2003, as a consequence of the recommendations made by the Lamfalussy Committee, each of the areas of the financial integration obtained two new specialist committees to improve the overseeing and monitoring cooperation. The committees in the financial services sector are the following: the European Banking Committee, Committee of European Banking Supervisors, the European Insurance and Occupational Pensions Committee, committee of European Insurance and Occupational Pensions Supervisors, the European securities Committee and Committee of European Securities Regulators. Lamfalussy Committee’s advice was for the committees to deal with policy matters and technical side of application in order to approximate or assimilate all financial correlated mechanisms.”

¹⁰⁹¹ CATHERINE BARNARD, *THE SUBSTANTIVE LAW OF THE EU: THE FOUR FREEDOMS*, Oxford University Press 2004, at 11.

¹⁰⁹² Treaty of Rome.

¹⁰⁹³ Case 15/81 *Gaston Schul Douane Expeditie BV v. Inspecteur der Invoerrechten en Accijnzen, Roosendaal* (1982) ECR 1409, paragraph. 33.

¹⁰⁹⁴ See WALKER, *EUROPEAN...*, *op. cit.*, at 50: Initially another organisation was to be called into being at Breton Woods which was an International Trade Organisation (ITO) whose objective was to

Trade in services as such was not included in the GATT – it was contained in the GATS in 1994. Its target was to set up a multinational scheme for trade and services within the GATT. The core agreement banned its signatories on discriminating against trading partners or most favoured nation, provided for full disclosure of information and required commitment to partake, according to a fixed agenda, in works ensuring gradual liberalization. The plans or schedules of obligations were prepared by members individually and reflected the country's willingness to open the market access and national treatment in terms of specific services sectors.¹⁰⁹⁵

However, the GATS weakness is the fact that the member countries can liberalize their market only to the extent they agreed on while taking upon specific obligations.

dispose of trade tariffs and import controls. Unfortunately, because of the US objections the entity was actually not set up, yet what was agreed on was the introduction of trade reforms under the GATT. The agreement was open for ratification on 30th October 1947 and is now superintended by the World Trade Organization (WTO) which eventually came into existence on 1st January 1995.

¹⁰⁹⁵ See *id.* at 60:

“The European Union being one of the most complex trade systems is not a monolith with one set of fixed instruments and provisions to regulate the whole scheme. It is rather a collection of various parallel structures and procedures to ensure the entire body goes on well. Shared aims are to be obtained through a sequence of coordinated modules via specific defined activities. The goals, which the Union wishes to reach, are specifically fostering congruent, equitable and maintained improvement of economic activities, a high degree of jobs and social security, equality of the sexes, sustainable and no inflation inducing growth, a high level of competitiveness and evening the economic performances, focus on perseverance development of the environment, elevating the living standards and ensuring the solidarity among its members.

The free movement of all the production factors is expected to bring numerous positive outcomes. Removing quotas and tariffs should encourage the consumers' choice and improve the market competition while production and supply of goods should be optimised through free flow of workers, enterprises and money, which can through optimum apportionment of resources increase the economic effectiveness as well as provide the general affluence.

It does not mean, however, that a member state is not allowed to protect its own domestic products by employing discriminatory tax procedures. Additionally, private entities may also negatively influence the market by forming syndicates or maintaining a privileged position as oligopoly. To avoid that, the pact introduced a number of anti-competitive provisions to minimise the likelihood of corrupt practices.

Together with the application of negative market protection, through bans and prohibitions, the Treaty includes a collection of regulations which have a profound positive impact on harmonization via imposing accurate internal criteria in numerous fields.

Considering the above, one can notice that the legislators of the primary pact established an entirely new economic practice founded on a set of coordinated legal rights and undertaken responsibilities. To that degree, the European Community can be perceived as a body that has been granted a legal personality and validity under the international law. Having in mind ensuring the process of integration, the agreement functions through independent, yet corresponding, new legal order placed on a set of interconnected trading relations.

The obligations in questions can be avoided on the basis of general and specific exceptions. What is more, GATS does not provide any hints for the future liberalization talks which the countries are not bound to take part in. Their participation is founded merely on their uttered intentions to liberalize, yet it does not have to move the process forward.

On its part, transparency means solely the publication of measures that will be applied to limit trade and services. The information disclosure can have only local range and does not need to be presented in the WTO Secretariat either.¹⁰⁹⁶

As described above, the Treaty of Rome provided the platform for the integration in services (Art. 59), the right of establishment (Art. 52), free movement of capital (Art. 67) and free movement of workers (Art. 48).¹⁰⁹⁷ In 1992 the Treaty on European Union changed the name from the European Community to European Union and its scope covers as well Common Foreign and Security Policy and provisions on justice and home affairs.¹⁰⁹⁸

There is a right of establishment (Art 52 and 59) in Services, and they are subject to non-discrimination regulation. The ECJ passing a verdict on the *Van Binsbergen* case announced that "specific requirements imposed on the person providing the service cannot be considered incompatible with the treaty where they have as their purpose the application of professional rules justified by the general good - in particular rules relating to organization, qualifications, professional ethics, supervision and liability which are binding on any person established in the state in which the service is provided."¹⁰⁹⁹ Thus, non-discrimination regulation may be protected under certain circumstances, even though the regulation differs from that imposed by other member states and even though it imposes differential burdens on persons than other member states. The ECJ invalidated here the Dutch residence requirement.

¹⁰⁹⁶ See *id.* at 61.

¹⁰⁹⁷ Treaty of Rome Arts. 59, 52 and 48.

¹⁰⁹⁸ Trachtman, *International Trade in Financial Services id.* at 59.

¹⁰⁹⁹ *Id.*

In the German Insurance case, (Case 205/84 Commission v. Germany, 1986 E.C.R. 3755, 3803) the ECJ held that requirements of local establishment could only be imposed if there are "imperative reasons relating to the public interest which justify restrictions on the freedom to provide services" and if these imperative reasons are neither satisfied by home state rules nor capable of being achieved by less restrictive rules.¹¹⁰⁰

The goal of the EU in financial services was to create a legislative framework that would allow greater integration of financial markets without sacrificing public policy interests of each member states regarding prudential rules, market stability and consumer protection.

The new way of looking on the goods and services in general led to reconsidering the idea's implementation into the financial services area which applied a parallel principle of home country control. In its history, in spite of initial economic obstacles which the institution encountered in the late 1970s and early 1980s, the further advancement followed gradually to end up with establishing the internal market by the year 1992 founded on the judgement of the European Court of Justice in Cassis de Dijon of 1979.¹¹⁰¹

In this sense, as Walker has pointed out the EU has come up with one of the most intricate and complex regulatory and supervisory schemes in the world, namely Financial Services Action Plan, and it includes all main domains of domestic and cross-border financial services. The programme itself results from different approaches to multinational cooperation in the institution's history and gradual development from ideas of full harmonization, which was supposed to impose entire collections of fixed standards on all of the fields listed in General Programmes falling under the original EEC Treaty, to notions of the *mutual recognition* of agreed standards, which stressed the importance of outlining common minimum standards for all the members in important areas.¹¹⁰²

¹¹⁰⁰ *Id.*

¹¹⁰¹ *Id.* at 40

¹¹⁰² *Id.* at 11:

"In this sense, the European Union being one of the most complex trade systems is not a monolith with one set of fixed instruments and provisions to regulate the whole scheme.

The EU experience is important because in some countries financial sectors were competitive prior to the single market while others had heavily regulated financial sectors with a major part in the hands of the government.¹¹⁰³

To sum up, the European Union is a good example of the liberalization in the financial services as a single market.¹¹⁰⁴ Nevertheless, still some that believe that the European Union is “still a fragmented market,”¹¹⁰⁵ and in practice, it had brought a heterogeneous integration across both sectors and countries.¹¹⁰⁶

It is rather a collection of various parallel structures and procedures to ensure the entire body goes on well. Shared aims are to be obtained through a sequence of coordinated modules via specific defined activities. The goals, which the Union wishes to reach, are specifically fostering congruent, equitable and maintained improvement of economic activities, a high degree of jobs and social security, equality of the sexes, sustainable and no inflation inducing growth, a high level of competitiveness and evening the economic performances, focus on perseverance development of the environment, elevating the living standards and ensuring the solidarity among its members.

The free movement of all the production factors is expected to bring numerous positive outcomes. Removing quotas and tariffs should encourage the consumers' choice and improve the market competition while production and supply of goods should be optimised through free flow of workers, enterprises and money, which can through optimum apportionment of resources increase the economic effectiveness as well as provide the general affluence.

It does not mean, however, that a member state is not allowed to protect its own domestic products by employing discriminatory tax procedures. Additionally, private entities may also negatively influence the market by forming syndicates or maintaining a privileged position as oligopoly. To avoid that, the pact introduced a number of anti-competitive provisions to minimise the likelihood of corrupt practices.

Together with the application of negative market protection, through bans and prohibitions, the Treaty includes a collection of regulations which have a profound positive impact on harmonization via imposing accurate internal criteria in numerous fields.

Considering the above, one can notice that the legislators of the primary pact established an entirely new economic practice founded on a set of coordinated legal rights and undertaken responsibilities. To that degree, the European Community can be perceived as a body that has been granted a legal personality and validity under the international law. Having in mind ensuring the process of integration, the agreement functions through independent, yet corresponding, new legal order placed on a set of interconnected trading relations.

¹¹⁰³ See STIJN CLAESSENS & MARION JANSEN, ed. *THE INTERNATIONALIZATION OF FINANCIAL SERVICES: ISSUES AND LESSONS FOR DEVELOPING COUNTRIES* (2000) at 5, for example, Italy, Portugal, Greece Spain were heavily regulated.

¹¹⁰⁴ See Trachtman *Id.* at 59. The European Union's single passport idea has become greatly exported to other regions, such as NAFTA and MERCOSUR. This objective has been achieved since the Second Banking Directive (SBD) in 1989.

¹¹⁰⁵ See K.N. SCHEFER, *INTERNATIONAL TRADE IN FINANCIAL SERVICES* (2000) at 261. Schefer and Rogers consider that despite the liberalization in the provision of banking services the integration of the banking market in the EU is far from complete. Also Wijsenbeek a European Parliament deputy from Netherlands said:

“Possibly in response to the advent of the monetary union, there was a mergers of financial institutions...however the banking sector is still a highly fragmented

Nevertheless the foregoing mentioned by Schefer, it is evident that one of the most outstanding achievements of the EU was to call into being one single market for banking and financial services, on which the whole community economic and financial is based. One particular difficulty here is to stabilize the market both at a local and regional level trying to foster the market access within the internal system at the same time. Appropriate supervision and monitoring are necessary to lessen the vulnerability of the financial sector which is subject to instability due to the interdependence with other members' economies. The organization has been gradually working on the issues of ensuring both the access and the control over it. While doing so, it evolved its approach from the full harmonization to the mutual recognition and minimum harmonization.¹¹⁰⁷

2. Banking and Financial Markets in Europe.

The essentiality of the banking and financial ingredient in the single European market cannot be refuted as it assists the financial markets and bears high economic value to the European economy estimated in total consumer surplus increase as much as between £7.7 and £23.1 billion of which the banking industry earned between £5.6 and £15.4 billion. It meant that financial services constituted about 6% of EU GDP and created 2.45% of overall employment posts. What is more, it demonstrated one of the biggest dynamics for employment expansion as noted by the Commission's Employment Rates Report.¹¹⁰⁸

market...even the largest European banks do not account for more than one or two per cent of the total volume of banking services at Union level.”

See also Rogers, Arthur. “EU Parliamentarians Weigh Changes to Allow Freer Cross-Border Banking Activity” 70.20 BNA Banking Rep 826 (18 May 1998).

¹¹⁰⁶ See Inter-American Development Bank, *Financial Integration*, in BEYOND BORDERS: THE NEW REGIONALISM IN LATIN AMERICA 106 (2002). [hereinafter Inter-American Development Bank, *Financial Integration*]. While the banking sector deepened its integration process, retail banking remained fragmented and strongly localized. Securities market led to deeper integration but insurance faced obstacles due to legal barriers.

¹¹⁰⁷ See WALKER, EUROPEAN..., *op. cit.*, at 12.

¹¹⁰⁸ *Id.* at 6:

“In addition, the financial integration was calculated to bring approximately supplementary 5 to 7% per annum to EU GDP. Nevertheless, the financial and banking system can be intrinsically unsteady leading in some cases to general regional instability and downfall by way of chain reaction. Individual institution problems can cause the spread of crisis onto the entire intra-sector which will be passed on to the system nationally. The national sector collapse can infect the regional organism and contaminate a greater general financial area resulting in a large crisis. The factors

As mentioned earlier, the EU has come up with one of the most complex regulatory and supervisory schemes in the world, namely Financial Services Action Plan (FSAP), and it includes all main domains of domestic and cross-border financial services. Yet, while evaluating the programme and appreciating its achievements one cannot forget that some issues concerning further development, present frame and substance together with its successful termination may demonstrate a few problems. To be fully recognized as the efficient financial scheme it has to address some general integration issues as well as specific financial ones to avoid partial evaluation, diminishing its importance or pertinence.¹¹⁰⁹

3. Financial Integration in Europe

As mentioned earlier, the Treaty of Rome, which tried to regulate the operations of banks and banking itself, faced obstacles in the light of lack of any particular regulations resulting from a course of action void related with monitoring and ensuring provisions for the financial market.

The treaty included many development provisos comprising areas such as competition law, agricultural policy, improvement and implementation of atomic energy resources, however, the financial field was deprived of similar legislation. In fact, there existed a number of general principles that could be derived from chief aims and regulations of the pact but they present minor aid in establishing a thorough scheme for financial market supervision and regulation. The European Community, being one of the most complex regional structure in the world, has been treated as an example while creating other regional schemes in Latin America, South Africa or Asia, though one has to admit that none of them has ever reached its range or complexity. Enjoying free trade ensuring completely unrestrained flow of all factors of production plus joint control framework of outside the internal market products together with the implementation of a common policy in numerous fields including

seemingly contributing to the threat are 'individual bank failure, contagion and systemic collapse; information asymmetries and natural monopolies'. That is why it is so important to create an efficient monitoring scheme to assure all the participants about the steadiness and ensure secure system operation."

¹¹⁰⁹ *Id.*, 11.

legal and institutional structures, the European Union established new regulations within one regional agreement.¹¹¹⁰

The new way of looking on the goods and services in general led to reconsidering the idea's implementation into the financial services area which applied a parallel principle of home country control.¹¹¹¹ In its history, in spite of initial economic obstacles which the institution encountered in the late 1970s and early 1980s, the further advancement followed gradually to end up with establishing the internal

¹¹¹⁰ *Id.* at 11-37:

“One of its most outstanding achievements was to call into being one single market for banking and financial services, on which the whole community economic and financial on is based. One particular difficulty here is to stabilize the market both at a local and regional level trying to foster the market access within the internal system at the same time. Appropriate supervision and monitoring are necessary to lessen the vulnerability of the financial sector which is subject to instability due to the interdependence with other members' economies. The organization has been gradually working on the issues of ensuring both the access and the control over it. While doing so, it evolved its approach from the full harmonization to the mutual recognition and minimum harmonization.

Financial integration is only a part of a broader economic integration but the same rules apply in both. The underlying principle is the optimum apportionment of resources together with stability and effectiveness of the system functioning. Capital and investments should be allocated in such a way to maximise the efficacious operation, transaction costs should be reduced for the investors and merchants and their profits increased.

In spite of the banking and financial market functioning policy being one part of the larger economic system, it plays an essential role in terms of savings, credits and payments in making the entire system function properly. They simply act according to the current level of integration being on one hand independent areas within a new economy, and on the other hand providing important mechanisms and crucial support channels for each of the created markets.

Throughout the European community history, there have been some substantial measures employed to ensure deeper and deeper financial integration. One of them was The Bretton Woods system, which fixed the values of all foreign currencies to dollar whose value on its part was fixed to gold. Due to later speculative dollar fluctuations and implementation of protectionist measures in Europe, the system collapsed in 1971 accompanied by the floating currency rates and 1973 oil crisis.

The 1980s brought the attempts of gradual liberalisation through the adoption of Euro for the transfers and transactions, increasing the freedom of capital movement across the continent together with the decision to finalise the free movement application under the Treaty with the 1985 Internal Market programme. A significant progress was noted under new Commission President Jacques Delors, although the idea of the completion had been undertaken by ECOFIN as early as in 1982. The aim was to oversee if all the means to ensure complete free movement of goods and services together with factors of production were employed properly and accurately. Decision taking provisions of the Treaty were updated and institutional reforms introduced under the Single Act of 1986. Jacques Delors took over the initiative and supervised the capital liberalisation while Lord Cockfield, the US Commissioner, and Margaret Thatcher oversaw the complete realisation of the potential increase of benefits.

¹¹¹¹ *Id.*, at 40.

market by the year 1992 founded on the judgement of the European Court of Justice in *Cassis de Dijon* of 1979.¹¹¹²

1979 was also the year of exchange rate fluctuations stability and encouragement of inflation rate evening with calling into being the European Monetary System. This evolution of European fusing can be viewed from point of view of various general approaches to it, functionalism, neo-functionalism and neo-realism among others. Functionalism emphasises the fostering of joint operation through particular economic activity, neo-functionalism accepts the presence of competitive economic and political high class to ensure the integration process, while neo-realism on its part stresses the promotion of national interests instead of regarding national governments as the initiators of the entire blending process. The two latter have been replaced since the late 1980s by a thorough research on the political and organizational units and the way they are managed and interconnected.¹¹¹³

¹¹¹² *Id.*

¹¹¹³ *Id.*, at 43:

“Economic fusion entails numerous strata of interwoven ties, links or operations. The general division here can be made into free trade area – which by definition is free of customs, duties and quotas on an interstate trade, though some rules in connection with the goods from third countries may be applied, a customs union – in which members unanimously agree on tariffs and quotas imposed on internal and external goods, a common market – which comprises the previous regulations plus the freedom of all trade factors including unrestricted flow of labour, capital, goods and services, economic union – meaning agreeing on common economic policy dealing with many aspects such as market regulation, competition or industrial framework, monetary union – based on the common currency or settling the exchange rates and full political union – understood as acting according to common regulations and competences shared by all the member states. The first three deal generally with particular market aims while the three latter are associated with general policy goals.

The history of Europe demonstrates that economic integration has not until recently been a target as such. It has rather been a side effect of overall high-tech and industrial transformations. Deliberate economic integration was considered no sooner than after WWII and it was exactly when it began to aim at mutual economic dependence and profit with tightening of political alliance.

Regional agreements concerning trade have in mind creating an internal market in which the transaction costs would be maximally lowered and profits made from free movement maximised. The early internal market of the European Community was with this respect different from the full common market represented by the United States of America. The core dissimilarity would lie rather in the social outlook on the transactions than the open market itself.”

The EU has been trying to regulate the issues of technology, public purchasing, state support policy or taxation demonstrating a new view on technological harmonisation based on the minimum harmonisation and mutual recognition principle under the 1985 White Paper.

While the United States forms a single market, still the discrepancies in legal, tax and regulatory systems exist. Various states apply different laws considering goods and services and even the fiscal policy shows diversity across the country. And although federal regulations forbid discernment on the basis of the state of origin and anti-

4. Assessment.

The gains of forming of a single market within the European area have been regarded with respect by many experts in the topic. One of the most thorough ones was the 1988 report by Paulo Ceccini on the “Benefits of a Single Market” which included a few interesting points. According to Ceccini, disposing of the obstacles such as tariffs, quotas, cost-increasing barriers, market entry restrictions and government market distorting activities would result in competition stimulation and costs lowering, which would lead to price reduction and investment facilitation.¹¹¹⁴

What is more, the internal market would foster capabilities of supplies thus enlarging total demand. Another assessment from a world wide known consulting group Price Waterhouse appeared a bit earlier than Ceccini’s report, namely in 1986. However, the approach was completely different. It looked at costs of European financial services union non-existence. It carefully provided an analysis for present framework of financial services, macro-economy, regulatory barriers as well as control restrictions on trade in financial services and their economic impact on integration itself.

5. Regional Integration.

While laying the foundations for the European Union, its creators skilfully used then existing international agreements such as the GATT, however, they moved a few steps forward. It is a fact that the main ideas and operational procedures of the GATT initially inspired the “founding fathers” of the EU but their vision extended the scope of the GATT with regard to integration market security. As it has been mentioned earlier trade in services as such was not included in the GATT, as it was contained in the GATS in 1994. Its target was to set up a multinational scheme for trade and services within the GATT. The GATS generally relies on lack of discrimination

competitive means, yet they lack the monitoring and control over public purchase or state support.

Europe has to be careful not to introduce sophisticated and inconsistent regulations to avoid augmentation of transactional costs and diminishing of the profits resulting from the integration. Appliance diversities among its members or no regulation implementation at all assisted by cultural dissimilarities and institutional controversies will divide Europe and contribute to legislative irresolution.”

¹¹¹⁴ *Id* at 54.

embodied in the national treatment and most favoured nation principles assisted by transparency tenet all of which are referred to in a core agreement, which outlines prevailing obligations and regulations germane to all sectors, and the register of commitment plans. The financial specifications comprising insurance and associated services, banking and securities are listed in the Annex on Financial Services. The core agreement banned its signatories on discriminating against trading partners or most favoured nation, provided for full disclosure of information and required commitment to partake, according to a fixed agenda, in works ensuring gradual liberalization. The plans or schedules of obligations were prepared by members individually and reflected the country's willingness to open the market access and national treatment in terms of specific services sectors.¹¹¹⁵

However, as it has been pointed out the GATS weakness is the fact that the member countries can liberalize their market only to the extent they agreed on while taking upon specific obligations. The obligations in questions can be avoided on the basis of general and specific exceptions. What is more, the agreement does not provide any hints for the future liberalization talks which the countries are not bound to take part in. Their participation is founded merely on their uttered intentions to liberalize, yet it does not have to move the process forward. On its part, transparency means solely the publication of measures that will be applied to limit trade and services. The information disclosure can have only local range and does not need to be presented in the WTO Secretariat either.¹¹¹⁶

The main differences between the EU and NAFTA are as follows: NAFTA is open to any new members. Within the range of the agreement there are no tariffs on trade, although individual external tariffs are sustained. What it means is that in NAFTA the three countries form a free trade union but not a customs union. Chapter 14 of the pact and its Annexes deal with the financial services and ordain unqualified national treatment but they do not require any harmonization or impose mutual recognition. What they allow is the autonomy of the member countries as far as regulation is concerned.¹¹¹⁷

¹¹¹⁵ *Id.* at 60. See also CRAIG & G DE BURCA, *EU LAW*, Ch 1. Oxford University Press 2a ed. 1998.

¹¹¹⁶ *Id.* at 61.

¹¹¹⁷ *Id.*

Mercosur on its part was started by Argentina, Brazil, Paraguay and Uruguay in 1991 and now constitutes the third biggest trade market in the world. The assumptions of the treaty were to establish an internal market by the year 1994 with the incorporation of common external tariff and free movements of labour, goods, services and capital which were supposed to liberalise the market gradually. Similarly to the GATS and NAFTA, Mercosur fosters both the intercontinental and local trade.

6. European Court of Justice.

The European Court of Justice has played an important role in developing a coherent policy of EU in terms of banking and financial area, however nothing was actually done before the transitional period ended on 31st December 1969. Since that time the Court has recognised its cruciality in participating in creation of the regulations of the pact, notably when it comes to the free movement provisions. Still, though numerous, both universal and particular, regulating acts have been acknowledged by the Court in the evolution of free movement, there exist some doubts about the range of some main issues. One of them is whether the extent of limitations provided in the text of the Treaty in the field of free movement should be decided on by the means of discrimination, both direct and indirect, or effects based test. Other dilemmas appear in associating these juridical rules to make them compatible with provisions designed by the Commission and Council while devising legislative sub-programmes.¹¹¹⁸

In 1996 the Court addressed the case of *Reiseburo Broede*, which dealt with the licensing requirements. The managing director of INC Consulting SARL was hindered from executing her right obtaining debt payment from Mr. Sandker in Germany on the foundation that applicable provisions made it impossible for the representative of the creditor clients to act on their behalf in legal proceedings as debt collectors. However, the German Government and Commission's objections as to the case dealing with no cross-border matter were rejected. The Court stood on a position that *Reiseburo Broede* had granted the power of attorney to INC Consulting

¹¹¹⁸ *Id.* at 92.

residing in France which, on its part, gave the power of attorney to its managing director in Germany. Therefore, it was indeed the case of a cross-border issue. Additionally, the Court decided that applicable Treaty regulations were the ones which handled services, not residence. As a result, the debt collection interdiction within Germany without the participation of a lawyer would limit services as they could not be provided on German territory by unqualified personnel.¹¹¹⁹

In 1997 the Court addressed the local licensing requirement again in *Parodi*. The Dutch de Barry Bank granted a mortgage loan to a French real property company – Parodi – in November 1984, which case was dismissed by the Regional Court and Appeal Court. After that the *Cour de Cassation* required from the Court a confirmation if national provisions demanding authorization to assist banking services in the local area was in contradiction to Arts. 59 (4) and 61 (2) (51) of the Treaty. The Court stated that the need to obtain additional authorization put the credit company in a less favourable position as to providing cross-border banking services and in consequence limited its freedom of supplying services. It also noticed that the banking area is specifically sensitive if it comes to consumer rights.¹¹²⁰

Art. 52 (1) (ex 63) includes the guidelines in order to ensure the freedom of establishment and services as it was outlines in earlier General Programmes. As a result, the Second Bank Directive imposed a complete mutual recognition of national licenses among all Member States on the foundation of the adopted rule of minimum harmonization agreed on in the First and Second Directive.¹¹²¹

5. The Financial Services Action Plan.

Following the implementation of Action Plan for the Single Market of 1997 Amsterdam European Council Summit, the Commission presented its first framework for action in the banking and financial sectors a year later. One of the main purposes of the plan was to get rid of accumulation of issues connected with applicable Single Market regulations complete introduction. Consequently, the

¹¹¹⁹ *Id* at 165.

¹¹²⁰ *Id* at 169.

¹¹²¹ *Id.* at 171.

number of non-implemented measures in Member States fell down dramatically. Yet, there was a lot to be done to meet the deadline outlined for 1st January 1999. To ensure the success of the undertaking, the Action Plan included four “Strategic Targets” whose roles were to ensure the effectiveness of market regulations, eliminating market obstacles and contortions and fostering individual profits. The Plan comprised as well measures for three stages of varied application (Annex 1) and enumeration of priority actions (Annex 2). Eventually, the document was adopted in the financial sector in 1998 this was a huge step forward, yet there were many things to be done on the way to ensure a real Single Market.¹¹²²

6. The Process towards Mutual Recognition.

7.1. Mutual Recognition.

The mutual recognition is not as simple as it may seem. It may adopt various meanings depending on what context it is used in. When it comes to judiciary understanding, mutual recognition is associated with the examination of its correspondence or analogousness of national restriction measures. This will be taken into consideration by the Court while researching mandatory requirements and passing judgement if there exists any national interest which should be put before the basic provision of free movement.

In *Cassis de Dijon* that examination of correspondence and analogousness was reverted into a separate law provision. This move leads to understanding that Member States are obliged to revise other members’ laws and adopt their own to adjust to international regulations. That, together with minimum harmonization, contributed to creating the “White Paper” which ensured a new market approach. Mutual recognition is often referred to as far as *mutual identification and acknowledgement of national powers* execution is concerned in terms of European directives, including financial ones. It is connected, for instance, with confirming the legitimacy of the broadened range of each of individual licenses (passports as well) issued according to applicable directives that allow banks and other financial entities

¹¹²² *Id at 247*

accredited in one Member State to provide services in all others.¹¹²³ Finally, mutual recognition can be used as referring to the Commission's new approach to European integration or more generally to any instance of mutual analogy or approbation. In judicial terms it can also mean an individual act of validation or acceptance done under European legislative measure. Acceptance function of mutual recognition correlates with the need for easy access market within a regional treaty and comprises numerous regulatory provisions.¹¹²⁴

7.2. Minimum Harmonization.

It is not easy to provide a definition for minimum harmonization, either, although it does not seem to be as problematic as mentioned earlier mutual recognition. It can pertain to the choice of main sectors for legislative actions or agreed minimum level of protection under any specific provision. The 1985 White Paper noted that creation of the Single Market entails both mutual recognition and minimum harmonization in legislation considered generally and as a part of home control, particularly in the financial area.¹¹²⁵ With reference to minimum harmonization, the White Paper emphasizes the importance of legislative harmonization in sectors like health and safety which would be mandatory in all Member States. This would ensure the free movement of a product. In cases in which there must be some kind of restrictions to assure citizens' safety and health, the minimum harmonization principle would not outline requirements but rather prerequisites. In other cases, companies would need to comply with an individual set of rules to exercise free movement within the Community. Therefore, minimum harmonization may deal with particular areas for future legislation as well as creation of common European regulations together with fixed minimum levels of protection.¹¹²⁶

¹¹²³ See WALKER, EUROPEAN..., *op. cit.*, at 247.

¹¹²⁴ *Id.* at 304-305.

¹¹²⁵ *Id.*

¹¹²⁶ *Id.* at 307.

7.3. Home Country Control.

Home Country Control was a new point in the new approach to Commission's integration strategy. The treatment of banking and financial services under the White Paper was analogous to the one given to industrial and agricultural products under Cassis. This harmonization of specific fundamental principles was in reality making financial institutions subjected to supervision of home country control through competent authorities of a country of origin. Soon it started being treated as an independent law and together with mutual recognition and minimum harmonization became fundamentals of banking and financial programmes. The fact is that the three principles were only enounced in the late 1980s; however they evolved from previous commencements.¹¹²⁷ In July 1972 the Committee of Experts presented an original directive project which was founded on the full harmonization idea. In 1974 it was proposed that credit institutions should be absolved from national license while establishing branches in other Member States. It surely preceded the introduction of a single passport as a result of the Second Banking Directive in 1989 functioning on the foundation of mutual recognition considering authorization and supervision of a Member State as sufficient by all other states.¹¹²⁸

The home country control has been regarded as a crucial component in the area of finances from the very beginning. It is one of the outstanding characteristics of this field to instantly reassess and supervise the surveillance operations functioning within this domain. All of the mentioned above constituents (apart from minimum harmonization), which found themselves in the eventual European strategy, were forethought by 1972. The case is with post-entry validation system based on original lawful production and first market placement of 1979 Cassis, mutual recognition being substituted by 'license validation' while home country control would connote mutual recognition as well as minimum harmonization.¹¹²⁹ The utilization of home country control principle was thought of as early as 1974-1975, which could be perceived in the works of 1975 Basel Committee on Banking Supervision. The initial idea was of mutual responsibility which soon was converted into partition of liability

¹¹²⁷ *Id.* at 308.

¹¹²⁸ *Id.* at 309.

¹¹²⁹ *Id.* at 310.

between the country of origin and the host country authorities in reference to specific functions comprising bank solvency and liquidity. The result was issued in 1975 First Concordat by the Committee complemented by a requisite of general collaboration and data interchange. Later documents together with 1983 Revised Concordat led to the requirement of home country control with reference to capital sufficiency and joint supervision. What differentiates the European and Basel requirements is that the first one comprised a market access right or entitlement added to basic allocation of responsibility. This component was proposed in 1974 First Bank Directive, though it was anticipated in the initial version of the first directive outlined by the Committee of Experts in 1972.¹¹³⁰

Taking into account that all banking and financial programmes are founded on the three core principles mentioned earlier, there is one more regulation worth mentioning here - general good. Originally there was no intention to place this rule in the Second Banking Directive, yet eventually it was done thanks to persistence of Italian and French representatives working on that. The present functioning of this regulation is fully explained in the Court's verdict in *Gebhard and Gouda* where it was agreed that the measure taken must be 'non-discriminatory, non-harmonized, recognized, not duplicatory, necessary and proportionate.'¹¹³¹

7.4. Host Country Control.

Similarly to general good, host country control rule has not been included in the main constituents. The Banking Consolidated Directive 2000/12/EC functions by designating the 'prudential supervision' of credit entities to the potent authorities of the home Member State, though it should be done without compromising any other regulation of the Directive. The Directive does not mandate the home country control itself, yet broadens the range of home country power to include prudential supervision. Regrettably, the definition of 'prudential supervision' is not provided, though it is generally referred to capital and liquidity and systems and control requisites demanded from the bank.¹¹³²

¹¹³⁰ *Id.* at 311.

¹¹³¹ *Id.* at 312.

¹¹³² *Id.* at 313.

7.5. Assessment.

As Cranston correctly points out the aim in the EU is to create a single market in financial services through establishing branches in other parts of the Union or providing services cross border, thus through mutual recognition a bank established in one member State has a “single passport” to establish branches or to provide services in other member State.¹¹³³ Consequently, a single license is required for all the EU instead of licensing in each Member State.

As exposed earlier this directive gave the idea of home country control and minimum harmonization as opposed to full harmonization of regulatory rules. Home country control means that the primary responsibility for regulatory oversight of banking institutions resides with the institutions’ home country supervisors.¹¹³⁴ The same is with the principle of “freedom of establishment,” which flows from EU Treaty Rights and provides any financial institution in the EC with conducting permitted services in another EC member country. This has become known as the single banking license.

Therefore, the principle of mutual recognition entails recognition for all member-states of other banking laws and regulations.¹¹³⁵ This was designed to encourage free

¹¹³³ See ROSS CRASNTON. PRINCIPLES OF BANKING LAW, 2 ed. (2002), at 433. The passport does not apply to a bank based outside the EU the third country bank must incorporate a “subsidiary” in the Community and be licensed in at least one jurisdiction.

¹¹³⁴ See Inter-American Development Bank, *Financial Integration*, at 112.

¹¹³⁵ See WALKER, EUROPEAN..., *op. cit.*, at 199: “In 1985 the Commission issued a White Paper, in which it described its new approach in the banking and financial sectors, which adopted principles of mutual recognition and minimum harmonization. To understand the importance of mutual recognition notion, one needs to look at famous 1979 Cassis de Dijon which explains its origin and validity. Although the European Court did not address the issue of mutual recognition directly, it referred to it in its verdict discussing ‘lawful production and first placement of goods’. It remarked that the products could be labelled in such a way to notify the consumer about the place of origin and the content of the product. The Court’s judgement was founded on three basic elements of authority, mandatory requirements and assessment. The Court agreed with the right of a country to regulate issues that were not embraced by any general provision at the European level. It also confirmed that a country could sustain restrictive measure implementation if a vital public interest was satisfied, even if it had trade-restrictive consequences. Yet, in the light of evidence presented by the German Government, the Court decided the measure maintenance as unlawful on the basis of proportionality.”

trade in financial services without the requirement to harmonize banking laws among all the member states and its impact has been remarkable.¹¹³⁶

In this sense, participants' national laws do not have to be fully harmonized and home rules are accepted to govern cross border provisions. The adoption of minimum harmonization and mutual recognition outside the EU is problematic because its implementation is premised upon a transfer of sovereign authority from member states to the EU Commission and such compromise of national sovereignty is impossible to achieve in other contexts.¹¹³⁷

In this context, the EU Single Passport idea has become attractive for other foreign banks, such as the U.S. banks, which having a subsidiary in Europe allow them to use the single passport within the 25 countries.¹¹³⁸ However, if the U.S. bank sets up just a branch, this single passport benefit would not apply.¹¹³⁹

The integration of the EU brought the following benefits: a) greater exposure to international competition, b) improved efficiency in financial intermediation, c) more efficient capital utilization, d) development of the financial industry itself and e) better fiscal discipline.¹¹⁴⁰

Finally, it is worth mentioning that when establishing any regional trading scheme or treaty a conflict between easy market access and control inevitably emerges. Together with disappearing current national market levels and diminishing technical and consumer protection to ensure market entry to new incumbents, applicable control mechanisms may be remarkably diminished or completely withdrawn from. In the light of lack of central body exercising its surveillance within the regional integration system, the European Community Treaty faces a strategy

¹¹³⁶ The OECD Regulatory Reform in the Financial Services Industry, Volume I, Sectoral Studies, 1997 at 79.

¹¹³⁷ See J. Ane Kaufman Winn. "National Treatment v. Reciprocity in International Banking: United States and European Community at 9. In J.J. NORTON et al (eds.). INTERNATIONAL BANKING OPERATIONS AND PRACTICES: CURRENT DEVELOPMENTS (Graham & Trotman / Martinus Nijhoff 1994).

¹¹³⁸ The single passport idea is better understood now with the new enlargement.

¹¹³⁹ Because the branch is just an office of the parent bank without legal entity and thus it would not be liable, while the subsidiary held a separate legal entity.

¹¹⁴⁰ Inter-American Development Bank, *Financial Integration*, at 106.

void in the matter of supervision. As financial market is extremely susceptible to insecurity, the market regulation is influenced at national or host levels.¹¹⁴¹

While creating programmes for this field only a small step forward was made to insure the minimum of regulatory framework operation. Minimum harmonization and obligatory mutual recognition face tremendous obstacles due to unbalanced adoption, interpretation and application in various Member States. What it means is that mutual recognition based strategy to ensure regulatory 'equivalence or convergence' has not been implemented in many countries yet.¹¹⁴² What is more, the countries lack the willingness to establish efficient collaboration to ensure the surveillance of financial entities through competent authorities. There is a debate going as to whether create a central agency responsible for supervision but many issues have to be addressed there including costs, bureaucracy and financing pattern. In the absence of such institution, a need to cooperate more efficiently visibly arises.¹¹⁴³ With regard to free movement, there exists an urge to straighten all the discrepancies and uncertainties appearing within the law. This could be done through the implementation of GATT or GATS free trade strategy introducing among others a discrimination test to future internal market provisions.

Another issue is the parallel home country control and concurrence. Based on the Cassis Court verdict, it implies that where a sufficient level of protection has been maintained under the home regulations, the host country will not be capable of implementing similar provisions. The assessment will be done on the basis of examination of regulations implementation and the scope of their security they provided, and finally, a competent entity dealing with free movement's scope of jurisdiction needs to be established as quickly as possible to allow better legal certainty which on its turn can only foster operational access, stability and implementation and resulting market integration.

¹¹⁴¹ See WALKER, EUROPEAN..., *op. cit.*, at 345.

¹¹⁴² *Id.* at 346.

¹¹⁴³ *Id.* at 347.

8. Conclusion.

The EU has come up with one of the most intricate and complex regulatory and supervisory schemes in the world, namely Financial Services Action Plan, and it includes all main domains of domestic and cross-border financial services. The programme itself results from different approaches to multinational cooperation in the institution's history and gradual development from ideas of full harmonization, which was supposed to impose entire collections of fixed standards on all of the fields listed in General Programmes falling under the original EEC Treaty, to notions of the *mutual recognition* of agreed standards, which stressed the importance of outlining common minimum standards for all the members in important areas. Therefore, the principle of mutual recognition entails recognition for all member-states of other banking laws and regulations. This was designed to encourage free trade in financial services without the requirement to harmonize banking laws among all the member states and its impact has been remarkable.

The integration of the EU brought the following benefits: a) greater exposure to international competition, b) improved efficiency in financial intermediation, c) more efficient capital utilization, d) development of the financial industry itself and e) better fiscal discipline.

APPENDIX 5:

Gambling with Derivatives Burned Mexican Companies

In the autumn of 2008, BANXICO's International reserves decreased in double digits and only traders were profiting, while financial institutions were going through a really tough financial distress.¹¹⁴⁴

For years, Mexican companies were betting, literally, on certain stability in the foreign exchange market, specifically, in the USD/MXN in hedge contracts. The USD rate was at MXN\$10.50. A lot of investors made “easy” money with this situation; due to the kind of derivatives contracts, some of them even multiplied their profits, the same size of the losses in other companies. Little by little, as of September 15, the level of virtual debt of several companies started growing in the banks' assets above US\$50 million.¹¹⁴⁵

The tragic week of Mexican companies finished with a total loss of more than US\$2,500 million. CEMEX, Alfa, Bachoco and some others were in dire straits, but the worst part was taken by Controladora Comercial Mexicana (COMERCI), a company that had to face a loss of US\$1,080 million and started restructuring negotiations in order to avoid bankruptcy. At the same time, Grupo Maseca suspended its quotation in the stock market and was facing a virtual loss of more than US\$1,200 million. Lawyers, bankers, auditors and economists describe a scenario with several factors at stake. They talk about extremely high exposure to risk and no control at all; lack of reports to financial Committees, ignorance, bad luck and even lies. Such complex financial instruments as the derivatives were a “time bomb”, as Warren Buffet described them 5 years ago. However, it all shows that it was caused by wrong decisions by some executives, scared of failure and allured by greed.¹¹⁴⁶

¹¹⁴⁴ See Zacarias Ramirez, Gisela Vázquez and Gilberto Bello, *Double or Nothing. Casino of Derivatives*, in EXPANSION (Nov 23, 2008) at 129.

¹¹⁴⁵ *Id.* at 129. See also “The CNBV investigates Mexican companies” Wednesday 15th October 2008. El Universal.

¹¹⁴⁶ *Id.*, at 130.

Derivatives are instruments that reduce risk to companies when applied correctly, but when they are used for mere speculation, they can be extremely risky. A derivative needs a low initial investment, which can lead to an extremely high leverage, even above the capacity of payment of the company. When the USD reached MXN\$11.00, bankers started calling people who had the most sophisticated derivatives contracts: TARNs (Target Accrual Redemption Notes), which punish severely an investor who placed a wrong bet. It's something similar to Casino chips.¹¹⁴⁷

The TARNs are a kind of derivative that makes cheaper the cost of getting such instrument in exchange of a "bet" on a foreign exchange rate or a product. If the client makes a wrong bet (in most cases it's unlikely), his loss is larger than his possible pay-off. The reason why a company takes the risk is the possible profit and savings in the costs of these contracts. The most aggressive Mexican companies in the derivatives markets made a huge profit in the last couple of years with this kind of operations. Comercial Mexicana reported a profit of MXN\$360 million in 2007 with derivatives, 7.4% of its EBITDA. Financial derivatives were invented in order to protect companies against shocks in their raw materials, foreign exchange rates or energy prices, but were used instead as casino chips for irresponsible bets, a situation that was pointed out by the Mexican Central Bank.¹¹⁴⁸

Comercial Mexicana (Comerci) reported that their derivatives used for hedging imports or debt had a "fair value" of MXN\$125 million by the end of 2007. The rest, up to MXN\$367 million, were "negotiations", or better said, speculation. It seems that the company was using its Treasury in order to obtain extra profits in foreign exchange markets betting on the Mexican Peso and the euro vs. the USD. At that time, nobody questioned its operations. COMERCI accepts that these operations took place only in September that year, when its treasurer doubled the bets, but a bad end came along. Nobody was expecting a banking crisis in the global economy or in the foreign exchange markets.¹¹⁴⁹

¹¹⁴⁷ *Id.* at 130 See also "The CNBV investigates Mexican companies" Wednesday 15th October 2008. El Universal.

¹¹⁴⁸ *Id.* at. 132

¹¹⁴⁹ *Id.* at. 133

By the end of the second quarter of 2009, the game stopped being fun. GRUMA reported a loss of US\$70 million as of May 30 of 2008. Comercial Mexicana watched its comprehensive financial cost grow up to MXN\$400 million due to “derivatives operations”. The National Banking and Securities Commission in Mexico, or CNBV, (similar to the SEC in the U.S.) is currently analyzing thoroughly if the companies and banks acted clearly and ethically in their derivatives operations. In addition, it will check if rules of conduct need to be strengthened. In its view, the crisis in these Mexican companies was due to lack of control within the decision-making process; some basic considerations were overlooked within their corporate government. Specially, when a great deal of the derivatives contracts were made by the treasurer without telling the Board of the company. All the moves and “strategies” inside COMERCI went wrong: *they bet on the appreciation of the Euro and a stable MXN/USD, exactly the opposite of the actual facts.*¹¹⁵⁰

Are Derivatives Safe?

The depreciation of the Mexican Peso and low energy prices made companies acknowledge important losses when assessing its derivatives operations:

Company	Loss (US\$ millions)	% of its Assets
Comercial Mexicana	1,080	25.0
Gruma	684	18.2
Vitro	227	7.5
Alfa	191	2.0
Bachoco	50	2.6
Grupo Industrial Saltillo	49	4.5
Autlán	40	9.2
Grupo Posadas	38	3.0

Source: Mexican Stock Exchange, Banamex Accival, Fitch Ratings.¹¹⁵¹

¹¹⁵⁰ *Id.* at 134. also “The CNBV investigates Mexican companies” Wednesday 15th October 2008. El Universal.

¹¹⁵¹ *Id.* at 136.

COMERCI states that some of the derivatives operations made from July-September that year, which caused the actual default, were carried out by the treasurer without telling the Board of Directors. On Monday October 3rd, the company's treasurer told its General Director about the whole situation; with an exposition of US\$1,080 million (the banks say it was US\$2,000 million) Credit Suisse was brought to the picture to start a restructuring process.¹¹⁵²

The Minister of Finance, Dr. Agustín Carstens, said that the speculation of some companies added an important pressure to the exchange rate in Mexico. Afterwards, the Mexican Central Bank criticized the company (COMERCI and some others) by saying that they were negotiating unusual financial operations totally different to their business line. All of the sudden, the third largest retail sale company in Mexico, with annual sales of US\$5,000 million, had to inform the Mexican Stock Exchange that its debt had quadrupled to US\$2,000 million, that it had defaulted a corporate bond and hence, it was facing restructuring negotiations. As soon as some of its suppliers knew about this situation, they took immediate action: MABE cancelled the delivery of 10,000 home appliances.¹¹⁵³

Some of the solutions arrived soon and outside the court room in an effort to avoid a decline in the company's market value. In order to guarantee payments to suppliers, the company announced on October 29 that it got access to two credit lines of MXN\$3,327 million for COMERCI, COSTCO or the California restaurants. One credit from a private entity of 327 TARNs and a contribution made by the Mexican Development bank called NAFIN (Nacional Financiera S.N.C.) of MXN\$3,000 million for a trust fund for suppliers' payments. The company was asked to leave collateral such as real estate assets of the company's group.¹¹⁵⁴

A weak regulatory scenario definitely helped the creation of this memorable disaster. It must be kept in mind that derivatives contracts are not public. The sellers couldn't know the level of risk taken by companies with other banks. In this case, most of the operations were made in New York, even the Ministry of Finance (*Secretaría de*

¹¹⁵² *Id.* See also "The CNBV investigates Mexican companies" Wednesday 15th October 2008. El Universal.

¹¹⁵³ *Id.*

¹¹⁵⁴ *Id.*

Hacienda y Crédito Público) was not aware of the market value of these contracts. Some of the new proposals or suggestions in the market are that companies will have to inform more specifically about the potential risks in their derivatives contracts, and the Ministry of Finance will have to supervise and keep tight control of information in national companies regarding these kind of financial operations.¹¹⁵⁵

The C-10 bulletin of the Financial Information Regulations in Mexico establishes that all companies must reveal their positions in financial derivatives when used in order to change their risk profile associated with variations in interest rates and exchange rates in which the debt is denominated.

For each operation, they must inform if the derivative was used for hedging (mark to market) or for cash flow. Late explanations about the derivatives crisis arrived later on. Some traders claimed that a strong Mexican peso was supported by high liquidity in the global economy. An important factor to be pointed out is that the crisis in Mexico could bring legal and serious consequences if an investor, being a shareholder or a bond holder, files a lawsuit or a formal complaint claiming that he was deceived by him who was, in theory, responsible for informing about the company's situation he was investing in.¹¹⁵⁶

It is most likely that the story of Comercial Mexicana will bring new rules of conduct and regulations in the Mexican financial law. One of the lessons learned is that Corporate Government attends Committees more than four times a year; it implies identifying potential and sensitive risks, assessing them and deciding whether to report them in detail or not to its investors. In the meantime, consensus suggests that it is mandatory to find new formulas that will prevent, if possible, financial crisis in the Mexican market.¹¹⁵⁷

¹¹⁵⁵ *Id.*, at 136

¹¹⁵⁶ *Id.*

¹¹⁵⁷ *Id.* at 136.

APPENDIX 6:

The BCCI Affair and

the Three Rivers District v. Governor and Company of the Bank of England case

The litigation known as *Three Rivers District v. Governor and Company of the Bank of England* (the Three Rivers case for short), was originated by a law suit filed by ex-depositors of the Bank of Credit and Commerce International (BCCI) accusing the Bank of England of insufficient surveillance over BCCI, which resulted in losses of about 10 billion Sterling Pounds for around 6,000 depositors in Britain (including the Three Rivers District Council, Hertfordshire, the Western Isles Council and other authorities in Scotland), after the Bank of England closed down BCCI in July 5, 1991.

The initiator of the BCCI enterprise and president of the bank for almost all of its 19 years life was the India-born Pakistani Agha Hasan Abedi (also known as Agha Sahab), whose Shiite Muslim ancestors “had been courtiers and advisers to feudal princes for generations” in India.¹¹⁵⁸

According to BCCI’s official history (still available at its official website as of early 2011),¹¹⁵⁹ Agha Hasan Abedi’s plan for BCCI was spelled out in Beirut to “a group of people who had worked with him over many years” (including childhood friends who fled with him in 1947 from India to the newly independent Islamic nation of Pakistan.¹¹⁶⁰

The bank was nevertheless incorporated in Luxemburg as BCCI SA, where it was licensed to conduct business in 1972. A post-BCCI-scandal document by the United Nations Office for Drug Control and Crime Prevention reports Belgium’s criticism of

¹¹⁵⁸ Robert McG. Thomas, Jr., *Agha Hasan Abedi, 74, Dies in the Shadow of a Vast Fraud*, THE NEW YORK TIMES, Aug 6, 1995; available at: <http://www.nytimes.com/1995/08/06/obituaries/gha-hasan-abedi-74-dies-in-the-shadow-of-a-vast-fraud.html>

¹¹⁵⁹ www.bcci-bank.com/organisation_origins.html

¹¹⁶⁰ See Thomas, *op. cit.*

Luxembourg's secrecy laws "on the grounds that [they] attract dirty money from African dictators."¹¹⁶¹ This document suggests that such state of affairs has been true long time ago and was a factor in Abedi's choice of jurisdiction to incorporate BCCI. This is supported by the fact that from the beginning BCCI was actually run from headquarters in London (Leadenhall Street, in the City).

Notwithstanding the aforesaid, the INQUIRY INTO THE SUPERVISION OF THE BANK OF CREDIT AND COMMERCE INTERNATIONAL prepared by Lord Justice Bingham (hereinafter THE BINGHAM REPORT),¹¹⁶² records Abedi's claim that "before ever incorporating BCCI in Luxembourg, he sought to incorporate it in the UK, but was rebuffed when the Bank [of England] called for capitalization of a new UK bank in a sum he could not then raise."¹¹⁶³

According to BCCI's own literature (posted at its website), Abedi's plan for BCCI was to be "a truly international Bank, a bank that would have its early roots in the Middle East, and over a period of time would grow into a multinational organization with close connections with the Third World..." This statement hinted subtly key BCCI features. The largest portion of its original capital (USD\$2.5 million Dollars) was invested by the Sheikh Zayed bin Sultan Al Nahyan of Abu Dhabi, who remained the largest shareholder until its liquidation with 77% of the shares.¹¹⁶⁴ The remaining part of the capital was invested by Bank of America.

BCCI "internationality" did not stop there. "The BCC Group was originally conceived as an international organization to provide commercial banking services world-wide" (BCCI's official website). Therefore, in addition to the London branches, Abedi opened branches in more than 70 countries. Another key insight to BCCI's international growth, hinted in its official website, was BCCI's openness to do things differently in order to achieve world-wide effects:

¹¹⁶¹ FINANCIAL HAVENS, BANKING SECRECY AND MONEY LAUNDERING; available at: <http://www.caerdydd.ac.uk/socsi/resources/levi-laundering.pdf>.

¹¹⁶² LORD JUSTICE BINGHAM, THE BINGHAM REPORT (Oct 1992); available at: <http://www.official-documents.gov.uk/document/hc9293/hc01/0198/0198.pdf>.

¹¹⁶³ *Id.*, at 30

¹¹⁶⁴ See Deloitte, "BCCI Bank Fraud Begets Silver Lining 13 Years Later;" available at: http://www.deloitte.com/view/en_CA/ca/services/financialadvisory/case-study/4e0d899a961fb110VgnVCM100000ba42f00aRCRD.htm.

In BCC we are building an institution that will bring about a new balance in the world economy. We are doing something new and so we have to find new ways of working. The institutions that dominate today's world have their own style. The institutions of tomorrow need a different style – less rigidly structured, more adaptable and more and more in harmony with the flow of change.

The truth is that, as “A Report to the Committee on Foreign Relations” of the USA Senate says:

Unlike any ordinary bank, BCCI was from its earliest days made up of multiplying layers of entities, related to one another through an impenetrable series of holding companies, affiliates, subsidiaries, banks-within-banks, insider dealings and nominee relationships. By fracturing corporate structure, record keeping, regulatory review, and audits, the complex BCCI family of entities created by Abedi was able to evade ordinary legal restrictions on the movement of capital and goods as a matter of daily practice and routine. In creating BCCI as a vehicle fundamentally free of government control, Abedi developed in BCCI an ideal mechanism for facilitating illicit activity by others, including such activity by officials of many of the governments whose laws BCCI was breaking.¹¹⁶⁵

Along the same lines, Mr. Anthony Nelson, former Economic Secretary to the Treasury of the UK, said:

The narrative of the events that make up a large part of Sir Thomas Bingham's report has two main themes. The first is of a bank that was structured in such a way as to maximise its potential for concealing information from both its auditors and the supervisory board around the

¹¹⁶⁵ Sen. John Kerry & Sen. Hank Brow, A Report to the Committee on Foreign Relations”, United States Senate (Dec 1992) 102d Congress 2d Session Senate Print 102-140 at Executive Summary; available at: http://www.fas.org/irp/congress/1992_rpt/bcci/01exec.htm. According to Nikos Passas, the BCCI affair “revealed extensive networks of ‘ordinary criminals,’ white-collar offenders, and respected professionals and organizations from a number of industries-banking, insurance, trade in commodities, telecommunications, etc. Holy and unholy alliances with mixed ideological, geo-political and financial motives operated with and through this bank” (PETRUS C. VAN DUYNE, KLAUS VON LAMPE, NIKOS PASSAS, eds., UPPERWORLD AND UNDERWORLD IN CROSS-BORDER CRIME (2002), at 19; available at: <http://www.cross-border-crime.net>. Passas refers to other articles by him where the aforesaid is developed: *Structural Sources of International Crime: Policy Lessons from the BCCI Affair*, CRIME, LAW AND SOCIAL CHANGE (1993) at 293-305; *The Mirror of Global Evils: A Review Essay on the BCCI Affair*, JUSTICE QUARTERLY (1995) at 801-829; and *The Genesis of the BCCI Scandal*, JOURNAL OF LAW AND SOCIETY (1996) at 1, 52-57).

world that sought to regulate its activities. The bank's guiding principle was divide and deceive.¹¹⁶⁶

As a result, BCCI attracted not only wealthy people but also various criminal and terrorists organizations, as well as from the cabal of anti-Soviet intelligence agencies (the "Safari Club", which included Saudi Arabia, Egypt, Iran, France and Morocco, lead by the USA's Central Intelligence Agency) that were behinds its founding and founders, and which used the bank for their unauthorized or even independent operations.¹¹⁶⁷

According to the Bingham Report, BCCI's speed of growth first elicited concern in the summer of 1974, but reports from the Luxembourg Bank Commission (LBC) and the Bank of America were favorable. Then by 1975, the first criticisms of BCCI's business practices came to the notice of the Bank of England, but THE BINGHAM REPORT reckons them "at that stage isolated and insubstantial."¹¹⁶⁸

In March 1976 the Bank of England learned about Abedi's decision to restructure the BCCI group "by forming a non-bank holding company in Luxembourg (BCCI Holdings Luxembourg SA) to become the parent of [BCCI] SA and a second banking subsidiary in the Caymans, BCCI Overseas," as a likely response –according to THE BINGHAM REPORT– to LBC's pressure "to restrict the speed BCCI SA's expansion. One of the expressly mentioned purposes of the Cayman subsidiary (BCCI Overseas) was the opening of branches in the UK, although branches of BCCI SA were already operating in the UK."¹¹⁶⁹

In June 1976, BCCI Overseas opened its first UK branch, which finally concerned the Bank of England, "primarily because of the confusion which branches of SA and Overseas, operating together were liable to cause". At the time BCCI SA already

¹¹⁶⁶ The Economic Secretary to the Treasury (UK), Mr. Anthony Nelson, BCCI (Bingham Report), HC Deb 06 November 1992 vol 213 cc523-94; available at:

<http://hansard.millbanksystems.com/commons/1992/nov/06/bcci-bingham-report>.

¹¹⁶⁷ See JOSEPH J. TRENTO, PRELUDE TO TERROR (2005) at Chs. 14, 16, 18, and "Legacy"; and PETER DALE SCOTT, THE ROAD TO 9/11 (2007) at 62-64, and Ch. 6). Trento describes BCCI as "a world-wide money-laundering machine, buying banks around the world to create the biggest clandestine money network in history." According to UPPERWORLD AND UNDERWORLD IN CROSS-BORDER CRIME (at 23), some BCCI managers have argued that being "a bedfellow of intelligence services in several countries" was "the only way BCCI could hope to survive and do business internationally.

¹¹⁶⁸ THE BINGHAM REPORT, at 31.

¹¹⁶⁹ *Id.*

enjoyed some interim exchange control permissions, with “the hope of full exchange control authorization within the foreseeable future.”¹¹⁷⁰

THE BINGHAM REPORT acknowledges there were rumors about BCCI’s business integrity already that 1976 (and implies that the support of Bank of America’s and its presence at board level out-weighted such rumors), and that the Bank of England’s and LBC’s concern about the speed of BCCI’s growth was shared by some other bankers, although –THE BINGHAM REPORT notes— the market opinion in the UK was not “strongly hostile” at that point in time.¹¹⁷¹

Also in 1976 and 1977, the New York Superintendent of Banks rebuffed BCCI attempts to acquire New York banks due to the lack of a single regulator responsible for overseeing BCCI’s worldwide operations. THE BINGHAM REPORT explains (and almost dismisses) the contrast in the New York and the UK’s attitudes and responses to BCCI as due to the Superintendent’s “personal experience of problems caused by lack of a singular regulator,” which the Bank of England had not had “up to then,” and reckoning the Superintendent’s decision, “particularly by the standards of the day,” as “wise and farsighted decisions.” The Bank [of England] –continues commenting the report—was aware of his thinking, but when the licensing stage in the UK came it did not (perhaps because it felt it could not) apply it.¹¹⁷²

By 1977 it became evident that BCCI’s expansion was being carried out through BCCI Overseas, “which was subject to little or no supervision,” which elicited concern. There was also “a concern that in the drive for expansion such mundane prudential matters as ratios and bad debt provisions were somewhat neglected.” Likewise, it was thought that the UK branches were over-trading and trading at a loss, over-lending in certain areas and to certain borrowers, and doing little business with other banks. It was also realized “for the first time... that BCCI did no sizeable banking business in Luxembourg or the Caymans, whereas the bank had more

¹¹⁷⁰ *Id.*

¹¹⁷¹ *Id.*

¹¹⁷² *Id.*

branches in the UK than in any other country, and that the London office appeared to play a central role in the group.”¹¹⁷³

Reckoning the above as “nebulous concerns”, THE BINGHAM REPORT says that the Bank of England “had more solid material telling in BCCI’s favour.” Such evidence was that: Bank of America, “represented in the London office and on the board, reported nothing amiss,” “The LBC continued to inspect the UK branches and continued to give [BCCI] SA a clean bill of health;” and that “There was no evidence of malpractice.”¹¹⁷⁴ The report records, nevertheless, the acknowledgement that it was not clear how closely Bank of America touch with BCCI business, as well as the acknowledgement of LBC’s representatives about the impossibility of supervising BCCI SA effectively from Luxembourg, and the desirability of having the Bank of England supervise BCCI’s UK branches.¹¹⁷⁵

Even as early as 1977, no supervisor supposed that incorporating a single subsidiary for UK operations “could wholly insulate the local company against the effects of disaster afflicting the rest of the group,” and there were those “who felt that the responsibility of supervising a local subsidiary was one which the Bank [of England] could not adequately discharge and should therefore not undertake.”¹¹⁷⁶

In spite of the above the Bank of England encouraged the scheme described above and BCCI applied to the Department of Trade for its approval. The proposal eventually failed mainly because: 1) It was not possible to obtain the accustomed letters of comfort from BCCI’s ultimate owners;¹¹⁷⁷ 2) LBC expressed reservations, particularly its Director-Manager; and 3) According to the proposed legislation that would become the Banking Act 1979, “unless a UK subsidiary of BCCI were recognized as a bank in the UK, it could not use a banking name under the proposed legislation, and recognition was (at best) uncertain,” all of which made it potentially disadvantageous for BCCI “to encourage a UK subsidiary, which might then be

¹¹⁷³ *Id.*, at 32.

¹¹⁷⁴ *Id.*

¹¹⁷⁵ *Id.*

¹¹⁷⁶ *Id.*

¹¹⁷⁷ In the process Bank of America’s intention of withdrawing from BCCI became apparent, something that Abedi had concealed from LBC and the Bank of England who –says THE BINGHAM REPORT—was “confirmed in its suspicion that he was a man whose frankness could not be relied on” (*id.*, at 33).

denied use of the name under which SA's business in the UK was already being done."¹¹⁷⁸

What becomes clear at that point in the report is that, already at this stage in the BCCI story (13 years before its closure), there is a paradox: a dubious (at the very least) bank operating in the UK that cannot be brought under full supervision of the UK authorities (the Bank of England at that time) precisely for the same reasons it needs to be brought under full supervision, which are the same reasons why it is dubious should not be operating in the first place. This anomaly is explained by THE BINGHAM REPORT as due to the fact that the Bank of England lacked formal powers (the 1979 Act being not yet in force); "internationally accepted principles of supervision were only beginning to take shape;" and BCCI was still a little-known entity.¹¹⁷⁹ Lord Bingham reckoned that moving forward with the proposal that would have put BCCI under British authorities' supervision (in spite of its lack of qualifications) would have been an advance, which is of course said in light of what happened over a decade later.

Notwithstanding the above, the Bank of England still came up with a scheme (supposed) "to curb BCCI's over-rapid growth in the UK and end the confusing dichotomy between SA and Overseas." The scheme could not be imposed Abedi, "but he did accept it (if reluctantly) and he did what was asked of him." Likewise, the LBC "was content that all the UK branches, as part of SA, would be its responsibility. The scheme was to freeze the overall number of BCCI branches in the UK; put all the UK branches owned by BCCI Overseas (Cayman) into BCCI SA (Luxembourg); and let the Bank of England "receive information on the UK branches as if they were part of a UK bank" and have routine prudential meetings.¹¹⁸⁰

Once the Banking Act 1979 came into effect (for the most part in October 1979) BCCI SA applied for the required recognition to carry on deposit-taking business in the UK. But, upon "a careful and well-devised consultation exercise", the Bank of England concluded that BCCI did not meet the requirement of enjoying and having

¹¹⁷⁸ *Id.* For Lord Bingham's assessment of the reasons afore mentioned see *id.* (2.18).

¹¹⁷⁹ *Id.*, at 33-34.

¹¹⁸⁰ *Id.*, at 34.

enjoyed for a reasonable time “a high reputation and standing in the financial community.” Yet the bank had more concerns about the BCCI group, all which were related in one way or another to the opacity of its structure and operation and the lack of proper supervision of the overall group.¹¹⁸¹

In spite of such concerns, the Bank of England decided to license SA as a deposit-taking institution.¹¹⁸² Lord Bingham reckons that: “Refusal of a license would, in all probability, have caused loss to depositors and other creditors and exposed the Bank to accusations of racial prejudice, xenophobia and so on.”¹¹⁸³ He then goes on to speculate briefly on the alternative possibility of having indicated to Abedi that the Bank of England was not satisfied that the prudence criterion was fulfilled, in order to push Abedi to do “all he could (to the length of making structural changes) to alleviate the Bank’s concern.”¹¹⁸⁴ Yet, Lord Bingham himself realizes that, “in the light of what is now known, that the group’s exposure to Gulf and the Gokals was already such by 1980,” Abedi could not afford to let the truth appear without jeopardizing the future of the group.¹¹⁸⁵

Lord Bingham asserts that BCCI’s principal place of business was in the UK, not Luxembourg, and therefore was not entitled to a license as a deposit-taking

¹¹⁸¹ See *id.*, at 36-37.

¹¹⁸² For the criteria involved and the way it was assessed by the Bank of England in the case of BCCI, see *id.*, at 37-38.

¹¹⁸³ *Id.*, at 38.

¹¹⁸⁴ *Id.*

¹¹⁸⁵ *Id.* BCCI’s “exposure to Gulf and the Gokals” refers to Abbas Gokal. Gokal was head of the Gulf Group, “a large shipping business based in Geneva with offices in over forty countries.” Gokal and his Gulf Group secretly received many millions of dollars from BCCI in London “even though he knew, as did senior BCCI management, that his Gulf Group were insolvent. To cover up the fact that massive unsecured loans of more than \$830 million were being made, Gokal and his fellow conspirators falsified documents on a vast scale and engineered an intricate money laundering operation.” According to the Serious Fraud Office (SFO), “BCCI’s massive un-repaid loans to Gokal’s Gulf Group inevitably played a significant part in the collapse of the bank”. A British judge concluded that Gokal was an “intelligent, sophisticated and unscrupulous man” who “put his own interests and those of his family before all else, and before any obligations to conduct his business affairs with honesty and straightforwardness.” Gokal was sentenced to 14 years’ imprisonment for offences of false accounting and conspiracy to defraud for his part in the BCCI banking fraud and Confiscation order made by the SFO for £2.94 million Sterling Pounds. (SFO, “Sequel to biggest banking fraud in history: Bank of Credit & Commerce International” (Mar 16, 2001); available at: [http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2001/sequel-to-biggest-banking-fraud-in-history-bank-of-credit--commerce-international-\(bcc\).aspx](http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2001/sequel-to-biggest-banking-fraud-in-history-bank-of-credit--commerce-international-(bcc).aspx)).

institution and to use a banking name. The report says that the Bank of England recognized this point shortly after the grant of the license but did not act on it.¹¹⁸⁶

The Bank of England requested BCCI SA to commission Ernst & Whinney (BCCI SA's auditors) to review the the loan book and report back to the Bank of England. Such exercise was carried out three consecutive times (1980, 1981 and 1982). In spite of improvements, a June 1982 paper by Mr Brian Gent (a deputy head of Banking Supervision at the Bank of England) found the following usual concerns about BCCI: "the persisting caution of the market, the issue of the risks inherent in the structure of the group, the crying need for a single overall supervisor, the fiction of the group's Luxembourg assurances when the group's principal place of business was in the UK."

The paper's argument was that "no supervisory authority other than the Bank [of England] could reasonably be expected to take on the supervision of BCCI and that the Bank [of England] should do so, rather than let a large international group continue in business on a largely unsupervised basis." Yet, not action followed the paper.¹¹⁸⁷

A few months after Gent's paper, a by officials of the Bank of England to 100 Leadenhall Street left them "in no doubt that London was the head office of the [BCCI] group." Around the same time Luxembourg indicated that a recent attempt to conduct consolidated supervision had been thwarted by lack of information from BCCI and the Institut Monetaire Luxembourgeois's¹¹⁸⁸ own lack of resources. These two factors strengthened Mr Gent's argument that, "Either BCCI's UK licence should be revoked or it should be properly supervised" by the Bank of England.¹¹⁸⁹

A revised version of Gent's paper was finally forwarded to the Governor in January 1984. The paper suggested that consolidate supervision of BCCI group's

¹¹⁸⁶ THE BINGHAM REPORT, *op. cit.*, at 38.

¹¹⁸⁷ *Id.*, at 39.

¹¹⁸⁸ The IML replaced the LBC.

¹¹⁸⁹ *Id.*, at 40. Yet another paper was written in October 1983, reiterating the illegality of BCCI SA's operation with a banking name in the UK since it had not been recognized under section 36 of the Act, assuming that the principal place of business was the UK not Luxembourg. The paper went further to argue that BCCI Overseas was not entitled to conduct any deposit-taking business in the UK, including the Central Treasury operation, since it held not UK license at all (see *id.*).

worldwide activity could be conducted by the Bank of England by moving the incorporation of the holding company to the UK. The paper also suggested that prior to taking that step, “a comprehensive review of BCCI’s worldwide business should be undertaken at BCCI’s expense.”¹¹⁹⁰ The Governor of the Bank of England approved of this overall strategy.

But Abedi was resistant to the plan, presented to him in April 1984, even “truculent and angry.” The plan was “quickly snuffed out.” According to Lord Bingham, Abedi saw “no need to fall in with the Bank’s wishes;” and the Bank of England “had no immediate ground for taking action against [BCCI] SA under the Banking Act and thus lacked formal means of exerting leverage on it.”¹¹⁹¹

Yet Lord Bingham finds it “surprising that no effort was made to bring the Bank’s traditional authority to bear on Abedi to seek to secure his compliance;” and speculates that possible “the introduction of formal legal powers led officials to lose sight of the Bank’s informal authority, which had proved efficacious in the past.” In Lord Bingham’s assessment, the Bank of England was “rather easily deterred.”¹¹⁹²

Between September 1983 and January 1985, the Bank of England “received eight reports on BCCI’s activities in the financial and commodity markets... the scale of BCCI’s activity had attracted the attention of seasoned market professionals, some of whom were sufficiently puzzled or concerned to feel that the Bank should know...” One of such professionals –THE BINGHAM REPORT says—had ceased “doing options business for BCCI because it felt BCCI was taking too many risks.”¹¹⁹³

For all response, the Bank of England merely passed on the said information to the IML. According to THE BINGHAM REPORT, the Bank of England “adopted this passive role because it regarded the IML as the primary supervisor of SA and the group and did not regard itself as being responsible for the supervision of Overseas.” In Lord Bingham’s assessment, “this was a highly unsatisfactory supervisory situation, as should have been obvious at the time,” especially since “the Central

¹¹⁹⁰ *Id.*

¹¹⁹¹ *Id.*, at 41.

¹¹⁹² *Id.*

¹¹⁹³ *Id.*, at 44.

Treasury was based and operated from 100 Leadenhall Street (although a part of [BCCI] Overseas, with transactions booked in the Caymans).”¹¹⁹⁴

The Bank of England’s concern about lending by BCCI continued over 1985, and even Luxembourg’s IML “was becoming restive.” That year, Abedi presented to the Bank of England two alternative schemes, both of which depended on the approval of USA authorities. Abedi, nevertheless, never consulted such authorities, although he was advised to do so by the Bank of England.¹¹⁹⁵

In October of 1985, the IML caused BCCI to commission Price Waterhouse (BCCI Overseas’ auditors at that time) to review the Central Treasury’s investment activities. The exercise revealed that BCCI Overseas “had made and were making substantial losses on option contracts, the extent of which had not been revealed by the accounting method used.” The losses were quantified at the time at USD\$ 285 million Dollars and, attributed by PW, “to incompetence, errors made by unsophisticated amateurs;” and “the accounting treatment of these transactions to lack of expertise.”¹¹⁹⁶

The Bank of England was not told about the above, despite Price Waterhouse advice to do so and IML’s belief that it had done so. It was until May 1986 that the Bank of England first heard about the said losses, and addressed the issues at a meeting later that month. As a result the Bank of England reviewed the position of and its relationship with BCCI SA. The Bank of England concluded that: 1) BCCI’s Central Treasury should not be part of a UK subsidiary; 2) “since there was no basis of trust for the Bank’s supervision and the management had shown itself to be reckless,” it was “difficult to contemplate BCCI incorporating in the UK at all;” 3) “BCCI’s continuing presence in the UK called for consideration.”¹¹⁹⁷

Subsequently the Bank of England assessed the viability of BCCI SA getting a license to incorporate in the UK (although no application had been submitted by BCCI). The result of the exercise reflects the lukewarm and ambiguous, if not

¹¹⁹⁴ *Id.*

¹¹⁹⁵ *Id.*, at 41.

¹¹⁹⁶ *Id.*, at 44.

¹¹⁹⁷ *Id.*, at 45.

contradictory, position of the Bank of England regarding BCCI. In spite of conclusions mentioned in the previous paragraph, it concluded that “there appeared to be no immediate danger to depositors,” especially since “the financial loss had been made good and the group’s controls were under review” by Price Waterhouse.¹¹⁹⁸

Yet, THE BINGHAM REPORT also records what seems more likely to be the real and most weighty factor for the Bank of England’s attitude described above, namely, that “the closure of 45 UK branches would cause substantial political and diplomatic problems.” Why should the closure of a private bank cause *substantial* political and even diplomatic problems is a question not answered in the main body of the report.

Yet, THE BINGHAM REPORT included a “top secret” Appendix 8 (to remain unpublished until October 2042) about the involvement of British and foreign intelligence agencies in the BCCI affair. The “substantial political and diplomatic problems” alluded above as a reason not to close BCCI in the UK may refer to BCCI’s dealings and involvement with a cabal of international intelligence agencies (including, notably, Saudi Arabia’s and the USA’s Central Intelligence Agency), as well as the use that, eventually, British intelligence and made of BCCI as source of information on the activities of terrorist groups that held accounts at London branches.

According to Conal Walsh, Roger Barnes of the Bank of England’s supervisory division met with MI6 officers, in the spring of 1989, to talk about BCCI. Barnes told them that BCCI had:

...‘no natural or established customer base [and] there was no obvious, respectable explanation as to how it came to grow so quickly and become so profitable... it was widely assumed that the BCCI management were less than meticulous as to what funds they handled.’

Other Bank of England officials were more forthright, telling MI6 of allegations linking BCCI to drug gangs in Colombia and to the military regime of General Manuel Noriega in Panama.¹¹⁹⁹

¹¹⁹⁸ *Id.*

¹¹⁹⁹ Conal Walsh, *What Spooks Told Old Lady about BCCI: MI6 and the Bank had suspicions, so why was nothing done, creditors ask in the High Court*, THE OBSERVER (Jan 18, 2004). Although the link

According to Walsh, the “Appendix 8” makes it clear that the Bank of England “received a host of additional warning from intelligence agencies about alleged misconduct at BCCI.”¹²⁰⁰ Walsh wonders, if the Bank of England “knew of alleged unsavoury dealing at BCCI, why didn’t it investigate them?” And appropriately points out “That is the question at the heart of the block buster legal case that began at the High Court in London,” alluding precisely to the Three Rivers litigation.

Walsh seems to be providing an answer to his own questions when, reporting the contents of the “Appendix 8”, he says that around the same time, 1987, “spy chiefs” (as Walsh refers to British MI5 and MI6 intelligence agencies) discovered that the terrorist organization lead by the notorious Palestinian terrorist Abu Nidal (responsible of kidnapping and murdering several British citizens) held several accounts at BCCI London branches, “worth at least \$50m... but decided to discreetly monitor the accounts rather than freeze them.”¹²⁰¹

This may be at least one of the “substantial political and diplomatic problems” alluded by THE BINGHAM REPORT; a diplomatic problem, as well as political because, according to Adams & Frantz, between 1987 and 1991, British intelligence and CIA just monitored the terrorists’ and arm dealers’ transactions without further action against them or BCCI.¹²⁰²

Another possible “substantial” diplomatic problem may have come from the significant involvement of the Sheikh Zayed bin Sultan Al Nahyan of Abu Dhabi in BCCI. In addition to owning the majority of BCCI’s stock, it was an Abud Dhabi oil

to the original publication at THE OBSERVER’s website is no longer active, a transcription of the article is available at several place in the Internet (including: http://www.democraticunderground.com/discuss/duboard.php?az=show_mesg&forum=102&topic_id=628226&mesg_id=629921). Walsh implies that portions of the 30-page “Appendix 8” were made public (with still some passages “blacked out” for security reasons), yet it was not possible for this author to confirm that or to have access to it for the elaboration of this appendix.

¹²⁰⁰ *Id.*

¹²⁰¹ *Id.* In July 1991, THE SUNDAY TIMES OF LONDON published that BCCI London branches had 42 accounts belonging to 11 terrorists and arm dealers, including Abu Nidal and Ben Banerjee, “an Indian-born arms dealers named in the Iranian arms-for-hostages scandal,” and Samir Najmeddin, “an Iraqi businessman who supplied arms to Saddam Hussein and to Argentina during the Falklands war” (Steven Prokesch, *Terrorists Used Bank in London*, THE NEW YORK TIMES (Jul 22, 1991); available at: <http://www.nytimes.com/1991/07/22/business/terrorists-used-bank-in-london.html>). See also JAMES ADAMS & DOUGLAS FRANTZ, A FULL SERVICE BANK (1992) at 89-91 and 135-136.

¹²⁰² See ADAMS & FRANTZ, *op. cit.*, at 89.

account which bailed out BCCI in 1989 when, intelligence communicated to the Bank of England, suggested “that BCCI was in serious financial difficulty.” Walsh writes that “Officials at Threadneedle Street appear to have done nothing to investigate BCCI’s solvency.”¹²⁰³

But the involvement of the USA’s Central Intelligence Agency was itself dubious. An October 1988 USA Customs’ operation arrested several bankers lured to Tampa, Florida, from other jurisdictions. “Within 72 hours after the Tampa trap was sprung, American and British customs agents arrested 40 bankers and narcotics traffickers in London and several U.S. cities on money laundering and other charges.”¹²⁰⁴ TIME goes on to explain:

The investigation, the largest and most complex yet into money laundering, was called Operation C-Chase for the \$100 bills (C-notes) that are the denomination of choice in major drug deals. While previous probes had netted mostly low-level operatives, C-Chase bagged far bigger suspects. The arrests were based on indictments handed up by federal grand juries in Tampa and other cities. The indictments named some 80 defendants and the first banking company ever charged in the U.S. with money laundering: the Luxembourg-based Bank of Credit and Commerce International, the seventh largest privately held financial institution in the world (assets: \$20 billion).¹²⁰⁵

At the time of the aforesaid operation, TIME reported that BCCI operated 400 branches in 73 countries and was owned by 51 shareholders “including members of the Saudi Royal Family.”¹²⁰⁶ In 1990, BCCI (Luxembourg) pleaded guilty “to laundering millions in drug money” and “agreed last week to close its U.S. offices and give up its previously hidden interest in First American, a Washington-based bank holding company.”

In spite of all the above, it still took another year for the Bank of England to close BCCI in the UK. The Bank of England “maintained that it could not close BCCI Down until clear evidence of malpractice and impropriety in the UK had been

¹²⁰³ Walsh, *op. cit.*

¹²⁰⁴ Janice Castro, Elaine Shannon *et al*, “The Cash Cleaners” TIME (OCT 24, 1988); available at: <http://www.time.com/time/magazine/article/0,9171,968767,00.html#ixzz1M5kTfL98>).

¹²⁰⁵ *Id.*

¹²⁰⁶ *Id.*

uncovered.” The evidence came in the form of a report under section 41 of the Banking Act 1987, by Price Waterhouse, which confirmed that fraud had taken place. “After the report was produced the bank was immediately closed down.”¹²⁰⁷

Yet, the hesitation and delay manifested by the Bank of England to take timely and appropriate actions toward protecting the British depositors of BCCI was regarded by their defense counsel and BCCI liquidators (Deloitte & Touche) as misfeasance in public office.¹²⁰⁸ The action of tort for misfeasance commenced originally in May 1993.¹²⁰⁹ Yet among other preliminary issues to be considered was whether the Bank of England and the other defendants “were capable of being liable for the tort of misfeasance in public office, whether alleged losses were caused in law by the acts or omissions of the defendant and whether the plaintiffs are entitled to recover for the tort as existing or potential depositors.”¹²¹⁰

Judge at first instance Clarke, ordered a trial on preliminary questions on Jul 19, 1995. A re-amended statement of claim was lodged on 21 August 1995. First instance judgments were delivered on Apr 1 and May 10, 1996. “A series of further amendments were the proposed to the statement of claim and an eighth draft produced on January 1997.” Yet “Clarke J concluded that the claim was bound to fail on the basis of the evidence available.” The action was struck after further hearing (Apr 1997) on Jul 30, 1997. The Court of Appeal upheld but granting leave to appeal to the House of Lords (Jan 21, 1999).¹²¹¹

In 2000, the House considered the components of the tort of misfeasance in public office and issued its judgment on May 2001, which held that a public power “had to be exercised for an improper purpose with the specific intention of injuring a person, or persons, or a public officer had to act in the knowledge that he had no power to do

¹²⁰⁷ George Walker, *Regulatory Misfeasance – Three Rivers v The Bank of England*, BANKERS’ LAW Vol. 1, No. 2, at 8.

¹²⁰⁸ As Walker explains, the Bank of England “(and now the FSA) have immunity from suit in negligence under the Banking Act 1987, section 1(4) and the Financial Services and Market Act 2000, schedule 1, paragraph 19(1)” (George Walker, *Chapter 6: Misfeasance in Public Office and Three Rivers v the Bank of England* (unpublished work 2004), at 2.

¹²⁰⁹ For an account of the stages of the trial from its first summons on, see also CHARLES CHATTERJEE, SUPERVISION AND SURVEILLANCE: THE ORIGINS AND POWERS OF THE FSA (2001) at 110-136, and Walker, *Regulatory...*, op. cit.

¹²¹⁰ *Id.*

¹²¹¹ *Id.*, at 2 and 10.

the act complained of and that it would probably injure the claimant.”¹²¹² BCCI ex-depositors based their claim on the second ground above described. In this case, Walker explains, “an act performed in indifference to the outcome was sufficient.”¹²¹³

After almost 8 years of litigation, on March 2001, the House of Lords held:

...that the claim against the Bank [of England] for misfeasance in public office in failing properly to supervise BCCI, or close it down, had been adequately pleaded and that the claim could not be said to have no real prospect of success and therefore should not be struck out as an abuse of the court process.¹²¹⁴

Therefore, the House of Lords allowed liquidators Deloitte & Touche to sue the Bank of England over 1 billion pound on behalf of BCCI’s ex-depositors.¹²¹⁵ The issues, positions and conclusions discussed and held at the House of Lords can be summarized as follows.

For Lord Steyn, according to earlier authorities, an action for compensation for losses suffered as a result of breach of statutory duty could not be maintained (citing *Yuen Kun-Yeu v. A-G of Hong Kong*). Consequently, depositors could not sue the Bank of England for losses resulting from the negligent licensing, supervision or failure to withdraw a license. If tort was to be pursued.

The House of Lords considered whether individual depositors had any rights, regarding which Lord Millet concluded that an authority’s failure to provide continuous and effective supervision (in violation of Arts 6 and 7 of the First European Banking Directive) did not confer rights on individuals. Therefore the appeal to community law was dismissed.

The tort for misfeasance in public office dates from the 1671 case *Turner v. Sterling*¹²¹⁶ and is generally based on *Ashby v. White* (1703). Walker explains that:

¹²¹² *Id.*, at 2.

¹²¹³ *Id.*

¹²¹⁴ *Id.*, at 1.

¹²¹⁵ See *id.*, at 10.

¹²¹⁶ *Id.*, at 2-3.

This established that an elector who was willfully denied a right to vote by a returning officer would have a cause of action. Although the tort was recognized in a number of cases during the 18th and 19th centuries¹²¹⁷

It was nevertheless until the Three Rivers case that the House of lords was able to identify the components of the tort action for misfeasance in public office, which according to Lord Steyn are six:¹²¹⁸

- i) The defendant must be a public officer;
- ii) The conduct must be in exercise of a public function;
- iii) There had to be targeted malice or abuse and probable injury;
- iv) There had to be a duty to the plaintiff;
- v) There had to be causation; and
- vi) There had to be foreseeable damage.

In March 2001, Lord Hope reckoned that THE BINGHAM REPORT was inadequate and insufficient as evidence or ever as a fair source of information for a trial on the issues relating to the tort of misfeasance in public office in the BCCI affair.¹²¹⁹ Consequently, he reckoned that it was necessary to hear oral evidence since the assessment of the state of mind of the Bank of England's officials at each of the various stages throughout the collapse process could not be determined only by the documents.¹²²⁰

Lord Hope also admitted that the trial would be lengthy and expensive, but that justice required that the claimants be given an opportunity to present their case at trial so that its merits may be assessed in light of the evidence. Connected with this, Walker records that Lord Hope attempted to act with neutrality and without

¹²¹⁷ *Id.*, at 3.

¹²¹⁸ *Id.*, at 3.

¹²¹⁹ *Id.*, at 4.

¹²²⁰ *Id.*, at 5.

assumptions about the competence or integrity of the Bank of England or its officials, before examining the available evidence.¹²²¹

Along similar lines, for Lord Steyn, the House of Lords had to reckon the matter for itself and not rely merely on THE BINGHAM REPORT. To him it was indisputable that the Bank of England knew from April 1990 onward that BCCI was in imminent danger of collapse with inevitable loss to depositors; and concluded that the case should be examined and tested with the procedural advantages of a fair and public trial. Lord Hutton accepted Lord Hope's account of the factual and statutory background to the appeal and with his general conclusion and reasons behind it.¹²²²

The minority votes of Lord Hobhouse and Lord Millet were against allowing the trial to proceed. Lord Hobhouse concluded that the appeal should be dismissed because the tort used by the plaintiffs required proof of actual bad faith or dishonesty on the part of the officials concerned, and to him alleging that without prima facie evidence in support was an abuse of process.

The trial began on 13 January 2004, but was later abandoned formally on November 2, 2005.

¹²²¹ *Id.*

¹²²² *Id.*, at 5-6.

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WTO: World Trade Organisation and GATT

REI: Regional Economic Integration

ITL: International Trade Law

F&D: Finance and Development

IFS: International Financial Services

GB: General Banking

FDI: Foreign Direct Investment

IP: Intellectual Property

MEX: México

CB: Comprehensive Bibliography

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