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# MEXICAN PRIVATIZATION: THE COUNTRY PREPARES FOR FULL FLEDGE CAPITALISM

BARRY S. FEATHERMAN\*

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## I. INTRODUCTION

The wave of privatization programs now sweeping throughout Latin America represents a fundamental shift in the legal, political, and economic regimes that have dominated the region for the greater part of the twentieth century. The 1980's witnessed a dramatic transition from military, totalitarian-led governments to more democratic, capitalist-oriented regimes.<sup>1</sup> The legal and economic framework within which these new governments will have to function will be based primarily on free market principles. This important precept, combined with the staggering foreign debt left by their predecessors, has brought to the new Latin American leaders the recognition that longterm economic development will depend on free market forces, not state-run forces.

Interestingly, many Latin American countries have ratified new constitutions which affirmatively state that the free market will be the primary economic fuel to run the state engine.<sup>2</sup> With the prospect of a free trade agreement with the United States looming on the horizon, the Mexican government has begun to

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<sup>1</sup> In South America, for example, Argentina, Bolivia, Brazil, Chile and Paraguay all became democratic during the 1980's.

<sup>2</sup> Brazil and Perú are just two examples of countries that have recently ratified new constitutions with just such provisions.

target large sectors of the country's economic and industrial base for privatization.<sup>3</sup> Indeed, privatization has become crucial for Mexico's economic future. If the proposed U.S.-Mexico Free Trade Agreement (FTA) is signed, Mexican industry will have to compete freely alongside more experienced, technologically-advanced American corporations. Moreover, if the FTA is extended to cover the entire hemisphere, Mexican companies will also have to compete freely with Canadian and other Latin American industries. Today's Mexican industry, heavily subsidized and protected by high tariffs, is ill-equipped to compete in such a free market. Privatization, then, remains Mexico's only sure chance to successfully compete with other countries.

This article has a twofold objective. First, it seeks to present a brief analysis of the Mexican privatization program. To this end, it discusses the scope of the program, its success in industries that have already gone through the privatization process, the manner in which the program is being implemented, and the way in which private investors, both foreign and domestic, can benefit from it. Second, since an analysis of the Mexican privatization program would not be complete without taking into consideration the enormous debt burden that confronts the country, this article discusses the privatization of the Mexican banking industry. In doing so, it seeks to show how the privatization of financial institutions can relieve the economic pressures imposed by foreign debt.

## I. THE SCOPE OF THE MEXICAN PRIVATIZATION PROGRAM

President Salinas' Privatization Program is one of the most far-reaching economic measures ever introduced in the Mexican state. The program includes the denationalization of telecommunications, transportation, banking, steel, shipping and related industries.<sup>4</sup> President Salinas, however, has pledged to the Mexican people that certain industries - *i.e.* industries characterized as strategic by the country's constitution - would remain in the public domain.<sup>5</sup> This includes railroads, electric power plants, and the extraction of oil and uranium.<sup>6</sup> Nevertheless, evidence continues to mount that even these sacred industries could soon be sitting on the auction block. A good example is Mexico's highly protected petrochemical industry, which is suddenly being opened up to private investors.<sup>7</sup>

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<sup>3</sup> See Shoreham, *Privatization Gains New Momentum*, EUROMONEY, Mar. 1990, at 105.

<sup>4</sup> See Appendix 1 for a list of some of the major industrial companies to be privatized.

<sup>5</sup> See Gardels, *Mexico's Move to the Market*, *New Perspectives Quarterly*, Fall 1990, at 291. (Interview with Mexico's Foreign Minister Fernando Solana).

<sup>6</sup> *Id.* at 43.

<sup>7</sup> Layton & Turner, *Mexico Opens Door for Private Sector*, CHEMICAL WEEK, Aug. 30, 1989, at 25.

The Secretariat of Energy, Mines, and Parastate Companies (SEMIP), the government department which, *inter alia*, oversees the petrochemical industry, publishes a basic list which enumerates those products that can be manufactured only by *Petróleos Mexicanos* (PEMEX).<sup>8</sup> Recently, SEMIP reduced the number of petroleum products on the basic list from 34 to 20.<sup>9</sup> The products removed from the basic list are now considered secondary products, and, therefore, non-Mexicans are now able to form partnerships with Mexicans manufacturers for the production of those products. The Mexican partners, however, must hold a minimum of 60 percent of the undertaking. Interestingly, the government has also begun to reclassify secondary products so that foreign companies can produce them at wholly owned facilities, and the figures are staggering. The government's reclassification scheme has reduced the number of petrochemical products on the secondary list from 605 to 66. This major shift has resulted in the privatization of 75 percent of Mexico's petrochemical industry.<sup>10</sup>

Furthermore, the government is still considering several proposals which would divide PEMEX into five distinct companies, each of which would be open to private investment.<sup>11</sup> Indeed, President Salinas' argument that the economically strategic oil industry will not be privatized is not completely true; rather, it is serving as a smoke screen to appease domestic critics who argue that he is giving away the Mexican store, and as a bargaining chip in his free trade negotiations with the United States. In any event, although the transference of product lines from Pemex to the private sector will amount to certain economic and technological gains, the impact on overall exports, at least in the short run, will probably be low. Yet, the long term economic health of Pemex will still depend on private investment. Given the fact that the petrochemical industry has historically been such an important strand in the web of Mexican state nationalism, its dissolution signals that Mexico has embarked on a new economic era.

Moreover, Privatization may in reality be the only sure way for Pemex to obtain the capital and technology that it so desperately needs. As one U.S. chemical executive has noted,

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.* See also Appendix 2.

<sup>10</sup> Robinson, *Privatization's Quickening Pace*, INSTITUTIONAL INVESTOR, June 1990, at 13.

<sup>11</sup> *Id.* at 13. Mr. Rogelio Ramirez de la O, Director of Ecanal, a consulting firm concerned with economic affairs has argued that "eventually PEMEX has to go on the market." Baker, Borrus & Weiner, *Mexico, A New Economic Era*, BUSINESSWEEK, Nov. 12, 1990, at 108.

Pemex spent the last year (1989) . . . going around the world inviting companies like us, the Europeans, and the Japanese to take part in joint ventures offering financial packages as well as payments in kind for technology brought into such ventures [,] and a market franchise for the output. But the idea 'didn't fly' and the move of more than five hundred products from the secondary to non-secondary list evidences that failure. Nobody showed interest in the last year [,] but if a lot of companies had, this reclassification would not have come about.<sup>12</sup>

Certainly, foreign corporations had reservations about investing capital in an organization known for its corruption and inefficiency. Yet, after products in the SEMIP's list were reclassified, private investors took charge of a major segment of the industry, and capital investment by private actors climbed to several billion dollars.<sup>13</sup>

The Mexican privatization program has become much more widespread and pervasive than anyone could have predicted. First, the program covers more industries than expected. Second, in terms of raw figures, the number of businesses that have gone private has been astonishing. For example, of the 1,155 industries owned by the state in 1983, only 496 remained in government hands by the Spring of 1990.<sup>14</sup> Of these, 130 were privatized. The remaining entities were liquidated, transferred to the state or local governments or merged with other existing companies.

Critics of former President Miguel de la Madrid's privatization program argue that, until 1987, Mexico's much touted privatization initiative was largely an illusion.<sup>15</sup> They claim that, although Señor de la Madrid would boast that he was responsible for a substantial reduction in publicly owned entities, most of that reduction was the product of the "dissolution of paper companies, the merger of small firms, or the mere transference of entities from the national government to the state government and to government affiliated unions."<sup>16</sup> They contend that, as a result, the impact on the federal budget was almost infinitesimal and so was its ultimate effect on the government payrolls.<sup>17</sup> Yet, even these critics have begun to change their minds as President Salinas dangles the family jewels in front of private investors. Indeed, the Government has

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<sup>12</sup> Layton & Turner, *supra* note 7, at 25.

<sup>13</sup> INSTITUTE FOR INTERNATIONAL ECONOMICS, *LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED?* 160 (Williamson ed. 1990).

<sup>14</sup> *Id.*

<sup>15</sup> *Mexican Privatization, Getting Down to Business*, THE ECONOMIST, May 7, 1988, at 65.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

started the privatization of major Mexican transportation and communication firms. It has also admitted privately that port facilities and other sales to private investors are currently under consideration.<sup>18</sup> The most significant event with respect to the privatization of transport occurred on April 16, 1988, when the Mexican government declared *AeroMéxico* bankrupt.<sup>19</sup>

## II. AEROMEXICO'S PRIVATIZATION: THE BEGINNING OF THE END FOR STATE OWNED INDUSTRY

On April 13, 1988, 7000 employees at Mexico's state owned Airline, *AeroMéxico*, went on strike to protest the government's decision to terminate several uneconomical routes and sell thirteen of the company's planes.<sup>20</sup> Only three days later, the government broke the union by declaring the company bankrupt and sacking its workers.<sup>21</sup> Union leaders were up in arms over the government's decision, charging that the airline's financial problems were the result of its government appointed managers.<sup>22</sup> The government responded by selling the airline's remaining 26 jets to *Aeronaves de México*, which restructured and streamlined the company.<sup>23</sup> Today, *AeroMéxico* is as strong as it has ever been. In fact, in September 1988, a group of Mexican and foreign investors, including British raider Sir James Goldsmith and Chase Manhattan Bank, paid \$140 million for a 25 percent managing share in Mexicana Airlines.<sup>24</sup> The new capital will assist the carrier in updating its fleet so that it can effectively compete with airlines such as "*AeroMéxico* [,] which went private last year and has been winning over passengers with hitherto unheard of on time flights."<sup>25</sup>

*AeroMéxico's* privatization represents a turning point in the Mexican state's approach to economic affairs. What it has brought to Mexican economic thinking is an idea that those of us north of the border have taken for granted throughout our history: the notion that in order to maintain and develop economically, an industry must make consumer satisfaction a top priority. Under state administration, *Aeroméxico* had a bottomless source of funds, and

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<sup>18</sup> See Bussey & Work, *Bienvenidos to a Fire Sale*, U.S. NEWS & WORLD REPORT, Oct. 16, 1989, at 100.

<sup>19</sup> See Mexican Privatization, *supra* note 15, at 65.

<sup>20</sup> *Id.*

<sup>21</sup> See Baker, *For Salinas the Real Campaign is Just Beginning*, BUSINESSWEEK, Dec. 5, 1989, at 48.

<sup>22</sup> See Mexican Privatization, *supra* note 15, at 66.

<sup>23</sup> *Id.*

<sup>24</sup> See Bussey & Work, *supra* note 18, at 100.

<sup>25</sup> *Id.*

service to customers took a backseat. This led to its demise as a state enterprise, and to its resurrection as a private company. In private hands, corporate funding will come out of consumer pockets. Under Mexico's old economic arrangements, bureaucrats and trade unionists placed a noose around the neck of the Mexican state from which its economy could not escape. President de la Madrid and his successor Carlos Salinas de Gortari decided to untie the noose because they realized that the state's economic resources and Mexican citizens would be suffocated unless drastic measures were taken. Commentators have referred to Mexico's privatization as "perestroika"<sup>26</sup> and "Salinastroika"<sup>27</sup> and to Mr. Salinas' economic thinking as "Thatcherite" due to Mexico's extreme economic restructuring.<sup>28</sup> Mexicans have obviously taken the decision that they do not want to continue to serve as economic oxygen tanks for poorly managed state-owned industries such as *AeroMéxico*. Indeed, I would mark the *AeroMéxico* privatization as a red letter date in Mexican history, for it represents a point of departure from which other major Mexican industries will be privatized.

### III. DEREGULATION: CREATING AN ENVIRONMENT FOR PRIVATE INDUSTRY TO FLOURISH

#### A. The Trucking Decontrol Program

In addition to the privatization program currently underway in the transport industry, the Commerce and Transport Ministries have initiated a major deregulation program.<sup>29</sup> The program involves overhauling the rules restricting highway cargo transport and the elimination of ninety regulations dealing with packaging and containers.<sup>30</sup> The deregulation program has successfully changed the structural framework within which the Mexican trucking industry has to operate.<sup>31</sup> The former regulatory scheme was dominated by an archaic set of laws that produced vast inefficiency throughout an industry overseen by a small number of regional "chieftains".<sup>32</sup> Drivers were given specific routes and were often required to return to their original point of departure with empty

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<sup>26</sup> Baker, *supra* note 21, at 100.

<sup>27</sup> Hoosie, *Mexico's Salinastroika*, *WORLD PRESS REVIEW*, Apr. 1990, at 62.

<sup>28</sup> Bussey & Work, *supra* note 18, at 100.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> Neuman, *Trucking Decontrol: Truckers Say It Works, Shippers Say Same Service*, *JOURNAL OF COMMERCE AND COMMERCIAL*, Oct. 30, 1990, at 6A.

<sup>32</sup> *Id.*

loads.<sup>33</sup>

The newly introduced deregulation program permits truckers to operate in all corners of the country.<sup>34</sup> Efficiency and service have dramatically improved. The Secretariat of Trade and Industry (SECOFI) has estimated that close to \$600 million will be saved this year alone as a result of increased efficiency. This savings is due to new regulations allowing truckers to backhaul, effectively increasing capacity by roughly ten percent over night. The program has also brought truckers who were unregistered, operating with out-of-date permits, or hauling unauthorized loads, into the new regulatory fold.<sup>35</sup> This is the case because they will no longer be bound by layers of regulatory procedures.<sup>36</sup> This informal sector has now 35,000 vehicles registered with the government. Under the new system, permits can easily be obtained within two weeks of submission of an application. At one time, this process consumed between nine months to two years.

The larger Mexican trucking corporations have clearly benefited most from the deregulation.<sup>37</sup> In fact, many smaller companies have sought affiliation with the larger ones in order to remain competitive and expand their service areas. Yet, smaller companies have benefited by their ability to serve the lesser traveled routes which the bigger companies have avoided because of their relatively low profitability.

*B. The Salinas Balancing Act: Initiating Bold Legislative Enactments within the Confines of a Hitherto Intransigent Political Structure*

The deregulation prong of the Salinas privatization initiative establishes another point of this analysis. That is, can a country that has embarked on a major economic structural change resist the temptation of state intervention when its basic political framework has remained essentially intact? The answer here is yes. In fact, as demonstrated by the success of the trucking decontrol program, not only has the government gone as far as privatizing the industry, it has also opened up markets for competition. Even former British Prime Minister Margaret Thatcher didn't have to do that during her privatization

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<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> See Neuman, *supra* note 31, at 6A.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*



program, for Great Britain already had open markets.<sup>38</sup> When Mrs. Thatcher came to power, she had a mandate to sweep socialism from the United Kingdom. Mr. Salinas did come to power with a mandate for change, but he still must operate within the confines of a political machine that is resistant to losing many of its privileges. The deregulation program shows Mr. Salinas' willingness to go out on a limb and interject true market forces into the Mexican economy. Opponents within his own party abound, and Mr. Salinas has suffered severe criticisms as a result of his decisions. In fact, many have called his privatization program a "national giveaway,"<sup>39</sup> arguing that sales of state-owned companies are not very lucrative.<sup>40</sup> In 1989, Mr. Salinas tried to allay fears that he was giving away the store by vowing that the government would fulfill its revolutionary mandate to deliver social justice, including state ownership of gasoline, electricity, trains, telegraphs and most banking services.<sup>41</sup> With the success of privatization in other areas, however, Mr. Salinas has realized that perhaps such a revolutionary mandate is not consistent with Mexico's current economic needs, and has placed the telephone company and the country's banks before the bidders.

Having discussed the widespread nature of the privatization program, its success to date, and the political tightrope that President Salinas has had to walk to achieve much of what has been gained, let us now turn to a privatization that is currently taking place and see how the government privatizes a state-owned industry.

#### IV. THE NUTS AND BOLTS OF THE PRIVATIZATION PROGRAM: HOW IT WORKS

Anyone who has ever visited Mexico or done business there has no doubt at one time or another had to confront what many regard as the antithesis of a communication system: *Teléfonos de México* or TELMEX. One would expect that any nation, particularly a Latin American one, would face enormous opposition to a governmental decision to privatize the national telephone system - the communication life blood of a country. Yet, in the case of Mexico, there has been little opposition to the President's decision to privatize TELMEX. As one observer has noted, "privatizing TELMEX would more likely spark

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<sup>38</sup> The Thatcher analogy is probably least applicable here because Mr. Salinas is operating within the *Partido Revolucionario Institucional* (PRI), a political party which has been historically associated with stateism and that has dominated Mexican politics for the greater part of this century.

<sup>39</sup> Bussey & Work, *supra* note 18, at 100.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

celebration than national opposition: frustrated callers have come to associate the company with extortionist repairmen and crossed lines, not national pride."<sup>42</sup> Certainly, stories about TELMEX's inefficiency are legendary, and the following case of Banamex is a poignant example of how TELMEX's inefficiency, were it to continue, would stymie production and economic growth in the country.

Banamex, Mexico's largest bank, began construction of a central computer facility and contacted TELMEX to connect 200 telephone lines to its leading branches in five cities across the country.<sup>43</sup> TELMEX tendered a bid for \$860,000 and a completion date some two years away.<sup>44</sup> Naturally, Banamex refused to wait that period of time and pay those bloated costs.<sup>45</sup> Instead, the company made the decision that it would be more efficient to carry out the job itself. Thus, Banamex purchased a microwave uplink and set up its own phone network. The two hundred lines became operational quite rapidly. Obviously, privatization became inevitable. In fact, even the workers of the telephone company voted unanimously to go private in order to obtain the better salaries that could only come from economic expansion. Certainly, without state funds for expansion, the only solution was privatization.

The privatization of TELMEX, in its final days at the time of this writing, is expected to raise the company's service to international standards. It presents what I consider to be a substantive portrait of how the federal government is handling the privatization of non-strategic companies. According TELMEX's General Manager, Alfredo Barranda, four criteria are being utilized in the selection of a buyer for TelMex.<sup>46</sup>

### 1. Price -

Although price is a major component in the selection process, Mr. Barranda has stated categorically that it will not be the only determinant in choosing the company's future owners.<sup>47</sup> Furthermore, Mr. Barranda has refused to comment on how much money the government hopes to obtain in the sale of TELMEX. What Mr. Barranda has stated is that given the fact that 20.4 percent of the company is now for sale, an amount which would provide its

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<sup>42</sup> Baker, *supra* note 21, at 105.

<sup>43</sup> See Shoreham, *supra* note 3, at 105.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Mexican Telephone Service Should rise to International Standards After Sale*, 7 INT'L TRADE REP. (BNA 1847) Dec. 5, 1990.

<sup>47</sup> *Id.*

purchaser with administrative control of TELMEX, the government would expect the purchase figure to exceed the current market price of between \$1.7 and \$1.8 billion.

## *2. A Guarantee of Growth and Service Improvement -*

The Mexican Government will seek guarantees from the purchasing party for improvements in TELMEX's operations.<sup>48</sup> Such guarantees will be required despite the fact that recent changes in the national tax code contain a variety of economic incentives which permit TELMEX to reduce or eliminate a 29 percent tax by deductions accrued through its investment programs. The Mexican government can determine which buyer has the wherewithal to improve TELMEX's performance using the second requirement as a guide. Clearly such assurances should be provided to the government no matter what company is on the auction block. The data which the government will employ to verify such guarantees is still unclear but is likely to center around the purchaser's past performance in other ventures.

## *3. Technological Improvement -*

The government will seek out needed technology, currently unavailable in Mexico, from foreign partners taking part in the bidding.<sup>49</sup> That is precisely the reason why the government has mandated that Mexicans who are participating in the bidding have a foreign partner. This is a sure fire way for TELMEX to rapidly improve the service that it provides across Mexico. At least, that is what the government is banking on.

## *4. International Investment -*

This component seeks to transform TelMex into an investor in international or foreign communications.<sup>50</sup>

While the foregoing determinants do not represent a hard and fast rule by which buyers will be determined, they are generic criteria which a purchaser of any public industry must take into account. At the time of this writing, just two of the three bidders have named their foreign partners. The third bidder has submitted a plan which would accept the participation of any willing foreign partner selected by the Mexican Government. Mexican bidders and their foreign partners include:

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<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

- (1) The Mexican stock exchange firm, Acciones y Valores, headed by Roberto Hernández, with Telefónica Espanola and GTE;
- (2) The Carso Group, headed by Mexican investor Carlos Slim, with Southwestern Bell and France Cable et Radio; and
- (3) The Generator Group of Monterrey in Northern Mexico. The group, headed by Javier Garza Sepúlveda, submitted a bid without a foreign partner, but, as previously stated, has offered to enter into a partnership agreement with a company chosen by the Mexican government.<sup>51</sup>

Given the requirement that majority control of TELMEX must be in national hands, 20.4 percent of the company for sale will be combined with a minimum of 10.4 percent of the company going to a Mexican partner, and up to 10 percent to a foreign partner. This will still permit the private investor to retain administrative control of the company because in early 1990 TELMEX gave each stock holder 1.5 non-voting "L" shares for every share already owned.<sup>52</sup> This created a large volume of non-voting shares. The Mexican Government, which retains 51 percent of the company, owns 20.4 percent of AA voting shares, now up for sale, and over 30 percent of the "L" stock. According to Mr. Barranda, the government's "L" shares will be sold in both domestic and foreign stock markets, but significant amounts will only be sold as timing warrants.

TELMEX has geared up for the sale during the past year by going through a thorough restructuring combined with fiscal reforms that are likely to continue once the new buyer takes over. For example, a number of taxes that ranged from 22 to 72 percent have been eliminated.<sup>53</sup> In addition, rates for internal service have increased, while international long distance rates, which at one time were three times as costly as long distance rates in most other nations, have fallen. It is hoped that long distance rates will remain low enough so that when competition for international service is permitted in five to six years, the competing companies will be virtually forced to keep their international rates low. The effect of these rate changes will be to increase the income that the company receives from every phone line from about \$400 to \$700 a year.<sup>54</sup>

The company has also gone to great pains to improve its current fiscal condition, and some of the methods that it has utilized are quite novel. For example, the company has purchased \$670 million of debt on the international

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<sup>51</sup> *Id.* at 3.

<sup>52</sup> *Id.* at 4.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 5.

market at a discount and has used that purchase to discount its own \$1.1 billion debt. Furthermore, the company has made great strides in adding 650,000 new telephone lines without enlarging its 50,000 employee work force. Moreover, union relations remain very good because workers are obviously much more concerned about maintaining their employment status and improving their company's service than making sure their wage increases stay on an even keel with company profits. Thus, the well respected union leader Francisco Hernández Juárez has struck a bargain: the union modified job descriptions in exchange for a promise from the company that jobs would be preserved.<sup>55</sup> Regarding the agreement, President Salinas said "The workers of the telephone company voted unanimously for privatization because they knew the only way of obtaining better salaries and maintaining their employment was with expansion that could only come from the injection of additional resources from private investors."<sup>56</sup> Clearly, the courting of labor has been a primary component of the President's strategy. Indeed, organized labor's intransigence could potentially destroy the entire Salinas initiative. TELMEX, however, is an extraordinary example of union cooperation with the government, and is in many ways a testament to President Salinas' dynamic political ability. Finally, the company has been freed from the requirement that it obtain government approval before taking major decisions.<sup>57</sup>

TELMEX's departure from state ownership is significant, not only in a domestic Mexican context, but in a Latin American context as well. First, if communications rise to international levels as the Mexican government and economic commentators have asserted, it could serve as an impetus for the privatization of communication systems in other Latin American countries, many of which have already begun privatization programs of their own.<sup>58</sup> Second, as the world's fourth largest privatization, the transfer of TELMEX will be a gauge on how smoothly and efficiently the Mexican government is able to effectuate privatization programs of scale. Third, the ability of the new owners of TELMEX to control and bring order to the rank and file of the union, after the privatization process has been completed, will be the final indication of whether TELMEX will improve and expand efficiently.

It is obvious from the economic restructuring within the corporation, that the Mexicans hope to deliver a company that will be well situated for future international competition. It is important to keep in mind that although

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<sup>55</sup> See Shoreham, *supra* note 3, at 109.

<sup>56</sup> *Id.*

<sup>57</sup> See Mexican Telephone Service, *supra* note 46, at 5.

<sup>58</sup> See, e.g., the new Privatization statute recently enacted by the Peruvian Congress in Amado, *Peru's New Investment Laws: Privatization and Foreign Investment Statutes*, 1 U. MIAMI Y.B. INT'L L. 392 (1991).

privatization may at first blush appear to be an economic bonanza both for major corporate investors as well as the government, it can only be a bonanza if the company is placed on a sound financial footing prior to its sale. This obviously requires a significant amount of work. Fiscal health, however, makes the company more attractive to investors and in turn will result in a higher purchase price for the country. The privatization of TELMEX demonstrates the great strides that the Mexican government has made along these lines.

#### V. MEXICO'S BANKS: BALANCING THE BUDGET BY SELLING A KEY NATIONAL ASSET

When the President of Mexico announced his intention to privatize the nation's banking industry in May of 1990, the move was hailed by both the domestic and foreign business community as the needed impetus for bringing capital investment back to Mexico.<sup>59</sup> Although nationalization had not weakened the fundamental infrastructure of Mexican banks in the same way in which it had in other industries, President Portillo's September 1982 legislative enactments had led the banking sector to grow in what many characterized as a "lopsided manner".<sup>60</sup> Critics charged that while the banks did generate profits, which were invested in technology and product expansion, reserve requirements of 90 percent meant that banks took deposits from the public and lent the funds to the state, thereby halting commercial lending to private businesses for most of the decade.<sup>61</sup> Moreover, a vacuum in the area of home mortgage lending had been created.<sup>62</sup> Clearly, for a country in need of debt relief, the sale of the nation's state-run banking sector represented a golden opportunity to reduce its debt burden.

President Salinas' state-of-the-nation address in December 1989 made many people realize that the nation's banks would become a target for privatization. In his address, the President neglected to mention the banking industry as an area which should remain in the public domain.<sup>63</sup> Moreover, during a trip to Europe in early 1990, the president indicated that a change in the nation's constitution would be required before any type of privatization program could be initiated.<sup>64</sup> This of course included the banks.

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<sup>59</sup> Green, *Banks for Sale: Mexico Could See Up to \$ 18 Billion*, JOURNAL OF COMMERCE AND COMMERCIAL, Oct. 30, 1990, at 5A.

<sup>60</sup> Marray, *Privatization Can Be a Complicated Process*, EUROMONEY, Sept. 1990, at 163.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> See Laurie, *Aperture of Opportunity*, THE BANKER, Apr. 1990, at 51.

<sup>64</sup> *Id.*

During January 1990, Congress amended several of Mexico's banking regulations,<sup>65</sup> including granting foreign investors access to the nation's financial institutions.<sup>66</sup> The legislative package also contained a provision authorizing the integration of financial consortiums, something that had previously been prohibited by the government.<sup>67</sup> This legislation provides a basic framework for the future creation of non-bank holding companies in Mexico.<sup>68</sup> This means that the private sector will be able to have a controlling interest in three financial service areas - brokerage, insurance, and foreign exchange.<sup>69</sup> President Salinas is trying to foster rapid financial sector growth by creating these groups, rather than depending solely on bank privatization. Yet, these holding companies could play a pivotal role in the purchase of the nation's banks.

On May 2, 1990, President Salinas submitted a constitutional amendment to the Mexican Congress, which in effect authorized the reprivatization of the nation's banks.<sup>70</sup> The amendment was approved on June 10, 1990 by a two thirds vote of the Congress.<sup>71</sup> Subsequently, on July 18, 1990, the Congress approved a new law governing credit institutions and one regulating financial groups.<sup>72</sup> The rules governing the privatization of Mexican banks have been summarized in the *New York Law Journal*<sup>73</sup> and are reproduced here in order to facilitate an informed analysis of this legislation and to compare it with the laws covering other industries, particularly the regulations concerning TELMEX:

1. The Ministry of Finance and Public Credit (Hacienda) will review and approve a plan to be prepared and submitted by the board of directors of each Mexican bank for the reorganization thereof as a regular mercantile corporation. The plan will include the procedure for the exchange of the outstanding certificates of contribution for new shares of common stock.

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<sup>65</sup> Mitchell, *Privatization of Mexican Banks*, N.Y.L.J. Sept. 26, 1990, at 3(3).

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> See Laurie, *supra* note 63, at 52.

<sup>69</sup> *Id.*

<sup>70</sup> See Mitchell, *supra* note 65, at 3.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

2. The new law provides that there will be three types of stock in Mexican banks, which will be issued in exchange for the outstanding certificates of contribution as follows:
  - A. 51 percent of the outstanding Series A certificates of contribution (which are currently owned by the Mexican government) will be exchanged for Series A common shares. This series of shares will represent at all times at least 51 percent of the capital stock of each bank and may be acquired only by Mexican individuals, the Mexican government or Mexican holding corporations organized in accordance with the law to regulate financial groups.
  - B. The remaining Series A. certificates (which currently represent up to an additional 15 percent of the capital stock of each bank) and all Series B certificates will be converted into Series B common shares that may be acquired by those persons qualified as holders of Series A shares as mentioned above as well as by Mexican private corporations that are not directly or indirectly controlled by foreigners and insurance and investment companies. Series B common shares can represent up to 49 percent of the capital stock of each bank. Upon reorganization of each bank, the present holders of Series B certificates of contribution (most of which are stock exchange investors) will be entitled to withdraw from the reorganized corporation within 90 days following the date on which the decrees of reorganization become effective. Such holders will receive reimbursement for their certificates, at book value.
  - C. Foreign investment will be restricted to no more than thirty percent of any bank. In this respect, Foreign investors that are not controlled by foreign governments or government entities will be allowed to acquire only Series C common shares, which series may represent up to 30 percent of the capital stock of each bank. The issuance by any bank of Series C common shares must be previously approved by the Mexican government. No foreign government or foreign official governmental agency will be allowed to hold at any time a participation in any bank.

Also, in accordance with the law for the promotion of Mexican investment and the regulation of foreign investment (*Ley para Promover la Inversion Mexicana y Regular la Inversion Extranjera*), which provides that the participation of foreign investment in the capital stock of each such corporation, such foreign investors will only be able to have a 30 percent minority participation in the administration of the reorganized banks and therefore will not be able to make major decisions as to how the



banks will be run.

Foreign investment will not be permitted in the development banks (e.g. Banco Obrero, S.A.), which will continue to be organized as National Credit Institutions in which the Mexican Government will hold at least 66 percent of the relevant certificates of contribution, and it is unlikely that the Mexican government will allow foreign investors to hold a majority interest in Mexican Banks.

3. No single individual or corporation will be permitted to hold more than 5 percent of the paid-in capital stock of a single bank at any time, except for the Mexican government and certain institutional investors and holding corporations organized under the law to regulate financial groups. However, Hacienda can make an exception to this principle and allow a private entity to hold up to 10 percent of the capital stock of a bank.
4. The administration of each bank will be vested in a board of directors consisting of 11 members or other multiples of 11. Series A shareholders will be entitled to appoint six members of such board, and Series B shareholders can appoint up to five members. Series C shareholders will only be allowed to appoint one director for each 10 percent of paid-in capital that they hold, and any such director will reduce the number of directors that Series B shareholders can appoint.
5. All current obligations and liabilities of the Mexican banks, whether of a fiscal, labor or other nature will remain outstanding upon their reorganization as private corporations.

Having explained the reprivatization process - the question arises as to who the most likely buyers will be. Many people expect that they will be the same financiers who were at the helm of the nation's banks prior to their expropriation.<sup>74</sup> Indeed, under the regulations dealing with financial groups, such individuals could potentially hold 5 percent or perhaps 10 percent, with government approval, of the holding companies that would run the banks.<sup>75</sup> The government has made it clear that it will closely scrutinize buyers, in order to prevent those who once dominated the industry from regaining control.<sup>76</sup>

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<sup>74</sup> See Brown, *Familiar Faces Tough Rules in Selloff of Mexico's Banks*, AMERICAN BANKER, Sept. 17, 1990, at 15.

<sup>75</sup> See Marray, *supra* note 60, at 163.

<sup>76</sup> See Brown, *supra* note 74, at 15.

Furthermore, as 2(C) of the foregoing regulations make clear, foreigners will only be allowed to purchase a total of 30 percent of a bank and have non-voting shares. This provision is somewhat worrisome and represents a more restrictive view than other privatization legislation. Although domestic interest in bank sales will be high enough to satiate the Mexican economy, it is evident that foreign bankers are weary of investing in such a dicey undertaking without having control.<sup>77</sup> Indeed, it has been reported that the restrictions on foreign ownership have "dampened" interest by banks outside Mexico.<sup>78</sup> Before those banks begin investing, they will want a clear picture of who is exercising leadership at those banks.

The purpose of the privatization of banks is not only to obtain quick capital but also to look at long term technological growth. If the Mexican government wants to advance technologically in banking it must immediately permit full foreign participation in the banking sector. Otherwise, this short term infusion of capital from domestic investors could whittle away without foreign capital or foreign technology which is sorely needed for advancement. The legislative framework does provide an arena for improvement in banking services in Mexico, and the Salinas initiative is indeed commendable. But in the area of banking, and having said that the banking sector is no longer strategic, the President should open it up more fully to outside investment, thereby bringing a more immediate and sustained influx of capital and technology to the nation.

## VII. CONCLUSION

The transfer of much of Mexico's public sector, including capital infrastructure to the private sector, represents a fundamental change in the economic arrangements that have traditionally characterized the country. The Salinas initiative, although flawed in some aspects, is a bold new undertaking which is both widespread and, to date, quite successful. It represents a good opportunity for American investment.

Unfortunately, the paucity of information available to Americans about the program means that potential Mexican investment opportunities could go to the Europeans or the Japanese. At the very least, this broad survey of the Salinas privatization program should serve to illuminate some vital aspects about the new investment opportunities being offered by Mexico. Indeed, the government's willingness to surrender more than 51 percent of some industries previously considered strategic means that the country is gearing up for full

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<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

fledged capitalism. With the advent of velvet revolutions throughout Eastern Europe, competition among countries for American investment is likely to be fierce. Therefore, the Mexican government should accelerate its privatization program and permit even greater foreign participation in its economy.

*Appendix 1*<sup>79</sup>SOME OF THE MAJOR INDUSTRIAL COMPANIES  
TO BE PRIVATIZED

NAME	LINE OF BUSINESS
Alto Horno de México	Steel
Sicarsta	Steel
....	....
Siderúrgica Nacional	Metal Foundry
Tabacos Aztecas	Tobacco
Exportaciones Tabaco Mexicano	Tobacco
Aceitera Turboreactores	Aircraft engines
Compañía Naviera Minera del Golfo	Shipping
Dina Autobuses	Transport Equipment
Dina Motores	Truck engines
Fábrica de Tractores Agrícolas	Tractors
Petroquímica de Mexico	Petrochemicals
Plásticos Automotrices	Auto Parts
Tubacreo	Steel Pipes
Real del Montey Pachua	Gold and Silver Mining
Inversiones Urbanas Monterrey	Real State
Telmex	Communications

*Appendix 2*<sup>80</sup>BASIC AND SECONDARY PETROCHEMICAL PRODUCTS  
AFTER MEXICO'S RECLASSIFICATION

## BASIC

Ammonia	Methyl tertiary butyl ether
Benzene	N-paraffins
Butadiene	Ortho-xylene
Carbon black	Para-xylene
Dodecylbenzene	Pentane
Ethane	Propylene
Ethylene	Propylene tetramer
Heptane	Tert amyl methyl ether
Hexane	Toluene
Methanol	Xylenes

<sup>79</sup> Robinson, *supra* note 13, at 13.<sup>80</sup> Layton & Turner, *supra* note 7, at 25.

## SECONDARY

2-ethyl hexanol	Ethylene oxide
Acetaldehyde	Ethylene-propylene copolymer
Acetic anhydride	Formaldehyde
Acetylene	HDPE
Acetone	Internal olefins
Acetone cyanohydrin	Isobutanol
Acetonitrile	Isobutyraldehyde
Acrolein	Isoprene
Acrylonitrile	Isopropanol
Acrylonitrile styrene	LDPE
Acrylonitrile-butadiene-styrene	LLDPE
Alpha olefins	Maleic anhydride
Ammonium Nitrate	Methyl methacrylate
Ammonium Phosphate	Methylamines
Ammonium Sulfate	N-butanol
Aniline	Nitrobenzene
Butayraldehyde	Nitrotoluene
Caprolactam	Oxo alcohols
Chlorobenzenes	Paraformaldehyde
Chloromethanes	Pentaerythritol
Chloroprene	Phenol
Cumene	Phthalic anhydride
Cyanohydric acid	Polybutadiene
Cyclohexane	Polypropylene
Cyclohexanone	Propylene oxide
Dichloroethane	Styrene
Dimethyl terephthalate	Styrene-butadiene oil
Ethanolamine	Terephthalic Acid
Ethyl Chloride	Urea
Ethylamines	Vinyl Acetate monomer
Ethylbenzene	Vinyl Chloride