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U.S. Trade and Investment in Mexico: An Overview of the Eighties

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COMMENTS

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I. DOWN THE UP STAIRCASE

Jimmy Durante used to say that we ought to be nice to the people we meet on the way up because they are the same people that we are going to meet on the way down. The United States on the way up was not very nice to Mexico.

In the first place, the United States took more than half of Mexico's land. What to northern eyes were the gallantry of the Alamo and San Jacinto, the intrepid reconnaissance of Captain Robert E. Lee across the Pedregal, and a sagacious Gadsden Purchase, from the Mexican perspective was unvarnished theft. Adding insult to injury, the United States turned those 600 million dry, man-forsaken acres [1] into a cornucopia of productivity. Twice our armed forces violated the Mexico that remained—in 1914 to redress a miff in Veracruz and in 1916 to chase after Pancho Villa. But our most devastating invasion was cultural: tides of North American tourists, films, magazines and television, eroding a mountain of Mexican religious and family values and inciting a headlong imitation of Yankee industrialism that seared the Valley of Mexico and Monterrey with devastating urban blight. "For [Mexicans]," Octavio Paz wrote, "the United States is, at the same time and without contradiction, Goliath, Polyphemus and Pantagruel." [2]

Those things happened during the first century and a half of Mexican independence, when the United States was on her way

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1. More specifically, 606,114,713.6 acres, based upon estimates that attribute 2,378,000 square kilometers to the Peace Treaty of Guadalupe Hidalgo between the United States and Mexico, February 2, 1848, 9 Stat. 922, T.I.A.S. No. 960, and 75,000 square kilometers to the Gadsden Purchase. United States and Mexico, December 30, 1853, 10 Stat. 1031, T.I.A.S. No. 208. For a discussion on the Treaty of Guadalupe Hidalgo, *see* M. BASURTO ANGEL, LA EVOLUCIÓN DE MÉXICO (24th ed. 1977). For a discussion on the Gadsden Treaty, J. MORENO, HISTORIA DE MÉXICO (9th ed. 1977).

2. O. PAZ, LA ULTIMA DÉCADA 19 (U. Texas 1969).

up—the confident young Colossus of the Western Hemisphere growing into the world's top industrial and military power, and seeming, in the process, to dwarf Mexico in both performance and potential. Now times are changing, and with them a new relationship is forming between the two countries. The Eighties dawned upon a United States stationary, if not descending, on the staircase—a post-Vietnam, post-Watergate nation of eroding military strength, an ailing currency, and a recession-prone economy—and upon a Mexico bounding upwards—a nation rich in oil, industrializing rapidly, in the diplomatic forefront of the Third World, and anxious to demonstrate her emancipation from the United States.

For the United States and Mexico the criticial issue of the Eighties is how quickly and comfortably the two nations can adjust to the reality of their new velocities on the staircase. It is not a question of *whether* the United States will have a relationship with Mexico; geography settled that. The question is what sort of relationship it will be—empathic and reciprocal or grudging and uncoordinated.

II. Historical Patterns

United States trade and investment in Mexico have always been correlative of the political relationship between the two countries, but the way those factors interact is a curious mixture of cause and effect. On the one hand, the political relationship determines the scope accorded to foreign enterprise by opening or closing the border to merchandise, permitting or forbidding equity acquisitions, and the like. On the other hand, the degree of foreign penetration often determines the political relationship because the political posture of Mexico toward the United States is frequently merely a reflex of Mexico's hunger for, or satiety of, the United States' goods and capital.

Foreign economic involvement in independent Mexico began inauspiciously. First came the national bond issues of 1824 and 1825, which were defaulted. Maximilian issued more national debt, which Juárez repudiated, and the foreign investments that entered during the Juárez years were mostly British mining ventures that failed.[3]

The picture changed radically during the thirty-four year presidency of Porfirio Díaz. Consciously courted, foreign capital inundated Mexico. By 1911, foreigners owned more than half the nation's

3. H. K. Wright, Foreign Enterprise in Mexico 52-53 (1971) [hereinafter cited as Wright].

wealth, including one-fourth of all Mexican land, and dominated every major economic sector except agriculture and handicrafts.[4] The greatest concentrations of foreign ownership were in railroads, oil, utilities and mining. The closing years of the Porfirio Díaz administration witnessed some steps to limit foreign investment—by government purchase of 51% of Mexican Railways, for example, and restrictions on foreign ownership of mining claims near the border—but the Díaz era is indelibly identified as the high-water mark of foreign involvement in the Mexican economy and evokes passionate xenophobia to this day.

Codifying the sentiments of the 1911 Revolution against foreign economic penetration, the 1917 Constitution institutionalized expropriation, declared subsurface minerals the inalienable patrimony of the State, and prohibited foreign surface acquisitions in border and coastal zones.[5] Although the next twenty years saw vacillating enforcement of those constitutional principles, foreign investment declined in most areas other than oil and electric power. Finally President Cárdenas expropriated the remaining 49% of Mexican Railways and all of Mexican oil.[6]

The predictable result was a massive flight of foreign enterprise. By 1940 the level of foreign investment had dropped to nearly one-fourth the figure of the mid-1920's and mining and electric power accounted for almost 90% of that which remained. Only in manufacturing did foreign investment increase, and there insignificantly.[7]

The next period of Mexican economic history, from 1940 to 1968, was one of aggregate but selective growth in foreign investment. President Avila Camacho settled the international expropriation claims and renegotiated Mexico's external debt. To control the World War II influx of flight capital, he issued the famous 1944 decree[8] that limited to a minority position new foreign equity in specific enterprises. President Alemán opened the door wider, and President Ruiz Cortines stabilized that position.[9] During the administration of Pres-

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4. *Id.* at 53.

5. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS, (Mexico) February 5, 1917, art. 27 [hereinafter cited as CONSTITUCIÓN].

6. WRIGHT, *supra* note 3, at 65-70. Smaller railroad units remained in private hands, the last one being acquired by the Mexican Government on June 30, 1970. BRITANNICA BOOK OF THE YEAR 510 (1971).

7. WRIGHT, *supra* note 3, at 70.

8. Decree of June 29, 1944, D.O., July 4, 1944. For a detailed discussion, *see* WRIGHT, *supra* note 3, at 101-13.

9. WRIGHT, *supra* note 3, at 73-80.

ident López Mateos, Mexican investors bought out the telephone system,[10] the Mexican government purchased the major electric utilities, and a government-controlled company acquired U.S. steel holdings.[11]

Of the traditional areas of foreign investment, only mining, which remained 90% foreign-controlled,[12] was left. López Mateos attacked that problem by amending the mining law[13] to shorten existing concession terms *ex post facto* and to limit renewals, new concessions, and tax advantages to companies that "Mexicanized"—that is, increased their Mexican-owned equity to 51%.

Most mining companies saw the handwriting on the wall, and "Mexicanized." President Díaz Ordaz brought to heel the major sulphur producer, a notable holdout, by withholding its export permits.[14] He also passed legislation limiting foreign ownership of Mexican banks and insurance companies.[15]

In retrospect, and with considerable oversimplification, the pattern of foreign investment in Mexican railroads, oil, utilities, and mining during the hundred year period that commenced with Porfirio Díaz and ended with Díaz Ordaz was: encouragement, growth, and nationalization (if by "nationalization" we mean Mexican acquisition, either public or private, coerced or consensual, of 51% to 100% of foreign equities). But as foreign investment diminished in those traditional sectors, it grew in the nontraditional areas of manufacturing and commerce. As recently as 1940, 90% of all foreign investment was in traditional, and only 6% in nontraditional, sectors. By 1967 the score-sheet was reversed: 12% traditional, 65% nontraditional.[16] It fell to President Luis Echeverría to codify the rules of "Mexicanization" in the sectors that remained accessible to foreign capital.

Echeverría, like Cárdenas, was almost an era in himself. Perhaps the most significant achievement of his career was the passage of the Mexican-sponsored resolutions of the United Nations Assembly that proclaimed a "New International Economic Order"[17] and enshrined,

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10. Done before President López Mateos took office but with his blessing. *See* WRIGHT, *supra* note 3, at 80.

11. WRIGHT, *supra* note 3, at 83.

12. *Id.*

13. Law of Feb. 5, 1961, D.O., Feb. 6, 1961. *See* WRIGHT, *supra* note 3, at 133-40.

14. WRIGHT, *supra* note 3, at 87-91.

15. Decrees of December 27, 1965, D.O., Dec. 30, 1965. *See also* WRIGHT, *supra* note 3, at 145-49.

16. WRIGHT, *supra* note 3, at 93.

17. G. A. Res. 3201, S-6 U.N. GAOR, Supp. (No. 1) 3, U.N. Doc. A/9559 (1974) [hereinafter cited as Declaration].

among other Third World objectives, a nation's right to expropriate foreign investment without paying compensation in accordance with international law standards.[18] Of more immediate interest, however, are the Echeverría statutes—the Technology Law,[19] Foreign Investment Law,[20] and Inventions and Trademarks Law[21]—which constitute the structural imperatives for foreign investment in Mexico today.

III. The Structural Imperative

The significance of the Echeverría legislation is "structural" because the international business lawyer approaches the planning of trade and investment, essentially, as a structural task. Faced with an export project he asks: "Can my client sell in Mexico without 'doing business' there? Where should title pass? Should he act through distributors or sales representatives? What happens if they are fired?" If the project is for direct equity investment his questions are: "How much equity may my client own? What is his best choice of business entity? What permissions and notices are required? What are the comparative tax costs of realizing returns through license fees, interest payments, and dividends? How can my client guard against expropriation?"

Viewed against those criteria, the structural imperatives for United States trade and investment in Mexico are, with five exceptions, not substantially more disadvantageous than those in most mature industrializing nations. The exceptions are these: *First*, for many years it has been well-nigh impossible to establish in Mexico a Mexican branch of a non-Mexican corporation. A Mexican entity is, in practice, necessary, and the resulting inflexibility usually increases, for foreigners, the net tax and paperwork costs of doing business in Mexico. *Second*, Mexico has no tax treaty with the United States, so the relatively steep Mexican tax rates on passive income paid abroad remain unmitigated. *Third*, under the Foreign Investment Law substantially all new foreign investment in Mexico must don the uncom-

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18. G.A. Res. 3281, 29 U.N. GAOR, Supp. (No. 31) 50, U.N. Doc. A/9631 (1974), art. 2.2(c). *See also* Declaration, arts. 4 and 4(e).

19. Ley Sobre el Registro de la Transferencia de Tecnología y el Uso y Explotación de Patentes y Marcas, Dec. 28, 1972, D.O., Dec. 30, 1972 [hereinafter cited as Technology Law].

20. Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera, Feb. 28, 1973, D.O., Mar. 9, 1973 [hereinafter cited as Foreign Investment Law].

21. Ley de Invenciones y Marcas, Dec. 30, 1975, D.O., Feb. 10, 1976 [hereinafter cited as Inventions and Trademarks Law].

fortable straitjacket of junior partner in a statutorily-coerced joint venture. *Fourth,* for foreign licensors the Technology Law and the Inventions and Trademarks Law make for a bureaucratic approval system, low royalties, and a rather queasy future for Mexican industrial property rights generally. *Fifth,* Mexico affords no international mechanism for assurances against, or compensation for, expropriation. Specifically, there is no Mexican-United States treaty basis for Overseas Private Investment Corporation (OPIC) insurance. Moreover, Mexican legislation is studded with Calvo clauses[22] and prohibitions against contractual reference to foreign law or foreign fora.[23] Mexico's adherence to the United Nations Foreign Arbitration Convention[24] is a rare exception to her credo of unqualified national sovereignty over the legal rights of aliens.

Despite these obstacles, Mexico provides considerable latitude for conventional structures of trade and investment. The export field provides the best example of this latitude. If title passes outside Mexico and the authority of the Mexican sales representative is properly limited, a United States exporter may sell for export to Mexico without incurring corporate registration or other "doing business" exposure there. Moreover, Mexican law is agreeably free from provisions that restrict a choice of sales representative or impose nonconsensual liabilities for terminating his appointment. The greatest potential for inordinate regulation of U.S. exports to Mexico lies in the fact that Mexican government agencies dominate many segments of the Mexican economy and therefore purchase, or control the purchase of, a substantial percentage of all Mexican imports. A Mexican statute[25] requires official registration of suppliers of goods and services to governmental agencies, but it has not been oppressively enforced.

As regards direct investment, the Echeverría legislation makes for cumbersome approvals and awkward equity structures, but within those constraints the system is viable. The foreign investor must register all new investments[26] and obtain prior authorization to acquire more than 25% of the capital or 49% of the assets of an enterprise.[27]

22. *See* CONSTITUCIÓN, *supra* note 5, and Foreign Investment Law, *supra* note 20, art. 3. *See also* WRIGHT, *supra* note 3, at 97-101.

23. *See, e.g.*, Technology Law, *supra* note 19, art. 7 (XIV).

24. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 3.

25. Ley sobre Adquisiciones, Arrendamientos y Almacenes de la Administración Pública Federal, Dec. 26, 1979, D.O., Dec. 31, 1979.

26. Foreign Investment Law, *supra* note 20, art. 23, transitory art. III.

27. *Id.*, art. 8.

Apart from sectors reserved exclusively to the state or to purely Mexican investors,[28] and those where Mexican-owned equity must be more than 51%,[29] the foreign investor may not acquire more than 49% of the equity of a Mexican enterprise without prior authorization of the National Foreign Investment Commission.[30] There are special restrictions, somewhat ameliorated by a trust regime, on foreign ownership of land in the "prohibited zone" along the seacoast and borders,[31] and an administrative exemption permitting 100% foreign-owned *maquiladora* industries.[32] The Foreign Investment Law explicitly prohibits devices whereby the foreigner achieves control disproportionate to his equity,[33] and, to keep the record straight, requires his share certificates to be nominative, not bearer.[34]

Complementing the Investment Law is the Technology Law, which subjects all licenses to approval and registration.[35] The statutory list of forbidden clauses[36] has familiar resonances for students of United States antitrust law and is generally reasonable. In practice the allowed royalties tend to be lower than the traffic would otherwise bear, but in principle the Mexican valuation procedure is not grossly dissimilar to the screening performed in many countries for purposes of exchange control or tax deductibility.

IV. FICTIONS AND FACTS

The Echeverría legislation was followed by a decline in new foreign investment in Mexico and a dramatic collapse of the peso in terms of U.S. dollars. So far during the administration of President López Portillo the rate of capital inflow has increased and the dollar value of the peso has not substantially changed.

Arranging this data into a plausible equation of cause and effect is problematic. Was the ebb of equity a calculated response by foreign investors to the black letter of President Echeverría's laws, or merely an emotional reaction to his personality and rhetoric? Was the 1976 devaluation a purely Echeverrían phenomenon, or the tardy re-

28. *Id.*, arts. 4, 7.
29. *Id.*, art. 5.
30. *Id.*, arts. 5, 12.
31. *Id.*, arts. 7, 18-22.
32. Foreign Investment Commission (Mexico), Resolution 1, Mar. 30, 1972; *see also* Regulations of the Mexican Customs Code, art. 321, ¶ 3, Oct. 26, 1977, D.O., Oct. 27, 1977.
33. Foreign Investment Law, *supra* note 20, arts. 5(d), 8.
34. *Id.*, art. 25, transitory art. II.
35. Technology Law, *supra* note 19, arts. 2-4, 7-8.
36. *Id.*, art. 7.

calibration of a more gradually overvalued peso? Did the resumption of capital inflow signal born-again investor confidence in Mexico, or only an opportunistic itch to share in the PEMEX budget? These are difficult questions, and ones which "statistics" may more obscure than elucidate.

It is always difficult to wring facts from the "statistics" on foreign enterprise in Mexico. One falls all too easily into statistical jargon that begs the very questions one is seeking to answer. The best examples are the two key phrases from the Echeverría laws: "transfer of technology" and "foreign investment."

It is possible to think of technology as esoteric bits of information, like the recipe for Greek Fire or an equation for squaring the circle, that can be "transferred," that is, moved from one human consciousness to another by pieces of paper called license agreements. By this reasoning, the material achievements of Western civilization are seen as the results of particular formulas and techniques to which objective economic values can be attributed, *e.g.*, x zillion dollars for discovering fire, y zillion for the wheel, z hundred per vehicle for the internal combustion engine. Thus, having fragmented technology and quantified its worth, economic development can be visualized as the purely administrative task of exchanging bits of information for bundles of currency.

All of this is rather fanciful; Western technology, like Western democracy and the Western Reformation, does not come in bits. It is merely one undetachable facet of a great cultural movement which included such elements as the growth of the middle class and the capitalist revolution that dominated the post-Renaissance world. It is the old story of petals and roses, of golden eggs and geese. Can Western technology, to any significant and self-perpetuating degree, be abstracted into formulas and techniques and "transferred" to a non-Western environment? The verdict of history, one infers, will be in the negative: Western industrialism cannot be unbundled and fractionalized from its capitalistic seed-bed without severing the very tap-root upon which its growth and viability depend.

If we could perceive the flow of United States' technology into Mexico with keener eyes, we would observe that the most valuable part of it crosses the Río Grande unlicensed and royalty-free in the skills of day-workers returning to Nuevo Laredo at sunset, in the brains of Mexican students flying home from Cal. Tech and M.I.T., in magazines, films, and catalogs, through imitated techniques of administration, and in the thousand other ways by which ideas and attitudes pass the permeable membrane of our cultural interface with

Mexico. In the relatively few situations where technology does pass by formal license, it usually goes for a price substantially less than its worth because the licensor is an equity participant in, a purchaser from, or a supplier to, the licensee, and the objective of the license is not to earn royalties but to enhance the profitability of the overall operation. In other words, the U.S. supplier of technology is not an entrepreneur because he licenses; he licenses because he is an entrepreneur.

In that sense the Mexican Technology Law is like the story about the policeman who, late one night, saw a drunk on his hands and knees searching frantically for something under a street light. He had lost his watch, the drunk said. "Exactly where?" asked the policeman. "Oh, I dropped it two blocks down the street," the drunk replied, "but I'm looking for it here because the light is better." The economic outflows the Mexican Technology Law is looking for are often, like the drunk's watch, several blocks down the street—in dividends, loan payments, the price of exported goods, and the cost of imports. Similarly, the really valuable "technology" that Mexico receives from the United States—techniques of management and capital formation, non-proprietary processes, marketing know-how and the like—are often invisible accretions of entrepreneurship that cannot be discerned under the street light of a license agreement. But the Technology Law persists in looking under the street light, in evaluating the formally imported technology and its formally attributed cost, simply because that is a convenient place to look.

The second great fiction about foreign enterprise in Mexico goes to the heart of the "statistics" of the post-Echeverría foreign investment boom. It is the proposition that every inflow of capital, regardless of its motivation and intended duration, is "investment." In fact there are marked differences between equity that is permanently placed, with a view to return only through dividends, and funds that are laid down for short-term profit or indirect advantage.

It would be interesting to know, of all the "investment" dollars that have entered Mexico, how many were intended as long-term investment in the former sense and how many went as funds of the latter type. The railroad equity that Díaz and Cárdenas nationalized was clearly long-term, as presumably were the utility and telephone investments that were bought out under López Mateos.

The Cárdenas-expropriated oil and the more recently "Mexicanized" mining equities are more difficult to classify. Probably their investors originally looked to dividends but later came to value their stakes chiefly for the control they afforded over exported crude oil and ores. For similar reasons we may guess that much, if not most, of the post-Echeverría influx of minority equity is not "investment" in the long-term, dividend-yielding sense of the word, but pseudo-equity with other motives, placed to protect existing markets and to nail down Mexican customers and suppliers, or to provide front-end money for short-term service contracts. If that is true, Mexico may learn to her disappointment that a dollar's worth of the new post-Echeverría minority equity, which comes for short-term benefits and will leave when they are no longer forthcoming, is considerably less valuable to Mexico than a dollar's worth of the old long-term majority equity, which came to earn dividends and stayed to provide the intangible but invaluable accretions of genuine capitalism.

V. Anticipating the Eighties

It is difficult, in this apocalyptic world, to predict the trajectory of nations over the next twenty-four hours and downright foolhardy to anticipate an entire decade, but certain predictions regarding the future of relations between Mexico and the United States appear to bear the force of probability. For one thing, the confrontation of the two countries in the Eighties *will* be a meeting on the staircase, with an increasingly confident Mexico moving toward world prominence at a faster clip than a dollar-poor, strategically frustrated, ideologically isolated United States. It will be surprising if the United States does not attempt to restore lost self-esteem by some vigorous assertions near home, thereby seeking stronger hegemony in a smaller sphere. It will be even more surprising if Mexico does not take offense at such pretensions, as she has already bristled to innuendos of a "North American Common Market."

The points of abrasion will be energy, trade, and immigration. In energy it will take several years, at best, to overcome the gaffes and gaucheries of the United States Government vis-à-vis the PEMEX gas contract, and in general to allay Mexican sensibilities concerning hydrocarbon exports to the United States. It will require of the United States monumental tact and an invisibly low profile—qualities not normally associated with ego-bruised and energy-hungry *gringos*.

Trade is a more complex, and encouraging, picture. Mexico's Industrial Development Plan for the 1980s[37] is impressive evidence

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37. Secretaría de Patrimonio y Fomento Industrial (Ministry of National Property and Industrial Development) Mexico—Industrial Development Plan, 1979-1982-1990 (1979).

that she is beginning, at last, to doubt the protectionist philosophy of import substitution which has shaped trade policy for three previous decades. Although Mexico's accession to the General Agreement on Tariffs and Trade (GATT) has now been postponed,[38] she may in time nerve herself to enter the real world of export/import, albeit featherbedded with low-cost petrochemical feedstocks. The United States presently accounts for 68% of Mexico's exports and 61% of her imports.[39] There is every reason for the United States to encourage Mexican aspirations toward freer and more diversified trade, and to accept politically disruptive Mexican exports, such as tomatoes, in the interest of cooperation and predictability in hydrocarbons.

The immigration problem is a paradoxical reversal of history: instead of nineteenth-century North American settlers occupying and purloining Mexico's northern provinces, we now have twentieth century illegal Mexican immigrants reconquering the border states by sheer force of wading and procreation.[40] The law is on the United States' side but has proven to be politically unenforceable. The irresistible trend appears to be the "Mexicanization" of the Sunbelt United States, a fusion of cultures that will play havoc with the Puritan ethic but might result in a pro-Mexico tilt in domestic U.S. politics—analogous to ethnic espousals of Ireland, Israel and Black Africa—that could make for better bonds of empathy across the Río Grande.

As for United States private investment, a plausible hypothesis for the Eighties is that it will not prodigiously increase. To the extent it does accelerate, it may well tend toward short-term and ulterior-motivated placements rather than long-term, dividend-regarding capital. On the U.S. side, those projections are supported by the fact that the dollar is dwindling in purchasing power and losing its appetite for foreign adventures. On the Mexican side, they are suggested by the disincentives of the Echeverría legislation and by the logic of Mexico's own petro-dollars and public borrowings abroad as preferred sources of domestic investment. One countervailing factor may be, in time, a growing realization on the part of Mexico that modest royalties and minority allotments for foreign equity do not constitute suffi-

38. Statement of President López Portillo, El Sol de México, Mar. 19, 1980, at 1.

39. Figures for 1979. Business Latin America, Feb. 11, 1980, at 46.

40. It is estimated that 800,000 Mexicans enter the United States each year as temporary workers and that between 1.8 and 4.2 million Mexicans are now illegally present in the United States. Stepan, *The United States and Latin America: Vital Interests and the Instruments of Power*, 58 FOREIGN AFF. 659, 666-69 (1980).

cient entreprenurial incentives to keep a manufacturing Mexico technologically abreast of an industrializing Third World.

The United States has always had much to learn from Mexico. The lesson for the explosive Eighties is that the two nations must break free from the crippling stereotype of their past relationship: "the old relationship of strong and weak, oscillating between indifference and abuse, deceit and cynicism."[41] As the United States stands on the threshhold of ten dangerous and demanding years, it would do well to ponder the advice of a wise and courageous man who preserved his country through an equally explosive decade more than one hundred years ago. "*El respeto al derecho ajeno es la paz,*"[42] Benito Juárez said: "Peace is respect for the rights of others."

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41. O. Paz, *Reflections—Mexico and the United States*, THE NEW YORKER 136, September 17, 1979.
42. Quoted in H. PÉREZ MARTÍNEZ, JUÁREZ 47 (2d ed. 1949).