

# MEXICO-UNITED STATES RELATIONS: ECONOMIC INTEGRATION AND FOREIGN INVESTMENT

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## I. INTRODUCTION

This article evaluates the relationship between Mexico and the United States from three different approaches. First, the importance of the relationship between the two countries is addressed. Second, the major legal instruments that have been created since 1985 which facilitate the expansion of free trade between the United States and Mexico are discussed. Finally, consideration will be given to the changes undergone in Mexico with the rules of foreign investment. To write about economic integration is also to ponder the future, which is appropriate at the beginning of a new decade.

## II. IMPORTANCE OF THE RELATIONSHIP

Understanding the relationship between the United States and Mexico is crucial to any consideration on economic integration. What follows are perspectives from both sides of the border.

With respect to the United States global interests, William D. Rogers<sup>1</sup>, a well-known observer in this field, commented recently that: "For a superpower with global interest[s], relations with every country are special. But some relationships are more special than others. Such is the case of America's relationship with Mexico. The United States and Mexico have importance for each other without parallel elsewhere in the world."<sup>2</sup>

The importance of this relationship has influenced the present foreign policy of the United States. George Bush relayed its significance to

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1. Former Assistant Secretary of State for Inter-American Affairs. Member of the Bilateral Commission on the Future of United States-Mexican Relations.

2. Rogers, *Approaching Mexico*, 72 FOR. POL. 196 (1988).

the American public and to Carlos Salinas de Gortari at a meeting in Houston on November 27, 1988. Both men were President-Elect of their respective countries at that time. A few months later, Secretary of State James Baker stated to the press that: "The United States have no other relationship that is more important than the one with their neighbor and friend, the Mexican Republic. . . these are not just words but a solemn commitment of the United States."<sup>3</sup>

On the other hand, President Salinas, in his speech before the United States Congress on October 4, 1989, expressed the following ideas when addressing the relationship between the two countries:

Our history is an ongoing awareness of sovereignty in a interdependent world . . . [b]ut we believe authentic interdependency takes place only among independent nations. The time has come to establish a new relationship free of myths, lack of trust, abuse and recriminations; a relationship involving an ongoing dialogue between our two nations . . . to achieve the cooperation that will benefit us. . . . We must grow; but growth needs a freer and safer access to the biggest market in the world.<sup>4</sup>

In his first report to the nation on November 1, 1989, President Salinas expressed before the Mexican Congress that:

We have been able to translate this spirit [of cooperation] into actual agreements. . . . We are achieving a greater and safer access of our products to the American Market . . . [we shall soon achieve] the abatement of non-tariff barriers for our most important sectors.<sup>5</sup>

Mexico is the third largest trade partner of the United States. This translates into an important source of employment as well as a considerable factor in both countries' production of goods and services. Exports to the United States represent sixty-five percent of Mexico's total exports, which amounts to nearly forty-five billion dollars.<sup>6</sup>

The importance of the two countries' relationship also derives from the ever-increasing migrating labor from Mexico to the United States. In 1978, some observers estimated that illegal Mexican workers numbered eight million in the United States work force.<sup>7</sup> However, other observers find this statistic excessive. For example, the 1980 United States census determined the total number of Mexican migrants to be 2.5 million.<sup>8</sup>

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3. El Universal, Aug. 8, 1989, at 1, col. 2.

4. See Visit of Mexican President Salinas, 89 DEP'T ST. BUL. 1 (Dec. 1989).

5. El Universal, Nov. 2, 1981, at 1, col. 1.

6. El Universal, *supra* note 3.

7. Zea-Prado, *Introducción al Problema de los Indocumentados*, 20 Relaciones Internacionales 7, at 9 (1978).

8. Rogers, *supra* note 2, at 197.

Moreover, some experts predict that:

Projections prepared for the Bilateral Commission on the future of the United States-Mexican relations suggest that by the turn of the century this number will have increased to 5.6 million if the migratory flow is "standard" and to 7.6 million if it is "high." Ten years later it may reach more than 9.5 million.<sup>9</sup>

Social interaction across the two thousand mile border in 1981 occurred between thirty-four Mexican municipalities and twenty-four American counties. Interaction across the border involved approximately seven million people<sup>10</sup> and a considerable flow of trade and labor. This contact takes place within a microcosm that is sometimes removed from, and usually differs from, the governmental relations between the two countries. Travel along the United States-Mexican border readily reveals the pervasive, reciprocal commercial and cultural influences.

Strong and continuous cooperation between the two countries exists in the fight against drugs. The importance of the countries' relationship is easy to grasp in this struggle. For both countries, the issue is vital to national security. Mexico has demonstrated its commitment by allocating one-half of the Attorney General's budget and one-third of the Army's budget to combat drug trafficking.<sup>11</sup>

These and other considerations indicate the need for more cooperation as the relationship grows. These central aspects of the relationship, together with the fact that both countries share some common basic tenets and values, forecast a greater interdependence in the last decade of the twentieth century.

### III. THE PROCESS OF ECONOMIC INTEGRATION

#### A. *Background: A History of United States-Mexican Integration*

In 1830, the American Ambassador to Mexico, Anthony Butler, complained to the Mexican Minister of Foreign Affairs, Lucas Alamán, that the Mexican Congress had not ratified the Trade Treaty between the two countries two years after it was submitted.<sup>12</sup> The Ambassador knew that the Mexican Government did not wish to have improved relations

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9. *Id.*

10. J. Bustamante, *La Interacción en la Frontera México-Estados Unidos: Un Marco Conceptual para la Investigación*, in *LA FRONTERA DEL NORTE: INTEGRACIÓN Y DESARROLLO*, at 26 (1981).

11. Address by President Salinas, *supra* note 4.

12. BOSCH GARCÍA, *HISTORIA DE LAS RELACIONES ENTRE MÉXICO Y LOS ESTADOS UNIDOS 1819-1848* (1985).

with the United States even though Mexico participated in the negotiations for the treaty. Mexico's conservative stance was the true motive for delaying ratification of the treaty.

From the very beginning, relations between both countries have been tainted by conflicting interests, differing conceptual points of view, misunderstandings, clashing passions, and even violence. However, times change, and positions and ideas are modified. The interdependence between the two countries becomes greater and unavoidable. The 1980s marked the beginning of a new relationship. The two neighbors have started down the road towards economic integration.

In 1982, the relationship between Mexico and the United States suffered a radical change. The crisis of the Mexican economy, which reached its peak during that year, forced the new Mexican Government to follow an economic policy intended to change the Mexican economic model. The Mexican Government abandoned the policy of inward development, which had been the primary characteristic of Mexican economic policy for the prior fifty years.<sup>13</sup>

The 1982 economic crisis forced changes in Mexican economic policies, which created considerable adverse effects. Economic experts estimate that the living standard of the Mexican population fell by fifty percent over the past eight years.<sup>14</sup>

The change from an inward development economic model to an exporting model had two immediate results: First, Mexico joined the GATT; second, Mexico's trade with the United States changed. This fundamental economic change signified the beginning of the economic integration of both Mexico and the United States. On April 23, 1985, the two countries signed the Understanding on Subsidies and Compensatory Taxes. Two years later, on November 6, 1987, both nations signed another agreement which was broader in scope, the Understanding on Trade and Investment.<sup>15</sup>

The new administrations in both countries have continued on the road of their predecessors. President Salinas visited Washington, D.C. in October 1989.<sup>16</sup> During this visit, President Salinas signed eight agreements.<sup>17</sup> The two Presidents also signed a ninth agreement in November 1989 which discussed the sharing of fiscal responsibilities. In less

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13. S. WEINTRAUB, *MÉXICO: FRENTE AL ACUERDO DE LIBRE COMERCIO CANADA-ESTADOS UNIDOS* (1989).

14. Address by President Salinas, *supra* note 4.

15. Understanding on Trade and Investment Relations, Nov. 6, 1987, United States-Mexico, 27 I.L.M. 438 (1988) [hereinafter 1987 Understanding].

16. Address by President Salinas, *supra* note 4.

17. Farnsworth, *Mexican-U.S. Pact Reached on Trade and Investments*, N.Y. Times, Oct. 4, 1989, at A1, col. 4.

than four years, the two countries have signed agreements never before contemplated.

### B. *The Executive Agreements*

The first agreement was a new Understanding on Trade and Investment which addressed subsidies.<sup>18</sup> This Understanding provided the basic rules pursuant to which petitioners in both countries must establish the "proof of injury." This proof is required in any proceeding instituted to apply countervailing duties. A duty will be levied only if exports took place under unfair conditions. The 1987 Understanding on Trade and Investment primarily favored Mexican goods in the American market.

The 1987 Understanding on Trade and Investments acknowledged that Mexico is a developing nation. Therefore, the United States granted Mexico preferential treatment in its trade with the United States. This preferential treatment is in accordance with the GATT. Conversely, Mexico acknowledges the important and supporting role direct foreign investment has in the economic growth of Mexico. Linked to the United States grant of preferential treatment is Mexico's commitment to amend its legislation regarding industrial property. Consultation mechanisms to resolve controversies between the governments were also provided for in the Understanding on Trade and Investment.

A new Understanding on Trade and Investment, signed in 1989, superseded the one signed in 1987; this Understanding is one more step in the gradual process towards free trade between the two countries.<sup>19</sup> While the 1987 Understanding only provided general directives, the 1989 Understanding obligates both countries to take concrete steps in reducing barriers to importation. Many consider the 1989 Understanding on Trade and Investment to be a catalyst of future agreements with a wider scope on free trade.

Various predictions exist regarding the manner in which the new 1989 Understanding will be applied. These predictions extend to the question whether the nations will comply with their obligations to reduce importation barriers, particularly with regard to the American market. The signing of this Understanding gave rise to over-optimistic estimates. Some forecasted that trade between the two countries would double within a few months.<sup>20</sup> Presently, the long-term effects of the new 1989 Understanding are still unknown.

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18. 1987 Understanding, *supra* note 15.

19. *Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, D.O., May 16, 1989 [hereinafter *New Regs*].

20. The trade flow increased up to 25% during the four months following the date on which it was signed. Mercado, *Relaciones Comerciales*, *EL ECONOMISTA* (Oct. 13, 1989).

The United States and Mexico are contemplating further negotiations on a variety of topics including: tariffs, non-tariff barriers, investments, industrial property, technology, services, and dumping. The Mexican Government hopes to eventually execute a free trade agreement with the United States similar to the one signed by the United States and Canada in 1989. The authors concur with another optimistic commentator who wrote: "Should the trend toward opening bilateral trade continue, it is likely that the Framework Agreement [the 1987 Understanding] will provide the impetus for achieving further integration."<sup>21</sup>

President Bush and President Salinas' Agreements covered all aspects of United States-Mexico trade relations. A 1989 steel agreement provides that, within the limitations specified in the Agreement on Voluntary Restrictions, Mexican exports of steel may double within a year, from 400,000 tons to 800,000 tons.<sup>22</sup> The Understanding Concerning Industrial Property provides that Mexico will undertake efforts to protect American patents and trademarks. The United States has insisted on strict compliance with the Agreement, notwithstanding amendments already made to Mexican patent and trademark law. In this regard, the United States has recently adopted a policy of consultation and negotiation within a framework of "cooperation, not of imposition" in order to achieve mutually satisfactory agreements.

Mexico and the United States have also reached agreements regarding agriculture, automobile engines, and custom procedures. The Agriculture Agreement created five technical teams, and charged these teams with the duty of issuing opinions on actions needed to foster agricultural trade. In the Automotive Agreement, the United States agreed to continue the importation of automobile engines from Mexico. An Agreement on Customs Procedures will expedite cargo transportation. The United States agreed to consider including forty-three new products in the General System of Preferences (GSP). This Agreement particularly reflects the open attitude of the United States to move towards free trade; in the past, Mexican products were rarely eligible for the GSP.

Both the number of issues included in the October 1989 agenda and the number of agreements reached indicate that the administrations of Presidents Bush and Salinas are willing to open up their markets to a larger flow of trade. Many believe that the agreements between Mexico and the United States are the Mexican counterpart of the new free trade

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21. Smith, *The United States-Mexico Framework Agreement: Implication for Bilateral Trade*, 20 *LAW & POL. INT'L BUS.* 655, at 681 (1989).

22. *BOLETÍN DE RELACIONES COMERCIALES Y POLÍTICA COMERCIAL ENTRE MÉXICO Y ESTADOS UNIDOS* (1989).

agreement between the United States and Canada. Some believe that the United States-Mexico agreements represent a larger trend toward free-trade agreements in all of North America.<sup>23</sup> Indeed, on his visit to Mexico in March of 1990, the Canadian Prime Minister, Brian Mulroney, signed ten cooperation agreements including economic and trade policies. He stated that Mexico should not fear to participate in a North American Common Market.<sup>24</sup>

#### IV. NEW RULES ON FOREIGN INVESTMENT IN MEXICO

##### A. Introduction

Foreign investment in Mexico has been significantly deregulated over the last year. The following analysis will explore foreign investment in Mexico in sectors where American investment is the largest.<sup>25</sup> The Federal Executive, exercising the authority granted in Section I of Article 89 of the Political Constitution of the United Mexican States,<sup>26</sup> provided measures to assure compliance with the Law on Foreign Investment (FIL). The Federal Executive took the initiative, exercising his authority rather than asking Congress to make substantial amendments to the statute.

When the new Mexican Foreign Investment Regulations (New Regulations)<sup>27</sup> became effective, they derogated several provisions of the Resolution for the Systematization and Updating of the General Resolutions issued by the National Commission of Foreign Investment.<sup>28</sup> More importantly, articles five and seven, and transitional article six of the New Regulations amend article five of the Law on Foreign Investment which states: "[I]n cases in which legal or regulatory provisions do not require a fixed percentage, foreign investment may participate in a proportion not to exceed forty-nine percent of the capital stock of the companies."<sup>29</sup>

23. WEINTRAUB, *supra* note 13.

24. But the Canadian Trade Minister is not quite so cooperative: "U.S. Senators cannot drag Canada into a free-trade deal with Mexico unless Canada is interested . . . and Canada is not interested," *The Globe and Mail*, June 8, 1989.

25. "The predominance of Americans in foreign investment, which represents 62% of the total, seems to be losing ground, as in 1983 it represented 66.3% of the foreign capital invested in Mexico, and this is the reason for wishing to adjust the framework of trade relations, in order to take advantage of the new opportunities arising from the new rulings on foreign investment." *El Universal*, Oct. 2, 1989, at 3, col. 1.

26. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS D.O., Feb. 1, 1917, art. 89, § 1 [hereinafter CONST.].

27. New Regs., *supra* note 19.

28. *Resolución General que Sistematiza y Actualiza las Resoluciones Generales Emitidas por la Comisión Nacional de Inversiones Extranjeras*, D.O., Feb. 3, 1988.

29. *Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, D.O., March 9, 1973, art. 5 [hereinafter FIL]. The FIL went into effect on May 8, 1973.

Under the FIL, foreign investment should not represent a contribution to the capital stock of more than forty-nine percent. However, the National Commission on Foreign Investment has discretion to authorize a greater capital stock contribution. The Commission derives its authority from article twelve, section I of the FIL. In making its determination, the Commission must take into account the criteria referenced in article thirteen of the FIL.<sup>30</sup> However, the New Regulations have fundamentally changed the old law by allowing foreign investors to participate in capital stock of companies in any proportion at the time of their incorporation.

Article five and transitional article six of the New Regulations may aid foreign investors in the event of the purchase of company shares or fixed assets. Under certain circumstances, foreign investors may engage in activities not otherwise allowed by the other provisions of the New Regulations.

If their investments fit within the framework of the New Regulations, foreign investors need not seek authorization from the Ministry of Commerce nor from the National Commission on Foreign Investment. However, the following conditions must be met.

First, investments in fixed assets which are made during the pre-operational stage should not exceed an amount determined by the Ministry of Commerce. The Ministry periodically reviews and adjusts this amount. Initially, the Ministry fixed the amount at 250 billion pesos (100 million dollars).

Second, financial resources for such investments must come from abroad. Acceptable sources include capital stock contributions of foreign partners or shareholders, or financing granted from sources abroad. This requirement prevents foreign investors from using Mexico's scarce financial resources to foster investments that could eventually drain foreign currency from the country. Nevertheless, if the partners or shareholders of the incorporated companies are foreign investors already established within Mexico, they can invest by using their own local resources. Mexican companies which presently have foreign investors as majority shareholders may use undistributed profits to invest in other Mexican companies.

Third, the minimum amount of paid capital stock must equal twenty percent of the total investment in pre-operational fixed assets.

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30. The FIL requires the Commission to consider a project's impact on jobs, training of Mexican personnel, technology, national integration, export capacity, amount of capital, and geographic location to justify approval of 100% foreign ownership. *Id.*, art. 13. See generally J. Camil, *Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model*, 12 HOUS. J. INT'L L. 1, at 10 (1989).

This requirement facilitates financial stability before operations begin. This requirement differs from that of the General Law of Commercial Companies, which provides that the capital stock of corporations must not be less than 25,000 pesos, an obviously outdated amount.<sup>31</sup>

Fourth, companies should locate facilities for manufacturing or industrial operations in zones other than those with great industrial concentration. The Mexican government has already issued administrative directives addressing this topic. The government enacted these directives in order to provide relief for the big industrial cities, specifically Mexico City, Guadalajara, and Monterrey. With these restrictions, Mexico hopes to foster a stronger regional development consistent with its modernization policy.

Fifth, companies must keep their accrued balance of foreign currency at least at a break-even point during the first three years of operation. In essence, the *company* must produce a positive balance of payments in foreign currency. The question arises as to whether investments made with resources from abroad, obviously in foreign currency, may be recorded as income for the purposes of such balance. In our opinion, the company should be able to take the initial investment into account for such period. However, the governmental authorities seem to think differently. The authorities consider the start of operations to be the date on which a business first receives income derived from the commercial sale of its products or the rendition of services.

Sixth, corporations must use appropriate technologies and comply with legal provisions on environmental protection. This provision raises the question: What is appropriate technology? We must not forget that modern technology has been the subject of criticism by the developing countries. This criticism stems from the fact that technology is typically capital intensive and makes little use of human labor. For a country like Mexico, where employment is an important issue, the definition of "appropriate" technology is very difficult. According to data provided by the Secretariat of Labor and Social Planning, the under-employment rate, which includes both the unemployed and those persons who earn less than the minimum monthly wage, is fifty percent.

The New Regulations provide that: "[I]t shall be understood that foreign investors agree to the requirements provided for in this article by the sole fact of their acquisition of stock of the companies to be incorporated in accordance herewith [article 5]."<sup>32</sup> Mexico seeks to establish a

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31. CÓDIGO DE COMERCIO, art. 89, § II [hereinafter, COM. C.]. Commercial legislation in Mexico is federal in nature and derives its authority from constitutional powers granted to the Federal Congress.

32. New Regs., *supra* note 19, art. 5.

system which allows foreign investors to incorporate companies in Mexico freely by contributing 100 percent of the capital stock. This system does not require prior authorization from the National Commission of Foreign Investment or from the Secretariat of Commerce and Industrial Development. The system only requires that investors implicitly accept the commitments mentioned in article five of the New Regulations.

On several occasions, foreign investment officials have stated that the criteria set forth in the regulations are only *goals* to be achieved. The officials concede the difficulty in demanding strict compliance with the New Regulations. When the New Regulations are applied, the authorities will have to clarify a number of vague provisions. However, the political winds that have given rise to the publication of the Regulations should in all likelihood result in extremely liberal administrative approval of foreign investment in industries not allowed by a narrow reading of the New Regulations.

The FIL stated that foreign ownership could not be more than forty-nine percent unless authorized by a special administrative resolution. This general rule has now become the exception. The New Regulations allow foreign investors to contribute 100 percent of the capital stock if they simply comply with article five.

### 1. In-Bond Companies

Administrative regulations provide special rules for the in-bond manufacturing industry. An in-bond operation consists of duty free importation of components and raw materials by a Mexican company which components and materials are used to manufacture products only for export. Article six of the New Regulations grants foreign investors the authority to acquire shares if an in-bond company is already incorporated or is being incorporated. Thus, the New Regulations allow foreigners to acquire 100 percent ownership of in-bond companies. It is important to note that some exporting companies may incorporate with 100 percent foreign ownership under law pre-dating the New Regulations; these corporations need not comply with the limitations stated in article five of the New Regulations.

Article three of the Decree to Foster In-Bond Companies provides for simplification of administrative processing to establish new in-bond companies and to expand existing ones.<sup>33</sup> This decree clearly defines procedures that must be followed to gain approval by the Ministry of Commerce. The procedure uses an innovative "one counter" system. This

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33. *Id.*, art. 3.

system coordinates all governmental agencies and instrumentalities concerned into a "work team." The establishment of "work teams" should facilitate consistent decisions and authorizations.

Article five of the Decree provides that any person or company incorporated in Mexico may apply for authorization to operate as an in-bond company. However, the corporation must export 100 percent of its production. The Decree defines the in-bond industry as a strategic element in the country's opening to international trade. The language adheres closely to the general policy of opening up to trade.

## 2. Foreign Technology Transfer

The regulatory law on technology transfer began in Mexico in 1972. In 1982, the government amended the regulatory law by prohibiting medium- to high-royalty remittances. As a general rule, the regulation fixed royalty remittances at rates between two and three percent of the gross income on sale of products. New regulations were published on January 9, 1990.<sup>34</sup> These new regulations still obligate users to file agreements executed with foreign suppliers with specified administrative agencies.<sup>35</sup> However, the government has deregulated the registration process, allowing foreign suppliers of technology, management, copyrights, patents, trademarks, and computer programs greater participation in the operation of the Mexican licensee. Thus, the licensor can now better protect the quality of licensed products by using trademarks and by requiring better quality raw materials.

## V. CLOSING REMARKS

The modern Mexican economy is one of the most open economies in the world. Mexico has deregulated foreign investment, promoted in-bond companies, loosened up restrictions on technology transfer regulations, and reduced import tariffs.

At a time when the economies of the industrialized nations, in particular that of the United States, are moving towards greater protectionism, Mexico's decision to open the economy to trade would seem inadvisable. But we consider Mexico's approach rational because it contributes toward the economic integration of Mexico and the United

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34. *Reglamento de la Ley Sobre el Control y Registro de la Transferencia de Tecnología y el Uso y Explotación de Patentes y Marcas*, D.O., Jan. 9, 1990. This was a statutory ruling on the control and registration of transfer of technology and the use and exploitation of patents and trademarks.

35. One must still file transfer of technology agreements executed with foreign suppliers in these areas: patents and trademarks, industrial models and drawings, technical assistance, engineering supply, management contracts, copyrights, patents and computer programs.

States. Hopefully, the future holds further integration possibilities, and the entire North American continent shall become a free market.

Recently, another factor has emerged which indirectly influences this process. Changes in Eastern Europe may attract investments, once the turbulence settles. If Eastern Europe draws western investors, foreign investment in Mexico will suffer. Mexico must prove that investments in Mexico will compete in the global economy. Integration with the United States would aid Mexico's efforts to more fully integrate into the global marketplace.