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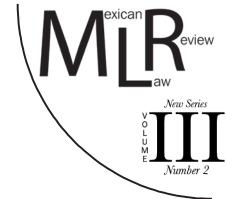

FOREIGN DIRECT INVESTMENT, RESTRICTIONS AND PRIVATIZATION: THE MEXICAN REGULATORY EXPERIENCE

Antonio M. PRIDA
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ABSTRACT. *This article studies Mexico's evolution from a protected economy in the 1970s to the free market economy of today. It also presents the different political and economic stages of this process, as well as the important changes made to laws on foreign investment in preparing for the North American Free Trade Agreement (NAFTA), the Mexico-European Union free trade agreement and other bilateral agreements on investment promotion and protection. This has also led Mexico to privatize its economy, its banks and telecommunications in particular. This article also explains the legal framework for this privatization and presents an outline on the possible opening of the electricity sector.*

KEY WORDS: *Mexico, closed economy, free market, foreign investment, privatization, free trade agreements, NAFTA.*

RESUMEN. *El artículo estudia el desarrollo que México ha tomado desde los años setenta de una economía cerrada a una economía liberal y abierta. Además, el artículo presenta las reformas sustanciales hechas a las leyes sobre inversión extranjera en preparación al Tratado de Libre Comercio de América del Norte (NAFTA), el tratado entre México y la Unión Europea y acuerdos de promoción y protección recíproca de las inversiones. Este camino también*

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ha llevado a México a privatizar su economía, especialmente la banca y las telecomunicaciones. El artículo detalla el marco jurídico para dicha privatización y presenta una perspectiva sobre una posible apertura del sector eléctrico.

PALABRAS CLAVE: *México, economía cerrada, libre mercado, inversión extranjera, privatización, tratados de libre comercio, NAFTA.*

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I. INTRODUCTION

Since 1994, Mexico has been able to substantially attract foreign direct investment from many different industry sectors, especially the manufacturing and automotive industries. It enjoys a strategic geographical position situated between the United States and Canada and Central and South America. It is a country with great natural wealth and has the advantage of having a young and skilled population. In recent years, Mexico has been pursuing the objective of promoting certain industries it considers strategic, such as aerospace, agriculture and food, automotive, creative industries, electronics, fashion and decoration, IT and software services, life sciences, renewable energy, and second homes-vacation homes. Mexico aims to become a global player in these key industries. It is currently the 13th most important economy of the world and has signed international trade agree-

ments with 49 countries.[1] For example, Mexican aerospace industry exports have grown 140% in the last five years. For 2010, the total amount of exports in this sector are expected to come to US$2 billion.[2] Mexico continues to grow in other strategic sectors: 1 of every 8 cars sold in the United States is made in Mexico; in 2008, it was the sixth largest exporter in the world of medical, surgical, dental and veterinary instruments and apparatuses; and it is the world's largest producer of organic coffee.[3] Mexico is committed to diversifying its trade relations with nations other than the United States.

In 2007, Mexico's foreign direct investment showed a 21% increase, amounting to US$23.2 billion,[4] the second highest amount recorded to date. The United States, the Netherlands and Spain are responsible for almost half of the foreign investment in Mexico.[5] However, this steady increase has suffered a setback in 2008 and 2009, due to the world economic crisis.[6]

These figures have not always been such. In fact, they are the result of a paradigmatic shift in economic policy over the last two decades. During this period, Mexico went from a closed, protected national economy[7] to an open market economy with nearly no restrictions on foreign investment. This economic shift was accompanied by a process of profound reform that aimed at introducing new economic mechanisms that would lead to less government involvement in the economy.[8] The purpose of this article is to provide a brief overview of Mexico's transition from a closed economy to an open market and of its efforts to reform the corresponding legal framework. Under the old economic model, the State and the national private

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[1] http://www.sre.gob.mx/tratados.

[2] Massachusetts Office of International Investment, Mexican Aerospace Industry, December 2007, available at: http://www.moiti.State.ma.us/pdf/Mexican%20Aerospace%20Industry.pdf as of January 2010.

[3] ProMéxico, *ProMéxico's Strategic Industries*, available at: http://www.promexico.gob.mx/wb/Promexico/sectors (last visited January 2010).

[4] EconomyWatch, Economy, Investment & Finance Reports, *Foreign Direct Investment in Mexico*, available at: http://www.economywatch.com/foreign-direct-investment/countries/mexico.html (last visited January 2010).

[5] EconomyWatch, Economy, Investment & Finance Reports, *Foreign Direct Investment in Mexico*, http://www.economywatch.com/foreign-direct-investment/countries/mexico.html (last visited January 2010).

[6] Patrick Harrington & José Enrique Arrioja, *Mexico Foreign Investment to Fall in 2008* (Bloomberg) available at: http://www.bloomberg.com/apps/news?pid=20601086&refer=latin_america&sid=aqX49GYcA08s (last visited January 2010).

[7] La Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera, published in the Official Gazette on March 9, 1973.

[8] ECLAC, *Estudios y Perspectivas 10, Foreign Investment in Mexico after Economic Reform*, Jorge Máttar, Juan Carlos Moreno-Brid, Wilson Peres, July 2002, p. 5, http://www.network ideas.org/featart/sep2002/Mexico.pdf (last visited January 2010).

sector invested and directed investment. Direct foreign investment only served to complement those investments. The new liberal model stresses both national private and foreign investments, thus replacing that of the State. Today, the State's role is to provide the legal grounds for foreign investment.

II. Mexico Changes from a Protected Economy to a Free Market Economy

In 1982, as oil prices collapsed and international interest rates increased, the Mexican economy showed how its dependency on oil exports increased its vulnerability. These experiences prompted the government to rethink the prevailing economic model and begin reforming it to strengthen the private sector.[9] This section reviews the most important changes made to Mexico's economic policies towards foreign investment and the relevant regulatory framework.

From 1986 on, and as a reaction to the oil crisis in the late seventies and early eighties, the Mexican government started to modernize its economic relations with the world. It understood that it needed to open the Mexican market to foreign investment and actively encourage investment in Mexico.[10] That year, Mexico joined the General Agreement on Tariffs and Trade ("GATT").[11] In 1993, Mexico joined the Asian-Pacific Economic Cooperation ("APEC")[12] and in 1994 it became a member of the Organization for Economic Co-operation and Development ("OECD").[13] But joining international trade organizations and treaties was only one step. If

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[9] Jorge Mattar et al., *Foreign Investment in Mexico after Economic Reform*,10 Estudios y Perspectivas 5 (2002), available at: http://www.networkideas.org/featart/sep2002/Mexico.pdf (last visited January 2010).

[10] Jesús Gerardo García Flores, Régimen jurídico de la inversión extranjera directa en México 11 (México, 2000).

[11] On July 15, 1986 the Meeting of the Council approved the adhesion of Mexico to the GATT and one month later, Mexico was incorporated as a contracting party to the GATT. Mexico participated in the Uruguay Rounds that took place in Punta del Este on September 15, 1986. The GATT was formed in 1947 and lasted until 1994, when it was replaced by the World Trade Organization in 1995. The original GATT text (GATT 1947) is still in effect under the WTO framework, subject to the modifications of GATT 1994.

[12] Mexico joined on November 17-19, 1993, http://www.apec.org/apec/member_economies.html as of January 2010.

[13] Mexico joined the OECD on May 18, 1994, becoming its 25th member State. The *Decreto de promulgación de la declaración del gobierno de los Estados Unidos Mexicanos sobre la aceptación de sus obligaciones como miembro de la Organización de Cooperación y Desarrollo Económicos* was published in the Official Gazette of the Federation on July 5, 1994.

foreign investment was to be attracted, Mexico had to open its local laws for foreign investment.

In 1990, the Mexican government reformed the foreign investment law of 1973,[14] opening certain sectors previously restricted to nationals or the State to foreign investment and foreign ownership. According to the 1973 law, certain industrial sectors were restricted to State ownership, such as oil and other hydrocarbons, basic petrochemical industries, uranium production and treatment, certain mining activities, electricity, rail transport and telegraphic communications.[15] Other industries only accepted national investment such as radio and television, road transport, domestic sea and air transport, forestry and gas distribution.[16] This law set maximum limits on the amount of foreign investment allowed in certain sectors like the secondary petrochemical industry, and the auto parts industry.[17] Foreigners were prohibited from owning property within 50 kilometers of the borders and coastlines. Inland investment had to be made through bank trusts.

In 1993, the Mexican government tackled the issue again, this time by publishing a new and completely revised foreign-investment law[18] that allows foreign investment in all industry sectors, except for those restricted by said law. This new law replaced the 1973 law and incorporated changes that had previously been made to the regulatory framework. This effort by the Mexican government to reform the national foreign investment regulations was made in preparation of the North American Free Trade Agreement ("NAFTA")[19] that was being negotiated between Mexico, the United States and Canada. According to this new foreign investment law, foreigners were allowed to invest in industrial, commercial, hotel and time-share developments along Mexico's coast and borderlines, although these investments had to be made through Mexican companies. However, the Mexi-

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14 *Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, published in the Official Gazette of the Federation on March 9, 1973; early regulations of foreign investment can be found in Art. 27 I, IV of the Constitution of 1917, the legislation of 1942 known as "Law of 51%", minimum to be held by nationals, and the Mixed Inter-Secretarial Commission of 1947.

15 Sergio Ahrens Ibargüen & Antonio Azuela de la Cueva, *Breve análisis sistemático de Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera y algunas consideraciones respecto del concepto de Empresa*, 8 Jurídica. Anuario del Departamento de Derecho de la Universidad Iberoamericana 269 (1976), http://www.juridicas.unam.mx/publica/librev/rev/jurid/cont/8/pr/pr9.pdf.

16 *Id*. at 295.

17 *Id*. at 296.

18 *Ley de Inversión Extranjera*, published in the Federal Official Gazette on December 27, 1993, entered into force on December 28, 1993, and was last amended on August 20, 2008.

19 NAFTA came into force on January 1, 1994, and superseded the Canada-United States Free Trade Agreement between the U.S. and Canada.

can government practically legalized what was already a common fact. Foreign investors had already been investing in restricted sectors through trusts and other structures.

The new Foreign Investment Law offers many NAFTA benefits, such as reducing the investors' risk by guaranteeing them the same legal rights as local investors, to the international business community since foreign investment is permitted and funds can be transferred. Nevertheless, there are still exceptions, especially in strategic activities reserved to the Mexican State, such as petroleum and other hydrocarbons; basic petrochemicals; the generation of electricity and nuclear energy; radioactive minerals; telegraph and radiotelegraphy and postal services; banknote issuing and coin minting; and the control, supervision and surveillance of ports, airports and heliports.[20] Also, some activities still remain restricted to Mexican nationals and companies such as ground transportation, retail distribution of gasoline, radio, television, development banks and certain professional services.[21]

Partial participation of foreign investment of up to 10 percent is allowed in cooperative production companies;[22] and up to 25 percent in domestic air, air taxi and specialized air transportation.[23] The new law allows foreign ownership of up to 49 percent in the following sectors: insurance and surety companies; money exchange offices; warehouses; retirement funds; the manufacture and distribution of explosives, firearms and ammunition; newspaper printing and publication for its exclusive circulation in Mexico; shares in companies that own agricultural, ranching and forestry lands; fresh water, coastal and exclusive fishing zones excluding fisheries; comprehensive port administration, port pilot services for inland navigation under the terms of the corresponding law, shipping companies engaged in the commercial exploitation of ships for inland and coastal navigation, excluding tourism cruises and the exploitation of marine dredges and devices for port construction; the conservation and operation, supply of fuel and lubricants for ships, airplanes and railway equipment; and telecommunications concessionaire companies with the exception of mobile phone companies.[24-25] It should be noted that this law has set the limit of foreign holdings at 49 percent by means of trusts and mechanisms to prevent complete foreign ownership of a company.[26]

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20 Article 5 of the 1993 Foreign Investment Law.

21 Article 6 of the 1993 Foreign Investment Law.

22 Article 7 of the 1993 Foreign Investment Law.

23 *Id.*

24 Article 12 par. 2 of the Federal Telecommunications Law.

25 Article 7 of the 1993 Foreign Investment Law.

26 Article 7 last par. of the 1993 Foreign Investment Law.

Some activities are subject to prior authorization if the investment exceeds 49% as in the case of maritime services, oil pipeline construction, and drilling for oil and gas. Foreign investment exceeding 49% and a certain amount[27] determined each year by the National Commission of Foreign Investment[28] has to be approved by this same commission.

To better understand the analysis of NAFTA and other treaties Mexico has celebrated, it is important to describe the classification of international treaties within the hierarchy of Mexican law. In this respect, after a systematic analysis of the Constitution that was required in the 2007 "McCain Case,"[29] the Mexican Supreme Court of Justice of the Nation established that international treaties formed part of the Supreme Law of the Union (*Ley Suprema de la Unión*) and, thus were classified as being above federal laws. The Supreme Court established the following hierarchy: 1. Constitution, 2. general laws and treaties (that apply to the entire nation), 3. Federal and State laws, and 4. Municipal laws.

In the above-mentioned case, McCain had challenged Article 8 of the decree issued by the Mexican President that established an applicable tariff for the general import tax for the year 2001 (*Acuerdo General 5/2001*) regarding goods that originate in North America, the European Community, Colombia, Venezuela, Costa Rica, Bolivia, Chile, Nicaragua and Israel. The decree was published in the Official Gazette of the Federation on December 29, 2002.

The Supreme Court of Justice analyzed McCain's claim that Article 133 of the Constitution had been violated by this Decree since the regulations contained in the Decree stood in contrast to more favorable international treaties, which should have been be applied instead of the *Acuerdo General 5/2001*.

The Supreme Court partially modified its view on this issue in a decision dated November 1999, in which the Court had simply held that international treaties stood only below the Constitution and above all other legal norms.[30]

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[27] MXN$2,756,411,632.00, according to General Resolution Number 10 of the National Commission of Foreign Investment, published on April 24, 2009, in the Federal Official Gazette, http://www.economia.gob.mx/pics/pages/1233_base/rg10cnie.doc.pdf.

[28] The National Commission of Foreign Investment is a federal agency in charge of overseeing the compliance to and application of rules on foreign investment.

[29] Amparo en revisión 120/2002 McCain México, S. A. de C. V., February 13, 2007, http://www.scjn.gob.mx/SiteCollectionDocuments/PortalSCJN/Transparencia/InformacionAdicionalTransparencia/HistoricoInformacionOtorgadaParticulares/Juridica/SegundaSala/2002/AR_120_02.pdf.

[30] Speech of Judge Olga Sánchez Cordero de García Villegas, Key note speaker at the Conference titled *La jerarquía de los tratados internacionales en el orden jurídico mexicano*, organized by the law department of the Tecnológico de Monterrey, Toluca Campus, on November 27, 2008, http://www2.scjn.gob.mx/Ministros/oscgv/Conf/tratados-internacionales-tolu

Since December 1993, most of the restrictions for foreigners to purchase real estate have been removed. The only restriction for foreigners remains on national territory within 60 miles to 100 km along the borders or 30 miles to 50 km along the shoreline.[31] If a foreigner wants to acquire real estate within the restricted areas for private residential purposes, this limitation may be overcome by setting up a trust ("*Fideicomiso*," see also for further detail "Trust") with a credit institution.[32] By law, all acquisitions must be authorized and registered with the Ministry of Foreign Relations. A trust fund allows the trustees to use and exploit this real estate without creating rights in favor of said trustees, and foreign investors must sign the "*Calvo Clause*."[33] However, the 1993 Foreign Investment Law allows Mexican corporations with a majority foreign capital to acquire properties within the restricted region if these lands are not destined for residential use. Outside the restricted zone, authorization from the Ministry of Foreign Relations is needed prior to its acquisition.

The 1993 Foreign Investment Law allows a trust to be used in certain cases as a vehicle for foreign investment to obtain ownership rights in certain industry sectors.[34] A trust in Mexico is similar to the one used for estate planning in the United States.[35] The trust is a form of ownership in which real property is transferred into a trust for the benefit of the real owner or beneficiary.[36] The contractual parties involved in a trust are the trustor, the trustee and the beneficiary. The trustor, the entity selling the land, sets up the trust. The trustee must be an institution (a bank) as stipulated by the General Law on Credit Institutions,[37] but may not be a beneficiary of the trust.[38] Trusts can be adapted to the specific need of the beneficiary. In this case, a foreign investor does not hold the deed to the property, but enjoys the property as if it were his or her own. This way, it is possible to ensure

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ca.pdf; MANUEL BECERRA RAMÍREZ, LA JERARQUÍA DE LOS TRATADOS EN EL ORDEN JURÍDICO INTERNO. UNA VISIÓN DESDE LA PERSPECTIVA DEL DERECHO INTERNACIONAL 306 (2009), available at: http://info5.juridicas.unam.mx/libros/6/2740/22.pdf.

[31] Article 10, 10A of the Foreign Investment Law from 1993.

[32] Article 11 of the 1993 Foreign Investment Law.

[33] The *Calvo Clause* is a provision requiring foreigners to consider themselves Mexican nationals with respect to real property and not to invoke the protection of their home governments. Provisions of this kind were widely enacted by Latin American countries in response to disruptive efforts of foreign governments to enforce foreign investors' claims against local governments.

[34] Chapter II of the Foreign Investment Law from 1993.

[35] Jorge Alfredo Domínguez Martínez, *El fideicomiso en México*, Conference, Podium Notarial, Actividades Instuitucionales, No. 32, December 2005, available at http://www.juridicas.unam.mx/publica/librev/rev/podium/cont/32/pr/pr32.pdf as of January 2010.

[36] Article 381 of the General Law of Titles and Credit Operations.

[37] Article 385 of the General Law of Titles and Credit Operations.

[38] Article 383 par. 4 of the General Law of Titles and Credit Operations.

that the trust is in line with the objective of the foreign investment. A Mexican trust, however, is known for its great flexibility. It is used as a legal resource to structure diverse sorts of financial, real estate and industrial projects in Mexico. This mechanism that has made it possible to set up several businesses and projects which would have been difficult to establish under other structures. Moreover, banks can use trusts as a means to secure payment of debt.[39]

III. NAFTA

As mentioned above, the 1993 Foreign Investment Law was enacted in preparation for the North American Free Trade Agreement, which would open the Mexican economy so as to attract foreign investment. By then, foreign investment was clearly welcome and NAFTA meant an important step towards the liberalization of the Mexican economy. NAFTA provided clear long term rules, limiting the control and interference by the Mexican political system, which at that time was controlled by a single political party.

NAFTA established a single trade zone between Mexico, the United States and Canada. The aim of NAFTA is among other things to immediately eliminate certain tariff barriers, phase out others over a period of approximately 14 years, promote conditions of fair competition, substantially increase investment opportunities and provide adequate and effective protection of intellectual property rights. NAFTA is considered an international treaty and is therefore superior to national law, but below the Mexican constitution.[40] NAFTA strengthened the rules and procedures governing trade and investment in the region. As of January 1, 2008 all remaining tariffs part of NAFTA have been reduced to 0%.

Chapter XI of NAFTA contains substantive rules which ensure non-discrimination against foreign investors. Generally speaking, the rules aim at encouraging cross-border investment. For example, the rule of national treatment prohibits NAFTA member countries from treating a foreign investor worse than a national investor. Hence, a NAFTA member country cannot limit the percentage of equity owned by a foreign investor in a national entity to a lesser amount than that allowed to a national investor. Another instrument contained in Chapter XI is the most-favored-nation-treatment which means that a NAFTA member country may not treat a NAFTA investor worse than a non-NAFTA investor. For example, it is prohibited to require an investor to export a certain amount of goods as a

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[39] Article 383 last par. of the General Law of Titles and Credit Operations.

[40] *Amparo* review 1475/98, May 11, 1999, 9ª Época, Pleno, Sem. Jud. de la Federación y su Gaceta, Tomo X (November 1999), Tesis P. LXXVII/99, p. 46.

condition to establish an investment. Furthermore, Chapter XI demands that member countries allow market-rate transfers of profits. Finally, investments can only be expropriated for public purpose upon prompt payment of the market value of the investment.

In order to ensure that NAFTA rules are followed, Chapter XI sets forth the rules for resolving conflicts. According to these provisions, an investor may summon a NAFTA country to arbitration for monetary damages alleging that it violated a Chapter 11 provision.

From Chapter XII to XVI, NAFTA establishes the rules for regulating services. These provisions are based on the aforementioned rules of national treatment and most-favored-nation treatment. These rules eliminate many barriers on providing services in the United States. Thus Canada could not demand that a Mexican or U.S. service provider charge a minimum price in order to be allowed to enter the Canadian market unless the same requirement is applied to non-NAFTA service providers. According to the EU-Mexico FTA, financial services, telecommunication, distribution, energy, tourism and environment services among others will be liberalized by 2011. Radio and television, maritime transport, and air services are excluded. The agreement guarantees that investors will not face restrictions on the number or kind of services¸ most favored nation rule or national treatment. NAFTA introduced rules to simplify the business people's entrance to member countries to enhance free market conditions. The basic rule is that the NAFTA countries must grant temporary entry to business people who are qualified for entry under that country's applicable law regarding public health, safety and national security. One aspect that has yet to be regulated is the situation of legal service providers. NAFTA establishes in Annex1210.5 Professional Services, Section B 1 that "[e]ach Party shall, in implementing its obligations and commitments regarding foreign legal consultants […] ensure that a national of another Party is permitted to practice or advise on the law of any country in which that national is authorized to practice as a lawyer." Until now, Mexico has not regulated this sector, possibly due to reasons of protectionism. However, reality has taken over in these situations as international law firms have opened offices in Mexico and foreign lawyers are providing consulting services in Mexico without needing to obtain a special license.

Investments in financial services is regulated in Chapter XIV of NAFTA. These provisions have influenced Mexico to change its banking regulations.[41] This chapter provides specific rules governing cross-border trade in financial services.

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[41] Héctor R. Nuñez Estrada, *Las reformas al sistema financiero mexicano en el inicio del gobierno de Clinton. Modificaciones requeridas para la aprobación y puesta en práctica del TLC*, available at http://www.azc.uam.mx/publicaciones/gestion/num3/doc06.htm.

Chapters III to VIII regulate trade between the NAFTA countries. These chapters state two important rules: NAFTA's rule of origin and tariff-elimination rules. Rules of origin govern which goods are eligible for NAFTA's preferential tariffs. Only goods which qualify under the NAFTA rules of origin may obtain a reduced or eliminated tariff. The NAFTA rules of origin take into consideration, among others, if the goods are produced in North America. The treaty parties want to ensure that only North American goods originating from the NAFTA Parties receive preferential tariff treatment.

These rules are designed to prevent a producer from just assembling the goods in a NAFTA country to later claim preferential treatment. The tariff-elimination rules governed the reduction of preferential tariffs on goods during a transition period that lasted until January 2008. Furthermore, NAFTA countries are prohibited from applying non-tariff barriers to circumvent the provisions in these chapters. These barriers usually consist of import licenses, taxes and quotas or standards. Through NAFTA rules, Mexico had to substantially lower its tariffs on imported goods.

Other aspects of the liberalization of Mexico's economy toward foreign investment are migration and visa regulations, which have changed significantly over the last two decades. For example, Chapter XVI of NAFTA has made temporary entry for business people to Mexico and other NAFTA countries easier. A NAFTA country may authorize temporary entrance to business people from another NAFTA party without the need of an employment permit. According to Chapter XVI, business people are defined as: business visitors, traders/investors, intra-company transferees and professionals. Business people entering as professionals may not incur in an activity that involves practicing their professions without prior authorization.

IV. Bilateral Investment Treaties

Mexico's opening to the global economy was further enhanced by celebrating Bilateral Investment Treaties ("BITs"). So far, Mexico has signed around thirty BITs with countries such as Argentina[42] and China.[43] For Mexico, negotiating international investment agreements is part of an economic policy that looks to diversify its inflows in view of the fact that the United States is still Mexico's most important trade partner. This policy also aims at stimulating business initiatives; improving the investment climate for foreign direct investment and promoting Mexican investments abroad.[44] To achieve these goals, Mexico has agreed to minimize certain

[42] Executed on November 13, 1996, entered into force on June 22, 1998.

[43] Executed on July 11, 2008, entered into force on June 6, 2009.

[44] Alejandro Faya-Rodríguez, *Mexico Signs Two New Bilateral Investment Treaties*, 15 (16) North American Free Trade & Investment Report 6 (2005).

levels of non-commercial risks that can affect foreign investment and guarantee it will abide by specific standards in its treatment of foreign investors and their investments.

Although a BIT in itself may not increase foreign direct investment, it sets the legal basis for promoting investments of this kind since BITs increase the levels of investor confidence, predictability and legal certainty. In general, BITs obligate a host country to the non-discriminatory treatment of investors and their investments based on the treatment given to their own nationals (National Treatment) or to nationals of a third State (Most-Favored-Nation Treatment). The host country also guarantees that investments will be treated in accordance with international law, including fair and equitable treatment and full protection and security. Furthermore, BITs strive to prevent expropriations or nationalizations except when serving public purposes or on a non-discriminatory basis, and permit all transfers associated an investment.

V. EU-Mexico FTA

Another free trade agreement that marked an important step towards attracting foreign investment and that should be seen within the context of a change in Mexico's treatment of foreign investment is the free trade agreement between the European Union and Mexico ("EU-Mexico FTA") signed on December 8, 1997, and in force as of July 1, 2000. Also known as the "Global Agreement," it was the first free trade agreement signed between a Latin American country and the European Union. The EU-Mexico FTA goes beyond goods, trade and border issues to include services, investment, public procurement, intellectual property and competition. The trade provisions are contained in two Decisions of the EU-Mexico Joint Council. Decision 2/2000, which was adopted on March 23, 2000, and entered into force on July 1, 2000, contains the text of EU-Mexico FTA relating to goods. Its purpose was to liberalize over 96% of traded goods by 2007. Adopted on February 27, 2001, and entered into force on March 1, 2001, Decision 2/2001 regulates the liberalization of services, investment, the protection of intellectual property rights and establishes a dispute settlement mechanisms.

On the issue of tariffs on industrial goods, the European Union aimed at achieving equal status with NAFTA. Mexico agreed to abolish tariffs vis-à-vis the European Union on 52% of its industrial products by 2003 and on the remaining 48% by 2007. The European Union had provided duty-free access for all Mexican industrial products by 2003. In agricultural trade, which represents 7% of total bilateral trade, tariffs on approximately 60% of the parties' commodities will be removed over a period of up to 10

years. In all, the EU-Mexico FTA already freed most of the trade from tariffs. Nearly all services will be liberalized over a maximum ten-year period. This preferential trade agreement is complemented by the Economic Partnership, Political Co-ordination and Co-operation Agreement,[45] which promotes political dialogue and intensifies technical and economic co-operation between both Parties. The agreement is overseen by a Joint Committee and Special Committees that meet once a year. The closeness of the EU-Mexico trade partnership is reflected at a multilateral level, where the EU and Mexico have cooperated closely in WTO Doha Round negotiations. [46]

In terms of trade value, Mexico ranks 26th among EU trade partners and 16th amongst its export partners. The EU is Mexico's second biggest export market after the USA. As a result of signing the EU-Mexico FTA, total trade between Mexico and the EU grew by 28.3 percent in the first two years. In 2007 the EU imports of Mexican goods totaled €11.9 billion, and Mexican imports of EU goods totaled €20.9 billion.[47]

The EU's key imports from Mexico are mineral products (24%), machinery and electric equipment (21.7%), transport equipment (18.7%) and optic photo precision instruments (10.1%). Key EU exports to Mexico include machinery and electric equipment (28.7%), transport equipment (14.5%), chemical products (14.4%) and mineral products (11.6%).[48] The EU buys travel, sea transport, air transport and construction services from Mexico.[49]

However until now, the EU-Mexico FTA has not lived up to Mexico's expectations. By 2006, Mexico's trade deficit with the EU grew from US$9.4 billion to US$16.9 billion.[50] Most of the Mexican imports are intermediate goods, which are not produced in Mexico and in order to export, Mexico must import raw materials. At the same time, the goods have a rather small amount of domestically produced content, which inhibits the development of domestic small and medium-size industry, as it is that in-

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[45] Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and its Member States, of the one part, and the United Mexican States, of the other Part, Official Journal of the European Communities, L276/45, October 28, 2000.

[46] Free Trade Agreement Mexico-European Union, available at http://economia-bruselas.gob.mx/sphp_pages/bruselas/business/ue_mexico_fta.htm.

[47] European Commission, Bilateral Trade, Country: Mexico, available at: http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/mexico.

[48] *Id.*

[49] *Id.*

[50] Rodolfo Aguirre Reveles & Manuel Pérez Rocha, *The EU-Mexico Free Trade Agreement Seven Years On, A Warning to the Global South*, Debate paper, Alternative Regionalisms, June 2007, Transnational Institute, Mexican Action Network on Free Trade (RMALC) ICCO, at 9.

dustry sector, which provides the domestic content through manufacturing.[51] Non-governmental organizations have thus requested rules of origin that would benefit domestic producers.[52]

Part of this deficit is, however, due to the lack of willingness of Mexican investors to refocus their investments from the United States to Europe. The US market is easier to manage. It is a market of approx. 200 million customers right across the border, it offers the same regulations for the entire country and its customers have the same taste from San Francisco to New York. The EU, on the other hand, is a patchwork of 27 countries with a highly divergent taste and many complicated legal frameworks.

The EU-Mexico FTA regulates, among other aspects, the free movement of goods. By the year 2007, customs duties for nearly all industrial goods were lowered to 0 percent. In 2000, the EU eliminated customs duties for 82 percent of Mexican industrial goods; Mexico liberalized customs duties for 48 percent of EU industrial goods and decreased customs duties on certain shoe products. Since 2003, the EU has liberalized customs duties on all Mexican industrial products and Mexico has lowered customs duties to 5 percent. As to the auto parts industry, EU exporters are no longer required to have a production site in Mexico to sell cars in Mexico. As of January 2007, all limitations such as import quotas on imports have been eliminated.

The EU-Mexico FTA also introduced a standard customs form called EUR.1, similar to the certificate of origin used in the NAFTA. Custom duties on imported Mexican agricultural products will be reduced to 0 percent in 2010 for approximately 74.14 percent of these goods and approximately 49.55 percent of EU products will be free of custom duties.

Public procurement is another important issue regulated by the EU-Mexico FTA. In general, it ensures that European companies will have the same access to public procurement for all goods and services as Mexican companies, like petrochemical and energy projects, and puts European companies on the same level as NAFTA companies.

To protect the rights of investors from both contract parties, the EU-Mexico FTA introduced dispute resolution mechanisms, including arbitration, based on the WTO Agreement, which do not affect investors' rights. However, arbitration does not apply to intellectual property disputes and anti-dumping measures, problems with balance payments and other issues covered in the WTO Agreement. Parties may not initiate proceedings for the same issue under the provisions of both the EU-Mexico FTA and the WTO Agreement.

Finally, another important aspects regulated by the EU-Mexico FTA are the rules of origin. According to that agreement, "originating goods"[53] are

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51 *Id.*

52 *Id.*

53 Article 401, Originating Goods.

those that have been completely produced in either Mexico or the EU, as well as goods that have been produced in Mexico or the EU and that contain less or the maximum amount of permitted materials from other economic regions, but have been sufficiently processed in Mexico or the EU. Assembling, packaging and labeling products are not considered sufficient processing.

EU investors should consider the advantage of profiting both from the EU-Mexico FTA and NAFTA by combining rules of origin. Investors should also bear in mind that goods with parts that originate in the EU or Mexico might enable them to obtain preferential customs treatment.

In general, both the NAFTA and EU-Mexico FTA rules of origin require that parts, which are not from Mexico or the EU, have to be sufficiently processed to be re-categorized under a new customs classification. In addition foreign content not coming from Mexico or the EU is limited to approximately 40 to 60 percent of the overall price of the final product. However, NAFTA and EU-Mexico FTA differ on how to determine "originating goods." While the EU-Mexico FTA uses customs classifications, NAFTA applies percentages on the price of the final product or on the costs of the non-"originating" parts. NAFTA requires Mexico to impose customs duties and a 16 percent value added tax on non-originating goods that will be imported to the NAFTA region. However, Mexico initiated special programs for certain industry sectors to compensate for this by providing lower customs duties for parts that will be exported to the NAFTA region after being processed. These programs eliminate import duties on certain components that originate from outside the NAFTA region and reduce the remaining duties to 5 percent. To benefit from these programs, investors need to set up a Mexican subsidiary or use a shelter company to manufacture in Mexico and register this company in the investment promotion programs.

VI. Mercosur and Japan FTA

At the Mercosur Presidential Summit Meeting in Buenos Aires, Argentina, on July 5, 2002, the Economic Complementation Agreement (ACE) No. 54 was signed between Mexico and Mercosur State members. This agreement proposes the establishment of a free trade area and is based on the treaties that have been signed or will be signed between the parties. These treaties will be subject to periodical renegotiations to eliminate tariffs, restrictions and other obstacles that affect free trade.

At that summit, the parties also concluded negotiations of a treaty on the automobile industry that will allow the effective integration of the sector. In

September 2002, Economic Complementation Agreement No. 55 was signed.[54]

The objectives of these treaties are to create a free trade area and eliminate trade restrictions, establish a legal framework that offers security and transparency, and promote mutual investment and economic cooperation.

Another important FTA is the Japan-Mexico Economic Partnership Agreement which was signed in 2004 and entered in force on April 1, 2005. The objectives of this treaty are to *(a)* liberalize and facilitate trade in goods and services between the Parties; *(b)* increase investment opportunities and strengthen protection for investments and investment activities by the Parties; *(c)* enhance opportunities for suppliers to participate in government procurement; *(d)* promote cooperation and coordination for the effective enforcement of competition laws; *(e)* create effective procedures to implement and enforce this Agreement and to settle disputes; and *(f)* create a framework for further bilateral cooperation and a better business environment. This treaty is the result of two years of intense negotiations between the parties and is the first treaty that has a bearing on the strongly protected Japanese agricultural market as it reduces tariffs for Mexican exports of pork, chicken and oranges.[55]

VII. Criticism of Mexico's Policy of Signing Numerous FTAs

Although the various FTAs Mexico has signed over the past years have had positive affects on its economic development overall, there are still many sectors of Mexican society that struggle and have not yet been able to grow or have developed slower than expected. When Mexico signed these FTAs, there were many hopes that, in retrospect, do not seem to have been fulfilled. However, some of the not-so-positive developments were due to factors that lie outside the FTAs and respond more to erroneous economic policies and international events, such as the the devaluation of the peso in December 1994 (the so-called "Tequila Crisis"). The struggle of Mexico's agriculture sector, which cannot yet be called an industry, is widely attributed to the negative effects of NAFTA, but this is due more to the fact that for decades the Mexican government has accustomed Mexican farmers to subsidies that are not linked to conditions, such as increase of productivity,

[54] Signed on September 27, 2002, and entered into force on January 1, 2003, according to Article 1, the treaty between the Mercosur and Mexico remains in force until replaced by a FTA between the Mercosur and Mexico.

[55] *Entra en vigor el TLC México-Japón*, International Center for Trade and Sustainable Development, Bridges Weekly Trade News Digest, Vol. 2, No. 7, April 14, 2005, http://ictsd.org/i/news/ puentesquincenal/10347.

accountability and market oriented production. Moreover, the agricultural sector has been politicized —used by political parties to gain votes and riding on national sentiments linked to crop and soil. Some of the factors that have kept Mexican farmers in a pre-industrial era are: *a)* small or micro parcels, *b)* production that is not based on consumer needs and requirements, *c)* a dependence on subsidies, *d)* the lack of financing and *e)* a lack of agricultural knowledge and technology. Unfortunately, for many farmers agriculture is not a way to make a living, but a necessity for survival. Farmers produce what they need to feed their families; any overproduction is sold at the local market.

Lederman, Maloney and Servén[56] have pointed out the positive effects of NAFTA, such as the fact that NAFTA has brought Mexico closer to the level of its commercial counterparts' development, and the treaty ensures economic convergence between the member States. Audley, Polaski, Papademetriou and Vaughan[57] state in their report that while NAFTA is neither a disaster nor a deliverance, it certainly does not generate sufficient jobs. More than 500,000 new jobs in the manufacturing sector partially counter the loss of about 1.3 million jobs in agriculture. Furthermore, NAFTA has not stopped immigration to the United States.

The challenge of free trade agreements and of economic opening in general lies in showing that there are more political and economic benefits than costs. This may legitimize the treaty before the population, but the benefits have to be measured not only in economic terms like commercial volume and the attraction of foreign investment, but also in associated costs and the creation of mechanisms that make it possible to pass on those benefits to parts of society that do not directly benefit from the treaties.

VIII. Privatization

Finally, another aspect of Mexico's shift from a protected economy towards a free market economy is privatization. Over the past 25 years, privatization has improved companies' performance, increasing profitability by 24 percent. "From this increase, at most 5 percent can be attributed to higher prices and 31 percent to transfers from workers, with the remaining 64 percent representing productivity gains."[58] In the early 1980s, the Mexi-

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[56] Daniel Lederman et al., Lessons from NAFTA for Latin America and the Caribbean, World Bank (Stanford University Press, 2005).

[57] Demetrios Papademetriou et al., NAFTA's Promise and Reality: Lessons from Mexico for the Hemishphere (2003).

[58] Alberto Chong & Florencio López-de-Silanes, *Privatization in Mexico*, 513 Working paper Inter-American Development Bank [banco Interamericano de Desarrollo (BID)], Research Department [departamento de investigación] 3.

can government owned 1,155[59] companies, which included *Petróleos Mexicanos* (Pemex), the Federal Commission of Electricity (*Comisión Federal de Electricidad*, CFE), National Railways of Mexico (*Ferrocarriles Nacionales*), and Sicartsa[60] in the steel industry. The government also operated mining firms, airlines, banks and hotels.[61] *Nacional Financiera*, S.N.C. (Nafin), the government development bank, provided the financing needed to uphold this system. The government believed that by controlling all kinds of industries, it could build up infrastructure and provide good service at reasonable prices. Moreover, the bloated apparatus of State-owned companies provided employment and subsidized bankrupt industries. But it had the opposite effect: service was lacking, the cost was extremely high and it created a number of unnecessary jobs to "demonstrate success at attracting and maintaining a support base, and to do so requires constant enterprise expansion in order to produce jobs and benefits for bureaucrats, union leaders, and workers and contracts for the private sector."[62]

As Teichman states,

> ...[i]ncentives in this system were skewed. With all the managers competing to expand their enterprises to please their supporters instead of competing in a free market to serve consumers, most of the State companies ran large deficits. The basic problem was lack of private property rights: because resources belonged to all Mexicans, they effectively belonged to no one.[63]

The government further distorted market conditions by introducing unions into the system. Some of the sectors that were privatized in the 1990s were the telecommunications and banking industry. In the following years, mining, and air and sea transportation followed. The subsidized system started to fall apart in 1982 when the economic crisis hit Mexico. Foreign loans were no longer available and oil prices fell. Inflation reached 100%, the GDP decreased, the foreign debt grew to US$87 billion, salaries dropped by around 12% and the Mexican Peso suffered a devaluation of 267%.[64]

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[59] Roberto Salinas, *Privatization in Mexico: Much Better, But Still Not Enough*, THE HERITAGE FOUNDATION, January 20, 1992 available at http://www.heritage.org/research/latinamerica/bu172.cfm.

[60] Sicartsa was privatized in 1991 and bought by Arcelor Mittal, *see Arcelor Mittal Acquires Sicartsa, The Leading Mexican Long Steel Producer*, available at http://news.thomasnet.com/companystory/502596.

[61] Horacio Lombardo Aburto & José de Jesús Orozco Henríquez, *Marco constitucional para la rectoría del Estado y la economía mixta. Régimen jurídico de las entidades paraestatales*, *in* CRISIS Y FUTURO DE LA EMPRESA PÚBLICA 369 (Macos Kaplan, coord., UNAM, 1994).

[62] JUDITH TEICHMAN, PRIVATIZATION AND POLITICAL CHANGE IN MEXICO (Pittsburgh University Press, 1996).

[63] *Id.*

[64] Manuel Barquín Álvarez, *La privatización y el sector paraestatal en México (Un enfoque jurí-*

This prompted the Mexican government to start re-privatizing since it could no longer finance the system it had created. The beneficiaries of these privatizations were foreign companies and families with important ties to the government and who, in part, owned the companies that had been nationalized. This was partially due to the fact that the government had to obtain the best possible price for the companies to pay back the external debt; and only leading Mexican (family-owned) companies and foreign corporations could pay the requested amounts.

1. *Banking*

Approximately eight years after the banks were nationalized, the government privatized them again. In the relatively short period of fifteen months, "controlling shares of 18 banks with aggregate assets of $128 billion were auctioned for $12.4 billion."[65] "At the time of the nationalization of the Mexican commercial banking system in 1982, there had been 60 Mexican banks, of which 58 were nationalized. In order to capture perceived economies of scale, Mexico reorganized the commercial banking industry —merging the 58 commercial State-owned banks into just 18. Although the industry had been consolidating prior to 1982 in any case, these new mergers represented a significant increase in industry concentration. Indeed, at the time of privatization, the three largest banks accounted for nearly three-fifths of total assets in the commercial banking system, while the three largest U.S. banking organizations at that time held about one-seventh of U.S. commercial bank assets."[66] According to Unal and Navarro "Mexico's experience with bank privatization is considered to be very successful and stands as an example to other countries considering the privatization of their banking system."[67]

2. *Telecommunications*

Another example of the privatization procedure is found in the telecommunication industry. Before the privatization process, there was only one player on the field: Telmex, a State-owned company. For decades, only 5

dico-institucional), *in* REGULACIÓN DEL SECTOR ENERGÉTICO 162 (1997), available at http://www.bibliojuridica.org/libros/1/153/11.pdf.

[65] Haluk Unal & Miguel Navarro, *The Technical Process of Bank Privatization in Mexico*, WHARTON WORKING PAPER 97-42 (1997), available at SSRN: http://ssrn.com/abstract=54460.

[66] William Gruben & Robert McComb, *Privatization, Competition, and Supercompetition, in the Mexican Commercial Banking System*, 2 FEDERAL RESERVE BANK OF DALLAS AND TEXAS TECH UNIVERSITY (1999).

[67] *Id.*

of 100 people had a telephone line because a private telephone connection cost approximately US$150.00. Carlos Slim Helú, a wealthy Mexican businessman who had close ties with then President Carlos Salinas de Gortari and the ruling Institutional Revolutionary Party (PRI), acquired Telmex in 1990, together with Southwestern Bell Corporation and France Télécom for approximately US$1.76 billion. France Télécom later left the business but Southwestern Bell Corporation worked closely with Carlos Slim Helú. According to Hughes,

> Telmex has experienced more capital spending after its privatization, which has speeded up the modernization of telecommunications in Mexico. Larger profits have also been seen after privatization occurred. For example in 1989 Telmex invested less than $500 million whereas in 1991 the year after privatization, investment was $2.75 billion. In fact the first six years after privatization, 1991-96, the total was $12 billion, including $1.3 billion for telephone equipment, $2.7billion for transmission equipment, $3.9 billion for switches and power equipment, and 3.7 billion for outside plant. Those investments were implemented in order to help satisfy some of the backorders for new service at the time of privatization and otherwise meet the requirements of the concession. Though more money had been invested for expansion and modernization since privatization, Telmex was able to achieve and even surpass the main performance criteria established by the Concession Title with 10.4 percent less than the $7.7 billion investment that had been planned for 1991-94. According to [Carlos] Slim Hel[ú], Telmex's Chairman and Mexican controlling shareholder, the decrease was due to a rationalization of the investment that allowed the company to meet the performance criteria established by the government for the period, obtaining at the same time savings through optimization. As [Carlos] Slim Hel[ú] Stated, they 'made more with less'. Telmex between 1991-96 spent $12 billion laying more than 18,000 miles of fiber-optic cable, increasing the number of telephone lines in the country by 66 percent, from 5.3 million lines to 8.8 million. However Telmex's new foreign owners reduced cable-laying process costs by 48 percent by providing expertise in fiber optics. 'By 1994, three years after privatization, Telmex had fulfilled and in some cases surpassed several of the goals in the Concession Title, particularly those related to network expansion and rural telephony' […] According to the data taken, in the years 1987-1990 teledensity experienced 21% growth.[68]

Unfortunately, Telmex remained a monopoly for a long time, only this time it was in private hands. This has led to much criticism, such as Denise

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[68] Robert Hughes, *Privatization and Modernization of Telecommunications in Latin America*, Center for International Studies, University of St. Thomas, Houston, Texas, Prepared for Delivery at the 82nd Annual Meeting of the South-Western Social Science Association, New Orleans, Louisiana (March 27-31, 2002), http://www1.appstate.edu/~stefanov/proceedings/hughes.htm.

Dresser's open letter to Carlos Slim Helú criticizing that he says he welcomes competition in his public speeches but spares no effort to maintain his position as sole provider of telecommunication services. However by now, many foreign and national companies have entered the Mexican market and provide these services. The newest twist is that television companies have entered the telecommunications market by offering telephone services through cable television. Along with the government's intention to open the market for so called "triple play" services, this situation is reshuffling the market. International telecommunications companies have now entered the Mexican market especially to provide mobile telecommunication services.

3. *Legal framework*

What is the legal framework for privatization that has changed Mexico over the past decades? To understand the Mexican regulatory basis for privatization, it is important to define the mechanisms through which a State provides its citizens with public services. There are basically four structures: *(i)* a liberal system that allows the private sector to provide services without much interference from the State (so called "*laissez-faire* regime"), *(ii)* concessions, *(iii)* mixed companies in which both the government and private equity participate under different participation models, and *(iv)* absolute intervention.[69] All of the above structures have been implemented in Mexico. The legal framework is set forth in Articles 25, 28, 90 and 134 of the Mexican Constitution and in the Organic Law of Federal Public Administration and the Federal Law on State-Owned Companies and Their Regulation. In addition to this, the procedures established by the Inter-Ministerial Commission for Expenses, Financing and Disincorporation[70] must be taken into account.

The Law of State-Owned Companies establishes that if a State-owned entity no longer meets the objectives it was created for, if it does not focus on an area deemed a State priority or if the operation is no longer in the public interest of the national economy, then this entity may be dissolved.[71] The Ministry of Finance and Public Credit shall present a request to dissolve the company to the Executive and the corresponding ministry for consideration. If the State-owned company was established by a law or a

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[69] Hugo Manlio Huerta Díaz de León, *Privatización y concesiones*, 4 REVISTA JURÍDICA DE LA ESCUELA LIBRE DE DERECHO DE PUEBLA 55 (2003).

[70] On December 31, 2009, the agreement was published in the Federal Official Gazette jointly with the Inter-Ministerial Commission on Expense, Financing and Disincorporation, which is a merger of the Commission on Expenses and Financing formed in August 1979 and the Commission for Disincorporation formed in April 1995.

[71] Articles 16 and 32 of the Law of State-Owned Companies.

congressional decree, then the dissolution must follow the same procedure that was followed for the constitution of such entity. Decentralized entities such as Pemex or CFE may be dissolved, liquidated, extinguished or merged.[72] For entities in which the State has majority participation, the State may alienate its participation,[73] as it recently did. On October 11, 2009, the Executive published a decree in the Federal Official Gazette that, based on Article 16 of the Federal Law of State-Owned Companies, extinguished the decentralized *Luz y Fuerza del Centro* company since its operation was no longer convenient for the national economy or public interest.[74] According to an official press release,[75] *Luz y Fuerza del Centro* was facing unsustainable financial difficulties. For the past 9 years, it had not been able to generate profits and reduce costs. The annual subsidies it received increased substantially over the years to stand at $42 billion pesos by 2009. The operation of *Luz y Fuerza del Centro* was inefficient and unproductive. The service provided to homes and industries in the central region of the country was unsatisfactory, which limited the development of much needed projects that would have created[76] employment opportunities. If the operation had continued thus, the current administration (2007 to 2012) would have had to fund *Luz y Fuerza del Centro* with $300 billion Mexican pesos, equivalent to more than six times the annual budget of the social Opportunities Program, the most important program to fight poverty, or to one 1.2 million low-income houses.

In response to the economic crisis in the early 1980s, the Mexican government sent to Congress a bill to amend Articles 25, 26, 27, 28 and 73 of the Constitution to remedy the effects of the crisis. The bill resulted in the reforms that were published on February 3, 1983. The reforms were meant to modernize the principle of State economic leadership, a mixed economy regime, a planning system for democratic development, the identification of the strategic areas exclusively reserved to the State and the operation of State companies.[77] Article 25[78] of the Constitution establishes the principle

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[72] Article 16 of the Law of State-Owned Companies.

[73] Article 32 of the Law of State-Owned Companies.

[74] Decree that Extinguishes Luz y Fuerza del Centro (*Decreto de Extinción de Luz y Fuerza del Centro*), published in the Federal Official Gazette on Sunday, October 11, 2009, available at http://www.actualidadesmexico.com.mx/destacados/decreto-de-extincion-de-luz-y-fuerza-del-centro.

[75] Ministry of Foreign Relations press release, dated October 13, 2009, available at http://portal.sre.gob.mx/japoni/pdf/LiquidationLuzFuerza.pdf.

[76] Press conference offered by the Secretaries of State, Fernando Gómez Mont; Energy, Georgina Kessel; Labor, Javier Lozano; Finance, Agustín Carstens, and the director of the Federal Electricity Commission, Alfredo Elías Ayub, México City, October 11, 2009, http://www.lfc.gob.mx/index.php?option=com_content&view=article&id=4.

[77] Lombardo & Orozco, *supra* note 61, at 27.

[78] Article 25: "Corresponde al Estado la rectoría del desarrollo nacional para garan-

of State economic leadership, without defining it. According to the Constitution, this leadership must be comprehensive and aimed at strengthening State sovereignty and inure to the benefit of the people and provide an equitable distribution of wealth. The same article gives clues as to what has to be understood as State economic leadership, providing that the State shall plan, conduct, coordinate and orientate as well as regulate and promote.

The privatization process was implemented gradually. Between 1983 and 1985, the State extinguished non-viable State companies; between 1986 and 1989, the State extinguished smaller State companies; and from 1990 on, the State privatized major corporations in the telecommunications industry and the banking sector.[79]

Concessions are also suitable mechanisms to open a market to private investment. In Article 28, the Mexican Constitution sets forth the basis for granting concessions for public services, the exploitation of resources and use of goods owned by the nation. Article 28 of the Mexican Constitution states:

> […]
> The State shall have the necessary institutions and enterprises to manage the strategic areas in its charge effectively, and for priority activities where, according to the law, [it] participates by itself or with the social and private sectors.
> […]
> In cases of public interest, and abiding by the laws, the State may grant concessions for the rendering of public services or the exploitation, use or development of State-owned goods, subject to the exceptions provided by said laws. The laws will determine the methods and conditions to assure the effectiveness of the rendering of services and the social use of such goods, preventing any accumulation of goods in a few hands that could affect the public interest.
> Public service systems shall abide by the Constitution and can only operate by means of law.
> Subsidies may be granted to priority activities, as long as they are general, temporary, and do not affect the Country's finances significantly. The State will survey their use and evaluate their results.

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tizar que éste sea integral y sustentable, que fortalezca la soberanía de la nación y su régimen democrático y que, mediante el fomento del crecimiento económico y el empleo y una más justa distribución del ingreso y la riqueza, permita el pleno ejercicio de la libertad y la dignidad de los individuos, grupos y clases sociales, cuya seguridad protege esta Constitución.

El Estado planeará, conducirá, coordinará y orientará la actividad económica nacional, y llevará al cabo la regulación y fomento de las actividades que demande el interés general en el marco de libertades que otorga esta Constitución […]"

[79] Lombardo & Orozco, *supra* note 61, at 371.

Article 28 of the Constitution establishes that concessions shall be regulated by law and according to the Constitution.[80] However, the Constitution limits concessions to industry sectors that are not expressly excluded in the Constitution and, if granted, the concession must also serve a social objective. The Constitution does not define a concession, nor do the laws that have been enacted to regulate concessions. Some authors define it as an agreement granting an individual the right to exploit a public good; others define it as a unilateral administrative act granting rights under certain non-negotiable conditions and yet others, as a mixed figure, part agreement and part administrative act.[81]

IX. The Electricity Industry: The Next Sector to be Opened to Private Investment?

In 1960, Mexico nationalized the electrical industry through a constitutional amendment. Since then, the electric power supplied to the public is under the exclusive domain of the State, through CFE.[82] The constitutional principles regulating the electricity sector are established in Articles 25, 27 and 28 of the Constitution. The industry sector itself is regulated by the Public Utility Law for Electrical Power (*Ley del Servicio Público de Energía Eléctrica*) and the Regulation of the Electrical Power Public Utility Law (*Reglamento de la Ley del Servicio Público de Energía Eléctrica*).

Until the 1980s, private entities were only permitted to construct power plants for self-supply.[83] In 1992, as a result of a concern that the country would be confronted with an insufficient supply of electricity if private sector participation were not permitted, the Public Utility Law for Electrical Power was amended to allow the private sector to generate electricity that would be used by CFE to provide public electricity service while keeping this service in the hands of the State.

Private entities were then allowed to generate energy in areas not considered part of the "public service." The reform included two legal models referred to as "independent production of energy" and "small production," and redefined the concepts of self-supply and co-generation. It also made it possible to import energy for self-supply and to export the electric power produced at the plants owned by permit holders. Thus, electric power gen-

80 *Id*. at 56, 57.

81 Barquín, *supra* note 64, at 169.

82 This public service is provided principally by CFE and, to a lesser extent, the *Compañía de Luz y Fuerza de Centro* ("LFC").

83 Javier Jiménez Gutiérrez, La reforma eléctrica, análisis sobre la situación actual y las perspectivas futuras del régimen legal aplicable a la electricidad en México 2 (Curtis, Mallet-Prevost, Colt & Mosle, S. C., 1992).

eration by private entities could take any of the following forms or modalities:

(i) Self-supply: The permit holder is allowed to generate electric power for self-supply, as long as this power comes from plants set up to satisfy the joint needs of the co-owners or partners. The permit holder is obligated to put its surplus electric power at the disposal of CFE.
(ii) Co-generation: The permit holder is allowed to generate electricity using thermal energy or fuel produced as a by-product of the permit holder's production processes. The power generated must be set aside to satisfy the needs of the establishment(s) involved in the co-generation. As in the case of self-supply, permit holders are obligated to put their surplus electric power at the disposal of CFE.
(iii) Independent Production: The permit holder is allowed to generate electric power for sale exclusively to CFE. The plant production capacity of independent producers must be greater than 30 MW. These independent production projects must be included in CFE planning programs and the electricity with the lowest long-term economic cost will be used by CFE.
(iv) Small Production: The permit holder is allowed to generate electric power in areas designated by the Ministry of Energy and in plants with a capacity lower than 30 MW. As a form of self-supply, the permit holder is also permitted to set aside the energy for small rural communities or isolated areas without electricity, provided that the total generation of electricity does not exceed 1 MW.
(v) Importing or Exporting: The permit holder is allowed to import electric power for its own use or to export electric power generated under the modalities of cogeneration, independent production and small production.

On May 24, 2001, the Executive published a reform to the Regulations of the Public Utility Law for Electrical Power. This reform sought to increase the established capacity of electricity that CFE could purchase from self-suppliers and co-producers without having to hold a public bidding process. Prior to the reform, CFE could purchase up to 20 MW of energy without holding a public auction for electric power generation. After the reform, CFE could purchase up to 50% of the total installed capacity of self-suppliers with an installed capacity greater than 40 MW and the entire surplus generated by co-producers.

In April 2002, the Supreme Court of Justice of the Nation (*Suprema Corte de Justicia de la Nación*) published a decision which annulled a change the Executive Power had made to the Regulations of the Public Utility Law for Electrical Power. This change consisted of increasing the amount of energy

that self-suppliers and co-producers could sell to CFE without a public bidding process. Even though the Court's ruling was limited to the constitutionality of the changes the President made to the Regulations, certain observations contained in the decision questioned the constitutionality of the 1992 amendments to the Public Utility Law for Electrical Power. Although these observations do not form part of the binding points of the Court's legal decision, they have introduced an element of legal uncertainty as to whether future expansion of the private sector's role in the electricity sector will be vulnerable to constitutional challenge.[84]

In recent years, political parties have made several proposals to reform the Public Utility Law for Electrical Power and the Regulations of the Public Utility Law for Electrical Power, but none of these bills has provided a detailed analysis of the issues that would be the object of future regulation, as in the case of issues that fall under Energy Regulation Commission (*Comisión Reguladora de Energía*) directives. In this respect, we agree with Jiménez that price rates is a central issue. Jiménez states that "[a]ssuming that the congressional group proposing to open the sector is able to obtain the consensus necessary to commence an analysis of its proposal so that it is not rejected *prima facie*, this position would still face the challenge of suggesting a price rate that on the one hand satisfies the members of Congress supporting the other position and on the other hand allows for economically attractive projects for private participation in the sector."[85]

X. Conclusion

It is evident that the privatization of many industry sectors was a reaction to economic restraints and pressure. Mexico was simply unable to uphold the level of subsidies needed to maintain the number of bloated State-owned companies. The results have been both applauded and criticized. For some,[86] privatization did not reach far enough and should have included strategic sectors, such as oil and gas that remained excluded, and others[87] were of the opinion that privatization only benefitted foreign corporations, wealthy Mexican families and leading companies, while ignoring the vast majority of Mexicans.

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84 *Id*. at 3.

85 *Id*. at 5.

86 Roberto Salinas, *Privatization in Mexico: Much Better, But Still Not Enough*, The Heritage Foundation, January 20, 1992 available at http://www.heritage.org/research/latinamerica/bu172.cfm; Chong & López-de-Silanes, *supra* note 66, at 3.

87 Judith Teichman, Privatization and Political Change in Mexico (Pittsburgh University Press, 1996).

However, it remains a fact that the opening to foreign investment and privatization has allowed the Mexican government to focus on providing a stable economy, and the income obtained from privatization has helped Mexico lower the accumulated external debt. Mexico's change from a closed State-run economy to an open market economy has propelled Mexico into the group of promising emerging markets that compete for global investments.

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