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## MEXICO'S 1989 FOREIGN INVESTMENT REGULATIONS: THE CORNERSTONE OF A NEW ECONOMIC MODEL

*Jorge Camil\**

### I. INTRODUCTION

The publication of Mexico's new Foreign Investment Regulations (New Regulations)<sup>1</sup> on May 16, 1989, took the Mexican legal community by surprise. Mexico's Foreign Investment Law (FIL)<sup>2</sup> had been in existence for more than fifteen years, and few practitioners believed that the forty-nine percent limitation on foreign ownership would be subject to change.<sup>3</sup> Although the FIL itself was not amended, the New Regulations, whose purpose is to interpret the FIL, were enacted by President Carlos Salinas de Gortari under regulatory powers delegated by the Mexican Constitution.<sup>4</sup>

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\* Licenciado en Derecho, Universidad Nacional Autónoma de México; J.D., University of Houston. Partner, Camil y Rojas, Mexico City.

1. *Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, Diario Oficial [D.O.], May 16, 1989 [hereinafter New Regs.]. The "old" regulations governed the *modus operandi* of the Foreign Investment Registry (FIR). See generally, *Reglamento del Registro Nacional de Inversiones Extranjeras*, D.O., Dec. 28, 1973 [hereinafter Old Regs.]. The New Regulations now regulate both the FIL and the FIR. New Regs., *supra*, Transitory art. 2nd., para. II.

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

3. One Mexican attorney predicted that "the general rule of 51-49% for Mexican joint ventures with foreign capital [would] not be changed." Treviño, *Mexico: The Present Status of Legislation and Government Policies on Direct Foreign Investments*, 18 INT'L LAW. 297, 298 (1984) [hereinafter Treviño]. Another Mexican attorney assumed that "the existing laws, regulations and policies governing foreign investment in Mexico [would] not change substantially . . . during the initial years of [President Salinas'] administration." Rojas, *Foreign Investment in Mexico: Practical Solutions, 1989 Policies*, 7 INT'L L.Q. No. 4, 14 (1989) [hereinafter Rojas].

4. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS[CONST.], D.O. Feb.

This Article presents an overview of the current framework of the Mexican economy under which the New Regulations were enacted, a review of the most important statutory restrictions on foreign investors, and background on some limitations resulting from economic policy. The enshrinement and application of the 51-49% rule and other related topics of the FIL will also be reviewed within the context of Mexico's large external borrowing of 1973-1982. Finally, the New Regulations will be discussed and evaluated as an important part of Mexico's new economic policy, which includes the liberalization of foreign trade.

## II. THE NEW REGULATIONS IN THE CURRENT FRAMEWORK OF THE MEXICAN ECONOMY

In 1984 the Foreign Investment Commission (FIC) reversed a decade-old policy of inflexible application of the FIL<sup>5</sup> and announced in major newspapers that it would allow majority foreign participation in a number of industrial activities and in tourist related enterprises.<sup>6</sup> This significant change in administrative policy, however, was not the result of either legislative amendment or regulatory enactment. The announcement was not even published in the *Diario Oficial*,<sup>7</sup> and there were no specific rules proposed by the FIC for the implementation of the new policy.

Essentially, the publication of the 1984 Guidelines resulted in much confusion. The initial impression that Mexico was changing the rules of the game soon gave way to the realization that all projects involving majority foreign participation would continue to depend on FIC discretionary approval.<sup>8</sup>

The New Regulations largely remove the powers of discretion away

1, 1917, art. 89, § I [hereinafter CONST.]. The Constitution went into effect on May 1, 1917. The Mexican Constitution grants the president the "power to enact general rules in the form of regulations (*reglamentos*). Regulations have the purpose of explaining and supplying detailed rules for the application of specific laws, and most statutes are supplemented in this manner." H. WRIGHT, *FOREIGN ENTERPRISE IN MEXICO*, 16 (1971) [hereinafter H. WRIGHT].

5. More than a decade after the enactment of the FIL, "exceptions to the 49-51% concept [had] been granted rarely and only under special circumstances." Maviglia, *Mexico's Guidelines for Foreign Investment: The Selective Promotion of Necessary Industries*, 80 AM. J. INT'L L. 281, 293 (1986) [hereinafter Maviglia]. By 1984, "there [had] been no more than 100 or 150 Mexican companies authorized with majority foreign equity investment." Treviño, *supra* note 3, at 307.

6. *National Foreign Investment Commission of Mexico, Guidelines for Foreign Investment and Objectives for its Promotion* (1984) [hereinafter 1984 Guidelines] (Copies available at the offices of the *Houston Journal of International Law*).

7. In the opinion of one author, "failure to publish the [1984] Guidelines in [the DIARIO OFICIAL] signified a definite effort to make clear that the change was one of policy." Maviglia, *supra* note 5, at 299. "The DIARIO OFICIAL is the only official repository of federal legislation, . . ." H. WRIGHT, *supra* note 4, at 16.

8. One analysis of the 1984 Guidelines inferred that their "[a]nnouncement . . . resulted

from the FIC.<sup>9</sup> The foreign investor must now comply with conditions established for incorporation with majority ownership. When the conditions are met, investors can automatically record their investments at the Foreign Investment Registry (FIR).<sup>10</sup> These conditions were finally made clear for investors interested in obtaining control of their Mexican subsidiaries, and they include: (a) the need to make capital investments<sup>11</sup> financed from abroad,<sup>12</sup> (b) the geographic location of manufacturing facilities,<sup>13</sup> (c) the foreign exchange balance of the Mexican subsidiary,<sup>14</sup> (d) the employment generation capacity,<sup>15</sup> and (e) the use of an "adequate" technology.<sup>16</sup> In an age of ecological awareness, foreign investors incorporating under the New Regulations are also obligated to observe

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in much speculation and misunderstanding." Maviglia, *supra* note 5, at 298. The same analysis concluded that "investments . . . subject to [the 1984 Guidelines] exceptions, however, [would] not be *approved automatically* [and would] *still need to be analyzed*" by the FIC in terms of the criteria set forth in the [National Development Plan] and FIL." *Id.*, at 304 (emphasis added).

9. The FIC recently stated that the New Regulations "have adopted transparent criteria to avoid discretion on the part of the authority" (translated by the author). *Resolución General número 1 que establece un procedimiento expedito para que la Comisión Nacional de Inversiones Extranjeras emita resoluciones específicas*, D.O. June 21, 1989 [hereinafter Gen. Res. 1], at Statement of Purposes. Pursuant to articles 5 and 6 of the New Regs., *supra* note 1, foreign investors are free to incorporate and acquire certain Mexican companies without governmental approval.

10. The FIR was created to record the following information: (i) foreign individuals and corporations making investments, (ii) Mexican corporations with foreign shareholders, (iii) trusts with foreign beneficiaries, (iv) stock certificates owned by or pledged in favor of foreigners, and (v) FIC resolutions. FIL, *supra* note 2, art. 23. The New Regulations amend the FIL by ordering recordation of information regarding only items in (i), (ii), and (iii) above. New Regs., *supra* note 1, art. 43.

11. Pursuant to article 5, § I of the New Regs., *supra* note 1, foreign investors willing to incorporate with 100% ownership "must invest in fixed assets . . . up to the amount determined from time to time by the [Ministry of Commerce and Industrial Promotion (SECOFIN)]" (translated by the author). The ceiling was originally established at 2.5 billion pesos (100 million U.S. dollars). New Regs., *supra* note 1, Transitory art. 4th.

12. New Regs., *id.*, art. 5, § II. Investors already in the country may fulfill this requirement "with reinvested dividends or retained earnings" (translated by the author). *Resolución General número 2 que establece criterios para la aplicación de diversas disposiciones del Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, D.O. June 21, 1989 [hereinafter Gen. Res. 2], rule 10.

13. Companies incorporated with majority foreign ownership must be located outside the Mexico City area, Guadalajara and Monterrey. New Regs., *supra* note 1, art. 5, § III; Gen. Res. 2, *supra* note 12, rule 2; *Decreto por el cual se establecen zonas geográficas para la descentralización industrial y el otorgamiento de estímulos*, D.O. Jan. 22, 1986.

14. Article 5, § IV of the New Regs., *supra* note 1, requires that 100% foreign subsidiaries maintain their cumulative foreign exchange flows in balance during the first three years of operation. In the case of foreign acquisitions of existing companies, the three-year term will be computed from the date of the corresponding acquisition. *See infra* note 19 and accompanying text.

15. Pursuant to article 5, § V of the New Regs., *supra* note 1, new corporations with majority foreign equity must "generate permanent employment and establish continuous training programs . . . for their workers" (translated by the author).

16. New Regs., *id.*, Art. 5, § VI. Officers of SECOFIN interviewed by the author believe that the liberalization of Mexico's foreign trade, should motivate investors to use the best technology possible in order to be competitive.

environmental protection laws.<sup>17</sup>

A three-year leave is granted by the New Regulations for the acquisition of a majority interest in existing Mexican corporations.<sup>18</sup> Foreign investors willing to benefit from this administrative holiday must comply with conditions similar to those established for incorporation with 100% ownership.<sup>19</sup> Clearly, incorporations and acquisitions not authorized by the New Regulations remain subject to ownership limitations under the FIL or to government waiver of the 51-49% limitation. Nevertheless, the New Regulations have substantially reduced the time periods required for FIC approval.<sup>20</sup>

Although the rules for majority foreign participation in Mexican companies are the highlight of the New Regulations, the scope goes beyond the matter of ownership to address other areas of concern, such as: (a) investments by international development corporations,<sup>21</sup> (b) beneficiary rights to stock and corporate assets in excess of the forty-nine percent limitation,<sup>22</sup> (c) foreign acquisition of beneficiary rights to public stock,<sup>23</sup> (d) temporary control of companies previously restricted,<sup>24</sup> and (e) real estate transactions.<sup>25</sup>

The relaxation of Mexico's foreign investment legislation, however, comes at a time when the country is crippled by an external debt of 100 billion dollars.<sup>26</sup> Rampant inflation has been curbed by the "Pact for

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17. *Id.*

18. The three year leave commences on May 17, 1989. *Id.*, Transitory arts. 1st. and 6th.

19. Pursuant to Transitory article 6th. of the New Regs. *supra* note 1, the acquisition of a controlling interest in existing companies is subject to:

(i) New capital investments for at least 30% of the net value of fixed assets declared in the last income tax return;

(ii) An increase of the paid-in capital by 20% of new capital investments; and

(iii) Compliance with all other conditions for incorporation with 100% ownership.

*See supra* notes 11-17 and accompanying text.

20. A major innovation was the establishment of short statutory periods for government consent. Approval is automatic if no formal response is made within the statutory periods. The longest period established is 45 business days. New Regs., *supra* note 1, art. 2.

21. Articles 8 and 9 of the New Regs., *id.*, establish the conditions for stock acquisitions by foreign corporations institutionally engaged in promoting economic development. The shares have to be sold at the end of a 20-year period, and there can be no conditions imposed on the domestic corporations receiving the investment. Eight development corporations have already been recognized by the FIC. Gen. Res. 2, *supra* note 12, rule 4.

22. Under articles 10 and 11 of the New Regs., *supra* note 1, SECOFIN may authorize the use of Mexican trusts to allow indirect foreign acquisition of stock and assets of Mexican corporations in excess of the 49% FIL limitation. Such trusts are also available to permit foreign commercial exploitation of a domestic corporation or its assets.

23. *See infra* notes 146-50 and accompanying text.

24. *See infra* notes 151-57 and accompanying text.

25. Articles 16 through 22 of the New Regs., *supra* note 1, regulate the terms and conditions for approval of real estate trusts in the so-called "restricted areas," which allow foreign beneficiary rights in industrial and tourist enterprises located in the borders and seacoasts. *See infra* notes 37-39, 128-30, and 142-45, and accompanying text.

26. Mexico owes approximately U.S. \$52 billion to commercial banks. "The balance of

Economic Stability and Growth" (PACT)<sup>27</sup> proposed by the government and accepted, willy-nilly, by the unions and the private sector.<sup>28</sup> The PACT has reduced inflation through a virtual control on wages, prices, import duties, and rate of exchange, but some fear that it will stagnate economic growth.<sup>29</sup>

Although the government has been unable to persuade the private sector to repatriate flight capital, the outflow has substantially receded in the initial months of President Salinas' administration.<sup>30</sup> Nevertheless, Mexico continues to transfer substantial amounts abroad for interest payments on the external debt and growing imports as a result of the liberalization of foreign trade.<sup>31</sup>

### III. AN OVERVIEW OF STATUTORY AND ECONOMIC POLICY RESTRICTIONS: 1910 - 1973

In 1910 Mexico replaced Porfirio Díaz, one of the longest reigning dictators of modern times, with a popular government that emerged from

Mexico's U.S. \$97 billion debt consists principally of debt to multilateral financial institutions [U.S. \$19 billion], official export credit institutions [U.S. \$9 billion], holders of publicly issued bonds [U.S. \$3 billion] . . . short-term revolving liabilities such as interbank lines, bankers acceptances and other trade-related credits [U.S. \$9 billion], and . . . private sector debt to foreign creditors [U.S. \$5 billion]." *Communication from Mexico's Minister of Finance and Public Credit to the International Banking Community*, 6-7, Sept. 15, 1989, [hereinafter *Minister's Communication*] (contained in *Bank Advisory Committee for Mexico, The United Mexican States, 1989-92 Financing Package*, Sept. 15, 1989. The Committee was co-chaired by Citibank, N.A. and Bank of America, NT and SA) [hereinafter *Financing Package*] (Copies on file at the offices of the *Houston Journal of International Law*).

27. The PACT, originally labelled "Economic Solidarity Pact," was signed during the administration of President Miguel de la Madrid on December 15, 1987. *Presidencia de la República, Dirección General de Comunicación Social, Pacto de Solidaridad Económica* (1987) [hereinafter PSE]. The new administration renewed the PACT under its present name on December 12, 1988, and has the intention of maintaining it in place at least until March 31, 1990. See *Presidencia de la República, Dirección General de Comunicación Social, Renewal of the Pact for Stability and Economic Growth* (1989).

28. Union and business leaders signing the original PACT agreed to mild wage increases and price controls as a necessary evil to reduce inflation. See PSE, *supra* note 27, at 25-30.

29. From its inception, the PACT has been subject to debate. Some have suggested that it may inhibit productive growth and provoke unemployment. *El Financiero*, Aug. 1, 1989, at 16, col. 1 [hereinafter *Financiero*]. See L. PAZOS, *HACIA DONDE VA SALINAS* 21 (1989). The chairman of the National Chamber of Commerce of Mexico has called for an end to the PACT in April, 1990. *Financiero*, Sept. 14, 1989, at 26, col. 1. At least one author has blamed the PACT for the poor showing of the government's party in the 1988 presidential elections. See T. HEYMAN, *INVESTING IN MEXICO* 47 (1989) [hereinafter T. HEYMAN].

30. A reduction of flight capital was reported during the initial months of 1989. *Financiero*, July 14, 1989, at 24, col. 1. Induced by high interest rates on deposits, and the PACT's protection against a major devaluation, approximately U.S. \$1.47 billion of flight capital had reportedly returned during the first quarter of 1989. *Financiero*, July 24, 1989, at 10, col. 1. Nevertheless, a subsequent drop in interest rates and the circumstances surrounding the announcement of a tax amnesty in favor of returning capital apparently reversed the trend. See *infra* notes 171 & 173 and accompanying text.

31. Foreign exchange transfers for debt service and imports created a current account deficit of the balance of payments of U.S. \$932 million during the first quarter of 1989. *Financiero*, July 14, 1989, at 24, col. 1.

the Revolution. Initially, the thrust of the Revolution had revolved around the democratization of the electoral process, but the goals went rapidly beyond the replacement of Díaz to the promotion of government control over natural resources.<sup>32</sup> Most of the Revolution's goals were achieved with the passage of the 1917 Constitution — a historic document that paved the way for modern Mexico and imposed the first set of restrictions on foreign investment.

The 1917 Constitution claimed direct government ownership over land,<sup>33</sup> waters,<sup>34</sup> and petroleum and other subsurface mineral deposits.<sup>35</sup> Nonetheless, certain ownership rights were recognized in favor of foreigners willing to waive the diplomatic protection of their home governments.<sup>36</sup>

Moreover, the 1917 Constitution banned foreign acquisition of land in the so-called "restricted areas," which are located within 100 kilometers from the borders and fifty kilometers from the seacoasts.<sup>37</sup> This limitation is now regulated by the FIL<sup>38</sup> and has gained political momentum in view of Mexico's concern over substantial foreign land holdings recently discovered in the State of Baja California.<sup>39</sup>

The minimal restrictions imposed by the 1917 Constitution were considerably expanded in the course of the next fifty years. Gradually, but persistently, the Mexican government claimed a larger role in the economic process, either nationalizing or subjecting to "mexicanization"<sup>40</sup> a number of economic endeavors. Thus, activities such as

32. See H. WRIGHT, *supra* note 4, at 61-70. This section relies heavily on H. WRIGHT for the discussion of statutory and policy restrictions on foreign investors from 1917 until the enactment of the FIL in 1973.

33. Under Mexican law, "[t]itle to land and waters within the national territory belongs, originally, to the state. The latter has the right to transfer domain thereof to private parties, constituting private property" (translated by the author). CONST. art. 27, para. 1. See H. WRIGHT, *supra* note 4, at 63.

34. CONST. art. 27, para. 1. See H. WRIGHT, *supra* note 4, at 63.

35. CONST. art. 27, para. 4. See H. WRIGHT, *supra* note 4, at 63-70.

36. CONST. art. 27, § I. Foreigners willing to waive diplomatic protection, were given the right "to acquire title to land or waters or concessions on mines, waters or combustible minerals." H. WRIGHT, *supra* note 4, at 63.

37. CONST. art. 27, § I. For a thorough discussion on the so-called "restricted areas," see H. WRIGHT, *supra* note 4, at 115-118.

38. See FIL, *supra* note 2, Arts. 18-22.

39. Undersecretary of Foreign Relations, Sergio González Gálvez recently stated Mexico's intention to curtail permits for new leases for single-family homes in Baja California. The undersecretary revealed that "35 percent of Baja California is owned by foreigners." San Diego Union, June 17, 1989, at 1, col. 1. This concern is reflected in the New Regulations, which subject real estate trusts in Baja California to special regulations. New Regs., *supra* note 1, art. 17.

40. "Mexicanization" was a policy conceived as a requirement that "new foreign investors should associate with Mexican capitalists and should ideally take a minority position in new undertakings." H. WRIGHT, *supra* note 4, at 154.

sulphur mining,<sup>41</sup> oil and gas exploration and production,<sup>42</sup> petrochemical production,<sup>43</sup> mining,<sup>44</sup> forestry and fishing,<sup>45</sup> transportation,<sup>46</sup> radio and television broadcasting,<sup>47</sup> electric power generation,<sup>48</sup> and automotive parts manufacturing,<sup>49</sup> were all either closed to foreign participation or severely restricted by the time of the enactment of the FIL in 1973.<sup>50</sup> A presidential decree enacted in 1944,<sup>51</sup> whose goal was to protect Mexico against the negative effects of flight capital during World War II, gave Mexican administrations<sup>52</sup> the justification to control foreign participation in domestic corporations for the next thirty years.<sup>53</sup>

Foreign investors were further induced to accept minority positions in manufacturing corporations by economic policies that promoted government concessions to companies controlled by Mexicans. Under the policies of "import substitution"<sup>54</sup> and "industrial integration,"<sup>55</sup> Mexican administrations since 1940 skillfully utilized tariffs, tax concessions, and import licenses to implement investment restrictions, which were dictated by the status of the economy, the balance of payments, or the prevailing political sentiment towards foreign capital.<sup>56</sup>

The growing restrictions on foreign capital did not deter foreign investors from participating in the Mexican industrial boom, which spanned three decades beginning in 1940.<sup>57</sup> Fully protected by tariffs,

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41. See *id.* at 87-90.

42. See *id.* at 126-28.

43. See *id.* at 128-32. See *infra* note 172.

44. See H. WRIGHT, *supra* note 4, at 133-40.

45. See *id.* at 140-42.

46. See *id.* at 142-43.

47. See *id.* at 143-44.

48. See *id.* at 144-45.

49. Immediately before the enactment of the FIL, domestic companies engaged in the manufacture of auto parts were required to have a minimum of 60% of their capital owned by Mexicans. *Decreto que fija las bases para el desarrollo de la industria automotriz*, D.O. Oct. 24, 1972, art. 33.

50. See FIL, *supra* note 2, arts. 4 and 5.

51. *Decreto que establece la necesidad transitoria de obtener permiso para adquirir bienes a extranjeros, y para la constitución o modificación de sociedades mexicanas que tengan o tuvieren socios extranjeros*, D.O. July 7, 1944 [hereinafter Emergency Decree].

52. Despite serious disputes about the constitutionality of the Emergency Decree, this significant piece of legislation was in effect during six presidential administrations. The Emergency Decree was finally rendered obsolete by the passage of the FIL in 1973.

53. See H. WRIGHT, *supra* note 4, at 101-113.

54. The policy of "import replacement" was designed to induce local manufacturers to change from "the establishment of plants for the mere assembly or final processing of imported parts or intermediate products," into real manufacturing facilities. *Id.* at 84.

55. "Industrial integration" is a term "applied in Mexico to the domestic production of a commodity from domestic raw materials and intermediate products and other Mexican-source supplies." *Id.* at 170.

56. See *id.* at 164-86.

57. In the period following World War II, "Mexico's economy [was] one of the fastest growing in the world. . . . By 1980, Mexico's absolute GDP exceeded the GDPs of Spain,

and stimulated by federal tax concessions and other incentives,<sup>58</sup> foreign investors thrived in the Mexican market. The country had very low inflation,<sup>59</sup> a sustained annual growth rate of six percent,<sup>60</sup> a growing urban population with an appetite for consumer goods,<sup>61</sup> and a stable rate of exchange with free convertibility.<sup>62</sup>

In 1970 foreign and domestic investors believed that the existing statutory and policy restrictions would stay in place for a long time, because they provided an adequate framework to implement changing government policy. The general belief was that the government would continue to resist "the temptation to enact a general law on foreign investment,"<sup>63</sup> for fear of "frightening away desirable foreign capital."<sup>64</sup> These predictions failed, however, in 1973, when the administration of President Luis Echeverría passed the FIL, which established the 51-49% concept as a general rule, and imposed further restrictions on foreign capital.

The Echeverría administration did more than promote the enactment of the FIL. In a major departure from long-standing government policy, the administration abandoned the economic model based on development with price and monetary stability<sup>65</sup> and embarked on a new policy that emphasized a more equitable income distribution.<sup>66</sup> In an

India, Belgium, Netherlands, or Australia. Its total GDP was equal to the combined GDPs of Venezuela, Argentina, Chile and Colombia." T. HEYMAN, *supra* note 29, at 1.

58. In 1971, in addition to federal tax concessions, "[v]irtually all states [offered] exemptions from various . . . taxes to new or necessary enterprises and to established companies [willing to] expand their plant capacity." H. WRIGHT, *supra* note 4, at 186 (footnote omitted).

59. Between 1935 and 1956 the average annual rate of inflation was rather high at 10%, because of World War II. However, from 1956 until 1970, prices grew at an average annual rate of 4%. C. TELLO, *LA POLITICA ECONOMICA EN MEXICO*, at 11 n.1 (4th ed. 1980) [hereinafter C. TELLO].

60. See T. HEYMAN, *supra* note 29, at 1.

61. For one economist, "[t]he industrialization process . . . introduced major changes in the Mexican social structure. The most evident was the accelerated growth of [Mexican] cities" (translated by the author). C. TELLO, *supra* note 59, at 29. In the opinion of this economist, Mexico's protectionism fostered an inefficient industry devoted, almost entirely, to satisfying a limited urban demand influenced by foreign consumer practices. *Id.* at 27-28.

62. From 1954 until 1976, Mexico had a stable rate of exchange of pesos 12.50 to U.S. \$1, with free convertibility. After 22 years of monetary stability, the government decided to float the Mexican peso in order to stop financing speculation and flight capital with external debt. See *id.* at 147.

63. H. WRIGHT, *supra* note 4, at 95.

64. *Id.*

65. See C. TELLO, *supra* note 59, at 41-182. See generally R. CORDERA AND C. TELLO, *MEXICO: LA DISPUTA POR LA NACION* (2d ed. 1981).

66. At his inauguration, President Echeverría stated that "it is not true that there is an inevitable dilemma between economic growth and income distribution. Those who preach that we must first grow in order to share, are either wrong or compelled to lie by self interest" (translated by the author). C. TELLO, *supra* note 59, at 41. See R. GREEN, *ESTADO Y BANCA TRANSNACIONAL EN MEXICO*, at 75-78 (1981) [hereinafter R. GREEN].

effort to promote the sharing of economic benefits, the government expanded its areas of endeavor,<sup>67</sup> subsidized the price of its goods and services,<sup>68</sup> and evoked the same kind of nationalism that spurred economic growth in the 1940s.<sup>69</sup>

#### IV. THE 51-49% RULE: CHOOSING DEBT OVER EQUITY?

In his 1970 inaugural address, President Echeverría strongly condemned the sale of Mexican companies to American multinationals.<sup>70</sup> The President also stated a clear preference to receive foreign investors willing to create new industries, contribute technology, and manufacture export goods.<sup>71</sup> Although the President's speech merely suggested that foreign capital should be "associated" with and "guided" by Mexican nationals, it was his Undersecretary of Industry who announced in New York, shortly after the inauguration, the administration's policy that foreign investors should be "associated in a minority position with Mexican capital, as a general rule."<sup>72</sup> Less than a year after this announcement, the 51-49% limitation became federal law.<sup>73</sup>

A considerable debate both preceded and followed the publication of the FIL.<sup>74</sup> The American ambassador claimed that Mexico was changing the "rules of the game,"<sup>75</sup> while the investment community took this as yet another opportunity for further conflict with the Echeverría administration.<sup>76</sup> Caught in the middle of this debate, foreign investors already established in Mexico feared retroactive application of the FIL. The official rhetoric surrounding the enactment of the new law gave cause for concern that the government might require the "mexicanization" of all existing foreign subsidiaries. Nevertheless, the retroactive application of the law, which would have been unconstitutional, never occurred, because the administration chose to apply the 51-49% rule for new companies only.

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67. In his inaugural address, President Echeverría expressed his intention to make public investment the pivot of economic growth. As a consequence of this economic policy, the government absorbed "a large number of enterprises engaged in a . . . variety of social and economic endeavors" (translated by the author). C. TELLO, *supra* note 59, at 187.

68. It has been suggested that one of the main sources of conflict between the Echeverría administration and the private sector, was the government's response to labor demands by way of subsidized food, housing, and consumer goods through government entities. See R. GREEN, *supra* note 66, at 88-91.

69. See *id.* at 75-109.

70. See C. TELLO, *supra* note 59, at 42.

71. For a relevant excerpt of the President's inaugural address, see *id.* at 58.

72. See *id.* at 58-59.

73. See *infra* notes 77-86 and accompanying text.

74. See C. TELLO, *supra* note 59, at 57-59. See also R. GREEN, *supra* note 66, at 87-88.

75. The ambassador also expressed concern about the possible retroactive application of the FIL. See C. TELLO, *supra* note 59, at 58.

76. See R. GREEN, *supra* note 66, at 87-88.

The FIL basically collected the principal restrictions on foreign investment existing in 1973. Consequently, the statute reasserts a ban on foreign participation in economic activities previously reserved for the federal government<sup>77</sup> or Mexican investors.<sup>78</sup> Three economic activities formerly restricted to foreign participation in proportions less than forty-nine percent were also included in the FIL.<sup>79</sup>

Nonetheless, the most far reaching restriction was the requirement that foreign capital, as a general rule, should not exceed forty-nine percent.<sup>80</sup> The FIL addressed the President's concern about foreign acquisition of Mexican companies by restricting the purchase of more than twenty-five percent of the capital or forty-nine percent of the assets of an existing Mexican corporation.<sup>81</sup> Thus, local businessmen were dissuaded from selling Mexican companies, which were a part of the "national heritage" in the opinion of President Echeverría.<sup>82</sup>

Management contracts were banned under the FIL to prevent circumventing the forty-nine percent ownership limitation,<sup>83</sup> and foreign participation on the boards of domestic corporations was limited to the proportion of foreign capital invested.<sup>84</sup>

Exceptions to the forty-nine percent ownership limitation were made available by the FIL only for special projects having characteristics consistent with economic policy. Accordingly, the FIC was obligated to consider the 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.<sup>85</sup> Nevertheless, the strict application of the FIL for the next fifteen years permitted very few exceptions.<sup>86</sup>

Despite all the controls imposed on direct foreign investment in

77. Article 4, para. 1 of the FIL, *supra* note 2, exclusively reserves the following activities in favor of the Mexican Government: oil and gas exploration and production, basic petrochemicals production, radioactive minerals production and nuclear energy generation, special mining activities, electricity generation, railroad operations, and telegraph and radio communications.

78. Article 4, para. 2 of the FIL, *id.*, exclusively reserves the following activities for Mexican investors: radio and television broadcasting, surface transportation, national air and maritime transportation, forestry, and gas distribution.

79. Pursuant to article 5, para. 1 of the FIL, *id.*, in the following activities foreign investment is allowed in proportions less than 49%: exploitation of national mineral reserves (34%), secondary petrochemicals production (40%), and manufacture of automotive parts (40%).

80. FIL, *id.* art. 5, para. 2.

81. FIL, *id.* art. 8, para. 1.

82. See C. TELLO, *supra* note 59, at 47.

83. Under article 5 para. 2 of the FIL, *supra* note 2, foreign investment may not exceed 49% as a general rule, "provided that foreigners do not have the right to determine the company's management" (translated by the author).

84. FIL, *id.* art. 5, para. 4.

85. FIL, *id.* art. 13.

86. See, *supra* note 5 and accompanying text.

1973, indirect foreign investment grew almost three times by way of external borrowing from 1973 through 1976.<sup>87</sup> In the opinion of a foreign debt specialist, the government resorted to foreign loans as the standard way of financing a growing government deficit.<sup>88</sup> Ironically, the administration that made an early condemnation of the size of Mexico's external debt and strongly emphasized nationalism, allowed Mexico's economy to be largely dominated by the international banking community for the next fifteen years.<sup>89</sup>

President Echeverría's concern with income distribution, however, was not totally unfounded.<sup>90</sup> An analysis of the Mexican economic development by 1971, shows that the country had very low income tax rates,<sup>91</sup> an overwhelming amount of public investment in industrial infrastructure,<sup>92</sup> and an exiguous social security coverage.<sup>93</sup> Consequently, Mexico's industrial "miracle" had turned into a development pattern that excluded large sectors of the population from the benefits of economic growth.<sup>94</sup>

The passage of the FIL in 1973 can not be interpreted to be the result of a deliberate choice of foreign debt over equity.<sup>95</sup> Nonetheless, the inhibition of direct foreign investment caused by the enactment of the new law, coupled with the government's expansion to promote a more equitable income distribution, induced the administration to incur a large external debt that would hinder economic growth for many years.<sup>96</sup>

The borrowing spree that commenced in 1973 was considerably intensified during the administration of President José López Portillo. The

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87. See R. GREEN, *supra* note 66, at 21-30.

88. See *id.* at 76, 78.

89. See *id.* at 51; 75-109.

90. See R. D. HANSEN, *THE POLITICS OF MEXICAN DEVELOPMENT*, (1974) [hereinafter R. D. HANSEN]. See generally E. PADILLA, *MEXICO: HACIA EL CRECIMIENTO CON DISTRIBUCION DEL INGRESO* (1981). See also C. TELLO, *supra* note 59, at 11-40.

91. A conclusion was reached in 1971 that the Mexican tax rate had been the lowest of all Latin American countries, with the exception of Guatemala, Paraguay, and probably, Colombia. R. D. HANSEN, *supra* note 90, at 84. See also C. TELLO, *supra* note 59, at 45 n.8.

92. In 1971 Mexico, compared to other Latin American countries, was dedicating a very small amount of public investment to social welfare: less than 15% per year from 1935 to 1960 and scarcely 20% from 1960. The overwhelming proportion of government investment was going to infrastructure. R. D. HANSEN, *supra* note 90, at 85.

93. Although Mexico was a leader in Latin America in the area of labor legislation "as of 1967, only 6.1 percent of the total Mexican population, or 18.9 percent of the Mexican work force, was covered by social security benefits." *Id.* at 116.

94. One foreign scholar concluded in 1971, that Mexico's development pattern "combined sustained sacrifices at the bottom of the socio-economic scale, with growing rewards at the top." *Id.* at 95.

95. See *infra* notes 176-77 and accompanying text.

96. Sixteen years after the passage of the FIL, external indebtedness continues to be the major issue in the Mexican economy. The agreement in principle reached with the commercial banks by President Salinas calls for full repayment by December 31, 2019. See generally *Financing Package*, *supra* note 26.

President ended his term of office in 1982 amidst economic confusion caused by the following factors: (a) the substantial fall in international oil prices,<sup>97</sup> (b) the ninety billion dollar external debt,<sup>98</sup> (c) the devaluation of the Mexican peso,<sup>99</sup> (d) the nationalization of commercial banks,<sup>100</sup> (e) the mandatory conversion of all domestic dollar deposits into pesos,<sup>101</sup> and (f) the imposition of foreign exchange controls for the first time in modern Mexico.<sup>102</sup> Under President López Portillo, Mexico continued the growth pattern of heavy reliance on external debt, with strict control of direct foreign investment.

President Miguel De la Madrid, who governed Mexico from 1982 until 1988, is largely responsible for the initial thrust to modernize Mexico's economy through the liberalization of foreign trade.<sup>103</sup> Although his administration issued the 1984 Guidelines, a more in-depth revision of the foreign investment legislation was perhaps averted by the President's dedication to more pressing economic matters, such as the restructuring of Mexico's large external debt,<sup>104</sup> the control of inflation,<sup>105</sup> and

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97. The substantial decrease in oil prices started in 1981 when the price of Isthmus oil fell from U.S. \$38.50 to U.S. \$35 per barrel. "Meanwhile, from 1979 to 1980, US interest rates spiralled from 8% to 21%, a post-war high." T. HEYMAN, *supra* note 29, at 29. "Between 1985 and 1986, the average price of oil exports . . . fell from US \$24 to US \$12 per barrel." *Id.* at 31.

98. Figures from the Mexican Treasury estimated the 1982 aggregate public and private external debt at U.S. \$87.6 billion. *Id.* at 8.

99. In February 1982, the peso suffered the first major devaluation since 1976. The peso-dollar rate of exchange was approximately pesos 26.00 to U.S. \$1 in January 1982, and approximately pesos 97.00 to U.S. \$1 in December 1982.

100. On September 1, 1982, all private commercial banks, with the exception of Citibank, N.A., and *Banco Obrero* (owned by the Mexican labor unions), were nationalized by President López Portillo. *Decreto que establece la nacionalización de la Banca Privada*, D.O. Sept. 1, 1982. See generally Camil, *The Nationalized Banking System and Foreign Debt*, 18 INT'L LAW. 323 (1984).

101. In a highly controversial move to avoid the "dollarization" of the economy, the President ordered, in the last months of his administration, the conversion of all dollar deposits held by Mexican banks into Mexican pesos. *Reglas para el pago de depósitos bancarios denominados en moneda extranjera*, D.O. Aug. 13, 1982.

102. Simultaneously with the bank nationalization, President López Portillo imposed generalized foreign exchange controls. *Decreto que establece el control generalizado de cambios*, D.O. Sept. 1, 1982.

103. Under President De la Madrid, the Mexican Congress passed a law authorizing the federal executive to liberalize foreign trade. *Ley Reglamentaria del Artículo 131 de la Constitución Política de los Estados Unidos Mexicanos en Materia de Comercio Exterior*, D.O., Jan. 13, 1986. Mexico joined the General Agreement on Tariffs and Trade (GATT) under the auspices of President De la Madrid on August 24, 1986. For a complete review of the circumstances surrounding Mexico's political decision to join GATT, see L. MALPICA, *¿QUE ES EL GATT?*, 297-438 (1st. rev. ed. 1988).

104. President De la Madrid made "successive debt renegotiations in each year [during his six-year term of office], the most recent having terminated in March 1987, and resulting in a stretching of maturities on the public sector [borrowings] to the year 2006." T. HEYMAN, *supra* note 29, at 7.

105. President De la Madrid was the creator of the original PACT. See *supra* notes 27-29 and accompanying text.

the consequences of the 1985 earthquake.<sup>106</sup>

## V. THE NEW REGULATIONS

The FIL weathered the changing policies of three administrations through general resolutions<sup>107</sup> published by the FIC in the *Diario Oficial*. Although general resolutions have pretended to clarify vague provisions of the FIL, they sometimes regulate the FIL in a manner that exceeds the FIC's legal authority.<sup>108</sup> Some Mexican lawyers have even questioned the constitutionality of the FIC's powers to issue general resolutions.<sup>109</sup>

When the current administration decided to change Mexico's policy regarding foreign investment, the dilemma must have been whether to amend the FIL, or to proceed by way of general resolutions. Amending the FIL had many political implications for a new administration facing a serious economic crisis, and a strong opposition in Congress. On the other hand, resorting to general resolutions would have been, apart from the constitutionality issue involved, an unreliable way to attract much needed foreign investment.

Although the government elected to use the President's regulatory powers,<sup>110</sup> the predominating opinion among the Mexican legal community is that the New Regulations virtually amend the FIL. Considerable debate is already forming around the constitutionality of the New Regulations and its effects on foreign investors.<sup>111</sup>

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106. On September 19, 1985, Mexico City suffered the most severe earthquake in history. The reconstruction efforts further drained the resources of the public sector.

107. Article 12, § VI of the FIL, *supra* note 2, empowers the FIC to "establish criteria and requirements for the application of statutory provisions and regulations on foreign investment." Article 23, § V of the FIL, *id.*, provides for the recordation of "resolutions dictated by the FIC." Finally, article 53 of the Old Regs., *supra* note 1, classified FIC resolutions as "general" and "specific" (all translations by the author). All of these provisions constitute the authority pursuant to which the FIC has issued general resolutions.

108. For a complete analysis on 13 general resolutions issued by the FIC, see generally I. GOMEZ PALACIO, *INVERSION EXTRANJERA DIRECTA*, ch. 12 (1985). The author concludes that several general resolutions actually regulate the FIL.

109. See *id.* at 239. The author determines that the FIC's publication of general resolutions is an unconstitutional regulatory act that belongs to the President.

110. See *supra* note 4 and accompanying text.

111. One Mexican lawyer has opined that the New Regulations are constitutional, because they (a) do not contravene the Mexican Constitution, (b) were issued by the President under constitutional regulatory powers, and (c) were duly signed by all corresponding members of the presidential cabinet. This lawyer concludes that the final determination on the constitutionality issue corresponds to the Mexican Supreme Court. *Legal Opinion addressed by Dr. Luis Miguel Diaz to Lic. Miguel Jáuregui, Chairman of the Mexican Legislation Committee, American Chamber of Commerce of Mexico*, July 13, 1989 (on file with Mexican Legislation Committee of the American Chamber of Commerce of Mexico City). Another Mexican lawyer strongly believes that the New Regulations are unconstitutional because both the FIL and the Mexican Constitution have the purpose of *regulating* and not *promoting* foreign investment. This argument seems to imply that the president is unable to issue decrees promoting foreign investment. I. GOMEZ PALACIO, *LEY DE INVERSION EXTRANJERA Y SU REGLAMENTO COMENTADOS*, 139-40 (1989).

The New Regulations constitute a major departure from the 51-49% rule, and establish the basis to reverse a fifteen-year trend of inflexible application of the FIL.<sup>112</sup> Although the 1917 Constitution stirred nationalistic feelings provoked by the overwhelming involvement of foreign capital during the Díaz regime,<sup>113</sup> foreign investment was always welcome to participate in postrevolutionary Mexico within the mild constitutional limitations.<sup>114</sup> Subsequently, after World War II, foreign capital thrived in modern Mexico's industrial boom. The passage of the FIL, however, marked the turning point from the benign statutory and policy restrictions of the 1950s and 1960s, into the strict control of the 1970s and 1980s. The requirement that foreign investment, generally, would have to participate in a minority position no doubt discouraged many worthy projects<sup>115</sup> and inhibited the contribution of state-of-the-art technology to the Mexican industrial process.<sup>116</sup>

The key to the New Regulations are the conditions<sup>117</sup> established for majority foreign participation in the incorporation of companies not subject to specific statutory restrictions.<sup>118</sup> Although most of the conditions already existed in the Mexican regulatory process for the granting of waivers to the forty-nine percent limitation, a major breakthrough was the elimination of administrative discretion, which had obligated foreign investors to painfully negotiate government approval of specific projects requiring 100% ownership.<sup>119</sup>

The considerable limitation of the FIC's discretionary powers by the New Regulations, together with the elimination of the negotiating process, were deliberate moves to deregulate foreign investment.<sup>120</sup> In the

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112. See *supra* note 5 and accompanying text.

113. By the turn of the century, "foreigners probably owned over half the total wealth of the country and . . . foreign capital dominated every area of productive enterprise except agriculture and the handicraft industries." H. WRIGHT, *supra* note 4, at 53.

114. See *supra* notes 33-37 and accompanying text.

115. This author negotiated for two years with the Mexican government a large industrial project which was to be owned 60% by Mexican public and private investors, and 40% by foreign shareholders. The prospective foreign investors eventually cancelled the project because of excessive government restraints on the approval of the manufacturing program and the documentation for the joint venture.

116. President Salinas recognized the need to open the Mexican economy to guarantee that "foreign investment [would] be associated with the right technology, increasing productivity" (translated by the author). New Regs., *supra* note 1, Statement of Purposes, para. 12.

117. See *supra* notes 11-17 and accompanying text.

118. The New Regulations contain an appendix consisting of a Classification of Economic Activities and Products (Classification). The Classification establishes the proportion of foreign capital allowed in various economic activities under the FIL and other federal statutes. All activities not included in the Classification are freely opened to foreign capital provided all other conditions for majority ownership are met. New Regs., *supra* note 1, art. 5, Appendix.

119. One Mexican lawyer recently deplored that the negotiating process before the enactment of the New Regulations could take up to 12 months, and that "the process [was] cumbersome, time consuming, and at times, frustrating." Rojas, *supra* note 3, at 15.

120. In an effort to modernize the Mexican economy, the Salinas administration decided to

words of President Salinas, the New Regulations are "a legal framework that provides certainty, permanence, clarity, and security."<sup>121</sup>

Foreign investors are also free to incorporate or acquire Mexican companies engaged in *maquila*<sup>122</sup> operations or in manufacturing and commercial activities connected with foreign trade.<sup>123</sup> These provisions substantiate Mexico's commitment to exports, which permeate the statement of purposes preceding the New Regulations.

In order to further deregulate foreign investment, the use of Mexican trusts, largely drawn from the anglo-american legal system,<sup>124</sup> is widely authorized by the New Regulations to circumvent constitutional or FIL limitations. The possibility of having a natural person serve as trustee is unknown to Mexico's legal system. Under Mexican law, only domestic banking corporations, now owned by the Mexican government, can act as trustees. Therefore, by means of this ingenuity,<sup>125</sup> foreigners can now become trust beneficiaries of stock in Mexican corporations,<sup>126</sup> in addition to land in the "restricted areas."<sup>127</sup>

Mexican trusts had been recommended by local attorneys prior to the publication of the FIL, as a reasonably reliable way to hold land in the "restricted areas," avoiding the more widespread and dangerous practice of using name-lenders.<sup>128</sup> This questionable use of trusts, however, was legitimized in 1972, by a presidential decree that allowed foreign landholdings in the "restricted areas" through the services of Mexican banks.<sup>129</sup> Subsequently, the presidential decree became a part of the FIL.<sup>130</sup>

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"simplify the criteria and procedures that regulate foreign investment" (translated by the author). New Regs., *supra* note 1, Statement of Purposes, para. 13.

121. *Id.* at para. 14.

122. For an excellent review of the Maquiladora concept (also called "twin-plants" or "in-bond plants") see Valdez, *Expanding the Concept of Coproduction Beyond the Maquiladora: Toward a More Effective Partnership between the United States and Mexico, and the Caribbean Basin Countries*, 22 INT'L LAW. 393 (1988).

123. New Regs., *supra* note 1, Art. 6.

124. See R. BATIZA, *EL FIDEICOMISO*, 75-101 (1976).

125. The cleverness of this device consists in conveying legal title in favor of the Mexican bank, and equitable title in favor of the foreign investor.

126. Pursuant to Title Three, chapters I, II, and IV of the New Regs., *supra* note 1, foreign investors may now own a beneficial interest in domestic corporations through Mexican trusts.

127. See *supra* notes 37-39 and accompanying text. See also *infra* notes 128-30 and accompanying text.

128. In the past, many foreign land holdings in the "restricted areas" were arranged through bearer stock companies incorporated by Mexican nationals, who would subsequently endorse the stock over to the foreign investors. This, obviously, was in violation of constitutional limitations.

129. *Acuerdo que autoriza a la Secretaría de Relaciones Exteriores para conceder a las instituciones nacionales de crédito, los permisos para adquirir como fiduciarias el dominio de bienes inmuebles destinados a la realización de actividades industriales o turísticas, en fronteras y costas*, D.O. Apr. 30, 1971.

130. See FIL, *supra* note 2, Arts. 18-22.

Trusts were never readily available to bypass limitations on stock ownership imposed by foreign investment legislation.<sup>131</sup> The device, however, was occasionally tolerated prior to the passage of the FIL to facilitate the "mexicanization" of industrial companies willing to participate in government incentive programs. After the enactment of the FIL, trusts were sporadically authorized by the FIC as an indirect method to allow foreign investors without suitable Mexican partners to make or maintain their investments.<sup>132</sup>

The New Regulations authorize the use of Mexican trusts to allow foreign participation in areas or activities previously restricted. This form of participation, albeit indirect, permits foreign investors<sup>133</sup> (a) to acquire stock<sup>134</sup> and corporate assets<sup>135</sup> in excess of the forty-nine percent limitation,<sup>136</sup> (b) to purchase non-voting participation certificates in investment trusts holding public stock,<sup>137</sup> (c) to obtain beneficial title to land and waters within and without<sup>138</sup> the "restricted areas," and (d) to make twenty-year temporary<sup>139</sup> investments in companies previously closed to foreign investment<sup>140</sup> or subject to ownership limitations less than forty-nine percent.<sup>141</sup>

A major innovation in the New Regulations was the decision to extend the thirty-year trusts previously authorized for land holdings in the "restricted areas."<sup>142</sup> Investors had been concerned for years about the final outcome of their investments upon the expiration of the original term. Now, despite an FIL provision that such trusts would "under no

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131. A controlling trust over stock without FIC approval would violate the 51-49% concept. Under the FIL, foreigners cannot have, "under any title," unauthorized control over Mexican corporations. FIL, *supra* note 2, art. 5, para. 2.

132. The availability of trusts to circumvent FIL limitations on foreign ownership has largely depended on prevailing government policy. See *infra* note 157 and accompanying text.

133. Under certain conditions, trusts are now also available for the acquisition of a 100% Mexican company with land in the "restricted areas", by another Mexican company with foreign partners. New Regs., *supra* note 1, art. 12.

134. Article 10, § I of the New Regs., *id.*, permits the use of a trust to acquire voting and dividend rights in excess of the 49% limitation. See *supra* note 22 and accompanying text.

135. Article 10, §§ I and II of the New Regs., *supra* note 1, permits the use of a trust to buy corporate assets in excess of the 49% limitation. See *supra* note 22 and accompanying text.

136. Companies that do not qualify for majority foreign participation under the New Regulations, are still subject to the 49% ownership limitation. FIL, *supra* note 2, art. 5, para. 2; art. 8, para. 1. Article 7 of the New Regs., *supra* note 1, seems to expand the FIL limitation for acquisition of stock in existing Mexican corporations from 25% to 49%.

137. See *infra* notes 146-50 and accompanying text.

138. Article 36, para. 2 of the New Regs., *supra* note 1, permits the Foreign Ministry to authorize the use of trusts outside of the "restricted areas" in favor of foreigners acquiring land, waters, and their appurtenances.

139. See *infra* notes 151-56 and accompanying text.

140. See *infra* notes 151-52 and accompanying text.

141. See *infra* note 153 and accompanying text.

142. Article 20 of the New Regs., *supra* note 1, authorizes the Foreign Ministry to approve a new trust on the expiration of the original 30-year term. The approval is basically conditioned upon maintaining the same beneficiary, and the original terms and conditions.

circumstances exceed thirty years,"<sup>143</sup> the New Regulations provide the mechanism to extend the original term by way of consecutive trusts.<sup>144</sup>

The transfer of beneficiary rights to thirty-year trusts in the restricted areas had been generally handled by means of an assignment of the remainder; hence, this left the new beneficiary with a trust that expired in less than thirty years. In order to avoid discrimination, the New Regulations expressly authorize the settlement of a new thirty-year trust in favor of the assignee.<sup>145</sup>

A special kind of stock is also authorized by the New Regulations for Mexican companies listed in a stock exchange. The stock is designed to constitute a special series to be named "N" (for neutral) and may be subscribed only by Mexican investment trusts.<sup>146</sup> Subscribing trustees are then authorized to issue non-voting participation certificates, including only "pecuniary rights derived from the entrusted stock."<sup>147</sup> The participation certificates may be directly acquired by foreign investors in the Mexican stock market or through foreign financial institutions, which are also authorized to purchase them for their own account.<sup>148</sup>

Based on the participation certificates representing series "N" stock, foreign financial institutions may issue depository receipts destined to be traded in foreign stock markets.<sup>149</sup> Mexican public companies willing to expand their operations, may also convey common stock restricted to Mexican investors into investment trusts opened to foreigners via participation certificates.<sup>150</sup>

Twenty-year temporary foreign investments are now permitted in areas such as air and maritime transportation<sup>151</sup> and in gas distribution,<sup>152</sup> which were formerly closed to direct foreign investment. The concept of temporary investment also allows for predominant foreign participation in areas of the economy where foreign investment was earlier tolerated in proportions less than forty-nine percent.<sup>153</sup>

Temporary investments must be made through Mexican trusts,<sup>154</sup>

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143. FIL, *supra* note 2, art. 20.

144. The New Regulations do not establish a limitation on the number of trusts that may be authorized in favor of the same beneficiary.

145. New Regs., *supra* note 1, art. 21.

146. New Regs., *supra* note 1, art. 13, § I.

147. Foreigners holding participation certificates may collect dividends and amounts resulting from the redemption of stock, but are not entitled to vote. *See id.*, § II.

148. *See id.*, § III.

149. *Id.*

150. *Id.* Art. 14.

151. *See supra* note 78 and accompanying text.

152. *See id.* and accompanying text.

153. *See supra* note 79 and accompanying text.

154. New Regs., *supra* note 1, art. 23.

and their availability is restricted to companies in need of financial reorganization<sup>155</sup> or companies willing to expand and modernize their operations with a view to exports.<sup>156</sup>

Although the conditions to qualify for a temporary investment are not simple, the availability of this concept is a relief for companies involved in highly restricted activities, where minority foreign investors may be willing to make additional capital contributions to avoid liquidation or increase production in the absence of interested Mexican partners.<sup>157</sup>

*Maquiladoras* and export oriented corporations<sup>158</sup> are free to expand their existing investments through new establishments,<sup>159</sup> economic activities, or product lines.<sup>160</sup> The same benefit is awarded to other corporations willing to make additional capital investments and comply with conditions similar to those required for incorporation with 100% foreign ownership. Companies resulting from corporate mergers are also free to expand their existing investments.<sup>161</sup> This simplification of administrative procedure can be regarded as an additional effort to deregulate foreign investment.

Consistent with the administration's policy to deregulate economic activities as much as possible, the New Regulations largely exonerate Mexican corporations, with or without foreign partners, from the obligation to obtain a government permit previously required to amend their corporate bylaws.<sup>162</sup> Mexican companies that exclude foreign participation, whether by law or by voluntary design of the incorporating shareholders, are now exempt from requesting government consent for the acquisition of real estate in the "restricted areas."<sup>163</sup>

Foreign individuals and corporations and Mexican corporations with foreign partners are now permitted to enter into long term land

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155. Article 23, § I of the New Regs., *id.*, makes temporary investments available to companies with substantial liabilities in foreign currency, or with a drastic reduction in sales.

156. *See id.*, art. 23, § II, paras. (a) and (b).

157. Prior to the New Regulations, the author participated in the financial restructure of a restricted corporation where foreign shareholders and creditors offered debt capitalization to avoid chapter 11 (*suspensión de pagos*). After months of negotiations failure was not avoided, because the proposed capitalization exceeded the 40% limitation imposed by the FIL. Preliminary inquiries with government officers to explore the availability of a statutory exemption through a Mexican trust were met with absolute rejection.

158. *See supra* notes 122-23 and accompanying text.

159. Pursuant to article 27, §§ I-III of the New Regs., *supra* note 1, "establishments" are classified as "industrial," "commercial," and "service oriented."

160. New Regs., *id.*, art. 29, at § II.

161. New Regs., *id.*, arts. 28, § I (c) and 29, § III.

162. The permit is now only required to include an article in the bylaws excluding foreign partners and to amend the corporate purpose. New Regs., *id.*, art. 33.

163. New Regs., *id.*, art. 36.

leases outside of the "restricted areas" without a formerly required government permit.<sup>164</sup>

Finally, a large section of the New Regulations is dedicated to govern the *modus operandi* of the FIR.<sup>165</sup>

## VI. PARTNERS, INSTEAD OF CREDITORS

Clearly, Mexico will not have easy access to international credit in the foreseeable future. The size of the Mexican debt exposure<sup>166</sup> and the losses suffered by the international banking community have removed Mexico's attraction as an international borrower. Moreover, commercial banks around the world are either suspending or substantially reducing international lending, particularly in Latin America.

Mexico's new administration recognizes this turn of events, and accordingly, has adopted a bold and imaginative economic program that represents, in many respects, a major break with the past. The new priority is to recover sustained economic growth.<sup>167</sup> To achieve this end, President Salinas is emphatically attempting to reduce inflation,<sup>168</sup> the level of external debt,<sup>169</sup> and the size of the federal government.<sup>170</sup> In order to persuade foreign and domestic investors to spur economic growth, the new government has substantially reduced domestic interest rates<sup>171</sup> and deregulated other sectors of the economy,<sup>172</sup> as well as foreign investment. Also, tax incentives have been offered to induce the

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164. New Regs., *id.*, art. 37.

165. Almost half of the New Regulations are dedicated to the operation and organization of the FIR. The New Regulations, however, have considerably simplified the registration procedures.

166. See *supra* note 26 and accompanying text.

167. Mexico's debt restructuring efforts are directed at recovering "its historical growth rates in the context of price stability." *Minister's Communication*, *supra* note 26 at 1.

168. See *supra* notes 27-29 and accompanying text.

169. The *Financing Package*, offers creditors a range of options which include principal reduction, interest reduction and new money options. See *Financing Package*, *supra* note 26. Preliminary polls indicate that 60% of the banks will opt for interest reduction and 20% for a proposed 35% principal reduction. The remainder will accept the new money option. Wall St. J., July 25, 1989, at A13, col. 1.

170. President Salinas has considerably reduced the size of the federal government. Under his administration, the government expects to continue the massive privatization of public sector companies commenced in 1982. See *Financiero*, July 31, 1989, at 38, col. 1. The more spectacular divestitures announced were the sales of Mexicana de Aviación, the leading national airline, and Teléfonos de México, the government-owned telephone communications monopoly. See INT'L BUS. WEEK, Aug. 28, 1989, at 14-15. See also THE NEWS, Oct. 8, 1989, at 44, col. 2.

171. To promote investment and reduce the government's cost of domestic funds, interest rates dropped 40% during the latter part of July of 1989. *Financiero*, Aug. 1, 1989, at 8, col. 1.

172. In addition to deregulating foreign investment, President Salinas has deregulated transportation and the petrochemical industry. Further deregulation is expected before the end of 1989 in the Maquiladora, pharmaceutical, and automotive industries. *Financiero*, Sept. 19, 1989, at 23, col. 1.

return of flight capital.<sup>173</sup>

The archaic concept of an all encompassing federal government is being substituted with a new vision of a modern, more efficient state. The economic model adopted by the new administration is predicated upon a federal government concerned with national priorities and not engaged in commercial competition with the private sector.<sup>174</sup> For the first time since the enactment of the FIL, the government has recognized the need to promote foreign investment to attain economic growth.<sup>175</sup>

A government sponsored report, published almost simultaneously with the enactment of the FIL in 1973, demonstrated a marked preference for international loans over direct foreign investment. The authors asserted that direct foreign investment has a more pervasive effect on the balance of payments, because it "gradually reduces new capital contributions and increases the transfer of funds abroad in the form of dividends, royalties and payments for technical assistance."<sup>176</sup> The report concluded that international loans, on the contrary, "provide from the outset the nature, conditions and term of the ensuing obligation."<sup>177</sup> Fifteen years of economic crisis have more than proved the fallacy of this argument. As a consequence of the most recent debt renegotiation, Mexico will be repaying in the year 2019 some medium-term credit obligations incurred in the 1980s.<sup>178</sup>

Placed in a dilemma of choice between direct and indirect foreign investment, President Salinas has, compelled by economic circumstances and deliberate choice, clearly preferred foreign equity over external debt.

Nevertheless, whether foreign investment will flow in response to Mexico's recent change of attitude is difficult to predict. There are many indications that foreign investment was moved primarily in the past by the allure of trade barriers designed to protect companies with domestic

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173. See *Decreto que otorga facilidades administrativas en el Impuesto Sobre la Renta por depósitos o inversiones en el extranjero que se reciban en México*, D.O., Aug. 2, 1989. Nevertheless, there was widespread concern that the implementation of the conditional amnesty could subject *sacadólares* (dollar takers) to constant tax surveillance. *Financiero*, Aug. 14, 1989, at 1, col. 2. Immediately following the announcement of the amnesty, tax officials indicated their willingness to use information apparently obtained on the whereabouts of U.S. \$12 billion. *Financiero*, Aug. 4, 1989, at 12, col. 1.

174. Referring to the recent privatization of one of Mexico's leading airlines, President Salinas indicated that public funds should not be used to subsidize inefficient government companies. *Jueves de Excelsior*, Sept. 7, 1989, at 7, col. 1.

175. New Regs., *supra* note 1, Statement of Purposes, para. 3. In the past, the role of foreign investment was always limited to "complementing" domestic investment. See FIL, *supra* note 2, art. 13, § I.

176. B. SEPULVEDA & A. CHUMACERO, *LA INVERSION EXTRANJERA EN MEXICO* 41 (1973) [hereinafter B. SEPULVEDA].

177. *Id.*

178. The agreement in principle reached with the Bank Advisory Committee for Mexico on August 24, 1989 calls for a 30-year rescheduling of Mexico's public debt. See *Financing Package*, *supra* note 26.

manufacturing facilities.<sup>179</sup> Ironically, the protectionism that induced many foreign investors to manufacture in the captive Mexican market, has recently been blamed for Mexico's inability to compete in world markets.<sup>180</sup>

Although the government expects that the pressure of Mexico's open economy will promote exports by persuading local manufacturers to reduce prices and increase quality, the fact is that some of the most important foreign investors presently in the country are resisting change.<sup>181</sup> An impending liberalization of the auto industry, the last bastion of Mexican protectionism,<sup>182</sup> is causing some automobile manufacturers to reconsider the advantages of maintaining their local plants.<sup>183</sup> The implication seems to be that it would be easier to import vehicles if the borders were opened.<sup>184</sup>

## VII. CONCLUSIONS

The enactment of the New Regulations represents a major departure from previous government policy. Mexican administrations from 1944 gradually increased the degree of statutory and policy restrictions imposed on foreign investors. These restrictions, which culminated with the 1973 publication of the FIL, were applied without flexibility for more than a decade.

The passage of the FIL coincided with the change in Mexico's economic model, which had been followed by local administrations from the end of World War II. The old model was based on price and monetary stability and predicated economic growth upon a flourishing Mexican industry. Certain government policies consistent with the postwar economic model fostered a strong protectionism, which isolated Mexican industry and created a captive market for foreign manufacturers. This protectionism was ultimately responsible for Mexico's sagging exports.

In 1973, the new economic model proposed was based on a more equitable income distribution. The implementation of the new model expanded government influence into all sectors of the economy and resulted in a large deficit, which was substantially financed with external debt.

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179. See B. SEPULVEDA, *supra* note 176, at 51.

180. See IBAFIN, *HACIA UNA NUEVA POLITICA INDUSTRIAL*, 23-39 (1988). See generally E. HANEINE, *SUSTITUCION DE IMPORTACIONES* (1987). See also *supra* note 61.

181. Some of Mexico's most important auto manufacturers are strongly opposing Mexico's impending new automotive decree, which is expected to substantially liberalize the car market. *Wall St. J.*, Aug. 8, 1989, at A6, col. 1.

182. On the eve of a new automotive decree, Mexico's automobile industry remains the most protected industry in the country. *Id.*

183. *Id.*

184. *Id.*

Although the FIC announced in 1984 its willingness to entertain applications for projects involving 100% foreign ownership, the absence of clear rules for the application of the 1984 Guidelines dampened the effect of the announcement. Additionally, the publication of the 1984 Guidelines did not remove the element of governmental discretion from the foreign investment process.

A thorough review of the statement of purposes preceding the New Regulations, reveals that the simplification of Mexico's foreign investment legislation was an indispensable step to implement the new administration's economic model. Mexico could not have attempted to open its economy and modernize its industrial infrastructure without a substantial change of attitude toward foreign investment. One of the priorities of the new administration, the privatization of strategic companies owned by the federal government, would have been very difficult to achieve without the participation of foreign capital.

Legislation alone will not ensure the favorable response of foreign investors to Mexico's recent change of attitude. Many economic factors will have to be in place to induce the participation of foreign capital in Mexico's economic growth. Inflation, the major threat to President Salinas' economic program, must be held in check. In fact, the balancing act will depend on achieving economic growth with very low inflation. Mexico must also revamp its public services, which are severely affected by many years of neglect. Roads, transportation, telephones, and electric power require substantial investments to meet the challenge of recovering sustained economic growth.

The unknown variable will be the willingness of foreign manufacturers to make or maintain their investments in the absence of a captive Mexican market fostered by protectionism.

With its new economic model, Mexico is returning to price and monetary stability to achieve economic growth. This, however, is not a return to the past. The economic stability promoted by President Salinas is being pursued within the context of an open economy, the liberalization of foreign investment, and the privatization of most of the companies previously owned by the federal government.

The New Regulations represent one of the most far reaching decisions of the new administration. With their enactment, President Salinas reverses a thirty-year trend of nationalistic suspicion of direct foreign investment and promotes economic growth under circumstances that will avoid external indebtedness and provide state-of-the-art technology to Mexican industry.