THE NAFTA INVESTMENT CHAPTER AND FOREIGN DIRECT INVESTMENT IN MEXICO: A THIRD WORLD PERSPECTIVE

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ABSTRACT
The investment provisions of NAFTA, which establish a liberal investment regime and a hospitable atmosphere for foreign investment amongst its signatories, the United States, Canada, and Mexico, represents a new chapter in Mexico's approach to foreign investment. This Article examines the significance of Mexico's shift to welcoming foreign investment and its concomitant acquiescence to traditional notions of expropriation and compensation espoused by more developed states. The author explores Mexico's historical love-hate relationship with foreign investment and its role over the years as leading voice for Third World concerns regarding the potentially exploitive nature of such investment. In this Article, a less flattering view of Mexico's participation in NAFTA emerges, one that perceives the Mexican government as repudiating not only its role as guiding hand in its own economy, but also its place as the leading proponent of the Third World cautionary approach to foreign investment.

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The North American Free Trade Agreement (NAFTA) is the first regional trade pact between a Third World state and two industrialized states. Chapter 11 of NAFTA (Investment Chapter or Chapter 11) establishes a liberalized investment regime that expands the protection of foreign investors and investments beyond any treaty to which any NAFTA signatory is a party. Most of the provisions contained in this Chapter have been fashioned on traditional rules of international law that Mexico had successfully challenged since the end of the nineteenth century and for most of this century. Thus, the provisions in Chapter 11 amount to a repudiation of long-standing differences between Mexico and the United States concerning the protection of foreign investors and investments. Moreover, Chapter 11 will have far-reaching implications in the larger context of international economic relations between Third World and industrialized states. Throughout the last century, the Third World has opposed traditional rules of international law governing the rights of foreign investors. This opposition has caused significant conflict in North-South relations. In the post-World War II era, developing states asserted their right to...
"full sovereignty" in the treatment of foreign investment located in their territories and used the United Nations and other multilateral fora to support
On the other hand, the United States and other industrialized states have insisted that, under traditional principles of international law, foreigners and foreign-owned property possess superseding contractual rights. The conflict has sharpened with the increasing prevalence of Transnational Corporations (TNCs), which are the main vehicles of foreign direct investment and major actors in international economic relations. Recently, the conflict has intensified with the phenomenon characterized as an emerging de facto system of transnationalization or globalization of economic relations. This change in international economic relations has led to attempts by both Third World and industrialized states to devise international mechanisms to support their respective positions regarding the rights of foreign investors. Third World states have unsuccessfully advocated for control of TNCs, while the United States and other industrialized states have attempted to reaffirm the traditional rules of international law through bilateral arrangements. For these reasons, most Third World states, especially Mexico and other Latin American states, resisted negotiating these bilateral arrangements in the past. They instead have chosen to debate the foreign investment issue in the multilateral arena. This was true until the last decade, when the Third World, lacking other financial alternatives, became more desperate for capital. In recent years, debt-burdened Third World governments increasingly have opened their economies to foreign investment. To assure a meaningful assessment of the NAFTA provisions, the analytical framework of this Article includes the broader issues implicated in international economic relations; specifically, it addresses the conflict between Third World and industrialized states over the rules governing foreign investment. The obligations contained in NAFTA's Chapter 11 are part of an emerging new pattern of legal rules that promote the traditional principles of international law. Part II of this Article examines the international controversy over legal rules governing foreign direct investment, focusing on the divergence of interests between Third World and industrialized states. Part III focuses on the role of foreign direct investment in Mexico's economic development and the evolution of its legal framework for foreign direct investment. This Part also evaluates, from a historical perspective, the role the Mexican government has played in the state's economic development and regulation of foreign direct investment. For the balance of the Article, Parts IV and V discuss the NAFTA investment provisions and the implications for the Third World.

II. THE INTERNATIONAL FRAMEWORK OF FOREIGN DIRECT INVESTMENT: A HISTORICAL POLITICO-ECONOMIC THIRD WORLD PERSPECTIVE

A. The Nineteenth Century and Rules of State Responsibility to Aliens and Alien Property

The international regime for foreign direct investment can be
fully understood only in the context of the politico-economic factors that typify the international arena. The history of the ever-evolving international framework for foreign direct investment has been molded by the diverse political interests and economic circumstances of developed and developing states. [FN10]

Since the end of the nineteenth century, the developed states have been preoccupied with securing international standards for the protection of the
investments of their nationals and firms abroad, fashioned on the traditional rules of the protection of property. These traditional rules were developed from the law of state responsibility of injury to aliens and alien property. [FN11] The law of state responsibility of injury to aliens and alien property, "inspired by Western laissez-faire ideas and liberal concepts of property," [FN12] underlies the traditional principles of customary international law. [FN13] This doctrine emphasizes restricting the extent to which the host state can interfere with private property, thereby protecting the private property of aliens. In this regard, a breach of the international minimum standard "provides a legitimate basis for the exercise by the home State of the right of diplomatic protection of the alien." [FN14]

In the nineteenth century, when the prevailing rules governing foreign capital were legitimated mainly by treaties and custom, acceptance of these rules by the colonial territories and noncolonial territories economically linked to the European powers [FN15] ultimately derived from the military [FN16] and the financial strength of the European powers. [FN17] Notwithstanding the strength of the European powers and the need for foreign capital by underdeveloped territories, the traditional standard was challenged at the turn of the century by Latin American jurists and the socialist states of Eastern Europe. [FN18] The Latin American opposition to the implications of the traditional law of state responsibility, developed in the nineteenth century and reinforced in the twentieth, is embodied in the so-called Calvo Doctrine. [FN19] The Calvo Doctrine advocates the position that as a matter of international law, no state may intervene, diplomatically or otherwise, to enforce its citizens' private claims in a foreign state. [FN20] "[T]he Latin American response to the international minimum standard was the doctrine of national treatment." [FN21]

B. The Twentieth Century and Emerging Rules for the Protection of Foreign Direct Investment

1. The Post-World War Period and Emerging Norms Relating to the New International Economic Order

At the turn of the century, the United States joined the European powers in safeguarding foreign capital, utilizing the same measures under the same traditional rules. [FN22] The emergence of new states from colonial status after World War II, [FN23] and the sustained attempts of these states to assert their economic independence and restructure their national economies, led to challenges to both the existing legal principles governing foreign direct investment and the legal rules themselves. [FN24] Unable to challenge these traditional rules unilaterally, the newly independent states and other less developed states joined forces in multilateral fora, especially the United Nations. [FN25] To overcome the grand obstacles of bargaining individually, the developing states in 1962 created a caucus as a
means of coordinating their views and insuring some degree of solidarity in the international arena. Because seventy-seven states participated in the first meeting of this group in the United Nations, it came to be known as the Group of 77. [FN26] In 1964, having become sufficiently more numerous to take advantage of their collective voting strength, the developing states managed to secure the establishment of the United Nations Conference of
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While UNCTAD was designed to serve as a forum in which the newly emergent former colonies could bargain collectively with the developed states for more preferential terms of trade, it also became the forum for the developing states to come together to adopt a collective negotiating strategy and express a unified Third World position on matters important to them. The creation of UNCTAD marked the emergence of economic development as a major concern of Third World states, with foreign direct investment inextricably intertwined. While the eventual comprehensive formulation of the Third World's claims regarding foreign direct investment arrived in the 1970s, it was fueled by the expansion of TNCs in the 1960s. A TNC may be defined as a business enterprise composed of a parent company and one or more subsidiaries located in two or more states, organized for the conduct of profitable international production and provision of goods and services. Characterized by an ability to shift capital and resources, the TNC relies on technological innovations, which often result in oligopolistic control of markets. Although the TNC parent and its subsidiaries are incorporated under national laws, the extension of TNC networks across national boundaries prevents municipalities from fully addressing the TNC. This inability of any one state to fully control TNCs, and their status, as major vehicles for foreign direct investment, made TNCs the source of much concern for both industrialized and Third World states. While industrialized states sought to secure stable international regimes for their TNCs, Third World states feared TNC strategies. Third World intellectuals and policymakers focused on the economic and political power TNCs could wield in developing states, including their ability to penetrate class structure, national ideology, and local production bases. In addition, TNCs were criticized as primary perpetuators of extreme economic dependence, as well as economic, social, and political underdevelopment. Third World states, suspicious of the impact of foreign direct investments and TNCs on their societies in general, and economic development in particular, called for the following changes: (1) restructuring the system of international organizations; (2) making reforms in the methods and objectives of international regulation; and (3) establishing a new international economic order. [FN34]

Developing states sought the creation of rules of international law that would promote rapid economic development by insuring they received their fair share of benefits accruing from TNCs in their territories. In 1974, using their majority in the United Nations, these developing states succeeded in passing the United Nations General Assembly resolutions on the Establishment of a New International Economic Order (NIEO). [FN36]

The NIEO has three dimensions; political, economic, and legal. Politically, the NIEO asserts the primacy of the nation-state. Pursuant to the principles of the NIEO, the nation-state is entitled to exercise full and effective control
over its resources, including the right to nationalize foreign assets and other "conditions and requirements calculated to enhance the dignity and authority of the nation-state." [FN39] Economically, the NIEO calls for "economic justice," [FN40] a restructuring of the global economy that would promote rapid economic development by guaranteeing developing states their fair share of the world economy. [FN41]

One of the key components of the NIEO is the Charter of Economic
Rights and Duties of States, adopted by the United Nations in 1974. The Charter of Economic Rights was conceived originally as the basic framework of fundamental principles for international economic relations between Third World and developed states. It advocates the advancement of more rational and equitable international economic relations, the strengthening the economic independence of developing states, and the necessity for the entire international community to promote economic and social progress in all states, especially developing ones. One of the main principles of the Charter, Article 2 (2), confers on every state the right to regulate foreign investment, including the activities of TNCs within its national jurisdiction; it also confers the right to nationalize alien property upon payment of adequate compensation. The Charter thus challenges traditional principles of customary international law that govern foreign direct investment, such as determining compensation for expropriation or nationalization and settling foreign investment disputes.

Article 2 of the Charter of Economic Rights asserts that the right to nationalize and the standard of compensation are governed by domestic laws and policies, not international law. In this regard, Article 2 has been described as "a classic restatement" of the Calvo Doctrine. While the industrialized states do not object to the developing states asserting their rights to nationalize or to expropriate foreign property, they have expressed substantial concern over the issue of compensation. Industrialized states, particularly the United States, have urged full and adequate compensation for any expropriated party. Third World states, while not denying payment of compensation, insist that the decision should rest solely with the expropriating state in accordance with its national laws or policies. If a dispute arises from the sovereign exercise of nationalization, expropriation, or over any foreign investment matter, Article 2 of the Charter of Economic Rights provides that the dispute be resolved in accordance with the national judicial or arbitral procedures. Industrialized states have opposed this position; they argue that the appropriate approaches are the settlement of foreign investment disputes, international arbitration, or adjudication. The proposition of an independent international authority for the resolution of investment disputes, which has been challenged by Latin American states since the end of the nineteenth century, generally has been rejected by Third World states.

2. The Aftermath

The so-called North-South dialogue, a phrase coined in the 1970s to describe the necessary framework for negotiations between Third World and industrialized states in the aftermath of the adoption of the NIEO and Charter of Economic Rights, now has been referred to as the "North-South stalemate." Although the United Nations has respected the spirit of the declaratory
principles of the Charter, particularly by establishing the Commission on Transnational Corporations to deal with issues concerning TNCs, [FN55] very few results have been realized. Third World states have made various attempts in multilateral fora to introduce new legal norms to govern foreign investment and technology transactions to safeguard their economic interests. [FN56] To achieve this end, Third World states have vigorously pursued the creation of international agreements and codes of conduct to regulate the
activities of TNCs. [FN57] The various international and regional efforts at creating a multilateral system for the regulation of TNCs stem from concern regarding the negative aspects of their operations. Moreover, the Third World has recognized that national regulation, unaided by some international mechanism, is clearly inadequate to deal with the global strategies of TNCs. [FN58]

The 1980s witnessed a substantial decline in the flow of direct and indirect investment to Third World states. Specifically, gross foreign direct investment declined during this period from $13 billion in 1981 to $9.5 billion in 1986; in 1987, however, it returned to the 1981 level. [FN59] The pre-1987 decline was due partially to the perception by industrialized states, especially the United States, that the legal standards for the protection of foreign investment in developing states were unstable [FN60] following the Third World's call for a NIEO. Consequently, TNCs from developed home states invested in other developed states rather than Third World states. By the mid-1980s Third World states with an increased need for capital, and left with few other financial alternatives, began negotiating bilateral investment treaties (BITs) with developed states. [FN61] Although the BIT movement began slowly, and failed to attract the most developed of the Third World states, such as Mexico, it has grown tremendously in the last decade. [FN62]

The BIT movement has removed the North-South issue of foreign direct investment and TNC operations from the multilateral fora. Developed states, greatly outnumbered in the multilateral fora, have sought instead to structure stable international environments for foreign direct investment that reaffirmed the traditional principles of customary international law governing the protection of alien property. [FN63] The political unwillingness of industrialized states to address the issue of international regulation of foreign direct investment and TNCs on a united basis has nearly forced Third World states to utilize the constraints of the old international economic order. International arrangements such as the General Agreement on Tariffs and Trade (GATT) [FN64] and the International Monetary Fund [FN65] have facilitated the flow of foreign investment and the development of TNCs. International minimum standards of state responsibility have protected these entities, [FN66] thereby eroding the gains of the NIEO and the Charter of Economic Rights.

III. MEXICO: FOREIGN DIRECT INVESTMENT AND ECONOMIC DEVELOPMENT 1910-1993

A. Historical Role of Foreign Direct Investment in Mexico: An Overview

Foreign direct investment first assumed a major role in Mexico's economy during the administration of Porfirio Diaz (1876-1911). [FN67] The ascendance to power of President Diaz brought to Mexico the political stability of a thirty-four year dictatorship and liberal economic policies that welcomed foreign investment. [FN68] Believing that substantial investments in
mining, utilities, and basic industries would bring Mexico into an economic position commensurate with that of industrialized states, this administration established a deliberate policy for attracting foreign investment. [FN69] President Diaz and the cientificos embraced an interpretation of economic liberalism that led the Mexican government to open the door to foreign investment.
At the end of the so-called Porfiriato, foreign investments poured into railroad construction, mining, public utilities, real estate, banking, manufacturing, and commerce. The Mexican economy thrived on exports of primary products, with communications and other infrastructure designed to serve the needs of the mostly foreign owned export companies. Although actual figures are not available, recent studies suggest that by the end of the Porfiriato, foreigners owned over half of the total wealth of Mexico and foreign capital dominated most areas of productive enterprise.

The presence of foreign investors during the Porfiriato was largely to blame for many of Mexico's economic ills at the beginning of this century and fueled the Mexican Revolution of 1910. The Revolution established the ideological and political foundation for a fundamentally different state role in the Mexican economy. The new boundaries for the role of the Mexican state were established in the Mexican Constitution of 1917, which placed restraints on foreign economic activities and foreign land ownership. By incorporating the anti-foreign sentiments of the Mexican revolutionaries, the Mexican Constitution emphasized Mexican sovereignty and independence from foreign economic control.

For more than sixty years, the interventionist, nationalist Mexican state, created by the Mexican Constitution, contributed significantly to the regulation of foreign direct investment in Mexico. Indeed, foreign direct investment provided the most direct challenge for state policy during this so-called nationalist period. Yet the Mexican policymakers were able to meet these challenges by choosing new policy instruments as new problems with foreign direct investment were identified. Until the economic debt crisis of 1982, Mexico was able to structure a pattern of state action that was not irrational "nor did it reflect passive submission to the preferences of foreign investors."

The evaluation of Mexico's strength and endurance regarding foreign direct investment requires familiarity with the history of Mexican economic development in general and foreign direct investment in particular. From Mexico's economic development strategies of primary product exports to import substituting industrialization, the Mexican state has intervened in the process of Mexico's economic development, and much of that intervention has been against the interests of foreign capital. The result of this interventionist state action is that, although Mexico continues to be one of the largest foreign direct investment hosts among developing states, foreign investment has been limited to those sectors defined by the Mexican government. Foreign direct investment in Mexico has increased steadily since 1940 and rapidly since 1960, as global investment has grown. Nevertheless, Mexico's share of global foreign direct investment has diminished steadily.
developing states, Mexico's dependence on foreign direct investment is only average. [FN86]

B. The Constitutional Context

The 1917 Mexican Constitution [FN87] embodies the principles of the Mexican Revolution of 1910, [FN88] including sovereignty and independence from foreign, economic, and political control. The modernization of Mexico during the

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Porfiriato, [FN89] based on integration in the world market and foreign control of vital sectors of the economy, created a dependent economic structure that limited the Mexican government's control over these sectors, and consequently hampered its ability to direct economic development. [FN90] By the early twentieth century, the economic penetration of Mexico by foreign enterprises triggered a growing fear of increasing foreign influence. [FN91] In response to this fear, the Mexican Constitution established the framework for a strong interventionist state [FN92] and reserved to it exclusive control over the Mexican economic system. [FN93] These constitutional principles support the restrictive Mexican economic policy toward foreign investment that predominated until a decade ago and continues to influence Mexico's economic development today. [FN94]

The Mexican Constitution divides the enactment and investment policy implementation authority between the Mexican Congress and the Federal Chief Executive (Executive). [FN95] Article 73 empowers Congress to encourage the promotion of Mexican investment and regulation of foreign investment. [FN96] Article 89 compels the Executive to see that laws passed by the Congress are faithfully executed. [FN97] Amendments to the Constitution in 1983 further expanded the broad system of government powers to direct the national economic development. [FN98] These amendments, which were a response to Mexico's economic crisis in 1982, [FN99] permit the Mexican government to adopt broad measures in economic matters and to reorient the principles governing the actions of the state and private individuals. [FN100] In recent years, these measures have emphasized the role of private investment as the catalyst for economic development. [FN101] Accordingly, the Mexican government has actively promoted foreign direct investment as a critical element of its plans for the future growth of the Mexican economy.

Articles 27 and 28 of the Mexican Constitution have set the foundation for most government regulation in the area of foreign investment in Mexico since 1917. These Articles largely are directed against foreign interests. Article 27 has three very important provisions that have impacted the regulation of foreign investment in Mexico: (1) national sovereignty over national resources, (2) the implementation of the "Calvo Clause" [FN102] and, (3) the formation of the so-called "Restricted Zone." [FN103] Article 27 vests land ownership, water, and subsoil rights in the Mexican state and gives the state the right to regulate the use of national resources to preserve and ensure a more equitable distribution of public wealth. [FN104] Section I of Article 27 further vests only Mexican nationals with the right to own land, waters, and their appurtenances. [FN105] The Mexican state may grant the same ownership rights to foreigners if they agree to consider themselves nationals with respect to the property and promise not to invoke the protection of their governments. Violation of this agreement results in forfeiture of the property. This "Calvo Clause" is required not only in all
cases in which property is purchased by a foreigner, but also in all contract concessions with the Mexican government. [FN106] Article 27 specifically prohibits foreign ownership of land within a zone of one hundred kilometers along the borders and fifty kilometers along the shores. [FN107] This is the so-called "Restricted Zone." [FN108] Article 28 expressly reserves exclusive control by the Mexican government of "strategic" sectors of the economy. [FN109] These sectors now include oil exploration, oil
refining and pipelines, other hydrocarbons, radioactive materials, electricity, basic petrochemicals, mail, satellite telecommunications, and railways. [FN110] In the 1920s and 1930s these Articles induced a series of government expropriations in the energy, transportation, and agricultural sectors, which deterred most foreign investment in the Mexican economy for many years. [FN111] The recovery of Mexico's "economic destiny," one of the main ideals to emerge during the Revolution of 1910, was reflected in the Mexican Constitution. Until recently, these ideals remained an important component of every Mexican administration. The constitutional constraints on foreign economic activities and foreign land ownership dictated the role of foreign investment in Mexico for more than seventy years.

C. Liberalism v. Nationalism: The Mexican Model of Development

The Mexican nationalization of the United States and British-owned oil industry in 1938 [FN112] was significant for both domestic and international reasons. Domestically, the Mexican oil nationalization constituted the core of what became Mexico's national policy toward foreign direct investment and its impact on economic development for most of this century. This policy mandated active participation by the state as a "countervailing force to both foreign investors and their home governments." [FN113] Internationally, the Mexican nationalization of a basic natural resource proved that a less developed state could take control of a key economic sector, previously controlled by foreign capital, in order to control its economy and economic development. [FN114] The Revolution of 1910 had no damaging impact on the Mexican petroleum industry, which by 1921 was predominantly foreign-owned and the second largest in the world. [FN115] The foreign-owned oil companies largely escaped damage because of their location along the Mexican coastline. [FN116] Stimulated by wartime demand, the oil companies substantially expanded their production during the Revolution. [FN117] The oil industry was affected, however, by the demands for social justice, land reform, and control over natural resources espoused by those who opposed the foreign investment policies of the Porfiriato. [FN118] Article 27 of the Mexican Constitution, which established Mexico's direct ownership of all subsurface mineral deposits and abolished private property rights in petroleum deposits, was seen as a threat by oil companies to their established property rights. [FN119] The United States oil companies enlisted the support of the United States embassy to buttress their position. [FN120] By 1923, the United States government reached an agreement with Mexico that protected foreign properties and assured compensation for any expropriated land. [FN121] Specifically, Mexico promised that Article 27 would not be applied to oil companies that had engaged in "positive acts" in developing their properties. [FN122] During the 1920s and 1930s the Mexican government attempted to
negotiate with the foreign-owned oil companies on issues of taxation, drilling permits, and the replacement of fee simple titles by concessions. [FN123] The oil companies refused to negotiate on any of these issues and continuously sought the support of diplomatic representatives to bolster their position. The United States diplomats considered it their duty under international law to extend diplomatic protection to the property of their nationals abroad. [FN124]
The attack on the oil companies and other foreign holdings changed during the nationalistic administration of President Lazaro Cardenas (1934-38). President Cardenas' policies, a renaissance of the Revolution of 1910, were characterized by the slogan "Mexico for the Mexicans." Although politically the nationalization was a great success, economically the impact was uncertain. Faced with the possibility that other Latin American states would follow in Mexico's footsteps, the oil companies instituted a boycott of Mexican oil, which touched off an increased flight of foreign and domestic private capital.

The oil nationalization was also significant because it generated the United States policies toward nationalization and the formulation of its "prompt, adequate, and effective" standard for just compensation. Although the United States response to the Mexican nationalization was divided, the irony was that this division was founded on United States dominance in Mexico's mining, oil, and foreign commerce. Economic sanctions or military intervention would threaten United States interests in Mexico. The result was lengthy negotiations, which included a letter by United States Secretary of State Cordell Hull to President Cardenas insisting that Mexico pay "just compensation . . . having a present effective value" to the oil companies.

The Mexican government, rejecting the traditional rule, responded inter alia: (a) nationalization was a legitimate exercise of its sovereign right to restructure its economy; (b) the compensation demanded by the United States would constitute an inadmissible fetter upon this right: "[T]he future of the nation could not be halted by the impossibility of immediately paying the value of the property belonging to a small number of foreigners who only seek a lucrative end;" and (c) United States investors were not entitled to higher compensation than Mexican owners. These two opposing views, which emanated from the diplomatic exchanges between the two governments, would characterize their respective positions for almost the entire century.

D. Economic Development Strategies and Foreign Direct Investment

1. Import Substituting Industrialization: 1930-1970s

Foreign direct investment contributed significantly to Mexico's implementation of the model of economic development referred to as "import substituting industrialization" (ISI). The ISI focuses on the development, production, and manufacture of certain intermediate and capital goods to lessen imports and build the local infrastructure to produce goods. After the Mexican Revolution, foreign direct investment severely declined in Mexico, except in the petroleum sector. During the 1930s, the nationalization of the petroleum industry further
decreased foreign direct investment. Although the elimination of petroleum holdings was mainly responsible for this drop, the level of investments in other attractive industries and in public utilities also declined rapidly. [FN138] It was not until World War II that foreign investors more actively participated in the Mexican economy, [FN139] as the demand for raw materials accelerated and the industrial capacity of states diverted to wartime production. Mexico found
new markets for primary exports and diminished competition from imports in its domestic markets. [FN140] While ISI began as an informal process, it became an explicit governmental policy for achieving rapid industrial growth during the administrations of Manuel Avila Camacho (1940-1946) and Miguel Aleman (1946-1952). During this period, foreign investment significantly contributed to the Mexican economy, except in the manufacturing sector. [FN141] In response to international demand, nationalist policies allowed foreign firms to move out of attractive industries and utilities and into manufacturing. [FN142] In the post-World War II era, Mexican policy makers became more sensitive to the need to protect local industries from foreign domination. President Manuel Avila Camacho took advantage of his extraordinary wartime powers by issuing the Emergency Decree of 1944, [FN143] which introduced restraints on the "creation, modification, liquidation and transfer of Mexican stock." [FN144] The Emergency Decree exemplified a strong nationalist response by the Mexican government to the growth of foreign investment in the post-World War II era. The Decree granted extensive discretionary control over foreign capital to the Ministry of Foreign Relations, [FN145] allowing it to mandate both Mexican majority ownership in certain industries [FN146] and majority Mexican control. [FN147] The Decree was intended to avoid disrupting the economy by the temporary investments of flight capital. Mexico's booming economy during the World War II attracted an influx of foreign capital, and the Mexican government feared that existing Mexican investments would be displaced by foreign investors. Although the extraordinary powers of the president were lifted in 1945, revocation of the Emergency Decree was accompanied by executive orders relating to state intervention in the Mexican economy that would be retained under the law.

Between 1940 and 1965, foreign direct investment almost quadrupled. By the late 1950s, the nationalist position toward foreign direct investment reflected by the Emergency Decree gave way to a different attitude towards foreign capital. [FN148] The shift resulted in massive increases of foreign direct investment [FN149] in various industries, providing the momentum for the investment pendulum to swing back during the 1960s under the policy of "Mexicanization." [FN150]

2. Mexicanization: 1960s

The Mexican government's shift in attitude toward foreign direct investment in the late 1950s, and the subsequent massive increases in foreign capital during this period, led to demands from Mexican industrialists to limit the inflow of foreign capital. [FN151] Not surprisingly, with the political legacy of foreign investment and Mexico's past vigilance of its economic and political independence, the government pursued and strictly implemented national policies defining and controlling the activities of foreign capital and individuals. [FN152] The policy of Mexicanization adopted during the administration
of Avila Camacho, which required at least fifty-one percent of all private business and industry in particular, to be owned by Mexican nationals to ensure local control of the economy and local participation in its benefits, was accelerated during the 1960s. During this time President Lopez Mateos (1958-1964) developed economic nationalist policies and expanded the state's role in the Mexican economy.
economy in response to a sudden upsurge of foreign investment to more than ten percent of the total. Between 1960 and 1963, exercising the authority granted under the Emergency Decree of 1944, the Ministry of Foreign Relations extended the list of industries in which majority Mexican equity was required to the automotive supply, chemicals (including fertilizers and insecticides), and office equipment industries. The Ministry excluded by legislation foreign participation in Mexico's banking, insurance, and other financial institutions. [FN153] The Mexican government also employed other techniques to displace foreign investment, including discriminatory taxation, awarding government contracts on a discriminatory basis, and the selective use of permits and licenses. [FN154] The antiforeign investment efforts by the administration of Lopez Mateos had a significant impact on the outflow of capital from domestic and foreign sources in 1960 and 1961. [FN155] This forced the Mexican administration to take a more conciliatory position toward foreign direct investment, causing the pendulum to swing away from nationalist policies.


By 1970, Mexico had "demonstrated consistent patterns of state intervention in the economy," especially with regard to foreign direct investment, but inconsistencies in the application of that intervention continued. [FN156] The policy of encouraging Mexicanization through selective enforcement of various instruments affecting majority foreign-owned enterprises (such as discriminatory taxation), continued during the administration of Gustavo Diaz Ordaz (1964-1970). [FN157] Simultaneously, however, this administration courted both domestic and foreign capital to invest in Mexico's private sector, which resulted in a significant increase in foreign investment, especially from the United States. [FN158] While Mexican business supported the administration's open attitude toward private capital in general, it demanded more restrictive policies toward foreign investment. [FN159]

The widespread proliferation during the late 1960s and 1970s of foreign-owned TNCs in Mexico, coupled with the negative sentiments toward TNCs by developing states in the international arena, [FN160] had a significant impact on Mexico's nationalist position toward foreign direct investment in the 1970s. The Mexican government, like other third world governments, became highly sensitive and critical toward the harmful effects of TNCs. [FN161] Once seen as sources of technology, employment, training, and entrepreneurial skill, by the 1970s TNCs were perceived as foreign intruders that sought personal profits without considering the social and economic needs of the host state. [FN162] By the time President Luis Echeverria (1970-1976) took office, the Mexican government was making a more concerted effort to regulate the activities of foreign direct investors and firms. This effort was in response to domestic and international
criticisms about the role of foreign direct investment in general and TNC operations in particular in the economic development of developing host states. [FN163]

Although the Echeverria administration remained committed to industrial growth, ISI policies alone were insufficient to attain this goal. [FN164] The administration therefore began to promote development of export-oriented
To increase its exports, Mexico needed foreign assistance to improve technology, invest in new industries, and manufacture goods for export, while assuring that these foreign interests conformed to Mexican national objectives. Accordingly, the Mexican Congress passed the Law for the Promotion of Mexican Investment and for the Regulation of Foreign Investment (1973 FIL). Its purpose was "to promote Mexican investment and regulate foreign investment in order to stimulate a just and balanced development and consolidate the country's economic independence." The 1973 FIL did little to discourage foreign direct investment in Mexico during the 1970s. The Mexican government and its agencies still enjoyed too much discretion to expand or limit the possible areas of investment. President Jose Lopez Portillo (1976-1982), pressured by the Mexican business community to encourage domestic and foreign investment in Mexico, responded by applying the 1973 FIL in a very flexible manner, the result of which was to increase foreign direct investment.

By 1976, Mexico's financial straits mandated more than domestic policy changes. Plagued by massive capital flight, inflation, unproductive experimental development programs, and external account imbalances, the Bank of Mexico had to devalue the Mexican peso, forcing the Echeverria administration to seek the help of the International Monetary Fund (IMF). The Mexico IMF Agreement obligated Mexico to change a number of its economic policies as a condition to lending. Although the Agreement had a duration of three years, Mexico ended the Agreement prematurely during the massive oil discoveries of the late 1970s, the so-called "oil boom."

During the oil boom, which was concentrated between 1978 and 1981, Mexico's traditionally restrictive policy toward foreign investment reemerged, nationalistic priorities were emphasized, and significant investment barriers were enforced. The nationalist period did not last long. Mexico launched an ambitious development process based on future oil projections and borrowed heavily from international financial firms to finance its domestic agenda. By 1981, however, oil prices began to drop sharply and the Mexican economy suffered a dramatic decline, leading to the economic crisis of 1982.

4. The 1982 Crisis and Modern Mexican Foreign Investment Policy

On August 20, 1982, Mexico announced that it could no longer service its debt. This debt crisis severely constrained Mexico's ability to pursue the economic nationalist policies of the past. Accordingly, this crisis has been one of the most significant factors in the turnaround of Mexican economic policy. The turnaround, often referred to as the new "Southern Liberalism," was precipitated by a series of economic problems. Following a period of impressive growth from the oil discoveries in the 1970s, the Mexican economy suffered a series of drastic reversals precipitated by a sudden...
fall in the world petroleum price. [FN182] At the same time, the
demand for goods generated by the oil exports had spurred
imports, causing imports to increase more rapidly than exports,
[FN183] which resulted in balance of payments difficulties.
[FN184] Additionally, international banks and financial
institutions generated a plunge in the supply of money and
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The rapid deterioration and ultimate collapse of the Mexican economy in mid-1982, combined with the world recession, left Mexico with few economic policy choices. In 1982, President Lopez Portillo attempted to revitalize the economy by nationalizing the banks. When President Miguel de la Madrid (1982–1986) took office in December 1982, he set in motion new economic policies oriented toward liberalizing the Mexican trade regime, creating a more favorable climate for foreign direct investment. Accordingly, after years of obdurate Mexican resistance, President de la Madrid announced in 1986 Mexico’s entry to GATT.

President Carlos Salinas de Gortari has undertaken a restructuring of the foreign investment policies in Mexico as part of an overall economic reform. Moreover, foreign direct investment is an integral part of President Salinas’ National Development Plan (1989-1994) for revitalizing the Mexican economy.

E. The Legal Framework of Foreign Direct Investment in Mexico

1. The Law to Promote Mexican Investment and Regulate Investment

The 1973 FIL codified applicable constitutional principles and established a rigid system of regulation over foreign investment. Mexican policymakers in the early 1970s were concerned about foreign investment and TNC operations on Mexico’s economy and had been enlightened by similar concerns in other Latin American nations and the Third World. These policymakers therefore emphasized the need to reaffirm Mexico’s sovereignty and economic independence in the 1973 FIL. Accordingly, the FIL set forth the following main objectives: (1) foreign investment should complement Mexican investment; (2) foreign investment should associate with domestic capital, but only on a minority basis; and (3) concentration of foreign ownership by sector or region should be avoided. The purpose of the law was "to promote Mexican investment and regulate foreign investment in order to stimulate a just and balanced development and consolidate the country's economic independence." The themes of economic sovereignty and state autonomy over the control of foreign investment in the 1973 FIL echoed the themes of the Charter of Economic Rights that would be adopted by the United Nations one year later; hardly surprising, since it was Mexico that had proposed the Charter. The FIL established the national boundaries for the regulation of foreign direct investment, while the Charter established the international boundaries. The framework for the "balanced development" objective prescribed in the FIL is embodied in a regulatory scheme that requires majority Mexican participation in a broad
spectrum of economic sectors and activities, while limiting foreign participation to specific designated areas. [FN195] Accordingly, the 1973 FIL classifies economic activities exclusively reserved for the Mexican government, [FN196] those reserved to Mexican individuals or corporations without foreign participation, and those in which foreign participation [FN197] is specifically limited to less than forty-nine percent. [FN198] The FIL also contains a general provision limiting foreign participation...
The FIL vests the highest authority to regulate foreign investment in Mexico with the National Foreign Investment Commission (FIC). [FN202] Under its broad discretionary powers, the FIC has the option to increase the maximum forty-nine percent foreign investment limitation whenever it deems the project beneficial to the Mexican economy. [FN203]

The FIC, which consists of representatives of the Mexican president and seven ministries, [FN204] served as the screening mechanism for majority foreign equity investment in Mexico until the late 1980s. [FN205] Pursuant to its statutory powers, the FIC can: (1) increase or reduce the percentage of foreign participation in geographical areas or economic activities when definite percentages are required and establish the terms and conditions under which the investment will be received; [FN206] (2) set forth specific percentages and conditions for those projects which "may justify special treatment;" [FN207] and (3) establish "requirements and criteria" for the application of foreign investment laws and regulations. [FN208]

The 1973 FIL provides exceptions to the forty-nine percent requirement in few instances and only under special circumstances. [FN209] The FIC bases its decision to grant exceptions on the criteria set forth in the National Industrial Development Plan (NIDP) and the FIL. [FN210] Each NIDP has provided specific indicators of the attitude and direction to be taken by the incumbent administration toward foreign investment. The few exceptions made by the FIC were in sectors such as tourism, priority industries, advanced technology, capitalization and investments preserving employment, and for priority activities of Mexican corporations with severe economic problems.

2. The 1989 Regulations

In 1989, pursuant to the constitutional authority under Article 89 of the Mexican Constitution, [FN211] President Salinas issued the new foreign investment regulations (1989 Regulations), [FN212] amending the 1973 FIL. The 1989 Regulations repealed all existing regulations, resolutions, and decrees, but did not modify the 1973 FIL itself. [FN213] The stated purpose of the Regulations is to increase the volume of investment capital and to accelerate the flow of investment capital by deregulating foreign investment procedures. Consequently, the 1989 Regulations do not actively promote foreign investment, for there are no provisions granting incentives such as tax breaks or cost reductions in land. [FN214] Rather, the intent of the Regulations is to promote foreign investment by simplifying and clarifying the investment
mechanisms. [FN215]

The 1989 Regulations accord foreign investors a broad range of investment opportunities by eliminating the need for prior authorization from the National Foreign Investment Commission, if certain conditions are met. [FN216] The most significant provision of the 1989 Regulations, Article 5, grants foreign investors the right to acquire up to 100 percent of the shares in an existing enterprise without prior authorization, as long as the investor complies with
set conditions and requirements and the activity is not listed in the included classification. [FN217] The 100 percent provisions of Article 5 contradict the 1973 FIL. [FN218] These contradictions have caused legal insecurity among foreign investors in Mexico. [FN219]

The 1989 Regulations constitute a major shift in foreign investment policy in Mexico. The nationalist policies toward foreign direct investment of the 1973 FIL have been replaced by the more open foreign investment regime of the 1989 Regulations.

IV. THE NAFTA INVESTMENT CHAPTER AND MEXICO: NEW RULES GOVERNING FOREIGN DIRECT INVESTMENT

Chapter 11 of NAFTA establishes an open investment regime that expands the protection of foreign investors and property beyond any treaty to which a NAFTA signatory is a party. The NAFTA investment obligations, particularly with respect to treatment, protection against dispossession, and compensation for expropriation of alien property, represent a significant shift in Mexico's position regarding traditional rules governing foreign investment. Since the nineteenth century, Mexico has contested vehemently the traditional principles of international law governing the protection of foreigners and foreign property. [FN220] As previously discussed, the Mexican Constitution [FN221] embodies the Calvo Doctrine, [FN222] a direct challenge to the international minimum standard doctrine advocated by industrialized states in international economic relations. [FN223] Furthermore, in the international arena, Mexico has led the Third World in a call for restructuring international law to support the sovereignty of every state in the treatment of foreign investment located in its territories. [FN224]

A. Scope and Coverage: General Overview

The principles regarding scope and coverage application are found in the NAFTA provisions defining "investors" of the signatories. [FN225] Under the treaty, an investor of a NAFTA party is defined to include "a NAFTA party or state enterprise thereof, or a national or an enterprise of such [p]arty, that seeks to make, is making or has made an investment." [FN226] An enterprise of a NAFTA party includes all forms of business entities "constituted or organized" under the laws of that NAFTA party. [FN227] The provisions of the Investment Chapter cover not only investors from a NAFTA party, but also investors with substantial business activities in NAFTA states. [FN228] Investment is defined to include ownership and all interests in an enterprise, such as certain loans to an enterprise and equity and debt security of an enterprise. [FN229] Investment covers interests that entitle an owner to share in income or profits of the enterprise, assets of the enterprise on dissolution, real estate, and tangible or intangible property, [FN230] including intellectual property.

The Investment Chapter covers all areas of investment not addressed in its other chapter. [FN231] Furthermore, provisions in Chapter 11 not only cover investors from NAFTA states, but
also investors with substantial business activities in NAFTA states.

B. General Treatment Standards

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1. National and Most-Favored-Nation Treatment

The Investment Chapter provides that each NAFTA party must treat NAFTA investors and their investments no less favorably than its own investors and investments. [FN232] This principle, called a national treatment obligation, ensures the equality of treatment between foreigners and nationals. [FN233] Furthermore, NAFTA provides that each NAFTA party treat NAFTA investors and their investments no less favorably than it treats investors or investments from third parties. [FN234] This principle, known as Most Favored Nation, guarantees that treaty-protected investments will be treated at least as favorably by the NAFTA state as nationals and firms from any third state. To illustrate, if Mexico extends a particular benefit to investments from a state like Brazil, it must offer the same benefit to investors from the United States and Canada. These treatment principles apply to all measures relating to the "establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." [FN235] Subject to the agreed exceptions in the annexes, [FN236] these obligations ensure that a NAFTA party may not subject enterprises to different or more onerous operating conditions simply by virtue of foreign ownership. NAFTA provides that a NAFTA party must accord the better of either national or Most Favored Nation treatment. [FN237] This allows the foreign investor to take advantage of whichever standard of treatment is more beneficial, ensuring that the foreign investor will suffer no disadvantage in relation to either host state nationals or to investors from third states. NAFTA expressly prohibits certain commonly encountered impediments to investment, such as requiring that a minimum level of equity be held by nationals or that certain senior management positions be reserved to local nationals.

For Mexico, the national treatment standard is clearly a departure from the requirement of minority ownership and control of the 1973 FIL. [FN238] As noted previously, the 1973 FIL codified the policy of Mexicanization, mandating that at least fifty-one percent of all private enterprises in Mexico, particularly industry, be owned by Mexican nationals to ensure local control of the economy and local participation in its benefits. [FN239] The Mexicanization policy governing foreign investment was pursued even before its codification in the 1973 FIL, and was replaced when the 1989 Regulations [FN240] were issued. Since the 1973 FIL remains intact, however, the liberalized foreign investment scheme of the 1989 Regulations can only be assured by the passage of NAFTA. Since the 1989 Regulations did not change the 1973 Law, NAFTA will assure that the liberalization of foreign investment in the 1989 Regulations remain intact. [FN241]

2. Minimum Standard of Treatment

NAFTA requires that the host state accord to investments of a NAFTA party "treatment in accordance with international law, including fair and equitable treatment and full protection and
security." [FN242] The reference to international law in NAFTA signifies a recognition by the parties that customary principles of international law exist external to the treaty. "Fair and equitable" treatment is a classic formulation of international law. While the precise meaning of the phrase is open to a variety of interpretations, an important aspect of this standard is that foreign investors should not lack the
Another important implication of the standard is that foreign investors should not, in comparison with nationals, be put at a competitive disadvantage in obtaining permits or authorizations necessary to conduct business operations in the state concerned.

C. Prohibition of Performance Requirements

NAFTA prohibits the imposition of performance requirements "in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or a nonparty in its territory." [FN243] The list of performance requirements includes export performance, [FN245] domestic content, [FN246] domestic sourcing, [FN247] trade balancing, [FN248] product mandating, [FN249] and technology transfer requirements. [FN250] In addition to prohibiting these requirements, NAFTA prohibits a party from conditioning receipt of incentives in connection with an investment in its territory by requiring the investors of a NAFTA party or a nonparty to (1) give preference to domestic sourcing, (2) achieve a certain level of domestic content, or (3) achieve a certain trade balance by restricting domestic sales to some proportion of exports or foreign exchange earnings. [FN251] NAFTA allows the NAFTA states, however, to condition the receipt of investment incentives on the location of production facilities, employment, employee training, or expansion of facilities in the NAFTA territory. [FN252]

The NAFTA prohibition on performance requirements is a departure from the Mexican foreign investment regime under the 1989 Regulations. [FN253] The 1989 Regulations liberalize foreign direct investment by allowing foreign investment in any proportion without governmental authorization for those activities not explicitly reserved for the state or for Mexican nationals. [FN254] As a condition to the one hundred percent foreign ownership rule in the 1989 Regulations, however, the foreign investor must maintain a balance in foreign currency operations for the first three years in operation. [FN255] These criteria resulted from governmental policies designed to encourage foreign investment that would complement and bolster the Mexican economy. The 1989 Regulations, while representing a dramatic departure from Mexico's restrictive 1973 FIL, were balanced with the requirements that would promote investment pursuant to Mexico's own self-determined economic development needs. [FN256]

In the last decade, a number of Third World states have adopted more flexible foreign investment policies, partly because of their need for additional foreign capital to fuel economic growth. [FN257] The incentive policies to attract foreign capital often were coupled with controls on foreign direct investment as a means of curbing the practices of TNCs. [FN258] Industrialized states maintain that these performance requirements limit foreign participation in these markets and can be as injurious as restrictive tariffs. [FN259] In their view, these performance requirements, if left to multiply, could become a serious impediment to a liberal world trading environment. The issue of
restrictive and distorting effects of performance requirements has reemerged in the Uruguay Round of GATT. [FN260] Although performance requirements have been discussed on several occasions in past GATT rounds, in the Uruguay Round, the United States and some contracting parties to GATT offered certain "proposals" aimed at expanding GATT's institutional structure.

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One of these new issues, connected with issues of trade-related investment measures (TRIMs), seeks to link investment policy with trade policy and thereby bring within the framework of GATT rules those government investment measures that have a serious trade restrictive and distorting effect. The objective of the Uruguay Round with respect to TRIMs is to liberalize international investment so that it operates on the same basis as the conduct of international trade.

After having sought input from the business community, the United States offered an illustrative list of TRIMs in its negotiating plan. This extensive plan listed the kinds of TRIMs to be prohibited and basic principles for an agreement. The initial list of TRIMs submitted by the United States was rejected by developing states because it constrained the ability of developing states to control TNCs in their own territory. The coverage of TRIMs accorded in the draft Uruguay Round text has been limited primarily to domestic content and trade balancing requirements.

The performance requirements in the Investment Chapter of NAFTA, which parallel the original United States proposals during the Uruguay Round, are much broader than the GATT TRIMs. Because the Uruguay Round ended without the contracting parties extending GATT to TRIMs, the performance requirements in NAFTA will give the United States a significant amount of leverage during the next Uruguay Round negotiations.

D. Transfers Relating to Investments

A foreign investment would be seriously impeded without the ability to transfer capital and profits out of the host state. Consequently, the transfer provision is one of the most important provisions in NAFTA. The NAFTA monetary transfer provision covers five basic issues relating to an investment of a NAFTA party in the territory of another NAFTA party. NAFTA provides that all of these transfers be made "freely and without delay," in "a freely usable currency at the market rate of exchange." This includes transfers to the investor, such as remittance of profits and dividends, the payment of interest and capital gains, management fees, and proceeds from the sale of liquidation of an investment. Transfer provisions in NAFTA also apply to payments under contract for goods or services in an investment to a third party, such as a subsidiary.

Industrialized states consider the ability to make monetary transfers one of the most important provisions in an investment treaty. Nevertheless, chronic balance-of-payment difficulties of most host states, and the host states' need to conserve foreign exchange to pay for essential goods and services, often make them unwilling or unable to grant investors the unrestricted right to make monetary transfers. Most Third World states have exchange control laws to regulate the conversion and currency abroad. For further protection, Third World states either have stipulated a rate of exchange in bilateral arrangements or have referred to IMF exchange
regulations. [FN269] The monetary transfers dilemma exemplifies the conflicting goals of the industrialized and Third World states. While industrialized states seek broad, unrestricted guarantees on monetary transfers, Third World states seek more restrictive options.

The NAFTA provision regarding monetary transfers echoes the guarantees that industrialized states and their investors and firms seek in order to maximize...
Under NAFTA, foreign investors will be able to make any transfers relating to an investment in a NAFTA state with broad and unrestricted guarantees.

E. Expropriation and Compensation

The United States and other industrialized states have maintained that the most dangerous risk to a foreign investor is the expropriation of his property without compensation or with inadequate compensation. [FN270] In their view, the fear of expropriation and nationalization always has constituted a serious impediment to foreign investment in Third World states. [FN271] For their part, Third World states, particularly Mexico and the rest of Latin America, as an expression of economic self-determination, [FN272] have called for a reappraisal of norms of customary international law governing expropriation and nationalization issues. [FN273] The result has been an international community divided along North-South boundaries that is unable to formulate an effective legal mechanism to deal with this conflict. [FN274] In the absence of an international consensus, industrialized states have sought to establish legal regimes for protecting foreign investments of their nationals and firms through bilateral arrangements and now through NAFTA. At the same time, they have sought to reaffirm in these agreements traditional principles of international law of nationalization and expropriation, including standards of compensation that reflect the customary international law of an earlier era. In this context, the NAFTA agreement on expropriation and compensation clearly has fulfilled the United States objectives. NAFTA provisions represent a significant shift from Mexico's longstanding challenge to these principles—a challenge that originated in the nineteenth century and is embedded in the very fiber of Mexico's legal structure. To fully understand the significance of these NAFTA provisions, one must look at various elements of the treaty's expropriation and compensation article, from an historical perspective, with an emphasis on Mexico and the Third World.

Article 1110 of the NAFTA Investment Chapter provides for the protection of foreign investments against nationalization, expropriation, and other forms of interference that are "tantamount to nationalization or expropriation." [FN275] The Article covers direct, indirect, and "creeping expropriation." [FN276] In accordance with traditional principles of international law, the Article provides that investments may not be expropriated except: for a public purpose; on a nondiscriminatory basis; in accordance with due process of law; and upon payment of compensation as specified in the Article. [FN277] Generally, the right of a sovereign nation to expropriate foreign property in its territory has not been disputed by Third World and industrialized states. [FN278] The dispute usually involves one or more of the four specified conditions. The condition most often the source of controversy...
between the United States and Mexico in particular, and Third World and industrialized states in general, is the condition requiring payment of compensation. NAFTA provides that adequate compensation is a condition for lawful expropriation or nationalization and that compensation must be paid without delay, [FN279] equal to the fair market value of the investment immediately before the expropriation took place, [FN280] including interest from the date of expropriation, [FN281] and be fully realizable. [FN282] The compensation must also be fully transferable, as provided by the transfer
The NAFTA standard for compensation, providing that the compensation be made "without delay," "equal to the fair market value of the investment," and "fully realizable," is the United States modern version of the Hull formula. [FN284] Most Third World states oppose such high standards of valuation, and instead argue for "appropriate compensation ... taking into account ... all circumstances that the State considers pertinent." [FN285] In order to understand fully the significance of the compensation standard in light of North-South differences, it is important to discuss each element of the formula.

The NAFTA element "fair market value" for compensation by an expropriating state is the standard advocated by the United States and other industrialized states. [FN286] The combination of "fair market value in freely transferable dollars" provides the foreign investor the highest value for the expropriated property. [FN287] In recent years, the United States and other industrialized states have attempted to incorporate the "fair market value" standard in their BITs. [FN288]

Third World states challenged the traditional stand in the Charter of Economic Rights and Duties of States, which provides for compensation that is "appropriate" to the circumstances giving rise to the expropriation. [FN289] Mexico's special standard for compensation employed during the oil nationalizations, excusing expropriations that were "inspired by legitimate causes and the aspirations of social justice," has also challenged the traditional rules. In addition, Latin American states that support the Calvo Doctrine allow their domestic courts to determine the appropriate standard of compensation. [FN290]

Third World opposition to the fair market value standard has focused on the "ability to pay." Third World states have argued that the problem with the fair market value standard, which reaffirms the traditional rules of customary international law, is that it would "thwart their efforts to carry out badly needed social and economic reforms." [FN291]

F. Settlement of Investment Disputes

Subchapter B of Chapter 11 establishes a mechanism for the settlement of investment disputes between a NAFTA state and an investor of another NAFTA state: through international arbitration in accordance with the International Centre for Settlement of Investment Disputes Convention (ICSID Convention) [FN292] or the United Nations Commission on International Trade Law Arbitration Rules (UNCITRAL Arbitration Rules); [FN293] or through litigation before the courts of the NAFTA state, at the election of the investor. It represents the first time Mexico has entered into an international agreement providing for investor-state arbitration. An overview of some of the most important provisions is important before discussing the significance of the agreed-upon dispute provisions for Mexico.
1. Coverage

Under the investor-state arbitration mechanism of Article 1116 of NAFTA, an investor of a NAFTA state, on his own behalf, may submit to arbitration a claim for loss or damage resulting from a breach by the NAFTA host state of a treaty provision. [FN294] Article 1117 permits an investor to assert a claim on behalf of another.
Subject to NAFTA, the investor-state arbitration provisions reach actions taken by federal, state, and provincial governments; certain actions by state enterprises; and actions taken by certain state-chartered monopolies when the actions are inconsistent with NAFTA. An investor must bring a claim within three years of when the investor or enterprise first acquired or should have acquired knowledge of the loss or damage. Subchapter B of Chapter 11 does not require or even encourage arbitration as a first resort, nor does it require an investor to exhaust local remedies. It seeks to preserve the maximum scope for amicable settlement of disputes. Article 1118 therefore promotes initial dispute settlement through consultation or negotiation. If these efforts at an amicable settlement are not successful, then NAFTA provides for the submission of the dispute in accordance with previously agreed procedures.

2. Submission of a Claim to Arbitration and Conditions Precedent

With certain exceptions, the stage of compulsory arbitration in Article 1120 is reached after six months have elapsed from the date giving rise to the claim. An investor may submit a claim for arbitration under the Investment Chapter only if certain conditions are satisfied. First, the investor (and enterprise, when the claim is submitted on its behalf) must consent to arbitration in accordance with the procedures set out in NAFTA. Second, the investor and the enterprise must waive the right to initiate or continue before any administrative tribunal or court, under the law of any NAFTA state, or other dispute settlement procedures, any proceedings on the measure that is alleged to breach NAFTA, except for proceedings for injunctive, declaratory, or other extraordinary relief not involving the payment of damages. Third, the consent and waiver must be delivered to the host state in writing.

Article 1122 provides that a disputing investor may submit the claim to arbitration under: the ICSID Convention, provided that both the host and the investor's home state are parties to the Convention; the Additional Facility Rules of the ICSID Convention, provided that either host state or the investor's state is a party to the Convention; or UNCITRAL Arbitration Rules. At present, only the United States is a party to the ICSID Convention.

3. Consolidation of Claims

When two or more claims submitted to arbitration have a question of law or fact in common, Article 1126 provides that the claims may "in the interests of fair and efficient resolution of the claims" be consolidated and heard by a tribunal established under the UNCITRAL Arbitration Rules, except as modified by NAFTA. After hearing the disputing parties on whether consolidation in a particular dispute meets the criteria of
Article 26, the decision to consolidate can be made.

4. Governing Law

   Article 1131 provides that an arbitration tribunal must decide the issues of dispute in accordance with NAFTA and applicable rules of international law.
5. Significance to Mexico

The NAFTA investment dispute settlement mechanism represents a significant departure for Mexico with respect to the role of international law in international economic relations. Mexico's distrust of private-state arbitration stems from the Calvo Doctrine, [FN303] which denies that the state of the owner can intervene on his behalf against the host state. Investment contracts between states and foreign investors commonly include a Calvo Clause [FN304] under which a foreign investor agrees, as part of his submission to local law, not to seek the diplomatic intervention of his government in any matter arising out of the contract. The Mexican interpretation of these clauses is that the foreign investor is bound by the local rule of law, even in the face of a violation of international law. [FN305] When foreign investment is concerned, the import of the Calvo Doctrine is that arbitration is an unacceptable yielding of sovereignty. The arbitral procedures in the dispute settlement mechanism in NAFTA will have a significant impact on international economic relations between Third World and industrialized states.

V. THE SIGNIFICANCE OF THE NAFTA INVESTMENT PROVISIONS FOR THE THIRD WORLD

The foregoing assessment of the investment provisions in Chapter 11 of NAFTA demonstrates that Mexico's attitude towards foreign direct investment and the role of international law in its regulation have changed significantly. Since the nineteenth century Mexico persistently has challenged the traditional principles of state responsibility, asserting the sovereign interests of the host state. Inspired by the profound transformation in the political structure of the world in the 1960s and 1970s, Mexico led the Third World in challenging the traditional principles that had been established without the Third World's participation and consent. Third World states, contending that political developments had not been followed by economic and social transformation, called for a restructuring of international law. The emergence in the mid-1970s of the proposals for a NIEO was one of the many indicators of the development of a consensus among the developing states on the rules governing North-South economic relations. The purpose of these new legal rules was to replace the structure of international economic relations with a fairer system, in an attempt to close the widening gap between Third World and industrialized states to remove international disequilibria and disparities.

More than two decades after the attack by Third World states on the traditional concept of state responsibility, the Third World is experiencing changing attitudes about foreign investment. Debt-burdened Third World states, in need of capital, have begun to re-open their economy to foreign investment. Like Mexico, these states are entering into arrangements with industrialized
states that are reinvigorating traditional rules for international investment protection. But none of these arrangements have the broad scope of protection for foreign investment found in the investment provisions in NAFTA. These provisions reaffirm the traditional principles of international law. The negotiation of NAFTA by a Third World state and two industrialized states is significant for future North-South international economic relations.

A. Toward A New Framework for the Regulation of Foreign Direct...
The investment provisions in Chapter 11 of NAFTA probably will serve as a model for other treaties between the ninety industrialized and Third World states in future negotiations. While on a theoretical level a trilateral accord is not likely to serve as the basis for the development of customary norms of international law, the combination of the BIT movement and the investment provisions in NAFTA may be seen as part of an ongoing process to create a new international framework for the regulation of foreign direct investment. While NAFTA only binds the three signatories, the powerful position of the United States in the international arena, and of Mexico in the Third World, certainly will promote the NAFTA framework for foreign direct investment and lay the foundation for the creation of an international investment framework that may eventually attract the consensus of both Third World, and industrialized states. For industrialized states, the provisions of the NAFTA Investment Chapter-establishing a secure investment environment through the elaboration of broad rules of fair treatment of foreign investment and investors, removal of barriers to investment by eliminating or liberalizing existing restrictions, and dispute settlement mechanisms for investors and host states-serve to provide a stable environment for their investments abroad, in a manner which responds to the demands of the new interdependent global economy. Third World states, needing foreign capital and nonindigenous technological expertise to develop their economies and promote growth, will be under more pressure by industrialized states to accept investment protection provisions similar to those enunciated in NAFTA. Using the United States BIT movement as a source of comparison, the states formerly representing the Soviet bloc and the Latin American states, ideologically or legally opposed to the free-market model underlying the BIT, have found that much needed capital for economic development superseded their initial rejection of the BIT. The provisions in the NAFTA Investment Chapter will also have a significant impact on the new wave of bilateralism for negotiating foreign investment regimes. The United States and other industrialized states consistently have been utilizing the bilateral approach for negotiating with Third World states for the last decade. While general bilateral commercial agreements have a long history, the specialized bilateral investment treaty is a relatively new phenomenon the origins of which lie in the post-World War II era. The new barriers to foreign direct investment that Third World states erected during the 1960s and 1970s, inspired by nationalistic concepts as permanent sovereignty over natural resources and economic activities and the NIEO, [FN306] urged the United States and other industrialized states to develop a model and prototype investment treaties to serve as a basis for bilateral treaty negotiations. While the initial attempts during the 1980s appeared successful, in reality it had only moderate success. The underlying open investment regime in NAFTA will encourage other industrialized states to take the bilateral
approach.

The problem with the bilateral approach is that Third World and industrialized states are unequal political and economic partners. As such, their primary concern is protecting foreign investment, not addressing the concerns of TNC operations or economic development.

B. The End of the North-South Dialogue

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The negotiation of the open investment regime in NAFTA between Mexico, one of the most developed Third World states and an opponent of international rules governing property, and the United States, demonstrates the success of bilateralism. The multilateral arena, including the United Nations family of organizations, GATT and others, frequently have been dominated by North-South disagreements. Within this multilateral fora, the industrialized states are greatly outnumbered. As such, with regard to international economic relations, the United States and other industrialized states have attempted to secure legal rules for the protection of their nationals and their property abroad through bilateral arrangements.

The bilateral process, particularly between two states of unequal political and economic power, may have significant implications for Third World states. Mexico's need to reform its economy was widely publicized. President Carlos Salinas de Gortari travelled to Europe and Asia in search of commitments of foreign capital to spearhead Mexico's economic reforms. Unable to obtain commitment from either state, Salinas' only option was to ask the United States about the possibility of negotiating a trade pact.

The NAFTA investment provisions, reaffirming the traditional rules governing foreign property, do not incorporate any of the concerns of Third World states, particularly regarding the behavior of TNCs in host territories. The Third World states need for capital and technology will force others to enter into similar agreements. Even if this is the case, Third World states should be concerned about the long-term durability of these bilateral arrangements. While the less developing states were the most attracted to bilateral arrangements in the early 1980s, Mexico's negotiation of NAFTA has now placed bilateralism in a different light.

C. National Sovereignty and Property Rights

In the promotion for new international rules governing foreign investment, developing states have asserted the right to modify property relations in accordance with national priorities. The open investment regime in NAFTA, with no provisions addressing either development objectives of the host state or TNC operations, in essence places the state in a position in which its sovereignty and autonomy are compromised.

While both Third World and developing states have adopted policies and mechanisms for the promotion and protection of foreign investment through the use of industrial and fiscal incentives and the creation of protective legal regimes, the internalization of the global economy and the interdependence of industries and economies have demonstrated the need for a compromise international regulation scheme. Industrialized states have attempted to formulate this scheme on a bilateral basis assuring that their TNCs have free access to developing states. The lack of national control over economic decisionmaking and the loss to the national economy of high profits are among the most
serious effects of foreign direct investment on Third World nations.

VI. CONCLUSION

Chapter 11 of NAFTA represents a major departure from Mexico's previous position on foreign investment and international economic relations. Since the nineteenth century Mexico has challenged the traditional rules of international law governing foreign investment and has pursued a restrictive nationalist policy.
During the 1960s and 1970s, Mexico and other Third World states called for the restructuring of international law in order to equalize in