VENTURE CAPITAL OPPORTUNITIES AND MEXICAN TELECOMMUNICATIONS AFTER THE PASSAGE OF THE NAFTA AND THE LEY DE INVERSION EXTRANJERA*

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I. INTRODUCTION

The North American Free Trade Agreement (NAFTA)1 and the Ley de Inversion Extranjera (the Foreign Investment Law of 1993 or FIL)2 represent two significant milestones in Mexico's revolutionary shift in national economic policy from self-reliance and nationalism to an export based economy and globalism. Although Mexico unilaterally took the first steps to initiate this process several years ago, the NAFTA and the new laws surrounding it have become the largest demonstration of Mexico's dedication to free market economics and the globalization of its economy. The shift has opened up entire sectors of the broader marketplace through the lifting of controls and restrictions on market access.

The new legal framework should help Mexican businesses fulfill their capitalization requirements. Traditionally, the want of capital has posed one of the principal barriers to development in every market.3

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3See Gustavo del Castillo V., The NAFTA: A Mexican Search for Development in NAFTA AS A MODEL OF DEVELOPMENT 102, 104 (Richard S. Belous & Jonathan Lemoa eds. 1993) (noting the need for capital investment to increase technological advancement and
Capital and the expertise to manage capital frequently bypass the smallest participants in the market. These parties often either do not present large enough investment opportunities or carry far too much risk for traditional forms of financing.\(^4\) Particularly when one considers the current status of Mexico, it becomes apparent that capital access problems of small businesses are exacerbated by the immature and evolving financial structures.\(^5\) Furthermore, the financial assistance provided by multilateral organizations and foreign governments rarely has been allocated directly to small business interests. Instead, these resources, when provided, are often only available in the form of loans to the governments of developing countries.\(^6\) Promoting new opportunities to acquire venture capital,\(^7\) especially foreign venture capital, provides a solution to this

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\(^4\) Small and medium sized firms traditionally have trouble securing financing from traditional routes such as bank lending. This is true of both start-ups and growth companies. Funding normally comes from a few basic sources, the entrepreneur's own capital, venture capitalists that specialize in start-ups, companies that are interested in acquiring the new company or have a need for the product, and friends or business associates of the entrepreneurs. Alan E. Saltzmann & L. John Doerr, The Venture Financing Process, in START UP COMPANIES § 7.02, at 7-5 to 7-6 (Richard D. Harroch ed. 1985).

\(^5\) One of the main problems immature markets, such as Mexico's, face is the volatility initially associated with attracting foreign capital investment. Although such capital may be abundant at times, it can be "subject to massive withdrawal at the first sign of potential trouble." Anthony Fama, The Regulation of Foreign Investment in Mexico: Heading in the Right Direction, MEX. TRADE & L. REP., May 1, 1992, at 16, 17.

\(^6\) Public venture capital in the form of enterprise funds, as in the case of the United States government's SEED Act funds, has gained prominence only recently. See, e.g., Support for East European Democracy (SEED), 22 U.S.C. § 5401, sec. 2(a) (1989). The World Bank Group has also made a dramatic shift from direct lending to both structuring financial deals that can be self-supporting and taking equity stakes in infrastructure projects. Bruce Zagaris, Financing Participation in Caribbean Basin Investments & Trade, 17 U. MIAMI INTER-AM. L. REV. 97, 116 (1985). This trend towards utilizing free market mechanisms also has given a great deal of power to the Overseas Private Investment Corporation (OPIC), a U.S. government corporation providing investors with political risk insurance and financing programs. OPIC has grown to be a major player in development because of its success with free market techniques. Randi S. Cohen, Note, OPIC Insures Investment in Central and Eastern Europe and the Baltic States, 1 NEW EUR. L. REV. 95, 96 (1992). OPIC has both continued to sustain its initial Congressional directive to self-fund its operations and structured several funds which have proven to most efficiently utilize public investment in other countries. Id. at 101.

\(^7\) The term venture capital has taken many meanings in modern business usage. It is often misunderstood as any capital put forth for any venture. More accurately, the term "venture capital" denotes "[e]quity investment in young private companies." Richard A. Brealey & Stewart C. Myers, PRINCIPLES OF CORPORATE FINANCE 339 (4th ed. 1991). The dilution of the term's meaning has occurred because of the popularity of venture capital as a financing vehicle. In the 1980s, venture capital attracted a great deal of interest in the public realm because it made possible the successes of several high technology entrepreneurs. Daniel H. Case, III, An Overview of Venture Capital, in START UP COMPANIES, supra note 4, § 6.01,
development problem.

In the past, however, Mexico and many other countries with protectionist economic policies effectively restrained the types of foreign venture capital investing that now occurs frequently in the United States, Europe, and Japan. Fortunately, the NAFTA and the FIL have, in the process of opening Mexico's markets, made many such investment opportunities available.

Before these reforms, Mexico's nationalist economic policies focused on the promotion of local business enterprises for domestic consumption. This economic theory, known as import substitution,\(^9\) proved itself to be an empirical failure throughout Latin America. The adverse impact of such policies eventually culminated in the Latin American debt crisis of the 1980s.\(^{10}\) The changes ushered in by the

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\(^6\) Although protectionist tendencies dominated only a relatively small portion of Mexico's economic history, post-World War II protectionist policies evoked images of Latin America's "stagnating economies laboring inefficiently behind high trade walls erected to promote domestic industrialization." Joseph Grunwald, *The Rocky Road Toward Hemispheric Economic Integration: A Regional Background with Attention to the Future in NAFTA AS A MODEL OF DEVELOPMENT*, *supra* note 3, at 51. Evidencing this phenomenon, in the years spanning from 1963 to 1991, exports to Latin America averaged less than 16% of total U.S. exports. *Id.* at 55 (table).

\(^9\) As an economic model, import substitution focused on enlarging domestic industry's role in the economy. *See* Fernando Sánchez Ugarte, *Mexico's New Foreign Investment Climate*, 12 *Hous. J. Int'l L.* 243, 244 (1990). During the 1950s and 1960s, Mexico expanded the number of local industrial branches to fulfill its goals of self-sufficiency in the production of intermediate and capital goods. *Id.*

\(^{10}\) Because of Mexico's long standing fixation on import substitution and the accompanying protectionist policies, monopolies became prevalent. Ugarte, *supra* note 9, at 244. The policies of the government were unable to boost lagging Mexican competitiveness, and financial and technological crises soon followed. *Id.*

The failure of Mexico's import substitution scheme resulted in the "most serious economic recession since the Great Depression of the 1930s" in Mexico. Wilson Peres Nuñez, *FOREIGN DIRECT INVESTMENT AND INDUSTRIAL DEVELOPMENT IN MEXICO* 39 (1990). The magnitude of the degeneration of the Mexican economy was nearly stupefying:

[In 1982] the growth rate was 7.9 per cent, but it was obtained at the cost of aggravating the main macroeconomic imbalances. The deficit in current account rose to $12.5 billion, nearly half of which was to service the external debt. At the same time, capital flight took on alarming proportions, reaching some $17 billion in 1981-1982. . . . The fiscal deficit was over 10 per cent of GDP [Gross Domestic Product] . . . adjusted for inflation. The peso was overvalued by about 30 per cent and, as imports soared and exports remained stagnant, this lead to a 50 per cent hike in the trade deficit in manufactured goods. The trade deficit, added to the flight of capital, meant that the net debt contracted that year reached 10 per cent of Mexico's GDP. *Id.*
NAFTA and the FIL have emphasized development through free market economics, bringing a promise of new growth.

The NAFTA and the FIL largely focus on national scale plans and projects, so called "top down" development.\(^{11}\) This article argues that the NAFTA and the FIL also present superior opportunities for "bottom up development,"\(^{12}\) especially in the telecommunications market, by combining enhanced financing for Mexico’s small entrepreneurs with the opening of Mexico’s domestic markets. Small entrepreneurs present an outstanding opportunity to couple the strengths of local innovation with foreign venture capital, thereby quantifying some of the previously incalculable dividends that Mexico and the United States will earn from the NAFTA and the FIL.

The Mexican telecommunications sector is the focus of this article for two reasons. First, the telecommunications sector represents an important aspect of Mexican business development, as demonstrated by its treatment in the NAFTA\(^{13}\) and by its general treatment in the development community.\(^{14}\) Second, innovation in high-tech industries such as telecommunications comes predominantly from small to medium-

\(^{11}\)Briefly, a "top down" development model concentrates on macroeconomic development and directs resources primarily to products that are national in scale. See Owen Furuseth & Chris Cocklin, An Institutional Framework for Sustainable Resource Management; The New Zealand Model, 35 NAT. RESOURCES J. 243, 266 (1995).

"Top down" development programs alone are rarely sufficient to fulfill a country’s economic policy needs, because a "top down" focus "does not allow for localized differences in policy development [and] cannot engender public commitment and support necessary to bring about a sustainable alternative." Id. Moreover, such centralized planning stifles creativity and initiative among individuals. See Steven R. Salbu & Richard Brahm, Planning Versus Contracting for International Joint Venture Success: The Case for Replacing Contract with Strategy, 31 COLUM. J. TRANSNAT’L L. 283, 313 (1993).

\(^{12}\)As the term suggests, "bottom up" development focuses on individuals and other stakeholders to initiate development at the proverbial "grass roots" level. See William F. Miller, What Part Will America Play in the Growth of the World Economy? An Introduction to the Industrial Policy Symposium, 5 STAN. L. & POL’Y REV. 11, 13 (1993). Furthermore, a "bottom up" orientation recognizes that "[m]uch of the infrastructure necessary to support an industrial cluster is local in character — business services, education, and quality of life services. Even transportation and communications have a strong local quality." Id.

\(^{13}\)See generally NAFTA, supra note 1, 32 I.L.M. at 653.

\(^{14}\)The prevailing view is that Mexico stands to benefit more than either Canada or the U.S. from NAFTA’s implementation. See, e.g., Daniel Szabo, Mexican Economic Development and the NAFTA in NAFTA as a Model of Development, supra note 3, at 117, 119. Business, both within and outside Mexico, also eagerly awaits NAFTA’s effects on Mexico’s telecommunications market. See, e.g., Andrew H. Decker & Philip Townsend, Through the Year 2000, LATINFINANCE, Apr. 1992, at 36.
sized businesses, which in the U.S. have proven themselves to be very successful venture capital projects.\(^\text{15}\)

In a more general sense, the Mexican telecommunications sector exemplifies Mexico’s new economic policy and effectively demonstrates the potential for development under the NAFTA and the FIL. Although the telecommunications sector has already realized the development opportunities in larger Mexican infrastructure projects, smaller scale initiatives remain to be exploited.\(^\text{16}\) The liberalization of Mexican law and the relationship between the U.S. and Mexico have encouraged the privatization of state monopolies. Furthermore, these events have created great potential for smaller purveyors of new technologies and services.

II. ANALYSIS OF MEXICAN FOREIGN INVESTMENT POLICY

A. Mexican Investment Policy Before Passage of the NAFTA

In past decades, the United States and Mexico have not always shared the twin policy goals of uninhibited trade and investment. Unlike those demanded by the present global economy, only four generations ago these goals were neither desirable nor necessary. Prior to the Mexican Revolution of 1910, the government of Porfirio Diaz promoted the export of primary goods to generate growth.\(^\text{17}\) The Mexican economy grew rapidly under this regime of passive economic control. U.S. and other foreign interests were free to exploit the markets and resources of Mexico without limitation. These direct foreign investments which so

\(^{15}\)Venture capital, in the form of the Small Business Investment Company (SBIC), was also responsible for the success of other companies such as Digital Equipment, Federal Express, People Express, and Apple Computer. Case, supra note 7, at 6-9. SBICs also financed Intel, Compaq, and Symbol Technologies, which were all involved in significant technologies vital to U.S. growth. Investment Advisory Council, Financing Entrepreneurial Business: An Agenda for Action, An Analysis of the Small Business Investment Company Program Together with Findings and Recommendations Concerning its Effective Operations, Feb. 1992, at 26.

\(^{16}\)For instance, although telecommunications giants AT&T and MCI have already established themselves in Mexico, the cellular telephone market is just now beginning to realize its potential. See Deborah Eby, After the NAFTA Battle: Let the Trading Begin, TEL. ENG’G & MGMT., Dec. 15, 1993, at 17. The rapidly growing Mexican market for cellular telephone services, a field in which ten companies are currently competing for Mexican market share, is expected to continue to grow at a 40% annual rate in the immediate future. See Cellular, LATIN AM. TELECOM REP., June 1, 1993, available in LATATELE database, 1993 WL 2690838.

\(^{17}\)See Ugarte, supra note 9, at 244. The Mexican emphasis on exports produced a ponderous inflow of foreign capital, an objective Mexico is once again trying to achieve. In 1897, Mexico was the recipient of 31.5% of all worldwide U.S. foreign investment. See VAN R. WHITING, JR., THE POLITICAL ECONOMY OF FOREIGN INVESTMENT IN MEXICO 59 (1992).
strongly controlled the means of commerce and production in Mexico also precipitated, in part, the Nationalist Revolution which swept the nation in 1910.\textsuperscript{18} The revolution produced a nearly two decade long period of social and political instability which ultimately lead to an abandonment of the free market model.\textsuperscript{19} The Constitution of 1917, the creation of the National Revolutionary Party in 1929, and the start of the worldwide depression further combined to bring about what was internationally viewed as a wave of nationalist actions by the Mexican state.\textsuperscript{20} While foreign domination of many Mexican domestic sectors continued,\textsuperscript{21} the decline of foreign investment commenced during this period.\textsuperscript{22}

During the 1930s, the government’s efforts to reconstruct the Mexican economy focused on infrastructure, the domestic market place,

\textsuperscript{18}The 1910 Revolution initially had at its root the democratization of the electoral process. Jorge Camil, Mexico’s 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model, 12 Hous. J. Int’l L. 1, 5-6 (1989). By the time the smoke cleared, however, it became apparent that the revolution’s lasting effect would be the transfer of Mexico’s natural resources from foreign control to that of the Mexican government. \textit{id.} at 6.

\textsuperscript{19}Post-revolution changes ranged from constitutionalizing the social function of private property to regulation of labor. The theme shared by all these reforms was a dissipation of capitalist notions in favor of an economy pervaded by state intervention. \textit{See} \textit{Whiting}, \textit{supra} note 17, at 61-62; Ugarte, \textit{supra} note 9, at 244.

\textsuperscript{20}These three factors combined to cause the Mexican government, reinforced by popular sentiment, to reject its earlier policy of achieving growth through the exportation of goods. As governmental power coalesced in a single party, the economic policy objectives became the reconstruction of the domestic economy and expansion of local markets. Ugarte, \textit{supra} note 9, at 244. Both of these goals meant that government would need to retain a firm grasp on Mexico’s natural and other resources. Hence, Mexico embarked on a period of "Mexicanization" overwhelmingly characterized by nationalist policies. \textit{See} \textit{id.}

\textsuperscript{21}By 1911 the main economic activities of [Mexico] were controlled by foreigners. The participation of foreign capital in mining was 97.7 percent, in petroleum 100 percent, in electricity 87.2 percent, in railroads 61.8 percent, in banking 76.7 percent, and in industry 85 percent.\textsuperscript{a} \textit{Whiting}, \textit{supra} note 17, at 59-60.

\textsuperscript{22}The shift from private and foreign ownership to a domestic and public focus of property rights was memorialized in the Mexican Constitution of 1917, art. 27, which stated: Ownership of all lands and waters comprised within the boundaries of the national territory is vested originally in the Nation. The Nation has had, and has, the right to convey title thereof to private persons, so establishing private property.

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The Nation shall have at all times the right to impose on private property such modalities as the public interest dictates, and the right to regulate the use and exploitation of all natural resources susceptible to appropriation, in order to preserve, and to effect an equitable distribution of, the public wealth \textit{\ldots}

\textit{Mexican Const.} art. 27 (1917), \textit{translated in} \textit{Whiting}, \textit{supra} note 17, app. one, at 243.
and the control of strategic domestic industries. The process began in 1938 with the nationalization of the petroleum industry, Mexico's primary export. After World War II, Mexico formalized these policies in a system of import substitution. Under this economic structure, the Mexican government used fiscal and financial incentives to promote domestic industries tailored to support domestic markets.

The main tenets of this nationalist "metapreference" for domestic interests included the following:

1. exclusive state ownership of strategic or basic industries, especially those based on raw materials or physical infrastructure;
2. national ownership of all industries in which the domestic private sector could produce efficiently;
3. foreign ownership to complement nationally owned industries to produce what state and domestic private firms could not.

For purposes of foreign investment, the significance of these policies was that, while foreign enterprises could invest in Mexico, strong restrictions on ownership and other measures designed to promote economic self-reliance limited foreign investment opportunities in the country.

During this period, constitutional limits and general law reserved investment in a number of sectors to domestic interests. The government restricted or eliminated foreign involvement in the following industries: oil, mining, electric and nuclear power, and, most recently, banking. Other industries endured various restrictions on foreign ownership. For example, in 1945 the Ministry of Foreign Relations issued an interim list of industries so restricted. This list, later reaffirmed in law, included: transportation (domestic air and ground transport), communications (radio broadcasting, motion pictures, publishing, and advertising), fishing and fisheries, as well as the production, distribution, and sale of carbonated beverages. These policies continued throughout the decades leading up

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23Ugarte, supra note 9, at 244.
24Id.
25Id., supra note 17, at 63.
26Id.
27Id.
28MEXICAN CONST. art. 73, § X.
29Whiting, supra note 17, at 71 (citations omitted). Most of these industry segments were reserved strictly for Mexican ownership in one fashion or another via the Ley Para Promover La Inversion Mexican y Regular La Inversion Extranjera (The Law to Promote
to the NAFTA’s passage. The effect of this policy on American investment was apparent. American investors, finding no opportunities to invest their capital with their southern neighbors, simply focussed their efforts elsewhere.

The scarcity of foreign investment heightened in the early 1970s. The Mexican government continued to pursue its policies designed to ensure greater control of the existing domestic economy and redistribute the national wealth of the nation. This preoccupation reached its high point in 1973 with the passage of the Law to Promote Mexican Investment and to RegulateForeign Investment (LPMI).

The LPMI extended restrictions on foreign owned investments in a number of ways. It not only limited foreign ownership to a minority interest in all industries, but also imposed greater limitations on access to previously restricted industries. Specifically, the law restricted the acquisition of more than one-fourth of the capital or forty-nine percent of the fixed assets of an on-going or new enterprise. Exceptions to these rules were permitted by De la Comisión Nacional de Inversiones Extranjeras (The Foreign Investment Commission or FIC), but only within the guidelines set forth in the LPMI. While grandfathering


Whiting, supra note 17, at 70-79. Other Mexicanized industries included, by decree in 1970, aluminum, cellulose, cement, fertilizers, glass, and steel. Id. at 78.

The portion of total U.S. foreign investment directed at Mexico dropped from 25% in 1910 to 10% at the start of the Depression to less than 2% after 1960. Whiting, supra note 17, at 64. From a Mexican perspective, the level of U.S. investment as a share of total foreign investment in manufacturing accounted for about 80% of all foreign investment during the period of 1957 to 1970. Id. at 67.

Mexican policy during this period was often evidenced in the rhetoric of the country’s politicians. President Echeverría said at his inauguration in 1970 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." Camil, supra note 18, at 8 n.66.

See supra note 29.

LPMI, arts. 4-5 & 8, translated in NATIONAL COMMISSION OF FOREIGN INVESTMENTS, supra note 29, at 46-48, 50.

LPMI, art. 8, translated in NATIONAL COMMISSION OF FOREIGN INVESTMENTS, supra note 29, at 50. Many commentators expressed concern at the time that Mexicanization might be forced onto existing companies, an action of questionable constitutionality. In any event, such enforcement never came to pass. See Camil, supra note 18, at 13.

LPMI, arts. 5, 12-17, translated in NATIONAL COMMISSION OF FOREIGN INVESTMENTS, supra note 29, at 47-48, 52-57. The FIC exercised this control through the chartering process, conceptually somewhat similar to registering a corporation in the U.S., but with far more restrictions and less transparency. See Camil, supra note 18, at 3 & n.10.
provisions automatically approved ownership at levels existing when the law was passed,\textsuperscript{37} the law clearly burdened new venture capital activities.\textsuperscript{38} Furthermore, the LPMI facilitated broad power for bureaucrats and, in some cases, outright corruption.\textsuperscript{39} As a practical matter, the FIC exercised broad discretion over all applications to increase ownership or control. Thus, it could extract concessions from businesses with virtual impunity.

By the mid-1970s, Mexico began to feel the adverse effects of its protectionist policies.\textsuperscript{40} The regulatory environment in Mexico certainly was inhospitable to the fledgling venture capital industry then emerging in the United States.\textsuperscript{41} Because of the debilitating bureaucracy, foreign investors favored acquisition of existing enterprises over starting subsidiary ventures.\textsuperscript{42} This trend indicated that, for even better

\textsuperscript{37}Whitning, supra note 17, at 99. The prevailing view at the time was that the law had not gone far enough and the exemptions were viewed as a serious weakness. \textit{Id.}

\textsuperscript{38}This result came to pass because the venture capital dynamic was inevitably influenced by the ability of the financing parties to take control of the company if necessary to protect their interests. Although many small investors were able to avoid these restrictions through \textit{prestanombres}, or name-lenders, the arrangement did not meet the needs of modern venture capital investors who desired rapid growth followed by liquidation of their interests. See Whitning, supra note 17, at 100. The Mexican legal structure created a hopeless situation. Successful ventures presumably created the kind of growth in size that affronted the interests of the FIC. Thus, the FIC would respond by ultimately limiting the sale of such enterprises to only local interests. This factor alone certainly did not bar foreign investment, but every such barrier potentially restricted a venturer’s exit and decreased the projected future value of the investment. See Camil, supra note 18, at 14 & n.115.

\textsuperscript{39}The breadth of power wielded by the FIC becomes apparent when one considers that only seven ministers held primary authority over economic decisions that affected the entire country. Although Mexican government officials originally felt a commission of seven ministers was sufficient to prevent corruption, such a simple structural mechanism was no match for the temptations present. One commentator has elaborated on just how pervasive the corruption was during this period:

\begin{quote}
The commission and the foreign investment registry initially shared the good reputation that the technology transfer registry achieved. One low-level employee in the registry was dismissed for accepting bribes, but the problem was endemic here as elsewhere in Mexico. Some officials complained that certain lawyers representing foreign investors were more likely to propose improprieties than the executives of the firms themselves, who hardly ever made such proposals. Some even suggested that this was the major service that lawyers offered.
\end{quote}

Whitning, supra note 17, at 100.

\textsuperscript{40}Ugarte, supra note 9, at 244-45.

\textsuperscript{41}The U.S. venture capital industry raised approximately $450 million from 1969 to 1973, at a pace that would not significantly increase for the next eight years. Case, supra note 7, at 6-2 to 6-3. By way of comparison, in 1983 alone the venture capital industry raised $4.1 billion. \textit{Id.} at 6-3.

\textsuperscript{42}The Mexican regulatory scheme was geared to funnel new capital, technology, and
capitalized operations, the country was not fertile ground for incubating smaller enterprises from abroad. The oligarchic nature of domestic industry also limited the appeal of start-up companies for investors who sought to exploit advantages in established industries. In any event, the need for economic reform became readily apparent by the early 1980s.

In 1982, the end of the oil boom, more than any other factor, precipitated that decade's economic crisis and the later liberalization of investment laws. Mexico’s nationalization of its oil industry prior to World War II had permanently changed the relationship between the Mexican government and foreign investors far beyond petroleum-related enterprises. The dramatic increase in the price of oil in the 1970s brought huge profits to the state through its wholly owned enterprises. Relying on the continuation of such good fortune, Mexico took on substantial foreign development debt during these same years. The skills to the Mexican markets. See Whiting, supra note 17, at 82. Thus, subsidiaries established in Mexico by transnational corporations became subject to regulations designed to meet these ends. As a result, the obvious response for foreign investors became to acquire existing Mexican enterprises. Id. at 82-84. This process largely defeated the administration’s economic policy goals because it meant no new resources were being contributed to the economy. Id. at 82. Control over and profits derived from those resources merely shifted to foreign ownership. Id.

Two different studies quantified evidence of this process. One study, sponsored by the United States Senate Subcommittee on Multinational Corporations of the Committee on Foreign Relations found that 43% of the corporations in its sample had been acquired through purchase of an existing enterprise rather than through start-up companies. See id. at 84-85. The other, a Harvard University sponsored project, came to the conclusion that, from 1966 to 1973, this figure topped 67%. See id. at 83-85 (table).

The data accumulated at the time is somewhat unclear whether the preference for acquisition was a result of the existing oligarchic nature of these industries or whether the preference for acquisition served to deter Mexican and foreign companies from attempting start-up ventures. See Whiting, supra note 17, at 84-86. In either scenario, however, the ultimate result was the same. Sector production became concentrated in a few suppliers, largely consisting of existing companies acquired by foreign interests. See id. at 86.

In the late 1970s, the primary force behind Mexico’s continued growth was its government dominated basic petrochemicals and refining industry. See Nuñez, supra note 10, at 18. Because of major price fluctuations from 1978-1980, the petrochemical industry was Mexico’s most important sector in intra-regional trade. See Rudolf M. Buitelaar, Dynamic Gains from Intra-Regional Trade in Latin America, in NAFTA AS A MODEL OF DEVELOPMENT, supra note 3, at 75, 89.

Mexico’s success in the petroleum sector, however, would prove to be a double edged sword. At the start of the new decade, oppressive economic conditions in the United States coupled with an oil glut to sweep the foundation out from under Mexico’s oil industry. See Camil, supra note 18, at 11-12, & 12 n.97. By 1986, the average price of Mexican oil exports was just $12, only half of what it had been just the previous year. Id. at 12 n.97 (quoting T. Heyman, INVESTING IN MEXICO 31 (1989)).

At the close of 1982, Mexico’s aggregate public and private external debt amounted
LPMI also drove the increase in debt because it severely limited equity investment in the country.\(^46\)

The oil price crash of 1982 at the end of the Portillo administration brought this capital cycle to a stop. By almost any standard, the country was devastated at all levels. Employment, investment, tax revenue, wages, and gross domestic product all suffered in the years that followed.\(^47\) The nationalist goal of import substitution that had driven policy for so long became untenable, in part because domestic capital, so important in a system dedicated to its superiority, disappeared.\(^48\) Investment liberalization became the necessary national policy, in part, facilitating the ascent to power of policy makers who rejected the old paradigm.\(^49\)

One precursor of the coming change was the public announcement in 1984 by the de la Madrid administration’s Foreign Investment Commission of a reversal in its policy of limiting foreign participation in

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\(^46\)See Camil, supra note 18, at 12 n.98. In 1981 alone, the borrowing from foreign commercial banks increased by $20 billion or 60%. See Chris C. Carvounis & Brinda Z. Carvounis, United States Trade and Investment in Latin America: Opportunities for Business in the 1990s, at 91 (1992). In light of these figures, few were surprised when, in 1982, then Mexican President Lopez Portillo announced that Mexico would be indefinitely suspending payments on the principal of its foreign debt. See id.

\(^47\)The following catalogue of the effects on Mexico’s economy due to the 1982 collapse of the oil industry demonstrates just how financially shattered the country had become:

[In August of 1982, the boom went bust. . . . Gross national product was stagnant. Production per person fell steadily. The real minimum wage dropped every year from 1983 through 1987. On the external account, the terms of trade, based on an index of 1980 equal to 100, had dropped to 77 by 1983 and to 57 by 1987. Interest payments on nearly U.S. $100 billion of debt took more and more export earnings; and at the same time exports were harder to acquire.

The net flow of capital that had until 1981 been in Mexico’s favor now turned sharply in the other direction: capital flowed out of Mexico to its creditors at a rapid rate. Financing these flows required cutting back on imports, even imports necessary for continued industrialization, and promoting exports. Given the declining terms of trade for commodities, the promotion of manufactured exports became even more important.]

See Whiting, supra note 17, at 232; see also supra note 10 and accompanying text.

\(^48\)In the wake of the near economic collapse, Mexico’s policy of import substitution became untenable. Most resources had to be focussed on servicing the outstanding debt. Furthermore, foreign investors, skittish because of the calamity, pulled back on their contributions. Therefore, all Mexican attentions had to be focused on encouraging exports to generate needed funds in the short term. See Whiting, supra note 17, at 232.

\(^49\)Id. at 234-35.
domestic businesses. That change was further solidified in 1989 with the President’s issuance of the Regulations to the Law to Promote Mexican Investment and Regulate Foreign Investment (RLPMI). These regulations were widely viewed by Mexican lawyers as amending the LPMI despite the purported use of only regulatory power by the Mexican president.

The most important change, from a venture capitalist’s perspective, was the codification of conditions required for foreign enterprises to take control of domestic investments. Defining such tangible standards eliminated a great deal of the FIC’s administrative discretion. The revised legal framework imposed the following conditions on investment from abroad: (1) a demonstrated need to obtain capital investments financed from abroad; (2) location of manufacturing facilities in areas other than Mexico City, Guadalajara, and Monterrey; (3) the maintenance of an even foreign exchange balance of the company for the first three years of the investment; (4) the capacity to generate sufficient employment opportunities; and (5) the use of competitive technologies.

Furthermore, the RLPMI standards scaled back the limitations on the control afforded to venture capital financiers and other investors. The regulations constrained FIC discretion to boundaries specified in the

50 See Camil, supra note 18, at 2. These guidelines applied to certain industrial sector enterprises and tourism-oriented businesses. Id. Although their limited publication reflected only a change in policy, not law, the guidelines were evidence of the forces coming to bear on the Mexican economy. Id. at 2 & n.7; see also Sandra F. Maviglia, Mexico’s Guidelines for Foreign Investment: The Selective Promotion of Necessary Industries, 80 Am. J. Int’l L. 281, 299 (1986) (noting that the failure to publish the guidelines in the Diario Oficial was intended to indicate that only a change in policy, not law, was required to change the FIC’s practice of strict enforcement of the 49% ownership cap).


52 Camil, supra note 18, at 13.

53 Id. at 14.

54 This particular provision sought to direct development to other areas of the country because these locales were already heavily industrialized and densely populated. See RLPMI, art. 5, § III, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.4-11.

55 RLPMI, art. 5, §§ 1-VI, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.4-10 to A.4-11; Camil, supra note 18, at 3 & nn.11-15. The RLPMI’s modification were important because Mexico, unlike most countries, primarily defined the legal relationship between the state and foreign investment concerns through the procedural requirements for business registration. See Jesús Bugeda Píteiro, Foreign Investment in Mexico: Procedural Aspects, in DOING BUSINESS IN MEXICO, supra note 2, at 8-1, 8-22. Before these reforms, the FIC was afforded broad authority under the LPMI, permitting it to initiate substantive changes in the investors’ obligations. Id.
published parameters. This revision improved the old law because typical techniques employed to rescue troubled companies, such as mezzanine financing used to dilute domestic owners' interests and other actions designed to take control of troubled ventures, were difficult to implement under the old law. Since such methods could only be initiated by incorporation into or modification of the corporate charter, a process subject to FIC approval, the old law effectively barred such

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56. The benefits of the RLPMI primarily derived from the elimination of administrative discretion on the part of the managing agency. This move significantly sped up the process for foreign investors hoping to exceed the 49 percent foreign ownership limitation. See Camil, supra note 18, at 14 & n.119.

Significantly, rather than reserving particular industry sectors to Mexican ownership and control, the RLPMI established qualitative restrictions on what companies could surpass the limits. The RLPMI provided that no Ministry authorization was required if:

I. [Foreign investors] invest in fixed assets to be used to carry on the enterprise's economic activities, in the enterprise's preoperating period, for up to the amount established by the Ministry from time to time, in order to update them.

II. The investments referred to in the above Section are made with foreign resources obtained through capital contributions of the partners or shareholders or through foreign funded loans made by foreign legal entities or by credit institutions.

If the partners or shareholders of the companies which are incorporated are foreign investors established in the country, they may invest with their own resources.

At the end of the preoperating period, the paid-in capital stock must equal at least 20% of the aggregate investment in fixed assets.

III. The companies which are incorporated locate in the industrial facilities they need to carry on their industrial or manufacturing activities outside of the growth-controlled geographical zones having the highest industrial concentration, as defined by the applicable administrative provisions.

IV. The companies which are incorporated at least break even in their aggregate foreign exchange balance, during the first three years of operation.

V. The companies which are incorporated must create permanent jobs and implement continued training, education, teaching and personal development programs for the workers, pursuant to applicable laws.

VI. The companies which are incorporated must use proper technology and abide by the legal provisions regarding ecology.

RLPMI, art. 5, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.4-10 to A.4-11.

57. "Mezzanine financing" is a term which generically refers to financing at later stages of operations, as opposed to investments made at the initiation of the project. See RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 328 n.6 (3d ed. 1988).

58. The problem posed by many mezzanine financing techniques was that they could have the effect of diluting domestic ownership, thereby invoking the 49% Mexican regulatory cap. See Camil, supra note 18, at 9.
venture financing.\textsuperscript{39} Under the new law, as long as the company met the other stated goals, these techniques could be adopted.\textsuperscript{60}

The change also facilitated venture capitalists' attempts to repatriate profits\textsuperscript{61} during the life of the investment. Developing countries such as Mexico often limited both the repatriation of profits and capital and the payment of dividends to prevent the demand created by these activities from draining the country's foreign currency reserves.\textsuperscript{62} Although dividends were not relied on by venture capitalists to the same extent they valued capital repatriation, these restrictions had the effect of locking in foreign investors for a fixed period not of their choosing.\textsuperscript{63} The RLPMI eliminated FIC oversight of foreign ownership and participation once a break-even foreign exchange balance was maintained for first three years.\textsuperscript{64} Therefore, outside this period, venturers could repatriate capital

\textsuperscript{39}Once the FIC became involved in the process, progress inevitably ground to a halt. The FIC held administrative sway over any project that exceeded the foreign ownership limitations. See Camil, supra note 18, at 14. This frustrating exercise could consume up to a year of a project development schedule. \textit{Id.} at 14 n.119.

\textsuperscript{60}See RLPMI, art. 5, \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.4-10 to A.4-11.

\textsuperscript{61}Repatriation, as used in this context, refers to the process by which foreign investors take profits on capital from the host country economy. \textit{John M. Rothgeb, Jr., MYTHS AND REALITIES OF FOREIGN INVESTMENT IN POOR COUNTRIES: THE MODERN LEVIATHAN IN THE THIRD WORLD} 78 (1989). One of the risks associated with repatriation of capital or profits is that foreign investors will "convert debt bought at a discount for near the face amount of the debt and then immediately convert the local currency received back into dollars for a greater return on [the] initial investment." Jennifer L. Zaiser, Note, \textit{Swapping Debt for Education: Harvard and Ecuador Provide a Model for Relief}, 12 B.C. THIRD WORLD L.J. 157, 189 n.45 (1992). Another problem with repatriation of capital is "a reduced ability to marshal the domestic investment needed to promote growth, leading to an inability to develop, particularly in areas such as manufacturing, where high amounts of capital availability are required." \textit{Rothgeb, supra}, at 78.


\textsuperscript{63}The extraction of any substantial amount of cash in the form of dividends from the venture created substantial problems under the old scheme. The commission's broad discretionary powers meant that the effect of capital outflows through dividends on the FIC's disposition toward the corporation had to be considered. The LPMI specifically provided that one factor to be weighed in determining whether to exempt a venture from the ownership restrictions was "[i]ts positive effects on the balance of payments." LPMI, art. 13, § III, \textit{translated in NATIONAL COMMISSION OF FOREIGN INVESTMENTS}, supra note 29, at 54.

Payments of dividends posed a problem here because, to the extent dividends were paid out to foreign investors, that money disappeared from Mexico. The result was a reduction in the company's balance of payments which had to be accounted for elsewhere. See Buckheit, supra note 62, at 406.

\textsuperscript{64}RLPMI, art. 5, § IV., \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.4-11.
with minimal concern for the impact on foreign exchange balances.

The RLPMI also extended its reforms, albeit modestly, to the area of business resale. Before the RLPMI, the exit vehicle of any venture was subject to the restrictions imposed by the FIC.\(^\text{65}\) For example, a typical venture might be funded at the outset by foreign capital amounting to forty-nine percent ownership. Assume, furthermore that the company had obtained permission from the FIC to include legal mechanisms in the company's charter allowing the minority owners to obtain effective control if the operation failed. If, for instance, eight years later that company had been successful and both the domestic operators and foreign investors sought to sell it, they would be limited to selling it to a Mexican concern. Otherwise, the parties again would have to obtain the consent of the FIC. As this example demonstrates, before the passage of the RLPMI, investors considering whether to fund a venture had to confront their practical inability to sell the company at the end of their investment without obtaining the discretionary approval of the FIC. After the RLPMI was enacted, such financiers could enter with the knowledge that the bureaucratic decision at exit would be guided by concrete standards.\(^\text{66}\)

Finally, the RLPMI impacted on two additional areas of modest interest to potential venturers. First, the law expanded the use of trusts in the control of enterprises.\(^\text{67}\) Previously, the practice was permitted only on a limited basis.\(^\text{68}\) This change opened another avenue of

\(^{65}\)Mexico significantly restricted repatriation of capital in the initial years of investment. Mexico's 12 year prohibition on capital repatriation made its policy one of the most restrictive of any developing country. See Stuart M. Berkson & Bruce A. Cohen, Tax Implications of Debt-For-Equity Swaps, 12 Hastings Int'l L. & Comp. L. Rev. 575, 579 n.8 (1989). The stated rationale for this policy was to prevent foreign investors from draining excess profits out of the venture in the opening years of the project. See Steven M. Cohen, Comment, Give Me Equity or Give Me Debt: Avoiding a Latin American Debt Revolution, 10 U. PA. J. Int'l Bus. L. 89, 117 n.203 (1988).

\(^{66}\)See Camil, supra note 18, at 14.

\(^{67}\)As one commentator has noted, the RLPMI's treatment of trusts provided foreign investors with an indirect but useful means of participating in restricted sectors of the economy:

This form of participation, albeit indirect, permits foreign investors
(a) to acquire stock and corporate assets in excess of the forty-nine percent limitation, (b) to purchase non-voting participation certificates in investment trusts holding public stock, (c) to obtain beneficial title to land within and without the "restricted areas," and (d) to make twenty year temporary investments in companies, previously closed to foreign investment or subject to ownership limitations less than forty-nine percent.

Id. at 16; see also RLPMI, arts. 10-15, translated in Doing Business in Mexico, supra note 2, at A.4-13 to A.4-15.

\(^{68}\)The concept of a trust administered by a private trustee was largely foreign to Mexico
investment structure. Trusts allowed foreign interests to obtain controlling interests of organizations that by law were restricted to Mexican ownership.

The second change opened operational control of certain enterprises to foreigners. Under the LPMI, foreign administration of a company was not permitted to exceed foreign ownership.\textsuperscript{69} Thus, without a rarely granted permission from the FIC, foreign entities usually could not control operations because they could not hold majority ownership. For venturers, this restriction denied them practical control even when majority ownership was still retained by Mexicans. Furthermore, Mexican nationals also suffered because the restriction denied them access to foreign expertise. The RLPMI changes allowed majority ownership, and, with it, a shift in corporate control to foreign investors.

Despite these changes, there remained a number of deterrents for potential venture capital investment in Mexico. First, the bureaucratic restrictions of the FIC still existed.\textsuperscript{70} Although the standards became more transparent after the RLPMI, the fact that a central entity controlled the entry of foreign capital into the equity market remained a serious impediment.\textsuperscript{71} Further, entities with majority foreign ownership, a typical result of mezzanine financing or management reorganization, could not be listed on the Mexican stock exchange.\textsuperscript{72} Because many, if not most,

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before the RLPMI. Until the early 1970s, the only trusts existing in Mexico were those administered by the state owned banks. \textit{See} Camil, \textit{supra} note 18, at 15. In any event, even had trusts been more widely accepted in Mexico, their use by foreign investors would not have permitted them to escape the reach of the FIC. The commission’s enabling legislation provided that foreigners could not hold controlling interests under any title, a concept certainly broad enough to restrict ownership of shares held in trust. \textit{Id.} at 16 & n.131; LPMI, art. 5, \textit{translated in National Commission of Foreign Investments, supra} note 29, at 47-48.

\textsuperscript{69}LPMI, art. 5, \textit{translated in National Commission of Foreign Investments, supra} note 29, at 47-48.

\textsuperscript{70}Although the RLPMI authorized foreign investors to acquire stock ownership in excess of 49%, Ministry authorization was still required except in certain circumstances. \textit{See} RLPMI, arts. 5-7, \textit{translated in Doing Business in Mexico, supra} note 2, at A.4-10 to A.4-12.

\textsuperscript{71}As of 1992, a number of industries, including telecommunications, construction, mining, and financial services, were still heavily restricted even under the changes proffered by the RLPMI. Fama, \textit{supra} note 5, at 18. Investors were required to seek FIC approval, were limited to a minority stake, or were precluded from entering the industry altogether. \textit{Id.}

\textsuperscript{72}See Samuel Wolff & Javier Lizardi Calderon, \textit{The Securities Market and Regulation of Mexico,} 19 DENJ. INT’L L. & POL’Y 369, 584 (1991). Nevertheless, foreign institutional investors could have limited access through the use of American Depository Receipts (ADRs). ADRs are securities tradable on United States markets. \textit{See} Reinaldo Planchart, \textit{Corporate Finance Opportunities in Mexico, LatinFinance,} June 1993, at S6. Essentially, an ADR, through a series of financial maneuvers, represents the underlying stock of a foreign company in a way that avoids technical restrictions on majority foreign ownership. \textit{See} id. The chief advantage of these investment tools is that they often may be sold to institutional investors.
venture projects look to a public offering to generate significant capital, this Mexican market characteristic limited the appeal of venture deals.\textsuperscript{73}

Restrictions on the repatriation of capital posed another potential obstacle to the success of future rounds of venture financing. Additional venture financing assumed importance when capital contributions became necessary in the one or two year periods immediately before a company was to be resold by venturers.\textsuperscript{74} Restrictions on repatriations of funds which locked in contributions for lengthy periods prevented later round contributors from recouping their investments.

Regardless of the RLPMI's impact on the broader Mexican economy, for the telecommunications sector investment policy remained essentially unchanged by its passage. The underlying restrictions of the RLPMI on foreign investment in the telecommunications industry still stood as barriers to venturers.\textsuperscript{75}

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See id.

In addition to ADRs, investors in Mexico can also utilize Mexico's stock market, the Bolsa Mexicana de Valores (BMV), as an additional exit vehicle. The BMV recently initiated a second tier market for small- and medium-size companies. See The Mexican Second Tier Market, LATINFINANCE, Sept. 1993, at 74. To limit transaction costs and account for low trade volumes, the second tier market operates by bundling a number of orders for trade and periodically trading them together. Id. To qualify for a listing on the second tier market, companies generally must (1) exhibit high growth potential, (2) have a net worth between $7 and $33 million, and (3) have posted positive earning figures on average for the three years prior to applying. Id. As of the date of placement, 30% of the company's capital must remain in the market and the company must continue to have 100 or more investors. Id. Furthermore, following second tier listing, the company must maintain a net worth in excess of $3 million, a 20% paid in capital rate, and at least 50 investors. Id. Given these demanding prerequisites, it is no surprise that, as of September 1993, only one company had achieved a second tier listing. Id.

\textsuperscript{73}Although venture capital projects are typically initially financed by the principals and other insiders, public offerings represent one means of obtaining needed funds. See Salzman & Doerr, supra note 4, § 7.02[3], at 7-5. Additionally, at later stages of financing the principal investors may become reluctant to contribute additional equity and seek to spread the risk by bringing in additional investors. See R. DUANE HALL, THE INTERNATIONAL JOINT VENTURE 43 (1984).

\textsuperscript{74}Mexico restricted repatriation of capital for up to 12 years from the time it was initially invested. See supra note 63 and accompanying text.

\textsuperscript{75}The RLPMI explicitly retained the 49 per cent ownership and control restrictions in the telecommunications industry. See RLPMI, art. 7, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.4-12; see also Fama, supra note 5, at 18 (discussing ownership restrictions applicable to foreign investment in the telecommunications industry).
B. Mexico's Current Foreign Investment Policy

1. The NAFTA's Role

Although the RLPMI failed to extend its reforms to the telecommunications sector, the NAFTA accomplishes both the opening of the broader Mexican market and the telecommunications sector in particular. While many of the provisions of the NAFTA retain certain restrictions and procedures established under the LPMI, several areas important to venture capitalists are beyond the RLPMI and will benefit from the NAFTA's passage. These areas, therefore, may provide fruitful avenues of investment for venture capitalists.

As a general matter, NAFTA's national treatment requirement for investments bars the government from creating new laws tending to swing the pendulum back to a nationalist economic policy. This provision provides an important safeguard because several aspects of the existing regulatory structure remain in place. Notably, Mexico is permitted, under the treaty, to retain a number of existing restrictions and

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76See generally NAFTA, supra note 1, Annex I, 32 I.L.M. at 704.
77As set out below, "National Treatment" requires each NAFTA signatory to approach foreign investment as it would treat such investment by its own citizens:
1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party to which it forms a part.
4. For greater certainty, no Party may:
   (a) impose on an investor of another Party a requirement that a minimum level of equity in an enterprise in the territory of the Party be held by its nationals, other than nominal qualifying shares for directors or incorporators of corporations; or
   (b) require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment in the territory of the Party.
NAFTA, supra note 1, art. 1102, 32 I.L.M. at 639.
reservations. Although limited, Mexico also retains a measure of governmental power to review foreign investments through its reservations to the treaty. The Mexican government has specifically reserved the right of the FIC to review acquisitions of more than forty-nine percent ownership interest in companies valued in excess of $25 million. The FIC, also by reservation, retains its other qualitative review powers created in the RLPMI. Notwithstanding these exceptions, the NAFTA’s impact on Mexico’s regulation of foreign investment is both pervasive and significant. Venturers, who previously had been limited to a small number of unrestricted industries, have been permitted by the treaty to expand into new areas of operation. Similarly, these favorable modifications allow foreign venture capitalists to take controlling interests of suitable enterprises or avail themselves of structures eventually permitting the acquisition of such interests. The NAFTA also specifically allows the transfer of dividends, capital gains, and similar profits. This change permits the possibility that properly managed enterprises may avoid the FIC restrictions by restructuring to repatriate profits during the lifetime of the investment.

2. Impact of Mexico’s Foreign Investment Law

Whatever shortcomings may limit NAFTA’s effectiveness at removing regulatory barriers, these criticisms do not apply to the Ley de Inversion Extranjera (Foreign Investment Law or FIL). Far surpassing the checks on regulation crafted in the NAFTA, the FIL removes hosts

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78 Article 1108 outlines, in general form, reservations and exceptions permitted under NAFTA. Briefly, each party is permitted to retain those reservations and exceptions (1) as set out in its respective schedules in Annexes I through III, or (2) as provided in this section. See id., art. 1108, 32 I.L.M. at 640. In addition, the provision grants a two year grace period for states or provinces of any signatory to bring their practices in conformity with the treaty. See id.

79 Id., Annex I, 32 I.L.M. at 705. The threshold value of a company for which review by the FIC is required increases from $25 million in the first three years after the NAFTA is entered into force to $150 million nine years after the NAFTA is entered into force. Id.

80 See id.

81 For instance, NAFTA reverses decades of Mexican foreign policy to the extent that it forbids any party to require the maintenance of minimum levels of equity held by nationals of the country. See NAFTA, supra note 1, art. 1102, 32 I.L.M. at 639.

82 Id., art. 1109(1), (4), 32 I.L.M. at 641.

of administrative and industrial restrictions on foreign investment. The new law expressly repeals the LPMI.\textsuperscript{84} Furthermore, the FIL retains the RLPMI provisions only during the interim period until new regulations can be published.\textsuperscript{85} Although the FIL reinstitutes the FIC, it at the same time limits the scope of the agency's powers.\textsuperscript{86} For instance, Mexican interests do retain exclusive rights over numerous sectors and FIC approval is still required for others. Nevertheless, the FIL reinforces the expanded scope of foreign ownership authorized by the NAFTA.\textsuperscript{87} The

\textsuperscript{84}FIL, 2d transient art., \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-24.

\textsuperscript{85}FIL, 2d & 4th transient arts., \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-24.

\textsuperscript{86}See FIL, art. 28, \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-16 to A.2-19.

\textsuperscript{87}Generally, the tone of the FIL is much more agreeable to foreign ownership. The law at one point expressly states, "Foreign investment may ... participate in any proportion in the capital stock of any Mexican corporation or partnership . . . ." FIL, art. 4, \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-5.

Yet, the FIL does not entirely eliminate restrictions on foreign direct investment. Article 5 reserves the following segments exclusively for the state: oil and all other hydrocarbons; basic petrochemicals; electricity; generation of nuclear energy; radioactive minerals; satellite communications telegraph services; radiotelegraphy; the mail; railroads; issuance of bank notes; minting; and control, supervision and security of ports, airports, and heliports. FIL, art. 5, \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-5 to A.2-6.

Similarly, Article 6 permits only those domestic companies that have pledged not to take on foreign investment to engage in the following industries: land transportation of passengers, tourists and cargo within the country, except for courier and package delivery services; retail sale of gasoline and L.P. gas; radio broadcast and other radio and television services, but excluding TV cable; credit unions; development banks; and certain other professional and technical services. FIL, art. 6, \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-6 to A.2-7.

Article 7 also places foreign ownership restrictions ranging from 25% to 49% on companies operating in the following market sectors: air transportation within the country; air taxi transportation; specialized air transportation; bank holding companies; full-service banking institutions; brokerage firms; securities specialists; insurance companies; surety companies; money exchange houses; bonded warehouses; financial leasing companies; factoring companies; limited purpose financial institutions as defined by article 12-bis of the Securities Market Law; certain corporations, also as defined in article 12-bis of the Securities Market Law; fixed portion of capital stock in mutual funds; most manufactures and sellers of explosive materials; domestic newspaper publishers; certain shares of corporations owning land for agricultural and forestry purposes; TV cable; basic telephone services; most commercial fishing; port management; most inland shipping companies; accessories to railroad service; and supply of fuels and oils for vessels, aircraft, and railroad equipment. FIL, art. 7, \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-7 to A.2-9.

Finally, FIC approval still appears in certain industries when foreign ownership in excess of 40% is contemplated. See FIL, art. 8, \textit{translated in DOING BUSINESS IN MEXICO}, supra note 2, at A.2-9 to A.2-10.
FIL even permits 100% ownership of some companies whose assets do not exceed a commission determined level, initially set at 85 million New Pesos. Review of foreign ownership shares by the FIC, when required, will follow general guidelines incorporating only those "conditions that will not adversely affect international trade."

Within the telecommunications sector, foreign ownership in several market areas has also been liberalized. The law permits minority foreign ownership of cable television enterprises and basic telephone service companies. Subject to FIC approval, foreign investors even may increase their holding to become majority owners in certain market segments such as cellular telephones and related services.

The most important change made by the FIL is the creation of a forty-five day limit on the approval process. The new law requires the FIC to rule on applications for exceptions to ownership restrictions within forty-five business days after submission. Failure to reach a decision in the allotted time results in automatic approval. Taken as a whole, the FIL represents a marked departure from the Mexican government's past preoccupation with complete control.

II. MEXICAN TELECOMMUNICATIONS

A. The Market Potential

In a much acclaimed report on the NAFTA, two noted economists have summarized many of the treaty's highlights. One of the most highly touted areas is the NAFTA's liberalization of the

83FIL, art. 9, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.2-10.
84FIL, 10th transient art., translated in DOING BUSINESS IN MEXICO, supra note 2, at A.2-27.
85FIL, art. 29, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.2-18.
86FIL, art. 7, § IV(m), (n), translated in DOING BUSINESS IN MEXICO, supra note 2, at A.2-7 to A.2-9.
87FIL, art. 8, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.2-9 to A.2-10.
88See FIL, art. 28, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.2-18.
89FIL, art. 28, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.2-18.
90Gary Clyde Hufbauer and Jeffrey J. Schott authored a report making recommendations on how the NAFTA should be negotiated. See generally GARY C. HUFBAUER & JEFFREY J. SCHOTT, NORTH AMERICAN FREE TRADE: ISSUES AND RECOMMENDATIONS (1992) [hereinafter HUFBAUER & SCHOTT, ISSUES AND RECOMMENDATIONS]. They then produced an analysis of the NAFTA prior to its ratification which compared how the completed NAFTA fared against their recommendations. GARY C. HUFBAUER & JEFFREY J. SCHOTT, NAFTA: AN ASSESSMENT (1993) [hereinafter HUFBAUER & SCHOTT, ASSESSMENT].
telecommunications trade. Because the markets of the two other signatories, Canada and the United States, are already open, the NAFTA focuses on opening the Mexican telecommunications market. In many ways, however, the NAFTA simply reflects the prevailing market conditions existing in Mexico. One commentator has aptly described the activity in Mexico prior to the passage of the NAFTA as a "telecommunications revolution."

The Mexican government views telecommunications as a key instrument in Mexico's overall development strategy. Quite simply,
doing business in the future in Mexico without telecommunications modernization will prove to be very difficult, if not impossible.\textsuperscript{101}\footnote{An enhanced Mexican telecommunications industry is a fundamental element to allow its businesses to rise to the standards of the global market.\footnote{Both the internal and external competition that the trade agreement is expected to precipitate will continue to provide strong incentives for Mexico to modernize as quickly as possible.\footnote{This modernization of the long neglected Latin American telecommunications infrastructure is accompanied by both rare national economic health as measured by its per capital Gross National Product and the number of access lines in service. Decker \& Townsend, supra note 14, at 33. Another study prepared by the U.S. Embassy in Mexico City stated the following about the impact of telecommunications on the Mexican economy: \textquoteleft\textquoteleft\textquoteleft A telecommunications revolution is under way in Mexico that is aimed at transforming the Mexican telecom network into the largest, most comprehensive and modern in Latin America. . . . Mexico's S8 billion market for telecom equipment is a testament to the level of economic activity taking place there . . . . \textquoteright\textquoteright\textquoteright \textnormal{Larry Luxner, NAFTA Could Create Telecom Field Day for U.S. Firms Looking to Invest, TELEPHONY, Nov. 29, 1993, at 9, 16 [hereinafter Luxner, Telecom Field Day]. These findings and conclusions also are shared by members of the Mexican government. One prominent bureaucrat recently observed: \textquoteleft\textquoteleft The Mexican economy has to be a lot more efficient to compete in an environment of openness, so we have to modernize at an accelerated pace. . . . Telecommunications has a direct impact on almost every aspect of the economy.\textquoteright\textquoteright\textquoteright \textnormal{Larry Luxner, NAFTA Fuels Mexico's Telecom Explosion, BUS. LATIN AM., Jan. 13, 1992, at 1 [hereinafter Luxner, NAFTA Fuels] (quoting Carlos Mier y Teran, Undersecretary for Communications, Mexico Secretariat of Communications and Transportation).\footnote{As recently as the 1980s, Telmex delivered dismal service to Mexico, creating an obvious deterrent to investment. On average, telephone lines took over three years to install and faxes were impossible to acquire under then existing import restrictions. \textit{Update, supra} note 99, at 15. \textit{See also} Stephen Fidler, Survey of Mexico, FIN. TIMES, Nov. 20, 1992, at III (noting that poor telecommunications capabilities impeded business activities in Mexico).\footnote{Mexico has realized that \textquoteleft\textquoteleft telecommunications has emerged as one of the most critical elements underpinning a country's economic development program.\textquoteright\textquoteright\textquoteright \textnormal{Decker \& Townsend, supra note 14, at 33. As related below by Mexico's Subsecretary of Communications and Technological Development, Mexico has taken a comprehensive view toward achieving the goal of communications competitiveness:

One of our priorities is the development of the telecommunications infrastructure in every sense, such as in special areas and regions, in a form that can provide the required telecom services, in the most efficient and economical fashion. This is why we have key projects, such as the launch of new Solidarity Satellite System, fiber optic networks, and microwave systems that cover the entire nation. \textit{An Interview with Raul Zorilla Costo, E. EUR. FORMER SOVIET TELECOM REP., Oct. 15, 1993, available in EEFSTR database, 1993 WL 2664317. See also HUBBAUER \& SCHOTT, ASSESSMENT, supra note 95, at 77 (concluding "Mexico will benefit by the rapid conversion of its third-world telecommunications system to first-world performance levels").\footnote{See Deregulation, supra note 97, at 547.}}}}}}}}}}
opportunity and staggering cost.\textsuperscript{104} Infrastructure modernization and maintenance is seen as one of the most lucrative investment opportunities in Latin America.\textsuperscript{105} Because Latin American governments generally lack the resources to independently finance the modernization effort, they present investment opportunities to both the local private sector and the outside world.\textsuperscript{106} For their part, foreign investors seem eager to finance these endeavors as long as a "stable regulatory environment" remains in place.\textsuperscript{107}

Reform under this new government atmosphere is aimed at complementing privatization. For example, the Secretariat of Communications and Transport (SCT) has withdrawn as the government supplier of telecommunications equipment and service.\textsuperscript{108} The SCT is

\textsuperscript{104}International Monetary Fund figures predict that "with a population of 347 million (1991), and a teledensity of 6.82 [phones]/100 [persons] (1991)] it will require $137.2 billion to raise the average teledensity from the current 6.82% to 20% (or from the current total of 23.662 million lines to 69.39 million lines)." Andrew E. Fyfe, \textit{Telecommunication Regulation in Latin America and the Caribbean}, LATFINANCE, Jan. 1994, at 36. These calculations do not include the 1.9% growth rate forecasted for the Caribbean and Latin American areas. \textit{Id.}

\textsuperscript{105}Anna Szterenfeld, \textit{Building for the Future}, BUS. LATIN AM., June 28, 1993, at 5 ("The World Bank's International Finance Corp. (IFC) calculates that there are currently $36 billion in infrastructure projects on offer to private investors in Latin America."). Nevertheless, a recent study of North American telecommunications markets bodes ill for smaller telcos. \textit{COMMUNICATIONS DAILY}, Apr. 22, 1993, \textit{available in COMMD database, 1993 WL 2635540}. These telcos, notably GTE and RHCs, will have to compete with fiber optics services and satellite connections. \textit{Id.} A combination of the NAFTA, privatization, regulatory liberalization, and open markets in Argentina, Chile, and Venezuela all increase competition in the American telecommunications market. \textit{Id.}

\textsuperscript{106}Szterenfeld, \textit{supra} note 105, at 4-5. The Organization of American States predicts that to maintain present Latin American telecommunications operating ability, an investment ranging between $70 to $130 billion is necessary through the end of this century. Robert B. Shanks et al., \textit{Insulating the Deal}, LATFINANCE, Apr. 1992, at 39.

\textsuperscript{107}Fyfe, \textit{supra} note 104, at 36. Raul Zorilla Cosio, the Subsecretary of Communications and Technological Development, discussed the extent of telecommunications improvements required, stating:

\begin{quote}
In order to achieve these [development] objectives, we had to modernize communications, in a way that supports the development of these economic goals and places Mexico in an international competitive framework, in which the state becomes an organ of regulation and a promoter of development, leaving the operation and service side to private initiative and maintaining a clear regulatory framework that promotes competition in all services and greater efficiency and quality.
\end{quote}

\textit{An Interview with Raul Zorilla Cosio, supra} note 102, \textit{available in EEFSTR database, 1993 WL 2664317}. Cosio's statements evidence the sheer immensity of the investment opportunities such activities may create.

\textsuperscript{108}Update, \textit{supra} note 99, at 15. In doing so, it created a semi-autonomous government owned company called \textit{Telecomunicaciones de Mexico} (Telecomm), which is now a constitutionally authorized supplier of satellite and telegraph service. \textit{Id.}
now relegated to the position of regulator for the industry.\textsuperscript{109}

The modernization plan also is being implemented under reforms initiated in 1989 to privatize Teléfonos de Mexico (Telmex)\textsuperscript{110} as a regulated monopoly.\textsuperscript{111} In turning Telmex over to the private sector, Mexico has followed the global trend of privatizing publicly owned utilities.\textsuperscript{112} Although Telmex will retain a government backed monopoly, its market control is subject to certain caveats.\textsuperscript{113} The monopoly

\textsuperscript{109}An Interview with Raul Zorilla Cosio, supra note 102, available in EEFSTR database, 1993 WL 2664317. The Subsecretariat of Communications and Transport (SCT) has transformed itself to support the burgeoning industry emerging in the wake of the government’s development plan. The SCT has promulgated the New Telecommunications Regulations to begin the process of installing a regulatory regime to oversee this market. \textit{Id.} The most significant of these new rules include:

- the actualization and definition of terminology;
- the establishment of the regulatory power of SCT;
- the establishment of new conditions for public telephone network concessions;
- the creation of new conditions for special value-added services and permits for private networks;
- the establishment of a competitive regime for service provision;
- the liberalization of private networks and foreign investment up to 49 percent;
- the specification of requirements and conditions for interconnection with public networks;
- the outlining the administration and utilization of the radioelectric spectrum;
- the terms for the granting of concessions and permissions for radiocommunications services;
- the reform of tariff policy; and
- the requirements for the homologation of equipment.

\textit{Id.}

\textsuperscript{110}Telmex is the national telephone company of Mexico. \textit{See} Luxner, \textit{Telecom Field Day, supra} note 100, at 16.

\textsuperscript{111}Hufbauer & Schott, Issues and Recommendations, supra note 95, at 79.

\textsuperscript{112}Szterenfeld, supra note 105, at 5. According to World Bank data, power, telecommunications, and transportation total 41% of all state assets privatized between 1988 and 1992 in Latin America. \textit{Id.}

\textsuperscript{113}Hufbauer & Schott, Assessment, supra note 95, at 76. The Mexican government is requiring Telmex to invest $2 to $3 billion annually "to improve service in exchange for less obtrusive regulation of prices and generous tax treatment." \textit{Id.} Other requirements include:

- an obligation to achieve aggressive modernization objectives;
- annual growth of 12 percent;
- the achievement of rates of quality and continuity of service;
- the prohibition of monopoly practices and cross subsidies;
- the obligation to permit the commercialization of user equipment;
- to protect telephone service for rural populations with fewer than 500 inhabitants;
- an exclusive right for national long distance and international service
provisions for national and international long distance service extend to Telmex only until August 1996. At that time, the two services will be separated and Telmex will be subject to outside competition. In anticipation of this event, contenders for the services market are poised and ready to take the market from Telmex in 1996 if they can. MCI, for example, has embarked on a joint venture with the largest financial group in Mexico, Grupo Financiero Banamex-Accival (Banacci), to provide long distance service in Mexico.

The RLPMI also complements the reforms by allowing up to forty-nine percent foreign ownership of Mexican telecommunications companies. The RLPMI precipitated the purchase of a 20.4% controlling share in Telmex by an international consortium consisting of the Carso Group, Southwestern Bell, and France Telecom. Further reform also has been evidenced in the area of cellular communications. This increasingly important technology is replacing or competing directly with traditional phone lines in many Latin American countries, including Mexico, because many countries lack a traditional telecommunications infrastructure. The government has responded by

until August of 1996;
and the obligation, in 1997, to interconnect with another public or private network under equitable competition terms.

An Interview with Raul Zorilla Cosio, supra note 102, available in EEFSTR database, 1993 WL 2664317.


MCI's partnership with Banacci will make MCI the holder of the first integrated North American Network. Id. Ownership of the venture is distributed 55% to Banacci and 45% to MCI. Id. MCI alone expects to invest $450 million into the project. Id.

RLPMI, arts. 5-6, translated in DOING BUSINESS IN MEXICO, supra note 2, at A.4-10 to A.4-12.

Hufbauer & Schott, ISSUES AND RECOMMENDATIONS, supra note 95, at 79 & n.15. The sum paid, $1.76 billion, is dwarfed by the $13 billion in anticipated Telmex expenditures for the coming years. See Luxner, Telecom Field Day, supra note 100, at 16.

Update, supra note 99, at 15. Cellular phones, due to their convenience, accessibility, and affordability, have replaced traditional phone lines in many areas of Mexico lacking a modern telecommunications infrastructure. See id. at 17. Cellular telephones have become very popular since their 1989 introduction to the Mexican market. Cellular, supra note 16, at 1, available in LATATELE database, 1993 WL 2690858. The estimated 500,000 customers in the country are expected to almost double each year. Id.

Furthermore, the earnings from sales to support Mexican infrastructure development, combined with NAFTA's reforms, will secure U.S. preeminence as a supplier of equipment. Id. See also Interview, LATIN AM. TELECOM REP., Jan. 1, 1994, available in LATATELE database, 1994 WL 2408711 (discussing with Motorola's head of Latin American Operations,
dividing cellular service into nine regions in which Telcel, a subsidiary of Telmex, competes with another local company. Although Telmex, thanks to its government authorized duopoly, remains the dominant cellular service company, other providers are making inroads. U.S. companies also stand to earn strong returns from supplying cellular equipment and services for the industry.

This combination of necessity, opportunity, and the proper government response has made Mexico the leader in Latin American trade liberalization and privatization. The privatization of state-owned telecommunications providers manifests the revolution occurring in broader Mexican economic policy. As a first step, the turn to a more "pragmatic" and "active" but "streamlined" government is of great significance to investors. The NAFTA represents the next phase of this process.

James J. Daley, the inability of local telephone companies to provide basic quality service to rapidly expanding economies in desperate need of telecommunications, and the viability of cellular as an option to "landline" service. Daley maintains that Mexico, with the help of NAFTA, is the most encouraging and dynamic cellular market in Latin America for Motorola. Cellular, supra note 16, at 1, available in LATATELE database, 1993 WL 2690858.

111See Update, supra note 99, at 16; An Interview with Raul Zorilla Costa, supra note 102, available in EEFSTR database, 1993 WL 2664317. "Regional service is currently provided by 10 companies: Baja Celular Mexicana, Celular de Telefonia, Comunicacion Celular de Occidente, Sistemas Telefonicos, Telecomunicaciones del Golfo, Portatel del Sureste, Iusacell, Movitel del Noroeste, and Telefonia Celular del Norte and Telcel, the only company that offers nation-wide service." Cellular, supra note 16, available in LATATELE database, 1993 WL 2690858.

112Telmex clearly remains the industry leader, holding approximately 50% of the cellular market through its subsidiary Telcel. Update, supra note 99, at 16. However, further market growth has dwindled, as Telmex faces stiff competition from, among others, Iusacell, a powerful private alliance of a Mexican company and Bell Atlantic Corporation. See Market Trends, TELECOM REP., Nov. 1, 1993, available in LATATELE database, 1993 WL 2690809.

113U.S. firms are represented in six of the nine cellular zones. Motorola, McCaw, Contel, General Cellular, and others are poised to take advantage if Telmex stumbles. See Update, supra note 99, at 16.


115See CARVOUNIS & CARVOUNIS, supra note 45, at 99. On nearly all economic fronts, Mexico has moved away from attempting to actively manage its economy under direct governmental control. Mexico's efforts to privatize its industry is just the most visible incarnation of this trend. In the period spanning 1983 to 1990, the number of entities owned by the government has decreased from 1155 to a mere 350. Id.
B. The NAFTA Liberalization

Although the NAFTA’s provisions do not cover the operation and provision of telecommunications networks, such as basic voice service, they do address the subject of access to public telecommunication transport networks and services. Under the NAFTA, both public networks, public services, and information must be made readily available. The NAFTA also includes provisions requiring disclosure of information absent the organization’s setting the standards for such use; the conditions for the attachment of terminals or other equipment to telecommunications networks; and notification, permit, registration, and licensing requirements.

Moreover, the NAFTA creates procedural safeguards for companies entering the Mexican telecommunications market. Access to networks and services must be provided on reasonable and non-discriminatory terms for firms using the networks for "the conduct of their business." To this end, the NAFTA signatories may impose limitations on the reasonable conditions of access. These conditions restrain access and use under certain narrowly delineated circumstances, mostly associated with concerns about safety and technical efficiency.

127 NAFTA, supra note 1, art. 1301(3)(a)-(b), (d), 32 I.L.M. at 653-54.
128 Id., art. 1302, 32 I.L.M. at 654.
129 Id., arts. 1302, 1306, 32 I.L.M. at 654-56. Tariffs and other terms and conditions of service as well as specifications of network and service technical interfaces are among the required information. Id., art. 1306(a)-(b), 32 I.L.M. at 655.
130 Id., art. 1306(c), 32 I.L.M. at 655.
131 NAFTA, supra note 1, art. 1306(d), 32 I.L.M. at 656.
132 Id., art. 1306(e), 32 I.L.M. at 656.
133 Id., art. 1302, 32 I.L.M. at 654. As defined by the NAFTA, reasonable conditions of access and use include the following: the entity interested in the use of the networks and services must be able to lease or buy private lines; attach equipment, such as terminals, to the networks; interconnect private circuits to public networks; perform switching, signaling, and processing functions; and finally, accommodate the user’s choice of operating protocols. Id., art. 1302(2)(a)-(b), 32 I.L.M. at 654.

Under NAFTA, rates for public telecommunications transport services must be a product of actual economic costs. Id., art. 1302(3)(a), 32 I.L.M. at 654. Moreover, private leased circuits must be accessible on a flat-rate pricing structure. Id., art. 1302(3)(b), 32 I.L.M. at 654; HUFBAUER & SCHOTT, ASSESSMENT, supra note 95, at 74 (citations omitted). Prior to NAFTA’s passage, leased circuits were priced based on average usage of a switched circuit instead of the cost of providing the service. Id. at 74 n.71. At the same time, however, NAFTA does not prohibit cross-subsidization among different public telecommunications transport services in NAFTA countries. NAFTA, supra note 1, art. 1302(3), 32 I.L.M. at 654. Further, public networks are available to relay information on a domestic level and internationally among the NAFTA countries. Id., art. 1302(4), 32 I.L.M. at 654.

134 Specifically, these conditions aim to safeguard the public service responsibilities of
The NAFTA also encourages investment and trade in enhanced or value added services.135 Enhanced or value added services are those that use various forms of computer processing applications,136 such as "electronic mail, on-line information and data base retrieval, electronic data interchange, store and forward facsimile services, and alarm services."137 Expanded access to and use of these products has the potential to benefit cross-border trade in this area.138

Under the NAFTA, government authorization to employ enhanced or value-added services, such as that required to obtain licenses for enhanced or value added telecommunications services, must be "transparent," "non-discriminatory," and supplied "expeditiously."139 Enhanced providers are not subject to the same requirements that public networks and services endure. These providers need not furnish services to the public generally140 or obtain approval of their rates.141

There are areas, however, in which liberalization of the telecommunications sector is limited. Notably, the NAFTA does not compel signatories to authorize foreign owned operation or provision of telecommunications transport networks or services.142 Countries also may prohibit private network operators from providing public networks and services.143 Finally, existing regulatory constraints on ownership of radio

135Id., art. 1302(5)-(6), 32 I.L.M. at 654. Possible restrictions include those on the resale or shared use of public telecommunications transport services, limitations on the interconnection of private circuits to provide public networks or services, and mandatory use of specified technical interfaces with public networks or services. Id., art. 1302(7), 32 I.L.M. at 654.

136Id., art. 1301(3)(c), 32 I.L.M. at 654; see also HUFBAUER & SCHOTT, ASSESSMENT, supra note 95, at 74.

137Id.

138HUFBAUER & SCHOTT, ASSESSMENT, supra note 95, at 74 n.69.


140Id., art. 1301(2), 32 I.L.M. at 653.

141Id., art. 1303(1)(a), 32 I.L.M. at 653.

142Id., art. 1303(2)(a), 32 I.L.M. at 654. Unlike providers of enhanced services, providers of telecommunication networks and services must provide their services to the public. Id., art. 1302(1), 32 I.L.M. at 654.

143Id., art. 1303(2)(b), 32 I.L.M. at 654; id., art. 1302(1), 32 I.L.M. at 654. Providers of public telecommunications transport networks and services are subject to rate limitations. See id., art. 1303(3), 32 I.L.M. at 654.

144Id., art. 1301(3)(a)-(b), (d), 32 I.L.M. at 653-54.

145NAFTA, supra note 1, art. 1301(3)(e), 32 I.L.M. at 653-54.
and television stations also may, at the election of the signatory countries, remain undisturbed. Notwithstanding these constraints, the NAFTA provides that member countries will continue to discuss reforms with the aim of liberalizing every aspect of the telecommunications industry.

Although the Mexican government has reserved authority to control the operation and provisions of public telecommunications networks and services, it appears so far to have conservatively exercised these powers. Moreover, other aspects of Mexican policy have evidenced the country’s desire to continue trade liberalization. The fact that Telmex’s monopoly is limited and expires in 1996 indicates the government’s stance in this area. Thus, despite the NAFTA’s exclusion of basic voice service, the treaty continues the vitalization of the Mexican telecommunications market that began when Mexico, of its own accord, took the first tentative steps to signal its new receptiveness to foreign investment.

Even treaty provisions which appear to be very protective, such as the NAFTA’s acceptance of some monopolies in certain areas, are tempered in scope and effect. The NAFTA recognizes that a country may monopolize or designate a monopoly provider of public networks or services. Nevertheless, it also requires the country to safeguard against the abuse of that monopoly power. Potential abuses include, but are not limited to, engaging in anticompetitive conduct adversely affecting

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144 Id., art. 1301(2), 32 I.L.M. at 653.
145 Id., art. 1309(2), 32 I.L.M. at 656.
146 Id., art. 1301(3)(a)-(d), 32 I.L.M. at 654-66.
147 In fact, in 1993 President Salinas proposed a bill that would allow foreign companies headquartered in Mexico to be considered native companies, thereby circumventing the foreign ownership restrictions on any remaining protected industries. See New Nationality, LATINFINANCE, May 1993, at 11.
148 See HUFFBAUER & SCHOTT, ASSESSMENT, supra note 95, at 74.
149 Long before the NAFTA was a reality, the Salinas administration began the privatization of Telmex and eliminated some import restrictions in the telecommunications sector. See Luxner, NAFTA Fuels, supra note 100, at 1. These moves, however, were not completely without outside prodding. Even before the advent of the current Mexican administration’s reforms, the U.S. government had pressed for a Mexican initiative. During the Bush administration, the U.S. government had sought privatization of telecommunications utilities in many countries. See Deregulation, supra note 97, at 547.

The U.S. effort, lead by current Trade Representative Michael Kantor, has continued to push for open global telecommunications markets. Recent efforts in this area include the NAFTA, the General Agreement on Tariffs and Trade (GATT), and trade talks with Japan. See U.S. Trade Rep Argues for Trade Initiatives, GLOBAL TELECOM REP., Aug. 9, 1993, available in OTECOMR database, 1993 WL 2679918. Consistent with the U.S. position as a leader in the telecommunications industry, Trade Representative Kantor has indicated that the main goal of these efforts from a U.S. perspective is to secure market access. Id.
150 See NAFTA, supra note 1, art. 1305, 32 I.L.M. at 655.
entities of another NAFTA member in market segment not sheltered by the government’s monopoly.\textsuperscript{151} In telecommunications, this restriction bars a company such as Telmex from misusing its monopoly privilege through cross-subsidization or restricted access to public networks.\textsuperscript{152}

The treaty also calls for the prompt elimination of tariff barriers in the telecommunications industry.\textsuperscript{153} Before the passage of the NAFTA, Mexico limited foreign investment in designated enhanced-value firms\textsuperscript{154} to a forty-nine percent equity interest.\textsuperscript{155} The NAFTA abolishes foreign investment constraints and "local presence" criteria.\textsuperscript{156} In addition, NAFTA entities engaged in cross-border services, which include telecommunications services, shall receive the better of most-favored-nation status or national treatment.\textsuperscript{157} Furthermore, many telecommunication product tariffs are eliminated by the treaty. Among the tariffs initially to be repealed are those burdening private branch exchanges, cellular systems, satellite transmission and earth station equipment, and fiber optic systems.\textsuperscript{158} The remaining tariffs are

\textsuperscript{151}Id., art. 1305(1), 32 I.L.M. at 655. The text relates that "[s]uch conduct may include cross-subsidization, predatory conduct and the discriminatory provision of access to public telecommunications transport networks or services." \textit{Id.} Although NAFTA addresses the problem of anticompetitive conduct, Mexico has extended its efforts beyond those required by the treaty. President Salinas, in reply to U.S. apprehensions about monopolies, pushed for an economic competition law comparable to European and American laws. In addition, to enforce this law, the Salinas administration created a fair trade and anti-monopoly agency, the Commission on Economic Competition. \textit{Business Briefs — Country by Country}, E. EUR. & FORMER SOVIET TELECOM REP., Oct. 15, 1993, available in EEFSTR database, 1993 WL 2664320; see also \textit{Mexico: Competition Prevails}, BUS. LATIN AM., July 25, 1994, available in BUS-INTL database (noting that Mexico’s anti-monopoly commission has not shied from confronting some of the most powerful state owned or controlled monopolies). Once again, however, Telmex retains its privileged status and is exempt from these particular reforms. \textit{Business Briefs — Country by Country}, supra, available in EEFSTR database, 1993 WL 2664320.

\textsuperscript{152}HUFBAUER & SCHOTT, ASSESSMENT, supra note 95, at 75.

\textsuperscript{153}Id.

\textsuperscript{154}See supra notes 135-37 and accompanying text for a definition of enhanced value services.

\textsuperscript{155}HUFBAUER & SCHOTT, ASSESSMENT, supra note 95, at 75.

\textsuperscript{156}Id. Constraints on videotext and enhanced packet switched data services were to be removed by July 1995. \textit{Id.} Nevertheless, Mexico does have the option to continue investment constraints in entities engaged in the provision of telecommunications transport networks, basic and long distance telephone services, and telecommunications services. NAFTA, supra note 1, Annex II, Mexico, 32 I.L.M. at 752.

\textsuperscript{157}NAFTA, supra note 1, art. 1202-1204, 32 I.L.M. at 649. In effect, parties are required to provide the same treatment given to their own investors or that treatment afforded to other countries, whichever is better.

\textsuperscript{158}HUFBAUER & SCHOTT, ASSESSMENT, supra note 95, at 75. U.S. and Canadian companies will immediately benefit from NAFTA’s reduction of over 80% of all tariffs on
scheduled to be incrementally eliminated within five years after the passage of the NAFTA.\textsuperscript{159}

III. POST-NAFTA U.S. AND MEXICAN DEVELOPMENT

The combination of greater access to networks, easing of restrictions on the provision of enhanced and value added services, and general trade and investment reforms portends a significant increase in cross-border trade in telecommunications equipment.\textsuperscript{160} The recent gains in the voice communications market have been accompanied by increases in other lines of commercial communication including faxes, bank transfers, and authorization of credit cards.\textsuperscript{161} All of these services significantly rely on telecommunications equipment.\textsuperscript{162}

In Mexico, the demand for telecommunications equipment continues to grow, amassing a market totaling $790 million in 1991.\textsuperscript{163} Telmex remains the largest customer.\textsuperscript{164} Further, Telmex underestimated telecommunications equipment. \textit{Special Report - NAFTA Telecom, supra note 97, available in LATATELE database, 1993 WL 2690859}. Cellular phones, line equipment, telecommunications part exports, and PBXs are included in the first phase of the tariff reductions. \textit{Id.} Approximately 70\% of all the products that Mexico exports to the U.S. are affected and approximately 40\% of the products that Mexico imports from Canada and the United States are affected. \textit{NAFTA May Produce $6-Billion Annual Telecommunications Market in Mexico, COMMUNICATIONS DAILY, Nov. 19, 1993, available in COMMD database, 1993 WL 2627270.}

\textsuperscript{159}HUFBAUER \& SCHOTT, ASSESSMENT, supra note 95, at 75. The tariffs will be phased-out on products including CO switches, radio transmitters, and radio receivers. \textit{Special Report - NAFTA Telecom, supra note 97, available in COMMD database, 1993 WL 2690859.}

\textsuperscript{160}HUFBAUER \& SCHOTT, ASSESSMENT, supra note 95, at 74. Mexico has awarded AT&T a $130 million contract to connect 54 cities with fiber optics and a $29 million contract for switching systems. \textit{NAFTA May Produce $6-Billion, supra note 158, available in COMMD database, 1993 WL 2627270.}

\textit{AT&T, among other U.S. companies, can compete for the Telmex market with prices reflective of the market, free from encumbering tariffs. Eby, supra note 16, at 17. NAFTA allows U.S. companies access to the Mexican government procurement market and state-owned companies. Id.}

\textsuperscript{161}Luxner, \textit{NAFTA Fuels, supra note 100, at 2.}

\textsuperscript{162}See id.

\textsuperscript{163}HUFBAUER \& SCHOTT, ASSESSMENT, supra note 95, at 76.

\textsuperscript{164}Id. For example, projections placed Telmex’s expenditures at $8 billion for the first stage of the complete overhaul of the Mexican phone system. \textit{See Update, supra note 99, at 18. The Mexican need for telecommunications equipment is illustrated by the 60\% of public telephones in Mexico City that are inoperable due to vandalism and neglect. See Mexico’s Payphone Market, LATIN AM. TELECOM REP., Jan. 15, 1995, available in LATATELE database, 1995 WL 8681923. To remedy the situation, each year for the next several years, Telmex is planning to add 30,000 vandal-proof phones at a per unit cost of $1000. Id.}

\textit{Mexico’s current five year plan, which expired at the end of 1995, called for total}
the modernization task and has had difficulty achieving its modernization goals within the confines of its original expenditure projections as a result. The process continues at a rapid pace, with 50,000 lines per day being added in 1993; nevertheless, requests for phone lines continue to outpace Telmex’s output. Predictions for demand, already formidable, also have increased. The U.S. Department of Commerce estimates that the $8 billion Mexican equipment and services market will continue to grow moderately in the near future. In addition, with cellular phones having become attractive alternatives to traditional systems, this market promises continued growth.

Expenditures of nearly $13 billion to upgrade the nation’s telecommunications infrastructure. See Bob O’Brien & Dolores Kazanjian, Teléfonos de Mexico: Initiatives to Upgrade the National Infrastructure; Latin American Perspectives, TELECOMMUNICATIONS, Dec. 1993, available in TRD & IND database. Central to the success of the modernization plan is an increase in both the number and quality of phone lines available:

Telmex installed 702,000 new lines in 1992, raising the number of lines in service to 6.5 million, with a goal of 9.4 million by 1994, an 80 percent growth over 1990. . . . The goal is to increase overall telephone density from 5 lines per 100 inhabitants to 8.6 by 1994. Telmex also plans to increase the total number of long-distance circuits to 77,000, to handle its rapidly expanding long-distance traffic, which is growing at 10 percent a year, and international traffic, primarily to the United States.

Id.

Given the immensity of Telmex’s slated expenditures, it is no surprise that Telmex currently accounts for approximately 70% of all Mexican telecommunications purchases. See Luxner, Telecom Field Day, supra note 100, at 16.

See An Interview with Raul Zorilla Cosio, supra note 102, available in EEFSTR database, 1993 WL 2664317. The middle region of Mexico, where the national demand level is concentrated, has especially presented a challenge to the company. Id.

Update, supra note 99, at 18.

Mexico has an estimated 6.5 million telephone lines installed or 7.7 lines for every 100 inhabitants. Id. at 15. Approximately one-half of the phone lines in the country are in Mexico City, Monterrey (Nuevo Leon), and Guadalajra (Jalisco). Id. Mexico will reach 11 lines for every 100 inhabitants by 1995 at its present growth rate of 13% per year. Id. This pace is still below the average industrialized country rate of 20 lines per 100 inhabitants and the U.S. rate of over 50 lines for every 100 people. Id.

Special Report - NAFTA Telecom, supra note 97. NAFTA creates a $6 trillion market with over 360 million consumers. Id. The increase in government procurement opportunities further expands the market for U.S. goods and services in the telecommunications field. Eby, supra note 16, at 17.

Already, Northern Telecom Limited has been awarded a $13 million telecommunications contract by Petroleos Mexicanos (PEMEX), the national oil company. Northern Telecom Limited, MEXICO BUS. MONTHLY, Mar. 1993, available in MXBUSM database, 1993 WL 2508268.

Cellular, supra note 16. "The Mexican market for cellular telecommunications equipment has expanded from $78.4 million in 1990 to $116.8 million in 1992, and it is expected to grow at a 40% annual rate over the next three years." Id.
Combined with the fact that Mexico has no principal equipment supplier, the increased investment and trade liberalization in Mexico promise opportunities for suppliers.\textsuperscript{170} The same reform process that drives the NAFTA also has resulted in active trading of fourteen percent of Telmex's stock on the New York Stock Exchange.\textsuperscript{171} The proceeds from these sales are intended to fund the estimated $7.7 billion required to improve Mexico's phone lines and switches.\textsuperscript{172}

The U.S. telecommunications industry has the most to gain from access to this market.\textsuperscript{173} The U.S. enhanced telecommunications sector is the world's largest and most competitive. In contrast, Mexico's market remains immature and receptive to new investment.\textsuperscript{174} Furthermore, the U.S. already holds the largest market share of the Mexican cellular market.\textsuperscript{175} The combined effects of the NAFTA's favorable treatment and the compatibility of American and Mexican equipment suggest that this supremacy will not falter.\textsuperscript{176}

Although the NAFTA is expected to speed the pace of reform and growth, the whole development program may still fall short of its goals. Mexico will most likely face difficulty accessing capital and obtaining assistance from both "management and technology resources."\textsuperscript{177} These hardships owe largely to Mexico's standing as a competitor with a number of other developing nations for a limited pool of investors and

\textsuperscript{170}Lynch, supra note 138, at 44-45.
\textsuperscript{171}Hufbauer & Schott, Issues and Recommendations, supra note 95, at 79. In August 1991, ADRs in Telmex equalled $8.9 billion of its $9.8 billion value. Id. at 81.
\textsuperscript{172}Id. at 79. While Telmex only expects a new line installation rate of less than 7.8% it anticipates an increase in line replacement upgrades of four times the one million completed in 1993. Business Briefs, supra note 151.

Furthering Telmex's ability to invest in equipment and services, Mexico has provided the company ample tax incentives and a reduced regulatory regime. Hufbauer & Schott, Assessment, supra note 95, at 76.

\textsuperscript{173}Substantial Market Opportunities in Telecommunications Await, Mexico Trade & L. Rep., June 1, 1993, at 17.

\textsuperscript{174}A numerical comparison between the Mexican and United States enhanced telecommunications industries proves almost staggering. Mexico's revenues of $130 million in 1987 are dwarfed by the over $90 billion the U.S. recorded in 1991. Id. The fact that the U.S. already has a $1.9 billion international trade surplus proves that the Mexican market is ripe. Id.

\textsuperscript{175}Cellular, supra note 16. No other country comes close to the size of U.S. interests in Mexico, as the following passage indicates: "As of last year [1992], U.S. manufacturers were faced with competition from Japan, which had 16.7% of the market share, Sweden, holding 10.3%, and Norway, holding 7.5%." Id.

\textsuperscript{176}Id.

\textsuperscript{177}See Decker & Townsend, supra note 14, at 34.
telecommunications experts.\textsuperscript{178} Operations will only pay for about half of the total expenditure needed in Latin America.\textsuperscript{179} To finance that expansion, more fully developed capital markets will be necessary.

International equity markets may not represent a viable option because market-makers seek liquidity that the Mexican market cannot yet offer.\textsuperscript{180} Many export credit agencies are willing to assist in the modernization efforts but this contribution alone is insufficient.\textsuperscript{181} In addition, predictions have warned of a restricted Mexican domestic commercial credit market, especially for small and medium sized banks.\textsuperscript{182} Both traditional forms of financing and more creative joint financing techniques may favor larger projects and allocate all the limited resources without addressing the needs of smaller businesses.

Smaller enterprises on both sides of the border, therefore, are essential instruments of development and growth. Small U.S.

\textsuperscript{178}\textit{Id.} at 36. One financial model has suggested that up to 150 developing countries will be pursuing some form of telecommunications modernization in the next decade. \textit{Id.} The authors of this study suggest that a large portion of the projected $47 billion worldwide cost will be incurred in Latin America. \textit{Id.} Approximately one-fourth of this amount will have to be financed by outside sources. \textit{Id.} at 34-36. Thus, for purveyors of telecommunications technology, it is most definitely a seller's market.

\textsuperscript{179}Irene Recio, \textit{Paying the Telephone Bill}, \textsc{LatinFinance}, Apr. 1992, at 20. In 1992 alone many developing countries' telecom operators, finding themselves facing the same shortfall as Telmex, had to raise $10 billion from international equity markets. \textit{Id.}

\textsuperscript{180}Decker & Townsend, \textit{supra} note 14, at 36. Additionally, predictions for the 1990s indicate that the world capital markets will be strained to meet the needs of the German reconstruction, the declining savings rate of Japan, and the demands of developing nations in Latin America, the Middle East, and the Socialist republics. Shanks et al., \textit{supra} note 106, at 39.

\textsuperscript{181}\textit{See A World of Possibilities}, \textsc{LatinFinance}, July 1993, at A18. These include The Export Development Corporation in Canada, the Export-Import Bank in the United States, the Export Credit and Guaranty Department in the U.K., and multilateral agencies such as the International Finance Corporation of the World Bank. \textit{Id.}

\textsuperscript{182}Mexico: \textit{Credit Crunch}, \textsc{LatinFinance}, May 1993, at 70. The feared credit crunch owed largely to high rates on Mexican bonds. This condition, at least in the short term, created the risk that many of Mexico's small- and medium-sized banks might not persevere until the NAFTA's effects reached them. \textit{Id.}

This apprehension was largely born out this past year when a combination of events produced the much-maligned Mexican Bailout. What appears to have been a product of an unwieldy current accounts deficit, an overvalued peso, political instability, and just plain growing pains lead to a crisis situation. By the time the Clinton administration bypassed Congress to authorize $20 billion in new loans for Mexico, the nation's currency reserves had slid to $3.5 billion. \textit{See John Greenwald, Don't Panic: Here Comes Bailout Bill, Time}, Feb. 13, 1995, at 34; \textit{see also} Moises Naim, \textit{Mexico's Larger Story}, \textsc{Foreign Policy}, Summer 1995, at 112.
telecommunications firms can serve niche markets and capitalize on the opportunities in the services and equipment markets. With the reforms that have opened Mexico to venture financing, Mexican firms will have access to such capital. The increase in popularity of cellular service demonstrates how niche market companies can, out of necessity, become fierce competitors with traditional line service providers. Additionally, rapid technological progress in the telecommunications industry and the development of new products and services will inevitably need financing.

IV. PROPOSAL AND CONCLUSION

If NAFTA's reforms are to replace the popular caricature of U.S.-Mexican relations with a structure that will permit Mexico to develop into a strong and economically stable U.S. trading partner, they must address Mexican development. Attaining this goal requires reaching the twin aims of creating a favorable investment environment for foreign venturers in the short term and encouraging Mexican entrepreneurs in the long term. To foster Mexican innovation and entrepreneurship, business will need technological assistance from more developed nations such as the U.S. The NAFTA technology transfer and standards provisions will inevitably foster the exchange of telecommunications expertise between foreign investors and Mexican firms. This is precisely the kind of expertise needed to create enterprises suitable for venture financing in Mexico.

For the present, Mexico has succeeded in promoting the interests of the foreign venture capitalists which are essential to the development of its telecommunications industry. In pursuit of this end, Mexico has reformed its foreign investment laws, through trilateral negotiation and unilateral action, to facilitate foreign venture capital investment. Although further economic reforms are necessary to broaden the economic impact of these changes, the financial foundation has been laid

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183 According to the U.S. Chamber of Commerce, 
"[f]or large U.S. companies, NAFTA would create new export and investment opportunities. U.S. service firms, including financial services, would gain increased on-site access to the fast-growing Mexican market. For small companies, NAFTA offers the chance to enter a small yet growing market at the ground floor. In the short term, small companies could service niche markets and see increased opportunities as Mexico's distribution system develops and consumer demand grows . . . " . . .

for both increases in traditional investments and small venture capital development. The initial impact of these reforms is to attract venture capital which may assist small business interests in the U.S. to meet demands of the new market created by the NAFTA. Therefore, U.S. interests reap an immediate benefit from NAFTA’s opening of the Mexican telecommunications market.

Eventually venture capital financing, under the NAFTA provisions which liberalize cross-border financial services, also has the potential to assist such telecommunications entrepreneurs in the Mexican market. The relationship between high-tech industries and venture capital, evident in the United States and other developed countries, should manifest itself in the Mexican telecommunications market. Thus, while Mexico immediately benefits by elevating its telecommunications industry and its overall business capabilities to global standards, in the future its domestic telecommunications entrepreneurs may be able to turn to venture capital for much needed financial assistance. Additionally, the fostering of a venture capital community with interests in Mexico will create a class of successful entrepreneurs willing to facilitate financing for additional new entrepreneurs in telecommunications and other business sectors.

From the outset of the NAFTA debate, small business interests were aware of the treaty’s ramifications. This foresight was evidenced by the presence of telecommunications firms among the small business concerns represented in a 1992 U.S. Small Business Administration trade mission to Mexico.184 Moreover, the growth of small business interests in the U.S. complements the Mexican development plan, which, until now, has focused on the larger infrastructure telecommunications network. Small business interests on both sides of the border may have much to gain from the venture capital financing that has traditionally assisted small business only in the United States.

Mexico also has positioned itself to join the leading edge of the telecommunications revolution. With the liberalization of its domestic market, home grown expertise should flourish. This knowledge base will, in turn, spur venture financing interest. While development will take time, the NAFTA and the FIL have created an investor friendly environment for venture capitalists.

Cultivating entrepreneurship is consistent with the economic reforms of the Madrid and Salinas administrations and extends economic development past basic infrastructure construction. Addressing the

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problems and potentials of growth companies prepares Mexico for the next stage of its economic evolution. Entrepreneurial development extends the promise of prosperity beyond the PRI\textsuperscript{185} and upper classes and rewards merit. As recent political and civil crisis in Mexico has demonstrated, the poor believe that the benefits of the new economic regime, despite its promises of prosperity for all Mexico, have been unfairly distributed.\textsuperscript{186} The recent financial crisis in Mexico is a reminder of the fragile nature of a developing economy,\textsuperscript{187} even one with great potential. A healthy Mexican entrepreneurial class will provide support for both political and financial stability, demonstrating to both Mexicans and foreign investors that free market reforms can succeed in Mexico and creating a sound economic climate eagerly hoped for by both foreign investors and all Mexicans.

\textsuperscript{185}The PRI is the Institutional Revolutionary Party presently headed by President Zedillo and has been the ruling party in Mexico for over 60 years.

\textsuperscript{186}See Anthony DePalma, \textit{After the Fall: 2 Faces of Mexico's Economy}, N.Y. Times, July 16, 1995, § 3, at 1.

\textsuperscript{187}See supra note 182.