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Legal and Economic Aspects of the North American Free Trade Agreement

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Regional economic integration is beneficial, not only for the countries within the region, but also for those outside of it. It has been the policy of the United States since World War II to convince the peoples of the world that peaceful competition within the framework of liberal trading regimes will produce far more wealth and prosperity than aggressive territorial expansion at the expense of less fortunate nations. This message has been favorably received in Western and Central Europe. France and Germany have taken the lead in establishing a European Common Market, now called the European Union. Despite occasional quarrels, mostly over European barriers to American agricultural products, the United States has consistently supported European efforts towards economic and social integration.

Until recently, the United States has been content to work for liberalization of trade and investment barriers in a global context within the framework of the General Agreement on Tariffs and Trade. For various reasons (some related to American frustration with the slow pace of GATT negotiations in the Uruguay Round), a decision was made to pursue the possibility of entering into bilateral or even regional trading arrangements. NAFTA, the North American Free Trade Agreement, is the product of these trade policy overtures.[1]

NAFTA joins together Canada, the United States and Mexico to create one of the largest and richest markets in the world with 380 million consumers and an annual output of amost $ 7 trillion in goods and services. Building upon and enlarging the 1988 Canada-United States Free Trade Agreement[2], NAFTA will phase out virtually all trade barriers between

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1 North American Free Trade Agreement Between the Government of the United States of America, the Government of Canada and the Government of the United Mexican States, entered into force on 1 January 1994, abridged version in 32 *International Legal Materials* 296 (1993) [hereafter NAFTA].

2 27 *International Legal Materials* 281 (1988).

the three countries over the next fifteen years.

As recent events have shown, the road to North American economic integration will require patience, perseverance and large amounts of money moving from North to South. The challenge which Mexico poses to Canada and the United States is not dissimilar to that posed to the more well-to-do countries of the European Union by certain of its less developed member states on the shores of the Mediterranean. It is also comparable to the task of qualifying the Visegrad countries of Central Europe (Poland, Hungary and the successor republics to Czechoslovakia) for full fledged membership in the European Union.

To be sure, significant differences exist between NAFTA and the Rome Treaties, as amended by the Single European Act and the Maastricht Treaty on European Union. For one thing, NAFTA envisages essentially a free trade area and not a customs union. Unlike the nations of the European Union, NAFTA countries share no common external tariff border. Each NAFTA member state applies its own customs regulations to trade with third countries. This means that, since Canada, the United States and Mexico are all members of the GATT (now the World Trade Organizaton), European Union countries, although not eligible for NAFTA tariff rates, are still entitled to most-favored-nation tariff treatment under the GATT.

Another point of difference between NAFTA and the European Union relates to the so-called "Four Freedoms" of Parts I-III of the Treaty of Rome (free movement of capital, services, goods and persons). Only the first three of these are mentioned in the NAFTA. Omitting guarantees for the free mobility of labor was no oversight. To be sure, Chapter Sixteen of the NAFTA does provide for the temporary entry of business persons on a reciprocal basis, but NAFTA otherwise leaves the thorny problem of unskilled migrant workers seeking to enter the local labor market of another member state untouched. From a U.S. perspective, a successful NAFTA would tend to reduce migration from Mexico. Increased trade should mean increased employment opportunities, also in Mexico. Logically, one could therefore expect a decrease in the number of destitute Mexicans illegally crossing the U.S. border in search of employment.

This is one of the more important goals which the United States hopes to obtain from NAFTA. In addition, NAFTA should raise the standard of living in Mexico. A prosperous Mexico may become a politically democratic and stable Mexico; an affluent Mexico also may be able to afford the money to clean up and to protect its environment; an economically thriving Mexico may want to improve its dismal human rights record, permitting its workers the right to organize and its journalists the right to publish critical commentary on the establishment; a wealthier Mexico could result in the creation of a middle class to serve as a check against the social, economic and political elitism which has plagued the country since the times of Iberian imperialism.

The NAFTA is thus more than just a legal and economic instrument. It has social, diplomatic and even geopolitical strategic significance. The border between Mexico and the United States runs for some 2,000 miles. It is the world's longest frontier between a developed and an undeveloped country. It separates not just two countries, two peoples who really know very little about each other, but two civil societies radically different in attitudes, values and modes of conduct. There are probably no two geographically contiguous countries in the world that pose so great a cultural contrast as do Mexico and the United States. Not only language, ethnicity, social structure, economic development, wealth distribution, standard of living, but the prevailing political and legal culture, largely determined by historical experience - all represent significant points of departure. Since NAFTA will not be implemented in a vacuum, all these factors are relevant in assessing its chances of success.

In the United States (and for that matter, also in Canada), legislation, administrative regulations and judicial decisions are taken seriously. *Gesetz ist Gesetz.* In Mexico, law is marginalized in favor of informal arrangements consisting largely of a network of personal and family relationships. These relationships shade imperceptibly into corruption. It has been said that corruption is so deeply embedded in Mexican public life that the legal system would probably not survive without it. The Mexican judiciary is not independent. In the annual reports which the U.S. State Department is required by statute to submit to Congress concerning the condition of human rights in virtually every country in the world, Mexico

consistently earns poor grades. Despite some recent changes on the local scene, national political power remains firmly in the hands of the *Partido Revolucionario Institucional* (PRI), the same group that has governed Mexico for over 60 years.

These assymetrics constitute the environment in which NAFTA will be implemented. The Agreement itself contains over 2,000 pages of text, plus 3 volumes of tariff schedules, plus 2 Supplemental Agreements, one on "labor cooperation", the other on "environmental cooperation". In order to keep my presentation within time limits, careful selection will be necessary. Attention will therefore be given to those aspects of the Agreement which arguably hold the greatest interest to a European audience, especially one concerned with supranational economic integration.

Trade in Goods. Consistent with Article XXIV of the General Agreement on Tariffs and Trade, the NAFTA establishes a free trade area between its member countries. The Agreement will remove all tariffs between the three countries under several timetables, depending on the economic sensitivity of the product. About half of all Mexican tariffs were eliminated the day the NAFTA took effect. Almost all of the rest will be eliminated in five or ten years, with equal annual reductions. Tariffs on a very few highly sensitive products (such as corn, beans and raw sugar) will be phased out over 15 years.[3]

Consistent with Article III of the General Agreement on Tariffs and Trade, NAFTA provides that each Party shall accord national treatment to the goods of another Party. National treatment by a political subdivision of a Party (such as a State of the United States or a Province of Canada) is defined to mean treatment no less favorable than that afforded by the Party of which it forms a part.[4]

Trade in Cross-Border Services. Chapter Twelve of NAFTA generally eliminates barriers to cross-border trade in services. Member states are required to accord national treatment or most favored nation treatment to

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3 NAFTA, Annex 302.2.

4 NAFTA, Article 301.

service providers.[5] This measure will be welcomed by a host of professionals such as accountants, architects, attorneys, bankers and civil engineers. The Agreement also recognizes the existence of a professional known as a "foreign legal consultant".[6] Such a person, a national of another Party, is permitted to practice or advise on the law of the country in which that person is authorized to practice as a lawyer. Mexico, in Annex VI, conditions the right of a Canadian or U.S. lawyer to offer foreign legal consultancy services in Mexico on reciprocity.[7] This makes sense because each State of the United States has its own rules governing the practice of law. Those States which recognize the right of a "foreign legal consultant" to practice within their jurisdiction are listed on the Schedule of United States in Annex VI.[8] A U.S. lawyer from a State not so listed could be denied the opportunity to offer foreign legal consultancy services in Mexico.

Financial Services. Chapter Fourteen pertains to financial services, not only as an incident to cross-border transactions, but also as an integral part of the domestic economy. Financial institutions desiring to offer a full range of financial services (accepting deposits, making loans, etc.) are accorded national treatment and most-favored-nation treatment in the establishment of such an operation.[9] The financial institution making the investment is free to choose whatever juridical form (a subsidiary or a branch) best suits its needs.[10] After a transitional period, these provisions will open up Mexico to U.S. and Canadian banks;[11] they will also serve Mexico's interests in facilitating the flow of foreign investment into all branches of the Mexican economy.

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5 *Id.*, Articles 1202, 1203 and 1204.

6 *Id.*, Annex 1210.5, Section B.

7 *Id.*, volume 2, p. VI-M-2.

8 *Id.*, p. VI-U-2,3.

9 *Id.*, Articles 1405 and 1406.

10 *Id.*, Article 1403.

11 *Id.*, Article 1404; Annex VII Schedule of Mexico, Section B. The transitional period is intended to give Mexican institutions time to adjust to enhanced competition.

By eliminating barriers to trade in goods and services, NAFTA encourages its member states to more efficiently employ the productive forces at their disposal. This is the theory of comparative advantage. The idea is that the welfare of all will be maximized when, through specialization and economies of scale, inefficient external costs are eliminated.

Rules of Origin. Since a free trade area allows each member to maintain its own external customs duties against non-member countries, it is of critical importance to be able to distinguish an originating good from one which originates from outside the area. Such differentiation is necessary in order to avoid the problem of transshipment of imported items from the low tariff to the high tariff member of the free trade area. Rules of origin determine what constitutes an essentially free trade area product which is eligible for duty free treatment within the area.[12] Generally, rules of origin seek to assign origin to the country where the last significant economic activity took place. The United States uses a substantial transformation test: has a process been done which results in a new article with a distinctive name, character or use?[13]

NAFTA's rules of origin are somewhat complicated.[14] To qualify as North American origin, and thus be entitled to the new beneficial tariff rates, products must (1) be of fully North American content, that is, their labor and materials content must have come entirely from Canada, the United States or Mexico; or (2) if the product contains components imported from elsewhere, it has been sufficiently transformed within the NAFTA region so as to undergo a change in tariff classification.[15] In

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12 Rules of origin may also exclude products which are merely assembled, packaged or diluted with water after having been imported from a third country.

13 The 1991 Europe Agreements of the European Community with Poland, Hungary and the CSFR contain a similar rule of origin test, requiring that the transforming process should result in a product which is classified for customs purposes "in a heading which is different from that in which all the non-originating materials used in its manufacture are classified". See Protocol 4 of the Interim Agreement between the EEC and Poland on Trade and Trade-Related Matters, *Official Journal of the European Communities*, L 114/1992 of 30 April 1992. Compare NAFTA, Article 401.

14 See Chapter Four of the Agreement.

15 NAFTA, Article 401.

addition, local content rules apply to many manufactured items, such as automobiles and light trucks.[16] These, as well as the engines and transmission for such vehicles, will have to contain 62.5 percent North American content (parts or labor added in North America) in order to qualify for NAFTA's preferential tariff treatment.[17]

The purpose of these liberalization measures is to eventually create a single North American automobile market. NAFTA thus continues a process that began with the 1966 U.S.-Canada Automotive Parts Agreement[18] and was expanded by the 1988 Canada-United States Free Trade Agreement.[19] Investment should be rationalized and economies of scale improved. In time, the global competitiveness of NAFTA-based automobile companies should be enhanced.

Compatibility of NAFTA with Other International Agreements, especially the General Agreement on Tariffs and Trade. At first blush, an international agreement that does not extend agreed-upon tariff reductions to third countries seems to violate the principles of non-discrimination contained in the most-favored-nation clause of the GATT.[20] But sometimes rules have exceptions. Article XXIV of the GATT permits trade discrimination within the framework of a free trade area or a common market. Free trade areas that involve "substantially all the trade" between the member states are permitted by GATT, so long as "the duties and other regulations of commerce" of the free trade area countries are "not ... higher or more restrictive than" they were before the free trade area was established. The NAFTA easily passes this test. It covers "substantially all trade" between its member states, and non-

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16 *Id.*, Article 402 provides that the regional value content shall be calculated on the basis of either the transaction value method or the net cost method.

17 This means that if Japanese or German cars contain 38 % non-NAFTA parts they will be assessed customs duties at GATT MFN rates.

18 Agreement concerning Automotive Products between the Government of Canda and the Government of the United States of America, entered into force on 16 September 1966, 17 UST 1372, TIAS no. 6093.

19 *Op.cit.*, supra, footnote 2.

20 GATT, Article 1.

originating goods imported into the NAFTA region are still entitled to MFN tariff treatment. By their very nature, free trade areas and common markets discriminate against outsiders. Their saving grace is the hope that the trade which they divert will be more than compensated for by the trade they promote.

Will NAFTA produce some distortions in the flow of international trade and investment? The potential for such diversion is certainly present. A 62½ % local content rule could be a trade barrier. Some exporters will successfully adjust to the requirement; others will not. Those that do adjust may do so by investing (or by expanding an already existing investment) in a NAFTA country, most likely in low-wage Mexico. Such investment diversion (which may be Mexico's strongest reason for joining the NAFTA) could disadvantage other capital-importing countries, not only elsewhere in Latin America, but also in Eastern Europe.[21]

It is difficult to predict the future. Who could have predicted the ineptitude with which Mexican officials mismanaged the peso devaluation in December 1994? The inflationary spiral caused by thus bungled administrative measure wiped out 50 % of the value of foreign investments in Mexico. Alarms about the country's creditworthiness led to a massive exodus of capital, much of which had been speculative investment in equities or short-term deposits, rather than the foreign direct investment that tends to be less sensitive to money market fluctuations.[22]

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21 Roberto Salinas-León, "Free Trade and Free Markets: A Mexican Perspective on the NAFTA", in: Terry L. Anderson, *NAFTA and the Environment*, San Francisco: Pacific Research Institute for Public Policy, 1993, explains on pp. 20 and 21 that "[NAFTA] is less a trade accord than an investment strategy intended to generate resources [attract foreign investment capital] to finance new jobs." "... the NAFTA was crafted in Mexico to give the country an important advantage over other underdeveloped nations in generating an attractive investment climate. This is seen in Mexico as an all-important feature of the NAFTA." The same point is made by Rogelio Ramírez De la O, "The North American Free Trade Agreement from a Mexican Perspective", in: Steven Globerman and Michael Walter, *Assessing NAFTA: A Trinational Analysis*, Vancouver: The Fraser Institute, 1993, pp. 60-86 at 61-62.

22 "Under the volcano", *The Economist*, 7-13 January 1995, p. 14 notes that investors were also worried about "perceived changes in the country's political fragility". Taking economic and political factors into account, the Economist Intelligence Unit ranked Mexico the fifth credit-riskiest country (after Iraq, Russia, Nigeria and Venezuela) in what appears to be a fairly comprehensive survey. See *The Economist*, 13 May 1995, p. 120.

Thus, despite NAFTA, money has been leaving Mexico. The instability of the peso has also complicated the pricing of international trade transactions. At this point, no definitive conclusion can be reached on the issue of whether the wealth-creation effects of NAFTA will outweigh the diversionary aspects.

One thing can be said with certainty, however: with or without the NAFTA, an economically integrated North American market is an idea whose time has come. Years before NAFTA, U.S. corporations began investing, producing and trading in Mexico. Much of this activity was based on coproduction arrangements. Even now, more than half of Mexico's (and Canada's) manufactured exports to the United States are intrafirm.[23] Realistically, this private entrepreneurial activity has driven the politicians to the negotiation of the NAFTA. In this respect, NAFTA represents a formal recognition at public international law level of an inexorable process of private economic integration which was already taking place over a considerable period of time within and between multinational corporations.

In sum, NAFTA should be regarded as a supplement to, rather than a replacement of the GATT duties of the member states. Technical expressions and words of art (such as "goods of a Party"; "national treatment") are used in the NAFTA with reference to their meaning in the GATT.[24] Rights and duties under NAFTA are often expressed in relationship to relevant GATT provisions.[25] To be sure, in the event of a conflict between NAFTA and the GATT, the former shall prevail. But the spirit of NAFTA is perhaps best expressed in article 103, which provides that "The Parties affirm their existing rights and obligations with respect to each other under the General Agreement on Tariffs and Trade and other agreements to which such Parties are party."[26]

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23 Sidney Weintraub, "The North American Free Trade Agreement as Negotiated: a U.S. Perspective", in: Globerman and Walker, *op. cit.*, note 21, pp. 1-31 at p. 24.

24 See, for example, NAFTA Articles 201 and 301.

25 See NAFTA Articles 301, 317, 603, 704, 705, 802 and 903.

26 NAFTA, Article 104 and Annex 104.1. make reference to 5 international envi-

Compatibility of NAFTA with the Domestic Law of the Parties. Like no other international law issue in recent times, NAFTA unleashed a prolonged, animated grass-roots debate along a broad spectrum of U.S. society. The labor unions opposed NAFTA, fearing a loss of jobs to low-wage Mexico. The environmentalists argued that NAFTA would exempt imports from strict U.S. domestic laws protecting the public against carcinogenic food additives and similar health hazards. In a word, liberalized trade rules would result in a down-scaling of U.S. laws protecting the work place and the natural environment. This popular uproar, although largely unfounded, led to the conclusion of two "side agreements", one on labor, the other on the environment, which supplement and are an integral part of the NAFTA. These side agreements fulfill a promise which the politicians made to the American people, namely, that they would not support NAFTA without them, but the side agreements do not satisfy the demands of the NAFTA-objecting public, namely, that NAFTA be amended to establish within it institutions with authority to harmonize and to enforce in all member countries high standards of labor relations and environmental protection.

Under NAFTA and the side agreements, each member state maintains its own labor[27] and environmental laws,[28] and the right to enforce them, although such standards may not be used as a disguised non-tariff barrier to trade.[29] Each member state is free to modify its law pertaining to trade, investment, labor relations or environmental protection, but NAFTA requires that in some cases advance notification and consultation be afforded to the other Parties.[30] In no event may a member state legis-

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ronmental and conservation agreements which, should they conflict with NAFTA, shall prevail.

27 North American Agreement on Labor Cooperation [hereafter: side agreement on labor], articles 2 and 3.

28 NAFTA, Article 712.

29 *Id.*, Article 715.

30 *Id.*, Articles 414, 512, 718, 1022, 1803, 2006. In addition, Annex II, Reservations for Future Measures, gives each country the right to modify its obligations under the NAFTA in certain specific sectors, e.g. "Canada reserves the right to adopt or maintain any measure relating to residency requirements for the ownership by investors of another Partiy, or their investments, of oceanfront

late to create a private cause of action based on an alleged violation of either the labor or the environmental side agreements.[31]

Under the U.S. Constitution and the U.S. foreign relations law that pertains to it, the NAFTA is an international Congressional Executive Agreement. It was negotiated by the President under Congressionally authorized fast-track procedures, and was later approved by both houses of Congress. It does not create judicially enforceable rights for private parties. NAFTA proceedings and the documents generated therein are confidential and therefore not open and available to the public. If, during the course of domestic judicial or administrative proceedings, an issue concerning the interpretation or application of the Agreement should arise, NAFTA provides for a procedure whereby the Agreement's Free Trade Commission, after soliciting the views of all Parties, may submit an appropriate nonbinding interpretation to the domestic court or administrative body concerned.[32] The intervention of the Commission takes place pursuant to a request from the domestic court or administrative body, a procedure largely unknown in U.S. law, but which in certain respects may be compared to the preliminary question procedure in German law[33] and in European Union law.[34]

Dispute Settlement in NAFTA. The Agreement establishes an institutional framework for the resolution of disputes. Different types of disputes are handled differently. Chapter Twenty, which contains the *general* dispute resolution mechanism, creates the Free Trade Commission, comprised of cabinet-level representatives of the member states. If the disputing member state Parties are unable to agree upon a solution after consultation, which is the primary method of dispute settlement, any of the consulting

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land."

31 Side agreement on labor, article 43; North American Agreement on Environmental Cooperation [hereafter: environmental side agreement], Article 38; NAFTA, Article 2021.

32 NAFTA, Article 2020.

33 See Article 100 of the German Basic Law (*Vorlageverfahren: Konkretes Normenkontrollverfahren).*

34 Article 177 of the Rome Treaty (*Vorabentscheidungsverfahren).*

Parties may request a meeting of the Commission. The Commission may: (1) call on technical advisers or create working groups of experts; (2) have recourse to good offices, conciliation or mediation; or (3) make recommendations to resolve the dispute. If after 30 days the dispute is still unresolved, a five member binational arbitral panel is constituted.[35] The arbitral panel, composed of five individuals possessing appropriate professional credentials, conducts hearings, takes evidence, and issues an initial and final report evaluating the dispute. If the disputing Parties are still unable to resolve the matter, the complaining Party is entitled to suspend equivalent benefits to the other Party.[36]

NAFTA also contains *special* preceedures, similar to those employed in the Canadian - U.S. Free Trade Agreement, for settling disputes pertaining to dumping and subsidy cases.[37] Each Party applies its own antidumping law and countervailing duty law to goods imported from the territory of any other Party. In the United States, this is done by the International Trade Administration of the Department of Commerce (which determines whether imported goods are being dumped or subsidized) and the International Trade Commission (which determines whether such goods have caused material injury). Final antidumping or countervailing duty determinations are, with respect to goods imported from non-NAFTA countries, subject to judicial review before appropriate U.S. federal courts. NAFTA replaces judicial review with binational panel review. In its review, the five member panel, chosen by the disputing Parties from a roster of some 75 appropriately qualified citizens of Canada, the United States and Mexico, determines whether the administrative determination was made in accordance with the relevant law of the importing Party. In its decision the panel may (1) uphold the administrative determination; or (2) remand it for action not inconsistent with the panel's decision. The decision of the panel is binding. No judicial review of it is possible.

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35 NAFTA, Articles 2008-2011.

36 *Id.*, Article 2019.

37 *Id.*, Chapter Nineteen.

There is, however, an "Extraordinary Challenge Procedure."[38] If the decision of the panel has been tainted by the gross misconduct of one of its members, or if the panel manifestly exceeded its powers, the adversely affected Party may request the establishment of a three member "Extraordinary Challenge Committee."[39] This committee, composed of former or active federal judges of the Parties, examines the panel's decision and either affirms it or, if grounds for impropriety are found, vacates it and remands it for action not inconsistent with the Committee's decision. The decison taken by the "Extraordinary Challenge Committee" is binding on the Parties with respect to the issues determined.

It should be noted that, with just a few exceptions relating to health or environmental measures (where only NAFTA proceduces may be invoked), a member state Party is free to select either the NAFTA dispute settlement procedures or those of GATT. Once such a selection has been made, the forum selected has to be used to the exclusion of the other.[40]

Special arrangements are also envisaged for the settlement of disputes relating to *labor relations and the environment*. As noted above, NAFTA creates no central regional institution with supranational authority to promulgate regulations and directives to achieve the objectives of the Agreement.[41] No NAFTA institution can mandate harmonization of the Parties' laws. There is no NAFTA Court of Justice to interpret the Agreement. Each country maintains its own laws and its own institutional structure for amending and enforcing them. What the NAFTA does do is to obligate the Parties to "effectively enforce" the laws and regulations which they already have on the books.[42] This was the most that the member states, jealously safeguarding their own sovereign prerogatives, were willing to concede to each other.[43] A Party's "persistent pattern of

38 *Id.*, Article 1904 (13).

39 *Id.*, Annex 1904.13.

40 *Id.*, Article 2005 (6).

41 *Id.*, Articles 102 and 105.

42 Article 3 of both the environmental and the labor side agreements.

43 To be sure, NAFTA occasionally (as in article 2 of the environmental side agreement) recommends suggested improvements in the law of the parties, but

failure to effectively enforce its environmental law" entitles any other Party to invoke the consultation and dispute resolution procedures of the side agreement.[44] If, at the end of this procedure, which involves several steps including consultation between the concerned Parties, a special session of the Council[45], an initial and a final report by an arbitral panel, the concerned Parties cannot agree on the implementation of a mutually satisfactory action plan, a monetary assessment (not to exceed $ 20 million or .007 percent of trade) or, if this asssessment is not paid within 180 days, suspension of equivalent NAFTA trade benefits, is possible.

From the above it is clear that the institutional dispute settlement machinery provided by the NAFTA depends far more on cooperation than on compulsion. The Agreement in effect permits the Parties to accept the withdrawal of concessions if they choose to disregard the decisions of dispute settlement panels.[46] Sovereignty is thus preserved; the integrationist aspects of the Agreement go as far as politics permit. *Lex non intendit impossibile*. A more resolute settlement procedure is applied to *investment disputes*. Here, in this very sensitive area, the Parties have agreed that investment controversies between a Party and a private investor of another Party may be submitted to international arbitration under either the ICSID convention or the UNCITRAL Arbitration Rules.[47] This is a remarkable development, as are those provisions of the Agreement which

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these provisions are clearly hortatory and impose no obligation to approximate laws.

44 Part Five of the environmental side agreement. A similar procedure, which is not exposed in this article, is set forth in the side agreement on labor.

45 Part Three of the environmental side agreement establishes a new three country institution, the Commission for Environmental Cooperation, comprised of a Council, a Secretariat and a Joint Public Advisory Committee.

46 Frederick M. Abbott, "Integration Without Institutions", 40 *American Journal of Comparative Law* 917, 945 (1992) considers this feature a factor which may lead to "the slow disintegration of the union because it encourages the parties to gradually withdraw the trade concessions they initially grant."

47 NAFTA, Article 1120. The ICSID Convention (Convention on the Settlement of Investment Disputes between States and Nationals of other States, done at Washington, 18 March 1965); the UNCITRAL Arbitation Rules were approved by the U.N. General Assembly on 15 December 1976.

guarantee the investor the better of national treatment or most-favored-nation treatment[48], no restrictions on the transfer or repatriation of profits[49], and the prohibition of most performance requirements (such as the need for local content or export output).[50]

Such liberalization in the investment area is especially significant because for many decades Mexico pursued an isolation policy of national economic self-sufficiency. This was a reaction against perceived abuses associated with the extensive foreign investment which flowed into Mexico during the late nineteenth century. During the 35 years (1876-1910) when Mexico was ruled by General Porfirio Díaz, foreign investors, mostly Americans, owned and operated the natural resources (*patrimonio*) and the infrastructure that was necessary to transport them out of Mexico for refinement elsewhere. When the Revolution came (1910-1917), the holdings of the foreign investors were expropriated, generally without compensation. Fearful of its powerful neighbor to the North, Mexico intentionally reduced its economic dependence on international trade. It embraced a xenophobic development policy called import-substituting industrialization. High tariffs and severe restrictions on foreign investment encouraged domestic production of previously imported goods. Such protectionism worked well enough for a while[51], but Mexicanization in an increasingly interdependent global economy ultimately proved inadequate. In the 1980's Mexico's leaders, many of whom had studied in the United States, began to rethink the wisdom of their country's paranoic autarky.[52] Some dramatic changes were introduced. In 1986 Mexico signed on to the

48 NAFTA, Article 1104.

49 *Id.*, Article 1109.

50 *Id.*, Article 1106.

51 In the period from 1940 to 1975, the Mexican economy grew at a very impressive 6 % annual rate. See Tom Barry et al. *The Great Divide*, New York: Grove Press, 1994, p. 264.

52 Economic indicators in Mexico during the 1980's reached catastrophic proportions: the currency had been devalued by 90 %; the country was unable to pay the interest on its external debt, which stood at $ 120 billion; all banking assets had been nationalized; there were over 1,000 state-run enterprises; inflation had zoomed to 159 % by the end of 1987; the exchange rate dropped to 2,800 pesos to the dollar, precipitating a $ 80 billion flight in capital. See Roberto Salinas-León, *op.cit.*, footnote 19, pp. 13-26.

General Agreement on Tariffs and Trade.[53] Over the next few years Mexico adopted a series of liberalization measures that gradually opened up its markets to international trade and investment.[54] Ratification of NAFTA in 1992 furnished the most transparent proof of Mexico's emphatic abandonment of protectionism.

This capsule summary of recent Mexican history is necessary in order to evaluate the chances that NAFTA will be able to sucessfully integrate the economies of its three member states. Both Canada, and especially Mexico, have been traditionally wary of U.S. private entrepreneurial investments. NAFTA's policy of open investment purports to reverse decades of Mexican restrictions on foreign investment. This is a very welcome development, but the Agreement also contains reservations pertaining to certain politically sensitive Mexican industries such as energy[55], communications[56], maritime, land and air transportation, as well as agriculture, livestock, forestry and lumber activities.[57] NAFTA also recognizes the provision in Article 27 of Mexico's Constitution, which prohibits foreign nationals or foreign enterprises from owning real property in a 100-kilometer strip along the country's land borders or in a 50-kilometer strip along its maritime borders.[58]

Any Party desiring to expropriate the assets invested by another Party's national is obligated by NAFTA to carry out any such measure: "(a) for a

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53 The oil collapse made GATT membership critical in boosting Mexico's non-oil exports. See 2 *International Trade Reporter* 977, 7-30-86.

54 The legal aspects of this liberalization process are traced by Professor Jorge Vargas, "Conflict of Laws in Mexico", 28 *International Lawyer* 659 (1994); "Enforcement of Judgments in Mexico", 14 *Northwestern Journal of International Law and Business* 376 (1994); "Mexico's Foreign Investment Act of 1993", 16 *Loyola of Los Angeles International and Comparative Law Journal* 907 (1994).

55 NAFTA, annex 602.3 reserves to the Mexican State all exploration and exploitation of crude oil and natural gas, all refining and processing, and all production of artificial gas, and basic petrochemicals. See also Annex II, Schedule of Mexico.

56 *Id.*, Annex I, Schedule of Mexico.

57 *Id.*

58 *Id.*

public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and [international law]; and (d) on payment of [prompt, effective and fair market value] compensation".[59] As noted above, investment disputes may be submitted to an international arbitral tribunal, the final award of which is enforceable in the territory of the expropriating Party pursuant to the provisions of relevant international conventions.[60] Acceptance of these NAFTA provisions by Mexico constitutes not only a recognition of the official U.S. international law position on this issue, but also an abandonment by Mexico of policies which in the past it had vigorously supported in diplomatic and international institutional representation.

Conclusion. NAFTA contains much more than has been discussed in this paper. There are provisions in it relating to government procurement, telecommunications, financial services, competition policy, and intellectual property. In all these areas NAFTA is striving to dismantle artificial trade barriers. And the free trade area it establishes covers more than trade in goods. Investment, services and industrial property are all subject of its liberalizing provisions. A number of institutional arrangements for dispute settlement and law enforcement monitoring, especially in the fields of labor relations and environmental protection, may be a harbinger of greater things to come. As a vehicle for regional economic integration, NAFTA is a milestone on the long and arduous path toward market-based global economic growth.

A few sober words of caution may be appropriate, however, It is doubtlessly true that free trade tends to increase the wealth of all trading partners, but NAFTA is an experiment virtually without precedent in world economic history. Never before has a country with such enormous global power, supported by the most advanced technological and scientific base, atempted to integrate its economy with such a uniquely qualified developing country. NAFTA deserves study and observation because, if successful, it may offer a model for North-South integration elsewhere.

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59 NAFTA, Article 1110.

60 *Id.*, Article 1136.

As noted above, the free fall devaluation of the peso in December 1994 has had disastrous effects on the Mexican economy. NAFTA was supposed to stimulate investment in Mexico. Instead, capital, especially easily disposable portfolio investments, has fled in panic, causing consternation not only in Mexico, but in emerging market economies all over the world. NAFTA was supposed to stem illegal immigration from Mexico. Instead, increased unemployment in Mexico has precipitated a new wave of illegal border crossings into the United States.[61] The dismal economic situation in Mexico has dampened the enthusiasm of many of NAFTA's supporters. It will take years of consistent growth to lift Mexico's people out of poverty. NAFTA, together with the policies of liberalization, privatization, deregulation and open markets which it encourages, are Mexico's only hope for a kinder and gentler future.

61 "Immigration. Tucson or bust.", *The Economist*, 20 May 1995, p. 59.