MEXICO & NAFTA

(A Series of Articles Written in Early 2006)

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Maquiladoras are manufacturing facilities established in Mexico by U.S. corporations for the purpose of transforming imported materials ("inputs") into finished goods that are shipped back into the U.S. Established to stimulate foreign investment, create domestic jobs, encourage technology transfer, and spur exports, maquiladoras may import supplies on a duty-free basis on the proviso that the finished goods are then exported.

Prior to the adoption of Article 303 ("303") of the North American Free Trade Agreement ("NAFTA") in 2001, all production inputs regardless of origin were exempt from import duties. Now, however, only inputs originating from NAFTA-member countries (U.S., Mexico, and Canada) are eligible for exemption. Because items imported from elsewhere are assessed duties, finished products made from these inputs are more costly. In this manner, maquiladoras are encouraged to do business with North American suppliers whenever possible.

In a further attempt to regulate trade, certain producers may qualify for one of the available Sectoral Promotion Programs ("PROSEC") which apply preferential duty rates based upon a complex tariff classification system. While 303 sought to tie duty waivers on inputs to the requirement that the resulting manufactured goods be exported to the country of input origin, PROSEC now effectively severs that link, creating a bifurcated system that circumvents the spirit of 303.

Maquiladoras have suffered a decline in recent years, in part attributable to a fundamental change in U.S. demand for Mexican products and by the devaluation of the American dollar relative to the Mexican peso, as well as the implementation of 303 which made it more costly for firms to do business in Mexico. PROSEC was instituted in an attempt to offset this dilatory effect.

But PROSEC is administratively complex and in direct contravention to 303's intent which was to encourage Mexican producers to purchase supplies from fellow NAFTA-members. Instead, PROSEC offers its preferences based on product classifications irrespective of NAFTA membership. Time will tell whether these regulatory changes will help or hurt maquiladoras as U.S. firms may elect not to establish operations in Mexico.

Product standards are established by consensus and approved by a recognized professional, regulatory, or governmental body. They are used as a basis for commercial contracts, to preclude or settle disputes, to develop products, and to accelerate the use and transfer of technology. Where standards are uniform, businesses benefit from certainty. But such homogeny often does not transcend international borders. While trade partners could develop identical standards or accept each other's guidelines, the current lack of international cooperation continues to hamper trade.

Article 904 of NAFTA's Standards Related Measures agreement specifically grants the right to each contracting nation to adopt any measure that it deems appropriate to protect the health and safety of humans, animals and the environment, even if such measure may ultimately deter

another party's imports. And yet, no nation may "create an unnecessary obstacle to trade." But where a party can demonstrate a legitimate objective and can show that it is not excluding another party's goods prejudicially, its measures are deemed acceptable. Hence, parties could—at least in theory—adopt either higher or lower standards than those established by accepted international authorities.

Standard-making organizations, staffed by representatives from participating nations, seek to reconcile competing national measures and create uniform standards acceptable to all. However, member nations are not obligated to adopt these standards, although NAFTA does require each of its contracting parties establish a National Notification Authority (NNA) and a National Inquiry Point (NIP). NNAs must notify fellow NAFTA members of all proposed technical regulations and standards that deviate from international standards, while NIPs must respond to all reasonable inquiries and provide documentation to ensure transparency of standards-related measures.

Thus, while it is possible for standards to vary from country to country, it is not necessarily desirable. Global—or at least North American—standardization can serve to destroy trade impediments, whereas continued inconsistencies can lead to erratic enforcement, increased production costs, lack of innovation, technological obsolescence, and incompatibilities that discourage the purchase of foreign products.

NAFTA has encouraged the free flow of goods and services across international borders and thereby created demand for the multi-jurisdictional practice of law. Attorneys called upon by domestic and foreign clients to represent their interests, must comply with regulations imposed upon them by foreign countries which often present insurmountable obstacles.

New York was the first to license foreign attorneys as Foreign Legal Consultants (FLCs), although NAFTA and GATT later included similar provisions. Defined as an attorney, licensed in another country who has received a Certificate of Registration, an FLC may practice law in a limited manner in the host jurisdiction. Typically, the foreign-trained attorney must meet certain criteria, but need not re-enter the legal profession as a novice and attend a full academic curriculum.

However, FLCs may not always offer all services. California, for example, allows a Mexican registered as an FLC in California to practice Mexican law in California, but prohibits him from practicing California law. He may also not appear in any court or administrative proceeding, prepare any legal documentation transferring title of real property, or draft any wills and trust. Similar restrictions are imposed upon a California attorney licensed as an FLC in Mexico, although Mexico additionally requires that any FLC-owned law firm must be co-owned predominantly by Mexican attorneys.

To qualify as an FLC in California, the foreign applicant must have been admitted to practice in his home country for at least four of the most recent six years, be of good moral character, and agree to maintain an E & O insurance policy. Foreign applicants seeking FLC status in Mexico must apply to the Mexican Bureau of Professions which has not yet developed a transparent set of rules allowing U.S. attorneys to obtain FLC-licensing. Hence, no FLC licenses have yet been issued!

NAFTA specifically addresses issues related to the financial service sector in an attempt to open these markets to the trading partners. Although each partner committed to the Agreement, each also sought to protect its existing market by listing treaty exemptions in the General Annex VII.

Whereas Canada has a long history of stable banking operations, Mexico's financial service sector has been plagued by uncertainty as banks have on occasion been nationalized and re-privatized as recently as 1982 and 1990, respectively. Variously seeking to protect the domestic banking industry from foreign competition and prevent accumulation of financial power in the hands of private investors, Mexico succumbed to its need for foreign capital with the devaluation of the peso in 1994 and has since gradually opened its financial markets.

But Canada has remained more reluctant to open its markets in part because its banking system is well-established, heavily and effectively regulated, and because its banks may offer investment services that have historically been prohibited in the U.S. under the Glass-Steagall Act.

Unlike its NAFTA partners, the U.S. has granted access to its markets much more freely. In fact, the U.S. specifically offered a five-year grace period to allow Mexican bankers to transition to U.S. banking law and even granted an exception for Canadian government securities to be treated as bank-eligible securities.

U.S. and Canadian operators are allowed to establish wholly-owned subsidiaries in Mexico without the market share limitations that expired in 2000 and may even acquire Mexican banks as long as all board members reside in Mexico. Because local authorities hope to maintain regulatory control, cross-border banking must be done on a subsidiary basis, which means that the foreign bank must register in the host country, develop an internal infrastructure that is independent of the parent corporation, and meet local capitalization requirements.

Neither Mexico nor Canada permits the establishment of branch operations by foreign banks. On the other hand, the U.S. allows branching as long as the foreign institution is in compliance with the Foreign Bank Supervision Act of 1991.

Worried about regulatory or discriminatory practices instituted by host governments, investors are often leery of committing capital abroad. Chapter 11 of the NAFTA Agreement ("the Agreement") outlines the procedures designed to placate and protect investors of member nations who make foreign investments in Mexico, Canada, or the United States.

While most provisions of NAFTA allow member *nations* to file disputes against each other, Chapter 11 allows individual foreign *investors* to initiate the grievance process against host states. Petitioners are not required to exhaust other remedies prior to seeking arbitration under the Agreement, which may be substituted for domestic litigation in Canada and the U.S.

However, Mexico's Calvo Clause requires that foreign investors operating in Mexico be treated as Mexican nationals. As such, they must submit all disputes to the domestic system of jurisprudence. And once a claim has been adjudicated by the local courts, it may not again be submitted for international arbitration.

This restriction, of course, violates NAFTA's intentions to offer an international (and presumably impartial) venue to aggrieved investors. But because NAFTA has been incorporated into Mexican law, Mexican nationals cannot avail themselves of treaty benefits, and instead remain subject to national rather than international law.

Foreign investors treated as Mexican nationals would similarly be exempt from transnational arbitration. However, under the Mexican Law Concerning the Making of Treaties adopted in 1992, Mexico agreed to honor arbitral awards granted to foreign investors who have exercised their treaty rights.

Neither Canada nor the U.S. has incorporated NAFTA into domestic law. In the U.S., for example, treaties are generally not deemed self-executing, thus Congress must enact adoptive legislation. As a result, Mexicans investing abroad cannot avail themselves of domestic courts in the host country when pleading NAFTA violations since neither U.S. nor Canadian courts have the power to enforce treaty provisions.

Dumping involves the importation and sale of foreign-made goods at prices substantially below domestic prices for the same items. It is often used to gain a foothold in a foreign market or to reduce excess inventory at home. To protect against these predatory pricing practices, nations may impose tariffs upon foreign importers.

Remedial measures can only be imposed after a compliant has been filed and dumping has been found to have occurred. Thereafter, injuries—if any—can be determined and countervailing duties may be assessed. While the initial determination is made by each NAFTA member, unfavorable decisions may either be appealed domestically or to a bi-national panel ("the Panel") as established under the provisions of Annex 1901.2 of the NAFTA Agreement.

Complaints brought by Mexican nationals are initially heard by the Secretary of Economy (SECON) who must determine that an imported product was sold for less-than-fair-value (LTFV) and thereafter must also quantify the injury. While this unitary process has the benefit of efficiency, decisions may often be subject to political influence exercised upon this sole arbiter.

In contrast, the U.S. system takes a bifurcated approach where the LTFV determination is made by the International Trade Administration (ITA) of the Department of Commerce, and the injury assessment is made by the International Trade Commission (ITC) but only after the ITA has first established that an importer has engaged in unfair pricing practices. As a result, the American method is significantly more time-consuming and often causes an aggrieved party to suffer longer than he might have under the Mexican system.

On the other hand, the ITC is comprised of commissioners with significant administrative law experience who can render seasoned opinions based on precedent, which is not attributed much merit in Mexico. There, a legal issue must be litigated and decided consistently in five separate cases before it can be deemed to have any precedential value. So where bureaucratic duplication may hamper the process of settling trade disputes under the bifurcated approach, the need to continuously re-examine issues under the Mexican system may be equally inefficient.

Although the protection of labor rights was not directly incorporated into NAFTA, the issues were addressed in the North American Agreement on Labor Cooperation (NAALC) which was adopted as a supplement to the free trade agreement. This addendum represents a cooperative effort between Canada, Mexico, and the U.S. and is designed to protect domestic labor from foreign competition while simultaneously ensuring enhanced opportunities for cross-border and international employment.

Under the NAALC, each Party must establish a National Administrative Office (NAO) to serve as a point of contact between governments and with the Commission for Labor Cooperation (CLC) as established by the international agreement. Complaints regarding labor law violations may be filed with an NAO by any citizen or organization. Upon acceptance and review of the complaint, the NAO may recommend government review which in turn may lead to the formation of an international Evaluation Committee of Experts (ECE) if the matter is deemed to be trade-related.

While the NAALC vests considerable autonomy and authority with each Party by granting initial review of complaints to an NAO, this sovereignty also exposes the process to political influence and potential corruption. In the U.S., for example, the NAO is comprised of individuals who represent business, labor and academic interests, as well as the public at large. Intended to balance each other in the U.S., Mexico cannot proclaim similar neutrality since labor organizations have historically been entwined with the government.

Since the NAALC does not mandate standardized worker protection laws but merely demands that each Party enforce its own laws, NAOs cannot provide for uniform, standards. However, consolidation of complaint initiation with review by an international committee would streamline the process. Given that all NAFTA parties have greed to promote free trade, they have also implicitly agreed that the labor required to accomplish trade should be protected. With similar goals supported by the Parties, a tri-national committee can better understand domestic laws and offer effective enforcement.

Adopted shortly after NAFTA, the North American Agreement on Environmental Cooperation (NAAEC) was drafted as a side agreement to protect the environment from degradation due to increased cross-border trade. The NAAEC sought to establish an enforcement mechanism with which to investigate allegations of wrongdoing and arbitrate environmental disputes.

By creating the international Commission on Environmental Cooperation (CEC)—composed of administrators from each Party's environmental regulatory agency—and granting to it the authority to sanction violators, the NAAEC can coerce cooperation amongst the Parties.

The dispute resolution process begins with submission of a complaint from any non-governmental organization or person, who must petition the CEC Secretariat, which must evaluate the complaint to determine if it merits a response. Presuming that the complaint has been submitted in a proper form, the Secretariat may demand a response from the alleged violator and publish a factual record in hopes of influencing the Parties to adopt a mutually agreeable settlement. However, Article 14 does not provide for any binding resolution and does not endow the Secretariat with any authority to mandate compliance with environmental laws.

Article 14(3) provides an escape clause in that any Party may in a timely fashion advise the Secretariat that the matter is being or was handled in another forum and that private remedies

rather than NAFTA trade sanctions are available and have been pursued. If it can be established that the matter has been submitted and is subject to a pending judicial or administrative proceeding, the Secretariat must dismiss the submission to avoid duplication and potential conflict and may not develop a factual record on the issue.

Furthermore, the NAAEC seeks to encourage Parties to exhaust all available private remedies prior to availing themselves of the international resolution process. But ironically; while Article 14.2(c) requires any complainant to first pursue all available private remedies, he cannot do so if there is another proceeding underway.