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MEXICAN POLICY TOWARD FOREIGN INVESTMENT

by

Dwight S. Brothers

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MEXICAN POLICY TOWARD FOREIGN INVESTMENT[1]

by

Dwight S. Brothers

I

Mexican policy toward foreign investment has been a pacesetter throughout most of this century. It is on the restrictive side that the record of Mexican policy is particularly pertinent to other countries concerned about the degree of foreign ownership and control or dissatisfied with the sectoral concentration of foreign investment. This paper reviews the historical sequence of successive Mexican policies toward foreign investment and describes several recent episodes in the record of Mexican efforts to establish national control in sectors of the economy previously dominated by foreigners. Some attention is also given to the criteria currently governing attempts to regulate the amounts and types of new foreign investment. The underlying thesis is that other countries concerned to limit the scope afforded foreign investors in accordance with national economic priorities and political realities can learn from the successes and shortcomings of Mexican policy.

II

Historical Sequence

While the role of foreign investment has been of substantial

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[1]This paper draws heavily on a book in preparation tentatively titled "The Political Economy of Mexican Development: An Interpretation of Mexican Nationalism" (Dwight S. Brothers and Miguel S. Wionczek, co-authors).

importance throughout Mexico's history as an independent nation, it has undergone considerable changes from one stage to another in the country's economic and political development. During the first fifty years following achievement of independence in 1821 the attractiveness of Mexico to foreign investors was fairly limited as a result of the country's chaotic domestic and international political affairs. The investors were mainly British and the investments were largely confined to mining enterprises and related transport facilities. Following the establishment of the Porfirio Diaz dictatorship in 1876 a combination of favorable "climate" and attractive opportunities produced rapid expansion of foreign investment, with the result that the economy came to be largely dominated by foreigners. While the policy of heavy reliance on foreign investment was successful, judged on the basis of the criteria and objectives that motivated it, the activities of foreign companies and the behavior of resident aliens inevitably generated a nationalist reaction.

Discontent over the degree of foreign influence in the economic and political affairs of the country first became evident during the decade preceding the Revolution of 1910/11. Anti-foreign sentiment was stimulated by employment policies that discriminated against nationals, by refusal of foreign technicians and managers to accommodate to Mexican social customs and to adopt Spanish as the language of commerce, and by the degree of influence in the political and economic affairs of the country that foreign interests exercised. Furthermore, some political leaders and intellectuals apparently feared that the United States was

bent on absorption of Mexico through economic means. However, despite manifestations of suspicion and hostility toward foreigners during the final years of the Diaz regime, the volume of foreign investment continued to increase until the Revolution intervened.

By 1911 direct foreign investment is estimated to have totaled almost $1.5 billion, roughly 40% of which originated in the United States, 30% in Britain, and 20% in France. As shown in Table I, the major share was concentrated in railroads and mining ventures (about 40% and 30%, respectively), but substantial amounts were also invested in public services, real estate, financial and commercial enterprises, manufacturing facilities and petroleum properties. In addition, the external indebtedness of the government amounted to almost $250 million -- over half of which was owed to France. While these estimates are rough, it is evident that foreign capital had achieved an unprecedented position -- perhaps to the extent of accounting for two-thirds of total national investment outside the agriculture and handicraft sectors and of controlling as much as one-seventh of the country's land area. As Vernon has said, ". . . when Mexico's decade of revolution begins, foreigners had come to control so high a proportion of Mexico's wealth that the proportion may have set all-time records for any country claiming political independence."[1]

While there was ample evidence that foreign investment had made

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[1] Raymond Vernon, "An Interpretation of the Mexican View," in Raymond Vernon, editor, How Latin America Views the U. S. Investor, 1966, Page 98. Vernon's essay covers much of the same ground as this paper, but with a somewhat different emphasis.

TABLE I

Foreign Investment in Mexico in 1911

	Total	U.S.	Britain	France	Other
			(millions of dollars)		
Direct	1,451.4	616.5	453.4	290.3	91.2
Railroads	565.3	267.3	200.7	58.1	39.1
Mining	408.6	249.5	58.4	89.8	10.9
Public Services	118.9	6.7	105.8	5.0	1.3
Real Estate	97.2	40.7	45.5	8.0	3.0
Banks	82.9	17.2	8.8	50.0	7.0
Manufacturing	65.5	10.6	5.4	36.0	13.5
Commerce	61.1	4.5	.1	40.0	16.4
Petroleum	52.0	20.0	28.6	3.4	-
Indirect (Public Debt)	249.0	29.7	41.4	164.1	13.9
Total	1,700.4	646.2	494.7	454.3	105.1

Source: Luis Nicolau D'Olwer, "Las Inversiones Extranjeras," in Daniel Cosío Villegas (ed.), Historia Moderna de México, El Porfiriato, La Vida Económica (México, D. F.: Editorial Hermes, 1965), tables 65 + 66, pp. 1154 + 1155. (As reproduced in Harry K. Wright, Foreign Enterprise in Mexico: Laws and Policies, unpublished manuscript. The dollar figures were converted from pesos by Wright at the prevailing official exchange rate of 1 peso: $.50).

a major contribution to the economic development that occurred in Mexico during the thirty-four years of Diaz rule -- and that this earlier investment had generated much of the capital plant, technological capability, and entrepreneurial talent required for the development process initiated after the Revolution -- it was nevertheless difficult to find in post-Revolution Mexico political or intellectual leaders willing to admit the foreign contribution or to argue for continued heavy reliance on foreign investment. On the contrary, the prevalent belief was that foreigners had drained away the country's natural resources to the advantage of themselves and their home countries; that Mexican labor had been exploited in the process; and that the nation had gained little by way of permanent benefit while coming perilously close to permanent loss of economic and political control to foreign investors and their home country governments. The fact that Mexico remained largely dependent on exports of primary products and on imports of manufactures, together with the fact that the welfare of the vast majority of Mexicans had advanced little, if at all, was taken as evidence enough by the post-revolution generation of Mexican nationalists that the open door policy under Diaz had not served the national interest.

The Revolution was primarily a domestic political phenomenon, propelled by demand for agrarian reform and directed at large landowners both national and foreign. The concentration of agricultural land in huge <u>haciendas</u> that had occurred during the latter half of the nineteenth century was, for the most part, a case of disfranchisement of Mexicans by

Mexicans although, as already noted, title to a substantial amount of Mexican territory came to rest in the hands of non-resident owners. The rhetoric of the Revolution was not basically anti-foreign, and foreign enterprises were not singled out as objects for attack by any of the several contesting groupings in what was truly a civil war. Furthermore, one of the earliest official statements made by Madero as leader of the revolutionary regime proclaimed that obligations to foreign governments and foreign enterprises undertaken by the Diaz government would be honored.

An anti-foreign, and especially anti-American, orientation developed during the period of post-Revolution disorder after the United States became implicated in the internal power struggle (first through political meddling on the part of U. S. business interests and the American ambassador and subsequently by the military intervention ordered by Woodrow Wilson in 1914 that took 300 Mexican lives). Aspiring Mexican politicians were thus provided with a golden opportunity to bid for popular support on an anti-American platform, and Carranza astutely out-did the others by promising nullification of contracts and other agreements with American and other foreign investors.

It was against this background that the constitutional reform of 1917 was undertaken. On the economic side the main innovations introduced at that time related to the system of land tenure, the rights of labor, and the scope for foreign investment. Of particular importance to foreign investors was Article 27 which proclaimed that title to all

sub-soil mineral deposits resided in the state.[1] The clear implication was that exploitation of these minerals required as a prerequisite that operators were to negotiate concession agreements with the government. Also significant were the constitutional provisions that required foreigners holding titles to land or minerals to renounce recourse to the diplomatic protection of their home governments, that prohibited foreigners from owning land or mineral titles in border or coastal regions, and that conferred on the President the right to deport, without trial, any foreigner whose continued presence in the country was deemed not to be in the national interest.[2]

The foreign-owned petroleum companies were singled out for attack at the time of the constitutional reform and subsequently because of the favored legal status previously conferred on them, because of their political activities during and following the Revolution, and because they were the most dynamic vehicles for foreign investment. The companies had been little affected by the Revolution (their properties in the coastal regions around Tampico having been protected by private armies and by

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[1]This provision had particular pertinence to the foreign petroleum companies since, unlike traditional mining enterprises and contrary to a basic principle of Spanish property law, the companies did not have operating agreements with the government. This anomalous situation prevailed because in the mining code of 1884 and the petroleum law of 1901 it was provided that surface title carried with it ownership of sub-surface deposits of bituminous and other mineral fuels and non-metallic minerals. Thus, so long as the companies had valid land titles, they could produce petroleum without governmental authorization. Source: Harry K. Wright, Foreign Enterprise in Mexico: Laws and Policies, unpublished manuscript prepared under the auspices of The American Society for International Law (scheduled for publication by University of North Carolina Press in the fall of 1970).

[2]These provisions were contained in Article 27 and Article 33, respectively

warships provided by the United States and other major world powers); so that after a decade of rapid expansion between 1911 and 1921 Mexico had become the second largest oil-producing country accounting for about a quarter of the world's output.[1] Following adoption of the new constitution, tax exemptions granted under the Diaz administration were declared invalid and an effort was made to force the companies to obtain concessions from the government. The companies resisted these measures by every available means, and while higher taxes were eventually paid under protest the companies were able by a complicated series of negotiations and with the aid of strong diplomatic pressures from the United States to sustain the contention that Article 27 should not be applied retroactively to the mineral rights acquired in perpetuity prior to 1917.

Petroleum investment continued to grow throughout most of the 1920's but beginning in the latter half of that decade, following the discoveries in Venezuela and signs of impending economic difficulties in the United States, exploration and development activity declined. The Mexican investment of United States petroleum companies reportedly declined from $206 million in 1929 to $69 million in 1936.[2] The Mexican economy was, of course, badly hurt by curtailment of foreign investment in petroleum

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[1] The foreign mining enterprises and related railroads were less fortunate, these being quite hard-hit during the Revolution and the post-Revolution period of disorder.

[2] Source: United States Department of Commerce, as reported by Wright, op. cit.

(as well as in virtually all other sectors), and there developed a widespread feeling that Mexico was being victimized by "foreign monopolies" and a "conspiracy among foreign capitalists."

It was in this context that President Cardenas (1934-1940) supported the petroleum workers' union in its demands for greatly increased wages and jurisdiction. Intransigence and miscalculations on all sides led first to a strike by the workers' union, then to refusal by the companies to abide by the recommendations of an arbitration board or to accept a ruling by the Mexican Supreme Court, and finally, in 1938, to issuance of an expropriation decree by Cardenas. There is no evidence to indicate that the nationalization of the petroleum industry had been planned, or even wanted, by the government.[1]

There were other relatively minor restrictive actions taken by the government during the 1920's and 1930's, but the large decline in foreign investment that occurred was mostly due to expropriation of the foreign-owned petroleum properties and haciendas, nationalization of various railroad systems, and lack of enthusiasm on the part of foreign investors for expanding operations in other sectors attributable to the Mexican political environment and international financial circumstances. By 1940 the total amount of foreign private direct investment amounted to

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[1] For a fuller description of this episode, and for information on the subsequent development of the nationalized petroleum industry, see Richard J. Powell, The Mexican Petroleum Industry, 1938-1950, 1956.

only $450 million. As shown in Table II, transportation facilities, the electric power industry and traditional mining activities accounted for almost 90% of the total -- and even these had declined substantially in book value from prior years.

As a result of World War II the United States and other interested foreign governments were distracted from pursuit of the unresolved issues surrounding the petroleum expropriation and Mexico was enabled to negotiate a quite favorable settlement of outstanding obligations with foreign claimants. The way was thereby cleared for resumption of normal international commercial relations and sizable foreign capital inflows were received during the war years consisting of a combination of private direct investment, official loans (these two sources originating primarily from the United States), and flight capital from Europe.[1] Following the war Mexico was able to sustain the incipient industrialization process initiated by the wartime conditions in spite of periodic balance-of-payments crises by reliance on an increased domestic savings capacity and substantial amounts of foreign financing in the form of official loans for infrastructure development and direct investment in manufacturing enterprises. Import substitution was the basic industrialization strategy, and the domestic market for manufactured products was the main stimulus to new foreign investment. By 1950 foreign investment in manufacturing surpassed

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[1]The latter source gave rise to considerable consternation and an emergency decree was issued in 1944 in an effort to prevent takeovers of Mexican enterprises and financial institutions by foreign capital thought to have connections with the axis powers or to be subject to repatriation following the war. This decree provided the Mexican government with a semi-legal basis for the "Mexicanization" policy pursued during the 1950's and 1960's as discussed later in this paper.

TABLE II

Foreign Direct Investment in Mexico, 1940-1965

	Total	Transport	Electricity	Mining	Manufacturing	Commerce	Agriculture	Other
			(book values - millions of dollars)					
1940	449	142	141	108	32	16	8	2
1950	566	75	137	112	148	70	4	20
1960	1,081	31	15	169	602	196	19	49
1965	1,762	30	-	140	1,180	300	25	87

Source: Grupo Secretaria de Hacienda - Banco de México. (As reported in Dwight S. Brothers and Miguel S. Wionczek, The Political Economy of Mexican Development: An Interpretation of Mexican Nationalism, unpublished manuscript.

that in any other sector, the total amount of such investment having more than quadrupled since 1940 (as shown in Table II). The relatively rapid growth of foreign investment in the manufacturing sector continued throughout the 1950's resulting in a predictable nationalist reaction toward the end of the decade.

As a result of a combination of ideological, political and economic forces President Lopez Mateos (1958-1964) was compelled to adopt a more restrictive policy toward foreign investment than that pursued by his post-Cardenas predecessors. According to official pronouncements the primary objective was majority Mexican ownership in enterprises engaged in exploitation of natural resources or producing essential services or products for the domestic market. This "Mexicanization" objective was subsequently extended to include a wide variety of arrangements ranging from minority Mexican participations in joint ventures to outright nationalization of foreign enterprises. It appears that an additional (or perhaps corollary) stratagem was to increase Mexico's public foreign indebtedness relative to the claims of private foreign investors while at the same time attempting to sustain the thrust of the import substituting industrialization process.

The present presidential incumbent, Diaz Ordaz (1964-1970), has continued on the course charted by his predecessor, but with fewer pyrotechnics and with somewhat greater political and economic sophistication. Both new and existing foreign-financed enterprises have been vigorously (but not dogmatically) persuaded to enter into joint ventures with Mexican

capitalists, to utilize domestic inputs to the fullest possible extent, and in general to accommodate to national development priorities. A variety of techniques have been employed to induce the desired behavior as well as for dealing with recalcitrants and for blocking foreign investor initiatives that for one reason or another were judged to be undesirable. During the past several years the government's policy toward foreign investment has evidenced an increased concern for estabishment of an export capability on the part of Mexican industry and for the requirements on the side of scale, technology, and foreign market access which this implies. Stated in the most general terms, the strategy manifested under Diaz Ordaz has been that of attempting to cope with the economic problems that the prior period of heavy reliance on import substitution has produced, utilizing foreign investment to the extent that Mexico's relatively strong bargaining position and relatively high political sensitivity to foreign investors will permit.

III

Recent Episodes

The opposition to direct foreign investment that developed during the 1950's was led by the national chamber of manufacturing industries (CNIT) representing the smaller and generally less efficient Mexican enterprises. The motivation appears to have been based in large part on fear of competition from enterprises with access to foreign capital and technology, but the fact that labor leaders and intellectuals joined in the campaign indicates that nationalist antagonisms toward

foreign investors were of various sorts. The basic argument made for restricting the scope for foreign investment was that the industrialization process should be premised on the broadest possible use of domestic capital, skills and natural resources as supported by imported technology divorced insofar as possible from foreign control. Implied in this was a statist development strategy that incorporated not only the usual import substitution doctrine but also fairly sophisticated notions about the way backward and forward linkages could be forged to bring about a coupling of the industrialization process with development of the country's natural and human resources.

The coalition of those favoring further curtailment of the scope for foreign investment was successful in gaining widespread public support and ultimately in forcing the Lopez Mateos administration to search for opportunities to reorient official policies in a more restrictive direction. The task was complicated by the fact that by the time the political pressures for restricting the scope for foreign investment had become irresistible the industrialization process had entered a new phase in which the country's dependence on foreign financing, capital goods and markets was greater than ever. This new phase was related to the difficulties inherent in the import substitution process and to complications confronting the government in attempting to maintain monetary stability without bringing the development process to a standstill.

An important dimension of the stabilization problem was the need to rationalize and reduce the numerous direct and hidden subsidies to the

industrial sector afforded by means of underpriced goods and services such as transport facilities, petroleum and electric energy. Reformation of the rate schedule for consumers of electric power was even more difficult politically than were measures to put the nationalized railways and petroleum industry on a sounder financial footing because higher electricity rates would benefit foreign-owned companies. The problem was resolved by first nationalizing the electric power industry and subsequently increasing user charges. An important adjunct of this procedure was the requirement that the proceeds received by the foreign companies for their nationalized properties were to be invested in Mexican manufacturing facilities.

The nationalization of the electric power industry was especially delicate because a deadlock between the foreign-owned companies and the government might have produced an adverse effect on Mexico's international financial standing. Fortunately, however, the interests of the companies and the government were rather easily reconciled. The companies were quite willing to sell their properties if the price were right and the government wanted to acquire the properties so that the industry could be restructured in a way that would permit rate increases and thereby allow Mexico to qualify for the external financing required to expand capacity. Under these circumstances, and given the availability of the necessary financing from U. S. banking institutions, it was not difficult to arrive at an agreement that satisfied everyone -- the foreign power companies, Mexican nationalists, and prospective foreign lenders.

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[1] For a fuller description of this episode see Miguel S. Wionczek, "Electric Power: The Uneasy Partnership," in Raymond Vernon, editor, Public Policy and Private Enterprise in Mexico, 1964, Pages 19-110.

Another instance in which the government was confronted with political limitations on development policies as a consequence of the presence of foreign investors was in the field of mining. Mining activity had been stagnant for many years, largely because it was politically infeasible to provide investment and production incentives so long as such actions would benefit foreign investors and do nothing to reduce their control. As in the case of electric power, but by means of Mexicanization of ownership rather than outright nationalization, the deadlock was finally resolved by elimination of foreign control.

The pressure for "Mexicanization" of mining had started in the late forties as domestic demand began to grow at a rather rapid pace. By the second half of the 1950's between one-fifth and one-fourth of domestic production was being consumed by Mexican industry, and Mexican manufacturers utilizing these products were anxious to achieve greater control over their sources of raw materials. The government was likewise anxious to eliminate the preponderance of foreign control over mining activities for a variety of reasons: to accommodate nationalist pressures; to promote processing industries and exports of refined products; and to prepare the way for revival of the mining sector through application of fiscal stimulants. As in the case of electric power, the problem was to devise the means for transference of foreign claims to national ownership without generating an adverse reaction. The technique employed was to change the mining law in such a way as to encourage foreign-owned companies to share ownership "voluntarily" with Mexican partners, utilizing as an inducement to compliance

substantial fiscal incentives. Within five years after the introduction of the new mining legislation and the proffered fiscal benefits, all major foreign-owned mining enterprises except two sulphur companies found it convenient to comply with the Mexicanization provisions.

In retrospect it appears that all parties were reasonably well satisfied, and indeed some of the mining companies have intimated unofficially that they received a better deal than expected. Earnings on the minority interests received by the foreign companies appear to be at least as large as those realized before Mexicanization, reflecting not only tax benefits but also various fees charged the new joint ventures under management and technical assistance contracts with the former parent companies. Moreover, the funds received from Mexican investors have generally been invested in highly profitable industrial enterprises. The advantages accruing to domestic entrants into these mining joint ventures have probably not fully matched their expectations, since mining stocks have not yet prospered in the market due to a general depression of stock market activity, but presumably considerable dividends to the new domestic entrants into mining have been realized by integrating their industrial activities with raw material sources. The reaction of public opinion to the Mexicanization of mining has been extremely favorable; only a few lonely voices have questioned the diversion of domestic savings and fiscal resources to the mining sector, and these have been dismissed as anti-patriotic outbursts.

Other actions taken during the same period included restriction

of foreign investment in the petrochemical industry and negotiated arrangements with the foreign-owned automobile companies under which imported components were substantially reduced relative to domestically produced inputs.

The decision to restrict foreign investment in basic petrochemicals involved fewer complications than the others since governmental control over other phases of the petroleum industry was already well established. The regulations prohibited all private investment in "primary" petrochemicals (constituting de facto nationalization of this segment of the industry) and restricted foreign investment in "secondary" petrochemical enterprises to minority positions. While some foreign chemical companies and interested Mexicans expressed dismay over the barring of private capital from any part of the industry, the government defined the limitation prudently enough so as not to antagonize private enterprise proponents unduly. That part of the petrochemical industry reserved for public enterprise was restricted to processing, stockpiling, transportation and initial distribution of products originating in petroleum and natural gas and destined for use as industrial raw materials. The governing regulations provided that further processing into intermediate and consumers goods was open to private enterprise, and investors in the exempted petrochemical enterprises were given to understand that supply prices of basic petrochemicals to user industries would be "reasonable" rather than being dictated wholly by cost of production. The prospect of assured access to relatively cheap raw materials -- and the corresponding removal of the

uncertainties which had previously confronted user industries dependent on imported supplies -- served to forestall criticism of the extension of the exclusive prerogatives of Petroleos Mexicanos (the nationalized petroleum monopoly) into the petrochemical industry. Furthermore, the fact Petroleos had emerged from its first twenty years with the financial, technological and managerial capacity to extend its operations into an area traditionally considered as the preserve of highly advanced industrial countries and the large multinational corporations appears to have generated a good deal of nationalist satisfaction in many quarters.[1]

The motivation for transforming the foreign-owned automotive enterprises from essentially assembly-type operations into integrated domestic industrial activities was to force the pace of the backward linkage process and, thereby, to alleviate growing balance-of-payments difficulties and provide new industrial employment opportunities. Imports of autos, trucks and buses (mainly component parts and accessories shipped from U. S. parent companies to their Mexican subsidiaries) had become the single largest import item, increasing from $37 million in 1950 to $95 million in 1960. Because of the growing domestic market, the automotive industry was an obvious candidate for integration in accordance with established import substitution policy. The problem was to find a formula under which the foreign companies could be assured that the

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[1] For details on the laws and regulations pertaining to this episode and those described subsequently in this paper, see Wright, op. cit.

profitability of their Mexican operations would be maintained through some combination of higher prices for finished units and increased sales volume in the Mexican market. The government recognized that production costs would rise, but it was thought that this disadvantage would be offset by opening opportunities to Mexican supplier industries and by stimulating an infusion of modern technologies into these industries. Another consideration was that by stimulating the growth of a variety of smaller national enterprises the government would be able to offset to some degree the pronounced concentration that was rapidly becoming a characteristic of the Mexican industrial structure. As was to be expected the larger foreign firms (especially Ford and General Motors) attempted to resist the new policy. Only after several smaller manufacturers (principally European-owned companies) were induced by preferential assembly quotas to cooperate did the larger firms decide to comply. Within five years from the introduction of the new policy, and without any major overt conflict, all automobile units manufactured in Mexico reportedly embodied domestically produced inputs to the extent of at least 60 percent of the "direct cost of production" -- and the government was preparing to promote industrial integration in other industries characterized by foreign-owned assembly plant operations (e.g., constructive machinery, electronics and office equipment) in accordance with the model afforded by the automotive industry.

All these actions were initiated at a time during which long dormant tensions between the political Left and the Right in Mexico had been brought to the surface by events in Cuba and by mounting concern over the income distribution consequences of various government policies. In searching for ways to restore domestic tranquility, the Lopez Mateos administration apparently had decided that it was politically necessary to demonstrate that there existed both the will and ability at the highest political level to revive the statist tradition of the Revolution and to reassert the primacy of domestic over foreign interests -- even at the risk of endangering Mexico's external financial and commercial links upon which the development process had become heavily dependent. This is not intended to suggest, however, that the actions taken, and their timing, were governed by strictly political considerations since the economic rationale in each instance appears to have been fairly compelling as well.

With the end of the Lopez Mateos administration in 1964 the foreign business community expected the restrictiveness of government policy toward foreign investment to be eased. The new president, Gustavo Diaz Ordaz (1964-1970), was thought to represent the right wing of the Mexican establishment and it was supposed his administration would favor private enterprise and be somewhat less restrictive toward foreign investment. Expectations with regard to prospects for government policy toward foreign investment appear to have been influenced by the fact that Mexico's dependence on external financing had increased sharply in preceding years.

The foreign indebtedness of the public sector had more than doubled during the previous six years as a consequence of several factors including the unsatisfactory performance of the fiscal system, difficulty in establishing centralized control over the financial affairs of the large array of public enterprises, and the external borrowing associated with the nationalization and Mexicanization initiatives undertaken by the Lopez Mateos administration. Because of Mexico's increased dependence on external financing, it was predicted that Diaz Ordaz would have to follow a less restrictive policy toward foreign investment if only to assure continued access to international lending agencies and foreign capital markets.

To the great disappointment of those who had anticipated a 'new deal' for foreign private investment, the Diaz Ordaz administration made it clear at the outset that a significant departure from the established trend toward further restriction would not be forthcoming. The signals were, of course, indirect and subtle, in accordance with the tradition of Mexican politics. They were initially transmitted by initiatives in the fields of mining and banking rather than in the manufacturing sector. The foreign-owned sulphur companies were forced to Mexicanize their operations shortly after Diaz Ordaz assumed office as a result of a confrontation with the government during which exports were temporarily prohibited; and the law governing banking and insurance companies was amended in December of 1965 to reaffirm the long-established ban on foreign investment in the financial sector. With foreign investment in agriculture, mining, basic infrastructure and the financial sector virtually eliminated the government was free to concentrate

its attention on the various technical aspects of foreign investment in the manufacturing and commercial sectors. As a result issues such as transfer pricing, technology licensing and management fees, and degree of integration with domestic sources of supply tended to become more central in discussions between government officials and the foreign business community.

Statements by high government officials indicated that foreign direct investment proposals were to be appraised on a case-by-case basis and acted upon in accordance with a vaguely defined index of their usefulness to the economy, an index composed of the following elements: technology and managerial expertise, risk-taking, manpower training, employment creation, complementarity with existing industrial structure, and foreign exchange contribution. These statements regularly emphasized the government's strong preference for joint ventures, and it was intimated that eligibility for import licenses, tax benefits and supplier contracts with public sector enterprises would be restricted to foreign-affiliated companies willing to share ownership with Mexican investors in accordance with what the government judged to be desirable in individual cases. It was also made clear that while foreign purchases of established Mexican enterprises was not prohibited, the government took a dim view of such acquisitions -- except in those instances where foreign marketing expertise was essential for realization of export potential.

The annual presidential messages have repeatedly and unequivocally stated that Mexico preferred foreign loans (whether of public or private origin, but especially in the form of purchases of government bonds which

were being issued in international capital markets with increasing frequency) over additional direct foreign investment. The mix of direct and portfolio investment from abroad that would be acceptable was not made clear, but the implication was that direct foreign investment was looked upon as a residual rather than the primary source of foreign financing.

The Mexicanization policy as extended under Diaz Ordaz was strongly supported by most segments of Mexican public opinion -- the main exception being the radical left (which apparently considered it an insufficient strong defense against further penetration of the Mexican economy by U. S. financial and industrial interests) and a few individuals associated with some of the larger Mexican industrial-financial groups (who questioned the wisdom of using Mexico's relatively scarce supply of savings and foreign exchange for purchasing assets from foreign companies already established in the country). In addition to the political reasons for sustaining the Mexicanization initiative, the government found that its ability to deal with domestic entrepreneurial groups and foreign investors linked together was often substantially strengthened as compared to situations in which national and foreign interest groupings had to be negotiated with separately. Furthermore, by fostering linkages between foreign investors and domestic entrepreneurs the government was able to achieve a form of control over the practices of foreign enterprises with respect to transfer pricing, other forms of profit remittances such as charges of technology and management, and employment policies and export orientation that could not be easily achieved without the establishment of a vested interest on the part of national partners in these enterprises.

But while the motivations of the government with respect to the recent pressures for Mexicanization of manufacturing enterprises have been reasonably clear, those of the various definable national interest groupings have been somewhat more obscure. The basic distinction here is between those Mexican entrepreneurs who felt themselves able to cope effectively with foreign investors on their own with minimal governmental intervention and those who felt themselves to be at a relative disadvantage in dealings with, or competition against, foreign investors. A related distinction is between those domestic interest groupings that advocated Mexicanization of established foreign enterprises and those that advocated application of the Mexicanization policy only to new foreign ventures. Generally speaking, those favoring an across-the-board approach on the part of the government were those least able to bargain effectively with foreign industrial interests on their own account, whether because of insufficient skill or financial resources. This is not intended to suggest that those favoring confinement of Mexicanization pressures to new foreign industrial ventures did not welcome occasional assistance from governmental pressures on their behalf in specific bargaining situations, but rather to indicate that the more powerful domestic industrial-financial interests were concerned about the possibility that the government might spoil the "climate" for foreign investment by excessive administration intervention or doctrinaire extension of the Mexicanization requirement retrospectively to all established foreign-owned enterprises.

Those less able to negotiate attractive joint ventures with prospective foreign investors were inclined to push for participation in foreign ventures that had been proven successful not only because of the more highly nationalistic orientation of this group but also because of recognition that access to participation in these ventures afforded a means to avoid being squeezed out of the industrialization process by more powerful domestic and foreign competitors.

Government spokesmen have maintained a cautious silence about the extent to which Mexicanization of manufacturing industry would be pushed to apply to established foreign-owned enterprises, although numerous "old line" foreign investors apparently have been pressured into sharing equity with Mexicans whether by making public stock offerings or entering into negotiated joint ventures with Mexican entrepreneurs. Instead of addressing this issue directly the government has publicized official efforts to further diversify the national origins of private direct investment. A number of officially sponsored investment promotion missions have been sent to advanced countries other than the United States, and the message has been passed around the world that Mexico would like to decrease its dependence upon the United States. Invitations have been issued to European and Japanese industrialists to become engaged in Mexico -- combined with subtle warnings that otherwise they might find themselves effectively cut off from the Mexican market. This campaign, which began in 1965 when still some 75 percent of new foreign investment originated in the U. S., has been supplemented by government-supported efforts on the part of Mexican industrialists to search for needed foreign technologies on a wider geographic basis.

IV

Mexican policy toward foreign investment has undergone substantial change during the past decade. The electric power industry which was formerly largely dominated by foreign-owned companies has been nationalized; traditional mining activities which were likewise conducted largely by subsidiaries of the international mining companies have been Mexicanized; and foreign manufacturing enterprises have been subjected to a variety of pressures to enter into joint ventures with Mexican partners, to increase utilization of Mexican inputs, and to expand exports. While the consequences of governmental initiatives directed toward foreign investors are difficult to measure in quantitative terms, there is no doubt that the market orientation and ownership structure of foreign companies operating in Mexico has been significantly and irreversibly changed.[1]

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[1]According to a recent study by Herbert K. May, carried out under the auspices of the Council for Latin America, exports as a percentage of total sales by U. S. manufacturing affiliates operating in Mexico increased from about 1.5% in 1957 to about 12.5% in 1966. The Effects of United States and Other Foreign Investment in Latin America, January, 1970. Page 39.

Another statistical compendium, prepared at the Harvard Business School as a part of the Multinational Enterprise Study under the direction of Raymond Vernon, reveals that the number of large U. S. manufacturing corporations with non-wholly-owned Mexican subsidiaries increased from 27 to 112 between 1957 and 1967. In percentage terms this represented an increase from 23.7% to 43.9% of the total number of Mexican manufacturing subsidiaries of the U. S. corporations included in the sample. The number of subsidiaries in which the U. S. corporations included in the sample held a minority ownership position increased from 10 to 50 between 1957 and 1967, or from 8.8% to 19.6% of all Mexican manufacturing subsidiaries of the large U. S. corporations. James W. Vaupel and Joan P. Curhan, The Making of the Multinational Enterprise, 1969. Page 387.

When viewed against the perspective afforded by the historical sequence of changes in the role accorded foreign investment in Mexican development, events during the past decade are not at all surprising and, indeed, can be seen to be the logical sequel to the 1940-1960 and the 1910-1940 phases of post-Revolution policy. The longer-term record clearly indicates that Mexico will continue to gradually and pragmatically impose additional restrictions on foreign investment in accordance with the country's endemic nationalist propensities and its changing needs for linkages with external sources of capital, technology, and markets.

Present indications are that in addition to continued pressure for sharing of ownership with Mexican investors the objectives likely to be emphasized during the 1970's by means of further adjustments in policy toward foreign investment are increased export capability on the part of Mexican manufacturing industry[1] and modified regional location of industrial activities -- with particular attention to the dual problems of unemployment and disparities in income distribution. As in the past, the strategies and specific techniques employed by the government in pursuit of these objectives will no doubt be largely determined by political expediency.

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[1] It was announced early this year that automobile companies will be required to compensate with exports 5% of their 1970 quotas for imported components. In 1971 the compensating export requirement is scheduled to be increased to 15% and to be progressively increased thereafter until by 1979 all imports will have to be balanced by exports. This new approach apparently indicates that the government has decided not to further increase the domestic-content requirement for automobile manufacturers. Source: Business International, February 20, 1970. Page 63.