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Canadian participation in USA -
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# Canadian Participation in USA - Mexico Free Trade Discussions

## Preliminary Agricultural Perspectives

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INTRODUCTION

Earlier this summer, the United States and Mexico agreed to explore further the possibility of launching free trade negotiations.

The purpose of this paper is to provide a preliminary assessment from an agricultural perspective whether it would be in Canada's interest to participate in these negotiations.

## Economic and agricultural policy developments in Mexico

With an annual population growth rate of over 2%, the population of Mexico is expected to reach 105 million by the year 2000. However, Mexico's economic growth has not kept pace with its demographic trends. Hence, the need for economic policies that will ensure economic prosperity to this growing population.

Country General Information

| 1988 basis | Population Million | GNP/capita US $ | GNP/capita 80-88 growth |
|---|---|---|---|
| Canada | 26.1 | 16,760 | 2.3% |
| U.S.A. | 245.9 | 19,790 | 2.1% |
| Mexico | 83.5 | 1,820 | -1.4% |
| Total | 355.5 | | |

The economic strategy pursued by the Mexican government included various measures designed to moderate inflation and stabilize the economy; many sectoral reform programs were set out in support of an opening of trade and softening of foreign investment restrictions.

Hence, under certain conditions, restrictions have been removed on foreign investments of less than US $100 million in most industrial sectors. 100% foreign ownership is now allowed in different sectors like mining, auto parts manufacturing as well as the agri-food sector. Many privatization operations have also been conducted; about 650 state-owned firms have been dismantled, consolidated or sold.

A major economic reform has been Mexico's accession to the General Agreement on Tariffs and Trade in 1986. Consequently, Mexico has greatly modified its import regulations and has significantly reduced barriers to trade. Mexico implemented a much more open trade regime by reducing tariffs significantly, harmonizing the tariff structure, abolishing official prices and removing most import licensing requirements.

All Mexican tariffs were bound to 20%. As a result, the average tariff rate is now only 6%. Mexico has five years from December 1986 to complete adjustments to its tariff structure. So far the import licensing requirement has been eliminated on 96% of the tariff categories. However, 60 agricultural products categories, including grains, oilseeds, dairy goods and certain horticulture products still require import permits. Over the 1987-89 period, these commodities accounted for 85% of the Canadian agri-food exports to Mexico. Recently, the import permits which served as the mechanism to enforce the quantitative restrictions, are issued more readily.

Part of the Mexican economic strategy has been to undertake negotiations with trading partners. For instance, before launching Mexico-U.S. trade talks, Mexico had already negotiated with Chile a free trade deal that will be signed on October 4, 1990. Further trade agreements will likely occur as Brazil and Argentina are looking forward to construct a common market by 1994 including Chile, Uruguay and Paraguay. Current trends point towards the development of larger regional trading groups. This underscores the need for Canada to position itself to take advantage of these new trade alliances.

## Agricultural Trade Situation

From 1982 to 1988, the combined value of USA and Mexico agricultural trade increased by 57% to reach over $4 Cdn billion. During the same period, the USA has been Mexico's major supplier of agricultural products and the largest market for Mexican agricultural exports. In contrast, Mexico's agricultural trade with Canada is small.

Agricultural Trade: 1989, million $Cdn

| Exports to:<br>From: | Mexico | USA | Canada |
|---|---|---|---|
| Mexico | 0 | 2,372* | 110 |
| U.S.A. | 1,867* | 0 | 4,189 |
| Canada | 150 | 3,109 | 0 |

* 1988 Figures

However, despite its relative smallness, Canadian agricultural trade with Mexico can be of significance to some commodity sectors and may offers potential market developments for others.

In the future, Mexico may have to rely more on imports to supply basic foodstuffs to its growing population because of limiting agricultural conditions such as restricted water supplies and a limited arable land base. Furthermore, changes are expected in the eating patterns of Mexicans due to urbanization and the higher incomes that may result from enhanced economic conditions.

Exports

Mexico is Canada's 15th largest export market for agri-food products, accounting for about 1% of such exports. Over the 1987-89 period, agri-food exports to Mexico averaged $149.1 million. The share of total exports to Mexico accounted for by agri-food products has increased over the last twenty years; rising from about 10% in 1970 to an average of almost 28% in the 1987-89 period. Mexico is Canada's largest market for skim milk powder and second largest for canola. Other important exports include grains dairy cattle and pork products.

Several commodities are considered to have good potential for increased exports to Mexico. These include special crops (canary seed, lentils, coloured beans and selected forage seed), breeding livestock (swine, dairy and beef cattle), pork and edible offals.

Imports

While Mexico is the 8th largest supplier of agri-food products to Canada, it accounts for less than 2% of total food and agricultural imports. Over the last three years, agri-food imports averaged $117.7 million or about 8.4% of all Mexican exports to Canada. The majority of imports are unprocessed products and do not compete directly with Canadian production. For instance, imported vegetables are largely complementary, in that the great majority are imported during the nine months when domestic produce is not available.

During 1987-89, principal agricultural imports included vegetables (averaging $38.3 million), fruits and nuts ($30.2 million) and plantation crops ($32.6 million). Most of the fruits imported cannot be produced

in Canada (bananas, mangoes, pineapples and grapefruit), are produced in very limited quantities (cantaloupes and melons) or are largely imported when they do not compete directly with Canadian production (tomatoes and grapes). Imports of plantation crops consist largely of coffee.

Major imports of processed agri-food products in 1989 included alcoholic beverages ($15.3 million), tomato paste ($3.8 million), frozen vegetables ($3.7 million) and frozen strawberries ($2.7 million - primarily for processing purposes). For the most part, these imports compete with Canadian production.

There appears to be good potential for Mexico to increase export supplies of both fresh and frozen fruits and vegetables, and alcoholic beverages, particularly beer.

**Canada's Agri-Food Trade with Mexico - Average 1987 - 89**
$ Millions

| | Exports | Imports |
|---|---|---|
| Grains and products | 21.1 | 1.8 |
| Oilseeds and Products | 70.4 | -- |
| Live animals | 6.2 | -- |
| Red Meats & Animal Products | 10.9 | -- |
| Dairy Products | 34.6 | -- |
| Poultry & Eggs | 0.8 | -- |
| Fruits & Nuts | 0.3 | 32.0 |
| Special Crops | 3.6 | -- |
| Vegetables | 0.1 | 38.3 |
| Plantation Crops | -- | 32.6 |
| Alcoholic Beverages | 0.2 | 12.8 |
| Other | 1.0 | 2.0 |
| **Total Agri-Food** | **149.1** | **117.8** |
| **Total Trade** | **538.0** | **1,399.7** |
| Agri-Food as a % of Total | 27.7% | 8.4% |

Recent trade data indicate that Canadian exports of grains and oilseeds have lost grounds in the Mexican market while Canadian exports of pork and genetic material (mainly bovine) have increased.

Agri-food Regulations

Differences in the agri-food regulatory systems and procedures of Canada and Mexico can be a constraining factor in influencing business decision making to pursue agri-food trade opportunities. Among the regulatory differences between Canada and Mexico that have affected trading patterns are mandatory health and sanitary standards as they apply to horticultural, plant and meat products and animals.

Consideration of regulatory concerns affecting traded products has typically taken place in the context of regular consultative meetings among the three North American governments through institutions such as the North American Plant Protection Organization and tripartite animal health meetings. Further bilateral meetings of specialists have also occurred. Resolution of health and inspection issues ensures that animal, plant and human health are not compromised and that Canada's internationally recognized elite health status is not jeopardized.

The outcome of the Uruguay Round of Multilateral Negotiations on sanitary and phytosanitary issues will have a significant impact on the ultimate resolution of the current technical barriers that exist between Canada and Mexico. Expansion of the mechanism set up in the Canada-USA free trade agreement to resolve technical issues could be useful in developing North American harmonized standards.

Grains and Oilseeds

The three major cereal crops grown in Mexico are corn, wheat and sorghum. Average production for the 1985-86 to 1989-90 period was 10.1, 4.0 and 3.8 million tonnes, respectively. Average areas for the same time period were 6.0, 1.0 and 1.3 million hectares, respectively. Soybeans is the predominant oilseed crop, with 334,000 tonnes being produced on 142,000 hectares in 1988.

Mexico's grain imports are sporadic, depending upon domestic supply. Wheat and flour imports are generally distributed between the USA, Canada and Australia, with the US being the major source. Mexico imported 66,000 tonnes of Canadian wheat and flour in 1988-89 while imports from the USA were 1,067,000 tonnes. This should not be considered the average, as both the volume and the distribution among exporting countries varies considerably from year to year. A grains agreement, signed in early 1990, provides for the sale of Canadian wheat and barley to Mexico over the 1990 and 1991 calendar years.

The USA dominates the Mexican coarse grains import market. In 1987-88 Mexico imported a total of 3,715,000 tonnes of coarse grains, of which 3,707,000 tonnes was supplied by the USA. Argentina supplies the Mexican coarse grains market to a marginal extent while Canada does a minimal amount of business.

A bilateral agreement between the USA and Mexico would virtually eliminate Canada's presence in the Mexican grain market. The USA currently enjoys certain advantages with Mexico and a bilateral agreement would further enhance these advantages. Canadian grain exports would be subjected to continued licensing restrictions which USA exports would be excluded from, thereby reducing Canadian competitiveness.

A trilateral agreement would improve Canadian access to the Mexican market. Now that import restrictions are being relaxed, processors have the opportunity to deal directly with foreign exporters. They can be more selective regarding type, quality and source of grain that is best suited to their individual needs. In addition, a trilateral agreement would provide the opportunity for a more balanced trade environment. It is this opportunity which holds the greatest potential for exports of Canadian grains and oilseeds.

The Mexican market shows considerable potential, due to the high rate of population growth. Canada has begun to make inroads into this market and would be impeded if excluded from an agreement.

Special Crops

Mexico is a major consumer of pulse crops, particularly coloured beans. Increased support payments to pulse growers should enable Mexico to regain its former high level of self-sufficiency in coloured beans. For other pulse crops, Mexico will continue to be an importer.

Mexican pulse production averages about 1.3 million tonnes per year with dry beans accounting for about 85 %. The remainder is made up of dry peas, lentils, fababeans and chick peas.

Mexico imports of all pulses averages about $40 million per year and represents about 2% of all agricultural products. Canada's share of Mexican imports of pulses averaged about $5 million during the last two years or 12.5%. However, imports are variable from year to year depending on domestic production levels.

Both Canadian and American pulse growers are very efficient and price competitive. There is little threat that a Canada-USA-Mexico free trade agreement will adversely affect Canadian production. Moreover, preferential access could mean that we would maintain or expand exports, particularly to the benefit of Alberta and Manitoba growers. If Canada was not a party to the USA-Mexico free trade agreement, there is a possibility that Canada's pulse sector could lose its current competitive access position to the Mexican market, vis-à-vis the USA.

Horticulture

Annual Mexican imports of fresh fruits and vegetables represent less than 10% of exports. Climate and low labour costs allow Mexico to be competitive on the North American market in the production of a wide range of fruits and vegetables. In recent years there has been increased emphasis on the production of processed products, in particular frozen vegetables. Canada is a significant market for Mexican fruits and vegetables for

both fresh ($54.5 million) and processed ($11.4 million) products. However, exports to Canada represent only 5% of fruit and vegetable exports to the USA of $783 million fresh and $249 million processed in 1989.

A USA-Mexico free trade agreement, which would give the USA an advantage, would have limited impact on the Canadian exports of horticulture products to Mexico ($175,000 in 1989). USA exports of horticulture products to Mexico in 1989 were $116 million up 87% from 1988.

Mexican exports of fresh fruit and vegetables are geared to the late winter to early summer marketing period when North American produce prices are normally high. Improved access (i.e. lower tariffs) to Canadian markets would impact mainly greenhouse vegetables such as tomatoes, cucumbers and peppers. Currently, there is a trend toward increased Mexican production of summer vegetables. The more significant fact, in the longer term, is the ability of international companies to increase Mexico's output of processed vegetables (primarily frozen) for export. Increased exports of Mexican products to the USA may also have the effect of diverting some US products to Canada or competing with Canadian exports to the US. The USA market represents 90% ($673 million) of Mexican fruit and vegetable exports.

In terms of access to the Mexican market, a trilateral trade agreement would be more beneficial for USA horticulture than Canada, given the USA competitive advantage over Canada in horticultural products and the significant transportation cost of shipping from Canada. Participation in the trade negotiations would allow Canada to influence the outcome in this sensitive sector.

<u>Red Meats</u>

Improved economic conditions in Mexico will be necessary to increase per capita meat consumption which is relatively low compared to North American and/or world levels.

The USA is Mexico's major trading partner in livestock and red meat products. Mexico is a significant trading partner with the USA in both live beef cattle exports and dressed imports. Canada is the USA's chief foreign competitor in the Mexican market for livestock and livestock products.

Per capita beef consumption, in Mexico in 1988 was about 21 kg compared to 40 kg for North America and 12 kg for the world. Also beef consumption through the 1980s has been growing both through increased production from heavier market weights and increased imports.

Exports to Mexico of beef and veal products from Canada and particularly from the USA have increased sharply during the late 1980s. While Mexico is a leading world market for relatively low-priced beef offals (variety meats), exports of high-quality beef have also increased. Mexico is a small producer of high-quality feedlot beef but rising demand mainly from tourists outstrips local production.

Through the 1980s, pork production in Mexico generally declined. High feed costs and animal disease outbreaks have continued to limit Mexico's hog herd expansion with a corresponding rise in pork imports .

Mexico has become a growing market for USA and Canadian pork. Prior to the mid-1980s, Mexico imported very little pork. Pork variety meats (offals) continue to make-up the greatest share of Mexico's imported pork products.

Pork remains the preferred meat product of the Mexican consumers, according to the US Department of Agriculture. However, they are very responsive to changes in retail meat prices.

Livestock inventory levels in Mexico reflect limited arable land, water supplies, and especially acute supply-demand imbalances in the grains and oilseeds sectors. Mexico is not likely to become self-sufficient in livestock or in an export position in the near future. Notwithstanding changes in price controls and in ad valorem import tariff rates, a growing demand for breeding livestock and livestock products in Mexico should be anticipated by Canada.

Canada's chief foreign competitor in Mexico for livestock and meat products will continue to be the USA. Canadian participation in a North American trade agreement would ensure that Canada is in an equal position to take advantage of the export potentials in the expanding Mexican market.

Dairy

Canada exports dairy products to Mexico, in particular skim milk powder, pure-bred dairy animals, and bovine semen. Skim milk powder is our main dairy export. In fact, Mexico is our main purchaser of skim milk powder, accounting for $46 million or 60% of our skim milk powder exports in 1989. In terms of dairy genetic exports, for the period 1980-88, Mexico was our number two market (after the US). Annual Canadian sales over this period averaged $6 million.

Exports of skim milk powder are expected to diminish because of Canadian internal balance of skim milk powder to be reached within 5 to 10 years. Consequently, the Canadian participation in a North American free trade agreement will not have a significant impact on our skim milk powder sales to Mexicans.

Our exports to Mexico of live animals and bovine semen should not be affected to a great degree, considering that we are now trading in a competitive market. In fact, our exports of live animals are expected to increase over the coming years. However, this could be jeopardized if Mexico and the U.S. agree bilaterally to accord each other preferential treatment.

Poultry

Canada's trade with Mexico in the poultry and egg sectors has evolved in the context of certain significantly constraining characteristics, the foremost of which is the operation of a supply management in Canada which limits the potential for expansion or export market penetration. Additionally inadequacies in the Mexican inspection system and the presence of poultry diseases exclude Mexican product from Canada. Trade may take place in concert with direct foreign investment in Mexico and better control of health, sanitary and other quality factors at the Mexican production site.

A trilateral agreement would enable Canada to influence regulatory requirements and would provide Canadian breeder exporters with a better political and developmental framework.

A bilateral agreement would not necessarily change the sales of poultry breeding stock to Mexico since these products are already permitted free and equal access to the Mexican market. Expansion would be dependent on market development and the cultivation of inter and intra firm linkages.

There would appear to be little role for exports of Canadian final product as Mexico is largely self-sufficient in poultry. Exceptions to this may be low value parts and dark meat for which there is a high demand in Mexico, and turkey which Mexico has difficulty producing.

## CONCLUSION

The Canadian agri-food sector has important interests to safeguard in the case of a Canada-USA-Mexico trade agreement. Currently, Canadian agri-food exports to the Mexican market are valued at $150 million per annum. Imports from Mexico, mainly complementary fresh and processed fruits and vegetables, were valued at $110 million. The protection of existing market access to Mexico (equal tariff opportunities compared to the USA and cooperative industry arrangements) and the prospective market opportunities (growth in Mexican population and incomes) mitigate in favour of participation in the trilateral trade negotiations.

The downside risks from not participating in such a trade negotiation could be the negotiation of a preferential USA-Mexico trade market to the benefit of the USA agri-food industry and potential loss of Canadian market share. A USA-Mexico agreement could put at risk traditional exports of Canadian grains, oilseeds, dairy products and a range of other developing export markets (semen, live animals). Additionally, it will be important to ensure that the access opportunities or competitive position for Canadian agri-food exports to the USA, secured under the CUSTA, would not be jeopardized under a USA-Mexico trade agreement.

# North American Trade Liberalization

# Sector Impact Analysis

Industry, Science and Technology Canada
September 1990

## NORTH AMERICAN TRADE LIBERALIZATION
## SECTOR IMPACT ANALYSIS

### I AGRICULTURAL, FISH AND FOOD PRODUCTS

1. Meat and Processed Grain Products
2. Grocery Products/Further Processed Foods
3. Fishery Products
4. Alcoholic Beverages

### II RESOURCE-BASED PRODUCTS

1. Iron and Steel
2. Metals and Minerals Processing
3. Primary Wood Products
4. Pulp and Paper
5. Petrochemicals
6. Plastics
7. Pharmaceuticals

### III TEXTILES, APPAREL AND FOOTWEAR

1. Textiles
2. Apparel
3. Leather and Footwear

### IV TRANSPORTATION EQUIPMENT

1. Autos and Parts
2. Urban Transit and Railway Systems

### V MACHINERY AND EQUIPMENT

1. Agriculture Machinery and Equipment
2. Mining Machinery and Equipment
3. Electrical Products
4. Machine Tools and Tooling
5. Plumbing Products

### VI INFORMATION TECHNOLOGIES EQUIPMENT AND SERVICES

### VII SERVICE INDUSTRIES

1. Commercial Services
2. Construction Contracting

### VIII TOURISM

## NORTH AMERICAN TRADE LIBERALIZATION

## SECTORAL IMPLICATIONS FOR CANADA

Mexico and the United States have agreed in principle to negotiate a comprehensive free trade agreement. Consideration is being given to the possibility of expanding the negotiations to include Canada.

This document attempts to provide a very preliminary assessment of the potential impact that further trade liberalization might have on a number of individual Canadian sectors. While not all sectors are presented in these assessments, the range of sectors are considered to be broadly representative.

These assessments highlight existing Canada-Mexico sectoral trade patterns and attempt to provide an indication of the potential sectoral impacts on Canadian trade and investment interests arising from a bilateral Mexico-United States trade agreement and from a trilateral Mexico-Canada-United States trade agreement.

**In view of the high degree of uncertainty concerning the specifics of any negotiated agreement - whether bilateral or trilateral - these assessments must be considered as only being indicative of what the potential sectoral impact might be.** They have been prepared at this time to assist in determining whether or not Canada might wish to participate in these negotiations and, if so, to assist in development of specific negotiating objectives.

# I AGRICULTURAL, FISH AND FOOD PRODUCTS

## 1. Meat and Processed Grain Products

Mexico is increasingly unable to produce its own basic foodstuffs such as wheat, dairy products, livestock feedstuffs (especially protein meals), vegetable oils and meats (especially pork) due to its limited arable land base, its growing population and increasingly restricted water supplies. Trade in these commodity items is limited and no distinct trends have emerged over the past decade.

U.S. suppliers are better positioned to service the Mexican market and would be able to quickly take advantage of a bilateral trade agreement. Canada's trade with the U.S. in these products would not be adversely affected in view of Mexico's limited production capacity. Canadian firms would not be likely to shift production to Mexico as their operations are tightly tied to the raw material base in Canada.

Canadian suppliers have limited experience in the Mexican market due to long standing trade restrictions (import quotas, state procurement agencies, etc.), and exchange controls. Nevertheless, if these restrictions are eliminated, there will be opportunities for ongoing sales of raw agricultural commodities (canola, wheat, barley, beans), primary processed products (malt, flour, canola meal, skim milk powder, etc.) and selected meat products (pork offal, tallow, lard, etc.).

## 2. Grocery Products/Further Processed Foods

The Canadian grocery products sector is largely domestic market oriented, although this is gradually changing as a result of the need to respond to the new global competitive environment. Exports and imports average about 10 percent of shipments overall, primarily to and from the border regions of the U.S. In 1989, Canadian shipments of grocery products (i.e. excluding plant and animal, fisheries products and beverages) to Mexico totalled $8.5 million. Processed vegetables and vegetable preparations accounted for the bulk of this, with $7 million of exports. Imports from Mexico into Canada of grocery products were over $46 million, with coffee accounting for $26.7 million of this figure. Canada imported $8.6 million worth of processed vegetables and vegetable preparations from Mexico.

A trilateral free trade agreement would be likely to have only a limited impact on the sector. A key Mexican advantage, cheaper labour, is a relatively small cost factor for processed foods compared to agricultural inputs, where Mexico would have fewer advantages (fruits and vegetables being an exception).

Imports of fresh vegetables and fruit could increase although these largely replace out-of-season Canadian supplies. Export gains for Canadian food processors would be

limited. However, as Mexican standards of living rise, opportunities may be created at the upper end of the market for specialty foods from Canada.

### 3. Fishery Products

In 1989, Mexico's fish catching goal was 1.36 million tons from ocean stocks and 200,000 tons from fish farms. Shrimp production is an area of growth, but Mexican shrimp is a different market size compared to Canadian shrimp. In the period 1981-86, Mexico's fish exports ranged between $371 U.S. million and $49.4 U.S. million, while imports were generally less than $10 U.S. million.

Key Canadian fishery product exports to Mexico in 1989 were: hake ($736,000), salted fish ($422,000), and fish fresh or chilled (species not specified $854,000). The principal fishery import from Mexico in 1989 were shrimps valued at $2.2 million.

A preliminary analysis suggests that a free trade agreement that linked Canada and Mexico would not have major trade implications for the fishery sector. Some opportunities might emerge for lower priced Canadian species in Mexico and saltfish. Some opportunities for Canadian/Mexican joint ventures could develop, based on Canadian infrastructure/technology investment.

### 4. Alcoholic Beverages

Non-tariff barriers are of greater significance to trade in alcoholic beverages than tariffs.

The alcoholic beverage sector is increasingly global in its approach to trade and investment. A bilateral U.S.-Mexico agreement would not likely have any significant impact on Canadian interests. A trilateral agreement is not expected to have a significant impact on Canadian trade in distilled beverages or wines, but may exert further pressure on the Canadian beer sector.

## II RESOURCE-BASED PRODUCTS

### 1. Iron and Steel

Mexico's iron and steel exports to Canada are not very significant and would not greatly affect our industry in the event of a free trade agreement. However, Mexican goods could displace other countries' exports in the U.S. market. This would primarily affect exports from countries outside North America since Canada and Mexico sell into different markets in the U.S. Canada focuses on the northeast and midwest U.S. states, whereas Mexico focuses on the U.S. southern states. Transportation costs and quality factors make it unlikely that Mexican steel will make inroads in the near future into Canada's major U.S. steel markets.

Tariffs are not regarded as an impediment to the flow of steel products between Canada and the U.S. Non-tariff barriers have been a concern and the Canadian industry would like to see any remaining ones removed.

It is possible that increased economic activity in Mexico will result in increased exports of Canadian steel products. However, to the extent that Mexico imported more steel products, one would expect most of them to come from the U.S. especially if it enjoyed a tariff advantage over exports from Canada.

A bilateral agreement between Mexico and the U.S. would affect the investment opportunities in Canada. Canada's preferential access to the U.S. market, obtained under the FTA, would be diluted.

## 2. Metals and Minerals Processing

The Metals and Minerals processing sector includes all refined non-ferrous metals, ferroalloys, abrasives, refractories and some ceramics.

Mexico is a major producer of copper, lead, gold, silver and zinc. Prices are established on world commodity exchanges and Canada is considered to be competitive internationally. The sector is not expected to be affected by either a bilateral or trilateral agreement.

## 3. Primary Wood Products (lumber, panels, shingles. etc.)

Canada's trade in primary wood products with Mexico is very modest. Canadian exports to Mexico in 1988, were only $150,000 and imports were $300,000: a fraction of Canada's global trade in such products.

Mexico's trade in wood products with the U.S. is equally moderate. With the minimal levels of existing trade, even a free trade agreement that excluded Canada would not provide Mexico with an advantage that could affect the overall level of Canadian exports to the U.S. or provide the U.S. with an advantage that would threaten Canadian exports, marginal as they are, to Mexico.

Canada has had a minimal share of the primary wood products market in Mexico because of the proximity of sources of supply in the southwestern parts of the United States. These factors, coupled with a growing domestic wood products industry indicate that there would be little impact on the Canadian industry. However, Mexican tariff rates on wood products are in the 10 to 20 percent range and Canadian participation in any North American agreement will ensure access for Canadian exporters to an important market on the same basis as U.S. competitors. The Mexican market, however, would be one that required a significant investment on the part of Canadian industry to develop.

**4. Pulp and Paper**

The Mexican pulp and paper industry is composed of 70 plants located in most of the northern and central states. For some years, Mexico has had a policy designed to promote domestic production of most paper grades needed in the domestic market. Imports of Canadian newsprint (1989 sales $6.6 million) are controlled exclusively by a Mexican government agency. Scandinavian producers are active in the market but the U.S. continues to be the largest supplier of pulp and paper to Mexico, exceeding Canadian sales by a ratio of 12:1.

Under a strictly bilateral U.S.-Mexico FTA, there could be some trade diversion from Scandinavian sources in favour of increased U.S. supplies. Under a trilateral FTA that included Canada, Canadian producers would continue to face vigorous competition from U.S. producers, although there is some scope to displace Scandinavian suppliers in the Mexican market.

**5. Petrochemicals**

In an effort to attract investment in petrochemicals and to force efficiencies in the sector, the Mexican government has drastically reduced tariffs and will eliminate or ease the requirement for import permits. It will also allow more foreign investment participation in some of the derivative chemicals which before were limited to either minority foreign ownership or were reserved outright for Petroleos Mexicanos (PEMEX), the state-controlled oil company.

Greater access to the Mexican market will not necessarily lead to greater Canadian exports since U.S. production, centred largely in the gulf coast area, will still have a large freight advantage over Canadian producers. In the medium term at least, investments in the Mexican petrochemical industry will go to meeting local demand.

U.S. investment in the Canadian petrochemical industry should continue to be significant under liberalized trade in North America. The Canadian industry will continue to have transportation cost advantages over Mexican producers in the U.S. midwest and northeast areas.

**6. Plastics**

Trade in plastics materials and products between Canada and Mexico has been modest, averaging about $7 million in each direction during the past few years. This represents less than 1 percent of Canadian plastics trade. Canada's principal trading partner, the U.S., accounts for roughly 90 percent of total Canadian exports of plastics products.

Plastics products, with a few exceptions, are regionally-traded commodities, limited in their distribution range by relatively high transportation costs. Most production is, accordingly, located in proximity to major customers. Mexico, therefore, represents neither a major direct competitor to, nor a direct customer for Canadian facilities; but it is a direct competitor to Southern U.S. locations. Elimination of tariff and non tariff barriers would have a larger direct impact on Mexico and the U.S. than on Canada. Labour costs typically represent about 15 percent of plastics manufacturing costs, and therefore are not a major factor in favour of Mexican competitiveness.

Plastics markets could be indirectly affected, however, if major end-use sectors, such as automotive and electrical-electronics, migrate south as a result of the liberalization of trade with Mexico. Should this occur, supplier industries such as plastics would be required to relocate close to their customers, to the disadvantage of Canadian facilities.

A U.S.-Mexico FTA might have the effect of accelerating industry rationalization along the Mexico/U.S. border. U.S. producers may be able to maintain sufficient value-added to comply with country of origin provisions under the Canada-U.S. FTA and gain a competitive advantage over Canadian manufacturers in supplying North American markets.

### 7. Pharmaceuticals

Less than 1 percent of Canadian pharmaceutical exports are destined for Mexico. Similarly, less than 1 percent of Canadian imports come from Mexico. About 40 percent of our pharmaceutical exports go to the U.S. The U.S. imports about three times more from Canada ($88 million) than from Mexico ($26 million). Under a bilateral U.S.-Mexico trade agreement, Mexico has the potential to become a more serious competitor.

The pharmaceutical industry is undergoing a wide-spread process of rationalization. New investments in the industry are likely to result in products which meet U.S. regulatory requirements and which would be given product mandates for broad geographical areas.

The greater integration of the North American market would accentuate the rationalization process of this industry. However, a trilateral arrangement would not create a preference for U.S. production sites as would occur under a separate bilateral trade agreement between the U.S. and Mexico.

## III TEXTILES, APPAREL AND FOOTWEAR

### 1. Textiles

Mexico enjoyed a comfortable trade surplus in textiles with Canada in 1989, with shipments of Canadian $42.3 million against imports from Canada of only $8.1 million.

Mexican exports to Canada of acrylic yarn and textured polyester yarn have made significant inroads into these Canadian markets. However, imports of other textile products, including those of natural fibres (cotton, wool) have not been as significant. Canadian exports of textiles to Mexico are primarily commodity products (e.g. man-made fibres).

Under a U.S.-Mexico FTA, Canadian exports to Mexico could be displaced by U.S. exports. Over the longer term, investment may be diverted from Canada to Mexico to take advantage of lower labour costs, as well as proximity to major regional markets in the southern U.S.

Under a trilateral agreement, there are not likely to be significant export increases to Mexico, while pressures from Mexican products would continue.

## 2. Apparel

The Mexican market is not of significant export interest to the Canadian apparel industry at the present time. Apparel imports from Mexico are not significant, although the situation could change to the disadvantage of some Canadian firms if an FTA were negotiated between the U.S. and Mexico or trilaterally.

Mexico possesses a high number of firms involved in sub-contracting within the Maquiladora industry. These firms offer the advantages of low-cost labour to complement their attractive in-bond manufacturing facilities located mostly along the U.S.-Mexican border. Many U.S. apparel firms have set up subsidiaries in Mexico to combine the advantages of the Maquiladoras with sophisticated cost-averaging strategies involving Mexican and domestically-made goods.

If the U.S. were to negotiate an FTA with Mexico, it could be difficult for Canadian firms to adjust to imports of commodity-type apparel from the U.S. A U.S.-Mexico FTA would add to the existing pressures on the apparel industry to re-structure. Over the long-term, Canadian apparel manufacturers and foreign investors might consider diverting planned investments from Canada to Mexico.

Similarly, a trilateral FTA would probably increase the pressure on Canadian manufacturers of commodity apparel. Over the longer term, the larger manufacturers in Canada might decide to invest in Mexico to make products to complement their Canadian lines. Canadian manufacturers of non-commodity or fashion oriented apparel would not be faced with the same degree of competition.

A trilateral FTA would do little to enhance Canada's export opportunities in Mexico.

### 3. Leather and Footwear

Leather and footwear trade between Canada and Mexico is very minimal. However, trade from each country to the U.S. is substantial. Canada exported U.S. $40 million worth of footwear and $30 million worth of leather to the U.S. in 1988. Mexico's exports to the U.S. were $102 million and $24 million, respectively.

Since a large proportion of Canada's footwear exports consists of winter related products in which Canada has developed particular expertise and has acquired a favourable image, it is unlikely that our exports to the U.S. would be displaced by a U.S.-Mexico trade agreement.

A U.S.-Mexico free trade agreement would probably not have a noticeable impact on investment in Canada. Other countries are seen as preferred locations for new investment in the footwear industry.

The major impact that a trilateral agreement would have on the domestic footwear manufacturing industry would be the duty free access to the Canadian market of products partially or totally manufactured in Mexico. This could result in significantly increased import pressure from Mexico products, mostly in the medium-to-low end segment of the market. Some larger Canadian manufacturers could benefit from this agreement by having part of their production made in Mexico for re-export in the U.S. and even to Canada.

## IV TRANSPORTATION EQUIPMENT

### 1. Autos and parts

The Canada-U.S. Free Trade Agreement reconfirms the Auto Pact principles of rationalized motor vehicle and original equipment parts production within an integrated North American market. Participating Canadian Auto Pact companies continue to be eligible to import automotive products duty-free from both the U.S. and from Most Favoured Nation (MFN) countries, such as Mexico. Non-Auto-Pact companies import automotive products from Mexico at the General Preferential Tariff rate of 6 per cent.

Canada has been in an automotive trade deficit situation with Mexico for several years. Canadian imports of Mexican automotive products amounted to approximately $299 million in 1989, roughly one third of which were passenger cars, and the remainder were comprised mostly of automotive parts and components. Exports of Canadian automotive products to Mexico amounted to $71.6 million in 1989 and consisted entirely of automotive parts. If other tariff line items are included, such as certain types of machinery, stereos and glass used in the production of vehicles, total automotive imports from Mexico amount to about $680 million. Over 98 per cent of automotive imports from Mexico enter duty-free under the Auto Pact.

The elimination of the U.S. tariff on automotive products would not in itself provide great incremental benefit for Mexican exports. While the average U.S. parts tariff is currently 3 to 4 percent, most automotive goods enter U.S. free trade zones where, as a result of their incorporation in automobiles, they become upon exit, dutiable at the lower rate of 2.5 percent.

In addition, under the outward processing provisions of U.S. trade law, when the products are exported to the U.S., duty is, in effect, paid only on the Mexican value-added (since most of the original components used are of U.S.-origin). The program is successful because it allows auto parts producers to benefit from low Mexican labour costs while maintaining near duty-free access to the U.S. market. It is estimated that approximately 200 auto parts manufacturers have established Maquiladora facilities which produce mostly labour-intensive, low technology components. General Motors, Ford and Chrysler have established approximately 42 plants in the Maquiladora region.

In effect, one way "de facto" free trade already exists between Mexico and the U.S. and Canada for automotive products because of the combined effects of the Auto Pact provisions, the Maquiladora industrialization program and U.S. trade regulations. As a result, Canadian parts producers and exporters have faced and are currently facing competitive pressures from labour-intensive, low-technology Mexican parts exported to Canada and the U.S. In addition, Canadian parts producers are under pressure from the Big Three and the transplants to lower their costs.

In 1989, a new Mexican decree was introduced (for implementation in late 1990) which would ease some of the current restrictions in that country on automotive trade and investment. It would, for example, abolish import licensing requirements and allow 50 percent or more foreign ownership of domestic companies. It would also lower the Mexican content requirement from 60 to 36 percent on average, making it easier for vehicle assemblers in Mexico to achieve higher levels of quality through the use of imported parts.

The decree is intended to improve the climate for automotive investment in Mexico, particularly in the area of high-technology, high-quality parts (a product segment where Mexico is weak), and in vehicle assembly. In essence, the measures of the new decree are designed to bring the Mexican automotive industry up to international levels of quality and competitiveness. However, these reforms will still leave the Mexican industry with a high degree of protection. The complete removal of the remaining barriers would place the domestic Mexican industry (in particular their assembly operations for the Mexican market--as opposed to parts production for export) under severe competitive pressures.

A free trade arrangement between the U.S. and Mexico would not significantly change the North American environment in which Canadian automotive companies compete. It might, however, have the effect of accelerating several trends which are already occurring in the industry, i.e., the growth of the Mexican automotive parts industry, increased sourcing of labour intensive, low-technology Mexican parts by North

American companies, and further foreign investment in parts facilities in Mexico, particularly in the high-technology, high-quality parts segment, and increased competition from Mexican-manufactured vehicles. In terms of a Canada-U.S.-Mexico free trade area, as stated previously, virtually all Mexican automotive imports enter Canada duty-free, and therefore there would likely not be significant additional downsides compared to the status-quo. On the export side, it is clear that competition from Mexican parts and components in the U.S. market will increase. To date, Mexico has not moved into the assembly for export in a large way, but the possibility exists nonetheless. As for the Mexican market, the opportunity for additional direct exports of Canadian parts or vehicles would appear to be limited. However, as the Mexican market for North American vehicles expanded, Canadian materials and parts would move into Mexico as part of U.S. vehicle exports.

Whether a free trade arrangement is struck between the U.S. and Mexico or not, Canadian automotive vehicle and parts producers will be faced with increased competition in the 1990's from producers in Mexico (and if not Mexico, other low-cost suppliers in South East Asia or Brazil).

### 2. Urban Transit and Railways Systems

Urban transit equipment includes urban (city) buses and highway (inter-city) motorcoaches as well as light rail vehicles (LRV), subway cars, and related support systems. The railway segment includes locomotives, rolling stock, and signalling and communications systems. With regard to urban transit equipment and buses, Mexico's "Buy National" policies, recent economic problems and high tariffs have combined to constrain significant imports, but Canadian firms continue to be very interested. Mexico City alone is planning on spending about U.S. $180 million to upgrade its metro system. Sales of railway equipment have been made in the past to Mexico as a result of funding from the Canadian International Development Agency (CIDA). Canadian railway equipment manufacturers in Canada will continue to be interested in the Mexican modernization program.

Current Mexican production capability is not considered to be competitive. There is only one major bus producer in Mexico which is not regarded as a potential threat to Canadian manufacturers in either the Canadian or U.S. market. If Mexican economic activity increases and as the government increases its investment in the country's infrastructure, medium to long term opportunities could be realized by Canadian manufacturers of railway and urban transit equipment.

## V. MACHINERY AND EQUIPMENT

### 1. Agriculture Machinery and Equipment

Canada has allowed duty free entry for nearly all types of farm machinery from all countries since 1944.

A bilateral U.S./Mexico agreement would provide U.S. manufacturer of large scale farming equipment with an advantage over their Canadian competitors in the Mexican market. This could affect about $5 million in sales annually. In a trilateral agreement, Canadian firms would gain duty free access to the Mexican market which would improve their competitiveness with non-North American manufacturers while maintaining their competitive position via-à-vis U.S. firms.

## 2. Mining Machinery and Equipment

Canadian production of mining equipment is $450 million a year, of which 73 percent is exported, principally to the U.S. and South America. Canadian imports are $370 million (75 percent of the domestic market), of which 70 percent comes from the U.S. Mexico imported $300 million worth of mining equipment in 1988. Though Canada supplied a very modest $10 million of Mexico's overall imports, there is good potential for expansion of Canadian exports in this sector as a result of recent changes in investment rules. U.S. companies are much more aggressive in Mexico and supply the bulk of their needs.

Under a bilateral FTA, the U.S. would gain additional advantages (Mexican tariffs plus administration fees are roughly 20-25 percent in this sector) but the likely trade diversion effects on Canada would be modest (European and Japanese suppliers would likely be hit harder). In a trilateral agreement, Canadian firms would likely improve their competitive position in the Mexican market relative to offshore suppliers.

## 3. Electrical Products

"Capital intensive" products are mature, mass produced items such as small electric motors, industrial motor controls, light bulbs, and distribution transformers. For these products, a large degree of capital investment in new plant and equipment is constantly required to remain competitive. A tripartite FTA would likely soften the impact on Canada of increased U.S. competitiveness that would be a consequence of a bilateral U.S.-Mexico FTA, by enlarging access to Mexico for some of the more competitive Canadian plants.

Another category of electrical products includes those that are mature, highly price competitive, and sensitive to freight costs. Examples are electrical conduits, fittings, standard medium voltage transformers, and the larger standard electric motors. In general, these products will tend to be manufactured on a local and regional basis in all three countries with minimal disturbance, regardless of the evolution of free trade.

In addition, there are products such as lamp ballasts and batteries which are labour intensive. In these areas, a shift from the U.S. to Mexico is already occurring, a shift that would be accelerated under a bilateral U.S.-Mexico agreement. Certain

Canadian subsectors could face additional competitive pressures as the industry is fiercely price competitive and labour intensive.

### 4. Machine Tools and Tooling

Canadian machine tool producers have made periodic sales of large machining systems to manufacturers in Mexico. Tooling manufacturers, on the other hand export custom built tools on a regular basis ($1.5 to $2 million annually). Imports of machine tools and tooling products from Mexico have not been significant over the past five years.

Mexico is not seen as a major market by Canadian machine tool and tooling producers, however, some producers are exporting to that market. A free trade agreement with Mexico would allow Canadian producers to identify and develop market strategies to pursue export opportunities.

### 5. Plumbing Products

Mexico has been a significant supplier of ceramic sinks, washbasins and sanitary fixtures for both the American and Canadian market. The production of porcelain china sanitary fixtures is both an energy and non-skilled labour intensive process. Many U.S. companies have started or are committed to transferring significant production of ceramic plumbing fixtures from U.S. locations to Mexico.

Canada currently exports a very limited quantity of porcelain china sanitary fixtures ($1.9 million) in 1988. Canada imported $39.2 million in 1988 with $5.9 million from Mexico. Canada would experience minimal, if any, increase in exports to Mexico with the introduction of a trilateral free trade agreement. However, there could be substantially increased imports from Mexico as the industry there becomes stronger.

## VI INFORMATION TECHNOLOGIES EQUIPMENT AND SERVICES

Mexico is not considered to be a major market for Canadian information technologies manufacturers. In 1989, Canadian producers directed approximately one half of one percent of total exports to Mexico. The Mexican market is not yet sophisticated enough to absorb high value added Canadian products which tend to be very application specific, though there is some potential for Canadian suppliers of business and rural communications equipment. Mexico does, however, have the potential to become a leading North American supplier of high volume/high labour content information technology products. Companies such as IBM have established high volume manufacturing and assembly operations of items such as PS/2s and computer keyboards in Mexico. Canada had a trade deficit in information technologies equipment in excess of $280 million with Mexico in 1989.

There is a possibility that over time Mexico will develop a more sophisticated manufacturing capability in competition with Canada's high-value added producers. If a bilateral U.S.-Mexico agreement were to be concluded, foreign multinationals deciding on an investment location for volume manufacturing targeted towards the U.S. market would likely invest in the U.S. to take advantage of both the Canada-U.S. FTA and a bilateral U.S.-Mexico FTA.

A trilateral North American agreement may displace imports from offshore. However, the incremental investment would probably take place in Mexico (low cost labour) or the United States (high value added, R&D capability, access to capital). At best, Canadian manufacturers will have tariff free access to Mexican inputs for their final products. This, however, will have a negative impact on our infrastructure of industry suppliers.

It is conceivable that a trilateral agreement will be of some benefit to Canada's telecom industry. The Mexican telecom equipment market is not insignificant, at one-half the size of the Canadian market, and growing twice as fast. While Canadian exports to this market have been small (perhaps 1 percent of total exports), there are opportunities in the areas of rural, remote and business telecommunications, where the principal competition is from producers based in Japan and Europe.

## VII SERVICE INDUSTRIES

### 1. Commercial Services

Trade in commercial services between Mexico and Canada is not significant, in part because Mexico maintains a number of barriers that discourage such trade.

A bilateral U.S.-Mexico FTA would likely have little immediate impact on Canadian service exporters given the little trade now ongoing between Canada and Mexico. Such a bilateral agreement would, however, be detrimental to Canada's potential prospects for trade with Mexico.

A trilateral FTA may ensure that Canada retains the option of exploiting opportunities in Mexico as they arise. Mexican service activity in Canada would not be expected to increase. Any negotiations would have to take into account the results of the MTN negotiations in the area of services.

### 2. Construction Contracting

There is little or no activity by Canadian contractors in the Mexican market, although other foreign contractors are active in Mexico through Mexican affiliates in

areas such as the construction of tourist facilities. This suggests that Canadian contractors probably could find potential opportunities in supplementing the capability of Mexican companies.

There would be no significant impact on Canadian contractors from a U.S.-Mexico agreement. The Mexican industry is not large and would not compete with the limited Canadian activity in the U.S. which is concentrated in the northern border area, although Mexican companies are increasingly competing with Canadian companies outside Mexico, particularly in Central America.

## VIII TOURISM

The tourism industry is of significant importance to the Mexican economy as an employment generator and foreign exchange earner. Bilateral tourism agreements already exist between Mexico and the U.S. and between Mexico and Canada.

Tourism is basically a de-regulated industry (except for air bilateral agreements) and consequently governments find tourism a relatively easy area to achieve consensus in the overall trade negotiation process. If Canada was to pursue trade talks with the U.S. and Mexico, tourism would be a subject of easy agreement between all three countries. While there are likely no major benefits for Canada to be gained from a tri-national tourism agreement, there are likely to be no detrimental effects on the Canadian tourism industry as a result of such an agreement.

Working Paper

Document de travail

# Canada and a Mexico-United States Trade Agreement

July 1990

Juillet 1990

International Economic Relations

International Trade and Finance Branch

Department of Finance Canada

Relations économiques internationales

Direction des finances et du commerce internationaux

Ministère des Finances Canada

*WORKING PAPER*

# CANADA AND A MEXICO-UNITED STATES TRADE AGREEMENT

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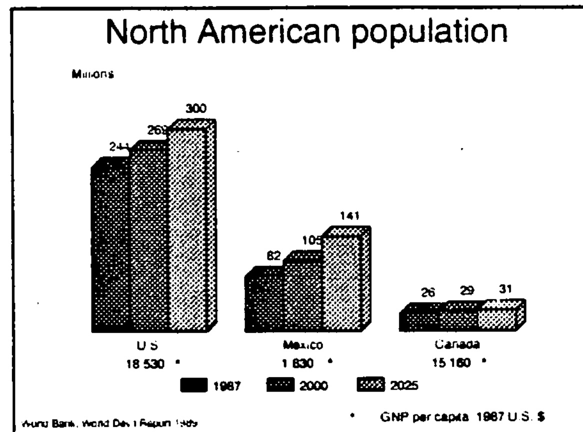
## I. Introduction

On June 10, 1990, Presidents George Bush and Carlos Salinas de Gortari announced that they had determined that a "comprehensive Free Trade Agreement" was the best vehicle to achieve a vigorous partnership for sustained economic growth that will open markets so that trade and investment can expand further. The two presidents then directed their two trade ministers to begin the consultations and preparatory work needed to initiate negotiations on a free trade agreement. They were to report back to the two presidents before their next meeting in December of this year.

This announcement ends months of speculation as to whether or not the U.S. and Mexico would initiate a process towards a free trade agreement. While the announcement is still some steps removed from the actual launching of negotiations and is only a call for a study, it would appear that the interests of Mexico, in particular, but also that of the U.S. are such that it is expected that the report will recommend the launching of negotiations. In beginning first with a study, both parties will have an opportunity to better define the parameters of the negotiations before starting and also begin the actual negotiations after the conclusion of the Uruguay Round of the GATT Multilateral Trade Negotiations.



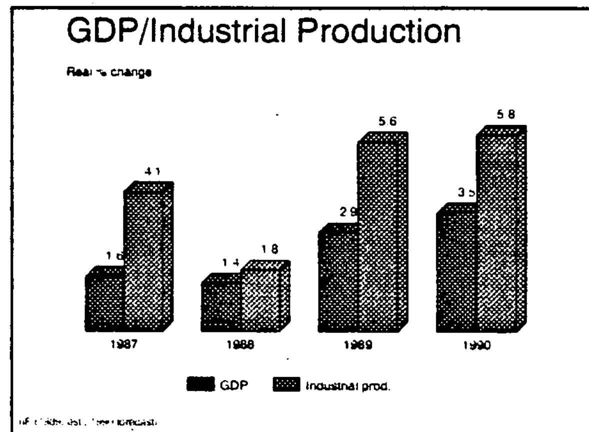

The purpose of this background paper is to focus on the economic implications for Canada should the U.S. and Mexico proceed without Canada or should Canada choose to be directly included. The paper is not intended to be comprehensive or definitive, but attempts to provide an overview of the various economic implications that will need to be taken into account in reaching a decision on Canada's approach to North American freer trade. No attempt is made in this paper to speculate on the scope or nature of any possible trade agreement that might be negotiated (either between the U.S. and Mexico or including Canada), but the general assumption for the purposes of this paper is that what is being explored is a free trade agreement and not a customs union with a common external tariff.

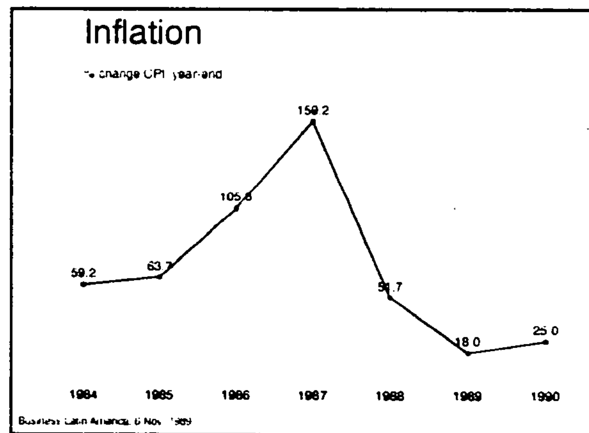
In examining the implications for Canada, the paper begins with a review of why Mexico needs a trade agreement and the extensive economic changes that have taken place over the past four years in Mexico. Next, it briefly examines the interests of the U.S. in a trade agreement with Mexico, focusing on the economic aspects. The third section begins with an overview of Canada's trade with both Mexico and the U.S. and an assessment of how Canada might be affected by an agreement between the U.S. and Mexico. The paper also examines in greater detail the impact of a North American agreement on certain key sectors and on

Canada's markets, not only domestic, but also in the U.S. and Canada's export interests in Mexico. Given that a major reason for Mexico embarking down the path towards free trade is to attract greater foreign investment, an effort is made to examine the potential long term impact on investment flows to both Mexico and Canada. In conclusion, the paper seeks to summarize the main economic issues for Canada.

## II. Why Mexico wants a trade agreement

As the smallest, most protected and poorest of the three nations in North America, in economic terms Mexico clearly has the most to gain from greater trade access with the U.S. and Canada. Moreover, further North American trade liberalization is, from a Mexican perspective, the logical consequence of the economic strategy pursued by the Salinas government. This strategy is designed to ensure that Mexico is able to overcome the threats posed to its development by the combined effect of domestic demographic pressures, its large international debt, capital flight and the internationalisation of the world economy. The government's strategy is set out generally in a National Development Plan for 1989-1994 and in 21 sectoral reform programs which stress the on-going opening of trade and investment as vital parts of the drive to modernize the economy.




The government also maintains a package of measures under the so-called Pact for Stability and Economic Growth (PECE) which aims to keep the lid on inflation and stabilize the economy. The PECE includes the following key measures:

- daily mini-devaluations of the peso;
- no wage increases are included in the renewed Pact;
- business and labour agreed to conclude a national accord for improvement of productivity; and
- an upward price adjustment for energy.

# *Overview of Mexico's economic reforms*

## IMPORT LIBERALIZATION

• Mexico has joined the GATT, reduced tariffs significantly, harmonized its tariff structure, abolished official prices, and removed most import licensing requirements. All Mexican tariffs are bound; maximum rates are reduced from 100% to 20% and its average tariff rate is only 6%. It has eliminated the import licensing requirement for 95% of its imports.

• **Computers:** All import permits have been eliminated and tariffs have been reduced significantly (5 to 20 percent range, expected to be down to 5% in two years). Producers can import duty free if the end-product satisfies a 30% local content requirement.

• **Pharmaceuticals:** Import permits will be fully eliminated by 1993.

## PRIVATIZATION

• By the end of 1989, about 650 state-owned firms had been dismantled, consolidated, or sold.

• **Banking:** The re-privatization of domestic banks was announced on May 2. It is expected that divesture will be phased in and will lead to a mixed system of ownership. Minority foreign ownership is expected to be allowed.

• **Telecommunications:** Shares in Telmex, the national monopoly, will be floated this year. Foreigners will be allowed to purchase up to 49% of the company's shares.

• **Airlines and steel:** Both domestic airlines have been privatized. The government also intends to sell two of the country's largest steel plants.

## FOREIGN INVESTMENT

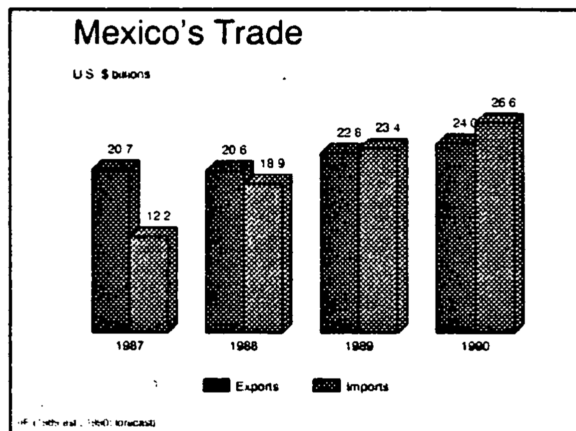
• Restrictions on foreign investments of less than U.S. $100 million have been removed in most industrial sectors if they are found to create local employment and transfer technology.

• 100% foreign ownership is now allowed in **mining, auto parts manufacturing,** and **secondary petrochemicals** if the investor provides suitable technology or invests in a company with international balance of payments problems.

## INTELLECTUAL PROPERTY

• New regulations have removed limits on royalties, extended the protection of industrial secrets, and simplified the registration and approval of licensing agreements. New patent and trademark legislation is expected in 1991.

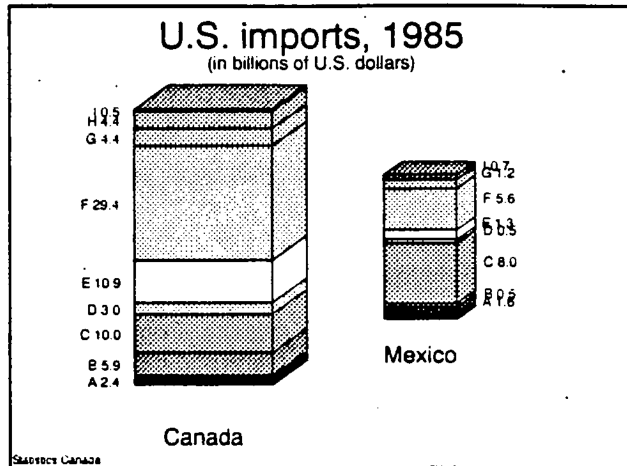
Another essential element of the Salinas economic program fell in place in March 1989 with the successful conclusion of debt re-scheduling negotiations which saw the Mexican debt cut by U.S. $21.38 billion. The agreement is considered by the Mexican government as giving its plans for the modernization of the economy sufficient room to manoeuvre.

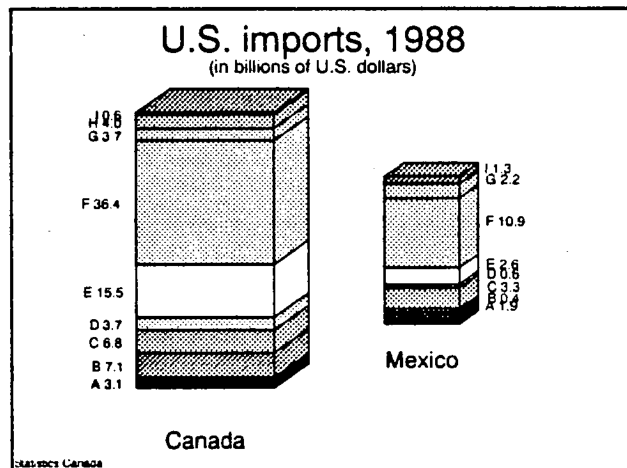


The drive to seek an improvement in economic relations with the U.S. predates the Salinas government. In 1987, the U.S. and Mexico concluded a framework agreement which established a comprehensive trade and investment consultative mechanism. An "Immediate Action Agenda" was also attached to the framework agreement which called for bilateral consultations to begin on the following sectors: textiles, agriculture, steel, investment, technology transfer, electronics, intellectual property, and services. This process led to the October 1989 doubling of the U.S. quota on Mexican steel and to the February 1990 agreement on textiles eliminating U.S. quantitative restraints on 52 types of Mexican textiles and increasing the quotas for 38 other categories. This agreement is expected to permit a 100% increase in Mexican textile exports to the U.S. over the next two years. Subsequently, petrochemicals, coffee, and beef were added to the list of sectors under discussion.

As for trade remedy actions, since 1984 only six U.S. anti-dumping investigations have been initiated against Mexican goods. There are only three Mexican products presently faced with the imposition of U.S. anti-dumping duties (elemental sulphur, cooking ware and cut flowers). The U.S. has, however, made greater use of its countervail laws against Mexico. Eleven Mexican exports presently are faced with countervailing duties with four more being the object of undertakings. As for Canada, anti-dumping duties are being imposed on imports of only one Mexican product, namely electric motors. Trade remedy actions have not, to date, been a major concern for Mexico.

Mexico's dependence on the U.S. market has grown significantly in recent years, growing from 52% of its exports in 1982 to some 73% in 1988. Indeed, Mexico's reliance on the U.S. market now rivals that of Canada. In contrast, Mexico's trade with Canada is quite small. The U.S. is the principal market for Mexico's manufactured (non-petroleum) exports. With the establishment of the maquiladora program in the late 1960's (under which U.S. firms are able to establish assembly plants and import components duty free and pay U.S. duties only on the value-added) Mexican exports of manufactured goods have risen spectacularly. The opening of the border has, however, led to a surge in imports in late 1989 and so far in 1990 that has led to predictions that Mexico may face a balance of trade deficit for 1990 as a whole.




The result and the definitive character of the extensive reforms that have been put in place by Mexico is probably best expressed by a quote from a Mexican Commerce Secretariat official: "In the end, we will have a completely transformed economy, a fully competitive exporting economy. There is no turning back from that aim."

<u>LEGEND</u>: **U.S. IMPORTS 1985 AND 1988**

| | |
|---|---|
| A | Food and live animals |
| B | Crude materials, inedible, except fuels |
| C | Mineral fuels, lubricants and related materials |
| D | Chemicals and related products |
| E | Manufactured goods classified chiefly by material |
| F | Machinery and transport equipment |
| G | Miscellaneous manufactured articles |
| H | Commodities and transactions not classified |
| I | Sum of Beverages & tobacco and Animal & vegetable oils, fats & waxes |

Indeed, the economic reforms already put in place coupled with those that have been announced will, in and of themselves, make the Mexican economy a more competitive force. Given the low level of the current U.S. tariffs facing Mexican exports[1], the primary effect of a free trade agreement with the U.S. will be to accelerate the restructuring process within Mexico and encourage investors to commit greater resources to Mexico.

## III. Why the United States is interested

There would appear to be a number of complex reasons that drive the U.S. response to President Salinas' free trade initiative. The U.S. is eager to lock in the unprecedented market oriented reforms undertaken by the present Mexican government. The U.S. government recognizes that a free trade agreement could be an important element in improving Mexico's economic situation. This would, in turn, accelerate debt crisis recovery and may even pay dividends in terms of improved management of the drugs and immigration areas.

In economic terms, a free trade agreement with Mexico (a country with only one-twentieth of U.S. GDP) would provide only a very modest increment to the U.S. economy. Nonetheless, it is important for the U.S. that the Mexican economy be strengthened. The constant flow of immigrants (legal and illegal) places a burden on the social infrastructure of the Southern border states. As an export market, Mexico is the third largest single destination for U.S. exports totalling U.S. $20.6 billion in 1988. However, this is well behind U.S. exports to Canada ($70.9 billion) and Japan ($37.7 billion). If the EC were considered as a single destination ($75.9 billion), Mexico would be a distant fourth. Nonetheless, with a present population of 85 million projected to rise to 100 million by the end of the century, Mexico is potentially an important market for U.S. goods and one in which preferential access could be useful for U.S. exporters who already dominate. A North American economic grouping that included the U.S., Canada and Mexico would result in a market as large and populous as the European Community and the European Free Trade Association (EFTA) combined.

| | GNP | Population |
|---|---|---|
| | U.S.$ billions | millions |
| EC plus EFTA | 5,385 | 357 |
| North America | 5,528 | 355 |

1. According to the GATT Tariff Study (1988 data), the U.S. MFN weighted average tariff on agricultural products was 3.3% compared to 5.0% on industrial products. The weighted average tariff faced by Mexican goods would be lower than this given the eligibility of some Mexican exports for GSP treatment.

However, Mexico is the smallest, most protected and poorest of the potential parties to a North American economic grouping. It adds the least relative to the others (3.2 % of North American GNP and 4.5 % of total exports in 1988). In addition, there is a large disparity in per capita income between Mexico and its northern neighbours. When the EC incorporated Spain and Portugal, their per capita GNP levels at the time of accession (January 1987) were 51 and 24 % of average EC-10 per capita GNP. By comparison, Mexico's per capita GNP is only one-tenth that of the U.S. and one-eighth that of Canada. The challenges, therefore, are great, but the longer-term U.S. political (a more secure southern border) and economic interests (a prosperous Mexico that can provide jobs for Mexicans and markets for U.S. goods) could outweigh those challenges.

## IV. What are the implications for Canada

Canada's trade relations with Mexico are very modest. Canadian exports to Mexico in 1989 were worth $603 million (less than half a percent of total Canadian exports; 17th most important Canadian export market). Our 1989 imports from Mexico totalled $1.7 billion, which represents just one percent of our total imports. The current average rate of duty on dutiable imports from Mexico is 10.6%. However, given that many Mexican goods are eligible for preferential rates under Canada's Generalized System of Preferences (GSP) for developing countries, and a large number of products already enter duty free, the average rate of duty on all imports from Mexico is 2.4%. The short term trade impact of increased access to the Canadian market for Mexican goods would appear to be limited.

From Mexico's perspective, Canada is a relatively more important trading partner than they are to us. Just as we do, however, they rely overwhelmingly on the U.S. as a market for their exports (73%) and as a source of imports (75%). In the course of North American trade liberalisation negotiations, Mexico would obviously concentrate its efforts on improving its access to the American market.

An important concern flowing from the creation of any free trade area is the risk of trade diversion for those countries not within the free trade area. A bilateral free trade agreement between the U.S. and Mexico could potentially result in the displacement of some American imports from Canadian sources by imports from Mexico. At the same time, Canadian firms would not have the same access as American firms to both Mexican inputs and markets.

The advantage for Canada in participating in a North American free trade agreement would be that it would ensure that Canadian producers have tariff free access to all three markets (both for exports and for the importation of inputs) on the same basis as U.S. producers, an important factor in ensuring that Canada remains a competitive base for investment. Some trade diversion concerns might still exist within a trilateral North American free trade area (also coupled with trade creation effects). However, given the small weight of Mexico in the North American economy (3.2% of combined GDP), it can be expected that a North

American free trade agreement would have only a modest short-term impact on Canada. Nonetheless, with adequate investment over the long term, Mexican exports could become competitive, not only in the labour-intensive textiles, apparel and footwear sectors, but also in consumer electronics and other assembly operations. While much of this may simply displace other low-cost sources, it will likely further encourage the restructuring of both the Canadian and U.S. economies towards higher value-added products.

As was the case in our negotiations with the U.S., Canada will have to pay attention to the rules of origin provisions of any agreement liberalizing North American trade. The problem most often mentioned is the potential use of Mexico as an location for Japanese "screwdriver plants". However, both Canada and the U.S. will likely be able to ensure that a basic amount of local value-added takes place before the product can benefit from FTA rates by establishing rules of origin along the lines of the Canada-U.S. FTA.

### A. Impact on Canada's domestic market and on our export interests in the United States

It is essential to understand that, with or without an agreement to liberalize trade with Mexico, Mexican goods will become more and more competitive both in the Canadian and American markets as a result of the domestic reforms undertaken by the Salinas government. Mexican exports in a number of industrial sectors have increased significantly since 1985 even in the face of substantial tariff and non-tariff barriers to trade. Domestic reforms are already improving Mexico's international competitiveness; a trade liberalization agreement would marginally accelerate this process but would not radically alter it.

Following are assessments of the impact of further North American trade liberalization on four key industrial sectors.

#### 1. Agricultural products

Mexico's vegetable and fruit exports to Canada reached $70 million in 1989 but, due to their earlier seasons, are for the most part not in direct competition with Canadian produce. North American trade liberalization could, however, have a ripple effect in the agricultural sector in general (e.g. pushing U.S. produce north). The additional competition faced by U.S. producers might lead to lower prices for Canadian consumers. A free trade agreement which included Mexico would probably not result in immediate change in the competitive situation of Canadian producers but could result in further adjustments within our horticultural industry over the medium term. Canada's **processed and semi-processed vegetable industry** (U.S. $48.9 million in exports to the United States in 1988) will also face greater competition from Mexican products in the U.S. market. Some of these challenges could be offset by greater export opportunities for Canadian agricultural goods in the Mexican market.

2. Energy and petrochemicals

While Mexico produces and exports many types of **petroleum products** which could compete with Canadian exports to the U.S., in most cases competition with Mexico is not an issue due to differences in crude quality and transportation networks which have resulted in the development of regional markets in North America which are supplied by different suppliers. Nonetheless, Mexico's sheer potential as a supplier of petroleum products would require the Canadian government to give particular attention to any U.S.-Mexico agreement affecting this sector in order to ensure that the U.S.market share of western Canadian production is not unduly affected. The direct impact of improved Mexican access to the Canadian market in coal, petroleum, and gas, would, however, appear limited.

**CANADIAN TRADE WITH MEXICO**
**(Thousands of dollars)**

| | 1989 |
|---|---|
| **TOTAL EXPORTS** | **603,098** |
| Vehicles, parts & accessories | 71,552 |
| Iron and steel | 71,324 |
| Machinery & mech. appliances... | 63,495 |
| Oil seed, oleagi fruit;... | 59,772 |
| Dairy products... | 46,404 |
| Salt, sulphur; earth & stone;... | 41,034 |
| Aircraft, spacecraft, and parts | 40,119 |
| Pulp of wood... | 23,819 |
| Articles of iron or steel | 20,627 |
| | 1989 |
| **TOTAL IMPORTS** | **1,698,368** |
| Machinery & mech. appliances... | 466,177 |
| Electrical machinery equipment... | 335,103 |
| Vehicles, parts & accessories | 299,415 |
| Precious stones & metals, coins | 199,528 |
| Mineral fuels, oils... | 49,406 |
| Edible vegetables... | 41,835 |
| Edible fruits and nuts... | 29,963 |
| Coffee, tea... | 26,507 |
| Salt, sulphur, earth & stone;... | 21,976 |
| Articles of iron or steel | 19,209 |

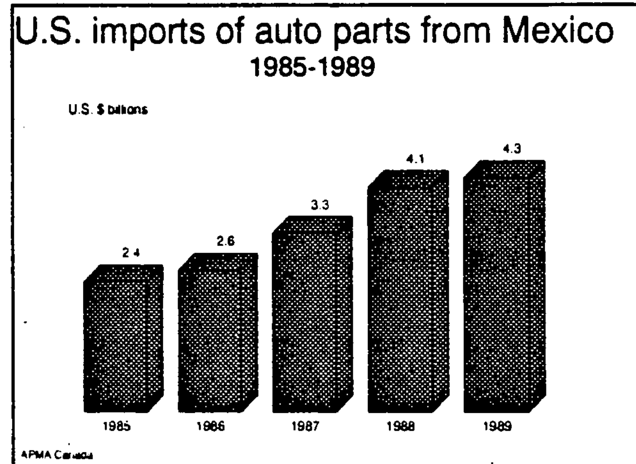
Source: Statistics Canada

The **petrochemical industry** is, however, becoming more competitive. Petroleos Mexicanos (PEMEX), the state-controlled oil company, still holds exclusive rights for the production of 20 basic petrochemicals. Seventy-five percent of the secondary petrochemical industry is, on the other hand, in private hands. Complete foreign ownership of firms in the secondary petrochemical industry is now allowed if the investor provides suitable technology or invests in a company which was facing international balance of payments problems. Further foreign investment in this sector could lead to increases in productivity with Mexico becoming a more important competitor for both Canadian and American producers.

3. Autos and parts

Canadian imports of Mexican automotive products amounted to approximately $299 million in 1989, and were comprised mostly of automotive parts and components. Exports of Canadian automotive products to Mexico amounted to $71.6 million in 1989 and consisted entirely of automotive parts. If other tariff line items are included, such as certain types of machinery, stereos and glass used in the production of vehicles, total automotive imports from Mexico

amount to about $680 million. Over 98 per cent of automotive imports from Mexico enter duty-free under the Auto Pact. The remainder are imported by non-Auto Pact companies at the GPT rate of six per cent.




The volume of U.S.-Mexico trade in automotive products is much greater. For example, U.S. imports of Mexican auto parts were well in excess of $5 billion in 1989. A substantial portion of these imports are manufactured under the maquiladora industry program, a border industrialization program initiated by Mexico in 1965. This program allows the duty-free entry of raw materials and components into Mexico on the condition they are exported as finished products. When the products are exported to the U.S., duty is, in effect, paid only on the Mexican value-added (since most of the components used are of U.S.-origin). The program is successful because it allows auto parts producers to benefit from low Mexican labour costs (about $1.50/hour) while maintaining near duty-free access to the U.S. market. It is estimated that approximately 200 auto parts manufacturers have established maquiladora facilities which produce mostly labour-intensive, low technology components. GM, Ford and Chrysler have established approximately 42 plants in the maquiladora region.

In effect, one way "de facto" free trade already exists between Mexico and the U.S. and Canada for automotive products because of Auto Pact privileges and the maquiladora industrialization program. As a result, Canadian parts producers and exporters already face some competitive pressures from labour-intensive, low-technology Mexican parts exported to Canada and the U.S. Various analysts have estimated that for selected components, the landed-cost advantage for Mexican parts in the U.S. and Canada is in the range of 5-15 per cent.

In 1989, a new Mexican decree was introduced (for implementation in late 1990) which would ease some of the current restrictions in that country on automotive trade and investment. It would, for example, abolish import licensing requirements and allow 50 per cent or more foreign ownership of domestic companies. It would also lower the Mexican content requirement from 60 to 36 per cent on average, making it easier for vehicle assemblers in Mexico to achieve higher levels of quality through the use of imported parts. The decree is considered an important incentive for automotive investment in Mexico, particularly in the area of high-technology, high-quality parts (a product segment where Mexico is weak), and in vehicle assembly. In essence, the measures of the new decree are designed to bring the Mexican automotive industry up to international levels of quality and competitiveness. However, these reforms will

still leave the Mexican industry with a high degree of protection. The complete removal of the remaining barriers would place the domestic Mexican industry (in particular their assembly operations for the Mexican market -- as opposed to parts production for export) under severe competitive pressures.

A free trade arrangement between the U.S. and Mexico would not significantly change the North American environment in which Canadian automotive companies compete. It might, however, have the effect of accelerating several trends which are already occurring in the industry, i.e., the growth of the Mexican automotive parts industry, increased sourcing of labour intensive, low-technology Mexican parts by North American companies, and further foreign investment in parts facilities in Mexico, particularly in the high-technology, high-quality parts segment, and increased competition from Mexican-manufactured vehicles. In terms of a Canada-U.S.-Mexico free trade area, as stated previously, virtually all Mexican automotive imports enter Canada duty-free, and therefore they would likely not significantly affect the status-quo in the short-run. On the export side, it is clear that competition from Mexican parts and components in the U.S. market will increase. To date, because of scale and infrastructure problems, Mexico has not moved into the assembly for export in a large way, but the possibility exists nonetheless. As for the Mexican market, some opportunities for additional direct exports of Canadian parts or vehicles may exist.

Whether a free trade arrangement is struck between the U.S. and Mexico or not, Canadian automotive vehicle and parts producers will likely be faced with increased competition in the 1990's from producers in Mexico (and if not Mexico, other low-cost suppliers in S.E. Asia or Brazil).

4. Textiles and clothing

Mexico is our third largest unrestrained supplier of textile products. However, because its exports are spread across a range of product categories, "market disruption" has so far not been a problem.

As a result of proximity to the U.S. market and the special U.S. outward processing programs, Mexico has developed a sizeable clothing sewing and processing capacity. The potential to take action under the Multi-Fibre Agreement (MFA) and the FTA rules of origin have probably limited the impact on Canadian producers from large scale imports of Mexican textile products or U.S. textile products further processed in Mexico.

In the case of textiles, Mexico's oil industry gives it a competitive advantage in the production of synthetic/man-made fibres. In this regard, Canada has, in the past, negotiated some voluntary arrangements with Mexico on their exports to Canada of polyester textured yarn and worsted spun acrylic yarn. The Mexican textile industry over the long-run may have possibilities for increased production.

Regarding the issue of increased competition in the U.S. market, the elimination of duties and other restrictive regulations of commerce (e.g. quota restraints) on Mexican textile and clothing products entering the U.S. would likely result in increased competition in that market for some Canadian exporters. This information must, however, be considered in relation to the present state of the Mexican industry. Its apparel industry is fragmented and dominated by small family-run sewing operations. The level of investment in the textiles sector has been low. The Mexican industry basically competes at the lower end of the U.S. apparel market (i.e., lower-cost commodity products) whereas Canada's competitive advantage generally lies in higher/less price-elastic apparel goods.

While Mexico's utilization of its guaranteed access levels in the U.S. market has been high, Canada and Mexico do not compete head-to-head in the U.S. market. This situation would likely continue in the medium term. In textiles, while Mexico does not appear to pose a threat to Canadian producers in either the domestic or U.S. markets, some potential exists for greater Mexican competition. However, with respect to clothing, given Mexico's likely concentration on the low end of the quality scale, they will most likely displace other low-cost producers in Canada and the U.S. rather than compete with Canadian goods.

B. Canadian export interests in Mexico

The volume of Canadian exports to Mexico has been relatively small over the years. Nonetheless, it appears that the Canadian business community does attach some importance to improving our access to the Mexican market. The Mexican market is considered as having considerable potential given its present relatively low level of development, its rapidly increasing population, and, most importantly, given the impact that the Salinas reform program is perceived as having on the Mexican economy. In the event of the successful negotiation of a trade agreement with Mexico, Canadian firms would likely wish to ensure that they are not disadvantaged relative to American firms operating in the Mexican market.

Canada's main export interests in the Mexico centre around the elimination of various quantitative restraints and import licensing requirements affecting a wide range of sectors (such as crustaceans, milk powder, oilseeds, newsprint, computer equipment and auto parts). Canadian firms have also found their export opportunities are restricted by Mexico's "Buy National" government procurement practices as well as various performance requirements on foreign direct investment (e.g. local content measures).

On a product by product basis, our export interests in Mexico would appear to be concentrated in sectors where Canada has traditionally benefitted from a comparative advantage. Our principal export interests have been identified in the following sectors:

- **Agricultural products:** live beef; beef, pork and horses meat; edible offal; and lard.
- **Fisheries products:** frozen fish; prepared or preserved fish; and crustaceans.
- **Minerals and chemicals:** asbestos; chemical fertilizers; nickel; aluminum (in all forms); magnesium; and bismuth.
- **Wood, pulp, and paper:** sawn wood; plywood; shakes and shingles; pulp of wood; fluting paper.
- **Iron and steel products:** rails.
- **Manufactured goods:** air conditioning machines; certain machine tools; ball or roller bearings; electrical transformers; telephonic switches; colour cathode tubes; mattresses and bedding articles; and lamps & lighting fixtures.
- **Public transit equipment:** subway and rail cars.

C. Financial services

1. Proposed Financial Sector Reforms in Mexico

All Mexican banks are nationally owned with limited (if any) direct involvement by foreign institutions. Also, there is no foreign participation in the securities industry and only a limited foreign presence in insurance.

Earlier this year the Mexican government announced that it would relax certain foreign ownership restrictions through the following measures:

- With respect to national banks, foreign ownership in any one bank will be permitted up to a maximum of 34% of non-voting shares.
- In insurance, up to 49% foreign participation would be permitted, with Ministerial approval.
- Foreign participation in exchange and securities firms will continue to be barred.

On May 2, 1990, President Salinas announced the re-privatization of Mexican banking system (the banks were nationalized in 1982). The Mexican government proposes the establishment of a mixed regime but has not identified which banks will be privatized nor the amount of the government's shareholdings which will be put up for sale to domestic and foreign investors. It is assumed that the big development banks (Nafinsa and Banobras) will remain state-owned.

2. Trade in Financial Services with Mexico

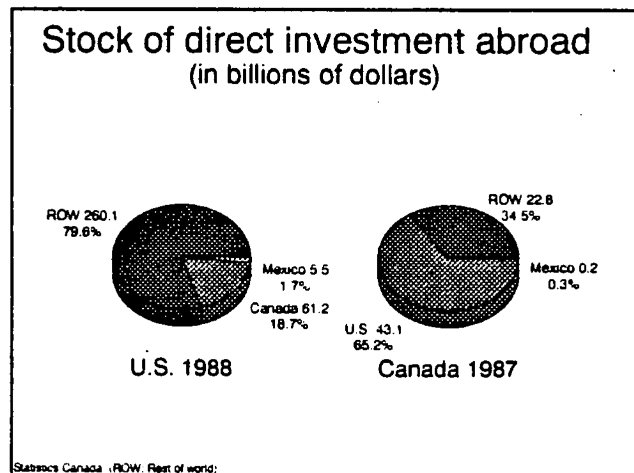
Mexican institutions have no presence in Canadian financial markets. Likewise, there are no Canadian financial institutions operating in Mexico, to our knowledge, either on a branch or subsidiary basis. Some Canadian banks have Mexican representative offices used for marketing purposes solely. Also, while affiliates of foreign-owned Canadian insurance companies operate in Mexico, this has no bearing on Canadian firms. Aside from syndicated loans to Mexico (which grossed $4.5 billion for all Canadian banks in October 1989), there does not appear to be any other direct dealing by Canadian financial institutions in Mexico.

3. Potential Implications of U.S.-Mexico Deal

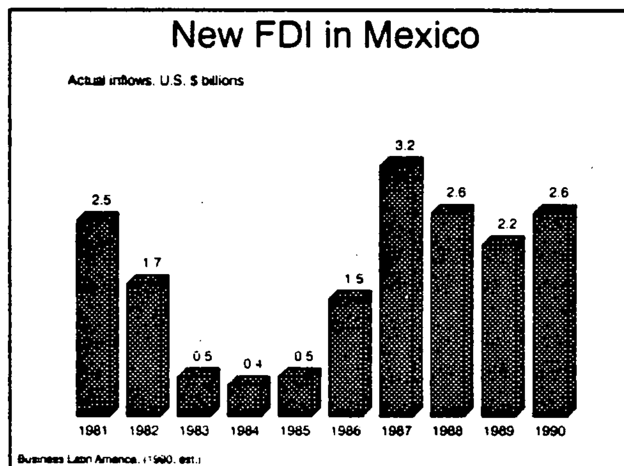
There would not appear to be any major implications from trade liberalization between Mexico and the U.S. for Canadian financial institutions. Any increase in trade, however, is likely to result in greater opportunities for Canadian financial institutions to service the companies involved in that trade. The resultant stimulus to Mexico's economy under a free trade deal would lead to a higher volume of trade financing with Mexico over time.

## V. Potential long term impact on investment flows

The previous sections of this paper indicate that the actual short to medium term impact of further North American trade liberalization would have only a limited effect on Canada's trade with the U.S. and Mexico. However, there could be potential for increased competition between Canada and Mexico as foreign direct investment (FDI) recipients, either as a result of a bilateral U.S.-Mexican agreement or a trilateral agreement including Canada.



The reforms undertaken by the Salinas government have already had an impact on the perception of the private sector of Mexico as a potential location for FDI. The liberalization of the autos & parts industry, for example, has led to large new foreign investments in Mexico which have greatly improved the country's competitiveness in that sector. Such inflows of investments are bound to continue as foreign firms, spurred on by the economic reforms of the Salinas government, decide to take advantage of Mexico's relatively low labour costs and natural resource base (particularly to its petroleum and gas resources). The resumption of the debt for equity swap program is also expected to increase FDI in Mexico. It can therefore be expected that, independently of any trade agreement, other industries will eventually benefit from an influx of foreign capital brought about by the Mexican government's reform program. The impact of a U.S.-Mexico FTA would reinforce the effect of the reforms discussed above and would make investing in Mexico, particularly in the autos & parts and textile & clothing, even more interesting for both U.S. and third country firms.




An important issue from Canada's perspective is to what extent Canada actually competes with Mexico as a location for FDI by firms wishing to service the North American market. Firms base their decision to invest abroad on 1) the size and growth of the foreign market, 2) the costs of production and distribution, 3) the nature of competition involved, and 4) government attitude to business (i.e. fiscal, commercial and regulatory policies). In the event of the creation of a North American FTA, a firm deciding where to locate in North America would base its decision on a comparison of Mexico and Canada's relative advantages with regard to factors 2) and 4).[2]

Canada is not threatened by the possibility that high distribution costs will divert investments to Mexico. Canada's infrastructural links with the U.S. market and its established distribution networks provide considerable assurance that distribution costs will remain competitive in most sectors. The north/south regionalization of market shares already apparent in certain sectors of the U.S. market (e.g. Canadian firms supplying the northern tier states while Mexican firms concentrate on the southern tier) could become even more marked as a result of a North American FTA. Such a phenomena is, however, the natural result of geography and transportation links and a North American FTA would only accelerate what is already taking place.

2. Factors 1) and 3) have less impact on the location decision within a given region but will greatly influence the inter-regional decision (ie. whether to invest in North America or Europe).

Mexico has a definite advantage over Canada in terms of wage rates but these constitute but one component of actual production costs. The availability of specialised labour, the research and development infrastructure, the access to financial, professional and other types of services, even the types of services provided by the different levels of government, have direct or indirect impact on the actual cost of production and productivity of a firm. The differences between Canada and Mexico in terms of all of the above factors are significant and likely contribute to higher overall Canadian productivity which, in a number of sectors, compensate for the higher Canadian wage rates.

It can be argued that Canada and Mexico compete for FDI in North America on the basis of different comparative advantages and that an FTA will therefore not have a significant diversionary impact on foreign direct investment. The Canada-U.S. FTA was part of the government's strategy to accelerate the adjustments within Canada and the restructuring of our economy towards higher value-added production. A North American free trade agreement would simply reinforce the importance of such restructuring.

## VI. Conclusions

Mexico is clearly undergoing a massive economic transformation towards becoming an outward-oriented, market-based economy. Since 1986, when Mexico joined the GATT, it has significantly liberalized both trade and investment and has embarked on an important program of privatization. The Salinas government has accelerated this pace of change and is seeking to maintain the momentum of economic reform by reaching a trade agreement with, in particular, the U.S. The U.S. has become over the past decade Mexico's predominant market and, as Canada, it is logical for Mexico to seek to obtain secure market access to the U.S.

The U.S. also has strong interests in promoting Mexican economic growth. A stronger Mexican economy would accelerate the repayment of debt, bolster democratization, ensure a more secure southern boundary, and could pay dividends in drug control and immigration areas. A free trade agreement would also go a long ways towards locking-in the unprecedented economic reforms being put in place by the Salinas government. U.S. exporters have an interest in the Mexican market, especially a growing and more affluent one.

For these and a host of other domestic and geopolitical reasons, it would appear that the study process initiated on June 10 by Presidents Bush and Salinas will develop into the launching of negotiations on a "freer trade agreement". Given the difference in economic levels of development and the past history, the negotiation of a free trade agreement will not be an easy process for either the U.S. or Mexico. Both countries will seek to protect their sensitive sectors and there may be difficulties in dealing with labour mobility (potentially an important goal for Mexico).

Canada's interests in becoming involved in a freer trade arrangement involving both the U.S. and Mexico are a little more complex and indirect. In terms of exports, Canadian exporters see real potential in the Mexican market, although the immediate benefits are not likely to be large. The import impact of freer trade with Mexico would appear to be varied, but in general there are likely to be only marginal concerns over the short-term. In addition, given increased globalisation and the likelihood of reduced tariffs flowing from the Multilateral Trade Negotiations (MTN), Canada will face increased competition in the U.S. market from Mexico and other low-cost producers regardless of a free trade agreement between the U.S. and Mexico.

Consequently, the real question for Canada is how it can best position itself to remain competitive in the North American and world market over the medium to long term. As industries restructure in order to adapt to the competitive pressures, whether from Mexico or elsewhere, it will be important that firms located in Canada are perceived to have access to the same markets as firms located elsewhere in North America. Participation in a trilateral free trade agreement would allow Canadian producers to have access to the entire North American market both as exporters and importers on the same basis as American producers. This will assist in ensuring the continuation of the current adjustment taking place in Canada towards higher value added production and that Canada maintains its competitiveness as a host for new investment.

# Canada-U.S.-Mexico Free Trade Negotiations:

# The Rationale And The Investment Dimension

August 1990

*INVESTMENT CANADA*

*INVESTISSEMENT CANADA*

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## Introduction and Principal Conclusions

President Bush announced on August 8 that the United States and Mexico have undertaken to negotiate a free trade agreement. This undertaking is much earlier than expected and President Bush will seek Congressional approval for the initiative in September. In order for Canada to be included in the initiative, the Government of Canada must formally request the President to enter into trilateral negotiations.

This note explores some of the factors bearing upon the decision facing Canada. The purpose of this note is basically twofold:

i) to set out arguments relevant to a decision on whether or not to join the U.S.\Mexico trade negotiations;

ii) to provide preliminary material on investment regulations and flows, in the expectation that investment concerns will figure importantly in the negotiations.

The paper is divided in two parts, reflecting the dual purpose described.

The analysis and conclusions of this paper are necessarily preliminary. More work needs to be done on key issues, including the issue of potential trade and investment diversion from Canada in favour of Mexico as a consequence of a North American free trade agreement. The Economic Council of Canada and a number of universities are undertaking indepth research on these issues. Investment Canada has supplementary research underway on the issue of investment diversion.

At this juncture, the following observations appear to be defensible. It is in Canada's interest to participate in trilateral free trade negotiations with the United States and Mexico. This interest is more broadly based than the recognition that the United States and Mexico are committed to proceeding with or without Canada. A North American free trade zone will strengthen Canada's ability to create global corporations and to specialize in knowledge-based industries, both of which are needed to compete more effectively against other major industrialized countries.

While many Canadians may be concerned that extension of the Free Trade Agreement to include Mexico will lead to job losses, the ultimate outcome should be better job and income prospects for all participants to the extended agreement - including Canadians. Whereas a bilateral agreement between Mexico and the United States might result in negative consequences for Canada, there is little reason to believe that a trilateral agreement would yield a zero sum result. On the contrary, productivity gains from greater economies of scale, lower cost inputs, and industry rationalization based on different comparative advantages should enable Canada to better compete in markets in North America, Asia and Europe.

Mexico has the potential to become an important export market for Canada. By the end of the century its population will be close to 100 million. Sweeping economic reforms, notably liberalization of its trade and investment regulations, are propelling Mexico towards the remarkable achievements already experienced by several countries in Southeast Asia. Formulation of a North American Free Trade Agreement will help Mexico adhere to the economic liberalization so long advocated by the advanced industrialized countries - including Canada. The growth of Mexico is an opportunity for Canada, not a threat. It would be against Canada's self-interest to say no to Mexico's inclusion in a North American free trade agreement. It would also be contrary to improved prospects for developing countries throughout Latin America and abroad. The challenge is to negotiate an agreement that builds upon the interests of the three countries concerned.

The prospect of a North American free trade agreement is capturing a lot of interest in Central and South America. Indeed, several Latin American countries have expressed interest in the possibility of an "America's Accord". While it is very premature to speculate on this possibility, it must be acknowledged that a multilateral approach of this sort is much more desirable than the hub and spoke model. The latter would entail a series of bilateral agreements with the United States, with only it having free access to the markets of the participants. It is this danger that Canada - by agreeing at the outset to trilateral negotiations - can help to avoid.

# Part I: The Rationale For Canada's Participation In Trade Negotiations With Mexico And The United States

## The Objectives To Be Pursued

Arguments for and against participation in trilateral negotiations with Mexico and the United States will be influenced by the objectives of the Government of Canada, and the likelihood of these objectives being shared or accepted by the other two countries. For purposes of discussion, the key objectives are assumed to be:

i) to secure, in a fair and reciprocal manner, assured access by Canadian business interests to the Mexican market;

ii) to extend the FTA to include Mexico in a manner that minimizes the need for bilateral adjustments between Canada and the United States.

It is assumed, therefore, that participation in the negotiations will not entail, to any substantive degree, further liberalization of Canada's trade and investment provisions with the United States. In particular, another round of negotiations is not anticipated to result in further institutional integration of the Canada\U.S. economies.

## The Conventional Economic Assessment

The usual approach to assessing a Canada-Mexico-U.S. free trade agreement is based upon an examination of trade and investment flows among the three countries. More particularly, the assessment entails the following:

- the degree of trade and investment between Canada and Mexico; currently, the flows are very modest; less than half of one percent ($600 million) of total Canadian exports are destined for the Mexican market; imports from Mexico account for 1 percent ($1.7 billion) of total Canadian imports; investment flows are even more modest (the stock of Canadian direct investment in Mexico in 1989 was US$361, or 1.5 percent of the total for Mexico); <u>from the perspective of current trade and investment flows between Canada and Mexico, it would appear that extension of the Canada\U.S. free trade agreement to include Mexico would be of only marginal significance;</u>

- the potential for trade diversion favouring Mexico at the expense of Canada; both Mexico and Canada are heavily dependent upon the United States as an export market; in each case roughly three-quarters of Canadian and Mexican exports are destined for the United States; preliminary analysis indicates that trade diversion could be significant in respect to autos & parts and textiles & clothing; however, structural reforms in Mexico will lead to trade diversion whether or not there is a free trade agreement; <u>an agreement per se will have only marginal significance in terms of competition between Canada and Mexico for the U.S. market;</u>

- the potential for trade creation benefitting all three parties to the agreement; Mexico has a population of 85 million, which is expected to rise to 100 million by the end of the century; with the sweeping economic reforms or "Salinastroika", Mexico could well become a NIC with growth prospects similar to Thailand and Indonesia; per capita incomes would rise sharply, as would the demand for imported consumer products and capital goods; nonetheless, in light of Mexico's small economic stature relative to the U.S. and Canadian economies, the potential gains from trade creation in the short to medium term are very limited;

- the potential for long-term investment diversion; a Mexico\U.S. free trade agreement would certainly undermine Canada's current advantage as the sole country having assured and free access to the U.S. market; this development, together with the increasing attractiveness of Mexico resulting from its structural reforms, may cause a significant increase in its share of the world's flow of direct investment; Mexico's investment gains could be at the expense of Canada, although this presumes a zero sum game; both countries could be more attractive to foreign investment as a result of a North American free trade agreement; one business association has indicated that some of its members foresee a shift concerning the location of manufacturing establishments in low-cost countries, from Southeast Asia in favour of Mexico; because of the all-important rules of origin issue, Canada is more likely to benefit from this shift if it is a member of a trilateral agreement rather than simply a participant in paired agreements (i.e., Canada\U.S. and U.S.\Mexico);

- the strategic interests of tracking an initiative involving Canada's major trading partner; defensive considerations would suggest that it is in Canada's interests to be at the bargaining table, even if the outcome is not expected to appreciably affect its trade and investment flows; Canada should endeavour to shape the outcome of the negotiations in a manner that is most favourable to it; in particular, Canada should endeavour to ensure itself access to low-cost inputs and to allow for an appropriate period of adjustment.

Conventional economic analysis, therefore, would suggest endorsement of trilateral negotiations involving Canada, Mexico and the United States. There are, however, reservations that could be raised. There is, for example, legitimate concern about the complementarity between bilateral (or trilateral) and multilateral agreements - particularly the implications for the MTN given their critical stage. GATT negotiations have so far been unable to resolve subsidies and other forms of protectionism involving agriculture. Canada could find its position on agriculture is at odds with both the United States and Mexico, a danger that is less critical in a multilateral context. Also, there is a danger that the United States could try to bend the trilateral negotiations to reopen "unfinished business" with Canada. In respect to investment, this could entail attempts to have Canada drop its screening process, its imposition of performance requirements, and its restrictions concerning the energy and cultural sectors. On the

other hand, there is increasing concern about foreign investment in the U.S., and there are significant geopolitical stakes for the U.S. in its relations with Mexico. These two factors could lead the U.S. to be flexible in negotiations on investment.

While these and other concerns are valid, it must be recognized that Mexico and the United States intend to proceed in defining a free trade accord. Canada, therefore, faces Hobson's choice. Conventional economic analysis may not be fully persuasive, but it is a solid part of the rationale for participation in trilateral negotiations.

## Limitations Of Conventional Economic Analysis

The basic problem with sector-by-sector cost analysis or static equilibrium analysis is that the whole theory and application of comparative advantage is overlooked. While Mexico is a very low wage country (the hourly wage in maquiladora operations is about $1.50), it is also a very low productivity country. Unit labour costs in Mexico tend to be high, except in those firms where modern management techniques and modern capital equipment can offset the lack of skills of the labour force.

Mexico's capacity for efficient production is expanding rapidly, but from a small base. Although it has a population of 85 million, its GDP is little more than one-third of Canada's and its per capita income is one-eighth. Mexico's exports to the United States (its main market) expanded at the rate of 7 percent annually between 1984 and 1988, which is a healthy rate but hardly spectacular or trade threatening. Further, it should be noted that U.S. exports to Mexico during this same period expanded at a much faster rate - 18 percent annually. Canada experienced a similar dichotomy between exports and imports from Mexico; in fact, between 1988 and 1989 Canadian exports to Mexico increased by 160 percent while imports from Mexico increased by only 28 percent (albeit from a much larger base).

To grow from its impoverished state to a middle-income state will take Mexico at least a decade and a huge amount of capital investment. It may take several decades before Mexico's labour force is anywhere near being fully and productively employed. During this transition its appetite for imported capital and consumer goods will be insatiable. Indeed, large foreign capital inflows will be required to offset a substantial current account deficit. The Middle East crisis and the approximate $10 a barrel increase in world oil prices has bolstered Mexico's external position - enhancing its ability to import capital and consumer goods. The increase in the oil price, if maintained over a full year, would generate an extra $ 5 billion or more in export earnings for Mexico; this is equivalent to at least a 2.5 percent increase in its GDP.

The transfer of wealth from oil-consuming nations to oil-producing nations underscores a basic lesson of comparative trade theory. No matter how productive a nation (e.g., the United States) or how low-wage a nation (e.g., Mexico), it cannot produce sufficiently to satisfy domestic markets - let alone world markets. As a result of

its structural reforms, outside capital infusions, and improved terms of trade, Mexico's development prospects are excellent. Its penetration of the U.S. market can be expected to increase, displacing Canadian and American products in the process. In turn, however, Mexico will draw much more heavily upon Canadian and American exports - both to sustain the investment boom and to satisfy the pent-up demand of a more affluent Mexican population. Adjustment will be required on the part of both Canada and the United States, but this adjustment may be accommodated - for the most part - by the ongoing process of adjustment, capital renewal and change in the labour force (through exits and entrants). Canada can expect to benefit from increased economies of scale and productivity gains, benefits that are not reflected in conventional economic analysis.

## Explaining the Issues

The Canadian worker is highly susceptible to arguments about the loss of jobs following free trade, especially when the new partner is sometimes portrayed as having sub-standard labour conditions. Debate about the Canada\U.S. free trade agreement has illustrated just how nervous many workers are about fundamental changes in economic policy. Debate about a deal with Mexico may be more muted, since it is relatively remote and the links with Canada are limited. Nonetheless, Canadian workers will want to be reassured that their interests are being protected.

It is going to be a challenge to deal with the natural inclination of working Canadians to feel threatened by changes to the trading relationship. There is no easy solution to this problem, for it is easy for the critics of free trade to point out where job losses are most likely (e.g., the auto parts and textile industries). Unfortunately, it is very difficult for economists and industry experts to state, with any degree of confidence, where job opportunities will arise. Since a job in hand is worth (at least) two in the bush, advocates of the negotiations face a tough task of explaining how a free trade accord with a low wage, labour surplus nation would be to Canada's gain. The sector analysis provided by the Economic Council during the Canada\U.S. free trade debate was digested by very few experts. The overall job loss\gain predictions of various organizations, including provincial governments, unions and business organizations, lacked credibility.

Perhaps the best response to the issue of potential job loss is attention to how to strengthen Canada's productivity performance. Productivity will ultimately determine the degree to which Canada benefits from freer trade and the process of globalization. Attention to productivity accentuates structural adjustment, such as measures needed to end the poverty\welfare trap and the high level of unemployment (more properly, the non-accelerating inflation rate of unemployment).

Explanation will be needed to refute the worst scenarios about free trade, but the difficulty with this sort of focus is that it inevitably requires acknowledgement of problem areas. This, in turn, calls for adjustment assistance or outright protection (e.g. treatment of agriculture under the FTA). Resources could be expended on shoring-up or accommodating weak sectors. Since the resources available to government are extremely limited, this could mean resource allocation to weak sectors at the expense of support for industries having strong growth potential. Such a scenario would be counter to sound economic policy, and in any event, would not be warranted given our assessment of the small changes in the short- to medium-term and the overall positive benefits of a trilateral agreement.

## The Global Vision

A very different perspective of the Canada\U.S.\Mexico trade negotiations is gained by considering the north\south dichotomy and, more generally, the globalization of world economies. Mexico is obviously a very poor country struggling to overcome a backbreaking external debt situation and a rapidly growing population (approximately 3.5 percent a year). After many years of extensive state intervention and unsuccessful economic policies, including very restrictive policies concerning foreign investment, Mexico has emerged in recent years with a fresh approach to development. It has demonstrated its willingness to implement the tough structural adjustment measures long advocated by the IMF and the World Bank.

The pace of reform in Mexico is astonishing. It has joined the GATT and dramatically liberalized import restrictions and tariffs. Literally hundreds of state-owned enterprises have been privatized or simply closed. The banking system is to be re-privatized and other key sectors, such as telecommunications, airlines and steel, are to be opened up for private sector participation - including foreign investment. Indeed, foreign investment restrictions have largely being replaced - or are in the process of being replaced - by overtures to take advantage of Mexico's low wage, labour surplus situation. The expansion of the maquiladora program (under which U.S. firms are able to establish assembly plants and import components duty free and pay U.S. duties only on the value-added) is one manifestation of this new attitude towards foreign investment. Another manifestation is the proposed U.S.\Mexico free trade agreement, which the Mexican Government believes will lead to greater confidence and hence greater investment in the country.

Mexico's success is vital to the western world, for it signals endorsement of the market-lead, outward-orientation approach to development so long advocated by western economists. The success of Singapore, South Korea, Taiwan, Hong Kong, Thailand, Malaysia and, most prominently, Japan has stood in stark contrast to the stagnation or reversals suffered by socialist or protectionist countries (e.g., Vietnam and the Eastern Bloc generally). While the break-up of the Soviet "empire" has greatly propelled the adoption of market solutions to age-old development problems, there is a great number

of Third World countries in a highly confused state. Unfairly, but with some effect nonetheless, their regressive economic performance is often attributed to unworkable IMF\World Bank prescriptions. Mexico, like Indonesia and a small number of emerging "NICs", is a model of those same prescriptions applied successfully.

Canada, along with the United States and other G7 countries, has a lot at stake in nurturing Mexico's fledgling success. Part of this stake is purely self-interest. Canada's official development assistance, for example, is approximately $2.5 billion annually. Further, extreme poverty in Latin America and elsewhere in the world compounds the refugee problem. Even the drug problem is believed to be linked with north\south income disparities. More compelling than self-interest, however, is the moral obligation to work towards a more just society on a world scale. In this context, the issue of trilateral trade negotiations does not reduce to quantification of Canada's interests in joining Mexico and the United States at the bargaining table. Rather, the issue is whether we should say no to a developing country that is pursuing newly formed market oriented policies - including now a request to join the United States and Canada in a North American free trade agreement. If we do say no bilaterally, utterances by Canada at the multilateral level in support of Third World development may be regarded as little more than lip service.

Yet another aspect of this question is the globalization of world economies and the implications of this for Canada's trade and investment policies. Investment Canada's research report on this subject (The Business Implications of Globalization) noted that there is little option for Canada but to aggressively adapt to the pressures of globalization. This includes acceptance of world competition for domestic and international markets, unencumbered by tariff and non-tariff barriers. While the world trading system is still fractured by imperfections, there can be little doubt that global corporations are rapidly forcing governments to rely on productivity performance rather than protection to ensure quality jobs for their citizens. Intra-corporate trade is vitally important and, as a reflection of this, direct investment abroad is increasingly a complement to trade rather than a substitute. Investment, in fact, is expected to figure importantly in the negotiations between Canada, the United States and Mexico.

## Summary To Part I: The Rationale For Canadian Participation

Conventional analysis of Canada's interests in a North American trade accord including Mexico leads to the following conclusion: the impact of an expanded trade agreement would be marginal, but it is nonetheless in Canada's interests to be part of the negotiations given that Mexico and the United States are committed to proceeding. Less conventional analysis and reflection, which goes beyond simple cost comparisons and description of current trade\investment flows, provides a much stronger case for Canada's involvement in trilateral negotiations. Mexico has adopted the economic prescriptions long advocated by western industrialized countries, including Canada. To help ensure the success of these reforms, Canada should - in concert with the United States - be willing to liberalize trade with Mexico. In any case, with or without a bilateral or trilateral trade agreement, Mexico can expect to develop rapidly if its structural reforms are maintained. Its participation in U.S. and Canadian markets will increase, displacing some jobs in the process. At the same time, however, Mexico's import requirements will soar. Canada must be prepared to respond to these export opportunities. A trilateral trade\investment accord would facilitate a positive response.

# Part II: Information And Data Relevant To The Investment Dimension

**Section A: Investment Data Re Canada, Mexico And The United States**

**Section B: The Regulation Of Foreign Investment In Mexico**

## Section A: Investment Data Re Canada, Mexico And The United States

The following identifies and assesses the recent patterns of investment and, to a lesser extent, trade among the three prospective partners of a North American Free Trade Agreement (NAFTA). Section C.1 of this paper explores in detail recent trends in the pattern of foreign direct investment (FDI) in Mexico (based on Mexican government sources). It examines the major sources of FDI in Mexico, the industry composition of this investment, followed by a brief note on the maquiladora or "inbond" industry and its performance. Section C.2 deals with changes in the stock of U.S. direct investment abroad (USDIA) during the 1980s, as well as the magnitude of U.S. capital flows - particularly to Canada and Mexico. This section also examines the allocation of USDIA by industry in Canada and Mexico. Section C.3 concludes with a brief consideration of the potential for investment diversion.

### I. Foreign Direct Investment In Mexico

Among developing countries, Mexico has become an increasingly attractive market for foreign investors, in large part due to the progress in relaxation of regulations over the past five years and its proximity to the U.S. market. In introducing the latest regulatory changes to foreign investment, the Mexican government has made it clear that foreign investment is a top priority and is critical for the future growth of the Mexican economy. Among the Latin American countries, Mexico has the second largest amount of foreign direct investment, exceeded only by Brazil. Despite significant growth of FDI in Mexico over the past several years, however, total FDI in the 1980s has constituted less than 10% of total gross fixed investment in the Mexican economy and its share of GDP has been less than 5 percent.

At the outset, it is important to understand the two different methodologies used by Mexican sources for calculating FDI:

- The Bank of Mexico definition of FDI includes four components of annual flows which, when combined, show the net increase in FDI in a given year. These four components include new investment, reinvestment, accounts with parent companies (accounts relating to intercompany debt flows) and, lastly, purchases of foreign companies (via liquidations, disinvestments). The major drawback of this data is the absence of any information to reflect the aggregate FDI flows by country of origin, including any data on the stock or cumulative value of FDI by country of origin.

- The definition of FDI by the National Foreign Investment Commission (NFIC) is based on investments authorized by the Commission. This figure is usually larger than actual flows, both because of timing considerations and because in some cases this investment does not materialize (or is smaller than authorized).

This source has a major advantage as a measure of FDI since, unlike the Bank of Mexico figures, cumulative flows of FDI can be disaggregated by the country of origin. Thus, despite the fact that these statistics on FDI are higher than the actual levels, they nonetheless provide a measure of the trend in FDI by country.

(a) FDI in Mexico by Country of Origin:

Table I.1 presents the cumulative value of FDI in Mexico by country of origin based on the statistics published by the NFIC on approved foreign investment projects. The cumulative value of FDI are computed from the annual inflows of FDI in Mexico as shown in Table I.2. At the end of 1989, the estimated amount of accumulated FDI in Mexico stood at approximately US$26.5 billion.

By country of origin, 95 % of the stock of foreign investment came from 10 countries at the end of 1989:

1) 63% from the U.S.;
2) 6.7% from the U.K.;
3) 5.1% from West Germany;
4) 5.1% from Japan;
5) 4.4% from Switzerland;
6) 3% from France;
7) 2.6% from Spain;
8) 1.4% from Canada;
9) 1.3% from Sweden; and
10) 1% from Netherlands.

The United States continues to be the largest direct investor in Mexico by a decisive margin, but its share has declined from as high as 69% in 1980 to 63% at the end of the decade. In the interim, the U.K. has doubled its stake of FDI in Mexico, surpassing West Germany as the second largest foreign investor in 1988, with a share that jumped to an all time high of 7.3% that year. The respective positions of other foreign investors in Mexico, including Japan, have not changed substantially since the beginning of the 1980s.

On the basis of NFIC statistics, new foreign investment projects authorized by the Commission during 1989 totalled US$2.5, down from US$3.2 billion in 198[1]. Of this

[1]However, based on a measure of actual investment flows in accordance with the methodology applied by the Bank of Mexico, inflow of FDI decreased from US$2.6 billion in 1988 to US$2.2 billion in 1989. Some US$1.2 billion dollars correspond to new investments, US$365 million to intercompany financing and US$643 million to reinvested profits. In other words, actual flows of

total, 49 percent were authorized by the NFIC and 51 percent through automatic registration. The flow of authorized FDI in 1989 was the highest in the last decade (excluding debt/equity swaps).[2] At the same time, slow economic growth and worldwide recession reduced the dollar earnings of foreign affiliates, which inhibited both reinvestment and equity investment by U.S. firms.

According to available statistics for 1988, almost three quarters of the US$3.2 billion in new investments came from five source countries: the U.S. (39.3%); the U.K. (24.3%); France (4.8%); Japan (4.7%); and West Germany (4.3%). Preliminary estimates covering the first quarter of 1990 indicate that a total of US$982 million in foreign direct investments were authorized by the NFIC; the largest share of those authorized flows came from the U.S.(45%), followed by France (13%), West Germany (11.1%) and Switzerland (7.6%).

At the end of 1989, the authorized amount of accumulated Canadian direct investment in Mexico reached US$361 million, almost a threefold increase from the levels attained at the beginning of the decade (see Table I.1). However, Canada's share of cumulative FDI in Mexico continues to be less that 1.5% and it is the eighth largest source of foreign capital for Mexico. Of the total amount of US$2.5 billion in authorized new foreign investment in Mexico in 1989, Canada accounted for only US$37.4 million or 1.5% of those investment flows.

Since 1985, the total number of companies with foreign direct investment in Mexico increased by about 2000 to reach 8862 enterprises at the end of 1989. The largest representation of foreign multinational companies with direct investment interests in Mexico are from the United States. Table I.3 shows the rankings of some of

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investment represented almost 90% of authorized investments during 1989.

[2] Between May 1986 and October 1987, the Mexican government carried out a highly successful debt/equity swap program which, combined with the government's increasingly favourable attitude toward foreign investment, brought almost US$ 3 billion in new foreign investment commitments to the country. After a suspension of the debt/equity swap program in November 1987 because of its inflationary and subsidy effects, Mexico recently announced the resumption of a scaled-down version of the program in which the only eligible investments will be equity participation in parastate companies up for sale and infrastructure projects approved by the federal government. The new regulations limits swaps to a total of US$ 3.5 billion over the next three-and-a-half years, and will apply to all public debt that was renegotiated by Mexico and its commercial bank creditors last year.

the major foreign enterprises in Mexico in 1987. To date, there are 214 Mexican companies with Canadian capital, of which 154 are minority owned (less than 49%) and the remaining 60 are majority owned. Table I.4 lists some of the major Canadian investors with either minority/majority ownership in Mexican enterprises.

(b) FDI in Mexico by Industry:

At year-end 1989, just over two-thirds of the total stock of US$26 billion of FDI in Mexico was concentrated in the manufacturing sector, predominantly in the maquiladora operations. The next largest sector to attract FDI was services (24.5%), followed by commerce (7.4%), mining (1.5%), and agriculture and fisheries (0.1%). The share of the manufacturing sector in FDI has averaged about 75% since the beginning of the 1980s.

It is anticipated that the reforms introduced to liberalize Mexico's foreign investment regime will lead to significant expansion of investment opportunities for foreign companies in Mexico's tourism sector, thereby increasing the importance of the services sector.

(c) The Maquiladoras:

Within the manufacturing sector, companies that manufacture under the maquiladora program and export their products to the U.S. enjoy significant competitive advantages in labour costs, logistics, transportation, management, and other factors unavailable to non-participating firms. In an effort to expand employment and training opportunities, the Mexican government allows duty free imports of machinery parts, and raw materials for assembly and finishing of products in Mexico for re-exports into the U.S. or other countries. Most components and raw materials used in production are of U.S. origin and are imported ready for processing. After the assembly process is completed in the maquiladora operation, virtually 100% of the finished or semi-finished products are exported to the U.S. under sections 806 and 807 of the U.S. Customs Code. These sections state that U.S. customs duty on goods originally exported from the U.S. will be paid only on the value which has been added by assembly operations, which in this case would be the value-added in Mexico. Duties vary considerably depending on the type of raw material and the type of manufacturing article.

As a result of these incentives by the Mexican government, the maquiladoras have grown rapidly and countries other than the U.S. are now participating. Mexico's restrictions on the level of foreign ownership do not apply to the maquiladora operations. ~~Since 1971,~~ Mexico has allowed 100% ownership of the maquiladora plants. ~~except those in the textiles and apparel sectors, where 49% foreign ownership still remains.~~ Since the inception of the program almost 25 years ago, employment in the maquiladoras as well as the number of maquiladora plants have grown very rapidly. In 1965, the first year of operation, 12 plants were established employing 3,000 people. By

1970, there were 120 maquiladora plants in operation, and by 1980 that number had reached 620. By year-end 1988 there were total of 1490 companies operating under this program employing almost 400,00 workers, or 1% of Mexico's total employment. By area of principal location, 42% of the total maquila plants in 1988 were located in Baja California, and 21% in Chihuahua along the Mexican-U.S. border zone, each accounting for 20% and 40%, respectively, of total employment in the maquiladora operations during that year.

The total value added to the materials for exports from the maquiladoras totalled US$1.6 billion in 1987 and US$2.4 billion in 1988 (see Table I.5). By industry, electronic machinery and equipment and other accessories accounted for about 41% of the value added in 1989, followed by transportation (25.5%), textiles (8.9%), furniture (4.9%), and food (1.3%). In contrast, chemical plants produced less than 1% of the total value added that year. The electrical/electronic and transportation industry employed 40% and 21.4% of the total workers engaged in the maquiladora operations in 1988, roughly in the same proportion as their respective contributions to value added.

About 60% of maquiladoras in operation in 1986 were either wholly or partially owned by foreign affiliates. The bulk of the foreign-owned maquiladoras are affiliates of U.S. companies. In 1986, however, there were 20 Japanese maquiladoras operating in Mexico, all associated with Japanese corporations that already had productions facilities in the U.S.. Of the top ten maquiladoras operating in Tijuana in 1988, four were Japanese, and their plants accounted for 45% of the employment of the top ten. They are mainly engaged in the assembly of consumer electronic products, automotive parts and accessories, semi-conductors, as well as cutting, forming and machine steel. Their participation tends to be understated since they account for only maquiladoras that are free-standing subsidiaries of these corporations, and exclude other maquila forms that serve them, such as "shells" (Mexican-owned and run industrial parks) and "contract operations" (captives or Mexican subcontractors).

Some researchers argue that many third-country maquiladoras, particularly those from Japan, are able to take advantage of Mexico's cheap labour while avoiding U.S. trade sanctions (e.g. voluntary restraint agreements). These analysts argue that third-country maquiladoras, because of the flexibility in determing local content and value-added, are able to gain access to low tariffs.

## 2. United States Direct Investment Abroad: Canada And Mexico

Table II.1 illustrates the level of USDIA in the 1980s according to principal geographical areas, and, in particular, the relative trend in the USDIA position in Canada and Mexico. At the outset, it is important to note that both the level and growth in USDIA are affected by several factors. First, the value of USDIA, as shown in Table II.1, represents the book value or original purchase price of direct investment assets by U.S. multinationals. These official figures make no allowance for subsequent

capital gains. In view of the historical evolution of USDIA, the values grossly understate the actual market value of many assets, especially since many such investments were undertaken in the post-war era and have matured considerably since that time.

A second caveat in analyzing USDIA concerns the influence of currency translation gains and losses on the level of dollar-denominated USDIA, and as a result, on their relative growth trends. In brief, these gains and losses arise from the conversion of foreign currency denominated investment values into U.S. dollars. Thus, to a certain extent, currency translation losses were behind the slow growth of USDIA between 1980 and 1985 when the U.S. dollar appreciated vis-a-vis other major currencies; by the same token, currency translation gains were behind the resurgence of USDIA from 1986 to 1988, when the dollar depreciated against major world currencies.

(a) United States Direct Investment in Canada (Book Value):

At year-end 1989, USDIA in Canada amounted to roughly US$67 billion, the largest concentration of American direct investment in any host country[3]. However, there has been a significant decline in the Canadian share of worldwide U.S. direct investment assets in the post-war period: In 1950, almost 30% of all USDIA, or one-half of USDIA in the developed economies was held in Canada. Between 1966 to 1980 Canada's share dropped from a third to a fifth of total USDIA, and has averaged around 18.5% since 1986.

In the first half of the 1980s, USDIA growth in Canada stagnated, symptomatic of the slow pace of worldwide USDIA activity during this period. In the early 1980s, U.S. direct investment in Canada was also constrained by the prevailing investment climate which was generally not conducive to attracting American capital. The establishment of the Foreign Investment Review Agency (FIRA) and the National Energy Program was considered by many to have a debilitating impact on the confidence of U.S. and other foreign investors, and resulted in slowing down their direct investment activities in Canada. These programs not only inhibited new direct investment in Canada, but also encouraged sales of existing direct investment assets in the petroleum and mining industry.

[3] At year-end 1989, the total book value of worldwide USDIA amounted to US$373 billion, up 12% from the previous year. Three-quarters of these assets were located in the developed economies. Europe, with US$176 billion, accounted for almost half these assets, followed by Latin America (including Central America and the Caribbean Islands), and Asia and Pacific with shares of 16.4% and 15%, respectively. Of the US$40 billion jump in USDIA in 1989, almost half of the direct investments went to Europe and another one-fourth was located in Latin America, while Canada accounted for about 11% of that growth.

As Table II.1 indicates, between 1980 to 1985 growth of USDIA in Canada averaged less than one per cent, although its share of total USDIA at the end of 1985 remained virtually unchanged at around 20%. However, the poor growth of USDIA in Canada was generally consistent with very slow growth in worldwide USDIA during this period. In part, the slowdown in worldwide USDIA growth in the 1980s can be attributed to the effects of converting the value of USDIA from local currency into U.S. dollars at a time when the U.S. dollar appreciated against most major currencies[4]. At the same time, slow economic growth and worldwide recession reduced the dollar earnings of foreign affiliates, which inhibited both reinvestment and equity investment by U.S. firms.

In the mid-1980s, the pace of USDIA in Canada began to accelerate after a period of depressed growth. This coincides with the liberalization of the foreign investment regime in Canada when the Investment Canada Act replaced the more restrictive FIRA in 1985. The stock of USDIA in Canada increased from about US$47 billion in 1985 to US$67 billion in 1989, representing an average annual growth of just over 9%. Although the pace of USDIA in Canada during this period was significantly higher than that recorded in the first half of the 1980s, there was a persistent decline in our share of USDIA from 20.4% in 1985 to just under 18% in 1989. During this period, other regions, notably Europe and Latin America, increased their respective holdings of U.S. direct investment assets. In particular, Latin America increased its share of USDIA from 12.3% in 1985 to 16.4% at year-end 1989, led by a remarkable growth which averaged over 21%, compared to 13% in aggregate USDIA.[5]

(b) United States Direct Investment in Canada (Capital Flows):

Table II.2 indicates the annual net direct investment flows from the U.S. to Canada, Mexico and the other principal regions from 1985 to 1990. In this context, it is

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[4] Between 1980 to 1985, the U.S. dollar appreciated by 18% against the Canadian dollar, 44% against the U.K. £ sterling, 62% against the Deutschmark, 113% against the French Franc, and a 123% against the lira.

[5] At year-end 1989, the Bahamas, Bermuda and Panama accounted for US$30 billion or nearly one-half of all USDIA in Latin America (South and Central America and the Caribbean Islands). Almost 85% of U.S. direct investments in these countries were located in banking and finance. USDIA in such offshore banking centres has accelerated since the mid-1980s to a take advantage of the absence of direct local taxes on income or capital gains, few regulatory requirements regarding international capital flows and financial disclosure, and lower reserve requirements for banks. Apart from these offshore banking centres, Brazil and Mexico accounted for over a third of USDIA in Latin America at the end of 1980s.

important to note that growth in the USDIA position occurs primarily in three ways: (1) equity increases through capital infusion by U.S. parent companies in new or existing foreign affiliates; (2) intercompany lending by parent companies to affiliates; and (3) reinvestment of earnings of foreign affiliates. These three elements are included in the measure of net capital flows of USDIA. Any residual between the net change in USDIA position and net capital flows is reconciled by a fourth item, viz, valuation adjustments. These adjustments reflect capital gains and losses arising from nationalizations, sales or liquidations of foreign affiliates, periodic revaluation of assets to reflect current prices for accounting purposes, or loss due to natural disaster.

The last column of Table I.2 indicates that, from 1985 to 1989, the cumulative value of worldwide U.S. direct investment flows amounted to almost US$111 billion. Two-thirds of this amount was destined for the developed economies, with Europe receiving the lion's share of those flows (47%). As a regional bloc, Latin America was the second largest recipient of USDIA outflows following Europe, attracting about 30% of the direct investment flows from the U.S. between 1985 and 1989.

From 1980 to 1989, Canada's share of the cumulative flows stood at US$12 billion or roughly 12% of the aggregate outflows. Reinvested earnings of Canadian affiliates continue to be the major factor behind USDIA growth in Canada. For example, between 1980 and 1988, cumulative reinvested earnings contributed to roughly 90% of the increase in the USDIA position in Canada. These figures reflect the autonomous nature of many Canadian affiliates of U.S. multinationals who are productive enough to generate earnings to finance their expansion from internal sources rather than rely on funds from their parents.

(c) United States Direct Investment Position in Mexico (Book Value):

In the early 1980s, the debt crises and accompanying slowdowns in South and Central America significantly affected the level of USDIA in that region. While debt problems and related austerity programs reduced the rate of investment in all high-debt countries, some countries were more affected than others. Of the three major debtor countries - Mexico, Argentina and Brazil - only Mexico experienced a major decline of U.S. direct investment from 1980 to 1986.

As Table II.1 indicates, the stock of USDIA in Mexico actually fell from about US$6 billion dollar in 1980 to US$ 4.6 billion by year-end 1986, declining at an average annual rate 4.2% during this period. USDIA in Mexico peaked in 1981 at about US$ 7.0 billion, before declining for two consecutive years (not shown in Table II.1). The fall in the USDIA position in Mexico was primarily due to foreign currency transaction losses

arising from the devaluation of the peso against the dollar[6].

In addition, the decline in U.S. direct investment in Mexico in the first half of the 1980s was precipitated by adverse economic conditions (viz., high inflation and high interest rates on external debt, domestic austerity measures, and government-imposed exchange controls to prevent capital flight from the country). Indeed, these conditions were endemic to most Latin American countries during this period. These sluggish economic conditions reduced the earnings of Mexican affiliates, which in turn reduced funds available for reinvestment. At the same time, economic recession in the U.S. also severely hampered the availability of U.S. source funds to finance Mexican affiliate operations.

Since 1986, there has been a resurgence of USDIA in Mexico, in concert with the significant jump in worldwide USDIA and consistent with the new liberalized foreign investment regime. By year-end 1989, the USDIA position in Mexico stood at US$7.1 billion, slightly more than the peak level attained in 1981. However, the Mexican share of global USDIA declined in the interim, from 2.8% in 1980 to about 2% in 1989. In addition, although no data is available from U.S. sources, new U.S. investment in the export-oriented maquiladora in Mexico has been particularly strong in recent times.

(d) Distribution of USDIA by Industry - Canada:

By the end of 1989, the largest proportion of U.S. direct investments in Canada was concentrated in manufacturing (48.4%), followed by the financial sector (including banking, 19%), petroleum (16.3%), "other" industries (8.5%) and wholesale trade (6%). Canada's share of USDIA in petroleum, manufacturing, and the "other" industries at the end of 1989 was higher than the corresponding proportion of total USDIA in those industries. The "other" sectors in USDIA in Canada, composed mainly of natural resource-based industries (agriculture, forestry, fishing, mining, construction and retail trade) accounts for less than 9% of USDIA in Canada. However, from a global perspective, Canada accounts for nearly 35% of all USDIA in this sector, a share which has remained fairly stable in the 1980s. The relative share of resource based industries in aggregate USDIA has declined from about 6% in 1984 to 4.4% in 1989.

The declining position of U.S. direct investment in the Canadian Petroleum industry reflects the cumulative effects of sale of equity interests, both total and partial, in certain Canadian petroleum affiliates that occurred in the early 1980s. They appear to have been partly in response to Canada's energy policies (NEP), which called for an increase in Canadian participation in the industry. The USDIA stake in Canadian

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[6] In 1982, the peso was devalued from 24.5 pesos to the US dollar to 56.4 pesos, a 130% depreciation. In 1983, the peso was devalued by an additional 112% to an exchange rate of 120 pesos to the dollar.

petroleum actually declined from US$11.2 billion in 1984 to US$10.4 billion as a result of the sale by Chevron Corporation (U.S.) of Gulf Oil (Canada) Ltd. to a Canadian company. In the following two years, U.S. direct investments in the petroleum sector in Canada rose marginally, reaching US$12.1 billion in 1987, before falling to their 1989 levels. In 1989, the divestiture of Texaco Canada and its sale to Imperial oil was primarily responsible for net equity inflows of USDIA of US$2.7 billion from the petroleum industry in Canada, and the consequent decline in USDIA position in that industry.

Within Canada's manufacturing sector, USDIA is most heavily concentrated in the "other" manufacturing sector (textile products and apparel, lumber wood, furniture and fixtures, paper and allied products, leather and allied products, etc.), transportation equipment and chemicals. As Table II.3 indicates, with the exception of the transportation sector and "other" manufacturing industries, the share of all other industries in USDIA in Canada's manufacturing sector declined between 1984 and 1989.

Traditionally, the transportation sector, composed mainly of motor vehicle and equipment manufacture, has been the major recipient of USDIA in manufacturing. However, in 1989, the "other" manufacturing sectors received almost 60% of the increase in USDIA in Canada's manufacturing industries, boosting its share from 9% of total USDIA in Canada in 1988 to about 12% the following year.

At year-end 1989, 11.5% of USDIA in Canada was held in transportation and equipment, up from 9.3% in 1984. This also represented a higher proportion than the share of worldwide USDIA tied up in this industry. Most U.S. direct investment in the automotive sector continues to be held by the "Big Three" U.S. auto companies - General Motors, Ford, and Chrysler - which over the years have invested heavily to take advantage of the cross-border free trade in automobiles under the Canada-U.S. Automotive Products Trade Agreement of 1965. Nonetheless, an interesting trend has been emerging in the past few years that shows the rapid decline in the importance of USDIA in this industry in Canada relative to other countries. In 1989, worldwide USDIA in transportation stood at about US$ 24 billion, roughly a third of which was concentrated in Canada. This share has steadily declined from as high as 40% in 1984 to 36% in 1988, before dipping to its present all time low.

The industry share of USDIA in chemicals and allied products in Canada also suffered a decline from 10.2% in 1984 to 9.8% in 1989. More importantly, this decline also resulted in a loss in Canada's market share of global USDIA in this industry. In 1984, Canada accounted for one-quarter of total USDIA in chemicals, but by 1988 that share had dropped to about 18% as other markets raised their stake in USDIA in this industry.

Outside of the manufacturing sector, USDIA growth in Canada has been most notable in the finance, insurance and real estate sector, where the industry share

increased from just over 13% in 1984 to 17.5% in 1989. The growth of USDIA in financial industries in Canada averaged around 14% between 1984 to 1989. However, this expansion was relatively insignificant compared to the explosive growth recorded in worldwide U.S. direct investment in this industry (38%) during the same period. USDIA in the financial sector in Canada is likely to pick up its pace once deregulation of the industry takes place in the foreseeable future.

(e) Distribution of USDIA by Industry - Mexico:

In 1989, the stock of USDIA in Mexico reached just over US$7.1 billion, tying the record-high level set in 1981. The expansion in USDIA in Mexico from 1984 to 1989 has been slower than total USDIA growth (9% vs 12%), but in those years, the pace of USDIA has accelerated in certain sectors of the economy, causing some significant changes in the industrial composition of USDIA in Mexico. At year-end 1989, the overwhelming concentration of USDIA in Mexico continued to be in manufacturing (83%), followed by wholesale trade (6.%). The relative importance of some of the other sectors cannot be determined as statistics on the amount of direct investment in those industries were suppressed for confidential reasons.

Within manufacturing, the bulk of USDIA in Mexico, like Canada, is concentrated in three major industries, namely, chemicals, transportation equipment, and "other" manufacturing. These industries together account for almost two-thirds of all USDIA in Mexico. The most remarkable growth in U.S. direct investment activity has centred around the transportation industry where the level of USDIA stood at US$1.5 billion in 1989, increasing threefold since 1984. The increase in USDIA in the Mexican transportation sector by US$1 billion during this period accounted for 40% of the growth in total USDIA in Mexico during the five year span. The industry experienced an average annual growth of 25% in USDIA between 1984 and 1989, which almost doubled its share of industrial-USDIA in Mexico from 11% to 21.5% during this period. Mexico's chemical sector also attracts over 20% of USDIA and has experienced strong growth since the mid- 1980s.

In recent times, much of U.S. direct investment in Mexico's transport industry, like other sectors, has been primarily motivated by the significant cost advantages in Mexico's maquiladora region . The "Big Three" U.S. auto producers were among the top five of the five hundred largest enterprises in Mexico in 1987, with 100% U.S.-ownership in the Mexican affiliates (see Table I.3). These auto manufacturers have taken advantage of the maquiladora rules which allow for auto equipment part and components to be imported into Mexico free of duty and re-exported back after assembly into the U.S. with duty being levied on the value added in assembly in Mexico and any component not of U.S. origin.

## 3. Summary

The preceding is but a first step in the analysis of the investment implications of a Canada-U.S.-Mexico free trade deal. Further research on issues such as investment creation/diversion in the context of a NAFTA is required. It should be noted, however, that investment diversion under a bilateral U.S.-Mexico accord would likely be more significant than under a trilateral arrangement.

In sum, the U.S. is the predominant source of foreign capital for both Canada and Mexico. At present, bilateral investment between Canada and Mexico is of marginal significance, each accounting for less than 2% of total foreign direct investment in their respective economies. The U.S. continues to hold the largest share of the outward stock of global direct investment, and Canada is still the largest host to worldwide U.S. direct investment assets. Canada accounts for roughly one-fifth of U.S. direct investment abroad, while the U.S. accounts for about two-thirds of all FDI in Mexico.

Many factors need to be taken into account in an assessment of the potential gain or loss to Canada in terms of investment creation and diversion. Significant changes in the pattern of global investment flows have occurred in the past few decades, and such changes in foreign direct investment flows may continue, irrespective of whether Canada joins a NAFTA. For example, while the U.S. remains the dominant source of foreign investment in Canada, other countries (notably the U.K., Japan and West Germany) have significantly increased their share of foreign direct investment in Canada in recent years.

A bilateral or trilateral trade agreement could result in some investment diversion to Mexico and the U.S., at Canada's expense. Another possibility, however, is that a North American free trade area will result in higher economic growth and investment creation, to Canada's benefit.

While quantitative models on trade diversion and trade creation have been extensively used in conventional analysis to address the impact of "freer" trade between one or more member countries, investment diversion/creation cannot be analyzed with the same degree of precision. Further research with respect to the pattern of investment creation/diversion in a NAFTA scenario must take into account a host of underlying factors and assumptions. If it is true that the recent explosion in international direct investment is primarily market-driven and guided by globalization motives, then it is reasonable to expect more investment flows into countries which offer the greatest potential in terms of both market size and growth prospects. A NAFTA would strengthen the investment attractiveness of all three parties to the agreement.

**Table I-1**

**Foreign Direct Investment in Mexico**

**Cumulative Value of FDI in Millions of U.S. Dollars**

| | 1980 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | Average Annual Growth 1980-85 | 1985-89 | 1980-89 |
|---|---|---|---|---|---|---|---|---|---|---|
| U.S. | 5,836.6 | 8,513.4 | 9,840.2 | 11,046.6 | 13,716.2 | 14,957.8 | 16,748 | 11.0 | 14.2 | 12.4 |
| % of FDI | 69.0 | 66.0 | 67.3 | 64.8 | 65.5 | 62.1 | 63.0 | | | |
| FRG | 676.7 | 1,125.4 | 1,180.8 | 1,399.4 | 1,446.3 | 1,583.0 | 1,675 | 11.8 | 9.1 | 10.6 |
| % of FDI | 8.0 | 8.7 | 8.1 | 8.2 | 6.9 | 6.6 | 6.3 | | | |
| Japan | 499.1 | 816.0 | 895.3 | 1,037.5 | 1,170.3 | 1,319.1 | 1,356 | 12.4 | 10.9 | 11.7 |
| % of FDI | 5.9 | 6.3 | 6.1 | 6.1 | 5.6 | 5.5 | 5.1 | | | |
| Switzerland | 473.7 | 647.7 | 788.9 | 823.0 | 918.2 | 1,004.5 | 1,170 | 10.7 | 10.3 | 10.6 |
| % of FDI | 5.6 | 5.0 | 5.4 | 4.8 | 4.4 | 4.2 | 4.4 | | | |
| Spain | 203.0 | 369.6 | 383.6 | 477.3 | 603.1 | 637.2 | 691 | 13.6 | 15.9 | 14.6 |
| % of FDI | 2.4 | 2.9 | 2.6 | 2.8 | 2.9 | 2.6 | 2.6 | | | |
| U.K. | 253.7 | 395.5 | 451.9 | 556.2 | 987.1 | 1,754.7 | 1,781 | 12.2 | 40.9 | 24.2 |
| % of FDI | 3.0 | 3.1 | 3.1 | 3.3 | 4.7 | 7.3 | 6.7 | | | |
| France | 101.5 | 237.3 | 248.0 | 564.9 | 596.1 | 748.5 | 798 | 19.6 | 33.9 | 25.7 |
| % of FDI | 1.2 | 1.8 | 1.7 | 3.3 | 2.8 | 3.1 | 3.0 | | | |
| Sweden | 126.9 | 230.4 | 235.9 | 260.5 | 297.2 | 329.7 | 346 | 13.2 | 10.0 | 11.8 |
| % of FDI | 1.5 | 1.8 | 1.6 | 1.5 | 1.4 | 1.3 | | | | |
| Canada | 126.9 | 194.8 | 229.7 | 270.3 | 289.6 | 323.5 | 372 | 12.6 | 12.8 | 12.7 |
| % of FDI | 1.5 | 1.5 | 1.6 | 1.6 | 1.4 | 1.3 | 1.4 | | | |
| Netherland | 93.0 | 138.8 | 161.2 | 171.4 | 204.7 | 272.8 | 266 | 11.6 | 13.3 | 12.4 |
| % of FDI | 1.1 | 1.1 | 1.1 | 1.0 | 1.0 | 1.1 | 1.0 | | | |

**Table I-1 (continued)**

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Italy | 25.4 | 33.9 | 34.5 | 38.5 | 41.3 | 41.3 | 53 | 6.3 | 11.4 | 8.6 |
| % of FDI | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | | | |
| Others | 42.3 | 197.1 | 178.9 | 404.2 | 659.9 | 1,112.0 | 1,329 | 33.4 | 65.1 | 46.7 |
| % of FDI | 0.5 | 1.5 | 1.2 | 2.4 | 3.2 | 4.6 | 5.0 | | | |
| Total Cumulative FDI | 8,458.0 | 12,899.9 | 14,628.9 | 17,043.8 | 20,927.0 | 24,084.1 | 26,584 | 11.6 | 16.1 | 13.6 |

Source: Executive Secretariat of the National Foreign Investment Commission, Mexico.

**Table I-2**

**Cumulative Flow of Direct Foreign Investment as Measured by the National Foreign Investment Commission (Millions of U.S. Dollars)**

| Year | New Investment | Percent Change | Cumulative Direct Foreign Investment | Percent Change |
|---|---|---|---|---|
| 1973 | 287.3 | 51.3 | 4,359.5 | 7.1 |
| 1974 | 362.2 | 26.1 | 4,721.7 | 8.3 |
| 1975 | 295.0 | -18.6 | 5,016.7 | 6.2 |
| 1976 | 299.1 | 1.4 | 5,315.8 | 6.0 |
| 1977 | 327.1 | 9.4 | 5,642.9 | 6.2 |
| 1978 | 383.3 | 17.2 | 6,026.2 | 6.8 |
| 1979 | 810.0 | 111.3 | 6,836.2 | 13.4 |
| 1980 | 1,622.6 | 100.3 | 8,458.8 | 23.7 |
| 1981 | 1,701.1 | 4.8 | 10,159.9 | 20.1 |
| 1982 | 626.5 | -63.2 | 10,786.4 | 6.2 |
| 1983 | 683.7 | 9.1 | 11,470.1 | 6.3 |
| 1984 | 1,442.2 | 110.9 | 12,899.9 | 12.5 |
| 1985 | 1,729.0 | 19.9 | 14,628.9 | 13.4 |
| 1986 | 2,431.1 | 40.6 | 17,060.0 | 16.6 |
| 1987 | 3,870.0 | 59.2 | 20,930.0 | 22.7 |
| 1988 | 3,150.0 | -18.6 | 24,084.0 | 15.1 |
| 1989 | 2,500.0 | -20.6 | 26,584.0 | 10.4 |

**Table I-3**

**Major Foreign Investments in Mexico**

| Name of Enterprise | 1987 Rank[1] | Type | Origin of Capital | Percent Foreign Owned |
|---|---|---|---|---|
| Chrysler de Mexico | 2 | Automotive | U.S. | 99.99 |
| General Motors | 3 | Automotive | U.S. | 100 |
| Ford Motor Company | 5 | Automotive | U.S. | 100 |
| Volkswagen de Mexico | 8 | Automotive | FRG | 100 |
| Celanese Mexicana | 10 | Artificial fibers | U.S. | 40 |
| Kimberly-Clark | 12 | Paper & Cellulose | U.S. | 45 |
| IBM | 14 | Electronics | U.S. | 100 |
| Industrias Resistol | 17 | Petrochemical | U.S. | 39.2 |
| Compania Nestle | 13 | Food | Swiss | 100 |
| American Express | 22 | Financial Services | U.S. | 100 |
| Spicer | 29 | Autoparts | U.S. | 33 |
| Ericcson (Mexico) | 33 | Electronics | Sweden | 73 |

1. 500 Largest Enterprises in Mexico 1987, Expansion Magazine, August 17, 1990.

**Table I-4**

**Main Canadian Companies in Mexico**

| Canadian Investor | Mexican Company | Sector |
|---|---|---|
| NEI Canada Ltd | Transformadores Parsons | Industrial |
| Chempharm Ltd | Farmaceuticos Lakeside, S.A. | Industrial |
| Diversey Worls Holding Inc | Diversey Mexico, S.A. de C.V. | Industrial |
| Pharma Investment Ltd | Cafes Industrializados de Veracruz, S.A. de C.V. | Industrial |
| Cominco Ltd | Minera Maria, S.A. de C.V. | Industrial |
| Moore Corporation Ltd | Moore Business Forms de Mexico, S.A. de C.V. | Industrial |
| Canada Wire and Cable International Ltd. | Industrias Axa, S.A. | Services |
| Philips Trans-America Holdings Corp. | Philips Mexicana, S.A. de C.V. | Industrial |
| Sapac Corporation Ltd | Roche Mexicana de Farmacos S.A. de C.V. | Industrial |
| Noranda Inc | Grupo Industrial Premenal, S.A. de C.V. | Industrial |

Source: Direcion General de Inversion Extranjera

**Table 1-5**

**Value Added in Maquiladora for Processed Products**
**(Millions of U.S. Dollars)**

| | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|
| National Total | 1,267.2 | 1,294.5 | 1,598.1 | 2,337.4 |
| Foodstuffs processing | 10.3 | 10.9 | 15.7 | 23.3 |
| Textiles, apparel | 87.2 | 83.5 | 101.4 | 127.7 |
| Shoes, leather goods | 20.9 | 16.8 | 19.5 | 28.2 |
| Wooden, matallic furniture and parts | 49.9 | 55.0 | 78.4 | 126.5 |
| Chemical products | 1.8 | 4.4 | 10.0 | 18.3 |
| Transport equipment | 329.5 | 307.9 | 381.6 | 596.3 |
| Equipment and tools, non-electric | 20.3 | 24.9 | 28.2 | 37.3 |
| Electrical, electronic machinery, equipment | 240.5 | 269.5 | 283.4 | 382.1 |
| Electrical, electronic materials, accessories | 328.8 | 315.1 | 393.2 | 585.8 |
| Toys and sporting goods | 39.6 | 40.7 | 44.3 | 66.4 |
| Other manufacturing sectors | 86.1 | 117.0 | 191.5 | 282.9 |
| Services | 52.4 | 48.8 | 50.9 | 62.7 |

Source: Secretariat of Programming and Budget, Bank of Mexico.

**Table II-1**
**United States Direct Investment Abroad (USDIA)**
**Canada, Mexico and Other Principal Destinations**
**(In Million of U.S. Dollars)**

| | U.S. Direct Investment Position | | | | | | Average Annual Growth (percent) | | | Change in Stock |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1980 | 1985 | 1986 | 1987 | 1988 | 1989 | 1980-85 | 1985-89 | 1990/89 | 1990/89 |
| Canada | 45,119 | 46,909 | 50,629 | 57,783 | 62,610 | 66,856 | 0.8 | 9.3 | 6.8 | 4,246 |
| % of DIA | 20.9 | 20.4 | 19.5 | 18.4 | 18.8 | 17.9 | | | | 10.6 |
| Europe | 96,287 | 105171 | 120724 | 150439 | 156932 | 176736 | 1.8 | 13.9 | 12.6 | 19,804 |
| % of DIA | 44.7 | 45.7 | 46.5 | 47.9 | 47.1 | 47.3 | | | | 49.6 |
| EC[1] | 73,569 | 81,380 | 95,629 | 119428 | 125590 | 143360 | 2.0 | 15.2 | 14.1 | 17,770 |
| % of DIA | 34.2 | 35.3 | 36.8 | 38.0 | 37.7 | 38.4 | | | | 44.5 |
| OECD | 158214 | 172058 | 194280 | 237508 | 252757 | 279310 | 1.7 | 12.9 | 10.5 | 26,553 |
| % of DIA | 73.5 | 74.7 | 74.8 | 75.6 | 75.8 | 74.8 | | | | 66.5 |
| Latin America | 18,714 | 28,261 | 36,851 | 47,551 | 51,041 | 61,364 | 8.6 | 21.4 | 20.2 | 10,323 |
| % of DIA | 8.7 | 12.3 | 14.2 | 15.1 | 15.3 | 16.4 | | | | 25.8 |
| Mexico | 5,986 | 5,088 | 4,623 | 4,913 | 5,694 | 7,079 | -3.2 | 8.6 | 24.3 | 1,385 |
| % of DIA | 2.8 | 2.2 | 1.8 | 1.6 | 1.7 | 1.9 | | | | 3.5 |
| Asia[2] | 22,384 | 35,378 | 36,144 | 44,057 | 49,628 | 55,827 | 9.6 | 12.1 | 12.5 | 6,199 |
| % of DIA | 10.4 | 15.4 | 13.9 | 14.0 | 14.9 | 14.9 | | | | 15.5 |
| LDCs[3] | 53,206 | 52,764 | 61,072 | 73,017 | 77,560 | 90,552 | -0.2 | 14.5 | 16.8 | 12,992 |
| % of DIA | 24.7 | 22.9 | 23.5 | 23.2 | 23.3 | 24.2 | | | | 32.5 |
| Others[4] | 32,871 | 14,531 | 15,452 | 14,477 | 13,290 | 12,653 | -15.1 | -3.4 | -4.8 | -637 |
| % of DIA | 15.3 | 6.3 | 5.9 | 4.6 | 4.0 | 3.4 | | | | -1.6 |
| Total | 215375 | 230250 | 259800 | 314307 | 333501 | 373436 | 1.3 | 12.9 | 12.0 | 39,935 |

Notes:
[1] The 1980 EEC includes 7 countries: Belgium, Luxembourg, France, FRG, Italy, Netherlands, and the U.K. From 1985-1990, the EEC represents 10 member countries with the addition of Denmark, Greece and Ireland.
[2] The Asia-Pacific region includes Australia and Japan.
[3] Developing countries exclude Australia, Japan, and South Africa.
[4] All "Others" include New Zealand, Africa, Middle-East and other direct investment transactions not allocated to any country of destination.

**Table II-2**
**U.S. Direct Investment Abroad: Net Capital Outflows (Inflows [-])**
**Canada, Mexico and Principal Destinations**
**(in Millions of U.S. Dollars)**

| | Capital Outflows | | | | | Cumulative Net Flows |
|---|---|---|---|---|---|---|
| | 1985 | 1986 | 1987 | 1988 | 1989 | 1985-89 |
| Canada | 173 | 2,400 | 6,200 | 2,587 | 1,352 | 12,712 |
| % of total | 1.3 | 12.8 | 20.0 | 16.0 | 4.3 | 11.5 |
| Europe | 7,592 | 7,587 | 12,691 | 8,464 | 15,315 | 51,649 |
| % of total | 57.7 | 40.6 | 40.9 | 52.2 | 48.3 | 46.6 |
| EC | 6,450 | 6,667 | 9,581 | 8,358 | 13,644 | 44,700 |
| % of total | 49.0 | 35.7 | 30.9 | 51.5 | 43.0 | 40.3 |
| Developed | 8,548 | 10,713 | 21,326 | 13,189 | 19,264 | 73,040 |
| % of total | 64.9 | 57.4 | 68.7 | 81.3 | 60.7 | 65.9 |
| Latin America | 4,210 | 7,445 | 8,127 | 2,705 | 10,004 | 32,491 |
| % of total | 32.0 | 39.9 | 26.2 | 16.7 | 31.5 | 29.3 |
| Mexico | 458 | -132 | 328 | 579 | 1,360 | 2,593 |
| % of total | 3.5 | -0.7 | 1.1 | 3.6 | 4.3 | 2.3 |
| Asia[1] | 1,047 | 1,821 | 3,621 | 3,475 | 4,804 | 14,768 |
| % of total | 8.0 | 9.7 | 11.7 | 21.4 | 15.1 | 13.3 |
| Developing[2] | 4,436 | 8,724 | 9,942 | 3,532 | 12,135 | 38,769 |
| % of total | 33.7 | 46.7 | 32.0 | 21.8 | 38.3 | 35.0 |
| All Others[3] | 140 | -574 | 406 | -1,013 | 247 | -794 |
| % of total | 1.1 | -3.1 | 1.3 | -6.2 | 0.8 | -0.7 |
| Total Capital Outflows | 13,162 | 18,679 | 31,045 | 16,218 | 31,722 | 110,826 |

Source: U.S. Department of Commerce, Survey of Current Business.

NOTES:
1 The Asia-Pacific region includes Australia and Japan, but excludes the Middle East.
2 Developinc countries exclude Australia, Japan, and South Africa.
3 All "Others" include New Zealand, Africa, Middle-East and other direct investment transaction not allocated to any country of destination.

**Table II-3**
**U.S. Direct Investment Position Abroad**
**Industry Detail for Canad and Mexico, 1984 & 1988**
**(in Millions of U.S. Dollars)**

| | Canada | | Mexico | | All Countries | |
|---|---|---|---|---|---|---|
| | 1984 | 1989 | 1984 | 1989 | 1984 | 1989 |
| All industries | 46,730 | 66,856 | 4,597 | 7,7079 | 211,480 | 373,436 |
| Petroleum | 11,156 | 10,912 | 71 | 68 | 58,051 | 57,495 |
| % of total[1] | 23.9 | 16.3 | 1.5 | 1.0 | 27.4 | 15.4 |
| Manufacturing of which: | 20,986 | 32,333 | 3,650 | 5,837 | 85,865 | 115,704 |
| Food products | 1,634 | 2,175 | 414 | 466 | 8,156 | 15,783 |
| % of total | 3.5 | 3.3 | 9.0 | 6.6 | 3.9 | 4.2 |
| Chemicals | 4,777 | 6,580 | 746 | 1,505 | 19,200 | 36,157 |
| % of total | 10.2 | 9.8 | 16.2 | 21.3 | 9.1 | 9.7 |
| Fabricated Materials | 1,672 | 2,437 | 332 | 269 | 5,256 | 8,194 |
| % of total | 3.6 | 3.6 | 7.2 | 3.8 | 2.5 | 2.2 |
| Machinery | 2,491 | 3,316 | 202 | 321 | 14,816 | 27,137 |
| % of total | 5.3 | 5.0 | 4.4 | 4.5 | 7.0 | 7.3 |
| Electrical | 1,594 | 2,173 | 450 | 451 | 8,193 | 11,872 |
| % of total | 3.4 | 3.3 | 9.8 | 6.4 | 3.9 | 3.2 |
| Transport | 4,337 | 7,673 | 505 | 1,518 | 10,664 | 23,480 |
| % of total | 9.3 | 11.5 | 11.0 | 21.4 | 5.0 | 6.3 |
| Other | 4,480 | 7,970 | 1,001 | 1,308 | 19,581 | 33,081 |
| % of total | 9.6 | 11.9 | 21.8 | 18.5 | 9.3 | 8.9 |

## Table II-3 (continued)

| | | | | | | |
|---|---|---|---|---|---|---|
| Wholesale trade | 2,439 | 3,917 | 443 | 395 | 21,117 | 37,735 |
| % of total | 5.2 | 5.9 | 9.6 | 5.6 | 10.0 | 10..1 |
| Banking | 521 | 945 | -3 | 0 | 13,516 | 19,875 |
| % of total | 1.1 | 1.4 | -0.1 | 0.0 | 6.4 | 5.3 |
| Insurance | 6,139 | 11,680 | 195 | 130 | 15,683 | 77,112 |
| % of total | 13.1 | 17.5 | 4.2 | 1.8 | 7.4 | 20.6 |
| Services | 705 | 1,385 | -26 | 138 | 4,447 | 8,812 |
| % of total | 1.5 | 2.1 | -0.6 | 1.9 | 2.1 | 2.4 |
| Other | 4,785 | 5,684 | 268 | 0 | 12,799 | 16,253 |
| % of total | 10.2 | 8.5 | 5.8 | 0.0 | 6.1 | 4.4 |

Source: U.S. Department of Commerce, Survey of Current Business, August 1989.
NOTE: [1] "% of total" indicates sector as a percentage of total U.S. Direct Investment in the country.

## Section B: The Regulation of Foreign Investment In Mexico

Mexico has exhibited a long history of economic nationalism, a policy based upon its distrust and resentment first of European, and then of US, economic colonization of the country. As a result, for the past 70 years Mexico has enforced laws restricting foreign investment. Since the mid 1970's, the framework and climate for foreign investment was set by three laws designed to Mexicanize the economy by stimulating domestic private investment and restricting foreign investment: the 1973 Law for the Promotion of Mexican Investment and the Regulation of Foreign Investment; the 1973 Technology Transfer Law (revised January 11, 1982); and the 1976 Law on Patents and Trademarks (modified in 1986).

Since 1986, however, under the direction of President Miguel de la Madrid Hurtado and, more particularly, under his successor Carlos Salinas de Gortari, Mexico has undergone a dramatic change with respect to its economic policies. The new policy direction involves nothing less than a fundamental restructuring of the Mexican economy and a sweeping change with respect to attitudes toward foreign investment.

The following material reviews the important changes which have been made since 1988 in the laws regulating foreign investment in Mexico. An understanding of current regulations is highly pertinent since a key U.S. and possibly Canadian objective in free trade negotiations with Mexico is to secure the progress made in trade and investment liberalization to date. An international accord would better ensure that future governments in Mexico would adhere to the trade and investment liberalization already established by Salinas.

Investment Canada's assessment of Mexico's investment regulations is based upon documentation provided by Mexican officials and other written material. A full appreciation of Mexico's foreign investment policy and regulatory process will require further research. It is clear that some degree of discretion remains in the interpretation and application of the Mexican investment regime. Under the circumstances, a judgement of the actual liberalization achieved or intended by the Mexican government must await actual future developments with respect to specific instances of foreign direct investment.

## Law For The Promotion Of Mexican Investment And The Regulation Of Foreign Investment

### Former Foreign Investment Restrictions

The 1973 Law on Foreign Investment limited foreigners to minority ownership. Foreigners could not acquire more than 25 per cent of the shares or 49 per cent of the fixed assets of any Mexican company without prior authorization from the National Commission on Foreign Investment (NCFI), a semi-autonomous agency within the Ministry of Commerce and Industrial Development. Authorization of ownership in excess of these levels was approved or rejected based on the NCFI's judgement as to whether a higher level of foreign investment would be beneficial to the economy. Seventeen criteria, or General Resolutions, were considered in making such a decision. Permission for foreign ownership in excess of the regulatory levels was given increasingly frequently, especially in later years and particularly in industries regulated under Sector Development Programs. However, decisions reportedly took from 8 up to 16 months and were made on a fairly discretionary basis. Foreign investors lacked clear, neutral and fixed guidelines. Prior approval was also required by foreign investors for all increases in existing investment, including the undertaking of new activities, the introduction of new product lines, as well as for expansions and for relocations.

### Regulations of the Law to Promote Mexican Investment and to Regulate Foreign Investment, May 16, 1989

In May 1989, the Mexican Government announced a comprehensive reform of the law regulating foreign investment. The changes provided clear-cut and neutral regulations governing foreign direct investment, facilitated procedures for making new foreign investments, and opened many new areas for majority foreign ownership. The changes have been made with the specific intent of attracting foreign investment, which the Salinas government recognizes as essential in achieving the economic growth required to complete the transformation of Mexico into a modern, industrial economy. Provisions of the revised regulations are detailed below.

**Legal status.** The new regulations, which were implemented through presidential decree, modify the 1973 law, which remains the fundamental legal framework governing foreign investment in Mexico.

**Invariable guidelines.** The revised rules provide a precise, neutral and standard framework for all investment projects. Case by case authorizations will now be limited to exceptional instances.

**Administrative time limit.** The NCFI must act on a foreign application within 45 working days of its receipt. If no response is given within that period, the application is deemed automatically approved.

**Registration of foreign companies.** As previously, all corporations wholly or partially owned by foreign investors must register with the National Registry of Foreign Investments a sub-unit also of the Ministry of Commerce and Industrial Development. Foreign firms must also obtain a permit from the Secretariat of Foreign Affairs to authorize the acquisition of property; this step is routine once approval (automatic or processed) of the investment has been granted by the NCFI.

**Expanded foreign majority ownership possibilities.** The regulations now permit foreign investors to form new Mexican corporations, with up to 100 per cent ownership, in "unclassified" activities accounting for approximately two thirds of Mexican gross domestic product. Furthermore there has been a radical broadening of the range of economic sectors open to wholly-owned foreign investment. Now included in the "unclassified" sector are the previously restricted glass, cement, iron, steel and cellulose industries. Of the remaining 141 classified activities, 58 more are open to 100 per cent foreign investment with prior NCFI approval. In addition majority foreign ownership in other classified activities is possible through the medium of a temporary, 20-year trust mechanism.

**Automatic approval of foreign majority ownership in unclassified activities.** Authorization of up to 100 per cent foreign ownership is automatic upon registration of that investment with the National Commission on Foreign Investment, where the following conditions are satisfied:

- the investment is made in an "unclassified activity";
- the investment does not exceed $100 million;
- financing, either debt or equity, is accomplished with foreign-sourced funds. Foreign investors already established in Mexico may use funds they already possess in Mexico. At the end of the pre-operating stage, shareholders' equity must be equal to a minimum of 20 per cent of the investment in fixed assets;
- the investment is located someplace other than in the highly populated areas of Mexico City, Monterrey, Guadalajara or certain municipalities of the states of Hidalgo and Mexico; this provision applies only to industrial projects;
- the company maintains, on a cumulative basis, a favourable balance of foreign exchange during the first three years of operation;
- the investment creates permanent employment for Mexican workers and provides continuing training and educational programs to upgrade employee skills;
- the investment incorporates technology that satisfies existing environmental requirements.

**Restrictions on Foreign Ownership.** Restrictions on foreign investment apply in the case of 141 activities. These activities are listed in the "Classification" which forms part of the May 1989 Regulations to the Foreign Investment Law. The classification is subdivided into six categories (see Annex B-1 for details):

| | |
|---|---|
| Category 1 | Activities reserved exclusively to the state (12 activities) |
| Category 2 | Activities reserved to Mexican nationals (34 activities) |
| Category 3 | Activities that allow up to 34% foreign ownership (4 activities) |
| Category 4 | Activities that allow up to 40% foreign ownership (8 activities) |
| Category 5 | Activities that allow up to 49% foreign ownership (25 activities) |
| Category 6 | Activities that require prior authorization for majority foreign ownership (58 activities). |

Even though certain sectors remain restricted, noteworthy liberalization has taken place within sectors.

- In the telecommunications sector (formerly reserved exclusively to the state), foreign investment is now allowed up to 49 per cent.

- In the petrochemical sector, fourteen petrochemicals have been reclassified from "basic" (reserved exclusively to the state) to "secondary"; 539 petrochemicals have been reclassified from "secondary" (minority foreign participation permitted) to "tertiary" (open to 100 per cent foreign participation).

- In the insurance industry the permissible level of foreign investment has been raised from 15 to 49 per cent. (See section on The Regulation of Foreign Investment in the Insurance Industry.)

- Banking, although remaining closed to foreign control, will now apparently be open to foreign participation up to a maximum of 30 per cent. (See Section on The Regulation of Foreign Investment in Banking.)

**Establishment of new firms, with foreign participation in excess of 49 per cent, in certain classified activities.** Foreign investment of up to 100 per cent may be permitted by prior authorization of the NCFI in Category 6 activities if the NCFI is satisfied that the investment will satisfy the following criteria:

- serve as a complement, not as a replacement, to domestic investment;
- promote exports and contribute positively to the balance of payments;
- create jobs and improve the remuneration of employees;
- contribute to the development of less economically developed regions;
- bring in technology and/or undertake R&D in Mexico.

**Acquisition of existing corporations.** Under the 1973 law, acquisition by foreigners of more than 25 per cent of the shares or 49 per cent of the fixed assets of any existing enterprise required authorization by the NCFI. As a result of the 1989 revisions, during a three year period ending on May 16, 1992, foreign investors may now - without prior authorization - acquire up to 100 per cent of the stock of existing corporations engaged in an unrestricted activity. The acquiring firm must undertake to satisfy the criteria for automatic approval of foreign investment in an unclassified activity and to invest in additional fixed assets an amount equal to at least 30 per cent of the acquired firm's current fixed assets.

**Expansion of existing foreign investment.** Under the 1973 law, prior authorization was required for relocation, expansion, new product lines and the undertaking of new activities. Under the 1989 revisions, these activities may be undertaken without prior authorization, where an enterprise undertakes to invest in additional fixed assets an amount equal to at least 10 per cent of the net value of its current fixed assets and to meet the requirements for new foreign investment in unclassified activities.

**Temporary foreign majority ownership in certain classified activities.** Foreign investors may now, through participation in special trust mechanisms, acquire temporary majority ownership in any of the classified activities that are subject to specific percentage limitations for foreign investment. Included under this provision are the important sectors of gas distribution and domestic air and maritime transportation (normally reserved for Mexican nationals); mining, secondary petrochemicals, automotive parts, fishing, and financial leasing (normally restricted to a maximum foreign ownership of 34 or 49 per cent). Trusts may be established for up to a 20-year period. In the case of majority ownership through trusts, the following conditions must apply: the company acquired is experiencing financial difficulties and/or has large foreign currency liabilities; the acquired company needs new capital to finance investment designed to upgrade technology, modernize operations, increase production, manufacture new products or increase exports; no interested Mexican investors could be identified; Mexican investors have waived any existing preferential stock acquisition rights; the foreign investment will be in the form of cash or a capitalization of the company's liabilities.

Special trusts also permit foreign investors to acquire temporary control over restricted coastal and border zone real estate. Under the 1973 Foreign Investment Law, real estate trusts of up to 30 years could be established. Under the 1989 revisions to the law, trusts can now be renewed for an additional 30 years, thereby enabling foreigners to fully realize long-term investment projects. In a trust mechanism, ownership of property is vested in the trustee (usually a Mexican bank) but all other proprietary rights are exercised by the investor, including the right to build on the land, sell the rights to others, or order transfer of the title to a qualified Mexican owner. Real estate trusts may be established for either industrial or tourism purposes.

**Investment in Mexico's stock exchange.** The May 1989 regulations allow foreigners to undertake portfolio investment in Mexican equities through the medium of special 30-year trust funds. These trust funds are empowered to acquire and hold specially designated "N" or neutral shares of Mexican corporations and to pass on to foreign investors the economic rights to such shares through the sale of trust "participation certificates".

## Technology Transfer Law

Technology Transfer Law, 1973 (revised Jan. 11, 1982). In 1973, the Mexican government passed a law governing technology transfer. The intent of the 1973 law was to establish ground rules that would secure better treatment for Mexican firms in contracts for technology with frequently more powerful foreign firms. To this end, the 1973 law established a National Registry of Technology to review and approve all royalty and licensing agreements. The Registry enjoyed discretionary powers and, although in recent years it permitted more generous contract terms, it enforced fairly restrictive terms through the greater part of the 1973-mid-1980s period. In so doing, the law created a climate which discouraged foreign technology transfer. Advanced technology was withheld from the country, one factor leading to today's problem of inefficient, non-competitive industries.

Revision of the Technology Transfer Law, January 1990. The Mexican Government has undertaken the process of reforming its rules on technology transfer and intellectual property. In January 1990, it promulgated important changes to the existing technology transfer law. The changes provide for greater contract flexibility, greater confidentiality, a simplified administrative and reporting process, and some added protection against piracy for licensors of technology. Specifically, the January 1990 changes have the following effects:

- **term of contract:** technology transfer contracts were formerly limited to 10 years. Under the new rules, terms are no longer regulated.

- **royalties:** the earlier law contained no reference to any specific rate on royalties, license fees or other charges. However the National Registry limited royalties to 3% for some time, although royalties of 5 - 7% were approved in more recent years. Under the January 1990 revisions, royalties can now be freely negotiated.

- **approval process:** formerly lengthy and complicated. Now contracts are virtually automatically approved upon registration. This removes from authorities the power to require supplementary undertakings, a practice which was fairly common.

- **confidentiality**: contract provisions granting protection to licensors against unauthorized use of their technology by licensees can now be extended beyond the contract's expiration date. This possibility applies as long as the original technology was upgraded during the term of the original contract.

- **franchises**: franchise procedures and requirements are established in an effort to encourage investment under this form.

- **exports**: export requirements or limitations were often applied on a case by case basis. Now uniform regulations are clearly defined in the new law.

These revisions represent great improvements to the old law. Despite the many improvements, however, important gaps remain. The revised technology transfer law provides improved protection to licensors against infringements by licensees (confidentiality provision extension) but it does not protect against violations by third parties. This latter problem remains to be addressed by new legislation which the government plans to bring forward in the area of patents, trademarks and trade secrets.

## Patent And Trademark Law

Further improvement in this area remains a priority of the United States in its bilateral agenda with Mexico.

In January 1990 the Mexican Government announced it was drafting new legislation, to be sent for approval to Congress around the end of 1990, to provide for intellectual property protection "similar to that which is given in advanced nations". Given the necessary legislative process, it may take longer to accomplish these desired changes than was necessary in the instances of the laws on technology transfer and on foreign investment regulation. Changes to those two laws were made by presidential decree thanks to clauses in both laws giving the government discretionary powers to interpret and change those regulations.

Required improvements to the patent and trademark law include, first and foremost: extension of patent terms; extension of patent protection to products in such sectors as chemicals, pharmaceuticals and biotechnology; and further improvements in trade secret protection.

Nonetheless, on the basis of the Salinas government's clear intention to address these issues and the improvements already introduced to the Technology Transfer Law, the United States has removed Mexico from the US Special 301 "Priority Watch List" of nations lacking adequate intellectual property protection.

## Regulation of Foreign Investment in the Banking Sector

In July 1990, the new Law on Credit Institutions came into effect, re-establishing the framework for private ownership of commercial banks in Mexico. This law provides for the issue of three categories of common stock. The third category, "C" shares, may be purchased by foreigners. The issue of C shares is subject to approval by the Ministry of Finance and Public Credit. C shares, if issued, can equal up to 30 percent of bank capital.

With respect to individual participation, the law restricts any individual or entity, Mexican or foreign, to share holdings equivalent to no more than five per cent (10 per cent in exceptional cases authorized by the Ministry of Finance and Public Credit) of the capital stock of a commercial bank.

Foreign banks may now also hold a minority stake in holding companies of financial groups.

## Regulation of Foreign Investment in the Insurance Industry

New investment by foreign corporations in the insurance sector had been prohibited since 1935. Foreign companies already established in the sector at that time were allowed to remain but were required to reduce their participation to below 50 per cent; that level was later reduced to 15 per cent. Reforms announced in January 1990 remove the ban on new foreign corporate investment and raise the allowable level of foreign participation to 49 per cent.

## Law Regarding Maquiladoras

The maquiladora, or in-bond industry, is the most rapidly growing sector of the Mexican economy. Originally established in 1965 by agreement between the US and Mexican Governments, the program first started to come into its own during the mid-1970s, when increased competition from Asian countries forced US manufacturers to seek methods of lowering production costs. The 1984 peso devaluation gave a further boost to the program but the phenomenal expansion of this sector coincides with the implementation of the current economic reforms which began in 1985. Growth in value-added soared to 24 per cent in 1987 and to 46 and 30 per cent in 1988 and 1989. At the end of 1989, there were 1,800 maquiladora plants employing an estimated 500,000 Mexican workers. These plants produced an estimated US $13 billion in products, almost exclusively for export to the US market. In 1989 this production created an estimated US $3 billion in value-added income for Mexico. After the petroleum industry, the maquiladora sector is Mexico's largest producer of foreign exchange.

Under the maquiladora program, foreign corporations can establish wholly-

owned Mexican subsidiaries which operate under special customs treatment. The firms are allowed to import - duty-free and on a temporary "in bond" basis - machinery, equipment, parts, raw materials and other components used in the assembly or manufacture of semi-finished or finished products. The maquiladoras import semi-finished products from the US for assembly or further manufacture in Mexico. Under US tariff items 806.30 and 807.00, these products are then allowed to re-enter the US market with duty levied only on components that are not of US origin and on the "value added" during assembly or manufacture in Mexico.

Currently 60 per cent of existing maquiladoras are owned by US firms. However the maquiladora scheme is proving increasingly attractive to firms from other countries. Japan, West Germany, Canada, France, Sweden, South Korea, Hong Kong and Taiwan have all moved funds into Mexican maquiladora investments more recently.

Since 1983 certain industrial sectors have seen particularly strong expansion in the number of maquiladora factories: automotive accessories (+ 290%), electrical and electronics industries (+ 51%), and metal products (+ 44%). Based on the amount of value-added in 1988, the following were the most important sectors: electric and electronic goods (41%), transport equipment (26%), and textiles and apparel (6%).

The Mexican government is eager to encourage further investment of this nature. Regulations governing the maquiladora industry, already very liberal, were liberalized further by the government in December 1989. Major provisions regarding investment in this sector are as follows:

- 100 per cent foreign ownership is permitted
- investments may be made in any amount
- approval for foreign investment is automatic and can be obtained in 3 working days from the Ministry of Commerce & Industrial Development (SECOFI)
- administrative procedures necessary to establish or expand a firm are now the sole responsibility of SECOFI; six different departments were formerly involved
- maquiladoras now receive automatic authorization to locate plants in any area zoned for industrial development. Originally plants were restricted to an area close to the US-Mexican border. Since 1972, plants have been allowed to locate elsewhere and firms are showing an increasing preference for interior, one-company-town sites, as labour behaviour in northern border plants is becoming increasingly unruly. As of 1988, 18 percent of maquiladora plants were located in interior areas and that number is increasing.
- maquiladora licenses now carry open-ended terms; in-bond firms formerly had to seek pro-forma renewal of licenses every two years.
- under certain conditions, an in-bond firm may now sell locally an amount equal to 50 per cent of additional value above their annual exports sales. Initially the entire output of a maquiladora had to be exported. In 1983, regulations were relaxed to allow domestic sales equal to 20% of additional value above the

**previous year's exports.**

- **technology transfer is encouraged by: 1) allowing the in-bond importation of computers and telecommunications equipment for administrative purposes; and 2) authorizing maquiladoras, under certain conditions, to transfer machinery, tools and equipment to another maquiladora or to their domestic suppliers.**
- **under the new rules, Mexican companies which supply inputs to the maquiladoras are excused from paying value-added tax on the inputs supplied, reducing the price of their products by as much as 15 percent.**
- **maquiladoras may now enter into subcontracting agreements with domestic firms (further integrating maquiladoras into the Mexican economy).**

ANNEX B-I

## CLASSIFICATION OF ECONOMIC ACTIVITIES WITH RESPECT TO FOREIGN INVESTMENT LIMITS

The following classification of activities was published as part of the May 1989 Regulations of the Law to Promote Mexican Investment and to Regulate Foreign Investment. The classification defines the activities in which foreign investment is not permitted, is limited, or requires authorization to exceed 49% ownership. The law establishes the following six categories:

| Category | Restriction |
|---|---|
| 1....... | Activities reserved exclusively to the state. |
| 2....... | Activities reserved to Mexican nationals. |
| 3....... | Activities in which foreign participation is permitted up to 34% of the company's capital. |
| 4....... | Activities in which foreign participation is permitted up to 40% of the company's capital |
| 5....... | Activities in which foreign participation is permitted up to 49% of the company's capital. |
| 6....... | Activities where majority foreign participation is possible with prior authorization from the National Commission on Foreign Investment. |

Any activity not included in the classification is open to 100% foreign participation without prior authorization, provided certain requirements described in the regulations are met. The activities in Categories 5 and 6 are not required to secure prior authorization nor to meet these additional requirements if foreign investment does not exceed 49%.

### Category 1 - Activities reserved exclusively to the state

Oil and gas production
Mining and/or refining of uranium and radioactive minerals
Manufacture of basic petrochemical products
Oil refining
Treatment of uranium and nuclear fuels
Coin minting
Generation and transmission of electric energy
Supply of electric energy
Railroad transportation services
Telegraph services
Banking services
Financial trusts and funds

**Category 2 - Activities reserved to Mexican nationals**
Forestry
Forest nursery business
Retailing of liquified gas
Building materials transportation services
Moving services by road
Other specialized cargo transportation services by road
General cargo transportation services by road
Bus transportation services (intercity)
Urban and suburban bus transportation services
Taxis
Fixed route taxi services
Taxi stand services
School and tourism bus services
Coastal transportation
Coastal and high seas towing
Passenger air transportation in aircraft with Mexican registry
Air taxi transportation
Credit unions
Public warehouses
Foreign exchange houses
Financial consulting and promotion
Nonbanking savings and loans institutions
Other credit institutions
Brokerage firms
Investment companies (1)
Stock market services
Bonding
Insurance
Independent pension fund management
Private transmission of radio programs
Transmission and repetition of television programs
Notary public services (2)
Customs brokers and representative services (2)
Management of sea, lake and river ports

Notes:
(1) Fixed-income investment companies and their management companies are not eligible for investment by foreign governments or their agencies, foreign financial entities, or other associations of foreign persons, whether individual or juridical.
(2) Companies may have a foreign investment participation to the extent authorized by the National Commission for Foreign Investment. Providers of professional services are subject to the Regulatory Law of the Third Constitutional Article, pertaining to professional practices, and should be Mexican nationals.

**Category 3 - Activities that allow up to 34% foreign ownership**

Mining and refining of coal
Mining and/or refining of iron ore
Mining and/or refining of phosphoric rock
Mining of sulphur

**Category 4 - Activities that allow up to 40% foreign ownership**

Manufacture of secondary petrochemical products
Manufacture of parts and accessories for automotive electrical systems
Manufacture and assembly of bodies and trailers for automobiles and trucks
Manufacture of automobile and truck motors and their parts
Manufacture of automobile and truck transmission parts
Manufacture of automobile and truck suspension system parts
Manufacture of parts and accessories for automobile and truck brake systems
Manufacture of other parts and accessories for automobiles and trucks

**Category 5 - Activities that allow up to 49% foreign ownership**

Deep water fishing*
Shallow water fishing*
Fresh water fishing*
Artificial fish breeding*
Mining and/or refining of minerals containing gold, silver and other precious minerals and metals
Mining and/or refining of mercury and antimony
Mining and/or refining of industrial minerals with lead and zinc content
Mining and/or refining of minerals containing copper
Mining and/or refining of other nonferrous metallic minerals
Mining and/or refining of feldspar
Mining of gypsum
Mining and/or refining of barite
Mining and/or refining of fluorite
Mining of other minerals to obtain chemical products
Mining and/or refining of salt
Mining and/or refining of graphite
Mining and/or refining of other nonmetallic minerals
Manufacture of explosives and fireworks
Manufacture of firearms and cartridges

Retailing of firearms, cartridges and ammunition
River and lake transportation
Harbor transportation services
Telephone services
Other telecommunications services
Financial leasing

*Note: Does not include exploitation of species reserved for fishing cooperatives.

**Category 6 - Activities that require prior authorization if a majority foreign ownership is desired**

Agriculture
Stock breeding and hunting
Gathering of forestry products
Timber
Newspaper and magazine publishing (1)
Manufacturing of coke and other coal products (2)
Residential or housing construction
Nonresidential construction
Construction of urban works
Construction of industrial plants
Construction of power generating plants
Construction and laying of power transmission networks and lines
Construction of oil and oil by-products pipelines
Concrete structure erection or installation
Steel structure erection or installation
Ocean and river works
Construction of streets and highways
Construction of railroad tracks
Hydraulic and sanitary systems for buildings
Electric systems for buildings
Telecommunications installations
Other special installations
Earth moving
Foundations
Excavations
Underwater works
Installation of traffic and protection signals
Demolitions
Construction of water treatment plants
Drilling of oil and gas wells
Drilling of water wells
Other construction works

High seas transportation
Tourism ship chartering
Investment Companies (3)
Management companies of investment companies (3)
Private pre-school or kindergarten services
Private elementary school services
Private junior high school services
Private high school services
Private university services
Private educations services that combine kindergarten, elementary, high school, college, and university
Private commercial and language school services
Private technical, and handicrafts training school services
Private music, dance and other school services
Private special education school services
Legal Services (4)
Accounting and auditing services (4)
Management of passenger bus terminals and auxiliary services
Management of toll highways, international bridges and auxiliary services
Towing of vehicles
Other ground transportation services
Air navigation support services
Management of airports and heliports
Securities and investment consulting services
Insurance and bonding agency services
Pension consulting services
Representatives of foreign financial entities services
Other services related to financial, insurance and bonding institutions

Notes:
(1) Does not include printing of bank notes and postage stamps, activities that are reserved to the state.
(2) Does not include the production of oil, an activity that is reserved to the state.
(3) Fixed-income investment companies and their management companies are not eligible for investment by foreign governments or their agencies, foreign financial entities or other associations of foreign persons, whether individual or juridical.
(4) Companies may have a foreign investment participation to the extent authorized by the National Commission for Foreign Investment. The providers of professional services are subject to the Regulatory Law of the Third Constitutional Article pertaining to professional practices and should be Mexican nationals.

# Statement

# Déclaration

Minister for International Trade

Ministre du Commerce extérieur

90/58

CHECK AGAINST DELIVERY

STATEMENT TO THE HOUSE OF COMMONS'
STANDING COMMITTEE ON EXTERNAL AFFAIRS AND
INTERNATIONAL TRADE
BY THE
HONOURABLE JOHN CROSBIE,
MINISTER FOR INTERNATIONAL TRADE
REGARDING
CANADA'S PARTICIPATION IN NORTH AMERICAN FREE
TRADE TALKS WITH MEXICO AND THE UNITED STATES

OTTAWA
OCTOBER 9, 1990.

External Affairs and International Trade Canada

Affaires extérieures et Commerce extérieur Canada

Canada

## 1. INTRODUCTION

As I advised the House of Commons on Monday, September 24th, Canada has decided to participate in trilateral free trade discussions with Mexico and the United States.

Prime Minister Mulroney has written letters to President Salinas and President Bush stating Canada's interest in participating in negotiations with Mexico and the United States on a North American free trade agreement which would benefit all three countries.

In recent discussions with Mexico and the United States, we all agreed that Canada should participate in consultations designed to establish the basis for subsequent negotiations on a free trade arrangement linking Canada, the United States and Mexico.

Over the next several months, we will therefore be examining the scope, elements and procedures that would form the basis for subsequent negotiations.

I am confident these preliminary discussions will be productive and demonstrate that a mutually advantageous agreement can be concluded.

We do not expect formal negotiations to begin until sometime later next spring.

Last summer we conducted preliminary studies and consultations and we concluded that it was in the Canadian interest to participate from the outset in the Mexican trade initiative.

The alternative would be not to participate and to lose the opportunity to have a direct influence and role in negotiations which could affect our trade and investment interests in the vital North American market.

I will be tabling our preliminary studies at the end of my remarks today.

Before discussing the rationale and objectives we will be pursuing in these trilateral trade talks, I would like to bring you up to date regarding recent events surrounding our decision to participate.

## 2. CHRONOLOGY OF EVENTS LEADING TO THE DECISION

During the past year, Canada and Mexico have made significant progress in developing our trade relations.

In January, Canada hosted the 7th Canada/Mexico Joint Ministerial Committee to discuss ways to enhance our trading relationship.

During Prime Minister Mulroney's visit to Mexico last March, our relationship was further enhanced by concluding important bilateral agreements in several areas, including customs administration, agriculture and livestock, forestry, environment, tourism and taxation.

In April, I led a trade mission to Mexico to discuss Canada–Mexico trade and recent developments in the Uruguay Round of multilateral trade negotiations which are presently proceeding in Geneva under the auspices of the General Agreement on Tariffs and Trade ("GATT").

On June 12th, Mexican Trade Minister Serra and I met in Montreal to discuss our growing trading relationship and to consult regarding President Salinas' June 10th announcement in Washington that President Bush had agreed to the Mexican request to explore a comprehensive trade agreement between the United States and Mexico.

To prepare for these negotiations, President Salinas directed Minister Serra to work with his American counterpart, United States Trade Representative Carla Hills, to:

> *undertake the consultations and preparatory work needed to initiate such negotiations, in accordance with each country's internal procedures, and to report back to the two Presidents as soon as practicable, but in any event before their next meeting in December.*

The fact that Minister Serra travelled to Montreal to meet with me immediately after President Salinas' official visit to Washington illustrates the high degree of consultation, courtesy and trust that characterizes our relationship.

Within a week of my June meeting with Minister Serra, I met with our International Trade Advisory Committee and I appeared before your Committee to discuss the Mexican trade initiative on June 18th.

At that time I advised that Canada had not decided whether we would be involved in the Mexican trade initiative and that we would use the summer months to consult with the provinces, business and labour representatives, and conduct studies regarding Canada's options. I also indicated that we should make a decision by September regarding our participation in these trade talks.

During the summer, it became clear that the Mexicans did not intend to wait for the December presidential meetings before taking the next step.

As a result, at the August 8 meeting of the United States–Mexico Ministerial Commission in Washington, it was announced that President Bush proposed to seek negotiating authority from Congress in September and it was expected that negotiations could begin later next spring.

Last month, we began informally exploring with Mexico and the United States our participation in these trilateral talks. It has now been agreed that there should be consultations involving our three countries to establish the basis for subsequent negotiations on a free trade arrangement linking Canada, the United States and Mexico.

Over the next several months, we will therefore be examining the scope, elements and procedures that would form the basis for subsequent negotiations.

We will also continue to consult to ensure that we are fully prepared when the negotiations begin sometime later next year. We look forward to receiving your views in the coming weeks.

## 3. THE RATIONALE

The question of our participation in these talks has been extensively debated and written about in Canada since the prospect of a bilateral United States–Mexico free trade agreement first emerged last spring.

We have listened carefully to the views of the provinces, business, labour as well as distinguished academics and journalists. Most were persuaded that Canada should participate from the outset in the free trade talks which have resulted from Mexico's historical trade initiative.

The principal reasons for joining in these talks are twofold:

1. Mexico's recent reforms in its economic, trade and investment policies are creating trade opportunities for Canadian exporters in the growing Mexican market.

2. Given the vital importance of the North American market to Canada, we must participate in these talks from the outset to enhance our ability to compete effectively and attract investment in this emerging market of over 350 million.

## (a) Recent Mexican Reforms Are Creating Trade Opportunities For Canadian Exporters

During Mexican Trade Minister Serra's visit to Canada last month, we reaffirmed that Canada welcomes Mexico's trade initiative and their commitment to growth and the improvement of their living standards through open and outward looking economic policies, particularly in the areas of trade and investment.

In recent years, the Mexican Government has greatly modified its import regulations and has significantly reduced tariff and other barriers to trade, particularly since 1986 when Mexico joined the General Agreement on Tariffs and Trade ("GATT").

In the last several years, the Mexican government has initiated several comprehensive measures to strengthen their economy. Their economic policies have already brought annual inflation rates down from over 150% to a more manageable 20%.

In the recently released annual report of the International Monetary Fund, Mexico was commended for making real progress in dealing responsibly with its debt.

These and other reforms have created significant opportunities for Canadian exporters and investors, and have set the stage for expanded Canada–Mexico trade as we approach the 21st century.

The Investment Canada study which I will table in a few moments summed up the enormous potential of the Mexican market in the following terms:

> *Mexico has the potential to become an important export market for Canada. By the end of the century its population will be close to 100 million. Sweeping economic reforms, notably liberalization of its trade and investment regulations, are propelling Mexico towards the remarkable achievements already experienced by several countries in Southeast Asia....*
>
> *The growth of Mexico is an opportunity for Canada, not a threat.*

Mexico is already Canada's most important trading partner in Latin America. Trade between our two countries exceeded 2 billion dollars last year, a 25% increase over 1988. We expect that two-way trade will reach five billion dollars in the 1990s.

In the past, Canada's opportunities in Mexico were often limited by protectionist trade barriers. Recently, things have changed, especially since 1986 when Mexico joined the GATT.

We believe the growing Mexican economy offers Canadian exporters exciting new prospects, particularly in the areas of telecommunications, transportation, and environmental equipment.

Take, for example, telecommunications. Up until recently, Canadian telecommunication companies could not sell their products in Mexico due to restrictive government procurement practices. However, recent reforms have rapidly created new opportunities for Canadian exporters.

Mexico has less than 6 million telephone lines serving its population of over 80 million people. To develop their economy, the Mexican government recognizes that they must upgrade their communications system.

In the next five years, Mexico will attempt to double the number of telephone lines with a modernization program that could cost over

12 billion dollars. Bell Canada has already submitted a bid to be part of this ambitious program.

Likewise, Canada's Northern Telecom has secured several cellular telephone equipment contracts that have caused Canadian exports of telephone equipment to increase from 5 million dollars to 25 million dollars in the first six months of this year alone.

In addition to our shared commitment to develop our trading relationship, Mexico and Canada share strong geographic and economic links to the contiguous United States market.

Like Canada, Mexico's trade with the United States is essential to its economic prosperity. Mexico's two-way trade with the United States is valued at about 50 billion dollars, whereas Canada's two-way trade with the United States is about 200 billion dollars.

Given the enormous amount of trade between our three countries, it makes sense for Canada, the United States and Mexico to sit down together and pursue trilateral trade discussions to create a North American free trade market of over 350 million consumers.

By being part of a trilateral free trade discussions from the outset, we can ensure that Canadian exporters will prosper on an equal footing in the emerging North American market so that we can continue to maintain high quality jobs here in Canada.

**(b) Canada must participate in these talks from the outset to enhance our ability to compete effectively and attract investment in the emerging North American market**

By participating in the Mexico trade talks from the outset and developing a North American free trade market of over 350 million people, Canada will become a more attractive place in which to invest and create jobs for Canadians.

We are participating in these talks to build on the opportunities we created with the FTA.

One consideration for investors is the size of the market. The market sizes in the North American economy are roughly as follows:

| | |
|---|---|
| **Canada** | **over 25 million** |
| **United States** | **over 245 million** |
| **Mexico** | **over 80 million** |
| | |
| **Total Market** | **over 350 million** |

If Canada chose to remain outside of the emerging North American free trade market, the United States would be the only country with free trade access to the entire North American market of over **350 million** people.

If a firm invested in Mexico, it would have free trade access to a market of over **325 million**, whereas if a firm invested in Canada, it would only have free trade access to a market of about **270 million**.

It is therefore clear that, by being part of the emerging North American free trade market, Canada will have more to offer to investors than if we were confined to a smaller market.

In addition to helping to attract <u>new investment</u> and create jobs here in Canada, access to the immense North American free trade market will encourage <u>existing investment</u> to remain in Canada.

Demography, geography and history have taught Canadians that to prosper, we must have access to larger markets.

The experience of the Depression forcefully demonstrated that Canadians will not prosper if we are confined to a small market. This is why Canada is a trading nation that remains at the forefront of trade liberalization throughout the world.

## 4. CANADA'S TRADE PRIORITIES

The Mexico trade talks complement our overall trade strategy. The GATT remains the cornerstone of Canada's trade strategy. We are

strongly committed to the GATT multilateral trading order and we are continuing to work towards a successful completion of the Uruguay Round of negotiations later this year.

For many years, trade liberalization has been a key element of Canada's economic success. We have benefited from our membership in the GATT, and have played an active role in every round of multilateral trade negotiations.

Later this week, I will be hosting a quadrilateral trade ministers meeting in St. John's with my counterparts from Japan, the United States, and the European community. The Uruguay Round will figure high on our agenda.

Again, I would like to stress that formal negotiations with Mexico and the United States are not scheduled to begin until well after the conclusion of the Uruguay Round.

The Mexico trade talks complement our many other initiatives designed to position Canada as a competitive force in an increasingly open and interdependent global economy, including our tax reform policies, our employment retraining programs, and our Going Global trade development strategy.

## 5. CONTINUING CONSULTATION

As I mentioned earlier, during the last several months we have conducted preliminary studies and have consulted widely.

The question of Canada's participation in these talks has been extensively debated and written about in Canada since the prospect of a bilateral United States–Mexico free trade agreement first emerged last spring. Almost all serious analysis argues strongly for Canada's participation.

For example, the day following my announcement in the House of Commons, a Financial Post editorial stated:

> *"It has been said that the foreign policy of states lies in their geography. One overwhelming reason for proceeding with a North American Free Trade Area is proximity. What more obvious place to increase trade flow than on a continent with*

*relatively low transportation costs and a communications network of rail, road, air and telecommunications...*

*Our three countries contain 355 million people, more than the European Community's 324 million. Our combined gross national products total $US 5.5 trillion, considerably larger than the Community's $US 4 trillion. In economic terms alone, the potential is enormous...*

I would now like to table our preliminary studies and provide you with some of the extensive research that was done in the private sector regarding Canada's decision to participate in these North American free trade talks.

However, before concluding my remarks, I should point out again that, up until recently, Mexico had a relatively closed economy that made it difficult for Canadian exporters to increase their sales. This was particularly true in areas such as telecommunications and public transportation where restrictive government procurement practices discouraged international trade.

Any study that is based on past experience therefore fails to capture the enormous potential of the Mexican market. Likewise, static econometric analysis does not lend itself to measuring the rapidly emerging opportunities in this increasingly dynamic market.

To manage change, we must anticipate it and shape it. We therefore need trade policies that are anticipatory and forward-looking. Conventional wisdom that is rooted in the past will not serve Canada's interests as we approach the 21st century.

To position ourselves for the future, we must participate in the Mexican trade initiative to build a North American free trade market of over 350 million people.

We will continue to consult widely and openly in the coming months to ensure that Canada is well prepared for next year's negotiations.

We therefore welcome your public hearings, and we look forward to receiving your recommendations.

Thank you.

Office of the
Prime Minister

Cabinet du
Premier ministre

# Release

Date: February 5, 1991

For release: Immediate

The Prime Minister of Canada, Brian Mulroney, the President of the United States of America, George Bush, and the President of the United Mexican States, Carlos Salinas de Gortari, today announced their intention to pursue a North American free trade agreement creating one of the world's largest liberalized markets.

Following consultations among their ministers responsible for international trade, the three leaders concluded that a North American free trade agreement would foster sustained economic growth through expanded trade and investment in a market comprising over 360 million people and U.S. $6 trillion in output. In so doing, the agreement would help all three countries meet the economic challenges they will face over the next decade.

Accordingly, the three leaders have agreed that their trade ministers should proceed as soon as possible, in accordance with each country's domestic procedures, with trilateral negotiations aimed at a comprehensive North American free trade agreement. The goal would be to progressively eliminate obstacles to the flow of goods and services and to investment, provide for the protection of intellectual property rights, and establish a fair and expeditious dispute settlement mechanism.

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External Affairs and International Trade Canada Affaires extérieures et Commerce extérieur Canada

Canada

February, 1991

Février 1991

**Canada-Mexico-United States Trade**

As you know, Canada, Mexico and the United States have agreed to pursue discussions with regard to a proposed trilateral trade accord among the three countries.

The enclosed booklet explains Canada's interest in negotiating an agreement with Mexico and the United States to build a North American free trade market of over 350 million people.

Additional information and copies of this booklet in English, French or Spanish are available upon request. Please see the inside back cover of the enclosed publication for details.

**Commerce entre le Canada, le Mexique et les États-Unis**

Comme vous le savez, le Canada, le Mexique et les États-Unis se sont entendus pour poursuivre les discussions concernant un projet d'accord commercial trilatéral entre les trois pays.

La brochure ci-jointe donne les raisons pour lesquelles le Canada souhaite négocier une entente avec le Mexique et les États-Unis dans le but de former un marché de libre-échange de plus de 350 millions de personnes en Amérique du Nord.

On peut obtenir, sur demande, des renseignements supplémentaires ou des exemplaires de cette brochure en anglais, en français ou en espagnol. Veuillez consulter l'intérieur de la couverture arrière de la publication ci-jointe pour de plus amples renseignements.

J.A. Whittleton
Director General/Directeur général
Trade and Foreign Policy Communications Bureau/Direction générale des communications sur le commerce et la politique étrangère

# MEXICO FACT SHEET

## BASIC DATA

| | | |
|---|---|---|
| Area | 1,958,201 $km^2$ | |
| Population (1989) | 85 million | |
| Population density per $km^2$ | 42 | |
| Official language | Spanish | |
| Ethnic groups | Mestizo | 79% |
| | Indian | 11% |
| | Caucasian | 10% |
| Life expectancy | 66 years | |
| Major religion | Roman Catholic | 93% |

Main cities and metropolitan population

- Mexico City 19.3 million
- Guadalajara 3.4 million
- Monterrey 3.1 million

## POLITICAL STRUCTURE

Type of government: Federal republic, operating under a centralized structure, 31 states, 1 federal district (Mexico City)

Current government (elected 1988)

| | |
|---|---|
| President | Carlos Salinas de Gortari |
| Foreign Minister | Fernando Solana |
| Ruling party | Institutional Revolutionary Party (PRI), which currently holds 60 of 64 seats in the Senate and 263 of 500 seats in the Chamber of Deputies |
| Opposition parties | Several opposition parties share 200 seats (out of a total of 500) reserved for the opposition and allocated on the basis of proportional representation |

**ECONOMY**

| | |
|---|---|
| Per capita GDP (1989) | C$2,770 |
| Economic growth rate (1989) | 2.5% |
| Inflation rate (CPI) (1990) | 30.4% |
| Total external debt (1990) | US$93 billion |
| Debt held by Canada | Commercial banks: C$5.6 billion<br>EDC and CWB: C$661.3 million<br>ODA: nil |
| Foreign reserves (1990) | US$9.2 billion |
| Unemployment rate (1989) | 12-20% |
| Underemployment rate (1989) | 35-50% |
| Currency (Dec. 1990) | Peso (2,949 pesos = US$1 approx.) |

**FOREIGN TRADE**

| | 1988 | 1989 |
|---|---|---|
| | (US$ billions) | |
| Total exports * | $20.6 | $22.4 |
| Total imports * | $18.9 | $23.4 |
| Trade balance * | $ 1.7 | $-1.0 |

* Excluding trade conducted in the in-bond (maquiladora) industry, which is mostly with the U.S. Inclusion would increase the U.S. share of Mexican trade to over 80%.

| | |
|---|---|
| Major markets (1988 - percent average) | U.S. 67.3%, Japan 5.9%, Canada 5.1%, Spain 4.7%, France 2.7%, F.R.G. 2.1% |
| Major suppliers (1988 - percent average) | U.S. 68.5%, F.R.G. 6.2%, Japan 5.9%, France 2.3%, Canada 2.0%, U.K. 1.9%, Brazil 1.6% |

| **TRADE WITH CANADA** (C$ millions) | 1987 | 1988 | 1989 | 1990 (Oct.) |
|---|---|---|---|---|
| Exports to Mexico | 522 | 489 | 603 | 510 |
| Imports from Mexico | 1174 | 1320 | 1698 | 1467 |
| Balance | -652 | -831 | -1095 | -957 |

| | |
|---|---|
| Major Canadian imports from Mexico (1989) | Motor vehicle automotive parts and engines, TV/radio/sound telecommunications equipment and parts, office and digital processing equipment, precious metals and alloys, other metal ores, crude oil |
| Major Canadian exports to Mexico (1989) | Motor vehicle and engine parts, oilseed, dairy products, wheat, sulphur, wood pulp, steel plate/sheet and strip, telecommunications equipment and parts, potash |
| Canadian direct investment (1989) | US$361 million (representing 1.4% of total foreign investment in Mexico). Major Canadian companies include Placer-Dome, Mitel, Northern Telecom, Noranda, Moore Corp., Bata Shoes, Canada Wire, Cominco |

**CANADIAN AID**

No CIDA bilateral aid program
Embassy administers Canada fund of $350,000
Extraordinary Canadian aid for 1985 earthquake of $3.8 million

**OTHER DATA**

| | |
|---|---|
| Canadian visitors to Mexico (1989) | 550,000 (Mexican Ministry of Tourism) |
| Mexican visitors to Canada (1989) | 75,000 |
| Mexican immigration to Canada (1989) | 1,000 |
| Work permits for Mexicans per year | 6,000 (5,000 of which are for the Mexican Seasonal Workers' Agricultural Program [MEXSWAP]) |

Diplomatic relations established April 27, 1944

Canadian Embassy, Mexico City (21 Canada-based staff, 55 local staff)

Canadian Honorary Consulates:

Acapulco, Cancún, Guadalajara, Mazatlán, Puerto Vallarta, Tijuana

External Affairs and
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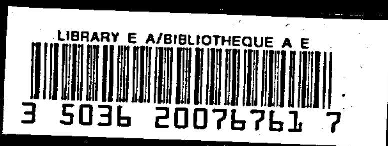
February 1991

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