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Foreign Enterprises in Mexico

by Klaus Matthies, Hamburg *

The uses and drawbacks of foreign capital and multinational enterprises have been discussed more thoroughly in the past few years also in Mexico. The Third World Trade Conference of 1972 (UNCTAD III), at which President Echeverría came forward with proposals designed to involve foreign enterprises in the development process, and the introduction of two laws dealing with investment and technology have stimulated this debate.

For foreign investors in Mexico the Investment Law has been of particular importance. The somewhat extremist utterances from Mexican Government quarters before the law was passed and the uncertainty about the Government's future policies after the change in the presidency had brought about a decline in foreign investment in 1971 and 1972. When the bill was finally introduced, investors were relieved to note that essentially it did no more than give legal force to the previous practices of the investment authorities. Convinced that foreign capital is indispensable as a factor of industrial and technological development, Mexico is still taking a generally positive attitude to investment by foreigners. The Investment Law is not aimed at excluding foreign capital from the Mexican economy but rather at inducing the foreign enterprises to play their intended complementary role in relation to the indigenous enterprises and not to obstruct the activities of the latter.

In consequence the influx of foreign capital rose by as much as 62 p.c. in 1973, the year when the Investment Law came into force¹. In 1974 it was not quite as high, which fact suggests that the foreign investors in 1973 worked off a backlog and largely undertook investments which had been deferred in the preceding year owing to uncertainties about the future.

The foreign investments in Mexico may currently have a value of about US-\$ 4 bn. Exact figures exist up to 1970² when 79 p.c. of the total direct investment of US-\$ 2.8 bn was controlled by investors from the USA. The remaining fifth was provided mainly by nine other western industrial countries, led by the Federal Republic, Great Britain and Switzerland with 3 p.c. each.

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¹ On the development of direct investment since 1970 cf. Banco de México, S.A., *Indicadores Económicos*, Vol. III (1973), No. 6, table III-1.

² Cf. B. Sepúlveda, A. Chumacero, *La inversión extranjera en México* (The Foreign Investment in Mexico), Mexico 1973, statistical appendix, table 3.

The foreign investors have been concentrating on the manufacturing industry. By 1970 three-quarters of all investments went into it; ten years earlier it had been only 56 p.c. The chemical, electrical and transport equipment industries have attracted most interest: together they accounted for one-half of all foreign investments and the chemical industry alone for 30 p.c.³

As a proportion of the total private investment in Mexico the capital formation by foreigners — 7.6 p.c. in the average of the years from 1960 to 1970⁴ — seems modest. In the light of this overall figure it does not seem likely that indigenous firms have been incommoded. A somewhat different impression of the significance of the foreign investments emerges if the comparison is confined to the largest enterprises. The situation in 1970 was that of Mexico's "497 largest companies, measured in terms of capital stock, 154, or 31 p.c., were partly foreign-owned. The percentage moves up in the case of the 200 largest firms and even more when considering the top one hundred"⁵.

The foreign enterprises are of special importance in the sectors of the manufacturing industry which play the major role in economic development. In some of these the foreign share of the production value was substantially above the 28 p.c. average of total manufacturing industry in 1970⁶. In the pharmaceutical industry, where the foreign share is about 80 p.c., the extent of foreign control has been repeatedly commented upon in public discussions⁷.

In the domestic *capital market* the foreign firms are competing on an increasing scale with local borrowers, for in their search for sources of finance

³ *Ibid.*, p. 59.

⁴ Cf. *La inversión extranjera directa en México* (The Foreign Direct Investment in Mexico), in: *Comercio Exterior*, Vol. 21 (1971), No. 11, p. 987.

⁵ Cf. *Regulation of Foreign Investment*, in: *Comercio Exterior de México*, Vol. 18 (1972), No. 11, p. 2.

⁶ Cf. B. Sepúlveda, A. Chumacero, *ibid.*, p. 56, table 3.

⁷ Cf. *Debate on the Chemical-pharmaceutical Industry*, in: *Comercio Exterior de México*, Vol. 20 (1974), No. 7, p. 18.

they show a growing tendency to go for domestic capital. In 1970 they obtained almost two-thirds of their finance in the Mexican market; in 1965 it had been only a little over one-half (52 p.c.). The proportion financed by foreign capital declined correspondingly from 48 to 36 p.c.⁸

On the other hand, additional resources are brought into the country by foreign investors in the form of the annual direct investment flows. As against this capital influx for investment purposes there is however an outflow in the form of dividend, interest and other payments which, since 1940 at least, have eclipsed the inflow, and the deficit is tending to increase. In 1960 for instance it still amounted to no more than US-\$ 63 mn; in 1973 it reached already US-\$ 230 mn. A 1972 estimate of an adverse balance of US-\$ 370 mn by 1976⁹ was overtaken in 1974 already when it worked out at US-\$ 432 mn.

Little Effect on Employment

This net balance is certainly an imperfect yardstick for measuring the effect of decapitalization through foreign investments. The effect of these investments on incomes, employment, taxes, etc., must also be analysed. No attempt has been made so far to quantify these indirect effects.

Those concerned with Mexico's economic policy also expect the foreign investors to make a contribution to *export expansion*. Foreign enterprises however do not settle in Mexico in order to engage in exports but in the main so as to supply the Mexican market sheltered from the outside¹⁰. If they give consideration to the export trade, they are thinking chiefly of countries in which Mexican products enjoy certain preferences (as in LAFTA) and not of the western industrial countries. This is probably often the case because of restrictions imposed by the parent companies. Of all enterprises in Mexico, indigenous and foreign, it is however true that the export trade has so far played a subordinate role¹¹.

The direct contribution to employment by foreign enterprises is insignificant in terms of total numbers employed. In 1969 they gave work to no more than 3 p.c. of the labour force in Mexico while accounting for close on 13 p.c. of production. There are considerable sector-to-sector differences in regard to employment by foreign firms which correspond to the differences in contribution to production value. In manufacturing industry for instance the rate of employment by foreign

firms is in part far above the average rate for the whole economy. In the mechanical engineering industry almost one-half of the labour force in 1969 was employed by foreign firms; in the chemical and transport equipment industries the proportion was 40 p.c. or more. Foreign enterprises however account in all sectors for a higher – and in part substantially higher – proportion of production than employment¹².

Technological Dependence

Access to new technologies is considered an important prerequisite to industrialization also in Mexico. A considerable part of them must be procured abroad, and this is done chiefly through imports of capital goods and finished products, foreign direct investment and licence contracts with foreign firms. In the case of Mexico it is the last-mentioned method which is of the greatest importance. The implications of technology imports are arousing misgivings although foreign technology is indispensable to Mexico. Of concern are in particular

□ Mexico's high degree of technological dependence, above all on the USA, and the inadequacy of its own technological structure, as a result of which foreign enterprises are gaining growing importance in the dynamic sectors of the economy, and

□ the negative effects of technology imports on the balance of payments. Mexican politicians attribute these negative effects to the high price of foreign technology and, amongst other factors, the lack of efforts to develop technologies inside the country which in turn is due to the relative ease – albeit at a high price – of access to foreign technologies.

The technological dependence upon the outside world is indicated by the number of patent applications. It must of course be borne in mind that the number of applications does not indicate how many patents are actually used in the production process. Nor does this numerical index say anything about the economic importance of a particular patent, which could perhaps be measured by the value of the output achieved with its help. While in 1950 and 1960 14 and 16 p.c., respectively, of the patent applications had still come from Mexicans, the corresponding figure for 1970 was only 7 p.c. By 1972 the situation had however been reversed to some extent; native applicants accounted for about 10 p.c. of all applications in that year¹³. The USA has predictably entered the largest number of patent applications. It accounted for 50–60 p.c. of the total, and it is to be

⁸ Cf. B. Sepúlveda, A. Chumacero, *ibid.*, p. 67, table B.
⁹ *Ibid.*, p. 74.

¹⁰ Cf. L. Müller-Ohlson, *Imports substitution und Exportdiversifizierung im Industrialisierungsprozeß Mexikos (Import Substitution and Export Diversification in the Industrialization Process in Mexico)*, Tübingen 1974, pp. 19 ff.

¹¹ *Ibid.*, esp. pp. 80 f.

¹² Cf. B. Sepúlveda, A. Chumacero, *ibid.*, p. 82, table 16.

¹³ *Ibid.*, p. 99.

assumed that the USA would figure even more prominently if the patents were compared in regard to their economic importance.

In the pharmaceutical industry for example Mexico's dependence upon foreign technology is shown by an estimate of the National Association of the Chemical Industry that "only 10.3 p.c. of the primary chemical products consumed by Mexico's pharmaceutical industry in 1968 was supplied locally. The remaining 90 p.c. was imported although the domestic manufacture of many of these materials is economically viable"¹⁴. Most of the technology used is of foreign origin. "Royalties paid in 1968 for foreign formulas and trade marks were the highest in the country's economy, in absolute terms and in relation to the sector's product, rising more than 10 p.c. over net sales in some cases"¹⁵. The fact that the indigenous industry carries out virtually no research of its own has a bearing on the preponderance of foreign enterprises in the pharmaceutical industry.

Balance of Payments Implications

The implications of the large and increasing technology imports for Mexico's balance of payments may be judged from a comparison of the trend of the royalty payments for patents and licences by foreign enterprises operating in Mexico with the direct investments effected each year. From 1953 to 1970 the (recorded) royalties increased by over 800 p.c. while new investment rose by just under 500 p.c.¹⁶. The ratio between the two flows reflects this change: in 1953 the royalty payments worked out at 39 p.c. of the investment inflow; by 1970 they had gone up to 65 p.c.

Another question arising in this context concerns the conditions under which enterprises in Mexico acquired foreign technologies in the past. According to the available information these conditions were in many cases restrictive. The most important of these restrictions relate to exports. According to enquiries by UNCTAD 106 out of 109 examined contracts concerning technologies in 1969 contained restrictive clauses relating to exports. In 53 cases exports were completely forbidden¹⁷.

The dependence upon the activities of foreign enterprises and foreign technologies caused the Mexican Government in 1972 and 1973 to present two new bills, the Law on the Transfer of Tech-

nology and the Use and Exploitation of Patents and Trade Marks and the Law to Promote Mexican Investment and to Regulate Foreign Investment¹⁸. The Technology Law serves the purpose of suiting the transfer of technology to the requirements of economic and social development and national independence. It therefore provided that all agreements on the use of foreign technologies, including those in existence before the law came into force, must be submitted to a National Registry at the Ministry of Industry and Commerce. Restrictive clauses on the use of technology are forbidden in principle. Unsuitable and unduly costly technologies are not to be sanctioned at all.

The Effect of the Transfer of Technology Law

According to an interim report on the first 15 months after the promulgation of the Technology Law 5,625 agreements had been submitted to the Registry. 73 p.c. of these were existing agreements for which a two-year time limit for adaptation to the requirements of the new law has been set. The others were submitted for registration¹⁹. Of 965 applications processed by the end of April 1974, 64 p.c. had been approved as meeting the legal requirements. The other 299 agreements were turned down in the first instance although about one-third of them had been modified before their submission. The most frequent ground for rejection was the consideration for the acquired technology: in 81 p.c. of all cases the Registry deemed it to be excessive. Other frequent causes for rejection on the ground that legal requirements were not met were: unduly long duration of the contract, restrictions on production or stipulations regarding selling prices (40 p.c. each), restrictions on exports (26 p.c.), restrictions on research activities (26 p.c.), commitment of the technology recipient to the provision of technology of his own to the technology supplier (25 p.c.), and stipulation of a foreign venue of jurisdiction in case of disputes (23 p.c.).

The Technology Law undoubtedly strengthens the negotiating position of the Mexican licensee and, moreover, helps to lower the costs encumbering the economic development of Mexico. This is of relevance to the balance of payments which is

¹⁴ Cf. M. García Hernández, Structural Deformations in the Chemical-pharmaceutical Industry, in: Comercio Exterior de México, Vol. 20 (1974), No. 7, p. 20.

¹⁵ Ibid., p. 21.

¹⁶ Cf. B. Sepúlveda, A. Chumacero, *ibid.*, table p. 102.

¹⁷ Cf. M. S. Wionczek and L. M. Leal, Toward Rationalization of the Transfer of Technology to Mexico, in: Comercio Exterior de México, Vol. 18 (1972), No. 7, p. 15.

¹⁸ Ley para Promover la Inversión Mexicana y regular la Inversión Extranjera del 26 de febrero de 1973 (Law to Promote Mexican Investment and to Regulate Foreign Investment of February 26, 1973), in: Diario Oficial de la Federación, March 9, 1973; Ley sobre el Registro de la Transferencia de Tecnología y el Uso y Explotación de Patentes y Marcas del 28 de diciembre de 1972 (Law Concerning the Registration of the Transfer of Technology and the Use and Exploitation of Patents and Trade Marks of December 28, 1972), in: Diario Oficial, December 30, 1972.

¹⁹ Data given by M. de María y Campos, La política mexicana sobre transferencia de tecnología: una evaluación preliminar (The Mexican Policy Concerning the Transfer of Technology: a Provisional Evaluation), in: Comercio Exterior, Vol. 24 (1974), No. 5, pp. 472 ff.

eased if the cost of technology imports is reduced, to the export trade to which previously closed markets are opened, and for technological progress which is freed from some restrictions.

On the other hand, the Law can certainly not have the result that imports of technology will in future invariably take place on the stipulated terms. There is also a possibility that restrictive conditions will not be put down on paper or contracts will be signed in another country. If the Law has the consequence that less foreign technology reaches Mexico in future — possibly because the technology supplier would not derive enough revenue or have to fear undesirable competition — there would be a greater need for the development of technologies inside Mexico but it might also involve a risk of growth being slowed down through lack of suitable technologies. The Mexican Government will in any case be faced with the necessity of taking measures to encourage the development of technologies in the country for which no provision is made in the Technology Law.

The New Investment Law

The Investment Law, which was passed after the Technology Law, is designed to "promote Mexican investment and regulate foreign investment in order to stimulate a just and balanced development and consolidate the country's economic independence" (Art. 1). Foreigners are allowed to invest in the Mexican economy provided that their capital participation does not exceed 49 p.c., except in certain areas which are reserved altogether for domestic capital owners²⁰. An authorization by the newly established National Commission on Foreign Investment is required if the foreign participation exceeds 25 p.c. of the capital stock or 49 p.c. of the fixed assets of the Mexi-

²⁰ Essentially these sectors are the basic industries and public utilities.

can enterprise. Enterprises in which foreigners have holdings must be registered with a Registry of Foreign Investments.

The Commission may sanction deviations from the 49 p.c. limit if it is in the interest of Mexico's development objectives to do so. Express mention is made in this context of positive effects on the balance of payments, especially on the growth of exports, effects on employment and training, use of domestic products and services, contributions to technological progress, and assistance for development regions. This pragmatic arrangement will be of use primarily to big enterprises which are best able to offer the benefits on which the Law insists. Small and medium-sized enterprises will in most cases have to accept a Mexican partner and a minority participation for themselves. They will have to rely on other ways of compensating for their minority holding, for instance by stipulating a 55 p.c. majority for the taking of decisions or by means of indirect participation²¹.

The attempt to limit the foreign influence in the Mexican economy is a logical step in continuation of the previous policy of encouraging local ownership of Mexican enterprises²² without scaring away foreign capital. The fact that the provisions of the Investment Law have no retrospective effect seems to reflect the realistic judgment that a stronger domestic influence on capital and technology must be a very long-term objective. This aim will be most difficult to achieve in regard to the large foreign enterprises which offer the Mexican economy the greatest potential benefits and thus possess the greatest bargaining power.

²¹ On the various possibilities cf. S. I. de Villalbar, *El sistema mexicano de regulación de la inversión extranjera: elementos y deficiencias generales* (The Mexican System of Regulating Foreign Investment: General Elements and Shortcomings), in: *Foro Internacional*, Vol. 15 (1975), No. 3, pp. 331 ff.

²² On the recent Mexicanization policy cf. V. Cable, *Mexico, The Role of Foreign Investment*, in: *Bank of London & South America Review*, Vol. 8 (1974), No. 8, pp. 464 f.

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