An Alternative to Unilateral Immigration Controls: Toward a Coordinated U.S.-Mexico Binational Approach

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I. INTRODUCTION

On November 5, 1986, President Reagan signed an immigration bill designed to curtail the increasing flow of Mexicans migrating to the United States. The legislation attempts to curb migration through two means: (1) by increasing the border patrol, and (2) by suppressing the demand for undocumented Mexican labor by threatening U.S. employers with criminal and civil sanctions. Critics of the bill abound both on the left and the right. Many economists state that the bill is economically dysfunctional, since immigrants increase the economic welfare of U.S. citizens. Civil rights activists argue that the provisions for employer sanctions and worker-identification cards will lead to discrimination against Latinos at the workplace. Moreover, critics note that unless the U.S. erects a Berlin Wall along its 1960 mile border with Mexico, it is unlikely that any U.S. law alone can stem the tide of illegal immigration.

A central problem with the 1986 Immigration Reform and Control Act is that it is a unilateral attempt by the United States to resolve an

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* J.D., 1988, Stanford Law School.
2. See, e.g., J. Simon, How Do Immigrants Affect Us Economically? 89-91 (1985) (arguing that immigrants enhance national productivity and contribute more to public coffers than they take in social services); After Liberty Weekend, New Republic, July 28, 1986, at 9-10, quoting Beryl Sprinkel, chair of the Council of Economic Advisors to the President ("[O]verall, . . . job opportunities, real wages, and economic welfare are increased by immigration."). Clark Reynolds, Coordinator of the Project on United States-Mexico Relations of Stanford University, calculates that the United States will need an increasingly larger supply of low-wage labor than the domestic market can produce. Reynolds, The United States-Mexican Labor Market of the Future, 2 Sw. Rev. 57, 60 (1982).
3. Linda Wong, associate counsel of the Mexican American Legal Defense and Educational Fund in Los Angeles, argues that Hispanic Americans will "bear the brunt of employer sanctions by becoming employment untouchables—a suspect class of workers who by accident of birth, race, or accent represent nothing but trouble to the prospective employer." Immigration Bill Takes the Wrong Way Out, San Jose Mercury News, Oct. 26, 1986, at 1P, col. 1. 5P, col. 4.
inherently bilateral matter. As the Mexican and American economies grow increasingly interdependent, a restrictive U.S. policy toward Mexican immigration, without other countervailing measures, will only exacerbate the present Mexican economic crisis, leading to even higher levels of Mexican unemployment.4 An intensified economic crisis could threaten Mexico's political stability, which in turn would increase the incentives for Mexicans to migrate to the U.S., regardless of border patrols and incarceration centers.5 Moreover, Mexico's economic crisis has severe consequences for the United States in terms of lost trade opportunities and the stability of U.S. financial institutions.6 Because of its economic situation, Mexico cannot afford to buy as many U.S. imports, resulting in the loss of U.S. manufacturing and export-service jobs. Such a result is contrary to a central goal of the 1986 Immigration Reform and Control Act: protecting the U.S. job market.

Current U.S. and Mexican economic and immigration policies often counteract each other, impeding Mexican development, and thus increasing the pressure on Mexicans to migrate. This note will analyze these inconsistencies in current U.S. and Mexican immigration, tax, trade, and investment policies. The note argues that a more effective approach to the regulation of Mexican immigration to the United States is for both countries to recognize their shared interests in Mexican development, and to coordinate their policies to achieve this end. A coordinated approach to Mexican development, especially Mexican regional development, would benefit both the U.S. and Mexican economies, and allay the pressure on rural Mexicans to migrate to the United States and to Mexico's overcrowded urban areas. Part I will outline the historical, social and economic background to U.S. immigration policy, and present the rationale for an alternative approach. Part II will analyze the current U.S. and Mexican legal regimes that bear on Mexican development. This section will focus on the inconsistencies between the two nations' legal systems, and one attempt to coordinate these systems through what is known as the Maquiladora program. Part III will explore the potential of bilateral tax, investment, and trade measures that

4. See notes 26-42 infra and accompanying text.
5. If the economic and political situation in Mexico grows sufficiently dire, as it did in Vietnam and Cambodia in the 1970s, little could deter Mexicans from migrating. For a discussion of the exodus of Southeast Asian refugees, see J. Knudsen, Boat People in Transit (1983); M. Tsamenyi, The Vietnamese Boat People and International Law 1-8 (Griffith Univ. Centre for the Study of Australian-Asian Relations Research Paper No. 14, 1980). And given the situation in Guatemala and El Salvador, countries which now have refugees in Mexico, it is doubtful Mexicans would head south.
would foster Mexican development, especially in those regions from which most Mexican immigrants migrate.

II. THE "PUSH-PULL" DEBATE AND THE SOCIAL AND POLITICAL BACKGROUND OF MEXICAN IMMIGRATION TO THE UNITED STATES

A. The Debate

Analysts have long debated the causes of Mexican migration. The "push-pull" theory maintains that the economic disparity between Mexico and the United States creates the incentive for unemployed and underemployed Mexicans to migrate in search of improved economic opportunities. Though purportedly value-neutral, this theory has served as a basis for commentators to place responsibility for the migration and its resultant hardships on either Mexico or the United States, depending on the commentator's political perspective.

Those who emphasize the "push" factors for migration blame Mexico for its "abject failure" to manage the nation's economic development, and its unwillingness to acknowledge the nation's overpopulation. Restrictionists claim that corrupt and inept government officials pilfered and squandered government revenues, particularly oil revenues. These commentators would restrict Mexican immigration in order to compel Mexican officials to make the public policy changes necessary to eliminate the motive to migrate. In their view, the United States, by keeping open the safety valve of emigration through lax migration controls, merely subsidizes the corrupt practices of Mexican elites.

On the other hand, commentators who oppose strict restraints on immigration often stress certain "pull" factors. They maintain that Mexicans have migrated to the United States not only because of the economic disparity between the two countries, but also because of active American recruitment of cheap Mexican labor. The anti-restrictionists charge that U.S. employers were the primary cause for the substantial increase in Mexican migration at the beginning of this cen-

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9. Shutt reports that in 1982, "up to one-third of Mexico's accumulated debt—which then totalled over $70 billion—never entered the country... but instead went straight from the lending institutions to offshore bank accounts of government officials and others involved in negotiating the contracts." H. SHUTT, THE MYTH OF FREE TRADE 128-29 (1985).
11. This argument is discussed in Teitelbaum, Right Versus Right: Immigration and Refugee Policy in the United States, 59 FOREIGN AFF. 21, 47-48 (1980).
tury, and that the U.S. government has either welcomed or tolerated the resulting migration during most of the last one hundred years.\textsuperscript{12}

Anti-restrictionists argue that these pull factors remain. They state that immigrants contribute to the net general welfare of U.S. citizens,\textsuperscript{13} and that the aging demographic structure of the United States is leading to an increasing need for lower-skilled labor.\textsuperscript{14} To remain internationally competitive, and to sustain modest economic growth, the U.S. economy may require substantial immigration of lower-skilled labor.

B. \textit{Historical Overview of Mexican Migration}

The history of relations between the United States and Mexico illustrates both the naturalness of human and capital migration between the two countries and the mutual suspicion that the nations hold toward each other. Before 1849, much of the United States was legally part of Mexico, including all of California, Texas, New Mexico, and Arizona, and parts of Colorado, Utah, and Nevada. In 1849, at the end of the Mexican-American War, Mexico ceded this land to the United States in the Treaty of Guadalupe Hildalgo.\textsuperscript{15} Most Mexicans however, remained in the annexed territory and became U.S. citizens.\textsuperscript{16} Although sovereignty changed hands, there were no formal border controls from 1848 to 1894.\textsuperscript{17}

Throughout most of the twentieth century, the United States has encouraged, or at least not discouraged, Mexican migration. In 1924, when American restrictionism reached its height, the U.S. Congress enacted a quota system that severely limited immigration to the U.S. by those outside of Western Europe.\textsuperscript{18} Latin Americans, however, remained free from all but qualitative restrictions on entry.\textsuperscript{19} Mexicans were too important to the Southwest as cheap labor for the development of natural resources and industry. Organized labor tolerated their migration, "as long as Mexicans were restricted to employment in southwestern agriculture and other stigmatized jobs."\textsuperscript{20} Similarly, as a result of a labor shortage during World War II, the United States negotiated a treaty with Mexico, establishing what was known as the \textit{Bracero

\begin{thebibliography}{99}
\bibitem{12} See López, supra note 7, at 641-72.
\bibitem{13} See J. Simón, supra note 2.
\bibitem{15} López, supra note 7, at 642.
\bibitem{16} C. McWilliams, \textit{North From Mexico} 51 (1949); López, supra note 7, at 642.
\bibitem{17} López, \textit{supra} note 7, at 643 n.145 ("In 1894 the first two inspection stations were established along the Mexican border, primarily aimed at curbing the entrance of Chinese."); \textit{see also} W. Toney, \textit{A Descriptive Study of the Control of Illegal Mexican Migration in the Southwestern U.S.} 58-59 (1977).
\bibitem{18} Act of May 26, 1924, Pub. L. No. 139, ch. 190, 43 Stat. 153 (repealed 1952); see M. Jones, \textit{American Immigration} 276-77 (1960).
\bibitem{19} See López, supra note 7, at 657.
\bibitem{20} \textit{Id.}; \textit{see also} Heller, \textit{Immigration and Regulation} 34 (Sept. 24, 1986) (unpublished manuscript) (on file with the Stanford Law Review).
\end{thebibliography}
Program.\(^{21}\) The program provided Mexicans temporary work in U.S. agriculture. It lasted until 1964, and supplied the U.S. economy with nearly five million Mexican workers.\(^ {22}\)

Today, there are over four million legal and undocumented Mexican migrants in the United States.\(^ {23}\) That constitutes "approximately four percent of the U.S. labor force and one-fifth of the Mexican working population twelve years and older."\(^ {24}\) Individuals of Mexican heritage are the United States’ fastest-growing ethnic group, and may exceed blacks as the largest ethnic group by the year 2000.\(^ {25}\)

C. The "Crisis"

In the past six years, the economic situation within Mexico has dramatically worsened, increasing the pressure to migrate. On August 20, 1982, in part due to a dramatic fall in oil export revenues, Mexico announced that “it was out of cash and could no longer make payments on its $75 billion in foreign debts.”\(^ {26}\) By the end of 1986, Mexico owed $101 billion in debt.\(^ {27}\) The debt crisis is only one symptom of Mexico’s economic problems. The Mexican peso’s value has dropped in relation to the dollar by 300-400 percent since 1982,\(^ {28}\) and in 1987, inflation rose to 159 percent.\(^ {29}\) As a result, the purchasing power of the Mexican minimum wage fell by twenty-five percent in 1983, eight percent in 1984, and eleven percent in 1986.\(^ {30}\) Even worse, it is estimated that over a third of Mexican workers do not earn the minimum wage of less than 40 cents an hour.\(^ {31}\)

Even without the economic crisis in Mexico, the growth of the Mexican labor force would create employment shortages. Although Mexico’s population growth rate dropped to 2.7 percent by 1980 from an all-time high of 3.4 percent during the 1970s, the labor force will continue to grow at record rates.\(^ {32}\) This is because of the Mexican popula-

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23. Reynolds, supra note 2, at 57.
24. Id.
26. Rowe, supra note 6, at H1, col. 6.
27. Id. at col. 4 (map).
28. See id. at H1, col. 2.
30. Orme, End of Mexico’s Oil-Boom Era Has Meant Hardship For Citizen, Wash. Post, Aug. 16, 1987, at H1, col. 1, H2, col. 3. (“In 1987 this trend continued with wages lagging about 10 percent behind inflation.”); see also Eckhouse, supra note 29, at A6, col. 2 (“workers’ real wages have fallen about 60 percent in the past five years”).
31. Orme, supra note 30, at H2, col. 3.
tion’s youth. Almost half of Mexico’s population is less than fifteen years old, and this generation will soon be demanding jobs. Moreover, the percentage of women entering the work force is increasing, especially in the border industries. Thus while the annual population rate was falling to 2.7 percent, the labor force grew at annual rates between 4.9 and 5.6 percent. In other words, just to match the increased supply of labor, the Mexican economy must produce about 5 percent more jobs annually.

Yet currently, the economy is creating no new jobs. In fact, the economy’s annual growth rate has declined from a 7.9 percent increase in 1981 to a 3.8 percent decrease in 1986. Real investment in Mexico declined by 31 percent between 1980 and 1986. Mexican unemployment stood at 4.9 million in 1985 and continues to grow. Labor demand projections indicate that Mexico’s gross national product (GNP) must reach a sustained growth rate of 6.6 percent by the year 2000 in order to employ new workers. This rate would still not alleviate the underemployment problems that would affect over ten million workers. With each year of stagnant economic growth, the projected needs increase.

Past studies estimate that almost 80 percent of Mexican migrants to the United States come from rural sending communities. The underemployment in these rural regions is responsible not only for the migration to the United States, but also for the migration to Mexico’s increasingly overpopulated metropolitan centers. Over 80 percent of all Mexican manufacturing is located in the metropolitan areas of Mexico City, Guadalajara, and Monterey—with “more than half of it in the Mexico City metropolitan area alone.” Just as the U.S. government wishes to deter cross-border migration, the Mexican government is increasingly concerned with the migration to its metropolitan centers. The successful implementation of a rural development program is therefore in both countries’ interest.

D. The 1986 Immigration Act

Against this background of history, debate, and economic crisis, the

34. See W. Cornelius, supra note 32, at 19; S. Reyes, supra note 32, at 4; see also S. Weintraub, supra note 33, at 98.
36. Rowe, supra note 6, at H5, col. 5 (chart).
37. Id. at col. 1.
38. S. Reyes, supra note 32, at 10.
41. W. Cornelius, supra note 32, at 31 n.32.
42. Id. at 36.
IMMIGRATION CONTROLS

1986 Act was passed as a compromise package.\(^{43}\) That package involved a tradeoff between three major provisions: legalization, employer sanctions, and a guest worker program. Immigrants who can prove that they have been illegally in the United States since 1982 are eligible for legalization.\(^{44}\) Employers who engage in a pattern or practice of hiring undocumented workers are subject to civil and criminal penalties, including jail terms of as long as six months.\(^{45}\) Growers are assured a steady supply of foreign laborers to harvest perishable agricultural products.\(^{46}\) And despite the budget crisis in Washington and the deep cuts made in other government programs, Congress earmarked an additional $800 million to help the U.S. border control monitor the border.\(^{47}\)

Congress attempted to counter the anti-restrictionist argument that the United States has not met its moral obligations toward Mexican migrants through the Act's legalization provisions.\(^{48}\) These provisions recognize the community ties that migrants have formed in the United States, and offer amnesty to those who have resided there since at least January 1, 1982.\(^{49}\) Moreover, the provisions enable the United States to claim that it has fulfilled its responsibility to those who migrated here

\(^{43}\) The law was passed after four years of Congressional debate. A. ANDERSON, ILLEGAL ALIENS AND EMPLOYER SANCTIONS: SOLVING THE WRONG PROBLEM 1 (1986) (Hoover Institute monograph). Some members of Congress considered the legislation necessary in light of Immigration and Naturalization Service (INS) figures recording a "startling surge" (in the words of INS Commissioner Alan Nelson) of illegal aliens entering the country from Mexico. Shenon, "Startling" Surge Is Reported in Illegal Aliens From Mexico, N.Y. Times, Feb. 21, 1986, at 1, col. 1. For example, Senator Lawton Chiles (D., Florida) said that "[i]f we do not regain control of our borders . . . I think that within ten years, we will not recognize the United States as the United States we see today." The Changing Face of America, TIME, July 8, 1985, at 28. However, many commentators dispute the INS figures and the assertion that the U.S. has lost control of its borders. See, e.g., A. ANDERSON, supra, at 5; J. SIMON, supra note 2. They criticize the INS' methodology, which multiplies every border apprehension by two or three to estimate the number of immigrants successfully evading capture—"even though INS has no way to count the people it apprehends more than once," and even though the increased number of arrests obviously measure to some degree the 33 percent increase in border control enforcement in 1986. A. ANDERSON, supra, at 5.


\(^{46}\) Under 8 U.S.C. § 1160a(1)-(2) (Supp. IV 1986), special agricultural workers may apply for temporary residence status, and subsequently for permanent residence status, if they performed either 90 days of work each year between May 1, 1983 and May 1, 1986, or 90 days of work between May 1, 1985 and May 1, 1986. The only difference between the two groups of workers is that the former will be eligible for lawful permanent residence sooner. In addition, from 1990 to 1993, 8 U.S.C. § 1161(a)(1) (Supp. IV 1986) admits special agricultural workers if the Secretaries of Labor and Agriculture recognize a shortage of such workers.


\(^{48}\) Some anti-restrictionists state that immigrants' expectations of work, resulting from an officially sanctioned, long-standing practice have created a moral right to be part of the communities to which they have contributed and upon which they have depended for their livelihood. See López, supra note 7, at 695-702. López states, "If involvement and neighborhood matter, undocumented Mexican workers are part of the living and working community. They are we." Id. at 713.

because of past officially and unofficially sanctioned U.S. recruitment efforts.\(^{50}\)

Congress intended to eliminate such recruitment efforts—the "pull" factors within the United States—by applying sanctions to employers continuing to employ undocumented workers.\(^{51}\) By hampering the "pull" factors, the United States hopes to significantly curtail Mexican immigration. The employer sanctions provision is especially important to organized labor, which fears that migrants depress wages and threaten working conditions.\(^{52}\) It is also important to "nativists," who contend that mass migration threatens the cultural identity of the United States.\(^{53}\) The provision can silence charges that the U.S. is responsible for the migration because of its failure to discourage or prosecute employers who recruit or hire undocumented workers. In this way, the United States can wash its hands of responsibility for "Mexico's problem."

On the other hand, the guest worker provisions demonstrate that the "pull" factors within the United States are still very much alive.\(^{54}\) These provisions authorize the recruitment of Mexican agricultural labor. Although the provisions do not apply to other industries that have traditionally employed Mexicans, such as the restaurant and hotel industries, they nonetheless reveal the continued U.S. demand for Mexican labor, and its importance to the U.S. economy.

E. An Alternative Approach

The 1986 Immigration Act will most likely fail to achieve its goal of decreased migration because of its nationalist bias. Unilaterally cutting off the "pull" factors by erecting barriers to migration will only cause unemployment to worsen in Mexico and further strain the country's ability to provide basic social services to its population.\(^{55}\) An aggra-
imated Mexican economic crisis will in turn intensify "push" factors in Mexico that impel Mexicans to migrate. Moreover, the United States will lose jobs related to trade with Mexico, the United States' fourth largest trading partner.56

Recent studies demonstrate that, in fact, the 1986 Immigration Act may not be as successful in deterring Mexican migration as its sponsors had hoped. Although Mexican migration to the United States, as measured by the number of border apprehensions, declined during the twelve months following the Act's passage, migration rates rose to almost record levels at the start of 1988.57 Preliminary findings also show that most employers and employees in immigration-dependent firms feel that the employer sanctions law will be ineffective in deterring migration because of the availability of fraudulent documents and the lack of government enforcement. Employers' needs for young, lower-wage workers are apparently not being met by the U.S. labor force.58

Loosening trade barriers between the two countries is an alternative means of affecting Mexican migration to the United States. Capital flows from the United States to Mexico can moderate labor flows in the opposite direction.59 Presently there is a seven-to-one differential between U.S. and Mexican wages.60 Were the United States and Mexico to implement a policy of full capital exchange, such that U.S. corporations would be free to invest in Mexico and send manufactured goods back to the United States without any trade barriers, that wage differential would narrow. Although the differential would remain significant because of the United States' comparative advantage in high-wage industries,61 certain social groups in both countries would be harmed.62

57. Applebome, Immigration Law's Impact Still Tough to Measure, N.Y. Times, March 13, 1988, at E4, col. 1, col. 4 (citing North study for the Center for Immigration Studies); Immigration Arrests Up on State-Mexico Border, San Jose Mercury News, April 4, 1988, at D1, col. 1. The number of border crossings may have fallen initially because Mexicans who formerly crossed the border a few times a year, remained in the U.S. to take advantage of the amnesty provision. Additionally, the Border Patrol made fewer arrests while awaiting guidelines on enforcing the new law. See Reinhold, New Law Appears to Deter Aliens, N.Y. Times, Feb. 20, 1987, at A1, col. 4.
60. Id. at 220.
61. See id. at 219 (only 10% of U.S. labor force in "low-wage" sectors compared with 75% of Mexican labor force). The United States has a comparative advantage in industries that demand an educated, highly skilled workforce.
62. See notes 179-181 infra and accompanying text.
Though highly efficient in generating economic growth, full exchange, which is free trade taken to an extreme, is infeasible. It would result in a loss of control over economic affairs that no government could accept. Interdependence is a matter of political economy, in which the benefits of fuller exchange are balanced with the costs perceived by various social groups on either side of the border.

Between the extremes of unilaterally increased labor market controls (as provided in the 1986 Act) and free exchange of labor and capital (the open border approach) is a policy of managed interdependence. Negotiation and compromise are in both countries' interests. Yet contrasting views regarding the role of government in the economy have impeded dialogue between the two countries. Until recently, U.S. policymakers have espoused the wonders of free trade, often in "semi-religious" tones. Mexico, on the other hand, has been committed to highly protectionist, import-substitution policies, determined to protect its economy from U.S. encroachment. Recently, elements in both governments have experienced a change of mind. Mexico, recognizing the need to enhance the competitiveness of its products, has joined the General Agreement on Trade and Tariffs (GATT), and begun to liberalize its markets. The United States, seeing its position as the world's premier economic power under siege, is reconsidering its views on the efficacy of protective trade barriers and of government-business cooperation. The differences between the two nations' views on economic development are narrowing. The nations' choice of economic policy cannot be limited to free trade or government intervention. Rather, the choice is between an ad hoc policy of adjustment or degrees of government-business coordination.

Implementable policies must further a nation's perception of its self-interest. The interests of Mexico and the United States are inextricably intertwined. Ultimately, the two nations can most effectively further their interests by working together. Increased U.S. investment in Mexico would increase real wages in Mexico, providing for increased consumer spending and increased consumer gross national income. An upturn in Mexico's economic situation would favorably affect the U.S. economy. The U.S. export sector would benefit from increased Mexican consumption of U.S. products, and employment in the U.S. services sector would benefit from increased Mexican imports. Moreover, increased trade would help Mexico grow out of its debt crisis. This would calm U.S. financial fears that Mexico will declare a debt moratorium on the billions of dollars it owes U.S. banks, and would

63. Reynolds, supra note 39, at 42.
65. See S. Weintraub, supra note 33, at 172-73.
66. See notes 247-251 infra and accompanying text.
67. See notes 116-120 & 146 infra and accompanying texts.
68. See note 6 supra. Currently Mexico spends much of its GNP in interest payments to
calm U.S. geopolitical fears of a Nicaragua-like political upheaval in Mexico.\textsuperscript{69}

The vision behind the 1986 Act is misfocused because it centers only on migration controls. The other half of the equation—the need to bolster Mexico’s economic situation—was ignored by the 1986 Act. The following section will analyze U.S and Mexican laws that bear on Mexico’s development. This section will show how those laws presently counteract each other, and will lay a foundation for the coordinated, bilateral development policy proposed in the concluding section.

\section*{III. \textbf{The Current Legal Regimes Governing Trade and Investment}}

\subsection*{A. Mexican Law}

\textbf{1. The liberalization of Mexican law on investments.}

Since the Mexican Revolution in 1911, Mexican economic policy has restricted, and in some cases outlawed, direct foreign investment, in order to protect Mexican sovereignty. Foreign control of important sectors of the Mexican economy, and foreign possession of one-fourth of Mexican land, fueled the popular resentment that led to the 1911 revolution.\textsuperscript{70} Mexico’s new Constitution reflected this distrust of foreign investment by declaring subsurface minerals to be the state’s inalienable property, and prohibiting foreign ownership of border and coastal lands.\textsuperscript{71} By 1940, the Mexican government had expropriated large agrarian properties, and nationalized the petroleum and railroad industries. Correspondingly, foreign investment fell to about one-fourth the 1926 level.\textsuperscript{72} In 1944, the government instituted a policy of “Mexicanization,” transferring control of Mexican industries from foreigners to Mexicans. The government limited foreign corporate ownership to forty-nine percent, and closed certain key industries to foreign ownership entirely.\textsuperscript{73} During the 1960s, the government increasingly preferred indirect foreign investment, in the form of bank

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71. \textit{Id.} at 150, discussing Const. art. 27 (Mexico).

72. In 1926, foreign investment was about $1.7 billion; by 1940, it was approximately $449 million. See Creel, \textit{Foreign Investment in Mexico: New Rules of the Game? in 1 Doing Business In Mexico} 15B-1, 15B-7 (1987), citing A. Navarrete, \textit{EL FINANCIAMIENTO DEL DESARROLLO ECONOMICO} (Financing of Economic Development) 521, (Fondo de Cultura Economic 1950); \textit{Banco De Mexico, Cuaderno Sobre La Inversion Extranjera Directa: 1938-79} (information booklet on foreign investment).

73. Emergency Decree of June 29, 1944, art. 5 (Mexico), 145 D.O., No. 6, at 2 (1944).
loans and international bank issues, to direct foreign investment.\textsuperscript{74}

This preference for indirect over direct foreign investment culminated in the 1973 "Law to Promote Mexican Investment and Regulate Foreign Investment" (the Foreign Investment Law).\textsuperscript{75} The law specified the conditions under which foreign investment would be accepted. In conjunction with domestic content provisions and technology transfer rules, the Foreign Investment Law channeled foreign investment toward the promotion of new industries, rather than the displacement of existing ones. It expanded the list of industries completely closed to foreign investors, specifically in the areas of mineral extraction and infrastructure,\textsuperscript{76} and limited foreign ownership of some industries, including the automobile industry, to less than a forty-nine percent interest.\textsuperscript{77} These limitations, however, were not absolute. The National Foreign Investment Commission (FIC), a Mexican national body comprised of seven ministers of state, bears wide discretion to modify the allowed percentage of foreign investment in an enterprise in order to further Mexico's economic interests.\textsuperscript{78} Since the end of the highly protectionist Echeverria administration in 1976, and the onset of a serious economic crisis, the Commission has interpreted the Foreign Investment Law much more favorably to direct foreign investment.\textsuperscript{79}

In 1983, under the presidency of Miguel de la Madrid, Mexico adopted a new 5-year National Development Plan.\textsuperscript{80} The Plan acknowledged the need for direct foreign investment in order to develop Mexico's industrial capacity, increase exports, and substitute domestic products for imports. Mexicanization was to be determined on a more rational and selective basis, rather than as a matter of general policy. Although the new development plan did not change the Foreign Investment Law, it established interpretive guidelines for the Foreign Investment Commission that are more attractive for foreign investment.

In 1986 and 1987, Mexico made serious efforts to attract foreign

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\textsuperscript{74} See Fiszman, supra note 70, at 147. Government borrowing from U.S. banks, as opposed to direct investment by U.S. corporations, allows the Mexican government to exert control over development and to preserve its political legitimacy while maintaining the flow of foreign capital. See Frieden, Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea, 35 INT'L ORG. 407, 416-18 (1981).

\textsuperscript{75} Ley Para Promover La Inversion Mexicana y Regular la Inversion Extranjera, D.O., Mar. 9, 1973 [hereinafter Foreign Investment Law], translated in DOING BUSINESS IN MEXICO, supra note 72, at *app. I2.

\textsuperscript{76} Foreign Investment Law, supra note 75, art. 4. For a discussion of the Foreign Investment Law, see Creel, supra note 72, at 15B-13 to 15B-16.

\textsuperscript{77} Foreign Investment Law, supra note 75, art. 5.

\textsuperscript{78} See Creel, supra note 72, at 15B-16.

\textsuperscript{79} The Executive Secretary of the Foreign Investment Commission, Adolfo Hegewisch, has stated that the Commission will even consider 100 percent foreign investment in new Mexican firms, under certain circumstances. Remarks of Adolfo Hegewisch at the Escuela Libre de Derecho, Mexico City, June 16, 1983, quoted in Creel, supra note 72, at 15B-37.

investments. In April 1986, Mexico established a "debt for equity" program as a means to relieve the burden of the country's external debt. By the end of June, 1987, transactions involving $1.52 billion had transpired. In September, 1987, the Mexican government announced that small and medium-sized companies would no longer need to petition the Foreign Investment Commission for authorization to start wholly owned operations. Though large companies still need to apply for authorization, the Commission has granted authorization to multinationals such as IBM and Hewlett-Packard. In November, 1987, Mexico and the United States concluded negotiations for a "framework" agreement on trade and investments. The bilateral agreement creates "a permanent consultation and dispute settlement mechanism between the two countries to minimize disruptions in their trade relations."

The potential for increased foreign investment in Mexico is large. Mexico currently ranks thirteenth among foreign recipients of U.S. direct investment. Considering Mexico's 2,000 mile border with the U.S., and the fact that Mexico consistently ranks as the United States' third or fourth largest trading partner, there is much room for growth.

2. Investment incentives through Mexico's tax system.

Mexico's development program has attempted to balance investment requirements, such as local content and export requirements, with investment incentives, especially tax incentives. Corporations currently pay Mexican income tax at a forty-two percent rate, but under Mexico's 1987 tax reform law, the corporate tax rate will fall to thirty-five percent by 1991. Although Mexico's effective corporate tax rate is higher than that under current U.S. tax law, the Mexican tax system

81. In 1986, the government approved $2.4 billion of direct foreign investments, a 30 percent increase over the previous year's historic high. By year's end, foreigners had invested $900 million. See Mexico Fails To Get All The DFI It Wants, Latin Am. Newsl., Sept. 24, 1987, at 4.
82. Id.
83. "These companies must have sales of less than U.S. $8 m[illion] dollars a year," and must employ "fewer than five hundred employees." Id.
84. Mexico recently signed an agreement with IBM to construct a wholly owned microcomputer manufacturing facility in Mexico. IBM will invest $91 million in the facility, and in addition, will construct a semiconductor and software development center to foster Mexican technology development. Sinkin, The Mexican Economy in Crisis, in 1 DOING BUSINESS IN MEXICO, supra note 72, at 3-26.
85. TRADE AGREEMENTS PROGRAM, supra note 56, at 4-35. Farnsworth, Mexico, U.S. Easing Trade Policies, N.Y. Times, Jan. 11, 1988, at 19, col. 3.
86. TRADE AGREEMENTS PROGRAM, supra note 56, at 4-37 (Part II of III).
88. Gutiérrez, Mexican Taxation of Commercial Enterprises, in DOING BUSINESS IN MEXICO, supra note 72, at 16-1, 16-3, 16-4. Business enterprises in Mexico also must distribute profits to their employees up to a rate of 10% of taxable income. Id. at 16-6. The effective rate is actually higher than the old 42% rule when this nondeductible, employee profit-sharing percentage is added.
does offer a variety of business incentives. However, current U.S. tax and trade policy may eliminate the potential benefit of these incentives.\textsuperscript{89}

As a general business incentive, Mexico maintains energy prices below international levels.\textsuperscript{90} The government also offers more specific incentives on the basis of new investments and increased employment. Investments in specified industries within designated national priority zones receive an investment credit.\textsuperscript{91} The country is divided into three basic zones: Least developed regions constitute zone 1, which has the highest priority; regions of "state priority" constitute zone 2; and the most developed regions, including Mexico City, constitute zone 3.\textsuperscript{92} Capital investment credits range from fifteen to twenty-five percent. An additional five percent credit applies to investments in Mexican-produced equipment.\textsuperscript{93} To encourage greater employment, the government awards credits of twenty percent of the local minimum wage per job created.\textsuperscript{94}

In 1983, Mexico added an accelerated depreciation allowance to the income tax law to stimulate economic activity for those companies that have not received other incentives or subsidies.\textsuperscript{95} Assets in the first priority zone entitle the company to a fifty percent depreciation allowance, while those in the second priority zone receive a twenty-five percent allowance.\textsuperscript{96} Businesses that sell real estate in the Federal District (Mexico City) and invest the proceeds in fixed assets in other zones also receive a credit.\textsuperscript{97}

These incentives serve multiple objectives. The tax structure seeks to increase employment, to stimulate investment in priority activities, to foster balanced regional development, and to promote the formation of small industries.\textsuperscript{98} By stimulating employment in Mexico's underdeveloped regions—the regions from which most Mexicans migrate to the United States—the plan could alleviate the pressure to immigrate. However, these investment incentives only function if they are not

\begin{thebibliography}{99}

\bibitem{89} See notes 139-182 infra and accompanying text.
\bibitem{91} \textit{Id.} Qualifying industries include farm products, industrial machinery, steel and cement, textiles, electrical items, petrochemicals, and minerals. \textit{Business Operations in Mexico}, Tax Mgmt. (BNA), Foreign Income Portfolios No. 136-4th, at A-5 (1984). For a general discussion of available tax incentives, see Aguilar & Kryzda, \textit{Tax Incentives for Industrial Investments}, in \textit{1 Doing Business in Mexico}, supra note 72, at 26-1.
\bibitem{92} \textit{Business Operations in Mexico}, supra note 91, at A-5; Aguilar & Kryzda, supra note 91, at 26-6.
\bibitem{93} \textit{Business Operations in Mexico}, supra note 91, at A-5.
\bibitem{94} \textit{Id.}
\bibitem{95} \textit{Id.}
\bibitem{96} \textit{Id.}
\bibitem{97} The credit is 50% of the tax on the real estate acquisition.
\end{thebibliography}
taxed by the U.S. Treasury, or countervailed by the Department of Commerce, or offset by other Mexican trade and investment barriers.

3. Mexican trade restraints.

Traditionally, Mexico has taken a highly protectionist position in international trade in order to promote its domestic industries. This strategy, known as import substitution, used tariff barriers, import-licensing requirements, and quotas, to restrict imports. Tariffs sometimes rose by as much as 100 percent, and import licensing effectively banned the importation of many products. During the early 1970s, the government combined import protection measures with large subsidies to domestic industries; these industries “became dependent on fiscal incentives, subsidized imports, preferential credit, and ‘buy Mexico’ procurement policies.” The result was that most Mexican products could not compete internationally. This lack of competitiveness aggravated the crisis of 1982.

After the 1982 crisis, Mexico gradually shifted its development policy toward increased export promotion. A major change in Mexican trade policy occurred in August, 1986, when Mexico became a contracting party to GATT. To join GATT, Mexico agreed to a number of trade concessions. It accepted a maximum tariff of fifty percent on all of Mexico’s tariff lines. The government also promised to justify before GATT what remains of its import licensing system, and to eliminate the system shortly. It immediately eliminated licenses on 175 of 210 priority items. In addition, Mexico eliminated its “official price” system of tariff valuation (which raised the value for many goods for customs purposes), agreed to phase out its “buy national” policy, and promised to follow GATT codes on antidumping and subsidies. The government’s rationale for loosening import restrictions is to enhance the competitiveness of Mexican industry and to reduce inflation.

99. See notes 156-158 infra.
100. By 1982, import licensing requirements affected 80% of imports by value. Squaring Up to Big Brother, LATIN AM. WEEKLY REP., Feb. 12, 1982, at 5. Import licensing is a costly bureaucratic mechanism whereby customs must grant permission before imports can enter the domestic market. Refusal to grant a license results in complete protection. S. WEINTRAUB, supra note 33, at 67.
101. DEBT-SERVICING PROBLEMS, supra note 6, at 18-19. By 1975, government subsidies of economic activity comprised sixty-one percent of total governmental expenditures. Id. Under a “buy Mexico” procurement policy, the government will only buy domestic goods regardless of the cost differential. Id. at 19. This assures a monopoly market for an inefficient producer. See generally S. WEINTRAUB, supra note 33, at 73-82.
102. See note 159 infra and accompanying text.
105. On many tariff lines, an even lower binding tariff rate applies. Id. at 48.
Such changes amount to a major shift in Mexican development policy, and provide hope for a more cooperative, bilateral economic relationship with the United States.

4. The Maquiladoras.

In 1965, the Mexican government established the *Maquiladora* program, also known as the in-bond assembly plant program, to address the critical levels of unemployment that appeared after the termination of the *Bracero* program. The in-bond plants import merchandise and raw materials and process them immediately for export. The finished goods are not intended for sale in Mexico, and the Mexican government assesses no customs duties on them. Twin plants often operate on either side of the border: The capital-intensive portions are located in the United States, the labor-intensive in Mexico. In this way, U.S. companies may better compete with labor-intensive products from Asia, while Mexico obtains income to service its debt and jobs to relieve its unemployment. Because of their geographical proximity, these twin companies can coordinate their operations to a degree unattainable in most foreign locations of in-bond operations.

The Mexican government has strongly promoted the program. In 1973, it exempted the *Maquiladora* industry from the forty-nine percent ownership requirement, so that *Maquiladoras* could be wholly foreign owned. The Foreign Investment Commission has expedited customs regulations, realizing that the viability of the program depends on an easing of trade barriers. Though the *Maquiladora* program was originally associated with the Mexican/U.S. border area, customs regulations have eliminated geographical restrictions on plant location, except in areas that are overdeveloped, such as Mexico City, or areas

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108. See Engle, Mexico's *Maquiladora* Program: An Inviting Alternative For U.S. Manufacturers, 14 Tex. MGMT. Int'l J. 117, 121 (1985). Under certain circumstances, a *Maquiladora* company may sell up to 20% of its production in Mexico, provided that no less than 20% of the product’s content is local, and that the item is not produced elsewhere in Mexico. Id. at 121.

*Maquiladoras* invest primarily in the following sectors: electronic equipment (24.6%); textiles & clothing (14.6%); electronic machines (10.3%); furniture (8.6%); transportation equipment (8.6%). *Maquiladora* Update, BUS. MEX., March, 1987, at 64, 65.

109. Fontes-Moreno, Mexican Law On In-Bond Processing Plants, in DOING BUSINESS IN MEXICO, supra note 72, at 33-1, 33-2.

110. For instance, the operations in Nogales, Sonora, and Nogales, Arizona, offer the combined benefits of the Mexican program with a U.S. free trade zone, “thereby avoiding customs duties on both sides of the border during the entire manufacturing and assembly process.” Engle, *supra* note 108, at 118.

111. In 1983, a government commission was formed specifically to promote the industry. See *id.* at 119-20.

112. *Id.* at 118.

113. *Id.* at 121. Today, the in-bond plants are exempt from many exchange-control guidelines. They may also import materials and supplies needed for assemblage duty-free, in a streamlined manner. *Id.*
important for national security. Instead, the government has established priority zones, called “Motivation Centers for Industrial Development,” and has encouraged plant location therein by developing industrial parks and other infrastructure. The program has employed so many people that in some border cities, such as Ciudad Juárez, there is a growing labor scarcity. This labor scarcity has induced some firms to locate farther into the Mexican interior.

An important part of the success of the Maquiladora program is U.S. Customs’ treatment of Maquiladora products. United States tariff schedules permit goods that have been processed in Mexico to be returned to the United States either duty-free, or subject to customs duty only on the added value of the Mexican processing. Without these provisions, the program’s benefits could not be realized.

The Maquiladora program is an example of what can be accomplished through international coordination of the two nations’ policies. Beginning with twelve plants along the northern border, the program has expanded to include more than 1000 foreign entities which directly employ over 333,000 workers, indirectly generate more than 450,000 additional jobs, and contribute an estimated $1.4 billion in badly needed foreign exchange to Mexico each year. Unlike the rest of the Mexican economy, the Maquiladora industry performed well in 1986, and has surpassed tourism as Mexico’s number two industry after oil. After oil exports, in-bond plants are Mexico’s largest source of foreign exchange.

The Maquiladoras, however, have also suffered criticism. Mexican critics charge that the program facilitates U.S. domination of the Mexican economy. They contend that U.S. companies exploit impoverished Mexican workers, especially women, paying them only $2 to $4 a day for work that can pay over $20 an hour in the United States.

114. Id. at 120-121. Although 90% of the plants are still located along the border, Maquiladoras are increasingly found along the coast and in some interior locations. Id. at 120.


116. U.S. goods may qualify for duty-free entry under either the generalized system of preferences, or Item 800.00 of the tariff schedules. Under Item 800.00, products are returnable duty-free to the United States “as long as the goods have not been advanced in value or improved in condition.” Such duty-free products include, for example, pharmaceuticals re-packaged for the retail or prescription market. Under tariff schedules 807.00, 806.20, and 806.30, customs duties are based only on the value added outside the United States. See Engle, supra note 108, at 122; see also Fontes-Moreno, supra note 109, at 33-5.

117. Fontes-Moreno, supra note 109, at 33-1.

118. Tarbox, supra note 107, at 109; see also Ambassador Pilliod Says North American Common Market Possible, 4 Int’l Trade Rep. (BNA) 717, 718 (May 27, 1987); Engle, supra note 108, at 126 (citing figure of $1 billion in foreign exchange); The Rise of Gringo Capitalism, Newsweek, Jan. 5, 1987, at 40, 41 (citing figure of 250,000 employees and 1.4 billion in foreign exchange); Eckhouse, U.S. Manufacturers Send Some Jobs South, San Francisco Chron., Feb. 29, 1988, at A1, A6, col. 1 (citing figure of 333,000 employees).

119. Engle, supra note 108, at 117.

120. Id.

121. Eckhouse, supra note 118, at A6, col. 1.

122. Ross, Mexican Candidate for President Maps Out Plan: Woo U.S. Latinos. San Francisco
They point out that the program also has not significantly reduced unemployment among adult males, and has failed to fulfill hopes that it would be used to train domestic labor in high technology industries. Moreover, almost none of the inputs in the assembly of the products come from Mexican sources and therefore, linkages between the program and the rest of the Mexican economy are minimal. Though Mexican officials do not advocate abandoning the program, many contend that the program must be better integrated into the Mexican economy by using more Mexican produced inputs and spare parts in Maquiladora manufacturing, and by expanding the program into the Mexican interior.

Expanding the Maquiladora program, however, would only further incense U.S. critics. They argue that the program exports U.S. jobs by subsidizing the transfer of U.S. assets to Mexico. Corporations such as General Motors, General Electric and Zenith Electronics, these critics note, have laid off thousands of American workers while opening Maquiladora plants in Mexico. In an effort to curtail the transfer of production to Mexico, legislators introduced a bill in Congress in 1987 to repeal the U.S. tariff schedules that benefit the Maquiladora program.

Yet despite the problems noted by U.S. and Mexican critics, the program has employed significant numbers of Mexicans and has provided Mexico with valuable foreign exchange. Maquiladoras also have the potential to diversify the Mexican economy. Diversification is important for Mexican economic growth, stability and independence, and offers a safeguard against U.S. product-specific protectionist measures. Supporters of the program argue that in the long run, the U.S. also has a strategic self-interest in contributing to Mexico's economic and polit-
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Moreover, despite the claims of many American critics, the Maquiladoras may actually create net employment in the United States. A Department of Commerce study concludes that Maquiladoras resulted in 500,000 new U.S. jobs. Another study shows that "upward of 3,000 companies and 3 million U.S. workers [are] dependent on the maquiladora industry, plus an additional 15,000 suppliers of raw materials to the Mexican plants." The program also helps U.S. companies compete against Pacific Rim rivals, thereby preserving jobs that would be lost if whole industries decided to relocate in Asia. As a result of the Maquiladora program, some companies have even relocated manufacturing from the Pacific Rim to Mexico, and in the process moved higher skilled jobs back to the United States.

United States companies are not alone in their interest in the Maquiladora program. Japanese manufacturers have already spent more than a billion dollars on border assembly plants in Mexico, and companies from Taiwan and South Korea are expected to follow suit. U.S. companies, having been stung by competition from the Pacific in a number of markets, do not wish to lose out in this one as well.

Although the Maquiladoras create jobs in the U.S., there is no denying that they also displace some U.S. workers. The response to these real human costs, however, should not be to curtail the program, but to fashion a cost-effective adjustment assistance program that meets these workers' needs.

The Maquiladora program is one area in which Mexico and the United States have coordinated their legal systems in order to increase

131. See Reynolds, supra note 39, at 33 (citing estimate that "from one to three jobs are created in the United States for every Mexican job in the border plants through the demand for imports from supplies and purchases by Mexican employees"); see also New U.S. Study Deflates Criticism of Offshore Production, BUS. LAT. AM., Feb. 15, 1988, at 50, 50-51 (referring to findings of International Trade Commission study which reported that "any gain in assembly jobs resulting from elimination of 806/807 would be offset by loss of U.S. jobs in industries supplying 806/807 type industries"); The Rise of Gringo Capitalism, supra note 118, at 41 ("Brownsville, Texas...took in approximately $47 million in 1986 in new wages and related spending thanks to neighboring Matamoros [Mexico]."). See generally U.S. INT'L TRADE COMM'N, PUB. NO. 2053, THE USE AND ECONOMIC IMPACT OF TSUS ITEMS 806.30 AND 807.30 (1988).
132. See Kolbe, supra note 130, at 2, col. 3 (citing U.S. Dept. of Commerce report).
133. Eckhouse, supra note 118, at A6, col. 6 (citing study by Donald Michie at Univ. of Texas at El Paso).
134. See New U.S. Study Deflates Criticism of Offshore Production, supra note 131, at 51.
136. See Japan Finds Mexico a Profitable "Back Door" to U.S., San Francisco Chron., March 1, 1988, at A8, cols. 1 & 6; see also O'Reilly, supra note 125, at 72; BUS. LAT. AM., March 7, 1988, at 80.
137. See discussion of adjustment programs in notes 290-304 infra and accompanying text.
economic exchange. This has benefited both countries and has relieved, to some extent, the pressures on Mexicans to emigrate illegally. The two countries should not cut the program, but should expand it by employing more Mexican inputs in Maquiladora production, and by selling the products in Mexico as well as in the United States. The Maquiladoras would then be better integrated into the Mexican economy. As a result, the domestic value added to production by the Maquiladora industry, and the corresponding profits generated, would be increasingly distributed within Mexico. In this way, the Maquiladoras represent hope for increased coordination of liberalized economic relations between Mexico and the United States.

B. United States Law

1. United States trade law.

Tariff policy. American trade law has provided few incentives that benefit developing countries. In 1975, after years of opposition, the United States finally accepted a generalized system of tariff preferences (GSP) for imports from developing countries. However, protectionist groups were able to restrict GSP coverage so as to exclude many products in which developing nations were competitive. More recently, in 1987, the United States removed duty-free treatment from thirty-four Mexican products (worth $867 million) in retaliation against Mexico's failure to sufficiently recognize the "intellectual property rights of U.S. exports."

Past commissions of the U.S. government have recognized the need to increase trade with Latin America and the Caribbean. Yet policymakers in Washington have either ignored these policy recommendations or have gutted them upon adoption. When the Kissinger Commission published its report on Central America in 1984, there

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138. Value added refers to the net amount of value added by each input in the production process.


140. Sapir & Lundberg, supra note 139, at 199. The 1974 Trade Act excluded from GSP treatment such products as textiles, footwear, glass, watches, import-sensitive electronic items, and import-sensitive steel items. Id.


142. The Report of the President's National Bipartisan Commission on Central America (1984). The Commission recommended that the U.S. provide nonmilitary economic
was much talk of a "Marshall Plan" for the region. But one hears little of that now. In 1982, President Reagan announced the Caribbean Basin Initiative (CBI), under which the United States would open its markets duty-free to Caribbean nations. However, provisions of the CBI limit its practical benefits for development. First, a Caribbean nation must meet strict criteria in order to receive beneficiary status. Second, as with the GSP, Congress has excluded so many articles from CBI treatment that only ten percent of the goods Caribbean nations presently export fall within the law's provisions.

Although neither CBI nor the Kissinger Commission report applies to Mexico, both reveal a tension in the United States concerning development incentives for developing countries: a desire to promote regional trade and development, counterbalanced by political pressure to protect declining domestic industries.

**Non-tariff barriers to Mexican imports.** As with all developing countries, Mexico's access to the U.S. market is severely limited by non-tariff barriers to imports, most notably quotas and countervailing duties against government subsidies. A recent World Bank study found that non-tariff barriers in leading industrialized countries impeded approximately thirty-four percent of exports from developing countries, compared to twenty-one percent among developed countries. Since 1980, the U.S. has increased quantitative restrictions on developing country exports by over fifty percent. U.S. quotas particularly limit importation of Mexican steel, agricultural, and textile and apparel products.

Quotas often appear under such euphemisms as "Voluntary Restraint Agreements" and "Orderly Market Agreements." These agreements are designed to protect specific U.S. industries from foreign competition. Developing countries agree to them in order to avoid unilateral U.S. imposition of even more stringent import quotas or tariffs. Of all Orderly Marketing Agreements, the Multifiber Arrangement (MFA), governing textile and clothing manufacture, has had the greatest impact on developing countries. Since much of textile pro-

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145. See Hackney & Shafer, supra note 139, at 228.

146. For instance, in December, 1984, Mexico signed a Voluntary Restraint Agreement with the U.S. under which Mexico has consented to limit steel exports to the U.S. for a 5-year period.

147. See note 149 infra.

148. H. SHUTT, supra note 9, at 116.
duction is relatively labor-intensive, low-wage developing countries such as Mexico have a significant economic advantage over higher-wage industrialized countries. MFA quotas limit that advantage. In July 1986, Congress renewed the MFA for another five years and expanded its product coverage. Some commentators claim that this new version of the MFA is the most protectionist to date.

U.S. countervailing duty law serves as another barrier to Mexican imports. The U.S. imposes countervailing duties to offset subsidies that foreign governments provide to their domestic industries. The goals of the law are to protect domestic interests, while promoting the cause of free trade. U.S. industries contend that foreign subsidies bestow an unfair, competitive advantage on their foreign rivals. Free trade theorists argue that government subsidies are economically inefficient because they create misallocations of world resources. Thus, while the statute protects certain U.S. business interests, it can be supported as a disinterested application of a particular economic theory.

U.S. countervailing duty provisions do not extend to foreign government subsidies. The U.S. is a signatory to the GATT subsidy code, which expressly recognizes that domestic subsidies can further important domestic social objectives, particularly in the case of developing countries. For this reason, the GATT code emphasizes the prohibition of export subsidies, since the motivation behind such subsidies is more easily linked to bestowing competitive trade advantages, rather than promoting domestic social policy. U.S. law, however, countervails two forms of domestic subsidies in addition to export subsidies: those targeted to particular industries, and those targeted to


151. See, e.g., Lehmann, The Definition of "Domestic Subsidy" Under United States Countervailing Duty Law, 22 TEX. INT'L L.J. 53, 84 (1986); Panzarella, Is the Specificity Test Generally Applicable? 18 LAW & POL'Y INT'L BUS. 417, 423 (1986); see also Barceló, Subsidies and Countervailing Duties—Analysis and a Proposal, 9 LAW & POL'Y INT'L BUS. 779, 792 (1977). Free trade theory is based on the "law of comparative advantage," which states that all countries benefit if each country specializes in the product it produces most efficiently and no countries impose tariffs which impede the sale of that product in the world market. All countries benefit, because even those that cannot produce a given product as efficiently as another country will reallocate their resources to more efficient enterprises, eventually resulting in an optimal use of global resources.

152. For a description of countervailing duty procedure, see Roggensack, supra note 98, at 185-89 (1984).


154. Yet in the case of developing countries, the Code does not prohibit export subsidies per se, but states that such subsidies should be analyzed to determine the extent to which they are consistent with the countries' "competitive and development needs." Subsidies Code, supra note 153, at art. 14(5).
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particular geographic regions.\textsuperscript{155}

U.S. domestic producers can use the complicated machinery of the countervailing duty statute to harass and deter importers through a succession of legal proceedings.\textsuperscript{156} These proceedings impose large costs on developing economies which, burdened with debt obligations, already experience a shortage of capital. Countervailing duty actions are initiated more frequently in the U.S. than in all other industrialized countries combined. Between 1980 and 1984, the European Community initiated only six actions and Japan only one under their respective statutes, while the U.S. initiated 123.\textsuperscript{157} Between 1980 and 1985, twenty-eight U.S. cases involved Mexican products, including steel, cement, ceramic tiles, bricks, toy balloons, textiles, lime, and fresh flowers.\textsuperscript{158}

U.S. industries have used the U.S. countervailing duty law successfully to attack specific components of Mexico's National Industrial Development Plan. In 1982, Mexico suspended its program of tax rebates, originally intended to stimulate exports, after the U.S. imposed the highest countervailing duty in its history.\textsuperscript{159} The U.S. International Trade Commission also imposed duties against Mexican low-interest loan programs and regional development incentives.\textsuperscript{160}

Duties imposed against regional development incentives are particularly pernicious in the context of Mexican immigration. Migration of Mexicans originates predominantly from specific regions.\textsuperscript{161} Development of those regions, and the resulting employment opportunities, would weaken the incentives to migrate. Mexican regional development programs thus not only serve important domestic policy goals, but also contribute to the U.S. goal of deterring illegal Mexican immigration. Moreover, regional aid policies arguably correct trade distortions rather than create them. As long as regional aid only offsets the increased infrastructure costs that an enterprise suffers because it agrees to invest in an underdeveloped region, the enterprise receives no real benefit.\textsuperscript{162} However, the legislative history of the U.S. counter-

\textsuperscript{155} See Lehmann, supra note 151, at 59.

\textsuperscript{156} Vernon, Trade and Investment in Mexico-United States Relations, in U.S.-MEXICO RELATIONS: ECONOMIC AND SOCIAL ASPECTS, supra note 39, at 171.

\textsuperscript{157} G. Hufbauer & J. Shelton-Erb, supra note 153, at 16.

\textsuperscript{158} U.S.-MEXICO TRADE, supra note 104, at 50 n.2.; see also N.Y. Times, May 22, 1984, at D15, col. 1 (discussing U.S. countervailing duties). Until 1985, countervailing duties could be imposed against Mexican products even in the absence of any economic injury to a U.S. industry. Although this rule was changed by the 1985 U.S.-Mexico agreement regarding subsidies, U.S. countervailing duty law remains a threat to Mexican development. See Bueno, El Tratado del Libre Comercio entre Estados Unidos y Canadá, 1987 COMERCIO EXTERIOR 926, 929.

\textsuperscript{159} See Roggensack, supra note 98, at 200.

\textsuperscript{160} Id. at 203-05.

\textsuperscript{161} See note 40 supra and accompanying text.

\textsuperscript{162} See Lehmann, supra note 151, at 76. It is interesting to note that many U.S. regional aid programs attempt to achieve the same effects as many of these proscribed practices. Although the U.S. government currently offers no programs which subsidize industry in depressed areas, programs such as the Tennessee Valley Authority flourished during the New
vailing duty statute clearly states that the disadvantage of a depressed regional location is not a permitted offset in the calculation of a subsidy.163

The efficiency consequences of a subsidy program can be best understood only within the context of a developing nation's overall social and economic policies. For instance, Mexico may resort to subsidies as a second-best policy to offset the disadvantage of an overvalued currency.164 Subsidies also provide such "social" benefits as employment stimulation, community stability, and the development of infant industries,165 all of which affect immigration patterns.

The U.S. also employs many government subsidy programs. Examples include special benefits to U.S. agriculture, detailed provisions of U.S. tax law which benefit specific industries, Commerce Department assistance to U.S. exporters, and the bailouts of Chrysler (1979), Penn Central (1970), and New York City through low-interest loans or insurance against default.166 Much of the nation's development has resulted from cooperation between government and business. Today in the U.S., the Southwest is attracting labor and capital investment from the Midwest.167 Yet U.S. government support was largely responsible for the Sunbelt's development, through such projects as the nineteenth century land grant programs,168 twentieth century price controls on natural gas, subsidized power generated from federal dams, and subsidized water from government river control projects.169 Even today, government procurement programs offer important support to the Sunbelt's electronics and aerospace industries.170

U.S. countervailing duty law is justified by a particular ideology re-
garding the proper role of the government in the economy.\(^\text{171}\) Such policies are connected to the specific experiences and interests of U.S. business and government leaders. Yet certain forms of government promotion of economic activity are more pertinent to a developing country such as Mexico, than to the United States. This does not mean that the U.S. should be unconcerned with the effect of Mexican economic policies on competition in the U.S. market. Yet the U.S. should realize that the present application of its countervailing duty statute can thwart Mexican development objectives and thereby impair the mutual U.S.-Mexican goals of managing the debt crisis and of curbing migration patterns.

2. United States tax treatment of investment in developing countries.

The current approach. The United States has also looked unfavorably upon tax incentives for private investments in developing countries. Since 1962, successive administrations have eliminated provisions that even remotely favored foreign over domestic investment.\(^\text{172}\) Of all major industrial countries, only the United States gives no tax concessions to private investment in developing countries.\(^\text{173}\)

The keystone in the U.S. scheme is the foreign tax credit.\(^\text{174}\) Its purpose is to avoid double taxation by providing a credit for foreign income taxes and foreign taxes imposed in lieu of income taxes.\(^\text{175}\) If the foreign tax due on a given amount of income is equal to, or greater than, the United States tax due on that income, then the U.S. Treasury collects nothing. If the foreign tax due is less than the U.S. tax due, then the U.S. Treasury deducts the foreign tax paid from the amount due under U.S. rates and collects the difference. In this way, the credit mechanism requires the U.S. taxpayer to pay the higher of the U.S. tax or the foreign tax, ceding to the source country the first slice of tax jurisdiction.

Developing countries criticize this tax scheme because it impairs the effectiveness of tax policies that they employ to attract U.S. investment.\(^\text{176}\) When Mexico seeks to attract U.S. investment through low

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171. See Tarullo, supra note 164, at 569-70.
173. Anthoine, Provisions in Tax Laws of Developed Countries Bearing Upon Private Direct Investment in Developing Countries, in United States Taxation and Developing Countries, supra note 172, at 70. Anthoine states that in comparison with other major industrial nations, "U.S. tax policy towards developing countries seems niggardly indeed." Id. at 72.
175. I.R.C. § 903 (Supp. IV 1986) (enumerating taxes falling into this category).
176. Miller, supra note 172, at 88.
corporate tax rates, credits, or allowances, such incentives are neutral-
ized by U.S. taxation of the repatriated profits. In effect, under the
present system, the U.S. collects the tax exempted by the Mexican gov-
ernment’s investment program. Thus, the investment program sub-
dizes the U.S. Treasury rather than direct foreign investment.\textsuperscript{177} For
this reason, developing countries contend that the United States, as the
leading industrialized country of the world, should grant tax-sparing
credits like those granted by almost all other industrialized coun-
dies.\textsuperscript{178} Under a tax-sparing approach, the United States would grant a
full credit for the amount of tax that an investing firm would have paid
to the developing country’s treasury if that firm had not received a tax
incentive.\textsuperscript{179}

On the other hand, some analysts argue that the deferral provision
of the U.S. tax code actually promotes more foreign investment than do
the tax-sparing programs common in Europe.\textsuperscript{180} Under the deferral
provision, the government foregoes tax on certain categories of foreign
corporate income until the income is distributed to U.S. shareholders,
usually in the form of dividends.\textsuperscript{181} As long as the subsidiary reinvests
its profits abroad, U.S. tax law will not frustrate a developing country’s
tax incentives. In this way, and in contrast to tax-sparing agreements,
the U.S. system encourages reinvestment of profits rather than rapid
remittance. This encouragement has bred strong political opposition
to the provision within the U.S., particularly from labor, on the grounds
that it reduces domestic investment and employment by subsidizing
“runaway plants.”\textsuperscript{182}

Objectives of current U.S. approach: A critique. The underlying ideals of
current U.S. tax law are tax neutrality and tax equity. The principle of
tax neutrality holds that tax laws should not affect business decisions;
the principle of tax equity, that those similarly situated should be simi-

\textsuperscript{177} Moreover, any foreign government subsidies rendered in connection with foreign
taxes reduce the portion that can be claimed as a tax credit. See I.R.C. § 901(i) (Supp. IV
1986). For example, if Mexico offers low-cost energy inputs to a U.S. company in exchange
for operating in a depressed region, the company’s U.S. tax credit may be reduced by this
subsidy’s value. For a discussion of U.S. tax policy toward foreign subsidies, see Rev. Rul. 84-
143, 1984-2 C.B. 117 (holding that Mexican official exchange rate is not a tax subsidy).

\textsuperscript{178} For an outline of the tax policies of other industrialized nations that bear upon
private direct investment in developing countries, see notes 210-213 infra and accompanying
text.

\textsuperscript{179} Miller, supra, note 172, at 98.

\textsuperscript{180} See, e.g., Shoup, Effects of U.S. Tax Laws on the Tax Systems of Developing Countries, in
United States Taxation and Developing Countries, supra note 172, at 181, 192 (deferral
provisions induce a company to retain earnings in the developing country rather than repatri-
ate them).

\textsuperscript{181} See generally J. Bischel & R. Feinschreiber, supra note 174, at 83-110 (discussing
circumstances determining application of deferral provision).

\textsuperscript{182} See Frank & Freeman, The Domestic Employment Costs of U.S. Investment in Developing
Countries, in United States Taxation and Developing Countries, supra note 172, at 1, 7;
Pugh, The Deferral Principle and U.S. Investment in Developing Countries, in United States Taxa-
tion and Developing Countries, supra note 172; W. Schmidt, U.S. Capital Export Policy: Back-
larly taxed.183 Like the classical law of comparative advantage,184 these theories seek to further the free movement of capital. Tax incentives, it is argued, distort markets by artificially inducing investors to invest in one location over another because of a lower tax burden. These distortions create inefficient allocations of resources and depress real world output.185 The strong version of these principles implies that differential tax policies should never be applied to achieve economic goals.

However, if one acknowledges that the United States can make an important contribution to global development, and if one accepts the premise that increased private investment stimulates Mexican development and reduces migration pressures, then the principle of tax neutrality becomes less relevant.186 In a world in which seventy-four percent of humanity possesses only twenty percent of the world’s resources, humanitarian objectives should also play a role in U.S. international tax policy.187 Moreover, from a practical standpoint, U.S. companies must compete against multinationals from other nations that do provide preferential tax treatment for investment in developing countries. In a world of multiple tax systems, pure tax neutrality does not exist. Unshaking adherence to such a principle could further harm the United States’ competitive position.

Applying the tax equity principle to U.S. investments in developing countries is also questionable. Companies investing in developing countries are not similarly situated to those investing in the United States. They face much greater investment risks and operate in areas with much lower levels of social services, thereby requiring greater infrastructure expenditures.188 A tax benefit offsetting these costs does not therefore offend the tax equity principle.

Besides raising theoretical concerns, preferential tax treatment

183. M. Rao, Double Tax Treaties Between Developing and Developed Countries 12-13 (1983). For a general discussion of the application of these principles to the policy of tax concessions for investment in developing countries, see Hellawell, United States Income Taxation and Less Developed Countries: A Critical Appraisal, 66 Colum. L. Rev. 1393, 1409-11 (1966); Pugh, supra note 182, at 278-80.
184. See note 151 supra and accompanying text.
185. World output is maximized when investment funds are free to move to where they command the highest real rate of return, discounted by the risk incurred. See Hellawell, supra note 183, at 1409. One ground for opposition to the deferral provision is that it allegedly violates the principle of tax neutrality, and thereby distorts investment decisions. See Frank & Freeman, supra note 182, at 6-7; Pugh, supra note 182, at 278-79. On the other hand, supporters of deferral argue that it is tax neutral if one focuses on the import of capital to developing countries rather than on the export of capital from them. With respect to unremitted profits, if there were no deferral provision, U.S. companies would not “compete on an equal tax basis” with companies from other nationalities. Pugh, supra note 182, at 278-79.
186. See Hellawell, supra note 183, at 1410-11.
187. See Pugh, supra note 182, at 296. Moreover, the U.S. tax system presently offers some incentives, such as the asset depreciation range for rapid depreciation, only to domestic investments, thereby discriminating against investment in developing countries in favor of domestic investment. Prior to the passage of the 1986 Tax Reform Act, the investment tax credit was likewise inapplicable to foreign-earned income. Id. at 278.
188. See M. Rao, supra note 183, at 110.
faces substantial political opposition in the U.S. because of the perception that investments in developing countries take jobs from Americans. The effect of the deferral provision on U.S. employment appears to be negligible.\(^{189}\) Although certain jobs are displaced by foreign investment, others are created, both to service imports and to provide inputs in connection with those investments. Manufactured inputs for use in foreign industries are less likely to be available locally in developing countries than in developed countries.\(^{190}\) Moreover, jobs provide Mexicans with capital so that they are better able to afford higher quality U.S. exports.

This relationship between U.S. exports and Mexico’s economic health is demonstrated by the fact that during Mexico’s 1982 crisis, U.S. exports to Mexico dropped by $10 billion, resulting in the loss of about 240,000 U.S. jobs.\(^{191}\) In 1986, U.S. exports to Mexico dropped by almost $12 billion because of “depressed demand” in Mexico attributed to currency fluctuations and a “virtual lack of domestic bank credit.”\(^{192}\) This time almost 300,000 jobs were lost to the U.S. economy.\(^{193}\)

Mexico’s depressed economy results in reduced employment opportunities in both countries. The Mexican economy is short of the capital necessary to promote domestic investment, and therefore could benefit significantly from increased U.S. investment. The precise effect of a tax-sparing mechanism favoring investment in Mexico is unclear. Yet it appears that, as in the case of the Maquiladoras, jobs lost to foreign investment could be more than offset by jobs created through increased trade with a rejuvenated Mexican economy.\(^{194}\) Thus, it appears that a tax-sparing mechanism’s primary effect would be to shift U.S. employment from more labor-intensive, import-competing jobs to higher-productivity, export-oriented ones.\(^{195}\)

The final question that supporters of preferential tax measures must answer is whether they efficiently achieve their goal of promoting development or whether, instead, they constitute expensive windfalls to investors who would invest in developing countries anyway for nontax reasons. There is evidence that many developing countries’ past tax

\(^{189}\) Compare Anthoine, supra note 173, at 73 ("the present U.S. tax regime does not result in any significant loss of U.S. jobs") with Frank & Freeman, supra note 182, at 21 (repeal of deferral would lead to 5,000-7,000 extra jobs in the U.S. economy). The latter figure is a negligible amount in comparison to the number of U.S. jobs lost because of Mexico's economic difficulties. See notes 191-192 infra and accompanying text.

\(^{190}\) Hellawell, supra note 183, at 1399.


\(^{192}\) Trade Agreements Program, supra note 56, at 4-32.

\(^{193}\) See Brock, supra note 191, at 1045 ($1 billion in U.S. manufacturing exports results in around 24,000 U.S. jobs).

\(^{194}\) See notes 131-135 supra and accompanying text.

incentive programs have been poorly designed, and thus overinclusive.\footnote{196} To the extent firms would invest anyway in a developing country, tax concessions merely deny the public treasury badly needed revenue. Opponents of concessions argue that the governments of developing countries merely cave in to pressure from powerful foreign firms.\footnote{197}

Yet there is countervailing evidence that incentive programs do affect investment patterns.\footnote{198} The effectiveness of tax-sparing incentives was central to the 1987 Congressional debate concerning whether § 936 of the Internal Revenue Code, the possessions tax credit, should be repealed, maintained, or expanded. The possessions tax credit, which previously applied only to investments in Puerto Rico, is a tax-sparing credit that applies even if the U.S. possession grants investments a complete tax exemption, known as a “tax holiday.”\footnote{199} The purpose of this tax-sparing credit is to “assist the U.S. possessions in obtaining employment-producing investments by U.S. corporations” through tax concessions that would otherwise be negated by the U.S. tax structure.\footnote{200} Studies demonstrating the effectiveness of the tax-sparing approach in generating investment in Puerto Rico led Congress to modify the Code so that companies with investments in Puerto Rico could expand manufacturing operations to qualified Caribbean Basin Initiative countries and still receive § 936 treatment.\footnote{201}

The more selective the approach to tax concessions, the more likely they will generate investment efficiently.\footnote{202} In this spirit, § 936 does not provide automatic benefits, but rather requires a formal application

\footnotesize{\begin{itemize}
\item 196. In their 1959 study of Mexico’s experience, Ross and Christensen concluded that most firms took little to no account of tax exemptions. S. Ross & J. Christensen, Tax Incentives for Industry in Mexico 136 (1959) (using a questionnaire with 25 firms). After a survey of 55 Jamaican companies, one study concluded that most companies would have invested in Jamaica despite the concessions, and consequently that the concessions were economically unjustified. Chen-Young, Evaluating Tax Incentives: The Case of Jamaica, in Readings of Taxation in Developing Countries 378-86 (R. Bird & O. Oldman eds. 1975). Such studies assessing tax performance are critiqued in Bird, Assessing Tax Performance in Developing Countries: A Critical Review of the Literature, in Taxation and Economic Development 33, 47-50 (J. Toye ed. 1978). One problem with the studies is the difficulty of assigning values to such externalities as employment generation. Despite the critical studies, developing countries still find tax concession policies in their interest. See M. Rao, supra note 183, at 15.
\item 197. See Shah & Toye, Fiscal Incentives for Firms in Some Developing Countries: Survey and Critique, in Taxation and Economic Development, supra note 196, at 269, 285.
\item 198. See Kopits, Effects of Tax Changes on Direct Investment Abroad, in United States Taxation and Developing Countries, supra note 172, at 224, 237.
\item 199. I.R.C. § 936 (1982 & Supp. IV 1986). For an overview of the credit, see J. Bischel & R. Feinschreiber, supra note 174, at 163-75. See also note 217 infra and accompanying text (discussing tax holidays).
\item 202. See M. Rao, supra note 183, at 16 (stressing importance of placing limits on eligibility); Hellawell, supra note 183, at 1424 (stressing the need for selectivity to reduce windfall benefits).
\end{itemize}
from investors and compliance with specific operating requirements.\textsuperscript{203} For a corporation to qualify as a possessions corporation, substantially all of the corporation’s income over a three-year period preceding election “must be derived from sources within a possession,”\textsuperscript{204} and most of its income during such period must “be derived from the active conduct of a trade or business” within a possession.\textsuperscript{205} Were such an approach extended to Mexico, a mechanism could be negotiated to specify qualified investment targets in order to tailor concessions to Mexico’s specific development needs.

One approach to tax concessions argues that they are forms of privatized foreign aid.\textsuperscript{206} Although the U.S. foreign aid program has been cut recently, the program was curtailed less for its objectives than for its deemed wastefulness. The Reagan administration has argued that foreign aid must be privatized to avoid misallocation or embezzlement by corrupt bureaucrats and their supervisors.\textsuperscript{207} This rationale counters the argument that direct subsidies to foreign governments are economically more efficient than tax incentives.\textsuperscript{208} Tax incentives go to companies that meet specified criteria, not to public projects through a bureaucratic intermediary.

Given the current U.S. deficit and the political attitude in Washington toward foreign aid, Congress is unlikely to enact tax incentive measures for investment in Mexico unless they appeal to U.S. as well as to Mexican interests. A properly tailored tax incentive mechanism needs to rely on the justifications of the \textit{Maquiladora} program: that in benefiting the Mexican economy, such a policy increases the purchasing power of Mexicans to buy U.S. products, and generates export-producing and import-servicing jobs in the U.S.; that such a program provides valuable capital for Mexico so it can both service its debt to U.S. financial institutions and meet its public’s basic needs so as to alleviate the pressure to migrate to the U.S.; and that such a policy helps maintain the economic, political, and social stability of a country that shares a 2,000-mile border with the United States.\textsuperscript{209}

\textit{Alternative tax incentive mechanisms.} There are numerous varieties of tax incentive mechanisms involving tax exemptions, tax-sparing credits, tax deferrals, and tax deductions. Scandinavian countries widely apply

\begin{itemize}
\item \textsuperscript{203} J. BISCHL \& R. FEINSCHREIBER, supra note 174, at 164.
\item \textsuperscript{204} I.R.C. § 936(a)(1)(A) (1982).
\item \textsuperscript{205} I.R.C. § 936(a)(1)(B) (1982).
\item \textsuperscript{206} See Hellawell, supra note 183, at 1424 (“The incentives should be recognized as a device of our economic aid program.”).
\item \textsuperscript{207} Widespread corruption is associated with Mexican project finance. See H. SHUTT, supra note 9, at 128-29.
\item \textsuperscript{208} The argument for direct grants instead of tax incentives is made in Raedel, Comment., in \textit{UNITED STATES TAXATION AND DEVELOPING COUNTRIES}, supra note 172, at 117 (“It may be more useful to provide help for developing countries outside of the tax system in a direct and targeted manner.”).
\item \textsuperscript{209} Regarding justifications for the \textit{Maquiladora} program, see notes 129-135 supra and accompanying text.
\end{itemize}
tax exemptions to investments in developing countries, the ultimate form of relief.\textsuperscript{210} Canada, Switzerland and the Netherlands do not tax dividends from foreign subsidiaries under specified conditions.\textsuperscript{211} The German system prolongs deferral of taxation for labor-intensive foreign investments.\textsuperscript{212} Japan and the United Kingdom have signed tax-sparing treaties with certain developing nations.\textsuperscript{213} The United States actually signed treaties that provided a seven percent investment credit with Brazil, Israel, and Thailand in the 1960s, but Congress never ratified the treaties.\textsuperscript{214}

One disadvantage of the tax-sparing methods listed above compared to deferral is that these methods do not discriminate between deferred and repatriated income, so that in some instances they may promote repatriation of income rather than reinvestment in the developing country.\textsuperscript{215} On the other hand, such approaches may create greater amounts of initial investment. These approaches can then be supplemented by host country programs encouraging reinvestment. Brazil, for instance, in order to develop its Northeast region, allows qualified corporations to deposit one-half of their income tax liability in Brazilian banks. The investors may then use these deposits, if matched by outside funds, for new investments in the region. These new investments are also entitled to income tax exemptions for a period of years.\textsuperscript{216}

Developing countries employ numerous forms of tax incentives to attract investment. The most common form is the tax holiday.\textsuperscript{217} Generally, a tax holiday grants complete income tax exemption for a period of about five years. A variation of this approach is a partial exemption, in which a holiday is limited to a specified percentage of investment. Tax holidays are not biased against labor-intensive industries, since they are tied not to capital inputs, but to profits.\textsuperscript{218} However, they are also rather expensive in terms of foregone tax revenue.

Developing countries also use allowances and tax credits as techniques to attract investment. Under these approaches, investors can respectively deduct or credit a percentage of new investment against taxable income. The disadvantage of these techniques, especially in the

\begin{thebibliography}{9}
\bibitem{210} M. Rao, supra note 183, at 11.
\bibitem{211} Id.
\bibitem{212} Bryan, Commentary, in \textit{United States Taxation and Developing Countries}, supra note 172, at 76.
\bibitem{213} Anthoine, supra note 173, at 71. This form of tax-sparing occurs when a developing country reduces or eliminates taxes as part of an investment-incentive program. The developed country will recognize this program by granting credit for the amount that would have been taxed if there had been no tax incentive.
\bibitem{214} Miller, supra note 172, at 99.
\bibitem{215} Id. at 90.
\bibitem{216} Lent, \textit{Tax Incentives in Developing Countries}, in \textit{Readings on Taxation in Developing Countries}, supra note 196, at 375.
\bibitem{217} Id. at 367-68; Shan & Toye, supra note 197, at 275.
\bibitem{218} Lent, supra note 216, at 367-68.
\end{thebibliography}
context of lessening migration pressures, is that they invariably promote capital-intensive investments at the expense of labor-intensive ones.219 Unlike tax holidays, the credited amount is tied to capital inputs, not profits. Investment grants carry the logic behind allowances a step further, by making outright payments to qualified firms. Grants are typically paid as construction is completed, so they are not contingent on an enterprise’s success. These grants, though highly attractive to foreign investors, are applied less often than other incentive mechanisms because they are so speculative; the developing country, not the investing firm, assumes the risk of failure.220

IV. A DIFFERENT APPROACH: BILATERAL MANAGEMENT OF TRADE AND CAPITAL FLOWS

A. Managing the Interdependence of Migration and Trade Policies

The tax, trade, and migration policies of the United States and Mexico are interdependent. When the United States erects barriers to Mexican trade or when Mexico erects barriers to direct U.S. investment, pressures to migrate from Mexico intensify. Similarly, when the United States erects barriers to migration, unemployment worsens in Mexico, straining the country’s ability to provide basic social services and draining it of capital to buy U.S. exports.221

Mexican officials are now realizing that Mexico’s traditional, inward, protectionist orientation and its bias against labor-intensive sectors have led to high unemployment, low wages, and large-scale migration to the U.S. and to Mexican urban centers.222 Comparative studies show that the policies of “closed” countries like Mexico have led to slower economic growth than the policies of export-oriented countries, in large part because international competition stimulates efficiency

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219. See id. at 366, 368-69 (discussing comparative merits of tax holidays and investment allowances). Similar in effect to investment allowances are remission of customs duties on construction materials, machinery and equipment. Again such a remission promotes capital-intensive operations. Id. at 365-66.

220. Id. at 367; Shah & Toye, supra note 197, at 278 (in their study of 28 countries, only Fiji offered investment grants, and then “only in the hotel construction sector”).

221. “[R]elentless economic forces give rise to what has been called increasingly ‘silent integration’...” Reynolds & McCleery, supra note 59, at 217 (analysis of results of an economic model measuring effects of various immigration trade and investment policies on Mexican migration to the U.S.). This interrelatedness was demonstrated during the Mexican economic crisis of 1982. See Brock, supra note 191, at 1045. Similarly, the U.S. stock crash on “Black Monday,” October 26, 1987, was followed by an even greater plunge in the Mexican stock market. Wall St. J., Nov. 10, 1987, at 31, col. 1.

222. See Farnsworth, supra note 106, at 21, col.3; see also B. BALASSA, G. BUENO, P. KUCZYNSKI & M. SIMONSEN, supra note 164, at 22 (1986). Despite Mexico’s comparative advantage as a labor-surplus country, the Mexican government has subsidized capital-intensive, natural-resource-based industries and has suppressed food prices to the detriment of Mexican agriculture in order to appease urban labor. Id. at 92; W. CORNELIUS, supra note 32, at 33; see also Warman, The Future of a Crisis: Food and Agrarian Reform, in U.S.-MEXICO RELATIONS: ECONOMIC AND SOCIAL ASPECTS, supra note 39, at 209.
and productivity. In line with this recognition, Mexico has begun to restructure its economy, opening it to international trade and investment in order to make Mexican products more competitive, to create downward pressures on prices, and to release entrepreneurial spirit.

Yet, powerful interests in Mexico oppose such change. Government bureaucrats oppose reductions in public sector activity in areas of direct production and regulation, as does much of the Mexican private sector. Those who claim that Mexico’s economic ills can be cured merely through privatization, through a reduction of the role of the state in economic life, misunderstand the traditional relationship between the private and public sectors in Mexico. The private sector thrives on government regulation and protectionist measures. Mexico’s inward-oriented development policy guaranteed a monopolized market for a private sector that became accustomed to state subsidies, import barriers, and easy profits. If Mexico’s future lies in opening up its society to competition, the private sector must adjust as well.

Also running counter to the new emphasis on export promotion is the growth of neoprotectionism in the United States. In 1987, a number of protectionist bills were introduced in Congress, and protectionism under the logo of “fair trade” is an important issue in the 1988 Presidential campaign. The United States’ commitment to liberalized trade policies is being questioned because of the following conditions: the decline in U.S. productivity, the trade deficit, the government deficit, and the dollar’s loss of status as the world’s legal

223. See B. BALASSA, G. BUENO, P. KUCZYNSKI & M. SIMONSEN, supra note 164, at 52-53 (chart demonstrating that whereas Mexico’s per capita gross domestic product grew by only a factor of 2.3 between 1950-1985, that of more export-oriented countries such as Korea, Taiwan, and Greece grew by factors of 5.88, 6.22, and 4.41 respectively); see also Little, The Developing Countries and the International Order, in CHALLENGES TO A LIBERAL INTERNATIONAL ECONOMIC ORDER, supra note 195, at 259, 267 (citing studies which demonstrate that relatively open countries have grown faster).

224. See Farnsworth, supra note 106, at 21, cols. 3-4. In 1987, the Mexican inflation rate soared to 159%. Rohter, Mexican Candidate Ties Debt Service to Economy, N.Y. Times, Jan. 18, 1988, at 6, col. 1.

225. Aguayo, Behind the Public Profile of Mexico’s Private Sector, Wall St. J., Dec. 18, 1987, at 23, col. 3; see also Rohter, A Radical Diagnosis of Latin America’s Economic Malaise, N.Y. Times, Dec. 27, 1987, at 3, col. 1 (discussing Hernando de Soto’s new book, The Other Path: The Informal Revolution, a best seller in many Latin American countries). De Soto claims that “Latin America has never experienced true modern capitalism”; rather, the countries of the region are mercantilist societies producing “privilege, corruption, and inefficiency.” Id.

226. See, e.g., H.R. 3, 100th Cong., 1st Sess., 133 CONG. REC. H101 (daily ed. Jan. 6, 1987). In light of the disingenuousness of the political debates, one commentator has coined “a new Orwellian slogan: Protectionism is Free Trade.” H. SHUTT, supra note 9, at 7.


229. Peterson, supra note 227, at 44 (paid $136 billion in interest payments on the national debt in 1986). By the end of 1987, the U.S. owed foreign creditors $400 billion. Id. at 49.
tender,230 and the migration of U.S. manufacturers abroad because of cheap labor.231 Whereas traditionally it was Mexico that feared free trade would undermine its national sovereignty,232 one now hears similar fears pronounced in the U.S. Congress.233

The expression of such fears could signify a shift in U.S. policy from an almost religious defense of a simplified version of "free trade" to a search for appropriate forms of government intervention in the economy to stimulate U.S. competitiveness and manage the country’s economic destiny. The major competitors of the United States all use variants of deliberate business-government collaboration to a greater extent.234 The success of the Japanese economy in particular has challenged U.S. policy. Now that the U.S. economy is losing its predominant status in the world, and U.S. business and labor interests are demanding government intervention to offset the onslaught of imports and the loss of foreign markets, U.S. economic policymakers are beginning to realize that government efforts to manage markets might be enduring features of an interdependent world economic system, not irritating anomalies.235

United States trade “policy” has often entailed more ad hoc adjustment to foreign competition than rationally devised programs.236 The U.S. government has subsidized U.S. industry through inadvertence rather than planning through such measures as trade quotas in response to complaints of foreign dumping, emergency bailouts, commercial spinoffs from military research and development programs such as the Strategic Defense Initiative (alias “Star Wars”).237 Political candidates have now begun to call for increased government expenditures on education (an implicit subsidy), on worker retraining, and on

230. Heilbroner, supra note 227, at 105.
231. Id. at 97 (radical change has occurred in international economic relations now that advanced equipment can be installed in a country with cheap labor). Since 1913, the dominant capitalist economies’ share of world industrial production has dropped from over 90% to just over 50%. Id. at 100.
232. An example of the argument of the dependencia school, stressing the need for Latin America to protect its economic autonomy, is found in Raul Prebisch’s work. See, e.g., Prebisch, Commercial Policy in the Underdeveloped Countries, 49 AM. ECON. REV. 251 (1959). See also S. WEINTRAUB, supra note 33, at 154-61.
233. As one Senator recently stated during a floor debate, “We are a dependent nation that is beginning to lose control of its fate. . . . I can foresee a time when . . . our foreign creditors and foreign owners will demand concessions from us. . . . These concessions will undermine our independence.” Tolchin & Tolchin, Foreign Money, U.S. Fears, N.Y. Times, Dec. 13, 1987, (Magazine), at 64, col. 4 (statement of Senator Dale Bumpers, D-Ark, during debate on the Bryant Amendment, which would require major foreign investors in the U.S. to disclose their identities and holdings).
235. Zysman, supra note 64, at 149-50; see, e.g., W. DIEBOLD, INDUSTRIAL POLICY AS AN INTERNATIONAL ISSUE (1980).
236. As economist Robert Kuttner states, “Our financial and political institutions and our free market ideology typically combine to produce bailouts rather than dynamic or strategic advantages.” Kuttner, supra note 234, at 22.
237. The U.S. military consumes 73% of federal R&D funding. Id. at 25.
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direct, rather than indirect, commercial R&D. The choice for U.S. policy may no longer be narrowed between free trade and government intervention. Rather, the choice is between ad hoc adjustments and degrees of government-business coordination.

Decisions over the level and form of government involvement in the U.S. economy will have effects outside the United States as well as within. The world markets, and particularly the U.S. and Mexican markets, are inextricably intertwined. Economic growth will falter if it becomes a hostage to domestic political constraints. Coordination between the United States and Mexico means each country must recognize the other's interests. Otherwise, growth will stagnate since Mexico can purchase more U.S. imports only if it earns sufficient capital through exports to the U.S. and other markets. Fuller economic exchange furthers major goals of both U.S. and Mexican policy by curtailing Mexican migration, stimulating Mexican employment, and generating Mexican income. The purchasing power of increased Mexican income will attract U.S. exports and thus create U.S. export-related employment. It will also ease the servicing of Mexico's debt.

B. A Proposal for a Coordinated Approach

The United States has three primary goals from a coordinated approach: (1) to open the Mexican market to increased U.S. trade and investment; (2) to promote the adjustment of U.S. resources from lower to higher productivity sectors; and (3) to restrain illegal Mexican immigration. Mexico has two primary goals from a coordinated approach: (1) to promote a balanced development of the Mexican economy through an outward orientation emphasizing exports, diversification, product upgrades, and production sharing; and (2) to significantly increase employment opportunities, especially in underdeveloped regions. These Mexican goals may conflict when development policies call for capital-intensive rather than labor-intensive investment. To avoid these conflicts, Mexico will need to develop a program that is flexible enough to differentiate between the needs of different regions and economic sectors.

238. Analysts similarly stress the need for the U.S., Japan, and West Germany to coordinate their policies in order to avoid a contraction of the world economy. See Greenhouse, When the World's Growth Slows, N.Y. Times, Dec. 27, 1987, § 3, at 24, col. 4.

239. See notes 191-193 supra and accompanying text (discussing relation between U.S. exports and the health of the Mexican economy).

240. With increased exchange, Mexico can purchase back its debt at discounted rates. This approach was embodied in a plan devised by Morgan Guarantee Trust Company. Though the result of the plan did not meet Mexico's expectations, since it only reduced $1.1 billion of debt, this approach will be explored further in the future. See Truell & Moffett, Meager Debt Results Force Mexico, Other Countries to Explore Alternatives, Wall St. J., March 7, 1988, at 16, col. 2; Sachs, Mexico Plan a Model for Other Debtors, Wall St. J., Jan. 9, 1988, at 28, col. 3.

241. See G. THOMAN, FOREIGN INVESTMENT AND REGIONAL DEVELOPMENT: THE THEORY AND PRACTICE OF INVESTMENT INCENTIVES, WITH A CASE STUDY OF BELGIUM 64 (1973) (urging flexible system of incentives to respond to varied governmental goals).
Two decades ago, Mexico never would have agreed to a development policy with a central focus on rural employment. The government would have regarded such a proposal as an imperialist threat to Mexico's future, sacrificing capital-intensive, urban manufacturing for the benefit of U.S. migration concerns.\textsuperscript{242} Today, given the failure of Mexico's capital-biased, import substitution program, the size of Mexican unemployment, and the overcrowding and pollution of Mexico's urban centers, Mexican officials recognize the pressing need to create employment, especially in rural areas.\textsuperscript{243} Reducing protection of capital-intensive manufacturers relative to labor-intensive sectors, such as agriculture, could lead to significant increases in employment.\textsuperscript{244} Such a policy change could stimulate the export of processed foods and cash crops such as cotton, fruits, tomatoes, and other winter vegetables.\textsuperscript{245}

1. Production sharing: complementing U.S. and Mexican resources.

To further their goals, Mexico and the United States should consider ways in which their economies can complement each other. An economic policy of production-sharing draws on the complementarity of Mexican unskilled and U.S. skilled labor.\textsuperscript{246} Automobile manufacturers already use this technique, combining inputs manufactured in the U.S. and Mexico to produce automobiles at more competitive prices.\textsuperscript{247} This coordinated approach addresses a fundamental problem in developing countries such as Mexico—a lack of complementary resources.\textsuperscript{248} Mexico lacks the physical capital and managerial and technological know-how needed to best employ its greater supply of unskilled labor. An economic policy favoring production-sharing would permit Mexico to make better use of its comparative advantage in labor-intensive production.\textsuperscript{249} As in the Maquiladora program, U.S. firms would apportion different stages of production between the two.
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A U.S.-Mexican effort to coordinate their resources can create synergistic benefits for both countries. For the United States, U.S. products would be more competitive internationally, and Mexican workers would have greater funds with which to buy them. For Mexico, production-sharing would increase Mexican employment, and diversify Mexican production processes. Over time, as Mexican labor became more skilled, Mexico could upgrade and diversify its exports. Diversification would foster stability within the Mexican economy, which is now overdependent on oil revenues. It would also reduce the threat of U.S. protectionism, which is generally industry-specific.250

Some commentators advocate this form of production-sharing as part of a "stages approach" to comparative advantage.251 Under this approach, the structure of a nation's manufactured exports evolves with the growth of its physical and human resources. As developing countries like Mexico develop a more highly skilled labor force and their comparative advantage gradually shifts to capital-intensive production, their exports can expand into higher-productivity sectors. These exports can replace those of developing countries that graduate to the manufacture of even more technologically advanced products. In this way, developing countries can expand and diversify their trade in manufactured goods with less fear of protectionist reprisals,252 as long as developed economies can make smooth upward adjustments.

2. Direct foreign investment.

Further economic integration through production-sharing will involve additional direct U.S. investment in Mexico, inciting traditional Mexican fears of economic subservience.253 While a nation gains from increased trade and investment, these gains come at the sacrifice of some national economic autonomy.254 Direct foreign investment thus entails political tradeoffs. At this point, however, the benefits to Mexico from increasing direct foreign investment appear to far exceed the costs. Mexico desperately needs foreign exchange, especially in light of its debt burden of over $100 billion.255 Direct investment constitutes a form of capital infusion which does not create debt, nor host country

250. See B. Balassa, G. Bueno, P. Kuczynski & M. Simonsen, supra note 164, at 161 (need for diversification); W. Cline, supra note 129, at 128 (stressing need to diversify manufactured exports to avoid protectionism).


252. Id. "This approach also permits one to dispel certain misapprehensions regarding the existence of a foreign-demand constraint for the developing countries' manufactured exports." Id. at 165.

253. See S. Weintraub, supra note 33, at 2; notes 70-72 supra and accompanying text.


255. See notes 26-27 supra and accompanying text.
commercial risk, at a time when alternative sources of funds are not readily available.256

Businesses demand higher returns to compensate for bearing the risk of investment in developing economies, and thus the effects of such investment on a host country's balance of payments are subject to frequent debate.257 Nevertheless, direct foreign investment has numerous, positive effects. Aside from providing much needed employment, it also serves to train employees and to introduce technical, managerial, marketing and entrepreneurial expertise.258 Foreign investment can offer Mexican workers the skills and industrial experience requisite for indigenous growth.

Increased investment by foreign enterprises is beneficial to an outward-oriented development strategy because such companies possess both international marketing capabilities and political power to resist protectionist pressures in their home countries.259 Increased foreign investment in Mexico would also stimulate the efficiency and competitiveness of domestic Mexican companies,260 many of which have grown lazy from government subsidies and import protection. The monopoly profits that Mexican companies reap primarily benefit the wealthy, not the lower classes which must pay higher prices for inferior goods. Competition would create downward pressures on domestic prices, and thus increase the purchasing power of the poor and the middle classes.

The Mexican economy has suffered particularly from the flight of billions in Mexican capital to the United States,261 because this money was no longer available for employment-generating domestic investment. Increased foreign investment can help reverse this process by providing greater domestic opportunities for the deployment of Mexican capital.262 In fact, between early 1986, when Mexico began to restructure its economy,263 and the stock crash of October, 1987, Mexi-
can investors repatriated about $3 billion. Foreign firms also induce repatriation when they stimulate the creation of new businesses to supply them with inputs and to service their outputs. This process further facilitates a meshing of domestic surplus labor with capital inputs.

By providing domestic employment, foreign investment also decreases the pressures to migrate. According to a model by Clark Reynolds and Robert McCleery, a $5 billion per year capital flow between the United States and Mexico would significantly curtail migration. They calculate that by the year 2000, the undocumented migrant population in the U.S. would decrease to less than 1 million from the present population of over 3 million. New investment of $5 billion per year is not infeasible. In 1981, before the debt crisis began, and when Mexican policy looked less favorably on foreign investment, the Mexican economy still attracted $3.5 billion of new foreign direct and portfolio investment. Though Mexico has suffered a substantial decline in foreign investment since 1981, a restructured Mexican economy should appeal again to foreign investors.

To attract foreign investment, Mexico needs to narrow the scope of discretionary government regulation. Foreign investors fear that their investments can be impaired by discretionary actions of government officials because investors presently have no legal recourse outside of Mexican law. These fears would abate if Mexico agreed to participate in mandatory arbitration of investment disputes through a non-partisan, international organization. However, to attract foreign investment, Mexico also needs the assurance of the developed nations, especially the United States, that these countries will open their markets to Mexican imports.

265. See Hawkins & Walter, supra note 258, at 172.
266. See Reynolds & McCleery, supra note 59, at 221. Under their model, if there were a $5 billion yearly capital flow, the population of Mexican migrants in the U.S. would have peaked at 3.5 million in 1985, compared to a peak of 5 million in 1995 if there were no increase in capital flow; see also Adams, Study Urges Investment in Mexico as Best Way to Stem Tide of Aliens, AM. BANKER, March 6, 1982, at 2 (referring to study of A. Davida, economist at the Federal Reserve Bank of Dallas). Estimates of current migrant population in the U.S. vary, but a figure of 3-4 million seems reasonable. See A. Anderson, supra note 43, at 4-6.
268. Id.
3. Trade policy: opening up markets.

Like increased investment, increased trade between the United States and Mexico would enhance the competitiveness of Mexican products. By revitalizing its economy, Mexico would become an even more important market for U.S. exports, which again should generate net U.S. employment gains. However, if trade between the two countries is to increase, U.S. trade policy must abandon its partial protectionist stance toward Mexico and begin to assist Mexican development. Import barriers against Mexican products do not create jobs. Rather, they protect specific jobs at a huge economic cost. For instance, one recent study calculated that protectionist barriers to foreign imports cost U.S. consumers between $55,000 and $1 million for each job saved. These increased costs can be particularly burdensome on the poor. According to one estimate, U.S. restrictions on clothing (including shoes), sugar, and automobiles cost families with an income of $7,000 to $9,000 per year an income surcharge of 23 to 66 percent in 1984.

By protecting specific jobs, U.S. import barriers also hurt workers in other industries. Attempts to save jobs in one industry can reduce U.S. competitiveness in other industries that rely on that product. For example, a study of the U.S. steel industry estimates that, although the 1984 steel agreement saved 16.9 thousand U.S. steel manufacturing jobs, it also resulted in the loss of 52.4 thousand manufacturing jobs in steel-using industries. These U.S. industries were at a competitive disadvantage because the cost of their steel was higher than the world price of steel paid by their foreign competitors.

In return for opening its market, the United States will justifiably demand that Mexico do the same. Since increased trade should benefit the Mexican economy, Mexico should continue to make concessions. Mexico can gradually open its market in order to ease adjustment. Moreover, since increased trade would benefit the U.S. export sector, it would help diffuse political opposition to U.S. tax and tariff concessions to Mexico.

Future trade agreements between the two countries may be on a sectoral basis. This process is already occurring. In 1987, U.S. and Mexican negotiators agreed to a percentage increase in Mexican steel and textile imports in return for increased access to the Mexican market.

271. See notes 222-224 supra and accompanying text.
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for U.S. steel and textile manufacturers. The two countries should also pursue agreement with respect to agricultural products and processed foods, as well as a gradual phase-out of the multi-fiber agreement. The United States should agree to modify the application of its anti-subsidy law to avoid offsetting legitimate Mexican regional development policies. Otherwise, U.S. subsidy law will directly counteract the interdependent goals of Mexican economic development and U.S. immigration policy.

4. A more direct approach: tax incentives for investment in depressed regions.

There is a more direct approach to restrain migration from Mexico to the United States than liberalizing capital flows. The two governments could stimulate investment in the rural sending communities through a binational tax and investment policy. This is an area in which the United States and Mexico can better coordinate their legal systems. Mexico currently offers tax credits to investors in underdeveloped regions. However, foreign companies are hesitant to invest in Mexico because of a lack of infrastructure, which entails higher costs for the firm. This problem is exacerbated by the U.S. tax system's neutralization of Mexico's tax incentive scheme. Although the deferral provision of the U.S. tax code encourages companies to reinvest their earnings, it does not stimulate initial investment in these regions. In order to assist Mexico in attracting employment-producing investments, the United States should strongly consider extending the principle behind the possessions tax credit to qualified regional investments. Under this approach, the United States would recognize certain designated Mexican tax incentives which it would neither countervail nor tax through the operation of the foreign tax credit. This approach would provide U.S. firms with additional incentives to channel investments into Mexico's underdeveloped regions.

275. See Farnsworth, supra note 106, at 21, cols. 5-6.
278. See notes 155-163 supra and accompanying text. The Canada-U.S. Free Trade Agreement of 1987 embodies an alternative approach to subsidies that could be applied to Mexico as well. Canada and the U.S. have agreed to replace current trade law with mutually beneficial legal regimes. They also agreed to create a bilateral panel that will have final review of all domestic countervailing duty cases. See Int'l Trade Comm. Group, Canada-U.S. Free Trade Agreement ch. 19 (1987) (on file with the Stanford Law Review).
279. See notes 87-93 supra and accompanying text.
280. See notes 199-205 supra and accompanying text.
The feasibility of this approach depends on the level of national priority that the U.S. places on Mexican rural development and the resulting decrease in Mexican immigration. The degree of priority, in turn, would determine the amount of tax dollars the U.S. would be willing to forego. At a time when the U.S. deficit is of increasing national concern, a development policy which reduces the amount of tax revenues may be politically infeasible. However, despite the budget deficit, the U.S. does offer such tax treatment to Puerto Rico, and, in 1987, it extended this treatment to Caribbean Basin Initiative beneficiaries under specified conditions. Providing tax incentives would be more efficient than giving direct grants in foreign aid. Funds would go directly toward investment, and not pass through a bureaucratic intermediary. Eliminating the intermediary would reduce transaction costs and would abate fears that the funds were being embezzled by corrupt officials.

A coordinated agreement could be based on the paradigm of the § 936 possession tax credit. Alternatively, negotiators could use an approach that would exempt specific percentages of taxable income of qualifying investments. These mechanisms would be combined with a modification of the Mexican tax system. To attract more labor-intensive investments, Mexico would replace its investment tax credits with partial income tax exemptions for qualified investments in economically depressed regions. This change would not only further Mexican employment objectives. It would also be more compatible with the United States' goal of sustaining the manufacturing base to its economy.

In general terms, the program's incentives must be sufficiently selective to minimize windfalls, yet sufficiently large to attract significant employment-generating investment. The Mexican National Commission of Foreign Investment would determine qualifying investments based on specific criteria to meet specific regional needs. The amount of tax exclusion should reflect the amount of employment generation and the type and size of the investment, and should not be biased against labor-intensive investments.

The advantages of a bilateral approach over a unilateral change in U.S. tax and trade laws are multifold. First, the program can be tai-
lored to the particular needs and demands of the two countries. Sec-
ond, since only two nations would be involved, the effects of the policy
are more easily assessed and monitored. Third, because of the
tradeoffs the U.S. could receive, a bilateral approach is more politically
feasible.

As part of a package, Mexico could agree to loosen its barriers to
U.S. investment in specific regions, and to participate in mandatory
arbitration of investment disputes with companies in those regions. In
return, the U.S. could agree to amend its anti-subsidy law's prohibition
against regional development incentives, and agree to limit its tax-
ation of qualifying regional investments through a tax-sparing approach.
In addition, the two countries could negotiate for increased access to
each other's markets in specific sectors, such as agriculture and
processed foods.

Since policies affecting migration, debt, investment, and trade inter-
act with each other, the development of a binational investment-tax
agreement is neither sufficient nor required to restrain migration from
Mexico. The precondition for effectively addressing such migration is
not the passage of another law, but the recognition by both the U.S.
and Mexico that migration, trade, and investment policies affect one
another, that the United States and Mexico have important mutual eco-
nomic interests, and that these interests can be most effectively pursued
not through unilateral action, but through bilateral negotiation. Once
the two countries recognize that coordination toward fuller exchange
of trade and capital flows serves the interests of both nations, appro-
piate policies can be adopted. The proposed binational agreement is
merely one means to achieve policy coordination.

5. Adjustment assistance: aid to displaced workers.

Shifting labor and capital resources into more productive activities
is a key to economic growth. If a nation rigidly protects existing in-
dustries, the economy can experience sclerosis, "a hardening of the
economic arteries." A decline in economic growth would result in
decreases in productivity, net employment, and national wealth. How-
ever, this churning of productive resources also results in worker dis-
placement and industrial dislocation. Although net jobs are created
and society as a whole benefits, workers and investors in specific sectors
suffer.

288. See notes 155-163 supra and accompanying text.
289. See notes 275-277 supra and accompanying text. Bargaining could also encompass
forms of debt relief. For instance, debt-equity swaps could be included as part of a tax incen-
tive plan. Participating U.S. equity investors would receive favorable U.S. and Mexican tax
treatment.
290. H. Gray, T. Pugel & I. Walter, International Trade, Employment and Struc-
tural Adjustment: The United States 1 (1986).
291. Id. at 106.
The process of adjustment must be considered as part of a bilateral approach. If the *maquiladora* program expands and if the U.S. removes trade barriers to Mexican imports, many labor-intensive sectors in the U.S. economy would have to contract. In the absence of income support and training assistance for displaced workers and their families, some U.S. workers would endure severe costs. Rather than trying to freeze its inefficient industries in the status quo through trade barriers, the U.S. government should direct its assistance to those who suffer the direct shocks of trade displacement.292

There are three primary rationales for an adjustment program: equity, efficiency, and political efficacy.293 First, for equitable reasons, society should part with a portion of its net gains from the reduction of protectionist barriers to compensate workers displaced by those policies. Second, depending on its cost-efficiency, an adjustment policy can also be more efficient than a pure free trade policy. By subsidizing the retraining and relocation of displaced workers, government can facilitate the redeployment of labor resources into more productive activities. Third, if the U.S. provides an effective workers' adjustment program, the proposed measures to enhance trade and investment between Mexico and the U.S. become more politically feasible. Since jobs lost from liberalized trade policies are often more visible to the general public than those gained, Congress is more likely to support a bilateral agreement if displaced workers receive assistance. This has been true in the past. For example, in the 1960s and 1970s, adjustment assistance programs were instrumental in Congress' passage of liberalized trade agreements.294

Current U.S. law provides adjustment assistance through two mechanisms: the so-called escape clause and a trade adjustment assistance program. The escape clause is targeted to assist firms. It allows domestic industries to receive temporary protection from imports that threaten them with serious economic injury.295 The trade adjustment assistance program provides aid to displaced workers, as well as to trade-impacted firms and communities.296

292. Under Balassa's theory, U.S. policy logically should aim at "promoting the movement of resources from lower to higher productivity activities" so that existing protection in such major sectors as textiles, steel, and footwear can be dismantled. Balassa, supra note 195, at 298.


When it provides protection, the escape clause can be exceedingly costly to consumers, especially when quotas are imposed instead of tariffs. Although the President has the discretion to deny relief if protection would impair U.S. economic and foreign policy interests, Congress has successfully exerted pressure on the executive branch to implement even more costly protectionist measures. These pressures would diminish if Congress expanded the current worker adjustment assistance program in a cost-effective way.

Past trade adjustment assistance programs have wasted targeted aid because the programs have assisted those firms with the poorest prospects of recovery, and have not provided displaced workers with adequate incentives to seek employment. Moreover, the size of the program has shrunk significantly during the Reagan administration. Under an agreement that liberalized trade and investment flows between the United States and Mexico, the current adjustment program would need to benefit more workers.

The U.S. government could fund an expanded program from the vast economic gains resulting from increased trade. If import protection costs consumers tens of billions of dollars each year, as estimated in numerous studies, then savings from phasing out these protections could more than adequately fund the expansion of a worker aid program that only totaled $280 million between 1982-1985. If the U.S. converted non-tariff barriers into declining tariffs, these tariff funds could be targeted specifically for displaced workers.

V. CONCLUSION

In passing the 1986 Immigration Reform and Control Act, the

297. See R. Lawrence & R. Litan, supra note 293, at 48.
298. See id. at 42-49, 52.
299. Id. at 52-57.
300. Id. at 57-59.
301. Although the program needs to be expanded, it also needs to be tailored to provide adequate incentives for workers to find new jobs. Lawrence and Litan propose a system which should meet these criteria. Benefits would be provided to compensate workers “only when they accept new employment” unless they reside “in regions of high unemployment where alternative jobs may be less plentiful.” Id. at 112. Benefits would partially offset the percentage loss in salary that tenured workers suffer when they are forced to seek new employment. The amount of the offset would increase with the age and experience of the worker. These funds would supplement unemployment insurance payments. Id.
302. For citation of numerous other studies, see id. at 69-70; see also notes 272-274 supra and accompanying text.
303. See R. Lawrence & R. Litan, supra note 293, at 57.
304. See id. at 115; see also Jacobson, supra note 294, at 69-70. The federal government could also legislate that in the case of massive layoffs or plant closings, corporations must provide workers with severance payments and a longer period of advance notice. See generally L. Rothstein, Plant Closings: Power, Politics, and Workers (1986). Most other developed countries extend broader protection to workers. See C. Frank, supra note 293, at 124-28. Local communities could also organize and finance insurance pools to protect themselves from plant closings and the consequent losses in their tax bases to fund the increased demand on social services. R. Lawrence & R. Litan, supra note 293, at 119-22.
United States unilaterally attempted to cut back the flow of Mexican labor to the United States. This law will prove ineffective because it does not recognize two prerequisites for an effective policy. First, immigration policy must be coordinated with trade, investment, debt, and tax policy so that these policies do not counteract each other. Second, these policies must be bilaterally coordinated in order to foster Mexican economic development. Otherwise, a distressed Mexican economic situation will continue to frustrate achievement of the goals behind abstract laws.

In a world of interdependent labor and capital migration flows, Mexico and the United States can no longer insulate themselves from each other. Mexico cannot shut itself off from U.S. trade and investment if it wishes to grow economically, to provide employment for its people, and to raise their standard of living. Similarly, the United States must recognize that Mexican development does not represent a further threat to a U.S. economy already under siege from imports. Instead, such development bears the potential for access to a larger Mexican consumer and industrial market, and for a coordination of resources that can enhance the international competitiveness of truly "American" products. Only then will Mexican migration, both to the United States and to Mexico's overcrowded industrial centers, diminish. Mexican regional development is in the interests of both countries.