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Abstract

This article explores the relationship between international trade law, foreign direct investment (FDI), and economic growth of developing countries. Here, I argue that a developing state needs to capture the right combination of the different types of FDI to promote domestic growth. I apply principles of law, economics, and finance to my analysis of the importance of Bilateral Investment Treaties (BITs), compared to Regional Trade Agreements (RTAs) to FDI inflow, and how it can impact economic growth in developing countries. I show that the RTAs give a signal that the country is open to foreign investment, and therefore it promotes FDI inflow more efficiently than BITs. Nevertheless, there are different levels of states' commitment to free trade, and to the RTA signed, which does impact the kind of FDI received. I compare Brazil and Mexico's FDI inflow and national regulatory governance to illustrate my theory. Finally, I propose that the goal of developing countries' international trade policy should go further than just the promotion of FDI inflow. It should focus on promoting the right combination of the different types of FDI inflow that will promote long term investment and stable economic growth.

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1. INTRODUCTION

International economic law scholars consider the relationship between bilateral investment treaties (BITs) and the inflow of foreign direct investment (FDI) an important empirical question.[1] Many studies have ventured into the exercise of statistical analysis to answer this question without achieving a final consistent theory.[2] I believe that the answer to this question is not relevant; I may venture to say that "do BITs work?" is not the important question. BITs do present a cost to the countries signing them, which should be offset by the increase in the inflow of FDI. I do agree that FDI does promote economic growth, but I believe that we should better qualify the question by asking "what type of FDI" or "what combination" brings the most benefits to developing countries.

The current assumption is that BITs promote protections for foreign investors, therefore creating an incentive for investments in the developing country that is party to the BIT. But after some research, I found an indication that BITs may not deliver as promised, which moved me to identify other legal instruments that can promote FDI inflow.

In this paper, I aim to assess the relationship between Regional Trade Agreements (RTAs), FDI inflow, and developing countries' economic growth. I show here that RTAs are better instruments than BITs, as they impact domestic governance. In this study, I will compare Brazil and Mexico's FDI inflow and national regulatory governance to illustrate my theory. Instead of focusing on BITs, I use RTAs, MERCOSUR, and NAFTA to identify how they impacted the domestic regulatory system of each country respectively and the influx of FDI. I also break FDI into horizontal and vertical investments and qualify it as greenfield or merger and acquisition (M&A) type.[3] Applying these distinctions, I found theoretical evidence that for developing countries to achieve stable economic growth it requires not only the influx of FDI, but a balance between greenfield and M&A inflow.

Next, I will discuss the literature and the foundational basis for my theory. In Part 3, I present the key characteristics of the different types of foreign direct investment (FDI), and how each one impacts economic growth. In Part 4, I discuss Mexico's motivations to conclude the NAFTA agreement, and how its commitment fit with Mexico's economic policy at the time, and the importance of the USMCA (as a continuation of NAFTA) to Mexico's economic growth. In Part 5, I discuss the MERCOSUR in more detail, review its more than twenty-five years of existence, and evaluate its impact on Brazil's regulatory governance, the promotion of FDI inflow, and Brazil's economic growth. Finally, in the conclusion, I emphasize the results from the

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1 Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT'L. L. 397, 442 (2011).

2 *Id.* at 405 (Prof. Yackee presents a review of the empirical literature).

3 In part 3, labeled Foreign Direct Investment, I explain each one of these qualifications of investment in detail.

adoption of trade liberalization policy versus promotion of domestic industry policy along with my final considerations and recommendations.

2. THE FOUNDATIONS – A MULTIDISCIPLINARY OVERVIEW

Professor Yackee, applying three different tests, found that "BITs spur investment only irregularly, inconsistently, and with generally unassuming impact."[4] Reviewing the literature on BITs, FDIs, and economic growth one can conclude that investors do not take BITs into consideration when assessing foreign investment opportunities,[5] and that influx of FDI is not of major importance for the economic growth of developing countries when taken separately.[6]

One such example is Brazil. The country is well recognized for its aversion to international arbitration mechanisms.[7] The argument presented to justify such aversion alludes to the unfairness of privileging foreign investors to the detriment of domestic investors.[8] To this effect, from 1994 to October 2019 Brazil has signed 26 BITs, and only one is still in force.[9] As of the writing of this paper, the only Brazilian BIT in force is the one signed with Angola in 2015.[10] Under this BIT, there is no investor-state dispute resolution mechanism, just state-to-state arbitration. However, the arbitration can only be initiated after the disputing state brings the issue to a special committee but is not satisfied with the committee's final recommendation.[11] Even though Brazil does not have BITs, the country has been able to capture expressive FDI over the years, which is contrary to what would be expected

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[4] Yackee, *supra* note 1, at 434.

[5] Yackee, *supra* note 1, at 414.

[6] Paul Krugman, *International Finance and Economic Development*, *in* FINANCE AND DEVELOPMENT: ISSUES AND EXPERIENCE 11 (Alberto Giovannini ed., 1993). Here, Krugman states that capital accumulation is not of major importance for economic growth and that there is no historical evidence that capital would flow from rich into poor countries due to financial liberalization. *Id.* at 14-22. Further in this paper, I will demonstrate that recent literature may offer a qualification to Krugman's theory.

[7] Paulo Cavallo, *Brazil, BITs and FDI: A Synthetic Control Approach*, Journal of World Investment & Trade 20 (2019) 68–97, at 75. Brazil has refused to sign the ICSID Convention, and as the Cavallo mentions, Brazil's Congress had not ratified BITs because arbitration is seen as interfering with the country's sovereignty.

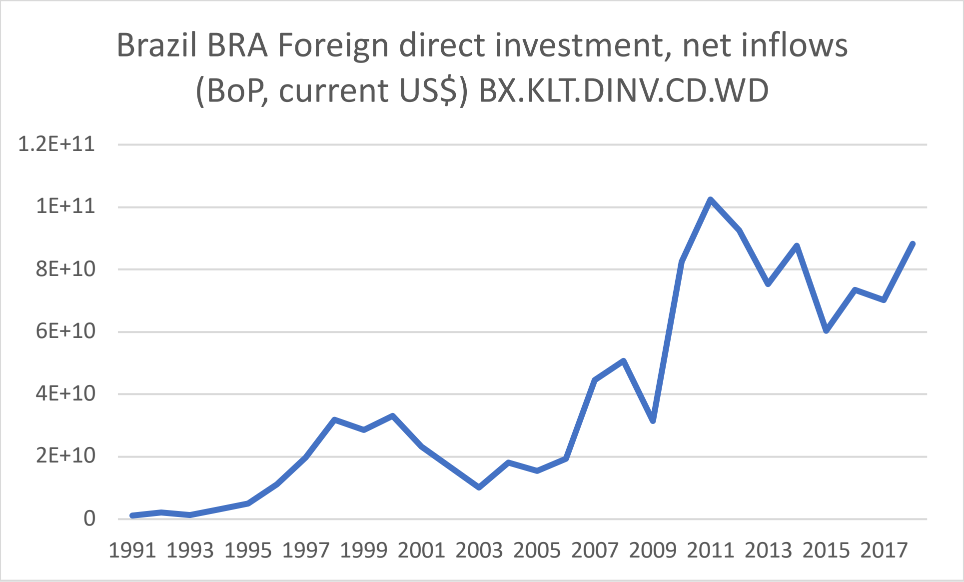
[8] *Id.*

[9] *International Investment Agreements Navigator – Brazil,* UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/countries/27/brazil (last visited in Nov. 24, 2019).

[10] *Id.*

[11] Acordo de Cooperação e Facilitação de Investimentos Entre o Governo da República Federativa do Brasil e o Governo da República de Angola, Brazil-Angola, § IV art. 15, 2015, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4720/download. This committee has equal representation from both states and is formed once a complaint is presented by one of the states. *Id.* at § II art. 4. However, the many steps that are set up before the arbitration can in fact make the arbitrage an unlikely occurrence. *See id.* at § IV art. 15.

if BITs are necessary to promote FDI inflow. Graphic 1 below shows Brazil's FDI inflow from 1991 to 2017.[12] From 1994 to 2000 there was an increase in FDI inflow, even though no BIT was in place. If not BITs, then what does promote FDI inflow? I propose that Regional Trade Agreements (RTAs) are a better instrument than BITs to promote FDI inflow.



This graphic also shows us that the inflow of foreign direct investment in Brazil was not stable, and the drops in investment were timed with economic crises and domestic political instability. From 2000 to 2003 Brazil experienced a monetary crisis and the uncertainty of the policies that would be implemented by the newly elected president, Mr. Lula da Silva.[13] Then FDI inflow increased under the administration of President Lula, but it dropped almost halfway during the economic crisis in 2008, as graphic 1 shows. Brazil experienced another substantial increase soon after, but it did not resist the political turmoil under allegations of corruption at the highest level of administration, which led to a presidential impeachment.[14]

I believe that these spurs of growth followed by a deep decrease in the inflow of FDI, as seen in the graphic above, require further qualification to

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[12] *Foreign direct investment, net inflows (BoP, current US$) – Brazil,* THE WORLD BANK https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=BR (last visited Nov. 24, 2019).

[13] Mr. Lula da Silva is a member of the Labor Party (Partido dos Trabalhadores), and was the first left-wing candidate ever elected in Brazil.

[14] In April 2016, Ms. Dilma Rousseff was the second President of Brazil to be impeached. She was elected under the support of Mr. Lula da Silva.

my initial assumption. It is not only the existence of RTAs that matter, but specific characteristics within the RTAs. As I discuss below, the RTAs give a signal that the country is open to foreign investment, therefore, it promotes FDI inflow. Nevertheless, in this paper, I show that there are different levels of the state's commitment to free trade, and to the RTA signed, which does impact the kind of FDI received. Finally, I propose that the goal of developing countries' international trade policy should go further than just the promotion of FDI inflow. It should focus on the promotion of the right combination of the different types of FDI inflow that will promote long term investment and stable economic growth.

In the late 1980s and early 1990s, many countries that were traditionally closed to foreign investment started opening their markets due to the need for capital inflows.[15] Brazil and Mexico were no exceptions; however, each country embraced a very different policy strategy. Mexico embraced trade liberalization[16] and the jurisdiction of international law through investment arbitration mechanisms,[17] whereas Brazil focused on state promotion of domestic industries,[18] and avoided international arbitration mechanisms.

Because MERCOSUR and NAFTA are the most important regional trade agreements signed by Brazil and Mexico respectively, I focus on the effects each agreement had on the national regulatory governance of each country, and how it impacted the inflow of foreign direct investment (FDI) in Brazil and Mexico. Graphic 2 below shows us the inflow of FDI in Brazil (blue line) and Mexico (orange line).[19] Brazil has received a higher inflow of FDI overall; however, Mexico's inflow of FDI was less affected than Brazil's inflow during the periods of economic crisis. In this paper, I aim to explain the reason for this difference and its impact on the countries' economic growth, considering the impact of MERCOSUR and NAFTA in each country respectively.

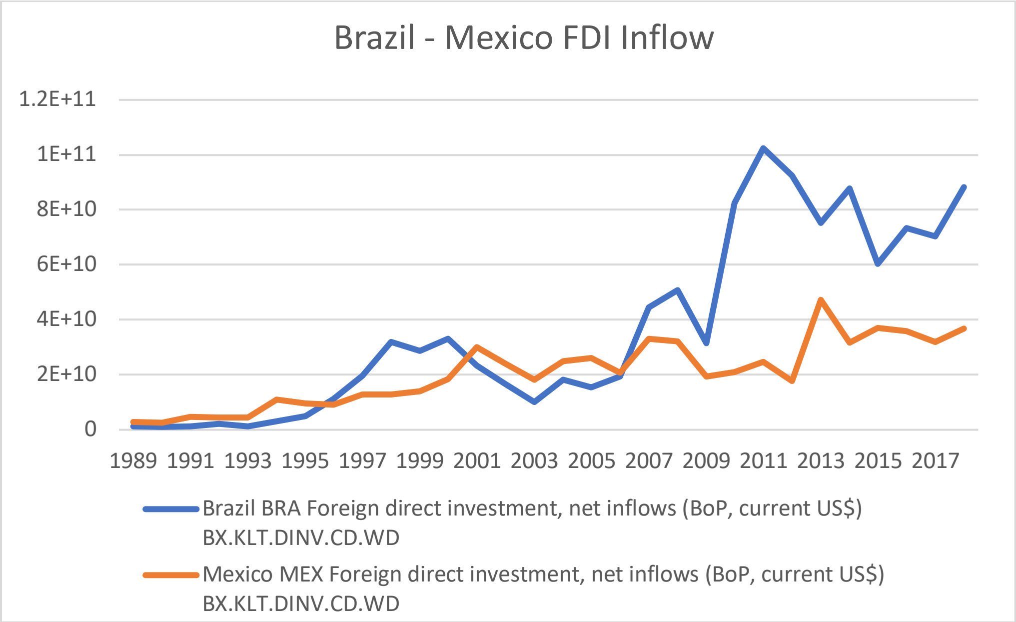
[15] See generally DAVID A. GANTZ, REGIONAL TRADE AGREEMENTS: LAW, POLICY AND PRACTICE, (1st ed. 2009) [hereinafter GANTZ, REGIONAL TRADE AGREEMENTS].

[16] Alvaro Santos, *Carving out Policy Autonomy for Developing Countries in the World Trade Organizations: The Experience of Brazil and Mexico*, 52 VA. J. INT'L. L. 551, 551-632 (2012).

[17] Sergio Puig, *NAFTA Authority and Political Behavior: The Case of Mexico*, 5 SANTA CLARA J. INT'L L. 363, 371-77 (2007).

[18] Santos, *supra* note 16.

[19] *Foreign direct investment, net inflows (BoP, current US$) – Brazil, Mexico,* THE WORLD BANK, https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=BR-MX. (Last visited Nov. 24, 2019).



More than twenty-five years after both agreements entered into force, much has changed in the international and domestic scenario for both countries. MERCOSUR has not achieved the expected unification goal. On the other hand, NAFTA, although generally successful, has been renegotiated recently by its members. The new United States-Mexico-Canada Agreement (USMCA) was signed by the members on November 30th, 2018. The USMCA entered into force and replace the NAFTA in June 2020.[20] Although the USMCA presents a few and quite important changes to NAFTA, I will not discuss them here because my analysis focuses on the past impact of NAFTA. I do believe that USMCA requires further study to identify how it will impact Mexico's FDI inflow, but it is not for this paper. For now, I appraise the impact of regulatory changes implemented by Brazil and Mexico under the influence of these RTAs and assess the impact of both agreements on FDI inflow in the respective countries.

This study will better inform Brazilian and Mexican policymakers towards structuring new regulatory reforms that can best promote development. This topic is quite current as Brazil and Mexico have new Presidents, both elected on a platform that called for major changes from the

[20] The USMCA is set to enter into force on June 1, 2020. The agreement was ratified by Mexico on June 19, 2019. The United States ratified it on January 29, 2020, after adding stronger labor provisions. It was finally ratified by Canada on March 13, 2020 without changes. *A new Canada-United States-Mexico Agreement*, CANADA.CA, https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cusma-aceum/index.aspx?lang=eng (last visited March 16, 2021).

economic policies of their previous governments. This paper also adds to the current literature as it presents a novel approach to the study of the relationship between FDIs, regulatory governance, and economic growth in developing countries.

The recent economic and political crises Brazil has experienced offer an opportunity for re-evaluation of recent policies and regulations, leading to recommendations for deep and substantial reforms that can better support sustainable economic growth. Some of the reforms recommended and discussed in this paper are being currently addressed by the Brazilian President, Mr. Jair Bolsonaro.[21]

Vast literature, especially in economics, has indicated the importance of law and legal institutions to economic growth, presenting empirical and theoretical evidence of the positive effect of credible legal rules and institutions in economic growth and FDI inflow.[22] Globerman and Shapiro identified governance infrastructure as an important determinant of FDI inflow and outflow.[23] Brunetti, Kisunko & Weder developed an indicator of the "credibility of rules" and ran a regression model, using 73 countries; the results showed significant association between credibility and cross-country differences in economic growth and investment.[24] A Buchanan, Le, and Rishi study has shown a direct relationship between institutional quality and volatility of FDI.[25] Furthermore, poor institutional quality increases volatility of FDI inflow and volatile inflow has negative influences on economic growth, as Lensink and Morrisey have found.[26]

Historically, Brazil has embraced a less ambitious strategy on trade liberalization with shallow measures to open its market, maintaining its loyalty to the development of domestic industries in detriment of the liberalization of trade. Since then, the FDI pattern in Brazil has been volatile, generating spurts of economic growth followed by long periods of

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[21] I will discuss the current recommendations being addressed by the Brazilian government within the presentation of the recommendations in Part 4.

[22] Fathi A. Ali, Norbert Fiess & Ronald MacDonald, *Do Institutions Matter for Foreign Direct Investment?,* 21 OPEN ECON. REV. 201, 201–19 (2010); Frank B. Cross, *Law and Economic Growth*, 80 TEX. L. REV. 1737 (2002).

[23] Steven Globerman & Daniel Shapiro, *Global Foreign Direct Investment Flows: The Role of Governance Infrastructure*, 30 WORLD DEV. 1899 (2002). This article defines governance infrastructure as political, institutional and legal environment.

[24] Aymo Brunetti, Gregory Kisunko, & Beatrice Weder, *Credibility of Rules and Economic Growth: Evidence from a Worldwide Survey of the Private Sector*, 12 WORLD BANK ECON. REV. 353 (1998) (the indicators of credibility in this model are: predictability of rule-making, subjective perception of political instability, security of persons and property, predictability of judicial enforcement, and corruption).

[25] Bonnie G. Buchanan, Quan V. Le, & Meenakshi Rishi, *Foreign Direct Investment and Institutional Quality: Some Empirical Evidence*, 21 INT'L REV. FIN. ANALYSIS 81 (2012).

[26] Robert Lensink. & Oliver Morrissey, *Foreign Direct Investment: Flows, Volatility and the Impact on Growth,* 14 REV. INT'L ECON. 478 (2001).

recession.[27] Brazil's strategy requires a domestic entrepreneurial environment to promote economic growth.[28] However, Brazil's regulations and public policy do not foment a favorable business entrepreneurial environment.[29]

On the other hand, Mexico has adopted a policy of trade liberalization, especially with its neighbor, the United States.[30] With the exception of a few programs aiming to help small and medium size business as well as the export industry, Mexico dismantled most of its protectionist industrial policies.[31] Mexico's regulatory reform was crowned with the conclusion of NAFTA, which bound the country's commitment to market liberalization policy, even attaching to future government leadership. Leadership in Mexico changes every six years with Presidential elections, but since NAFTA the administrations prior to current President López Obrador[32] maintained, and in recent years furthered, regulatory reform. The effect of NAFTA has been an increase in inward flow of FDI and a change in the investors' perceptions of factors that determine FDI.[33] One example of regulatory change is the reform on secured transactions laws based on the UNCITRAL Model Law,[34] and the changes to the Foreign Investment Law (1993) that relax the limitations imposed on the majority of capital flows, government approval requirements, and management control allowed to foreign investors.[35] Another positive impact credited to NAFTA are the improvements to the banking regulatory system.[36] Although Mexico has promoted many legal reforms to support more globalized growth, it has not fulfilled all the

[27] Thorsten Beck, *Impediments to the Development and Efficiency of Financial Intermediation in Brazil*, WORLD BANK FIN. SECTOR STRATEGY & POL'Y DEP'T (Policy Research Working Paper, June 2000); *Inflação passa de 10% em 12 meses pela primeira vez desde 2003,* VEJA (Dec. 9, 2015) http://veja.abril.com.br/noticia/economia/inflacao-passa-de-10-em-12-meses-pela-primeira-vez-desde-2003.

[28] Buchanan et al., *supra* note 25, at 82.

[29] Otaviano Canuto, Matheus Cavallari, & José Guilherme Reis, *The Brazilian Competitiveness Cliff*, WORLD BANK ECON. PREMISE, (Feb. 2013).

[30] Santos, *supra* note 16, at 551.

[31] Santos, *supra* note 16; Andreas Waldkirch, *The Effects of Foreign Direct Investment in Mexico Since NAFTA*, 33 WORLD ECON. 710 (2010) [hereinafter Waldkirch, *Effects*].

[32] Although being elected on a protectionist platform, López Obrador's administration has maintained the commitment through the renegotiations of NAFTA, which concluded with the creation of the USMCA that had already been ratified by Mexico.

[33] Andreas Waldkirch, *The 'New Regionalism' and Foreign Direct Investment: The Case of Mexico*, 12 J. INT'L TRADE & ECON. DEV.151 (2003) [hereinafter Waldkirch, *New Regionalism*].

[34] Boris Kozolchyk & Cristina Castaneda, *Invigorating Micro and Small Businesses Through Secured Commercial Credit in Latin America: The Need for Legal and Institutional Reform*, 28 ARIZ. J. INT'L & COMP. L. 43 (2011); Boris Kozolchyk, *Secured Lending and Its Poverty Reduction Effect*, 42 TEX. INT'L L.J. 727 (2006).

[35] Waldkirch, *Effects*, *supra* note 31.

[36] Ross Levine, *International Financial Liberalization and Economic Growth*, 9 REV. INT'L ECON. 688, 697-98 (2001).

commitments under NAFTA, which may explain the initial timid impact of NAFTA.[37]

Overall, it seems that the "take it or leave it"[38] approach adopted by the United States during the negotiations of NAFTA positively influenced Mexico, encouraging regulatory changes. Nevertheless, like any other regional trade agreement, NAFTA has its shortcomings. The fact that Mexico took more than ten years to promote and implement the necessary regulatory changes and that Mexico has not yet improved in other important areas such as education and the protection of peasants against the effects of agricultural imports from the US attest to its shortcomings.[39] Had Mexico implemented the necessary changes and reforms from day one, the country could be in a better economic position today. Yet, NAFTA is an example of an RTA with binding effect on future government leadership, which positively impacts how investors see Mexico because of this strong commitment effect. As a result, Mexico has captured more than double the amount of greenfield investment projects than Brazil, as data from 2005 to 2015 shows.[40]

3. FOREIGN DIRECT INVESTMENT (FDI)

According to my theory, developing countries should promote a balanced inflow of different types of FDI. Policy makers should aim for a balance between investments that are seeking to access new markets (horizontal FDI) and others taking advantage of host country's comparative advantage (vertical FDI). Before I can discuss how to promote inflow of the correct mix of FDI, I should explain here the different types of FDI.

FDI can be horizontal or vertical. Horizontal FDI is when a firm reproduces abroad the same business it operates domestically.[41] In this case, trade and investment are substitutes as the operation of the business abroad

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[37] Alfredo Cuevas et al., *Foreign Direct Investment in Mexico Since the Approval of NAFTA*, 19 WORLD BANK ECON. REV, 482 (2005). When the authors applied their estimation to the Mexican data, they found that "factors not included in the regressions caused exceedingly slow growth of FDI inflows in Mexico in the late 1990s.".

[38] Eric Gillman, *Legal Transplants in Trade and Investment Agreements: Understanding the Exportation of US Law to Latin America,* 41 GEO. J. INT'L L. 263, 300 (2009). In this paper, the authors emphasized the U.S.'s position when negotiating FTAs with Latin American countries as rigid and demanding of the commitment to regulatory changes.

[39] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 156.

[40] Courtney Fingar, *Mexico Foreign Direct Investment Races Ahead as Brazil Sputters*, FIN. TIMES, (August 25, 2015, 1:29 PM), http://www.ft.com/intl/cms/s/e938840a-4b13-11e5-b5588a9722977189,Authorised=false.html?siteedition=intl&_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F3%2Fe938840a-4b13-11e5-b558-8a9722977189.html%3Fsiteedition%3Dintl&_i_referer=&classification=conditional_premium&iab=barrier-app#axzz43Ol52vje. This article used data from the FDI Markets and the Economist Intelligence Unit for the period from 2005 to 2015.

[41] Waldkirch, *Effects*, *supra* note 31, at 719, 726. The author explains the main characteristics of vertical FDI (exploiting comparative advantage) and horizontal FDI (market seeking).

does not complement the domestic operation, therefore, the investors are looking for access to a new market.[42] This is the type of investment mostly captured by Brazil because of its historically unchangeable implementation of an import substitution economic strategy.[43] On the other hand, vertical FDI exploits comparative advantage as the investor identifies where the investment abroad complements the firm's domestic operation.[44] The supply-chain model, and a correlation between intra-firm trade and FDI inflow, is the consequence of vertical FDI.[45] Both vertical and horizontal investments can be of the greenfield, or merger and acquisition (M&A) mode. It is important to consider the difference between inflow of greenfield versus M&A investment to better evaluate the importance of the country's regulatory environment to the promotion of inflow of FDI. Greenfield investment is the establishment of a business abroad from the ground up. M&A, or acquisition,[46] is the acquisition of an existing business abroad.

The current global trade market is no longer rigidly defined by import versus export interests, but by an interconnection of these interests, known as the supply-chain model. Supply-chain requires trade facilitation, logistics, and infrastructure such as border efficiency; all of which implicates more investment from businesses and states. Businesses, as they increase operational capital and investment in resources, know-how, and research across borders are requiring more protection not only for tangible, but for their intangible assets as well.[47]

Greenfield investments require a long-term commitment of capital since the business is established from the ground up. This does not permit immediate, or even short-term return on the capital invested. In this case, it does not matter much if the investment is horizontal (as it is seeking access to a new market) or vertical (which promotes inflow of FDI as a result of intra-firm trade).[48] Meanwhile, M&A requires lower sunk costs, as the acquired business is already established, which allows for an expectation of return on investment in a shorter period. In response to political uncertainties and economic crisis, the M&A investor may have an incentive to sell the investment, if possible, or at least reduce or suspend further inflow of capital,

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[42] Waldkirch, *Effects*, *supra* note 31, at 719.

[43] Santos, *supra* note 16, at 596, 598.

[44] Waldkirch, *Effects*, *supra* note 31, at 718-19.

[45] Waldkirch, *Effects*, *supra* note 31, at 727.

[46] In this paper, the terms M&A and acquisition may be used interchangeably when talking about the type of investment where the investor acquires a business already established or expands an existing business but not enough to generate new business or create new a market. When the expansion of operations is expressive enough to generate new businesses or create new markets, it is considered a greenfield investment.

[47] Richard Baldwin, *WTO 2.0: Global Governance of Supply-Chain*, CEPR POL'Y INSIGHT, Dec. 2012, at 1. Baldwin focuses on the importance of property rights protections but extending such to the protection of intangible assets such as technology and know-how; *id.* at 9, 15.

[48] Waldkirch, *Effects*, *supra* note 31, at 727.

depending mostly on the investment being horizontal or vertical.[49] The greenfield investor, on the other hand, has an interest in maintaining a certain level of capital flow to avoid losing the investment altogether during the economic crises.

One of the theories that explain an investor's choice between greenfield and M&A investment is the communication-based theory.[50] This theory establishes that the cost of communication is an important element to the decision-making process by multinational enterprises (MNEs) when deciding between greenfield or M&A investment in a foreign country.[51]

Verbal communication is key to successful parent-subsidiary management, and there are four main reasons for such communication, (1) the need to exchange knowledge, (2) "the coordination of activities, (3) monitoring, and (4) socialization."[52] As expected, different languages between parent and subsidiary increase the cost of communication and is even higher in case of acquisition compared to greenfield investment.[53] Hence, acquisition may present higher communication costs because it requires more extensive parent-subsidiary communication due to the pre-establishment of a business philosophy prior to the acquisition, which the new parent needs to change in order to maintain a homogenous identity with the new subsidiary. Although the key to understanding the investor's decision-making process, the communication-based theory does not consider the other elements deliberated during the choice process.[54] Some of the elements that are also important are the regulatory environment and, to some extent, the level of protection offered to foreign investments in the country of destination.[55]

These other elements, not considered by the communication-based theory, are extensively discussed under transaction costs and property rights theories. In sum, the literature addresses the relationship between the host state's contracts and property rights law along with the strong institutions and investments. Nobel Prize winner Douglass North argues that strong institutions provide property rights protections that encourage investments, which promotes production and organizational development, that leads to economic growth.[56]

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[49] In the case of horizontal investment, if the crisis has a strong impact on the firm's market, it may be better to accept the loss and move altogether out of the market. Now in the case of vertical investment, it will depend on the correlation between intra-firm trade and the inflow of FDI. But in any case, a reduction of inflow of investment is expected.

[50] Arjen H. L. Slangen, *A Communication-Based Theory Choice Between Greenfield and Acquisition Entry*, 48 J. MGMT. STUD. 1699, 1719-21 (2011).

[51] *Id* at 1719-21 (2011).

[52] *Id.* at 1700.

[53] *Id.*

[54] *Id.* at 1721-22.

[55] *Id.* at 1709-11.

[56] *Id.*; *see also* DOUGLASS C. NORTH INSTITUTIONS, INSTITUTIONAL CHANGES AND

In the particular case of an international joint venture (IJV), applying the transaction cost theory to understand the reasons behind the formation of IJVs in developing countries,[57] the literature shows that in the majority of IJVs the foreign partner brings the money and the domestic partner offers the local knowledge and real estate.[58] In this partnership, the risk is shared between the foreign and the domestic partners. The IJV can be in either the acquisition or greenfield investment mode; hereafter, the same arguments presented above also apply to IJV. In M&A, the foreign partner will opt between ending the partnership or reducing influx of capital in a time of crisis.

One way of evaluating the success of regional trade agreements (RTAs) is to consider the effects of intra-firm transactions in the country's economy.[59] According to this economic theory, foreign-owned manufacturing firms tend to concentrate trade with the country of origin of their capital.[60] A direct relationship also exists between the "weight of foreign trade in relation to net earnings" and increases in a firm's export to the country of origin of capital.[61] The theory indicates that to compensate for trade diversion effects it is important to capture the investments that will generate intra-firm transactions.[62]

The importance of identifying the elements considered by the investors during the decision-making process of selecting between greenfield and M&A lies in the welfare effect that each mode of FDI (greenfield vs. acquisition) inflow promotes. Ben Ferrett developed an economic model that allowed for the investigation of the interactions between greenfield and

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ECONOMIC PERFORMANCE, THE POLITICAL ECONOMY OF INSTITUTIONS AND DECISIONS (1990); Douglass C. North, *Institutions, Transaction Costs and Economic Growth*, 25 ECON. INQUIRY 419 (July 1987); Gary D. Libecap, *Douglass C. North: Transaction Costs, Property Rights, and Economic Outcomes*, (Nat'l Bureau of Econ. Research, Working Paper No. 24585, May 2018), https://www.nber.org/papers/w24585.

57 *See* Bruce Kogut, *Joint Ventures: Theoretical and Empirical Perspectives*, 9 STRATEGIC MGMT. J. 319 (1988) (Kogut applies transaction cost and strategic behavior theories to explain the motivation to joint venture). Pierre-Xavier Meschi, *Government Corruption and Foreign Stakes in International Joint Ventures in Emerging Economies*, 26 ASIA PAC. J. MGMT. 241 (2009) (Meschi isolates corruption as one of the causes of environmental uncertainty and economic instability in his analysis of the survival of IJVs in emerging Asian economies, under the light of transaction costs theory).

58 *Id.*; Kogut, *supra* note 57, at 327 (the author highlights the local legal knowledge as well as the understanding of the local marketing as key incentives for the formation of an IJV).

59 Renato Baumann & Francisco Galrão Carneiro, *Behaviour of Brazilian Export Firms: Implications for the Free Trade Area of the Americas*, 78 CEPAL REV. 145 (2002).

60 *Id.* at 146.

61 *Id.* at 157.

62 *Id.* at 146. "Trade creation (emergence of new activities in the trade between the participating countries) and trade diversion (reduction of imports of products offered by third countries)"– are the two basic concepts the focus of most analysis of impact of trade. The authors found that the evaluation of integration process shows beneficial results when intra-firm trade is considered.

M&A foreign investment with other industry characteristics, such as investment level in R&D.[63] The results present strong indications that M&A represents economic growth of the receiving country in the short run because it results in higher prices and lower consumer welfare, while greenfield investment increases consumer welfare and promotes stable economic growth in the long run.[64] Greenfield investment promotes market growth, and even the establishment of new markets, which by definition is not promoted under M&A. Such results emphasize the need for developing countries to focus on balancing the inflow of greenfield investment with the inflow of M&A, which requires governmental long-term commitment to regulatory change in favor of a pro-market policy and strong property rights.[65]

Now that we have an understanding of the different types of FDI and an overall view of the impact of each, I move to the discussion of NAFTA's provisions on treatment of foreign investment and investor-state dispute settlement through international arbitration, along with its long-term binding effect on future governments.

4. NAFTA AND MEXICO[66]

In light of the discussion above, it seems that NAFTA has presented the necessary incentives to investors, increasing the inflow of greenfield investment in Mexico's manufacturing industry from over $3 million in 2005 to a little over $21 million in 2008.[67] Even though NAFTA has been renegotiated and a new deal has been signed (the USMCA), my discussion will continue to focus on NAFTA since I am evaluating the impact of it up to now. Still, it is important to address here some of the changes that are introduced by the USMCA agreement once it enters into force.

First of all, the elimination of internal tariffs, with a few exceptions, is still the main focus of USMCA as under NAFTA.[68] The state-to-state dispute

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[63] *See* Ben Ferrett, *Greenfield Investment Versus Acquisition: Alternative Modes of Foreign Expansion,* (Univ. of Nottingham GEP Research Paper Series no. 39, 2005). This model includes level of investment in R&D and number of firms as endogenous variables, which allows for a more complex investigation of the interaction between greenfield and acquisition FDI.

[64] *Id.* at 14-15.

[65] Libecap, *supra* note 56, in sum, weak property rights increase transaction costs, which increases risk of investment.

[66] Although NAFTA has been renegotiated and a new agreement (USMCA) will replace the current NAFTA once it is ratified by all three members, the historical motivation of NAFTA is still valid and important as it is still the agreement in force. Once USMCA enters into force in many sectors, such as auto rules of origin and ISDS under NAFTA Chapter 11, there is a phase in period of three years. Thus, NAFTA in many respects will control at least until 2024 and longer if ratification is delayed.

[67] Fingar, *supra* note 40, reporting greenfield investment in Mexico.

[68] A copy of the signed USMCA document is available at https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between, (link last visited on September 18, 2019). The USMCA did not deviate from the

settlement mechanism[69] has not been significantly altered, even though it is faulty because it allows the defendant state to stonewall the panel appointment process indefinitely.[70] The investor-state dispute settlement mechanism (ISDS) suffered major alterations. In reality, ISDS is no longer available for foreign investors in Canada or the United States;[71] however, ISDS access for U.S. investors in Mexico will exist, although considerably limited, except for a few key sectors such as hydrocarbons, power, telecommunications, and certain infrastructure.[72] The impact of the new agreement and its significant lessening in investors' protection may have an impact on future investment, but it is not the point of this paper, which concentrates on the results of NAFTA, from its establishment to now.

Mexico's motivations to join NAFTA were primarily economic in nature[73]. Mexico wanted to expand employment and exports through the maquiladora program or otherwise stimulate job growth and technology transfer, mitigate the impact of the 1982 financial crisis through trade liberalization,[74] and increase the inflow of FDI.[75] It followed the economic theory that boosting productivity growth—increasing total factor productivity (TFP)[76]—promotes growth in GDP per worker, boosting economic growth.[77]

Also, Mexico had already initiated economic reform towards liberalization beginning in 1985, including but not limited to joining the

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main principle of freer trade between the three members.

69 *See* NAFTA chapter 20, and USMCA chapter 31.

70 Sergio Puig, *The United States-Mexico-Canada Agreement: A Glimpse into the Geoeconomic World Order*, 113 AM. J. INT'L L. UNBOUND 56, 57 (2019); David Gantz, *United States-Mexico-Canada Agreement: Settlement of Disputes* 6 (Ariz. Legal Stud. Discussion Paper No. 19-08, 2019) [hereinafter Gantz, *United States-Mexico-Canada Agreement*].

71 As for Canadian investors in Mexico and vice-versa, the protection would be under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Comprehensive and Progressive Agreement for Trans-Pacific Partnership art. 9, Mar. 8, 2018, https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cptpp-ptpgp/text-texte/cptpp-ptpgp.aspx?lang=eng.

72 ISDS is found under NAFTA chapter 11 and USMCA chapter 14. I am not going to discuss the details of the changes from NAFTA to USMCA because this paper focuses on the impact of NAFTA from its creation to now, and USMCA enters into force in 2020. *See generally* John S. Baker & Lindsey Keiser, *NAFTA/USMCA Dispute Settlement Mechanisms and the Constitution*, 50 U. MIAMI INTER-AM. L. REV. 2 (2019); Puig, *supra* note 70; Gantz, *United States-Mexico-Canada Agreement*, *supra* note 70.

73 GANTZ, REGIONAL TRADE AGREEMENT, *supra* note 15, at 108.

74 GANTZ, REGIONAL TRADE AGREEMENTS. NAFTA is still in force, which is the reason why the discussion here focuses on it even though USMCA will also be discussed here.

75 Waldkirch, *New Regionalism*, *supra* note 33, at 152.

76 According to Business Dictionary, TFP measures the efficiency of all inputs to a production process. TFP growth represents a part of the output not explained by the input used in production, usually from technological innovation or improvements.

77 Levine, *supra* note 36, at 689.

General Agreement on Tariffs and Trade (GATT).[78] President Salinas understood the importance of the pressure from treaty obligations to promote necessary internal reforms. NAFTA was seen by Mexico's federal government as a security blanket that would impede future governments from returning to protectionist policies without breaching international obligations, truly embracing the open market philosophy.[79]

At the time of NAFTA negotiations, the Uruguay Round was stalled and the political significance of this agreement to the three states was such that many items not yet implemented under WTO were incorporated into the agreement. NAFTA incorporated rules on foreign investment protections, trade in services, technical standards, sanitary and phytosanitary standards, intellectual property, government procurement, and investor-state dispute settlement provisions, to cite a few.[80] Because of its all-inclusive characteristic, NAFTA became the model Free Trade Agreement (FTA) for all three members and influenced other countries' FTA models as well.

Even though NAFTA has no provisions for harmonization of laws, with the exception of Chapter 5 on harmonization of customs regulatory procedures,[81] it has permitted the transplanting of U.S. laws into the Mexican legal system as Mexico introduced new laws and regulations implementing trade liberalization.[82] NAFTA has assured foreign investors of Mexico's commitment to reform; one example is the relaxation of rules on foreign ownership, which now allows for majority foreign ownership in Mexico.[83] The literature also credits the increase of FDI inflow into Mexico to NAFTA's binding effect, to its duty-free treatment of most imports from Mexico into the United States, and to Mexico's geographical proximity to the United States and Canada.[84] It is estimated that FDI inflows in Mexico in the second half of the 1990s were about sixty percent higher than they would have been without NAFTA.[85]

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[78] Ivan T. Kandilov & Ash Leblebicioglu, *Trade Liberalization and Investment: Firm-level Evidence from Mexico*, 26 WORLD BANK ECON. REV. 320, 321, 323-24 (2012) (using data from 1984 to 1990, the authors wanted to evaluate the impact of the trade liberalization program launched in 1995. They found "that the decrease in input tariffs, as well as import license coverage, resulted in higher investment in Mexican manufacturing establishments").

[79] Waldkirch, *Effects*, *supra* note 31, at 710-711.

[80] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 105.

[81] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 115. Chapter 5 of NAFTA establishes the steps to be followed by an importer to acquire a NAFTA Certificate of Origin, which require a great deal of cooperation and coordination among the three members' customs services.

[82] *See* Gillman, *supra* note 38.

[83] Waldkirch, *Effects*, *supra* note 31, at 715.

[84] Gillman, *supra* note 38, at 265; Waldkirch, *New Regionalism*, *supra note* 30, at 154, 175.

[85] Cuevas et al., *supra* note 37, at 473, 482. Demonstrating a study where the authors used a panel model to estimate total net inflows of FDI into a country considering indicators of macroeconomic stability and direct measure of globalization process. They concluded that

The major deregulation in the Mexican Foreign Investment Law has been the relaxation of Mexican rules restricting foreign ownership of enterprises in Mexico, which earlier limited foreign capital participation and control to forty-nine percent, but today is no longer applicable for investments of less than $150 million.[86] The Foreign Investment Law of 1993, which allows foreign investors to control up to 100% of a Mexican enterprise, also prohibited foreign investors' access to some activities that had been reserved exclusively to the Mexican Government and/or to Mexican citizens.[87] Mexico's ranking on the "Ease of Doing Business" indicator[88] from the 2011-2015 period compared to the 2006-2010 period had improved on a steady pace (from 43 to 38), contrary to Brazil's ranking, which had worsened across the same periods (from 111 to 116).[89]

The more stringent requirements imposed by NAFTA provisions on technical standards, sanitary and phytosanitary standards, intellectual property, and ISDS have increased the competitiveness of Mexican industry.[90] This is especially true when compared with Brazilian industry, which is inefficient and not competitive since it depends on state subsidies and protectionist regulations, including but not limited to high protective tariffs.[91] In any event, it is undeniable that Mexico's commitment to open markets, reflected in unilateral reductions of applied tariffs in recent years to about five to six percent[92], and the implementation of changes to its legal

FDI was sixty percent higher as a result of "NAFTA-induced exports"); Waldkirch, *New Regionalism*, *supra* note 33, at 168 (explaining that the Waldkirch estimation has quite similar results, as it concluded that FDI in Mexico would be below forty-two percent without NAFTA).

86 Michael W. Goldman et al., *An Introduction to Direct Foreign Investment in Mexico*, 5 IND. INT'L & COMP. L. REV. 101, 111-13 (1994); Jorge A. Vargas, *Mexico's Foreign Investment Act of 1993*, 16 LOY. L.A. INT'L & COMP. L. REV. 907, 927 (1994).

87 The foreign participation in regulated activities is limited to certain percentages varying between 10%, 25%, and 49%, according to article 7 of FIL 1993. Goldman et al., *supra* note 76, at 115-16, 118-19 (presenting a detailed analysis of the evolution of Foreign Investment Law in Mexico); Vargas, *supra* note 86, at 912, 926, 936-37.

88 The "ease of doing business" is an indicator developed by the World Bank that ranks economies based on their regulatory environment. The World Bank provides details on the elements evaluated by this indicator and a complete ranking list. *Ease of Doing Business Index (Most Business-Friendly Regulations)*, WORLD BANK, https://data.worldbank.org/indicator/IC.BUS.EASE.XQ (last visited March 17, 2021) [hereinafter *World Bank Index*].

89 R. Shyam Khemani & Ana Carrasco-Martin, *The Investment Climate, Competition Policy, and Economic Development in Latin America*, 83 CHI.-KENT L. REV. 67 (2008); *World Bank Index*, *supra* note 88 (indicating that the rankings for the periods above were collected from the "ease of doing business").

90 GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 105.

91 Canuto and Reis, *supra* note 29, at 8; Rafael A. Porrata-Doria Jr., *MERCOSUR: The Common Market of the Twenty-First Century?*, 32 GA. J. INT'L & COMP. L. 1 (2004), throughout the paper, Porrata-Doria discusses Brazil's protectionist measures and tariffs

92 David A. Gantz, The Risks and Rewards of Renegotiating the North American Trade Relationship, 33 MD. J. INT'l L. 127-161, 149 (2018). Gantz, *Regional Trade Agreements*, *supra* note 15, at 112.

system[93] are the key difference between Brazilian and Mexican policy strategies.

Simple observation of data collected in the late 1990s gives a false impression that NAFTA did not impact Mexico's FDI inflow when it is compared to FDI inflow to other Latin American Countries.[94] However, applying a flexible statistic model, Monge-Naranjo was able to confirm that NAFTA did indeed help Mexico attract more FDI than its neighbors.[95] These findings are confirmed by another study using empirical data and regression model research, which demonstrated an increase in investments in Mexico, more from partners—the United States and Canada—but also from other countries, as an effect of NAFTA.[96]

Mexico suffered some setbacks in the first year of NAFTA that are credited with lessening the positive effects expected from the agreement.[97] The uprising of southern states unhappy with alleged special attention offered to the northern states, the assassination of presidential candidate Luis Colosio, the uprisings in Chiapas, and the peso crisis beginning in December 1994[98] scared some of the investors who were afraid of the political and economic repercussions of these issues.[99] Mexico's industry also lost some enterprises because of lower manufacturing costs in China, but the country was able to recover because of Mexico's strong commitment to trade liberalization and global competition through efficient industrialization.[100]

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93 GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 156.

94 Alexander Monge-Naranjo, *The Impact of NAFTA on Foreign Direct Investment Flows in Mexico and the Excluded Countries,* NW. UNIV. (2002), http://ctrc.sice.oas.org/geograph/north/monge.pdf; Rene Cabral et al., *Capital and Labour Mobility and Their Impact on Mexico's Regional Labour Market*, 46 J. DEV. STUD. 1523, 1523-42 (2010).

95 *Id.* Monge-Naranjo explains that the model is a flexible one because it excludes the FDI from privatization. In the late 1990s, many Latin American countries, including Brazil, had captured FDI by privatizing oil, energy, mining, and other sectors that were controlled by the government. As investment captured by privatization is not in competition with investment fomented by NAFTA, the flexible model allows for a better evaluation and assessment of the impact of NAFTA in Mexico's FDI inflow.

96 Cabral et al., *supra* note 94; Waldkirch, *New Regionalism*, *supra* note 33. Waldkirch clarifies that Mexico was leading in FDI inflow until Brazil started its privatization process, which brought most Acquisition-FDI into Brazil.

97 Gary Clyde Hufbauer et al., *NAFTA at 20: Misleading Charges and Positive Achievements*, PETERSON INST. FOR INT'L ECON. (May 2014), http://www.piie.com/publications/pb/pb14-13.pdf; Cuevas et al., *supra* note 37. The authors speculate that a hold on privatization in Mexico was one of the explanations.

98 Cuevas et al., *supra* note 37. Also known as the Tequila crisis, the peso crisis may have had a lesser negative weight as it reduced the cost of production in Mexico. However, it still explains the lukewarm performance.

99 Hufbauer et al., *supra* note 97.

100 *Id.*; *Two Ways to Make a Car,* THE ECONOMIST, (Mar. 10, 2012), http://www.economist.com/node/21549950/print. It is also important to remember here that cost of labor in China had increased and some business that had gone to China are returning to the NAFTA bloc. Still, Vietnam and India are viable competitors for the labor-intensive industry that is moving from China.

NAFTA has positively impacted Mexico, especially because of the incorporation of alternative dispute resolution mechanisms, which demonstrated Mexico's commitment to a "pro-international law" policy.[101] Nonetheless, it is the domestic implementation of the necessary pro-trade environment through regulatory reforms that had bolstered and solidified the effect and impact of the economic integration agreement.[102]

The disputes brought by investors before various international arbitration bodies, under NAFTA Chapter 11, tested the binding effect of the dispute settlement provisions and the limitations imposed to the Mexican government by the obligations assumed under the agreement.[103] Foreign investment and arbitration laws can be considered "global administrative law,"[104] even though they are not uniform, because of the powerful influence exerted by them within governmental agencies.[105] These "laws" limit the agencies and judiciary power to implement protectionist rules, offering the necessary protection to foreign investors.[106]

Many of the commitments assumed by Mexico had not been followed by the necessary public policy reforms at the proper speed. If Mexico had promoted the development of infrastructure and logistics, along with reforms in labor laws, education policies, and the development of agricultural labor affected by NAFTA (corn imported from the United States instead of domestically produced displaced unskilled labor), it would be a more competitive country today, less dependent on the existence of NAFTA.[107] It is important to mention here that Mexico promoted the implementation of key reforms in 2013, which were ignited by the "Pacto por Mexico,"[108] and included the reforms of the education and energy sectors.[109]

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[101] Claus von Wobeser, *Mexico*, in LATIN AMERICAN INVESTMENT PROTECTIONS: COMPARATIVE PERSPECTIVES ON LAWS, TREATIES, AND DISPUTES FOR INVESTORS, STATE, AND COUNSEL 361 (Jonathan C. Hamilton et al. eds., 2012).

[102] Monge-Naranjo, *supra* note 94. By comparing the increase in FDI in Mexico (under NAFTA) and Costa Rica (under the Caribbean Basin Initiative), Monge-Naranjo found that just an agreement is not enough to increase FDI. This was concluded because Costa Rica benefited the most from CBI since it implemented the necessary regulatory reforms.

[103] Monge-Naranjo, *supra* note 94.

[104] Here, I use such comparison to facilitate the understanding of the impact of ISDS in curtailing domestic protectionist rules. However, I do not ascribe to the new line of study that recommends that international law, especially WTO dispute settlement, be enforced under the full lenses of administrative law.

[105] Javier Robalino-Orellana, *International Investment and Administrative Law in Latin America*, 101 AM. SOCY. INTL. L. PROC. 465 (2007).

[106] *Id.*

[107] Cuevas et al., *supra* note 37.

[108] Pacto por Mexico is a political document signed by then-President of Mexico Pena Nieto, the President of the National Action Party, the Chair of the Institutional Revolutionary Party, the Chair of the Party of Democratic Revolution, the party of the current President, and the Green Party of Mexico. The pact framed Mexico's public policy proposals including education and energy reforms.

[109] For an evaluation of the Pacto por Mexico, I recommend Mark Weisbrot, et al., *El*

The reform of the energy sector was designed to open a sector where both domestic and foreign private investment were traditionally barred by the Mexican Constitution, eventually allowing for foreign investment in the energy sector, which should become a major driver of Mexico's economic growth.[110] The Mexican Constitution was amended and the Energy Reform Plan was signed into law in December 2013 by President Pena Nieto.[111] These reforms have brought much excitement among investors; however, the convoluted regulatory framework could be holding back the development of most of the projects. The question now is if President Lopez-Obrador will support the reforms as they have been orchestrated by his predecessor. A possible hindrance could be the return of nationalism to Mexico's public policy, which was the candidacy promise of Mr. Lopez-Obrador, in line with the new Moreno Party (formerly with the leftist Party of the Democratic Revolution ("PRD")). It is worth mentioning here that in the sectors of oil and gas, energy power, transportation, telecommunications, and some infrastructure, protection for foreign investment under USMCA was not eliminated, but it has been limited to contracts signed with the Mexican government. Such protection may be an indication that President Obrador may follow the Energy Reform Plan. [112]

Furthermore, Mexico's reforms in investment law and secured transactions law, among other regulatory reforms, have opened the door to greenfield investment, which is a long-term investment. Even without ISDS protections and enforceable labor protections under USMCA, if Mexico does not panic and adversely react, one can expect that it should be able to retain most of the manufacturing industries already established there. due to the costs of disinvestment and the many other factors that made Mexico an important destination for U.S. manufacturing, including its proximity to the United States, low wage costs,[113] and a twenty-five-year history of friendly

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Pacto por México Después de Cinco Acinco ños: ¿Cómo le ha ido?, CTR. FOR ECON. & POL'Y RES. (June 2018), http://cepr.net/images/stories/reports/mexico-spn-2018-06.pdf.

[110] José Ramón Cossío Díaz & José Ramón Cossío Barragán, *The New Energy System in the Mexican Constitution*, *in* THE RULE OF THE LAW AND MEXICO'S ENERGY REFORM, JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY OF RICE UNIVERSITY (2017).

[111] Decreto por el que se Reforman y Adicionan Diversas Disposiciones de la Constitución Política de los Estados Unidos Mexicanos, en Materia de Energía [Decree that Amends Provisions of Mexico's Constitution Concerning Energy], published at the DIARIO OFICIAL DE LA FEDERACIÓN (Dec. 20, 2013), available at http:// www.diputados.gob.mx/ LeyesBiblio/ref/dof/CPEUM_ref_212_20dic13.pdf.

[112] *See* Baker & Keiser, *supra* note 72; North American Free Trade Agreement, Can.-Mex.-U.S., ch. 11, Dec. 17, 1992, 32 I.L.M. 289 (1993); United States-Mexico-Canada Agreement, Can.-Mex.-U.S., ch. 14, Annex, 14-D, Annex 14-E, Nov. 30, 2018, https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/14-Investment.pdf.

[113] Even though USMCA added enforceable labor protections under chapter 25, and the "rapid response labor mechanism" under chapter 31, there has been criticism that these measures are not strong enough to make an expressive impact on cost of labor. However, as the USMCA is not the focus of this paper here, I refrain from assuming any strong position of the future cost of wages.

government policies, among others.

Under the USMCA, a few provisions have suffered extensive modifications.[114] NAFTA Chapter 11 dispute mechanism has been eliminated between the United States and Canada, and has been limited for use between Mexico and the United States, as I have mentioned above. As for the Rules of Origin and Regional Value content, although the United States wanted to bring the minimum North American content up from 62.5% to 85%, a compromise was reached at 75%.[115]

Another key issue for the United States was the low labor wages in Mexico; USMCA addresses this by requiring that 40% of auto and 45% of small truck content must be made by workers making at least $16.00 per hour (for the most part only obtainable in the United States and Canada). Another important change is the introduction of the Sunset Clause stating that the agreement ends in 16 years unless the parties agree to extend it.[116] USMCA also requires Mexico to implement legislation that permits independent unions with full collective-bargaining powers, up to now a rarity in Mexican unions.[117]

The impact and general success of this new agreement once it enters into force depend in significant part on Mexico's implementation of the still necessary reforms, which should allow for some independence from its partners, the United States and Canada. Mexico has the potential to capture more investment from other countries and regions. According to data for the first quarter of 2019, from Statista.com,[118] Mexican inflow of FDI from NAFTA members was at 48%, of which only 5% was from Canada. The second biggest investor in Mexico is Spain (13.8%), trailed by Belgium (6.9%) and the Netherlands (5.2%).[119] Spain and Belgium are already investing at higher levels than Canada, but the NAFTA members are still responsible for almost 50% of all the FDI in Mexico.[120]

As I mentioned before, Brazil opened its market around the same time

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[114] *See supra* text accompanying note 72; *see also* GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 144. The author shows that the initial proposal from the United States would allow the state to opt out of the ISDS altogether. Instead, a categorization of the process is the final product.

[115] *See generally* Agreement Between the United States of America, the United Mexican States, and Canada, Can.-Mex.-U.S., ch. 4, Nov. 30, 2018, https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/04%20Rules%20of%20Origin.pdf.

[116] USMCA, Article 34.7 of final provisions, Full text provided by the US Trade Representative at https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/34_Final_Provisions.pdf.

[117] *See* USMCA, annex 23-A.

[118] *Distribution of Foreign Direct Investment (FDI) in Mexico in 3rd quarter 2019, by Country of Origin*, STATISTA, https://www.statista.com/statistics/709875/fdi-mexico-origin/ (last visited Novermber 24, 2019). The data presented here is from Statista.com and refers to the 1st quarter of 2019.

[119] *Id*

[120] *Id.*

as Mexico but adopted a different policy, a more protectionist policy. MERCOSUR was signed with the promise of an integration between its South American members and a movement towards a freer market.[121] Next, I evaluate the MERCOSUR and its impact in Brazil.

5. MERCOSUR AND BRAZIL

MERCOSUR has suffered many setbacks during its twenty-five plus years of existence. The impeachment of Brazil's President in 1992, the Argentine great depression and devaluation in 1998, and the global financial crisis of 2008 are some of the developments that retarded the success of MERCOSUR.[122] Despite the setbacks, it is necessary to recognize that the commerce within the bloc had increased, along with the fact that Brazil, Argentina, and Uruguay had opened key markets to private investors through privatization of state-owned enterprises.[123] However, in the long run, it is evident that MERCOSUR members, especially Brazil, have not fully embraced more open markets and liberalization of trade.[124] They rushed into an ambitious agreement that required domestic commitment to implement, even if gradually, the adoption of open market policies and coordination of macroeconomic policies among the members.[125] Such coordination involves trust, political, social, and economic synchronization among the members for the domestic implementation of trade liberalization, especially when implementing policies addressing the effects of external shocks.

To better understand its impact on Brazil's economic growth, I evaluate the MERCOSUR under four categories identified as key to understanding why it never succeeded in becoming the expected powerful bloc of the Southern Cone. First, based on Buchanan et al., finding that "institutional quality has a positive and significant effect on FDI,"[126] I evaluate the strength of the institutions established under the MERCOSUR. Second, I review the

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[121] Santos, *supra* note 16, at 555.

[122] José Manuel Quijano, *MERCOSUR: ¿el relanzamiento?*, 199 NUEVA SOCIEDAD 53, 53-58 (2005). The author analyzed the major economic issues that affected the bloc and its member in his study of MERCOSUR from 1986 through 2005. The paper pinpoints the major economic policies adopted by each member and how it impacted the bloc.

[123] *Id.* Here Quinjano mentions that from 1990 to 1999 there was an important movement for denationalization of state-owned enterprises with Argentina leading the bloc, while Brazil and Uruguay's efforts towards privatization were more timid.

[124] Santos, *supra* note 16, at 600.

[125] Paulo Roberto Almeida, *Uma Historia do MERCOSUR do Nascimento à Cris*e, 191 REVISTA ESPAÇO ACADÊMICO 106 (2011). Paulo Roberto is a Brazilian diplomat and professor of Political Economy in Brazil. In this article, the author discusses the many issues that have weakened the bloc along its lifetime.

[126] Buchanan et al, *supra* note 25. The authors' regression model examined the relationship between institutional quality and volatility of FDI and found an inverse relationship between volatility of FDI and institutional quality.

lack of harmonization of macroeconomic policy among its members; third, I assess the efforts, if any, to implement the necessary harmonization of law within the bloc; and finally, fourth, I discuss the members' commitment to trade liberalization and the existence, or not, of binding and enforceable commitments within the provisions of the MERCOSUR agreement.

A. Failure to Establish Strong Institutions under MERCOSUR

The MERCOSUR bloc was a response to the establishment of the European Union (E.U.) and NAFTA. The adoption of more open trade policies worldwide, combined with Brazil's desire to establish itself as a powerful political as well as economic leader in South America, and the lacuna left by the decline of the United States' influence in the region, was the breeding ground for the formation of the bloc.[127] All four initial members – Argentina, Brazil, Paraguay, and Uruguay – benefited from a similar political momentum as new democracies willing to take part in the economic liberalization movement that was taking place in the world.[128] The members had participated in previous, less ambitious endeavors towards trade liberalization under the Latin American Free Trade Association (LAFTA) in 1960, later replaced by the Latin American Integration Association (ALADI in Spanish), and had established limited cooperation among themselves in the past.[129] However, the MERCOSUR was a plan too ambitious for the existing infrastructure, which was not strong enough to support an effective planning and implementation of the MERCOSUR. Weak infrastructure, as well as the members' unwillingness to effectively implement the necessary institutions, lead to the bloc's failure.

Mattli offers an analytical framework that was adopted by Hummel and Lohaus in the analysis of the MERCOSUR.[130] According to Mattli's model[131], the strength of the institutions impacts the success of the regional agreement as it can offset the risks brought by the uncertainty of the behavior of each member. The Treaty of Asuncion[132] created a basic but complex structure that required a series of treaties and protocols for its implementation.[133] The structure was inspired by the E.U.; however, the members of MERCOSUR did not have the same commitment to the rule of

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[127] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15; Felix Hummel & Mathis Lohaus, *MERCOSUR: Integration through Presidents and Paymasters, in* ROADS TO REGIONALISM: GENESIS, DESIGN AND EFFECTS OF REGIONAL ORGANIZATION 59 (Tanja A. Borzel et. al. ed., 2012).

[128] Porrata-Doria Jr., *supra* note 91; Gabriel Gari, *Regional Integration: Comparative Experiences: Free Circulation of Services in MERCOSUR: A Pending Task*, 10 LAW & BUS. REV. AM. 545 (2004).

[129] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 368.

[130] Hummel & Lohaus, *supra* note 127, at 59-77.

[131] *Id.*, at 60.

[132] The Treaty of Asuncion, signed on March 26, 1991, established the MERCOSUR.

[133] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 368.

law or to the implementation and development of the bloc as the European states had and still have. The institutions under MERCOSUR have never had the same independence, power, and degree of commitment as the ones within the E.U.[134]

Many of the protocols that created important institutions have not entered into force because the members have not ratified them, or they have not been implemented because they require domestic regulatory reform by each member, and such reforms have not yet been adopted.[135] Also, the decisions, norms, and protocols that entered into force are not always executed at the domestic level because the institutions established within the MERCOSUR do not have the power to monitor and enforce the domestic execution of the regulations approved by the bloc.[136] Although the MERCOSUR regulations are supposed to be binding, the need for ratification and the absence of efficient monitoring and enforcement remedies permit the members to defect as they please.

Weak institutions give emphasis to Presidential diplomacy as the liberalization process requires constant participation and influence at the presidential level to be successful.[137] The presidents, especially of Argentina and Brazil, set the agenda, define the foreign policy, and, most importantly, set the focus of the MERCOSUR.[138] The development of the bloc is strongly dependent on each member's domestic agenda and its changes or stalls, as new governments are elected, which is aggravated also by the fact that the members are not in sync when it comes to their diplomatic policies.[139] Furthermore, the bloc does not cultivate a strong strategic agenda with long-term planning and incentives for implementation of approved measures.[140]

B. Lack of Harmonization of Macroeconomic Policies

MERCOSUR has its merits as the state members went from "restricted trade to a practically free-trade area[,]"[141] but it could have achieved broader

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[134] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 365-92. The author presents the structure of MERCOSUR, and not much has changed since the book's publication. For a complete updated organogram with detailed information on each institution established under the MERCOSUR and their respective functions and attributions, visit the MERCOSUR page available at https://www.mercosur.int/pt-br/institucional/organograma-mercosul/ (last visited January 28, 2019).

[135] For a complete list of the protocols, norms, and agreements signed under the MERCOSUR along with their status visit http://www.mre.gov.py/tratados/public_web/ConsultaMercosur.aspx (last visited January 28, 2019).

[136] *Id.*

[137] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15.

[138] Mario E. Carranza, *Can Mercosur Survive? Domestic and International Constraints on Mercosur*, Latin American Politics and Society, Vol. 45, No. 2, 67-103, (Summer, 2003),

[139] *Id* at 75.

[140] *Id* at 69.

[141] Paulo Paiva & Ricardo Gazel, *MERCOSUR: Past, Present, and Future,* 13 NOVA ECONOMIA BELO HORIZONTE 115, (2003).

importance and a leading role in bringing South America into the globalized trade market. Instead of embracing open trade as the bloc public policy, the countries' economies are dependent on state subsidies and protection of selected industries through high tariffs, as economists call it industrialization by import substitution, with the state as the main investor in domestic production, all of which reduces imports.[142] Such policy results in an in efficient and non-competitive industry that is easily swayed by domestic and international economic fluctuations.[143]

From 1997 to around 2002, the financial world experienced the Asian financial crisis, the default by Russia on its debts, the devaluation of the Brazilian currency, and the Argentine economic crisis.[144] Brazil and the other members of MERCOSUR reestablished trade barriers to protect their own industries.[145] The bloc did not present any effort to coordinate a united response to the issues.[146] The uncoordinated response to the external crises and unilateral implementation of protectionist policies damaged the bloc' credibility among members, outside partners, and international lenders and investors.[147] It confirmed to the world that the MERCOSUR members lacked commitment to open market policies, to the integration process, and to the success of MERCOSUR as a regional trade bloc.[148]

Brazil has pursued an import substitution policy since the end of the Second World War as a strategy to grow selected key industries.[149] At that time, the strategy favored the establishment of Brazil's industry with foreign capital because there was no "know-how" and there were no proper funding opportunities to help domestic firms grow or to help nationals acquire capital.[150] The result was an artificially induced industrialization dependent on foreign and government-funded capital.[151] In the past, import substitution promoted rapid growth, which was not, and still is not, sustainable in the long run as it does not increase real income and consumption. Meanwhile, it increases potential future liability due to capital flight risk.[152] Under such a

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[142] *Id.*

[143] *Id.*

[144] Carranza, *supra* note 138, at 69-71.

[145] Paiva & Gazel, *supra* note 141 at 127.

[146] Porrata-Doria, *supra* note 91; Hummel & Lohaus, *supra* note 127.

[147] Graphic 1 shows how unstable is the inflow of FDI in Brazil. Also, it has already been demonstrated that the members of the bloc do not coordinate their public policies, Finally, the multidisciplinary literature presented emphasize the importance of institutional credibility for the promotion of FDI inflow. All supporting this author's assumption.

[148] As I said here before, it is not BITs that promote FDI, but the RTAs that do promote FDI. However, it still requires domestic commitment to the terms of the RTA.

[149] Samuel A. Morley & Gordon W. Smith, *Import Substitution and Foreign Investment in Brazil*, 23 OXFORD ECON. PAPERS 120, 135 (1971).

[150] *Id.* at 130.

[151] *Id.* at 131.

[152] *Id.* at 132 (in this study, Morley & Smith emphasized the lack of commitment from foreign investors and how fast they would take away their investments at the first sign of

policy, with tariffs protecting the domestic industry, local goods are more expensive and, more often than not, they are of low quality when compared to the competing goods offered in the world market.

During the 2003-2017 period, the bloc experienced a sharp shift in its trade policy as left-wing governments were established in the region. Under the guidance of Mr. Lula in Brazil, and Mr. Kirchner in Argentina, MERCOSUR lost its focus on trade.[153] Lula and Kirchner marked the relaunch of MERCOSUR with a new agenda. A new dimension for integration within the bloc was introduced, with the focus moving from open international economic trade policy to a social-political policy.[154] Starting in the earlier 2000s, the MERCOSUR was used as a tool for political regime integration, moving away from its foundational purpose.[155] The suspension of Paraguay and the accession of Venezuela in 2012 (since suspended) was a series of political maneuvers to consolidate the new purpose of the bloc.[156] The suspension of Paraguay was the bloc's response to the impeachment of its left-wing president in 2012, and permitted the admission of Venezuela as a full member on that same year, which had been blocked by Paraguay.[157] This maneuver was the formalization of MERCOSUR's divorce from its initial goal of integration through free trade of goods and services. Proffessor Porrata-Doria, in his reevaluation of the MERCOSUR, emphasized that the accession of Venezuela changed the focus of the bloc since the idea of integration under the late president, Hugo Chavez, was "incompatible with . . . open markets and free trade,"[158] which has remained the case under Mr. Maduro.

New unilateral policies amplifying the negative effects of the 2007-

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political instability).

[153] Mariana Vazques & Jose Briceno Ruiz, *O Mercosul na Epoca de Lula e Kirchner: Um Balanco, Seis Anos Depois*, NUEVA SOCIEDAD 33, 48 (2009). The authors applaud the new multidimensional approach of MERCOSUR integration; however, they do not consider the economic implications of such a change in focus.

[154] *Id.*

[155] Porrata-Doria, *supra* note 91.

[156] Guilherme Frizzera, *A Suspensao do Paraguai no Mercosul: Problema Interno, Solucao Externa*, 2 CONJUNTURA GLOBAL 156, 164 (2003).

[157] Venezuela had not been fully admitted before because Paraguay would not ratify the country's accession, and with the suspension of Paraguay, its ratification became unnecessary. Brazil's push for Paraguay's suspension has been seen as a political maneuver to facilitate that accession of Venezuela since Paraguay was not willing to ratify Venezuela's accession. *See Mercosur Suspends Paraguay over Lugo Impeachment*, BBC (June 29, 2012), http://www.bbc.com/news/world-latin-america-18636201; *Paraguay Suspended from MERCOSUR*, THE GUARDIAN (June 29, 2012), https://www.theguardian.com/world/2012/jun/30/paraguay-suspended-mercosur; Guido Nejamkis & Ana Flor, *Mercosur welcomes Venezuela, suspends Paraguay*, REUTERS (June 29, 2012), http://www.reuters.com/article/us-MERCOSUR-idUSBRE85S1JT20120630.

[158] Rafael A. Porrata-Doria Jr., *MERCOSUR at Twenty: From Adolescence to Adulthood?*, 27 TEMP. INT'L & COMP. L.J. 1 (2013).

2009 economic crisis affecting the region were implemented.[159] As could have been anticipated, such policies produced distortions to the economic relationship among the members and with foreign investors, once more negatively impacting economic integration and economic growth in the region and solidifying MERCOSUR and Brazil's economic irrelevance in the global marketplace.[160]

The aftermath of the 2008 global financial crisis, which started in the United States and spread quickly because of globalized trade and financial markets, did not spare the Latin American countries.[161] Although the problem deserves a more in depth analysis not offered here, it is fair to say that the slowdown in China's investments in South American countries' infrastructure, along with the relationship between China's exports and South American imports and exports (particularly Argentinian and Brazilian soy exports and Brazilian iron ore exports) have contributed to the still-lingering effects experienced by Brazil and Argentina.[162] Without fully returning to closed trade market models, many countries had adopted some protectionist measures to safeguard key industries and export sectors.[163] Such measures were often labeled as "stimulus packages."[164] But they were protectionist, nevertheless.

Brazil adopted stimulus packages to "improve energy and transportation services, support social and urban housing projects."[165] However, recent criminal investigations conducted in Brazil[166] have indicated that much of this money was illegally diverted into the pockets of various government officials.[167] Such political crises, combined with the lack of commitment to open market policies, may be further exacerbating the devastating consequences of the most recent economic crisis experienced by Brazil.

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[159] Hummel & Lohaus, *supra* note 127; Carranza, *supra* note 138; Paiva, & Gazel *supra* note 141.

[160] Gabriel V. Montes-Rojas, *A Note to Building a Counterfactual for MERCOSUR,* 15 LATIN AM. BUS. REV. 315 (2014).

[161] Padideh Ala'I, *The Impact of the Financial Crisis on Trade and Investment,* 104 AM. SOC'Y INT'L L. PROC. 447 (2010).

[162] Under "leftist" governments, Brazil's and Argentina's high spending during the boom period of China's investment is prolonging even more the effects of China's slowdown.

[163] Quijano, *supra* note 122.

[164] Ala'I, *supra* note 161, at 448.

[165] *Id.*, at 449.

[166] The "carwash operation" (Operacao Lava-Jato) was launched in 2006 to investigate alleged involvement of a former Congress representative in money laundering. By 2013, many members of the President's party and officers of the high government were indicted or under investigation. The investigation has indictments all the way up to both Presidents from the Worker's Party, Mr. Lula and Mrs. Dilma Rousseff.

[167] In April 2016, Ms. Dilma Rousseff was the second President of Brazil to be impeached. Now, not only Ms. Rousseff but many of her allies, cabinet members, and associates, are still being investigated for corruption during her government as well as during the tenure of previous president, Mr. Lula da Silva. President Lula was jailed from April 2018 until November 2019. He is still answering to many criminal charges brought against him.

The political turmoil being experienced by South American countries, focusing here on Brazil and Argentina, is slowing the process for social and economic recovery[168]. The slow recovery of these two economies is negatively impacting Paraguay, Uruguay, and the other members of the MERCOSUR.[169] Brazilian President Bolsonaro is trying to stimulate the economy by reducing expenditures, easing up financial and commercial regulations, and reducing bureaucracy.[170] Many of the proposed reforms aim at moving Brazil up in the World Bank Ease of Doing Business ranking.[171] Argentina seems to be moving towards a different track. After losing the August primary, President Mauricio Macri tried adopting more Peronist policies in an effort to win elections against the leaders of the opposition, Mr. Alberto Fernandez, and his vice president, Ms. Cristina Kirchner. However, Macri lost the elections and, as President, Mr. Fernandez is bringing Argentina back to Peronism.[172]

C. Harmonization of Laws

MERCOSUR's ultimate success as a mechanism for economic integration and economic development throughout the region requires the standardization of regulations and efficacious implementation of its law.[173] Many decisions, resolutions, and protocols have been approved by the members with definitions and regulations to guide the market participants in a more interventionist fashion, which is in line with civil law tradition.[174] However, the success of this approach requires strong institutions with the necessary power to monitor and enforce the domestic implementation of

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[168] Here I am referring to the popular revolt in Venezuela; the popular manifestation of dissatisfaction with the left-wing governments that plagued Brazil; the effects of the "carwash operation," which led to the prison of Mr. da Silva, the bustling elections in Brazil (which elected President Bolsonaro under the promises of end of corruption and economic reforms, and the Argentinean economic crisis that influence the election of the center-left opposition candidate Mr. Alberto Fernández.

[169] Carranza, *supra* note 138 at 75, 76 (the impact of Brazilian crisis in the other members), at 82 and 83 (the dependency of the other members on Brazil and Argentina), at 93 (how Brazil's devaluation affected the bloc); at 98 (Paraguay and Uruguay cannot leave the bloc due to its economic dependency).

[170] The biggest step so far has been the reform of the Brazilian social security system, which is in the final phase of approval by congress as of the writing of this paper. Without this reform, Brazil is expected to be bankrupt in less than ten years.

[171] As of 2019, Brazil ranks 109 out of 190. The Ease of Doing Business rank can be accessed at https://www.doingbusiness.org/en/rankings (last visited Sept. 19, 2019).

[172] Mr. Fernandez is a member of the nationalist Peronist movement, and defended the return of Peronist policies during his presidential campaign. https://www.wsj.com/articles/argentinas-alberto-fernandez-leads-results-of-presidential-vote-with-47-2-support-11572223112 (last accessed in May 2021).

[173] Porrata- Doria *supra* note 90, at 10, 17, 57-58, 69-70; Gantz *supra* note 15, at 365 and 391; Paiva *supra* note 140, at 125; Hummel & Lohaus *supra* note 127, at 65.

[174] *See* FRANCISCO DUINA, THE SOCIAL CONSTRUCTION OF FREE TRADE: THE EUROPEAN UNION, NAFTA, AND MERCOSUR (2006).

these rules.

The institutions within MERCOSUR are weak and do not foster the proper environment for the coordination and unified application of proper market policies. Professor Trachtman's analytical framework and theory of international economic organizations show that for the success of an integration mechanism, it is necessary that the members empower the institutions and relinquish control over common affairs to the MERCOSUR,[175] as we can observe under the European Union. Rulemaking authority, which sets the responsibilities and benefits of the market actors and promotes regulatory predictability, will reduce the influence of uncommitted members and the risk of unpredictable and uncoordinated individual response to an economic downturn, crisis, or recession.[176] Key protocols have not been properly implemented by the members up to the writing of this paper, illustrating the current state of disharmonized legislation within MERCOSUR.[177] The investor-state dispute resolution established through the Protocol of the Colonia and the Non-Party Protocol has not been ratified by any of the members since their signature more than a decade ago.[178]

D. Lack of Commitment to Trade Liberalization

There are many examples of public policies adopted by the members that depart from the goals of MERCOSUR. In 1999, Argentina imposed import quotas on some of the goods traded with Brazil in response to the devaluation of the real.[179] In 2012, Brazil and Argentina had adopted protective measures to balance trade in cars and parts under the Car Agreement with Mexico, which resulted in the renegotiation of the agreement changing the provisions from tariffs to tariff-rate quotas, in spite of Mexican efforts to increase trade liberalization under the agreement.[180] Furthermore, the Common External Tariff (CET) still has special products that the members can set their own tariffs independently from each other.[181]

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[175] Joel P. Trachtman, *The Theory of the Firm and the Theory of International Economic Organization: Toward Comparative Institutional Analysis,* 17 NW. J. INT'L L. & BUS. 470 (1996).

[176] Porrata-Doria, *supra* note 91, at 41, 61, 71.

[177] For a full list of all Protocols decisions and treaties under the MERCOSUR and status information visit https://www.mercosur.int/pt-br/documentos-e-normativa/tratados/.

[178] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 380.

[179] The real has been the Brazilian currency since 1994. When it was introduced, the real had a fixed exchange rate with the U.S. dollar of 1:1, but such a plan was not sustainable, and the 1998/1999 economic recession led to the devaluation of the real.

[180] THE ECONOMIST, *supra* note 100.

[181] Gantz, REGIONAL TRADE AGREEMENTS *supra* note 15, at 370. In December 2020, the Brazilian government informed, through its official media vehicle, "Agencia Brasil", that the revision of the CET has been postponed to 2021 https://agenciabrasil.ebc.com.br/en/politica/noticia/2020-12/mercosur-puts-common-externa. For the CET most current list, visit the MERCOSUR official website at https://www.mercosur.int/politica-comercial/ncm/.

The bloc does not have sufficient coordination for the treatment of tariff distribution among themselves after entry of goods; for this reason, if the goods cross borders within the bloc they pay duty twice.[182] No customs union can function without the implementation of a system that collects the common tariffs at the port of entry and remits it to the country of ultimate destination.[183] Finally, more than twenty-five years have passed since the establishment of MERCOSUR and still, there is neither full integration nor free trade of goods, and not much improvement in intra-regional trade in services.[184]

E. Other Considerations

MERCOSUR was established over twenty-five years ago with ambitious goals towards liberalization of trade and regional socio-economic integration. It was intended to give a voice to South America in the globalization arena and crown Brazil as an influential country both politically and economically not only in the Southern Cone but globally. Today the bloc has not developed much beyond the progress achieved during its first five years of existence. It has neither achieved the goal of integration among the members nor has it become the voice representing South America. The MERCOSUR members identified the structure required to achieve its goals in its earlier years; nonetheless, they have not been able to develop and implement them as a strong independent body.[185]

MERCOSUR never acquired the necessary independence from the members' governments, maintaining its initial intergovernmental approach. As if an infant, MERCOSUR is still dependent on presidential diplomacy to determine and implement the bloc's agenda.[186] The control over common affairs has not been relinquished to the bloc because the necessary institutional infrastructure has not been constituted.[187] The institutional weakness of MERCOSUR is what empowers the major members, Brazil and Argentina, to impose their own domestic agenda on the bloc if they are in

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[182] GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15, at 371.

[183] *Id.*

[184] *MERCOSUR R.I.P.?,* THE ECONOMIST (July 2012), http://www.economist.com/node/21558609/.

[185] The current structure of the MERCOSUR. Its organogram and existing offices within the bloc, confirms the members' understanding of the needs of a strong common market agreement. However, the lack of implementation of approved norms and protocols, hinders evolution of MERCORSUR towards fulfilling its potential. Gantz, REGIONAL TRADE AGREEMENTS *supra* note 15, at 391; Porrata-Doria, *supra* note 91.

[186] Hummel & Lohaus, *supra* note 126*,* at 69-74.

[187] One example is the creation of the Parlasur, which is the common Parliament. The members created the Parliament in 2005 and except for Paraguay, the state members have not implemented domestically the selection process of their representatives. Such process has already been defined by current MERCOSUR regulation. All the regulation is available at https://www.mercosur.int/pt-br/documentos-e-normativa/tratados/.

sync or otherwise further disrupt the bloc's agenda.[188] In line with the theory presented in this article, such weakness continues to compromise MERCOSUR's success as a freer trade market. Here we see the disadvantage of not having a developed country in the bloc. As we discussed above, it was the influence of the U.S. that pushed Mexico to implement regulatory reform domestically.[189] Also, we can see the dominance of Germany and France in some areas of the EU, but with a more coordinated agenda.[190]

The political character and the strong influence of the members' domestic agendas remain present in the MERCOSUR activities. Only five years after being admitted in the bloc, Venezuela was suspended from all rights and obligations under MERCOSUR in response to Mr.Maduro's policies that have ruptured the democratic order.[191] As the members of MERCOSUR experienced, once again, change in government leadership moving away from left-wing leaders, the members' political agenda is reflected in the bloc decision to suspend Venezuela.[192] I believe that, in spite of the most recent political animosity between Brazil and Argentina[193] MERCOSUR may renew its purpose of economic integration, but for the bloc to regain the momentum, it will require more than the recent agreement signed with the European Union.[194]

I believe that the MERCOSUR has become a cautionary tale with

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[188] GANTZ, REGIONAL TRADE AGREEMENTS *supra* note 15, at 388-389. The ascension of Venezuela during the Presidency of Mr. da Silva in Brazil, and Mr. Kirchner in Argentina confirms this point.

[189] Gillman, *supra* note 38.

[190] Here I refrain from making any judgment of the appropriateness of such dominance as it has been appointed as one of the possible reasons for the Brexit. My point here is that when the supposed dominance is exercised by a developed country, the impact is not as negative as seen in the MERCOSUR because there is proper observance of the rule of law and the overall goals of the bloc.

[191] MERCOSUR/CMC/ACTA N. 01/17. For access to the full decision on Venezuela's suspension visit the MERCOSUR official website at https://documentos.mercosur.int/public/reuniones/doc/6354.

[192] Such suspension is more in tune with the purpose of the MERCOSUR, but with strong institutions the MERCOSUR would not be so susceptible to the political winds of the region.

[193] Brazil and Argentina have been quite vocal about their mutual dislike and conflicting political agenda. Unfortunately, for the MERCOSUR, they have been using the bloc to threaten each other. https://www.washingtonpost.com/world/the_americas/personal-animosity-between- argentine-brazilian-leaders-complicating-relations-between-south-americas-largest-economies/2019/12/08/06313c9c-0702-11ea-9118-25d6bd37dfb1_story.html; https://www.batimes.com.ar/news/latin-america/were-not-a-burden-fernandez-clashes-with-mercosur-leaders.phtml; https://www.dw.com/en/brazil-threatens-mercosur-exit-if-argentina-opposition-wins-presidency/a-50045628.

[194] The free trade agreement between these two blocs was signed in June 2019, after many years of slow negotiations. The agreement is not in force yet and it is under scrutiny by EU members such as France, which are in clear opposition to many of the policies being implemented by the current Brazilian president, Mr. Bolsonaro. The official press release referent to the agreement is available at https://trade.ec.europa.eu/doclib/press/index.cfm?id=2039.

lessons on what not to do, guiding present and future regional trade integration endeavors. Without a strong domestic commitment to open markets from its key members – Brazil and Argentina – the region would have benefited more from a less ambitious free trade agreement than the regional integration proposed under MERCOSUR. Nonetheless, even a less ambitious agreement would have required regulatory reforms to promote stable economic growth, as I demonstrate when discussing the positive impact of NAFTA above.

For these reasons, MERCOSUR is neither an instrument that promotes domestic governance nor a pro-trade regulatory environment. Therefore, it does not promote the inflow of the correct balance of FDI. Although Brazil has received high levels of FDI, the country has not been able to promote a healthy level of inflow of greenfield FDI, which, according to my theory, is one of the reasons for its unstable and unsustainable spurs of economic growth.

6. CONCLUSION

Mexico's choice of trade liberalization and acceptance of international law, combined with the conclusion of NAFTA and its concomitant effect, have promoted stable, if slow, economic growth. This is due to the resulting pro-trade regulatory environment, which has stimulated the inflow of greenfield and vertical FDI. Even though Mexico has not implemented all the reforms that would promote even greater growth and stability, it opened its market and promoted open market policies for the past twenty-five years. It is still too early to know how the country will fare under Mr. Lopez Obrador's more populist policies, but if the renegotiations of NAFTA and the ratification of the USMCA (the new NAFTA) are any indication, I do believe Mexico may continue moving its economic policies in the right direction.

Meanwhile, Brazil's enforcement of protectionist measures under import substitution economic policies and the weakness of MERCOSUR can be identified as one of the causes for the country's sporadic periods of economic growth followed by long periods of recession and stagnation. Under a more pro-trade administration, Brazil may start moving in the right direction.[195]

NAFTA was negotiated under the auspices of a strong developed country with a very strong private sector, with both the U.S. government and the private sector actively promoting the conclusion of the agreement, all with the ultimate strong support of another highly developed country, Canada. Such strength influenced Mexico's market opening, complemented

[195] Brazil's current Minister of Economics, Mr. Paulo Guedes, and his immediate team are graduates from the Chicago School of Economics, and the ones who graduated from other programs have published many studies, papers and other research geared toward freer trade policies as a more efficient way to promote stable economic growth.

by Mexican President Carlos Salinas' commitment to essentially all the same objectives. Meanwhile, MERCOSUR was an overly ambitious project negotiated and implemented under very protective market conditions strongly influenced by the nationalist policies that were being implemented, and to some extent still are, within its member nations.[196] The lack of a developed country as a member, and without any membership states have a sufficiently strong private sector, which would favor rather than oppose freer trade, resulted in the MERCOSUR not being a force moving its members towards a freer market.[197]

The fact that most empirical studies of FDI do not separate data from greenfield-FDI to acquisition-FDI,[198] and the high level of horizontal FDI captured by Brazil, explains why Brazil is reported to receive more FDI than Mexico. However, the concentration in acquisition and horizontal FDI does not promote the same stable economic growth experienced by Mexico. Mexico's commitment was strengthened under NAFTA and further consolidated by the domestic implementation of regulatory changes in favor of market deregulation.[199]

Brazil has since been diverging even further away from the global trade market as it continued to refuse to implement the minimum protection of foreign investments such as through the ISDS mechanism and other necessary regulatory reform. The inaugural speech of the Brazilian President, Mr. Jair Bolsonaro[200] indicated the possible emergence of a new era, moving away from recent protectionist policies towards the liberalization of trade and the reinforcement of contractual obligations and property rights, perhaps including protection and attraction of foreign investment.[201] However, there are so many domestic issues that need to be addressed in Brazil, including violence, corruption, and the environment, that the international trade agenda

[196] Paiva & Gazel, *supra* note 141 at 116; GANTZ, REGIONAL TRADE AGREEMENTS, *supra* note 15 at 391-392. *See generally*, Carranza, *supra* note 138.

[197] Gilman, *supra* note 38, as the author explains the positive results from USA pressure over Mexico during the NAFTA negotiations.

[198] Ferret, *supra* note 63.

[199] Fingar, *supra* note 40.

[200] The inaugural speech in Portuguese is available at https://agenciabrasil.ebc.com.br/politica/noticia/2019-01/no-discurso-de-posse-bolsonaro-pede-apoio-para-reconstruir-o-pais),Mr. Bolsonaro was elected President of Brazil in November 2018, and inaugurated on January 1, 2019. President Bolsonaro was elected as the symbol against corruption and with a liberal economic agenda.

[201] President Bolsonaro has promised to bring Brazil to the top 50 under the Doing Business ranking, and to implement policies towards freer market. Bolsonaro's inaugural speech, on January 1, 2019 and his open speech at the 2019 World Economic Forum Annual meeting, emphasized the promises of his presidential campaign (summary available at https://www.weforum.org/press/2019/01/we-are-building-a-new-brazil-says-newly-elected-president-bolsonaro/; and the full speech is available at https://www.weforum.org/events/world-economic-forum-annual-meeting-2019/sessions/special-address-by-jair-bolsonaro-president-of-brazil.

is not among its first priorities.[202]

Mexico has also elected a new President, and as in Brazil, this election has great significance as the platform of Mr. Lopez-Obrador is directly opposite to that of the former President, Mr. Pena-Nieto.[203] Brazil is moving away from left-wing policies while Mexico is embracing them. The next few years will show whether Mexico's existing strong commitment to freer markets can hold up under the guidance of Mr. Lopez-Obrador, who took office December 1, 2018. It is still early to tell, as it is with Brazilian President, Mr. Jair Bolsonaro.

Although this paper identifies how regional trade agreements can support developing countries' economic growth through the promotion of a mix of horizontal and vertical investment as well as a balance between greenfield and M&A FDI, there are many questions that remain to be answered. New governments taking place in Mexico and Brazil will undoubtedly offer a great case study for further evaluation of the long-term impact of RTAs. Will the USMCA agreement, when it enters into force, flourish and continue to bring benefits to Mexico as did NAFTA, even under a nationalist/populist government? Many of the necessary reforms are still underway in Mexico; how much of this political change will affect Mexico's economic stability and FDI inflow?

As for Brazil, seeing that MERCOSUR did not have the expected impact, and to this day it is not closer to becoming a powerful trade bloc than it was twenty-five years ago, we must ask what should happen next with the bloc. Should Brazil take the lead once again and exert the necessary pressure on its neighbors to move towards the long-expected economic integration? It does not seem that either Brazil or Argentina has the necessary strength and influence to do so.

Brazil's new President has promised to bring the country toward a new era of open markets and freer trade. What are the necessary reforms within the country that can promote a balanced inflow of FDI, greenfield, and acquisition, which will support the country's growth? Should those reforms be coordinated with Argentina, Paraguay, and Uruguay to improve not only national but regional economic growth?

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202 The main focus of this administration has been the reform of the retirement pension system, which is the major economic issue in the country. This reform will change the structure of the social security system in Brazil. Once the reform is approved the Brazilian government is expecting to see an increase in investment and industrial development along with financial savings in the order of over $10M per year.

Hamilton Ferrari & Alessandra Azevedo, *Reforma da Previdência deve economizar R$ 1,164 trilhão em 10 anos*, CORREIO BRAZILIENSE (Feb. 20, 2019), https://www.correiobraziliense.com.br/app/noticia/economia/2019/02/20/internas_economia,738665/impacto-da-reforma-em-10-anos-e-de-r-1-164-tri-ministerio-da-economia.shtml.

203 For better understanding of Mr. Obrador and his political agenda visit https://www.britannica.com/biography/Andres-Manuel-Lopez-Obrador. News coverage of Mexican elections in 2018, https://www.bbc.com/news/world-latin-america-44646478.

Finally, future empirical studies should measure greenfield and M&A FDI inflow to better inform trade policies and necessary regulatory reforms that will support developing countries' stable economic growth. The important question is not "Do BITs work?" but how RTAs can support the inflow of the right type of FDI that promotes stable economic growth.