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ENERGY IN THE NAFTA: FREE TRADE CONFRONTS MEXICO'S CONSTITUTION

I. THE IMPORTANCE OF ENERGY IN NORTH AMERICA

When the three largest nations of the North American continent agreed to negotiate the provisions of a free trade agreement, it was inevitable that energy would play a major role in the resulting agreement.[1] The modern petroleum industry had its beginnings in the United States;[2] the United States has been, by any measure, one of the world's leading consumers of energy;[3] and energy has long played a prominent role in U. S. politics and public policy.[4] To the north, Canada has been an important energy-producing and energy-consuming nation.[5] And to the south is Mexico, a leading producer and sometimes a leading exporter of energy,[6] where oil has played a pivotal role in the politics and national self-identity of the Mexican people.[7] In view of the General Agreement on Tariffs and Trade,[8] which provides that such a free trade agreement must apply to "substantially all the trade" among the trade agreement parties,[9] the neces-

1. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 605 [hereinafter NAFTA].

For general assessments of the NAFTA, the following major sources are the most helpful: GARY C. HUFBAUER & JEFFREY J. SCHOTT, NORTH AMERICAN FREE TRADE; ISSUES AND RECOMMENDATIONS (1992), a study published by the Institute for International Economics of Washington, D.C., soon after the negotiations began; and GARY C. HUFBAUER & JEFFREY J. SCHOTT, NAFTA: AN ASSESSMENT (1993), a study completed by the same authors after completion of the negotiations that evaluates the extent to which their recommendations were followed; a macroeconomics study, THE BROOKINGS INSTITUTION, NORTH AMERICAN FREE TRADE: ASSESSING THE IMPACT (1992); a brief summary of the impact on a major energy-producing state adjacent to Mexico, JAN G. RICH & DAVID HURLBURT, FREE TRADE WITH MEXICO: WHAT'S IN IT FOR TEXAS? (1992), from a comprehensive examination conducted under the direction of Professor Sidney Weintraub at the U.S. Policy Studies Program, Lyndon B. Johnson School of Public Affairs, The University of Texas at Austin; and ROBERT A. PASTOR, INTEGRATION WITH MEXICO: OPTIONS FOR U.S. POLICY (1993).

For a collection of assessments of various legal aspects of the Agreement, *see Annual Symposium: The North American Free Trade Agreement (NAFTA)*, 27 INT'L LAW 589 (1993).

2. DANIEL YERGIN, THE PRIZE: THE QUEST FOR OIL, MONEY & POWER 24-26 (1991).

3. *Id.* at 724, 745.

4. *See, e.g., id.* at 472-75, 674-76, *and generally passim.*

5. CIA, HANDBOOK OF ECONOMIC STATISTICS, at 84-85 (1991). For a very brief history of petroleum in Canada, *see* ROBERT O. ANDERSON, FUNDAMENTALS OF THE PETROLEUM INDUSTRY 67 (1984).

6. *See infra* part II.A.

7. YERGIN, *supra* note 2, at 665-67. *See also infra* part II.

8. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A3, 55 U.N.T.S. 187 [hereinafter GATT]. The current version is at 4 GENERAL AGREEMENT ON TARIFFS AND TRADE, BASIC INSTRUMENTS AND SELECTED DOCUMENTS, *reprinted in* JOHN H. JACKSON, WORLD TRADE AND THE LAW OF GATT 799 (1969). All three parties to the NAFTA are contracting parties to the GATT. The United States and Canada were original contracting parties. JACKSON, *supra* at 898-99 (1969). Mexico became a contracting party in 1986. *See* Richard D. English, *The Mexican Accession to the General Agreement on Tariffs and Trade*, 23 TEX. INT'L L. J. 339 (1988); John M. Vernon, *Mexico's Accession to the GATT: A Catalyst at Odds with the Outcome?* 24 ST. MARY'S L. J. 717 (1993).

9. GATT, *supra* note 8, art. XXIV, para. 8(b).

sity of producing an agreement compatible with the GATT provided a further reason, one based in international law, to address the issue of energy.

The unique place of the petroleum industry in the three nations ultimately meant that the energy provisions in the NAFTA would have their own distinctive shape. Since Canada and the United States had in 1988 already negotiated a free trade agreement,[10] which had included specific provisions on energy,[11] the negotiators were already familiar with the problems of trade in energy that such an agreement would need to address. Canada and the United States, with legal systems based generally on the English common law tradition[12] and regulatory systems not too dissimilar,[13] found important agreements on energy possible to reach. However, the role of energy in the history and political culture of Mexico was so distinctive that the discussions of this new trilateral agreement would confront new and unique challenges.

II. PETROLEUM AND MEXICAN HISTORY

A. *The Petroleum Industry in Mexico*

The results of the negotiations on energy in the NAFTA agreement cannot be eradicated from their deep roots in Mexican history. The importance of petroleum to the Mexican people extends far beyond its importance as a natural resource, as significant as it is in economic terms alone. As one author states, oil has been "inseparable from the concept of nation," more an issue of "political passion" than economic reason.[14] Mexican history has seen oil transformed from a badge of "foreign domination and interference" to a symbol of "pride, self-respect, and independence."[15] In the final analysis, it was not in the realm of possibility that months of trilateral negotiations would overturn decades of history.

In a country with a turbulent history, the history of the Mexican oil industry has been no less eventful.[16] In pre-colonial times, oil was known to the Aztecs and Mayans, who were able to make little use of this resource seeping from the ground.[17] During this period, the strong influence of Spanish law meant that such natural resources were owned by the State.[18]

10. U.S.-Canada Free Trade Agreement, July 2, 1988, 27 I.L.M. 281 [hereinafter USCFTA].

11. *Id.* ch. 9.

12. The legal systems of Canada are based on the English common law, except in Quebec, where the civil law tradition in its French form prevails. CIA, THE WORLD FACTBOOK 1991, at 54 (1991). This exception in Canada has a parallel in Louisiana, where the civil law tradition is established. Mexico has a legal system based on the civil law tradition, although its constitutional theory has been influenced by the United States. *Id.* at 204.

13. Gary B. Conine, *Natural Gas Transactions Between the United States and Mexico: Political and Legal Impediments to Free Trade*, 27 TEX. INT'L L.J. 577 (1992).

14. ALAN RIDING, DISTANT NEIGHBORS 227 (First Vintage Books ed., 1986) (1984).

15. *Id.*

16. This brief summary, without which no understanding of Mexican energy policy or the NAFTA provisions is possible, will follow the division into five phases found in DANIEL LEVY & GABRIEL SZEKELY, MEXICO: PARADOXES OF STABILITY AND CHANGE 214-20 (1983).

17. *Id.* at 214.

18. *Id.* at 214-15.

However, in 1884 a new era[19] began when, under Mexican President Porfirio Diaz, the Mexican Congress passed a new law that allowed the government to grant titles to land to foreign companies.[20] This change evidently encouraged foreign exploration for oil, and in 1886 such activities began in southern Mexico.[21] The entrepreneurs conducting the exploration efforts were overwhelmingly foreign, consisting primarily of American and British businessmen.[22] Despite enactment of laws that embodied the concept of private property rights in land and natural resources, the entrepreneurs did not avoid difficulties with property rights.[23] Commercial oil production began in 1901.[24] By 1905, in the wake of a recession, these activities had already produced a nationalist reaction.[25] Despite the fact that the Mexicans retained the ability to set the basic rules for foreign investment, the excessive dependence on foreign capital, and ultimately the control of the Mexican economy, had already become a serious domestic political issue.[26] Despite these problems, by 1911 Mexico was exporting oil.[27] However, in that year the regime of Porfirio Diaz ended, as this long-serving President fled to exile in France.[28]

The adoption of a new Constitution in Mexico in 1917 marked the beginning of a third phase, since this new Constitution included a provision, Article 27, that natural resources were the property of the Mexican nation; this reversal of constitutional policy raised the tensions between the Mexican nation and foreign companies operating in Mexico.[29] However, production nevertheless increased. By 1921, Mexico was producing twenty-five percent of world oil output and was the largest producer in the world.[30] After lengthy diplomacy by the United States, Mexico agreed not to apply this constitutional change retroactively.[31] However, in 1925, President Plutarco Elias Calles issued a new Petroleum Law that required the

19. A comprehensive history of the Mexican oil industry from 1880 to 1920 is found in JONATHAN C. BROWN, OIL AND REVOLUTION IN MEXICO (1993).

20. LEVY & SZEKELY, *supra* note 16, at 215. *See also* BROWN, *supra* note 19, at 92. A second law passed in 1892 provided that the owner of the soil could exploit subterranean minerals freely without prior governmental approval. However, other laws obscured the true legal nature of the property rights involved. BROWN, *supra* note 19, at 92.

21. LEVY & SZEKELY, *supra* note 16, at 215.

22. *See* Brown, *supra* note 19, at 4, 9, 213-14.

23. *Id.* at 38-39.

24. LEVY & SZEKELY, *supra* note 16, at 215.

25. BROWN, *supra* note 19, at 39.

26. *Id.* at 91.

27. LEVY & SZEKELY, *supra* note 16, at 215. During the U.S. participation in World War I, 1917-1918, Mexico was the source of ninety-five percent of the oil imported by the United States. RIDING, *supra* note 14, at 229.

28. FRANK BRANDENBURG, THE MAKING OF MODERN MEXICO 47 (1964). Porfirio Diaz had assumed the presidency of Mexico in 1876 and provided the country not only stability but also a centralized, authoritarian rule, *see id.* at 30, 37-47. He also led Mexico toward an exceptional period of economic modernization, and opened Mexico's economy, but never to the extent of "free operation of market capitalism." *See* BROWN, *supra* note 19, at xi, 92.

29. LEVY & SZEKELY, *supra* note 16, at 215.

30. *Id.*

31. *Id.* The diplomatic resolution was known as the Bucareli Agreements.

oil companies to register their titles with local authorities and limited their rights to fifty years.[32] Although the law created the potential for a diplomatic crisis between the United States and Mexico, restraint on both sides allowed such a result to be avoided.[33] However, during this decade the focus of world production moved away from Mexico to Venezuela and the Persian Gulf, where production costs were lower.[34]

President Lazaro Cardenas began a fourth phase in 1938 with the nationalization of the oil industry.[35] Mexico had already ceased to be a major supplier of oil on the world markets, partly because of declining production and partly because of the increase in domestic consumption.[36] More than any other factor, the need to assert Mexico's sovereignty was seen by the Mexicans as the reason for the expropriation.[37] In a dispute with the Confederation of Mexican Workers, the foreign oil firms challenged the Nation's judicial authorities. The oil firms refused to comply with the recommendations of the courts on the improvement of the workers' living standards.[38] The words of President Cardenas are instructive:

> It is the nation's sovereignty itself that could be exposed to maneuvering by foreign capital, which has forgotten its previous commitment to respect national laws, and is now seeking to avoid fulfillment of its duties as dictated by the country's authorities. It is a clear-cut case, and it leaves the government no choice other than to apply the current Law of Expropriation.[39]

The United States, pursuing a Good Neighbor Policy under President Franklin Roosevelt and seeking to keep the Western Hemisphere united in anticipation of the Second World War, avoided a confrontation over the expropriation of its companies' properties and limited its demands to compensation.[40] However, a complete boycott of Mexican oil products ensued.[41] Nevertheless, U.S. and Mexican negotiators were able to reach agreement on compensation for expropriated U.S. interests in 1942.[42] The expropriation also resulted in the creation of the state-owned company called Petroleos Mexicanos, also known as PEMEX, on June 7, 1938.[43]

During this era in the history of the Mexican petroleum industry, domestic demand for oil grew with the needs of an expanding population,

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32. *Id.* at 215-16.

33. *Id.* at 216.

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. Universidad Nacional Autonoma de Mexico, *General Lazaro Cardenas: Voz viva de Mexico* 7 (Mexico City 1978), *quoted in* LEVY & SZEKELY, *supra* note 16, at 217. Riding suggests that Cardenas was insulted by a foreign oil company official who doubted Cardenas' word, thus adding a personal impetus to the nationalization. RIDING, *supra* note 14, at 232. Riding also states that the nationalization made Cardenas a national hero on the order of Cuauhtemoc and Juarez. *Id.* at 233.

40. LEVY & SZEKELY, *supra* note 16, at 217.

41. *Id.*

42. *Id.*

43. RIDING, *supra* note 14, at 233.

while discoveries and production failed to keep pace.[44] By 1969, Mexico had ceased to be an oil exporting country.[45] With the advent of the first energy crisis of the 1970s in 1973, however, Mexico began to increase its investment in oil and natural gas exploration, and soon Mexico became an exporter of oil again.[46]

By late 1976, Mexico had entered the present phase in the history of its petroleum industry as a major supplier of world markets.[47] By 1981, new discoveries had given Mexico the fifth largest oil reserves and the seventh largest gas reserves in the world.[48] Mexico sought to resist overdependence on the United States as a customer, and President Lopez Portillo ordered that no more than fifty percent of Mexico's crude exports should be exported to a single country.[49] Increasingly in this era, Mexico began to consume, rather than to flare, natural gas.[50] In 1977, Mexico had made arrangements with U. S. pipeline companies to build a pipeline to transport natural gas, a plan which was blocked by the U. S. Administration because of pricing issues.[51]

However, as a part of recent economic reform, PEMEX has been changing. The National Energy Modernization Plan for the years 1989 to 1994 aimed at producing a greater energy supply for a growing population, increasing revenue, enhancing environmental protection, and decentralizing and reorganizing the energy sector.[52] To support these objectives, it should increase PEMEX's productivity, encourage the nation to use energy more efficiently, create financing mechanisms for the expansion of supply, diversify Mexico's sources of energy, and expand its presence in foreign markets.[53] In the three years after the adoption of this plan, PEMEX had decreased the number of its employees and reduced its costs by seventeen percent, or one billion dollars per year.[54] In June 1992, PEMEX reorganized its operations into four subsidiaries for exploration and production, refining, natural gas and primary petrochemicals, and secondary petrochemicals.[55] As the negotiations drew to a close, President Salinas summarized the state of PEMEX as follows:

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44. LEVY & SZEKELY, *supra* note 16, at 218.

45. *Id.*

46. *Id.* at 218-19.

47. *Id.* at 219.

48. RIDING, *supra* note 14, at 240.

49. *Id.* at 241.

50. *Id.* at 240. Natural gas was still being flared in Mexico as late as the 1970s. *Id.* at 239.

51. *Id.* at 241-42.

52. HUFBAUER & SCHOTT, NORTH AMERICAN FREE TRADE; ISSUES AND RECOMMENDATIONS, *supra* note 1, at 190. As part of a more general trend toward liberalizing Mexican investment regulations, which historically precluded foreign ownership of Mexican companies, President Salinas liberalized regulations with regard to investment in secondary and tertiary petrochemicals in 1989. Dale A. Kimball, Jr., Comment, *Secondary and Tertiary Petroleum Operations in Mexico; New Foreign Investment Opportunities*, 25 TEX. INT'L L. J. 411, 413 (1990).

53. HUFBAUER & SCHOTT, NORTH AMERICAN FREE TRADE; ISSUES AND RECOMMENDATIONS, *supra* note 1, at 190.

54. *Id.*

55. HUFBAUER & SCHOTT, NAFTA: AN ASSESSMENT, *supra* note 1, at 36-37.

> The oil will remain Mexican. But we introduced recently to Congress a law to restructure PEMEX and to form independent companies within it. No private businessman can participate in PEMEX ownership, but they are welcome to participate in service contracts — not risk but service contracts . . . . PEMEX can contract with private drillers, Mexicans or foreigners, but they are paid in cash, and the oil that is found remains in PEMEX, as the constitution establishes.[56]

The President also rejected the ideas of "crude sharing" and joint ventures for finding crude oil.[57] The announced reforms improved PEMEX, but they failed to alter the constitutional principle that supported this state-owned enterprise.

The policies and practices of PEMEX reflect the enduring impact of the petroleum industry on the strong historical consciousness of the Mexican people. That consciousness affects the domestic politics and the policies of Mexico today. The legal expression of this phenomenon is found in the extensive provisions of the Mexican Constitution.

B. The Mexican Constitution and Energy

The impact of the petroleum industry on the economic system of Mexico is shown clearly in its constitutional provisions. In contrast to the Constitution of the United States, the Constitution of the United Mexican States has extensive provisions on the energy industries. These provisions continue to determine the content and limitations of Mexico's energy policies.

The Mexican constitutional provisions on energy, announce the general principle that "ownership of the lands and waters within the boundaries of the national territory is vested in the Nation, which has had, and has, the right to transfer title thereof to private persons, thereby constituting private property."[58] However, the provision also states that private property may not be expropriated except for reasons of public use and subject to the payment of indemnity.[59] The Constitution gives the Nation the right at all times to impose on private property "such limitations as the public interest may demand," as well as the right to regulate the utilization of natural resources which are susceptible of appropriation, in order to conserve them to ensure a more equitable distribution of public wealth, to attain a well-balanced development of the country, and to improve the living condition of the rural and urban population.[60]

With respect to natural resources, the Constitution provides that the direct ownership of various specified natural resources is vested in the Nation.[61] These natural resources to be owned by the Government of

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56. *We had to react quickly*, FORBES, Aug. 17, 1992, at 64, 66.

57. *Id.*

58. MEX. CONST. art. 27, *reprinted in* CONST. OF THE COUNTRIES OF THE WORLD 23 (Albert Blaustein & Gilbert H. Flanz eds., 1988).

59. *Id.*

60. *Id.*

61. *Id.* The Constitution also provides that only Mexicans by birth or by naturalization and Mexican companies have the right to acquire ownership of lands, waters, and their appurtenances, or to

Mexico include petroleum and all solid, liquid, or gaseous hydrocarbons; mineral or organic deposits or material susceptible of utilization as fertilizers; and solid mineral fuels.[62]

The Constitution also provides that with respect to these categories:

> ownership by the Nation is inalienable and imprescriptible, and the exploitation, use, or appropriation of the resources concerned, by private persons or by companies organized according to Mexican laws, may not be undertaken except through concessions granted by the Federal Executive, in accordance with the rules and conditions established by law. The legal rules relating to the working or exploitation of the minerals and substances referred to in the fourth paragraph [provisions governing the ownership of natural resources] shall govern the execution and proofs of what is carried out or should be carried out after they go into effect, independent of the date of granting the concession, and their nonobservance shall be grounds for cancellation thereof.[63]

The Constitution also provides that in the case of petroleum and hydrocarbons, no concessions or contracts will be granted, nor may those that have been granted continue, and that the Mexican government will carry out the exploitation of these products in accordance with the provisions indicated in the respective regulatory law.[64] It goes on to say that no concessions for this purpose may be granted to private persons, and the nation will make use of the property and natural resources which are required for these ends.[65] All contracts and concessions made by previous governments since the year 1876 which have resulted in the monopolization of lands, waters, and natural resources of the nation, are declared subject to revision, and the Executive, the President of Mexico, is empowered to declare them void whenever they involve serious prejudice to the public interest.[66]

With regard to electrical energy, the Constitution further provides that it is exclusively a function of the Nation to generate, conduct, transform, distribute, and supply electrical power which is to be used for public service. No concessions for this purpose are to be granted to private persons,

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obtain concessions for the exploitation of mines or waters. *Id.* It continues with a provision that the State may grant the same right to foreigners, provided they agree before the Ministry of Foreign Affairs to be considered as nationals in respect to such property, and bind themselves not to invoke the protection of their governments in matters related thereto, under penalty, in case of noncompliance with this Agreement, of forfeiture of the acquired property of the Nation. *Id.* It also provides that commercial stock companies that are organized to operate any manufacturing, mining, or petroleum industry or for any other purpose that is not agricultural, may acquire, hold, or administer lands only of any area that is strictly necessary for their building or services, and this area shall be fixed in each particular case by the Federal or State Executive. *Id.* at 26.

62. *Id.* at 23. It is interesting to note that the catalogue of natural resources owned by the Nation also includes "all natural resources of the continental shelf and the submarine shelf of the islands; all minerals or substances, which veins, ledges, masses or ore pockets, form deposits of a nature distinct from the components of the earth itself; . . . ," categories that would also include petroleum if not already included. *Id.*

63. *Id.* at 24.

64. *Id.* at 25.

65. *Id.*

66. *Id.* at 32.

and the Nation will make use of the property and natural resources which are required for these ends.[67] The Constitution also declares that among the functions of the Nation is the use of nuclear fuels for the generation of nuclear energy and the regulation of its application to other purposes.[68] Nuclear energy may only be used for peaceful purposes.[69]

After condemning monopolies in other areas of the economy, the Mexican Constitution provides that the functions exercised by the State will not constitute monopolies within the meaning of those provisions, including specifically petroleum, other hydrocarbons, and basic petroleum chemistry; radioactive minerals and nuclear power production; and electricity.[70]

These provisions, the legal expression of a political imperative, have had a profound impact on Mexican economic policy and the development of the Mexican economy throughout most of the twentieth century. Together with the relative size of the industry in the Mexican economy, they have contributed to the great impact of the industry on the economic welfare and destiny of the average Mexican citizen. They were also fated to play an important role in the two most important events in the opening of the Mexican economy in the later decades of the century. Those events were Mexico's accession to the GATT and its joining with Canada and the United States to create a North American Free Trade area. In the negotiations leading to these two events, the enormous significance of energy to Mexico can be seen.

C. Energy in the Negotiations for Mexico's Accession to the GATT

Mexico's energy industry was an issue at the time of its accession to the GATT.[71] Concerned with the special role of its state-owned petroleum industry and its immense domestic significance, Mexico attempted to forestall any application of the GATT principles to the energy industry during the deliberations on its accession. In its Memorandum on Foreign Trade Regime, Mexico observed that its energy sector had been "closely linked with the country's historical process."[72] Mexico had written the principle of "the nation's exclusive and original ownership of its energy resources" into its Constitution.[73] The Mexican government "has consolidated its authority over this sector in the context of a mixed economy."[74]

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67. *Id.* at 35.

68. *Id.*

69. *Id.*

70. *Id.* art. 28, para. 4, at 33.

71. For a more general examination of the issues presented by Mexico's accession to the GATT and the resulting discussions by the contracting parties, *see* English, *supra* note 8, particularly 369-91.

72. *Memorandum on Foreign Trade Regime* 5, GATT Doc. L/5961 (Feb. 11, 1986).

73. *Id.*

74. *Id.* The fifteen national programs adopted by the Mexican government included the "National Energy Programme, 1984-1988." *Id.* at 7. It noted that an important factor contributing to the expansion of exports in the period leading up to Mexico's accession to the GATT was the "steady increase in petroleum sales abroad[,] which rose from US $ 557 million in 1976 to US $ 13,305 million by 1981, annually by 2289 percent; in other words, petroleum exports increased at an average annual

In response to questions from members of the GATT working party, Mexico stated that the state has "exclusive and original" ownership of forms of energy other than petroleum and natural gas, including the "generating and supply of nuclear and electrical energy."[75] Mexico stated its belief that its full ownership of energy resources "implies no adverse affects for international trade in energy resources."[76] The response from the Mexican government continued: "Based on the principle of competitive advantage, Mexico likewise considers that there is no distortion of international trade in products containing energy resources as inputs. Mexico sells petroleum, gas and petrochemicals to whoever purchases from us and at competitive prices in the international market."[77]

Mexico was asked whether it was seeking an "Article XI exemption"[78] for energy, including restrictions on exports.[79] Mexico responded that it hoped to be able to avail itself of all the rights deriving from its status as a contracting party.[80]

> In this sense, if it is deemed necessary to invoke any exceptions under any article of the General Agreement, according to circumstances, Mexico will avail itself of that right. In any case, Mexico considers that the energy sector presents characteristics which are so special that it is not covered by the provisions of the GATT, as evidenced by the fact that at no time have that sector's problems been discussed in this forum, as the energy producing members of the GATT well know.[81]

In fact, although the GATT contains neither an explicit nor an implicit exemption for energy, the problems of international trade in energy have

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rate of 88.7 percent during this period. Between 1982 and 1984, they continued at a high level, amounting to US $ 15,623 in 1982, and $ 14,968 in 1984." *Id.* at 30. In a response to a question about the meaning of the term consolidated, the government of Mexico responded:

> The term "consolidated" in the context of the paragraph under reference, means that Mexico exercises full authority over this sector. It does not mean that ownership of energy resources can be mixed, since Article 27 of the Constitution of Mexico stipulates that, no concessions nor contracts are to be granted in respect of petroleum and hydrocarbons and that the nation is to be responsible for exploiting these products.

Replies by Mexico to Questions Put by GATT Contracting Parties Regarding the Memorandum on the Foreign Trade Regime 10, GATT Doc. L/5976 (April 14, 1986).

75. *Replies by Mexico to Questions Put by GATT Contracting Parties Regarding the Memorandum on the Foreign Trade Regime*, *supra* note 74, at 10.

76. *Id.*

77. *Id.*

78. Article XI of the GATT contains the general prohibitions against quantitative restrictions as applied to exports and imports between contracting parties, GATT, *supra* note 8, art. XI, para. 1, and provides for exemptions for temporary export restrictions or prohibitions to prevent or relieve critical shortages of foodstuffs or other commodities, *id.* art. XI, para. 2(a), and for other limited reasons. *Id.* art. XI, paras. 2(b), (c). It is difficult to construe these limited exemptions as a general exemption for energy. Rather, exceptions to this general prohibition have more substantial justification under other GATT provisions. *See* discussion *infra* notes 184-99.

79. *Replies by Mexico to Questions Put by GATT Contracting Parties Regarding the Memorandum on the Foreign Trade Regime*, *supra* note 74, at 11.

80. *Id.*

81. *Id.*

not been among the most significant issues addressed by the GATT.[82] Problems in international trade in energy have tended to be resolved through other means.[83] The United States, for example, has imposed various restrictions on imports and exports of energy products based on national security, on the grounds of its needs for oil.[84]

In its Report,[85] the Working Party disagreed with any assertion or implication that the provisions of the GATT did not apply to the energy sector. In particular, it noted that the tariff items in the energy sector subject to import and export permits were listed in the Catalogue of the General Import Tariff.[86] Without questioning the principle of national sovereignty over energy resources, a number of members of the working party took strong exception to any interpretation that the GATT did not apply to energy.[87]

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82. Note the nearly complete absence of any references to energy, oil, and petroleum in the indexes to leading works such as JACKSON, *supra* note 8, at 925-48; KENNETH DAM, THE GATT: LAW AND THE INTERNATIONAL ECONOMIC ORGANIZATION 469-80 (1969); and JOHN H. JACKSON, THE WORLD TRADING SYSTEM 409-17 (1989).

83. The more serious problems of international trade in energy have concerned, first, the existence of an international oil cartel, *see* JOHN H. JACKSON & WILLIAM DAVEY, LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS, 982-87 (1986); and second, the related problem of oil supply emergencies. This second problem was addressed by the creation of the International Energy Agency by sixteen members of the Organization for Economic Cooperation and Development under that organization's auspices in 1974. Agreement on an International Energy Program, Nov. 18, 1974, 14 I.L.M. 1.

84. The United States imposed oil import quotas in 1959 as a security measure. 72 Stat. 678; Presidential Proc. No. 3279, 73 Stat. C25 (1959), 19 U.S.C.A. 1862; Presidential Proc. No. 3290, 73 Stat. C39 (1959). *See* JACKSON, *supra* note 8, commentary at 752. President Nixon increased the fees on oil imports, a decision upheld in Federal Energy Admin. v. Algonquin S.N.G., Inc., 426 U.S. 548 (1976). *See* EDMOND MCGOVERN, INTERNATIONAL TRADE REGULATION 426-27 (1986).

At the same time, the United States has imposed restrictions on exports, such as the prohibition of exports of Alaskan North Slope crude oil, the restrictions found in the Mineral Lands Leasing Act, 30 U.S.C. § 185(u)(1988), and the Outer Continental Shelf Lands Act, 43 U.S.C. § 1354(1988), and the compulsory licensing of refined petroleum products. MCGOVERN, *supra* note 84, at 440-42.

These exceptions to the application of the GATT principles can be justified under the GATT articles providing General Exceptions, particularly those addressing problems of "short supply," art. XX(g), and national security, art. XXI.

It should be remembered that the GATT obligations apply only with respect to relations between countries that are both contracting parties. MCGOVERN, *supra* note 84, at 423. For example, of the thirteen members of the Organization of Petroleum Exporting Countries, only six (Gabon, Indonesia, Kuwait, Nigeria, Qatar, and Venezuela) were contracting parties to the GATT. CIA, *supra* note 12, *compare* 379 (OPEC) *with* 368 (GATT).

85. *Report of the Working Party on the Accession of Mexico*, GATT Doc. L/6010 (July 4, 1986).

86. *Id.* at 23.

87. *Id.* In particular, some members of the working party disagreed with the assertion that paragraph (g) of Article XX meant that the energy sector was not covered by the provisions of the GATT. Article XX of the GATT, which provides for "General Exceptions," states in part that "nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures . . . (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption." GATT, *supra* note 8, art. XX. Clearly, this exception merely permits regulations and other governmental acts aimed at conservation to be enforced by measures such as quantitative restrictions on exports; it does not exempt products that are exhaustible natural resources or those that are derived from them, from the GATT. However, *all* the GATT obligations are subject to such

In any event, the representative of Mexico informed the working party that the inclusion of a paragraph on energy in the draft protocol of accession was not intended to establish special rights, but rather to underline the importance of this sector and secure the acknowledgment of its constitutional stature in Mexico.[88] Because of the provisions of Article 27 of the Constitution, the Mexican government's sovereign rights over energy resources could not be subject to concessions or contracts.[89] Therefore, the representative stated, the Mexican government would need to maintain its system of export permits.[90] For security purposes, energy resources were subject to import and export permits in a number of contracting parties.[91] In the representative's view, Mexico's policies were consistent with the provisions of the GATT.[92]

The final Protocol of Accession noted the following:

> Mexico will exercise sovereignty over natural resources, in accordance with the Political Constitution of Mexico. Mexico may maintain certain export restrictions related to the conservation of natural resources, particularly in the energy sector, on the basis of its social and development needs if those export restrictions are made effective in conjunction with restrictions on domestic production or consumption.[93]

It seems clear that, to the satisfaction of the contracting parties, Mexico accepted the notion that the GATT principles apply to international trade in energy. In fact, since the general principles of the GATT, such as the Most-Favored-Nation and national treatment principles, do not apply to international investment under the Agreement's terms,[94] nothing in Mex-

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exceptions. JACKSON, *supra* note 8, at 744. However, even when this exception is applicable, such measures may not be applied in a manner that would "constitute a means of arbitrary or unjustifiable discrimination" or a "disguised restriction on international trade." GATT, *supra* note 8, art. XX. Professor Jackson notes that these qualifications are modified forms of the Most-Favored-Nation and national treatment principles. JACKSON, *supra* note 8, at 743, *citing* GATT art. III.

88. *Report of the Working Party on the Accession of Mexico, supra* note 85, at 23. *See Protocol of Accession of Mexico to the General Agreement on Tariffs and Trade,* GATT Doc. L/6010, *and*, Basic Instruments and Selected Documents, 33rd supp. (1986), at 3-6.

89. *See supra* note 74 and accompanying text.

90. *Report of the Working Party on the Accession of Mexico, supra* note 85, at 23.

91. *Id. See also supra* note 74 (examples from U.S. practice).

92. The Mexican representative cited Articles XVII and XX. *Report of the Working Party on the Accession of Mexico, supra* note 85, at 23. Recognizing that State enterprises are unlikely to make decisions about the purchase or sale of goods on the same basis as commercial enterprises, which are able to make such decisions with a far greater degree of autonomy, the authors of the GATT provided that such enterprises must make their purchases and sales in a manner consistent with the general principles of nondiscriminatory treatment. GATT, *supra* note 8, art. XVII, para. 1(a). The Agreement also requires such enterprises to make these decisions in accord with "commercial considerations" including price, quality, availability, marketability, transportation, and other conditions of purchase or sale. *Id.* art. XVII, para. 1(b).

In fact, the presence of state enterprises presents substantial difficulties to any international system for controlling national barriers to trade and to the application of the GATT to Mexico's state owned petroleum enterprise. *See* DAM, *supra* note 82, at 316-32; JACKSON, *supra* note 8, at 329-64; and JACKSON, *supra* note 82, at 283-98.

93. *Protocol of Accession of Mexico to the General Agreement on Tariffs and Trade, supra* note 88, at 27.

94. *See* GATT, *supra* note 8, arts. I, & II. *See also* JACKSON, *supra* note 82, at 7.

ico's accession threatened the Mexican government's ownership of PEMEX. The provisions of the GATT for exceptions and waivers were adequate to accommodate any problems such ownership might have presented.

However, Mexico's accession to the GATT had implications that were much larger and much more significant. Mexico's accession to the GATT represented a revolutionary change in policy with regard to international trade, a turning away from protectionist import substitution policies toward a system more open to the outside world.[95] It was also the international aspect of a new policy of national economic reform. Finally, it was the crucial step that laid the foundation for liberalizing its trade with its neighbors to the north.[96]

III. NAFTA's Provisions on Energy

A. North American Free Trade

As Mexico joined its two neighbors to the north as a contracting party to the GATT, a general global trend toward economic reform and the reduction of trade barriers was eroding a myriad of obstacles to international trade and opening many of the world's most closed national economies. Across the Atlantic, the European Community was pressing to enact a complex program to eliminate technical, physical, and fiscal barriers to the free movement of goods, services, capital, and people across the national boundaries of twelve European nations by the end of 1992. Four South American countries (Argentina, Brazil, Paraguay, and Uruguay) had begun to discuss the possibility of a free trade area. The Association of South East Asian Nations was considering closer economic relations among its members. Reform in Central and Eastern Europe and the Soviet Union was rapidly turning into the transformation of entire economies. Throughout the world, a deep concern about international competitiveness impelled national leaders to give a new and serious consideration to their respective national economic policies and created a new willingness to contemplate closer cooperation with other countries. The leaders of Canada, the United States, and Mexico were among them.

The successful conclusion of negotiations for the U.S.-Canada Free Trade Agreement was a second major event leading to the possibility of a three nation accord. With its completion, the outlines of a three nation agreement became clear. And from that model, as well as the historic role that energy had played, in divergent ways, in the three North American

95. For a brief discussion of this point, *see* English, *supra* note 8, at 366-69 and 390-91.

96. For a very brief discussion of the manner in which Mexico's GATT accession prepared both countries for bilateral trade agreements with the United States, *see* English, *supra* note 8, at 391; Vernon, *supra* note 8; *and* Rudy Sandoval, *Mexico's Path Towards the Free Trade Agreement with the U.S.*, 23 Inter-Am. L. Rev. 133 (1991). Arguably, without Mexico's accession to the GATT, no one could have ever seriously or credibly proposed a North American Free Trade Agreement. In addition, the changes in economic policy made in association with Mexico's GATT accession were also excellent preparation for a trilateral agreement with two countries who were also contracting parties (indeed, *original* contracting parties, *see* Jackson, *supra* note 8, at 898-99) to the GATT.

economies, the contours of the provisions on energy and the major issues to be resolved among the three parties were becoming clear as well.

NAFTA's provisions on energy, for the most part, have precedents in the U.S.-Canada Free Trade Agreement.[97] However, two major provisions mark points of departure from this foundation. The first is the inclusion of more general principles for economic relations among the parties in energy.[98] The second is the general reservation of energy for the government of Mexico. These two additions to the previous accord were related.

B. The Principles for the Energy Sector

As the negotiations on the Energy Chapter began, it became evident to the negotiators that the principles governing the future of the relationship would be as important as the more specific obligations included in it. The Agreement sets forth three very general principles for energy trade and investment among the three countries.[99] First, the parties confirmed "their full respect for their constitutions."[100] Secondly, the parties recognized that it was desirable to strengthen the important role that trade in energy and basic petrochemical goods plays in the free trade area; additionally, they committed themselves to enhance the role of energy trade through sustained and gradual liberalization.[101] Finally, they agreed to recognize the importance of having "viable and internationally competitive energy and petrochemical sectors" to further their national interests.[102] While the three parties considered all of the principles important, most promising among these principles is the commitment to "sustained and gradual liberalization."[103] In effect, this principle obligates the parties to work together to find new possibilities for reducing barriers to trade and investment in the future. Mexico's reservation of its energy sector to itself is clearly the most significant limitation of the NAFTA's provisions on energy. The other provisions, while quite limited in immediate effect, nev-

97. *See* USCFTA, *supra* note 10, ch. 9. For exposition and commentary on the energy provisions of the U.S.-Canada Free Trade Agreement, the following may be helpful: U.S. Department of Energy & U.S. Trade Representative, *Analysis of Chapter Nine of the U.S.-Canada Free Trade Agreement, Concerning Trade in Energy* (May 1988); Andre Plourde, *Canada's International Obligations in Energy and the Free Trade Agreement with the United States*, 24 J. WORLD TRADE 35 (Oct. 1990); Shelly P. Battram & Reinier H. Lock, *The Canada/United States Free Trade Agreement and Trade in Energy*, 9 ENERGY L. J. 327 (1988); Philip H. Davies, *Marketing Natural Gas: Canadian Overview* 28 ALBERTA L. REV. 82 (1990); Douglas F. John, *Marketing Alberta Natural Gas in the United States after the Free Trade Agreement: Negotiating the U.S. Regulatory Maze*, 94 ALBERTA L. REV. 94 (1990); Dennis Stickley, *Toward the Integration of Canadian and United States Natural Gas Import Policies*, 25 LAND & WATER L. REV. 145, pts. 1, 2 (1990). Canadian energy policies are also considered in Conine, *supra* note 13, at 622-60.

98. There is no comparable section on principles in the Energy Chapter of the U.S.-Canada Free Trade Agreement. *See* USCFTA, *supra* note 10, ch. 9.

99. NAFTA, *supra* note 1, art. 601.

100. *Id.* para. 1.

101. *Id.* para. 2.

102. *Id.* para. 3.

103. *Id.* para. 2.

ertheless represent substantial progress in liberalizing energy trade and investment.

C. *The Scope of the Energy Provisions*

The chapter on "energy and basic petrochemicals" applies to "measures"[104] related to these goods "originating in the territories of the parties"[105] and "to measures relating to investment and to cross border trade in services associated with such goods, as set forth in this Chapter."[106] The definition of energy is comprehensive, but somewhat narrower than that under the US-Canada Free Trade Agreement.[107] Included within the scope of the Agreement are such solid fuels as coal, coke, and peat, such liquid fuels as crude oil, gasoline, jet fuel, and liquified petroleum gas, and such gaseous fuels as natural gas, coal gas, and liquified natural gas, electricity,[108] and nuclear fuels.[109] At the same time, the exceptions excluding products from the definition and, therefore, from coverage are minor. The scope of the energy provisions has another dimension, almost unprecedented in multilateral trade agreements,[110] a fact even more true for the

104. "Measure" is defined in the NAFTA to include "any law, procedure, requirement, or practice." *Id.* art. 201, para. 1.

105. "Originating" is defined to mean "qualifying under the rules of origin set out in Chapter Four (Rules of Origin)," and "territory" means "for a Party the territory of that Party as set out in Annex 201.1." *Id.* art. 201. The Rules of Origin determine where a good is considered to have been produced. Essentially the rules of origin provide that a good is produced where it is wholly obtained or produced entirely, or where each of the non-originating materials used in the production of the good has undergone an applicable change in tariff classification. *Id.* art. 401.

106. *Id.* art. 602, para. 1.

107. NAFTA uses the Harmonized Commodity Description and Coding System, as published by the Customs Cooperation Council. In the USCFTA, the scope of coverage of Chapter 9, concerning energy, is somewhat broader in that it specifically includes all of Chapter 27 of the Harmonized Schedule except headings 2707 and 2712. USCFTA, *supra* note 10, art. 901.

108. It has not been clear whether or not electricity is a "product" included within such major GATT provisions such as Articles I, II, III and XI. Plourde, *supra* note 97, at 36-37.

109. NAFTA, *supra* note 1, art. 602, para. 1.

110. A theoretical example of a multilateral trade agreement with the breadth to cover trade in services and transnational investment is the Treaty of Rome, the founding document of the European Economic Community. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY]. However, in contrast to the NAFTA, which is strictly a free trade agreement, the Treaty of Rome not only establishes a customs union within the meaning of the GATT, art. XXIV, para. 8, but also contemplates the development of "an ever closer union," EEC TREATY, pmbl. The Treaty of Rome, organized around the four principles of free movement of goods, services, capital, and people (id., arts. 3(a)-(c), 9-37, and 48-73), contains provisions creating a Commission that supervises a 12,000-employee bureaucracy, a Council of Ministers from the Member States, European Parliament, and a European Court of Justice (*id.* arts. 137-198), and includes articles providing for Community policies in the areas of competition (*id.* arts. 85-91), agriculture (*id.* arts. 38-47), transportation (*id.* arts. 74-84), economic and monetary union (*id.* art. 102(a)), social policy (*id.* arts. 117-128), economic and social cohesion (i.e., regional assistance) (*id.* arts. 130(a)-130(e)), research and technological development (*id.* arts. 130(f)-130(q)), and the environment (*id.* arts. 130(r)-130(t)), all of which extend its scope far beyond the bounds of the broadest trade agreement. From the very conception of the European Community, many Europeans have favored the idea of a federal political union. PAUL JOAN GEORGE KAPTEYN & PIETER H. VERLOREN VAN THEMAAT, INTRODUCTION TO THE LAW OF THE EUROPEAN COMMUNITIES 1-4, 21-28 (Lawrence W. Gormley ed. 1989); WALTER LAQUEUR, EUROPE IN OUR TIME 116-125 (1992). However, whether the European Community should evolve into a federal union or

NAFTA as a whole. The NAFTA addresses two topics relatively new to trade agreements: trade in services and transnational investment. In this respect, the NAFTA is substantially broader than the original General Agreement on Tariffs and Trade, which addresses only trade in goods, and achieves a breadth of application that the global trade and investment regulations are approaching only in the current Uruguay Round of multilateral trade negotiations. In some respects, the provisions of the NAFTA are much more advanced than the results that can be expected from a successful Uruguay Round.[111] At the same time, the progress achieved on energy was very limited. Even so, energy will remain, in a living, growing NAFTA, a topic of discussion, diplomacy, and negotiation in this much more broadly defined context. Both the progress and the limitations can be found in the specific provisions of the NAFTA chapter on energy and the Mexican reservations to its scope and coverage.

D. The Mexican Reservations as to Scope and Coverage

The most important exception in the chapter on energy is the reservation[112] of these "strategic activities" to the Mexican State.[113] The Mexican State reserves to itself exploration and exploitation of crude oil and natural gas; refining or processing of crude oil and natural gas; and the production of artificial gas, basic petrochemicals, and their feed stocks and pipelines.[114] Also reserved are foreign trade, transportation, storage, distribution,

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remain essentially an economic entity remains a controversial issue. *See, e.g.*, MARGARET THATCHER, THE DOWNING STREET YEARS 727-728, 742, 759-763, 814-815 (1993) *and* AXEL KRAUSE, INSIDE THE NEW EUROPE 240-250, 322 (1991). Therefore, although it is technically a trade agreement, the Treaty of Rome is also an agreement on a wide range of economic matters and possibly a constitution for a nascent federal Europe, and it is highly questionable to cite its provisions on free movement of services and capital, or their effect on the EEC TREATY's scope, as precedents for functionally equivalent provisions in any other trade agreement.

111. Hufbauer and Schott state that the investment provisions of the NAFTA provide a "useful model" for future GATT trade accords and that these provisions are "far superior" to the results produced in the TRIM (Trade Related Investment Measures) negotiations in the Uruguay Round. They recommend that the TRIM's negotiators replace those results with an investment code based on the NAFTA. HUFBAUER & SCHOTT, NAFTA: AN ASSESSMENT, *supra* note 1, at 3, 84. With regard to intellectual property, they say that the NAFTA has become the benchmark by which the Uruguay Round and other international trade negotiations will be measured. *Id.* at 90. *See* Charles S. Levy & Stuart M. Weiser, *The NAFTA: A Watershed for Protection of Intellectual Property*, 27 INT'L L. 671 (1993).

112. A reservation, a common device in multilateral treaties, is a unilateral statement made by a Government by which it excludes or modifies the effect of certain provisions of the treaty or other unilateral agreement in their application to that Government. ROBERT L. BLEDSOE & BOLESLAW A. BOCZEK, INTERNATIONAL LAW DICTIONARY 264 (1987). Reservations must be distinguished from other statements, such as understandings, interpretive declarations, and political assertions, that are not intended to have a legal effect. M.N. SHAW, INTERNATIONAL LAW 468 (1986). The principal problems with reservations arise where in a multilateral treaty a party attempts to make a reservation not accepted by the other signatories, a problem not present in the NAFTA. *See* BLEDSOE & BOCZEK, *supra*, at 264-67; SHAW, *supra* 467-72; *and* JOSEPH M. SWEENEY ET. AL., THE INTERNATIONAL LEGAL SYSTEM 967-79 (1981).

113. North American Free Trade Agreement Annex, Mar. 1993, U.S.-Can.-Mex., Annex 602.3 para.1, 32 I.L.M. 289 (1993) [hereinafter NAFTA, Annex].

114. *Id.* para. 1(a).

including the "first-hand sales" (that is, the first commercial transaction affecting the good in question,[115] of such products as crude oil, natural and artificial gas, goods obtained from the refining or processing of crude oil and natural gas), and basic petrochemicals.[116]

The Mexican government also reserved to itself the supply of electricity as a public service in Mexico, including the generation, transmission, transformation, distribution, and sale of electricity.[117] Finally, it reserved to itself exploration, exploitation, and processing of radioactive materials, the nuclear fuel cycle, the generation of nuclear energy, the transportation and shortage of nuclear waste, the use and reprocessing of nuclear fuel and the regulation of their applications for other purposes, and the production of heavy water.[118] The reservation, however, does not include coal and related products.[119] The reservation includes investment in strategic activities and the provision of services therein.[120] Clearly, the most important consequence of the reservation is that foreign investment in the Mexican petroleum industry will continue to be impossible so long as Mexico maintains the reservation.[121] If these reservations conflict with other provisions of the Agreement, then the reservations prevail to the extent of the inconsistency.[122]

Although the Agreement provides the protection of the national treatment principle for investments across the borders of the parties,[123] private investment is not permitted in the activities to which these reservations apply.[124] The provisions of the Agreement on services apply to the activities covered by the reservations only when Mexico permits a contract to be

115. NAFTA, *supra* note 1, art. 609 (definition of "first-hand sale").

116. NAFTA, Annex 602.3 para. 1(b), *supra* note 113.

117. *Id.* para. 1(c), *supra* note 113.

118. *Id.* para. 1(d).

119. *See id.*

120. President Salinas has been quoted to the effect that Mexico will need US $ 30 billion to develop its petroleum industry in the years 1991-1995. K. Shawn Kirksey, Comment, *Energy and Free Trade: A New Look at the Current Needs of Mexico's Petroleum Industry*, 28 TEX. INT'L L. J. 539, 541 (1993).

Hufbauer and Schott, economists at the Institute for International Economics, state that while Canada and the United States would benefit from relaxation of the restrictions on energy, Mexico would gain the most. HUFBAUER & SCHOTT, NAFTA: AN ASSESSMENT, *supra* note 1, at 34.

Murphy, who believes that foreign investment may be precisely what is needed to reverse the decline in the Mexican hydrocarbon industry, proposes the use of a subsidiary state corporation to act as a trustee for foreign investors, who would have beneficial trustee rights (*derechos de fideicomisario*) as determined by Mexican law. Ewell E. Murphy, *The Dilemma of Hydrocarbon Investment in Mexico's Accession to the North American Free Trade Agreement*, 9 J. ENERGY & NAT. RESOURCES L. 261, 271-72 (1991).

121. NAFTA, Annex 602.3, *supra* note 113.

122. *Id.*

123. NAFTA, *supra* note 1, art. 1102, para. 2 provides that each party must "accord to investments of investors of another Party treatment no less favorable that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." *Id.* 1, art. 1102, para. 2.

124. NAFTA, Annex 602.3, para. 2, *supra* note 113.

granted in respect of such activities and only to the extent of that contract.[125]

However, the reservation provides that the parties must permit end-users and suppliers of natural gas, together with any relevant state-owned enterprise, to negotiate supply contracts when those suppliers consider that such contracts may be in their interest.[126] The parties are required to leave the modalities of the implementation of such contracts to the end-users, suppliers, and any state enterprise of the party.[127] The modalities of implementation may take the form of individual contracts between the state enterprises and each of the other entities and be subject to regulatory approval.[128] Each party is required to allow its state enterprises to negotiate performance clauses in its service contracts.[129]

It should be noted that the reservations exclude the activities of Mexico's state energy enterprises, but do not exempt the entire subject of energy from the rules of the NAFTA.[130] The Agreement implicitly recognizes this aspect of the reservation, *inter alia*, by including additional reservations pertaining to energy.[131] It is also implicitly recognized in the provision that stipulates that reservation is to prevail if other provisions of the NAFTA conflict with it in particular applications.[132] The implications of this reservation in practice will be determined by experience under the NAFTA.

It seems that the reservation is carefully crafted to protect Mexico's historic political interest in preserving its sovereign control over the petroleum industry. Since the reservation is essentially a unilateral act accepted by the other parties to the Treaty, Mexico remains free to reduce the scope of its reservation at any time, to the extent its interests may require and its political necessities may permit. It is difficult to forecast, at this time, what needs might lead Mexico to follow this course of action. The most important aspect of the reservation is not that Mexico wishes to exclude PEMEX from the disciplines of open international trade, but rather that the other parties to the NAFTA must respect the unique role of this state-owned enterprise in Mexico.

In the United States, these reservations have caused great disappointment to participants and observers of the negotiations. That Mexican history suggests that these reservations were inevitable provides little consolation to those who were hopeful that the ideals of a free and open international economy could be made applicable to energy trade and investment throughout the North American continent. Yet the whole of the Agreement does offer important commitments for trade and invest-

125. *Id.*
126. *Id.* para. 3.
127. *Id.*
128. *Id.*
129. *Id.* para. 4.
130. *See generally* NAFTA, Annex 602.3, *supra* note 113.
131. *See* text *infra*, notes 200-14.
132. NAFTA, Annex 602.3, *supra* note 113, para. 1(d).

ment in energy. In addition to the general principles the NAFTA establishes for energy, these additional commitments can be found in the more specific rules of the chapter on energy.

E. Import and Export Restrictions

The parties, all contracting parties to the General Agreement on Tariffs and Trade, reaffirmed their commitment to the GATT principles with respect to energy by stating that they "incorporate the provisions of the [GATT] with respect to prohibitions or restrictions on trade in energy and basic petrochemical goods."[133] This provision is a specific application of a rule more generally applicable to all goods.[134] Essentially, the most important provisions of the GATT concern the granting to all other contracting parties of the GATT "most-favored-nation" advantages with respect to customs duties and charges,[135] the sharing of negotiated bound tariff rates among all the GATT parties,[136] national treatment with respect to internal regulations and taxes,[137] the general elimination of all quantitative restrictions,[138] and other commitments regarding non-tariff barriers.[139]

Of these GATT commitments, the most significant for energy is that of national treatment. The result of these provisions is that none of the parties will be able to discriminate in their enacted laws and regulations on the basis of the national origin of the energy goods.[140] Such discrimination could otherwise take a variety of forms, but examples relevant to energy include requirements that portions of a product originate domestically, discriminatory internal taxes, and prohibition of marketing foreign oil or coal to domestic buyers.[141] Imports into one country must be accorded treatment no less favorable than the treatment given similar domestic products in the laws, regulations, and other requirements concerning their sale, distribution, or use.[142] Requirements that specific proportions of the product

133. NAFTA, *supra* note 1, art. 603, para. 1. This provision is similar to Article 902 of the USCFTA, in which Canada and the United States reaffirm their rights and obligations under the GATT with respect to energy goods. USCFTA, *supra* note 10, art. 902. "Restriction" is defined to mean "any limitation, whether made effective through quotas, licenses, permits, minimum or maximum price requirements[,] or any other means." NAFTA, *supra* note 1, art. 609.

134. *See* NAFTA, *supra* note 1, art. 309, para. 1. This use of parallel articles providing national treatment for all goods and for energy goods originated in the USCFTA. *Compare* USCFTA, arts. 407, 408, 409 *and* arts. 902, 903, & 904. These obligations with respect to energy goods were not in any way more onerous than those for goods in general. *See id.* Essentially, in the USCFTA negotiations, agreement was reached on these principles with respect to energy goods earlier in the negotiations and then extended to all goods in general. It was evidently useful to emphasize the importance of these provisions with respect to energy goods, and that practice was followed in the NAFTA as well.

135. GATT, *supra* note 8, art. II.

136. *Id.*

137. *Id.* art. III.

138. *Id.* art. XI.

139. *See generally* GATT, *supra* note 8.

140. For comment on analogous provision in USCFTA, *see* Department of Energy-United States Trade Representatives, Memorandum, at 5 [hereinafter DOE-USTR, Memo].

141. Battram & Lock, *supra* note 97, at 352.

142. *See* USCFTA, *supra* note 10, *and* for comment an analogous provision *see* DOE-USTR, Memo, *supra* note 140, at 5. For natural gas, two major actions of the Federal Energy Regulatory

be from domestic sources are prohibited by the National Treatment Principle.[143] However, under the rules which the NAFTA incorporates from the GATT, these provisions do not apply to governmental procurement or to subsidies by governments.[144]

In addition, the parties were careful to emphasize that the GATT provisions prohibit minimum or maximum export price requirements[145] or minimum or maximum import price requirements in any of the circumstances[146] in which any other form of quantitative restrictions would be prohibited.[147] However, this reaffirmation of existing obligations under the GATT cannot be treated as merely a reiteration of existing obligations, since their incorporation into the NAFTA provides the parties with the remedies and other procedures the NAFTA affords to its respective parties.

It should be noted that these important GATT principles are subject to waivers, exceptions, and other limitations. For the energy industries, one of the most important exceptions has been that of Article XXI, which provides that nothing in the GATT will prevent "any contracting party from taking any action which it considers necessary for the protection of its essential security interests relating to fissionable materials . . . [or] relating . . . to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment."[148] Recent history has provided situations in which such leading powers as the United States, joining with allies and other supporting nations, have imposed economic sanctions for political reasons, for example, the sanctions against

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Commission evidently regarded by the U.S. Government as being consistent with the proscriptions against discriminatory regulatory actions are: Order No. 500, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 52 Fed. Reg. 30,334 (1987) (codified at 18 C.F.R. pts. 2, 284); and Opinion No. 256, Natural Gas Pipeline Co. of America, 37 F.E.R.C. ¶ 61,215 (1986). *See also* Battram & Lock, *supra* note 97, at 352.

143. *See* Battram & Lock, *supra* note 97, at 352 for comment on analogous provision in USCFTA.

144. "The provisions of this Article [Article III] shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale." GATT, *supra* note 8, art. III, para. 8(a). Subsidies are addressed in Article III, para. 8(b).

145. The GATT provides that no prohibitions or restrictions may be instituted or maintained by any contracting party on the importation or exportation of goods with respect to another contracting party except by means of "duties, taxes or other charges." *Id.* art. XI, para. 1. According to Professor Jackson, it was evidently the intent of the drafters to complement the limited permissibility of customs duties and charges under Article II. JACKSON, *supra* note 8, at 315. Therefore, the governments who are contracting parties may not maintain maximum or minimum prices. However, other articles of the GATT provide for exceptions to the rules of Article XI. *See, e.g.*, GATT, *supra* note 8, arts. XII, XX, XXI.

146. This reference to the circumstances in which any form of quantitative restriction is prohibited excludes those circumstances in enforcing quantitative restrictions for purposes permitted by the GATT, such as those applied for balance of payments purposes. *See* GATT, *supra* note 8, art. VII.

147. NAFTA, *supra* note 1, art. 603, para. 2. *See also* USCFTA, *supra* note 10, art. 902, para. 2.

148. *Id.* art. XXI, para. (b). Professor Jackson points out that Article XXI may shelter some protectionist measures that are ostensibly imposed for security reasons. Oil quotas maintained by the United States were cited by Professor Jackson as a measure which has been labeled a security measure and considered by many to be protectionist in nature. JACKSON, *supra* note 8, at 752.

Libya[149] and more recently those imposed against Iraq. The Agreement therefore recognizes that there may be circumstances in which a party imposes restrictions on importation or exportation of energy products with respect to a country that is not a signatory to the Agreement.[150] In that event, a party is permitted to prohibit or limit the importation of energy products from the territory of another party where the energy products had been imported from a country outside the NAFTA.[151] In similar circumstances, a party is also permitted to require as a condition of export of such energy or petrochemical good that the product be consumed within the territory of the other party.[152]

If a party adopts or maintains restrictions on the importation or exportation of an energy or petrochemical good with respect to countries that are not parties, any party may request consultations to prevent such restrictions from creating distortion or undue influence with pricing, marketing, or distribution arrangements in any other party.[153] This provision originated in the U.S.-Canada Free Trade Agreement to address the economic problems that would be created by the imposition of such measures as oil import fees.[154] Because it would be difficult to predict the consequences of such measures unless both the measure and the situational context were specified, in the U.S.-Canada negotiations it was decided to provide for consultations at the time of the imposition of such measures.[155] This solution was particularly advantageous since neither party to that agreement could foresee at the time of the negotiations any circumstances that would lead to such measures.[156] These considerations continued to be apposite for these provisions in the NAFTA.

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149. As stated in the joint memorandum by the Department of Energy and the Office of the United States Trade Representative, the comparable provision in the U.S.-Canada Free Trade Agreement (art. 902, para. 3) meant that the United States could continue to implement its prohibitions against the importation of Libyan or Iranian crude oil as well as continues its sanctions against the importation of South African uranium without violating that Agreement. DOE-USTR, Memo, *supra* note 140, at 7-8.

150. NAFTA, *supra* note 1, art. 603, para. 3. *See also* USCFTA, *supra* note 10, art. 902, para. 3.

151. NAFTA, *supra* note 1, art. 603, para. 3. *See also* USCFTA, *supra* note 10, art. 902, para. 3(a).

152. NAFTA, *supra* note 1, art. 603, para. 3(b). *See also* USCFTA, *supra* note 10, art. 902, para. 3(b). "Consumed" means "transformed so as to qualify under the rules of origin set out in Chapter Four [of NAFTA] (Rules of Origin), or actually consumed." NAFTA, *supra* note 1, art. 609. These definitions are essentially the same as those found in the USCFTA. These provisions permitted the United States to continue to impose requirements that crude oil exported to Canada be consumed in Canada. *See* Exports of Crude Oil to Canada for Consumption or Use Therein, 50 Fed. Reg. 26,145 (1985) (codified at 15 C.F.R. pt. 377).

153. NAFTA, *supra* note 1, art. 603, para. 4.

154. *See* USCFTA, *supra* note 10, art. 902 (3) *and* DOE-USTR, Memo, *supra* note 140, at 7-8. The historical background of the oil import quota program through 1969 is given in CARL H. FULDA & WARREN F. SCHWARTZ, REGULATION OF INTERNATIONAL TRADE AND INVESTMENT 306-363 (1970).

155. DOE-USTR, Memo, *supra* note 140, at 9.

156. The Reagan Administration, which negotiated the USCFTA, was very clearly opposed to the imposition of oil import fees and had no overwhelming pressures to impose them. Although some in the oil industry wanted oil import fees as a solution to the low oil prices that discouraged drilling in the middle 1980s, the industry was far from united on the issue.

Under the chapter on energy, each party is permitted to administer a system of import or export licensing for energy or basic petrochemical goods, if the system is operated in a manner consistent with the provisions of the Agreement.[157] The provisions here particularly cite the Agreement's commitment to the principles and provisions of the GATT and the Agreement's provisions on Monopolies and State Enterprises.[158] However, the Mexican government reserved to itself the right to restrict the granting of import and export licenses for crude oil, natural gas, and a large number of other petroleum products.[159] The sole purpose was to reserve foreign trade in those goods to itself.[160] This reservation was necessary in order for the Mexican government to prevent private entities from conducting international trade in energy products.

F. Permissible Export Restrictions

Despite these limitations, the Agreement permits a party to adopt export restrictions under certain carefully defined circumstances.[161] However, the circumstances under which they may be adopted are severely limited in comparison to the prior possibilities under applicable GATT law. First, the restriction must be justified under the applicable articles of the GATT.[162] Those articles restrict the use of quantitative restrictions to those situations in which they are applied temporarily to relieve critical shortages of products essential to the exporting party or to enforce measures undertaken for reasons related to domestic shortages or other adverse economic conditions. Secondly, the restriction must not reduce the proportion of total export shipments of the specific energy or basic petrochemical good made available to that other party, relative to the total supply of that good provided by the party maintaining the restriction available in the rep-

157. NAFTA, *supra* note 1, art. 603, para. 5.

158. *Id.*, art. 1502.

159. These included schedule numbers 2707.50; 2707.99; 2709; 2710; 2711; 2712.90; 2713.11; 2713.20; 2713.90; 2714; and 2901.10. NAFTA, Annex 603.6, *supra* note 113.

160. *Id.*

161. NAFTA, *supra* note 10, art. 605. *See also* USCFTA, *supra* note 48, art. 904.

162. *Id.* The GATT, Article XI, paragraph 2, provides for exceptions for prohibitions or restrictions necessary to prevent or relieve shortages of foodstuffs or other products essential to the exporting party, import or export restrictions necessary to the classification, grading, or marketing of commodities in international trade; and important restrictions on any agricultural or fisheries product in any form necessary to the enforcement of governmental measured for certain specified purposes. Another GATT article provides that, where the measures are not applied in a manner which would constitute a means or arbitrary or unjustified discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, contracting parties are permitted to adopt or enforce measures relating to the conservation of exhaustible natural resources if such measures are made in conjunction with restrictions on domestic production or consumption [GATT art. XX(g)]; measures undertaken in pursuant of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the contracting parties and not disapproved by them [GATT art. XX(h)]; and measures involving the restriction on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry at a time when the domestic price is held below world level as part of a domestic stabilization plan [GATT art. XX(i)]. GATT *supra* note 8, art. XX.

resentative period.[163] Thirdly, the party must not impose a higher price for exports of any such good to the other party than the price charged when consumed domestically.[164] In particular, measures such as licenses, fees, taxation, and minimum price requirements may not be used.[165] Fourthly, the restriction must not require the disruption of normal channels of supply to that other party, nor may the restriction require the disturbance of normal proportions among the specified energy or basic petrochemical goods supplied to that other party, for example, between crude oil and refined products and among different categories of crude oil and of refined products.[166] However, these provisions do not apply to relations between the other parties and Mexico because of its individual reservation.[167] Therefore, so long as Mexico continues its reservation, they essentially incorporate and continue existing obligations under the U.S.-Canada Free Trade Agreement.[168]

However, these provisions represent a significant reduction in the scope of the exceptions permissible under the GATT.[169] Undoubtedly, these further restrictions were possible in part because the GATT principles were to be applied to a more narrow category of trade and to a smaller number of countries. Here, the restrictions must not only comply with the GATT law but also with the three concurrent conditions added by the Agreement. However, unless Mexico decides to alter its reservation to this article, this provision represents merely a continuation of obligations already obtained in the negotiations for the U.S.-Canada Free Trade Agreement.

G. Export Taxes

The Agreement prohibited, without condition, qualification, or reservation, the adoption or maintenance of any duty, tax, or other charge on the export of any energy or basic petrochemical good to the territory of another party, unless such duty, tax, or charge is adopted or maintained not only on exports of any such good to the territory of all other parties, but also on such goods when destined for domestic consumption.[170] This prohi-

163. The representative period is the period that compares to the proportion prevailing in the most recent thirty-six month period for which data are available prior to the importation for the measure or such other representative period on which the parties may agree. NAFTA, *supra* note 1, art. 605(a).

For comments on the comparable provision in the U.S.-Canada Free Trade Agreement, sometimes called the "proportional access clause," *see* Plourde, *supra* note 97, at 51-54.

164. This restriction does not apply to a higher price that may result from a measure taken pursuant to paragraph (b) that only restricts the volume of exports. NAFTA, *supra* note 1, art. 605(b).

165. *Id.*

166. *Id.* para. (c).

167. NAFTA, Annex 605, *supra* note 113.

168. *Compare* USCFTA, *supra* note 10, art. 904, *with* NAFTA, *supra* note 1, art. 605.

169. In commenting on the comparable provisions in the U.S.-Canada Free Trade Agreement, the U.S. executive branch stated, "[t]he effect is to strictly limit the ability of either Party to disrupt its energy exports to the other Party. The narrowing of these exceptions, together with the narrowing of the GATT's 'national security' exception in Article 907, represents a major benefit for U.S. energy security." DOE-USTR, Memo, *supra* note 140, at 13.

170. NAFTA, *supra* note 1, art. 604. *See also* USCFTA, *supra* note 10, art. 903.

bition affects the public policies only of Canada and Mexico, since the United States Congress is prohibited from imposing export taxes by the United States Constitution.[171] Such export taxes would be equivalent to minimum export price requirements, which are elsewhere prohibited in the Agreement.[172] This prohibition imposes an obligation on the three parties beyond their obligations as contracting parties of the GATT, since the GATT does not forbid export taxes.[173]

H. Energy Regulatory Measures

The parties recognized that energy regulatory measures are subject to the disciplines of national treatment, import and export restrictions, and export taxes.[174] Energy regulatory measures are defined as "any measure by federal or sub-federal entities that directly affects the transportation, transmission or distribution, purchase or sale, of an energy or basic petrochemical good."[175] In particular, energy regulatory measures must observe the GATT discipline of national treatment generally applicable among the three parties that arose initially from their respective GATT participation and was renewed in the NAFTA.[176] In addition, the parties must seek to ensure that their domestic regulatory bodies avoid the disruption of contractual relationships as much as possible and provide for the orderly implementation of regulatory measures.[177] These provisions are

171. U.S. CONST. art. I, § 9, cl. 5.

172. NAFTA, *supra* note 1, art. 603, para. 2.

173. Article XI of the GATT, the provision most generally applicable against the contracting parties' export measures, specifically excludes taxes, and Article II contemplates schedules of concessions on tariffs only with respect to imports. *See* GATT, *supra* note 8, arts. II, para. 1(b) & XI.

Canada imposed export taxes on energy in the 1970s. *See* DOE-USTR, Memo, *supra* note 140, at 12.

174. NAFTA, *supra* note 1, art. 606.

175. *Id.* art. 609.

176. *Id.* art. 606. The National Treatment standard for the NAFTA incorporates certain provisions from the GATT. NAFTA, *supra* note 1, art. 301. The national treatment principle is extended to states and provinces by providing "treatment no less favorable than the most favorable treatment accorded by such state or province to any like, directly competitive or substitutable goods, as the case may be, of the Party of which it forms a part." *Id.* art. 301, para. 2. The National Treatment standards in the GATT essentially provide that the products of any contracting party imported into the territory of another contracting party must be "accorded treatment no less favorable than that accorded to like products of national origin with respect to all laws, regulations and requirements affecting their internal sale, purchase, transportation, distribution or use." GATT, *supra* note 8, art. III, para. 4. *See also id.* art. III. para. 1 (indicating that regulations must not be used to afford domestic products protection) *and id.* art. III, para. 5 (prohibiting internal quantitative restrictions imposed by regulation on private purchasers).

177. NAFTA, *supra* note 1, art. 606, para. 2. This provision addresses a long-standing concern, initially raised in the negotiations for the U.S.-Canada Free Trade Agreement, that regulatory agencies could overturn commercial contract provisions. Despite advocacy of "sanctity of contract," negotiators recognized that it would be impossible in the context of an international trade agreement to guarantee that provisions in contracts would not be overridden by subsequent regulatory decisions. Moreover, such a provision, though facially neutral, might have discriminatory effects. However, it was recognized at that time that national regulatory systems could cause distortions in bilateral energy trade. The solution in the U.S.-Canada Free Trade agreement was merely to create a special consultation process. DOE-USTR, Memo, *supra* note 140, at 17.

likely to have their greatest effects on the natural gas[178] and electricity industries.

This NAFTA article succeeds a provision of the U.S.-Canada Free Trade Agreement that addressed concerns about energy regulatory actions that would result in discrimination against imported energy goods inconsistent with the principles of the U.S.-Canada agreement. The Free Trade Agreement with Canada essentially provided for consultation.[179] However, the NAFTA's provision represents an advance over that accord in addressing these problems more substantively.[180]

Both the language[181] and the history[182] of this provision indicate that this provision addresses not merely facially discriminatory regulations, but far more importantly, regulations with implicit or unintended discriminatory effects. The article in the U.S.-Canada Free Trade Agreement from which it was derived arose from discussions among the negotiators concerning the two countries' respective regulatory practices,[183] and particularly Opinion 256 issued by the U.S. Federal Energy Regulatory Commission.[184] However, the history suggests this prior provision was intended to address discrimination that directly results from regulatory measures; evidently, discrimination not directly resulting from such measures would not be included.[185] Even with this limitation, the implications of this reinforcement of the national treatment principle are undoubtedly

178. With regard to natural gas, Conine contends that natural gas could be a more significant item of trade between Mexico and the United States, that the usual barriers of tariffs and import quotas have never been major obstacles to trade in natural gas, and that governmental decisions the terms of such transactions are the most common impediments. Conine, *supra* note 13, 622-23. He examines four options for eliminating these barriers, *id.* at 674-84, and concludes that the negotiation of a free trade agreement is probably the best of the four, *id.* at 680. Although the NAFTA as negotiated only partially solves the problems that Conine has presented with regard to natural gas, it does provide a forum and a process for pursuing the general commitment to sustained, gradual liberalization as it applies to natural gas.

179. USCFTA, *supra* note 10, art. 905, para. 1. As between the United States and Canada, this provision for consultation continues to apply, since the NAFTA does not abrogate the U.S.-Canada Free Trade Agreement. *See* NAFTA, *supra* note 1, arts. 101-105, 2201-2206. However, the NAFTA provisions prevail as between Canada and the United States in the case of conflict. *Id.* art. 103, para. 1.

180. The Department of Energy noted this point in its comments on the prior comparable section of the U.S.-Canada Free Trade Agreement, DOE-USTR, Memo, *supra* note 140, at 18.

181. In particular, the second paragraph, which guarantees that each party will seek to "avoid disruption of contractual relationships" and "provided for orderly and equitable implementation" of regulatory measure," NAFTA, *supra* note 1, art. 606, para. 2, clearly demonstrate concern over the impact of regulatory measure within natural gas markets. The first paragraph incorporates by reference the parties' commitments under Article III of the GATT to treat imported products no less favorably in "all laws, regulations, and requirements affecting their internal sale, offering for sale, purchase, transportation, or distribution, or use." *Compare id.* para. 1, *with* GATT, *supra* note 8, art. III, para. 4. The use of the term "affecting" indicates a broad application to cover any measure that might "adversely modify" conditions of competition between domestic and imported products. JACKSON, *supra* note 8, at 288.

182. DOE-USTR, Memo, *supra* note 140, at 15-19.

183. *Id.* at 17.

184. Opinion 256, 37 F.E.R.C. ¶ 61,215.

185. *Id.* at 16.

numerous.[186] This result is particularly true for the natural gas industry with its complex interaction of law and economics. Because the three parties to the NAFTA may address the same economic problems differently,[187] unintended distortions with discriminatory effects may need to be addressed pursuant to this article. The movement toward deregulation, particularly with regard to natural gas in the United States and Canada,[188] may tend to alleviate some of these consequences, but the potential for economic distortion will linger. It is fortunate that the NAFTA addresses these problems, even if only with general principles, and provides a forum for their resolution.

I. National Security Measures and other Provisions

The Agreement prohibits the adoption or maintenance of measures restricting imports or exports of energy or basic petrochemical goods among the parties for the purpose of protecting national security unless specified conditions are met.[189] However, this article, which is continued from the U.S.-Canada Free Trade Agreement,[190] confers no rights nor imposes any obligations on Mexico.[191] This prohibition governs the relationship even where such measures are permitted under Article XXI of the GATT, the GATT's major provision for a national security exception, or Article 2102 of the NAFTA, its own general national security exception.[192] However, the parties are permitted to have such restrictions where they are necessary to supply a military establishment, or to permit fulfillment of a critical defense contract of a signatory government, to respond to a situation of armed conflict involving the party taking the measure, to implement national policies or international agreements relating to the non-prolifera-

186. *See generally* Stickley, *supra* note 97.

187. Stickley shows that in the transportation of natural gas, the Canadian government has used a rate design providing a "straight" division into fixed and variable costs, the former assigned to the demand charge paid by the customer regardless of the volume of purchase and the latter to the commodity charge paid on the basis of volume purchased, a type of rate structure that has not been used in the United States for several decades. The United States, however, has assigned a portion of the fixed costs to the commodity charge, but its policies on rate design for transportation of natural gas have been evolving. Stickley suggests that these differences will have an impact on Canadian exports of natural gas to the United States. *Id.* at 355, 360-62. Conine states that Mexico's state-enterprise operated system produces "decisions that are more restrictive" than those in Canada and the United States. Conine, *supra* note 13, at 664.

188. *See generally* Stickley, *supra* note 97.

189. NAFTA, *supra* note 1, art. 607.

190. *See id.* While recognizing the fundamental importance of energy to national security, Canada and the United States concluded at the time of the negotiations for their bilateral trade agreement that the agreement, together with "their friendship, proximity, and close defense relationship" (e.g., their common membership in the North Atlantic Treaty Organization, *inter alia*), meant that the much broader exception provided in the GATT "was no longer appropriate and could even be detrimental . . . to the energy security of each." DOE-USTR, Memo, *supra* note 140, at 24. In the past, protectionist and nationalist policies had "inhibited trade, discouraged development, and exacerbated shortages." *Id.* at 25. The elimination of many restrictive regulations by both parties made a more narrow exception for national security not merely possible, but positively beneficial. *See id.*

191. NAFTA, Annex 607, para. 1, *supra* note 113.

192. NAFTA, *supra* note 1, art. 607.

tion of nuclear weapons or other nuclear explosive devices, or to respond to threats of disruption in the supply of nuclear materials for defense purposes.[193] The NAFTA has more general provisions on National Security;[194] however, the provisions on national security in the chapter on energy prevail over these more general provisions.[195] It should be noted that while all three parties remain bound to their GATT obligations and therefore confined to the restrictions of Article XXI of the GATT, the parties have simultaneously limited the use of measures restricting exports and imports.

The parties also agreed that they would allow existing or future incentives for oil and gas exploration, development, and related activities in order to maintain the reserve base for these energy resources.[196] These provisions specifically contemplate governmental incentives,[197] such as tax exemptions or favorable tax treatment for certain investments, or subsidies.[198]

The United States and Canada agreed to preserve the existing provisions of the U.S.-Canada Free Trade Agreement, to act in accordance with the terms of certain provisions,[199] and to incorporate those provisions into NAFTA.[200] However, these provisions do not apply to Mexico, on which they neither confer rights nor impose obligations.[201] Both signatories to the Agreement on an International Energy Program,[202] Canada and the

193. *Id.*

194. *Id.* art. 2102. This article utilizes the language of Article XXI of the GATT for the most part. However, it deletes the language that provides for the protection of interests "relating to fissionable materials or the materials from which they are derived" and substitutes "relating to national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices. . . ." *Compare* GATT, Art. XXI *with* NAFTA art. 2102. Arguably, the language in the NAFTA is more narrow, since it focuses the meaning on proliferation concerns and therefore excludes actions related to the non-military uses of nuclear materials. It should be noted that, at the time of the negotiation of the GATT in 1947, the United States was one of the few nuclear powers in the world. In contrast, the Bush Administration, which negotiated the NAFTA, came into office with the proliferation of nuclear weapons, missiles, and chemical and biological weapons as one of its greatest foreign policy concerns. Conversation between the author and Ambassador Dennis Ross, an advisor to the President-Elect and the Secretary of State Designate, and subsequently the Director of Policy Planning in the Office of the Secretary of State, and now Director of the office of Middle East negotiations, in which he stated that one of the greatest concerns of the incoming administration was "proliferation - nuclear, missile, and biological and chemical weapons." (contents on file with *Tulsa Journal of Comparative and International Law*). On chemical weapons proliferation *see* conversation between President Bush and National Security Advisor Scowcroft, MICHAEL R. BESCHLOSS & STROBE TALBOT, AT THE HIGHEST LEVELS 119-120 (1993).

195. Note the language introducing Article 2102 "Subject to Article 607 Energy — National Security Measures," and the inclusion of the specific reference "under Article 2102" in Article 607. NAFTA, *supra* note 1, arts. 2102, 607.

196. *Id.* art. 608, para. 1. *See also* USCFTA, *supra* note 10, art. 906.

197. In the U.S.-Canada Free Trade Agreement, Article 906 is titled "Government Incentives for Energy Resource Development." USCFTA, *supra* note 10, art. 906.

198. The complex issue of subsidies was not resolved in the negotiations for the U.S.-Canada Free Trade Agreement. Battram & Lock, *supra* note 97, at 348, 360-61.

199. USCFTA, *supra* note 10, Annexes 902.5, 905.2.

200. NAFTA, Annex 608.2, *supra* note 113, para. 1.

201. *Id.*

202. Agreement on an International Energy Program, *supra* note 83. This Agreement has as its purpose the attainment of a "common emergency self-sufficiency" in energy through the members'

United States expressly stated that they intended no inconsistency with the provisions of that agreement and that in the case of any inconsistency, the International Energy Program Agreement prevails.[203] This provision is also a continuation of the understandings reached in the conclusion of the U.S.-Canada Free Trade Agreement.[204]

J. Additional Provisions Affecting Energy

It is important to recognize that because of the comprehensive nature of the NAFTA, trade and investment across borders will be affected by provisions outside the Chapter on Energy. Energy will be included as tariffs are eliminated on substantially all products traded among the three North American nations on a phased basis.[205] These effects will arise not only from the substantive provisions on investment, competition policy, and governmental procurement, but also from the procedural provisions of the Agreement.

The chapter on investment assures most-favored-nation treatment[206] and national treatment[207] for transnational investments within the

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maintenance of emergency reserves, *id.* art. 1; their preparation of programs of demand restraint, *id.* art. 5, para. 1; cooperation on allocation of supplies, *id.* art. 6, para. 1; their common procedures for activation and deactivation of emergency measures, *id.* art. 12; and their establishment of a common information system, *id.* art. 25. This organization was established by members of the Organization for Economic Cooperation and Development, *see id.* at pmbl. *and* art. 71, whose twenty-four members, including the United States and Canada (but not Mexico) were eligible for membership in the International Energy Agency. *Id.* art. 71. *See* Plourde, *supra* note 97, discussion at 43-46.

203. Agreement on International Energy Program, *supra* note 83, annex 608.2.

204. USCFTA, *supra* note 10, art. 908.

205. Each Party is obligated to eliminate progressively its customs duties on the products originating in its territory according to its schedule annexed to the Agreement. NAFTA, *supra* note 1, art. 302, para. 2. No Party is permitted to increase its existing tariffs or create new tariffs on products originating in its territory. *Id.* para. 1. Goods are divided into five categories, which provide for different periods for the phased elimination of the tariffs. NAFTA, Annex 302.2, *supra* note 113, para. 1.

U.S. and Canadian tariff rates average about .5% ad valorem for crude petroleum and 1% for refined petroleum products, while Mexican tariffs average 5% and 8.6% on the same products respectively. These tariffs will be eliminated over a ten-year period. These reductions are not expected to have effects on the volume of trade in these products. U.S. INTERNATIONAL TRADE COMMISSION, POTENTIAL IMPACT ON THE UNITED STATES ECONOMY AND SELECTED INDUSTRIES OF THE NORTH AMERICAN FREE TRADE AGREEMENT 18-2 (USITC No. 2596 Jan. 1993).

206. Article 1103, paragraph 1 of the NAFTA, provides that each party must accord to investors of another party "treatment no less favorable than it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." NAFTA, *supra* note 1, art. 1103, para. 1. Para. 2 extends this same guarantee to the "investments of investors." *Id.* para. 2.

207. Article 1102, paragraph 1 of the NAFTA, provides that each party must "accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors" with respect to the same investment activities as it provides most-favored-nation treatment, and paragraph 2 of the same article extends this guarantee to the "investments of investors." *Id.* art. 1102, paras. 1, 2. Significantly, the national treatment provisions also prohibit the parties from imposing on investors a requirement that a minimum share of ownership ("equity") be held by its own nationals, other than with respect to nominal qualifying shares for directors or incorporators. *Id.* para. 4(a). This provision would tend to keep Mexico from retreating from the historic liberalization of its

NAFTA's geographic area.[208] Additionally, the NAFTA provides for minimum levels of protection for investors[209] and restricts the use of performance requirements.[210] As a general rule, investors from one party will be able to invest in assets in another party on an unrestricted basis and without discrimination. This general rule is severely limited in the case of the energy industries of Mexico. Additionally, the NAFTA permits the Canadian and Mexican governments to require their approval for acquisitions of assets worth more than certain specified limits.[211] More significantly, the Agreement allows Mexico to reserve to itself investment in certain "strategic activities,"[212] which essentially includes most energy-related activities, a provision that results from Mexico's constitutional provisions. However, the more general rules in the Agreement create a presumption in favor of free flows of capital and investment, a policy that is limited only where there are specific exceptions.[213] Additionally, the trend in Mexican public policy has recently been toward liberalization of investment policies, as many in Mexico recognize that Mexico needs to attract capital to finance continued economic progress. Therefore, the Agreement builds a foundation for future liberalization of restrictions on investment.

The NAFTA provision on competition policy prohibits unfair discrimination and anti-competitive practices by monopolies and state enterprises with respect to investments originating from other NAFTA parties.[214] Implementation of these provisions may necessitate changes in Mexican laws and regulations governing PEMEX, the most important state enterprise in Mexico. From the effective date of the Agreement, allegations of discriminatory treatment will create issues that can be addressed through the procedures established by the NAFTA.

The provisions on government procurement liberalize the practices of such state enterprises as PEMEX. From the effective date of the Agreement, fifty percent of the Mexican government's procurement will be available for bidding by suppliers from the other parties to the NAFTA.[215] This portion will be increased to one-hundred percent over a period of ten years.[216] However, these standards are limited to purchases of more than $

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former requirement that at least fifty percent of the equity of all businesses in Mexico be owned by Mexican nationals.

208. Daniel M. Price, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor State Dispute Settlement*, 27 INT'L L. 727 (1993).

209. NAFTA, *supra* note 1, art. 1105, para. 1.

210. *Id.* art. 1106.

211. The NAFTA permits Mexico to continue to review investments of more than US $ 25 million, to increase progressively to US $ 150 million, while Canada is permitted to review investments of more than C $ 150 million. The United States is permitted to continue reviewing investments in firms that raise national security concerns in accordance to the Exxon-Florio provisions of the Omnibus Trade and Competitiveness Act of 1988. HUFBAUER & SCHOTT, NAFTA: AN ASSESSMENT, *supra* note 1, at 82.

212. NAFTA, Annex 602.3, *supra* note 113, para. 1.

213. *See generally* NAFTA, *supra* note 1, ch. 11 (This chapter deals with investment).

214. *Id.* art. 1501, para. 1; *See generally* art. 1502, para. 3 *and* art. 1503, paras. 2, 3.

215. NAFTA, Annex 1001.2a, *supra* note 113, para. 2.

216. *Id.*

250,000 of goods and services and $ 8 million in construction services.[217] Although U.S. suppliers already have a significant share of the Mexican market, it is expected that these changes will result in significant increases in sales of petroleum equipment and supplies.

After the effective date of the Agreement, the activities and participants in the energy sector will also be affected by the administrative and institutional provisions which provide the procedural assurances designed to make the substantive provisions effective. In addition to requiring publication of laws, regulations, procedures, and administrative rulings,[218] the NAFTA requires that administrative proceedings be conducted only after reasonable notice with an opportunity for a fair hearing has been given to affected parties[219] in accordance with procedures provided by law.[220] These provisions also require procedures for the review of administrative proceedings.[221]

Of less immediate importance to the energy industries are the provisions on review and dispute settlement in anti-dumping and countervailing duty matters.[222] Most importantly, the NAFTA creates a "Free Trade Commission"[223] to supervise implementation of the Agreement and outlines the procedures for dispute settlement.[224] These provisions are important protections designed to make the other, more substantive articles more effective.

IV. THE NAFTA IN PERSPECTIVE

Among the many provisions of the NAFTA, the negotiations on energy provoked initially the greatest apprehensions in Mexico and ultimately the greatest disappointment in the United States.[225] The United States negotiators worked assiduously to persuade Mexico to liberalize its energy sector.[226] However, rumors during the negotiations that President Salinas de Gotari had "sold the national patrimony" forced the Mexican President to reaffirm his commitment to the Constitutional provisions on government ownership of energy resources.[227] The Advisory Committee for Trade Policy and Negotiations[228] warned Mexico that its economic

217. NAFTA, Annex 1001.1c, *supra* note 113.

218. NAFTA, *supra* note 1, art. 1802.

219. *Id.* art. 1804.

220. *Id.* cl. (b); (c).

221. *Id.* art. 1805.

222. *Id.* arts. 1901-11.

223. *Id.* arts. 2001-02.

224. *Id.* arts. 2003-19. Jeffrey P. Bialos & Deborah E. Siegel, *Dispute Settlement Under the NAFTA: The Newer and Improved Model*, 27 INT'L L. 603 (1993).

225. PASTOR, *supra* note 1, at 45.

226. *Id.*

227. *Id.*

228. The Advisory Committee on Trade Policy and Negotiations is an official advisory committee consisting primarily of representatives of United States businesses established to advise the United States Trade Representative and other United States Government trade negotiators on trade policy and its impact on U.S. business. *Id.*

future depended on its ability to "overcome historical trepidations about removing outmoded, statist controls in important sectors such as energy."[229] It concluded that "shortfalls in the agreement on energy [were] an unfortunate remnant of Mexico's isolationist past and in no way a precedent for future negotiations."[230] In particular, the petroleum industry in the United States welcomed the liberalization that was achieved, but was disappointed that more was not accomplished.[231] However, substantial progress was made in opening the energy sector of the Mexican economy.

Perhaps the greatest disappointment to United States negotiators and business was the failure to open the energy sector to foreign participation in the ownership of resources. Arguably, it is to Mexico's own advantage to relax its constitutional provisions, since such liberalization would permit a capital inflow helpful in improving and maintaining the technological proficiency of the Mexican energy sector. However, it must be recognized that such a course was fraught with immense domestic political difficulties in Mexico. In view of Mexican history and the symbolic importance of oil, it seems likely that any intrusion into such a sensitive area would have provoked great political trouble in Mexico and would jeopardize Mexican ratification of the Agreement.

A related, though equally inevitable failure was to move Mexican energy trade away from government control. The reservation specifically recognizes that the Mexican government has "reserved to itself" trade in energy. However, the existence of a state monopoly in petroleum substantially precludes trade in oil and natural gas on a commercial basis. In the struggle to open world trade since the negotiation of the GATT, the liberalization achieved as a result of elimination of trade barriers has foundered whenever it encountered state-owned enterprises. It is exceedingly difficult to ensure that such enterprises will make decisions on a commercial basis.[232] No truly free trade can exist in the energy sector until the Mexi-

229. ADVISORY COMMITTEE FOR TRADE POLICY AND NEGOTIATIONS (ACTPN), *A Report to the President, the Congress, and the United States Trade Representative Concerning the North American Free Trade Agreement*, Sept. 1992, at 42-43 *quoted in* PASTOR, *supra* note 1, at 45.

230. *Id.*

231. The Oil & Gas Journal, a leading industry journal, predicted that energy companies in the United States would benefit, but not as much as they had hoped. *NAFTA Due to End Most Barriers to Trade Among U.S., Mexico, Canada*, 90 OIL & GAS J. 30 (Aug. 24, 1992). According to the Journal, the American Petroleum Institute, which represents the larger, vertically integrated petroleum companies, concluded that the Agreement would produce economic benefits for all three countries participating, but regretted that the NAFTA failed to liberalize opportunities for investment in Mexico. *Id.* at 31. It reported that Cambridge Energy Research Associates and Arthur Anderson & Co. had issued reports forecasting that the agreement would increase exports of natural gas to Mexico. *Id.* For the petroleum equipment and supply industry, the reduction in tariffs from twenty percent to sixteen percent the first year and the subsequent phased reductions and the opening of procurement by PEMEX would be helpful. *Id.* at 30.

232. Consumers and enterprises are assumed to make purchasing decisions on the basis of price, quality, and other criteria that reflect their own interests. Where an enterprise is owned by the government, or where all trade is conducted through a state trading monopoly, decisions are likely to be made at least partly on the basis of other criteria. Similarly, the prices of goods supplied by state-owned enterprises are almost sure to reflect criteria other than those resulting from the processes of the market economy. Indeed, in the formerly socialist economies of Central and Eastern Europe and the

can government relinquishes control over foreign trade in petroleum and privatizes the Petroleos Mexicanos.

Although the chapter on energy liberalizes energy trade among the three countries in many respects, one of the greatest benefits is that it clearly defines the principles for international economic activity in North America. First, the chapter reinforces the application of the GATT principles and rules to energy. It reimposes the GATT disciplines, particularly the principle of national treatment, on the regulation of the energy industries and provides a process for resolving disputes. It prohibits export and import duties and taxes on energy products. These obligations to liberalize trade are modest but real. Moreover, it makes additional commitments to liberalize beyond those rules. Secondly, the NAFTA adds clarity and definition to the restrictions on investment in the Mexican energy and provides investors with more "transparent" rules. It establishes some general disciplines on state-owned enterprises, and it separates state decision-making from state enterprise decision-making by requiring administrative transparency. Thirdly, the NAFTA's provisions recognize half a decade of reform of the energy sector in Mexico and binds the Mexican government against a retreat from these reforms.[233] Finally, the NAFTA commits the parties to the principle of liberalization, which is mandated on a gradual but sustained basis.

Progress in liberalizing international trade has always been made on the basis of what has been possible, rather than what is ideal. The energy provisions of the NAFTA Agreement are no exception. Its real importance is the commitment of the three nations to sustained, though gradual, liberalization. Nevertheless, the NAFTA establishes a broad foundation for further progress toward the free movement of goods, services, and capital among the three great nations of North America.

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former Soviet Union, decisions on purchasing and pricing products were made on the basis of the government's plan. The contracting parties to the GATT have struggled with this problem throughout its history. *See* DAM, *supra* note 82, at 316-32; *and* JACKSON, *supra* note 82, at 283-98.

233. As reported in the Oil & Gas Journal, John Easton, the Deputy Secretary at the Department of Energy, observed that the NAFTA's energy chapter had reduced the risk of future governmental intervention into energy markets and that further liberalization was possible. *NAFTA Due to End Most Barriers to Trade Among U.S., Mexico, Canada, supra* note 231, at 30-31.