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## Discussion after the Speeches of Greg Mastel and Bradly Condon

Discussion

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## DISCUSSION AFTER THE SPEECHES OF GREG MASTEL AND BRADLY CONDON

COMMENT, PROFESSOR KING: We wanted to give Alejandro Nadal an opportunity to add a few thoughts. He is not on the program, but he is here. The important thing is to take advantage of a Mexican presence here.

COMMENT, MR. NADAL: First of all, let me tell you that I have enjoyed very much the meeting today and yesterday, I have learned a lot. I want to thank you for inviting me here. It is really a very, very refreshing experience to be talking to a group of lawyers and petitioners of law, and get away from economists.

What I want to say today, very rapidly, is that we have to be less naïve about NAFTA and about the economic model that underlies NAFTA. This goes for Mexico, too. My remarks are going to be focused on Mexico. We have to look with better lenses. We have to look at the asymmetries within the three countries. We have to take a very hard look at the economic realities of Mexico, the trends, and the perspectives of future evolution of that economy.

I think I tried to convince you yesterday, I do not know if I succeeded, that the economic model in Mexico needs some important changes. The model is not performing well. We have been having mediocre growth for the last fifteen years.

By "the model," I am referring to a set of policies that was implemented at least since 1987 or 1988, in a very decisive way, and since then the results in terms of the growth of the GDP are very disappointing. In addition to that, there are very serious distortions in the Mexican economy, and that is what I tried to convey yesterday. On top of all that, this is the model that generated the 1994 crisis, and that was a very critical event. We have not been listening to the signals coming out of that event.

What was the nature of the 1994 crisis? This is a very relevant question, because we have not done anything to change or reform the model that is associated with the peso crisis of 1994. Why did that crisis take place? People say it was human error, failure to devalue at the right time. I say it is intrinsic to the model that you have to despond the time for devaluation as long as you can. The model has in-

consistencies and internal contradictions that imply essentially that you do not have the possibility to render your internal adjustment and development compatible with your external economy.

Balance-of-payments crises are bound to come back again, maybe not as severe as the 1994 crisis was, because people will pay a little bit more attention to where it is going, that is true. But the tension between your current accounts in balances and your internal accounts, your internal economy, is going to be there, and therefore balance of payments crises, even moderate ones, are bound to be a chronic disease for the Mexican economy with this model.

I have asked the organizers of the conference to give me a chance to deliver copies of the paper I wrote on balance-of-payments provisions in the GATT and NAFTA. Balance-of-payments crises, even moderate ones, are bound to reappear. The graphs and tables I showed yesterday revealed that there is a trend for that to happen again.

The 1997 forecast for the Mexican economy is that we are going to have a five billion dollar deficit in our current account again, in spite of the massive adjustments of 1995. You have this problem reappearing very rapidly. This means that you need to cover your balances, attracting short-term investments. This raises your domestic rates of interest. That affects domestic sectors, investment growth, et cetera, and those are the types of contradictions I am talking about. We do not have time to go into that, so if you have questions, we can come back to that. But the point is we are bound to have the balance-of-payments crises again.

What does the NAFTA say about balance-of-payments provisions? In 1947 when the GATT was launched, the people who drafted it saw that there was a balance-of-payments crisis in European countries. This was after the war. It was clear that we had to do something about balance-of-payments crises. If a balance-of-payments crisis is triggered or driven by your trade deficit, the people who drafted GATT concluded, it is certainly more for exceptions. Let us allow member countries, the contracting parties with GATT, to have the right under Article 12 of the GATT to temporarily curtail imports. You can even introduce things like tariffs or COLAS, quantitative controls of imports, and tariff surcharges, although legal coverage for tariff surcharges was not very clear under GATT Article 12.

You did have the right to introduce quantitative restrictions on a transitory or an exceptional basis. You had to have consultations with your fellow GATT members, but that was it. You did not have the chance to restrict imports when you were facing the balance-of-payments crisis.

In the Uruguay Round, this was reaffirmed. There was a lot of

controversy about the role of tariff surcharges. Are they covered by this regime of import restrictions under exceptional basis or not? The Uruguay Round, ratified in Marakesh in 1994, clarified that by stating that there was an understanding of balance-of-payments provisions that once and for all does what could not be done in the Tokyo Round. It clarifies things quite a bit. You can use tariff surcharges to limit these imports, and you can even use quantitative restrictions. You can use tariff surcharges on a differential basis. So you do not have to play it across the board, you can hit consumption goods with higher tariff surcharges than intermediate goods or capital goods. That is essentially what was said in the Uruguay Round.

Let us come to NAFTA now. In 1994 the process exploded. We looked at NAFTA, Chapter 21, Article 2104. For the sake of time, I will spell it out very briefly. Essentially, Article 2104, Section 5, Paragraph D says that there are no exceptions. You will not be able to have tariff surcharges. You will not be able to have import COLAS, permits, or licenses. That is it. So the Chapter on exceptions for balance-of-payments reasons states that there are no exceptions.

Before that little phrase I just quoted, Article 2104(5)(D), what NAFTA does is force you to go to the International Monetary Fund (IMF) if you have a problem on your balance of payments. You go to the IMF and talk to them about exchange restrictions. This is a smoke-screen, in that Article, I think for one reason. It is totally redundant. You do that anyway if you want to impose exchange restrictions. You go to the IMF. That is an IMF jurisdiction. It is not GATT; it is not WTO; and it certainly would not be NAFTA. You have to go there anyway.

But import restrictions, which is the normal thing that you would find under the heading of balance-of-payments restrictions, are not exchange restrictions. They are import and trade restrictions. Therefore, NAFTA says, you go to the IMF, and the IMF will tell you that you cannot have exchange of restrictions. Article 8 of the Articles of Agreement of the IMF would interdict that. And then you cannot have import restrictions either because NAFTA says you cannot do it. By the way, if you look at the Canada/U.S. Free Trade Agreement, import restrictions were possible under the Free Trade Agreement.

When Mexico joins in that regime, and you have a Free Trade Agreement for the entire region, it is fairly obvious that the Americans, at least, want to prevent Mexicans from being able to restrict imports in the case of balance-of-payments crises. When that happens, you are doing the same thing for Canada.

There are two countries in North America that have resorted to

import restrictions and tariff surcharges under Article 12 of the GATT. One of those countries is Canada, and the other is the United States. It is interesting. But the country that was really targeted was Mexico. So the Canada/U.S. Free Trade Agreement had it; the Maastricht Treaty has it. This means that, even if you have deep economic integration, it still made sense to have access to the possibility of resorting to import restrictions when you have a balance-of-payments crisis. I urge you to look at Maastricht. It is very interesting.

The legal implication is that we cannot use import restrictions for balance-of-payments crises anywhere because it has to be nondiscriminatory. We cannot target China, Japan, or Korea. That would be GATT inconsistent. But if it is forbidden in NAFTA among NAFTA parties, that means it is forbidden for all of our trading partners. This is very relevant in the case of Mexico, because a huge chunk of the trade deficit is not related to our NAFTA partners whatsoever, but it is related to imports from Japan or European countries, or from China. So here we have a problem. We have a model that may be generating chronic balance-of-payments crises, and we have a treaty that says you cannot resort to import restrictions.

I prepared a scenario on what the effect would be of import restrictions on an exceptional basis. In 1994, it would have been an effective way to prevent the peso crisis, and, in fact, it would have aided Mexico to meet its financial obligation without resorting to the dollar-denominated Mexican Treasury bonds, which was really what started the Mexican monetary authority.

We need to change the economic model, and I think whatever is in NAFTA, that has to be changed as a result of NAFTA. I think we have to take a second very hard look and we have to improve what we have.

QUESTION, MR. EDWARDS: I have one question. Alejandro, I think there was one error with the IMF that relates to Article 8, Paragraph 2(A). It deals with exchange restrictions. The IMF does permit exchange restrictions by decision of the Executive Board. They have done it for a large number of countries. In a book I wrote I went through those, so it is wrong to say they are not permitted. They just have to go through that procedure.

COMMENT, MR. NADAL: You are right.

QUESTION, MR. MURPHY: Alejandro, one of the things you note in NAFTA in the investment chapter allows investors to remit money, dividends, or whatever. In the event of another crisis in Mexico with the balance of payments, do you think that Mexico should have the right to restrict those remittances, or would that just go back to the IMF and be considered exchange controls?

ANSWER, MR. NADAL: That would take you to IMF exchange restrictions. I do not think we need to close the economy. I do not like exchange restrictions. We tried those in the eighties, and it was a total failure to the sense that the economy backfired in some respects.

I think one of the things we have to do is to render the Mexican economy less dependent on your hot money portfolio investments. This is why I think that the way we deregulated trade was too fast, too abrupt, and nonselective. That created a trade deficit plus the debt burden. That was rescheduled in the early Salinas years.

There was some relief out of that, but it came back again when your interest rates increased. With the services for debt increases, and then the Peso crisis in 1994, the outstanding total public debt in Mexico neared one hundred billion dollars. If you add another sixty or seventy billion by the private sector, you are paying thirteen or fourteen billion dollars a year for interest. That is not compatible with growth objectives for the Mexican economy.

We have to do something with our creditors. We need to tell them that we want to pay. They want us to pay. We need to talk about another exercise that we should do. It can be done. There is a lot of literature about that.

So you have to do something about imports; something about your trade deficit; and do something about the debt service. That will make you less dependent on hot money portfolio investments. And you and I were talking about the Chilean experience after the crisis. It is not only how to arrange these short-term portfolio investments in the Chilean or Mexican economic space, it is how to be less dependent on them.

QUESTION, PROFESSOR KING: I think it is very original, very interesting to say we ought to get closer to Europe. I guess what I was concerned about is not in terms of growth potential. Is there not greater potential in Latin America than in Europe? You proposed a Transatlantic Free Trade Agreement arrangement. Did you want to comment on that?

I think it would be easier, perhaps, to get through Congress. You worked on the Hill quite a lot, would it be easier to get through Congress? There would not be the problem of the differentials in labor and all that. But I wonder if the real potential is in South America.

ANSWER, MR. MASTEL: Actually, that is a good question. I had not had a chance to study it in more detail, but I would like to throw out a couple of notes which I think would have to be taken somewhat critically. First of all, I disagree that the problem in Mexico in the balance-of-payments crisis was a trade problem. It was a result of not enough import restrictions. Secondly, politically speaking, if Mexico had proposed trade restrictions on U.S. exports in 1994, the NAFTA would

now be history. I mean, the political situation in the United States is such that those kind of restrictions just are not tenable. If anything, perhaps, it makes sense to go back to the GATT and allow a safeguard that applied to other trading partners, but not to the United States and not to NAFTA partners.

By way of introduction to answering this question, though, it seems to me that one of the real problems with the NAFTA, economically speaking, is that you are trying to bridge an economic gap between two systems that are at different levels of development. In some sense, I would say the peso crisis was really a result of different levels of development, different economic systems, which make trade sometimes difficult to conduct.

That would be primary, when I think about looking to economies like Europe as opposed to Latin America, in terms of future free-trade partners. As I said, the United States and Canada were easily able to adopt the free-trade system, or relatively easy to develop the free-trade system, in economic terms. I think the United States, Canada, and Europe did the same.

Moving south, you have the risk of confronting the same problem of differing levels of economic development. I think this can result in problems that, and I am not sure there is a political consensus in the United States to allow that movement in that direction. I think there is political consensus, however, for trade with developed countries where there is less of a differential.

I think there is substantial economic growth potential between the United States and Europe. As I said, you should only have trade between developed countries and developing countries. It makes perfect economic sense, and it would generate large benefits, which is kind of a burden in what you were saying. And I agree that the problem with the theory is that it ignores the fact that there are different economic systems and different legal systems. I think the lesson we can learn from the U.S./Canada FTA is that similar legal systems and similar economic systems make the benefits of free trade more easily realized, which is the primary case for looking to Europe as opposed to Latin America where you could conceivably deal with more peso-crisis-like problems.

COMMENT, PROFESSOR KING: And it makes it easy to sell in Congress.

QUESTION, MR. O'GRADY: I was thinking of the book Professor Galbraith wrote a few years ago on the economics of underdevelopment. He would probably think this was simplistic, but the basic point was that the best way to develop the underdeveloped world is incrementally to get it to adhere to the critical mass of development that already exists

in the world. So that sort of thinking does tend to suggest that alliances with Europe would be easier.

But assuming we do not get them and we are thinking about Mexico, how long do you contemplate that these import restrictions would continue? Is this not a two-way street? Is it not a street whereby Mexico uses a Free Trade Agreement to solve an existing balance-of-payments problem by improving their exports and keeping their imports at about the same levels? How do you make this saleable or attractive to your free trade partners?

ANSWER, MR. NADAL: First of all, I think we have to clarify a couple of things. When I talk about import restrictions and the need to change that Article in the NAFTA and allow for exceptions, people might think, this guy is advocating that we leave the economic model because it is going to be generating a chronic balance-of-payments crisis, and then we go get some insurance or use a slice of the pie, which is Article 2104. I mean for us to look at the emergency or exceptional measures, and open the door for exceptions, because the Mexicans are going to be having chronic balance-of-payments crises. I am not advocating that.

I am saying that is one example in which there are problems in NAFTA related to the underlying economic model of Mexico. I think we have to change the economic model in Mexico, we have to be less dependent on trade, on these portfolio investments, to finance our current account of balances.

And yes, I disagree with you, Greg. If you look at the figures, the trade deficit is really gigantic, and it was gigantic in 1993 and 1994. This is why people said you had to devalue. You had an appreciative peso because of all these capital inflows coming in, but also because it was part of your anti-inflation policy, and that generates a colossal unsustainable trade deficit, and that implies that you have to do something with your relative crises; in other words, you have to devalue.

My point is, it was very trade-disruptive to devalue. If you look at what happened in 1995, the reversal of the trade deficit that we had, and then to go to a trade surplus in 1995, we are talking about huge and colossal amounts of money there. That implied a lot of disruption in trade. In fact, you guys were running a deficit with Mexico again in 1995 and 1996.

My point, to summarize, is we do have to change the economic model; we have to reform that economic model. By this I am not saying let us go back to the 1970s; I am not advocating that whatsoever. We do not have to close the economy.

This is why lawyers think in terms of exceptions. It is better to



open a door for exceptions than to close it and make sure people are not going to violate that law because there are no exceptions. I think that is the legal mentality. You think in terms of an escape route or something.

But we do have to take a hard look at the crisis, at the model, and then take measures that would change that economic model. Whatever is in NAFTA has to be changed. I leave it up to lawyers and others to figure that one out.

As for the political liability, I do not know. I am not a politician. I am just pointing out the technical necessity. If there is no technical necessity to change the model, then the question about political liability becomes irrelevant. You do not have a political liability.

But if there is a necessity to change the model, then I say, let us take a hard look at the figures that show us what is going on in Mexico today and not start asking whether or not the Mexican economy is growing. What does that mean? It means that your export sector and your import sector are growing at spectacular rates while the domestic sector is stagnant.

Those distortions are not sustainable in the long run. Something is going to happen. People are not going to be there with their arms crossed waiting for the miracle of the market system to come one day in a sort of trickle-down thing and then in the year 2025 we will have some effects. People are not going to wait.

QUESTION, MR. TUTTLE: I was listening to Greg Mastel's comments focusing on the Transatlantic arrangement and also thinking about APEC, in which Canada has been involved. If you get too many of these agreements, then you are detracting from the whole WTO. One of the examples or one of the restrictions that Greg is talking about is, when you start dealing with the WTO, it tends to try to equate all the economies, even when you are dealing with intellectual property. Maybe there needs to be a two-tiered approach to the WTO. I think we have emerged into a WTO that tries to get everybody up to the same speed, and I am just not sure that it is feasible.

ANSWER, MR. MASTEL: Actually, there is an old idea called GATT Plus. It is a core agreement wanting to go further. Trade liberalization would go forward. I think it is a good idea. And in some sense, a TAFTA is another version of GATT Plus. I think it makes good sense, and I think it is another way of addressing the same issues.

That said, one of the reasons I was expressing some skepticism earlier is, I would not want to see us move backwards. In other words, we can take a group of countries that want to go above the WTO and negotiate an agreement that goes above it. I do not think it makes sense

for developing countries to go below the current level. It is a long debate.

It is my view that trade restrictions are not a solution to developing economic problems. In fact, they have more to do with the problem, and, in essence, are the cause of it. We can debate Mexico in more detail, but as I say, I think it does make sense for the countries that can move forward more quickly to do so.

Without dropping the current level, I think TAFTA is another way to look at a GATT Plus kind of arrangement, which I think makes good economic sense, and probably good political sense too. There is a bicycle theory of trade. Maybe you have heard about it. The idea is that if you keep trade liberalization agreements going, you keep momentum moving in that direction. I think there is some truth to that theory. That being the case, I think we need to look for what the most logical liberalization perspectives, or liberalization possibilities are. It seems to me TAFTA or GATT Plus is an idea that came of age ten years ago, but its time is now long past, and so I think it is a good approach.

QUESTION, MR. DATTU: Speaking on the Transatlantic idea, it certainly passed the three lenses test that Pat Murphy took us through yesterday; the economic integration, economic advantages, the perspective on it as well as the cultural advantage. I am wondering if there is another lens we ought to look through for this issue, that one being international politics.

We have, I think, come a long way in the last few years. We have managed to show many countries around the world that the way to progress economically is through free market economy principles and liberal trade, and that effort has been a multilateral approach and multilateral effort. And, indeed, if we end up doing a Transatlantic bloc, one has to wonder what implications that has for the north/south dialogue, whether in fact it may result in a polarization of the world and what the implications would be for international politics. There may be, indeed, certain countries left out of the Transatlantic bloc that may use that to their advantage to either cause other countries to move away from the free market orientation, or indeed result in a formation of a bloc that might see things in a very polarly opposite way. Is there a danger of that?

ANSWER, MR. CONDON: I think that is a good argument, something we really need to consider in a Transatlantic free trade area. I have a couple of thoughts on that.

First of all, it seems more likely to me that the result of a Transatlantic Free trade area is the leadership it would demonstrate. It would demonstrate how far liberalization could go and what directions could be

taken to the United States and Canada. It would be kind of a path-breaker. And it would also create a political incentive for countries to be part of the bloc. And so there are a lot of incentives in the other direction.

That is it. As I mentioned in my remarks, I believe there is likely to be, in the next ten years, a clash of economic systems, as there has been in the last ten years. But I think it could become more intense as China enters a very large economy with a very different way of looking at economics. But I think TAFTA is actually a way to prepare for that struggle. I think it will be inevitable, I think there will be a battle of the hearts and minds of the developing world among the competing economic systems. And I think, if the Western economic system is to prevail, it should look as strong as possible and present as solid a front as possible. One of the side benefits of TAFTA is it would allow those countries that subscribe to a Western model of market economics to work together a little more closely and hopefully to develop a common face to prevent the struggle. Because as I say, I think there is inevitably going to be in part a south/north dispute. I think the growth of the world, and certainly the Western economies, have a big stake in the outcome of that struggle.