Getting to "No": Defending Against Demands in NAFTA Energy Negotiations
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How can a developing country defend itself against unwanted demands in international economic negotiations, especially when the demandeuer is a stronger state? Such defense can be a necessary component of any strategy, not only a distributive one but also a mixed strategy aimed at a wider agreement that benefits both sides. Sometimes what looks like an unwelcome demand turns out, after exploration and exchanges of concessions, to be an acceptable element in a beneficial package deal. But some demands are unwelcome in the stronger sense that one’s government places an infinite reservation value on that particular issue. The government would prefer no agreement. In the case of a deal breaker, the delegation can walk away from the entire negotiation, but this could have large costs in opportunities foregone and even possible penalties imposed. What are the alternatives short of walking away? Mexico’s negotiators faced such situation in the North American Free Trade Agreement (NAFTA) negotiations with the United States and Canada (1990-1992), specifically in the energy sector. In general the three states sought a mutual-gains agreement, and in general each employed a mixed strategy. In energy, however, Washington made demands—regarding investment and supply commitments—which Mexico found unacceptable. At the end of the day the Mexican team managed to attain its main offensive negotiation aims in NAFTA (significantly improved market access, faster tariff reductions in the U.S. and Canada than in Mexico, and an effective dispute settlement mechanism), as well as the main defensive ones in energy. How did they do it? Structural conditions, such as being a neighbor of the U.S., gives Mexico certain leverage in negotiations, for the U.S. will typically take into account non-economic considerations when negotiating over economic issues. Nonetheless, many lessons derived from Mexico’s negotiation strategy in energy negotiations during NAFTA can be applied across a range of cases.

¿Cómo puede un país en vías de desarrollo defenderse ante demandas presentadas por un país poderoso en negociaciones económicas internacionales? La defensa puede ser parte no sólo de una estrategia distributiva, sino también de una estrategia mixta que busque generar beneficios para ambos países. Lo que a primeras luces puede parecer una demanda no deseable puede convertirse, una vez que se explora el intercambio de ciertas concesiones, en un elemento constitutivo de un acuerdo mutuamente satisfactorio. Empero, hay ocasiones en las cuales un
gobierno pone un valor de reserva infinito a un determinado tema: no hay circunstancia bajo la cual resulte acceptable ofrecer la concesión demandada, y resulta preferible que no haya ningún acuerdo a lograr un acuerdo a costa de otorgar la concesión en el tema. ¿Qué alternativas existen para un país que se encuentra en esta situación, más allá de retirarse de las negociaciones? Los negociadores mexicanos enfrentaron precisamente esta situación durante las negociaciones del Tratado de Libre Comercio de América del Norte (TLCAN) con Estados Unidos y Canadá entre 1990 y 1992, específicamente en el sector energético. Por lo general, los tres países buscaron lograr un acuerdo que beneficiara a todos y emplearon una estrategia mixta. Sin embargo, en el rubro energético Washington presentó una serie de demandas en inversión y compromisos de abasto que eran inaceptables para México. Al final del día el equipo mexicano logró sus principales objetivos ofensivos en la negociación (una gran mejora en acceso al mercado, una reducción arancelaria más rápida por parte de Estados Unidos y Canadá que de México, y el establecimiento de un mecanismo de solución de controversias efectivo), así como su principal objetivo defensivo en cuanto a inversión extranjera en el sector energético y compromisos de abasto energético. ¿Cómo lo logró? Ciertos factores de índole estructural, como la vecindad con Estados Unidos, le otorgan a México ciertas ventajas en una negociación, pues los Estados Unidos por lo general toman en cuenta factores no económicos durante negociaciones económicas internacionales. Sin embargo, el resultado de las negociaciones energéticas se debió en gran medida a la estrategia de negociación seguida por México, y de ella se pueden derivar varias lecciones que son aplicables a otros países y temáticas.
Introduction

Getting to “No:” Defending Against Demands in NAFTA Energy Negotiations

On 12 August 1992 Mexico, the U.S. and Canada finally completed the negotiations for the North American Free Trade Agreement (NAFTA), which had started more than a year earlier. They were unprecedented trade negotiations in that they posed Mexico, a developing country, against the world’s sole remaining superpower in an attempt to establish a deep integration agreement. There was little precedent to fall back on, and it was largely expected that the U.S. would virtually dictate the agreement, given the huge power asymmetries between the negotiating parties.

During NAFTA negotiations, Mexico was loath, because of the nationalization of the oil industry in 1938 and the weighty symbolic importance oil still had (and has) in Mexican politics, to permit U.S. participation in Mexico’s oil industry. For its part, the U.S. government was very interested in gaining access to Mexican oil reserves in terms of foreign investment access and supply guarantees. It was a complicated negotiating situation for Mexico, to say the least. As Jagdish Bhagwati stated, "If I were a consultant for Argentina or Brazil, I would tell them not to join NAFTA, because that is where the U.S. plays the game as they want to [...] just look at Mexico. They are sweating tears [...] because now the United States have started to negotiate free trade agreements with other countries. The advantages they [Mexico] had have disappeared and the concessions they made to achieve the agreement will stay in place, like the rights for oil exploration and intellectual property rights [...]. The United States is using all its lawyers and all its lobbyists to impose subtle barriers, above all in bilateral"

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1 This paper is a draft chapter for Negotiating Trade: Developing Countries in the WTO and NAFTA, a book edited by John Odell to be published by Cambridge University Press in 2006. This version provides more detailed information than the corresponding chapter in the Cambridge book, while the latter presents a closer link between hypotheses and findings. The book is summarized in Odell and Ortiz Mena L.N. 2005. The paper concentrates on the challenges and behavior of developing countries, and emphasizes the Mexican side of the story rather than the U.S. side. Likewise, I concentrate on Mexico-U.S. negotiations, and only tangentially touch upon Canada’s role, given that NAFTA energy negotiations were largely of a bilateral nature and carried out by the former two countries (author’s interview with Charles E. “Chip” Roh, Deputy Chief NAFTA negotiator, USTR. Washington, D.C., 30 September 30 2004). When reference is made to U.S. negotiation results, it should be understood that they also apply to Canada.

Lawrence might argue that NAFTA is not a deep integration agreement. While it is a free trade agreement and not a customs union or common market (which are regarded as deep integration agreements by Lawrence), the scope and coverage of NAFTA went way beyond most previous trade agreements. See Lawrence 1996; Hufbauer and Schott 1993 offer a summary of NAFTA.

3 See Meyer and Morales 1989; and Ortiz Mena L.N. 1993.

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agreements. And developing countries sometimes do not have either the time or the resources to follow all these developments."*4

Well, not exactly. While the adverse effects of preference erosion for Mexico are all too real, Bhagwati has got the story wrong. Mexico did not grant the U.S. any rights pertaining to oil exploration. In fact, under NAFTA "basic energy remains immune to free trade".5 How was Mexico able to successfully defend itself against distributive strategies by the U.S.?6 Did it have to pay a dear price for it? Are there any lessons from Mexico's experience in negotiating with the U.S. that may be used by other developing countries facing unwanted demands?

This paper examines the role played by Mexico's strategy choice,7 negotiator beliefs, domestic politics and markets on the outcome, that is, on the successful defense against distributive strategies by the U.S. during NAFTA energy negotiations. It proceeds as follows: section one deals with Mexico's negotiating position in a number of energy related issues, and the outcome of negotiations in each of these issues; section two presents alternative explanations that leave out the negotiations process and notes how they cannot on their own terms adequately account for the outcome, and then addresses key concepts developed by Odell to account for the outcome of NAFTA negotiations in energy.8 The final section summarizes the findings, considers the extent to which the lessons derived from Mexico's experience in NAFTA can be applied to other situations where defense against demands is a central part of the negotiation process, and suggests avenues for further inquiry into this topic.

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5 Hufbauer and Schott 1993, 5.
6 NAFTA energy negotiations were of an overriding bilateral nature, between Mexico and the U.S. Canada's main concern was that Mexico also submit to energy supply commitments, as Canada did in its bilateral free trade agreements with the U.S. Author's interviews with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003; Jesús Flores Ayala, Chair (Mexico), NAFTA Energy Negotiation Group. Mexico City, 14 June 2004.
7 Please refer to the Appendix B for an explanation of negotiation strategies.
8 See Odell 2000 and the introduction to this volume. Odell 2000 is also referred to as NWE (Negotiating the World Economy) throughout this chapter.
I.- The facts on energy: Mexico’s negotiating position vs. negotiation outcomes

In terms of the whole NAFTA negotiation Mexico had very specific offensive and defensive aims, which were made public by President Carlos Salinas (1988-1994) and Trade Minister Jaime Serra Puche. Offensively, Mexico wanted to achieve untrammelled market access to the U.S. and Canadian markets, a faster tariff liberalization by those two countries than that carried out by Mexico, and the establishment of an effective dispute settlement system to deal with unfair trade practices (subsidies and dumping). Defensively, Mexico maintains strict limits to foreign participation in the energy sector and did not want to undertake and energy supply commitments. Its defensive position on oil was set out in five "No’s," which are discussed below.

Mexico had vast oil reserves, and the U.S. was the world’s major oil importer. As such, it wanted to have access to Mexico’s oil, both for business-related purposes and to secure access to Mexican oil during times of energy shortages. For its part, Mexico badly needed investment in its oil sector to keep up with domestic demand and to make the most out of its oil export earnings. The U.S. in turn had a surplus of natural gas and Mexico a growing deficit. This is a classic case of comparative advantage, and there seemed to be a very wide positive zone of agreement.

However, for domestic political reasons Mexico did not want to include energy in NAFTA negotiations. It initially proposed an outright exemption of energy and basic petrochemicals from NAFTA negotiations and did not want to establish a working group on energy. The U.S. was against this position, and insisted on establishing a working group on energy. While Mexico in the end acquiesced to the establishment of an energy working-group, it did not flinch from its specific positions regarding energy.

The main issues where Mexico did not want to yield to U.S. pressures were investment in energy-related areas and energy supply commitments. These concerns were expressed in Five "No’s" regarding the role of energy in NAFTA negotiations. These "No’s" are the following:

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10 Hufbauer and Schott 1993, 34.
12 Maxfield and Shapiro 1998, 98.
13 As will be seen in the next section, these issues, which were non-negotiable in Mexico’s view, were made public on many occasions by President Salinas (see Salinas 2000, 39-157 passim). Trade Minister Jaime Serra also made frequent mention of these “No’s” (author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003).
i. There will be no foreign investment in the exploration, exploitation and refining of oil in Mexico. These areas are to remain under state control.

ii. There will be no risk-sharing contracts with payment in oil reserves.

iii. There will be no energy supply commitments.

iv. There will be no liberalization of gas imports; all imports must be done through PEMEX.

v. There will be no foreign retail gasoline outlets.

In addition, Mexican President Carlos Salinas publicly stated that all "strategic" economic sectors covered by Article 28 of the Constitution (basic petrochemicals, railroads, and electricity, among others) would remain under state control.\(^1\)

Given that energy negotiations in NAFTA covered a wide array of topics, for ease of discussion I have classified them in four areas: investment, trade, energy supply commitments, and other issues. In each area Mexico's position is set out, and then compared with the negotiation outcome.

a) Investment

Three of the five "No's" refer to investment-related commitments. Investment, together with energy supply commitments (discussed under "other topics," below), was the most contentious issue of NAFTA energy negotiations, if not of all NAFTA negotiations. Mexico's position on foreign investment in its oil industry was clear cut: no foreign ownership of oil reserves, no foreign production of primary petrochemicals,\(^2\) no foreign participation in the exploration, exploitation, and refining of oil and natural gas, no risk-sharing contracts,\(^3\) and no foreign participation in the retail gasoline market.\(^4\)

In electricity, Mexico's position was not as steadfast as in oil, although it did not envisage significant privatization of the former industry. It also fell within Article 28 of the Constitution, which provided for state control over "strategic" sectors of the economy.

The U.S. "pushed for as much liberalization as possible in primary and secondary petrochemical production and in the exploration, drilling and

\(^1\) Salinas 1994, 401. Serra also insisted on several occasions that the Constitutional limits to foreign participation in the oil sector were non-negotiable. See Serra 1994, 537,558, passim.

\(^2\) Primary petrochemicals, also called basic petrochemicals, are produced directly from oil, while secondary petrochemicals are produced from primary petrochemicals. Some secondary petrochemicals may also be classified as primary due to their "strategic" nature.

\(^3\) Risk-sharing contracts stipulate that companies jointly engaged in oil exploration will have joint ownership of any oil reserves found.

\(^4\) Author's interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
refining of oil and natural gas. The United States, furthermore, wanted immediate, rather than phased-in concessions.\(^\text{18}\)

In the end, U.S. gains in investment were limited in electricity, and negligible in oil and gas: "Mexico succeeded in keeping its hydrocarbon industries closed to foreign participation. NAFTA specifically reserves to the Mexican state the right to control all activities and investment in the exploration, exploitation, refining, transportation, storage, and distribution of crude oil and natural gas, as well as the production, transportation, storage, and distribution of artificial gas, primary petrochemicals, and all other goods obtained from the refining of crude oil and natural gas."\(^\text{19}\) In addition, risk-sharing contracts are not allowed, nor is foreign participation in the retail gasoline market. The U.S. did not attain its goals in key investment areas in the oil and gas sectors.

It did gain greater access to investment in petrochemicals. Basic petrochemicals were reclassified; 14 of the 19 basic petrochemicals that were present at the outset of NAFTA negotiations were liberalized, although 3 new basic petrochemicals were included in the list, so that 8 products remained off limits to foreign investors. A 40% cap on foreign investment in secondary petrochemicals was lifted gradually. Majority foreign investment in final petrochemicals was unilaterally liberalized since 1989.

Electricity was also liberalized. Under NAFTA, U.S. and Canadian investors are able to acquire, establish and operate electric generating facilities for their own use or for cogeneration. Nonetheless, all sales of surplus power must be done through CFE.\(^\text{20}\)

Coal was not regarded as a strategic sector when it came to making exchange of concessions. The 40% limit to foreign investment in coal mines and facilities was lifted after a three year phase-out period.

b) Trade

Cross border trade in gas and electricity was also a subject of interest in NAFTA negotiations. Mexico wished to maintain control over cross border trade in gas and electricity, while the U.S. wanted a strong degree of liberalization.

NAFTA did liberalize trade in gas and electricity, but with severe restrictions. While it allows for U.S. suppliers to negotiate contracts with and sell gas and electricity to end users in Mexico, all sales must be approved by PEMEX\(^\text{21}\) and CFE, respectively, and their infrastructure must be used to make

\(^{19}\) Maxfield and Shapiro 1998, 99.
\(^{20}\) CFE is the Comisión Federal de Electricidad, the government owned electricity monopoly (Federal Electricity Commission).
\(^{21}\) PEMEX (Petróleos Mexicanos) is the state oil monopoly.
the transfer. The Mexican government thus retains a veto over cross border sales of gas and electricity.

A much less contentious issue was trade in coal. Mexico had a 10% tax on coal. The U.S. requested the elimination of the tariff, and Mexico acquiesced.\(^2\)

Finally, trade in energy related equipment was also the subject of negotiations. Mexico treated it as a non-strategic issue, and negotiated sales of U.S. equipment to Mexico. There were discussions on rules of origin and tariff phase out calendars, but the end point was clear so that, at the latest, ten years after the entry into force of NAFTA all energy equipment sales to Mexico would be tariff free.

c) Energy supply commitments

The U.S. and Canada, as members of International Energy Agency, had signed an agreement in 1974 setting out the terms under which energy supplies to each other could decrease, and reaffirmed their commitment in the Canada-U.S. Free Trade Agreement, which had entered into force in January 1989. Mexico stated publicly, at the outset of negotiations, that it would not make any commitments regarding energy supplies ("No" number 3).

The U.S. and Canada "pushed adamantly for a Mexican commitment not to restrict energy exports to the other NAFTA countries during times of energy crisis."\(^2\) Mexico steadfastly refused to accept such a provision and remains unbound by commitments in this area.

d) Other issues

a. Procurement: Mexico stated at the outset that, regarding procurement, everything was on the table. The U.S. had great interest in participating in PEMEX and CFE contracts (Mexico is not a signatory to the WTO Government Procurement Agreement). As a result of NAFTA, a threshold of USD 250,000 was established, so that federal government enterprises not exempted from the Public Procurement chapter will open all tenders over this amount to North American competition. PEMEX and CFE were not exempted. Foreign participation in PEMEX and CFE contracts was fully liberalized after a 10-year transition period.

b. Performance contracts: While Mexico objected to risk-sharing contracts ("No" number 2) and its objection was recognized under NAFTA, it was not

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\(^2\) Hufbauer and Schott 1993: 36.
\(^2\) Maxfield and Shapiro 1998, 100.
opposed to using performance contracts as a bargaining chip. Under performance contracts, a service provider may earn a bonus if it exceeds certain pre-specified contract targets. The U.S. was interested in getting Mexico to accept performance contracts in the energy sector and Mexico acquiesced, although bonuses can only be paid in cash and not in kind.

c. Preferential energy prices: The issue at stake was that Mexican firms were getting lower oil and electricity prices than their foreign competitors in Mexico. Mexico was not unduly concerned about this issue and in any case was gradually reducing subsidies across the board, so it acquiesced to U.S. demands that it end preferential energy prices.

In short, Mexico had a clear stance in energy negotiations. It spelled out its five “No’s” and the fact that its Constitution would not be amended to accommodate NAFTA. In principle everything else was amenable to negotiation. Despite strong and consistent U.S. pressures to liberalize investment in the oil sector and subscribe to energy supply commitments, Mexico was able to fulfill its basic defensive aims in the NAFTA negotiations. How it managed to do it is examined in the following section.

II.- Available explanations

a) The puzzle revisited

The empirical puzzle can be restated in a succinct manner: how was Mexico able, despite extremely strong U.S. insistence and most political pundits’ expectations, to keep the energy sector largely out of NAFTA negotiations, and to avoid concessions in terms of energy security when both the U.S. and Canada “pushed adamantly” to make Mexico acquiesce?

The outcome is a puzzle if one places pride of place to Realist explanations that hinge on power disparities and on the specific needs of the U.S. in terms of energy security, with its southern neighbor possessing vast oil reserves and the precedent of having recently obtained energy supply

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24 Out of the five “No’s” three of them (those covering foreign investment in the energy sector, risk contracts, and trade in energy) could ostensibly be viewed as being covered by the Mexican Constitution under Articles 25, 27, and 28. The remaining two “No’s” (on energy supply commitments and on foreign retail gasoline outlets) may have been politically sensitive issues, but there were no constitutional prohibitions on the matter.

25 See Krasner 1990.
commitments with Canada under the Canada-U.S. Free Trade Agreement (CUSFTA). There are, of course, other stands of thought regarding the effects of asymmetry. For instance, Keohane argues that the interaction between stronger and weaker states need not necessarily lead to asymmetrical results, partly as a result of differences in preference intensity.\(^2^6\) However, unless we can account for preference intensity independently of negotiation results, this approach may lead to a post-hoc ergo propter hoc explanation. Given very intense preferences, weaker states must also be able to translate them into the desired outcome, and thus an examination of the negotiation process may still be apposite.

Likewise, analyses of NAFTA negotiations that look at initial positions and outcomes and conclude that the results show that Mexico gave precedence to sectoral aspects of the negotiation while the U.S. favored trade principles\(^2^7\) also run the risk of post hocery, unless careful attention is paid to the process that led from initial positions to eventual outcome.

Finally, pundits in Mexico pointed to the fact that Mexico would have to pay dearly to obtain its offensive and defensive aims in NAFTA, and that in any case the relative dearth of experience with international trade negotiations of the Mexican team would mean that U.S. negotiators would ride roughshod over them. Throughout the negotiation process, several Mexican newspapers reported the Mexico had "given in" on the energy issue, and simply thought it would be impossible to conclude a satisfactory negotiation for Mexico in terms of market access without relenting on energy.\(^2^8\)

From a theoretical perspective, the case can shed light on the way in which weaker states negotiating with stronger states can defend themselves effectively against unwelcome demands by the latter. Specifically, it explores the way in which different process-related variables affect the likelihood of successful defense against distributive strategies. The focus is on the options available to a weaker state defending against offensive distributive strategies. Before turning to the role that strategies, cognitive biases, domestic politics and markets played in NAFTA oil negotiations, I deal with alternative explanations.

\(^2^6\) See Keohane 1990.
\(^2^7\) See Maxfield and Shapiro 1998.
\(^2^8\) The Mexican daily El Financiero stuck to this line of reasoning throughout the negotiations. Among the pundits expecting Mexico to “give away the shop” were two prominent left-leaning intellectuals, Adolfo Aguilar Zinser and Jorge G. Castañeda.
b) Alternative explanations

Stephen Krasner holds that cooperation and the ensuing creation of international institutions is difficult when states with very different power capabilities interact, as a result of both stronger state and weaker state incentives. Stronger states will prefer to act unilaterally and to be unbound by restrictive accords with weaker states. The latter will be hesitant to negotiate agreements that will increase its interactions (and thus vulnerability) with stronger states, will not be able to effectively resist non-compliance by the stronger state while the weaker state will have to comply, will experience weakened autonomy, and will in any case have a better option in bargaining multilaterally, where coalitions are possible. These considerations led him to conclude that a trade agreement between México and the U.S., similar to the one established between Canada and the U.S., was extremely unlikely.

Krasner's prediction was not borne out, for NAFTA was signed just two years after publication of his article. One might argue, following an earlier work by Krasner, that U.S. national security interests are the driving force behind its behavior in the world political economy, and that security concerns explain why it chose to be bound by a restrictive accord instead of acting unilaterally in its relations with Mexico. However, the fact the investment in the oil sector and energy supply commitments, which were dear to U.S. negotiators, were left out of the agreement, raises questions about the alleged overdriving force that security concerns should have had in shaping U.S. negotiation aims, and more so results.

In terms of Mexico's securing an agreement where it obtained its main offensive and defensive aims, and where one of the offensive aims was precisely compliance guarantees through legalized dispute settlement, means that an approach to economic interaction among states of different power capabilities that leaves out process has difficulty in accounting for a key NAFTA outcome: energy negotiations.

Keohane does not expect necessarily asymmetrical results from asymmetrical interaction, nor does he see great impediments to international cooperation under this setting. He argues that in some issue areas (such as migration and drugs) it is difficult for stronger states to achieve their policy goals on a unilateral basis, so they have incentives to cooperate. Regarding weaker state leverage in international negotiations, he argues that preference intensity can sometimes compensate for the effects of power asymmetry, as

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29 See Krasner 1990.
30 See Krasner 1978.
31 See Ortiz Mena L.N. 2001 for coverage of compliance concerns and dispute settlement in NAFTA negotiations. The model therein developed attempts to account for symmetrical outcomes under conditions of asymmetrical bargaining by redefining conceptions of power and vulnerability, while still leaving out process.
32 See Keohane 1990.
can the fact that it is possible for weaker states to strike alliances with domestic groups in the stronger country, as part of its negotiating strategy.\textsuperscript{33}

While Keohane does contemplate the possibility of weaker states striking bargains with stronger states that are not the mere reflection of stronger state interests, his framework does not allow for a systematic analysis of the conditions under which weaker states may perform best in their negotiations with stronger states. In particular, a focus on preference intensity can lead to tautological reasoning. We need to understand what makes for weaker state influence, beyond generalities such as preference intensity and their ability to play the domestic politics game in the stronger state.

In terms of specific analyses of NAFTA negotiations, the works are relatively few. Most of them deal with negotiation outcomes, and the pros and cons of the bargains struck,\textsuperscript{34} rather than with the reasons for the observed gains and losses reflected in the legal text. Maxfield and Shapiro, Mayer, and Cameron and Tomlin are among the few works that deal with the reasons behind the negotiation outcomes.\textsuperscript{35}

Following a sectoral analysis, Maxfield and Shapiro attempt to assess who "won" and "lost" each sector. Regarding oil, their assessment is that the U.S. made some gains given the inclusion of energy in the negotiations despite initial opposition from Mexico and by the mere fact that there is an energy chapter in NAFTA, but lost on foreign participation, made only limited gains in market access and made no headway on energy exports in times of crisis. They conclude that "On balance, Mexico came out ahead in this chapter of the NAFTA negotiations."\textsuperscript{36}

Their explanation for the observed outcome is, however, unsatisfactory. They focus on initial preferences and negotiation outcomes, and largely leave out the negotiation process. They note that the U.S. tended to win in matters of trade law and principles (such as intellectual property rights and dispute settlement), while Mexico tended to win in sectoral issues, such as oil and agriculture, and conjecture that this may be the result of trade politics being more principles-based in the U.S. and sectorally-based in Mexico.

This, however, is a matter left to be explained, and there is considerable evidence that can yield opposite conclusions. Classics such as Schattschneider and Lowi, and more recent work with nuanced analyses such as Destler, O'Halloran, and Mayer point to the continuing importance of interest groups in the formulation of U.S. trade policy.\textsuperscript{37} Regarding Mexico, it opened up its economy on a unilateral basis during the 1980s and 1990s without strong

\textsuperscript{33} See also Odell 1980 on the use of transnational coalitions with domestic groups in the U.S. regarding U.S.-Latin American trade negotiations.  
\textsuperscript{34} See Hufbauer and Schott 1993; Leycegui and Fernández de Castro 2000; and Borja 2001, inter alia.  
\textsuperscript{35} See Maxfield and Shapiro 1998; Mayer 1998; and Cameron and Tomlin 2000.  
\textsuperscript{36} Maxfield and Shapiro 1998, 101.  
\textsuperscript{37} See Schattschneider 1935; Lowi 1964; Destler 1986; O'Halloran 1994; and Mayer 1998. Interestingly, Maxfield and Shapiro do mention Schattschneider, but do not follow upon his arguments.
pressure group action in favor of free trade, while a significant number of groups clamored for continued protection.\(^{38}\) In this view, U.S. trade politics should be portrayed as sectoral and Mexico’s as principles based, \textit{contra} Maxfield and Shapiro’s formulation. They suggest that research dealing with the relative insulation of trade policymakers and business preferences may shed some light on the NAFTA bargain.

A better understanding of negotiation outcomes thus requires, at a minimum, a closer analysis of the role played by domestic politics, and that is precisely what Mayer sets out to do.\(^{39}\) Following Putnam, he argues that the U.S. was interested, from a business perspective, in having Mexico open up its energy sector, which would benefit U.S. oil companies and their suppliers; from a national security perspective, secure energy supplies from Mexico would mean less reliance on “insecure” Middle Eastern supplies. Both of these considerations “weighed in” on key Texan political figures which were to play an important part in NAFTA negotiations: President George H. W. Bush, Secretary of State James Baker, Secretary of Commerce Robert Mosbacher, and Senate Finance Committee Chairman Lloyd Bentsen.\(^{40}\)

While Mexico needed foreign investment to modernize its inefficient oil infrastructure, domestic politics played a significant role in determining its negotiating position. Since the 1938 nationalization of the oil industry (largely affecting U.S. and UK interests), oil had become a symbol of national sovereignty. In the end, domestic politics and the symbolic importance of the oil industry outweighed purely economic considerations, and at the outset of the negotiations the Mexican government spelled out its five “No’s” regarding energy.

Following comments by U.S. Deputy Chief Negotiator Charles E. ”Chip” Roh on the logic behind Mexico’s stance, and the reasons for the position taken by U.S. oil firms, Mayer ventures that the strong position taken by Mexico may have been the result of advice given to them by Canadians, regarding the importance of stating explicitly at the outset of negotiations what is off limits, for otherwise the U.S. will “beat you and beat you again.” In addition, the strategy may also have been designed to play a role in Mexican domestic politics, so Mexican negotiators could say that they had been tough on oil, and thus the rest of the deal would look more palatable. The U.S. implicitly understood this, and countenanced from the outset that it could “come short” on oil, but expected to compensate with gains in other

\(^{38}\) Ortiz Mena L.N. 2004a.

\(^{39}\) Mayer uses three levels of analysis (international, domestic, and individual), and three modes of politics (rational choice, regime theory, and symbolic response), depending on the negotiation issue and aspect to be analyzed (Mayer 1998, 13-28). For the specifics of NAFTA negotiations (as opposed to the decision to negotiate, the fast track renewal negotiations, or the ratification), he largely focuses on domestic politics, or more precisely on a two-level bargaining model based on Putnam 1988.

\(^{40}\) Mayer 1998, 117-118.
areas. Finally, the U.S. oil industry had a clear sense of the possible and did not exert undue pressure after an initial try.41

In interpreting the outcome given these incompatible preferences, Mayer notes that for the U.S. one of the initial appeals of NAFTA had been improved access to Mexican oil, both in terms of investment and secure supplies, and that energy had been a most difficult issue from the outset of negotiations. Despite Mexican protestations, U.S. negotiators were not convinced that Mexico would not budge on the issues of foreign investment in the energy sector and on energy supply guarantees. Near the end of the negotiations, Mexican Trade Minister Serra threatened to walk away if the U.S. insisted on the oil issue, and the message was also conveyed to the U.S. delegation by President Salinas' chief of staff. The U.S. relented when it realized that Mexico would not budge, and at the same time the U.S. was by then in a hurry to wrap up the negotiations. It opted to make some gains in the energy procurement area instead.

In Mayer's view, then, two factors were key in determining the outcome of the energy negotiations: Mexico's domestic political constraints and domestic political developments in the U.S., which put pressure on Bush to wrap up the negotiations. The political costs that would have been borne in Mexico by acquiescing to U.S. demands on investment in oil and energy security would have been so high that no issue linkage (concession) by the U.S. would have compensated for it, and the U.S. finally came to understand this.42

As the November 1992 U.S. presidential election approached, Bush's approval ratings continued to deteriorate, and Republican political operatives decided it would be important for Bush to announce the successful conclusion of NAFTA negotiations during the Republican National Convention, which would take place in mid-August. They viewed the agreement as a political asset for Bush, that at the same time could be used to pressure candidate Bill Clinton to stop fudging on the issue and support NAFTA, lest he be accused of pandering to special interests (v.gr. labor). With that aim in mind, a negotiating session in the infamous Watergate complex started on 29 July, and ended shortly after midnight, 12 August. Energy was one of the issues not settled until the final stretch.43

Mayer's account of the energy negotiations is not inadequate, but rather incomplete. With his detailed analysis of domestic politics in the U.S. and Mexico, and how they played into the international negotiations, he goes further than is possible with Krasner and Koehane's basically systemic approach, and his explanations do not have a post-hoc tinge, as is the case.

41 Mayer 1998, 119. The quotes in this paragraph refer to Charles E. "Chip" Roh's views, as transcribed by Mayer.
43 Mayer 1998, 139-140.
with Maxfield and Shapiro. However, several important questions are left unanswered.

For instance, why was it that Mexico's domestic political constraints were not taken as credible by the U.S. at the beginning of negotiations but were so taken at the end? Did the urge to wrap up the negotiations make the U.S. relent on the issue, or did its conception of Mexico's reservation value actually change? Why wasn't the U.S. able to convince Mexico that its own reservation value demanded an agreement that included greater access for U.S. investors in the Mexican energy sector, energy oil supply guarantees, or both? Was not Mexico also under pressure to conclude the agreement, and if so why didn't the U.S. use that fact to force Mexico into granting additional concessions in this key sector? More generally, when is a domestic political constraint to be credible, and how can it override otherwise substantial power differentials among negotiators? If Mexico did manage to exclude a significant scope of its energy sector from NAFTA negotiations, did it have to pay a high price for it in terms of negotiation tradeoffs? Before turning to these issues following the NWE framework, I assess how well Cameron and Tomlin deal with them.44

Cameron and Tomlin provide a very detailed account of NAFTA negotiations by focusing on several key junctures in the process, and analyze the events through various approaches which include Neorealism, Neoliberalism, two-level game theory and their own "integrated" argument, which encompasses elements of the previous three approaches and negotiation theories. The key additional ingredient that is incorporated in the integrated approach is the notion of subjective utility attached by the negotiators to their non-agreement alternatives at any given point in the negotiation, which is in turn affected by the degree to which negotiators are risk averse. These considerations lead Cameron and Tomlin to make predictions in three issues, which are compared to the predictions made for those same issues by Neorealism, Neoliberalism, and the two-level game approach.

They expect that cooperation under anarchy among asymmetrical players will not necessarily lead to asymmetrical results, the reason for this being that the weaker state may have a better non-agreement alternative than the stronger one, and it may also have a lower discount rate. In terms of domestic politics, they expect negotiators of stronger states to be less responsive to weaker state demands vis-à-vis the stronger state's domestic constituents, and vice-versa. They also expect a bargaining process in which the lower the subjective utility awarded to its non-agreement alternative, the more a given country will perceive the agreement in terms of gains over its best alternative to a negotiated agreement (batna), the more risk averse it will be to achieve those gains, the less willing it will be to risk the agreement by withholding

44 See Cameron and Tomlin 2000.
concessions, and the more concessions it will offer in order to obtain an agreement (and vice versa). How well does the Cameron and Tomlin approach allow us to understand the outcome on NAFTA energy negotiations?

Regarding asymmetry, Cameron and Tomlin's approach yields equivocal results. They state that Mexico was the demandeur and wanted NAFTA "very badly," and that "the most important asymmetry lay in the fact that Mexico needed the United States much more than the United States needed Mexico. The Mexicans had examined the alternatives and had already decided that they preferred NAFTA to anything else available to them." While they recognize that at the end of the negotiations in August 1992 the U.S. was on a rush to conclude in order for Bush to present NAFTA as an important achievement, in an attempt to bolster his flagging ratings shortly before the November presidential election, it is not immediately clear whether the U.S. had more to lose than Mexico from a failure to conclude negotiations successfully. Their focus on the effect of each party's batna on negotiation strategies and outcomes is correct, but the ex-ante specification of batnas to allow clear predictions is very difficult. If only the asymmetry strand of their argument is contemplated, it does not explain why the U.S. relented on oil.

It is surprising is that the U.S. pushed for a liberalization of investment in the energy sector throughout the negotiations, but that U.S. oil companies did not exert undue pressure either on U.S. negotiators or directly on Mexican negotiators. "The major oil companies were [...] "pretty sophisticated" [...] in that they wanted to open up Mexico's energy sector but knew that Mexico would not do this at the behest of the United States." Thus, the U.S. pushed hard on liberalization without undue pressure from U.S. interests, and then relented in the face of steadfast Mexican opposition. A strict focus on domestic politics would have predicted less pressure on the investment issue, and cannot account for U.S. attitudes on energy supply commitments, for no specific interest group was pressing for it. By and large, U.S. negotiators were not acting on behalf of interest groups, and relented in the face of the weaker state's position on all major issues.

The third strand of their argument, on the bargaining process, can be seen as an extension of their parsimonious hypothesis regarding asymmetry. They give ample evidence to bolster their claim that Mexico was very risk averse and, as mentioned above, very badly wanted NAFTA. According to Cameron and Tomlin, during the Dallas plenary meeting held in February 1992 Mexico caved in too soon and gave away concessions to the U.S. (basically in financial services) in order to push along negotiations to an early conclusion. While Mexican behavior at Dallas coincides with Cameron and Tomlin's expectations,
subsequent behavior does not, especially in the energy area. Mexico’s high degree of risk aversity should have meant that it should not have been willing to put the whole agreement at risk by withholding concessions.

However, in the final stretch of negotiations which took place in the Watergate Hotel from July 31 to August 12, the Mexicans were “stubborn in their continued refusal to guarantee energy export levels to the United States during times of shortage [...], leading Canada to indicate that should Mexico prevail, they would seek to change the [CUS] FTA provisions on this issue.” With Mexico additionally adopting a maximalist position on procurement regarding PEMEX (it wanted to reserve all contracts for Mexican companies), trilateral discussions were suspended.

In the end, Mexico managed to get away with its five “No’s” (its main defensive aims), and at the same time to attain its main offensive interests in the negotiation: to ensure full market access to the U.S. and Canadian markets, to have a tariff reduction schedule that recognized asymmetries (the U.S. and Canada liberalized faster than did Mexico), and to establish an effective dispute settlement mechanism. Mexico attained all its negotiation aims without apparently paying too high a price for them. How was this possible, if the U.S. should have had the upper hand given asymmetry, domestic politics, and negotiation advantages?

Both Mayer, and Cameron and Tomlin, give partial answers to this question, but ultimately cannot explain how Mexico was able to defend successfully against demands by the U.S. In what follows, I examine the issue through the NWE framework.

c) The role of the negotiation process in successful resistance against U.S. demands

Odell analyzes how negotiator beliefs, markets, domestic politics, and the institutional setting influence negotiation strategies and, accordingly, outcomes. In what follows I examine the way in which these factors affected Mexico’s attempts to defend against demands by the U.S. in the NAFTA energy negotiations. In the final section 3, some hypotheses developed in Chapter 9 and recommendations set out in Chapter 10 of NWE are examined under this light.

There is much we still have to understand about successful defense against an offensive distributive strategy. In NWE, several cases are presented (Brazil defending against the U.S. on instant coffee, Mexico defending against U.S. AD actions on Mexican tomatoes, Japan defending against U.S. on

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50 Cameron and Tomlin 2000, 161-162.
51 Salinas 2000, 76.
52 See Odell 2000.
exchange rate adjustments, and on beef), but as Odell notes "the defending side will [...] want to tailor its tactics to the particular situation."\(^{53}\)

- Mexico’s sequentially mixed strategy

One key reason for this puzzling outcome is that Mexico displayed a sequentially mixed strategy, opening with mostly distributive moves and mixing in some integrative ones near the end.

There is a vast array of actions available to weaker states when they wish to defend against an offensive distributive strategy; a defensive distributive strategy is just one of the alternatives, and not always the best one, as demonstrated by the 1969 Brazilian instant coffee case.\(^{54}\)

During the pre-negotiation phase (from the announcement in early 1990 that a Free Trade Agreement --FTA-- between Mexico and the U.S. might be negotiated until the formal start of negotiations in June 1991) Mexico basically adopted a defensive distributive strategy. It maintained that strategy during the early phases of NAFTA negotiations, and when they neared the end Mexico turned to a mixed strategy. The decision to mix strategies in a sequential manner was decided from the outset of negotiations.\(^{55}\)

NAFTA negotiations started, albeit informally, earlier than is commonly known.\(^{56}\) In November 1988 President Bush met with President Salinas. Bush proposed an FTA to Salinas, but Salinas declined. During his campaign, Salinas had made no mention of the need to negotiate a free trade agreement with the U.S. On top of his doubts about the intrinsic convenience of striking such a deal, he was worried that Mexico was about to start negotiations over Mexico’s foreign debt with the U.S. and did not want to mix debt negotiations with trade negotiations, fearing that possible gains for Mexico in the debt area would be countered by concessions in trade.\(^{57}\)

In March 1990, a month after Mexican Trade Minister Serra had proposed the negotiation of a bilateral free trade agreement to the USTR’s Carla Hills, Canadian Prime Minister Brian Mulroney traveled to Mexico City and mentioned to Salinas that, in his dealings with the U.S. during the recently concluded Canada-U.S. FTA, he had learned that it was very important to make it absolutely clear to them at the outset of negotiations what was

\(^{53}\) Odell 2000, 210. The discussion is divided according to analytically separate concepts to clarify the arguments, but it must be borne in mind that their interaction is in reality quite complex.

\(^{54}\) Odell 2000, 141-147.

\(^{55}\) Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.

\(^{56}\) Please refer to the appendix to this chapter for a chronology of NAFTA negotiations.

\(^{57}\) Salinas 2000, 12.
simply non-negotiable, in order to avoid unpleasant surprises. Salinas heeded Mulroney’s advice.

At an economic cabinet meeting in May it was decided that oil would be excluded from the negotiations, according to the precepts of the Mexican Constitution. Thus, a negotiation tactic would be that Mexico’s Constitution would not be reformed to accommodate NAFTA negotiations, so Mexico’s limits regarding concessions were clear cut. This decision was conveyed to Brent Scowcroft, Bush’s National Security Advisor. At the same time, Serra had insisted that intellectual property rights (IPR) be kept as a negotiating card for future use.\(^5^9\)

Despite Mexico’s communications with top Bush advisors, the U.S. kept up the pressure to include oil in the negotiations even before they had formally started. For instance, in August 1990 U.S. Commerce Secretary Robert Mosbacher gave an interview to ABC News, where he stated that oil would be in the negotiations, and specifically the issue of oil supply guarantees.\(^6^0\)

The Mexican government realized that it would have to be prepared to counter U.S. pressures in the negotiations, and specifically on the oil issue. Accordingly, Salinas established an inter-ministerial commission, where all NAFTA-related issues would be discussed and cleared before any public airing of views.\(^6^1\) He also established the NAFTA Negotiation Office (which was highly centralized and answered directly to the president himself), kept recalcitrant members of the Foreign Ministry “out of the loop,” and favored the creation of COECE, the Foreign Trade Business Organization Council, which coordinated all private sector actions in relation to NAFTA negotiations.\(^6^3\)

Once the institutional structure for the negotiations was created, specific guidelines for negotiators were set out. In terms of defensive aims, at this stage it was deemed insufficient to simply rely on the assertion that the Constitution was not part of the negotiations. Thus, the five "No's" were dictated to the negotiating team with instructions to stand absolutely firm regarding those issues throughout the negotiations. They would simply state and restate the position, and not engage in any arguments about it. The defensive aims were at the same time coupled with offensive aims (market access that recognized asymmetries, and the establishment of an effective dispute settlement mechanism).

These guidelines allowed the possibility of striking a deal with the U.S., given the very wide range of issues that were subject to negotiations, through cross-sectoral tradeoffs (IPR and foreign direct investment -FDI-- liberalization

\(^{58}\) Salinas 2000, 60.
\(^{59}\) Salinas 2000, 67.
\(^{60}\) Salinas 2000, 71.
\(^{61}\) Salinas 2000, 72.
\(^{62}\) Schiavon and Ortiz Mena L.N. 2001.
\(^{63}\) Ortiz Mena L.N. 2004b.
together with investor-state dispute settlement were of paramount importance to the U.S. Mexico was also interested in getting agriculture on the table, even though it was extremely vulnerable in some areas, above all corn. Radical transformation of Mexican agriculture was required anyway, and it was used as a bargaining chip; current levels of domestic support for agricultural products were simply unsustainable, and something had to give. In addition, Mexico could make important gains in terms of market access. If Mexico requested exceptions, it would be inundated with requests from Mexican interest groups, and U.S. groups would soon start to follow suit. The basic tenet was that under NAFTA liberalization would be for real, and the negotiations would decide the "how" and "when," not the "if." Even the strict limits set out for oil still allowed some compromises; while the five "No's" indeed posed significant restrictions on what was clearly non-negotiable, there was room for a deal regarding foreign investment in secondary and final petrochemicals, electricity generation, international trade in oil and gas, performance contracts, and procurement. In addition, the sectors that were off limits from the negotiations were among the most politically volatile, so it was relatively easy to strike deals on the somewhat less politicized issues that were on the table.

While the Mexicans were preparing for negotiations, the U.S. continued to press Mexico on oil. In November 1990, a key meeting between Salinas and Bush took place in Monterrey, Mexico. Salinas asked Bush to include migration in the trade talks, but Bush replied that the U.S. Congress would not ratify the agreement if it encompassed migration. Salinas then acquiesced to excluding migration from the talks, but stated that oil would accordingly also be excluded. The reservation values had been clearly posited, although Bush noted that the ratification of the agreement without the inclusion of oil would not be easy. U.S. negotiators kept up the pressure on oil until the end of negotiations.

Mexico no longer insisted on including migration, and used similar integrative strategies to counter U.S. pressures. It did not attempt to offset defensive with offensive aims. The negotiating strategy was to offset its defensive distributive strategy with its partners' own defensive distributive strategy; otherwise it may have been under great pressure in terms of foregoing offensive aims or acquiescing to U.S. offensive aims in order to

64 The majority of Mexico's corn producers are very inefficient. Most of them are quite poor self-subsistence farmers.


maintain its energy sector off limits. The costs of exclusion may have been prohibitively high.  

Specifically, at the first preparatory meeting the Mexican team defended its demand to exclude petroleum by arguing that it was only fair, since the U.S. had decided to exclude maritime transportation, and Canada excluded (against strong U.S. objections) cultural industries. Given that each party had items that were off limits from the negotiations, Mexico argued that there was fairness in the position each had taken.

Mexico also understood that Canada would threaten to demand a modification of CUSFTA provisions on energy supply commitments should Mexico not accept a similar commitment, which in turn would generate incentives for the U.S. to press Mexico hard on the issue. Accordingly, an additional integrative strategy used was that each country was to reserve a strategic sector: for Canada, in addition to cultural industries, it was its vast freshwater reserves. If Canada had exempted water from the CUSFTA, Mexico was entitled to exempt oil from NAFTA, so the equivalence was oil vs. water, and not oil vs. oil.

Once formal negotiations got under way, Mexico started with a defensive distributive strategy: it refused to discuss the energy issue, and was opposed to the creation of an energy working group as part of NAFTA negotiations. Later on it acquiesced to U.S. Chief Negotiator Carla Hills’s demands for the creation of an energy working group, but Mexico insisted it be called an energy and petrochemicals working group, given there was space for negotiation on petrochemicals, but none on investment and energy supply guarantees.

This set the basis for the tactic used by Mexico whenever oil resurfaced in the discussions: it held fast to the five “No's”, tirelessly repeating them and entertaining no arguments about them; it offered to discuss energy related issues that were not contemplated in the “No's”, and it also stated that a violation of the five “No's” would not only shoot down the whole agreement but that if the U.S. pushed too far and too hard the whole issue would blow up in Mexican domestic politics with grave consequences for both countries.

Mexico’s strategy, however, was not sufficient on its own accord to successfully defend against demands. It had to be coupled with measures to guard against informational biases, actions in both the U.S. and Mexican

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68 Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
69 The U.S. exclusion involved Section 27 of the 1920 Merchant Marine Act, known as the Jones Act.
70 Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
71 Salinas 2000, 90.
72 Cameron and Tomlin 2000, 83.
73 Author’s interview with Jaime Zabludovsky Kuper, Deputy Chief NAFTA negotiator, Mexico’s NAFTA Negotiation Office, Mexico City, 15 August 15 2003.
74 Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003. The section on domestic politics elaborates on the way in which Mexico’s threat of domestic political instability was made credible.
domestic politics scene, and the reduction of potentially adverse effects from an unfavorable evolution of events that were beyond its control to achieve the results that we know.

Beliefs

The long NAFTA negotiation process turned out to be a blessing in disguise. The Salinas administration’s experience in dealing with the Bush team started with its debt negotiations of 1988-1989. During those negotiations, they learned that the U.S. delegation was not monolithic, that some officials could be played off against others, and that when negotiations reached delicate points it was both possible and useful to have Salinas speak directly to Bush, who would then exert pressure on his own team. The Mexican team was no longer under the impression that its U.S. counterpart was invulnerable.75

Fast track negotiations also helped the Mexican team learn about U.S. preferences. In order for President Bush to obtain a renewal of fast track negotiating authority, a major lobbying effort by both Mexico and the U.S. had taken place. In December 1990 Mexico opened a branch of its NAFTA negotiation office in Washington. Mexican officials of the Washington office made a concerted effort to establish close links with both U.S. legislators and U.S. interest groups to aid in fast track approval. The contacts and knowledge derived from the fast track negotiations proved invaluable for the subsequent negotiations. The “intelligence” work conducted by the Washington office was very sophisticated and useful for Mexican negotiators. For instance, they were able to make assessments with a high degree of certainty on how different configurations of rules of origin for a given sector would affect congressional votes at the time of ratification.76

In addition to establishing the Washington office, Mexico hired a team of lobbyists and lawyers. Among the firms hired were Burson-Marsteller, Charles Walker and Associates, and Manchester Trade. Robert Herzstein, who had been a top U.S. trade official during the Carter administration and was one of the leading legal experts on unfair trade practices,77 ably led a team of lawyers from Shearman & Sterling that closely advised Mexican negotiators throughout the process. Mexico also hired several former USTR officials. In all, it spent approximately $35 million USD on lobbyists and legal advice throughout the three-year NAFTA process.78

75 Salinas 2000, 9-37.
76 Von Bertrab 1996, 109, 118.
77 In the 1970s he had helped Mexico successfully defend itself against U.S. AD actions on Mexican tomatoes, see Odell 2000, 102-104.
78 Salinas 2000, 93-94.
Another source of information, which could always be checked against the Washington office's assessments and with Mexico's lawyers and lobbyists, was the fact that the U.S. negotiating team was very decentralized, and leaks were common.79

COECE also contributed to avoiding biased information and thus inadequate strategies. Mexican business leaders were in close contact with their U.S. partners and competitors and continually fed information to the Mexican team on the political economy of the trade agreement. At the same time, given the extremely close links between COECE and the NAFTA negotiating team, the latter had a thorough knowledge of business concerns in Mexico, and used the information effectively in the negotiations.

Finally, U.S. domestic politics dovetailed nicely with the measures implemented by Mexico in guarding against incorrect information on counterpart preferences and strategies.

- Domestic Politics

Domestic politics played a role in allowing Mexico to defend against demands in at least two ways: it helped guard against biases, and also allowed Mexico to adjust its negotiation strategy with a view to achieving its offensive and defensive aims.

The U.S. political system is complex given its decentralized nature, but it is also very transparent when it comes to interest group politics. This feature allowed Mexico's NAFTA office, together with its myriad advisors, to do a thorough job of detecting legislator positions on each issue throughout the negotiations, and to make calculations on the required winning coalition (218 votes in the House and 51 in the Senate) for NAFTA ratification.80

The decentralized nature of the system also allowed the Mexican team to use the counterpart it thought best at any given point in time. Salinas met with Bush several times during the negotiations, reiterating Mexico's position on oil. The "Texan" group (James Baker, Robert Mosbacher, and Lloyd Bentsen) was also approached during negotiations; they had the "big picture" of NAFTA negotiations and did not let specific issues get in the way of the deal, whereas Hills was focusing exclusively on trade issues and in fact was not keen on NAFTA, at least at the outset. Specifically, Serra found it very useful to have two counterparts: he would deal with Carla Hills most of the

79 Cameron and Tomlin 2000, 78-90; and Von Bertrab 1996, 92-93.
80 Some opponents of NAFTA argued that a qualified majority of 67 votes in the Senate were required to ratify NAFTA (61 Senators voted in favor of NAFTA).
81 Author's interview with Jaime Zabludovsky Kuper, Deputy Chief NAFTA negotiator, Mexico's NAFTA Negotiation Office, Mexico City, 15 August 15 2003. Following congressional positions proved difficult, for shortly after the end of the negotiations the House was renewed and the negotiation of labor and environmental side agreements took place, forcing Mexico to continue with its lobbying and intelligence efforts. See Von Bertrab 1996, 180-254.
time, but he also dealt directly with Commerce Secretary Mosbacher as the need arose. The U.S. did not have that advantage, in that there was no division between politicians and negotiators, and Serra was the sole leader of negotiations.  

The knowledge of congressional positions also made it very difficult for Hills to bluff in terms of how much room for maneuver she had from interest group pressures; the Mexican team had virtually the same information as did USTR. Her threats were for the most part not credible, and in any case México could counter them via direct contacts with the relevant legislators and interest groups.

México had an apparent handicap in that Salinas (and the top negotiators) could not credibly state that Mexico's Congress would not approve certain concessions, for the president effectively controlled Congress. However, this was overcome in several ways.

First, the opacity of the Mexican political system meant that Mexico possessed an informational advantage over the U.S. in terms of the potential domestic political consequences of certain concessions (such as investment in oil, or the failure of NAFTA ratification), whereas México was at no such disadvantage regarding U.S. politics.

Second, Salinas made public pronouncements in México regarding the fact that the Constitution would not be modified, and repeatedly stated the five "No's". It would have been extremely difficult to backtrack on such clear public statements.

Third, small incidents were magnified to bolster the credibility of Mexico's stance on oil. When a member of the U.S. negotiating team made a public remark stating that oil was in the negotiations, Serra forcefully complained to Hills, and the negotiator was pulled out of the team. Likewise, when a Mexican Trade Ministry official casually remarked that energy would somehow have to be addressed in the negotiations, he was summarily sacked. On one occasion, Serra asked Zabludovsky to head the working group on energy; this was extremely rare as Chief and Deputy Chief negotiators did not head working group sessions. Incidents such as these were used by Serra to send a signal both to his negotiating partners and to the domestic political establishment in Mexico in order to bolster the credibility of Mexico's position on oil.

Fourth, vociferous opposition to NAFTA negotiations, and specifically the inclusion of oil, was favorable for Mexico's negotiators. Four of NAFTA's most outspoken critics (former presidential candidate Cuauhtémoc Cárdenas- the

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82 Author's interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
83 Author's interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
84 See Martin 2000 for current theories on executive-legislative relations, foreign policy, and the credibility of commitments.
85 Author's interview with Jaime Zabludovsky Kuper, Deputy Chief NAFTA negotiator, Mexico's NAFTA Negotiation Office, Mexico City, 15 August 2003.
son of General Lázaro Cárdenas, who had nationalized the oil industry in 1938—
leftist intellectuals Jorge G. Castañeda and Adolfo Aguilar Zínser, and José
Ángel Conchello, Senator from the right of center National Action Party) made
their views amply known. Aguilar and Castañeda even testified before the
U.S. Congress. Critics such as these helped convey to the U.S. the difficulty of
liberalizing investment in the oil sector and undertaking supply commitments,
given the strong opposition to such measures in both leftist and rightist circles
in Mexico. 86

Finally, Mexico’s stance regarding the five “No’s”, and the general nature
of the offensive aims, meant that they would be the reservation value in
terms of which the whole agreement would be judged domestically. It is
worth noting that in the press conference offered by Serra on 12 August 1992
just after the end of negotiations the first thing he mentioned, after the
compulsory acknowledgement to all those involved in the negotiations, was
that the Constitution was respected and the five “No’s” had prevailed in the
negotiations; only then did he turn to the offensive aims and state how
asymmetries had been recognized in terms of the pace of market
liberalization. 87

The five “No’s” also allowed Mexico to sidetrack any political opposition in
Mexico regarding NAFTA ratification, so while it toiled hard to maintain its
stance throughout the negotiations, in the end it greatly facilitated the
politics of ratification in Mexico. The Mexican negotiating team went so far as
to demand that Article 601 of Chapter VI (the Energy chapter), state that the
Mexican Constitution would be respected. It seemed like stating the obvious,
given that NAFTA would have to comply with each country’s constitution, but
it was inserted anyway. It is the only place in NAFTA where there is an explicit
mention of the Mexican Constitution. 88 Mexico’s exemption from energy
supply commitments was also clearly spelled out in the same chapter. 89

Market Conditions

Given that NAFTA was a multi-issue negotiation, not only the oil market
was relevant in worsening or improving each country’s batna. Mexico was
additionally concerned about the evolution of certain indicators of market
expectations, such as the exchange rate and the Mexican stock market index.

86 Salinas 2000, 84, 88, 122-126.
87 (Serra 1994, 635-637). In terms of offensive aims and the recognition of asymmetries, Mexico made great
strides when it convinced the U.S. to bind Mexico’s GSP tariff at zero upon entry into force of NAFTA. At the time,
Mexico was the most important user of U.S. GSP concessions (author’s interview with Jaime Serra Puche, Mexican
88 Author’s interviews with Jaime Zabludovsky Kuper, Deputy Chief NAFTA negotiator, Mexico’s NAFTA
Negotiation Office, Mexico City, 15 August 15 2003; Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico
City, 19 August 2003.
89 Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
In terms of U.S. market developments that affected negotiations, Mexico was concerned about a worsening U.S. recession, which was a difficult environment under which to contemplate trade liberalization, and political calendars, if they can be considered a market insofar as they entailed a context over which negotiators had no control. U.S. presidential (and congressional) elections were slated for November 1992 and Mexico did not want to deal with a different political setting for NAFTA ratification than for negotiations, or even worse for negotiations to be carried out with two different administrations.

Mexico’s batna worsened as NAFTA negotiations progressed. Whereas no business group in Mexico had requested that Mexico negotiate an FTA with the U.S., once negotiations got underway a self-fulfilling prophecy started to take place, whereby significant business groups asserted that the failure to achieve a successful negotiation would generate great market uncertainty and possibly spell serious economic trouble for Mexico.90

The Mexican team did what it could to protect itself from market developments. In late 1990 it spent a considerable amount of resources buying oil futures, with the aim of being able to count on a minimum amount of income for public coffers should oil prices fall.

Throughout NAFTA negotiations pressures on the peso and capital flight were on the increase, so that by the end of negotiations the exchange rate was close to the upper band.91 Oil prices did decrease, but due to the futures trading their impact on public finances were minimal.

While negative market developments could be used by U.S. negotiators to pressure Mexico, the fact that Mexico was already the U.S.’s third trade partner meant that if market dislocations were extreme, the U.S. would also be affected by negative externalities.92 To offset market pressures to which Mexico was subject, but which might also affect the U.S. and Canada, early on in the negotiation process the three Ministers responsible for negotiations struck an agreement whereby none of them would publicly commit to a specific date for the end of negotiations. The mantra was that substance would drive pace, and not the other way around.93

Attempts to keep the political calendar out of the negotiation process nonetheless proved futile. During the Dallas "jamboree" Mexico had precipitated into granting concessions too early, wanting to wrap up negotiations quickly in order to avoid their becoming entangled with the U.S. presidential election, but the U.S. was still playing with time and Mexico realized it would not be possible to secure an early agreement.94

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90 Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
91 The exchange rate regime followed under Salinas was that of a band.
92 Author’s interview with Jainne Zabludovsky Kuper, Deputy Chief NAFTA negotiator, Mexico’s NAFTA Negotiation Office, Mexico City, 15 August 15 2003.
93 Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
94 Cameron and Tomlin 2000, 101-105.
Paradoxically, in the end U.S. delay tactics and the U.S. recession ended up helping Mexico. While the recession made for a hostile environment for trade negotiations, it also gradually eroded Bush’s popularity, which had been extremely high after the U.S. victory in the Gulf War in early 1991. After the blunder committed by Mexico in Dallas, it learned to be more patient and played for time when it realized Bush’s reelection was at risk. Indeed, “U.S. haste in August [1992] was one factor that contributed to Mexico’s ability to avoid concessions in energy, even at the very end of negotiations.”

The most delicate moments in terms of economic market developments for Mexico actually came after the end of negotiations, during the ratification phase. Tradeoffs and negotiations continued even after the NAFTA text had been signed by the chief negotiators in San Antonio in October 1992, with Salinas, Bush, and Mulroney as witnesses.

In September 1993 Finance Minister Pedro Aspe noted at an economic cabinet meeting that, should NAFTA fail to be ratified, Mexico’s economic policy would be unsustainable. In November, Miguel Mancera, the Central Bank governor, expected serious exchange rate disruptions if NAFTA was not ratified. The members of the economic cabinet argued that help from the U.S. Treasury would be required in case of defeat, and planned on asking Treasury Secretary Bentsen for help when the moment came. The Mexican government asked its pollster for a survey on public perceptions should NAFTA fail, and found out that there would be no undue irritation, if there were no exchange rate impact. It then proceeded to prepare investment agreements with Germany, the UK, Spain and Japan, proposed changes to the Foreign Investment Law, intensified its lobbying efforts to join the OECD and finalized the details of the financial rescue package that would be presented to Bentsen. A worst case scenario was planned for, just in case ratification fell through. In the end NAFTA was ratified, but ratification had been far from a foregone conclusion. A great deal of arm twisting and pork had been required to secure the deal.

- The Institutional Setting

The institutional setting helped Mexico’s defense against demands by the U.S., because in a sense NAFTA was not only a trade negotiation, but also an exercise in institutional creation. It would serve as a template for future trade agreements with developing countries that the U.S. could subscribe,

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95 Cameron and Tomlin 2000, 234.
96 By this time Lloyd Bentsen had left the Senate to become the U.S. Secretary of the Treasury.
97 Salinas 2000, 176-186.
98 For accounts of the politics of NAFTA ratification, see Salinas 2000 Chapter 5; Von Bertrab 1996 Chapter 4; Cameron and Tomlin 2000 Chapter 9; and Mayer 1998 Section III.
and also as a model for the inclusion of certain issues, such as IPR, in GATT's Uruguay Round.

There was no precedent in terms of deep integration between two such different countries in terms of their wealth. While CUSFTA partly served as a template, it had been an agreement that integrated two developed countries; NAFTA was charting new territory and offered scope for invention. Furthermore, if the U.S. wanted to use it as a template for future "North-South" agreements it had incentives to push as far as it could, but it could not push too far lest the whole deal fall apart. That was definitely not the precedent it wanted to set. In contrast, Free Trade Area of the Americas (FTAA) negotiations offer little room for improvisation; they are a straitjacket whereby the scope for broad changes to the template and content is quite limited.99

For México it was fortuitous that the Uruguay Round (1986-1994) coincided with NAFTA negotiations. The U.S. wanted to use NAFTA as a precedent for the way a number of issues should be treated in the Uruguay Round, and thus insisted on some key "principles" issues such as IPR and investment, and did not get hung up on specific sectoral concerns.100

The Uruguay Round also made it easier for México to make some difficult concessions, such as those in agriculture, for it believed it would have to liberalize anyway, and opted to do so under NAFTA instead of in the Uruguay Round.101

III. Implications

The preceding section shows how it was necessary for México to display a wide array of actions in order to successfully defend against demands by the U.S. during NAFTA energy negotiations. Does the observed negotiation behavior and outcome concur with the expectations set out in NWE? Are there any lessons to be drawn from Mexico's experience? In this section, these issues are addressed.

Perhaps the odds of success for México in its defense against demands by the U.S. would certainly have been lower if it did not have the advantage of being the U.S.'s neighbor, which gave Mexico certain leverage in the

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99 Author's interview with Jaime Zabludovsky Kuper, Deputy Chief NAFTA negotiator, Mexico's NAFTA Negotiation Office, Mexico City, 15 August 15 2003.
100 Author's interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
Maxfield and Shapiro correctly note that the U.S. had a penchant for "principles" issues, but they surmise this was due to the limited influence of interest groups in the trade policymaking process. A more plausible explanation would link the U.S. penchant to the NAFTA negotiations being embedded in the Uruguay Round. See Maxfield and Shapiro 1998.
101 Salinas 2000, 118.
negotiations, for the U.S. will typically take into account non-economic considerations when negotiating over economic issues, and if circumstantial issues like the difficulties faced by George H.W. Bush in the prelude to the 1992 presidential election had not played out the way they did. However, the negotiation strategies followed by Mexico did affect the outcome.

It is difficult to ascertain the relative importance of all the factors that affected the outcome from a single case study, but is it possible to envisage a situation where, in the absence of an adequate negotiation strategy, NAFTA would not have come to fruition as a result of Mexico’s refusal to liberalize investment in the energy sector and provide energy supply guarantees, or where the costs of a successful agreement would have been higher for Mexico in terms of foregone offensive aims.

The actions taken by Mexico in its strategy choice, measures taken used to correct biases, its insertion into U.S. domestic politics, and the implementation of measures to counteract the adverse evolution market conditions contributed to the negotiation outcome that is described in the Northwestern cell in Figure 1.

<table>
<thead>
<tr>
<th>MÉXICO AYTA NTS ITS DEFENSIVE AIMS</th>
<th>NAFTA ATTAINED; ENERGY INVESTMENT AND SUPPLY COMMITMENTS OUT; MARKET ACCESS, TARIFF LIBERALIZATION, DISPUTE SETTLEMENT SUITABLE TO MÉXICO’S NEEDS</th>
<th>NAFTA BREAKDOWN; ENERGY INVESTMENT AND SUPPLY COMMITMENTS MUST BE IN FOR MARKET ACCESS, TARIFF LIBERALIZATION, DISPUTE SETTLEMENT TO BE SUITABLE TO MÉXICO’S NEEDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>MÉXICO ATTAINS ITS OFFENSIVE AIMS</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>Yes</td>
<td>NAFTA ATTAINED; ENERGY INVESTMENT AND SUPPLY COMMITMENTS OUT; MARKET ACCESS, TARIFF LIBERALIZATION, DISPUTE SETTLEMENT SUITABLE TO MÉXICO’S NEEDS</td>
<td>NAFTA BREAKDOWN; ENERGY INVESTMENT AND SUPPLY COMMITMENTS MUST BE IN FOR MARKET ACCESS, TARIFF LIBERALIZATION, DISPUTE SETTLEMENT TO BE SUITABLE TO MÉXICO’S NEEDS</td>
</tr>
<tr>
<td>No</td>
<td>NAFTA ATTAINED; ENERGY INVESTMENT AND SUPPLY COMMITMENTS OUT; BUT MARKET ACCESS, TARIFF LIBERALIZATION, DISPUTE SETTLEMENT NOT FULLY SUITABLE TO MÉXICO’S NEEDS</td>
<td>NAFTA BREAKDOWN; EVEN WITH ENERGY INVESTMENT AND SUPPLY COMMITMENTS IN (A THEORETICAL POSSIBILITY BUT A POLITICAL IMPOSSIBILITY), MARKET ACCESS, TARIFF LIBERALIZATION, DISPUTE SETTLEMENT NOT FULLY SUITABLE TO MÉXICO’S NEEDS</td>
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The actions taken by Mexico in its strategy choice, measures taken used to correct biases, its insertion into U.S. domestic politics, and the implementation of measures to counteract the adverse evolution market conditions contributed to the negotiation outcome that is described in the Northwestern cell in Figure 1.
One may object to this assessment, by saying that it was in fact Mexico’s position as the U.S.’s neighbor and U.S. bottom-line disinterest in securing gains in energy that determined the negotiation outcomes, and that they had little or nothing to do with Mexico’s negotiation strategy and complementary actions. In the view of Charles E. “Chip” Roh, Deputy Chief NAFTA negotiator for the U.S., being a neighbor in fact cut both ways: it gave Mexico some leverage, but also proved to be a burden insofar as negotiations ended up involving the environment party as a result of its geographic location and concerns over negative externalities, so in the end the “neighbor” effect evened out.\(^\text{102}\)

Likewise, the U.S. was concerned about gains in the energy sector for both substantive and strategic reasons. Substantively, the U.S. thought it could get participation contracts (with payment in oil reserves), and was disappointed when it was unable to do so. It was truly disappointed when it was also unable to secure supply guarantees, insofar as Canada had granted them and they had nothing to do with foreign investment. U.S. negotiators also reasoned that such a commitment would not mean treading new ground for Mexico, insofar as it had already assumed a general commitment on the matter as a result of GATT rules on supply restrictions.\(^\text{103}\)

Strategically, the U.S. needed Mexico to deliver something on oil because an exception of that nature could create problems for the whole negotiations insofar as other groups -not only in Mexico but also in the U.S. and Canada-- might have started to demand their exclusion from NAFTA. The principle was that everything was on the table, and negotiations would be about tariff reduction schedules.

In terms of strategy choice, Roh also considers that they affected negotiation results. For instance, setting out in public the offensive and defensive aims at the outset of negotiations and sticking to that position throughout the negotiations was of great help in bolstering the credibility of Mexico’s position. In contrast, other countries have dithered, thus creating expectations in the U.S. that are difficult to back out from once they are in the air, and weaker countries typically find it very costly to walk out from negotiations once they have started.\(^\text{104}\)

Mexico also came to realize that the U.S. needed to gain something on oil for political and strategic reasons, as noted above, and provided it. While the U.S. negotiators recognize that it is not good foreign policy to abuse the power of the U.S. in negotiations with weaker states, there are some demands (offensive or defensive) that for substantive, strategic, or political reasons must be met, and unless weaker states recognize that, they run the risk of


\(^{103}\) GATT 1994 Articles XI, XII, XIII, XIV and XVIII.

\(^{104}\) Author’s interview with Charles E. “Chip” Roh, Deputy Chief NAFTA negotiator, USTR, Washington, D.C., 30 September 2004.
having negotiations unravel. Thus, without a mixed strategy by Mexico within the energy area the whole NAFTA deal would have been at risk.¹⁰⁵

In short, strategies do matter, and they matter a great deal. The negotiation strategies available to Mexico, described below, can be applied by other countries when facing unwanted claims by a stronger state. Other actions, such as those carried out to counteract biases, to use domestic politics for negotiation ends, and to counteract the potentially adverse effects derived from market developments may be applied in general, and not only when defending against unwanted claims.

a) Strategies

Mexico had to tailor its defensive strategy according to the specific situation it faced as suggested by,¹⁰⁶ but there are nevertheless some general lessons to be learned. The expectation that choosing a mixed strategy, rather than strict distributive one, may gain more or lose less under some circumstances, even when negotiators believe their main strategies are in conflict, was borne out, as did the fact that sometimes sticking exclusively to a defensive distributive strategy does not produce adequate results.¹⁰⁷ Conversely, it was also true that strict adherence to a defensive distributive strategy will fail to discover gains to one’s side that are only possible with an integrative strategy.¹⁰⁸

While Mexico stuck to a defensive distributive strategy throughout the negotiations in terms of its five “No’s”, it did offer some flexibility in other energy areas (such as secondary petrochemicals, trade in gas and electricity, and procurement) and in other NAFTA issues like IPR and investor-state disputes. If its strategy had consisted of defensive demands in a vast number of areas, the room for maneuver would have been scant and the possibility of striking a deal low. By allowing bargains to be struck in other areas (creating a positive zone of agreement), it was easier to successfully defend against demands.

It is worth noting that the mixed strategy was facilitated by the fact that energy negotiations were embedded within the larger NAFTA negotiation, so cross-sectoral deals could be struck. It was also possible to develop a mixed strategy within the energy area by actions such as naming the working group “energy and petrochemicals” and bringing petrochemicals into the discussion, and by including PEMEX and CFE in procurement negotiations. This was

¹⁰⁷ Odell 2000, 185-186.
especially important for the U.S negotiators, insofar they would find it hard to explain why the energy negotiations had been a complete washout. Thus, Mexico needed to offer a mixed strategy not only across sectors, but also within the energy sector itself.

In addition, the mixed strategy was also created by dividing the negotiation process into stages, so principles were agreed upon first (the creation of a working group), and the details were left for later. This helped to break the impasse on energy, and concurs with suggestions to break impasses offered by Odell.¹¹⁰

Negotiating over the trade-related issues encompassed by NAFTA helped Mexico defend against demands, but there was also a lesson in avoiding other types of issue mix, as was the case of debt and trade negotiations. Mexico might have paid a high price for the exclusion of the energy sector by obtaining a worse deal on its debt renegotiations than it actually did. By keeping these issues separate, it was able to secure a good deal on both of them. The lesson here is not that mixing or separating issues is good or bad per se, but that the decision must be made on a case by case basis, and that even when issues are separated it may still be possible to find a way to generate a mixed strategy.

Another lesson is that it is best to use a defensive distributive strategy against another defensive distributive strategy, and not against an offensive distributive one. By positing that an exclusion should be counteracted by another state’s exclusion, a positive zone of agreement is created, and the weaker state is no longer compelled to offset its exclusion against its own offensive aims. If Mexico had enticed the U.S. into negotiations by hinting that a deal on energy was possible, and balked at the end, this may have generated a great deal of confusion and the construction of a winning coalition of votes in the U.S. Congress would have been severely hampered.

The framing of the issue also had an important impact on the success of the defense against demands. Mexico started to play off its exclusion against U.S. exclusions even before formal negotiations started, as when Salinas proposed the inclusion of migration in the talks, and when Bush refused, giving Mexico a reason to exclude oil without any concessions: it had already accepted the exclusion of migration. This tactic was followed in the negotiations when Mexico argued that the exclusion of oil was equivalent to the exclusion of maritime transportation by the U.S. (even though Mexico had no overriding interest in amending the Jones Act), and when it framed Mexico’s oil exclusion as equivalent to Canada’s water exclusion, so as to make equivalent Mexican energy supply commitments with Canadian water (and not energy) supply commitments. The specifics of the strategy relied on

¹¹⁰ See Odell 2000, 212.
imagination in terms of how to frame an issue differently, to be able to offset an exclusion with another exclusion.

The sequential mixed strategy, as opposed to a simultaneous mixed strategy also worked well in defending against an unwanted claim. The sequential nature of the offer helped Mexico play for time, so the U.S. had to decide during the last stages of the negotiation if it wanted to accept the tokens offered by Mexico in energy. If the offer had been simultaneous, the U.S. would in any case have taken the tokens for granted and kept on asking for more. Just like not having offset Mexico's defensive distributive strategy against the counterparts' own defensive distributive strategy could have translated into much higher costs of exclusion for Mexico, a simultaneous offer could also have translated into unnecessarily higher costs of exclusion.

b) Beliefs

Mexico's actions to avoid biases were extremely successful, and bear out the expectation that "If negotiators are subject [...] to cognitive judgment biases, then gains and losses from a strategy will vary directly with the extent to which the negotiator uses tactics designed to compensate his own biases."\textsuperscript{111}

The experience with recent negotiations in the international finance area (foreign debt) helped Mexican negotiators become familiar with the ways of U.S. negotiators. The negotiations over fast track renewal also helped Mexico gather both experience and above all a great deal of information on key players of the trade game, and their policy preferences.

However, the most important action taken to avoid biases was with the hiring of lobbyists and lawyers, and having them interact with members of the Washington NAFTA negotiation office. They helped Mexico understand the U.S.'s reservation value on a number of issues, and thus to design a negotiation strategy that ensured there was a winning coalition as a result of Mexican offers. It also meant that Carla Hills could not credibly bluff in order to extract concession from Mexico. Under a biased information scenario, it is possible to imagine an outcome where the U.S. could credibly state that an agreement without liberalization of oil investment rules and commitments on energy supply would not be approved by the U.S. Congress, or where the costs of exclusion were unnecessarily high.

Foreign advisors aided Mexico in revealing correct information about U.S. preferences, and also helped it avoid making costly mistakes in apparently small details when negotiators' agreements were translated into legalese. The negotiations were undertaken in English, and the first legal text was in English, so Mexicans had to be extremely careful that what they thought they had agreed upon was effectively what the legal text stated. Likewise, after the end of negotiations there still remained a phase where Congress had to

\textsuperscript{111} Odell 2000, 184.
issue implementing legislation for NAFTA, and it was also possible to lose some gains that were made at the negotiation table in the process of turning NAFTA into U.S. domestic law. The lesson to be learned here is that while Mexico's negotiators were extremely capable economists, an area of vulnerability lay in the different nature of the U.S. legal system and its great complexity. If a country is to defend against demands by the U.S. in economic negotiations, it seems that the most valuable foreign advisers may be not economists but lawyers.

The success of Mexico's actions during NAFTA negotiations can be compared to the failure of the gas pipeline negotiations between Mexico and the U.S. in the 1970s, when the Director General of PEMEX had made a public commitment in terms of the minimal acceptable outcome for Mexico (much as with the five "No's"), but given his biased information the whole project fell through and proved to be very costly for Mexico.

A question that deserves further research is the extent to which "experience" can be bought. While it is surely best to have experienced negotiators at the table, the vast majority of Mexican NAFTA negotiators had precious little -if any- experience in trade negotiations, yet they were able to secure all of their main offensive and defensive aims. This may not have been possible without the very significant amount of financial resources spent on advisors, so in some sense experience and knowledge can be bought.

c) Domestic Politics

Defending against demands by the U.S. has some advantages. The pluralistic and transparent nature of its political system means that, while it is a very difficult (might one say expensive?) endeavor to follow the positions of key legislators, it is nevertheless possible to do so. Apart from the informational component that can be derived from the particulars of the U.S. political system, it is also possible to act within it. Mexico effectively lobbied both legislators and interest groups during NAFTA negotiations and the subsequent ratification phase. In comparison, defense against demands may be harder against the European Union, given it now encompasses 25 countries, and some issues are dealt with by the European Commission while others are reserved to the nation states. Mexico's experience in negotiating with both the EU and the U.S. in free trade negotiations indicates that this may in fact be the case.
Apart from lobbying with legislators and business groups, Mexico made use of contacts with top members of the Bush cabinet and, as required, with President Bush himself, so negotiations were not circumscribed to what was taking place at the negotiating table. Multiple points of contact with U.S. officials were used to convey credibility to Mexico’s position of defense against U.S. demands on oil. Salinas reiterated Mexico’s position personally to Bush. As such, it was difficult for the U.S. to view the position as mere tactical positioning at the negotiating table.

Mexico also used domestic politics as leverage against U.S. pressures, closely following the expectation that "As constituents in a target country raise the political cost of compliance for their government, gains from [an offensive distributive strategy] will diminish." NAFTA’s opponents actually helped negotiators by stating their steadfast opposition against the inclusion of energy in the negotiations. This effect was amplified by the fact that opposition came from both the left and the right of the political spectrum and that it was conveyed directly to the U.S. audience, including Congressional hearings. Thus, an apparent handicap that Mexico had in the inability of Salinas to credibly threaten that his legislature would not approve certain energy concessions was countervailed (inadvertently) by NAFTA’s opponents.

In addition, Salinas had repeatedly stated in public that the Constitution would not be amended as a result of NAFTA negotiations, and that the agreement would have to abide by the five “No’s”. Going public helped Mexico bolster the credibility of its defense against demands, and to set political limits to what was acceptable. The specificity of Mexico’s defensive distributive strategy also helped its successful defense; if the defensive distributive strategy had resided solely on the fact that the Constitution was not up for negotiation, there could have been several ways to circumvent it. The more specific the defensive distributive strategy, the easier it is to use public pressure to support it.

It is worth noting that out of the five “No’s”, only those pertaining to foreign investment in the energy sector, risk contracts, and trade in energy can be construed as being covered by the Mexican Constitution; there are no explicit Constitutional prohibitions on energy supply commitments and foreign retail gasoline outlets. Nevertheless, the five “No’s” were always treated as an indivisible grouping of items that were non-negotiable.

The public commitment that the Constitution would not be amended to accommodate NAFTA negotiation needs was maintained for the energy sector, but in fact the Constitution suffered sixty-one amendments during NAFTA negotiations and ratification (January 1990 to January 1994). It is difficult

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115 Odell 2000, 184.
116 Calculation by the author based on López Ayllón 1997, 281-315. It is true that some primary petrochemicals were reclassified as secondary during this time, but the practice had been ongoing since the early 1980s, and those changes did not require Constitutional amendments.
to ascertain whether some of those amendments were the product of derived from NAFTA negotiations, but the main point is that Mexico's successful defense against U.S. demands in the energy sector did not reside in the simple recipe that the Constitution was not up for negotiation and that, given Mexico's Constitutional prohibitions on energy, the result was easily derived from the negotiating premise. The fact that not all five "No's" were covered by the Mexican Constitution, and that the Mexican Constitution was amended on numerous occasions concurrently with NAFTA negotiations, casts doubt on this simplistic explanation.

The non-democratic nature of the Mexican political system at the time also played in Mexico's favor, for its negotiators had a better notion of what Mexico's reservation values were than did the U.S. Mexico could thus somewhat magnify the supposed potential negative consequences of the U.S. going too far in its offensive demands, so that uncertainty regarding Mexican domestic politics tended to favor Mexico.

The "theatrical" use of small incidents, such as the public sacking of a Mexican Trade Ministry official for even hinting that oil would be in the negotiations also bolstered the credibility of threats regarding the defensive distributive strategy. Thus, a non-democratic state may, in some circumstances, still be able to make credible threats and even use the non-transparent nature of its political system in its favor.

An issue that merits further research is the virtual absence of U.S. oil companies from NAFTA negotiations. According to Odell, "The more that constituents inside a threatening country express opposition to implementing the threat, the more they will diminish overseas gains from the offensive distributive strategy." Had these companies pressed hard for liberalization and lobbied before Congress, Mexico would have had a more difficult U.S. domestic political environment to contend with and would have faced a harder time in defending against U.S. demands. Cameron and Tomlin posit that the oil companies had a better understanding of Mexico's reservation value, and opted to make gains in ways other than direct confrontation. Serra was surprised in that he did not receive any pressures from U.S. oil interests during the negotiations.

d) Market Conditions

In multiple issue negotiations such as NAFTA, several market forces may affect negotiations. In terms of the energy negotiations, the U.S. was
concerned about ensuring secure energy supplies from Mexico, as demonstrated by Mosbacher’s pronouncements shortly before the start of the Gulf War. This meant that the more the U.S. decided to stop relying on oil supplies from the Middle East, the greater the value of securing an oil supply agreement with Mexico. Ceteris paribus, this should have translated into bargaining leverage for Mexico.

However, given that under no circumstances would Mexico entertain granting supply guarantees to the U.S., greater political instability in the Middle East worked against Mexico for it enticed the U.S. to make strong offensive demands in an issue that Mexico was not willing to negotiate. In the end, the Gulf War did conclude successfully from a U.S. perspective, and oil prices remained at acceptable levels for the U.S. It is worth pondering what would have happened in the negotiations had oil prices continued to rise as a result of continued instability in the Middle East. At an extreme, it is possible to envisage that an adamant demand from the U.S. on energy supply commitments might have derailed the whole agreement.

The oil market posed an additional problem for Mexico, given the reliance of public finances on oil exports. Should oil prices decrease (as they in fact did), the government’s fiscal stance would be in a delicate position, and U.S. negotiators could press hard at the negotiating table knowing the Mexicans needed an agreement to calm down markets. A lesson from the Mexican case is that it bought oil futures and thus had control over the worst possible scenario regarding oil prices. In other words, it was able to limit the potential damage from certain adverse market developments, and acted accordingly.

In other issues, such as pressures against the exchange rate and capital flight, there was less the government could do except to try to secure a good trade agreement and hope it was done before markets started discounting the possibility of a deal being reached.

Mexico was prepared for the failure of negotiations, and did not contemplate caving in on energy to avoid such scenario. The measures taken by Mexico to prepare for the failure to have NAFTA ratified (such as drafting investment agreements with several European countries and the design of a financial rescue package which would be requested to the U.S.) are a necessary counterpart to an effective defense against demands. Should there be no contingency plans, success in defense against demands could turn into a pyrrhic victory if an agreement falls through and markets react accordingly. By buying oil futures and designing contingency plans, Mexico improved its batna. Obviously, not all of these measures should be made public, lest

120 Approximately 1/3 of the federal government’s income derives from PEMEX earnings.
121 Odell presents an analogous lesson in the comparison of the strategies followed by Kennecott and Anaconda in the face of possible conflicts with the Chilean government. Kennecott had alternative plans for a “worst case” scenario, while Anaconda did not. See Odell 2000, 209-210.
they generate a moral hazard, but countries defending against demands would do well to have contingency plans and not improvise should negotiations fail.

The evolution of the U.S. economy also played into the negotiations, but paradoxically the worse the situation of the U.S. economy, the greater the leverage it gave to Mexican negotiators. This goes against the common knowledge that protectionist pressures tend to resurface during a recession, and that it is not the best economic environment under which to conduct trade liberalization negotiations.

During NAFTA negotiations, the negative evolution of the U.S. economy greatly affected Bush’s standing in the polls and his probability of being reelected. As the election approached, Bush needed NAFTA to show an important “presidential” achievement, which meant that the deteriorating economic situation worsened the U.S.’s batna more than it did Mexico’s and helped close the deal without the inclusion of oil. It is ironic that Mexico has been the demaner, and at the end of negotiations the U.S. apparently wanted NAFTA at least as badly as Mexico did. This concurs with Odell’s expectation in that “The worse the alternative the relevant market [...]

Had the U.S. economy been in good shape, it is probable that Bush could have expected a relatively easy reelection, and would not have been in a rush to conclude the agreement. Under a better U.S. batna, Mexico would have had to struggle harder to keep energy out of the negotiations.

In short, the lessons regarding markets while defending against demands are to take action in those market segments where it is possible to limit their effect on worsening your own batna, and to have contingency plans should all else fail. Likewise, apparently negative market developments can turn out to be positive in the end, so it is important not to prejudge a situation; tactics should be adjusted accordingly

e) Institutions

NAFTA negotiations were not only about tariff and non tariff reductions to trade and investment liberalization in North America. It was also an exercise in institutional creation, insofar as it was to be an example of the type of agreement that the U.S. wished to establish with developing countries. This generated pressures for Mexico to yield as much as possible, for it would be the standard against which other agreements would be judged in key areas of U.S. interest, such as IPR and investment. However, since this was the first agreement it also gave some leverage to Mexico: a failed agreement was

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{122} Odell 2000, 183.
worse for the U.S. than an imperfect one. Subsequent negotiations with the U.S. will prove more difficult, for the precedent has now been set. The FTAA may be a case in point.

The fact that NAFTA negotiations were concurrent with the Uruguay Round also benefited Mexico. Just as the U.S. wished to press hard on certain issues in order to be able to use the as a model and precedent in the Uruguay Round, Mexico knew that the strategic interest that the U.S. had in NAFTA negotiations could be used to Mexico’s advantage: it could concede in areas of supreme interest to the U.S., and in exchange it would be able to advance Mexico’s offensive and defensive interests. Overall, the evidence suggests that having NAFTA embedded within a multilateral trade negotiation round was positive for the country defending against demands.

f) Other Issues

The issues examined in this section of course require further research to provide us with a better understanding of the dynamics of defense against demands. There are additional issues that were not mentioned and likewise deserve further attention.

The role that individuals play in strategy design and implementation is important. Serra had a more economically liberal view on the energy issue than did PEMEX Director General Francisco Rojas. If Rojas had had his way, even the limited concessions on international trade in gas and electricity would not have been on the offer, making virtually all of Mexico’s energy stance that of a defensive distributive strategy, with unforeseeable effects on the negotiation.

Odell asks if the further away the status quo is from the Pareto frontier, the greater the probability that a state will favor an integrative strategy instead of a distributive one. If anything, NAFTA energy negotiations represent a typical case of comparative advantage and the possibility of mutual gains, for Mexico had vast oil reserves but no capital with which to fully exploit them, while the U.S. had capital and technology, and the need to import oil from Mexico. Mexico’s stance, however, was based on political considerations and economic rationale was thrust aside. Even though the status quo was very distant from the Pareto frontier, both sides stuck to distributive strategies in key energy-related issues.

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123 Author's interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
125 Odell 2000, 186.
126 Mayer deals with preference origins, and not only with the negotiation process once preferences are given. His admonition is to stay away from assumptions based on rational unitary actors if one wishes to understand international negotiations. See Mayer 1988, 152-155.
There is also the related question of whether negotiators weigh defensive aims more heavily than offensive ones.¹²⁷ In other words, did México place greater emphasis on the exclusion of oil than in attaining its offensive aims during NAFTA negotiations? According to Serra, there was no special emphasis on defensive aims over offensive ones;¹²⁸ it just so happened that defensive aims were quite specific while offensive ones were more general.

The role of negotiating team design likewise merits closer examination. Cameron and Tomlin note the pros and cons of a centralized vs. a decentralized negotiating team.¹²⁹ In their view, centralized teams are more prone to biases; if so, a redoubled effort must be made to compensate for it. More generally, governments that are functioning in an open economy would be wise to pay special attention to the design and functioning of their trade policymaking institutions. It is possible to make the best of the opportunities offered by the negotiation process only insofar as one has the adequate institutions and individuals. Otherwise, the negotiation process will only represent foregone opportunities.¹³⁰

¹²⁷ This notion is related to prospect theory, as developed by Daniel Kahneman and Amos Tversky 2000.
¹²⁸ Author’s interview with Jaime Serra Puche, Mexican Trade Minister 1988-1994, Mexico City, 19 August 2003.
¹²⁹ Cameron and Tomlin 2000, 120-125.
Appendices

A. NAFTA Negotiation Highlights

1988

November: Bush proposes FTA to Salinas; Salinas rejects it

1990

February: Serra proposes FTA to Hills
March: Bush gives go ahead for FTA with Mexico
August: Mosbacher publicly states that energy will be in the negotiations
September: Bush requests fast track authority renewal
November: Bush and Salinas meeting in Monterrey, Mexico; energy discussed

1991

January: Beginning of Gulf war
February: End of Gulf war
Canada joins FTA negotiations
May: Fast track authority renewed
June: Official start of NAFTA negotiations, Toronto (first Ministerial negotiating session)
August: Second Ministerial negotiating session, Seattle; Mexico states five No’s
October: Third Ministerial negotiating session, Zacatecas
1992

February: Fourth Ministerial negotiating session, Chantilly (VA)
Dallas "jamboree" (Chief negotiators and working groups negotiating sessions). Working group on energy established; Mexico states Constitutions will not be modified

April: Fifth Ministerial negotiating session, Montreal

July: Sixth Ministerial negotiating session, Mexico City

August: The Watergate sessions (Seventh Ministerial negotiating session), successful end of NAFTA negotiations

October: NAFTA negotiators initial the Agreement in San Antonio

November: U.S. presidential election, Clinton defeats Bush

1993

January: Clinton sworn is as the U.S.'s 42nd President

February: Start of NAFTA side agreements negotiations (labor and the environment)

August: End of side agreements negotiations

November: Negotiations on sugar and citrus (arm twisting and pork sessions) NAFTA ratified by U.S. House and Senate

1994

January: NAFTA entry into force

B A Typology of Negotiating Behavior\textsuperscript{131}

A. DISTRIBUTIVE STRATEGY. A party's strategy is "strictly distributive" if any of the following tactics are observed and no more than a small minority of the behavior fits the definition of "integrative strategy."

\textsuperscript{131} Taken from Odell and Ortiz Mena L.N. 2005.
BOTH DEFENSIVE AND OFFENSIVE VARIANTS. The negotiator
- criticizes the other country's or countries' actions or arrangements, blames them for the problem under discussion;
- attempts to exclude from the agenda issues on which her own country would probably have to make concessions;
- rejects or ignores demands for concessions or delays their consideration;
- avoids saying her own country is partly responsible for the problem under discussion, avoids expressing concern for the other's objectives or a desire for a mutual-gain outcome, avoids making a proposal characterized as beneficial to other parties or the world as a whole;
- manipulates information for her own advantage: avoids revealing information about own genuine objectives and priorities; makes arguments whose effect is to support her demands or refusal to concede and does not present information or arguments that are inconsistent with that position; e.g., argues that the other's alternative to agreement is worse for them than they realize, that our alternative is better than they realize, or that the other's forecasts showing future improvement for us (in absence of agreement) are not convincing, or that she simply does not have the capacity to deliver what is demanded; or that the other's proposal would harm our side or others;
- establishes a commitment to a particular outcome, by means of some public action tied to that outcome such that accepting less would be costly to the negotiator or her country;
- denies that he or she believes the other's commitments.

OFFENSIVE VARIANT: The negotiator also:
- demands concessions for the benefit of his or her own country without offering concessions in exchange;
- takes steps to worsen the other's alternative to agreement and improve her own--e.g., unilateral actions or negotiations with third parties that would help compensate it for a breakdown in relations with the other or provide itself with a superior alternative, or raise the cost of a breakdown for the other; actions could include introducing draft legislation for official consideration at home or "talking the national currency down";
- files a legal complaint against another state under global or regional rules and demands a change in current policy or practice that will benefit the complainant. The complainant typically perceives this move as responding to and righting a wrong done earlier. In any case, relative to the status quo and from a neutral standpoint, the move's effect on the negotiation process would be to help shift value from the respondent to the complainant rather than to make both better off than at the time of the complaint, as they see it.
• launches an antidumping or similar complaint through its national institutions, which could be done for external bargaining purposes as well as for the stated purposes;
  • threatens to take action harmful to others unless they yield the desired concessions;
  • actually imposes such penalties and implements its alternative to agreement.

DEFENSIVE VARIANT. The negotiator also:
• brings a counter-complaint under international rules against a state that has filed a complaint against it;
• threatens or imposes counter-threats sanctions.

B. INTEGRATIVE STRATEGY. A party’s strategy is “strictly integrative” if the following tactics are observed and if no more than a small minority of the behavior fits the definition of “distributive.” The negotiator
• states that the parties have an interest in common or expresses concern for an objective held by the other;
• proposes negotiations designed to benefit both or many sides, usually aiming to agree on a joint approach to a common problem or an exchange of concessions;
• praises the other and avoids public statements criticizing the other country or blaming it for the problem or issue under discussion;
• invites the other to state frankly its genuine concerns and objectives and their priority order, as distinguished from its demands and proposals;
• proposes and implements a series of meetings whose only or main purpose is to engage the parties in joint study of problems and objectives they have in common;
• uses and refers to information about the issue or problem without shaping it to her own side’s advantage; engages in an “even-handed” discussion of all the facts whether favorable or unfavorable to her side;
• proposes an exchange of concessions for mutual benefit or accepts a mediator’s proposal that entails such an exchange;
• argues that a different conception of others’ interests or a redefinition of the issues themselves could lead to an agreement that would benefit both parties;
• proposes a formula or agreement described as helpful to other parties as well;
• agrees to abide by binding arbitration, which can shorten a conflict and reduce its costs for all parties.
C. MIXED OR COMBINED STRATEGY. A party’s behavior in a conflict or negotiation is a “mixed” strategy if distributive and integrative tactics are mixed in some proportion, either simultaneously or in a sequence.
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