

3-1-1999

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Recommended Citation

Michael W. Gordon, Carlos A. Parra, Edmundo Elias-Fernandez, John H. Christman & Margaret E. Montoya, *The Mexican Maquiladora: Rumors of Its Death Are Premature (A Panel Discussion)*, 7 U.S.-Mex. L.J. 203 (1999).
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THE MEXICAN MAQUILADORA: RUMORS OF ITS DEATH ARE PREMATURE

Panel

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WHAT IS THIS THING CALLED THE MAQUILADORA?

ANGULO: A Maquiladora is a customs system that permits you to import whatever item that needs to be manufactured or needs service in support of a manufacturing process with the manufactured or assembled good ultimately being exported.

The Maquiladora is not a corporation. A corporation is a person under Mexican law, subject to rights and obligations.¹ A Corporation chooses a program to carry out its imports and exports. The Maquiladora and PITEX are Customs Law-related programs.² They enable a corporation to import whatever it needs for the type of services that will back up its production. With the current Maquiladora decree, a company from any country can open a branch in Mexico, request a Maquiladora permit, and operate under a Maquiladora permit. The only requirement is that the corporate entity, notwithstanding that it might be incorporated outside Mexico, has to be a Mexican resident.³ Therefore the company would register as a Mexican resident through a branch to be able to carry out the Maquiladora importation.

The word "Maquiladora" does not exist under U.S. or Korean law, but exclusively under Mexican law. The word "Maquiladora" does not mean assembling, manufacturing, etc.; it means importing and exporting. Multiple misconceptions exist about Maquiladoras. The word "Maquiladora," from an industrial jargon viewpoint, means the subcontracting part of a production process. It can be very simple assembly or full-fledged manufacturing from raw materials, to full transformation; it does not make any difference with respect to the Maquiladora program

CHRISTMAN: Maquiladoras should no longer be referred to as the border industry since only 63% of the plants are in border cities. The rest of the plants are either in northern tier states or in other parts of the country. Only one Mexican State does not have a registered Maquiladora plant. It has become more of a nationwide program, whereas originally it was a border program.

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1. *Codigo Comercio*, D.O. del 24 de Diciembre 1996. 1996 WL918461

2. See Mexico's Maquiladora Program: Questions & Answers, (last modified August 1998). <<http://www.customs.ustreas.gov/nafta/maquila.htm>>

3. Decree for the Encouragement and Operation of the Maquiladora Export Industry, *Diario Oficial de la Federacion* (D.O.), (last modified June 1998). <<http://www.natlaw.com/trans/tndccu69.htm>>.

GORDON: Another misperception is that the Maquiladora is a U.S.-Mexico program.

CHRISTMAN: The Maquiladora industry is a Mexican government program.

GORDON: Maquiladoras are something that countries other than the United States are participating in. Is the Asian segment increasing, or at least was it increasing?

CHRISTMAN: The Asian segment was increasing until the recent 'Asian flu' crisis, which has not gone away yet. The Mexican Ministry of Commerce and Industrial Development's (SECOFI) records indicate that we have about 170 Asian-owned Maquiladoras, which out of a total of about 3,000 plants is a relatively small percentile. But some of those are very much mega-Maquiladoras. Their suppliers have been literally imported from Asia as sub-Maquiladoras for these mega-Maquiladoras, particularly in electronics, certain automotive parts and components. Looking at the Asian effect on the Maquiladora industry, now we have to factor in RCA; even though RCA is now French-owned, 98% of all television sets sold in Canada, the U.S. and Mexico, are produced in Maquiladora plants in Mexico.

GORDON: How do you perceive, coming from the northern part of Mexico, the Maquiladora to be an important part of the industrial economy of Mexico?

ANGULO: The Maquiladoras have been the fuel that has kept the northern tier states of Mexico alive and kicking with respect to their economic growth and continued generation of employment. The problem has been that because of the recurrent Mexican economic crisis, the level of wages has not increased. The real wages are at the 1960s level. Many people are trying to blame the Maquiladoras for this situation. However, if we have to blame someone, it has to be the people in Mexico City in charge of Mexico's economic situation, the economic variances, and so on. Mexico's economy has not benefited the Mexican people but rather the small percentage of politicians-businessmen.

In Mexico there is an unfair distribution of public income proceeds within the three levels of government - federal, state, and municipal. For example, Ciudad Juarez is about the fifth municipality in Mexico, and only about four cents for each peso gets back to Juarez, whereas the generation of income tax - and Maquiladoras are head generators of income tax - is quite high, calculated at about 6.5 billion pesos annually. The budget of Juarez is about 700-800 million pesos. To give you the proportion rates, the budget of the University of Texas at El Paso is larger than the State of Chihuahua's entire budget. This illustrates the unfairness in distribution of public funds.

GORDON: What is the perception of Maquiladoras in other parts of Mexico, such as Mexico City, are they something to emulate or something to destroy?

CHRISTMAN: In Mexico City we have noticed more employment ads. There is a hiring away of people in central and southern Mexico to go to the U.S, to the border Maquiladoras. Additionally, many Maquiladoras, which are not subsidiaries of foreign corporations, are owned by Mexican nationals and are true Maquiladoras; they bring in and process raw materials and produce for export. For example, near the city of Oaxaca, there is an industrial park of textiles, most of which are owned by Mexican nationals. The state of Coahuila has a program where they plan to build a buffer building for Maquiladora plants, and lease it at nominal rentals, so the people set up Maquiladoras outside of the border area of Coahuila.

MONTOYA: With regards to the perception that it was a border program and that it was U.S.-Mexico, the history is important. Going back to 1965, at least a major

impetus of the creation of the Maquiladora program was the ending of the Bracero Program. There were millions of men, primarily, returning to Mexico from the Bracero Program. The men had low skills and were going to be a burden to the government. The government decided to create the Border Industrialization Program. Ironically, women, low-skilled, unmarried, childless women primarily staffed the early Maquiladoras. It is ironic because it didn't address the direct problem that it was intended to address. The old Maquiladoras were primarily labor-intensive. They were primarily in garment and electronics. This is not true of the new Maquiladoras. Many of the new Maquiladoras have higher technology; the gender of the workers is more diverse, and women employees are older and married.

At least part of the social cost of the Maquiladora has to be recognized as the dislocation that occurred within Mexico by the creation of a border program, and that continues until today. There was a migration from the center and the southern part of Mexico to the northern border. That is still a problem today. Even with NAFTA, the United States purposely and deliberately entered into an agreement to make the southern border more porous for goods, for services, for capital. It failed to deal with the labor implications, with the human migration that is necessarily a complement to the movement of people to the northern border. If you move people to the northern border with the incentive of higher wages, you do not have to be a rocket scientist to understand that there are higher wages on the other side of the border. This undocumented migration across the border continues to be one of the very mixed blessings for the U.S. economy. Historically the economies of California and Texas had always depended on the poorly paid labor of undocumented workers. Whole segments of California and Texas economies, and increasingly that of the entire Southwest, depend on low-wage, low-trained Mexican workers. It used to be agriculture. Today it is primarily the service industries; hotels and restaurants throughout the Southwest depend on undocumented workers. It has always been in Mexico's interest to allow the undocumented migration north, and it has always been in the United State's interest, despite all of the posturing that goes on about undocumented migration.

The Maquiladora program benefits both countries. There is no question that the Maquiladoras have created jobs. In the 1980s, much of Mexican job creation was in the Maquiladora segment. During post-1994, even though Mexico was in crisis and there was capital flight, Mexico did not go into depression. This is largely because of two implications of the Maquiladora. First, the Maquiladoras were continuing to create jobs, and served as the first most important source of foreign capital. We also have to factor in the importance of technology transfer and know-how, particularly with regards to the new Maquiladora.

There is no question that there has been environmental degradation because of the Maquiladora, not only along the border but also now with the movement southward of the Maquiladora plants. One of the requirements under each of the decrees is that waste is supposed to go back to the country of origin. This has continued to create a problem because of Mexico's infrastructure problems, primarily transportation. Identifying what is waste, putting it in containers and then moving it north is a considerable problem, which has been addressed at times by just untreated dumping.

A second consequence is labor unrest. If we look at the submissions that have been filed under the labor side agreements, most of them have to do with the inability of independent unions to be registered in Mexico. There is certainly a history of - some would say cooperation, some would say collusion - between the *Partido Revolucionario Institucional* (PRI) and the principal unions in Mexico. The unionization activities within the Maquiladora continue to challenge the way business has been done in the past.

A third cost to Mexico has been the social discontent, largely because of quality of life issues. With the movement of huge numbers of people into the areas where the Maquiladoras are located, there has been an inability to construct housing and to construct schools at the same rate. Not everyone lives in shanty conditions, but it is certainly not unusual for people to live in deplorable conditions.

Part of what has happened with the internationalization, or at least the influx of Asian money into the Maquiladora, has been the considerable benefit to the United States because of the location of the executive and managerial class in the United States. If we look at Sony, Sanyo, Matsushita—particularly in San Diego because of the location of the Maquiladoras in Tijuana—it has meant a clustering of highly paid foreign workers in the United States who then travel into Mexico to work. This has greatly benefited particularly the California economy, but also Texas. Their economies, which were formerly dependent on agriculture and the defense industry, have now been able to rely on the retail purchases and the housing and other social services that are being provided to very highly paid workers.

GORDON: What would Mexico be like right now if the Maquiladora program were simply absent?

MONTOYA: It is difficult to imagine that the United States would not have to create employment in Mexico, just because of the threats to our own stability that an undeveloped, unemployed country to the south of us presents. It is part of the impetus for free trade agreements; it is in our national interest to help with the development of Mexico. That has been the impetus for the border industrialization program; it has been the impetus for the Bracero program; it has been the impetus for NAFTA. It is very difficult to say, "Let's take away the Maquiladora program; let's imagine that it didn't happen." We have to imagine that something else would have developed.

My position is not that the United States should not have participated in the Maquiladora program. Rather, it has been unfortunate and we are reaping the cost of not having been more careful about the labor implications and the environmental implications, and now we have to address them. In fact, there are currently some creative programs. A number of the larger employers, General Motors certainly, are now working with Infonavit to establish funds for housing Maquiladora workers. If we could roll back the clock and have had those kinds of programs all along, we would not now have the dire problems that we have.

HOW DID THE MAQUILADORA COME INTO BEING?

CHRISTMAN: The Maquiladora industry officially started in 1965. The most recent decree has been in effect since June 2, 1998.⁴ The decree has basically abrogated the October 1996 decree provisions, which were anti-NAFTA⁵, at least in spirit if not in letter, and which also may have violated the Mexican Constitution. Those provisions are not in the new decree. The new decree is quite favorable to the Maquiladora industry. The new regulations in the foreign investment law do not greatly affect the Maquiladora industry. The new Maquiladora Decree reduces reporting requirements.⁶ It eliminates some of the Ministry of Commerce and Industrial Development's (SECOFI) arbitrary decision-making ability that existed in the October 1996 decree.⁷ It is expected that there will be one more Maquiladora Decree before the Zedillo presidency ends. The decree will determine how the Mexican government in its tariff schedules is going to treat certain non-NAFTA components into the Maquiladora industry. This is primarily to meet the lobbying efforts of the Asian investment in the Maquiladora industry.

During the first sixteen years, the Maquiladora's growth went from zero employment to 100,000 direct jobs. In its second sixteen years, to mid-1998, it has gone from 100,000 direct jobs to over 1,000,000 jobs. CIEMEX-WEFA works with current data and makes projections based to a large degree on the U.S. economic outlook. We are forecasting through the year 2002, which takes us past January 1, 2001, double-digit growth. That is in real terms, dollar terms, in the low double digits, averaging 13-15% a year. This depends on how the U.S. economy does. The latest forecast by our sister organization, the WEFA group out of Philadelphia, is that there is a 35% probability that the U.S. economy will be in recession next year. Of that, 5% looks for a deep recession and 30% looks for a moderate recession. There is a 65% probability that the U.S. economy will continue to grow. Their baseline forecast continues to show the U.S. economy growing at rates of 2% or better, which is an important growth plateau for Maquiladora industry growth, since the Maquiladora industry is heavily dependent on the U.S. economy. Little is dependent on the domestic Mexican economy.

As long as the U.S. Gross Domestic Product (GDP) is up 2% or more in a given year, the Maquiladora industry grows, and tends to grow in double digits. If the U.S. goes into recession, the Maquiladora industry will see a substantial decrease in its growth figures and might go into negative growth. If the United States can avoid a deep or prolonged recession, the Maquiladora industry will continue to grow. The Maquiladora industry will not disappear as of January 1, 2001, and there is nothing in NAFTA calling for its elimination per se.

Currently, there are more than 3,000 operating Maquiladora plants, which provide slightly over one million direct jobs. Our models, and our studies, working with different agencies in Mexico and in Washington, are that every direct Maquiladora job creates two indirect jobs in Mexico and either creates or sustains 1-1/2 indirect jobs in the U.S. The American Federation of Labor (AFL-CIO),

4. *Id.* at D.O., D.F. June 1, 1998.

5. *Id.*

6. *Id.*

7. *Id.* at D.O, Mexico, D.F., October 23, 1996.

which is looking at political issues and does not want the facts to interfere, disagrees with our contention. The AFL-CIO's contentions are backed up by organizations such as the United States International Trade Commission (ITC) with whom we constantly interface.

The Maquiladora industry was a precursor to the NAFTA, although the NAFTA certainly gave it new impetus, particularly in certain areas such as textiles and wearing apparel. There have been substantial growth figures both in operating plants and in employment, and in what we call gross production value. Incidentally, gross production value this year will be close to 60 billion dollars in the Maquiladora industry. For the year 2002, we are forecasting that gross production value will be very close to 100 billion dollars. That is also more or less where the exports will fall. So we are looking for continued growth in the Maquiladora industry. Rumors of its death definitely are premature and ill founded. There is a problem of misinformation, either inadvertent or purposeful, by certain sectors of both economies, certain advocacy groups that indicate that the Maquiladora industry is just going to dry up and disappear as of January 1, 2001. That is simply not the case. It may have a somewhat different shape, and somewhat different form. But Mexican industry, as yet, is not in a position to compete with the Maquiladora industry under NAFTA terms. Mexican industry will not really be able to compete with the Maquiladora industry in our respective lifetimes.

HOW DO YOU CHOOSE FROM AMONG THE VARIOUS FORMS OF MAQUILADORAS?

ELIAS-FERNANDEZ: The fact of just being a Maquiladora does not mean that you cannot be something else. You have a Maquiladora, which is basically just a program, a registration. There has also been a misconception that a Maquiladora can only be a Maquiladora. The Maquiladora program is just a customs program that entitles you to certain rights for importing and exporting. You can also have your company dedicated to other purposes. We have seen many companies create a similar concept to U.S. divisions; the Maquiladora division of a company within the same shell and the sales division and the service division, and so on. Different forms of Maquiladoras were created to emphasize the fact that there may be certain tailor-made Maquiladoras for each structure of a given company.

What is the "shelter" Maquiladora?⁸

The way it works is as follows. Imagine a dial - you have 0 at one end and 100 at the other end. Right in the middle, 50, is the shelter. What is 0 and what is 100? 100 is a 100% stand-alone Maquiladora, a corporate entity that does everything by itself. And zero is a 100% supply - you come in and buy some article from a manufacturing entity, you do not do anything with respect to manufacturing. Fifty percent is in the middle of the road; that is, the manufacturer does not get 100% involved in all the activities that you have to do from an industrial point of view. The shelter operator takes care of 50% and the manufacturer takes care of the other 50%. What is the difference? The shelter operator is really a Mexican Maquiladora or a Maquiladora that operates under this program, that houses a manufacturer who

8. *Supra* Note 3, D.O, Mexico, D.F. June 1, 1998.

knows how to carry out a manufacturing process. How do they house this manufacturer? They provide him a facility, they provide all the logistic services to establish his business: imports, exports, they supply the personnel and so on. The manufacturer carries out the production management, quality control, and the materials management and handling. The shelter operator carries out the rest of the logistics.

There are several types of modalities that you can use in a shelter situation. The 50% is a pure shelter. If you start moving up to 55%, 60%, 70% then the manufacturer is taking over parts of the items that used to be taken care of by the shelter operator until you go up to 100% until you graduate out of the shelter. You learn how to do business in Mexico from all the other items that are needed besides manufacturing. Typically, the shelter operator starts relieving its customers from some of the responsibilities. At the beginning they may take over accounting functions or administration of personnel. Recently there have been structures under which the customer of the shelter operator incorporates their own corporation and then hands out that corporation on the administration side to the shelter operator; then once they feel secure enough, they terminate the agreement and take the structure over completely.

CHRISTMAN: The shelter is a very popular form of usage for foreign corporations to get their feet wet in the Mexican Maquiladora industry. Many times they will opt out and go stand-alone after two or three years in the shelter system. A couple of companies have been in shelter systems now for twenty years and continue to be happy with shelter systems because the shelter operator assumes all of the fiscal, legal and labor liabilities in Mexico. They are happy to let the shelter operator, who is normally a Mexican corporation, handle that.

You will find virtually in any city where you have a rather heavy concentration of Maquiladora plants there is at least one, probably more, reputable shelter operators. They may be handling as many as 8-10 clients at a time, perhaps in different buildings, perhaps in the same building. But this has proven over the years to be a very successful *modus operandi* for a lot of companies working within the Maquiladora program. The cost may seem to be slightly higher, but for a lot of U.S. companies, particularly mid-sized companies that do not have any international experience, the comfort factor of operating with a reputable shelter operator in at least getting started is positive. You have an option clause in your shelter agreement, which states that after several years you can choose to go stand-alone and basically take the part of the labor force that you want to take with you, as long as you respect their seniority under Mexican Federal Labor Law. However, the Federal Labor Law will likely be amended within a couple of years.

ANGULO: First, about the shelter; on a shelter, you have an established Maquiladora to start with an existing operating permit. When you have a new shelter customer, the shelter operator files for an expansion of its program. If the first program of the shelter operator was manufacturing television sets and the second program is to do chairs and tables, then you expand your Maquiladora program to allow you to import the items needed, machinery, equipment, raw materials, to do chairs and tables. So it is really an expansion.

The relationship between the applicant and the government is really an administrative relationship. You have a decree, the Customs Law, you have a right

to request a permit, and you file the request and so on.⁹ Pursuant to the administrative procedural law, you have recourses that you file against the government and the government has obligations pursuant to those terms of law. It is not really a contract; it is an administrative relationship.

The agreement disclosed to the government is the agreement that the shelter operator may have with its parent or the U.S. company that is requesting the manufacturing through its subsidiary, it is a typical Maquiladora agreement. The shelter contract is not necessarily disclosed to the government.

CHRISTMAN: The fact that SECOFI requires or that the decree requires the filing of the contract is just an administrative requirement?

ELIAS-FERNANDEZ: Yes. They do not really review it. SECOFI never questions the agreement between or among the parties. We have never seen SECOFI cancel a program for not complying with the administrative requirements.

ANGULO: The only cancellations of Maquiladora programs that I have seen have been on Maquiladoras that are not doing anything. After a certain time, if they are not doing any imports and so on, SECOFI sends a Maquiladora cancellation advice.

*What is the export maquiladora?*¹⁰

ELIAS-FERNANDEZ: Basically, as defined in the Maquiladora decree, the typical export Maquiladora is the company which will import duty-free machinery and equipment, raw materials, inputs in general, to manufacture a product to be 100% exported.¹¹ This does not mean that the export Maquiladora may not sell into the Mexican market. It can sell into the Mexican market provided it complies with the restrictions and limitations set forth by the same decree.¹²

*What is the Idle Capacity Maquiladora?*¹³

ELIAS-FERNANDEZ: The Maquiladora with idle capacity appears similar to the PITEX program: Mexican companies doing business in Mexico, but exporting part of their production. If they were exporting part of their production, in order to promote such exports, they were given the option to import duty-free machinery and equipment and raw materials for that idle capacity they had and start exporting that part of their business.

ANGULO: Imagine that this square is a corporate entity and within the square you can do whatever you wish that is permitted by law. The idle capacity Maquiladora focuses on the following situation: you can do everything that is in this square pursuant to your industrial capacity. It is like a co-ownership situation; a co-owner does not own a little square of the property, he owns a pro-rata share of the property. If you get a Maquiladora permit for idle capacity, it permits you to be a Maquiladora as much as you choose. If you have a production output of 100, you can have a permit to carry out 20 and this would be 80, and then your idle capacity Maquiladora would be 20. Now flip the situation with respect to the PITEX. The

9. Title IV Customs Law, 1997 WL 685176, June 1997.

10. *Supra* Note 3 at Article 3, § 6

11. *Id.*

12. *Id.*

13. *Id.* at Article 3, § 7

PITEX Company starts being a non-Maquiladora company the same as this one; it is a non-Maquiladora and then gets a permit for idle capacity. When you get a PITEX program authorization, you commit to export a certain amount of your production output. You make a commitment that you need to export thirty percent of your 100% production output. It is a performance requirement. A Maquiladora does not have any performance requirements unless it sells into the Mexican market. A Maquiladora for idle capacity may have a program that initially you can design to be 20% and then not do anything. Nothing happens, you just are not using your Maquiladora program, whereas if you are a PITEX, you must export 30%, otherwise you will lose your PITEX program authorization.

This part of your Maquiladora permit allows you to import things such as raw materials, and machinery, on a duty-free, temporary basis, VAT-free, and so on, and export whatever you wish. You can start expanding the numbers of your program to 100% if you wish. You can sell into the Mexican market and continue doing business in Mexico outside the Maquiladora structure. The limitation to sell into the Mexican market established by the Maquiladora decree has to do with the Maquiladora part, not the non-Maquiladora part. You may have a Mexican entity that is selling 100% of its production output to the Mexican market without any performance requirements whatsoever, provided you are not doing that within the items that you have temporary imports under the Maquiladora program. It is important for you to analyze this distinction.

*Can you describe the Service Maquiladora?*¹⁴

ELIAS-FERNANDEZ: The service Maquiladora is a system that can go as long as your imagination can create concepts. We have seen service Maquiladoras go from coupon sorting to actual repair services, to warehousing services. Maquiladoras have rendered warehousing services where they import the goods to be used by another Maquiladora and warehouse it, store it, and sort it. It is an inventory control service. Then they transfer the warehoused materials or goods to another Maquiladora. The service Maquiladora has been an evolving concept which SECOFI has been promoting. The Ministry of Finance has created certain simplified procedures for the transfer of goods imported from one Maquiladora to another Maquiladora.¹⁵ These are called Maquiladora transfers, and this is basically to support the service Maquiladora. At the end of the day every Maquiladora, whatever different mode it is, is a service Maquiladora because it is rendering a service, whether a manufacturing, assembly, inventory or any other type of service.

*What is a submaquiladora?*¹⁶

ELIAS-FERNANDEZ: The Submaquiladora is basically a complementary service that a third party, which does not necessarily have to be a Maquiladora, can provide. Typically, you have a part that you do not transform or manufacture, and you give the component to a third party. Generally a non-Maquiladora, which performs a transformation or converts to a sub-assembly, gives it back to the Maquiladora so

14. *Id.* at Article 3, § 8

15. *Id.* at Articles 4-27

16. *Id.* at Article 3 §10

the Maquiladora can assemble it to the finished product. The Submaquiladoras are a good system if you have a third party providing certain sub-assemblies because you do not have full formalities for transferring back and forth the goods, but only just deliver them, get them transformed or sub-assembled, and then get them back. The Maquiladora remains liable for the responsibility regarding the importation and exportation of that good.¹⁷

WHAT OTHER CONSIDERATIONS ARE THERE IN CHOOSING A MAQUILADORA?

SERGIO: Regarding Maquiladora sales into Mexican markets, since 90% of them are not owners of the raw materials, and they sell into Mexico, do they have to buy those materials and pay the duties? Do you pay on the raw material or the final product? Is it the same, does it make any difference, or what do you recommend on this issue?

ELIAS-FERNANDEZ: First, if the Maquiladora wants to sell into the Mexican market, it must pay the duties based on the foreign components. If the Maquiladora sells directly into the Mexican market the duties would have to be paid based on the foreign components. NAFTA preferential duty treatment can be claimed on those components provided that certain requirements are met.¹⁸

The last amendment to the Customs Law created another form transaction where the goods do not have to leave Mexico.¹⁹ It is called a customs account. It is a sophisticated administrative program. The third party non-Maquiladora pays the duties for the finished product without the product leaving the country and it is deemed to be an export for the Maquiladora and a definitive import. The customs account is basically a banking account that is opened by the importer where they pay the duties and if they want to, also the Value Added Tax, for certain specific purposes set forth in the customs law. I have a customs account, I pay the duties and then acquire the goods from the Maquiladora to sell them. The customs account may have an impact on who owns the materials. If the foreign company owns the materials they also own a foreign entity because of their assignment to a Maquiladora, and the finished product. Then the foreign company sells to a third party who imports the goods into a customs account, and there may be Value Added Tax for the non-resident company of the Maquiladora selling those goods in Mexico.

ANGULO: In the ownership situation, many people think that if you carry out the Maquiladora importation through a temporary system, you must not own the items, or if you pay the duties and carry out that importation, the so-called definitive importation, you should own the items. Ownership and importation have no relationship to each other; they are mutually exclusive.

There is nothing that prevents the Maquiladora from owning its machinery and equipment; the problem that we see is a tax problem because they would have to pay the asset tax to start with and so on in another set of situations.

17. *Id.*

18. North American Free Trade Agreement (NAFTA), drafted Aug. 12, 1992, revised Sept. 6, 1992, U.S.-Mex.-Can., 32 I.L.M. 289 & 32 I.L.M. 605 (entered into force Jan. 1, 1994). Chapter 14, Article 1405. National Treatment.

19. Customs Law Title IV, 1997 WL 685176

They have the raw materials, again for convenience purposes, but this does not mean that a Maquiladora cannot own its own raw materials or components. The question here was, "I import raw materials and carry out a process and have a finished product that I want to sell to this non-Maquiladora." On a typical importation, say through a bonded warehouse, the customer comes here and the customer pays the import duties. Let us say that the U.S. company would be selling directly to the Mexican customer. The Mexican customer can either purchase the item in the United States and then carry out the importation by itself, or purchase it in the middle of the bridge or the middle of the border, and then carries out the importation and the customer pays the duties. In the case of the Maquiladora you have an intermediate step, which is that first you import raw materials, process raw materials, and the items are imported into Mexico. Before you carry out the sale to the customer, you have to pay the duties, you have to change the regime to pay the duties and then the customer acquires an already imported item. This is something to take into account.

If the Maquiladora carries out a transfer, and bear in mind that I am not saying "sales," this may continue to be within the Maquiladora world (that is, within the temporary importation system); therefore, there is no duty involved. This Maquiladora can export its products or sell into the Mexican market to a non-Maquiladora by doing this conversion of the regime, paying the duties and then selling to the non-Maquiladora customer. All of this can be done without performing a sale. This could be delivery, and the ownership may be in the United States.

A Maquiladora can transfer from here to here, the Maquiladora to the trading company. If the trading company is operating under a customs account regime or modality, the transfer from here to here in reality is an exportation and this is an importation, a definitive importation. The duties are paid on a customs account basis and then the trading company in turn can deliver the item to the customer and the customer does not have to pay any duties because the duties have already been paid. Or the trading company may deliver this item to a Maquiladora and get a refund of its duties.

DOES A MAQUILADORA PROVIDE ANY BENEFITS SUCH AS ONE-STOP SHOPPING WITH SECOFI OR IS IT MULTI-STOP SHOPPING? WHAT IS THE PROCESS FOR ESTABLISHING THE MAQUILADORA?

ELIAS-FERNANDEZ: The basic process of creating a Maquiladora is first determining what form of corporate organization the company or person has elected. Then obtain legal standing in Mexico by either incorporating a Mexican subsidiary or registering a Mexican branch. Upon achieving this, the process for establishing a Maquiladora is similar to that of any other company: similar registrations - taxpayer, social security, housing fund, secure a lease agreement or acquire a piece of real estate. The only difference is that the Maquiladora program requires an application to be filed on a prescribed form on which you provide various information to the Ministry of Commerce. Some of the required information includes the investment program, lists of equipment and machinery, inputs or raw materials or components that will be imported, description of the process, and the commitments on creation of employment.

The Maquiladora application form is filed by attaching a variety of other documents required by the Maquiladora decree. These documents include evidence of hiring at least one employee, which requires registration with the Social Security Institute. A copy of the lease agreement or title to the real property where the company will have its operations is evidence that the company has a physical presence and a place to conduct its operations.

GORDON: One of the forms is a certified copy of the formation deed of the company and any amendments.²⁰ Is that the formation of the Mexican Company? Do you need to provide any of the information about the parent company?

ELIAS-FERNANDEZ: No, none of that. It is only the information with respect to the Mexican Company. Here an important point is that the required criteria of the authority may vary. SECOFI is a federal authority; however, you may find differences in some local offices - for instance Tijuana has different criteria in certain aspects than Juarez or Monterrey or any other city - so you have to go get the right information as to exactly what they would require. In some cases they require a copy of the lease agreement; in some cases they want a certified copy of the lease agreement.²¹ There is only one way in which they are uniform. The Maquiladora contract must be filed and properly formalized or ratified before a Mexican public attester, either a notary public or a commercial broker.²²

Upon filing all these documents SECOFI must, under certain deregulating agreement or decree, issue the approval within seven days. If they do not issue the approval within seven days, it is deemed approved. Silence of the authority, or lack of response or requirement of any further documentation, is an approval. After the term has lapsed, the company may file a request for obtaining the program, which has to be issued in three days.²³ It is rare that you would have a case where they would reject a program, except if the application is not properly filled out.

GORDON: Article 6 says ten working days.²⁴

ELIAS-FERNANDEZ: They shortened it in a regulating decree published in the official gazette.

ROGERS: If rather than having employees, a company contracts services with a separate company, formed for the purpose of providing employment or personnel services, to what extent can the requirement of filing the collective labor contract or employment contract be satisfied by filing a copy of that services agreement?

ELIAS-FERNANDEZ: The Maquiladora contract calls for the creation of employment. It does not say or provide that the Maquiladora must directly hire the personnel. We have seen many Maquiladoras establish a services company, an employee leasing company that would only hire employees and it is not through the Maquiladora, and we have obtained approval without any problem whatsoever just by filing one single contract or the registration with the Social Security Institute. In some cases they have even hired an employee, obtained the social security registration and the following day terminated that relationship with the employee

20. *Supra* Note 3 at D.O., Article 6 § 1

21. *Id.* at Article 6 § 5

22. *Id.* at Article 5, § 5.

23. *Id.* at Article 7.

24. *Id.* at D.O., Article 6 § 7

and cancelled the social security registration, only for the purposes of obtaining the Maquiladora program.

ROGERS: If the company has no employees and does have a relationship with an employee leasing company, is there a way to satisfy that requirement?

ELIAS-FERNANDEZ: Sure, as long as it is creating jobs, there is no problem with it.

ROGERS: Through the separate company.

ELIAS-FERNANDEZ: Yes. Upon securing the Maquiladora program approval and the Maquiladora national registration number, which is important because this is how Maquiladoras are identified. The Ministry of Commerce would advise the Ministry of Finance and the Customs Department, which falls under the Ministry of Finance, that the company is ready to operate and you can start working under the program, start importing, exporting and conducting all your activities without any problem whatsoever.

ROGERS: What is the role of the Ministry of Finance and Public Credit, because apparently once it has been approved, it goes on to the Ministry?

ELIAS-FERNANDEZ: The Maquiladora concept when it is conceived, it has some labor, economic, and financial implications; however, when it is ready to operate, the Maquiladora becomes truly a customs program. The core of the Maquiladora program is customs. The authority regulating customs is the Ministry of Finance through the Customs Department or Customs Administration. The enforcement of all the different rights and obligations of Maquiladoras are generally enforced by the Ministry of Finance through Customs, and since the main activity of the Maquiladora will be importing and exporting, it will deal with Customs. That is the main role of the Ministry of Finance, to enforce the customs advantages and benefits the Maquiladora obtains under the program.

ANGULO: Transfer pricing is not a requirement. It is a very advisable thing to do, but if you do not do it, you are subject to audits. If you prove that you are operating at arms-length to the Hacienda you are home free. You are better off by choosing an advance pricing agreement or the safe harbor provision provided by the general rules dictated by Hacienda.

GORDON: It almost seems that if you want to get the benefits of dealing mostly with SECOFI, even if you did not have many benefits in terms of tariffs, it would still be better to stay within the program just to deal principally with one entity.

ANGULO: Yes. You do have to bear in mind that to the degree that you use the Maquiladora concept, you have to deal with SECOFI for the initial permit and for the sanctions of the permits. And the day-to-day implementation of your imports, and so on, are handled by Customs, which forms part of Hacienda.

GORDON: What I was suggesting is that if there are no real benefits to you from the Maquiladora program in terms of what we normally think they are, are you getting a kind of safe harbor by being a Maquiladora and dealing principally only with SECOFI?

ANGULO: A Maquiladora gets the safe harbor of operating in a very speedy and expeditious manner for exporting purposes.

BETETA: The policy and the requirement to establish a Maquiladora are handled by SECOFI. However, the fiscal or the duties and taxes regulations are handled and established by the Tax Administration Service of Mexico (SAT), which controls customs and has other offices such as the legal department of the SAT. But

basically, that would be the competent authority regarding the fiscal field of the Maquiladora.

GORDON: What are significant operational problems for the Maquiladora? Is continuing filing of what goes on in the company required? Certainly when you are talking about serving the domestic market at all and have received benefits of the program, you are going to have to pay import duties so there must be some monitoring of this.

ELIAS-FERNANDEZ: Once a Maquiladora is operating, it is a customs program and the main obligations of a Maquiladora are of a customs nature. Under the terms of the Maquiladora decree, the Maquiladora is designed for exports on a duty-free basis and free of taxes, components, raw materials, machinery and equipment.²⁵ They are transforming those components into finished products that are thereafter exported, either directly or indirectly. The main obligation of the Maquiladora is to be able to evidence throughout the life of the Maquiladora that everything it has imported has been exported. It is called a discharge or tracking system. It is the most difficult part of a Maquiladora. Approximately 99.9% of the existing Maquiladoras, if they were audited, would suffer for not being diligent in keeping track of what they are importing and what they are exporting.

Recently companies have been designing software that assists Maquiladoras in tracing the materials imported and the finished good exported. This will vary depending on the nature of the business. If you have three components, it is not a big deal discharging import documents versus export documents. If you have 1,000 components or 10,000 components, you have to work on a detailed basis. Some Maquiladoras choose to work under a kilo imported-kilo exported basis. This is not the correct way to do it. Some companies go through a more detailed form of operation through an "explosion of materials" where they allocate the bill of materials for a given product and they identify the inputs imported to a given product. When they have a finished product, they make the allocation from that import document how many components are used for this specific product and they start offsetting the import paperwork against the export paperwork. This is extremely complicated and is the part where Maquiladoras live and die in practice.

ANGULO: Possibly outside of the Maquiladora world, you can regularize irregular importation. The 99.9% not being accounted for exists, not because Maquiladoras are selling or smuggling things into the Mexican market, but because the paperwork is lacking information and that type of thing, in the extreme majority of cases, probably another 99.9%. Maquiladoras can not regularize the situation; it is a big gap in the law. It is something we have been trying to address. Recent developments address this specifically.

ELIAS-FERNANDEZ: The procedure is "iffy" on the one hand. On the other hand, you cannot claim preferential duty treatment in that change of regime. The Maquiladora has been claiming, "Hey, I have done nothing wrong; I have been importing duty free. Allow me to regularize the goods that I have in Mexico. I do not know how they got here. There might have been excess merchandise in the truck or I was just lousy in preparing my import paperwork. Allow me to bring

25. See Mexico's Maquiladora Program, (last modified June 1998) <<http://www.customs.ustreas.gov/nafta/maquila.htm>>

them into my program without paying duties." The Ministry of Finance is saying, "It is not my fault that you were lousy in doing that. If you want to regularize that now, you pay the duties." That is kind of a penalty for not being diligent in your activities.

That is why I return to the point that the Maquiladora program is a customs program. In the last three years, we participated in at least 10-15 audits. Every audit that we participated in, the Maquiladora has liabilities from at least \$2,000,000. Step one is be diligent. The best suggestion in avoiding problems while operating a Maquiladora is to be diligent in your customs obligations.

GORDON: Article 12 of the decree includes five requirements that the company commits to follow,²⁶ for instance, complying with the terms in the authorized program,²⁷ and attracting and training personnel.²⁸ Is that being done by Maquiladoras?

ANGULO: The Federal Labor Law has specific provisions that obligate employers to train personnel.²⁹ In reality, this provision of the Maquiladora decree overlaps with labor law.³⁰ Maquiladoras are the entities that train their personnel the most. They have basic training and continuing training programs for the benefit of production.

MONTOYA: This is related to my earlier comments about the new manufacturing environment that introduced the notion of what is called porous production and post-porous production. If we look at porous production, we are looking at what were the old Maquiladoras - traditional assembly line manufacturing, characterized primarily by inflexible manufacturing practices; that is, in which you have a worker who is trained for one task. That is not the rule for Maquiladoras or for most shop floors in the developed world. Today we have multi-tasking; that is, the workers have to be trained to do multiple jobs on the assembly line; there is job rotation.

The other aspect of the quality movement and "just-in-time" inventory control is workplace democracy. That is, the only way you can create quality circles is to have some confidence that your workers are really in alliance with management. This is becoming characteristic of the more highly trained Maquiladora workers, those who are working in advanced electronics for instance, as is true in Japanese manufacturing firms. The auto industry is a primary example of this.

The comparison of both the labor practices and the environmental practices of Maquiladoras with the rest of Mexico is a positive comparison. Their practices are generally better. That is an inappropriate comparison because these are primarily, not exclusively, subsidiaries of American corporations. If you compare the labor and environmental practices of the subsidiaries to the American parent the comparison is less favorable. That is true in terms of environmental practices with respect to what is being done with waste. It is also true with issues such as shop floor democracy, that companies have not been as aggressive in exporting. Why? Because they are more costly exportation of know-how and the kinds of practices that the side accords were intended to address.

26. *See Id.* at Article 12.

27. *See Id.*

28. *See Id.*

29. *See* Introduction to the Federal Labor Law, 1997 WL 686862, June 30, 1997.

30. *Supra* Note 3 at D.O., Article 12 § 3.

GORDON: If an American parent corporation were to say, "We are now going to adopt the same standards for labor, housing etc. and for the environment that applies in our parent to all our subsidiaries around the world," Where would the Maquiladora program be?

MONTOYA: Most analysts do not suggest anything like that; they suggest that the difference in the practices is great, and we know that to be true. For example, there was the submission that occurred with respect to gender discrimination,³¹ brought by a number of Non-Government Organizations (NGO) and both American and Mexican unions.³² They were alleging that there was a discriminatory practice in Maquiladoras; women workers were required to take pregnancy tests as a condition for employment.³³ As that was filed, General Motors (GM) changed its policy and said that in the future it would no longer require pregnancy testing. GM did not have to do that because the result of the submission was that there is a conflict on what the law is in Mexico, whether it is a violation of either the Constitution or the labor law to conduct pregnancy tests. GM decided that it was more consistent with its entire operation not to conduct pregnancy testing. Changes can be made that implicate higher labor costs but that are still more consistent.

We can talk about what happened to Nike and the "swoosh" because of being labeled a sweatshop operation. This is real loss in terms of the value of one of the most recognizable trademarks in the world. Consumers were making a decision to buy other than Nike because of the identification that had been made with these employment practices, largely in Indonesia. It is a bottom-line decision. It is good practice, primarily for corporations in the developed world, to make these sorts of decisions to protect trademarks and to protect the market both in the developed and in the developing world.

GORDON: Article 16 of the regulations has seven stages of which we are in the fifth. The fifth stage allows a Maquiladora to have part of the production go into the domestic market.³⁴ We are at a point now where some 75% may enter the domestic market. One question is whether Maquiladoras are really setting themselves up simply for exports and not participating in the Mexican domestic market. Are they losing opportunities in the domestic market? After all, we are at a pretty high percentage rate, with 75 percent.

CHRISTMAN: The average Maquiladora is still not looking at the Mexican market. An exception is TV sets and consumer electronics. The example of sales into Mexico applies more to the auto parts sector. However, these auto parts from a Maquiladora go to a terminal plant, and are then incorporated in the finished vehicle which, more often than not, is exported, but may be sold in the domestic market, like the utility vehicle automobiles. They will bring in the wire harnesses, for example, from a Maquiladora, and that is incorporated in a finished vehicle. Chances are that vehicle is going to be exported. If you take a look at the Mexican production of vehicles, 2/3 of their production is exported, primarily to the States but also to Chile, Central America and even to Japan in certain cases. These are in

31. See Annual Report: Cooperative Consultations and Evaluations, U.S. NAO No. 9701, <<http://www.naalc.org/english/publications/1997report3.htm>>

32. *Id.*

33. See *Id.*

34. *Supra* note 3 at Article 16

effect a “captive” Maquiladora selling to a specific client in Mexico with which it has a parent company relationship.

The problem for a Maquiladora selling into Mexico is that they are basically still production centers rather than sales centers, unless they have a captive client. Chances are they know very little about the Mexican market. They do not have a sales setup, they do not have a distribution setup, they do not have a staff set up for sales into Mexico. Few Maquiladoras, with the exception of electronics and the automotive sector, are really looking seriously at selling into the Mexican market, particularly in a period when the projections are that consumer spending growth in Mexico is going to tend to decelerate. It is not going to go back into the sharp decline we saw in 1995, but the growth rate is going to decelerate. Mexico’s population is almost a hundred million people, but that is not the consumer market. The Maquiladoras figure if they are going to sell into the Mexican market, it is still easier to ship back to the parent and have that production blended in with all the other exports that the parent is making to wherever in the world, and shipping back into Mexico.

GORDON: You are suggesting that there are a lot of business opportunities being lost?

CHRISTMAN: The Maquiladora has evolved and operates as a production center. Maquiladoras are not really geared up and they are not really gearing up for sales into Mexico.

MONTOYA: The Maquiladoras did not create a consumption market. As long as you have depressed wages, you necessarily have to depend on exporting that production. It was shortsighted on the part of those who are involved in this import-export relationship not to see that it is in the interest of the developed world - be it Korea, be it Japan or be it the United States - to create consumers in the producing country. We have to increase wages. As long as we have workers who are being paid something like \$15.00 a day in 1997, we cannot contemplate that they can buy televisions or, certainly, durable goods such as utility vehicles.

CHRISTMAN: You are looking only at the average Maquiladora wage of twelve cities on the northern border. Now the average Maquiladora wage for direct labor measured in dollars per hour is higher than the average manufacturing wage in Mexico -

MONTOYA: Absolutely, I do not deny that.

GORDON: If there had not been a collapse in the peso in December, 1994, which should not be blamed on the Maquiladoras nor on the worker, and instead the economy developed the way it had been going, the wage rate would be better than it is now.

MONTOYA: If we understand the Maquiladora as being involved in foreign direct investment as opposed to portfolio investment, the fact that there was that much foreign direct investment actually saved the economy from not going lower. Capital will flee as long as it is in stocks and bonds and other kinds of portfolio investments. If it is Maquiladora plants and equipment, it is less mobile. It is definitely in the interest of both Mexico and the United States to have capital be less mobile.

ANGULO: It is significant that a huge number of Maquiladoras are considered part of the automotive sector and are registered as the so-called national suppliers for the automotive industry. This gives them a niche with respect to the performance

requirements that the final manufacturer, the OEMs, or the after market still have under the automotive decree. This decree is in the process of phasing out its existence pursuant to a provision of NAFTA. Therefore Maquiladoras are very important in this structure for the automotive industry.

Maquiladoras are one of the most important suppliers of the automotive industry, and this may or may not be a domestic market transfer because if the automobile is exported, it is a little bit different than a Maquiladora transfer.

ELIAS-FERNANDEZ: Sometimes we determine whether Maquiladoras are selling to Mexico where the Maquiladora is actually selling but the product itself may be destined for the Mexican market without the Maquiladora selling the product, which is a big part of the market. We have seen cases where, in round-tripping the product you export it and it goes back to Mexico, where the distribution centers, for other reasons, are in the U.S. but the product ends up in Mexico. In the last seven to eight months we have been working with about 40% of our clients in designing different structures for conducting sales into the Mexican market, whether directly or indirectly.

Maquiladoras and, in general, other Mexican operations, have been focusing not only on the Mexican market but also the Latin American market. By manufacturing in Mexico under the Maquiladora program, the company may take advantage of other trade agreements that Mexico has entered into with other Latin American countries. They are importing to Mexico, manufacturing in Mexico and taking advantage of the preferential duty treatment they may be entitled to by importing into countries like Colombia, Venezuela, and Nicaragua. In general all Latin America has specific bi-lateral or multi-lateral trade agreements, but also under the Latin American Association for Integration, the so-called ALADI, which provides for duty discounts for goods produced in an ALADI member.

There are two trends. One is that Maquiladoras are at least starting to focus on the Mexican market seriously. Second, they are beginning to consider other markets using Mexico as a platform for manufacturing and exporting from Mexico.

THE DIFFERENCES BETWEEN PITEX AND THE MAQUILADORA

ELIAS-FERNANDEZ: When a company is about to make an investment and is deciding which program to choose, it is not like in the past, going either for the PITEX³⁵ or the Maquiladora; now you have to look for a tailor-made type of program.

Background on PITEX and the Maquiladora

ELIAS-FERNANDEZ: PITEX was conceived by the SECOFI as a program designed to compete with the Maquiladora program, but aimed for Mexican companies. Manufacturing would occur in Mexico and part of the production would be exported. As the two programs evolved, anyone could qualify for either program. Strictly from a customs standpoint, they are the same types of program.

The advantages or disadvantages of each type of program will depend on the intention of the company doing business in Mexico. If a company were a 100%

35. Programas de Importación Temporal para Producir Artículos de Exportación.

export company, except for some domestic sales that they may do, then you would definitely use a Maquiladora program, due to the restrictions to sales in the Mexican market that the Maquiladora program has, which appear not to be the case for PITEX.

PITEX, however, has certain restrictions that Maquiladoras do not have, and there has been misunderstanding about the respective decrees, particularly from the Ministry of Commerce. For instance, Maquiladoras have a limitation on sales to the Mexican market based on prior years' exports pursuant to both the decree and NAFTA.³⁶ It is a phase-out percentage; beginning in 2001, they will be selling 100% of their production in Mexico if they want to. Under the provision of PITEX, basically PITEX companies can only sell 30% of their goods in Mexico, and there is no phase-out period.³⁷ SECOFI has totally misinterpreted the PITEX decree and they are allowing PITEX companies to sell up to 70% into the Mexican market.

Interestingly, SECOFI is only the promoting agency. The enforcing agency is the Secretaría de Hacienda y Crédito Público (Ministry of Finance and Public Credit). There may be a situation where you are following the policy of the Ministry of Commerce but confronting the Mexican Ministry of Finance with respect to the violation of the PITEX agreement. A corporation must carefully review what the company's exact intention is with respect to its exports versus sales into the Mexican market to determine what program to choose.

Conceptually, there is no difference today in who would qualify for one program or the other. In practice, Maquiladoras are more "user-friendly" than PITEX. PITEX has been administered by the foreign trade sector of the Ministry of Commerce, whereas Maquiladoras historically have been administered by the industrial sector of SECOFI. These two programs are industrial programs; they are not foreign trade programs. Therefore, the people handling Maquiladoras are more experienced within the government to administer these programs. The reporting requirements are more cumbersome for PITEX. The approval process is different, and Maquiladoras are more beneficial than PITEX if you were to have a split decision regardless of all the conservation issues between these two programs. For certain purposes, PITEX is a great program and in some cases you may want to choose PITEX because it suits your needs. It is a tailor-made situation where you have to determine what your exact purpose is and how you should structure it accordingly.

GORDON: The difference of the origins of the PITEX and the Maquiladora is that the PITEX is for domestic sales and the Maquiladora is for exports. The government is likely to mold these together. Presumably in a few years we will not have the choice of the PITEX or the Maquiladora.

ELIAS-FERNANDEZ: It appears from conversations and meetings we have had with various officials of the Ministry of Commerce that SECOFI has the intention of creating a single importation program that would be in full compliance, as these programs are, with NAFTA. In order to avoid having to choose between the two programs, and having two programs that basically serve the same purpose, Mexico

36. *Supra* note 3 at Article 16.

37. Requirement to Obtain Benefits: Maquiladora, PITEX, ALTEX, (last modified may 1999).
<<http://www.mecdc.org/maq3.html>>

is going to create a single program that would take the positive aspects of both the Maquiladora and PITEX. They are already working on a draft of this program. They have said most likely they will distribute it among organizations for "public comment," but they will probably just issue it on December 31, 2000, a day before 2001 comes and changes the whole concept. At least they are working on it and trying to eliminate all the distinctions. To some extent, in practice, they are administering the two programs in a similar fashion.

We always get entangled in the raw materials and the input side of importing and exporting and the duty-free importation and duty-free exportation, but we rarely discuss the machinery and equipment issue. This is an extremely important issue because that is where the real value is. The Mexican authorities do not know how to deal with machinery and equipment.

The question is, "Should I make a huge investment before 2001 with the provision being grandfathered in? Or should I just wait and see what happens?"

THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

GORDON: Every free trade agreement created is intended to distort trade; it is a function of the free trade agreement, to change trading patterns, create preferences. It is going to cause losses. One hopes that trade creation outweighs trade diversion, and one also hopes that there will be combinations as we see it continually occurring. There ought to be a dynamic to the process of trade agreements and we certainly are seeing that occurring. The maquiladora decree that passed this summer mentions the NAFTA. Is the decree NAFTA-consistent?

ANGULO: The purpose of a trade agreement is the elimination of tariff barriers and non-tariff barriers. A Maquiladora eliminates tariffs in a temporary importation under the vision of Mexican law. The concept of duty referrals is a U.S. law concept. Under Mexican law there are no duty referrals, there is no duty because it is a temporary importation.

The concepts of duty referral and temporary importation collided when the NAFTA negotiations occurred. What you have in a Maquiladora is a redundancy if you compare it with NAFTA. If you import something into a Maquiladora, it is duty-free because it is a temporary importation. A non-Maquiladora, an entity that may be a Mexican company or branch of a non-Mexican company working outside the Maquiladora system, carries out a definitive importation using a NAFTA preference, and this importation may be duty-free. You have duty-free against duty-free. Goods from both Maquiladoras and non-Maquiladoras may be duty-free. This is always duty-free; this may be duty-free because there is a phase-in process of the NAFTA preferences. However, the non-Maquiladora importation, a definitive importation, is always subject to Value Added Tax. Maquiladora imports are never subject to Value Added Tax when it is a temporary importation.³⁸

The distortions come when the Maquiladora sells outside its Maquiladora system into the Mexican market, not to another Maquiladora but to a non-Maquiladora. Then you have to convert the importation into a definitive importation, but not on

38. See Mexico's Maquiladora Program, (last modified August 1998) <<http://www.customs.ustreas.gov/nafta/maquila.htm>>

the total value of the product on which you are changing the regime but only on the part of the product that you are changing the regime parts that were temporary imports. If you have inputs from Mexico and inputs from outside Mexico, you pay duty on this only. You do not pay duty on the Mexican inputs, including labor and any value added from Mexico. You only pay duties on this, and the duties you pay are the corresponding Mexican general tariff duty that would apply.

If the Maquiladora does the round-tripping, then the Maquiladora may be exporting something that ultimately may be imported into Mexico under the NAFTA regime duty-free into Mexico, but Value Added Tax (VAT) assessed. You have to take that into consideration.

Many provisions are related to the NAFTA rules of origin, but let us take one very simple one, change in tariff classification. I will use my usual example of the pen cap. Let us say that this pen has one tariff classification and that this cap here has a completely different tariff classification. If we put them together, it is a different tariff classification. Let us say that NAFTA will say (and this is not real, only conceptual) that if I do this, this processing, that will make it an originating product under NAFTA. Originating means that the product becomes a "Naftanian" product. A "Naftanian" product is a product from Mexico, Canada or the United States that is subject to the NAFTA rules of origin that are subject to the NAFTA duty preference. If I bring in the Far East pen into Mexico under the Maquiladora regime, it will not pay any duty because it is a temporary importation, and the cap will not pay any Value Added Tax because it is a temporary importation. If I put them together and it meets the NAFTA rule of origin, then this pen and this cap comes from the Far East. I put them together and it becomes a NAFTA originating product, a "Naftanian" product. Then the Maquiladora exports the item into the United States and the United States has to grant the NAFTA preference because it met the rules of origin. Therefore, there are zero duties, no importation or Value Added Tax in the United States.

The 2001 NAFTA provision signals changes in the coming years in this system. In the year 2001, Far East products that are going to be imported into Maquiladoras are going to be duty-free, Value Added Tax free upon importation. However, upon exportation to a NAFTA country, those items would have to pay the Mexican duty that they avoided paying upon importation. So, I import the Far East cap and pen into Mexico. I do not pay duties or Value Added Tax. If I export it into the United States then a clock will start ticking against the Mexican exporter, to pay the Mexican duty that he did not pay upon importation because this is a non-NAFTA component that is going to be imported into a NAFTA country, the United States. The same rule applies if the item is going to be sold into the Mexican domestic market, which is part of NAFTA; it is Naftanian. If in this extreme example I do not pay any U.S. duties because it is subject to a NAFTA preference I will have to pay Mexican duties that I did not pay upon importation. This is what will happen to Maquiladoras post-2001.

The difference lies in whether you are importing non-NAFTA components. If you continue importing components from Canada or the United States it is a Maquiladora as usual, even items that are still subject to the NAFTA phase-in process. If you import inputs from United States which under NAFTA may be subject to a small duty, 1% or whatever, into a Maquiladora and then back to NAFTA territory, it will continue to be like right now, duty-free import and export.

However, if you import items coming from outside of NAFTA, then this rule applies and you have to pay the duties when you export, the ones that you did not pay upon importation. When you export you have to pay those duties.

What happens when the item does not meet the rules of origin? When you export the item (and bear in mind the pen is from the Far East and the cap is from the Far East) you do the process and it does not meet the NAFTA rules of origin, you export into the United States, what happens? You have to pay the Most Favored Nation (MFN) duty in the United States, the general duty applicable to the item into the United States.

U.S. law visualizes NAFTA Article 303 as being a duty referral program and Mexico visualizes this structure as being a temporary importation; thus, the Article is difficult to understand.

GORDON: People often confuse most favored nation tariffs - Mexico's most favored nation tariff applied to Korea is not necessarily the same rate under most favored nation status for the same item that the United States might have for Korea. The most favored nation concept is that Korea gets as good treatment as Bolivia or any other country that is in that mix.

We could have a situation where the modem part comes into Mexico at zero tariffs and then feeds its way into the NAFTA system because it becomes a NAFTA product under the rule of origin. We could have something come in at zero tariff that does not feed its way and become a NAFTA product because it does not meet the rules of origin. The product then goes to the United States and the tariff is based on Most Favored Nation (MFN) status, which is less than the tariff that Mexico charged to Korea. The product could also go into the United States under a MFN tariff that would be higher than the Mexican tariff. All of these things have to be figured out.

MONTOYA: Is it not correct that one of the reasons we can anticipate that the Maquiladora will continue despite NAFTA changes, including 2001, is that the Maquiladoras will continue to enjoy the streamlined customs procedures that have been talked about earlier?

ANGULO: Definitely. The streamlined procedures will continue, and also the non-payment of Value Added Tax is an important financial impact.

ELIAS-FERNANDEZ: If you were to make a definitive import into Mexico, you would have to comply with many different requirements. Mexican official standards or NOMs include labeling and technical standards, which may really kill your importation or make you not want to import into Mexico. However, Maquiladoras do not have to comply with all these non-tariff requirements and barriers. That is a huge difference in the day-to-day operation, if you were to import any good into Mexico on a definitive basis. For instance, the product has to bear a label with Spanish information and the standard label in Mexico is quite cumbersome, whereas Maquiladoras just bring the goods into Mexico without any problem whatsoever. So as far as the customs procedures go, probably the most important part of it is the non-tariff requirement compliance exemption. Maquiladoras enjoy an extremely expeditious procedure called the *pedimento consolidado* or consolidated entry. To import to Mexico or export from Mexico, a formal document in prescribed form, called the *pedimento*, is required, and the use of a customs broker is mandatory. Maquiladoras are allowed not to use the import *pedimento* for each entry but rather just use a commercial invoice with certain information. They clear goods on a daily

basis with this commercial invoice, or consolidated *factura* or invoice, and every Tuesday, they file one single import *pedimento*, the formal entry covering all of the transactions performed during the previous week. This saves tons of money and procedures. Some TV companies clear goods in more than 250 trucks a day. Producing import *pedimentos* for each single crossing would make it impossible. With this consolidated system, it is very expeditious; they can just clear goods with a simple invoice a couple of requirements, nothing that would really kill you or make your transaction impossible.

Similar to this consolidated *pedimento* advantage or benefit, there are a number of other benefits that you cannot really see in the macro picture but on a day-to-day basis. If you import excess merchandise, you have ten days to self-correct without payment of duties. The inspection of the customs official sometimes is a lot simpler with Maquiladoras. One of the extremely important features is that with definitive imports there is a provision in the law that requires an importer to include in the paperwork the individual information of the good, including serial number, model number, trademark. When you are importing 10,000 items you have to inspect each individual one by one, and determine what is the serial number, trademark and model number. Maquiladoras are exempt from this obligation with respect to their raw material imports. So Maquiladoras enjoy a variety of different benefits from a customs standpoint, and again it is a customs program that will likely not disappear in 2001. The only provisions of NAFTA affecting Maquiladoras are those related to sales into the Mexican market and to duty deferral programs or the payment of duties. Those are the only two; there are no provisions dealing with the program's disappearance.

Article 303 of NAFTA deals with non-originating or non-Naftanian materials and only applies if the finished product is exported to the U.S. or Canada.³⁹ If you have materials from the NAFTA countries or if your product destination is not the U.S. or Canada, these provisions do not apply. Therefore, the Maquiladora continues operating as it has been in the past. There is the proposal for merging the PITEEX and the Maquiladora program into one. Another project that the Ministry of Commerce, SECOFI, and Hacienda have been working on is the possibility of setting Value Added Tax on temporary imports. This would kill the Maquiladora industry by assessing a Value Added Tax at a rate of 15% or 10% on temporary imports. They have been analyzing and discussing the possibility of doing so. It is not official, something that we just learned from some contacts we have. We are extremely worried about it because that would increase the costs of operation by 15%, just from one day to the other. Of course it requires an amendment to the Value Added Tax Law. That is probably the only reason why Maquiladoras' life may end, for a cost reason, but not a legal implication of NAFTA, per se.

MONTOYA: Another aspect has to be factored into the management of the Maquiladora, and that has to do with the submission process now available under the labor side agreements. When NAFTA was being considered, Clinton talked about or recognized the concern, or the cause for concern, that labor standards have been regularly violated, and that environmental standards have been ignored. What came out of the discussions in the U.S. were the two accords - the environmental

39. *Supra* Note 22 at Article 303.

and the labor side agreements, ACLAN for environmental and NAALC for the labor cooperation agreements. They allowed for public communications with each of the member states. No one knew how this process was going to work, because under the side agreements each of the countries can develop their own procedures.

There have now been ten or eleven submissions, most of them filed in the U.S., and one in Mexico, which was the Sprint submission. Out of the ones that have been filed in the U.S, eight have involved Maquiladoras, alleging not only industrial rights (that is, freedom of association, right to collective bargaining) but more recently raising issues having to do with gender-based discrimination, specifically the pre-employment pregnancy testing. In the Han Young submission, they raised not only freedom of association issues, but also issues having to do with health and safety. The importance of the health and safety is that the submission process is a tiered process so that of the eleven labor principles identified under the side agreement they receive different treatments. Only three of them - minimum wage, health and safety, and child labor - can go all the way to arbitration. All of the submissions that have been filed up to now have not raised what are called Tier 3 principles. So the limitation is on review and consultation. Several of the submissions have gone to ministerial consultation. That means that Secretary of Labor Herman in the United States consults with the Secretario de Trabajo Público in Mexico. The submissions have mostly entailed freedom of association collective bargaining issues. Han Young raises two issues involving health and safety. Specifically, Han Young was a chassis assembly plant, a welding operation for Hyundai. The allegations were that the working conditions were subjecting the employees to considerable health jeopardy, that there were leaks in the roof, which led to puddles on the floor and electrical cables in the puddles. The cables that held the chassis would break periodically and the chassis would fall on the workers. As a result of the submission, it was bifurcated in two. First, the industrial rights were treated separately from the health and safety violations. The inspectors in Mexico went to the Han Young factory four times and found forty violations. They eventually fined them in excess of \$9,000. The management of Maquiladoras must now factor in the submission process, that there is a supra-national process intervening in the labor practices. The relationship between management and workers is being overseen not only by the Mexican NAO, but also by the U.S. NAO and a whole variety of international NGOs who are now using the labor side agreements to raise concerns about labor violations. Similar to the environmental side agreement being used primarily by NGOs to raise concerns about environmental practices.

QUESTIONS & COMMENTS

VARGAS: Professor Montoya, with respect to the new decree on worker safety and health by the Mexican government, have we seen any new resources dedicated to enforcing or protecting worker safety and health in the past couple of years, especially in the Maquiladora industry? What can we anticipate in the future? Will we see more of a private sector type or more government involvement, or will we see cooperation between unions, businesses and government?

MONTOYA: One thing is that it has given the PAN (Partido Accionista Nacional) a live political issue. One of the things the PAN was able to do in Chihuahua in the

recent gubernatorial election, and in other states as well, was to raise some of these issues as domestic issues within the political discourse in Mexico. Issues such as worker safety, and the proposed changes to the Federal Labor Law, may have been brought to the table because of the desire to create a better environment for NAFTA, but it has created some interesting political discussions within Mexico. One of the things that we saw in Han Young was that the Hyundai Corporation, through its subsidiaries, did improve working conditions.⁴⁰ They bought extractors and put them in the factory. One of the problems with welding is that there are a lot of airborne contaminants. They bought better masks, better gloves and other kinds of rubber suiting for the workers, so there have been improvements.

40. See *Business Week*, June 8, 1998.

