

## **A Mexican Dividend: “Las Maquiladoras”**

In 1965, Mexico initiated its Mexican border program (Programa Nacional Fronteriza) for the purpose of bettering economic conditions on the Mexican side of the United States border.<sup>1</sup> One aspect of this program was to encourage the establishment of foreign manufacturing plants on the borders of México. It was natural for much of this corporate development to be an assembly plant type of operation in view of the availability of labor, the low labor cost factor, accessibility of transportation and the application of United States tariff item Nos. 806.30 and 807.00.<sup>2</sup> This particular type of corporate development is called the “Maquiladoras” in Mexico. The Maquiladoras receive materials for processing from the United States or other foreign countries and return them either to the exporting country or to a third country. Most of the plants are United States-owned and many United States companies have established a sister plant on the United States side of the border. A United States corporation, through the use of the Maquiladoras operation, can compete with imports to the United States from Hong Kong, Japan, Taiwan and also compete in the United States export market. Many of these products could not be produced in the United States but for the low labor cost factor inherent in the Maquiladoras operation.

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<sup>1</sup>Speech, August 1965, by Minister Campos Salas, Ministry of Industry and Commerce.

<sup>2</sup>Tariff Item No. 806.30 was incorporated into the tariff schedules of the United States in 1956. Its effect is to limit the duty to the value of the foreign processing of articles of metal (except precious metal) manufactured or subjected to a process of manufacture in the United States and exported for processing and return to the United States for further processing.

Tariff Item No. 807.00 was incorporated into the tariff schedules of the United States on August 31, 1963. Its effect is to limit the duty upon the full value of the imported products, less the value of the United States fabricated components contained therein to imported items assembled in foreign countries with fabricated components that have been manufactured in the United States. Articles imported under this item require no further processing in the United States.

There is no Mexican import or export duty imposed on the Maquiladoras, but there is a 4 percent sales tax on the Mexican components of all goods assembled and re-exported.<sup>3</sup> State taxes vary from 3 percent to 5 percent. Under a recent regulation,<sup>4</sup> assembly plants can now be established anywhere in Mexico. Previously, they were restricted to 12.5 miles from the United States border (from the Gulf of Mexico to the Pacific Ocean).<sup>5</sup> Materials which are shipped from the United States for assembly and processing in Mexico are entered into bond upon arrival. This bonding can now be arranged on an annual basis.<sup>6</sup> Prior permission for an assembly operation must be obtained from the Secretariat of Industry and Commerce and from the Secretariat of Finance and Public Credit for the temporary imports (with a copy to the Secretariat of Industry and Commerce).<sup>7</sup> [Permission is granted on a preliminary basis (Form EF-14) and confirmed on a permanent basis (Form EF-15).] A Maquiladora should initiate its imports within a period of four months following its date of approval of operation, but this period may be extended if necessary.<sup>8</sup> Temporary import authorizations are valid for 12 months from the date of first importation.<sup>9</sup> When this period has expired, a new application must be submitted.<sup>10</sup> Assembly plants may request permission for a percentage of their products to be sold in the domestic Mexican market.<sup>11</sup> Under the earlier regulation, the entire output of the plants had to be exported.<sup>12</sup>

Temporary imports permitted to be imported are:<sup>13</sup>

1. "Raw materials, auxiliary materials and parts for assembly, cutting, finishing, and, in general, to effect operations of assembly;
2. "Machinery, apparatus, instruments and equipment necessary to realize the above operations and those required for quality control of the products;
3. "Replacement products for the items in Section 2 above;
4. "Tools and equipment accessory to production and to security"; and

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<sup>3</sup>There is some question as to whether the 4 percent sales tax is applicable to assembled goods returned to the United States. Airgram, Department of State, A-478, p.5, 9/7/73.

<sup>4</sup>Article 3 of Regulation, paragraph 3; Article 321, Customs Code, United Mexican States for the Assembly Industry, 10/30/72; published in *Diario Oficial* 10/31/72.

<sup>5</sup>Article 2 of Regulation, paragraph 3; Article 321, Customs Code, United Mexican States, 3/15/71; published in *Diario Oficial* 3/17/71, effective 3/18/71.

<sup>6</sup>Note 4, *supra*, Article 12.

<sup>7</sup>*Id.* Article 2.

<sup>8</sup>*Id.* Article 6.

<sup>9</sup>*Id.* Article 6.

<sup>10</sup>*Id.* Article 6.

<sup>11</sup>Two firms have applied for permission to sell domestically. Certon Audio & Boss de Mexico. Airgram, Dept. of State, A-478 p. 9, 9/17/73.

<sup>12</sup>Note 5, *supra*, Article 1.

<sup>13</sup>Note 4, *supra*, Article 7.

5. "Containers, packing materials, labels, brochures, work materials and industrial designs."

Originally, assembly plants established under the free zone regulations did not have to register.<sup>14</sup> Under the new regulations, all assembly plants, no matter where situated, are required to register.<sup>15</sup> Although, under the current regulation, industrial wastes must be exported or destroyed,<sup>16</sup> it is now understood that some wastes may be donated to interested Mexican institutions.<sup>17</sup>

It should be obvious that prior to establishing an assembly plant one should, first of all

1. search for a logical site for an assembly plant (possibly visiting various industrial parks), considering availability, cost and attitude of labor, accessibility of transportation and cost of ancillary facilities required to operate effectively;

2. consider whether it is advisable to adopt the sister plant theory (with a plant in Mexico and one in the United States near the border to complement the whole operation);

3. consult with United States Customs Officials regarding the product to be exported to the United States to ascertain whether there is any unusual content inherent to the nature of the product that could create problems in importing into the United States.

The administrative and local steps necessary to establish such an assembly plant would then be:<sup>18</sup>

1. To incorporate in Mexico either as a wholly-owned foreign corporation or a joint venture; form a branch or proprietorship or agree to a leasing arrangement;

2. To apply for *registration* as an assembly plant operation (Mexican Form EF-14), or to apply for an *approval* of an assembly plant operation (Mexican Form EF-15). (The filing of EF-15 serves both as a registration and approval.);

3. To register as a taxpayer with the Mexican Ministry of the Treasury;

4. To be listed by the General Bureau of Statistics of the Ministry of Industry and Commerce;

5. To register as an employer with the Mexican Institute of Social Security;

6. To register with the Federal Housing Administration (an employer

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<sup>14</sup>Note 5, *supra*, Article 2.

<sup>15</sup>Note 4, *supra*, Article 5.

<sup>16</sup>*Id.*, Article 11.

<sup>17</sup>Depart. of State, Airgram A-478, p. 4, 9/17/73.

<sup>18</sup>See *Industrial Possibilities Program for Assembly In-Bond Plants*, published by Secretariat de Industria y Comercio, 1974, pp. 15-17.

must pay 5 percent of the total remuneration that a worker receives to the Federal Housing Administration);

7. To apply for authorization of temporary importation of raw materials (Mexican Form EF-16);

8. To apply for authorization of temporary importation of machinery and equipment (Mexican Form EF-17);

9. To file a statement as required of assembly plant operations every six months (Mexican Form EF-18);

10. Arrangements must be made to provide a guarantee for the payment of appropriate import duties, plus an additional 10 percent for possible fines.<sup>19</sup> In the event that a bond is accepted through a surety, such bond may cover only 40 percent of the tax liability. The guarantee can also be collateral, cash deposit or customs deposit.

Recently Mexico enacted a law on the Transfer of Technology and the Use and Exploitation of Patents and Trademarks<sup>20</sup> and a law to Promote and Regulate Foreign Investments.<sup>21</sup>

In brief, the Technology Law establishes a National Registry of the Transfer of Technology within the Ministry of Industry and Commerce. The National Council of Science and Technology acts as an advisory body. Under this law, all "individuals or entities of Mexican nationality" and "foreigners residing in Mexico and entities of foreign nationality established in the country" and "agencies or branches of foreign companies established in the Republic of Mexico"<sup>22</sup> are obligated to register all documents containing the acts, contracts or agreements of any nature effective in Mexico executed in connection with "the concession to use or authorization to exploit trademarks"; "the concession to use or authorization to exploit patents, improvements, models and drawings of an industrial nature"; "the providing of technical knowledge by means of plans, diagrams, models, instruction sheets, directions, formulations, specifications, preparation and training of personnel and other means"; "the providing of basic and detailed engineering for the installation of facilities or the manufacture of products"; "the technical assistance regardless of the matter in which it is rendered"; and "the services for the administration and operations of companies."<sup>23</sup> The request for regis-

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<sup>19</sup>*Id.*, pp. 16, 17. With respect to the inspection of imports and exports, forms DG-1 and DGA-2 are required.

<sup>20</sup>The law to Register the Transfer of Technology and the Use and Exploitation of Patents and Trademarks, published in *Diario Oficial*, 12/30/72.

<sup>21</sup>The law to Promote Mexican Investment and Regulate Foreign Investment, published in *Diario Oficial*, 3/9/73.

<sup>22</sup>Note 20, *supra*, Article 3.

<sup>23</sup>*Id.*, Article 2. The suppliers of technology residing abroad may also apply for registration with the National Registry of acts, agreements or contracts to which they are a party.

tration must be within sixty days after the signing of the agreement.<sup>24</sup> If the agreements are not registered, they are considered "without legal effect" and are not creative of rights under the law in Mexico.<sup>25</sup> The Ministry of Commerce and Industry shall not register documents that fall within the following categories:<sup>26</sup>

1. "When their purpose is the transfer of technology freely available in the country, provided that the same technology is involved;

2. "When the price or compensation are disproportionate with the technology acquired or constitute an unjustified or excessive burden for the national economy;

3. "When they contain clauses allowing the supplier to regulate or intervene, directly or indirectly, in the management of the party acquiring the technology;

4. "When the obligation is provided of assigning, for consideration or gratuitously, to the supplier of technology, the patents, trademarks, innovations or improvements obtained by the acquiring party;

5. "Whenever limitations are imposed on technological research or development by the party acquiring such technology;

6. "When the obligation is established of acquiring exclusively equipment, tools, parts or raw materials of a certain origin;

7. "When the export of goods or services produced by the acquirer is prohibited or limited, in a manner contrary to the interests of the country;

8. "When the use of supplementary technology is prohibited;

9. "When the obligation is established of selling the goods produced by the acquiring party in an exclusive manner to the supplier of technology;

10. "When the acquiring party is obligated to utilize permanently personnel indicated by the supplier of technology;

11. "When the production volumes are limited or sales prices or resale prices are imposed for national production or for the exports of the acquiring party;

12. "When the acquiring party is obligated to execute contracts for exclusive sales or representation in national territory with the supplier of technology;

13. "When excessively long terms are established. In no case may such terms be longer than ten years obligatory for the acquiring party"; and

14. "When the hearing or resolution of suits arising from the interpretation of or compliance with said acts or agreements or contracts is submitted to foreign courts."<sup>27</sup> (The Ministry of Industry and Commerce may register

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<sup>24</sup>*Id.*, Article 4.

<sup>25</sup>*Id.*, Article 6.

<sup>26</sup>*Id.*, Article 7.

<sup>27</sup>Arbitration in a foreign country is acceptable, provided that the laws of Mexico shall govern the

certain of the above categories if it is in the country's public interest, but no exceptions can be made regarding Sections 1, 4, 5, 7, 8 and 14.)<sup>28</sup>

One of the five exceptions to the requirement of registration includes the Maquiladoras, which gives an indication as to the importance of the Maquiladora operation to the economy.<sup>29</sup> The exceptions are as follows:

1. "The entering into Mexico of foreign technicians for the installation of factories or machinery or for making repairs;
2. "The supplying of designs, catalogues, or advice in general acquired with machinery or equipment and which are necessary for the installation thereof, provided it will not imply the obligation to make subsequent payments;
3. "Assistance in repairs or emergencies, provided that the same are derived from an act, agreement or contract which has been previously registered;
4. "The technical instruction training supplied by educational institutions, training centers or by the companies to their workers"; and
5. "The operations of the processing companies ("Maquiladoras") will be covered by the legal or reglamentary provisions which may be applicable."

There is also a provision to the effect that the National Registry must keep absolutely confidential registered technological data.<sup>30</sup> Reconsideration of a ruling of the Ministry of Industry and Commerce should be filed within eight days following notice and the Secretary must render a decision within forty-five days after the filing of the reconsideration.<sup>31</sup>

In brief, the new Investment Law sets up a National Registry of Foreign Investment which requires registration of all foreign capital.<sup>32</sup> It also establishes a National Commission of Foreign Investment.<sup>33</sup> Foreign Investment is defined as "foreign corporate bodies"; "foreign physical persons"; "foreign economic entities without legal personality"; and "Mexican business enterprises with majority foreign capital or in which foreigners are empowered by any title to determine the management of the business enterprise."<sup>34</sup> After May 8, 1973, there may be no more than 49 percent foreign investment in the capital of Mexican corporations unless it is in the national interest for the National Commission to increase or decrease foreign stock ownership.<sup>35</sup> The National Commission on Foreign Investment has the power, if it deems convenient, to grant a preferential option of Mexican investors to purchase

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performance and construction of the contract.

<sup>28</sup>Note 26, *supra*, Article 8.

<sup>29</sup>*Id.*, Article 9.

<sup>30</sup>*Id.*, Article 13.

<sup>31</sup>*Id.*, Article 14.

<sup>32</sup>Note 21, *supra*, Chapter V., Article 23.

<sup>33</sup>*Id.*, Chapter III, Article 11.

<sup>34</sup>*Id.*, Chapter I, Article 2.

<sup>35</sup>*Id.*, Chapter I, Article 5.

stock for a period not to exceed ninety days, if it is in the national interest.<sup>36</sup> Foreign investment in national mining reserves is limited to 34 percent and to 40 percent in manufacturers of automotive components and secondary petrochemicals.<sup>37</sup> The law does not apply to corporations in existence prior to May 8, 1973. A foreign investor interested in acquiring more than 25 percent of the capital or over 49 percent of the assets of an existing company must receive authorization to do so and must file an application with the National Commission which will refer the resolution to the Secretary of the concerned agency. Leasing of a business or assets is the equivalent of acquisition of assets.<sup>38</sup> All foreign-owned stock must be registered with the National Registry and issued in nominative shares. In the event ownership is in bearer form, it must be converted and registered. This applies to companies in existence prior to May 8, 1973 as well as future investment.<sup>39</sup>

The National Commission is given broad powers to regulate foreign investment generally.<sup>40</sup> The legislation also contains a provision concerning the law on the right of aliens to use and enjoy real property in the prohibitive zones, *i.e.*, 100 kilometers from the borders and 50 kilometers from the sea coast.<sup>41</sup> The Ministry of Foreign Relations is empowered to grant certain credit institutions the capacity to accept title and to act as fiduciaries to real estate in the prohibited zone and to issue participation certificates to the foreigner.<sup>42</sup> The property must be used for industrial or tourist activities.<sup>43</sup> Beneficiaries under the regime acquire no right in ownership in the real property.<sup>44</sup> The life of the trust is limited to 30 years, with a lease allowed for a ten-year term, renewable twice.<sup>45</sup> Upon expiration of the trust, the property is to be sold to persons legally qualified to acquire it, *i.e.*, Mexican citizens.<sup>46</sup> Land can also be leased for a ten-year period renewable by two additional ten-year periods.

The penalties for violating these provisions are not unsubstantial:

1. Companies failing to register foreign capital are not allowed to pay dividends;<sup>47</sup>
2. Actions taken in violation of provisions of the law are null and void and,

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<sup>36</sup>*Id.*, Chapter II, Article 9.

<sup>37</sup>*Id.*, Chapter I, Article 5.

<sup>38</sup>*Id.*, Chapter I, Article 8.

<sup>39</sup>*Id.*, Chapter VI, Article 25.

<sup>40</sup>*Id.*, Chapter III, Article 12.

<sup>41</sup>*Id.*, Chapter I, Article 7.

<sup>42</sup>*Id.*, Chapter IV, Article 18.

<sup>43</sup>*Id.*, Chapter IV, Article 18.

<sup>44</sup>*Id.*, Chapter IV, Article 18.

<sup>45</sup>*Id.*, Chapter IV, Article 20.

<sup>46</sup>*Id.*, Chapter IV, Article 20.

<sup>47</sup>*Id.*, Chapter VI, Article 27.

therefore, have no validity before any authority; offenders are to be fined up to the value of the unauthorized act; and unqualified violations shall be fined up to 100,000 pesos;<sup>48</sup>

3. Administrators, directors, general managers, and vigilance officers have a common responsibility with respect to their functions. Failure to meet this responsibility can result in the assessment of fines up to 100,000 pesos;<sup>49</sup>

4. Notaries and brokers violating the law may be deprived of their licenses should they certify documents that have not been properly authorized;<sup>50</sup> and

5. Imprisonment up to 9 years, and fines up to 50,000 pesos are to be applied to whomever simulates any action prohibited by this law.<sup>51</sup>

The Maquiladoras are exempted, however, from the most important provision of the above new Investment Law by resolution of the National Commission of Foreign Investments. The Resolution states that "such enterprises (Las Maquiladoras) can constitute themselves and operate even with 100 percent of foreign capital." This disposition does not, however, include those assembly in-bond enterprises that may be established for the textile industry and whose activities could affect the tariffs fixed for Mexican products by the importing countries.<sup>52</sup> The Maquiladoras are, nevertheless, subject to all the other provisions of the new Investment Law, including registration and conversion of bearer shares to nominative, and restriction of ownership of land within the "so-called" prohibited zones. One feature that may be important in the future is that assembly plants incorporated in Mexico are to be Mexican and receive preferential duty treatment in exporting to member countries of LATFA (Latin American Free Trade Association), provided that 50 percent of the product content is Mexican. The product content of United States origin is, of course, dutiable as if imported directly from the United States.<sup>53</sup>

In September 1974 there were at least 665 firms established as assembly plants employing some 74,000 Mexican employees.<sup>54</sup> Some of these plants were in the interior of Mexico performing in-bond operations on the contract basis. Most of the Maquiladoras process electronic equipment and apparel goods. It is understood that more established plants are considering moving into the interior, but a problem is that many locations in the interior do not have skilled labor or proper facilities for plant operation.<sup>55</sup>

<sup>48</sup>*Id.*, Chapter VI, Article 28.

<sup>49</sup>*Id.*, Chapter VI, Article 29.

<sup>50</sup>*Id.*, Chapter VI, Article 30.

<sup>51</sup>*Id.*, Chapter VI, Article 31.

<sup>52</sup>National Commission on Foreign Investment, Resolution No. 1, published 7/11/73.

<sup>53</sup>See resolution 11 (3/30/72) and resolution 13 (4/13/62) with the Permanent Executive Committee of LATFA.

<sup>54</sup>President Luis Echeverria's Fourth State of the Nation Report.

<sup>55</sup>Airgram, Department of State, A-478, p. 8, 9/13/73.

As stated above, many Maquiladoras have sister plants on the United States side of the border to complement their operations.<sup>56</sup> One such example is Brownsville, Texas. Fifty-four new industrial firms have been incorporated in Brownsville since 1966, resulting in 4,800 new industrial jobs.<sup>57</sup> It was estimated that for 1974, the value added in Mexico would reach \$450-million and the U.S. component's value will reach \$550-million.<sup>58</sup>

There was, however, a decrease in Maquiladora plant operations during 1974 due to increased costs (primarily labor costs) in Mexico and the United States recession. Thirty-two Maquiladora plants employing some 23,000 people have ceased operation since October 1974 and another 60 plants have reduced personnel. The drop in employment is estimated at 35 percent.<sup>59</sup>

A negative factor to the Maquiladora development in Mexico is new competition from countries with lower labor costs such as Haiti, El Salvador, Colombia, Costa Rica, Nicaragua, and Guatemala. In addition these countries as developing countries are entitled to trade preferences (generalized system of preferences—GSP) under the Trade Act of 1974. This means that eligible articles from these countries (*i.e.* those not considered import sensitive) would receive duty free treatment in the United States for ten years.<sup>60</sup> There have been rumblings that the application of U.S. tariff item Nos. 806.30 and 807.00 was not in the public interest of the United States, but this does not seem to be a reality.<sup>61</sup> There is a provision in the trade bill for import relief in this event.<sup>62</sup>

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<sup>56</sup>Labor rates in the interior are considerably lower than the minimum wages along the U.S.-Mexican border which range from \$6.00 to \$9.00 a day. In the State of Queretaro, Morelia, and San Luis Potosi, wages are \$4.00 per day. The wages in the State of Puebla are \$4.50 a day.

<sup>57</sup>*Supra* note 55, p. 10.

<sup>58</sup>The "First Billion-Dollar Year," by Richard Bolin, Chairman Maquiladora Advisory Council, American Chamber of Commerce of Mexico, A.C., published in *Mexican-American Review*, p. 18 6/74.

<sup>59</sup>Business trends, Vol. X No. 426, April 7, 1975, published by Publicaciones Ejecutivos de Mexico S.A.

<sup>60</sup>Generally speaking import sensitive items are textiles, apparels, watches, certain electronic items, steel, footwear, glass etc. Hearings were held in May '75 before the International Trade Commission on what articles should be eligible. In addition other hearing will be held soon by The Trade Policy Staff Committee of The Office of The Special Representative for Trade Negotiations (See Federal Register, Vol. 40, No. 85, p. 19045-19047, May 1, 1975).

<sup>61</sup>A 1970 study by the United States Tariff Commission regarding the economic factors affecting the use of item Nos. 806.30 and 807.00 concluded from the viewpoint of United States trade, production and employment that it would not be beneficial to repeal the said tariff items. United States Tariff Commission, Publication 339, economic factors affecting the use of items 806.30 and 807.00 of the Tariff Commission schedules of the U.S. 9/70, pp. 230-233.

<sup>62</sup>The Trade Act of 1974 provides for import relief in certain cases with respect to products imported under item Nos. 806.30 and 807.00. If the Tariff Commission makes a finding that increased imports have been a substantial cause of serious injury or threat, thereof, to a domestic industry, the President may then provide one, or a mixture of the following remedies:

- a. increases in duties;
- b. tariff rate quotas;
- c. quotas; or
- d. orderly marketing agreements.

It is the writer's prediction that there will be an increase in the Maquiladora development based on the fact that Mexico is stable and also benefits as a "developing country" in the trade preferences of the Trade Act of 1974.<sup>63</sup> In addition the Mexican Government, being seriously concerned with the recent downward trend, is studying possible incentives and future facilities that would encourage the Maquiladora development. For instance they are considering the possibility of approval of tax rebate certificates (CEDIs) for exports by the plants and an exemption from the Federal 4 percent gross receipt tax.<sup>64</sup> It is possible that labor unions along the U.S.-Mexican border may take a more moderate approach toward wage increases in view of recent developments. They are painfully aware that their increase in wages hurt the Maquiladora operation. There should be more corporate movement to the interior to benefit from more reasonable labor costs. The interior states can offer additional incentives such as tax reductions, financing, and use of their good offices to obtain concessions in foreign stock ownership. A number of companies will try to combine a basic manufacturing operation for the domestic market with a Maquiladora operation either by a separate division or by forming separate companies. (Permits have already been applied for by several companies to date.) In 1974, the industrial parks along the border were completely filled. Now there is space available at a possible lower rate. Two final factors to Mexico's advantage are the high quality of its labor force and the fact that transportation between Mexico and the United States is less costly and more immediate than in the other countries competitive to Mexico such as El Salvador.

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For purposes of this section of the Act, the President may suspend items 806.30 and/or 807.00 in lieu of, or in addition to, an increase in duty if it is determined that the injury to the domestic industry results from the application of item 806.30 and 807.00. Section 203(f)(3). No overall rate of duty, however, may be imposed which is greater than 50 percent *ad valorem* above the rate existing at the time of the President's proclamation. Section 203(d)(1).

<sup>63</sup>As opposed to items 806.30 and 807.00, which limit the application of U.S. duties to the value added abroad, the tariff preferences for less developed countries (zero duty treatment for 10 years) in Title V of the Trade Act of 1974 would cover U.S. components and value added abroad.

<sup>64</sup>*Supra* note 59.