

CONSIDERATIONS ON THE POSSIBLE EFFECTS OF THE FREE TRADE AGREEMENT BETWEEN MEXICO, THE UNITED STATES AND CANADA ON THE MEXICAN EXPORT MAQUILADORA INDUSTRY

René CACHEAUX AGUILAR

The author discusses the effects of a trilateral agreement on the Mexican export maquiladora industry. He begins by describing the industry's current situation and maintains that the maquiladora industry's participation in the agreement is highly important for political, social and economic reasons.

L'auteur explique les effets de l'accord trilatéral de libre échange sur l'industrie "Maquiladora". Il décrit d'abord la situation actuelle en soulignant que leur participation à l'accord de libre échange est très importante pour des motifs politiques, sociaux et économiques.

The author then describes the legal regime of the maquiladora industry and the foreign investment policy surrounding it.

L'auteur décrit ensuite le régime juridique des "Maquiladoras" et la politique d'investissement étranger qui s'y rapporte.

He concludes by outlining the sensitive branches of the maquiladora industry, namely textiles, automobile, electronics, agriculture and transportation.

Il termine en indiquant quelles sont les principales branches de l'industrie "Maquiladora": le textile, l'automobile, l'électronique, l'agriculture et les transports.

I. INTRODUCTION

Much has been said regarding the benefits and the disadvantages that would result for North American countries with the establishment of an FTA. Attempts have been made to predict the socioeconomic impact of the subject-matter, and of course, also the social and political implications that would surface with the establishment of free trade with one of the economically most powerful countries in the world, and with another of a highly developed economy such as Canada.

According to statistics, Mexico is the third trading partner of the United States, behind Canada and Japan.¹ According to these statistics, the Mexico-US balance of trade amounted to 52.2 thousand million dollars, of which, and to the surprise of many, Mexico had a surplus balance compared to the United States' bilateral balance deficit.² While Mexico carried out exports amounting to 27.5

1 The United States is Mexico's most important trading partner. Pg. 1. Letter of December 12th, 1990. National Governors' Association. Washington, D.C.

2 Pg. D-3. Review of Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States-Mexican Relations. Phase II. Summary of Views on Prospects for Future United States-Mexican Relations. October 1990. Investigation No. 332-282. United States International Trade Commission.

thousand million dollars, the United States imported goods from Mexico worth 24 thousand million dollars.³ Of course, it is important to note, regarding the American comparative trade balance, that Mexican imports represent only 6% of the total volume of international trade flow carried out with and toward the United States.

Mexico, the United States and Canada have perceived an opportunity for economic support which simultaneously represents an answer to the need for economic regional integration in the modern world. The European Common Market and the potential entailed by a supposed European self-sufficiency, calls for the integration of regional markets with the magnitude of the so-called North American common market. After the official communique presented by Presidents Salinas de Gortari, and George Bush, on June 11, 1990, announcing intentions to initiate negotiations for the establishment of a bilateral free trade agreement, Canada has expressed its desire to add itself to this negotiation effort in order to formalize a North American Common Market.⁴

In contrast with other purely commercial treaties, the objectives and scope of negotiations will cover a broad array of activities regarding subject-matters like: the liberalization of tariff and non-tariff barriers, foreign investment rules, the provision of ser-

3 Mexico's International Trade represents 6.9% of the American exports and 5.7% of this country's imports. Pg. D-3. *Idem.* Ant.

4 On said date, the Presidents of both countries declared that their negotiators would begin preparatory work for the future negotiation of a "comprehensive" free trade agreement. Pg. 111 Business America. No. 24, 1990.

vices at an international level, bilateral provisions for the settlement of disputes, and other areas regarding free trade access.

In spite of the extense publicity which has been given to the matter, little has been studied with respect to the legal implications which would result from a free trade agreement. Therein lies the importance of the Institute of Legal Research of the National Autonomous University of Mexico's sponsorship of this seminar.

The first strictly legal issue is the nature of the free trade agreement. Eventhough the intention is to sign a bilateral trade agreement with the United States, there exists a possibility of entering a trilateral trade agreement between the governments of Mexico, the United States and Canada.⁵ The United States has signed two free trade agreements, one with Israel and another with Canada.⁶ Said agreements were formalized under Chapter XXIV of the Multilateral Agreement on Tariffs and Free Trade (GATT).

5 A free trade agreement between Mexico, the United States and Canada would create a North American commercial block 36% bigger than the European Economic Community in terms of total production. Pg. 3 Comexus. December 1990. American Chamber of Commerce publication, Mexico, D.F.

6 The Agreement with Israel was signed in 1985 and the one entered into with Canada was signed in 1988. The former only covers exchange of goods aspects, while the latter is broader and covers not only commercial exchange but also other services, foreign investment, dispute settlement, administrative procurement. The latter convention contemplates the gradual elimination of tariffs over a period of ten years, and is thought to serve as the basis for the negotiations with Mexico. Speech delivered by Mr. Ewell E. Murphy, Jr. before the National Association of Enterprise Lawyers in Monterrey, Nuevo Leon, 30th of August of 1990.

Mexico, upon its entrance to the GATT in 1986, took an important step to establish the necessary and adequate basis to achieve a regional commercial integration with its northern neighboring countries. The changes in the legal structure adopted by Mexico in order to abandon internal protectionism and governmental intervention have entailed travelling a long road in the 1980's decade. Firstly, previous permit requirements for imports were eliminated regarding an important number of goods,⁷ thereafter, Mexico reduced its import tariffs and fixed a maximum rate of 20%.⁸ It then eliminated subsidies to exports. In May of 1989, the new Regulations of the Law to Promote Mexican Investment and Regulate Foreign Investment were enacted. Likewise, amendments were made to the Inventions and Trademark Law and to the Regulations on the Transfer of Technology.⁹ Regarding preliminary international treaties, Mexico joined the GATT, entering into treaties with the International Monetary Fund and the World Bank, in addition to entering into an important treaty with the United States regarding the Framework Agreement on Investment and Trade.

Chapter XXIV of the GATT allows party states to

7 Very few tariff sections still require previous import permits. Approximately 200 classifications in a universe of over 11,000 classifications, maintain the restriction. Pg. 2. Comexus. September 1990.

8 Notwithstanding the fact that Mexico, upon entering the GATT was required to fix its highest tariff rate at 50%. Pg. 1-2. The Likely Impact on the United States of a Free Trade Agreement with Mexico. USITC Publication No. 2353. United States International Trade Commission. February, 1991.

9 Additional amendments to said provisions and other laws and regulations are being considered.

enter agreements for the formation of free trade areas, as long as they eliminate their import taxes and other international trade barriers.¹⁰ This chapter is the basis for regional trade integration agreements and the link between multilateral agreements and bilateral or trilateral agreements such as the one Mexico, the United States and Canada endeavor to sign.

It is considered that the Free Trade Agreement will be effective in so far as it complies with the following conditions: 1. That the agreement establish that the signatory countries will eliminate tariffs related with imports from the other countries and non-tariff barriers still existing; 2. That the rules of origin of the products which benefit with the creation of a free trade area are accurately defined; and 3. That the adaptation period be as short as possible in order to guarantee the agreement's success.

Multiple organisms and associations, national and international, such the Maquiladora Industry National Council, the Regional Associations of the Maquiladora Industry, the Border Trade Alliance, the countries' border governmental meetings, the Mexican Authority organized by the Department of Commerce of the State of Texas, and like organisms established by other states in the US, have enabled trade authorities to acquire an understanding of their policies and practices within a social, economic and political context which is diametrically different. These organisms and others from the three countries

¹⁰ The Multilateral Agreement on Tariffs and Free Trade (GATT) was created on October 30th, 1947 and entered into force on January 1, 1948, to meet the need of world economic reorganization after the Second World War.

continue their studies in order to determine the short and long term effects of the free trade agreement.

II. CURRENT SITUATION OF THE MAQUILDORA INDUSTRY

In the analysis of the internal implications of the free trade agreement in Mexico, one cannot fail to consider the effects and consequences which the regional economic integration will represent for the export maquiladora industry. This industry, to a large extent, anticipatedly enjoyed the benefits which are sought with the commercial liberalization.¹¹

Statistics report that the export maquiladora industry has a very important participation in international trade activities with the United States. According to 1989 information, the Mexican maquiladora industry exported merchandise to the United States, which entered under former tariffs 807 and 808, relative to tariffs 9802.00.60 and 9802.00.80 of the Harmonized Tariff System.¹² Likewise, merchandise exported by maquiladoras established in Mexico for a value of 2,470 million dollars, entered the United States under the General System of Preferences.¹³

11 The maquiladora industry does not pay tariffs for the temporary importation of their raw materials, components, machinery and equipment brought to Mexico and only covers import taxes for products returned to the United States for their Mexican added-value. Additionally, imports coming from Mexico qualify to obtain the import tax exemption benefits fixed by General System of Preferences.

12 Of the total amount of US, importations coming from Mexico for over 26 thousand million dollars, 11,700 millions were for imports covered by classifications 9802.00.60 and 9802.00.80. Pg. D-6. Review of Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States-Mexican Relations. *Idem. Ant.*

13 Pg. D-6 Review of Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States-Mexican Relations. *Idem. Ant.*

The latter data indicates that the maquiladora industry's participation in the trade exchange between Mexico and the United States is highly important. Therefore, the analysis and study the legal consequences that the long-awaited free trade agreement will have for the maquiladora industry, are an indispensable subject-matter in this seminar.

Both countries will have to take into consideration that to date, there are over 1800 maquiladora enterprises in our shared border area which provide jobs for approximately 430,000 direct employees and an even larger number of indirect employees belonging to the peripheric goods and services enterprises of the maquiladora export industry.¹⁴ In 1990, this industry has incorporated an export added value of 4.7 trillion pesos. Likewise, it is a well known fact that the maquiladora industry is the second generating source of currency for Mexico, after the revenue from Mexican oil exports.¹⁵

Since 1965, when the northern border program was established in Mexico, over 25 years have shown that from an industrial and commercial point of view, the maquiladora industry has built firm foundations which have allowed Mexico to reach an understanding with the first economic power in the world.

Aside from political and social considerations, it is considered that the maquiladora industry has been one of the most important elements of cohesion in

14 Between 1985 and 1990, the maquiladora industry registered an average annual employment growth of 15%. In 1989, said industry generated currency in the amount of 3,052 million dollars. Informe Trimestral. December 1990. Published by the Center for Economic Analysis and Research, A.C.

15 Pg. 1-5. The Likely Impact on the United States of a Free Trade Agreement with Mexico. *Idem*. Ant.

closing the economic gap between the two countries, as well as for the launching of the initiative to commence trade negotiations to establish a free trade area.

III. LEGAL REGIME OF THE EXPORT MAQUILADORA INDUSTRY

The export maquiladora industry was established in Mexico in 1965 through the so-called border industrialization program. Through this program, an attempt was made to solve Mexico's northern border unemployment problem and to diminish the migratory flow towards the United States.

In 1971, the Mexican Federal government introduced the Northern Border Strip and Free Zones and Perimeters Development Program. This second program confirmed and strengthened the foundations of the export maquiladora industry.

In 1972, the first Bylaw of Paragraph 3, article 321 of the Customs Code was enacted. This Bylaw was the first antecedent of an integral and comprehensive legal body containing the basis for the operation of the export maquiladora industry.¹⁶

The Bylaw of Paragraph 3, Article 321, of the 1977 Customs Code, established certain rules which are worthy of being analyzed in this essay due to

¹⁶ Paragraph Three, Article 321 of the Customs Code in force then, established that the General Customs Office could authorize special temporary import and export operations, underscoring the customs requirements and the time limitations to carry out these activities. This paragraph was regulated initially on March 15, 1971, and thereafter on October 30, 1972 and on October 26, 1977. The Customs Code was repealed upon enactment of the Customs Code currently in force published in the Official Gazette of the Federation on December 30, 1981.

their pioneering regulation of Mexico's maquiladora industry. This legal text established that the maquiladora industries could be located in any part of the Mexican Republic, with the exception of the areas with the highest industrial concentration, taking into account environmental protection considerations. The Bylaw distinguishes two main groups of maquiladora enterprises, strictly maquiladora enterprises who import raw materials, equipment and the necessary machinery to manufacture or assemble export products; and enterprises established to supply the internal market and which will carry out temporary importations of raw material and equipment necessary for the assembly of exports. In this latter case, maquiladoras were required to achieve a national minimum contents integration of 20%. Article 17 of the Bylaw is an important antecedent of the integration phenomenon of the maquiladora industry in Mexico, because it contemplated the possibility of allowing the final or definitive importation of the products assembled or manufactured by the maquiladoras to be sold in the country, if and when the respective import permit was obtained, import taxes were paid, and the former Budget and Public Credit Ministries issued a special permit. Actually, said permit was very difficult to obtain and on the few occasions in which it was issued, its effectiveness was conditioned and limited.

The new Customs Law and its Bylaw¹⁷ contain express provisions which refer to the export maquiladora industry. Specifically, Article 135 of the

17 Published in the Official Gazette of the Federation on June 18, 1982.

aforementioned Bylaw, establishes that temporary importations of merchandise are permitted, regarding export products which are duty free, as long as the maquiladora industries have an industrial maquila program.

On August 15, 1983, the Official Gazette of the Federation published the first Decree for the Promotion and Operation of the Export Maquiladora Industry. This Decree is much more explicit than the Bylaw of Paragraph 3, Article 321 of the Customs Code, and contains provisions that enable us to trace the evolution of the export maquiladora industry.

According to this Decree, maquila programs would be granted only to physical individual persons of Mexican nationality, and to moral persons constituted according to Mexican laws.¹⁸ Once more, the difference between purely maquiladora enterprises and those which take advantage of their idle capacity to manufacture exports is established. In the first case, we are dealing with enterprises formed expressly to carry out wholly export activities regarding products assembled or manufactured in Mexico. In the second case, we are faced with enterprises organized to satisfy the internal

18 Foreign branches and establishments located in Mexico have never had access to the maquila program. The Ministry of Commerce and Industrial Promotion, through its National Registry of the Maquiladora Industry has not registered any maquila program for enterprises or branches thereof, constituted according to foreign law.

market and to take advantage of a marginal industrial capacity to export. In the latter case, we are dealing with idle capacity and not excedent capacity.¹⁹

Under the first decree governing the maquiladora industry, the establishment of this type of industrial plant was allowed in any part of the national territory, except in those areas with a high industrial concentration.

In the case of activities subject to specific export quotas, which is the case of the textile industry, the Ministry of Commerce and Industrial Promotion would be the entity in charge of assigning quotas to interested parties.

Article 12 of the Decree foresaw the possibility of authorizing the sale of manufactured products by maquiladoras up to a percentage which was not greater than 20% of the enterprise's annual production. The sale permit in Mexico was not granted in case the national production of the involved good sufficed, or in case there were production promotion programs in place. On the other hand, said enterprises had to comply with a degree of integration and a favorable balance of currency, according to the commitments made before the administrative authority. Once again, due to the restrictive nature of this type of permits and difficulties in complying with the aforementioned requirements, ma-

¹⁹ Idle capacity refers to industrial capacity not used by an enterprise due to market losses. Idle capacity cannot be converted into excess capacity. Excess capacity is the use of industrial space in excess of what was originally idle capacity. In other words, excess capacity is the abuse of idle capacity affecting the original efficient capacity.

quiladora enterprises did not benefit themselves with this type of authorization.

Take backs through third parties and transfer of inventory and submaquila operations were innovations incorporated in the first Decree which regulated the export maquiladora industry.

Finally, on December 22, 1989, the Official Gazette of the Federation published the second Decree for the Promotion and Operation of the Export Maquiladora Industry, which is still in force. The new decree established a series of definitions regarding: what is considered a maquila operation in a strict sense, maquila operations with idle capacity, shelter activities, transfer of equipment and inventories, submaquila, subcontracting and take backs through third parties. This new legal instrument incorporated all the practices and support procedures of the maquiladora industry and regulated them in a systematic fashion.

The new Decree underscores that the establishment of maquiladora enterprises will be permitted in any area of the national territory which is destined to industrial development, according to the urban development programs.

The exemption of import taxes regarding raw materials, machinery and necessary equipment to carry out the maquila program authorized by the Ministry of Commerce and Industrial Promotion was reconfirmed.

The rule for the allocation of specific export quotas by the administrative authority was confirmed, and specific requirements are established for the agroindustrial production programs.

Regarding domestic sales, the new Decree is much more open than the legal provisions which preceded

it. The existence of sufficient national production or of production promotion programs are no longer limitations for the obtention of sale permits in Mexico. This means that Mexico adopts a liberal rule, even under certain conditions of unfair competition, which allows the sale of import products assembled in Mexico via equipment temporarily imported duty free.²⁰ Sales are permitted in Mexico of up to 50% of the excedent production of the maquiladora, as long as a positive balance of currency is maintained regarding the payment of raw material imports that are to be used in the manufacturing of the products which are to be sold in the country.

The features of sale requirements in Mexico, by maquiladoras reveal a new tendency in legal provisions steered towards the integration of international trade carried out through these economic units.

On December 26, 1990, the Official Gazette of the Federation published amendments to the Customs Law and other tax provisions. Regarding the maquiladora industry, articles 84 to 87 were drafted to establish certain programs applicable to maquiladoras and to other enterprises with export programs authorized by the Ministry of Commerce and Industrial Promotion, like the case of the so-called Pitex enterprises.

It is confirmed that although the temporary importation regime has been restricted in an important fashion, maquilas authorized by the Ministry of Finance and Public

20 In other words, maquiladoras will have to produce—in excess of their normal anticipated production—the amount of products they wish to sell in the national market. It is prohibited to take a portion of the production existing at the moment of requesting the respective permit, to sell it in the country.

Credit, will continue to enjoy the benefits of temporary importation of their raw materials, equipment and machinery. Maquiladoras must now report their import and export operations, separating raw materials and components which are taxable in order to incorporate them to products sold in Mexico.

Current Article 85, Second Paragraph of the Customs Law establishes that import taxes can be paid in a differed manner whereby raw materials can be imported in a temporary fashion and, until sold, said temporary importation regime can be switched to final or definitive, through the payment of updated tariffs in the form established by the Federal Tax Code.

From all of the aforementioned considerations one can conclude that the export maquiladora industry maintains important benefits such as duty free temporary imports, the possibility of selling their products in Mexico up to 50% of their additional capacity and tariff differal regarding raw materials which are incorporated to the national consumption products. The restrictive proteccionist considerations regarding maquiladora sales in Mexico have disappeared. Such is the case of sufficiency in the national production of Mexican industries in relation with the products entered by the maquiladoras and the existence of promotion programs for the manufacturing of merchandise which is like or similar to that which is to be introduced by the maquiladoras.

Curiously enough and in spite of the fact that last year news was circulated of the intention to establish a free trade agreement, and that Mexican legislation has been transformed in a liberal sense, regarding international trade, this has not been the case

regarding the Customs Law with its restriction of the duty free temporarily import system and the establishment of a customs accounting system with a very peculiar system of tax drawback.

To date, the maquiladora industry enjoys a liberalization of tariff barriers and in certain cases of non-tariff barriers,²¹ which allow us to conclude that this industry is a clear example of what free trade in North America can be like.

IV. FOREIGN INVESTMENT RULES FOR THE MAQUILADORA INDUSTRY

As was the case with the Free Trade Agreement between the United States and Canada, one of the most important aspects is the liberalization of restrictions on foreign investment and the conditions for national integration or other barriers which limit the participation of said foreign investment in different fields of industry, trade and services.²²

In light of the fact that Mexico does not seek to carry out amendments to the Federal Constitution, there are foreign investment areas which will remain outside the free trade agreement.²³

21 An example is the textile industry, which is covered by the special regime for the maquiladora industry contained in the amendments to the Textiles Convention celebrated with the United States.

22 In the United States-Canada Agreement, nationals of one country are given national treatment in the other.

23 Such is the case of activities reserved to the Mexican State contained in Article 28 of the Federal Constitution. This the case of coin minting, mail, telegraphs, satellite communications, oil and other hydrocarbons, basic petrochemicals, electricity and railroads.

It is expected that the United States and Canada will try to obtain a recognition of treatment as nationals regarding investors of said countries in Mexico. The most logical assimilation will be an extension of the contents of article 6 of the Law to Promote Mexican Investment and Regulate Foreign Investment.²⁴

With the enforcement of the new Bylaw of the Law to Promote Mexican Investment and Regulate Foreign investment,²⁵ participation of foreign investment in Mexico has been liberated in a relative fashion. Articles 5 and 6 of the aforementioned Bylaw, established the basis for a greater participation of foreign investment in the domestic industry. Exporting enterprises now have the possibility of constituting themselves as corporations with 100% foreign investment. This is applicable not only to export maquiladoras, but also to other export enterprises like the Pitex.²⁶ Even in other restricted areas like the automotive industry and the secondary petrochemical industry, the new Bylaw foresees the concepts of neutral investment and temporary investment through trusts. In reality, although this Bylaw creates and establishes the basis for a greater opening to foreign investment, undoubtedly profound changes and amendments are required in the Foreign Investment Law.

Returning to the maquiladora industry, we can observe once again that this industry has to a large

24 Under the terms of said Article, investment carried out by foreigners residing in the country under the category of "inmigrado", is equivalent to Mexican investment.

25 Published in the Official Gazette of the Federation on May 29, 1989.

26 Previously, these enterprises were under the general 49/51% rule of Mexican majority investment.

extent assimilated the objectives sought through a free trade agreement regarding foreign investment. From its beginnings in 1965, and to date, the maquiladora industry has enjoyed ample leeway regarding foreign investment. Thus, it can be validly stated that majority foreign investment has always been permitted in the maquiladora industry, with the exception of the textile maquiladora industry.

Regarding the maquiladora industry, the periods regulating foreign investment and its liberalization can be clearly established and identified. From 1965, date of the establishment of the maquiladora industry, to 1973, the industry in general has no more restrictions regarding foreign investment than those imposed by the Federal Constitution and the provisions contained in the different special regulatory laws for each specific activity. During this time period, Mexico did not enact any specific law regarding foreign investments.

On March 9th, 1973, the Law to Promote Mexican Investment and Regulate Foreign Investment was enacted, which in addition to incorporating restrictions to investment, contemplated by the Federal Constitution and some contained in regulatory laws, developed other restrictions with regard to industrial areas.

In the case of the maquiladora industry, on June 7, 1973, the National Commission on Foreign Investment issued its General Resolution No. 1, which was related with the maquiladora industry, in said resolution, it contemplated that maquiladora enterprises could establish themselves and operate with up to 100% foreign capital. An exception to this preferential treatment were the textile industry maquiladoras whose activities could affect export quotas established for Mexican

producers by importing countries.²⁷ Resolution No. 1, quoted above, was kept in force until February 4, 1988, when the General Resolution which Systematizes and Updates General Resolutions was issued by the National Commission on Foreign Investment.²⁸ Section 5 of this legal text contains rules governing foreign investment in the export maquiladora industry. It reconfirmed that maquiladora industries could be formed entirely with foreign investment, and in addition, the restriction in the case of conflictive textile maquiladoras, due to quotas, was also eliminated, and thereafter could be formed with majority foreign investment. The foreign investment activity framework was extended to the maquiladoras in order to be able to establish new product lines, enter new fields of economic activity, lease enterprises or assets which are essential for the functioning of enterprises, without the need for permits or special authorizations.

The new Bylaw of the Law to Promote Mexican Investment and to Regulate Foreign Investment repeals the General Resolution which Systematizes and Updates the General Resolutions issued by the aforementioned National Commission on Foreign Investment, through its Second Transitory Article. Article 6 of the Bylaw follows the same liberalization line indicating that in maquiladora enterprises

27 Number One Resolution was augmented in 1974 and 1975, in order to ease the establishment of new industrial units of maquiladoras and to liberalize bureaucratic restrictions and requirements regarding the transfer of shares of foreign investors.

28 Published in the Official Gazette of the Federation on February 3, 1988.

foreign investors can acquire any proportion of shares which are representative of its capital.²⁹

As it was mentioned in this section, the maquiladora industry was always assimilated to Mexico's industry, as was the case in the Free Trade Agreement between the United States and Canada, and as is sought with the trilateral Free Trade Agreement between Mexico, the United States and Canada.

V. POSSIBLE EFFECTS OF THE FREE TRADE AGREEMENT ON THE MEXICAN MAQUILADORA INDUSTRY

The central aspect of this presentation is the analysis of the primary and secondary effects, short, and long term, that the free trade agreement with our northern neighboring countries will entail.

Of course, it is convenient to point out that projecting the effects of the North American Free Trade Agreement regarding a specific industrial sector, implies certain speculation when using premises which are assumed or taken to be true. On the other hand, we must take into consideration that the subject matter of international trade is, in the end, a trade subject, and therefore economic rules and principles become guidelines for further analysis.

On the other hand, it is convenient to underscore that express exceptions made, the following analysis is applicable only to the maquiladora industry with

²⁹ This treatment is extended to other exporting enterprises, such as the PITEX, ALTEX and border enterprises. It even includes other enterprises which do not have production programs authorized by the corresponding authorities.

American and Canadian investment. Maquiladoras with third country foreign investment will have similar benefits in so far as they carry out manufacturing activities in the countries which are parties to the Free Trade Agreement, supply raw materials originating in said countries and as long as they comply with the rules of origin for the products which are established for the free trade areas.

The study presented here discriminates between the economic and the strictly legal aspects. The effects of free trade and the tendency of manual labor costs are transcendental elements in defining the future of an industry based on the principle of world competitiveness. On the other hand, the legal rules that accompany and regulate economic phenomena attempt to direct the economy so as to achieve certain predetermined goals.

1. Economic principles

From a preliminary and generic point of view, the increase in investment in Mexico, as a consequence of the establishment of Free Trade, must lead to an increase in the standard of living of the benefited countries, in the Gross National Product, in foreign currency exchange and in the transfer of technology. These phenomena will influence the economies of the countries in question to the extent that the restrictive tariff and non-tariff rules are liberalized and unhindered foreign investment is allowed.

Notwithstanding the latter premise, we cannot fail to notice the important differences which exist between the involved economies, especially between the Mexican and the North American ones, which can lead to a distortion

of the referred principle, and which is especially important regarding the maquiladora industry.

The maquiladora industry has its foundations in the global competitiveness of the cost of manual labor. In reality, the cost of other investments and necessary expenses incurred in the normal management of a maquiladora industry are comparable with costs in developed countries' economies. The difference in manual labor costs per hour, between Mexico and the United States is currently in the range of 3.20 dollars.³⁰

In Mexico, the National Minimum Salaries Commission³¹ is an official organ which has traditionally established reference minimum wages in Mexico. During the past years, the influence of the so-called Solidarity Pact has contributed in an important fashion to strengthen the level of international competitiveness of manual labor costs in Mexico.

The first question presented by the maquiladora industry is how the Mexican government will define its economic policy regarding minimum wages. Will the definition and control of minimum wages continue to be fixed by the referred Commission? Will minimum wages be liberalized according to the economic laws of supply and demand?

On the one hand, it has been stated through the mass media that Mexico seeks to increase its standard of

30 The average cost of non-skilled Mexican manual labor is \$1.30 dollars per hour including taxes. The average cost in the United States is \$4.50 per hour.

31 Said Commission is based on clause IV, section A of Article 123 of the Constitution and in articles 551 and following of the Federal Labor Law. The Commission is composed with representatives from the federal government, employers and workers.

living and participate more in international trade as a consequence of the free trade agreement. This naturally implies a gradual increase in the population's salaries, particularly those of non-skilled workers. On the other hand, the United States and Canada have established as a relative hypothesis, that Mexico will sustain its competitive level of manual labor costs. This difference in criteria and perspectives will necessarily constitute one of the major negotiation issues in the near future.

International economic theory explains that one of the consequences of a Free Trade Agreement is the "equilibrium of the prices of goods subject to commercial exchange" between the involved countries, in our case between Mexico, the United States and Canada.³² According to this theory, the greater the exchange of goods between the involved countries and the greater the penetration of economies through foreign investment and the distribution of foreign products, the more the necessary outcome will be a standardization of the comparative cost of labor.

In so far as a larger number of exchangeable goods is available internationally, the value of the cost of manual labor and materials used for their elaboration will have to be become uniform. However, one of the conditions that must be met for this economic phenomenon to occur is uniformity among the exchange economies. In economies as different as the ones which are in play in North American trade, the application of said theory of equilibrium of the cost of manual labor, will have, in my opinion, a relative effect.

32 Pg. 2-5. *The Likely Impact on the United States of a Free Trade Agreement with Mexico. Idem. Ant.*

The economic phenomenon of a balance in the cost of manual labor in asymmetrical economies, considers the phenomenon of up and down adjustments. In theory, it could occur that the cost of manual labor in Mexico would increase and that the cost of manual labor in the United States would decrease lightly in some competitive sectors in the areas of commercial exchange. In an analysis made in 1984, it was calculated by economists that adjustments in the cost of manual labor could decrease at an average of 18%.³³ However, due to the reduced impact which is presented at the macroeconomic level by the free flow of Mexican trade to the American economy, it is expected that the adjustment in the cost of salaries will occur more frequently in Mexico. In the United States a lower, less evident adjustment is expected decreasing salaries in important sectors and industries like agriculture and in specific regions, of non-skilled workers.³⁴

The policy controlling the cost of non-skilled manual labor in Mexico will of course be one of the most important governmental determinations in defining the effects on the maquiladora industry. It is estimated the Mexican government will continue to control minimum wages in the immediate future. However, it is probable that as commercial exchange progresses and greater intensity is achieved in penetration, our government will decide to liberate wage controls in order to allow supply and demand to define the real level of salaries. In order

33 Pg. 2-5. *Idem. Ant.*

34 Pg. 2-6. *Idem. Ant.*

to achieve these goals, Mexico will have to decide the avenue it will take in the future and carefully evaluate the positive and negative effects of an increase in the cost of manual labor and the worldwide loss of competitiveness of said cost. The influence of foreign investment in the countries within the free trade framework and the levels of self-sufficiency in the North American block market will be some of the other factors which will allow Mexico to structure its criteria.

Based on the latter considerations, it is estimated that the maquiladora industry will undergo a transformation process in the long term, as the level of the cost of manual labor increases in Mexico. For some, this phenomenon will conclude with the integration to a multilateral economy, for others, the adoption of the agreement will signal the path to be followed by other countries which still sustain a competitive level in their salaries in the world scene.

2. *Legal aspects*

Aside from what occurs with the tendency of the equilibrium or balance in the level of the cost of manual labor, the changes and adaptations of Mexican legal provisions will cause important changes in the maquiladora industry.

The most important legal aspects for the maquiladora industry can be summarized as follows:

1. Restrictive tariff and non-tariff provisions;
2. Exchange control rules;
3. Tax rules;
4. Restrictions on foreign investment;

5. Rules of sales in Mexico; and
6. Rules regarding real estate property in Mexico.

A. Tariff and non-tariff restrictive norms

Although maquiladora enterprises enjoy preferential treatments established by the rules on temporary Mexican importation and preferential reincorporation to the United States, through the system of tariffs 9802.00.60 and 9802.00.80, and also the General System of Preferences, there are certain tariff and non-tariff barriers which are expected to disappear with the Free Trade Agreement.

Mexico established a system—from the beginnings of the maquiladora industry—based on the temporary duty-free importation of raw materials, equipment and machinery related with production processes. Even with the profound restructuring of the Mexican Customs Law undergone in the last part of 1990, the maquiladora industry was one of the few industries which maintained the temporary importation regime.³⁵ However, the Decree for the Promotion and Operation of the Export

³⁵ Starting in 1991, Article 75 of the Customs Law was reformed completely to limit the cases of temporary duty free imports. In other hypothesis, import taxes must be paid and at the moment they are exported there is a right to reimbursement of said taxes and to the interest generated in a special account known as the "customs account".

Maquiladora Industry establishes certain restrictions regarding the importation of certain equipment and merchandise which can only be imported through payment of tariffs or the obtention of special permits. This is the case of equipment and material for the construction of industrial plants and vehicles.³⁶ The complete liberalization of tariffs would allow maquiladoras to import —duty free— everything they require for their industrial plant, including materials and manufactured components and the necessary equipment and machinery, whether or not they would be directly related with the manufacturing process, and in the extreme case, even prefabricated plants. This Mexican tariff liberalization would add an incentive of lesser importance due to the fact that most maquiladora imports are currently carried out duty free. By not having to pay tariffs, all related rules of tariff guarantees through bonds, payment of inspection duties³⁷ and customs procedures, customs agency costs and administrative proceedings, result in an important benefit for the maquiladora industry.

Regarding Mexican non-tariff barriers, we believe

36 Article 10 of the Decree for the Promotion and Operation of the Export Maquiladora Industry in force, limits tax free temporary importations to raw materials, components, equipment and machinery related with the Maquiladoras production, as well as the containers and packaging materials, production tools, laboratory, analysis and measurement equipment, computer and telecommunications equipment and trailer boxes. Maquiladoras located in the border area with the United States have been able to obtain the benefit of exemption from import taxes of merchandise other than the aforementioned, through the use of the Decree to Promote Border Industry published in the Official Gazette of the Federation on October 31, 1989.

37 Duties on Customs proceedings can enact an important expense for maquiladoras. Until last year, it amounted to 8/1,000 on the value of the temporary import equipment and machinery. Starting in 1991, this duty was reduced to 1.76/1,000 for maquiladora temporary imports.

that the major benefit will come from the liberalization of the few areas that still require import permits, fundamentally in the agricultural sector. Likewise, phytosanitary rules, quarantine restrictions and protection of national production, are other restrictions which when eliminated will ease the functioning of agroindustrial maquiladoras whose activity is increasingly important in Mexico.

From the point of view of the United States, tariff liberalization will imply for the maquiladora industry an important promotion of the procurement of Mexican raw materials which will be imported duty-free. Currently, the United States applies import duties to Mexican added value on products which enter its territory, except in the case of imports which qualify under the General System of Preferences. In these terms, the greater the contents of materials with American origin, the smaller the impact of the import tax. In contrast, the greater the contents of Mexican raw materials, the higher the import taxes. The aforementioned American General System of Preferences has been an instrument which has benefited maquiladoras which are exempt from all kinds of import taxes.³⁸

The elimination of tariffs on imports from the United States will be greatly beneficial for the maquiladora industry and particularly for the Mexican

38 Maquiladora enterprises have benefited the most with the American General System of Preferences. The majority of imports exempted through this avenue belong to maquiladora exports.