MAQUILADORAS: A Basic Primer

Due to the opening of world markets and the consequent increased competition in the last decade, U.S. companies are being forced to look for cheaper ways to produce their products. Finding cheaper sources of labor and overhead appear to be fundamental to profitability in this new era of global competition. Mexico's Maquiladora program gives a competitive edge to international companies and allows them to expand their domestic and global markets.[1]

Foreign investors employ four methods to conduct business in Mexico: (1) subcontracting (2) shelter plans (3) joint ventures and (4) the maquiladora program. Subcontracting appeals to those companies that are new to the region and wish to limit their capital investment.[2] Under a shelter plan, the U.S. company can shield assets by allowing the Mexican shelter company to operate the assembly process and handle all the paper work and customs transactions. For companies that have identified specific marketing opportunities in Mexico, joint ventures are an option.[4] However, the most common approach to date is to establish a maquiladora.[5]

Mexico's maquiladora program began in 1965.[6] Maquiladoras allow the duty free importation of unassembled foreign components used to manufacture semi-finished or finished Products.[7] The unfinished product can only remain in Mexico for six months without obtaining an extension from the Mexican government.[8] Once assembled, the products must be exported back to the country of origin or a third country.[9] If the goods go to the United States, a duty is paid only on the value added to foreign-made components assembled in Mexico.[l0] Products made of U.S. components which are assembled in a foreign country enter duty free under items 9802.00.60 and 9802.00.80 of the Harmonized Tariff Schedule of the United States.[11] NAFTA will probably eliminate any remaining tariffs and duties.

The establishment of a maquiladora involves the incorporation of a Mexican corporation, also known as a Sociedad Anonima (S.A.). [12] There is a “one stop” procedure for investors so they need not travel from office to office for information and project approval .[13] This process should not change significantly with NAFTA. The investor submits an application for an incorporation permit to the Secretariat of Commerce and Industrial Development (SECOFI).[14] Once approved, the Mexican Customs Department of the Secretariat of the Treasury is notified.[15] The Customs Department then opens a file in which all imports and exports of the company are recorded. [16]

In addition to the incorporation permit, Mexico requires that each corporation be established by either a Mexican national or a Mexican.[17] The initial investment required for a maquiladora is $25 00000. There must be five shareholders in the corporation, either Mexican nationals[19] or foreigners[20]. The company can be 100% foreign owned[21] by having the corporation own 95% of the stock and having 4 executives of the corporation own the remaining 5% of the stock.[22] All foreign shareholders must issue powers of attorney to legal counsel in Mexico so that they can be represented in the formation of the corporation.[23]

The corporation may be managed either by a board of directors or a sole administrator. The sole administrator has the legal authority to represent the company and act on behalf of its owners with the same degree of authority granted by law to a board of directors.[24] A corporation managed by a board of directors must register its board members in the charter and have the minutes of their meetings kept on file in Spanish.[25] The incorporation permit must also include information specifying the manner in which the profits will be paid to shareholders.[26] Mexican law requires that at least 5% of the yearly profits be allocated to the formation of a legal reserve.[27]

The permit for incorporation is just one of many permits that will be required by the Mexican government. The United States imposes one condition on U.S. businesses as well. An incorporator must obtain a formal ruling from the U.S. Customs Service qualifying the proposed operation or product for the special tariff exemption.[28] Without this ruling, a corporation would spend millions of dollars forming a maquiladora yet be forced to pay full customs duties on the products.[29] A corporation should not wait until the last stage of planning to seek a U.S. Customs ruling.[30] These customs procedures will become irrelevant if NAFTA passes.

Maquiladoras offer the advantages of low labor transportation and overhead costs.[31] Other conditions must also be weighed before making an investment decision. Among these considerations are: (1) Mexico's overtaxed and inadequate infrastructure including but not limited to power water highways and bridges communications and sanitation[32] (2) aggravated pollution that cannot be controlled due to inadequate government supervision and enforcement; (3) the vested interests of labor and business leaders; and (4) inflation. The border area of Mexico is particularly underdeveloped with its straining infrastructure. In February of 1990, there were 1, 857 maquiladora plants in Mexico which employed approximately 500, 000 Mexican nationals.[33] Currently, ninety percent of the maquiladoras are located along the U.S. border.[34]

Industry needs are met by the creation of industrial parks with exclusive sources of power, water and sanitation,[35] while the surrounding population centers often lack these essentials.[36] The majority of the best highways in Mexico do not exceed two lanes.[37] The expected expansion of industry if NAFTA takes effect will create further congestion and slow transportation.[38] One Mexican study indicated that it will take an investment of $9.1 billion to meet the border area's infrastructure needs for the next ten years.[39] This study was based on the prevailing growth rate of the maquiladora industry, and did not take into account the potential growth resulting from a free trade agreement.[40]

Inexpensive Mexican labor and the proximity to the U.S. market virtually guarantee that industrial development will continue. U.S. businesses currently open plants in Mexico to take advantage of the low wage rate [41] which is approximately $1.63 per hour.[42] Assembly plants are strategically located no further from the border than is absolutely necessary, thus avoiding additional transportation costs.[43] The majority of goods produced by maquiladoras will continue to return to the U.S. market, incurring transportation costs going into Mexico as bulk materials and in returning to the United States after assembly.[44] Relocation of distribution centers to southern Texas is another expected result if NAFTA is put into place.[45]

A General Accounting Office study on Mexico has reported that even with planned improvements the Mexican transportation infrastructure cannot handle existing traffic.[46] An increase in the number of bridges and a streamlining of customs procedures will be necessary to facilitate a free flow of commerce.[47]

Another concern for companies considering relocating to Mexico is the environment.[48] Pollution is a serious problem in Mexico due primarily to lax enforcement of existing legislation. One fear of those opposing NAFTA is that some U.S. companies will relocate their more hazardous manufacturing processes to Mexico merely to take advantage of the lax environmental enforcement.[49] Tons of raw sewage from maquiladoras are dumped into the Rio Grande river.[50] The air in Mexico City is so polluted that school children paint gray skies instead of blue.[51] With cleaning and disposal costs representing a large part of production, U.S. manufacturing and chemical concerns may be tempted by significantly cheaper disposal costs in Mexico or by such practices as illegal dumping.[52] Mexican regulation of chemical dumping is less stringent than in the United States and some industrial zones have no provisions at all for chemical recycling[53] or hazardous waste disposal.[54] Mexico is making strides towards controlling the environment.[55] Laws as strict as those in the United States have been enacted recently, but enforcement still lags behind the letter of the law.[56]

Vested interests in Mexican industry may also be an obstacle to free trade. State owned and private monopolies have dominated major industry and weakened the Mexican economy.[57] Mexico has a tradition of protectionism and set-asides.[58] A traditional fear of yanqui imperialism led Mexico to implement high tariffs and domestic ownership laws that virtually shut foreign products out of the Mexican economy.[59] However, the trend towards privatization of state-owned monopolies and a free trade agreement may make many discriminatory practices illegal.

The Mexican government's Pact for Stability and Economic Growth (PECE) is credited with reversing Mexico's inflationary spiral.[60] One of the goals of the National Development Plan (PND) is to maintain stability during the expected growth brought on by free trade.[61]

The obstacles to doing business in Mexico are being addressed by that country. Meanwhile, the advantages of inexpensive labor, transportation, and overhead costs may help create the competitive advantage required by U.S. companies in the world market. The U.S. and Mexican governments are working together to develop the border infrastructure with the expected economic growth providing the necessary capital. President Salinas appears to have committed the Mexican economy to free trade and competition with the expectation that foreign influence will help alter the way of doing business in Mexico. Investors from other countries are recognizing these benefits and are opening maquiladoras to take advantage of the large U.S. market.

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