# Mexico Regulatory Change Redefines Maquiladora

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Mexico is significantly reorganizing how it regulates its export-oriented industry. Notably, it is merging the maquiladora program with a large program for resident Mexican companies, an explicit recognition that the maquiladora in the post-North American Free Trade Agreement (NAFTA) period can no longer be distinguished from these domestic companies in economically meaningful ways.

The maquiladora name will be retained even though the plants will no longer have a separate identity. But regulatory changes call for data to be reported only for the combined program. This will disrupt data collection and reporting on maquiladora activity, making it difficult for analysts to interpret manufacturing trends for the next several years.

## Why a Merger?

The maquiladora program began in the 1950s as a simple "twin-plant" concept. U.S. manufacturing companies would establish capital-intensive operations on the U.S. side of the border, move goods to Mexico for labor-intensive assembly or other processing, and return assembled goods to the U.S. for final sale. The raw materials moving into Mexico were free from customs duties as long as they were returned to the U.S. in assembled form within a fixed period. U.S. tariffs applied only to the value added by assembly.

The maquiladora has grown into a large and essential part of Mexico's employment, production and foreign-exchange earnings. Today's maquiladoras don't just bring in raw materials on a temporary basis; machinery, instruments, tools and replacement parts used in production enter duty-free for the life of the program. Maquiladoras also have shifted from their industrial roots and now operate call centers or provide services in engineering, coupon processing and electronic repair. Several sub-maquiladoras may provide complementary services under a single authorization.

What is a maquiladora today? As it has evolved from the twin-plant concept, the only sure answer is that it's a nonresident company operating within the maquiladora regulatory program under the Ministry of the Economy. This definition becomes more appropriate today as the maquiladora moves toward merger with an export-oriented program for resident Mexican companies known as the Program for Temporary Imports to Promote Exports (PITEX).

The Ministry of Economy, which also regulates PITEX, deemed it convenient to merge the maquiladora and PITEX programs into a new program, Maquiladora Manufacturing Industry and Ex-

Table 1
**Mexico's Manufacturing Exports and Imports**
(Billions of U.S. dollars)

| | 2000 | 2005 |
|---|---|---|
| Exports | 143.3 | 174.5 |
| Maquiladoras | 79.5 | 96.8 |
| PITEX | 53.9 | 52.3 |
| Other | 9.9 | 25.5 |
| Imports* | 133.6 | 163.5 |
| Maquiladoras | 61.7 | 75.1 |
| PITEX | 35.5 | 31.0 |
| Other | 36.5 | 57.4 |

*Intermediate imports only.

SOURCE: Secretaría de Economía, http://www.siicex.gob.mx/portalSiicex.

port Services, or IMMEX Decree.

PITEX was created in 1990 to provide a platform for Mexican domestic operations to better compete with maquiladoras. Plants that invoiced 10 percent or more of their sales as exports could bring in raw materials duty-free but would have to reexport them as finished goods within a fixed time frame. Plants with 30 percent or more of sales as exports qualified to bring in duty-free machinery and equipment. Essentially, the "export services" part of qualifying Mexican plants received maquiladoralike benefits. Table 1 compares the size and growth of the PITEX and maquiladora programs in recent years in terms of exports and imports.

The primary advantage of PITEX over the maquiladoras was unlimited sales in the Mexican market. The original maquiladora program forbade domestic sales, but restrictions were slowly relaxed over the years. In 1990, NAFTA put the maquiladora industry on an annual schedule that, by 2001, allowed maquiladoras unlimited sales in the domestic market.[1] For several years, there has been no significant difference between the customs status of maquiladoras and the "export services" of domestic plants operating within PITEX.

It is this similar customs treatment that drives the logic of the IMMEX merger, but the combined programs share similar fiscal treatment. Mexican law requires a 28 percent tax on corporate income, net of expenses; a 15 percent value-added tax on domestic purchases of inputs or imports; and a 1.5 percent asset tax. The asset tax functions as an alternative minimum tax, with companies paying the higher of the income or asset tax.

Maquiladoras previously held an advantage over PITEX in that they were exempt from value-added taxes. The new IMMEX program extends this exemption to export services of PITEX plants. Differences persist in income taxes only to the extent that maquiladoras can certify they are foreign establishments under Mexican income tax law[2] and can qualify for safe-harbor provisions that require a 3 percent rate on either return on assets or on income, net of expenses.[3] The alternative minimum tax holds, however, for both PITEX and maquiladora facilities.

The logic of the IMMEX Decree becomes inescapable because maquiladoras are given unlimited domestic opportunities and domestic plants are given the advantages of maquilalike export operations. The elimination of fiscal differences also solves a growing problem of companies switching programs, effectively shopping for the tax advantages that best fit their particular circumstances.

Table 2 shows the number of maquiladora and PITEX plants in key states. By their nature, maquiladoras are concentrated in border states like Baja California, Chihuahua, Sonora and Tamaulipas, while the largest number of PITEX plants is found in central states like México and Jalisco.

Table 2
### Number of Plants in Selected States

| | Maquiladora | PITEX | IMMEX |
|---|---|---|---|
| Baja California | 901 | 246 | 1,147 |
| Coahuila | 224 | 177 | 401 |
| Chihuahua | 395 | 107 | 502 |
| Distrito Federal | 17 | 237 | 254 |
| Durango | 42 | 74 | 116 |
| Guanajuato | 38 | 186 | 224 |
| Jalisco | 98 | 275 | 373 |
| México | 26 | 380 | 406 |
| Nuevo León | 213 | 432 | 645 |
| Puebla | 58 | 217 | 275 |
| Querétaro | 30 | 185 | 215 |
| San Luis Potosí | 30 | 100 | 130 |
| Sinaloa | 8 | 164 | 172 |
| Sonora | 213 | 214 | 427 |
| Tamaulipas | 337 | 93 | 430 |
| Veracruz | 2 | 98 | 100 |
| Yucatán | 74 | 52 | 126 |
| **Selected states** | **2,706** | **3,237** | **5,943** |
| **Nation** | **2,795** | **3,620** | **6,415** |

SOURCE: Instituto Nacional de Estadística, Geografiá e Informática.

## Data Issues

The fading distinction between maquiladoras and PITEX operations had become an issue for data collection and reporting as well. Mexico's chief statistical agency, Instituto Nacional de Estadística, Geografiá e Informática (INEGI), has for many years reported Mexican manufacturing data in two categories—domestic and maquiladora. PITEX operations were subsumed under domestic manufacturing and were never identified separately in past reporting.

As the maquiladora and PITEX programs began to merge in terms of their economic role, the question naturally arose as to why maquiladora data should be reported separately—or at least apart from PITEX. Further, as some companies began tax shopping and moving individual plants between the maquiladora and PITEX programs, they were causing large month-to-month swings in regional and national data that were not related to underlying economic events.

As a result, INEGI became the executing arm of the IMMEX Decree, and the agency is reworking its manufacturing-reporting system. It stopped reporting maquiladora data effective March 2007. Maquiladora activity will be included as part of aggregated Mexican manufacturing beginning March 2008. Data for the combined subset of IMMEX plants (maquila plus PITEX) will be published at the same time.

The changes in data reporting will pose temporary problems for analysts who follow manufacturing developments in Mexico. One issue is the 12-month gap between maquiladora industry reporting and the new IMMEX series. This is important because maquiladora data were the only source of regional Mexican manufacturing data, providing insight into the economic status of states and cities along Mexico's northern border. Publication of IMMEX data in 2008 will fill this gap and provide regional and industrial-sector detail similar to the old maquiladora series.

Another problem is that historical data won't be available when IMMEX data are published next spring. It will take several years to develop the information needed to separate cyclical, trend and seasonal components.

In the meantime, analysts can imperfectly fill the gap with data from Mexico's social security administration on employment by state and city[4] and with anecdotal information collected from maquiladoras. Both of these indicators are currently pointing to a significant slowdown in the industry, emphasizing the importance of monitoring events closely.

—Jesus Cañas
Robert W. Gilmer

## Notes

[1] NAFTA doesn't require the elimination of maquiladoras. The trade pact impacts maquiladoras in two significant ways. One is unlimited access to the domestic Mexican market, discussed in the text. The other is a minimum domestic content requirement on goods to receive NAFTA tariff benefits. Assembly is not enough to qualify for these benefits; assembled parts can have no more than 7 percent non-NAFTA content.

[2] Certification in this context means that inventories and other goods supplied are from a foreign entity and are held for purposes of a maquiladora contract for assembly, processing or repair.

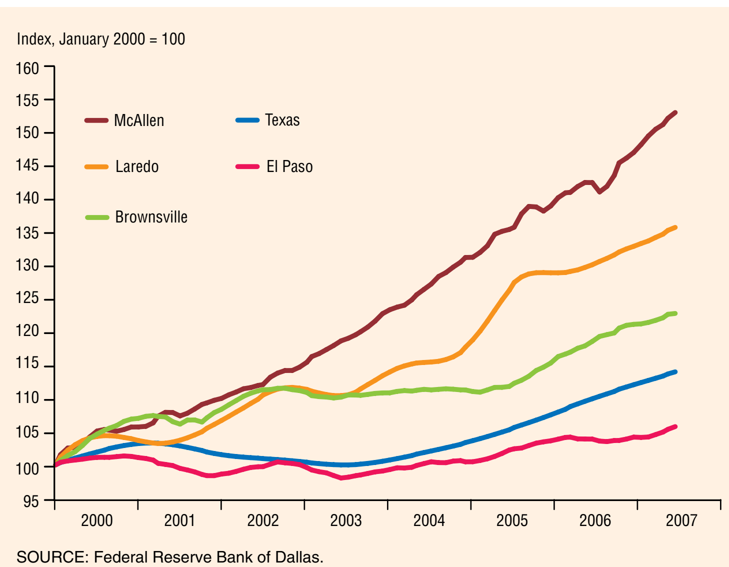
[3] Until 2003, these rates were 6.9 percent of return on assets or 6.5 percent of net taxable income. The lower rates continue under IMMEX.

[4] INEGI data are not collected by payroll or home establishment but by where the risk to workers' health and safety would be located. An accountant working from a downtown office but spending 90 percent of his time on construction sites is considered a construction worker. There is a strong correlation with historical data. For example, for the state of Chihuahua, monthly changes in employment data reported by INEGI and Mexico's social security administration have a correlation of 0.62.

## Border Metros See Economic Growth

McAllen and El Paso were among Texas border metros posting healthy economic growth in July, according to the Dallas Fed's Texas Business-Cycle Index. McAllen's business-cycle index rose at an annualized rate of 10.1 percent, while El Paso's index climbed 3.5 percent. The Texas index, an aggregate measure of the region's current economic activity, increased 3.2 percent.

### Business-Cycle Indexes: Texas and Border Metros




SOURCE: Federal Reserve Bank of Dallas.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