Another Step toward North American Integration
The Mexican Manufacturing, Maquiladora and Outsourcing Industry Decree

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Jennifer Szymaszek/Reuters

The latest step taken in Mexico toward deepening North American integration, after signing onto the Security and Prosperity Partnership in March 2005, is the creation in November 2006 legislation of the category of the Manufacturing, Maquiladora and Outsourcing Industry (its name in Spanish is "Decreto para el fomento de la industria manufacturera, maquiladora y de servicios de exportación"), or IMMEX. This sounds very much like "IME", the acronym for the maquiladora industry, and, yes, the IMMEX sprang out of the IME model, now expanded to most of Mexican manufacturing and export service industries as well. What we want to focus on is how this new industry deepens regional integration, with emphasis on defining exactly what "regional" means in the case of North America.

As most readers know, U.S. companies assemble products in Mexican maquiladoras for their home market. Canadian companies also have their own system of co-production with the U.S. and, after NAFTA, began setting up their own maquiladora operations in Mexico as well. Even though much attention has focused on this regional system of co-production, it is not really the relevant aspect of the current debate about North American integration. The real problem behind regional subcontracting is how it enables Asian

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intermediary goods to be transformed into regional ones, when they are incorporated into the final product and exported to the U.S. from Mexico and Canada. A good part of the US$138 billion deficit that the U.S. sustained with North America in 2007 can be attributed to Asian components, imported under specification of U.S. companies —and these indirect importations are only a fraction of the total, from the combined U.S. Asia-Pacific (APEC) trade, which racked up a US$542-billion deficit that same year.

We want to focus on how this system works with Mexico, without implying in any way that it is exclusive to this bilateral trade relationship. The central point that needs to be understood is that U.S. companies do not assemble parts and pieces of U.S. origin in Mexico. Even if intermediary goods are brought in from the U.S., that does not mean they were made there. To avoid round-abouts, through the U.S. into Mexico, the maquiladora industry has always been allowed to bring in whatever it needs from anywhere in the world. These intermediary goods are imported temporarily and are duty-free as long as they are re-exported later on. Tariffs are paid on them only when and where the final product is consumed —typically in the United States, paying its general tariff on value-added in Mexico.

When NAFTA was negotiated, attention focused on how this system should be changed, to keep third parties from using Mexico as a "back door" into the U.S. market. Rules were implemented to keep that from happening, which would have discontinued the system of temporary imports from third parties into Mexico from 2001 onward. After that date, additional tariffs have to be paid in Mexico, above and beyond the U.S. tariffs. The additional amount to be paid in Mexico is equivalent to the difference between Mexico's higher general tariff and the lower U.S. one. However, it is important to note that even though NAFTA changed third-party temporary imports into Mexico, it left the old system of duty-free temporary imports among the three North American partners intact; and that is the way U.S. companies use Mexico as a trampoline for introducing third-party intermediary goods duty-free into the U.S.

The objective behind NAFTA changes seemed to be tightening regional integration by encouraging increased regional production in North America, including the regional production of intermediary goods. However, shortly after NAFTA came into effect, it became apparent that the use of third-party intermediary goods would not be reduced in North American co-production. One year later, the World Trade Organization (WTO) was created, admitting China as a new member in 2001, along with other Asian countries. U.S. duties on Asian imports dropped to the most-favored-nation level as a result of their acceptance in the WTO. So, all that had to be done to circumvent the higher Mexican tariff was to import the Asian intermediary goods directly into the U.S., paying the lower tariff there. These goods could then be brought into Mexico under the North American system of temporary imports, which is not the same as the North American preferential tariff. However, the round-about would incur additional transport and handling costs, so a more feasible strategy developed, sourcing intermediary goods worldwide through newly-created companies in the U.S., and then assembling in China.

Faced with the prospect of losing its maquiladora business to the U.S. and China, what Mexico did was to create a series of special programs that unilaterally reduced its general tariff on third-party intermediary goods to the same level as that of the U.S., thereby eliminating the need to make any additional payments in Mexico. Now, third-party intermediary goods can be imported in either of two ways: temporarily, if imported under the auspices of a company with a regional program that allows duty deferral until entry into the U.S.; or permanently, if imported under the auspices of a company with a non-regional program that requires tariffs to be paid upon entry into Mexico. In the latter case, goods imported definitively into Mexico are then considered to be Mexican, for the purposes of regional co-production.

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These permanent third-party imports into Mexico can be introduced into the U.S. duty free, as Mexican, since NAFTA eliminated the U.S. tariff on "Mexican content" incorporated in U.S. goods assembled there. This system of global intermediary imports operates parallel to NAFTA's rules of origin requiring intermediary goods to be made in North America in order to move around the region duty-free. In regional co-production, duties on third-party intermediary imports are charged only once, regardless of the number of times they move across North American borders for produc-

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tive purposes. These duties are low, set in Mexico at the same level as the U.S., which ranges from zero to five percent.

U.S. companies' preference for third-party intermediary goods is, to a large extent, what is responsible for the trade deficit the U.S. has registered with its North American partners, which actually corresponds to Asia. It would be a mistake for NAFTA critics to try to decrease the U.S. deficit with the rest of North America by singling out and chastising maquiladora trade. Restricting the flow of Asian intermediary goods through Mexico would merely shift their importation again to the U.S., raising costs and reducing competitiveness, or would encourage the complete transfer of production to Asia. If the problem is the deficit with Asia, a more direct course of action would be to demand reciprocity from Asia, threatening with compensating duties, instead of trying to attack the problem indirectly by excluding Mexico from the system of global trade in intermediary goods.

Mexico wanted the relatively closed region promised by NAFTA, in which its intermediary goods would have tariff preferences over those from third parties; but shortly after the regional treaty was signed, the government followed the U.S. lead in opening the region to third-party intermediary imports. Now, Mexico has taken an additional step in that same direction. With its IMMEX decree, the temporary import system has been extended from a select group of exporting industries to almost the entire manufacturing sector. This move is qualitatively different from the first effort begun in the 1980s. The initial idea was to encourage the manufacturing industry to produce intermediary goods for the maquiladora industry —a strategy that petered out under the WTO agreement that brought competition from China aboard. Now Mexico is trying to convert its manufacturing sector in order to allow it to operate in the same way as the maquiladoras.

For example, the IMMEX decree reduces the concomitant export requirements to 10 percent of the recipient company's production, or a minimum of US$500,000 a year. And more importantly, it creates new modalities of both maquiladora and manufacturing companies: 1) "controlling companies" that manage temporary imports for others operating under their program, for whom they are fiscally responsible; 2) another similar type of importing company but that has no production facilities of its own and is not directly responsible for the recipient's fiscal responsibilities; and 3) chains of sub-maquiladoras and sub-manufacturing plants that have no importing program of their own but receive intermediary goods from companies that do, for whom they sub-contract. These arrangements allow global sourcing of third-party intermediary goods to extend further than before within Mexico.

An alternative to this global sourcing system would be to return to the original NAFTA idea of regional co-production; but this time based on trilateral industrial planning efforts rather than tariff preferences. Raising tariffs on third-party intermediary goods to their normal level would be easy for Mexico but impractical for the U.S. In Mexico the general tariffs were unilaterally reduced and therefore could easily be brought back up to their previous level; but raising the U.S. most-favored-nation tariff would violate the WTO agreement level, and the imposition of countervailing duties on intermediary goods would be impractical. Therefore, in lieu of tariff protection, the three governments could cooperate in eliminating obstacles to regional production for a wide variety of goods for which lower transportation costs within North America represent a comparative advantage or for which certification or standardization are required. This is already happening for a select number of goods such as the production and assembly of auto parts, flat-screen televisions and parts for the aeronautical industry, as well as the sale of electronic business services to the U.S.

However, in order for this regional model of co-production to grow and prosper, more is needed than just trilateral cooperation among the three governments. Widespread recognition of the fact that co-production in Mexico and Canada uses U.S. intermediary goods more intensely than similar production in Asia is required in order to change the growing perception among the U.S. public that its neighbors represent a direct threat to their jobs. On the contrary, encouraging production to return to North America, with Mexico as its preferred low-cost alternative site, would help solve a tandem of other regional problems as well: making regional manufacturing goods more competitive, helping correct the U.S. balance of payments, encouraging regional employment growth, perhaps even to the point of raising wages in Mexico, and reducing migratory flows. VM