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Fox Government Creates Incentives to Rescue Ailing Maquiladora Industry

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The Mexican government is attempting to rescue the maquiladora industry through simplification of paperwork and elimination of certain taxes levied on assembly plants along the US-Mexico border. In a proposal drafted jointly by the Secretaria de Economia (SE) and the Secretaria de Hacienda y Credito Publico (SHCP), President Vicente Fox's administration is seeking to phase out the payroll tax (Impuesto Sustantivo de Credito al Salario, ISCAS) and reduce the income tax (Impuesto Sobre la Renta, ISR) for maquiladora operations. The tax reduction is seen as a significant step toward ensuring the survival of the industry, which has been hit hard by the economic slowdown in the US and increasing competition from China.

Fox initially supported the ISCAS, implemented as part of the limited tax reform approved by Congress in 2002. The tax remains in place even though it was declared unconstitutional by the country's highest court (Suprema Corte de Justicia de la Nacion, SCJN) in May of this year (see SourceMex, 2003-05-28).

The effort to tax maquiladora earnings transcends administrations. In 1999, former President Ernesto Zedillo angered the maquiladora sector when he proposed a tax on payroll and inventory (see SourceMex, 1999-09-01). Under Zedillo, the government also began to charge import taxes on some components originating outside the US and Canada, primarily in Asian countries (see SourceMex, 2000-11-08).

**Fox seeks to begin phasing out payroll tax in 2004**

Sources said Fox is planning to ask Congress to begin phasing out the ISCAS in 2004 and to change the tax code to exempt most maquiladora operations from paying the ISR. At present, maquiladora operations already pay a very low ISR, equivalent to 6.5% of costs, compared with a general corporate rate of more than 30%. Fox first revealed his intention to phase out the ISCAS at the annual convention of the Consejo Nacional de la Industria Maquiladora de Exportacion (CNIME) in Guadalajara in early October. "Because of this sector's importance to Mexico, we are going to double our efforts to support the maquiladora industry," Fox said.

As expected, representatives of the maquiladora industry were pleased with the Fox proposal. "Our commitment now is to recover the 50,000 jobs lost because of the implementation of the ISCAS," said Daniel Romero Mejia, president of the Consejo Nacional de la Industria Maquiladora de Exportacion (CNIME).

The Fox government's proposal, which was published in the daily federal register (Diario Oficial de la Federacion), contains several nontax incentives. Key among these is a provision that significantly reduces the time and paperwork needed for a manufacturer to establish a maquiladora operation.
Under this plan, any company that has its documents in order can obtain a permit to operate a maquiladora facility within 15 working days of submitting its request. Another incentive paves the way for small and medium-sized maquiladora operations to receive the same type of certification as the larger operations.

The certification will allow these companies to expedite imports through customs checkpoints. At present only 165 companies, which represent 36% of Mexico's foreign trade, enjoy the special government certification.

By extending the program to smaller maquiladora operations, the government estimates that 70% of Mexican foreign trade will be conducted by certified companies before the year's end. "These reforms are a good signal from the government to investors who want to become involved in the maquiladora sector," said Rene Ortiz Muniz, vice president of trade and international affairs at the Camara Nacional de la Industria de Transformacion (CANACINTRA).

**Mexico seeks anti-smuggling accord with China**

The administrative and fiscal changes are only one step by which the Fox administration is attempting to support the maquiladora industry. The administration remains very concerned about the loss of maquiladora operations to China, which has contributed to the closure of more than 500 plants and the elimination of more than 200,000 jobs (see SourceMex, 2003-09-17). The Fox government has accused China of offering unfair incentives to Japanese, South Korean, and European companies to encourage them to move their operations from Mexico to China (see SourceMex, 2002-07-17 and 2002-12-13).

The administration, however, is also attempting to establish a working relationship with China to correct some of the economic imbalances between the two countries. At a meeting of the members of the Asia Pacific Economic Cooperation (APEC) in Thailand in mid-October, Mexican and Chinese officials agreed to create a working group to propose strategies to eliminate smuggling of Chinese products into Mexico, particularly triangulation. This is a process whereby Chinese products are smuggled into Mexico through a third country.

Foreign Relations Secretary Luis Ernesto Derbez said Economy Minister Fernando Canales Clariond first proposed the idea to Chinese counterpart Lu Fuyun at the World Trade Organization (WTO) meeting in Cancun this past September. The two countries then committed to proceeding with the plan at the APEC meeting.

Derbez said details of a proposal would be discussed during a visit by Chinese Prime Minister Wen Jiabao to Mexico in December. "At that time, they will discuss a specific structure for the working group and the procedures that will be followed during the next several years. The Camara Nacional de la Industria de Transformacion (CANACINTRA) said that one of every three products imported from China is smuggled into the country.

In the first two weeks of October alone, the Administracion General de Aduanas seized 200 tons of apparel smuggled from China. The merchandise was apparently destined for the infamous Mexico
City black market known as Tepito. If the shipments had reached the informal economy, they would have avoided import tariffs totaling 60 million pesos (US$5.3 million), the customs agency said.

CANACINTRA vice president Rene Ortiz said Mexico's trade deficit with China is expected to expand to about US$6.1 billion this year, compared with US$5.9 billion in 2002. "Undervalued products and disguised imports add another US$3 billion to the deficit," said Ortiz. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Oct. 22, reported at 11.23 pesos per US$1.00] (Sources: El Sol de Mexico, 10/01/03, 10/02/03; Notimex, 09/30/03, 10/09/03; Dow Jones news service, 10/09/03; The Herald, 10/03/03, 10/08/03, 10/10/03; La Jornada, 10/13/03; El Financiero, 10/01/03, 10/02/03, 10/07-10/03, 10/21/03; Milenio Diario, 10/10/03, 10/14/03, 10/21/03; El Universal, 10/13/03, 10/21/03; La Cronica de Hoy, 10/22/03)