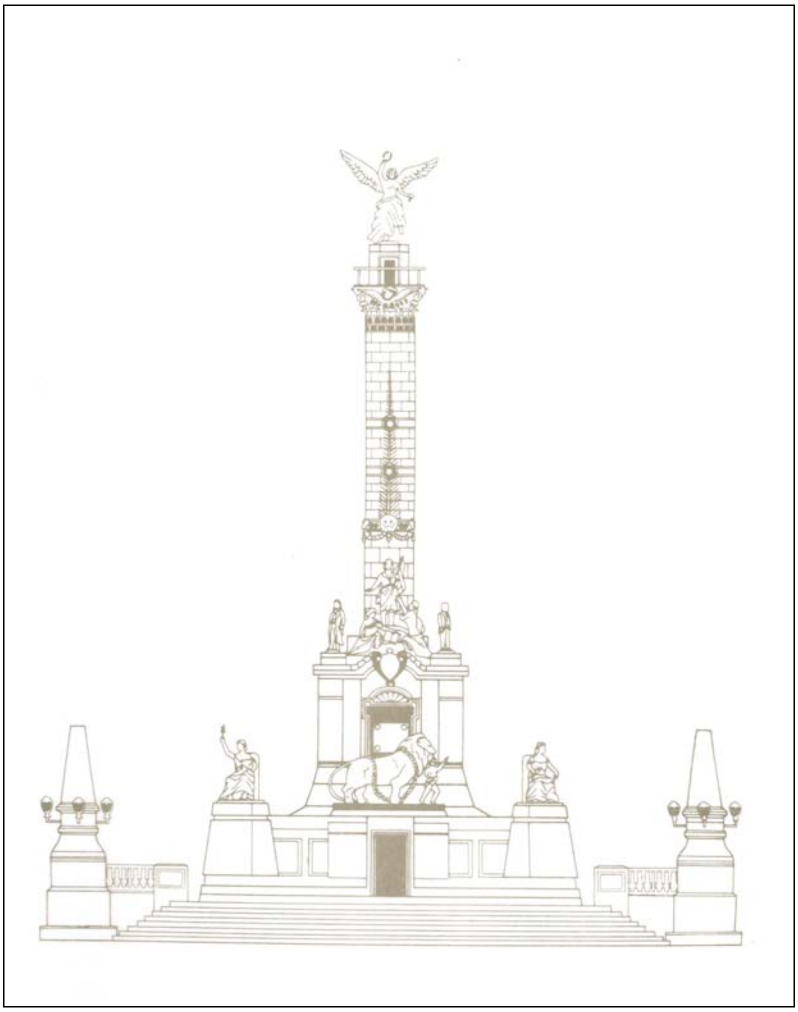
BENEFITS FOR INVESTORS UNDER THE MEXICO-EUROPEAN UNION FREE TRADE AGREEMENT



Goodrich, Riquelme
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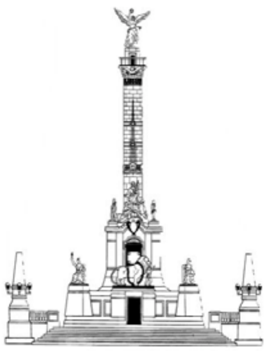

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BENEFITS FOR INVESTORS
UNDER THE MEXICO-EUROPEAN UNION
FREE TRADE AGREEMENT

Summary

On 1 July 2000, the Free Trade Agreement between Mexico and the European Union ("MEFTA") came into effect, as the culmination of years of mutual efforts to strengthen the commercial relationship between the parties.

MEFTA is composed of two main sections:

- Trade in Goods - 1 July 2000
- Trade in Services – 1 March 2001

PRINCIPAL OBJECTIVES OF MEFTA

The objective of MEFTA is to allow preferential access for EU and Mexican exporters of goods and services into their respective markets.

To achieve this, MEFTA provides for:

- Liberalization of trade in goods and services by:
  - ✓ the dismantling of customs tariffs, and
  - ✓ the elimination of all import and export restrictions, other than customs duties and taxes
- Removal of barriers to investment
- Guaranteeing equal treatment for the investors of the other party, as granted to their own domestic investors
- Ensuring that investment will not be coerced by restrictive government policies
- Protection of intellectual property
- Guaranteed access to government procurement contracts
- Co-operation in competition issues

- A dispute solving mechanism

Overall, MEFTA fosters the confidence required to make long-term investments and partnering commitments by investors of both parties.

With the implementation of MEFTA, Mexico secures access for its industrial products into the EU market, while the EU re-establishes the competitiveness of the EU exports to Mexico, securing access to Mexican market under the same benefits enjoyed by products originating from the North American Free Trade Agreement ("NAFTA") countries.

TRADE IN GOODS

The most basic achievement of MEFTA is the permanent elimination of all tariffs among the partners according to a rapid phase-out schedule. Only the most sensitive products are subject to a long phase-out.

Industrial Products

Industrial products account for more than 90% of the total bilateral trade in merchandise. In this case, the liberalization covers the entire range of products and is implemented progressively over a transitional period of 7 years. All tariffs are eliminated by 1 January 2007.

- On 1 July 2000, date of entry of MEFTA:
  - The EU eliminated tariffs on 82% of the Mexican industrial products
  - Mexico:
    - ✓ Liberalized tariffs on 48% of the EU industrial products
    - ✓ Eliminated the 1999 tariff increases on EU footwear and certain textile products (dismantling from 25%-35% to 10%-15%)

- On 1 January 2003:
  - The EU liberalized customs duties on all Mexican industrial products.
  - Mexico:
    - ✓ Eliminated tariffs on an additional 5% of EU industrial products, to total 52% of the same.
    - ✓ Ensured that the remaining 48% of the EU industrial products were subject to a maximum tariff of 5%.

- Mexico will gradually liberalize tariffs to their full elimination by 1 January 2007.

Automotive Sector

- EU exporters are not required to have a manufacturing facility in Mexico to be able to sell vehicles in Mexico.
- The importation of new vehicles from the EU is restricted by import quota limitations.
- Until 31 December 2006, the permitted import quota is equivalent to 15% of the total number of vehicles (manufactured and imported) sold in Mexico, during the prior calendar year.
    - ✓ From January 2004, the vehicles under the permitted quota may be imported free of duties.
    - ✓ Vehicles imported outside of the permitted quota are subject to a 10% import duty.
- On 1 January 2007, all restrictions and duties on the importation of new vehicles from the EU will be eliminated.
- Furthermore, the agreement envisages very favorable access for the main EU auto parts and components.

Customs Co-Operation

MEFTA introduces one single administrative document called EUR.1, in order to simplify:

- The classification of the originating status of the products
- The inspections and customs procedures in the carriage of goods

The EUR.1 is similar to the Certificate of Origin implemented by NAFTA.

Agricultural Products

- Agricultural products will be progressively liberalized so that by 2010, 62% of the bilateral trade will be fully freed up. Key products such as sugar, dairy, beef and grains will continue to be excluded.
- In the agricultural sector, both the EU and Mexico obtained favorable market access conditions for various of their key export products.

- The EU obtained the progressive and total liberalization of wines, beer, liquors and spirits (vodka, cognac, certain whisky and gin), cut flowers, tomatoes, pectic substances, tobacco, and olive oil.

- Mexico obtained the elimination of tariffs on coffee, tropical fruit and vegetables, and preferential contingents for concentrated orange juice, avocados, honey and cut flowers.

- Since 2003, 37.9% of EU agricultural products are free of duties, with two more tariff liberalizations in 2008 and 2010, up to 49.55%.

- For the Mexican agricultural products, in January 2003, 68.2% of agricultural products were liberalized, with two additional tariff eliminations by 2008 and 2010, to total 74.14%.

Fishing Sector

- The fishing sector is gradually liberalized with respect to more than 99% of the current volume of bilateral trade.

- From 2003, Mexico liberated 71% of the EU fishing products, while the EU eliminated tariffs on 88% of the products.

Safeguards

- Safeguards may be adopted in order to provide temporal relief to a sector that may be facing serious damages because of substantial increases in the imports between Mexico and the EU.

Government Purchases

- EU and Mexican investors have access to public contracts for all products, services and suppliers, based on the same national treatment as that accorded to domestic products, services and suppliers, provided that the value exceeds certain established threshholds. MEFTA provides for clear rules guaranteeing the transparency of the process.

- EU operators will have guaranteed access to Mexico's lucrative markets on the best terms substantially similar to NAFTA. Access to markets at federal government level includes most government enterprises and key sectors such as petrochemical (Pemex), dredging, construction and IT.

- Mexican investors receive the same benefits that the EU awards to its partners in the framework of the WTO public contracting agreement.

Intellectual Property

- The protection of intellectual property, such as patents, trade marks and copyrights is adjusted to the strictest international standards.

- EU investors have the guarantee that the EU competitive advantage in high technology is fully protected.

- A special Committee attends to the effective application of such rights.

Competition

- Various co-operation mechanisms are provided for to permit and facilitate the application of the respective legislations of the EU and Mexico governing competition.

Dispute Resolution

- MEFTA provides for an effective dispute solving mechanism, which also includes arbitration, without infringing upon the respective rights of the Parties, within the framework of the WTO. The decisions of the arbitration panel are binding on both parties.

- Arbitration procedures do not apply to intellectual property, anti-dumping matters, balance of payment problems, issues covered under the WTO, and free trade agreements with third countries.

- In addition, MEFTA allows an alternative procedure, under which either party may undertake a dispute settlement under the WTO framework. The only condition is that no action may be disputed simultaneously under both forums.

Trade in Services

- The service markets of both parties will be progressively liberalized within a period of no more than 10 years, that is, by the year 2011.

- The agreement covers all services, including, among others:

    - ✓ Financial, allowing all EU banks and insurance companies to directly operate in Mexico
    - ✓ Telecommunications
    - ✓ Distribution
    - ✓ Energy
    - ✓ Tourism
    - ✓ Environmental

- The only exceptions are audiovisual, maritime cabotage and air transportation services.

- From the date of entry, the parties agreed not to introduce new restrictions on EU or Mexican investors.

- The relevant provisions for services ensure investors that:

  - ✓ No restrictions on the number of operations or services provided in the other party's territory will be introduced

  - ✓ Full enjoyment of national treatment at equivalent conditions

  - ✓ Treatment of "most favored nation" will be granted, surpassing the benefits bestowed on third parties

Investment and Related Payments

- MEFTA confirms the international commitments of the parties on investment and related payments.

- Envisages a revision of the legal framework to evaluate the possibility of a subsequent liberalization.

MEFTA Rules of Origin

- The general structure and provisions of the EU standard protocol were followed.

- As such, the EU harmonized rules are applied to the vast majority of industrial, agricultural and fishing products.

- The exceptions can be classified as follows:

  - ✓ A transitional easing of the EU rules regarding certain sectors like textiles, granting an adaptation period for the Mexican industry.

  - ✓ A special adjustment of the EU rules for sectors like the chemical and automotive industry, due to the lack of raw materials or components, such as certain chemical products, complex auto parts and machinery.

  - ✓ A strengthening of the EU rules, accompanied by *ad-hoc* solutions for products like footwear, cotton and synthetic or artificial fabrics, to guarantee preferential access to the Mexican market for EU products.

Definition of Originating Products

Originating products are:

- Products wholly originated in Mexico or the EU;

and

- Products originated in Mexico and/or the EU that incorporate less or up to the maximum permitted amount of non-originating components, all of which have undergone sufficient transformation or processing.

Definition of Sufficient Processing or Transformation

- The Treaty provides for a specific description of transformation or processing to be carried out on the non-originating components in order for the finished product to obtain MEFTA originating status.

- The non-originating components must be classified within a heading (four digit code of the Harmonized System) other than that of the finished product. This means that the non-originating component must shift tariff classification.

Activities Not Considered Sufficient Processing or Transformation

The following activities are not considered sufficient work or processing on non-originating components:

- Preservation of products during transportation or storage

- Assembly of parts to constitute a complete product

- Packaging of goods (bottles, bags, cases or others)

- Affixing labels and other distinctive signs

Permitted Non-Originating Components

- The permitted value of all the non-originating components incorporated into a finished product varies in accordance with each product.

- Overall, the permitted amount is 40% to 60% of the ex-works price of the finished product.

- Ex-works price is equivalent to the sales price of the finished product.

WHY INVEST IN MEXICO?

There are many reasons why EU investors want and should look towards Mexico to do business. Among the main ones:

- Mexico is the eight leading exporter in world merchandise trade and the seventh country in amount of imports.

- The US is the largest trading partner, with the EU in second place.

- It is the strongest economy in Latin America with 44% of all exports and 49% of the imports of the whole region.

- As of September 2004, Mexico has entered into a network of eleven free trade agreements with 42 countries, enabling access to 860 million consumers.

TREATY	COUNTRIES	EFFECTIVE DATE
NAFTA	United States and Canada	1 January 1994
FTA G3	Colombia and Venezuela	1 January 1995
FTA Mexico Costa Rica	Costa Rica	1 January 1995
FTA Mexico – Bolivia	Bolivia	1 January 1995
FTA Mexico – Nicaragua	Nicaragua	1 July 1998
FTA Mexico – Chile	Chile	1 August 1999
MEUFTA	European Union	1 July 2000
FTA Mexico – Israel	Israel	1 July 2000
FTA Mexico – TN	El Salvador, Guatemala and Honduras	1 June 2001
FTA Mexico – European Free Trade Agreement	Iceland, Norway, Liechtenstein and Switzerland	1 July 2001
FTA Mexico – Uruguay	Uruguay	15 July 2004

- Negotiations for a free trade agreement with Japan have been concluded. Local ratifications are pending.

- Mexico has become a natural platform for trade and investment, strengthened by its strategic geographic position.

- It plays a pivotal role in international trade, being one of the most dynamic markets.

- Mexico is the only country in the world with free trade access to both trading blocks, the NAFTA market and the EU market.

- Mexico entails an excellent opportunity for EU suppliers of goods or specialized services.

- Among others, the main potential investment sectors are:

Agriculture	Education	Infrastructure (including transportation)
Airport	Electronics	Information Technology (IT)
Automotive	Engineering	Health Care
Communication	Financial Services	Mining
Construction	Food and Drink	Energy

More importantly, with the implementation of MEFTA, EU investors can benefit from NAFTA and MEFTA, simultaneously, being able to export their products to the US and Canada, free of any import duties, or at quite reduced ones.

How does an EU Investor Access the NAFTA Market through Mexico?

- Any EU company may benefit from the existence of NAFTA and MEFTA, by combining the rules of origin of each Treaty.

- Products that have content from both Mexico and the EU have a tariff advantage for import into the US and Canada compared with products either coming directly from the EU or from other parts of the world.

- Preferential access to US and Canada for Mexican production requires that a certain proportion of the finished product contains regional components (Mexico, US, or Canada).

- The key is the correct combination of the rules of origin provided for in each of NAFTA and MEFTA.

What are the NAFTA Rules of Origin?

- NAFTA requires that all non-originating components undergo a shift of tariff classification.

- As such, the classification of the non-NAFTA components imported into Mexico must be different from the tariff classification of the finished product to be exported.

- NAFTA provides two different types of valuations to determine the NAFTA content of the products:

  - ✓ Valuation based on the ex-works price of the finished product
  - ✓ Valuation based on the cost of the non-originating component

- Basically, the non-originating components can be 40% to 50% of the ex - works price of the finished product.

- There is no limit as to the percentage of regional (NAFTA) components to be included in a finished product.

Comparison between NAFTA and MEFTA Rules of Origin

- The two basic rules of origin, provided for in both agreements, are the following:

  - ✓ The non-originating components must be transformed into a different tariff classification in order to qualify as an originating product, *i.e.*, a tariff shift must take place.

  - ✓ There is a quantitative non-regional limitation of an average of 40% to 60% of the total ex-works price of the finished product

- The basic difference is the method of valuations of regional content:

  - ✓ **MEFTA** – The applicable rules of origin are determined by tariff classification per individual component.

  - ✓ **NAFTA** – The rules of origin may be determined by a percentage of the ex-works price of the finished product or the cost of the non-originating component.

HOW IS THIS PUT INTO PRACTICE?

Background

- All finished products that comply with the NAFTA rules of origin are not subject to US or Canadian import duties on their export from Mexico.

- However, from 1 January 2001, NAFTA required Mexico to grant the same tariff treatment to all non-NAFTA components, which are destined to be exported to the NAFTA region.

- Consequently, all non-originating NAFTA components, incorporated into finished products to be exported to the US and Canada, are subject to Mexican import duties, and the corresponding 15% Value Added Tax.

- To minimize the impact of such obligation, Mexico implemented Sector Promotion Programs, which objective is to grant a preferential *ad-valorem* tariff to non-NAFTA components to be incorporated into finished products to be exported anywhere in the world.

- As such, the Sector Promotion Programs:

  - ✓ Eliminate import duties on some of the non-NAFTA originating components, and

- ✓ Reduce the remaining ones to a maximum duty of 5%.

- ➢ As of October 2004, there are 22 Promotion Programs in place, classified by sectors or types of industries as follows:

Electrical	Electronic
Shoes	Mining and Metallurgy
Agricultural Machinery	Chemical
Pharmo-chemicals, Medicine and Medical Equipment	Transportation
Leather & Furs	Automotive and Auto Parts
Furniture	Toys & Sporting Goods
Capital Assets	Photography
Rubber & Plastic	Iron & Steel
Paper & Cardboard	Wood
Textiles & Clothing	Chocolates, Candies & Similar Products
Coffee	Diverse Industries

REQUIREMENTS TO MAKE THIS WORK

1. **Incorporation in Mexico** - The EU company must incorporate a subsidiary in Mexico, for the manufacturing, processing or final assembly in Mexico of the products.

2. **Maquila Program** - The Mexican subsidiary obtains an authorization to operate as a maquiladora. A maquiladora is the vehicle required to import all type of components, from any country in the world, on a temporary basis, free of any duties, so long as the finished product is exported.

3. **Sector Promotion Program** – Simultaneously, the Mexican subsidiary registers in the Sector Program corresponding to the type of finished product to be exported.

Once the aforesaid three premises are complied with, there are three possible scenarios:

First Scenario

- ➢ The EU parent company sells and exports to Mexico certain EU components, which, under MEFTA, are free of duties.

- ➢ The Mexican company purchases NAFTA originating components, and together with the EU components, manufactures, processes or assembles products in Mexico.

- ➢ As a result, the finished product will have a tariff classification different from any of the tariff headings of the components.

- The product obtains originating status, for purposes of NAFTA, and is free of US and Canadian import duties.

- Since under MEFTA, said EU components are free of duties, the Mexican import duty is zero.

- The Mexican company only has to pay the 15% Value Added Tax on the value of the EU components.

- Payment of the Value Added Tax is made 60 days after the actual export of the finished product to the US and/or Canada.

Second Scenario

- The EU parent company sells and exports to Mexico EU components, that are still subject to Mexican import duties under MEFTA.

- The Mexican company purchases NAFTA originating components, which with the EU components, are manufactured, processed or assembled into a finished product in Mexico.

- When the tariff shift occurs, the product obtains originating status for purposes of NAFTA, and is free of US and Canadian import duties.

- The finished product is exported, by the Mexican company, to the US and/or Canada, subject to payment of Mexican import duties on the EU components (up to 5% in 2004, and a maximum of 4% from 2005).

- The resulting duty would be paid by the Mexican company, sixty days after the date of export, together with the 15% Value Added Tax on the value of the EU components.

Third Scenario

- The Mexican company purchases non–EU or non-NAFTA originating components ("Non-Treaty Country Components").

- In addition, the Mexican company purchases NAFTA components, which together with the third party components, are manufactured, processed or assembled into a finished product in Mexico.

- When the tariff shift occurs, the product obtains originating status for purposes of NAFTA, and is free of US and Canadian import duties.

- The finished product is exported, by the Mexican company, to the US and/or Canada, subject to payment of Mexican import duties on the Non-Treaty Country Components.

- If there is an applicable Sector Promotion Program, the Mexican company benefits from the same, in which case the Non-Treaty Country Components would be subject to a maximum duty of 5%.

- If there is no applicable Sector Program, the applicable duty will be the one provided for by the Mexican general tariff system.

- The resulting duty would be paid by the Mexican company, sixty days after the date of export, together with the 15% Value Added Tax on the value of the Non-Treaty Country Components.

Conclusion

- Mexico offers major benefits for all EU investors that desire to access the NAFTA region free of duties.

- The key lies in the correct combination of the rules of origin provided for in MEFTA and NAFTA, together with the applicable Mexican domestic trade program, such as the maquiladora and the Sector Promotion Program.

- Finally, it should be noted that Mexico has a privileged position as a free trade partner, being the only country in the world, which is a member of both the NAFTA free trade area and the EU trading block.