



# Mexico Helps Reduce Transportation Costs

*The Ciudad Juárez-El Paso Metro Area Is the Ideal Location*

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High oil prices are indeed affecting U.S. and non-U.S. companies around the world. A U.S. company that manufactures a product 7,000 miles away from home is definitely running into cost problems due to the unprecedented high transportation costs. Non-U.S. companies that distribute their products in the U.S. are also being hit by high transportation costs when shipping their products to the U.S. Because of these high transportation costs, Mexico is still an optimal location to manufacture or assemble products distributed in the U.S. According to a recent *Wall Street Journal* article, most U.S. companies are bringing back their operations to North America—and that includes Mexico.<sup>1</sup> An October 2008 article titled *Outsource Closer to Home* states that a good number of U.S. manufacturing executives are “likely to move production to Mexico” in the next few months.<sup>2</sup> The U.S.-Mexico border, in particular, is

1) Timothy Aepfel, *Stung by Soaring Transport Costs, Factories Bring Jobs Home Again*, *The Wall Street Journal* A1, A9 (June 13, 2008).

2) Gail Dutton, *Outsource Closer to Home*, *Entrepreneur Magazine* p. 22 (October, 2008)

the ideal location for companies to reduce their transportation costs. Since the 1960s, *maquiladoras* (factories located mostly in Mexican border cities) have been manufacturing and assembling products that are distributed throughout the U.S. and the rest of the world. *Maquiladoras* provide U.S. and non-U.S. companies savings on labor, competitive Mexican workforce, and the convenience of being only a few miles from the continental United States.

At the midpoint of the U.S.-Mexico border, a binational metropolitan area has emerged as a world-class manufacturing center in recent years. Ciudad Juárez, Mexico (known as “Juárez”) and El Paso, Texas comprise the so-called *borderplex* with a combined population of over 2.5 million people, which also includes prosperous suburbs in the state of New Mexico. Both cities—connected by bridges used annually by 15 million private vehicles—operate as one metro area that comprises almost 20 percent of all the U.S.-Mexico trade. Juárez, which is home to dozens of *maquiladoras*, is now Mexico’s fifth most populous city and the largest employer in the manufacturing industry. *Maquiladoras* in Juárez assemble an extensive variety of products such as electronic components, appliances, medical devices, computer components, metal products, and even alternative energy products such as blades for wind turbines. A recent *New York Times* article published that Juárez “is now absorbing more new industrial real estate space than any other North American city” due to its prosperous manufacturing activity.<sup>3</sup> The *Foreign Direct Investment Magazine*—a publication of the Financial Times group—designated Juárez as the “city of the future” due to “its growing importance as a regional industrial and logistics centre on the border.”<sup>4</sup> Its sister city, El Paso, which is one of the fastest growing cities in the U.S., operates as a premier logistics hub in which distribution centers are located to support the *maquiladoras* in Juárez. This sophisticated binational product-sharing system makes the *borderplex* one

3) Lisa Chamberlain, *2 Cities and 4 Bridges Where Commerce Flows*, *The New York Times* (March 28, 2007).

4) *North American Cities of the Future 2007/08*, *fdi Magazine—Foreign Direct Investment Magazine* (published by the Financial Times group) (April 25, 2007).

of the largest manufacturing centers in North America with over a quarter of a million people working in the industry.

Juárez offers enormous benefits when establishing a business operation. Because of high transportation costs, its proximity to the continental United States is definitely the most important advantage. A manufacturing facility in Juárez is only a few miles from a U.S. port of entry. In addition, the proximity results in convenience for executives of U.S. companies. For instance, hundreds of these executives live in El Paso and commute to Juárez. The fact that El Paso Airport offers non-stop flights to major U.S. cities normally allows executives visiting facilities in Juárez from other regions in the U.S. to fly back home the same day. Besides these benefits, Juárez offers a very competitive and experienced labor force at lower costs. Because of these and other benefits, over 70 Fortune 500 companies are currently located in the region. Recently, a Taiwan-based company announced the construction of a *maquiladora* that may be hiring about 30,000 people in the next few years. According to officials, it will be the largest *maquiladora* in Mexico.<sup>5</sup>

A foreign company typically has the following options when manufacturing in Mexico: (1) establishment of *maquiladora*, (2) shelter operation, or (3) contract manufacturing. If the foreign company decides to establish a *maquiladora*, it will create a subsidiary in Mexico. The foreign company, as a shareholder or partner of the subsidiary, is ordinarily not liable for corporate indebtedness in Mexico. The most common business entities in Mexico to establish a subsidiary are the *Sociedad Anónima* and the *Sociedad de Responsabilidad Limitada*. Both entities may be 100 percent foreign-owned. The latter has become popular for U.S. companies due to the “pass through” benefits that it offers with respect to the U.S. entity. The subsidiary will be taxed in Mexico as is any other business entity, but the foreign company is not considered

<sup>5</sup> Diana Washington, *Maquila bordering New Mexico to employ up to 30,000*, El Paso Times A1 (July 22, 2008).

a taxpayer in Mexico. The subsidiary may purchase (or lease) land for its operations anywhere in Mexico. If the property is located in the *zona restringida* (restricted zone),<sup>6</sup> the subsidiary may purchase the land directly as long as it is for commercial or industrial purposes. Under the shelter program, a foreign company enters into an agreement with a shelter operator for the manufacturing of certain products. The foreign company, which does not have legal presence in Mexico, is normally responsible for providing raw materials, equipment, managers and supervisors, and quality control processes. Under the contract manufacturing method, a foreign company hires a third-party operator, and the former is normally responsible for providing raw materials and equipment. Operators in shelter and contract manufacturing will charge a fee for their services plus the cost of the operation.

The Mexican government continues providing incentives to the manufacturing industry coming into Mexico. In the last few years, Mexico's Ministry of Economy has issued various decrees for the manufacturing industry. The current applicable decree is the *Decreto para el Fomento de la Industria Manufacturera, Maquiladora y de Servicios de Exportación* ("IMMEX"). IMMEX provides benefits with regard to import duties and *Impuesto al Valor Agregado* ("IVA")—Mexico's sales tax payable on imports and purchases. Mexico's IVA rate is 15 percent, but it is only 10 percent if the company is located in a border city like Juárez. With respect to IVA, IMMEX allows inputs and components (incorporated into exported manufactured goods) and equipment and machinery (used in the production process) to be IVA exempt. In reference to import duties, NAFTA countries are exempt for inputs and components. A non-NAFTA country may be exempt from import duties on inputs and components if the country has a trade agreement with Mexico that provides an import duty exemption. In addition to IMMEX, the *Programa de Promoción Sectorial* ("PROSEC") offers other

<sup>6</sup> *Zona restringida* is the area of 50 km (31 miles approximately) inland from the coastline and 100 km (62 miles approximately) from any border. For residential purposes, foreigners may acquire the effective use of land in the *zona restringida* only through a trust.

benefits with regard to importing materials from a non-NAFTA country at a reduced or exempt duty.

The Juárez-El Paso metro area offers to U.S. and non-U.S. companies the ability to reduce their transportation costs by shortening their supply chain. In addition to the transportation benefits, the *borderplex* offers travel and residence convenience for companies' executives, competitive labor force at lower costs, and experienced legal and customs services. The incentives that the Mexican government provides through IMMEX and PROSEC facilitate the foreign companies' establishment of their operations in Mexico. For these reasons, Mexico, and specifically the Ciudad Juárez-El Paso region, is the ideal location for companies to reduce their transportation costs.

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