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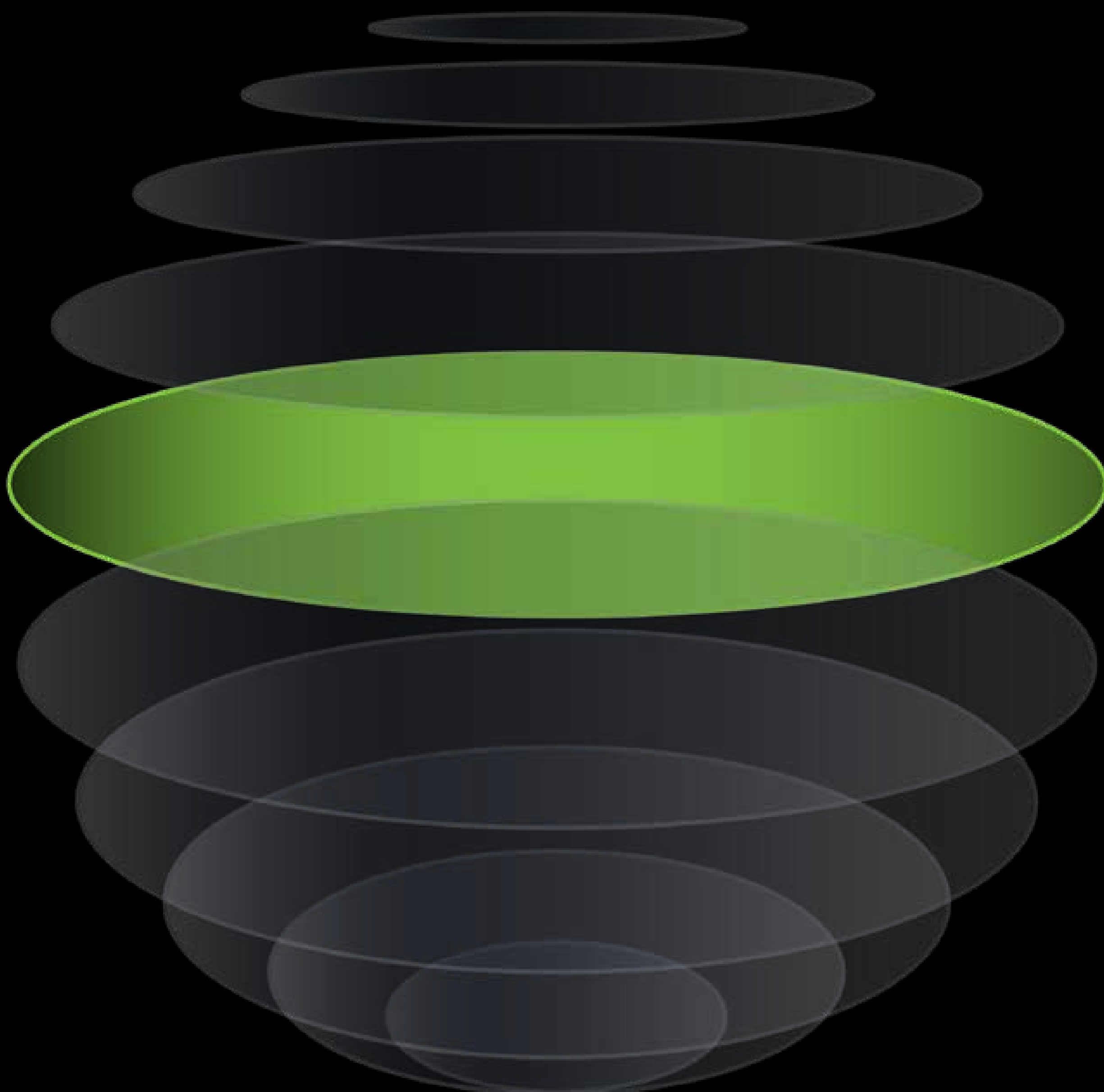


Economic Border Zone

A strategic analysis of the tax Reform Initiative for the Northern Border Region

Tax

Introduction

Even with its idiosyncrasies involving migration, security, infrastructure, and others, the northern border of region between the United States and Mexico can be seen as a touchstone in Mexico in terms of economic growth and generation of employment.

In recent weeks, the new administration (taking office on December 1) has outlined the economic-fiscal plans and strategies for several regions of the country, including a specific plan for the northern border zone.

In view of the relevance of these issues, Deloitte has performed a survey of the border zone business community in Mexico to learn the perspectives of businessmen regarding the new regional initiatives. On the basis of survey results, Deloitte offers a strategic analysis to support informed decision making.

The central thrust of the new administration's policy is the establishment of a new fiscal framework in the region for the purpose of promoting economic development.

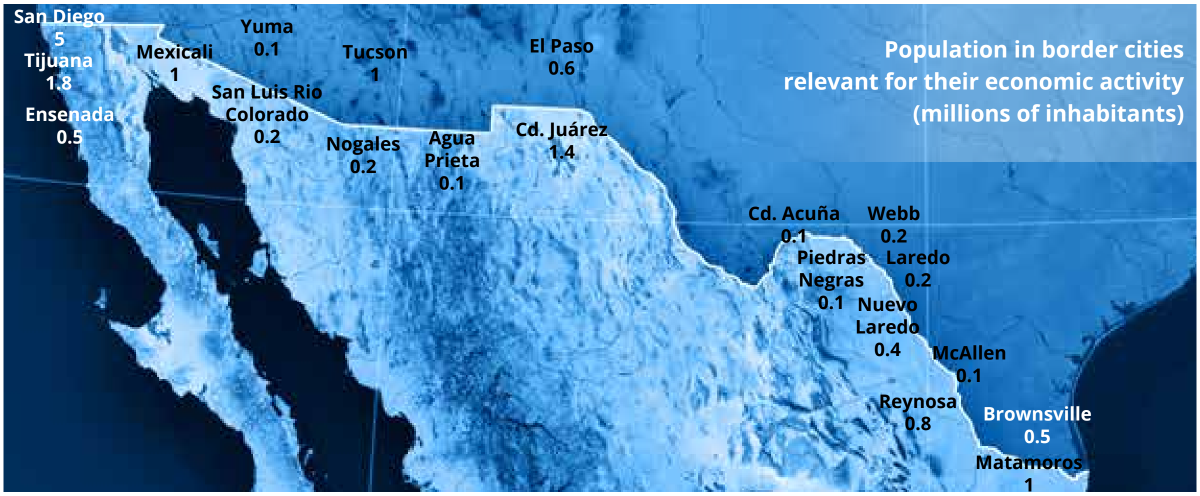
Two pressing issues for the region are concomitant with this initiative:

01. The need to generate economic development that allows border cities of northern Mexico to absorb the migratory inflows that traditionally flock there.
02. Competitiveness in terms of attracting investment to generate jobs, while driving consumption needed to capture consumer spending in Mexico, which often leaks to US cities just across the border.

Companies in the northern border region of the country must evaluate the effects these new economic and fiscal initiatives will exert on their operations in order to be in a better position to make timely decisions and take advantage of opportunities, while also anticipating challenges.

The proposal for the northern border region includes:

- Reduction of the corporate income tax rate from 30% to 20%.
- VAT reduction from 16% to 8%.
- Increase in the minimum salary from $88 pesos to $176 pesos per day.
- Matching of gas and electricity rates to prices in the cities of the southern United States.



The Northern Border Region by the Numbers

Faced with the impending conclusion of the "Bracero" program in the United States, the Border Industrialization Program of 1965 was a public policy measure to promote industrial growth along the northern border and employment for Mexicans who choose to remain in the border region.

Currently, the northern border region of Mexico includes more than 25 cities strung along a border of more than 3 thousand kilometers from the Pacific to the Atlantic Ocean. These cities are home to around 7 million permanent inhabitants, as well as a floating migratory population. According to the 2017 Survey on Migration in the Northern and Southern Borders Regions of Mexico, cities of the northern Mexico border region saw an influx of just over 300,000 people, who intend to reside in the region or cross over to the United States.

Of these Mexican border cities, Tijuana, Mexicali, Ensenada, San Luis Rio Colorado, Nogales, Agua Prieta, Ciudad Juárez, Ciudad Acuña, Piedras Negras, Nuevo Laredo, Reynosa and Matamoros are the largest. They also stand out for the severity of their social and public safety problems.

The northern border region of the country receives a migratory influx of more than 300 thousand people a year, a little more than 80% of which decide to stay in the cities of the northern border region of Mexico

The northern border of region Mexico cannot be properly understood without considering the cities mirroring them just across the border in the United States, which include several cities with more than 7 million inhabitants, most notably San Diego in California, Yuma and Tucson in Arizona, as well as El Paso, Webb, Laredo, McAllen and Brownsville in Texas.

Baja California is located within the 5 first places in the payment of federal taxes, but only receives 0.7% of the national infrastructure fund ".

The northern border region is in effect home to a series of binational metropolises of more than 14 million people, where economic, social and cultural flows of great relevance are generated. The population in the cities of the northern border region of Mexico represents approximately 6% of the total population of the country; and their economies contribute approximately 6% of the national GDP.

In terms of tax federal distribution, however, border region cities do not receive federal supports in the same proportion. One estimate, for example, has Baja California only 18% of the total federal taxes collected in the state returning to the state. According to former Baja California senator Jorge Ramos, the state ranks among the top five in federal tax collection, while receiving only 0.7% of the National Infrastructure Fund. Moreover, the state ranks among the last places in spending on education, health and social infrastructure

This imbalance undermines the region's competitiveness, especially since several US border cities levy sales taxes of 7.5% to 8.5%, monies that remain in the states and cities. This tax scheme has immediate, visible effects in the quality of the local infrastructure and services.

In 2014, it should be noted, the differential VAT was eliminated in the northern border region, moving the rate up from 11% to 16%. This had a negative impact on the region. Baja California, for example, saw a fall in economic activity of as much as -2.5%, according to the Quarterly Indicator of Economic Activity published by INEGI, which also reported inflation increasing to over 4% from the previous year's rate of 2.8%. As such, 2014 saw overall economic contraction of -6%.

The initiative to reduce the VAT rate in the border region to 8% will very likely serve to support reactivation of the region, since this rate would stand more in line with the rates prevailing in the cities of the southern United States.

In terms of industrial development, the northern border region is home to more than 1,600 companies registered in the IMMEX in-bond program. This represents 30% of the total nationally and provides employment to more than 800,000 people. Moreover, some estimates attribute three indirect jobs for each of these direct job. Hence, approximately 2.4 million inhabitants in the border region are directly or indirectly linked to the industrial development of the region.

In addition to population growth in the northern border region, migratory influx from diverse parts of the country and abroad swell the local population. The migrant population of foreign citizens comes mainly from Central America, as highlighted recently by groups of Haitian and Honduran citizens attempting to enter the United States, with no small number of these ultimately deciding to remain in northern Mexico.

This population growth exerts significant pressures on public services, including education, health, public security and others. Growing migratory flows into the border region are expected to continue, which cannot help but strain public infrastructure, while exacerbating traffic, general transportation issues and public security in the near term. In view of the recent tax reform in the United States, lowering the corporate rate to 21%, and competition from Asian manufacturing hubs, located largely in China and Vietnam, foreign investor naturally are standing aloof while Mexico defines public policies for this region.

It is clear that the northern border region of Mexico faces important challenges in the short term:

01. Migratory inflows will place significant demands on city services and infrastructure, which will strain to remain viable and sustainable.
02. Economic competitiveness allowing the region to attract national and foreign investment needed to generates jobs.

In light of these considerations, the opinions and outlook of the business community of the northern border region regarding the proposals tendered by the new federal administration are sure to provide valuable insights.

Reform Initiatives

As of the seating of LXIV Legislature, several initiatives have been presented to modify the tax burden to residents of the northern border region. The major thrusts of the tax reform proposed by the party in power for the border region, which once approved shall take effect on January 1, 2019, include:

- Reduction of corporate income tax rate from 30% to 20%. It should be noted that the 30% rate is to remain in effect in all other regions of the Republic. Several legislative initiatives propose decreases for physical persons, who currently are required to pay 35% on income. One such proposal would modify the Income Tax Act to put income tax on physical persons at 20%. At publication of this report, this matter is still unresolved.
- Reduction of Value Added Tax levied in the border region from 16% in force throughout the Republic to 8%.

  These several initiatives may entail some debate regarding what is understood as the border region. Before 2014, we should caution, the border region was taxed at a rate distinct from the general rate applicable in the rest of the country. It stands to reason that legislators will use this rate as a baseline when approving any new initiative.
- With regard to the minimum wage, starting next year, the norther border region will be considered a distinct economic zone, requiring establishment of a minimum wage of at least twice that of the general minimum wage in force in other regions of the Republic. For years the National Minimum Wage Commission approved upticks in tandem with inflation, a practice that did not allow the minimum wage to be increased as a function of a worker's need to meet basic needs as head of a family. Consequently, the real purchasing value of the minimum wage always decreased year in and year out. The issue of increasing the minimum wage was proposed in previous administrations, resulting in a national minimum wage in conjunction with minimums for the differentiated zones A, B and C. Moreover, the minimum wage as a unit of measurement was scratched from a range of laws. Currently the UMA (Updated Measurement Unit) serves to adjust indicators on the basis of increases in the general prices. Surely the new legislature will take steps to accelerate an increase in the minimum wage. In all events, the President Elect has stated that as of January 1, 2019, the minimum wage in the border region shall be 177 pesos per day, twice its current value.

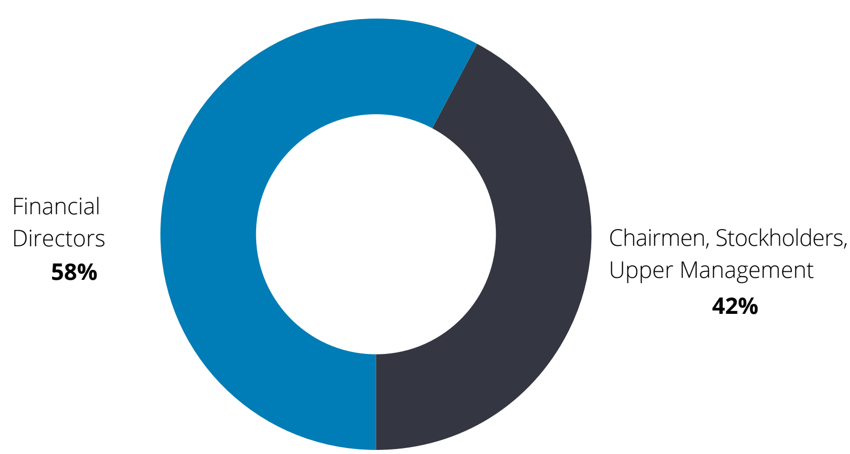
  In terms of legislation, issues surrounding labor unions are likely to take a front row. These matters should be monitored closely by each company.
- It remains to seen exactly which geographical areas shall enjoy decreases in income tax and VAT, and the increase in the minimum wage. This matter is especially important to cities such as Ensenada, which is particularly dependent on tourism and manufacturing, but lies beyond the traditional 30 kilometer border zone. If it were excluded from the benefits proposed for the northern border region, its economic development could be seriously affected.
- By the same token, the importance of judicial certainty for economic actors in the establishment of these changes cannot be overstated. In order to assure investors, these modifications of tax and wage laws must be clearly established by law, not relegated to later decrees or subsequent regulatory decisions.

Survey of business opinion in the northern border region of Mexico

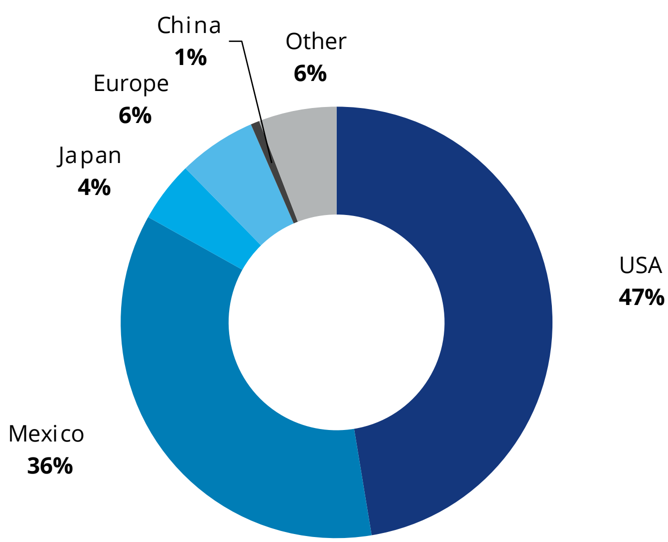
In light of these legislative initiatives before Congress and the statements of the incoming federal administration, this report shares the opinions of the business community of border cities, especially those of Tijuana, Mexicali, San Luis Río Colorado, Nogales, Ciudad Juárez, Laredo, Reynosa, Ciudad Acuña, Piedras Negras and Matamoros.

Survey participants

The survey was conducted of entrepreneurs operating in cities along the country's northern border. The distribution of respondents (chairmen, stockholders, senior management and financial managers) is shown below. The distribution aims to provide a balance of key decision makers.



Origin of investment

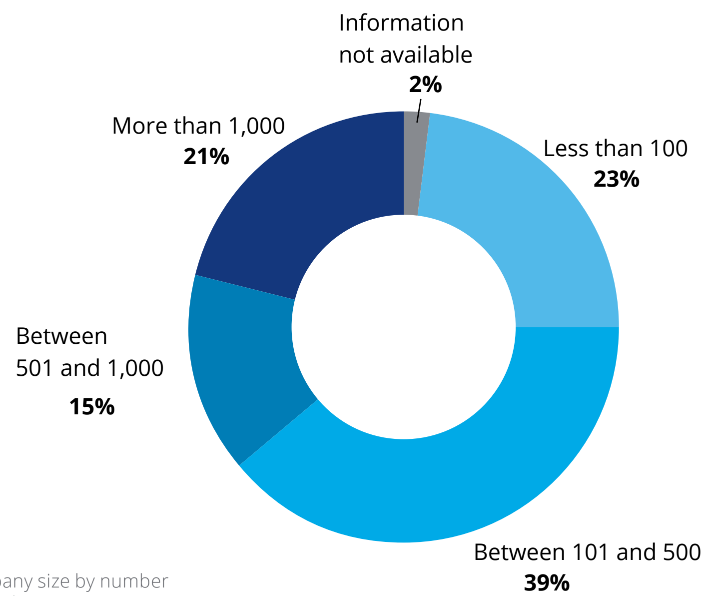


Sixty-four percent of those surveyed are executives who operate foreign capital businesses, while 36% are executives of national capital businesses. In general terms, this split between foreign and domestic investment actors corresponds to prevailing investment levels in the northern border region of Mexico. National investment in the northern border region is on a growth trend, largely in the areas of commerce, services and real estate; while foreign investment is focused in manufacturing activities (IMMEX). It is interesting to note that investment in public-private projects is expected to expand under the new administration. In view of the lack of sufficient public resources to execute the plans of the new administration, some analysts calculate that for each peso of public investment, private investors would contribute 20 pesos[vi].

Company size by number of employees

The survey provides a good distribution of small, medium and large companies. The region is characterized by many companies of diverse sizes. In addition to the jobs generated by the foreign and national private sectors, local governments also represent a relevant source of employment.

The survey includes, therefore, the opinions of companies of diverse sizes operating in diverse sectors of the border region economy, which allows for a more in-depth analysis

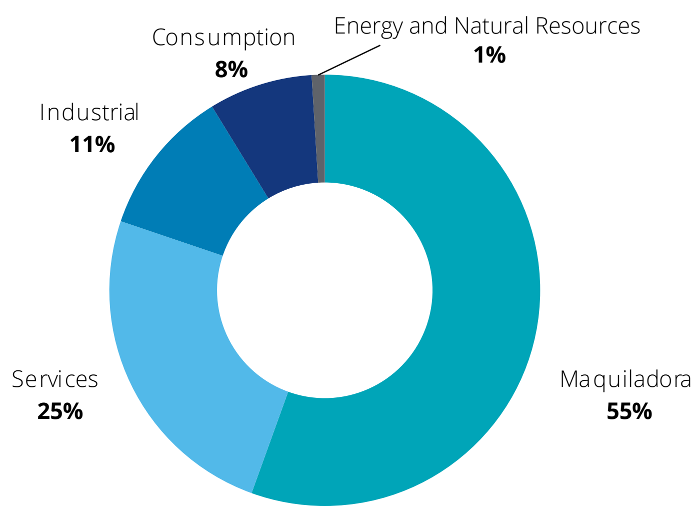


*Company size by number of employees

Economic sector

Within the formal entrepreneurial sector, 56% of the participants surveyed operate in export manufacturing, which is one of the region's strongest suits. Respondents working in the Services and Consumption sector account for 31% of those surveyed.

According to INEGI, informal labor in the northern border states with larger cities is less than 40%, versus the national average of over 50%. That is, the northern border region continues to be characterized by generating formal jobs, while informal labor is the rule in many other states of the country.



Likely impact of this initiative and how businessmen intend to respond

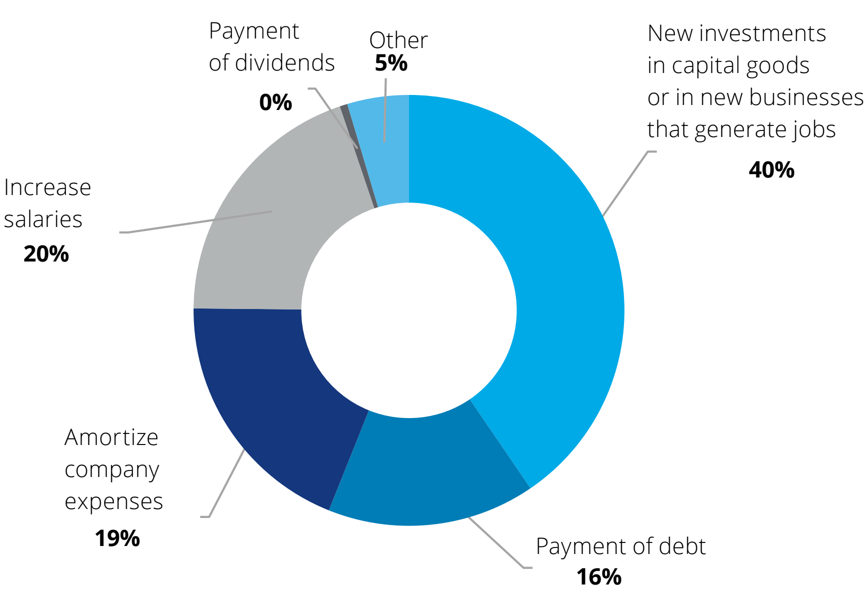
The survey results are as follows:

In the words of the transition team of the new administration, one goal is to decrease the income tax rate in order to allow investors to increase salaries. With the reduction of income tax in mind, the following question was put to participants:

01. Based on your company's knowledge of the corporate income tax reduction proposal to 20%, and in the event it is actually approved, how will your company allocate the additional liquidity?

Of the total responses received, 44% stated that this was as yet undecided, while the remaining 56% already have decided how to allocate such monies, most of these wishing to allocate additional funds to meet diverse cash flow obligations. Interestingly, 40% of this segment stated they would be willing to invest in new projects that eventually generate greater wealth, create jobs and expand the tax base; while 20% would consider increasing wages.

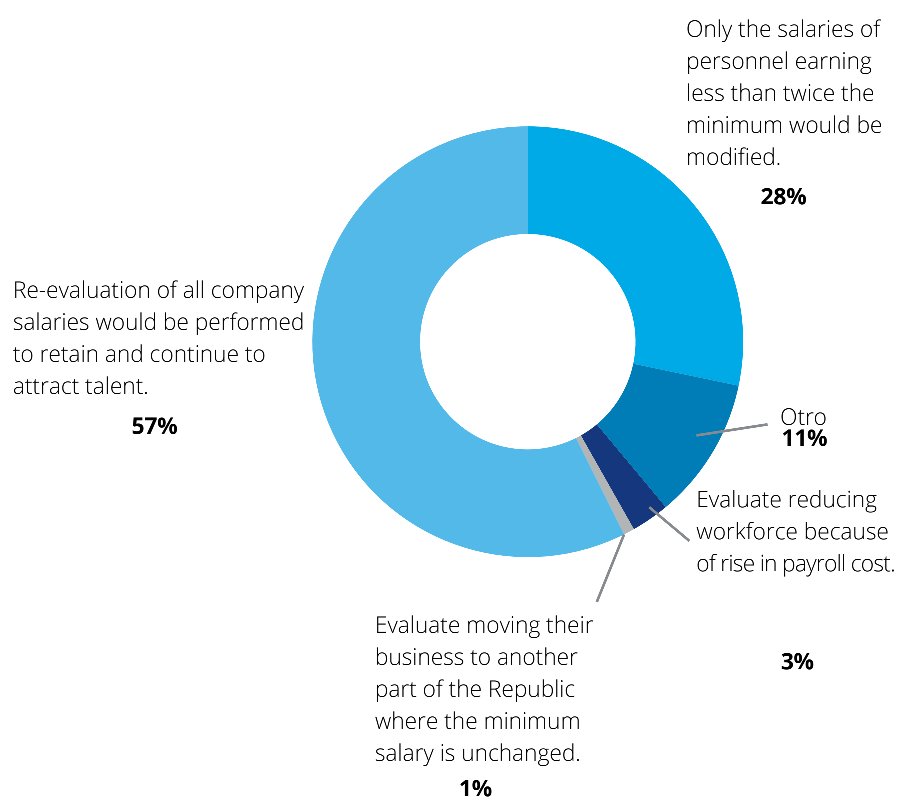
Finally, 35% of the decided segment would focus on covering short-term obligations (i.e. expenses and debt). It is interesting to note that none of the participants mentioned paying dividends.



The question of increasing the minimum wage was proffered as follows:

02. If the minimum wage for the border region is doubled (i.e., to $ 176.72 per day), what course of action would your company implement?

Of the total responses, 21% of respondents stated that no decision has been made in this regard. The responses of the remaining 79% break down as follows: Nearly 60% indicated that the company would perform a comprehensive review of the pay scale throughout the company in order to ensure retention of personnel and attract qualified talent. In contrast, 28% stated they would apply the salary increase only to personnel earning less than the new standard minimum wage. In this regard, a salary survey performed by the Association of Human Resources of Industry in Tijuana, A.C. (ARHITAC) points out that few companies actual paying the minimum wage, and on average companies pay their entry level workers $153 pesos per day, which already approaches twice the current minimum wage of 88 pesos. To evaluate the effects on payroll and profit sharing in any given company requires knowledge of the company's payroll structure.



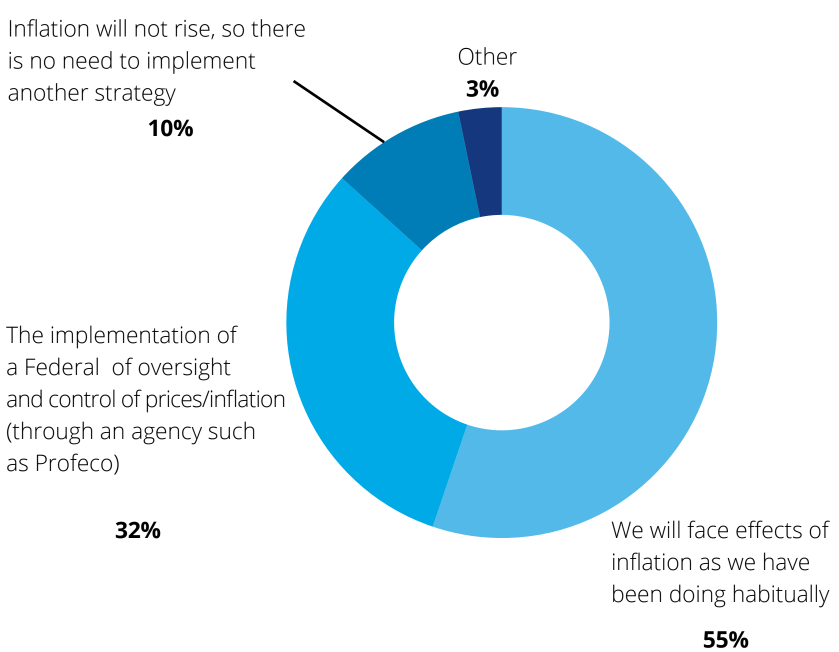
General impact in the region

Inflation is a key concern that requires examination. In recent years, the border region has recorded higher inflation than in the rest of the country (e.g., Tijuana and Mexicali have seen inflation top 7%). In this respect, the survey posed the following question:

03. We could expect that lowering VAT and income tax, coupled with an increase in the minimum wage, would drive consumer spending upward in northern border region of the country, while also bumping up inflation. In view of this scenario, how do you expect prices to behave generally?

Most of the respondents indicated that they will face the effects of inflation as they have done habitually in the region, while 32% expressed a preference for some kind of federal price control, and only 10% opined that inflation will not be an issue.

INEGI figures to September of 2018 put inflation in the northern border region at 5.6%, which is higher than national average of 5.0%. Tijuana tops the region at 6.8%, followed by Matamoros at 6.1% and Mexicali at 5.6%. Therefore, controlling prices appears to be a key if the intended benefit of the new administration proposals are to manifest.

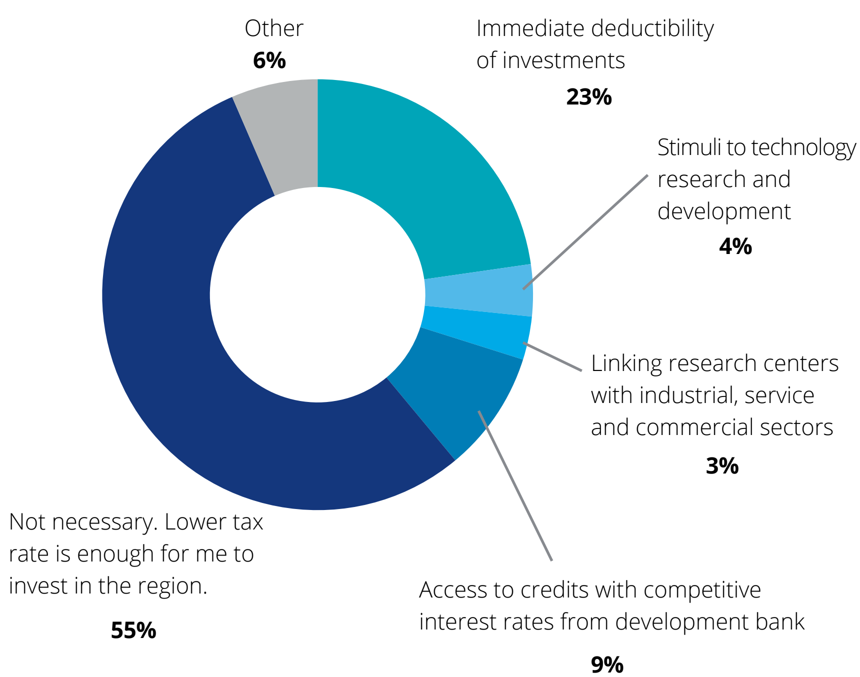


As noted above, investment traditionally is an important factor in the northern border region, especially in terms of generating jobs. In view of the need to retain and attract investment flows into the region, while continuing to drive opportunities for the expanding population, the survey poses the following question:

04. In order to retain investment inflows to the region and optimize the benefits of the new administration's initiative, please indicate additional incentives that might incentivize your company to increase investment in the region.

Interestingly, more than half of respondents believe that the administration's initiative will be enough to retain resources in the region and generate investment. This indicates that the business community agrees with the initial approach of the new administration.

In contrast, 23% believe additional support, such as the immediate deductibility of investment, could serve to attract and retain investment in the region. Of the total respondents, 16% cited the importance of research and development matters, cooperation between academic and productive spheres, and improved financing schemes.



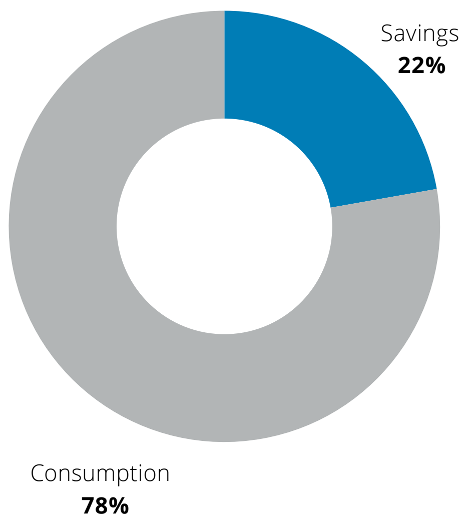
In view of the binational issues discussed previously, it must be noted that the border region maintains constant binational economic flows across a wide range of industrial, commercial and service sector activities. As such, the survey sought the opinion of entrepreneurs regarding the behavior of consumers faced with implementation of the new administration's reforms:

05. In terms of general consumption, physical persons will benefit from the lowering of the VAT rate from 16% to 8%. From the perspective of the city where you work, please indicate how consumers will spend the savings enjoyed under the lower VAT scheme.

It is important to note that results reflect the opinions of executives regarding spending trends among consumers in their respective cities. Respondents believe most of the benefit derived from the lowered VAT rate will be spent on additional consumption. Of those surveyed, more than three quarters believe the benefit will be spent on consumption, such as household items, automobile, tuition, mortgage payment and other debts, entertainment and other such outlays, including medical expenses. In this light it is clear respondents believe consumers are likely to spend any additional monies derived from the lower VAT rate rather than save it.

Of those who did cite savings, 20% expected such saving to occur in US banks.

Expectation of Savings vs. Consumption



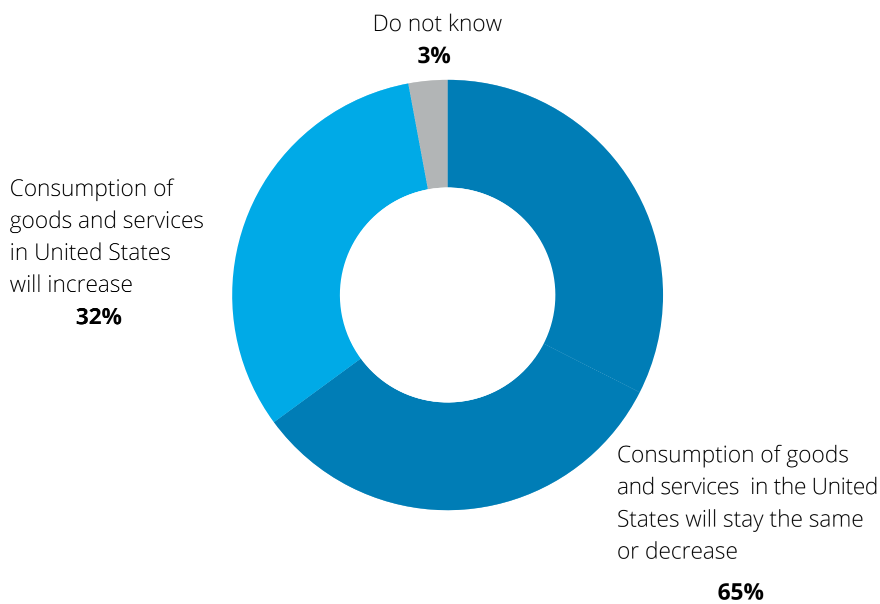
Nonetheless, consumption flows undergirding local economies occur on both sides of the border. In order to examine opinions regarding binational consumption, the following question was posed:

06. Given a lower tax burden, do you estimate cross-border purchasing of goods and services to increase? Will it remain the same or decrease?

This question serves to attain an understanding of expectations of executives regarding consumption in their respective cities. Interestingly, 65% of respondents expect cross-border consumption of goods and services to remain the same. In this light, entrepreneurs in the commercial, real estate and service sectors will be facing the most serious challenges.

According to several studies, losses of consumer spending fleeing the border region of Baja California Sur to the US amount to 7 billion dollars a year. These losses appear to be driven by the ease of purchasing, liberal return/exchange policies offered by US based stores, as well as the richness in availability of goods and services in Americans cities. Ultimately, these consideration could undermine the strategies proposed by the new administration. In this light, businessmen in the northern border region must evaluate their specific situation in order to seize opportunities and establish business strategies to optimize benefits.

Expectations of Consumption in the Northern Border Region



Analysis

A. Fiscal

With the implementation of the new administration's plans for the northern border region, several scenarios suggest themselves: These are posited merely for the purpose of illustration, and the actual effects of these measures will depend on each situation. Lowering of the VAT rate from 16% to 8% will likely result in an increase in the supply of goods and services, especially for physical persons as final consumers. In contrast, these measures will impact companies to a lesser degree, limited to palliative tax credits in the export sector, where many companies unable to demonstrate VAT outlays must resort to requesting refund of balances affecting working capital. With the lower VAT rate (lower VAT balance in favor), the sector could enjoy improved cash flows. Regarding the planned reduction of corporate income tax from 30% to 20%, we must evaluate the impact of this measure in conjunction with the announced increase in the minimum wage, which no doubt shall exert effects on payroll and associated costs, such as social security state payroll taxes and profit sharing. For this purpose, we shall evaluate three scenarios of companies with different profitability, while assuming a 5% increase in payroll costs. The increase in payroll leads to increased deductions and, therefore, lower taxable earnings. Lower taxable earnings, in turn, generates lower profit to be distributed among workers under profit sharing rules, as well as lower taxes due to the lower real rate. The question that follows is: Is the decrease in the income tax rate sufficient to offset the increase in the minimum wage? Obviously, there is no a single answer for all companies due to countless factors affecting each one; however, we can venture the following observations:

01. . Service companies, e.g., insourcing, outsourcing and in-bond manufacturers, whose prices include overhead and a profit margin, will suffer scant effects, since they report revenue on the basis of costs and expenses, an increase in payroll costs can be passed on contractually, as warranted, to customers. Each company should review the particular contractual terms it holds with its clients. While the profit margins of in-bond plant is associated with a cost center, the reduction of income tax by one third (30% to 20%) will exert an impact in the same proportion. An in-bond plant paying the equivalent of 3%, with the reduction in income tax, would incur 2% in the next fiscal year, i.e., a reduction of one percentage point. Moreover, competition for labor in the in-bond industry along the border has led companies to offer salaries above the minimum wage. For the new minimum wage to exert little or no effect on costs and expenses, it must not represent an increase of more than 1% of these costs and expenses. If the in-bond is not offering high salaries and doubling of the minimum wage exerts an impact of more than 1% over its costs and expenses, the reduction in income tax rate will not be enough to offset the increase in the minimum wage.

With constant pressure on companies to achieve efficiency and savings, a situation such as this could require establishment of new commercial zones to lower corporate overhead, thereby enhancing competitiveness of in-bond plants from different countries.

02. Profits of companies defined by annual payroll (i.e., those without significant cost components other than payroll) could be affected more significantly, since an increase in payroll of, for example, 5 % would be higher than the reduction in the income rate. In the following example, Company 1, whose payroll represents 80% of total deductions, the entrepreneur must discern between passing the additional cost of 0.24 to the consumer, cushioning this additional cost by squeezing the profit margin or a combination of both approaches.

03. Finally, companies where payroll is not the main cost component and companies that are highly profitable will enjoy real net savings from the reduction of income tax and profit sharing. Companies 2 and 3 below, in which the payroll represents 50% and 35% of the deductions, respectively, provide illustration.

Companies operating along the northern border should evaluate the impact of the increase in the minimum wage and the opportunities opened by lower income tax and VAT rates, since the effects will vary depending on each country’s structure.

	Company 1 payroll = 80% of deductions	**Company 2** payroll = 50% of deductions	**Company 3** payroll = 35% of deductions
Current:			
Income	100.00	100.00	100.00
Payroll	64.00	40.00	28.00
Other Deductions	16.00	40.00	52.00
Taxable earnings	20.00	20.00	20.00
Income tax (30%)	6.00	6.00	6.00
Border Zone Proposal			
Income	100.00	100.00	100.00
Payroll (+5%)	67.20	42.00	29.40
Other Deductions	16.00	40.00	52.00
Taxable earnings	16.80	18.00	18.60
Income tax (20%)	3.36	3.60	3.72
Summary:			
Added earnings from reduced income tax reduction	2.64	2.80	2.56
Decrease in profit sharing	0.32	0.20	0.14
Increase in costs (payroll)	3.20	2.00	1.40
Net effect	**0.24**	**- 1.00**	**- 1.30**

Illustrative example. Each case should be evaluated separately

The 5% increase used in the example is representative of a group of companies sampled, where it was observed that this does not proportionally impact the total cost of payroll, since higher salaries are paid to supervisors, managers and directors, who are not likely to receive substantial salary increases. In any case, an initial evaluation the impact on salaries, benefits and social security contributions. See the process flow chart below.

What to do?

Step 1
Inform the company administration.

Step 2
Evaluate the economic impact of the increase in minimum wage versus the status quo.

Step 3
Review in detail the benefits that surpass legal minimums. These are calculated as multiples of the minimum wage.

Step 4
Analysis of the social security and benefits plan, to evaluate any benefit based multiples of the general minimum wage.

B. Economy

Cities of the northern border region of the country contribute significantly to public coffers. According to several studies, the reduction in income tax and VAT could cause a drop in tax revenues of more than one hundred billion pesos. It is important to understand, however, that these reductions are intended to activate the economy of the region, and as more transactions are generated by businesses, one would expect tax revenues on expanding business transactions to offset to some degree the lost revenue. Since the fall in tax revenue estimated by several sources is not a one-way or static phenomenon, but rather a dynamic one; the effects of lower tax rates must be assessed in light of this multiplier effect. According to recent statements issued by the new administration's economic team, fiscal year 2019 is expected to conclude with balanced finances. It should be noted that at the time of publication of this report, a small primary surplus of 0.8% GDP has been attained. This budget package outlook proffered by the new administration's economic team takes into account the tax strategy for the northern border region.

Effects of income tax, VAT and increase in the minimum wage

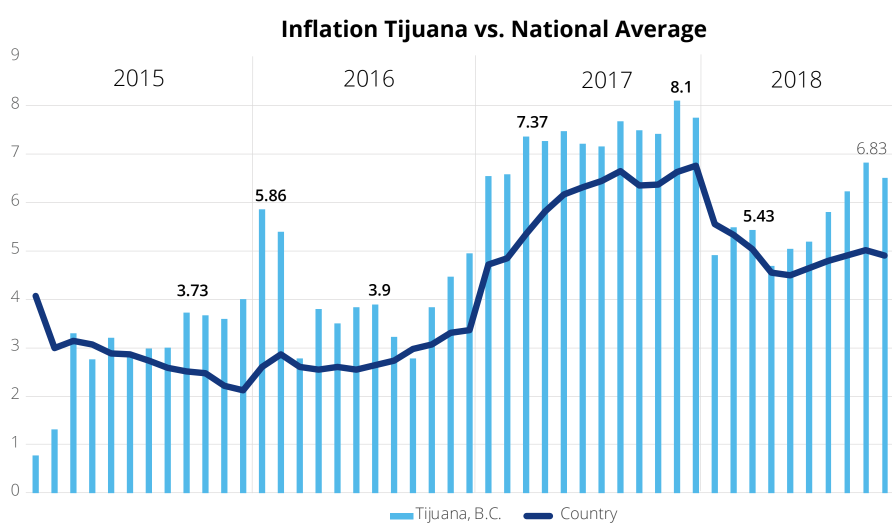
Several economic analysts have pointed to the need to increase the minimum wage, and the new administration has made this a key component of its strategy. As might be expected, there are diverse approaches to how to implement such an increase. In any open economy, one might expect salaries to track with productivity. In recent years, however, this has not been the case, the minimum wage, according to the National Council for Evaluation of Social Development Policy ("Coneval"), has lagged well below the well-being line.

As shown in our survey, a good portion of businessmen are willing to revise their salary scales upwards. Implementation of this process necessarily entails financial and fiscal challenges, which vary from industry to industry, company to company. The increase in the minimum wage and reduction of VAT and income tax further complicates matters, and it is clear that companies will not be affected in the same way or to the same degree. For many companies, increased wages and profit sharing can be priced in to the sale price of products and services, which, of course, are also subject to market pressures. Several regional businessmen believe that this will be a temporary issue, occurring around the time the new minimum wage is instituted in January 2019, while the 20% tax reduction will not be felt until March 2020, when annual earnings statements are filed.

In this light, companies may be forced to finance the increase in salaries, as well as some inflationary effects in the supply chain during the first year of implementation of this strategy in the northern border region. In this scenario, entrepreneurs would be well advised to assess their working capital needs and review sources of short- and medium-term financing in order to ensure operational viability and competitiveness.

Inflation

As previously suggested, the border region strategy is likely to drive inflation, which is expected to drive consumption. The new administration, however, hopes inflation to be offset by reduced VAT, and the matching of gasoline prices and electric rates to those in the cities of the southern United States. It should be noted that these prices are higher in the United States. It is uncertain whether these measures can keep inflation in northern border region, where many prices (e.g, rent, services, etc.) are dollarized, in check. Moreover, the depreciation of the peso versus the US dollar exerts a direct inflationary impact on the region, more so than in other regions of the country. It will be interesting to observe the mechanisms the new federal administration might implement for the northern border region to rein in inflation.



One scenario would see an initial stage marked by relatively high inflation rates in border region economies, resulting from the inflationary inertia currently prevailing. Once the market reaction to the rise of wages, reduction of VAT and homologation of energy prices are internalized, inflation might be expected to level off. This scenario would also depend on the exchange rate remaining largely stable.

Competitiveness and migration

As previously mentioned, cities of the northern border region need to ensure competitiveness in two key areas:

A. The attraction of foreign investment to continue generating good quality and well-paid jobs to meet the employment needs of the inhabitants of the region and to absorb the migratory flows that arrive to these cities.
B. Retention of wealth generated in the region, where consumption generated by economic growth occurs in Mexican border cities, rather than in the competing cites across the border. The reductions of income tax and VAT are key factors to encourage foreign investors to continue to expand their business operations in the region. These measures also incentivize local entrepreneurs to continue investing in goods and services operations benefiting consumers in the region. Businessmen in the northern border region will have to be flexible and alert to the following factors in order to optimize the benefits of this strategy:

- Supplying the local demand for goods and services not currently supplied on the Mexican side of the border, forcing consumers to purchase such goods in the United States.
- After-sales services to consumers comparable to the policies offered in the United States. In this process and to support investment decisions and enhance competitiveness, it is important for entrepreneur to identify the supports available and the legal conditions emanating from all levels of government and the legislature. Finally, in order to enhance competitiveness versus cities of the southern US border, cities must significantly improve infrastructure and public services. While the current estimated demand for labor in the in-bond industry is around 65 thousand workers, Mexico’s northern border region is uniquely challenged by the influx of more than 300 thousand people annually. This growing population will require housing, roads, services, education, etc. Moreover, border cities of northern Mexico must build and maintain new infrastructure to facilitate movement of people and goods, while also creating ever more formal jobs. The challenge posed by migratory inflows is not a small matter, and the economies of the northern border cities are called upon to generate sufficient jobs and build proper, quality infrastructure and public services to promote both well-being and public safety.

C. Foreign Trade

Key issue for cities along the northern border of the country. Our foremost commercial partner is the United States, accounting for more than 80% of our exports; and the northern border cities serve as the conduit through which all these goods must pass. In terms of the economic and social well-being of the region, however, the border region also imports significant quantities of goods and services to meet the particular needs of the region. Although Mexico has worked under NAFTA (recently morphed in to the USMCA), according to many businessmen, non-tariff barriers are what really encumber business development in the region.

Non-tariff regulations and restrictions in Mexico

Non-tariff regulations and restrictions on the import, circulation or shipment of merchandise in Mexico can be invoked in the following cases: When temporarily required to correct the balance of payments pursuant to international treaties and to regulate the entry of used or waste products, which lack a significant market in their country of origin. Such restrictions also serve to counter restrictions on Mexican exports unilaterally imposed by other countries, thereby preventing entry into the domestic market of goods imported under unfair international trade practices, pursuant to provisions of the Foreign Trade Act. When there are concerns regarding national security, public health, plant/veterinary hazards or ecology, as established under applicable law and not otherwise addressed in Official Mexican Standards (NOMs), additional restrictions can be triggered.

Existing foreign trade support programs in the border region

Nonetheless, non-tariff restrictions that might be established in the northern border region of the country also include commercial support programs for the importation of goods that enhance competitiveness. These supports include:

- Decree establishing the General Import Tax for the Border Region and the Northern Border Strip. The purpose of this Decree is to establish the general import tariff for the border region and the northern border strip. It allows importation of goods under a preferential tariff rate, provided the goods and/or services are consumed within northern border region. It is overseen by the Ministry of Economy and mainly offers reduced and/or more competitive tariff rates.
- Support Program for the Border Zone. This program was launched in 2013 for the purpose of establishing an effective regional economic development policy for expanding infrastructure. The central thrust of the program is to facilitate foreign trade by modernizing customs houses and operations through investment in infrastructure, implementation of best customs practices and processes in order to reduce associated costs. This program is overseen by the Tax Administration Service and serves to expedite import and export procedures specifically through the customs houses of the border region of the country.

Foreign trade support programs in Mexico

In Mexico, free trade zones equipped with Strategic Customs Sites serve to improve productive infrastructure. In many countries where these are established, the objective of foreign trade or free trade zones is the promotion of both regional and national economic development. Among other benefits of this approach is the generation of jobs, and capture of foreign exchange and tax revenue, as well as attracting direct foreign investment and impelling exports. The chief benefits of free trade zones for exports are:

- Exports: Growing exports increase foreign exchange reserves and improve the balance of payments.
- Regional input chains: More businesses based on domestic producers selling supplies to firms located in free trade zones.
- Foreign investment: This favors the process of capital formation.
- Employment: Generation of jobs.
- Income: Wages, while below those existing in the country of origin, that are higher than those offered in the importing country, which, moreover, shall tend to increase over time.

Outlook

In the area of consumer trade, Mexico has always been at a competitive disadvantage versus the United States. Even when the Value Added Tax was at 11%, the majority of local consumers habitually shopped across the border. In line with the policy changes discussed, in order to boost the local economy by increasing wages and reducing taxes, the consumer needs greater purchasing power; and the products they desire must be made available on the Mexican side of the border. In this way capital flight can be ameliorated. Raising awareness of tariff restrictions and other policies that facilitate commerce in the border region are key if the business sector is take advantage of them by offering goods and services within the country. Increased consumer activity within the country will have a salutary effect on tax revenues and public finances.

According to statistics from the National Institute of Statistics and Geography (INEGI), states of the northern region of the country lead most other states in terms of attracting Direct Foreign Investment (DFI) Moreover, these states exhibit the lowest informal labor indexes in the country, confirming that the northern region holds great potential to grow and compete with the US in both the consumer and services markets. Currently, tariff relief programs for the import of consumer goods and services are in place, which could be complemented directly by the additional purchasing provided by planned tax reductions, perhaps even stimulating US consumers to come into Mexico to shop, something that has not been seen for many, many years. These programs could be modified to eliminate restrictive non-tariff regulations (RRNA) imposed by the government.

Even as global trade trends are moving toward a world without tariff barriers, restrictive non-tariff regulations still encumber international trade flow of products and services. It is very important that these import support programs remain in place, since they can be used in conjunction with the proposed reductions in taxes. Moreover, reducing or eliminating restrictive non-tariff regulations would likely boost competitiveness by attracting foreign technology and trends in consumption or services, while also stimulating local consumption with a view to attracting foreign consumers. Merchants and entrepreneurs in Mexico, especially in the country's northern region, need to stand ready to participate in this transition process aimed at creating a robust and solid national economy that is capable in the near future of competing with the great world economies in diverse commercial areas.

Final thoughts

On the basis of this overview, we list the relevant variables to consider for the financial and fiscal operation of your company.

Favorable Factor		Challenges or matters yet to be defined	
For exporters, reduction of VAT balances to be returned.	▲	Increase in minimum wage and increase in social security contributions (IMSS, PTU).	▼
Reduction of income tax rate, promotion of foreign investment with internationally competitive tax rates.	▲	Increase in wages puts competitive pressures on manufactured goods.	▼
Reduction of VAT driving increased consumption and savings in local economy.	▲	Inflation driven by inertia, general inflation, increased overhead, increased consumption.	▼
Reduction of VAT supports purchasing power of the population.	▲	Opportunity for the local entrepreneur to meets the needs with competitive prices.	▼
Matching energy prices to those in US.	▲	Energy prices still under pressure to increase.	▼

01. In recent years, the northern border region of Mexico has contributed significantly to national wealth. However, its tax contribution has not been matched by the federal support needed to compete effectively with the United States.
02. Due to heavy migratory influx and the increasing competition with southern US cities, a comprehensive strategy is urgently required for the region.
03. The new administration's proposal represents a first step to undergird competitiveness and generate conditions needed to absorb migratory influx to regional cities. This initial effort on the part of the executive branch should be buoyed by:
    A. Coordinated business strategies to meet the needs of the region and optimize benefits.
    B. Identification of supports for entrepreneurs that allows them to generate growth efficiently, such as the elimination of non-tariff barriers.
    C. An infrastructure plan to ensure urban mobility, sustainability and quality public services.
    D. An operational plan for monitoring and controlling regional prices, such that rising inflation does not undercut benefits for the population and certainty for the entrepreneur.
04. Implementation of the strategy could bring adverse effects, such as inflation and increases in operational overhead of companies. However, each company must evaluate its specific situation and assess how to finance short-term working capital, while establishing effective talent retention practices and labor benefits management as needed to ensure operational viability and growth.
05. Labor-intensive companies must determine the impact of the hike in the minimum wage and concomitant increase in social prevision burdens. Company tax and legal advisors will be required to develop strategies to support timely decisions and effectively respond to the coming changes.
06. The taxpayers in the border region should be aware legal reforms, decrees and rules in order to understand the qualifications needed to enjoy preferential rates, as well as any and all associated prerequisites to be met, including the geographic zones where such rule operate, etc.

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