



DOING BUSINESS IN MEXICO

2020

VTZ

VAZQUEZ TERCERO & ZEPEDA
ABOGADOS

WHY INVEST IN MEXICO?

Questions? Contact us:
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1.1 Why Mexico?

Before the coronavirus outbreak, economists predicted that Mexico was heading to be the **seventh economy** of the world in 2050.¹ Mexico would be growing at a 3.5% annual average rate over the next three decades, a growth rate superior to that of developed economies. Mexico's size of the economy, demographic, sound macroeconomics, stable public finances, as well as recent amendments to strategic economic sectors have contributed to a better economic performance according to the OECD.²

Today, Mexico is one of the most attractive foreign investment destinations. Besides being the 15th largest economy in the world, Mexico is a "free market" economy that is opened to international trade and foreign investment. As a result, Mexico has a highly diversified economy, modern industries, and a developed financial market. This is the result of a shift from protectionist towards liberal economic policies since the beginning of the 1990s, particularly, with the North American Free Trade Agreement.

Needless to say, there is still much work to be done to improve the general conditions of life for Mexicans, as well as for the business environment. For instance, the World Economic Forum identifies Mexico's five most problematic factors for business: corruption, crime and theft, inefficient government bureaucracy, tax rates, and tax regulations.

However, there is hope. In recent years, business facilitation measures have been in the political agenda as well as tackling corruption, which is now more relevant than ever as a result of Mexico's modern free trade agreements (FTAs). In fact, it is clear that Mexico's competitiveness relies on its extensive **FTAs network** as a pivotal force for its economic development.

Therefore, the **United States-Mexico-Canada Agreement (USMCA)**, which entered into force in July 2020, will continue to consolidate the country as an attractive business destination as long as Mexico successfully implements said agreement.

Mexico is living a historic moment. The political map changed significantly following the general elections held in July 2018. Mexico's president, **Andrés Manuel López Obrador (AMLO)**, and his party, the National Regeneration Movement (Morena), have continued the trend to promote, for instance, free trade agreements, but they have also adopted new and controversial policies. For instance, Mexico's investment and trade promotion agency, **PROMEXICO**, was extinguished as result of "austerity" measures.

Vázquez Tercero & Zepeda (VTZ) seeks to fill that void and promote Mexico as a business destination for international companies and foreign investors in an honest and concise manner. This is why **VTZ** has developed **Doing Business in Mexico 2020**, which is divided into seven chapters: 1. Why Invest in Mexico? ; 2. Foreign Investment ; 3. International Trade Policy ; 4. Trade Policy for the Manufacturing Industry; 5. Creating a Company in Mexico; 6. Taxation; 7. Labor & Migration.

In these executive guides, **VTZ** aims to help and to provide insights regarding relevant legal topics on business, trade, tax, and labor for potential investors, that seek to reap the best out of Mexico and the manufacturing industry. This chapter, *Why Invest in Mexico?*, will serve as an introduction providing a general overview of the current economic and business environment.

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¹ PWC, The World in 2050, 2017 p 6.

² OECD, Towards a Stronger and More Inclusive Mexico, p 1

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1.2 Mexico in Competitiveness Rankings

Although Mexico is not one of the most competitive countries in the world, Mexico is the second Latin American most competitive economy according to the **World Economic Forum** (WEF) and the **World Bank** (WB). WEF's *Global Competitiveness Index 2019*, a yardstick for policy makers, analyzes 12 "broad" pillars that shape an economy of a country. Meanwhile, the WB's *Doing Business* gathers information regarding the regulatory environment and how it impacts in local firms, reporting 10 key indicators.

World Economic Forum's 12 Pillars

-  Institutions
-  Infrastructure
-  ICT adoption
-  Macroeconomic stability
-  Health
-  Skills
-  Product market
-  Labor market
-  Financial system
-  Market size
-  Business dynamism
-  Innovation capability.

World Bank's 10 Indicators

-  Starting a Business
-  Dealing with Construction Permits
-  Getting Electricity
-  Registering Property
-  Getting Credit
-  Protecting Minority Investors
-  Paying Taxes
-  Trading Across Borders
-  Enforcement Contracts
-  Resolving Insolvency

1.2.1 Positive Economic and Business Indicators in 2019

WEF's Global Competitiveness Index 2019

Mexico stands out in **macroeconomic stability** (41st) and **market size** (11th) pillars. This is no surprise as Mexico's inflation has been controlled, around 3% to 4% per year; its GDP has had a stable growth, about 3%, in the last decades; and, its public debt has been properly managed.

Needless to say, inflation has had few spikes, notably in 2017, as a result of the liberalization of energy goods; and, despite having the second largest market of Latin America (124 million people), Mexico has a low GDP per capita or purchasing power.

Furthermore, Mexico also stands out in the following specific indicators: **budget transparency** (6th), **energy efficiency regulation** (30th), **renewable energy regulation** (30th), **road connectivity** (22nd), **airport connectivity** (15th), **liner shipping connectivity** (34th), **electricity access** (% of population) (2nd), **debt dynamics** (36), **trade openness** (27), **ease of hiring foreign labor** (48), **financial stability** (30), **cluster development** (36), among others.

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WB's Doing Business 2020

Mexico is ranked in **60th** place overall, out of 190 economies, and is one of the top business-friendly environments in Latin America, only behind Chile that ranks in the 59th position. Mexico's top three topics or indicators are **getting credit** (11th), **resolving insolvency** (33), and **contract enforcement** (43rd).

As a result of strong legal rights in relation to collateral laws (securities) as well as a robust credit reporting system, Mexico outperforms most economies in getting credit. Mexico also has a decent performance in the resolving insolvency and contract enforcement indicators, particularly, due to time to carry out a dispute in a court (under certain assumptions) and strength of insolvency framework index.

1.2.2 Negative Economic and Business Indicators in 2019

WEF's Global Competitiveness Index 2019

Unsurprisingly, Mexico underperforms in the **Institution** and **Labor Market** pillars of the WEF's *Global Competitiveness Index 2019*. Although serious legislative steps have been made on security, corruption, and "regulatory improvement", Mexico continues to rank particularly low in a handful of matters that fall under the Institution pillar such as **security** (138th), **burden of government regulation** (116th), **judicial efficiency** (116th), **judicial independence** (103rd), as well as **incidence to corruption** (116th).

Insecurity is a concern not only for foreign investors. We note that the new administration has pushed for constitutional and legal reforms that have overhauled security bodies, the attorney general's office, and powers to the Tax Authority (**SAT**, acronym in Spanish) against tax evasion schemes. The Financial Intelligence Unit (**UIF**, acronym in Spanish) has been tackling high profile individuals and companies that are allegedly involved in laundering money or in corrupt practices.

As for the Labor Market pillar, Mexico underperforms in redundancy costs (e.g. severance of labor contracts) (103rd), as well as labor tax rates (116). Needless to say, Mexican Labor Law has undergone a significant overhaul as a result of USMCA's Labor Chapter, which seeks to protect collective labor rights. However, neither redundancy costs nor labor tax rates (i.e. a state tax) were addressed in such reform.

WB's Doing Business 2020

Known to have a complicated tax environment, Mexico is ranked in the 120th position out of 190 economies in the **Paying Taxes** topic of WB's *Doing Business 2020*. Under normal circumstances, a company would have to pay six taxes throughout the year, namely corporate income tax, value added tax, security social contributions, payroll tax, property tax*, and vehicle tax*.

Despite a low number of tax payments as compared to other jurisdictions, Mexico's tax environment is poorly ranked especially due to (1) total tax and contribution rate and (2) the post-filing index. For instance, Mexico's statutory tax rates for the corporate income and VAT, which are the most time consuming and prone to tax audits, are set at 30% and 16% respectively. Furthermore, VAT refunds or income tax corrections take a considerable amount of time and effort.

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Mexico's also underperforms in *Starting a Business* (107th). Though starting a business is discussed in the **Chapter 5- Creating a Company in Mexico**, the process to incorporate a company appears, in its face, straightforward in Mexico. According to the guide, a non-foreign entrepreneur has to complete eight procedures to incorporate a company and to have all registrations in order; however, a significant practical hurdle is that concerning to the company's registration before SAT.

Likewise, the number of procedures and time are factors that negatively affect Mexico's score in *Getting Electricity* (106th), meanwhile the number of procedures, cost, among other matters, influence Mexico's negative performance in *Registering Property* (105th).

1.3 Trade and Investment in the Manufacturing Sector

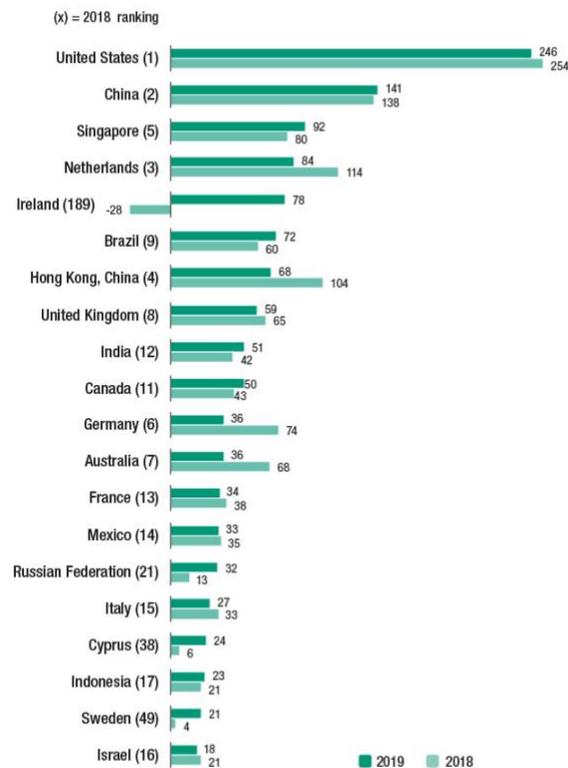
Mexico's foreign direct investment (FDI) and international trade is, to a great extent, attributable to the established manufacturing sector. According to UNCTAD's *World Investment Report 2020*, Mexico is the 14th country with most FDI inflows in the world in 2019. In sum, *Mexico is a top FDI destination*.

As noted by the WEF, Mexico has a strong cluster development. This feature explains why almost half of Mexico's FDI inflows are related to the manufacturing sector.

Investment Inflows in the Mexican Manufacturing Sector

The top five manufacturing sub-sectors that have attracted investment since 1999 to 2019 are (1) *transport equipment* (e.g. auto), (2) *beverages and tobacco*, (3) *chemical*, (4) *computer, communication and measurement equipment*, and (5) *the food industry*.

Figure 3. FDI inflows, top 20 host economies, 2018 and 2019 (Billions of dollars)



Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

For instance, FDI in the transport equipment (or auto sector) has amounted to **79,053 million USD** since 1999, which represents 21% of Mexico's total foreign direct investment inflows as noted in the table below:

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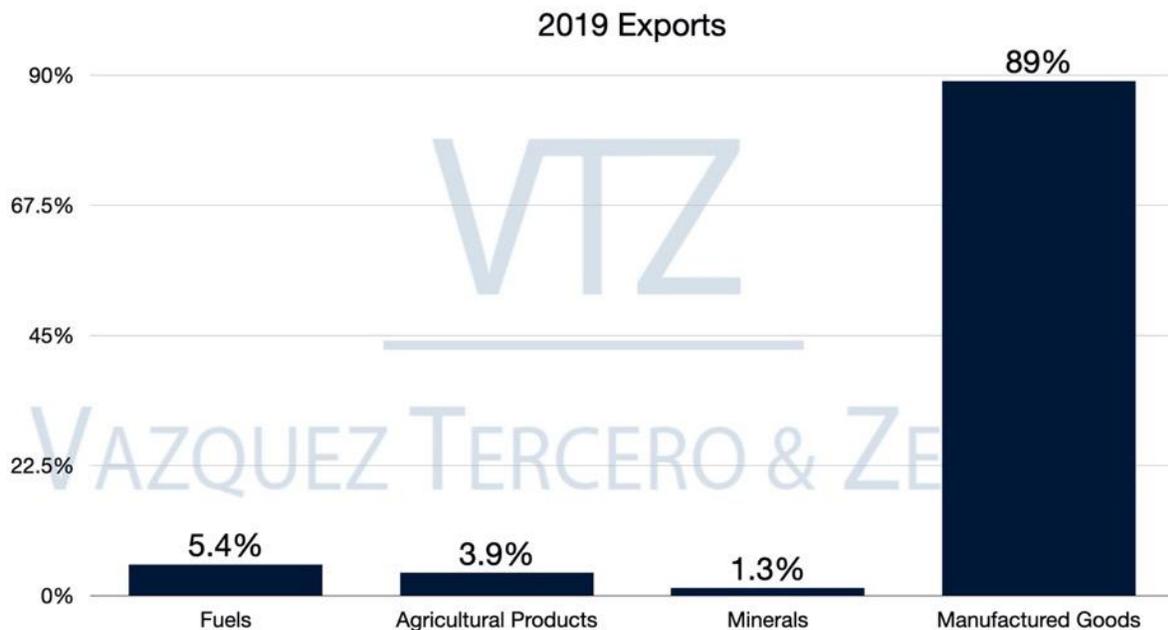
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International Trade and Manufactured Goods

Establishing itself as an important manufacturing hub, Mexico is an economy with a significant presence in international trade. Mexico ranks in 12th place among world economies in both exports and imports, its trade balance amounts to 916 billion USD in 2019. The World Trade Organization describes Mexico as:

"a 'buyer' in GVCs and therefore has a significant rate of GVC backward participation, standing at 36 per cent in 2015. The economy imports inputs mostly from the United States and China to produce its exports."³

Mexico's main **exports** include (1) manufactured goods, (2) fuels and mining products, (3) agricultural products that amount a total of 461 billion USD.



³ World Trade Organization, World Trade Statistical Review 2019, pg. 43

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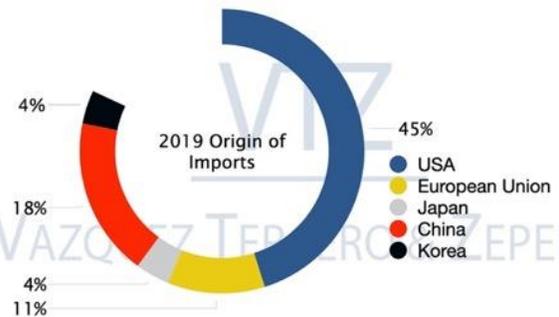
Mexico's Export Destination in 2019



Source: Mexican Ministry of Economy

In 2019, Mexico **exported** 461 billion USD. Unsurprisingly, Mexico's main export destination is USA exports amounting to \$371 billion USD, followed by the European Union \$24 billion USD, Canada \$14 billion USD, and China \$7 billion USD%.

Mexico's Origin of Imports in 2019



Source: Mexican Ministry of Economy

As for import data, US imports amount to 205.733 billion USD, China 83.052 billion USD, European Union imports amount to 51.237 billion USD, Japan 17.963 billion USD, and Korea 17.649 billion USD.

Comparing the US-China trade relations, US exports more goods in value to Mexico than to China. For instance, US exports to China amounted to \$106 billion in 2019.

1.4 Land in Mexico for Industrial and/or Manufacturing purposes.

Land in Mexico may be purchased or leased for industrial purposes. Needless to say, Mexican law has restrictions as to the ownership of land when, for instance, it is located in the northern border strip or near the coastline (see our **Foreign Investment Chapter**). The price of land or leases in Mexico, of course, varies not only as a result of the location, (i.e. the State and even at municipalities), but also due to zoning laws, if it is inside an industrial park, used or new facilities, a greenfield investment, etc.

Purchase and the lease of land are governed to a great extent by local law, i.e. the Civil Code of the State; Mexico has 32 states. Rules may vary from state to state and, thus, it is important to be familiar with the local law. For instance, the lease of land for industrial purposes may be subject to a maximum amount of years, e.g. 25 years in Jalisco, that may be renewed or extended per article 2045 of Jalisco's Civil Code. Also, some states may require to register a leasing contract in the State's Public Registry of Property depending on the duration of the contract.

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In Mexico, industrial leasing contracts, among other matters, normally entail:

- the use and/or purpose of the property,
- monthly installments,
- bonds as security,
- VAT of 16%,
- escalation clauses to address inflation,
- responsibilities of the lessor and lessees, e.g. maintenance and insurance of the property, permits, etc.

A potential investment in the manufacturing sector may benefit from service providers that can help potential investors to find industrial facilities to be leased with all necessary permits, but also benefit from specific customs and tax programs such as IMMEX. (See our **Trade Policy for the Manufacturing Industry Chapter**)

We have also prepared a real estate guide that is available in Alliot Group's website.

1.5 Security Considerations

Mexico lumps from security-related matters that affect its competitiveness indicators significantly. We cannot turn a blind eye on this fact, and foreign investors normally pose the question:

How risky is Mexico?

The **American Chamber of Commerce in Mexico** (*Amcham*), which we are members, published a *Business Security Survey* with its members and the results shed light on the security environment in Mexico. According to the 2018 report, we highlight the most relevant findings:

- most companies considered that the level of safety did not change in the last two years (2016-2018);
- the top 5 states with greatest security challenges are Tamaulipas, State of Mexico, Mexico City, Michoacán, and Guerrero;
- the top 5 states with least security concerns are Yucatán, Querétaro, Aguascalientes, Campeche, and Quintana Roo;
- most companies highlighted the following specific issues: safety for employees and family, information security, cargo transportation, the impact of crime, and the physical security of facilities; and,
- the top 5 most common crimes or incidents are raid on the supply chain transport, virtual extortion, theft, aggression, or threat to employees, facilities trespassing.

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Other significant findings are that most companies **did not suspend or relocate** their industrial facilities in Mexico due to security reasons. However, about 38% of the surveyed companies invest 5% or more of their annual operating budget in security.

In the following link, you can access **Amcham's** full report: [Business Security Survey 2018](#).

1.6 Mexico in Brief

1.6.1 Territory

- Mexico is the 14th largest country in the world covering an area of 1,964,375 km².
- Mexico's Exclusive Economic Zone (sea) extends to 3,149,920 km².
- Mexico borders to the north with the US (3,141km²) and to the south with Guatemala (962km²) and Belize (250km²).

1.6.2 Population

- Mexico's official language is Spanish and has between 52 and 62 indigenous dialects and languages exist.
- Mexico is the 11th most populated country in the world.
- Mexico's population was 119,938,473 million inhabitants in 2015.
- According to projections, Mexico's population will peak at approximately 135 million by 2030.
- 77% of its population lives in urban areas.

1.6.3 Economy

- Mexico's GDP amounts to 1.221 trillion USD in 2018
- Mexico's GDP per capita was 9,673.44 USD in 2018.
- The currency is the Mexican Peso.
- Mexico has two Stock Exchange Institutions, the oldest one is *Bolsa Mexicana de Valores* (BMV).
- The Leading Share Index is the *Índice de Precios y Cotizaciones* (IPC).

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- Besides Mexico City, Guadalajara and Monterrey are two major industrial hubs.
- Other important and developed cities are Tijuana, Ciudad Juárez, León, Querétaro, Puebla, Veracruz, Villahermosa, and Mérida.

1.6.4 Political and Legal Structure

- Mexico is a representative, democratic, and federal republic with executive, legislative, and judicial branches at a federal and state level.
- Mexico's legal system has its roots in the Napoleonic Code (i.e. civil law system) and it is divided into federal and state legal systems, each with its own Codes, laws, and procedures.
- The Federation has jurisdiction only over matters that are expressly provided in the Constitution, all other matters are within the jurisdiction of the States.
- For instance, corporate law, foreign investment, international trade, intellectual property, income and value-added tax, among others, are federal laws.
- The Mexican system shares more in common with other legal systems around the world (especially with Latin America and continental Europe) than it does with the U.S. legal system.
- After NAFTA, Mexico has modeled certain legislation after the U.S. practices, such as antitrust, environment, among others.
- Mexico's participation in the OECD and other international organization (e.g. the United Nations Commission on International Trade Law (UNCITRAL), WTO) has led to the implementation of business practices and legislation in accordance with international standards.

Executive branch

- The head of the federal executive branch is the President, currently Andrés Manuel López Obrador (2018-2024), who is responsible of appointing his ministers and enforcing the law.
- Presidential elections are held every six years and there is no possibility for re-election.

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Legislative Branch

- The federal legislative branch is organized as a bicameral congress formed by the Senate (upper house) and the Chamber of Deputies (lower house).
- The Senate has 128 members with a six-year term, while the lower house has 500 representatives with a three-year term.

Judicial Branch

- The Supreme Court of Justice is the highest court of the land, and the court's authority is to resolve constitutional matters, but it may also function as a sort of court of cassation.
- The Supreme court is made up by 11 justices, who are appointed by the President with Senate's approval.
- Federal Circuit Courts' hierarchy is below the Supreme Court of Justice and normally function as a court of cassation.
- A Federal District Judge's hierarchy is below the Federal Circuit Courts and function as a court of first instance or trial courts.
- Federal courts mostly deal with amparo actions (e.g. habeas corpus), federal crimes, commercial and bankruptcy cases, and federal civil cases.
- Mexico has specialized courts, such as a Federal Tax Court, Conciliation and Arbitration Labor Boards (soon to be replaced by Judges).
- Although commercial law is federal in nature, a constitutional provision authorizes both local and federal courts to deal with commercial cases.
- Mexican courts do not follow precedents (stare decisis) in the common-law sense, and there are no trials by jury

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