Chinese Investment in Mexico – An Overview

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In recent years, a number of Chinese companies have set their sights on Mexico as a new frontier for lucrative investment. The U.S. government has become increasingly hostile to direct Chinese investment into the United States, while the Mexican government actively seeks to deepen economic ties with China and has publicly announced its intention to increase Chinese investment in Mexico and Mexico's presence in China.[1] Mexico, acknowledging its heavy dependence on trade with the United States, aims to diversify the countries with which it does business, and some Chinese manufacturers have seized the opportunity to help Mexico achieve these goals. Recent economic initiatives announced by the Mexican government also suggest that there will soon be heightened opportunities for investment in the Mexican energy, telecommunications, transportation, and tourism sectors.

In light of the restrictive tariffs that the United States has placed on Chinese goods, Mexico can also be a strategic investment site for Chinese companies looking for alternative access to the U.S. market. In addition to sharing a border with the United States, Mexico, with its growing manufacturing capabilities, enjoys tariff-free access to the United States through its participation in the North American Free Trade Agreement ("NAFTA"), and will continue to do so under the soon-be-be-ratified United States-Mexico-Canada Agreement ("USMCA") that will replace NAFTA. Therefore, Chinese companies that manufacture goods in Mexico could bypass U.S. tariffs if the goods meet certain standards under NAFTA.

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1 *See* Dave Graham, *Mexico Seeks Closer China Business Ties During Testing Time on Trade*, Reuters (June 29, 2019), **https://www.reuters.com/article/us-mexico-china/mexico-seeks-closer-china-business-ties-during-testing-time-on-trade-idUSKCN1TU0N6**

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A. WHY MEXICO IS AN ATTRACTIVE INVESTMENT TARGET

1. Section 301 Tariffs have made it more difficult to import Chinese goods directly to the United States

Section 301 of the Trade Act of 1974 authorizes the United States Trade Representative to impose tariffs in retaliation against unfair trade practices.[2] The Trump Administration has used this authority broadly. In the last two years, the Trump Administration has alleged that China's practices harm American intellectual property rights and has imposed tariffs on over $300 billion of Chinese imports to the United States.[3] Because ongoing trade negotiations between the United States and China have repeatedly stalled, there is no indication if or when the United States will remove these tariffs. Even though China has concluded a phase-one trade agreement with the United States, the United States will not significantly reduce the imposed tariff unless and until a more comprehensive bilateral agreement is reached. Specifically, under the phase-one agreement the United States only promised to cut 15 percent tariffs on roughly $120 billion worth of Chinese goods to 7.5 percent. Notably, the heaviest 25 percent tariffs on $250 billion worth of Chinese goods will remain in place. The tariffs have made importing Chinese products into the United States more expensive. Furthermore, the practical impacts of the dispute resolution mechanism provided by the phase-one U.S.-China trade agreement remain to be tested. Other important trade conflicts, such as technology policies, industrial subsidies, and rules for state-owned enterprises still have not been resolved. Consequently, in spite of the phase-one trade agreement between the United States and China, Chinese companies have found that doing business with the United States can be uncertain and costly. The United States may remain hostile to imports from China indefinitely.

2. NAFTA gives Mexican-made goods tariff-free access to the North American market

By investing in Mexico, Chinese companies can take advantage of the liberal free trade rules governing trade between the United States and Mexico, while possibly avoiding U.S. Section 301 tariffs on Chinese goods. Goods produced in Mexico can be imported into the United States tariff-free pursuant to NAFTA. However, Chinese companies cannot merely use Mexico as a location from which to transport Chinese-made goods to the United States. Instead, to be considered a Mexican-made good, the product must undergo a "substantial transformation" in Mexico.

The "substantial transformation" rule means that a product must have undergone a fundamental change in form, appearance, nature, or character that adds a significant amount to its value to receive duty free status. For the purposes of NAFTA, a product that falls into one of the following four categories can be defined as originating in Mexico and thus subject to tariff-free treatment on importation into the United States (or Canada):[4]

a) The good is wholly obtained or produced entirely in the territory of one or more of the Parties, and doesn't include any non-originating materials;

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[2] Trade Act of 1974, 19 U.S.C. § 2101.

[3] China Section 301-Tariff Actions and Exclusion Process, **https://ustr.gov/issue-areas/enforcement/section-301-investigations/tariff-actions**

[4] North American Free Trade Agreement art. 401, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

b) The good is produced entirely in the territory of one or more of the Parties exclusively from originating materials, those originating materials can be made of or from non-originating materials;
c) Each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification set out in Annex 401 as a result of production occurring entirely in the territory of one or more of the Parties; and
d) The good does not undergo a change in tariff classification, but the regional value content of the good is not less than 60 percent where the transaction value method is used, or is not less than 50 percent where the net cost method is used.

3. The USMCA may further stabilize the market for investment in Mexico

Although NAFTA still governs trade among the United States, Mexico, and Canada, the three countries are close to ratifying the U.S.-Mexico-Canada Agreement ("USMCA"), which updates intellectual property, digital trade, financial services, data storage, and labor provisions. Although negotiators continue to work out details of the agreement, the U.S. House of Representatives approved the USMCA on December 19, 2019. The U.S. Senate subsequently approved the USMCA on January 16, 2020.[5] On January 29, 2020, the President of the United States signed USMCA, marking the successful closing of the ratification process in the United States. Because both United States and Mexico's Senate have ratified the USMCA, only ratification by Canada is required for the agreement to replace NAFTA.[6] Although Mexico, the United States, and Canada experienced economic uncertainty while officials negotiated the USMCA, Mexican officials are optimistic that approval of the trade agreement will spur a new chapter of investment and growth for Mexico, which could create a more favorable environment for Chinese investment in Mexico.[7]

4. Mexico is opening itself to private investment to stimulate economic growth

Opportunities in Mexico are not limited to manufacturing. Chinese investors may have heightened opportunities to invest in Mexican energy and infrastructure projects in the coming years. In the months following President López-Obrador's election in 2018, the Mexican government took a serious left-leaning approach that appeared hostile to foreign investment. As President López-Obrador cut back on spending and cancelled major public works projects, foreign investors began to reconsider their investments in Mexico and potential investors sought alternate markets. Consequently, Mexico's economy suffered and it entered a recession in 2019.

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[5] Erica Werner, *House Passes Reworked North American Trade Deal in Victory for Trump, Democrats*, Wash. Post (Dec. 19, 2019), **https://www.washingtonpost.com/us-policy/2019/12/19/house-passes-reworked-north-american-trade-deal-victory-trump-democrats/**.

[6] William Mauldin & Natalie Andrews, *House Passes North American Trade Pact with Bipartisan Support*, Wall St. J. (Dec. 19, 2019), **https://www.wsj.com/articles/usmca-clears-threshold-to-pass-in-the-house-with-bipartisan-support-11576790200**.

[7] *USMCA Approval Will Trigger Investment, Growth: Mexico Foreign Minister*, Reuters (Dec. 19, 2019), **https://www.reuters.com/article/us-usa-trade-usmca-mexico/usmca-approval-will-trigger-investment-growth-mexico-foreign-minister**.

However, to revive the lagging economy, the Mexican government has recently begun tempering its nationalist and populist policies and actively welcoming private investment. In November 2019, President López-Obrador announced a USD 44 billion infrastructure program from 2020–2024, seeking involvement from the private sector to finance major projects to spark the Mexican economy.[8] In 2020 alone, the program aims to begin 72 projects worth USD 22 billion, primarily involving tourism, transportation, and telecommunications.[9] The second round of projects is expected to focus mainly on the energy sector.[10] Although it remains to be seen how the program will be implemented and how the Mexican government will solicit bids for projects, the Mexican economy is likely to continue becoming more open to foreign, private investment in the coming years.

5. Many Chinese companies have had success in Mexico

Even under existing economic conditions in Mexico, Chinese companies have prospered in Mexico. Fuling Global Inc. is a Chinese manufacturer of plastic utensils that makes paper cups and straws for U.S. restaurants. The Trump Administration's actions under Section 301 included tariffs on paper products like the kind made by Fuling. In order to remain competitive in the United States, in the spring of 2019, Fuling announced that it planned to open a USD 4 million factory in Monterrey, Mexico. The factory was scheduled to start production and ship millions of paper straws across the border in July 2019. The company now takes full advantage of tariff-free exports to the United States, favorable business conditions in Mexico, and the lower transportation costs that a Mexican location provides.[11]

Hisense Co. Ltd., a Chinese company that is one of the world's largest television manufacturers, bought a manufacturing plant in Rosarito, Mexico from Sharp Corp. in 2015. The company invested in a Mexican manufacturing facility to target the U.S. consumer market even before the imposition of Section 301 tariffs by the Trump administration. In the spring of 2016, Hisense announced it would double its investment to update and expand its Mexican factory with an infusion of another USD 30 million to enhance automation and increase production capacity to four million units. Hisense stated that wages in Mexico are roughly equal to those in China, but maintaining a facility in Mexico saves about a month of travel time when compared with shipping the product from China.[12] Since the imposition of the Section 301 tariffs, Hisense's business decision to invest in Mexico allows Hisense products manufactured in Mexico to enter the United States without Section 301 duties.

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8 Sharay Angulo, *Mexico to Spend $44 Billion on Infrastructure in First Phase of Plan*, Reuters (Nov. 26, 2019), **https://www.reuters.com/article/us-mexico-infrastructure/mexico-to-spend-44-billion-on-infrastructure-in-first-phase-of-plan-idUSKBN1Y01UQ.**

9 Jude Webber, *Mexico Banks on $43 Billion Infrastructure Plan to Build Growth*, Financial Times (Nov. 26, 2019), **https://www.ft.com/content/d7f11c7a-1067-11ea-a7e6-62bf4f9e548a.**

10 *See* Angulo, *supra* note 8

11 Matthew Townsend & Eric Martin, *U.S. and China Got into a Trade War – and Mexico Walked Away Richer*, L.A. Times, (Mar, 27, 2019), **https://www.latimes.com/business/la-fi-china-trade-war-mexico-import-gain-20190327-story.html.**

12 Loretta Chao, *Hisense Targets American TV Market With Mexican Factory*, Wall St. J. (Mar. 2, 2016), **https://www.wsj.com/articles/hisense-targets-american-tv-market-with-mexican-factory-1456914603.**

B. HOW TO INVEST IN MEXICO

The Chinese government has certain rules governing enterprises' overseas investment into foreign countries. When a Chinese enterprise plans an overseas investment, it needs formal approval from three separate government authorities: the National Development and Reform Commission (NDRC); the Ministry of Commerce of the People's Republic of China (MOFCOM); and the State Administration of Foreign Exchange (SAFE). Each government authority has its own approval process.

1. NDRC

The NDRC classifies foreign investment as either a "sensitive project" or "non-sensitive project." This classification depends on the industry and the country in which the investment will take place. The sponsor of a sensitive project must submit a project application report containing detailed information about the investor, the investment, and any impact on Chinese national security. Non-sensitive projects do not go through substantial review and must only submit relevant documents for the record.

2. MOFCOM

MOFCOM also classifies investments as "sensitive" or "non-sensitive." A sensitive project must submit an application covering information about the investor and the investment, which goes through substantial review in determining approval. Non-sensitive projects must only fill out the Overseas Investment Recordation Form and submit it together with a copy of the enterprise's business license.

3. SAFE

Foreign exchange registration is required for overseas investment. Under the SAFE process, individual banks are responsible for examining and regulating the foreign exchange registration for a given investment; the SAFE will then oversee the bank's process. Thus, an enterprise may find it helpful to maintain a good relationship with one or more banks and have adequate capital in relevant bank accounts when making its SAFE foreign exchange application.

Our team's knowledge, experience, and in-depth understanding of the nuances of Chinese, Latin American, and U.S. businesses, cultures, and legal regimes allows us to offer innovative solutions that help clients achieve their business goals. Our team is comprised of multilingual attorneys who are fluent in Chinese, Spanish, and English. If you have any questions, please contact Roy Liu, Diego Durán de la Vega, or James Alford.

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