GBS International Business
Master Thesis No 2003:54

The Trade Policy Environment of Mexico in a Corporate Perspective

A Case Study of the Bus Industry in Mexico

Denina Karamehic and Evgenia Tsiogka

Graduate Business School
School of Economics and Commercial Law
Göteborg University
ISSN 1403-851X
Printed by Elanders Novum

Abstract

The multilateralism, regionalism and bilateralism trends are so dominant that nations, industries and individuals are fundamentally affected by them. The recent stagnation of the multilateral negotiations, the deepening and widening of regional integration especially in Europe as well as the spread of bilateralism reveals the dynamic nature of the trade liberalization developments. Moreover, the importance of following up and further studying these issues is emphasized.

Mexico's trade activism and parallel participation in multilateral, regional and bilateral negotiations makes it a perfect example of a multifaceted trade policy environment. The Mexican bus industry, due to its importance to the country and its engagement in international trade, serves as a suitable case when examining the effects of such a complex trade environment on the corporate level. The Swedish MNC Volvo Bus provides a good paradigm on which the above mentioned effects can be exemplified.

This study identifies the effects of the trade policy environment on the corporate level and suggests that deep knowledge and understanding of the way the trade policy is implemented, stands for a vital comparative advantage. The aim of the present study is to highlight the importance of the decisions made by the national and supranational administrations, regarding trade issues, on the corporate world.

Key Words: *economic integration, regional integration, multilateralism, bilateralism, trade policy environment, Volvo Bus de México, bus industry, trade policy implementation, NAFTA, EU-Mexico Free Trade Agreement.*

Acknowledgements

The completion of this thesis would have not been possible without the helpful assistance and inspiring comments from a group of people. We would like to express our appreciation to everyone that has actively guided us during the thesis writing process.

First of all, we would like to thank our supervisors Professor Claes-Göran Alvstam and Inge Ivarsson for the initiation of such an interesting topic and for the constructive criticism and inspiration during the writing process.

The guidance of Volvo Bus in Mexico has been of great support. We would like to express our special gratitude to Mr. Arturo Alanís, Mr. Salvador Cortéz and Mr. David Hernandez in Volvo Bus de Mexico for their assistance and advice on various issues.

We would also like to thank all the interviewees that we have been in contact with in Mexico and in Sweden not only for the insight that they gave on the discussed topics but also for their comments and opinions which have been a source of inspiration.

Last but not least, we would like to thank our families and friends for their support and tolerance during this period.

Gothenburg, December 2003

Evgenia Tsiogka Denina Karamehic

TABLE OF FIGURES

TABLE OF TABLES

Abbreviation List

Altex	*Programa de Empresas Altamente Exportadoras* (program for highly exporting companies)
ANPACT	*Asociation National de Productores de Autobuses, Camiones Y Tractocamiones,AC* (National Autotransportation Association)
APEC	Asia-Pacific Economic Cooperation
BANCOMEXT	Banco Nacional de Commercio Exterior (Nacional Bank of external comerse)
CFTA	U.S.-Canada Free Trade Agreement
DINA	The Diesel Autobuses SA de CV
DSU	Dispute Settlement Understanding
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTAA	Free Trade Agreement of the Americas
FTAs	Free Trade Agreements
FTZ	Free Trade Zone
GATS	General Agreement on Trade on Services
GATT	General Agreement on tariffs and trade
HS	Harmonized Commodity Description and Coding System
IMF	International Monetary Fund
LAIA	Latin America Integration Association
MASA	*Mexicana de autobuses SA; CV*
MB Bus	Mercedes Benz Omnibuses Mexico SA
MERCOSUR	*El Mercado Comun del Sur* (Southern Cone Common Market)
NAFTA	North American Free Trade Agreement
OEMs	Original Equipment Manufacturers
PAN	*Partido Accion Nacional* (National Action Party)
Pitex	*Programa del Importation Temporal Para Producir Articulos de Exportacion* (Temporary importation program for production of exportation articles)
PNR	*Partido Nacional Revolucionarion* (National Revolutionary Party)
PRI	*Partido Revolucionario Institucional* (Institutional Revolutionary Party)
PROSEC	Promotional Sectorial Program
RTA	Regional Trade Agreements
RVC	Regional Value Content
TRQs	Tariff-rate Quotas
VAT	Value Added Tax
VBM	Volvo Bus in Mexico

Background

Introduction
Methodology
Frame of Reference
The Bus Industry Business Environment

1 Introduction

The present study is going to explore the phenomenon of multilateral, bilateral and regional agreements and their effects on business organizations. The thesis is going to be concentrated on the effects of the trade policy environment of Mexico on the bus industry and will use Volvo Bus in Mexico as an illustration. The introduction addresses the issues of multilateral, bilateral and regional trade negotiations in connection to Latin America and Mexico. Moreover, an overall picture of the thesis, its problem statement and structure are presented.

1.1 The Multilateralism/Regionalism /Bilateralism Trend

The last decade of the twentieth century can be characterized as one of fundamental changes in the world economic scene. The main component of this shift is the emergence of globalization as the key principle characterizing economic transactions. The arguments advocating this trend emphasize that an undifferentiated and economically integrated world is going to become reality.[1] Indeed, in a world of increased complexity and instability, globalization as the "*…geographical expansion of economic activity across national borders but also the functional integration of such internationally dispersed activities*"[2] seems to be the pervasive movement.

Along with the globalization trend, regionalization is also changing the scenery of world trade. This process "*...whereby countries in a geographic region co-operate in order to reduce or eliminate barriers in the international flow of products, people and capital"*[3] has received increased attention and although different in form and degree of integration, it has been widely spread. Its purpose, as international trade theory suggests, is to improve the welfare of the member countries through trade creation among them that exceeds the trade diversion with non member states.[4]

[1] Akira K. (2000)
[2] Dicken P. (2001)
[3] Wild J.J. et al. (2000)
[4] Robinson S. et al. (1995)

Along with regionalism, bilateralism has emerged as a trend. It has been argued that the spread of bilateralism is so dynamic that the Uruguay round of the World Trade Organization **(WTO)** took place *"…in order to defend multilateralism from the spread of bilateral and regional responses to trade issues."*[5] Even though the countries participating in bilateral agreements argue that such a policy is compatible with existing multinational institutions, problems seem to arise from the fact that they are simultaneously participating in bilateral negotiations and in the Doha rounds and therefore have problems to maintain continuity between the bilateral and multilateral talks. [6]

The impact of these three trends is immense not only at the state or member-state level, but also at the company level through a considerable number of new regulations, measures and competition policies which facilitate flows of trade.[7]

1.2 The Free Trade Agreements

The execution of the Free Trade Agreements **(FTA)** can be seen as an expression of the globalization and regionalization trends described above.[8] Different agreements between neighboring nations have come to realize ambitious trade liberalization between them while, lately, multilateral trade negotiations move slowly towards greater achievements. More and more regional and bilateral trade agreements are signed and in year 2002 about 168 of them were in force. Those Free Trade Agreements do not include only neighboring countries but also liberalize trade beyond traditional regional borders. An example can be the agreements that the EU has signed with different Latin American countries. [9]

This Regional Trade Agreements **(RTA)** explosion has given rise to the debate about the effect of regionalism on multilateral trade negotiations and the role of the WTO in moderating these FTAs. There are arguments in favor of the RTAs which present them as building blocks to a free trade at a global level and describe them as rounds of free trade that expand until they finally join. On the other hand, opponents of RTAs argue that they promote preferentialism between certain blocks of countries, they endorse competition between trade interests and they hinder any multilateral agreement. Moreover, it is argued that

[5] Dijk van M. P. et al. (1996)
[6] GTN (2003)
[7] Akira K. (2000)
[8] Ojeda R.H. (2003)
[9] GTN (2003)

regional agreements complicate the WTO unifying efforts. Those arguments suggest that countries that benefit from regional agreements would be unwilling to fully liberalize their trade with third counties and face potentially greater risks. [10]

Critics against the Regional Trade Agreements usually use as examples of failure sectors that are traditionally hard to negotiate such as agriculture, textiles and automotive. Those sectors are indicative of the remaining obstacles that complicate the progress of both the regional and multilateral negotiations.[11]

Various Free Trade Agreements have an important impact on the corporate level and rules applied will in many ways decide how companies organize their production domestically as well as internationally. Vehicle manufactory is a good example of a transitionally organized sector of industry. The Swedish manufacturer Volvo Bus provides a suitable case, being present in Mexico through a recent acquisition of a domestic bus company.

1.3 Latin America in the International System

Latin America has been facing social, political and economical challenges. It is believed that in order to confront those challenges efforts should be made to improve regional cooperation and thereby diminish conflict between the countries and strengthen the region as a whole. Most countries in Latin America now identify the need of trade liberalization as an *"engine for growth"*. For a lot of countries in the area, regional and international trends are of outmost importance for their internal political and economic stability but most significantly for the *"hope of improved development in the future"*. Large poverty rates, huge gaps between poor and rich and unemployment can cause political disorder and tension, threatening thereby economic development. [12]

Regional cooperation in Latin America has intended to diminish and manage intraregional conflicts as well as to set the foundation for prosperity in the area. *El Mercado Común del Sur* **(MERCOSUR),** for example, is believed to have contributed to reduce tension and border disputes between its member countries. Added to the conflict reduction, Latin America has been very active in regionalization in order to avert globalization pressures. Hemispheric relations

[10] GTN (2003)
[11] Ibid.
[12] Ferguson R. J. (2003)

have moved towards a more institutionalized cooperation. This is apparent in the economic cooperation efforts such as the North American Free Trade Agreement **(NAFTA)**, MERCOSUR and the forthcoming Free Trade Agreement of the Americas **(FTAA).** It is also evident in political cooperation initiatives through multilateral diplomacy and peace-keeping cooperation. Moreover, even security collaboration seems to take place through measures taken among traditional rivals. The hemispheric relations are often illustrated with terms such as regionalism, consensus, multilateralism and convergence. [13]

Globalization had a direct impact in Latin America. Concerning trade, policies such as trade liberalization, open competition and access to all markets prevail over tariff protectionism and import substitution. Previous expectations to achieve protection for emerging economies until they develop were not met. The average regional tariffs dropped sharply, mainly due to various multilateral and bilateral cuts, regional trade agreements as well as the participation in the General Agreement on Tariffs and Trade **(GATT)** and the WTO. Nevertheless, there are still limits with regards to the trade flows created by regionalism in Latin America. The volume of trade is strongly related to bilateral exchanges, such as between the U.S. and Mexico or Brazil and Argentina. There is also a lot of criticism against regional integration in the Americas according to the fact that the Free Trade Agreements did not diminish the gaps between the "rich" and the "poor". [14]

1.4 Mexico's Trade Policy

Regarding the multilateralism, regionalism and bilateralism trend, Mexico has proved that it can manage all three of the trade commitments. Mexico has supported the Fourth WTO Ministerial conference held in Doha while simultaneously it has boosted regional and bilateral agreements. By following this strategy of trade liberalization within the framework of the WTO rules, Mexico has gained access to some of the most important markets of the world. The country has declared its ambition to continue playing an important role in the multilateral and bilateral trade liberalization process despite the recent slowdown in the world economy. [15]

[13] Ferguson R. J. (2003)
[14] Ibid.
[15] Maquila Portal 1

Nevertheless, when it comes to the coverage and enlargement of Regional Trade Agreements, it is argued that Mexico is one of the countries that have more to gain from bilateral Trade Agreements with potential new entrants rather than pursuing the widest possible coverage. Central to these arguments is the case of Mexico – U.S. trade and the possibility of the NAFTA enlargement.[16]

1.5 Volvo Bus in Mexico

Volvo Bus in Mexico **(VBM)** started its operations in 1998 when it acquired the Mexican manufacturer Mexicana de Autobuses SA de CV **(MASA).** VBM operates an assembly plant with a maximum capacity of 12 busses a day.[17] At the time of writing, VBM is not exporting to any other countries but all of its production is being sold in Mexico. The company has a dynamic presence in the market at the moment despite the fact that it not using its full production capacity.[18] Notwithstanding the lack of exports, the fact that VBM is importing various parts in Mexico for its assembly operations makes knowledge on the trade environment of Mexico and its volatile character vital for its success in the market.

1.6 Problem Formulation

The processes of multilateralism, regionalism and bilateralism are creating changing trade conditions and are generating opportunities and threats. Trade liberalization has a great impact on states, companies and individuals. A number of new agreements and policies are implemented in order to achieve the ultimate goal, which is to create trade and increase the welfare of the states involved. Those agreements include removal of tariff and non tariff barriers, national treatments, investments provisions, admission rights and other standards and requirements. Since the main objective is to serve the interests of all parties involved, those agreements can be complicated and even contradicting. As a result, their implementation and practical realization is not simple and various obstacles can threaten the well-function of what has been agreed upon. These obstacles depend on the industry, the country and even the willingness of the people involved. Therefore, it is of great interest and importance for the companies operating in any way in a country which is member of a regional inte-

[16]Robinson S. et al. (1995)
[17] Fredlund S-A. (2003)
[18] Cortéz S. 2003/11/10

gration agreement, to identify, monitor and compare those obstacles and opportunities in order to assure their own progress and objectives.

The present project aims at identifying these dynamics regarding the Mexican external and internal trade relationships and its effect on the bus industry. As a result, the main problem of this thesis is as follows:

Main Problem

How is the trade policy environment of Mexico affecting the bus manufacturing industry?

The dynamic nature of the trade policy environment in Latin America as well as the vast changes and commitments towards trade liberalization on behalf of Mexico are necessary to be tracked by private organizations. Moreover, the future trends are vital to be identified in order to set new goals and adjust to the new conditions. Therefore, a part of the solution to the main problem mentioned above is to gain broad as well as in-depth knowledge of the trade policy environment of the country in focus. That includes understanding of the general trends regarding the country's trade orientation as well as awareness of the signed agreements and their future developments. This aggregates the first research question of this study:

Research Question 1

How can the trade policy environment in Mexico be described?

The trade policy of Mexico influences all the companies operating in its environment. Nevertheless, not all of the agreements and practices used within this trade strategy are implemented in all sectors in the same way. Specific rules and incentives are designed in order to promote certain industries and secure their interests. The automotive industry, in most of the countries, has a great impact because of its size and the employment opportunities it creates. Therefore, while negotiating an FTA, it is very common that the automotive sector is being handled as a unique case. These specific regulations are often complex and procedural; however necessary to be explored and implemented if a company is to exploit its industry related opportunities. In a highly competitive global market where national borders seem to fade away, knowledge about the developments towards globalization and regionalization is a basic tool to remain competitive and effective. Therefore, the next step towards the solution of the main problem is to identify those distinctive issues, which leads to the second research question:

Research Question 2

How is the trade policy environment of Mexico implemented in the bus industry?

In order to illustrate the corporate level of the bus manufacturing sector, Volvo Bus in Mexico is chosen as an example.

1.7 Purpose

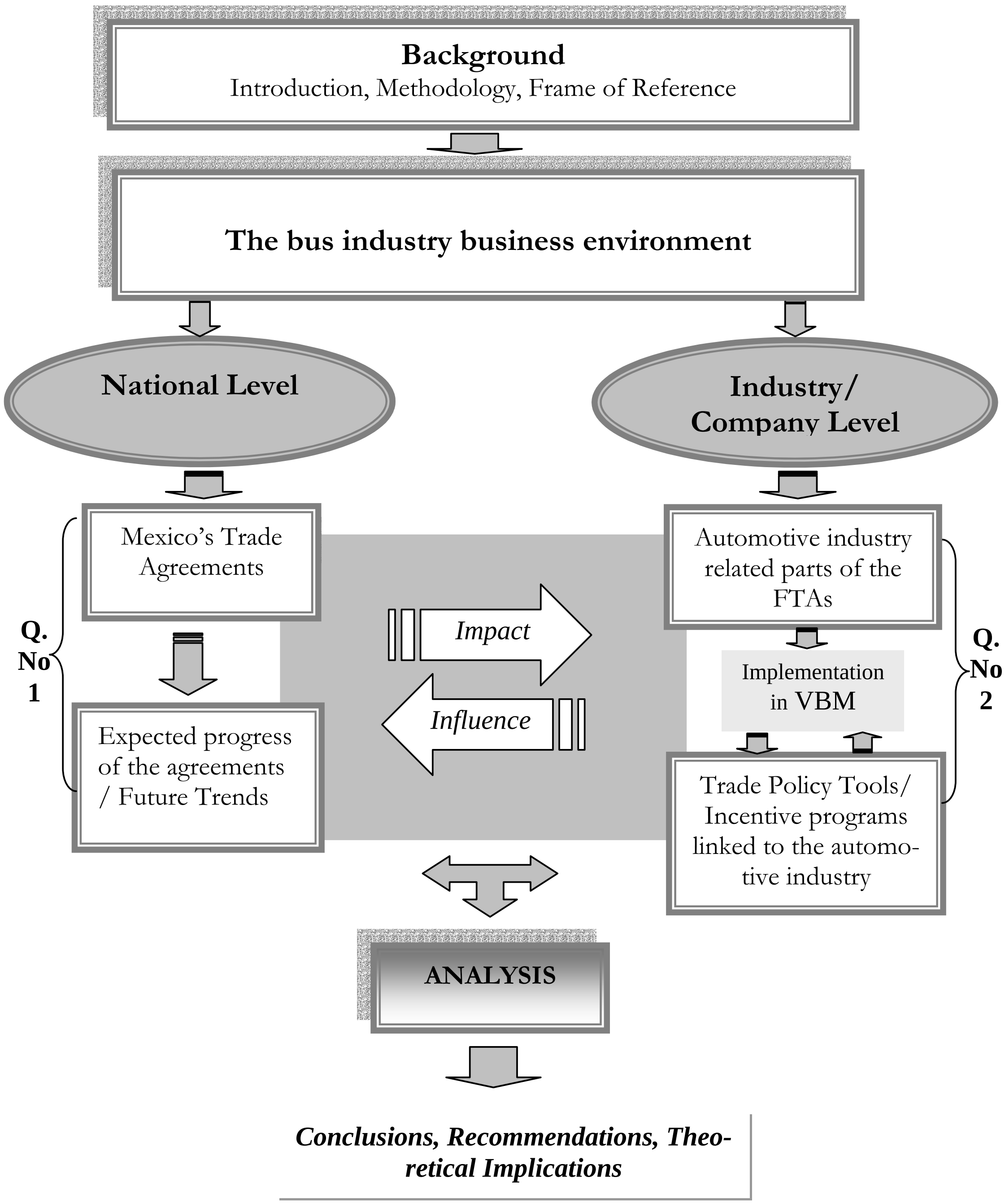
The purpose of the present thesis is to study the Mexican trade policy environment in relation to the bus industry and to identify and describe possible problems, obstacles and possibilities when it comes to its practical implementation. The thesis is going to use Volvo Bus de México as an illustration, and will identify opportunities and threats for the company in the Mexican trade environment.

1.8 Delimitations

Due to the wide range of trade agreements that Mexico is participating in, the scope of this thesis is limited to the ones with the greater relevance to the bus industry. The selection has been made throughout the data collection process and was based on the application and importance of the agreements on the specific sector. Moreover, not the whole content of those selected agreements are brought up in detail. Only the sections relevant to the automotive sector are thoroughly described.

Since the automotive industry is treated in the Free Trade Agreements in special clauses which are quite extensive, special focus will be put on the clauses concerning the importation of auto-parts. This does not imply that the significance of the exports is inferior, but the case of imports has been chosen after taking into consideration the special conditions under which the company that will be used as an example is operating.

1.9 Thesis Layout



In the graph above, the layout of the thesis is illustrated by describing the structure of the project. The study consists of three main parts; the background, the empirical study and the analysis/ conclusions.

In the first part, the problem and purpose of the study, the method followed in order to accomplish them as well as the theoretical references are introduced. Moreover, an overview of the country in focus is presented along with the case industry. This aims at introducing the reader to the empirical part and to facilitate the understanding of the more specified issues that follow.

The second part of the study presents the empirical findings. They are illustrated in two different levels according to the project's research questions, as shown in the graph above. The national level describes the general trends with respect to the trade policy of Mexico, the current negotiations and the future prospects. The Second level, the industry, refers only to those parts of the trade policy that are relevant to the automotive sector and includes technical details. As an example of the practical implementation of these issues, Volvo Bus in Mexico is used. By following these two sequel steps, the focus of the thesis is transferred from the nation to the industry in order to study the interdependence of these two levels. This leads to the analysis, which combines and connects the two descriptions with the theory and channels the study to the final conclusions and recommendations.

The next paragraph shows the precise disposition of the thesis chapters.

1.10 Chapter Disposition

Background

Chapter 1 Introduction	*Sets up the projects background by introducing the main concepts related to the topic along with the problem formulation and thesis disposition.*
Chapter 2 Methodology	*Presents the design of the research and execution of the study*
Chapter 3 Frame of Reference	*The Theoretical background used as a base of comparison with the empirical Findings*
Chapter 4 The Bus Industry Business Environment, Presentation of VBM	*The general framework of business setting necessary for the presentation and the analysis of the empirical findings and a presentation of the example company*

National Level

Chapter 5 Mexico's Free Trade Agreements	*The first part of the Empirical Findings presents the general framework of Mexico's range of Free Trade Agreements and the trends for the future*

Industry level

Chapter 6 The Automotive related parts of the FTAs	*This section of the Empirical study describes in detail those parts of Mexico's FTAs that are specifically applied to the automotive industry. VBM is used as an example.*
Chapter 7 Trade promotion programs	*Other parts of Mexico's trade policy connected with the automotive industry*

Outcome of the Study

Chapter 8 Analysis	*The analysis of the facts presented in the two levels of the empirical part in combination with the background and the theory*
Chapter 9 Conclusions and Recommendations	*The results of the study are presented by answering the research questions along with recommendations and suggestions for the example- company.*

2 Methodology

The methodology can be seen as a blueprint for the study. The method concludes a plan on how to collect, organize and structure the data.[19] *The choice of the method should be in accordance with the problematization of the study and aim at finding the most appropriate technique in order to come up with a valuable conclusion.*[20]

2.1 The Research Design

The research strategy applied in the present project is a **qualitative** one. The reasoning behind such a choice is the fact that the qualitative research investigates situations in their complexity, such as Mexico's trade policy environment and its implications studied in this thesis, trying to interpret them or make them more logical. The purpose of this project is to make a description and gain a holistic understanding of this political and social phenomenon, rather than to create a statistical or numerical measurement. [21] The nature of the main question of this project has impelled the use of the most common qualitative method, the case study. Its ability to answer to "how" and "why" questions and deal with a big range of different data sources further contributed to this choice. [22]

In order to study such a broad and multifarious phenomenon, a research design that would facilitate the collection and organization of the available information towards the solution of the main problem had to be decided upon. Initially, the research has been conducted in accordance with a broad problematization oriented towards the general framework of the Mexican trade policy. Therefore, the research design at this point was rather wide-ranging. At a second stage and after the field study in Mexico, the research design changed into a more pragmatic one. After the general framework of the trade had been explored, the field study gave the opportunity to investigate the bus industry in a more detailed way and to find out which particular parts of the national trade policy environment mostly influence it and in what way. Guidelines provided by the company used as an example, changed the focus to a more practical level. The final research design aims at incorporating both perspectives.

[19] Merriam S. B. (1994)
[20] Patel R. et al. (1994)
[21] Merriam S. B. (1994)
[22] Yin R.K. (1994)

2.2 Data Collection

Both primary and secondary data has been collected during the empirical research. The starting point was to develop a theoretical framework in order to facilitate this process. This frame of reference is later on used as a pattern with which the empirical results of the case study are compared.

The data collection process has been divided into two different stages depending on the time-period and the location the research took place in. In order to gain a better insight and knowledge about the topic, the study includes a field study in Mexico.

The first stage was the one of preparation. During this period, an effort to gather as much secondary data as possible in order to prepare the field trip was made. The main objective was to gain knowledge about the issues covered by the project and formulate a general background in order to make the best use of the short investigation time in Mexico. Furthermore, an attempt to find answers to the research questions by using secondary data alone took place. This data was later on revised and confirmed during the field trip. The secondary data used included web pages, books, and articles, official documents of the agreements, surveys and different reports. A valuable source of information was the Volvo library in Gothenburg. The intention was to cover multiple aspects of the thesis topic in order to be able to narrow the focus with more specific inquiries in Mexico. The secondary data was chosen so as to be updated and consistent. Sources older than year 2000 were used with caution. All of the reports used were published by internationally recognized organizations. Different interpretations of various agreements studied were not given priority over the original texts.

The second stage of information gathering took place in Mexico City and included mainly primary data. The objective was to find answers for specific issues and for the specified research questions. The collection of the primary data has involved a number of personal interviews with selected respondents, chosen because of their knowledge in the area. Depending on the different parts of the project that the information was needed for, there were three main categories of interviewees.

The first category of interviews involved personnel from the purchasing, marketing and traffic departments of Volvo Bus de México. The aim of those interviews was to narrow the scope of the thesis into specific issues that the company has pointed out for further investigation. Information about the company, its functions and the present procedures dealing with the topics in focus was obtained. Clarifications on practical issues and problems were used as a useful guide for the forthcoming interviews outside the company.

The second category of interviews was done at different governmental agencies dealing with trade issues. These agencies were selected during the preparation stage. These interviews covered issues such as the national trade policies and their implementation. Moreover, topics such as the attitude of the Mexican government towards bilateral and multilateral trade agreements and trade promotion programs were explored. The interviews aimed as well at identifying the intentions and future goals of the official Mexican state representatives. Issues such as bureaucracy and low responsiveness had to be overcomed during this process.

The third type of interviews involved private or public organizations directly involved with the automotive industry. Industry developments, specific parts of the trade policy that influence the sector and related problems were discussed. Furthermore the expectations of the sector from the government policy and needed improvements were under investigation. The respondents' knowledge and experience on both the local industry and the trade policy environment during these interviews was of great benefit and it led to constructive discussions.

In shape and in contents interviews have been very different. The majority of them were unstructured and open ended. The questions were loose and asked in a non specific order. The preparation stage helped formulate a general view on the industry and on the company. This groundwork was essential in order to evaluate answers and to be able to continue with a deeper discussion. The face to face contact with people directly involved in the issue of interest was the major advantage of the interviews compared with other sources of information. Their personal knowledge and experience, as well as the way they expressed it, gave a deep insight into the situation. Moreover, less familiar concepts and the latest developments were described and explained by them in detail. The informal style of the interviews created a relaxed atmosphere that allowed discussions, questions and answers that would probably not take place in a different occasion. Another way to encourage the interviewees was through ensuring their anonymity in case that was requested. In a lot of cases the interviewees themselves provided further contacts that according to them would be more relevant with the topics discussed. That facilitated the access to valuable information sources.

The main drawback of the interviews is that the objectiveness of the interviewees had to be questioned in some cases. Diverse opinions on the same topic were in a way constructive; nevertheless they revealed the subjectivity of some of the respondents. The fact that certain public administrators wanted to promote specific ideas within their areas of interest was taken under consideration. Moreover, the open ended questions and informal style of the interviews allowed some of the speakers to avoid the answers to specified questions and lead the discussion away from the main topic. Those kinds of responses were however treated with caution. Last but not least, in some cases unwillingness and reluctance to book the interview appointment had to be dealt with.

2.3 Quality of Research

In order to establish the quality of the study different methods can be applied. **Validity** deals with how well the research instrument has measured what it has indented to measure.[23] To reassure this, the interviewees were carefully selected so as the right person answered the respective questions. This was achieved by studying different organizations and their areas of responsibilities and by choosing the most relevant ones. The respondents were people working with the specific issues of interest in these organizations. Assistance with this selection was provided by Volvo Bus in Mexico. The interviewees were firstly introduced to the subject in order to reassure their relevance and knowledge. When that was not the case they were specifically asked to indicate the expert on the matter.

Different kinds of validity have to be considered in terms of the theoretical study's ability to correspond to the reality of the case, as well as in terms of the study's ability to generalize the findings to another case.[24] In order to increase validity in the present case study, multiple sources have been used so as to con-

[23] Keats D. M. (2001)
[24] Yin R. K. (1994)

firm each other. The two stages of data collection mentioned above aimed at applying this method of "*multiple sources of evidence.*"[25] Secondary data collected during the preparation period was confirmed in Mexico City by different sources. A problem that has occurred during this study is connected with the validity of the secondary information. Since the bus industry that is in focus is not as developed as the car and truck industry, most of the sources describe the later ones. Therefore, it has been of great importance to clarify which part of the information is specifically referring to the bus industry. In some cases this has not been possible, which could have been at the expense of the validity of the project.

In a qualitative method interpretation of data can be subjective and biased due to its very nature. This means that it is possible to read personal perceptions and opinions into this data. In case of an interview this personal bias can be observed on both the interviewer and the respondent.[26] Personal opinions and interpretations may also take place when documenting the results of the interview in a report. In order to avoid this and in order to increase the reports reliability, the preparation before the interviews was based on third "objective" sources that would decrease the personal involvement while conducting the interviews. Moreover, the same questions were posed more than once in a rephrased manner so as to verify whether the answer would be the same. Misinterpretation was also avoided by using a tape recorder and by documenting the interviews directly after they took place. Possible misunderstandings were able to be solved in that way at once by contacting the person involved.

Important to keep in mind in this case study is also the changing pace of the dynamics influencing the progress of the topic in focus. This implies that in case the same study would take place a year from today the results would probably be quite different. Therefore, it is difficult to safeguard reliability of this project with respect to this aspect.

[25] Ibid.
[26] Ibid.

3 Frame of Reference

The main part of the theoretical section will be based on the theories of economic integration and trade liberalization. The essence of the three integration trends in the world today will be discussed and the main trade policies used nowadays will be shown. The issue of protectionism and the reasons behind the governments' wish to restrict the trade will as well be addressed.

3.1 Theories of Economic Integration

The overall reductions in tariffs that have taken place through GATT and its successor the WTO, which will be described further down, have changed the scenery of the global market place into the one of higher level of economic interdependence between the nations and regionalism.[27] Some groups of countries have negotiated preferential trade agreements under which advantageous tariffs are applied with respect to each other but not to the rest of the world.[28] This process of cooperation between the countries in one geographical region in order to reduce or eliminate barriers to the international flow of products, people or capital is called a regional economic integration.[29]

There are different levels of arrangements of this kind, involving an ascending order of degrees of integration. It ranges from preferential trade agreements to free trade areas, customs unions, common markets, and economic and political unions.[30]

- *Preferential Trade Arrangements* provide lower barriers on trade mutually or by any of the parties. This is the lowest form of economic integration.
- In *a Free Trade Area* member countries seek to remove all barriers to trade among them while each one retains its own barriers to trade against non-member countries. The best known example is NAFTA.
- *A Customs Union* includes a completely free trade without the tariffs or other barriers on trade between the members of the union and harmonises trade policies with third countries.

[27] Dijk van M. P. et al. (1996)
[28] Krugman P. R. et al. (2000)
[29] Wild J. J. et al. (2000)
[30] Ibid.

- *A Common Market* goes one step beyond the Customs Union by also allowing the freedom of mobility for labour and capital among the members.
- *An Economic Union* implies a high degree of co-operation between the members and includes unification of the monetary and fiscal policies.[31]
- *Political Union* is the ultimate level of economic integration whereby countries coordinate aspects of both the economic and political systems.[32]

3.1.1 Motivations for Regional Integration

Nowadays, the world trend in both developed and developing countries is to pursue different ways of regional integration, the ideal sequence of which is the above mentioned order of integration forms. The motivations behind such efforts are rather wide and can be country or region specific. Nevertheless, there are some general ones that can be identified.

Firstly, there is an assumption that regional cooperation can promote national welfare more thoroughly than multilateral liberalization. The benefits of such agreements are supposed to derive from relocation of factors of production and from the obvious gains from economies of scale and specialization. Besides those static effects it is expected that productivity in total will rise due to increased competition and growing investment.

Secondly, being a member of a regional bloc is considered to be advantageous when it comes to the trade creation or trade diversion issue. These two topics are widely discussed within the frame of regional integration are. Trade diversion takes place when lower-cost imports from outside the regional bloc are replaced by higher cost imports from another union member. As a consequence, the welfare is reduced because the production is shifted away from comparative advantage.[33] But, if taking part in a regional bloc leads to the replacement of the high-cost domestic production with low-cost imports from other members of the regional bloc, a country gains due to the trade creation.[34]

[31] Salvatore D. (1999)
[32] Wild J. J. et al. (2000)
[33] Salvatore D. (1999)
[34] Krugman P. R. et al. (2000)

Finally, transportation costs in themselves can be an important motive for regional integrated economic activity regarding the gathering of information, communication and transportation. Factors such as macroeconomic stability and attraction of foreign direct investment are also strong reasons for pursuing integration.

Important to note here is that the drivers towards regionalism are not only economic ones but also political. It was more than often that political initiatives took over and outweighed other issues when decisions were to be made. The main arguments here are concentrated on the beneficial affects of integration on political stability and security. Nevertheless, the affiliation with a dominant power, the loss of national sovereignty and the weighting power in trade talk negotiations are also topics under consideration.[35]

3.1.2 Benefits of Regional Integration

The lower barriers to trade and investment and the opening of new markets for goods and services have resulted in the increase of the level of trade. Main impacts of the trade creation are wider selection and lower prices of goods and services which has led to higher demand for goods. [36]

Currently WTO consists of 146 countries. It can be very difficult for them to take explicit positions on some issues, for example related to trade, and gain consensus of all of the member countries. Thus the aim to further eliminate trade barriers in smaller groups of countries within one region can be more easily accomplished. This is one of the greater benefits of regional integration. Furthermore, in large forums of countries such as the WTO or United Nations, a group of countries can have significantly greater political weight than each country would have individually. Integration that involves political cooperation between the member countries can be seen as one way of preventing military conflicts. Finally, free movement of people aggregates the expanded employment opportunities. Hence, it can be said that this way regional integration is contributing to the improved quality of life and living standards of people.[37]

[35] Dijk van M. P. et al. (1996)
[36] Wild J. J. et al. (2000)
[37] Wild J. J. et al. (2000)

3.1.3 Drawbacks of Regional Integration

The diversion of trade with countries not belonging to trading blocs is one negative aspect of regional integration. As mentioned earlier, the latter can lead to the replacement of low-cost imports from outside the zone with higher-cost goods from member countries. It also leads to increased trade with less-efficient producers within the trading bloc and reduced trade with more efficient non-member ones. [38]

Because of the fact that the different trade agreements cause dislocations in labour markets, some jobs are lost while others are created. Shift of production to low-wage nations within the trading bloc will most likely occur in industries requiring mostly unskilled labour. Countries that are protecting low-wage domestic industries from competition will probably see these jobs move to countries where wages are low when trade and investment barriers are removed. This can also be an opportunity for workers to upgrade their skills and gain more complex job training which could increase the country's competitiveness. A more educated and skilled workforce attracts higher-paying jobs. [39]

The inevitable loss of autonomy is the greatest obstacle to integration. It has not been entirely overcomed even in the most successful of the common markets. However, in a Free Trade Area this is not one of the major issues, due to the fact that the least amount of sovereignty is being surrendered. [40]

3.2 Multilateral Trade Agreements

TheTtrade Agreements Act of 1934

The movement towards coordinated tariff reduction and international agreements regarding trade liberalization dates back to the 1930's when the United States of America passed the "Smoot-Hawley Tariff Act". Under this rule the tariff rates rose sharply as a means to protect its agriculture production. This act, combined with the Great Depression that took place in the 1930's resulted in world trade fall and general reduced economic activity in the world. The effect was rather disastrous since a lot of countries started raising their tariffs as

[38] Ibid.
[39] Ibid.
[40] Ibid.

an answer to the U.S. policy which led to an almost complete collapse of the world trade.[41]

Consequently, the U.S. administration concluded that tariffs needed to be reduced if trade volume was to increase. The best solution at the time seemed to be bilateral tariff negotiations which would create a win-win situation for both parties. This bilateral trade approach was passed in 1934 as a Trade Agreement Act which resulted in a 50% cut on the existing tariff rates. Bilateral negotiations however faced the serious inadequacy of including only commodities that dominated bilateral trade and although it could have a spill over on third countries it would not fully exploit world coordination and would limit the trade creation results. [42]

The General Agreement on Tariffs and Trade (GATT)

The next step in international trade liberalization after the bilateral agreements would be their generalization under multilateral negotiations which would involve a larger number of countries. The multilateral tariff reductions that took place after the World War II were realized within the framework of the **GATT** launched in 1947. GATT was an organization, which was dedicated to the promotion of free trade through multilateral agreement negotiations. GATT is based upon three basic principles:

- *Nondiscrimination*: Refers to the unconditional acceptance of the so-called most favored nation principal, according to which any reciprocal tariff reduction negotiated between two nations would be extended with any of each trade partners.
- *Elimination of non tariff trade barriers.* Exception to this is the agricultural products and nations with balance of payments obscurities.
- *Consultation among nations in solving trade disputes* under the umbrella of GATT

GATT covered 90% of the world trade by 1993. By that year, 123 nations signed the agreement and another 14 had applied for entrance. Among these nations were ones with major production outcome. A lot of developing countries were outside GATT. Nevertheless, GATT was extended to allow preferential trade treatment to developing countries so they can profit from tariff reduction between industrialized nations.

[41] Krugman P. R. et al. (2000)
[42] Wild J. J. et al. (2000)

The Uruguay Round

In 1993, the 8th and most ambitious round of trade negotiations was completed after seven years of torturous negotiations. The Uruguay round started in 1986 in Punta del Este in Uruguay and was scheduled to be completed by 1990. Due to political disagreements, especially between the United States and the European Union, the final document was not ready before 1993. The agreement in which 123 countries participated was signed in Morocco in 1994. The most important results of the agreement can be grouped under two categories: Trade liberalization provisions and administrative reforms.

Trade Liberalization: As previous GATT rounds the Uruguay agreement reduced tariff rates. The already low tariffs imposed by the developed countries fell almost 40%. Furthermore, the agreement provided a stricter framework to resolve disputes caused by antidumping laws, more measures regarding protection of intellectual property and services.

Administrative Reforms: The Uruguay round called for the replacement of the secretariat that administrated GATT with a new institution, the World Trade Organization. The WTO is to carry out old GATT functions under a different name and with some additional responsibilities. The main difference between GATT and WTO is that the latest will include a new process according to which the organization will be able to solve disputes between member countries. WTO has the so-called “Dispute Settlement Understanding” **(DSU)** which aims at reaching judgments regarding nation’s non-compliance with the agreement. Moreover WTO not only can penalize countries but also has the right to retaliate on the organization’s decisions. Last but not least the Uruguay round established a sub-agreement called the General Agreement on Trade in Services **(GATS).** That was the first time that services were included in any international agreement. [43]

Benefits and Drawbacks

Although the impact of the Uruguay round is difficult to estimate, due to the complexity of the agreement and the fact that it was signed recently, GATT itself and the Organization for Economic Cooperation and Development[44] suggest that the gain in the world economy will be immense. Regardless if this is confirmed or not, it is claimed that the usual trade liberalization logic will ap-

[43] WTO (1994)
[44] Another international organization consisting of developed countries, based in Paris

ply. According to this argument the costs of the Uruguay round will be concentrated on small clusters whereas the benefits are going to be diffused in broad population groups. The success of this round did not only result in the above mentioned benefits but more importantly it sealed the progress towards free trade that had already taken place during the past decades.

At this point it should be mentioned that there is a considerable amount of criticism against the Uruguay Round and the creation of the WTO. One of the problems that arose is that the Uruguay round has omitted to include in the agreement some important sectors and tariffs in some others remained too high. Despite the efforts to settle a dispute in a tighter legal framework, the possibility of antidumping action is not completely absent and the potential for disputes still remains. At a second level the Uruguay round and WTO is heavily criticized for not addressing a lot of trade problems of developing countries or for not accelerating the process of trade liberalization. [45]

The Doha Round

A new round of global trade negotiations took place in November 2001 at the fourth WTO Ministerial Conference in Doha, Qatar and is to be finalized by 2005. Moreover, issues to be considered in the fifth ministerial conference in Mexico in 2003 were brought up. The main aim of the Doha round was to promote the developing nations. It is stated that the agricultural subsidies alone in the developed countries worth six times more than their combined aid budgets towards developing nations. Among the benefits that should be created by the Doha meeting is the better access of developing countries production in developed markets. Moreover, poor nations were to receive more aid in order to be better integrated in the world trade environment.[46] Finally, it was in the Doha round that China and Taiwan became members of the WTO after 15 years of negotiations which gave to organization a genuinely global character.[47]

The Cancun Meeting

Recently, on 10-14 September, 2003 the WTO's Fifth Ministerial Conference took place in Cancun, Mexico. This meeting can be seen as a continuity of the Doha development agenda described above. The Cancun meeting is not the end of the Doha agenda which, as said, is to be completed in 2005 but more an in-

[45] Such us Prebisch, Singerand and Myrdal
[46] World Investment Report (2001)
[47] EU 1

termediate phase in the process where negotiators are to evaluate the progress of the agenda. [48]

Despite the high expectations for further integration between developed and developing countries, the meeting was deemed to failure due to serious discrepancies between the so-called "rich" and "poor" countries. The collapse of the talks has further hindered the world economy which has been staggering towards recession during the last two years. The main dispute was over the denial of developed nations to cut down on the large amount of subsidies to their agricultural sector. Moreover, the European proposals on foreign investment policies were rejected by developing countries out of fear of opening the way to foreign multinationals which would take over control of their own industries.

The main development of the Cancun Meeting is that rich and poor countries agreed to disagree and blamed each other for the breakdown. However, it was agreed that the ministers should meet up again on December 15th in order "*to reassess the future of the trade talks*".[49] Also on the bright side, the agreement to provide cheap medicines to developing countries will still be realized.

As a result of the described developments it is feared that the world trade system will lose its holistic character and will fragment into regional or bilateral agreements that in the end will be more harmful for poor nations. According to World Bank estimations, a successful global trade agreement would result in about 150 million people less suffering from poverty.[50] Trade has been setting in motion world economic growth for the last 50 years. However in the past few years there was a sever slowdown. Therefore a new successful deal would boost both growth and confidence. Despite the failure developing countries have still opportunities to benefit through the opening of the some markets and promises set up for the future.[51]

The New Politics in World Trade

As described above, the world trade took successive steps towards liberalization for the last 50 years. This liberalization process had largely involved political interaction. Over time, the more complicated the negotiations were, and the more countries were involved the more the trade talks were ensnared into

[48] EU 2
[49] BBC News, UK Edition (2003)
[50] Ibid.
[51] BBC News, UK Edition (2003)

political conflicts. Nowadays, these political quarrels have reached their peak as proven in the resent Cancun meeting. A good example is the incident in Seattle in 1999, when trade negotiations broke in the middle of mass demonstrations and deep disagreements between the two fronts: "the rich and the poor". Two years later, these issues were disregarded as Western countries were keen to show their willingness to deal with global poverty. After the Cancun meeting, it was made obvious that a lot of controversial matters that were believed to be tackled in trade negotiations should be re-examined.[52] It is therefore rational to claim that the collapse in Cancun "*may prove a historic turning point in the history of free trade*".[53]

3.3 Bilateral Trade Agreements

Bilateral trade agreements have a long history and have even played a key role in the early rounds of GATT in creating multilateral trade agreements. In general, GATT prohibits preferential trade agreements in which the tariffs that countries apply to each others' products are lower than the tariffs imposed on the same goods coming from other countries. However, it even makes an exception to this rule that says: *"It is against the rules for country A to have lower tariffs on imports from country B than on those from country C, but it is acceptable if countries B and C agree to have zero tariffs on each others' products."* In general, a violation of the Most Favored Nation principle is prohibited, but if preferential trade agreement leads to free trade between the agreeing countries then the exception mentioned above is applicable.[54]

The strength of bilateral agreements is their capacity to control parties. The possibility of monitoring them in a more effective way is higher than in a multilateral agreement. However, the problem of having a large number of bilateral agreements is that it requires considerable resources to negotiate and monitor them. Furthermore, it is easier to satisfy the needs of domestic interest groups through bilateral arrangements.[55]

Important drawbacks lie within the inability to take full advantage of international coordination. This means that benefits gained from bilateral trade can be

[52] Schifferes S. (2003)
[53] Ibid.
[54] Krugman P. R. et al. (2000)
[55] Hettne B. et al. (1999)

"spilled over" to countries that are not directly involved in bilateral negotiations and are not taking part in reduction of their own tariffs.[56]

Even though the process of trade liberalization through multilateral negotiations seems to have stagnated during the last couple of years, the multilateral processes have in the past proven to be more successful. Some of the most famous economists have also made the predictions about the future of the bilateralism. It has been concluded that *"although a world that consolidates into trading blocs could simultaneously reduce tariffs so as to avoid trade diversion, the optimal non-cooperative behavior of the blocs is actually to increase external tariffs."*[57] This will result in a reduced inter bloc trade. Moreover, predictions are that the net effect of bilateralism will be reduced world welfare.[58]

3.4 Methods of Promoting Trade

Subsidies

Subsidies are financial assistance to domestic producers in the form of cash payments, low-interest loans, tax breaks, product price supports or others. The main purpose of subsidies is to help domestic producers impede international competitors either in the home market or through increase of the competitiveness in international markets. The international agreement and WTO does not support this kind of assistance and is often called on to investigate charges of unfair subsidies. Furthermore, the critics argue that subsidies can lead to inefficiency and complacency by covering the costs that should be absorbed on their own in truly competitive industries.[59]

Export Financing

Export subsidies are financial assistance to domestic exporters or potential exporters in the form of direct payments or the granting of tax relief, subsidised loans and offering reasonably priced insurance services in order to stimulate the country's exports. Those incentives give producers an encouragement to export and make it more profitable for them to sell abroad than at home. Export financing is especially crucial to the success of small businesses that are just be-

[56] Krugman P. R. et al. (2000)
[57] Krugman P. R. et al. (2000), Jovanovic M. N. (1998)
[58] Ibid.
[59] Wild J. J. et al. (2000)

ginning to export. In many countries, there are special agencies that are specialised in helping their domestic companies to gain export financing.[60]

Even though many countries provide this form of financing in order to promote exporting, it contradicts with the rules set by the WTO.[61] The most criticised form of export financing is the one for large multinational corporations, while support of small business exporting activities, in general, is not so controversial.[62]

Foreign Trade Zones

A foreign trade zone (FTZ) is a selected geographic region in which merchandise is allowed to pass through with lower customs duties (taxes) and/or fewer customs procedures. Foreign investors in these zones are able to reduce production costs and the time it takes to get into different markets. The main purpose of the FTZs is to increase the employment by offering these possibilities to the foreign investors.[63]

Special Government Agencies

Special government agencies are responsible for promoting exports and are involved in helping companies, often small and medium size ones to generate contacts for new businesses outside of their home country. They are in charge of organizing activities promoting the home country's exports in other nations.[64]

3.5 The Case of Protectionism

Despite the advantages of free trade national governments continue to intervene in the trade of goods and services. The main explanation of such a behavior can be found in the fact that beside the economic motives governments are also influenced by political, social, and cultural drivers. The motives behind the case of protectionism are summarized further down.[65]

The main argument against free trade is that foreign competition costs jobs to the domestic economy. The social problems brought about by the industry-

[60] Ibid.
[61] Salvatore D. (1999)
[62] Wild J. J. et al. (2000)
[63] Ibid.
[64] Ibid.
[65] Wild J. J. et al. (2000)

specific unemployment caused by foreign competition are immense.[66] An additional political motive is the preservation of national security and the safeguard of valuable national resources. Certain sectors of the economy may appeal for protectionism because they are closely related to national security. Protectionism is also driven by the international influence game that a lot of countries are involved in especially when it comes to big developed countries and their authority over smaller nations.[67]

The most common economic motive behind protectionism is the attempt of nations to defend their own infant industries from international competition during their phase of development. The drawback here is that such strategies diminish competition, raise prices and limit incentives towards innovation. Followers of a protectionism strategy argue that governments can help companies exploit economies of scale and have a first mover advantage which will result in increased national income. Nevertheless, with such a policy there is a risk of inefficiency and increased costs. [68]

Last but not least it is argued that protectionism discourages dependency. This is a strong argument used by a lot of small or developing countries who don't want to end up relying on bigger countries and therefore they protect the industries they hold a comparative advantage. Moreover the issue of national identity is at stake and governments take action against imports that are considered to be harmful for their cultural heritage.[69]

3.6 Trade Policies

While free trade maximises world welfare, most nations impose some trade restrictions that benefit special groups. They have become popular tools for governments to promote exports and protect domestic firms from import competition. Trade barriers that are available to governments in order to restrict unwanted trade can be divided into two general categories. Tariffs, are taxes or duties levied on products as they cross a national boundary and, different kinds of non-tariff barriers that limit the quantity of an imported product. Historically, the most important type of trade restriction has been the tariff. Nowadays, most government intervention in international trade is in the form of non-

[66] Case K.E. et al. (1999)
[67] Case K.E. et al. (1999), Wild J. J. et al. (2000)
[68] Ibid.
[69] Ibid.

tariff barriers such as import quotas, local content requirements, embargoes, etc.[70] In this section, both types of trade restriction will be discussed.

Tariffs

There are three categories of tariffs which are classified according to the country that levies them. ***Export tariff*** is levied by the country that is exporting a product when the government of that country find the price of the product lower than it should be. This is often applied by developing countries in order to get better prices and raise revenues on exports that consist mostly of low-priced natural resources. *A* ***transit tariff*** is levied by the country that a product is passing through on its way to its final destination. These kinds of tariffs have almost entirely been abolished through international trade agreements. Finally, the most important and the most common tariff used by governments is *an* ***import tariff*** levied on the imported products. It can be ad valorem, specific, or compound. Ad valorem tariff is levied as a fixed percentage of the value of the traded product. The specific tariff is levied as a specific fee for each unit of an imported product. A compound tariff is a combination of an ad valorem and a specific tariff.[71] Generally, since World War II, tariffs have declined in industrial nations and now average less than 5% on manufactured goods. However, trade in some goods is still subject to relatively high trade barriers.[72]

Non-Tariff Barriers

As mentioned earlier, non-tariff barriers limit the quantity of an imported product. In turn, the lower quantity of the product available in the market tends to increase its price and thus decrease sales. As tariffs were negotiated down during the post-war period, the importance of non-tariff trade barriers has greatly increased and is now threatening the world trading system that has evolved since then.

Quota is the most important non-tariff trade barrier. It is a quantitative restriction on the amount (measured in units or weight) of a good allowed to be imported or exported during a certain period of time. Quota involves the distribution of quota licenses by the governments to the companies or governments of other countries (in the case of import quotas), and domestic producers (in the case of export quotas).

[70] Krugman P. R. et al. (2000)
[71] Salvatore D. (1999), Wild J. J. et al. (2000)
[72] Salvatore D. (1999)

Import quotas are imposed in order to protect the domestic producers by setting a limit on the amount of goods allowed to enter the country. This way, domestic producers get to keep their market shares and prices because competitive forces are restrained. For the consumers this means an increase in prices and limited selection due to lower competition. Domestic producers whose own production requires the import subjected to a quota loses as well. With a quota the government receives no revenue either. An import quota always raises the domestic price of the imported good.

Export quotas are imposed when a country wishes to maintain adequate supplies of a product in the home market which is most common among countries that export natural resources. Secondly, a country can restrict export of a good to restrict its supply on world markets, which would thereby increase the international price of the good.[73]

Embargoes are a complete ban on trade (both imports and exports) in one or more products with another country. This is the most restrictive one of the non-tariff barriers and in most cases it is applied to accomplish political goals. Today, embargoes are not used to the same extent as before due to the fact that they are very difficult to enforce. They can be declared by individual nations or by supranational organisations such as the United Nations.[74]

Local Content Requirement is a regulation that requires that some specified amount of a final good must be produced domestically. Local content laws have been widely used by developing countries trying to shift their manufacturing base from assembly back into intermediate goods. Local content requirement does not produce either government revenue or quota rents. Instead, the difference between the prices of imports and domestic goods in effect gets averaged in the final price and is passed on to consumers.[75]

An interesting improvement in local content regulations is that the legislation allows firms to satisfy their local Content Requirement through exporting instead of using parts for domestic needs. "…*This has become important in several cases: For example, U.S. auto firms operating in Mexico have chosen to export some components from Mexico to the U.S., even though those compo-*

[73] Wild J. J. et al. (2000)
[74] Wild J. J. et al. (2000)
[75] Ibid.

nents could be produced in the U.S. more cheaply, because this allows them to use less Mexican content in producing cars in Mexico for Mexico's market."[76]

Administrative delays are regulatory controls or bureaucratic rules which are designed to setback the rapid flow of imports into a country. This barrier contains a wide range of government actions, such as requiring international air carriers to land at inconvenient airports, requiring product inspections that damage the product itself, purposely understaffing customs offices to cause unusual time delays, and requiring special licenses that take a long time to obtain. Their main objective is to discriminate against imported products.[77]

Technical regulations and standards include safety regulations for automobile and electrical equipment, health regulations for the hygienic production and packaging of imported food products, and labeling requirements showing origin and contents.[78]

Other trade restrictions include laws requiring governments to buy from domestic suppliers, international commodity agreements and multiple exchange rates and currency controls (restrictions on the convertibility of a currency into other currencies).[79]

Antidumping. Under international trade law, dumping refers to a situation where a company exports a product at a price that is either lower than the *"fair"* price normally charged in its domestic market, or lower than the cost of production. According to Article VI of GATT, fair value is either the price at which the good is sold in the foreign market that fully allocated cost of production or the price at which the good is sold in a third-country export market.[80]

Antidumping laws are made to prevent such a situation. In order for governments to be able to impose those rulings on dumped imports, it must be shown that the domestic industry has suffered material injury due to dumping.[81] However, it is often difficult to determine the type of dumping and there is a risk

[76] Krugman P. R. et al. (2000)
[77] Wild J. J. et al. (2000)
[78] Salvatore D. (1999)
[79] Salvatore D. (1999)
[80] Roberts K. et al. (1996)
[81] Ibid.

that the domestic producers demand protection against any form of dumping which can result in unfair protectionism and abuse of antidumping laws.

3.7 Theory Application

The above mentioned theoretical framework will be used throughout this study both as a base for the empirical research and later on as an evaluation base for the analysis of the empirical findings.

The description of the forms of regionalism and economic integration as well as the relevant benefits and drawbacks will serve as guidelines when analyzing the specific choices of participation in regional agreements of the case country. Moreover, methods used by nations in order to promote trade were also addressed with the purpose to be identified during the case study. The discussion on the issue of protectionism and the reasons behind the governments' wish to restrict the trade as well as a presentation of different forms of trade policies used today aim at providing a better understanding of how these policies are applied with regards to this study. Both the analysis and evaluation of the advantages and disadvantages of economic integration, multilateralism, regionalism and bilateralism depend on the knowledge of the present and future developments of the trade patterns. Therefore, in order to be able to understand these trends, the evolution process of the world trade liberalization under GATT and its successive steps, together with the multilateral and bilateral trade agreements were discussed.

4 The Bus Industry Business Environment

The engagement of a country in trade negotiations is closely related to its political and economical state and stability. Therefore, before examining the Trade Policy environment in Mexico, a political and economical overview of the country is presented, aiming at identifying the drivers towards its trade strategy and at assessing its effects. Within the same context, the trade flows and trade partners of Mexico are briefly presented. This will be used as an evaluating factor of the most important trade associates and as a base of reasoning before choosing the regions that will be in focus with respect to Mexico's trade relations. Moreover, since this study is going to estimate the impacts of the trade policy on the bus industry, a general description of that industry is also presented as a background. Part of this description is the presentation of Volvo Bus in Mexico, which will be used as an empirical example during the study.

4.1 Mexico's Political and Economical Overview

4.1.1 Political Overview

Since independence from Spain in 1821, Mexico has undergone civil wars and predatory invasions.[82] An important development was the creation of the National Revolutionary Party **(PNR)** in 1924 which was renamed Institutional Revolutionary Party **(PRI)** in 1945. This party stayed in power until year 2000 and has been alleged for a lot of electoral frauds that kept it in power. It was not until 1994, when PRI representative Ernesto Zedillo won the presidency, that the elections were recognized as transparent. Mr. Zedillo, despite his efforts for political reforms, lost creditability over his ability to manage the economy. The main reason for that was the **peso crisis** that broke out in the beginning of his term and made his administration very unpopular.

In July 2000, **Vicente Fox Quesada**, representative of the National Action Party **(PAN),** was elected as president of Mexico. His election was very momentous as it put an end to the seven decades of political domination by the **PRI.** Governmental ability has been rather weak, since the ruling does not enjoy a majority either in the Chamber of Deputies nor in the Senate, which severely delays the legislation acts.[83] Vicente Fox introduced a new style of gov-

[82] States of California, Arizona and New Mexico
[83] The Economist Intelligence Unit Limited (2003)

ernance. The new government's advisors and cabinet members came mostly from the private sector and the academic world, whereas the whole style of governance became more informal. His election has been associated with promising forecasts for job creation and tax reductions. Central to these estimations were the increasing well-paid automotive related jobs.[84] Mr. Fox, despite the fact that he is not a novice in the political arena, is described as having a lack of political know-how in several issues. Moreover, his government's popularity has been falling, as it seems to have consistency issues unsolved. Adding to this, the period 2001-2002 was one of sharp economic downturn and one of government's failures to achieve its objectives included the creation of new jobs in the automotive sector. However, Mr Fox's personal approval ratings continue to be high as he is considered honest and well-intentioned. The next elections in Mexico are going to take place in 2006.[85]

Mexico's foreign policy has been fundamentally determined by the country's relations with the U.S. The political relations between the two countries have been intense. The expansion of the petroleum production after the mid 1970's empowered Mexico to favor left-wing administrations such as the one in Cuba which was opposed strongly by the U.S. The bilateral political relations remained tense until 1996, due to a series of events such as murders and U.S. allegations of Mexico's inability to control drug trafficking. This situation improved in 1996 after the arrest and deportation in the U.S. of one of the most notorious Mexican drug dealers. After the NAFTA was signed the goal of the Fox administration regarding the relations with the U.S. has been to persuade the U.S government to adopt a more liberal policy regarding Mexican immigration flows towards the U.S. Progress on immigration issues has been slow so far without any concrete results. [86]

4.1.2 Economical Overview

During the 1970's and 1980's, expansionary policies in addition to external shocks caused inflation pressures and balance of payment problems in Mexico. The fact that the country was cut off from the international markets added to its difficulties to pay its external dept, made the change of economic policy imperative in the 1980's. The policy changed during the Madrid and Salinas ad-

[84] Corbett B. (2001)
[85] The Economist Intelligence Unit Limited (2003)
[86] Ibid.

ministrations by the adoption of a more orthodox economic policy which followed the guidelines of the WTO and the IMF. Mexico joined GATT in 1986 and NAFTA in 1994. This lead to a major restructuring of the Mexican economy which was also encouraged by domestic structural reforms. These reforms included the decrease of restrictive laws on inward Foreign Direct Investment **(FDI)**, a considerable reduction of protection measures in terms of tariff and non-tariff barriers, as well as privatization of large state owned organizations. As a result, a more favorable investment climate has been created in Mexico since then.[87] [88]

While in the 1970's the economy heavily relied on oil for foreign exchange earnings, the manufacturing sector quickly took over. In 2002, manufacturing accounted for 20% of the GDP. The majority of exports were produced in the **maquiladoras** further described in Appendix I**.** However, it is services that contributed mostly to the economy's output, accounting for 37.9% of GDP.[89]
Table 1, presents some basic Mexican economic indicators for year 2002.

Table 1 Main economic indicators, 2002

GDP	US $ 900 billion
Real GDP growth	0.9%(based on constant 1993 prices)
GDP per capita	US$ 9,000
Consumer price inflation	5.7%
External Dept	US$140.8 billion (June 2002)
Exchange rate	Ps: US$ 9.68
Population below poverty line	40 %
Labour Force	39.8 million (2000)
Industrial Production Growth Rate	4.9%

Sources: The Economist Intelligence Unit Limited (2003)

The Peso Crisis 1994-1995

Mexico faced a severe financial crisis in 1994 during the Zedillo administration. In 1994, Mexico's economy seemed promising. Its potential to prosper was based on the NAFTA membership, solid steps towards economic reforms and positive growth rates during the second and third quarter of 1994. However, the over-valuated exchange rate and expanding current account deficits

[87] Busse M. et al. (2001)
[88] The Economist intelligence Unit Limited (2003)
[89] Ibid.

created a serious imbalance. In order to avoid an economic slowdown, the government tried to maintain its quasi-pegged exchange rate by limiting monetary retrenchment with pure intervention policies. Those policies proved to be unsustainable. Moreover, a sequence of *"political shocks"* occurred at the same time, contributing to the already unstable situation. These events included a revolution in the state of Chiapas, the murder of a presidential candidate, the kidnapping of local personalities and the assassination of another high level political figure. Added to this, the internationally rising exchange rates and fears of currency devaluation resulted in undermined investor confidence and contributed to large outflows of capital. The Central Bank of Mexico has used the foreign currency reserves in order to defend the currency. The diminishing reserves forced the government to alter its exchange rate strategy and allow the rate to flow freely in the last days of 1994. For decades the exchange rate had always been managed with a band or peg used as a tool to control domestic inflation. The subsequent adjustment in the Mexican financial markets resulted in a 30% to 40% devaluation of the peso relative to the US dollar. The ultimate result was a collapse of the exchange rate and elevated interest rates. President Zedillo, announced an emergency recovering economic program that included budget cuts and privatizations. Nevertheless, investor confidence failed to be re-established.[90,91]

The Recovery of the Economy

The above described economic crisis was proved to be disastrous to domestic investment and consumption. Nonetheless, the weak exchange rate and the preferential access to the U.S. and Canadian markets due to NAFTA became engines of export growth. Until the second quarter of 2002, external trade grew remarkably. This development is at a large extent attributed to the Maquiladora industry, described in Appendix I. Despite the fact that the economy has largely recovered since the peso crisis in 1995, private consumption remained low due to the decline in real wages, high unemployment and an immense debt.[92]

Except for a brief period in 1997, it is said that in reality Mexico has never recovered after the peso crisis. Proof of this is the next crisis that followed in 1997 and 1998. This crisis was a spin effect of the international crisis that started in Asia in 1997. Despite the efforts of the government to keep capital in

[90] Whitt J. A. (1996)
[91] The Economist Intelligence Unit Limited (2003)
[92] Ibid.

the country through increasing interest rates, capital outflows were not prevented. At the same time unemployment started to rise and the living standards of the workers dramatically fell. This situation was further accentuated by serious hits in the agriculture sector due to disastrous floods as well as scandals in the banking sector. This series of events contributed to a great destabilization of the economy.[93]

Growth slowed down in 1998 and in 1999 but in 2000 growth surged to 6.6% despite the fact that it was a year of presidential elections and traditionally a crisis would take place. Mexico suffered from the economic slow down in the U.S. in 2001 but managed to keep the private consumption levels due to the strong peso and dropping nominal interest rates. Although in that year GDP was at its lowest levels since 1995, the fall in demand resulted in lower inflation rates. As a matter of fact, in 2002 inflation reach a 30-year low level of 4.4%. During 2002 the economy started to recover due to the export sector which was the most important factor boosting GDP to higher levels.

The flexible exchange rate that was adopted in 1994, as described above, became a significant factor in maintaining stability in the volatile international financial markets. The floating rate has resulted in regular adjustments to external factors rather than rare but immense shocks. Moreover, the capital flows changed towards a more long term perspective and diminished the possibility of attacks through speculations.[94]

Despite the economic volatility during the last decade, with respect to the automotive sector, Mexico remains an important market. Mexico's advantages are its steady credit availability, strong peso, reasonable interest rates and as said declining inflation. The fact that president Fox's social and fiscal initiatives have not yet been realized is a serious drawback. These plans included new vehicle taxes and corporate income taxes elimination in order to promote foreign investment.[95]

The above described instability during the 1980's as well as the peso crisis are reflected on the exchange rate of the Mexican Peso in relation to the US dollar, before and after these periods and is shown in table 2.

[93] Nebbia G. (1998)
[94] Economy Report (2001)
[95] Corbett B. (2001)

Table 2 Exchange rate fluctuation 1984- Sept.2003

Exchange rate fluctuation											
Peso per 1000 US$		Peso per US $									
1984	1985	1986	1987	1990	1995	1996	1999	2000	2001	2002	Sept. 2003
167,825	266,87	0,611	1,37	2,81	6,41	7,59	9,56	9,45	9,34	10,16	10,92

Source: IMF-IFS (2002)

Technological Development

In 2001, the UN has released a report which has ranked countries according to their technological development. In this ranking, Mexico, Costa Rica and Chile were ranked as developing economies which are potential technological leaders.[96]

Within the automotive sector, since 1997, Mexico has moved towards the development of more complicated industrial processes. Advanced research centers have been established which provided technological innovations to the industry by recruiting high skilled personnel graduating from technological institutions in Mexico. Companies established in Mexico, such as General Motors, Nissan, Volkswagen and Delphi have developed an extraordinary capability in enhancing new processes and products.[97]

As a result of NAFTA and the other Free Trade Agreements, for the period 1994-2001 Mexico has received more than US$ 10 billion in new investments in the automotive sector. In that way, not only the sector was modernized but the whole region was also developed. Moreover, a whole cluster of suppliers and related industries was build up that promoted vertical integration and further supported the supply chain. Specialization in production was also enhanced. Moreover, FDI inward flows have contributed to the transfer of new technologies in the automotive sector which can partially explain the 40% increase of productivity levels since 1994. The enhanced auto industry has created many new and better paid jobs in Mexico and thus contributed to a better standard of living for the inhabitants. [98]

[96] Internet News (2001)
[97] Maquila Portal 2
[98] Maquila Portal 2

4.2 Mexico's Trade

Mexico is one of the most active trade countries in the world and the leading trade nation in Latin America, having a 16% share of the total regional trade. If one considers EU as one nation, Mexico is the 7th exporting nation in the world accounting for 2.6% of the world exports.

The most important job creator in Mexico is the export sector which is the most dynamic one of the economy. For the period 1993-2001, Mexican exports have accounted for more than half of the country's GDP. More than half of the generated jobs are linked to the export sector and to FDI inflows. Export activities have been expanded all over Mexico, allowing in that way every region to grasp the benefits of trade and growth. It should be stated that in the past, economic activity was concentrated in the biggest Mexican cities and in the Mexico-U.S. border area. The Free Trade Agreements Mexico has signed promoted the country as a manufacturing hub where a lot of foreign companies are rushing to invest and exploit the unique position and the trade policy environment opportunities provided by Mexico.[99]

Table 3 and Table 4 show Mexico's exports and imports for the period 1993-2002. The tables also show the main trading partners of Mexico regarding exports and imports as well as the evolution of their trade relationship over time. As seen, the U.S. is by far the most important trade partner of the country regarding both exports and imports. The trade figures show that an immense percentage of Mexico's exports are concentrated to the U.S market. There is a small decrease in the Mexican exports towards the U.S. as a percentage of total exports after year 2000. This can be combined with the slowdown in the U.S. economy that year. As seen in the tables, there is a growing share for the EU especially when it comes to imports. Trade with the EU is more important than trade between Mexico and Canada, despite the participation of both countries in NAFTA. Also impressive is the increase of the share of China regarding both exports and imports during the last years.

[99] The NAFTA Office of Mexico in Canada

Table 3 Mexican exports per trading Partner: 1993-2002(in US$ million)

	Mexico Total	U.S.	%	Canada	%	EU	%	Japan	China	Brazil	% Japan China, Brazil
1993	51,886	43,117	83	1,541	3	2,658	5	700	45	291	2.0
1994	60,882	51,943	85	1,470	2	2,748	5	988	42	376	2.3
1995	79,542	66,475	84	1,979	0	3,389	4	928	37	800	2.2
1996	96,000	80,673	84	2,170	2	3,553	4	1,363	38	879	2.4
1997	110,432	94,531	86	2,157	2	4,020	4	1156	46	703	1.7
1998	117,460	103,306	88	1,521	1	3,907	3	856	106	536	1.3
1999	136,403	120,393	88	2,391	2	5,197	4	776	126	399	1.0
2000	166,400	147,686	89	3,353	2	5,610	3	931	204	517	1.0
2001	158,547	140,296	88	3,070	2	5,333	3	621	282	585	0.9
2002	168,682	123,767	73	8,067	5	5,320	3	1,628	1,014	635	1.9

Source: IMF: *Direction of trade statistics* (2002)

Table 4 Imports to Mexico per trading Partner: 1993-2002 (in US$ million)

	Mexico Total	U.S.	%	Canada	%	EU	%	Japan	China	Brazil	% Ja-pan, China Brazil
1993	67,367	46,542	69	1,163	1.7	8,471	12.6	3,369	353	1,312	7.5
1994	79,346	57,009	72	1,600	2.0	9,848	12.4	3,812	429	1,326	7.0
1995	72,453	53,995	75	1,374	1.9	7,401	10.2	3,680	521	622	6.7
1996	89,469	67,629	76	1,744	1.9	8,506	9.5	3,901	760	759	6.1
1997	109,802	82,182	75	1,968	1.8	10,891	9.9	4,334	1,247	956	6.0
1998	125,373	93,252	74	2,292	1.8	12,867	10.3	4,553	1,818	1,142	6.0
1999	142,064	105,267	74	2,949	2.1	14,006	9.9	5,083	1,921	1,242	5.8
2000	168,400	127,534	76	4,017	2.4	16,253	9.7	6,466	2,880	1,983	6.7
2001	168,276	113,767	68	4,235	2.5	16,166	9.6	8,086	4,227	2,120	8.6
2002	168,679	97,531	58	1,509	0.9	14,145	8.4	3,766	2,864	2,282	5.3

Source: IMF: *Direction of trade statistics* (2002)

NAFTA Trilateral Trade

NAFTA has resulted in increased trade between the three member countries. Because of the product accessibility provided by NAFTA, Mexico has the opportunity to attain quality products produced in North America more economically. Outstanding business dynamics have been created in the area just because of the favorable conditions and trade flows have seen a great rise between the three countries. Consequently, North America is erected not only as one of the bigger and more competitive Free Trade Areas but also as one of the most promising trading regions. [100]

[100] The NAFTA office of Mexico in Canada

One third of the region's total trade takes place within the NAFTA partners. In 2001, trade between Mexico, Canada and the United States accounted for 113% more than the respective figures of 1993. The trade flows per country-member were as follows: [101]

• **Mexico –**Mexico's merchandise exports to NAFTA partners increased 225% from 1993 and to the rest of the world 93%. Only in 2001, Mexico exported US$139 billion to its NAFTA partners. U.S. market accounted for 89% of Mexico's exports in the end of year 2002, despite Mexico's efforts to diversify its trade.[102]

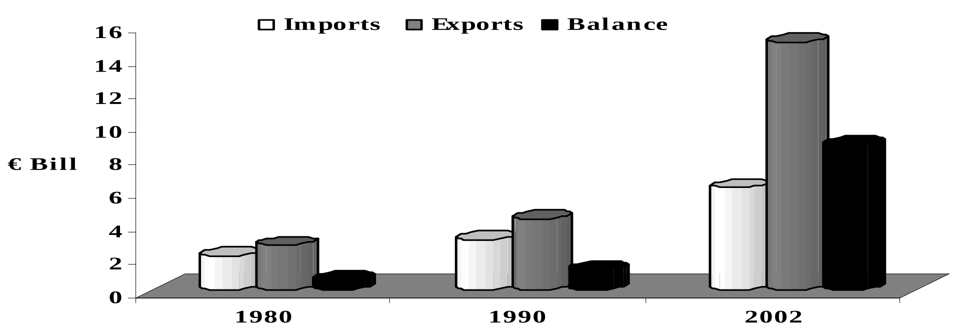
• **United States -** U.S. merchandise exports to NAFTA partners nearly doubled between 1993 and 2001. Growth in exports to the rest of the world within the same period was significantly lower amounting to 44%.

• **Canada** – From 1993 to 2001, Canada's merchandise exports to its NAFTA partners was 95% higher. Within the same period of time, exports to the rest of the world increased only

The EU- Mexican Bilateral Trade

Until 2001, Mexico has been a rather insignificant trading partner to the European Union. During the 1990's Mexico did not fully exploit the outward trade strategy of the EU. The bilateral trade between the two areas actually declined during this period, which coincides with the creation of NAFTA. Figure 1 shows the EU merchandise trade with Mexico during the 1980's, 1990's and 2002.

Figure 1 EU merchandise trade with Mexico



Source: Europa – DG Trade (2003)

[101] NAFTA at Eight

[102] The Economist Intelligence Unit Limited (2003)

EU relies strongly on manufacturing exports whereas Mexican exports consist of a large mining and agricultural share.[103] This difference illustrates a divergence between the EU and Mexico as shown from the share of bilateral imports and exports in three basic sectors in Table 5.

Table 5 Sectoral Structure and significance of bilateral EU-Mexican trade in 1999.

	EU Exports to Mexico		Mexican Exports to the EU	
	Structure[104]	Significance[105]	Structure	**Significance**
Agricultural products	4.1	0.8	9.0	**5.4**
Mining Products	1.2	0.4	21.4	**9.5**
Manufactures	89.5	1.4	68.7	**3.1**
-Non electrical machinery	29.0	2.3	3.2	**2.1**
-Automotive products	**13.6**	**2.1**	**29.2**	6.0
-Textiles	1.5	0.8	1.0	**2.1**
-Clothing	0.9	0.7	0.5	**0.4**
All commodities [106]	**10.9**	**1.3**	**5.2**	**3.8**

Source: Busse M. et al. (2001)

As presented in Table 5, within the manufacturing sector the automotive products represent by far the largest Mexican exports to the EU and the ones with the greater significance. Other sectors such as textiles and clothing have less importance in the Mexico – EU bilateral trade.[107]

4.2.1 Trade Within the Automotive Sector

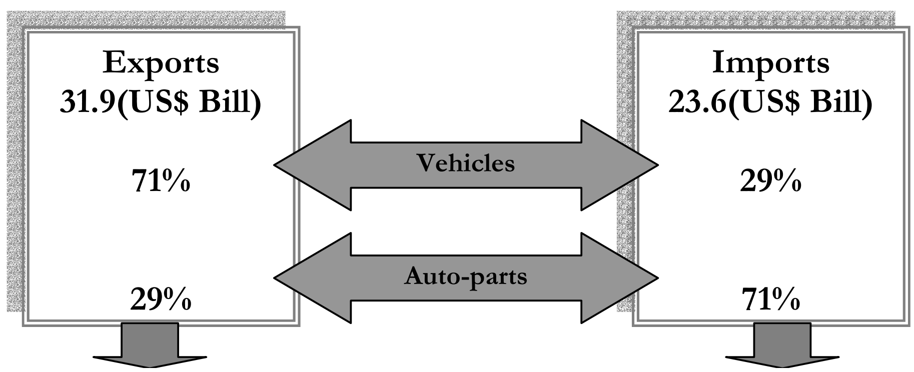
The country's exports have been diversified during the last decade from oil and raw materials to manufactured products.[108] The automotive sector has been one of the fastest growing sectors in Mexico representing 20% of the country's exports, where it is Mexico's largest employer. This sector represents 14% of the

[103] Busse M. et al. (2001)
[104] Share (in %) of all commodities
[105] Share (in %) of bilateral exports in respective total exports (third-country trade in the case of the EU)
[106] In $ billion for "structure" and in % for "significance". Including unspecified products.
[107] Busse M. (2001)
[108] ibid

Mexican economy's total imports.[109] It is a strong driving force towards the country's welfare and prosperity.[110]

In the automotive sector Mexico's trade is to a big extent concentrated in the North American region and especially in the U.S., both regarding exports and imports. Other countries that are important destinations for Mexico's exports and origin of its imports both in vehicles and auto-parts are Germany, Japan and Brazil. The Mexican automotive trade balance for 2002 is shown in figure 2.

Figure 2 Mexican Automotive Trade Balance 2002



Vehicles	%	Auto-parts %
U.S.	83.6	76.9
Canada	10.2	4.0
EU	3.9	3.6
Brazil	0.6	0
Others	1.7	15.5

Vehicles	%	Auto-parts	%
U.S.	72	U.S.	70.4
Canada	19	Canada	7.4
EU	8	Japan	6.1
		Others	16.1

Source: Bancomext (2003)

The automotive sector trade within the North American region has been benefited by NAFTA. Due to this agreement, the intraregional trade arrived to be almost 80% of the total NAFTA export of auto and auto parts. It is this industry that drives the region towards growing international competitiveness and global development. The three NAFTA countries have exported together more than US$160 billion in 2001, representing in that way one third of the total world automotive exports.[111]

[109] Bancomext (2003)
[110] Maquila Portal 2
[111] Just Auto (2001)

4.3 The Automotive Industry in Mexico

Mexico is the 10^{th} biggest automotive producer in the world, producing approximately 2% of the world output. At the time of writing, Mexico produces 2 million cars on an annual basis. Moreover, Mexico is the 8^{th} largest engine producer in the world and the 7^{th} largest engine exporter.

The basic factor for Mexico's increasing production in this sector is the supply of low cost labor as well as the country's trade liberalization policies, the most important of which is the country's membership in NAFTA. That led a lot of the largest world manufacturers to establish production facilities in Mexico and use that as a base in order to supply all North America. Mexico is a major player in the industry. Nevertheless, there is a deficit of vital component suppliers necessary for such a large manufacturing operation.[112]

Mexico calculates a rise in vehicle production of approximately 29% by 2004, two thirds of which will be for exportation. Because of Mexico's importance as a vehicle manufacturer in the world scene, leading companies have invested heavily in the area. Some of these companies are: Ford, General Motors, DaimlerChrysler, Volkswagen, BMW, Renault-Nissan and Honda. These companies produce not only for the needs of the local market but also for the large markets of U.S., Canada, South America and Europe.[113]

Despite the fact that the biggest foreign investor in the automotive industry of Mexico is the U.S., European companies have a strong presence. The incentive for automotive manufactures is that they anticipate enjoying flexibility and costing efficiency which will derive from the free move of parts in and out of Mexico to the U.S., Germany, France, Britain and Singapore. [114]

Over the years, since 1962, the automotive industry in Mexico has been strictly regulated requiring rigorous local content, sourcing, and trade balancing as well as imposing relatively high tariffs. Such regulations have led to a non-competitive local parts industry.[115] Recognizing the importance of competition in the development of its auto industry, the Mexican government tried to liber-

[112] UK Trade & Investment (2003)
[113] Maquila Portal 2
[114] Ibid.
[115] Norton J.J. et al. (1995)

alize the industry. These industry specific liberalization steps will be discussed further in this study.

4.3.1 The Bus/Coach Industry

For a lot of years the bus industry has been considered only as a separate sector related to truck manufacturing, which in turn is seen smaller and "inferior" to the car industry. Despite the fact that the bus is often considered a last resort means of transportation its significance is growing as the city centers in the developed world are becoming more congested and polluted. [116]

This growing significance of the bus industry is illustrated in the growing pattern of the sales figures in Table 6 below. There is a growth pattern in the NAFTA markets until 2003. Nevertheless, there is a forecast according to which demand in the NAFTA area is falling after 2004.[117]

Table 6 Bus and coaches sales 1999-2005 (Units)

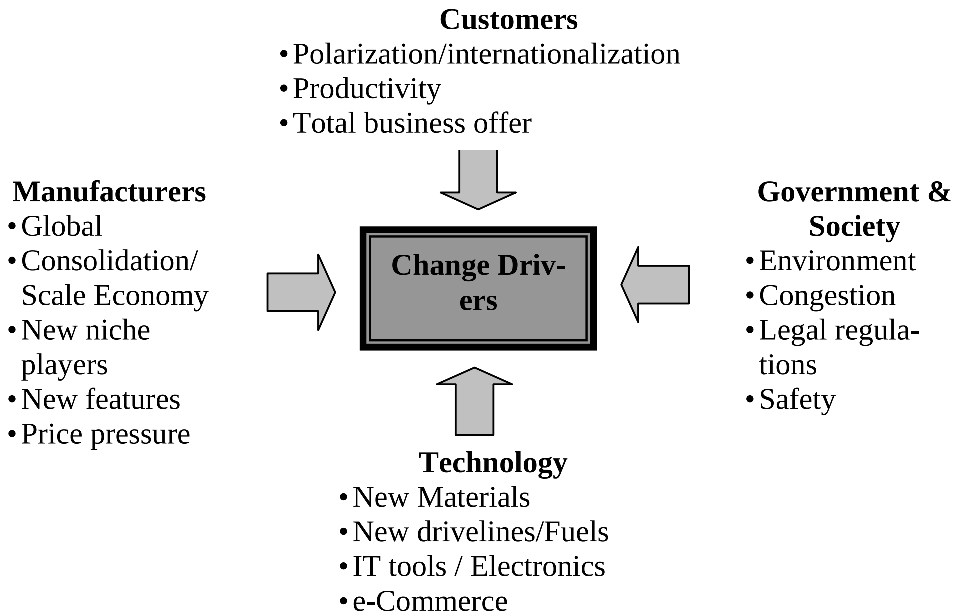
	1999	2000	2001	2002	2003	2004	2005
W. Europe	24,160	24,155	23,670	23,455	23,690	23,810	24,005
E. Europe	19,300	19,530	20,980	22,540	23,565	25,280	26,790
NAFTA	58,840	59,400	59,600	60,150	60,450	58,750	59,050
S. America	16,455	19,135	21,430	22,950	24,520	25,530	25,950

Source: The Economist Intelligence Unit Limited (2000)

[116] The Economist Intelligence Unit Limited (2000)
[117] Figure for 1999 is actual, the remaining are forecasts made in 2000.

The bus industry driving forces can be seen in Figure 3. As seen they include factors such as customers, manufacturers, governments and technologies.

Figure 3 Bus industry Driving Forces



Source: Volvo Bus Corporation (2003)

4.3.2 The Mexican Bus Industry

In recent years, there have been major changes in the North American bus and coach industry. The new political and economic environment with NAFTA in focus has made large-scale investments a real possibility, and has provoked some major restructuring within the industry. The industry has become more modern and is enhancing competitiveness. As a result of these developments, European manufacturers have lately invested heavily in bus and coach builders in the NAFTA region. [118] This European *"invasion"* is of a great concern for the major component suppliers.[119]

The main characteristics of the North American Bus market can be summurized as follows:

- *Registrations are low in comparison to the size of the region*
- *The manufacturing industry is dominated by W. European manufacturers*
- *It is a large market for unique design school buses* [120]

[118] The Economist Intelligence Unit Limited 1 (1999)
[119] The Economist Intelligence Unit Limited (2000)
[120] Volvo Bus Corporation (2003)

The Mexican bus and coach manufacturing industry is well-established and extensive. Companies present in the market, produce chassis, complete vehicles including integrals, and bodywork (For technical definitions see Appendix III). It is estimated that there are more than 130,000 buses and coaches in circulation in Mexico, including more than 40,000 coaches. The figures regarding the precise number of the bus fleet in Mexico are rather contradictory and depend on the source. One possible explanation is the fact that the Mexican government had difficulties publishing accurate formal information. These information difficulties can be illustrated by the fact that the public sector started to use computers to store relevant information five years ago. Therefore, the exact figures are difficult to find.[121] The rail system is poor and therefore an extensive network of express coach services is available. Some of the coaches are built to very luxurious standards. There are 10 million passengers per year using the intercity rail network. This can be compared with the respective coach passengers which are 2.5 billion on an annual basis.[122]

Mexico's Bus market has been growing after its first recovery in 1995. In 2000, the sales reached over 10,000 units which is a significant increase compared with 1994. Part of the growth can be explained by the Mexican authorities' efforts to reorganize the so far completely disordered transport system particularly in Mexico City. Traditionally, in Mexico City, most passenger were commuting with micro-buses which are *"vehicles built over an extended full-size pickup chassis."* The government has forced operators to use more contemporary and upgraded buses which may diminish to some extent the demand for lower truck class segments.[123] Table 7 shows the bus sales in Mexico for the years 1994 to 1997 and from 2000 to 2003.[124]

Table 7 Total Bus Market sales in Mexico 1994-1997 ,2000-2003

Category/Year	***1994***	***1995***	***1996***	***1997***	***2000***	***2001***	***2002***	***2003***
Coach	1,562	169	312	791	1,746	3,262	1,784	1,950
City/Intercity	5,289	637	2,137	3,752	8,460	8,460	7,239	6,350
Total Market	6,851	806	2,449	4,543	10,151	11,722	9,023	8,300

Source: ANPACT (2001)

[121] Cortéz S. 2003/11/10
[122] The World Bus & Coach Manufacturing Industry (2002)
[123] The World Bus & Coach Manufacturing Industry (2002), Volvo Bus in Mexico (2003), ANPACT (2001)
[124] 1994-2000 figures are actual, the remaining are ANPACT forecasts made in 2000

In 2000 Mexico's total bus production has increased dramatically compared with the 1996 levels. The peso crisis also strongly affected the bus industry. This effect is apparent in the production and sales figures in 1995 and 1996. The bus production for the years 1994 to 2000 is presented in Table 8

Table 8 Mexican Bus production 1994-2000

Category/Year	***1994***	***1995***	***1996***	***1997***	***1998***	***1999***	***2000***
Coach	1,015	315	636	1,045	1,608	1,378	1,515
City/ Intercity	7,928	650	1,529	5,362	5,571	6,228	8,028
Total Market	8,943	965	2,165	6407	7,179	7,606	9543

Source: ANPACT (2001)

4.3.2.1 The Demand

According to data analyzed by Volvo Bus Corporation, 43% of all travel in the world in 2000 was made by Public Transport. Out of this, transportation by bus and coaches stands for almost 60%. [125]

Moreover, data analyzed for Volvo Bus Corporation, shows that: [126]

- ✓ *"As the average income increases, the annual distance traveled per capita increases by roughly the same proportion".*[127]
- ✓ *"Time set aside for travel is typically 60 to 90 minutes per person per day".*
- ✓ *"The richer you are, the faster you go and therefore the more "mobility" you consume".* [128]

According to the same analysis, it is believed that Global Mobility will double in 2020, compared with the 1997 levels. It also predicted that buses share will remain the same. As a result, the fleet capacity is going to have to double within the next 20 years if *"utilization rates remain similar to today".*[129]

The average vehicle density in Mexico is estimated to be 7.6 persons per vehicle, which is far below the U.S. and the Western European car ownership standards. Moreover, it is calculated that 97.5% of public transport between the dif-

[125] Volvo Bus Corporation (2003)
[126] Ibid.
[127] In developing countries this is 3 to % of household expenditure. This rises to 10 to 15% of household expenditure in developing countries(car ownership)
[128] Volvo Bus Corporation (2003)
[129] Volvo Bus Corporation (2003)

ferent cities in Mexico is made by coach. This can be explained by the fact that the rail network is inadequate and is used mainly for the transportation of goods plus that the domestic airfares are costly.[130]

Interurban services in Mexico include approximately 30,000 coaches. Out of these, 8% are executive and luxury models which are constructed according to very high standards of comfort. First class coaches stand for 42% of the sector whereas 50% are economy vehicles used for short distances and are of a rather basic standard.[131] The market of these services is controlled by a small group of companies which charge according to the comfort they offer. The luxury coaches usually operate on a non-stop basis between the main centers.[132]

Out of the whole bus fleet, 24,000 of the buses belong to approximately 100 different transportation companies. These transportation companies in turn are usually a part of some of the alliances that exist in the country. Three of the major ones own 60% of the market. These are Flecha Amarilla/Grupo Toluca **(IAMSA)** with 7,830 coaches and 18,900 employees, **Estrella Blanca** with 5,600 units and 18, 900 employees and **ADO** with 4200 units and 24 400 employees.[133]

The problems related to congestion and pollution in Mexico City are dealt through banning microbuses and transporters that are old and not technologically advanced and replacing them with full size busses which have bigger passenger capacity. [134] The Mexican government is working on the implementation of a plan according to which incentives are going to be given to the present micro-buses owners in order to facilitate the replacement of the micro-buses with new and more functional ones.[135] This opens up some new possibilities for the players in this market as well.

[130] Doug J. (2003)
[131] Ibid.
[132] Ibid.
[133] Fredlund S-A (2003)
[134] The Economist Intelligence Unit Limited (1999)
[135] Cortéz S. 2003/11/10

4.3.2.2 The Competition

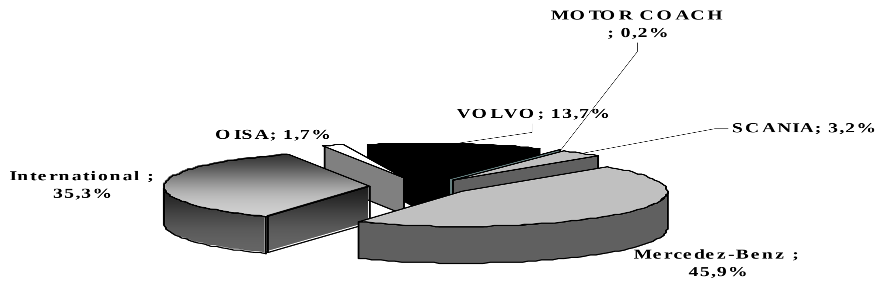
This section is going to present the main players in the Mexican Bus Market. Moreover, a brief description of their profile will take place.

- *Mercedes Benz Omnibuses Mexico SA (MB Bus).* The company is 85% owned by DaimlerChrysler's Mexican subsidiary, Mercedes Benz Mexico. The remaining 15% is owned by the Brazilian bodybuilder called CAIO.[136]
- *Mexicana de Autobuses SA (MASA***)** is based in Tultitlan close to Mexico City. As mentioned, the Mexican bus and coach manufacturer has been owned by Swedish **Volvo Bus** since 1998.[137]
- *The Diesel Autobuses SA de CV. (DINA)* It is based in Chimalistac and has a controlling interest in Motor Coach Industries International Inc. The later has plants in Mexico, Canada and the U.S.. [138]
- *Neobus*, which was founded in 1993 is a wholly owned Mexican company . The company produces among others Citiliner 40 and 45, Jetliner and Transliner buses [139]
- *Scania***,** opened its factory in Mexico in 1999. The factory builds truck and bus chassis and 2000, in which they sold 200 chassis, was the first year of production. In the 2001 production rose to 384 units. [140]
- *International* , has been present on the market since 1926 as a technological associate in different stages but not until 1996 did it establish its presence on the market manufacturing and marketing its product directly. The manufacturing plant has an area of 1.1 million m^2 and is located in Nuevo León. They produce school buses, urban buses and intercity buses.[141]

[136] The World Bus & Coach Manufacturing Industry (2002)
[137] Ibid.
[138] Ibid.
[139] Ibid.
[140] Ibid.
[141] International (2003)

The market share of each of the above mentioned actors is shown in Figure 4. As earlier explained, Volvo Bus in Mexico is going to be used as a practical example during this study; therefore this company is going to be in focus while describing the market shares.

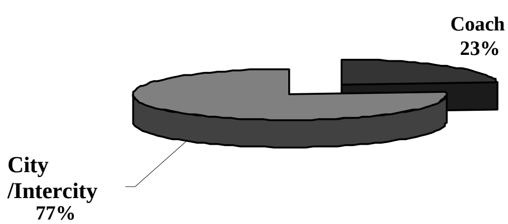
Figure 4: Bus Market Mexico – Sales Volume (Jan-Sept. 2003)



Source: ANPACT (2003)

As seen, Volvo Bus de México has a market share of approximately 14% of the total bus market in Mexico. This market consists of two segments: The coach segment and the City/Intercity Feeder segment. The Coach market in Mexico represents the 23% of the total bus market whereas the City-Intercity market covers the remaining 77%. The share of each segment is shown in Figure 5.

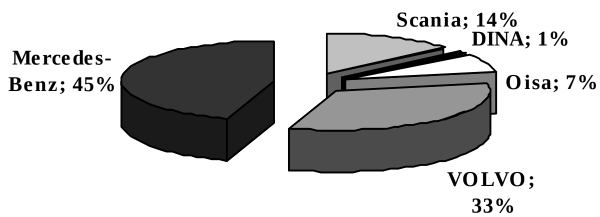
Figure 5 Bus Market Segments



Source: ANPACT (2003)

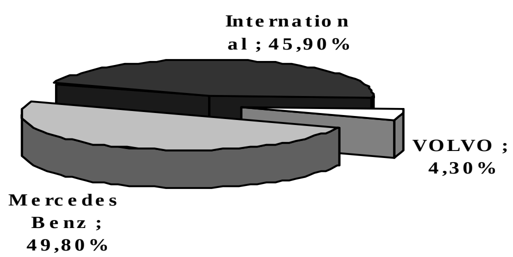
The market shares per company in these two different segments are shown in the figures below.

Figure 6 Coach Market share (Jan-Sept. 2003)



Source: ANPACT (2003)

Figure 7: City –Intercity Market share (Jan-Sept 2003)



Source: ANPACT (2003)

VBM is the leader in the coach market but has a very small share in the urban one. The company is planning to develop a special product for the city and intercity market, since there is a chance to grow in this segment. The idea is to promote the old MASA model rather that incorporating the new Volvo one since it is more expensive than what the Mexican market can maintain. The only way to penetrate this market is by introducing a cheaper bus, which does not exist at the moment.[142]

4.3.2.3 The Suppliers

In 2002 there were about 1350 registered auto parts suppliers in Mexico.[143] Local Mexican suppliers have been through difficult times since the Original Equipment Manufacturers **(OEMs)** have upgraded their products and processes

[142] Cortéz S. 2003/11/10
[143] Bancomext (2003)

and started asking for higher quality. These companies were negatively affected from the peso crisis, since the country was in complete lack of a raw material supply network which has been made up through imports. As a result and because of the extra cost, the profitability of the suppliers was seriously suppressed. A lot of auto parts firms were forced to close down when the OEMs moved closer to just in time and zero defects systems, since they could not meet the new upgraded quality standards. Moreover, competition in this sector became even fiercer because of the large neighboring U.S. component industry and the dramatically diminished levels of tariffs.[144]

4.4 Volvo Bus Corporation

One of the international companies operating in the Latin American trade policy environment is Volvo Bus Corporation. Volvo became an international player mainly in the 1990's. A highly successful move was the acquisition of the Canadian Prévost, on a 49:51 base with Henlys. After that the two partners bought NovaBus which is one of the most important bus manufacturers in North America. The company has rationalized its production in 2000, by concentrated on Sweden and Poland, the later being used as a low cost center supplying the Central and Eastern European markets. Volvo Bus was mainly a chassis manufacturer in the 1990's who had close cooperation with bodybuilders in selected markets. Volvo Bus had already bought Saffle in Sweden and other smaller bodybuilder companies. Only when the company acquired Prévost and NovaBus did it start to produce complete vehicles. The next step was the acquisition of the Finnish bodybuilder Carrus which had a long experience in building with stainless steel. As a result of this acquisition, the bus-design factory has been transferred to Poland and the inter-urban and luxury buses continued to be produced in Finland. [145]

Table 9 presents the most important markets for Volvo Bus Corporation for 2001. Data for 2002 and 2003 were not available.

[144] The Economist Intelligence Unit Limited (1999)
[145] The Economist Intelligence Unit Limited (2000)

Table 9 Volvo's most important markets -2001

	2001	Position in 2000
Mexico	1,745	1
U.S.	1,112	2
China & Hong Kong	934	7
UK	885	3
Iran	600	6
Brazil	514	4
Sweden	427	5

Source: Volvo Bus Corporation (2003)

4.4.1 Volvo Bus in Mexico

Mexicana de Autobuses SA de CV, also known as MASA, was created in 1959 and moved to its present location in Tultitlán just outside Mexico City in 1972. During the 1980s the company expanded substantially and in 1988 it was sold to private investors. MASA considered themselves as one of the top ten largest bus manufacturers in the world. According to the company, 80% of the transit buses in Mexico City and half of the coaches operating in Mexico during the 1980s were built by them. It was also a supplier to a number of neighbouring markets in Central America and it had a couple of strategic alliances with other producers on the U.S. and Brazilian markets for both inter-city busses and bus chassis.[146]

As mentioned, in 1998 Volvo acquired MASA, and set up a heavy-vehicle assembly operation at the same plant in Tultitlán.[147] At that time, MASA operations consisted basically of the production of complete city, intercity and tourist models of its own design. The initial aim of Volvo was to continue producing the models of MASA and not to introduce its own models. But, the increasing interest for the big, modern coaches built according to the European standards coaches, made Volvo decide to offer their 7550-series tourist. Soon thereafter, Volvo received an order for 900 buses from the IAMSA-group, one of the biggest players on the Mexican bus transportation market.[148] This order encouraged Volvo to invest US$23 million in extended facilities at the MASA factory,

[146] The World Bus & Coach Manufacturing Industry (2002)
[147] Couretas J. (1998)
[148] Truck & Bus Builder (2003)

which were opened in March 2000. Two years after, Volvo received orders for over 2,000 coaches and buses from three major customers including IAMSA. These orders give the company stability for the next three years, starting in spring 2002.[149] This order will be completed by the company by the end of 2005.[150]

Today, Volvo's plant in Mexico occupies approximately 60,000 sq m of covered area. It has the capacity of producing seven units a day, which is approximately 1,700 units per year. As said, the maximum capacity is 12 buses per day.[151] The Volvo Bus plant in Mexico has been modernized in order to meet the company's high international standards. Part of the plant produces the earlier MASA model of urban bus, with a high straight frame. A bigger part of the factory produces the coach range. The chassis for MASA model are produced in Mexico and in the U.S. For the coaches and integral buses, chassis come mainly from Sweden and Finland.[152] Actually, almost 50% of the company's imports come from the EU. [153] The TX platform is built on highly accurate stainless steel. This high standard equipment is complemented by the skilled local workers, especially when it comes to painting and welding.[154] With the new models of buses Volvo 9700 with the latest TX rear-engined platform and the 7350 models on the previous B12 chassis that also will be replaced with the new TX, Volvo has been able to set new standards and to continue being successful on the growing Mexican market.[155]

At the time of writing, VBM is not exporting to any other countries but all of its production is being sold in Mexico. The company has a dynamic presence in the market at the moment, despite the fact that it not using its full capacity of production.[156] Notwithstanding the lack of exports, the fact that VBM is importing various parts in Mexico for its assembly operations makes knowledge on the trade policy environment of Mexico and its volatile character vital for its success on the market.

[149] Fredlund S-A (2003)
[150] Cortéz S. 2003/11/10
[151] The World Bus & Coach Manufacturing Industry (2002)
[152] Cortéz S. 2003/11/10
[153] Reyes R. 2003/11/18
[154] Doug J. (2003)
[155] Truck & Bus Builder (2003)
[156] Cortéz S. 2003/11/10

The trade policy developments in Mexico are followed by VBM in two different stages: The purchasing department which makes the decisions regarding the location of the part acquisition and the traffic department which is responsible for the actual implementation of the provisions and specific regulations dictated by the national policy. This is not to suggest that those two departments are the only ones influenced by the trade environment, but that they are the ones putting into practice the directives of the trade policies in their everyday function. Before the purchasing department proceeds with an order of parts from abroad, the traffic department is consulted regarding the rules that need to be followed and the cost that needs to be paid with regards to the country's international trade relations. If the decision to import the part is made, the logistics department is responsible for its on-time delivery.

Traffic Department

The division responsible for following the tariff and non tariff barriers on the company's importations is the traffic department. It is this department that holds the task of tracking any new development regarding these issues. Moreover, its responsibility is to pay the relevant fees and discover saving opportunities. The traffic department keeps track of the 250 most important products based on their imported quantity. The first ten are the most essential ones due to the quantity and frequency of their importation. [157]

The products are listed according to their codes under the Harmonized System (HS). As explained by the company, this facilitates the inventorying and registration of the products since the HS code shows all the technical details of the part. (For further explanation of the function of the HS system, see Appendix II).[158] The classification of the products under the HS system is done by the company in coordination with customs. The traffic department receives the documents from the suppliers describing all the specifications of the imported products. As the product enters the country, it is classified according to these specifications.[159]

Purchasing

The purchasing department, before making a decision regarding the choice of a supplier, among other factors, considers the trade policy environment of the

[157] Alanís A. 2003/11/11
[158] Ibid.
[159] Ibid.

suppliers' country and its trade relation with Mexico. Therefore, the importance of acquiring the knowledge on issues such as the function of the FTAs and the specific subjects of the rules of origin and tariff elimination have been emphasized by both the purchasing and the traffic department.[160] VBM-Purchasing is acknowledging that *"…the most important barrier with the implementation of the different agreements is the lack of knowledge about it"*[161] Moreover, the significance of good communication between the purchasing, traffic and logistics has been emphasized. Purchasing has to have access to updated information and to make the best use of it.

The purchasing department is sourcing materials from all over the world. As mentioned, about 50% of the total imports derive from Sweden. Despite the cost considerations, parts are imported from Europe because of the advanced technology necessary for the Volvo Bus products and their Volvo-specific design. Moreover, cost is balanced due to the economies of scale achieved by the concentrated production in Europe. [162]

The Goals of VBM for the Future

Even though VBM is not exporting at all at the moment, there are discussions about this possibility in the company. The important issue regarding exports is that, at the time of writing, VBM does not have the kind of products that could be used in order to penetrate other markets. When it comes to Latin America, VBM needs cheaper products in order to be able to compete. When it comes to the U.S., Volvo Bus as a European producer does not fulfill the technical specifications necessary to enter that market. According to the company, only if an opportunity arises in the future that would be big enough to justify a considerable investment, the redesign of the bus and exports to the U.S. will be under consideration. For the time being, the U.S. market is not considered offering such opportunities. According to a VBM research, if exports would have taken place, the company would be able to sell approximately 20 to 80 buses on a monthly bases. According to the same research, the fact that 40% own a car makes the gap in the demand for buses not interesting. The only growing bus segment in that market is the one for school buses which is out of the VBM product range. [163]

[160] Reyes R. 2003/11/18, Alanís A. 2003/11/18
[161] Reyes R. 2003/11/18
[162] Ibid.
[163] Cortéz S. 2003/11/10

Despite the relatively good market performance in Mexico, the company realizes the risks of being highly depended on one market. According to the president of VBM, the company is a member of Volvo's North American manufacturing group and is conscious about the U.S. market. According to his interview in the bus ride magazine, in April 2003:"*Our first priority is to satisfy demand from our major customers in Mexico. We might even need to raise capacity, but we know that our coaches could meet customer requirements in the United States. We would obviously pitch in a different sector from Prevost, which has its own loyal following. The first logical step might be to look at cross border coach traffic, and develop from there*."[164]

VBM aims at exploiting to their maximum all the opportunities given by the trade policy of Mexico. The goal is to cut cost by finding cheaper sources of component purchasing that will still comply with the company's quality and technology standards. The company's objective is to use its full capacity of production and maximize its profits. [165]

[164] Doug J. (2003)
[165] Reyes R. 2003/11/18

National Level

Mexico's Free Trade Agreements
Future Trends

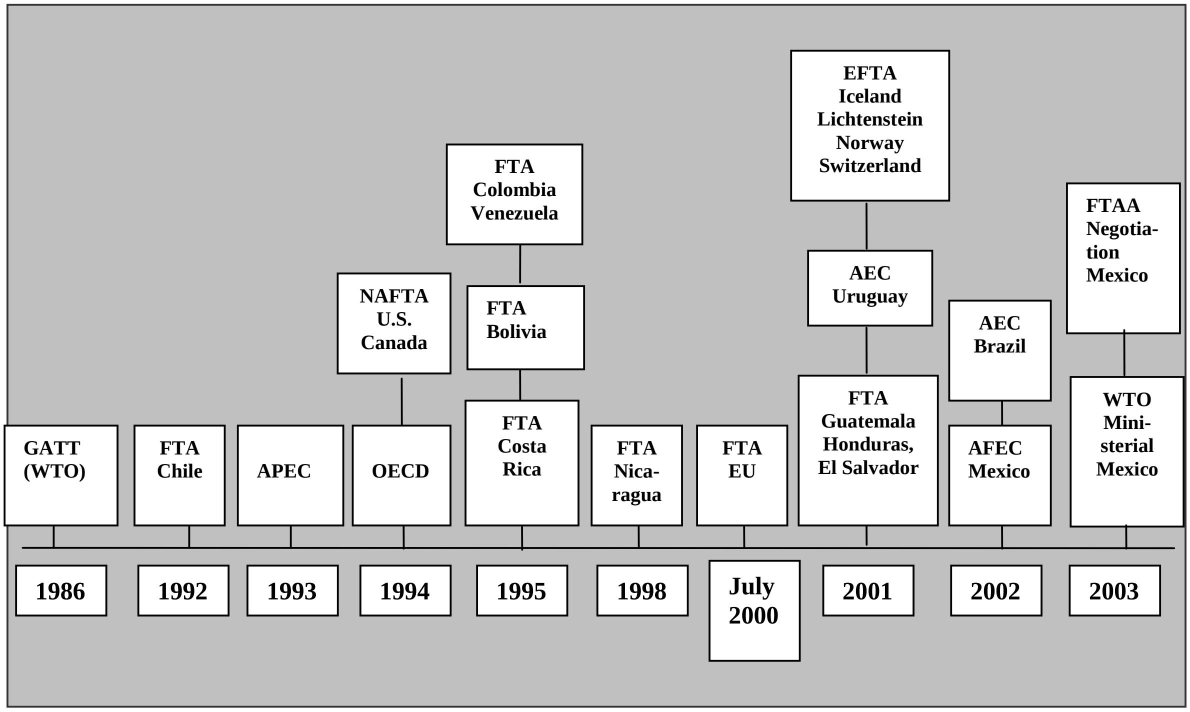
5 Mexico's Free Trade Agreements

This chapter represents the first part of the empirical study and refers to the general framework of the Free Trade Agreements that Mexico has signed as well as the current trade negotiations. A selection of the most important Free Trade Agreements according to their importance to the bus industry is made. Moreover, a discussion about the general effects of these agreements and the trends for the future takes place. The later will be used in the analysis when trying to estimate the progress of the negotiations and their impacts. The aim is to provide the necessary overview of the trade policy environment so as to facilitate the understanding of the more specific parts of the trade policy described in a later chapter.

As described in previous chapters, Mexico has taken enormous transition steps away from the closed economy that it used to be. Mexico has been one of the earliest reformers of its trade policy in Latin America. It assented to GATT back in1986 and became a member of WTO in 1995. Mexico started reforming its trade policy after the deep crisis in the early 1980's. The logic behind this was to promote trade as the leading sector for economic growth by exposing local producers to international competition while supporting them through the provision of foreign, more technologically advanced goods. That would modernize the production and the commercialization process and would further encourage local producers to start exporting activities themselves.[166] Nowadays, Mexico is one of the most opened economies in the world. Mexico has already singed 11 international agreements and several bilateral ones in order to promote its competitiveness and exports.[167] Figure 8 shows all the agreements Mexico has signed in chronological order.

[166] Busse M. et al. (2001)
[167] The NAFTA Office of Mexico in Canada

Figure 8 The Mexican Free Trade Agreements



Source: The NAFTA Office of Mexico in Canada

In the delimitation chapter of this study, it has been emphasized that not all of the trade liberalization processes that Mexico is involved in are going to be studied. The criterion of selection is the importance of each one of these agreements with regards to the Mexican bus industry.

As previously shown, Mexico's most important trading partners are the Northern American countries, the EU and at a much smaller percentage Japan, Brazil and lately China. In previous chapters the great trade dependence on the U.S. and the growing importance of the EU have been made apparent, especially in the automotive sector U.S., Canada, Germany, Japan and Brazil dominate as import sources or export destinations. Since most of the trade flows both in general and within the automotive sector concern these countries, the treaties and negotiations that take place between them and Mexico have been estimated as important for further study. Furthermore, the future trends of the trade negotiations with the specific regions are of utmost importance. Thereafter, the focus of this study will be put on NAFTA and the FTA between the EU and Mexico. Moreover, the preferential trade agreement with Brazil will be briefly described. Negotiations taking place with Japan and prospects of the integration initiated in Latin American and in the Asian Pacific region are also discussed.

5.1 NAFTA

5.1.1 Motivations Behind the Agreement

During the late 1980's, bilateral trade between the U.S. and Mexico began to liberalize. Selected Mexican exports were gradually allowed to enter the U.S. market through different programs.[168] Talks about the Free Trade Pact came on the agenda first in June of 1990 when Mexican President Salinas went to visit U.S. President George Bush in Washington. His vision was to improve the conditions for Mexico's increasing labor force by further improving the re-formed economic structure, rising the reception of foreign direct investment and catching up with more advanced technologies. Canada joined these talks in a later stage, since it had already entered a new bilateral U.S. – Canada Free Trade Agreement **(CFTA)** in 1989. According to this agreement, over 70% of merchandise trade between the two countries was allowed to enter duty free.[169]

As a result of this gradual process of trade liberalization between the three countries, in August 1992, a plan for free trade that would gradually eliminate tariffs over fifteen years and stimulate trade and investment was agreed upon. The North American Free Trade Agreement **(NAFTA)** took effect among the member nations on January 1, 1994.[170] Canada, the United Mexican States and the United States of America resolved among other issues "*contribute to the harmonious development and expansion of world trade and reduce distortions in the bilateral trade...*" [171]

NAFTA has created the largest common market in total production with 370 million consumers. While protecting the 1989 CFTA, the overall objectives of NAFTA are to: "*…eliminate barriers to trade, create effective procedures for the implementation and application of this agreement and establish a frame-work for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this agreement…*"[172]

[168] Zangari B.J. (1994)
[169] Gianaris N.V. (1998)
[170] Zangari B.J. (1994)
[171] NAFTA 1
[172] Ibid.

5.1.2 The Overall Effects of NAFTA

In 2001, eight years since its implementation, the NAFTA still proved to be beneficial for the main stakeholders of the signatories. Despite the tough economic slowdown for the world economy the results of NAFTA were clear. Lower trade barriers have caused the expansion of trade in all three countries, which in its turn led to increased employment, more choices for consumers at competitive prices, and rising prosperity. NAFTA intra-trade has increased sharply after the agreement's implementation. The positive impact of the NAFTA has made North America one of the most competitive, prosperous and economically integrated regions in the world.

Investment[173]

Due to its ability to foster a healthy environment of confidence and stability, necessary for long-term investments and partnering commitments, NAFTA has become an attractive area for foreign direct investment **(FDI)** from around the world. An integrated North American market has been stimulating capital flows, spreading of technology, increasing productivity, and higher wages. Only in Mexico, the amount of FDI was three times higher in 2000 compared to the pre-NAFTA period.

Employment, Earnings and Productivity[174]

Economic activity and production within the NAFTA area has been improved through the fantastic development of exports and investment mentioned above. This has resulted in the creation of more and better paying jobs in all three countries. The export sector in all three countries is not only the leading job creation machine but it also accumulates the highest wages. In Mexico, the hourly wage rate in export-supported jobs is 40% higher than in the non-export sector. More than half of Mexican manufacturing jobs were gained between 1994 and 2000.

The main outcomes of NAFTA – the gradual shift of capital, technology and new job opportunities – resulted in rise in productivity and increasing standards of living. Furthermore, tariff cuts on NAFTA imports have kept prices at a moderate level, which have been beneficial for both households and businesses.

[173] NAFTA at Eight
[174] Ibid.

This benefit will be even bigger when nearly all NAFTA tariffs are eliminated in the end of 2003.

Trade within NAFTA has also increased in sectors of the economy that have previously been rather unexploited. Because of its wide range of measures of dealing with the non tariff barriers, NAFTA can be seen as a milestone agreement.

In contrast to the above mentioned direct benefits of NAFTA, it has been claimed that the indirect impacts of NAFTA have been even greater. Access to the U.S. market has not increased markedly since the U.S. market was already largely opened. On the other hand, Mexico has been granted through this agreement that there can not be any unexpected protectionism moves from the U.S. that could seriously threaten its economy. Furthermore, NAFTA has sealed the path of the restructuring programs in Mexico. The agreement makes it harder for any Mexican government in the future to advert the economic and political reforms.[175] Even in the U.S., this indirect impact of NAFTA can be assessed as large. Mexico is on the border of the U.S. and its economic and political development would diminish U.S. concerns on immigration and corruption issues. Mexico's transformation from a low-income, semi-democratic country into a middle-income, democratic one promotes the U.S. national interests and security.[176] Although NAFTA is a young agreement and not fully implemented yet, more long run benefits are yet to come.[177]

5.1.3 Criticism of NAFTA

A lot of criticism against NAFTA is coming from politicians and economists from the U.S. Their fear is that low wages in Mexico will cause loss of jobs because Mexican wages in manufacturing are approximately one-fifth of those in the U.S. There is as well a fear of an immense flow of U.S. companies moving to Mexico, especially the firms that assemble goods in Mexico and then send the finished products back to the U.S. for duty-free exports. The only factor that is balancing this flow is the level of productivity that is at the moment much higher in the U.S. than in Mexico.[178] Furthermore, there is considerable speculation over NAFTA's impact on Mexican migration to the U.S. and Canada, al-

[175] Gianaris N.V. (1998)
[176] Ibid.
[177] Ibid.
[178] Gianaris N.V. (1998)

though NAFTA itself does not provide for open borders or the free movement of labor.[179]

Despite the criticism and skepticism that NAFTA has caused over the years when it comes to employment, job loses and wage competition there have been proof of the opposite. One of the UCLA's institutes[180] has estimated that the employment of U.S.-Mexico trade have not been significantly affected by the liberalization of tariffs as the result of NAFTA. [181]

Although NAFTA will most likely only have a modest net effect on the U.S. economy, it has launched another controversy over issues such as its impact on the environment, enforcement of labor standards, and migration. Those topics are not traditionally negotiated in trade agreements. NAFTA is also expected to encourage trilateral cooperation on environmental issues. [182]

5.2 FTAA - The Enlargement

The current member countries of the NAFTA have shown interest in extending the free trade zone in the Americas. This is to be achieved through the expansion of the Free Trade Area rather than through the further integration as a customs union. In recent years, representatives from 34 countries have been working to expand the NAFTA to Central and South America and the Caribbean. The accomplishment of the FTA would cover a combined population of about 800 million people, more than US$11 trillion in production, and US$3.4 trillion in world trade. Within this agreement a variety of different countries, when it comes both to size and prosperity, would be included.[183] The whole process is agreed to be completed by 2005. [184]

Overall, the FTAA process is on track, although much will depend on the health of the Brazilian economy and the political will of the U.S. to liberalize its own well-established trade barriers. Both countries have played an important role in the creation of the FTAA and are still essential for its success. Both countries have worked well together in the past and hopefully, they will be able

[179] Zangari B.J. (1994)
[180] North American Integration and Development Center **(NAID)**
[181] Zangari B.J. (1994)
[182] Zangari B.J. (1994)
[183] GAO (2001)
[184] FTAA 1

to build on these positive experiences and lead the FTAA negotiations to a successful conclusion.[185]

5.2.1 Benefits of the FTAA

Successful negotiation could produce important economic benefits for the United States. The FTAA region is already important economically for the United States. Business groups point out that if relatively high tariffs and other market access barriers are removed, U.S. trade with the region could expand further.[186]

The FTAA offers as well a number of potential benefits for the Latin American and the Caribbean countries:

- *Greater and more secure access to major markets* – Greater access to the United States or Canadian markets under the FTAA will be very advantageous.
- *Trade relief and dispute settlement* – Mechanisms for fair settlement of trade-related disputes are being settled and the security of market access is being enhanced.
- *Investment* – One of the greatest potential benefits of the FTAA can be gained through an increase in foreign direct investments.
- *Consolidation of the economic reforms and positive signs for investors* – Although the FTAA's main benefits will come when the agreement enters into force, the negotiations for the FTAA are already having positive results. These include a sense of urgency and direction for economic policies, which is a positive signs for investors.

Even thought it has been applied that Mexico has no incentives to further negotiate for the FTAA due to the NAFTA and the EU agreements, this statement has been rejected at the Ministry of Economy. There are many other unexplored markets within Latin America that Mexico has not had the access to and that would be good potential trading partners. Ecuador is just one of the examples. That Mexican government is actively participating and taking part in both negotiations with the WTO and FTAA. No matter which way the negotiations

[185] Ibid.
[186] GAO (2001)

go, Mexico is not going to be negatively affected by the fact that the other countries will have the same access to the U.S. and Canadian market.[187]

5.2.2 Challenges to the FTAA Process

In order to successfully complete the FTAA, a number of obstacles must be overcome. Due to the complex and controversial character of some issues and the diverse nature of the political and economic conditions of the participating countries, negotiators are facing a challenging task. Only the fact that 34 widely different countries are participating in the process of creating a hemispheric free trade zone in itself is an enormous complication.[188] Dealing with the diverse objectives of the key participants is another major obstacle. Furthermore, the FTAA negotiating process is challenging because it requires consensus. Here are just some of the main issues that are under discussion:

- The United States seeks broad improvements in trade rules and access, in addition to the lowering of regional tariffs
- Brazil is primarily interested in gaining access to certain sectors of the U.S. market in which it faces relatively high barriers
- The smaller economy countries are interested in protecting their economies from becoming overwhelmed by the larger ones while securing special treatment in an eventual FTAA; and
- Mexico has less economic incentive to pursue an FTAA because it already has preferential access to most hemispheric markets through a comprehensive network of free trade arrangements.[189]

5.3 EU– Mexico Free Trade Agreement

5.3.1 Motivation Behind the Agreement

The FTA between Mexico and the European Union, which came into force on July 1 2000 is the outcome of two main dynamics: The Mexican economy modernization that started in 1990’s and as a sequel effect of the NAFTA. After NAFTA, the Mexican administration continued to negotiate other trade agreements that were also spurred by the Mexican strategic position. The goals of the Mexican administration at the time were a sequence of three steps. First, Mexico would become a commercial link between North and Central-South Amer-

[187] Ochoa A. & Baker J-C. 2003/11/17
[188] GAO (2001)
[189] Ibid.

ica, second it would be a bridge between the Americas and Europe and third it could serve as a connecting bond between the Americas and Asia.[190]

Trade between Mexico and the European Union, already discussed in this section, was rather insignificant during the 1980's and 1990's. Mexico and EU started to strengthen their bilateral cooperation back in 1995. One reason has been the different bilateral agreements signed by both sides with third countries. As a result, both parties were trading more with countries they had preferential agreements with, rather than with each other.[191] NAFTA was a growth catalyst for the Mexican economy, but closeness and dependence on a strong partner such as the U.S. could be proved to be dangerous. EU-Mexico FTA would diversify the current U.S. dominance on Mexico's trade and investment relations. Furthermore, this agreement makes Mexico the only country in the world that enjoys a free trade agreement with both the United States and the European Union and therefore has the opportunity to reach a market of about eight-hundred million customers.[192]

Moreover, the European businesses find Mexico's strategic position, increasingly skilled workforce and growing market challenging and appealing. Diversification of Mexico's trade relations will be good for European firms which will be able to use Mexico as a platform in order to reach the big markets of its NAFTA partners. Mexico's attraction is based on the fact that it has become one of the most open markets in Latin America because of its liberalization policy. As a result of the EU-Mexico FTA, trade relations between Mexico and the EU are expected to elevate.[193] EU is Mexico's second biggest trading partner after NAFTA. A possible enlargement of NAFTA to other countries of Latin America is very possible to lead to a larger market share for the European Union. Any further FTA of Mexico with other Latin American counties would strengthen the presence of the EU in the area even more and would facilitate its access to a market with huge growth potential.[194]In addition, regionalism is a part of the EU policy and has been pursued since it is believed that *"multilateralism and regionalism are mutually supportive strategies in the pursuit of the international economic life."*[195]

[190] Peña A. (2002)
[191] Ibid.
[192] BBC News, UK Edition (2000)
[193] Latin Advisory (2000)
[194] Ibid.
[195] Europa – DG Trade (2003)

The Objectives of the Agreement

The objective of the EU-Mexico FTA is to create a Free Trade Area between Mexico and the EU, through a transitional period that will last a maximum of 10 years beginning in the year 2000.[196]

According to the EC- Mexico Joint Council, the objectives of the treaty are:

⇒To progressively and mutually liberalize the trade of goods between the two parties

⇒To unlock the agreed procurement markets of the parties

⇒To set up a collaboration mechanism with regards to competition

⇒To set up a consultation mechanism with regards to intellectual property issues

⇒To set up a dispute settlement system

5.3.2 The Effects of the Agreement

Table 10 shows the EU-Mexico FTA effect on the two parties' trade.[197]

Table 10 Trade creation, Trade diversion and total effects of the EU-Mexico FTA

Region	Trade creation		Trade Diversion		Total trade effects	
	US$ mill.	% of preferred imports	US$ mill	% of non-preferred imports	US$ mill	% of preferred imports
In Mexico	1,707	19.4	831	0.9	2,538	28.9
In the EU	107	2.5	106	0.02	212	4.9

Source: Busse M. et al. (2001)

EU benefits in Mexico are higher, according to this table. Total Mexican imports from the EU are expected to rise by 28.9% with trade creation being double of the trade diversion. These non-symmetrical effects of the agreement are due to the considerably higher Mexican tariffs before the treaty. Thereby, when the tariffs were dismantled there was more for the EU to gain. Before the treaty Mexico already enjoyed privileged access to EU markets. [198]

[196] Peña A. (2002)
[197] According to the calculation of a study made by the *Hamburg Institute of International Economics* **(HWWA).**
[198] Busse M. et al. (2001)

Table 11 shows which countries have been affected by the trade diversion in Mexico. As shown, while trade diversion in the EU is rather small, Mexico is concentrated by a large proportion on the United States. [199]

Table 11: Regional Distribution of Trade Diversion in Mexico

Affected region/country	Trade Creation	
	US$ mill	**In %**
U.S.	685.7	0.8
Canada	12.4	0.9
Japan	27.6	1.1
Central and South America	17.3	0.7
Rest of the world	88.3	0.5
Total Trade diversion	831.3	0.9

Source: Busse M. et al. (2001)

EU and Mexican preferential trade agreements have not caused serious distortion to third countries' trade. At a first level, significant trade effects are to be expected on the agricultural sector in the case of Mexico and in the finished products such as **machinery** and **transport equipment** for the EU. Another remark could be that because of the agreement trade creation clearly exceeds trade diversion and the EU is gaining much more from that compared with Mexico. [200]

Despite the fact that EU exports have mounted during the last decade, Mexican exports to Europe have not followed the same upward route. European investment in Mexico has taken place mainly in the manufacturing sector, transport and communication. Mexico is now EU's 18th export destination and the most important one in Latin America.[201]

The EU-Mexico FTA Effects on Mexico

The FTA entails new opportunities not only for Mexico and the EU but also for the other two NAFTA countries. This agreement opens up the European Union market for U.S and Canadian companies than now have the opportunity to export products that are manufactured in Mexico to the EU and thus pay low customs duties or not pay any customs duties at all. In order to be able to do that, the products need to comply with the rules of origin of the agreement. These conditions oblige U.S. and Canadian companies to invest in manufacturing fa-

[199] Ibid.
[200] Busse M. et al. (2001)
[201] Latin Advisory (2000)

cilities in Mexico. A consequence of this will be large employment opportunities for Mexico and the following positive economic and welfare effects. Moreover, EU companies will have a great incentive to invest in Mexico in order to reach the U.S. and the Canadian market with eliminated duties according to the NAFTA agreement. It is believed that this agreement will result in greater investment inflows in Mexico deriving from the European Union rather that the United States or Canada. This is because the investments already made by U.S. and Canada are much larger compared with the ones coming from EU in the area. Therefore, this agreement will be a tool that will mainly promote EU investment in Mexico.[202]

It is argued that exports from European affiliates in Mexico can complement, rather than be at the expense of sales of parent companies in Europe. This is particularly relevant to European industries such as **automobiles and machineries** which can use Mexico as a base in order to penetrate the U.S. market. On the other hand, U.S. firms can use the MEXICO-EU FTA in order to relocate exports towards the EU from domestic to Mexican sources or even increase exports to the EU through subsidiaries operating in Mexico.[203]

The above stated effects are not to say that the EU-Mexico FTA is a one way and perfectly unambiguous agreement regarding its impacts. Whether the FTA is going to increase FDI in Mexico or not is rather unclear. That is because the country's improved investment climate, due to the 1980's reforms, are not an economic growth guarantee themselves. Complex rules of origin discourage investors and deter companies, especially non-NAFTA ones. In addition, a considerable amount of corruption, crime and inflexible labor markets are not further promoting foreign investment in Mexico since they are to be taken under serious consideration.[204]

The effects of the EU-Mexico FTA are often compared with the ones of NAFTA. The comment of the European Union office in Mexico on this issue is that when it comes to NAFTA, trade already was taking place to a large extent and the agreement just added to an existent situation. On the other hand, the EU believes that the EU-Mexico FTA is clearly underused. Despite the fact that in the last ministerial level meeting between the two regions it has been proved

[202] Peña A. (2002)
[203] Busse M. et al. (2001)
[204] Ibid.

that trade increased by 25%, more unused opportunities have been identified. The EU considers that these prospects mainly concern the importation of Mexican products in the European market which should have been at much higher level, especially at a time that Mexico has a relatively weak currency. The EU office in Mexico explains this phenomenon as a result of the luck of support on behalf of the Mexican government to its companies in order to help them explore and enter the EU market.[205]

5.3.3 The Future of EU-Mexico FTA

The EU-Mexico FTA will liberalize trade between the two regions, further enhance their relations and as said promote foreign investment in Mexico. The future and the success of this agreement are very closely related to the achievements of NAFTA and the further integration of the Americas. Therefore, in order to examine the EU-Mexico FTA future trends one should look into the future of the NAFTA as well as the other agreements taking place in the Americas.

In the case of the realization of the FTAA, the agreement between the EU and Mexico will be the unique commercial link between the two continents and Mexico will become a bridge for trade and investment. However, such a development may be alerted by potential agreements between other American countries and the EU. Even in that case though, the EU-Mexico FTA will still have the advantage of being the first and probably the most advanced one, since it started so much earlier. [206]

In accordance with the EU office in Mexico further negotiations between the EU and Mexico will include the agricultural sector and services. A future development may be the acceleration of the tariff phasing out, especially if certain industries request the faster elimination of tariffs in certain goods. [207]

As with this agreement, tariff levels are falling and since the Auto-Decree mentioned below is going to be seized in 2004, new issues have arisen between the two trade partners. One example is the emission and safety levels on cars, buses and trucks. Mexico has considered harmonizing these standards but: "… *the*

[205] Sillvetti R. 2003/11/19
[206] Peña A. (2002)
[207] Sillvetti R. 2003/11/19

big question has been whether to standardize them according to the European ones"[208]

5.4 Other Agreements

Mexico has concluded Agreements with more than 30 countries, whereas more trade negotiations are carried out at the time of writing.[209] The next section is going to briefly present some of those agreements and negotiations that are expected to have the greater influence on the automotive industry.

The Latin America Integration Association **(LAIA)** is an example of the intra-governmental organization in which Mexico takes part. Its objectives are to promote trade and expand the integration of the region. Through this integration, the goal is to secure the economical and social development and in the end to create a common market. Within this organization twelve Latin American member countries are represented.[210]

Within the framework of LAIA, in 2002, Mexico and Brazil signed a preferential trade agreement which would intensify trade between the two regions by eliminating tariffs on a wide range of products.[211] This agreement is a supplementary agreement to the Economic Complementation Agreement with MERCOSUR. It is temporary and is planned to be substituted in the future by the FTA between Mexico and MERCOSUR.[212] The agreement will be effective on January 1, 2003. Its main goal is to strengthen the bilateral relationship between the countries involved and send out a political message to the rest of the members of MERCOSUR and LAIA. For the Mexican government, additional stimulus to make this agreement possible was the opportunity to access a new large market, satisfy the needs and interests of Mexican companies and complement the negotiation that will eventually lead to the agreement with MERCOSUR.[213]

Regarding the future process and progress of the agreement with Brazil, it is believed that it will be dictated by the market forces and by political factors. Nevertheless, it seems that the major parts of this process would follow the

[208] Baker J-C 2003/11/17
[209] Keidanren N. (2003)
[210] LAIA
[211] Maquila Portal 3
[212] ACE No 55
[213] Ibid.

steps towards integration in the whole continent and finish up with the negotiations of the FTAA.[214] At the ANPACT office, further negotiations with Brazil are seen as not very possible. "*For our sector (The autotransportation sector), the agreement with Brazil would not be beneficial. In Brazil the government is giving a lot of subsidies to the companies. This makes the competition much harder for us….*"[215] Moreover, the completion of this agreement will be discouraged due to complicate negotiations and bureaucracy obstacles.[216]

This treaty has already made Mexico a major export destination of Brazil automakers that could use this agreement in the future in order to reach the U.S. market. Based on this, there are contradictions with the above opinions that suggest that integration between Mexico and Brazil will speed up because of the vehicle manufacturers' willingness to persuade the policy decision makers in proceeding with such an agreement.[217] This can be the only way for them to rationalize their production and eliminate their big losses in South America. There are reasons to believe that such a pressure can be rather persuasive given the great employment opportunities that these manufacturers give to the respective countries they are located in.[218]

A part of Mexico's policy of expanding the range of Free Trade Agreements in order to promote certain sectors and their interests is the current negotiations with Japan.[219] So far the two nations have only studied the feasibility of a treaty. This agreement is for both sides part of an ambitious plan to deepen their economic association. Japan's main aim is to be able to equally compete with the U.S. and the EU when it comes to exports of Hi-technology products to Mexico. Mexico, on the other hand, will benefit from investment flows coming from Japan. The agreement will cover all sectors; agriculture being the most sensitive and hard to negotiate.[220] Japan is pressing on the closure of the agreement since there are opportunities for the Japanese industry discovered in Mexico. For Mexico this treaty will be one of the most important ones since it will connect the country with one of the most prosperous economies in Asia and will expand Mexico's FTAs to another continent.[221]

[214] Baker J-C 2003/11/17
[215] Espinosa I. 2003/11/19
[216] Alanís A. 2003/11/18
[217] Just Auto (2001)
[218] Just Auto (2001)
[219] Baker J-C 2003/11/17
[220] Maquila Portal 4
[221] Ibid

China has been a major destination of FDI during the last years basically due to its improved business clime and the country's accession to the WTO. [222] The above described FTA negotiation with Japan and the possibility of a deal comes at a very good time for Mexico since a lot of concerns have been expressed about the country's competitiveness as a manufacture base compared with some Asian countries and especially China. The Fox administration is working towards securing the maintenance of foreign manufacture companies by discourage them to move to China where labor is cheaper. Despite the benefits for tax-free importation given by the Mexican government, such as the PROSEC program described below, China seems to prevail as a cheaper location due to Mexico's strong currency and higher wages. Moreover, the economic slowdown in the U.S. constrains Mexico's argument of proximity to a big market, and encourages companies to look for cheaper locations.[223]

The lower cost competition from China is identified by the Mexican administration. According to the vice president of the automotive sector in Bancomext, Mexico is realizing that *"…China is creating problems at the moment"*. As he states, Mexico used to be the second largest trading partner of the U.S. until China came into the picture and brought Mexico to third place. He also describes what kind of policy the Mexican administration should follow in order to create more competitive conditions for the companies in the country. This policy includes measures for the support and integration of the local suppliers which would encourage companies to purchase components locally. The establishment of a new energy policy would also decrease the cost for production along with programs designed to promote the labor productivity levels. [224]

Moreover, Mexico participates in the Asia-Pacific Economic Cooperation **(APEC)**, another inter-governmental grouping of 21 member countries working together in enhancing economic growth and prosperity in the region. The members are under no treaty obligation and decisions made in the forum are undertaken on a voluntary basis. The main goals of APEC are to reduce tariffs and other trade barriers across the Asia-Pacific region, create efficient domestic economies and increase exports. Among the participating countries are China, the U.S. and Chile.[225]

[222] World Investment Report (2001)
[223] Donnelly R. (2002)
[224] Carrasco R. 2003/11/14
[225] APEC

5.5 The Goals of Mexico for the Future

Mexico's location in the centre of the Americas and with access to the Pacific Rim and the Atlantic Ocean places it as a trade doorway between the four cardinal points. Mexico's basic goal for the future is to proceed to deeper integration with its already existing trading partners as well as opening new markets for its export products. Within the Western hemisphere, Mexico is in a negotiation process with Mercosur (Argentina, Brazil, Paraguay and Uruguay) and bilaterally with Panama. It is argued that these agreements are going to be the foundation for the FTAA. Moreover, Mexico is looking for trade opportunities in areas beside the Americas. Currently it is negotiating with Singapore and Japan. [226] These actions are part of Mexico's strategy to broaden its trade activities away from NAFTA, and thus avoid the U.S. dominance by launching itself as a link between the Americas and Europe as well as between the Americas and Asia. However, Mexico has to preserve its position into NAFTA and protect it under the new circumstances that could have been created with the imminent Free Trade Agreement of the Americas. [227]

Bancomext considers NAFTA to be a well negotiated agreement that has brought a lot of benefits in the country, especially in the automotive sector. Therefore, there are no specific goals to amend it or further negotiate it. There are only some restrictions left to be discussed between the North American partners that are not considered to be as significant. Mexico intents to change its policy and focus more on strengthening its industry. The aim is to support medium and small enterprises through training, financing or with technology upgrading programs. According to Bancomext, Mexico has no intention to continue signing Free Trade Agreements since the already existing ones are considered to be enough. The agreements with Uruguay and Japan are going to be the last ones. When it comes to the further integration of the Americas with FTAA, it has been stated that in the forthcoming negotiations in Miami, U.S., Mexico will participate but without any specific proposal or initiative. Moreover, it has been stated that Mexico is more focused on bilateral rather that multilateral agreements. As the vice president of the automotive sector in Bancomext said: *"…In Mexico we are convinced that the best way to fight poverty is to open our country".* [228]

[226] The NAFTA Office of Mexico in Canada
[227] Busse M. et al. (2001)
[228] Bancomext (2003)

The Mexican Ministry of Economy has described the future goals of the country as combining bilateral and multilateral Agreements at the same time since they are not considered to exclude one another. The aim for the future is also to simplify and work towards a better functioning of the already existing agreements by introducing new creative ideas as for example how to simplify the rules of origin.[229]

[229] Baker J-C 2003/11/17

Industry Level

The automotive related parts of the FTAs
Trade Promotion Programs

6 The Automotive Related Parts of the FTAs

The next section presents the parts of the selected FTAs that are related to the automotive sector. Since the specific clauses are rather technical and sometimes complex, an example is going to be used in order to provide a better understanding of their function. For this purpose Volvo Bus in Mexico has been chosen. Therefore, while describing the specific regulatory framework, its application on the company is going to be exemplified.

In order to facilitate the process of describing the specific clauses of the agreements, 9 specific products were given by VBM. Those products are listed in Table 12 after their Harmonization System **(HS)** fraction number. As it will be shown during the description of the automotive related articles, the HS code of a product is of great importance since the products are categorized by the agreements in accordance with this fraction number and special rules are applied to each group of them. This table shows the percentage of tariffs on each one of the products that needs to be applied in accordance with the various FTAs and trade promotion programs that Mexico is implementing. Moreover, the product description is presented and the imported quantity as a percentage of the company's total imports.

Table 12 The 9 most important import products of VBM

	Fraction	Description	% Of Total Imports	Applicable Tariff				
				Normal	U.S.	CAN	EU	PROSEC
1	87060099	Chassis fitted with engines	44.59%	50	0	0	10	0
2	87082999	Parts and accessories of the motor vehicles	9.31%	18	0	0	5	0
3	84152001	Air-conditioning machines	8.81%	20	0	0	5	0
4	73066099	Steel welding machine	4.02%	25	0	0	5	0
5	87089999	Parts and accessories not included in 87082999 code	3.67%	13	0	0	4	0
6	70072102	Glass manufacturing equipment	1.99%	23	0	0	5	0
7	84159099	Components for air-conditioning machines	1.19%	18	0	0	5	0-3
8	87089915	Other parts for power trains	1.15%	18	0	0	5	0
9	72193301	Welded steel	0.95%	18	0	0	5	N/A

Source: Volvo Bus in Mexico (2003)

Those nine products alone represent almost 75% of the company's entire importation. As shown, almost 45% of them concern one specific product which is the bus chassis (See Appendix III for technical definitions), most of which are imported from Volvo's plant in Borås, Sweden. Unfortunately, no information on the origin of the rest of the nine fractions was given by the company. As said, the table also shows the applicable tariff on each fraction according to different agreements or programs. The first code, for example, is applicable to a 50% tariff if it is imported from a country that Mexico has no preferential agreement with. If the product is imported from the U.S. or Canada there is no tariff to be paid, whereas it is applicable to a 10% tariff if imported from Europe. Nevertheless, the company has a choice of using PROSEC which is one of the governmental programs aimed at promoting sectoral trade. Under these terms, this part can be imported with a zero level tariff from any country where it exists in the PROSEC list and the program can be applied. PROSEC will be further described in the next chapter.

6.1 NAFTA at the Industry Level

The automotive industry is among the largest in each of the three NAFTA countries constituting the largest trade sector between the U.S. and Canada and between the U.S. and Mexico. Due to the importance of automotive sector in the economies of Canada, Mexico and the U.S., the automotive industry is treated differently in different parts of the NAFTA agreement. The principal goal of the negotiations of this complex and sensitive issue was to establish market and investment conditions that will lead to a fully integrated North American automotive industry. Particular attention was given to diminishing Mexico's restrictions on automotive trade and investment and the integration of Mexico's highly protected automotive industry with the already highly integrated U.S.-Canadian one. This process of liberalization of trade and investment was planned to be gradually achieved. Rigorous rules in the agreement prevent non-NAFTA products from enjoying the preferential treatment given to the three NAFTA countries. [230]

To liberalize and integrate the North American market, NAFTA establishes tariff phase-out periods on automotive products,[231] specifies clear rules for phasing out Mexico's investment restrictions, **Auto Decree**[232] and **Auto - transportation Decree**[233] and mandates rigorous rules-of-origin requirements which are described below. Moreover, it establishes a **North American Automotive Standards Council** with the objective of facilitating compatible standards-related measures applicable to automotive goods and other related matters. According to the agreement, all parties have a *"…right to adopt, apply and enforce standards-related measures, to choose the level of protection it wishes to achieve through such measures and to conduct assessments of risk to ensure that those levels are achieved…"* These measures include even the prohibition of the importation of a good or service that does not comply with the applicable requirements.[234] Recommendations from the council require unanimous agreement. Where the adoption of a law is not required, each party will implement the council's recommendations voluntarily within a reasonable time. In the

[230] Norton J.J.et al. (1995)
[231] According to the definition in the Agreement: "Automotive products means motor vehicles and autoparts"
[232] "Decree for the Development and Modernization of the Automotive Industry" that covers vehicles with the Gross Vehicular Weight less or equal to 8864kg
[233] "Decree for Development and Modernization of the Autotransportation Vehicle Manufacturing Industry" applicable to all vehicles exceeding the Gross Vehicular Weight of 8864kg
[234] NAFTA 2

cases that the adoption of a law is required, each party is obliged to adopt the law and implement it within a stated period of time.

The ultimate goal of NAFTA is that, during the maximum period of 15 years, each country will phase down to zero all duties on its imports of North American ***"originating"*** automobiles, trucks and buses. Mexico, as the most protected market within the NAFTA area, has most trade barriers to eliminate.

When it comes to the U.S. and Canada and according to the treaty:
- ✓ The already low U.S. import duties on auto parts will be lifted over a 10 years phase-out.
- ✓ Light truck tariffs, which the U.S. has maintained at a relatively high level of 25%, will be immediately lowered to 10% for vehicles from Mexico that comply with NAFTA originating rules. Those tariffs will be phased-out completely over five years.
- ✓ Canada will eliminate its tariffs on vehicles imported from Mexico on the same schedule as Mexico will follow for imports from Canada.[235]

Upon implementation of NAFTA, Mexico is required to:
- ✓ Immediately reduce its tariffs on automobiles and light trucks imports from the U.S. and Canada from 20% to 10%. Then, it is required to phase out the remaining tariffs on autos to zero over 10 years, and for light trucks over 5 years. Mexico will phase out its tariffs on medium-sized and heavy trucks and buses over a 10 year period.[236]
- ✓ Slowly phase down the national added value for production in Mexico over a period of 10 years, though with slight concessions for manufacturers already established in the country. Mexico's local content requirement will be phased down from 36% to 34% for the first 5 years of NAFTA implementation, to 29% over the next 5 years, and to zero after 10 years with start in January of 2004.[237]
- ✓ Trade surplus requirements ($2 exported for each $1 imported in the sector) were immediately cut down to less than 1 to 1, and will disappear over a ten year transitory period.[238]

---

[235] Norton J.J.et al. (1995)
[236] Zangari B.J. (1994)
[237] Ibid.
[238] Zangari B.J. (1994)

- ✓ Mexico's general ban on used car and light truck imports will stay in place until January 1 2009, and then be phased out over the subsequent 10 years That is due to the concern that the elimination of the import ban would disrupt Mexico's new vehicle market by flooding it with large quantities of used vehicles from the U.S.[239]
- ✓ Phase out, during a period of 5 to 10 years, its tariffs on auto parts.

In the following sections, parts of the NAFTA agreement will be illustrate and explained. The structure is made according to the chapters of the agreement.

6.1.1 Tariff Elimination (Chapter 3)

The tariff elimination within NAFTA leads to a reduction in the final prices which is one factor for sales recovery as well as for the biggest variety of vehicles offered in the Mexican market.[240] This tariff elimination takes place over a phase out period. In reality, the actual NAFTA tariff schedules contain dozens of variations on these general phase-out rules.[241] Table 13 shows the NAFTA tariff elimination schedule that concerns the automotive sector, per vehicle category.

Table 13 Mexico, NAFTA tariff rate schedule per vehicle type 1994-2003

Year	Passenger Cars(%)	Light Commercial Vehicles(%)	Heavy Buses & Trucks(%)	Auto Parts (%)
1994	10.0	10.0	18.0	9.5
1995	8.9	7.5	16.0	7.5
1996	7.9	5.0	14.0	5.5
1997	6.7	2.5	12.0	3.2
1998	5.6	0.0	10.0	1.5
1999	4.5	0.0	8.0	1.2
2000	3.3	0.0	6.0	0.9
2001	2.2	0.0	4.0	0.6
2002	1.1	0.0	2.0	0.3
2003	0.0	0.0	0.0	0.0
2004	0.0	0.0	0.0	0.0

Source: The Economist Intelligence Unit Limited (1999)

[239] Norton J.J.et al. (1995)
[240] The Economist Intelligence Unit Limited (1999)
[241] Ibid.

This table clearly shows that tariffs on both buses and auto-pars are already zero since the beginning of this year.

In addition to tariffs, other existing non tariff barriers and "duty drawback" programs that allow duty rebates on re-exported goods were also about to come to an end. By June 30, 1999, each party eliminated many of the requirements that have been applied in the past to restrict trade, such as quotas, import licenses, export taxes and customs processing fees.[242]

6.1.2 Trade and Investment in the Automotive Sector (Appendix 300A.2)

One of the main goals of NAFTA has been to set the ground for the full integration of the Mexican automotive industry into the North American one. This has not been an easy task due to the much protected Mexican market. The country's automotive policy has been implemented through a series of decrees. Two of the most important ones have been the already mentioned, Automotive Decree which concerns the vehicles with the Gross Vehicular Weight minor than 8864kg and the Autotransportation Decree applied to vehicles with the Gross Vehicular Weight above this level including heavy trucks and buses. Both of the decrees have been imposing the restrictions on trade such as limitations on imports of vehicles, trade balancing- and national value-added requirements. The auto decree will be completely abolished in January 2004.[243]

The Autotransportation Decree

The *Decree for Development and Modernization of the Autotransportation Vehicle Manufacturing Industry* has been legally binding since January 1990. During the NAFTA negotiations, the goal of the U.S. and Canadian negotiators was to eliminate the Autotransportation Decree over a period of time. Mexican negotiators' goal was, on the other hand, to extend the elimination over as long period of time as possible.[244] One possible explanation, behind this reasoning is the perception that the Mexican industry needs time to adjust to the new regulatory framework in order to avoid the losses by opening up the market too fast.[245] According to the NAFTA Agreement (Appendix 300A), upon its implementation Mexico has immediately eliminated its Autotransportation De-

[242] Norton J.J.et al. (1995)
[243] NAFTA 2
[244] Johnson J. (1999)
[245] Espinosa I. 2003/11/19

cree. However, until 1999, there were still restrictions on the importation of the types of vehicles that were covered by the decree.[246]

Today, the decree has been almost entirely eliminated. Rules applying to importation of autotransportation vehicles have stopped being valid in 1999 and the only one remaining are the ones considering the Importation of Used Autotransportation Vehicles. In the agreement, it is stated that Mexico is allowed to adopt or maintain prohibitions or restrictions on imports of used vehicles from the territory of another party until January 2009. After this year this exception will gradually be phased out. [247]

6.1.3 Rules of origin (Chapter 4)

Chapter 4 of the agreement outlines the basic rules of origin that define which goods are entitled to the agreement's preferential tariff treatment. They are an essential part of any Free Trade Agreement and their purpose is to assure that the preferential treatment of goods, accorded by the NAFTA, safeguards the benefits for its participants.[248]

Article 401 – Originating Goods

Article 401 determines the four basic rules according to which a good originates in NAFTA. The preference criteria are as follows: [249]

"*Except as otherwise provided in this chapter, a good shall originate in the territory of a party where:*

a. The good is completely attained or produced in one of the participating countries.
b. Each of the non-originating materials that are used in the manufacture of the good goes through the related transformation in tariff classification as determined in **Annex 401,** described below. This transformation has to take place entirely in the territory of any of the parties. In some cases where the good satisfies relevant requirements set out in **Annex 401,** change in tariff classification is not necessary for the good to originate in NAFTA.

[246] NAFTA 2
[247] Ibid.
[248] Norton J.J.et al. (1995)
[249] NAFTA 1

c. The product is wholly manufactured in one of the signatories exclusively from originating materials, **or**

d. The product is completely produced in the territories of any of the parties[250] but, one or more of the non-originating materials which are used in the production of the good does not go through a change in tariff clarification because:

    a. Although the good was imported to any of the parties in an unassembled or a disassembled form it was classified as assembled good due to the General Rule of Interpretation 2(a)[251] of the **Harmonized System**

    b. The heading of the good particularly includes information for both the good and its parts, and is not further subdivided into subheadings. In the case that it does include subheadings, that good still applies to the exception if that subheading specifically describes both the good and its parts.

Appendix IV presents additional information with definitions of the terminology used above.

Prerequisite for the above mentioned conditions is that the Regional Value Content of the good that will originate in the territory of NAFTA is not less than 60% according to the transaction value method or is not less than 50% according to the net cost method. Both of the methods will be discussed further down. Additionally, all other requirements stated in the Rules of Origin Chapter must be satisfied.

Certificates of Origin

Certificates of Origin are documents used for verifying the origin of the products manufactured in one country. These documents are confirming that the products fulfill the criteria of origin set by different agreements. For example, in order for a Mexican manufacturer to import products under the preferential custom duty under NAFTA from the U.S. or Canada the Certificate of Origin must be obtained from the supplier. The same basic rules apply for the parts coming in from the European Union and other countries that Mexico has FTAs

[250] Except for a good provided fro in Chapter 61 through 63 of the Harmonized System

[251] Goods that fall under the General Rule of Interpretation can be classified as complete goods, even though they were imported into the country in disassembled or unfinished form, provided that they have "*the essential character"* of the complete or finished product.

with. However, the procedures regarding issuing of the Certificates of Origin are not the same. Within NAFTA, this process has been rather simplified over the years, which has been both beneficial and disadvantageous at the same time. Beneficial, because of the fact that the process is not hindering trade between the countries and because of the simplified administrative procedures. Disadvantageous since, due to the loose procedures, there have been cases of goods that have been traded as NAFTA originated ones without really complying with the relevant requirements. These processes and certificates should be simplified but not at the cost of the rules set up in the agreement.[252]

Annex 401

Annex 401 specifies the applicable change in tariff classification for each good in order for it to originate in NAFTA. The ones that can not undergo a sufficient change of tariff classification and in order to be considered as originating even if they contain non-originating materials, must fulfil the **Regional Value Content Requirement.** Furthermore, **Annex 401** categorizes those goods that must comply with the Regional Value Content requirement.[253]Automotive goods can be considered to be NAFTA originated only if they satisfy the Regional Value Content requirement and not according to the change in tariff classification set in **Annex 401**.[254]

Article 402 - Regional Value Content

Article 402 of the NAFTA, specifies the methods of calculating the Regional Value Content of a good.[255] This Regional Value Content is always expressed as a percentage and may be determined by one of two methods:[256]

1.) The transaction value method

$$RVC = \frac{(\text{Transaction Value} - \text{Value of Non-Originating Materials}) \times 100}{\text{Transaction Value}}$$

[252] Sillvetti R. 2003/11/19
[253] NAFTA 2
[254] Alanís A. 2003/11/18
[255] Norton J.J.et al. (1995)
[256] NAFTA 1

2.) The net cost method

$$RVC = \frac{(\text{Net Cost} - \text{Value of Non-Originating Materials}) \times 100}{\text{Net Cost}}$$

Generally, the North American regional value content must be at least 60% under the transaction value method or 50% under the net cost method for those goods requiring regional value content in order to be considered as originating.

The regional value content level of **automotive goods** rises in two stages over an eight year period. The *"net cost"* regional value content began at 50% and on January 1, 1998 it has been elevated to 56% on automobiles, light trucks and engines. On January 1, 2002, it was further elevated to 62.5% on the same items. A similar regional value content transition for Heavy Weight vehicles and parts ascends from 50% to 55% and then 60% during the same time periods.[257]

Originating materials that comply with the required tariff change and / or regional value content rules are generally considered as 100% originating intermediate materials when incorporated into a finished product.[258]

Regional value content rules are used for automotive goods and chemicals, but are quite limited in other product areas. Generally, exporters and producers may choose which valuation method they prefer, but there are exceptions. For automotive goods, footwear and word processing machines, only the net cost method may be used. Goods nominated as "*intermediate materials*" and goods for which *"accumulation"* of regional value content is used must also use the net cost method. For more information on accumulation and intermediate products, **Article 404** of NAFTA and paragraph 10-11 of NAFTA **Article 402** can be consulted.[259]

Article 403 – Automotive Goods[260]

Compliance to the requirements set in the regional value content are necessary in order for goods containing non-originating materials to be considered as

[257] Norton J.J.et al. (1995)
[258] Ibid.
[259] NAFTA 2
[260] Ibid.

originating and thereby enjoy the NAFTA benefits. As earlier mentioned, the regional value content of automotive goods can only be calculated under the **net cost method**. Within the NAFTA, **Article 403** is the one establishing the special rules for calculating this value. According to this article, each producer is required to report the value of specified parts imported from outside North America to the next producer in the production chain. The second producer has to include that value when calculating the value of non-originating materials in each good. This tracing applies to the value of non North American parts imported under the tariff provisions identified in **Annex 403.1** for cars, light vehicles and their original equipment parts. *"For example, the tariff provisions listed in that Annex include the sub-heading for brakes and their parts. If a brake producer imports a non-North American brake part to manufacture brakes that are sold to a car assembler, the brake producer reports the value of the brake part to the assembler. The assembler, in turn, includes the value of that non-North American part in its calculation of the value of non-originating materials in its good."*[261]

Parts identified in **Annex 403.2** are required to be traced when calculating the value content in the case of Heavy Weight vehicles and their engines and transmissions. Special averaging provisions for parts and vehicles and producers are also set out in the article. The purpose of these is to provide the automotive producers with greater flexibility. Vehicle producers are allowed to average their regional value content for one fiscal year over:

- the same model line produced in a plant;
- the same class of vehicles produced in a plant; or
- the same model line produced in the territory of a NAFTA party.

Vehicle producers that are investing in new plants within the NAFTA region and are producing a prototype product that has not been produced before in the same area qualify for a preferential tariff treatment at a 50% content level for that product over the first five years from its release. Moreover, a vehicle that is produced in a "*re-fitted*" plant and differs from the vehicles produced before the plant was "*re-fitted*" is also qualified for tariff preferences at a 50% content level, but in this case only for a period of two years. [262]

[261] Ibid.
[262] NAFTA 2

In order to illustrate how the rules of origin of NAFTA regarding the Bus industry are used, the case of VBM can be applied. Since, as said, VBM is not exporting at the moment there is no need to add regional value according to NAFTA rules. In the case that the company will consider starting exporting to the U.S., the only way that it could use the preferential tariff treatment under NAFTA would be to comply with the Regional Value Content Requirement since it belongs to the automotive sector. That implies that more national value must be added to its products. The precise value that would have to be added in that case can be calculated by the company's cost department by using the net cost method according to the NAFTA rules. As it has been described, Volvo in that case would have to demand each of its suppliers to report the value of the non NAFTA originating materials to the company so as to add this value in its own calculations of the regional value content according to the net cost method. According to this method, the good originates in NAFTA if the regional value content is at least 60% after January 2002 as described above. Therefore, the fact that the company imports most of the materials for its production from Europe at the moment means that it does not comply with the rules of origin of NAFTA for automotive goods and cannot export to the U.S. under NAFTA preferential terms.[263]

6.1.4 NAFTA Implications on the Automotive Industry

NAFTA enhanced the upgrading of Mexico's automotive industry through cross-border production partnerships which have improved the country's competitiveness and output. Mexico's automotive and automotive parts exports to the U.S. almost tripled since 1993 whereas Mexico's imports of U.S. automotive products have reached their peak. Nowadays, Mexico is the biggest export market for the U.S. automotive industry.[264]

Numerous manufacturers that have been operating in Mexico have been extremely profitable since their plants have been running to practically full capacity. Moreover, this extreme profitability is a result of the phasing out of other trade restriction which gave Mexico's manufacturers the opportunity to import almost 50% of the domestical sales vehicles. In addition to that, it should be stated that Mexico happened to grow economically at the time that its neighbor,

[263] Alanís A. 2003/11/11
[264] Carrasco R. 2003/11/14

the U.S., experienced a long economic expansion. That was particularly beneficial for its automotive industry.[265]

The agreement provided the vehicle manufacturers with clearly defined rules that have been crucial for planning and it enabled them to integrate production and marketing schedules with the operations in the U.S. and Canada. As a result of the agreement a truly North American automotive industry, in which Mexico has been able to rationalize production, has been created.[266] In the case of NAFTA, there are no bad negotiations concerning the automotive industry. The openness of the market has been very beneficial for the companies operating within this sector and the industrial activity has been enabled to further grow and develop.[267]

The status of the North American automotive sector will be reviewed by all three parties, no later than December 31, 2003. The aim is to assess the effectiveness of the above mentioned measures and to determine actions that could be taken to strengthen the integration and competitiveness of the sector.[268]

6.2 The EU-Mexico FTA at the Industry Level

According to the U.S.-Mexican chamber of Commerce, the *"auto and auto parts industries are winners of the EU-Mexico FTA"*. Mexico has been exporting almost one million cars to the North American market, because of the previously high EU tariffs on cars. This previous duty of 7% fell to 3.3% in July 2000 due to the FTA with the EU. This tariff is expected to fall to zero by the end of 2003 and given that the agreement's rules of origin are met. Moreover, Mexico is giving access to its market to the automotive manufactures of Europe. Before the FTA came into force, Mexico levied a tariff of 20% to automotive companies. Under the agreement lower tariffs have been established by Mexico. As an answer to this, opportunities brought the large investments from European companies such as Volkswagen and DaimlerChrysler.[269] The EU-Mexico FTA will provide the European companies with the opportunity to start exploiting the rich and big markets of North America. The EU-Mexico FTA has provided the basis for further development of the industry

[265] Just Auto (2001)
[266] Ibid.
[267] Carrasco R. 2003/11/14
[268] NAFTA 2
[269] Mexico – EU Free Trade Agreement 2

since it has enhanced bilateral trade between the two regions. Following is a short description of the most relevant parts of the content of the agreement with regards to the present study.

6.2.1 Tariff and Customs Duties Elimination

The EU-Mexico FTA covers all goods that are originating in the territories of the parties. The agreement considers a gradual reduction of tariffs or customs duties, having their complete elimination as an objective. This reduction, as will be described further down, is not symmetrical.[270] No new customs duties are to be imposed between the two regions whereas the ones already imposed cannot be increased. Moreover, the two signatories declared their willingness to accelerate the procedure of customs duty elimination or improve conditions for access in each-other's markets. The classification of the goods takes place according to each region's tariff regime and in agreement with the Harmonized System (HS).[271]

Industrial Products

The FTA between EU and Mexico will liberalize over 96% of EU- Mexico trade by 2007. Most of the tariffs will be reduced by January 2003. At the time of writing, 82% of Mexico's industrial products can enter the EU market tariff –free whereas at least 50% of EU products do not pay duties when exported to Mexico. By the end of the same year, when industrial products are fully liberalized in NAFTA, all Mexican imports will enter the EU territory duty free whereas the European products will only have to pay a maximum tariff of 5%.[272]

According to the agreement, all the **customs duties on exports** for products originating either in the EU or Mexico were totally removed as of July 2000. Moreover, the abolishment of **customs duties on imports** from both parties will be gradual, as follows:

[270] Peña A. (2002)
[271] Europa – DG Trade (2003)
[272] Europa – DG Trade (2003)

⇒Customs duties on imports of products originating from Mexico are subject to **Annex I** of the agreement which is establishing three main groups of reduction:

- ✓ Category A: Contains customs duties that were completely eliminated on July 1, 2000
- ✓ Category B: includes duties that will be eliminated in four phases: first is the one taking place on July 1, 2000 and the remaining three taking place on January 1 of each of the successive years, aiming at their complete elimination by January 1, 2003.
- ✓ Other Categories: include different duties that are to be reduced in 2010 at the latest.

⇒Customs duties on imports of products originating from the EU are subject to **Annex II** of the agreement which is establishing five reduction groups:

- ✓ Category A: Reflecting customs duties eliminated on July 1, 2000
- ✓ Category B: Includes customs duties that are to be reduced in four phases: first is the one taking place in July 1, 2000, and the other three phases that will take place on the first of January of each successive year aiming at their complete removal by January ,1 2003.
- ✓ Category B+: Consists of duties that are to be reduced until January 1, 2005
- ✓ Category C: Consists of duties that are to be reduced until 2007
- ✓ Other categories: include different duties that are to be reduced in 2010 at the latest.

The customs duties relevant to EU or Mexican products depend on the classification of each industrial product that is to be imported. As said, **Annex I** regulates the Mexican products imported to the EU, whereas **Annex II** will control the EU products exported to Mexico. The liberalization process which is relevant to Mexican products **(Annex I)** is different than the liberalization plan applicable to the EU products **(Annex II)**. As described above, most of the customs duties applicable to EU products will be reduced by 2007, whereas the majority of duties referring to Mexican products will be eliminated by 2003. As seen, the liberalization process is more firm when it comes to EU products compared to the Mexican ones. This gives a temporary advantage to the Mexican economy.[273]

The customs duties on imports into Mexico, as listed in Annex II and falling under the above mention **category B**, are to be eliminated in four equal stages and they were completely eliminated by the beginning of 2003.[274] The schedule of elimination of the customs duties on imports into Mexico on the products that fall under **category B+ and C** are shown in Tables 14 and 15

Table 14 Category B+ customs duty elimination schedule

Mexican Base Rate	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
20	18	12	8	5	2.5	0
15	13	10	7	5	2.5	0
10	8	6	4	4	2	0
7	5	4	3	2	1	0
5	**4**	**3**	**2**	**2**	**1**	**0**

Source: Mexico – EU Free Trade Agreement 1

The given products by VBM can be once again used as examples in order to show the function of the tariff phase out schedules. The fraction **84152001** (air-conditioning machines) for example, according to the treaty is listed under category B+. It was reported from the company that the Mexican base rate on the specific product is 20%. That means, according to the table above, that the specific fraction if imported from the EU in Mexico is applicable to a tariff of 5% until the end of the year 2004. The tariff on this product is not completely eliminated until 2005.

Table 15 Category C customs duty elimination schedule

Mexican Base Rate	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*
20	18	12	8	5	5	4	3	0
15	13	10	7	5	5	4	3	0
10	8	6	5	4	4	3	1	0
7	5	4	3	3	2	2	1	0
5	**4**	**3**	**2**	**2**	**2**	**1**	**1**	**0**

Source: Mexico – EU Free Trade Agreement 1

[273] Peña A. (2002)
[274] Mexico – EU Free Trade Agreement 1

A fraction belonging to this category, from the VBM example, is fraction number **73066099** (steel welding machine). This product is normally applicable to a tariff of 20%. If the product is imported from the EU in Mexico and if qualifies to be treated with preferential terms, then the tariff level on it will phase out in accordance with the table above. As shown in the table, this fraction is applicable to a 5% tariffs for 2003 and it can be imported completely tariff free in 2007.

Beside the above mentioned tariff reduction groups (A, B, B+, C) there are seven other categories of tariff elimination schedules (categories 1 to 7). Mexico is to successively eliminate the customs duties on products imported from the EU that fall under **category 2** and completely remove them three years after the decision enters into force. This successive tariff elimination is expressed as a percentage of reduction on the basic duty. For example, customs on products which are imported to Mexico from the EU and fall under category 2 shall be reduced to 50% of the basic duty one year after the agreement was singed. In the same way, customs on products falling under **category 4** are going to be sequentially reduced. Tariffs on these products will be completely removed ten years after the entrance into force of the agreement which is in 2010.[275]

In the VBM example, the product which represents the biggest percentage of the company's imports, fraction **87060099** (chassis fitted with engines) falls under category 4. Knowing (from the company) that the basic tariff on this product is 50%, it can be calculated according to the treaty's schedule that for 2003 that this product is applicable to a 10% tariff rate. Knowing that that this product is imported from Borås Sweden to Mexico and that it complies with the EU-Mexico FTA rules of origin,[276] one concludes that this product is applicable to a 10% tariff due to the agreement, which is one fifth of the normal tariff.

6.2.2 Automotive Tariff Quota (Annex II)

In Annex II of the EU-Mexico FTA there is a section regulating the automotive tariff quota. According to this, and after the entry into force of the decision, Mexico is eligible to apply a tariff quota on imports of motor vehicles that are originating from the EU. The specific product coverage of this decision according to the treaty is :***"Motor vehicles classified under headings 8703 and 8706***

[275] Mexico – EU Free Trade Agreement 1

[276] Alanís A. 2003/11/18

of the Harmonized System, and under headings 8702, 8704 and 8705 of the Harmonized System with a weight of less than 8 864 kg" [277]

In this section of the treaty, the minimum amount of the tariff quota is specified. In particular, the minimum size of the quota must be:

- "*For each year until 31 December, 2003, a quantity equivalent to 14% of the total number of vehicles, relevant to this decision as describe above, sold in Mexico during the previous years.*"[278]
- "*For each year from 1 January, 2004 until 31 December, 2006, a quantity equivalent to 15 % of the total number of the above mentioned motor vehicles sold in Mexico during the previous year."*[279]

This means that until the end of 2003, Mexico will allow up to 14% of its automobile imports to derive from the EU with special low tariffs (the in-quota tariff). For the period between 2004 and 2006, this percentage will rise to 15%. Mexico will distribute up to 10% of its imports to EU firms already established in Mexico and another 4% to EU firms that are going to be new in the country.[280]

According to the EU office in Mexico, this quota amount has been calculated to be about 136,000 units. In reality all exports from the EU at the moment go under this quota.[281]

In addition, preferential customs duties on the above mentioned kind of vehicles imported to Mexico from the European Union under the tariff quota may be applied. The tariffs on these "*in-quota"* vehicles that will be imported from the EU are identical to NAFTA: 3.3% for 2000, 2.2% for 2001 and 1.1% for 2002. After 2003 these duties will be completely eliminated. Mexico will still import automobiles from the EU above this quota, only that those will be subject to a 10% tariff. The title specifically rules that customs duties of the above mentioned vehicles are to be eliminated completely by January 1, 2007.[282]

---

[277] Mexico – EU Free Trade Agreement 1
[278] Ibid.
[279] Ibid.
[280] Mexico – EU Free Trade Agreement 2
[281] Sillvetti R. 2003/11/19
[282] Mexico – EU Free Trade Agreement 2

Quota Management

Mexico is compelled to manage the tariff quota by following specific methods or their combination. These methods are defined by the treaty as follows:

a. *Method based on the chronological order of the filing of applications (i.e. the "first come, first served rule")*
b. *Method of distribution in proportion to the quantities requested when the applications were filed (i.e. the "simultaneous examination" method)*
c. *Method based on taking traditional trade patterns into account (i.e. the " traditional importers/new arrivals" method)*

Any of the above mentioned methods used must allow the *"full utilization"* of the tariff quota and avoid any kind of discrimination between the involved operators. Mexico is allowed by the treaty to preserve part of the tariff quota for manufactures as formulated by the *Auto Decree* of December 1989, and its amendments of 1995. It is required though, that "*At least an amount equivalent to 4% of the total sales in Mexico is offered first to other operators"*.[283]

The method that Mexico has been using during the last year in order to manage this quota is published in the country's official newspaper. According to this a mixed system is employed: One part of the quota was assigned to Mexican authorized distributors of vehicles. However, this practice is going to stop with the abolishment of the Auto Decree in the beginning of 2004. The other part of the quota was given through a bidding procedure.[284] It will be interesting to see how they are going to manage the quota next year when the Auto Decree is going to stop.

6.2.3 Rules Of Origin (Annex III)

The products that are applicable to the EU-Mexico FTA and its advantages must originate either in the EU or Mexico. The products origin requirements are set by **Annex III** of the agreement. According to this:

- The product that receives the EU-Mexico FTA benefits must be "*considered to be originating in the territory of either Mexico or the EU*" - compliance with the **rule of origin**

[283] Mexico – EU Free Trade Agreement 1
[284] Sillvetti R. 2003/11/19

- ➢ The originating status must be obtained without disruption either in Mexico or the EU - **Territorial rule**
- ➢ Products have to be transported in a straight line between EU and Mexico - **Direct Transportation Rule**

Compliance with the above mentioned rules is necessary if a product is to receive the advantages or benefits originating by the agreement. [285]

The Rule of Origin

The rule of origin provides the originating feature to two kinds of products:

a) Those that are wholly obtained in the EU or Mexico
b) Those that are obtained in the EU or Mexico but they include materials that have not been wholly obtained in these two territories. For those products it is necessary to have been through a sufficient *transformation* (working or processing) in the EU or Mexico

For the purpose of this project and in order to give a more comprehensive description of the provision of the treaty regarding the rules of origin, some basic definitions as described in the original text of the agreement will be presented in Appendix V. This will serve as an attempt to simplify and to better understand the legal framework of the treaty by clarifying some of the legal terms used.[286]

With regards to the automotive industry and according to the agreement, local content should be at least 50%, based on the value added by Mexican producers for the three first years of the agreement. This is more firm than the relevant rule of origin of NAFTA, which gives all the value of an auto part to Mexico in the case that the components for that part have been significantly transformed in Mexico. This local requirement is raised to 60% after the third year of the agreement.[287]

The Territorial Rule

The territorial rule ensures that the above described originating status "*must be constantly applied in the territory of the parties*". According to this rule, the

[285] Mexico – EU Free Trade Agreement 1
[286] Mexico – EU Free Trade Agreement 1
[287] Ibid.

transformation that foreign materials have to go through in order to be converted into originating products must take place in the territory of the two parties. The main objective of this rule is to promote investment and increase employment opportunities in both Mexico and the EU.

The Direct Transportation Rule

According to the direct transportation rule, the products are to be directly transferred between the EU and Mexico. The transmission of the products through other countries to their final destination is still allowed. Nevertheless, the transit of the products through these countries must be temporal. This rule aims at altering any effort to include additional foreign materials in the products which do not originate in the parties. For VBM, this rule implies that the parts imported from the EU in the assembly plant in Mexico must be transferred directly between the two regions.

6.2.4 Rules and Exceptions Related to the Automotive Industry

Standards, Technical Regulations and Conformity Assessment Procedures (Article 19)

This article confirms the obligation of the parties related to the WTO Agreement of standards and technical regulations and verifies their will to intensify their bilateral cooperation in this field. In order to do so the two signatories are to exchange information on these issues, promote the use of international standards and facilitated the adoption of their respective systems. Moreover, the treaty establishes a Special Committee on Standards and Technical Regulations responsible for compromising representatives of the two regions on these issues.[288]

Prohibition of Quantitative Restrictions -Article 12

This article asserts that all import and export exclusions or restrictions to trade between Mexico and the European Union (except for customs duties and taxes) no matter their form (quotas, import or export licenses, etc.) must be removed, and no new such procedures are to be initiated.[289] Nevertheless, this condition has some exceptions. When it comes to the automotive industry, Mexico can

[288] Mexico – EU Free Trade Agreement 2
[289] Ibid.

maintain prohibitions and restrictions on the importation of the goods listed in Table 16 until 31, December, 2003. **(Annex IV)**[290]

Table 16 Exceptions to article 12 in the automotive industry

Item	Description
8407.34	Reciprocating piston engines of a kind used for the propulsion of vehicles of chapter 87, of a cylinder capacity exceeding 1 000 cc
87.02	Motor vehicles for the transport of ten or more persons. Only on vehicles weighing less than 8 864 kg.
87.03	Motor cars and other motor vehicles principally designed for the transport of persons, (other than those of heading 8702), including station wagons and racing cars
87.04	Motor vehicles for the transport of goods. Only on vehicles weighing less than 8 864 kg.
8705.20	Mobile drilling derricks. Only on vehicles weighing less than 8 864 kg
8705.40	Concrete mixers. Only on vehicles weighing less than 8 864 kg
87.06	Chassis fitted with engines, for the motor vehicles of headings 87.01 to 87.05

Source: Mexico – EU Free Trade Agreement 2

If one considers the products given by VBM as an example, it can be seen that the fraction **87060099** (chassis fitted with engines) falls under the exceptions of article 12. That means that until the end of 2003 Mexico can maintain prohibitions and restrictions on its importation. The rule however is not going to be valid after the end of the year. Moreover, no restriction on this products importation from Sweden has been reported by the company.[291]

6.2.5 Practical Implementation

When it comes to the implementation of the above mentioned provisions, it seems that there are practical obstacles that need to be overcome. In order for a European supplier to enter the Mexican market under the beneficial provisions of the agreement, origin has to be proven. This can be done in two different ways: Either with the submission of the **Euro1** document or with a relevant declaration in the invoice. In order to have this invoice declaration one must obtain the status of frequent exporter from the European Union Customs office. The Euro1 document is used in the case of small and occasional exporters and is not recommended for regular exporters since it must be filled every time an export takes place. This document has the form that the European Union has

[290] Mexico – EU Free Trade Agreement 1
[291] Alanís A. 2003/11/18

been using with all other Free Trade Agreements it has signed for a long period of time. Therefore, customs in Europe are used to stamp these documents in a certain way, which is adjusted to different needs and can be characterized as flexible. When it comes to exports from the EU to Mexico there is a special difficulty. The Mexican customs apply rules and procedures in a very strict way that contradicts the European Union flexible way of filling in the necessary documents. That persistence to follow rigorous rules is an explicit instruction deriving from the Mexican government in an attempt to prevent corruption, which has been an issue in the Mexican customs authorities. This inflexibility often leads to the rejection of EU imports even in cases that the relevant documents are filled in correctly.[292]

In Mexico companies are obliged by law to use a customs agent, so they cannot do the importation on their own. Those customs agents are private bodies that have a relative license and hold joint responsibility with the exporters regarding the compliance with the importation rules.[293]

Both the European Union and Mexico acknowledge that the rules of origin are quite complicated when it comes to their implementation. Therefore, the Brussels committee constituting experts on the rules of origin and the respective Mexican committee have been working on the simplification of the rules of origin since the agreement entered into force and have agreed upon the issuance of explanatory notes on procedural issues. The committees meet on a yearly basis whereas the last meeting was in November 2003. During this meeting, a new text of explanatory notes was agreed upon which specified in which cases there can never be a justification of a rejection of an import. At the time the EU-Mexico FTA was signed the Mexican government insisted that the rules of origin were much more complicated, compared to NAFTA which requires the filling of different kind of documents. Nonetheless, it seems that in the new trade agreements Mexico is signing the documents used to certify origin are similar to the ones with the European Union FTA. The reason the Mexican side changed its strategy regarding this topic is the detection of cases where non-NAFTA originating goods were entering the country as NAFTA originating ones due to relaxed implementation of the rules of origin. [294]

[292] Sillvetti 2003/11/19
[293] Ibid.
[294] Ibid.

Successful practical implementation of the agreement is also discouraged by the lack of communication between the government and the private companies operating in the country. In the private sector there are discussions about the lack of support and information regarding trade issues and technical details that could help the companies better apply the benefits deriving from the agreements in terms of tariffs, norms, standards and conformity assessments. Beside the practical problems regarding the implementation of the trade policy, the industry needs to deal with other obstacles. Although ANPACT (see Appendix VI) is concentrating industry related information and distributing it to the associated companies, the government does not proactively update the private sector. Nevertheless, the firms usually have at their disposal specialized departments and personnel that handles these issues. Frequently, the inability to use this information is depriving them from transforming it into concrete benefits.[295]

It is important to mention that the companies can take advantage of the flexibility of the Mexican administration, which allows them to participate in the formulation of the policy that concerns them, by proposing amendments for the legislation. Most of the original suggestions regarding legal modification come from the private sector.[296]

In the European Union office in Mexico, concerns have been expressed about the tendency of the Mexican government to sign agreements and then not use them to their potential. As mentioned, the Mexican government's strategy is to widen the range of FTAs and there is no focus on how to make these agreements work. Mexico has a good negotiation team that has a lot of experience but not as good implementation and support mechanisms. For example, the unit managing the EU-Mexico FTA consisted mainly of three people, two of which have been given the responsibility to negotiate other agreements. That leaves one person and one assistant managing the remaining implementation issues deriving from the EU-Mexico FTA. According to the EU office in Mexico, the support that has been provided so far by Bancomext is not enough and there is more that needs to be done. [297]

[295] Cortéz S. 2003/11/19
[296] Espinosa I. 2003/11/19
[297] Sillvetti 2003/11/19

In the Volvo example, at present, there are no major complications or difficulties when it comes to the importation of parts from the U.S. and the compliance with the NAFTA rules. When a good is transferred between the U.S. and Mexico and for some reason the certificate of origin is not the correct one (which implies that preferential tariffs can not be applied) the procedure of correcting this certificate is rather simple. One phone call is enough, since the two countries have been working together for a long period and through this experience they have managed to simplify the processes in favor of the private operators.[298]

Nonetheless, as shown, most of the company's imports come for the EU. The implementation of the treaty with the EU is harder and creates practical problems for the company. There are a lot of cases where the documents proving the EU origin are not correctly filled in. In the case of an importation coming from the EU, it takes a long procedure to correct these false documents. That procedure requires that the document is sent back to Europe to the products' producer for correction. The certificate of origin comes at the same time with the shipment, which means that the importer's products are stopped at customs until the false document is sent to Europe and re-delivered back to Mexico. The only way to unblock the parts from customs is to pay the general tariff that applies to products not originating in the European Union. However, the company is unwilling to pay such a tariff knowing that the product indeed originates in the EU, and that the price that it has to pay actually is the cost of a wrongly filled document.[299]

One solution to this problem could be the spread of the use of the classification custom codes to all the suppliers. The other solution could be simple consultation of the customs authorities in Mexico on the correct procedures and documentation.[300]

ANPACT maintains that the rules of origin are not complicated themselves, but the lack of knowledge on the treaties and their regulations creates an ambiguous situation. Companies that are not exporting have less interest to keep track

[298] Alanís A. 2003/11/18
[299] Ibid.
[300] Ibid.

of often complicated methods since they can import materials for their production duty free due to the PROSEC program, described in the next chapter.[301]

6.3 Mexico-Brazil Economic Complementation Agreement at the Industry Level

The bilateral agreement with Brazil has a great impact on the automotive industry; one of the strongest export sectors in both countries. One part of the agreement sets provisions applicable to the bilateral trade in the automotive industry between Mexico and Brazil. According to those rules, trade for vehicles weighing less that 8845kg will be liberalized starting on 1 January, 2007. This agreement contains norms considering the market access, rules of origin, technical formalities and applications. It is valid for the automobiles, vehicles with Gross Vehicle Weight smaller or equal to 8845kg, tractors and other vehicles used in agriculture and some of the automotive parts.[302,303]

The tariff reduction that has been negotiated so far does not apply to the Heavy Weight Vehicles. Furthermore, the auto parts have been only partly negotiated but far from all. There are many parts that still have not been included. As the situation is today, there are no suggestions of widening this agreement and including the Heavy Weight Vehicles as well. The most probable reason behind this is the difficulty to negotiate this sector of the automotive industry.[304] When looking at the VBM example, and while testing if any of the given codes are included within the auto-parts that will undergo a tariff dismantling, none of the specific fractions can be found. Moreover, since VBM produces vehicles that weigh more than 8845kg, it can be concluded that the company derives no advantages from this agreement at the moment.

The two parties do not seem to be able to agree on one particular matter. *"Whenever we come to negotiate, both of the parts have to be interested. This industry is one of the most integrated industries worldwide, so I suppose that Brazil does not necessarily want to have an agreement with Mexico. The other*

[301] Espinosa I. 2003/11/19
[302] Acuerdo de complementación Económica No 55 Celebrado entre el MERCOSUR y los Estados Unidos Mexicanos
[303] Anaya R. 2003/11/17
[304] Ibid.

side of the coin is that the sector in which these two countries are most integrated is the automotive one"[305]

The benefits and the future developments of this agreement are rather unclear. According to Bancomext, the fundamental thought behind this agreement was to promote joint ventures between Mexican and Brazilian small and medium size auto-producers. That would facilitate the transfer of technology from the technologically stronger Brazilian component sector.[306] Despite the Brazil's aim to include some 70 more auto-parts in the agreement, for the time being only some parts are included due to Mexican opposition. Mexico's objection is based on the fears that its suppliers will be exposed to fierce competition coming from Brazil. That is one of the reasons Mexico has stopped further negotiations and tried to promote joint ventures instead. The country is counting on its NAFTA membership to attract Brazilian companies to join the local ones.[307]

[305] Baker J-C. 2003/11/17
[306] Carrasco R. 2003/11/14
[307] Ibid.

7 Trade Promotion Programs

In addition to the agreements that Mexico has signed, different industry support programs have been developed in order to promote productivity and improve quality and prices of the local products. The ones that are relevant to the automotive sector will be briefly described further down. The reason these programs are treated separately within the industry level of the present project is their great importance and level of application in the bus industry. Thereby, those programs are not considered by this study within the national level since their application only in the automotive industry will be in focus during the following description.

7.1 Export Incentives

There are different programs in Mexico aiming to give incentives to companies and promote exports. The intent of these programs is to promote productivity and improve quality in order to boost the local companies' competitiveness. The "*Temporary importation program for production of exportation articles*" **(Pitex),** gives permission to firms to enter temporary imports of raw materials, parts, machinery and equipment that are used to produce export products. Having access to basic imports with better conditions in price and quality is crucial for the exporting companies in Mexico in order for them to compete internationally. Moreover, the "*program for highly exporting companies*" **(Altex),** refunds value-added tax **(VAT)** and import tariffs for customs clearance. Exporters may also get credit with interest below commercial banks rates from the National Bank of External Commerce **(Bankomext).** Furthermore, exporters are encouraged by the absence of foreign exchange controls. The import license requirements have been phased out and there are only a few in effect. Most of Mexico's imports quotas have been converted into tariff-rate quotas **(TRQs**, volume quotas), due to the big range of international trade agreements Mexico has signed.[308]

7.2 Promotional Sectoral Program (PROSEC)

As a consequence of the implementation of the NAFTA and its Article 303, that became effective on 1 January, 2001, manufacturing companies operating

[308] The Economist Intelligence Unit Limited (2003)

in Mexico under a Maquiladora or PITEX program, mentioned earlier, had to begin to pay duties in Mexico. These duties are applied to the NAFTA non-originating materials, used in the manufacture of finished products that are to be exported to the U.S. and Canadian markets. Furthermore, according to Article 304 of NAFTA and Mexico's obligations under the WTO, machinery and equipment importation was no longer exempted from payment of import duties. This has resulted in an increased overall cost of doing business in Mexico for a number of companies that have been importing their materials outside of NAFTA. The Mexican government has tried to approach this problem in two different ways. One way included an attempt to persuade companies faced with increased duties to source their materials within Mexico. Nevertheless, inability of the existing suppliers in Mexico to provide them with comparable quality, price and delivery times as their non-NAFTA sources, led the government towards another approach and made it adopt other measures in order to counterbalance the losses. Mexico pursued a strategy of negotiating FTAs but not even that has been enough to offset the impact of costs caused by import duties.[309]

For this reason, in 2001, Mexico's Sectoral Programs went into effect. The official name of this program is PROSEC, which is the short term in Spanish for "Programa de Promoción Sectorial" (Promotional Sectoral Program).[310]

The main drive force behind the creation of PROSEC was the need for increased international competitiveness of national manufacturing operations. Moreover, this program is seen as an opportunity to promote openness and commercial competitiveness as the fundamental elements of a dynamic and progressive Mexican economy and as an instrument for supporting the integration of different chains of production.[311]

PROSEC **reduces or eliminates import duties** on certain materials imported to Mexico, regardless where they originate from. It is available to all **manufacturers** in Mexico that produce finished goods listed in any of the 22 sectors and import inputs of the programs. The final products may or may not be exported. It applies for any kind of importation, both temporary and definitive. For many of the materials the PROSEC duty rate is 0%. The other duty rates applied are 3% up to 7%. The reason some materials still have duty rates and some materi-

[309] Maquila Portal 5
[310] Ministry of Economy (2003)
[311] Ibid.

als are still not negotiated is that the Mexican administration wishes to protect the domestic manufacturers that could provide satisfactory material. The companies that qualify to apply PROSEC can at any time apply for submission of another product or sector, if they consider that the conditions for its inclusion are right and that the local suppliers can not satisfy their requirements. This process is a complicated one though and includes significant costs. While submitting these kind of applications companies should be very cautious.[312] Firms that are not allowed to use this program are non producing companies, like different kind of distributors.[313]

Because of its availability to all Mexican manufacturers, PROSEC complies with NAFTA Article 303. If the Mexican government would offer this plan only to maquiladoras, it would not be in compliance with NAFTA Article 303.[314]

There are no quotas on the imported parts under the PROSEC as long as the custom fraction of the product is on the program's list. This means that a manufacturer within one sector can not use PROSEC to import products or materials not listed within this special sector. A vehicle manufacturer, for example, can not import promotional material like T-shirts, pencils and others under the PROSEC duty rate. [315]

When it comes to the implementation of the program, there is a general notion that PROSEC has been negotiated very well for the automotive industry and that it is, for the time being, functioning flawlessly. The representative of ANPACT maintains that this is a stable program that benefits many of the companies. It gives the opportunity to import many kinds of products from any country in the world at a preferential duty and it functions like a worldwide treaty. *"The government is protecting industries through programs like PROSEC by making it easier to operate in the market. This brings more benefits to the people working there and it gives companies' the opportunity to acquire knowledge and know how. This can eventually lead to price decreases."*[316]

[312] Maquila Portal 5
[313] Alanís A. 2003/11/18
[314] Maquila Portal 5
[315] Alanís A. 2003/11/18
[316] Espinosa I. 2003/11/19

However, there are a number of problems and drawbacks regarding this program. One of them is that there is non-equal distribution of the program's benefits on the whole automotive sector. While PROSEC is helping the automotive manufacturers to become more competitive, at the same time it is providing unbeneficial conditions for the small and medium size local suppliers that are not given the chance to develop and grow. By importing parts from other countries this sector is being undermined.[317] Actually, one of the main critics on the Mexican policy is that the given incentives do not promote a certain industry as a whole but rather encourage companies to have only assembly operations in the country. This creates pressures deriving from the small and medium size auto-parts suppliers.[318] On the same issue, the comment of ANPACT is that no matter what the small and medium producer's reaction is, Mexico's automotive and bus industry survives thanks to the big international producers operating in the country which benefit from PROSEC. "*Without PROSEC the whole industry would die and that would not lead to any kind of improvements for the manufacturers nor the suppliers. Small and medium size firms need to be supported through other programs*". [319]

Another drawback is the risk of unexpected changes in approved products and the duties applied to them. Many companies could suffer serious damages as a result of the instability and unpredictability of such programs.[320] There are indications that with future administrations PROSEC can undergo certain amendments.[321] Moreover, there is a long bureaucratic application procedure in order for companies to enjoy the benefits derived from PROSEC.

PROSEC is a trade policy tool extensively used by VBM. The company is aware of the specific rules that apply to the use of this benefit. For example, it is clear to the company that raw materials cannot under any circumstances be imported under PROSEC by VBM with the purpose of reselling them to their suppliers for further transformation. This is not allowed even if the end user of this transformed material is again VBM. [322]

---

[317] Alanís A. 2003/11/18
[318] Sillvetti R. 2003/11/19
[319] Espinosa I. 2003/11/19
[320] Keidanren N. (2003)
[321] Ibid.
[322] Alanís A. 2003/11/18

According to the director of the traffic department in VBM, for the time being no matter how much the tariffs are reduced due to Mexico's Free Trade negotiations with other countries, when it comes down to the company level, it is more useful to use PROSEC. As seen in Table 12, the products that comprise the larger part of the company's total imports fall under the PROSEC list and may be imported with zero tariff from any country. In the specific example, there is one fraction, the **72193301**(welded steel), that is not listed under PROSEC and therefore the program cannot be applied. Thus, if this product is imported from the EU it is eligible for a 5% tariff and if it is imported from NAFTA it receives 0%. If this good is imported from a country that Mexico has no agreement with a 20% tariff needs to be paid. This example emphasizes that not all imports are applicable to PROSEC.

In connection to the previous discussion about the program's weaknesses, the traffic department at Volvo Bus is bringing light to the problem of termination of this program. "*The minute the government would say no to this program, we would have a problem……. the risk is that our best benefit is in government hands, so it is better to find better ways to negotiate with suppliers*" The same view has been expressed at the European Union office in Mexico: "*This is an internal measure that can change tomorrow, not even tomorrow, it can change any minute. An international agreement can not. Therefore, the objective of an international agreement is to bind certain internal decisions*". The objective of an international agreement is to bind certain decisions. In a lot of cases international agreements add nothing new to the existing legislation besides binding the two signatories to a certain decision. [323] The negative aspects of the program are also emphasized by the director of the Japanese External Trade Organization in Mexico who believes that PROSEC has certainly helped companies but does not include all sectors and inputs. [324]

The governmental office representatives at the Mexican Ministry of Economy gave another perspective to this issue. On the comment that PROSEC is just a temporal solution, it has been stated that PROSEC is unilateral tariff elimination in contrast with the Free Trade Agreements where tariffs are eliminated bilaterally. It is argued that as the country moves towards total liberalization due to its array of FTAs, PROSEC will not make any difference. "…*Just look at the*

[323] Sillvetti R. 2003/11/19
[324] Donnelly R. (2002)

developments so far. 10 years with NAFTA and we are duty free with them. And 10 years from now it will be the same with the EU and so on"[325] There is no specific prediction regarding the maintenance or not of PROSEC in the foreseeable future, by the NAFTA office in the Ministry of Economy. However, in the auto-part industry department of the same ministry it has been argued that there is no intention to stop PROSEC for the time being, despite the pressures for the opposite coming from other industries than the automotive. [326]

7.3 Fiscal Deposit

An important part of companies' costs is the payment of import taxes when goods are entering Mexico. Fiscal deposit is a promotion program according to which companies have the right to store their imported materials in specified warehouses without paying tax for the period these products are stored. Under this system, companies can avoid paying taxes immediately after the importation of the materials. Therefore, the private sector has a time advantage. The firm has the opportunity to store materials for a period of time and if, for any reason, these goods are going to be returned to the country of origin, there is no tax cost for the period that these materials have been stored in Mexico. In the case that this material is going to be kept within the country, the tax on it will be paid within a specified period of time.[327]

This program is very beneficial for the automotive industry. All of the duties that are supposed to be paid can be delayed and when it comes to the customs procedures they are much simpler. The automotive materials are usually allowed to get into the country without any major check ups. This diminishes the administrative costs for the companies.[328] Furthermore, deposit certificates are a powerful instrument because they are widely accepted for guaranteeing credit operations. Thus, companies using these certificates can easily obtain a bank or stock market loans.[329] This program is a good complement to the PROSEC.[330]

---

[325] Baker J-C. 2003/11/17
[326] Lopez R. 2003/11/17
[327] Fiscal Deposit (2003)
[328] Espinosa I. 2003/11/19
[329] Almacenadota General S.A. (2003)
[330] Alanís A. 2003/11/18

These specific rules are not very well used by the companies overall. The ones that are having administrative problems could use this program in order to make the whole importation process easier.[331]

VBM is one of the companies using this program. The main benefit for them is the possibility to delay tax payment on imports. This is specifically valuable if the company, for different reasons, can not use the imported products and needs to return them. In this situation they are not obliged to pay any taxes. The product can be stored in their warehouses for a certain period of time. This program is also used when the company imports parts that are not shipped with the correctly issued certificate of origin; it can anyway store the material without paying taxes until the certificate is replaced with the correct one. If the disturbances with the documentation remain, the company can still send the shipment back to the country of origin without having to pay tax for the period that the materials were stored in Mexico. [332]

[331] Espinosa I. 2003/11/19
[332] Alanís A. 2003/11/18

Outcome of the Study

Analysis

Conclusions and Recommendations

8 Analysis

"Analysis and synthesis ordinarily clarify matters for us about as much as taking a Swiss watch apart and dumping its wheels, springs, hands, threads, pivots, screws and gears into a layman's hands for reassembling, clarifies a watch to a layman….." Unknown Author. [333]

The analysis is going to combine the two levels of description of the empirical part and will link it with the final conclusions. This part of the thesis is structured in accordance with the research questions and follows the pattern of the empirical study. The aim is to present an understanding of the two described levels and determine the degree of their interdependence. The focus of the analysis narrows the perspective down from the nation to the industry and ultimately to the company that has been used as an example throughout the whole study.

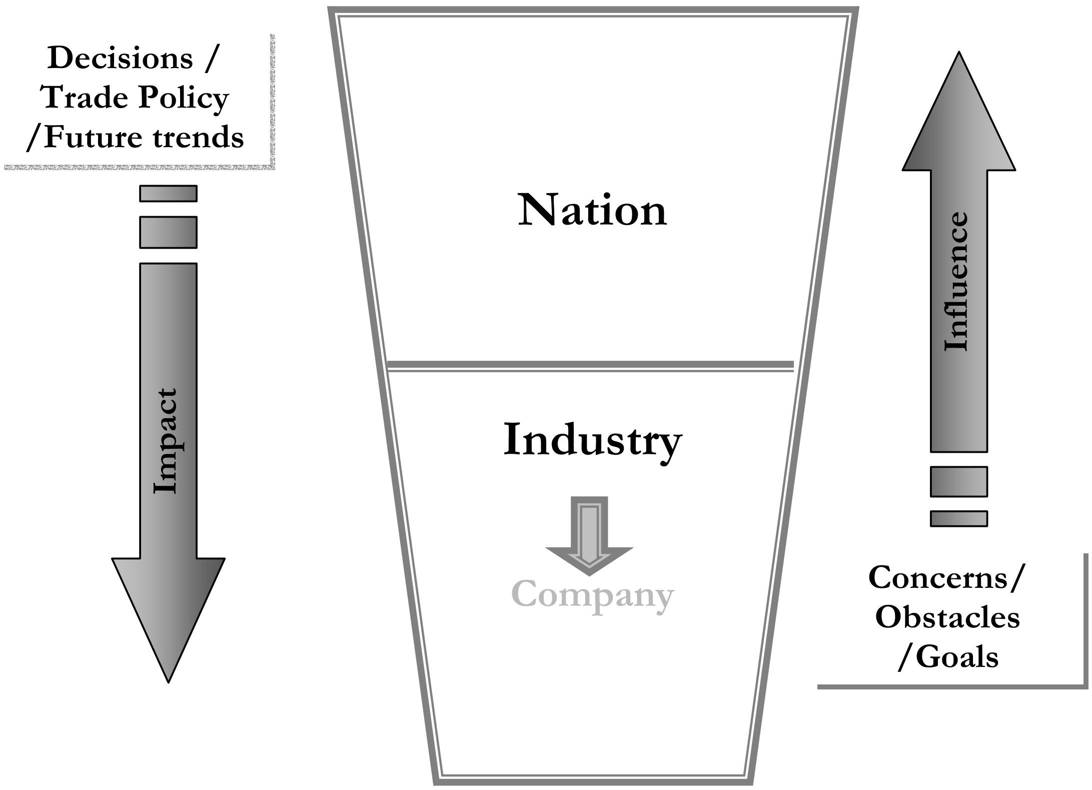
The starting point is to identify in what way the decisions made from the national government are implemented by the industry in order to study their impact. VBM is once again going to be used as an example in an attempt to clarify more the aspects that concern the bus industry.

Moreover, it will be shown how the industry's concerns influence the decisions made by the national administration. The idea is that both streams of influence exist and their final dependence on each other will be explored while taking into consideration the goals of all sides as well as the general trends for the future. Figure 9, shows the structure of the analysis.

Throughout the analysis, the theoretical part of this thesis is consulted and used as a reference in order to provide an understanding of the described trends and strategies. The theory is not used to narrow the perspective and restrict the range of the possible explanations by providing already made solutions and rigorous rules that need to be followed, but it will be used as stimulation for the discussion.

[333] The Quotation Page (2003)

Figure 9 **Analysis Disposition**



8.1 National Level

In the debate of an unformulated, so-called *"World order"* the two concepts of globalization and regionalization have gained more and more attention. These two processes that are occurring simultaneously deeply affect the world trade system and contribute to the transformation of the world order.

As shown in the theoretical part of this study, some of the reasons countries are engaged in multilateral, bilateral and regional agreements are the potential benefits from the expansion of the economy's choices and from their contribution to the income redistribution in such a way that everybody wins. Regionalism, bilateralism and multilateralism are expected to result in economic integration of countries. However, as theory has suggested, multilateralism is based on non-discriminatory trade while regionalism and bilateralism are based on cooperation between specific countries alone, which can be seen as a discriminatory trade policy. Therefore, one way of seeing regionalization and bilateralism is as counter-processes to the globalization movement. Regionalization, unlike globalization which entails a homogenization of the global system, is formulated between different cultural areas in the world. Nevertheless, it also homogenizes regional areas and diminishes the role of nation states in the political and economical decision making process.

It has been described that during the last century multilateralism has been pursued through agreements under the auspices of GATT and its successor the WTO. Nonetheless, after the Uruguay round there has been criticism regarding the slow process of the negotiations and the effects of the agreement on the developing countries. The recent WTO ministerial meeting in Cancun did not succeed to prove that multilateral agreements are offering solutions and bringing countries towards a coordinated course of action. Moreover, this meeting highlighted the political differences and the diverse goals between the participating members. It seems that a lot of trade issues cannot be reached with mutual understanding and willingness to compromise in favor of the common interest. Concerns about the efficiency and effectiveness of GATT have led the way towards more regional and bilateral agreements instead of multilateral ones. Within this context, preferential trade agreements can be seen as having a negative connection with GATT.

Nevertheless, the contribution of the FTAs to the speeding up of the liberalization process cannot be ignored. Having this in mind, bilateralism and regionalism came to be considered as "building blocks" rather than constraining worldwide trade harmonization. Furthermore, based on this, it is possible to explain the described world trend towards regionalism and the eagerness of countries to choose the bilateral Free Trade Agreements.

Mexico is one of the world leaders when it comes to regional and bilateral trade agreements, converting in this way its economy to one of the world's most open. This strategy of Mexico has been characterized as aggressive and forceful. Before analyzing the FTAs one by one and their impact, it is interesting to explore the driving forces behind such a policy and try to estimate the trends for the future.

Mexico's political environment has been unstable and explosive. It was not until 1994 that the president was elected with democratic procedures whereas the governance of the country was controlled by the same party for many decades until 2000. This instability can partially explain the country's eagerness to change its policy and to open up its economy as a tool towards a solid economic revival. This change of policy started, as described in the mid 1980s, with the most important development the country's accession to GATT.

Despite the obvious democratization steps, the peso crisis in 1994 and the crisis after that, as well as the repeated criticism against the current government for lack of political know-how, a rather unstable political situation was created. The trade liberalization policy can be connected with the recovery of the economy. For example, after the peso crisis, the combination of the weak exchange rate and the preferential access to the U.S. and Canadian markets due to NAFTA helped the economy recover. Moreover, since international agreements have a binding character, the policy of pursuing them may be interpreted as an effort to maintain this stability in the future. An administration that in the long run may want to change this liberalization practices cannot do it because of the commitment to international laws. As said in Bancomext: *"…In Mexico we are convinced that the best way to fight poverty is to open our country"*.

However, Mexico did not only open trade with its neighboring countries or with its biggest trading partners. The presented trade figures make the trade dependence on the U.S. apparent, whereas there is an increasing importance of the EU. The basic export destination being the U.S. and the principal import trade partners being the U.S. and the EU makes it interesting to investigate why Mexico chose a policy of opening up trade with more than 30 countries in total and what the implications are of such a policy.

The first hypothesis is that a big range of FTAs would diversify Mexico's trade away from specialization and U.S. dependence. In 2002, the U.S. market accounted for almost 75% of Mexico's total exports. Yet, it seems that the importance of Mexico's market access in North America will continue, especially due to the integration achieved in key sectors in the area, such as the automotive.

A second course of reasoning is that Mexico's experience with NAFTA has created a learning curve effect of signing multiple FTAs. This argument is in line with the view expressed in the EU office in Mexico, which implied that the country uses its NAFTA knowledge in order to sign more agreements since it has a skilled and experienced negotiating team familiar with the procedures. In such a case, NAFTA becomes Mexico's vehicle for trade liberalization. However, along with this argument there should be a discussion regarding the authorities' ability to administrate all these agreements. After considering the implementation problems and concerns expressed in the EU office in Mexico, it is clear that the Mexican authorities have pursued a lot of agreements but did not show the same enthusiasm in establishing good follow up and implementation mechanisms.

A third hypothesis could address political reasons behind Mexico's trade activism and it can be assumed after considering the future objectives of the Mexican administration of becoming the trade connecting link between the two hemispheres. Therefore, it can be stated that Mexico's strategy aims at strengthening its position in the international trade arena and increasing its bargaining power in the multilateral negotiations.

It is obvious that currently Mexico is engaged in some kind of a bilateral agreement hyperactivity which is giving the impression of a competition to sign as many agreements as possible regardless of the current trade relation. This supports the political hypothesis mentioned above. There seems to be some inconsistency between the Mexican administration representatives when it comes to the prediction on whether this policy will continue or not. On one hand, Bancomext has emphasized that the range of the country's FTAs have already offered the maximum of their potential regarding trade liberalization. Based on this argument it was highlighted that the future policy will change focus towards the strengthening of the local industry as a means to gain international competitiveness rather than opening up trade with more countries. One of the sectors in focus for future development is the automotive. On the other hand, the Mexican Ministry of Economy has declared that Mexico will continue to pursue bilateral agreements with more countries at the same time while participating actively in the multilateral organizations. For Mexico there is no multilateralism versus bilateralism dilemma. Moreover, the future policy will include the strengthening of the current FTAs and the simplification of their procedures. The first argument appears to be more realistic and is confirmed by Mexico's plans only to passively participate in the next FTAA meeting in Miami.

8.1.1 The Impact of NAFTA

NAFTA is the most important of Mexico's FTAs. This is based on the overall effects of the agreement on almost all of the aspects of the nation's economic activity. The presented figures on trade flows, investment and employment verify the magnitude of the impact of the treaty and place it as a cornerstone for the country's further policy incentives.

Coming into force in the mid 1990s, NAFTA can be seen as an expression of the regionalization movement described above, whereas its trade integration results can place it together with the EU on a pedestal as the most complex regional integration attempt in the world today. The basic difference between those two regional blocks is that NAFTA includes countries with a very diverse political and economical background and in contrast to the EU, no further integration steps were made beyond the Free Trade Area. A Free Trade Area has been described as the second level of a regional integration form and as one of the less binding ones. These specific characteristics of NAFTA can also explain the criticism against the agreement that has been expressed on both sides of the U.S. and Mexican borders. The mentioned criticism regarding the uneven distribution of the treaty's benefits must be seriously taken into consideration because it can be used as an argument against the further integration or even expansion of the NAFTA.

The bilateral negotiations between the U.S. and Mexico imply the interest of the U.S. to expand trade, to find more production opportunities and to support Mexico's free trade policy. The Mexican side apparently tried to expand trade and investment through this agreement and create employment opportunities in its territory. Moreover, it has been made evident that Mexico is using its participation in NAFTA as the core argument for investment attraction. If a company invests in Mexico it can take advantage not only of the incentives given by the Mexican government but also from its close relation with the prosperous and promising U.S. market. With NAFTA, Mexico extends its powers by representing a set of countries. This argument however refers only to trade and investment areas and should be evaluated with caution when considering political power issues.

8.1.2 The Impact of the EU-Mexico FTA

One of the main expressions of Mexico's policy to avert U.S. dependence is the agreement with the EU. This agreement is an initiative that Mexico took separate from NAFTA. Given the fierce competition between the U.S and European businesses in a lot of sectors, Mexican action could be seen as one that does not serve the interests of the group of countries it belongs to. Therefore, the treaty between Mexico and the EU may be considered as a treacherous act against NAFTA. The closure of the EU-Mexico FTA has been possible to realize away from the auspices of NAFTA due to the low level of integration of the free trade areas under which category NAFTA falls. In the case of an Economic Union such as the EU, there would be no possibility for any country-member to act in the same independent way. This treaty builds up a strong economic bridge between the two sides of the Atlantic and gives a more international dimension to regional integration agreements. The agreement is a "*new-generation*" trade agreement since it includes issues other than trade in goods, such as services, investment public procurement, intellectual property and competition.

Regionalism is at the heart of both the EU and Mexico trade policy and thereby this treaty can be seen as not a purely economic matter but rather a political one. The agreement has strengthened the links between the two continents by inserting a new dimension to regional agreements and placing it in a more multilateral context. Mexico's persistence in trade liberalization and its extensive networks of regional agreements have set the basis for long-term economic growth. Mexico has focused on negotiating liberalization, reflecting in this way its wish to pursue free trade at both a deeper and wider level. This approach has made Mexico an important partner for the European Union.

The preferential trade terms between the two parties did not only replace local production with more efficient imports but also substituted imports from non member countries. This is clearly shown in the presented trade creation/diversion effects of the agreement. Additional attention should be put on the comparison between the trade creation - trade diversion effects of the treaty, since as theory suggests, trade diversion may be one of the most important drawbacks of regional integration.

The trade effects of this agreement are non-symmetrical and the benefits are greater for the EU. However, Mexico will strengthen its position on the world trade scene by affiliating itself with one of the world's biggest trading blocks. EU and Mexico may also benefit from dynamic affects of the agreement such as the economies of scale that will be created and will positively influence both parties' income. In this sense, the outcome can be characterized as well-balanced and this agreement can be seen as a drive towards further liberalization moves in the area and therefore contributing to the objectives of the WTO. The agreement provides the EU firms with a unique opportunity to compete in the Mexican market since the European Union is provided with such rapid preferential treatment.

If one accepts that other FTAs were a response to the EU's preferential strategy, then it can be stated that the EU-Mexico FTA is a response to NAFTA, or even to the forthcoming Free Trade Agreement of the Americas. The protection or the elimination of the negative effects on European business because of FTAs in the Americas can be seen as a strong incentive behind the initiation of the treaty. Consequently, Mexico which has a relative economic and political stability in Latin America, is becoming a centre of foreign investment and a great FDI attraction hub. This agreement has sealed the aggressive trade policy of Mexico described above and confirmed Mexico's inclination towards trade liberalization.

8.1.3 The Future Trends

The ambition of expanding NAFTA is not only on a hypothetical or theoretical basis, but the first steps towards its achievement have been already made. A possible expansion of NAFTA would create a whole new world of opportunities for countries within and out of the continent. This puts Mexico in an advantageous position. Since Mexico already has a wide range of FTAs, in case FTAA will be realized the country will be the link connecting its current trading partners from other continents with all of the Americas. Nonetheless, it has been claimed that Mexico has no economical incentives in pursuing such a development since it already has preferential access to two of the largest markets in the world. The prospect of the FTAA may have a dramatic impact on Mexico, since it could overshadow the significance of NAFTA. In terms of reduced tariffs for U.S. trade, Mexico will no longer hold any advantage over other Latin American countries, since trade within the entire region will be tariff-free. However, due to its beneficial position in between the rest of Latin America and the U.S., Mexico will be able to compete with other countries not in terms of tariffs but, in terms of service, shorter delivery times and easier flow of information originating from the already established relations.

The fact that the Mexican administration representatives have denied the case of Mexico's negative attitude towards an FTAA can be considered with caution. The possible enlargement of NAFTA is a two sided coin case for Mexico. An FTAA would on one side create more market opportunities for Mexican companies by providing access in a large growing market area. On the other side, this expansion of NAFTA would mean creation of greater competition. Although it may be claimed that this competition would give an additional spur to the actors in the Mexican market, it could also undermine totally the local small and medium size suppliers that are obviously still in need of a certain level of protectionism in order to survive. Moreover, there is a likelihood that Mexico could begin to lose its appeal as a production base due to the FTAA, if one assumes that there are cheaper production locations in the American continent. The pressure is on for Mexico to redefine the advantages it possesses as a profitable export base over other countries in the region.

The plans of completing this process by the end of year 2005 seem to be rather unrealistic and optimistic. Mexico alone has already shifted focus and is currently negotiating a preferential agreement with Japan, the realization of which would place the country as a free trade partner with the three most prosperous economies in the world. Nevertheless, it can be assumed that the negotiations will be hard to conclude since indirectly there are more parties involved. This agreement apparently will expose the U.S. and European firms that can already access preferentially the Mexican market to a more fierce competition. The agreement with Japan will benefit Mexico in its low cost competition with China, regardless of the current indications that Mexico needs to do more than signing FTAs in order to win this antagonism. Moreover, the case of Japan added to the participation of Mexico in the APEC show the tendency to expand trade relations with Asia and attract more investment from this location.

One step towards Latin American integration is set out by LAIA, which was the first sign of efforts towards trade liberalization and willingness for cooperation. The slow process of these negotiations and the poor results added to the non binding nature of the rulings and the reluctances to further initiatives creates doubts about the final success of this cooperation. Within this Latin American integration process the negotiations between Mexico and Brazil stand out as another example of stagnation and reluctance. Despite the ambitious project to replace the current agreement with one between Mexico and MERCOSUR all the evidence shows that this agreement will take a lot of time to be realized and will be hard to implement. Proof of this are the fears about both the Brazilian and Mexican bureaucratic administration and the so far unwillingness of the two countries to compromise. The relevance of the agreement, if completed, will go beyond the two trading partners to develop trade links throughout the region. Knocking down trade barriers between Latin American countries will create an engine for economic growth, technological innovation and improved living standards.

The stance of the U.S., Brazil and Mexico has been described as a decisive one for the development of the FTAA process. The fact that a possible agreement between Mexico and MERCOSUR involves these three countries directly and indirectly raises questions on the reasons this agreement is still in Mexico's agenda and not abandoned as inferior and partial compared with the FTAA. There are a lot of integration processes that take place in the Americas on bilateral and multilateral levels in parallel to the FTAA, such as LAIA. This can be interpreted as a sign of inconsistency and can create doubts on how realistic the FTAA ambition is. There can be two possible explanations behind this phenomenon. The first assumption is that even if the FTAA will be realized, bilateral agreements will still be essential since the objectives of the countries in the Americas are so diverse at the moment that it seems to be impossible to satisfy the entire range of different requirements and find compromising solutions. Another explanation could be that the different bilateral agreements are used as fields of testing of possible compromising solutions before proceeding with the FTAA. A lot of bilateral agreements will give the opportunity to member nations to negotiate their individual interests and show the way to a more general consensus.

8.2 Industry Level

The development and advancement of the automotive sector in Mexico is closely related to the overall economical growth of the country due to the magnitude and the importance of the industry compared with other economic activities. This gives more incentives to the Mexican administration to pursue policies and agreements that would largely benefit this sector.

Up to the 1990s, the automotive industry has been under strict regulations. Many of the trade restriction policies have been imposed by the Mexican government through a series of decrees, such as the Auto Decree and the Autotransportation Decree. High levels of national value added, ad valorem import tariffs, trade balance and surplus requirements as well as import quotas have been disturbing the development of the Mexican automotive industry and restraining the competitive forces on the market.

The North American bus market is one of the most flourishing worldwide. The main bus industry driving forces include new tendencies regarding the manufacture, technology, customers and governmental attitude. These tendencies such as the customer polarization, technology developments and manufacture consolidation rely heavily on trade liberalization and initiatives that would facilitate the industry flow of information and technology. This can be used as an argument when connecting the trade liberalization programs in North America with the specific industry and can be used when evaluating the effects of such a policy.

Because of its importance and impact on the Mexican economy, the automotive industry is given a lot of attention and is included in separate clauses in different laws and Treaties. In order to get an understanding of the opportunities and threats given by these policies and regulations, each treaty needs to be studied separately and placed within the general context of Mexico's trade policy. The agreements that had the biggest impact on the automotive sector are the NAFTA and the FTA between Mexico and the EU. Moreover, important agreements or negotiations that may play an important role in the future with regards to the specific industry are the FTAA as well as the bilateral ones between Mexico and Brazil and Mexico and Japan.

As described, NAFTA has had the greatest impact of all the FTAs on the automotive industry. It has provided a new political and economic environment which has put the foundation for some major restructuring within this sector in Mexico. Besides the mentioned output and trade effects that have boosted productivity and profitability in the sector, the spin effect of NAFTA should be considered when evaluating the total effects of the Agreement. Trade creation and investment can be highlighted as technology upgrading factors which in turn caused the modernization of the whole industry. This creates more opportunities in terms of choices of technologies and suppliers. This statement leads to the argument that NAFTA should be definitely connected with the UN ranking of Mexico as one of the developing economies with great prospects regarding technological development.

It can be said that NAFTA is a wide-ranging trade agreement that improves practically all aspects of doing business within North America. It establishes the progressive elimination of all tariffs and quotas, some of the most important trade barriers, on goods qualifying as North American. The NAFTA agreement also removes almost all the tariffs imposed on automotive sector goods that are traded within its area and is imposing quotas only on a small percentage of imports from the U.S. to Mexico.

Since almost all the tariffs are going to be zero after the end of this year, when evaluating the impacts of the agreement in the bus industry, attention should be shifted towards non-tariff barriers, which according to the theory may be quotas, embargoes, local content requirements, technical regulations and antidumping laws. When it comes to NAFTA, the most important factor that should be considered in connection with the bus industry should be the rules of origin and how they are implemented.

Rules of origin determine the nationality or *"regionality"* of a product in order for it to be subjected to preferential tariff rates within the FTA. In the case of NAFTA they are used as the main protection device since products originating in non-member countries are excluded from the benefits of the treaty. The sufficient transformation in order to comply with the rules becomes a cumbersome and complicated issue and is obviously used as a tool of promoting local production and attracting investments within the area of the signatories. According to NAFTA, in order for a good to comply with the rules of origin it must undergo a specified by the treaty change in tariff classification or satisfy the Regional Value Content requirement. When it comes to the automotive sector the only way for a producer to prove NAFTA origin is to comply with the Regional Value Content. Since the RVC requirement according to NAFTA is 60%[334], that means that a producer operating in the country must incorporate in its production at least 60%

[334] Calculated under the Net Cost Method

of originating materials if the NAFTA benefits are to be used. Origin must be proven by the relevant certificates. Although this rule is technical and complex its understanding and implementation is of utmost importance. The only way for a company belonging to the automotive sector to enjoy the NAFTA treatment is the correct implementation of this requirement.

It has been shown that the automotive is the second most important manufacturing sector in terms of trade between EU and Mexico. The EU-Mexico FTA creates more investment opportunities for European companies which already before the agreement found Mexico as an appealing investment location. The EU- Mexico FTA eliminates the tariffs imposed on automotive goods. Most of the tariffs are reduced until the end of the current year. Therefore, it can be said that the beginning of year 2004 is the beginning of more export opportunities for European auto-producers as well as for Mexican manufacturers that wish to start exporting activities in Europe. Moreover, the flows of parts and materials between the two regions are largely facilitated.

Volvo Bus is a case of an EU company that has invested in Mexico. VBM is an assembly plant and as described, all of the company's production is sold within the country. However, most of the materials used in the manufacturing process are imported out of which the biggest percentage derives from Europe. Those materials are presented in the empirical part of the study and as said, they represent almost 80% of the company's imports. Therefore, the impact of the Mexican trade policy environment on the conditions under which these parts are imported can be said to be the impact of the trade policy on the company overall concerning imports. Since VBM aims at utilizing the opportunities given by the trade policy of Mexico in order to minimize importation costs, the importation of these specific products under preferential terms would be crucial.

In the empirical part of this thesis, the tariffs that these specific parts are subjected to, in accordance with the different treaties or programs, are listed. In the example of the product chassis fitted with engines, which is by far the largest importation of the company, it has been shown that it is applicable to a 10% tariff since it is imported from the EU and originates in that region. It was also shown that according to the treaty the tariffs on this part will be completely eliminated in 2010. Knowing that the normal Mexican import tariff on the specific component is 50%, one concludes that the company pays only one fifth of it. Given the importance of this importation, this represents an immense cost reduction for VBM. However, in this case it is more profitable for the company to apply PROSEC tariff which is zero since the specific product is listed in the PROSEC program directory.

Beside the tariff elimination, the EU-Mexico FTA agreement is imposing a quota for certain automotive goods. This quota however does not comprise an important barrier for the European bus industry. This is because, as it has been confirmed, the quota has been calculated to be so large so as to include all automotive EU exports to Mexico at the moment.

In the VBM case, when taking into account the imports, it should be stated that the company needs to pay special attention to the automotive quota imposed by the EU-Mexico FTA. The most important importation product of VBM falls under the quota. Nevertheless, when comparing the size of VBM production with the quota there should not be serious concerns for the foreseeable future. It is useful for the company to follow the ways this quota is managed and distributed by Mexico in order to be prepared for unpredictable developments in the future.

This agreement also includes rules of origin requirements, however in a different form than the NAFTA ones. According to these rules, if a good is to be applicable for preferential treatment it must contain 50% value added in Mexico. This good must undergo an applicable change in tariff classification as specified by the treaty. This procedure of transforming the good in order to turn it as originating must take place in the territories of the parties, whereas the transportation of the parts must take place directly between them. These rules of origin create favorable conditions for European companies established in Mexico since now they can import parts from EU tariff free as they comply with this rule. Moreover, the EU as a market opens up for the Mexican vehicle producers.

An important consideration regarding the rules of origin is the interrelation between NAFTA and the EU-Mexico FTA. As said, one of the major opportunities that EU-Mexico FTA is creating for the European producers is that it provides the conditions for them to use Mexico as a platform in order to reach the lucrative market of the U.S. In the same way U.S. producers can use Mexico in order to sell their products to the EU. However, in that case EU and U.S. manufacturers need to comply with both the EU-Mexico FTA and NAFTA rules of origin. On one hand this must be done in order to be able to bring the product tariff free from Europe, and on the other hand in order to be able to sell it tariff free to the U.S and vice versa. In that case, more investment should be made in Mexico in order to comply with both rules of origin. A company aiming at using the benefits of both of the agreements in this way should seek to conform with the stricter one of the rules of origin which implies more production to be transferred to Mexico.

This interrelation between the two agreements should be an important consideration for VBM. Although for the time being VBM is not at all engaged in exports, it is valuable to examine the influence of the trade policy environment on such a prospect. Regardless of the fact that VBM has officially denied that there are concrete plans to start exporting, it has been indirectly stated that such a possibility still exists. That may be based on the fact that the South American market has been growing whereas the North American one has been relatively stable. Moreover, the Americas are moving towards greater integration, which entails a lot of new opportunities for the companies. Lastly, there are indications that the Mexican market may not be enough for VBM and that more opportunities must be found. Being active only in the Mexican market, VBM is not using its full capacity today enduring the relevant costs.

There are two reasons VBM is not considering the case of exports yet. As explained, the U.S. market is not interesting enough since the demand for coaches is rather low. Moreover, VBM would have to change its product range in such a case in order to meet the U.S. product specifications. When it comes to Latin American, VBM does not have the products that satisfy the low price requirements of that market. When examining the case of exports from a trade policy environment perspective, these two reasons should not be the only ones constraining the company from exporting. If the NAFTA benefits are to be used in the future, more national value must be added in order to comply with the agreement's rules of origin. Given that for the time being VBM is importing a great percentage of its components from Europe such a case would compel immense changes in the production and in the purchasing process. Within this context, one should take into consideration the will of the Mexican government to upgrade the local suppliers which could imply that other sources of supply may be found within the country. The transfer of technology due to the trade liberalization process is an additional boosting power of this modernization process.

Nevertheless, this progression may take time before it results in the desired outcome.

It has been explained that the most important factor constraining the bus industry from using the benefits of both NAFTA and the Mexico- EU FTA is the difficulty in complying with the rules of origin as dictated by those agreements. This highlights that the falling tariff barriers due to the treaties do not completely liberalize trade in the respective regions. The almost complete elimination of the tariff barriers should make one consider that there is a possibility that other barriers will rise as well in order for the involved countries to protect their respective markets. This assumption can be drawn after bearing in mind the most usual causes behind countries' tendencies to protect their economies. In the case of Mexico, which is a developing country, the suggestion that less developed nations may lean towards protectionism as a tool to avoid the risk of international influence and dependence should be seriously taken into account. Furthermore, the need to protect the small and medium sized local enterprises may give another incentive for the country to engage in protectionism practices that at the same time would not jeopardize the general trade liberalization policy. Dealing with two of the most competitive regions in the world, Mexico should be cautious to take advantage of only the positive aspects of such an involvement and carefully avoid the negative ones. Lastly, the fact that the implementation of the Auto Decree will be finished in the beginning of 2004, accentuates the argument that new non-tariff barriers will appear, since now Mexico will lose the measure that so far has been protecting the automotive sector.

The protectionism measure that Mexico could use as a way to block the access of certain companies to its market in the future, as it has been implied by representatives of the Mexican administration, is the management of the technical standards and requirements. When studding NAFTA and the EU –Mexico FTA, there is no explicit regulation or decision that requires harmonization of the standards of the signatories. The agreements are just setting a general framework which establishes the basis for cooperation and discussion on this topic. Both NAFTA and the EU-Mexico FTA are setting up commissions which will be responsible to guide and coordinate relevant discussions. However, Mexico is not obliged by any of the treaties to accept any of the U.S. or European standards. So far, it has been unclear whether Mexico accepts the European or the U.S. standards and norms. It has been implied that this is a serious concern which has not been solved yet. Even the matter of standards harmonization has been discussed. It should be emphasized that the vague context of the regulations regarding this issues leaves a lot of space for different interpretations. The outcome of the discussion depends heavily on political forces and pressures from all sides. This can cause a lot of distortion especially in the bus industry where standards are essential when it comes to the ability of the firms to internationally commercialize their products.

VBM could be affected by such a development since it imports chassis fitted with engines from the EU. In this case, the standards that are accepted in Mexico regarding the emission level of the engines as well as the size of the imported chassis are relevant and should be carefully considered. Nonetheless, big foreign companies that have realized investments in Mexico, such as Volvo Bus, should have the means to influence policy decision makers on the implementation of such measures. This argument is stronger if one considers the eagerness of the Mexican administration to attract and maintain investments in the country, especially after the fierce competition from other locations.

It has been described how nations are using different methods to promote trade within their boundaries beside the engagement in international trade agreements. In Mexico, in addition to the FTAs that it has signed with different regions and countries, a lot of export and import incentives are used as a means to promote the automotive industry. The underlying reason behind these incentives seems to be the inability of the local suppliers to fulfill the necessary price and quality requirements set out by the big foreign automotive manufacturers. For many years, their competitiveness has been impeded by different protection policies and the local suppliers have not been given the chance to develop and grow. Consequently, the companies were forced to import the materials from other parts of the world. For most of the countries with which Mexico did not have a free trade agreement, tariffs have remained very high. In order for Mexico not to lose investment flows to other localizations with similar cost and production conditions, such as Brazil, China and India, the government had to implement other measures. The resolution to the problem was the creation of PROSEC, which allows tariff free importation of parts for the local producers from any part of the world.

Taking into consideration the great importance of this kind of programs, the question whether the agreements are not enough in order to maintain the high level of competitiveness of the Mexican industry can be raised. Despite the fact that the automotive industry is treated by most of the FTAs as a separate case, the programs aiming to support the sector in Mexico still remain. Those programs, unlike the agreements, have a unilateral character and are not a product of bilateral or multilateral negotiations. Beside the initial reason of the creation of the programs, there can be two more answers to why they still exist. Firstly, the opening of the market through the FTAs and the lowering of the barriers are long processes. Secondly, for the time being the FTAs are not sufficient to promote productivity of the local producers which are in need of further programs that would boost their competitiveness.

The implementation of PROSEC has had a two folded effect. On one hand, this program is undermining the local suppliers by allowing their easy replacement by foreign and more efficient ones. In this way the competitiveness problem of the local suppliers does not only continue to exist but their very survival is in danger. Some of them have suffered great losses and have not been able to endure this kind of competition. On the other hand, this increased competition has stimulated investment and contributed in upgrading the technological level. This has, together with the spur provided by Mexico's trade liberalization policy, helped to further modernize the automotive industry. This development is especially beneficial for the companies operating in the automotive sector in Mexico with the objective to export to other member countries of different FTAs. As it has been earlier explained, in order for them to be able to comply with the rules of origin while exporting, it is important to have suppliers in Mexico able to fulfill their technology and quality requirements.

Since the implementation of PROSEC, many of the bus manufacturers have been relying on its continued implementation. The tariff free importation of parts has benefited a lot of manufacturers by bringing down their importation costs. As shown, the belief among the people directly involved with this program that it will survive and continue to exist for many years to come is strong. However, the fact that is important to keep in mind is that this program is an internal measure created by the current government and it could be easily replaced. As earlier mentioned, new elections in Mexico will take place in 2006 and it is not safe to predict that Vicente Fox government will be elected for another mandate. He has been under a lot of pressure and among other issues criticized because of his inability to create more employment in the automotive industry, one of the most important sectors for the Mexican economy. It can be said that the probability that even a new government would choose to continue with this program is high, but there is no guarantee that this is going to be the case. If one considers that the political situation in Mexico has been stable for not such a along period, it can be safely concluded that one of the best saving sources of the bus industry in Mexico relies on rather unpredictable factors. Moreover, the fact that Mexican administration representatives have predicted that the program will continue should be evaluated with caution, given that their interest to attract further investments may result in them having biased and subjective opinions.

The application of PROSEC has benefits and drawbacks for VBM. On one hand, the implementation of this program is responsible for an immense saving, since without it, as explained above, a 10% tariff should be applied to the company's biggest import commodity. Moreover, the time-taking and sometimes complicated procedure to prove origin and to submit the relevant documents is avoided. Therefore, PROSEC does not only imply lower tariff cost but also easier procedures for the company.

Despite the great benefits of PROSEC, it is not binding and its continuality depends a lot on the attitude of each political administration. The application of PROSEC implies that the collection of the certificates of origin is not as essential since this program does not involve such requirements. This means that the importance of the certificates of origin can be ignored since under the rules of PROSEC it is not necessary to submit them. However, the program's temporal character should alert VBM to get these certificates anyway, since without them the preferential treatment according to the agreements would not be applicable. The company should also bear in mind that an important drawback of the program is that it does not necessarily include all automotive goods.

The procedure of proving origin is also a case that should be stressed. The case of the certificates of origin is not a simple one and should be emphasized when considering the implementation problems that have already been reported. This can be connected with the political situation in Mexico. Most of the reported problems derive from the extremely rigorous and bureaucratic implementation of the rules by the Mexican administration as a part of the efforts to control corruption. The fact that both the EU and Mexico are taking initiatives to simplify the rules of origin and to clarify their implementation reveals the complexity of that issue and stresses that the individual companies should be attentive.

Another beneficial program used in combination with PROSEC by VBM is Deposito Fiscal. This benefit should be categorized with PROSEC as a short-term and non predictable choice. Nevertheless, it may be a temporal solution to the above mentioned practical problems since it gives the company a time advantage and makes the bureaucracy easier to manage.

The above mentioned programs would have probably not been implemented if the auto supplier base in Mexico was strong enough to support the local manufacturers. The importance of having these well developed suppliers in Mexico is emphasized through the willingness of Bancomext, the special governmental agency responsible to support export activities, to promote the creation of joint ventures between Brazilian and Mexican companies. By pursuing this agreement, Brazilian companies have expressed their wish to have access to the Mexican market and through it to the U.S. one. The Economic Complementation Agreement negotiations have not been completed and have been facing a lot of constraints. The agreement does not even include most of the auto parts or the heavy weight vehicles. The fact that the negotiations are slowly progressing shows that there are a lot of obstacles to be confronted. The prospect of upgrading Mexico’s technological competence through this agreement is not recognized by the representatives of the bus industry in Mexico since it has been made clear that no benefits have been identified. On the contrary, it has been implied that the competition from the Brazilian suppliers is going to challenge the local ones since they are described as non competitive and inferior.

The slow process of the Preferential Trade Agreement with Brazil may exclude VBM from the opportunity to exploit that market, to find efficient suppliers or to participate in synergies that would reduce its production costs. However, the above described reasons that constrain Mexico from actively pursuing this agreement may be used by VBM in a beneficial way. Mexico’s denial to expose its small and medium sized producers to fierce competition shows that the administration has realized the lack in productivity and efficiency and thereafter will speed up the process of supporting them. VBM can take advantage of such a development by discovering new suppliers that would meet their requirements. Therefore, the case of an agreement with Brazil may end up in a win-win situation for VBM regardless of its outcome. If Brazil keeps pushing for this agreement there is a large possibility of discovering new purchasing opportunities. Furthermore, if the agreement will not be expanded to include all automotive goods, the political pressure on Mexico during the negotiation process may result in the country's decision to support its suppliers more, as described above. It should be mentioned that for the time being, regardless of the existence of an agreement between Mexico and Brazil, VBM can still import tariff free parts from Brazil due to PROSEC. This case entails some risks for the company as well. The imported parts must be included in the PROSEC list for the benefits to be utilized. Moreover, there may be administrative problems during the transfer of the goods, since there is not established agreement between the two countries and no specific procedures that follow a certain routine.

The same situation applies to the case of China. China's idiosyncrasy is that there is no sign that a preferential trade agreement will be initiated in the near future. The cooperation process started with APEC is very general and vague and it only sets the basis for trade collaboration in the future. Therefore, if one considers the low cost advantage of China and assumes that there may be a purchasing opening given that the right suppliers are found, it is still only PROSEC that VBM can rely on for a tariff free importation with the relevant disadvantages.

An indirect impact of the trade policy of Mexico on the bus industry can be identified when acknowledging the statement that as the average income in a country increases so do the mobility needs of its inhabitants. If one accepts that indeed the trade liberalization policies will benefit Mexico's welfare standard in the long run, then the mobility needs in the country will increase and the bus industry will have a bigger market. On the other hand, this increase in income may result in the abandonment of the bus as a means of transportation and its replacement by cars or planes.

8.3 Upstream Influence

The impact of the trade policy environment of Mexico has been so far analyzed as a sequence of effects on three different levels. Nevertheless, the flow of influence does not necessarily go only downwards, from national to industry and then to the company level. The same flow in some cases may as well go up-stream. There are situations where the needs and requirements of the industry influence the decisions made by the national administration. The weight of this influence depends on the size of the companies involved, their negotiating ability and power as well as on the organization of the specific industry in terms of lobbying.

In the case of the bus industry, it has been stated that the sector has the opportunity to influence decisions made on the national level either directly from the firms or through ANPACT. The ability and interest of the governmental authorities in Mexico to distribute information to the companies with regards to trade issues and developments at both the national and international level can be characterized as poor and reluctant. Therefore the private companies should take initiatives to extract this data, as competitive forces make knowledge on these issues essential for the firms' performance.

On the other hand, companies have the opportunity to familiarize the government with practical problems and future considerations and goals. Thereafter, a process begins showing the government the way its policy should be directed according to their interests. Moreover, assistance on practical issues can be provided. This is especially relevant in the case of the implementation of the rules of origin.

The flow of information and the issue of good communication within the companies should as well be addressed. For example, within VBM there is a lot of obtained knowledge on trade issues that is not exploited from all the departments to its maximum potential. The complicated nature of the implementation of the treaties makes the departments which are not directly involved in dealing with them disregard their importance. The fact that the purchasing department is not responsible for collecting and evaluating the certificates of origin does not imply that this department should not acknowledge the way these certificates function or their significance before making a choice of a supplier. The more this knowledge is embedded within the company and is not concentrated in one of its functions or even a person, the more possibilities are there for the firm to influence the industry and the national governance.

Before concluding, the issue of collaboration and coordination between these two flows should be discussed. As shown, the goals of the Mexican government and the ones of the company that has been used as an example are not diverse and it can be said that they are heading towards the same direction. The trade liberalization and further opening up of the market which is promoted by the government is a prerequisite for the exportation plans of VBM. Therefore, the good communication between these interdependent levels should be a crucial factor that would guarantee success and prosperity.

9 Conclusions

"The art of drawing conclusions from experiments and observations consists in evaluating probabilities and in estimating whether they are sufficiently great or numerous enough to constitute proofs. This kind of calculation is more complicated and more difficult than it is commonly thought to be...." Antoine Levoisier[335]

The trade policy environment of Mexico has a great influence on the bus manufacturing industry and consequently on the companies of this sector. The trade setting in Mexico is very dynamic and a lot of changes are to be expected in the near future. Mexico's distinctiveness is that the future progress regarding its trade policy environment does not only depend on the policy implemented by the country per se, but also on the developments that take place in the cluster of countries that Mexico has bound its policy with through a number of agreements. Notably, the most important one of these trade relationships is NAFTA. The effect of this volatile and powerful trade policy environment can be illustrated as a chain reaction that starts from the nation itself and spreads down to the industries and finally to the companies. The conclusions of this study on identifying those effects and pointing out the impacts of this process on the bus industry in Mexico are illustrated in the form of answers to the study's research questions.

How can the trade policy environment in Mexico be described?

Mexico's trade policy can be characterized as aggressive and open. This strategy is mainly pursued as a means to resolve economical and political difficulties. Given the binding nature of the international agreements, Mexico will continue with this liberalization policy and through this it is likely to gain stability.

Globalization and regionalization can be seen as incompatible processes. Since multilateral negotiations have been through a phase of stagnation, regionaliza-

[335] The Quotation Page (2003)

tion and bilateralism seem to gain support in Mexico as more effective integration processes and could spread more in the future.

The trade policy of Mexico includes agreements with a variety of countries regardless of the present trade flow between them. The concluding remarks based on the hypothesizes explaining this approach are:

- Mexico wants to avoid U.S. dependence and will take more such initiatives in the future.
- Mexico is proceeding with other FTAs based on the pattern of NAFTA due to learning curve effects. The new agreements to come will follow the same model and will be in coordination with NAFTA. In this way, U.S. dependence is difficult to overcome.
- NAFTA is not only Mexico's driver towards new agreements by providing the basic foundation on which they are going to be based, but also it is used by Mexico as a springboard to strengthen its international position and relation with other countries.
- Mexico's position will be strengthened in the future in the international trade arena. The variety of agreements strengthens the bargaining power of the country and more advantages are to be expected.

The drawback regarding the multiplicity of FTAs is that Mexico will probably not be able to administrate them in the future effectively.

There is inconsistency between the administration representatives over the continuality of the trade policy. The most realistic view is the one supporting that the FTAs will be brought to a standstill and the policy will change focus towards making the existing ones more functional. Therefore, a simplification of the procedures can be foreseen. Additionally, the strengthening of the automotive industry will be in focus by implementing more industry supporting measures.

If NAFTA functions effectively in the future, the criticism on the agreement can be overcome and it will boost the further process of the FTAA.

FTAA has both negative and positive effects on Mexico. It turns it into a link between all of its trading partners and the Americas. At the same time its effects can be limited because Mexico already has agreements with other bigger countries. Thus, Mexico is not expected to actively pursue the FTAA.

The process of the FTAA is going to be slow. Its development depends a lot on the political stance of the involved countries. If FTAA will be realized, Mexico will have to find other ways to compete with Latin American countries because it will no longer have the exclusive relation with the North American market.

The EU-Mexico FTA will strengthen the relations between the two regions. Currently, the agreement is more beneficial for the EU but in the long run it will be as advantageous for Mexico. More imports from Mexico to the EU should be anticipated.

The agreement with Japan will strengthen even more Mexico's international position but will be difficult to realize due to the indirect involvement of some of Japan's strongest competitors. The case of this agreement in connection with Mexico's participation in APEC are the first signs of Mexico's trade involvement in Asia. However, no agreement with China is expected to take place in the foreseeable future.

The preferential trade agreement between Mexico and Brazil will be hard to expand. Nevertheless, in Latin America, the bilateral agreements will be prioritized over the FTAA due to the great disparities in the region.

How is the trade policy environment of Mexico implemented in the bus industry?

Due to the implementation of FTAs that Mexico has signed with different countries, the previously rigorously restricted automotive sector has been more open. Year 2004 is an important year for the bus industry in Mexico since the sector is almost completely liberalized regarding the tariff barriers with NAFTA and the EU. Consequently, non-tariff barriers such as technical standards are expected to emerge. This development is possible due to the lack of firm or very well formulated regulations.

The trade policy imposes strict rules of origin if the benefits of the FTAs are to be received. Through these regulations the trade policy is designed so as to promote automotive production in Mexico. Knowledge and compliance with the rules of origin are so essential for the bus industry that they can be considered as an important comparative advantage for the firms that actually are familiar with their function.

The process of implementation of the regulations according to the treaties is slow due to their complicated nature and the Mexican bureaucracy. It is expected that these rules will be simplified in the future. However, the outcome of this simplification is closely connected with Mexico's determination to fight corruption.

The initiation of other industry supporting programs is a clear sign that the FTAs alone are not enough to meet the needs of the local auto-manufacturing sector. The survival of these measures in the future depends on the broadening and the efficient implementation of the range of Mexico's FTAs.

PROSEC and other trade promoting programs are extremely beneficial for the bus manufacturing sector but have a temporal and unpredicted character. However, PROSEC is not of assistance for the whole industry and especially for the local suppliers. The fact that PROSEC creates such disadvantages to local entrepreneurs supports the conclusion that there will be a lot of pressure for its abolishment.

The trade policy environment in Mexico generated a vicious circle result for the Mexican automotive suppliers. While the previous protectionism has deprived them from developing their competitiveness, trade liberalization has exposed them to fierce competition. That has deemed Mexico to be mainly an assembly location for international companies that source their materials from abroad. Therefore, the Mexican administration is very likely to create new supporting mechanisms in order to enhance their progress.

The unwillingness of the public administration to proactively inform the industry about the trade developments is an important obstacle with regards to the implementation of the trade policy in the specific sector. Companies should be more eager to collect this information through their own resources.

With the exception of NAFTA and EU-Mexico FTA, the agreements that have been described in this study cannot be said to be valuable for the Mexican bus industry when evaluated in a short term perspective. However, those agreements can set the basis for future development of the industry through the realization of more concrete trade cooperation between the countries. For the time being, the only way to import auto related items under preferential terms from the countries out of the range of the FTAs is by using temporal programs.

The role of ANPACT should be strengthened so as to build up a more powerful tool able to influence national trade decisions that would promote the bus industry in Mexico as a whole.

The above mentioned conclusions pave the way to the answer of the main question of this thesis.

How is the trade policy environment of Mexico affecting the bus industry?

Positive effects

- ✓ The trade policy environment is driving the country towards greater stability and creating favorable conditions for the bus industry.
- ✓ NAFTA and the EU- Mexico FTA are creating beneficial terms for the bus manufacturing industry. From a trade policy perspective, it is more advantageous for the industry to concentrate its imports and exports activities on these regions.
- ✓ More long run opportunities for trade with a large range of countries through the FTAA and the FTAs with Japan and Brazil have started to be created.
- ✓ More effective suppliers will possible emerge in Mexico in the future due to the governments intent to support them. As a consequence, in the long run the assembly character of the sector in Mexico is likely to change.
- ✓ There is a cost reduction opportunity since compliance with the rules of origin, as they are dictated by Mexico’s FTAs, results in preferential terms of exports and imports. Familiarity and compliance with the rules of origin of the NAFTA and the EU-Mexico FTA comprise a comparative advantage for the bus manufacturers.

Negative effects

- ✓ A lot of the industry's benefits regarding importations are based on temporal solutions given by the Mexican government.
- ✓ Due to the implementation difficulties of the industry related parts of NAFTA and the EU-Mexico FTA the industry cannot grasp all the related benefits.
- ✓ Mexico at the moment is more concentrated on spreading its range of FTAs rather than creating mechanisms that would make the existing ones more effective.
- ✓ Compliance with Mexico's FTAs' rules of origin implies great changes in the production and purchasing process which entails bigger costs.
- ✓ Trade liberalization exposes the already vulnerable local suppliers to fierce competition.
- ✓ The elimination of the tariff barriers will give way to non tariff barriers that the industry will have to overcome while exporting and importing. The non-tariff barriers that are most likely to emerge in Mexico are the technical standards and requirements.

To finalize the conclusions, it should be emphasized that the trade policy environment in Mexico positively affects the bus manufacturing industry in the country by providing more favorable conditions for the industry's operations. Since the bus industry drivers heavily depend on liberalization policies, the Mexican administration by adopting liberal strategy is enhancing the growth of the bus industry in the country. However, there are some issues that have been highlighted as preventing the proper-function and competitiveness of the industry. These issues underline that the liberalization policies have not yet succeeded to counterbalance the negative effects of the previously highly protected sector. Therefore, the bus industry in Mexico depends more on the governmental unilateral programs rather than on the rules determined from international agreements. The ability of the Mexican government to effectively support the local auto-parts suppliers will determine the progress of the trade policy and the content of the trade promotion programs in the future.

9.1 Conclusions Related to Volvo Bus De México

Despite the fact that the main focus of this study is on the bus industry in Mexico, some interesting observations have been made while trying to exemplify the implementation of the trade policy by using Volvo Bus in Mexico. Therefore as a part of the conclusions, a SWOT analysis of the company regarding the trade policy environment of the country it operates in is going to be performed. Finally, some specific suggestions for relevant adjustments according to the findings of this study will be underlined.

Strengths

- ✓ Being a part of a big international corporation gives VBM the ability to apply most of the beneficial measures provided by the trade policy environment.
- ✓ The company has at its disposal a special department responsible for following these issues.
- ✓ The size and significance of the company provides better odds to influence the decisions made on the national level.
- ✓ The participation of VBM in ANPACT allows the company to have easy access to valuable industry related information.

Weaknesses

- ✓ Knowledge on trade issues is not well spread within the company. It is concentrated on one department.
- ✓ There is a lack of communication between the departments directly involved with the importation of materials. The purchasing department has inadequate knowledge on how the trade policy is practically implemented.
- ✓ In the case of future exportation to the U.S., the NAFTA benefits cannot be applied for VBM because at the moment the company does not comply with the NAFTA rules of origin.
- ✓ The flow of information coming from the national level is unsatisfactory and scarce.

Opportunities

- ✓ Due to PROSEC, VBM has the opportunity to import most of the parts for its production tariff free from any part of the world.

- ✓ Almost all of the tariffs on the company's importations of NAFTA originating materials have been abolished.
- ✓ Most of the tariffs on EU originating importations have been eliminated.
- ✓ The determination of the Mexican government to support the local suppliers in order to ease the drawbacks of their exposure to the changing trade policy environment is creating more purchasing opportunities locally.
- ✓ More purchasing opportunities are created by the will of BANCOMEXT to promote joint ventures of Mexican suppliers with Brazilian ones.
- ✓ The tendencies to liberalize trade with Asian countries is creating long term prospects of new markets and purchasing sources.

Threats

- ✓ The company's importation under beneficial terms depends too highly on temporal solutions.
- ✓ The processes of new trade negotiations that Mexico is involved in regarding the heavy vehicle industry are too slow and no benefits can be found in the foreseeable future.
- ✓ VBM's suppliers are not well informed on the right procedures under which they can supply VBM under preferential terms. This may imply extra costs for the company.
- ✓ New non tariff barriers that would hinder trade between Mexico and the EU are likely to emerge, the most important of which is the technical standards and norms.

9.1.1 Recommendations

⇒The company should avoid the dependence regarding tariff free importation on governmental incentives with a temporal character by following and applying, to the greatest possible extent, the relevant regulations of the FTAs which offer safer and long term benefits.

⇒Despite the fact that the collection of the certificates of origin is not necessary for the moment due to the application of PROSEC, the company should make sure to collect the right certificates of origin anyway in order to avoid unpredicted developments in the future.

⇒VBM should proactively work on informing its EU suppliers about the proper importation procedures so as to facilitate the process of importing goods from the EU.

⇒The company must proactively collect information on changes in the trade policy environment either through ANPACT or by using its own resources. Furthermore, it should make better use of the given possibility to influence the decisions made on the national level.

⇒The company should add more regional value in its production in order to comply with the NAFTA rules of origin, if the plans to start exporting to the U.S under preferential terms are to be realized.

⇒VBM should follow the developments regarding new regulations on technical standards and norms.

⇒The firm should work towards implementing better communication mechanisms between the departments directly involved with the importation of the materials.

9.2 Suggestions for Further Research

The topic covered by this thesis is broad and can offer opportunities for further research. The trade liberalization process that countries are involved in, in multilateral, regional and bilateral level, is a continuous and exciting one. Therefore, a study of the trade policy environment and its implications on the corporate level can be performed in another Latin American country in order to be used as a base of comparison with the case of Mexico. A special case is the FTAA which offers a lot of ground for research on the initiation and the effects of that agreement.

As said in the delimitation part of this study, while examining the effects of the Mexican trade policy environment on the bus manufacturing industry, the case of material importations has been in focus. It would be interesting to gain a better understanding of the way the country's exports are influenced by the trade policy environment. In that case VBM could be once again used as an example.

It has been suggested that in the future the focus of the Mexican trade policy will shift, and instead of expanding the range of Free Trade Agreements the administration is determined to support the local suppliers and enhance their competitiveness. A future research could study in what ways the Mexican government is planning to develop the competitiveness of the local small and medium size enterprises and estimate if such a policy could flourish.

References

Reference List

Literature

Baldwin, Cohen, Sapir &Venables (1999) *Market Integration, Regionalism and The Global Economy*, Cambridge University Press

Case K. E., Ray C. F., Gärtner M. & Heather K. (1999) *Economics*, Prentice Hall Europe

Dicken P. (2001) *Global Shift – Transforming the World Economy*, 3rd Edition, Paul Chapman Publishing Ltd, London

Dijk van M. P. & Sideri S. (1996) *Multilateralism versus Regionalism: Trade Sigues alter the Uruguay Round,* Frank Cass, London

Dunkley G. (2000) *The Free Trade Adventure*, Zed Books, London

Fielding N. (2003) *Interviewing*, SAGE Publications, London

Gianaris N. V. (1998) *The North American Free Trade Agreement and the European Union,* Praeger Publishers, Westport

Hettne B., Inotai A. & Sunkel O. (1999) *Globalism and the New Regionalism*, in association with UNU/WIDER

Jovanovic M.N. (1998) *International Economic Integration – Critical Perspectives on the world economy, Volume I,* Routledge London

Keats, D.M 2001, *Interviewing-a practical guide for students and professionals*, Griffin Press, Australia

Krugman P. R. & Obstfeld M. (2000) *International Economics – Theory and policy*, 5th Edition, Addison-Wesley Publishing Company, Boston USA

LeClair M. S. (1997) *Regional Integration and Global Free Trade – Addressing the fundamental conflicts,* Avebury, England

Merriam S. B. (1994) *Fallstudien som forskningsmetod*, Studentlitteratur, Lund

Norton J.J. & Bloodworth T.L. (1995) *NAFTA and Beyond – A New Framework for Doing Business in the Americas*, Martinus Nijhoff Publishers, Dordrecht

Patel R. & Davidson B. (1994) *Forskningsmetodikens grunder*, 2nd Edition, Studentlitteratur, Lund

Perkmann M. & Sum N-L. (2002) *Globalization, Regionalization and Cross-Border Regions,* Palgrave Macmillan

Roberts K. & Wilson M. I. (1996) *Policy Choices – Free Trade Among NAFTA Nations*, Michigan State University Press, Michigan

Robson P. (1998) *The Economics of International Integration*, 4th Edition, Routledge, London

Salvatore D. (1999) *International Economics*, 6th Edition, John Wiley & Sons, Inc.

Wild J. J., Wild K.L. & Han J.C.Y (2000) *International Business*, 2nd Edition, Prentice Hall, New Jersey

Yin, R.K. (1994) Case *Study Research – Design and methods*, 2nd Edition, SAGE Publications, London.

Zangari B.J. (1994) *NAFTA – Issues, industry sector profiles and bibliography,* Nova Science Publishers, N.Y.

Articles

Corbett B. (2001) *Mexico Goes on Siesta by Brian Corbett*
Wards Auto - Nr 12, 2001

Couretas J. (1998) *Volvo sets Mexico deal,* Automotive News, October 5, 1998

Fredlund S-A (2003) *Bussens Förlovade Land*, Volvo på Väg - Nr 1, 2003

Peña A. (2002) *Free Trade Agreement between Mexico and the European Union,* Law and Business Review of the Americas

Truck & Bus Builder (2003) *Volvo makes progress on Mexican bus market*

Reports

ANPACT (2001)
La Industria Fabricante de Vehiculos de Autotransporte – La historia de una década 1990 – 2000

ANPACT (2003)
Asociation National de Productores de Autobuses, Camiones Y Tractocamiones,AC – Own research

The Economist Intelligence Unit Limited 1 (1999) – *EIU The Global Bus and Coach Industry*

The Economist Intelligence Unit Limited 2 (1999) – *Automotive Sectors of Latin America*

The Economist Intelligence Unit Limited (2000) - *EIU Motor Business International, 1st Quarter*

The Economist Intelligence Unit Limited (2003) – *Country Profile Mexico 2003/2004 Main Report*

IMF – IFS (2002) *International Financial Statistics*

IMF *Direction of Trade Statistics* (2002)

Volvo Bus Corporation (2003)
The Bus and Coach Industry Business Environment

Volvo Bus in Mexico (2003) *Company's own calculated figures*

The World Bus & Coach Manufacturing Industry (2002), T&BB Reports Ltd.
World Investment Report (2001) – *Promoting Linkages*

Internet Sources

Maquila Portal 1
Regionalism vs. Multilateralism: No such Policy Dilemma for Mexico (2003) Accessed 3 September 2003 at
http://www.maquilaportal.com/public/artic/artic209e.htm

Maquila Portal 2
Mexican Automotive Industry: A World-Class Player (2003) Accessed 5 October 2003 at http://www.maquilaportal.com/public/artic/artic228e.htm

Maquila Portal 3
Mexico and Brazil Sign Trade Agreement (2002) Accessed 10 October 2003 at http://www.maquilaportal.com/public/artic/artic207e.htm

Maquila Portal 4
Japan-Mexico on Negotiations for a Free Trade Agreement (2003) Accessed 10 October 2003 at http://www.maquilaportal.com/public/artic/artic266e.htm

Maquila Portal 5
Mexico finds answer to NAFTA Article 303 (2002) Accessed 23 October 2003 at http://www.maquilaportal.com/public/artic/artic118e.htm

WTO
Legal Texts: Uruguay Round Final Act (1994)
Accessed 5 September 2003 at
http://www.wto.org/english/docs_e/legal_e/ldc2_512.htm

EU 1
The Doha Development Agenda (2001) Accessed 5 September 2003 at http://europa.eu.int/comm/trade/issues/newround/doha_da/index_en.htm

EU 2
What Cancun is about (2003), Accessed 5 September 2003 at http://europa.eu.int/comm/trade/issues/newround/doha_da/cancun/index_en.htm

BBC News, UK Edition (2000)
EU, Mexico sign free trade deal (2000) Accessed 4 October 2003 at http://news.bbc.co.uk/1/hi/world/americas/688290.stm

BBC News, UK Edition (2003)
World trade talks collapse (2003), Accessed 4 October 2003 at http://news.bbc.co.uk/1/hi/business/3108460.stm

GTN (2003)
Global Trade Negotiations Home Page - *Regionalism Summary* (2003)
Accessed 2 September 2003 at
http://www.cid.harvard.edu/cidtrade/issues/regionalism.html

Internet News (2001)
U.N. Report Ranks Nations' Technological Development (2001) Accessed 4 September 2003 at http://www.internetnews.com/bus-news/article.php/800051

The NAFTA Office of Mexico in Canada
Mexico's Integration to the Global Economy (2003) Accessed 15 September 2003 at http://www.nafta-mex-ico.org/trade/Mexico_s_trade/Mexico_s_Integration_to_the_Wo/networkoMexico_s_integration_to_the_wo.html

Just Auto (2001)
Turbulence roils the automotive industry in Latin America: Mexico, Brazil and Argentina, 1995 - 2005 Accessed 16 October 2003 at http://www.just-auto.com/features_detail.asp?art=489&lk=nd02

Europa - DG Trade (2003)
Accessed 26 September 2003 at http://trade-info.cec.eu.int/doclib/cfm/doclib_results.cfm?action=results1

Europa – DG Trade 2 (2003)
Bilateral Trade Relations – Mexico Accessed Fall 2003 at http://www.europa.eu.int/comm/trade/bilateral/mexico/ftapr_en.htm

UK Trade & Investment (2003)
Automotive Industry Market in Mexico Accessed 4 November 2003 at http://www.tradepartners.gov.uk/automotive/mexico/profile/overview.shtml

International (2003)
Historia y filosofía Company Home Page,
Accessed 3 November 2003 at http://www.internationalcamiones.com/int.asp

Latin Advisory (2000)
EU-Mexico Free Trade Agreement: A "Win-Win" for Trade Liberalization – Both Regionally and Multilaterally Accessed 4 November 2003 at http://www.imakenews.com/texec/e_article000006139.cfm

Market Access and Compliance (2003)
NAFTA Rules of Origin – Regional Value Content Accessed 27 September 2003 at http://www.mac.doc.gov/nafta/5011.htm

Ministry of Economy (2003)
Home Page of Mexican Ministry of Economy, Accessed Fall 2003 at http://www.economia.gob.mx/
Fiscal Deposit (2003)
Valle de Mexico Warehouse , Accessed 6 December 2003 at http://www.alvamex.com/html/deposito_fiscal.html

Almacenadora General, S. (2003)
Accessed 6 December 2003 at
http://www.alvamex.com/html/deposito_fiscal.html

The Quotation Page (2003)
Accessed at 19 December 2003
http://www.quotationspage.com/search.php3?Search=analysis+&Author=&C=mgm&C=motivate&C=classic&C=coles&C=lindsly&C=poorc&x=51&y=11

Australian Bureau of Statistics (1998)
A Guide to Major ABS Classifications, 1998
Accessed at 22 October 2003
http://www.abs.gov.au/ausstats/abs@.nsf/0/5e0d3552aaa526eeca25697e00184b51?OpenDocument

International Business Training (2002)
The role of the Harmonized System in NAFTA
Accessed at 22 October 2003
http://www.i-b-t.net/article20.html

Internet Articles and Reports

Schifferes S. (2003) *The new politics of trade*, BBC News, UK Edition Accessed 4 October 2003 at http://news.bbc.co.uk/1/hi/business/3109778.stm

Nebbia G. (1998) President Zedillo slashes budget, World Socialist Web Site Accessed 6 October 2003 at http://www.wsws.org/news/1998/sep1998/mex-s24.shtml

Robinson S. & DeRosa D. A. (1995) *Trade Liberalization and Regional Integration: Implications for 2020,* International Food Policy Research Institute Accessed 5 September 2003 at
http://www.ifpri.org/2020/briefs/number12.htm

Whitt J. A. (1996) *The Mexican Peso Crisis* Accessed 9 September 2003 at
http://www.frbatlanta.org/frbatlanta/filelegacydocs/J_whi811.pdf

Akira K. (2000) *A Note on Globalization and Regional Integration* Accessed 3 September 2003 at http://project.iss.u-tokyo.ac.jp/jp/kikkawa/iss-1.pdf

Busse M. & Koopmann G. (2001) *The EU – Mexico Free Trade Agreement: Incentives, Context and Effects*, Hamburg Institute of International Economics, Germany Accessed 4 September 2003 at http://www.hwwa.de/PersHome/Busse_M/EU-MexicoFreeTradeAgreement.pdf

Ojeda R. H. (2003) *The theory and practice of regional integration: Trans – Antlantic Lessons for the New World*, University of California, Los Angeles Accessed 2 September 2003 at http://www.iadb.org/sds/doc/SOCPonenciaHinojosaENG.pdf

Ferguson R. J. (2003) *Latin America in Transition – From Colonisation to Nationalism to Globalisation*, The Department of International Relations, Bond University, Australia; Accessed 2 September 2003 at http://www.international-relations.com/WbLatinAmerica/WBLA-Lec2-2003.htm

Doug J. (2003) *Volvo invests heavily in its facility south of the American border*, Bus Ride Magazine Accessed 10 October 2003 at http://www.busride.com/2003/04/Volvo_Bus_in_Mexico.asp

Keidanren N. (2003) *Request for Bilateral Negotiations on a Japan-Mexico Economic Partnership Agreement, Japan Business Federation* Accessed 17 October 2003 at http://www.keidanren.or.jp/english/policy/2003/060.html

Donnelly R. (2002) *Dealing with the Rising sun – Mexico eyes a Japanese trade deal*, Mexico Connect Accessed 17 October 2003 at http://www.mexconnect.com/mex_/travel/bzm/bzmjapan.html

Johnson J. (1999) *NAFTA and the Trade in Automotive Goods*, The Fraser Institute Accessed 5 September 2003 at http://oldfraser.lexi.net/publications/books/assess_nafta/auto_goods.html

Economy Report (2001)
Mexico, Extracted from 2001 Economic Outlook Accessed 3 September 2003 at
http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan004971.pdf

GAO (2001)
Free Trade Area of the Americas – Negotiations at Key Juncture on Eve of April Meetings, United States General Accounting Office Accessed 25 October 2003 at http://www.sice.oas.org/geograph/westernh/Gao_03-01.pdf

Baz A. G (1994) What is maquiladora?
Bancomext Accessed 23 September 2003 at
http://www.udel.edu/leipzig/texts2/vox128.htm

Agreements Original Texts

NAFTA 1
North American Free Trade Area, Canada, Accessed Fall 2003 at
http://www.dfait-maeci.gc.ca/nafta-alena/agree-en.asp

NAFTA 2
SICE – Foreign Trade Information System, Accessed Fall 2003 at
http://www.sice.oas.org/trade/nafta/naftatce.asp

FTAA 1
Free Trade Area of the Americas, Accessed Fall 2003 at http://www.ftaa-alca.org/View_e.asp

ACE No 55
Acuerdo de Complementación Económica México-Brasil

LAIA
Latin American Integration Association Accessed Fall 2003 at
http://www.aladi.org/

APEC
Asia-Pacific Economic Cooperation, About APEC Accessed 3 December 2003 at http://www.apecsec.org.sg/apec/about_apec.html

Mexico – EU Free Trade Agreement 1
Legislative acts and other instruments, Accessed Fall 2003 at
http://www.europa.eu.int/comm/trade/issues/bilateral/countries/mexico/docs/en2_decision_goods.pdf

Mexico – EU Free Trade Agreement 2
United States – Mexico Chamber of Commerce, Accessed Fall 2003 at
http://www.usmcoc.org/n4.html

Brochures

Bancomext (2003)
Automotive Sector Investment Opportunities in Mexico

NAFTA at Eight – A Foundation for Economic Growth, Office of the United States Trade Representative Accessed 26 September 2003 at http://www.ustr.gov/naftareport/nafta8_brochure-eng.pdf

Interviews

Estrada C. *Metallurgy Sector Executive*, Bancomext, Mexico City 2003 – 11 – 12

López M. Custom Union Subd*irector* Ministry of Economy, Mexico City 2003 – 11 – 13

Carrasco R. *International Marketing Manager – Automotive Sector* Bancomext, Mexico City 2003 – 11 – 14

Ochoa A. *Legal Advisor* Ministry of Economy, Mexico City 2003 – 11 – 14 and 2003 – 11 – 17

Baker J-C. *Director for NAFTA, Technical Regulations and Standards* Ministry of Economy, Mexico City 2003 – 11 – 17

López R. *Director for the Auto-parts Industry* Ministry of Economy, Mexico City 2003 – 11 – 17

Anaya R. *General Manager of Central America and LAIA* Ministry of Economy, Mexico City 2003 – 11 – 17

Alanís A. *Managing Director, Traffic Department* Volvo Bus de México, Mexico City 2003 – 11 – 11 and 2003 – 11 – 18

Reyes R. *Managing Director, Purchasing Department* Volvo Bus de México, Mexico City 2003 – 11 – 18

Cortéz S. *Managing Director, Marketing Department* Volvo Bus de México, Mexico City, 2003 - 11 – 10 and 2003 – 11 – 19

Silvetti R. *Commercial Legal Advisor* European Union Delegation in Mexico, Mexico City 2003 – 11 – 19

Espinosa I. *Economic Studies Director* ANPACT, Mexico City 2003 – 11 – 19

Appendix

Apendix I

The Maquiladora Industry

The maquiladora program started in Mexico in 1965. The aim of its implementation is to allow foreign companies to bring parts and raw materials into Mexico duty-free in order to assemble or manufacture them as long as the final product would return to its country of origin.[336] A maquila program allows a company to participate in foreign investment and management up to 100% without any special authorization and it entitles it to special customs treatment.[337] The maquiladoras produce a variety of goods including vehicles, electrical gods and textiles, and are based in the U.S.-Mexican border. [338]There are over one million workers working in almost 4.000 maquiladoras. They are owned by U.S., Japanese and European countries. Mexican labor is cheap and due to NAFTA, taxes and custom fees are almost non-existed.[339] Nowadays, the Mexican maquiladoras have to confront international competition especially after China's admission to the WTO which opens up a lot of opportunities for companies.[340] Moreover, under NAFTA the maquiladoras have started to pay duties in Mexico on non-NAFTA originating resources used in the production. The governments have created the Programas de Promoción Sectorial in order to offset these extra duties. According to these programs duties are eliminated on certain imports into Mexico regardless of their origin and are available to all producers.[341]

[336] Baz A. G (1994)
[337] Ibid.
[338] The Economist Intelligence Unit Limited (2003)
[339] Baz A. G (1994)
[340] The Economist Intelligence Unit Limited (2003)
[341] Ibid.

Appendix II

The Harmonized Commodity Description and Coding System

The Harmonized Commodity Description and Coding System has been built up in order to provide international uniformity in goods classification. Moreover it was formed with the aim to renew and update the Customs Co-operation Council Nomenclature **(CCNN)** which was use before that, in order to embrace changes and technological progress in goods traded in the international arena. Also this system would make simpler the collection and analysis of international statistics.

Structure of the classification

The HS has a 6 digit structure that is illustrating goods, important to world trade. The hierarchy arrangement of HS categories is as follows:

22 Sections, 98 Chapters, 1260 Headings at the 4 digit level, 5142 Subheadings at the 6 digit level [342]

These categories provide detailed definitions of the products and are adding additional information about them as digits are added to their code. The HS number is unique for every product. For products under this level, individual countries may add their own additional digits as sub codes depending on their own national requirements.[343]

The role of the Harmonized System in NAFTA

The **HS** is essential in the NAFTA context since the process of determining whether the good is "originating" or when the tariff on the product will be eliminated depends on the HS number. An in-depth study of the HS number is essential in order to classify goods properly and apply the suitable NAFTA rule of origin. [344]

The NAFTA benefits on most of the goods are related to Tariff Eliminations or to Value-Content rules. Since these rules depend on the HS classification number its vital to determine this number correctly for every product. [345]

[342] Australian Bureau of Statistics (1998)
[343] International Buisness Training (2002)
[344] Ibid.
[345] Ibid.

Appendix III

Basic Bus Manufacturing Terms

Coaches

"Coaches are vehicles designed and constructed to carry passengers on express services, tours and private hire. A coach has one or more separate compartments for carrying luggage, below the main passenger compartment."[346]
On the Mexican market coaches play an important role. This is due to the large distances between the main centres of population and most of all due to the poorly developed rail networks, with slow and infrequent services. In Mexico, whole networks of express coach services have been established, often with more operators competing on the main routes.[347]

Principal Construction Types of Busses[348]

On the Mexican market there are two main types of construction of the busses. The first one consists of a chassis[349] built by one manufacturer with bodywork by another. Because the making of chassis, engines, gearboxes, axles and other parts necessary for the motion of the vehicle require higher capital investment and greater volumes, there have always been comparatively fewer countries capable of building them. On the other hand, bodywork is, although to a less extent than before, still a relatively labor intensive and unsophisticated business. Furthermore, disciplinary tariffs on any attempts to import bodywork or complete vehicles are still imposed by many countries in order to protect domestic industries.

The second type of construction is the integral vehicle which is built wholly by one manufacturer. As the result of some duplication of metal in the chassis and body combinations, integral vehicles are usually lighter in weight. In general, they require higher capital investment in jigs and tooling. For that reason manufacturers have to be quite sure that the volume of the production will be high over a period of year, before they commit to make the capital investment. Furthermore, the integral manufacturer needs higher funding than a bodybuilder,

[346] The Economic Intelligence Unit Limited 1 (1999)
[347] The World Bus & Coach Manufacturing Industry 2002
[348] Ibid
[349] "A self-supporting frame, carrying all the units and components which are necessary for the motion of the vehicle" EIU The global bus and coach industry; Definitions of terms

unit for unit, because it has to pay for mechanical units, whereas chassis are generally supplied on free issue during the bodybuilding period.

More recently a new, third category of the buses has come up in the developed countries, the integrated buses, which is the mixture of both chassis/body combination and the integral vehicle. With the latest generation of low floor city buses, there has to be a much higher degree of collaboration between them.

Appendix IV

Definitions in NAFTA Rules of Origin

Chapter	Chapter of the Harmonized System
Heading	The first four digits in the tariff classification number under the Harmonized System
Section	A section of Harmonized System
Subheading	The first six digits in the tariff classification number under the Harmonized System
Tariff Item	The first eight digits in the tariff classification number under the Harmonized System as implemented by each Party

Source : NAFTA 2

Appendix V

Important Definitions in the EU-Mexico FTA Rules of Origin

Manufacture	**Any kind of working or processing, including assembly or specific operations**
Material	Any ingredient, raw material, component or part used in the manufacture of the product
Product	The product being manufactured, even if it is intended for later use in another manufacturing operation
Goods	Both materials and products
Non- originating products	Products or materials which do not qualify as originating under Annex III

Source: Mexico – EU Free Trade Agreement 1

Appendix VI

BANCOMEXT and ANPACT

Bancomext

Bancomext is the Governmental institution with the mission to stimulate the growth of Mexican companies, primarily the small- and medium size ones. Trough the financial assistance, different promotion programs and created possibilities of integration the aim is to increase their competitiveness and participation on the global arena.[350]

ANPACT

La Asociación Nacional de Productores de Autobuses, Camiones y Tractocamiones was built in 1992 and is the representative office of the Mexican manufacturers of vehicles with the Gross Vehicular Weight above 6 300kg. Their mission is:

- To support and make possible further development of the Autotransportation industry in Mexico.
- To represent, promote and defend the interests of the heavy weight vehicle manufacturing companies and other institutions directly connected to this industry both nationally and internationally.[351]

[350] Bancomext (2003)
[351] ANPACT (2003)