

Mexico-Japan EPA. A Success Story

New Investment Opportunities.

Automotive and Energy Sectors.



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Antecedents

Mexico and Japan share a long history of Friendship and Economic Relations. The first contacts between the People of Mexico and Japan can be traced back to the XVI Century. The first official contacts between the two countries date from more than 400 years ago, when a Commercial Mission lead by Tsunenaga Hasekura arrived to the Mexican coast of Acapulco, and discussed with Mexico's officials on trade relations.

Diplomatic Relations between the two countries were established with the conclusion of the Friendship, Commerce and Navigation Treaty on November 30th of 1888. The 1888 Treaty, which adopted a reciprocal Most-Favored-Nation Treatment, represented for Japan its first Treaty concluded on an egalitarian basis with a Western country. The Treaty served as a crucial legal precedent that allowed the Meiji Government to successfully reviewed unequal treaties that Japan had concluded previously with Western powers. Following the conclusion of the Treaty, immigration, cultural and economic exchanges between Mexico and Japan began.

Mexico-Japan Economic Partnership Agreement

Recognizing the long historical friendship, the strong economic and political relationship, and the high level of economic complementarity, Mexico and Japan took a very important decision at the beginning of the XXI Century: To further strengthen their Friendship and Economic Relationship by negotiating a Free Trade Agreement (FTA). Negotiations for the conclusion of a FTA between Mexico and Japan started in November 2002. Japan had not concluded a FTA with any country by that time. After almost two years of an intense process of negotiations, both countries signed the Economic Partnership Agreement (EPA) on September 17th 2004. The Agreement entered into force on April 1st 2005 after the corresponding ratifications by the

Congress of Mexico and the Diet of Japan.

For Japan, and as it was the case back in 1888 with the conclusion of its first equal Treaty, the EPA with Mexico was its first Free Trade Agreement full-fledged, with all sectors included according to the World Trade Organization disciplines. For Mexico, the EPA with Japan was its first Free Trade Agreement with a country from Asia, and it further consolidated Mexico's FTA Agreements Network with preferential access to more than 45 countries in the World.

The Mexico-Japan EPA, with 18 Chapters and 177 Articles, is a state of the art Trade Agreement, since it establishes not only all the disciplines comprising a FTA: Trade and Investment Liberalization; Market Access Improvement; Investment Protection; Dispute of Settlements; Government Procurement; Customs Procedures; Rules of Origin; etc., but it includes a strong mechanism of bilateral cooperation to further strengthen the economic relationship, and maximize the trade and investment liberalization; investment promotion and facilitation; sanitary and phytosanitary measures, etc. Additionally, the EPA includes a very important mechanism for the improvement of the business environment, through the Improvement of Business Environment Committee, where representatives of both Governments and the private sector give recommendations in order to further strengthen the Mexico-Japan economic partnership.

Mexico-Japan EPA. A Success Story.

April 1st of 2017 marks the 12th Anniversary of the entering into force of the EPA. As we will describe, as a result of the great efforts by the private sector and Governments of both countries, the EPA has been a Success Story for both Countries in the first decade of its implementation. The EPA has further strengthened our friendship, bilateral trade, the flow of direct investment, is supporting industries and small and medium size companies, and is fostering bilateral cooperation in key sectors of their respective economies. Addition-

ally, the EPA is strengthening further the Global Strategic Partnership between Mexico and Japan.

Bilateral Trade

Since the EPA was signed, bilateral trade has increased 84.2% from USD12.75 billion in 2004 to USD23.49 billion in 2016. During this period, Mexico's exports to Japan increased 164.9%, from USD2.16 billion to USD5.74 billion. In the same period Japanese exports to Mexico increased 67.7% from USD10.58 billion to USD17.75 billion.

In 2016, bilateral trade reached USD23.44 billion with an increment of 6.2% compared with 2015. During 2016, Mexico's exports to Japan registered USD5.74 billion last year, with an increment of 21% compared to 2015. Japanese exports to Mexico reached USD17.75 billion in 2016 with an increment of 2.2% compared to the previous year.

Thanks to the EPA, Mexico is for Japan it's most important trading partner in Latin America.

Japan is for Mexico its fourth largest trading partner just after its NAFTA partners, the US and Canada, and China. Moreover, Japan has become the second most important market for Mexico's exports of agriculture, fisheries, and beverage products just after the US, accounting for USD1.01 billion in 2015.

As a very positive result of the EPA, the composition of Mexico's exports to Japan has been changing. Mexican exports of manufactured and added value products to Japan have been increasing, serving as evidence of the crucial role of the automotive, energy, electric, chemical etc., in the bilateral trade. Moreover, these industries are helping to increase and diversify our trade and to link global supply chains in which both countries are involved, benefiting both countries. Additionally and after more than ten years, Mexico has resumed its export of oil and petroleum products

to Japan, being the number one sector in our exports to the Japanese market.

Mexico's main products exported to the Japanese market in 2016 were oil and petrochemical products, salt, minerals, auto parts, machinery, electronic components, optical instruments, chemicals, agriculture products and other commodities.

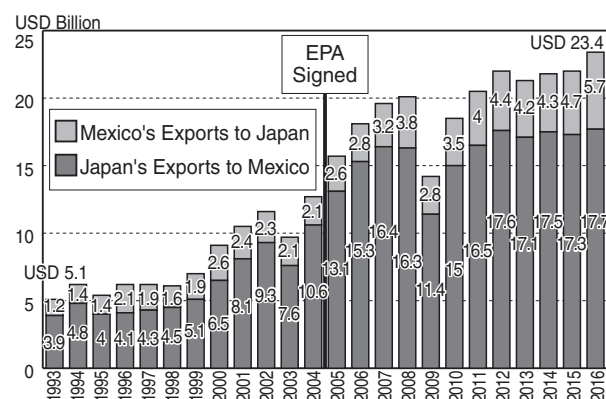
Main Japanese products exported to Mexico last year included motor vehicles, auto parts (cylinders, gear boxes, chassis, machinery and mechanical appliances, specialized steel), precision tools and instruments, electronic boards, etc. More than 90% of Japanese exports to Mexico are capital and intermediate goods that are required by Mexico's industries to insert them in the global value chains in order to export later on finished goods to the different markets in the world.

Japanese Investment into Mexico. Legal Certainty and Protection.

The EPA contains state of the art provisions that give certainty and legal protection to the flow of direct investment. The EPA states in Article 1 as one of the main objectives: To increase investment opportunities and strengthen protection for investments. Investment Chapter 7 of the EPA recognizes important principles for investors of both countries: National Treatment (Article 58); Most-Favored-Nation-Treatment (Article 59); and General Treatment (Article 60). Additionally, Article 63 allows all transfers relating to investment activities including but not limited to: Profit; dividends; interest; capital gains; royal payments, etc.

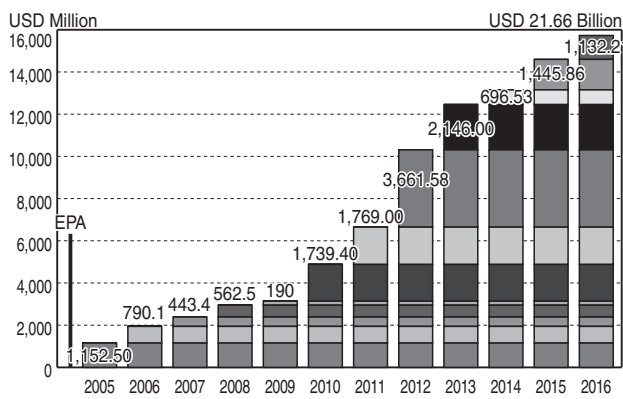
As we will now describe, the economic and political stability of Mexico, the EPA with Japan and its important provisions giving legal certainty and protection to investors, and Mexico's vast FTAs Network, have further consolidated the country as an important

Mexico - Japan Trade, 1993 - 2016.



Source: Representative office in Japan of Ministry of Economy of Mexico, with data of the Bank of Mexico and the Ministry of Finance of Japan

Accumulated Japanese Investment into Mexico, 2005 - 2016.



Source: Representative office in Japan of Ministry of Economy of Mexico

destiny of Japanese Direct Investment.

In the 1990s Mexico undertook a far reaching Trade Liberalization process by concluding FTAs. The most important catalyst of the process was the North American Free Trade Agreement (NAFTA) which entered into force in 1994, and later on FTAs with Latin American Countries, the European Union, the European Free Trade Association, and an EPA with Japan in 2005. Mexico's Trade Liberalization has been successful. Mexico is now an important player in the World's Trade and it is the number one exporter of Latin America. Moreover, Mexico ranks top in Latin America in the World Bank's Doing Business 2016 Report, and top in Japanese companies' perception for exploring new business in Latin America in the JBIC's FY2016 Survey Report. Due to the Japanese Trade-oriented Investment and Market-oriented Investment models, Japanese companies are now taking more advantage of Mexico's preferential access to the most important markets in the world, competitive human resources, and its strong business environment. As a result, Mexico has become not only an important destiny for Japanese direct investment, but an important platform for Japanese companies' production and a gateway of their exports to the most important markets in the world.

Since the EPA entered into force in 2005 until 2016, there has been an unprecedented flow of Japanese Direct Investment into Mexico. During that period, Japanese companies have announced major investment projects in Mexico worth more than USD21.66 billion in several key Mexican economy sectors including but not limited to: Automotive; Energy; Infrastructure; Electric and electronics; Metallurgic; Agroindustry, among others.

Japan has become the most important source of foreign direct investment from Asia into Mexico. Moreover, Japan is now the third most important source of foreign direct investment into Mexico worldwide.

Since the entrance into force of the EPA and a result of its regulations protecting the flow of capital, increasing business opportunities and new investment projects, the number of Japanese companies established in Mexico has increased 209%, from 326 companies established in 2005 to 1008 in 2016.

Importance of the Automotive Industry in the Economic Relationship

Antecedents

Japanese Original Equipment Manufacturers (OEMs) have been operating and contributing to Mexico's Au-

tomotive Industry for more than 50 years now. Nissan started operations in May of 1966 with its First plant in Cuernavaca, Morelos, Mexico. A Second plant was built in Aguascalientes, Mexico, starting operations in November of 1982.

Honda started production of motorcycles in Jalisco, Mexico, in 1971. Later on Honda started the production of vehicles and auto parts in 1996.

Toyota Motor Sales de Mexico initiated operations in April of 2002. Later on, Toyota Motor Manufacturing initiated operations in Baja California, Mexico in 2004, for the production of Tacoma for the US market.

Japanese Investment in the Automotive Industry.

Since the EPA was concluded in 2005, Japanese Direct Investment into Mexico has been more heavily concentrated in the Automotive Industry. All major Japanese OEMs and their suppliers have announced major investment projects for the production of automobiles and products in related sectors such as electronic components, specialized steel, plastic, chemicals, etc., serving North America (Mexico, US and Canada) Europe, and Latin America.

In 2011, Mazda announced an investment of USD770 million for the construction of its First plant in Mexico. Mazda de Mexico started production of Mazda 3 in its new plant in Salamanca Guanajuato, Mexico, in January of 2014. The plant has a production capacity of 200,000 units.

In January of 2012, Nissan announced an investment for USD2 billion for the construction of its second plant in Aguascalientes, Mexico. In November of 2013 the new plant of Nissan was inaugurated with a production capacity of 175,000 units.

Additionally in 2014, Nissan announced another investment project in Mexico, together with Daimler AG, worth USD1.2 billion for the construction of a plant for the production of high end automobiles, Infinity and Mercedes Benz. The new Nissan-Daimler AG plant in Mexico will have a production capacity of 300,000 units per year when it reaches full capacity.

In 2012, Toyota Motor Corp. announced a new investment project in Guanajuato for production of automobiles in the Mazda Plant within the framework of the Investment and Supply Agreement between the two Japanese OEMs. In April of 2015, Toyota announced another new investment for approximately USD1 billion to build a new plant in Guanajuato. The new plant will have an annual capacity of 200,000 units, starting production in 2019.

In February of 2012, Honda announced an investment of USD1.2 billion for the construction of its

Second Plant in Guanajuato with a production capacity of 200,000 units. In February of 2014 Honda began production of the Fit model mainly for the North American market.

Since the signing of the EPA and due to the major projects announced by the Japanese OEMs and their suppliers, Nissan, Honda, Toyota and Mazda have increased production in Mexico by 301.2%, from 346,626 units in 2004 to 1,390,738 units in 2016.

**Mexico’s Automotive Industry.
Investment Opportunities.**

Mexico is the seventh largest producer of automobiles in the world. In the last twelve years, Mexico’s production has increased 130%, from 1,507,175 units in 2004 to 3,465,615 units in 2016.

Mexico is the fifth largest exporter of automobiles in the world. In the last twelve years, Mexico’s exports of vehicles increased 153% from 1,094,306 units in 2004 to 2,768,268 units in 2016. Additionally, sales in Mexico of automobiles reached 1.6 million in 2016, with an increment of 18.6% in comparison with 2015.

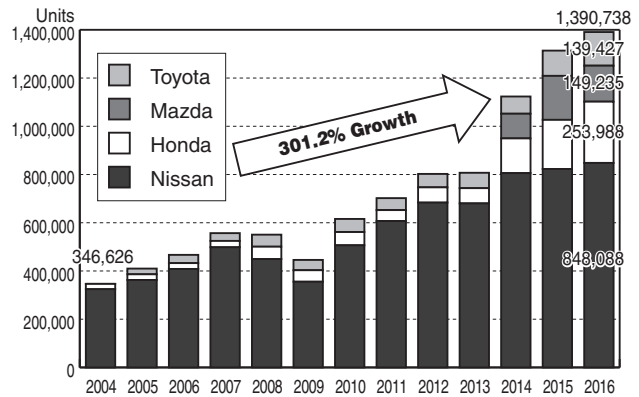
As a result of the leading OEMs new major projects and expansions of production in Mexico, there are an increasing number of investment opportunities for Tier 1, 2 and 3 companies to further strengthen the supply value chain, supplier capacities, and the development of the local supply chain. Due to the increasing production of automobiles in Mexico, including now high-end vehicles as well, there are more business opportunities and growing demand for: Specialized steel; plastics; molding; foundry; forging; machining; aluminum die casting; plastic injection; semiconductors; design and engineering; and human capital. There are also business opportunities for the transfer of technology, materials and components for auto parts manufacturing in accordance with Japanese OEM’s specifications.

Importance of the Energy Sector in the Economic Relationship.

Antecedents

During the 1970s important events took place in the bilateral economic relationship. From the first oil crisis in 1973, Japan was probably the most affected industrialized country. Japan’s dependency of crude oil at that time from the Middle East, the region in conflict, represented 77.5%. Moreover, Japan’s dependency on oil supplies from OPEC countries represented 92.9%. Due to this scenario, Japan had to take measures to cope with the situation. The Adjust-

Japanese OEM’s Production in Mexico, 2004 - 2016.



Source: Representative office in Japan of Ministry of Economy of Mexico, with data of AMIA

ment of Supply and Demand of Oil Law and the National Law of Emergency Measures were enacted. Additionally, the Energy General Council delivered a Report in 1974 stating that the supply and demand of crude oil would be uncertain. With this analysis, three main policies were established in Japan: 1) To achieve a stable supply of energy; 2) To diversify its imports of oil and natural gas; 3) To create an industrial structure aimed to conserve energy and increase energy use efficiency. In 1978 a new conflict in the Middle East started and as a result of the production and exports cuts, the second oil crisis began in 1979.

Meanwhile, Mexico started a period of economic recovery in 1976. There is no doubt that the most important element of the beginning of the economic recovery was the discovery of important oil fields by PEMEX. During the 1970s Mexico became an important oil producer and exporter outside OPEC.

With these scenarios, Japan revised its policy towards Latin America giving a more relevant place to its political and economic relationship with Mexico. As a result, Mexico and Japan started negotiations on the possibility of supplying Mexico’s oil to Japan. In June of 1978 PEMEX and Mitsubishi Corporation signed an Agreement to send samples of crude oil to Japan. In September of 1978, the Chairman of the Japan Economic Federation (Keidanren) visited Mexico and continued negotiations for the supply of oil with Mexico’s official. These negotiations gained momentum with the visit of the President of Mexico to Japan in October of 1978. The Presidential visit produced concrete results for increasing trade, investment, scientific and cultural exchanges and the supply of Mexico’s oil to Japan began. This change of views and perceptions from both countries had a strong and rapid impact on the economic relationship.

Japanese Investment in the Energy Sector. Mexico's Energy Reform

Since the Mexico-Japan EPA came into force in 2005, Japanese companies have been winning more public biddings for energy projects with PEMEX and CFE, and concessions for water treatment and infrastructure for an amount of approximately USD5.26 billion until 2016. The EPA has been a key element for the increasing participation of Japanese companies in this sector in Mexico like Mitsui & Co, Mitsubishi Corporation, Sumitomo Corporation, Mitsubishi Heavy Industries, Mitsubishi Hitachi Power Industries, Toshiba, Chubu Electric Power, etc., and with the important financial support of JBIC in some of the projects.

Mexico, a non-OPEC country, is one of the ten largest oil producers in the world. Similar to what happened back in the middle of the 1970s, we believe Mexico and Japan have a new opportunity with the energy sector to improve and consolidate their economic relationship further. On December 23rd 2013, Mexico's Energy Reform formally became law following the approval in Congress and the ratification by the majority of Mexico's States Legislatures. The objective of the Energy Reform is to increase the competitiveness and efficiency of the energy sector to contribute to Mexico's sustainable economic growth. The reform modified three articles of the Constitution of Mexico, allowing domestic and foreign private investment together with PEMEX and the Mexican utility company CFE.

Mexico's Energy Reform is generating high expectations in the international markets and among leading energy's companies worldwide. The Energy Reform represents a great opportunity for Japan to more actively participate in Mexico's energy sector, and diversify its sources of energy within the framework of its own Energy Reform.

There are increasing investment opportunities in Mexico's energy sector:

Upstream: Exploration and production of hydrocarbons.

Midstream: Transportation and storage; expansion of pipelines; liquefaction terminals; compression and re-gasification of natural gas.

Downstream: Refinery (production of gasoline and diesel, commercialization of gas, diesel, natural and LP gas; distribution network and storage of gasoline and diesel).

In July of 2014, the Prime Minister of Japan paid an official visit to Mexico, and together with the President of Mexico highlighted the positive results of the EPA between both countries. Within the framework of the visit, 14 MOUs were signed between institutions

of both countries, several of them in the energy sector with PEMEX, JBIC and JOGMEC, with the objective to increase cooperation in the energy industries of both countries.

In November of 2014, the Information Center for Petroleum Exploration and Production sent a representative of the most important Japanese companies in the energy sector to Mexico to explore new business opportunities in the country within the framework of the Energy Reform. In the same year, the Japan Electric Power Information Center sent Mission to Mexico to evaluate and explore business opportunities for its members in the energy sector in Mexico.

After these visits, several seminars on investment opportunities in the energy sector have been organized in Mexico City and in Tokyo.

On December 2016, the Japanese company INPEX, together with PEMEX and Chevron, were successfully awarded an exploration license for an important block in the Trion field of the Gulf of Mexico. This concrete result with the participation of a Mexican, Japanese and US company is relevant, since it was the first deep water lease auction in Mexico within the framework of the Energy Reform.

Mexico is one of the most open economies and is among the largest exporters in the world. The country has become a successful player in the global economy, and it has consistently continued free trade policies for more than two decades.

Mexico and Japan have shared a global vision based on the principles of friendship, commerce and cooperation for more than 400 years. There is no doubt that the first decade of the Mexico-Japan EPA has been a success based on the results described above. Both countries are neighbors in the Asia-Pacific region, the most dynamic in the world, with more economic growth expected in the future. Based on these principles of free trade and increasing cooperation in key sectors of both economies including but not limited to: Automotive; energy (oil and gas); electric power plants; electric-electronics; chemical and metallurgic; mining; metal mechanic; infrastructure; agroindustry; steel; and new sectors like Aerospace, Biotechnology, telecommunications, IT, renewal energy and clean technologies, will further strengthen the Economic Relationship.

Finally, we firmly believe that increasing cooperation, investment and joint venture projects among companies of both countries, particularly in the energy sector, will be a catalyst for a new era of the Global Strategic Partnership between Mexico and Japan, stated in a Joint Declaration by the Leaders of both countries, in the XXI Century. 