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TRADE SUMMARY

Two-way trade between the United States and Mexico grew from \$81.5 billion in 1993 to \$235.5 billion in 2003. United States trade with Mexico has grown at an average annual rate of 11 percent since implementation of the NAFTA, which contributes to Mexico's status as the United States' second largest trading partner since 1999. Approximately 89 percent of Mexico's exports go to the United States, while 62 percent of Mexico's imported goods come from the United States. In 2003, Mexico held an 11 percent share of total U.S. imports.

United States goods exports to Mexico were \$97.5 billion in 2003, virtually unchanged from the previous year. Imports from Mexico were \$138.1 billion, an increase of 2.6 percent from 2002. The United States trade deficit with Mexico for 2003 was \$40.6 billion, an increase of \$3.5 billion from the 2002 deficit.

Mexico has signed a total of 11 free trade agreements with 33 trade partners, including the European Union, Chile, the five economies of the Central American Common Market, and Israel. The newest of these agreements is an FTA with Uruguay, which President Fox signed in November 2003 – the first FTA achieved under the Fox Administration. The number of countries with which Mexico enjoys FTAs will grow to 43 in May 2004, with the accession of 10 new members into the European Union and their inclusion in the Mexico-EU FTA.

North American Free Trade Agreement

The North American Free Trade Agreement (NAFTA), signed by the United States, Canada, and Mexico, entered into force on January 1, 1994. The NAFTA progressively eliminates tariffs and non-tariff barriers to trade in goods; improves access for services trade; establishes rules for investment; strengthens protection of intellectual property rights; and creates an effective dispute settlement mechanism. The NAFTA is accompanied by supplemental agreements that provide for cooperation to enhance and enforce labor standards and to encourage environmentally friendly practices and bolster environmental protection in North America.

IMPORT POLICIES

Tariffs and Market Access

Under the terms of the NAFTA, Mexico eliminated tariffs on all remaining industrial and most agricultural products imported from the United States on January 1, 2003. Remaining tariffs and non-tariff restrictions on corn, sugar, dairy products and dried beans will be phased out by January 1, 2008. Mexico's average duty on U.S. goods has fallen from 10 percent prior to the NAFTA to less than 0.1 percent today.

Trade growth in agricultural products has in fact been remarkably balanced since the NAFTA was implemented, with U.S. exports increasing by 118 percent from 1993 to 2003, and imports from Mexico increasing by 131 percent. However the numbers are less balanced when considering only non-agricultural trade. U.S. imports from Mexico grew 251 percent, compared with U.S. export growth of 139 percent from 1993 to 2002.

A number of U.S. exports are subject to antidumping duties, which limit access to the Mexican market. Products subject to these duties currently include beef, apples, rice, liquid caustic soda, ammonium sulfate, polyvinyl chloride, bond paper, and corrugated rods. Mexico initiated antidumping investigations of pork, industrial fatty acids, stearic acid and welded carbon steel pipe and tube in 2003. As part of an

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agreement with the United States, Mexico also imposed safeguards on poultry leg quarters in July of 2003. The United States exempted Mexico from the recently ended safeguard action on steel.

On January 1, 2001, as required by NAFTA Article 303, Mexico implemented limitations on the use of duty drawback and duty deferral programs. Therefore, the duties waived for non-NAFTA originating goods incorporated into products that are subsequently exported to the United States or Canada may not exceed the lesser of: (a) the total amount of customs duties paid or owed on the good initially imported; or (b) the total amount of customs duties paid to another NAFTA government on the good, or the product into which the good is incorporated, when it is subsequently exported.

To minimize the increase in input costs for its manufacturers as a result of these new limitations, Mexico created several "Sectoral Promotion Programs" (PROSECS). PROSECS reduce the MFN applied tariffs (often to zero) on items in over 16,000 tariff categories used to produce specified products in 22 industries. While the industries and items eligible for the reductions are those of greatest importance to the temporary import (maquiladora) sector, the reduced tariffs are available to all qualifying producers, regardless of nationality, and do not condition benefits on subsequent exportation.

Implementation of NAFTA Article 303 continues the process of integrating maquiladoras into Mexico's domestic economy. During 2003, the Mexican government implemented a series of measures to reduce regulatory barriers for the maquiladora sector. The United States continues to monitor the consistency of Mexico's PROSEC programs with the NAFTA.

On January 1, 2002, Mexico published amendments to its Income Tax Law that appear to discriminate against small retailers and distributors that sell imported products by subjecting them to higher taxes and more burdensome administrative reporting requirements. Article 137 precludes small companies that sell imported products from qualifying as "small contributors" for tax purposes, even if they meet all other qualifications (e.g., annual income limit of less than approximately \$150,000 per year). As a result, small companies selling imported goods are categorized as "medium contributors," with an annual income not to exceed \$400,000. Meanwhile, small companies only selling products produced domestically can continue to enjoy the "small contributor" status. Officials have raised this matter with the Government of Mexico.

Agricultural Products

The United States exported \$7.9 billion in agricultural products to Mexico in 2003, a new record. Mexico is the United States' third largest agricultural market. Under NAFTA, Mexico has eliminated nearly all import tariffs and tariff-rate quotas on agricultural products from the United States. As of January 1, 2003, the only U.S. agricultural exports subject to tariffs or tariff-rate quotas are corn, sugar, dry beans, chicken leg quarters, and non-fat dry milk.

Mexico's Secretariat of Economy (SECON) continued antidumping duties on beef, rice, and apples, while eliminating antidumping duties on live hogs. SECON has also initiated an antidumping investigation on U.S. pork. Concerns about Mexico's methodology for determining injury to the Mexican domestic industry and for calculating dumping margins in the rice case have led the U.S. to challenge the antidumping measure at the WTO. In the case of beef product exports, the dumping duty rates assigned to individual companies only apply to beef aged less than 30 days and graded Choice or Select; for all other cuts of beef subject to the order, the higher rate applies. These policies have reduced the number of U.S. suppliers and have altered product trading patterns. Industry believes that between \$100 million to \$500 million is lost each year due to dumping duties in this sector.

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In July 2003, Mexico imposed a NAFTA safeguard on U.S. chicken leg quarters that will remain in effect until December 31, 2007. The safeguard takes the form of a tariff-rate quota on chicken leg quarters. The TRQ preserves market access for U.S. exporters at levels achieved in recent years. Pursuant to the NAFTA, Mexico agreed to provide compensation to the United States, including a commitment not to impose any additional import restrictions on U.S. poultry products and to eliminate certain sanitary restrictions on U.S. poultry products.

Mexico's cattlemen have also submitted a proposal for a global safeguard on beef. SECON has not yet decided if it will conduct a beef safeguard investigation.

On December 31, 2001, the Mexican Congress approved a 20-percent consumption tax on certain beverages sweetened with ingredients other than cane sugar, including HFCS. This action has prevented a settlement of broader sweetener disputes between the United States and Mexico. Industry estimates that the cost of this trade barrier to the United States is roughly \$200 million in U.S. corn and HFCS exports and \$800 million in U.S. investment in Mexico. HFCS sales fell well below prior volumes, as bottling companies in Mexico switched to cane sugar. On March 5, 2002, the Fox Administration suspended the tax for a period of seven months; however, the Supreme Court ruled this action unconstitutional and reinstated the consumption tax on July 12, 2002. The tax was renewed by the Mexican Congress for 2003 and 2004. On March 16, 2004, the United States requested consultations under the dispute settlement procedures of the WTO.

In late 2002, Mexico announced its "Agricultural Armor" initiative, a package of measures designed to keep Mexican agriculture competitive. The initiative calls for measures to increase sanitary, phytosanitary and food safety inspections and impose quality standards. The initiative also proposed modifications to Mexico's antidumping and countervailing duty laws, which resulted in amendments to the Foreign Trade Law in early 2003. The United States is challenging several of these provisions before the WTO. On April 28, 2003, the Government of Mexico and producer groups signed the National Agricultural Accord. The document's most specific measures echo what was contained in Mexico's Agricultural Armor package, such as stricter enforcement of sanitary and phytosanitary measures. In addition, the agreement proposes approaching Canada and the United States to investigate the possibility of revising the dry bean and white corn provisions of the NAFTA.

Sanitary and Phytosanitary Issues

Mexican sanitary and phytosanitary standards have created barriers to exports of certain U.S. agricultural goods, including grains, seed products, apples, stone fruit, pork, beef, poultry, citrus, wood and wood products, dry beans, avocados, and table eggs. In addition, procedural requirements regarding sanitary and phytosanitary inspections at the port-of-entry often do not reflect agreements reached between U.S. Department of Agriculture officials and the Mexican Secretariat of Agriculture, resulting in unnecessary delays at the border, seaports, and airports. In 2003, significant quantities of imports were rejected or delayed at the border. Disagreements over the prevalence of certain pests and certain administrative requirements led to a delay in the implementation of the California Stone Fruit protocol in 2003 and 2004, which provides for a systems approach to prevent transmission of quarantinable pests. Because of this delay in implementing the systems approach protocol, the U.S. industry is reverting to more costly fumigation procedures. Similarly, in October 2001, the Mexican quarantine monitoring system for apples was to have been transferred to APHIS. While all but one Mexican inspector was withdrawn from the State of Washington, the program remains in operation and the final transfer is subject to additional reviews. Also, Mexican plant quarantine authorities have notified APHIS of their intent to add new pests to their lists of quarantine concerns, even though no quarantine pests have been detected in over 52 million boxes of apples the United States has shipped to Mexico since 1993. USTR and USDA have

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raised these issues several times over the last year, including jointly in the bilateral Consultative Committee on Agriculture.

Mexico banned imports of U.S. beef in December 2003 with the detection of one positive case of Bovine Spongiform Encephalopathy (BSE) in the State of Washington. Mexico announced in March it would accept U.S. boxed beef under 30 months of age. As of the publication of this report, the U.S. government is taking aggressive action and is working intensively to fully re-open the market as quickly as possible. In addition, the United States is working in the International Organization for Epizootics to revise international standards on BSE to reflect current scientific knowledge.

Despite the eradication of Low Pathogenic Avian Influenza (LPAI) in eight U.S. states, Mexico maintains a complete ban on all poultry products from those states. Mexico continues to restrict imports from three U.S. states where Exotic Newcastle Disease was detected in poultry in early 2003.

Administrative Procedures and Customs Practices

U.S. exporters continue to complain about Mexican customs administration procedures, including the lack of sufficient prior notification of procedural changes; inconsistent interpretation of regulatory requirements for imports at different border posts; and discriminatory and uneven enforcement of Mexican standards and labeling rules. Agricultural exporters note that Mexican inspection and clearance procedures for some agricultural goods are long, burdensome, non-transparent and unreliable. Customs procedures for express packages continue to be burdensome, though Mexico has raised the *de minimis* level to fifty dollars from one dollar. However, Mexican regulation still holds the courier 100 percent liable for the contents of shipments.

To be eligible to import any of well over 400 different items, including agricultural products, textiles, chemicals, electronics and auto parts, Mexican importers must apply to the Secretariat of Finance and Public Credit (SHCP) and be listed on a special industry sector registry. U.S. exporters complain that the registry requirement sometimes causes costly customs clearance delays when new products are added to the list of subject items with immediate effect, thereby denying importers sufficient notice to apply. They also report that certain importers have been summarily dropped from the registry without prior notice or subsequent explanation, effectively preventing U.S. exporters from shipping goods to Mexico.

Mexico requires import licenses for a number of commercially sensitive products. Mexico also uses estimated prices for customs valuation of a wide range of products imported from the United States and other countries, including apples, milled rice, beer, distilled spirits, chemicals, wood, paper and paperboard products, textiles, apparel, toys, tools, and appliances.

Since October 2000, the Mexican government has imposed a burdensome guarantee system for goods subject to estimated prices. Importers cannot post bonds to guarantee the difference in duties and taxes if the declared value of an entering good is less than the official estimated price. Instead they must deposit the difference in cash at a designated Mexican financial institution or arrange one of two alternative sureties (a trust or line of credit). The cash deposit is not returned for six months, and then only if the Mexican government has not initiated an investigation and if the supplier in the country of exportation has provided an invoice certified by its local chamber of commerce. Mexican banks charge as much as \$1,500 to open an account for this purpose and \$250 for each transaction, making this a burdensome and costly regulation for businesses on both sides of the border. The United States and Mexican governments are discussing an exchange of customs data for security purposes that would result in the lifting of the estimated pricing regime.

STANDARDS, TESTING, LABELING AND CERTIFICATION

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Changes to the 1997 Federal Metrology and Standardization Law provided for greater transparency in the rules applicable to technical regulations and voluntary standards. However, the Mexican government continues to consider certain regulations to be executive orders that are allegedly exempt from WTO and NAFTA rules concerning notification and comment periods.

Under NAFTA, Mexico was required, starting January 1, 1998, to recognize conformity assessment bodies in the United States and Canada on terms no less favorable than those applied in Mexico. To date, no U.S. certification bodies have been recognized by Mexico.

U.S. exporters have complained that standards are enforced more strictly for imports than for domestically produced products, and of inconsistencies in the treatment of goods among ports of entry. Mexico has over 700 mandatory technical regulations (NOMs) issued by a number of different agencies, each with its own compliance procedures. Only the Secretariat of Economy and the Secretariat of Agriculture (for a limited subsector of its NOMs) have published their procedures. After discussions with the United States government, the Secretariat of Economy implemented procedures in 2000 designed to reduce the cost of exports to Mexico by allowing U.S. manufacturers and exporters to hold title to a NOM certificate of compliance (an official document certifying that a particular good complies with applicable standards) and assign it to as many distributors in Mexico as needed to cover the market. Previously, only Mexican producers or importers were allowed to obtain a NOM certificate posing a problem for U.S. firms using multiple importers. Each importer had to pay to have the exact same product tested at a Mexican lab every year. The costs associated with this redundant testing was industry's main complaint. While the new procedures were supposed to address redundant testing requirements, U.S. firms are complaining that the certification bodies have increased the cost of certification and are charging for certificates to be assigned to other entities. In addition, key Mexican ministries such as Health, Energy and Labor have yet to publish their product procedures.

The Mexican government, citing the need to ensure the quality of Mexican tequila, is considering amending the official standard for tequila to require that tequila be "bottled at the source." Currently, the Mexican standard requires that only "100 percent agave" tequila be bottled at the source. Ordinary tequila can be sold and exported in bulk form under the current official standard. If the draft standard prepared in 2003 is adopted, it will require that all tequila be bottled within the territory of the Mexican appellation of origin, and bulk exports will be prohibited.

The United States is Mexico's largest export market for tequila, accounting for 50 percent of Mexican production. In 2003, the United States imported over \$402 million in tequila. Approximately 77 percent of the total volume was tequila in bulk form. Government officials and industry stakeholders from the NAFTA partners are engaged in consultations, with the aim of removing the export ban from the proposed standard.

U.S. exporters of certain vitamins, nutritional supplements, and herbal remedies have reported that Mexico's revised health law regulations impede access to the Mexican market. While the Mexican government has stated that it is looking at ways to address these concerns consistent with WTO and NAFTA obligations, the U.S. Government has seen no progress. According to industry's estimates, the cost of this trade barrier to the United States is over \$500 million each year.

GOVERNMENT PROCUREMENT

Mexico's efforts to make its government procurement regime more transparent through policies and technologies have resulted in increased competition as well as savings for the government. The Mexican government has established several "e-government" Internet sites to increase transparency of government

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processes and establish guidelines for the conduct of government officials. “Compranet” allows on-line processing of government procurement and contracting. According to the Mexican Secretariat of Public Administration, 321 government offices processed 3,800 electronic transactions for procurement through Compranet in 2002.

In addition to continuing allegations of corruption, several problems remain with Mexico’s procurement market. The NAFTA Government Procurement Chapter allowed Mexico to cover only a temporary, narrow list of services, based on the requirement that it would develop a complete list of covered services by July 1, 1995. However, Mexico has not yet completed the permanent list.

NAFTA provides for the gradual increase of U.S. suppliers’ access to purchases by the two largest Mexican procuring authorities, Mexico’s parastatal petroleum and electricity monopolies, PEMEX and the Federal Electricity Commission (CFE). As of January 1, 2003, NAFTA limits the total value of contracts that PEMEX and CFE may remove from coverage under NAFTA to \$300 million per year. The United States has not been able to confirm whether this commitment has been properly implemented, as Mexico has not provided the statistics called for under NAFTA.

The United States also has concerns with CFE procurement practices, in particular its domestic content requirements in procurements for sub-stations and transmission lines. Also, as a result of CFE’s decentralization of its procurement activities in 2002, the number of procurements covered by the NAFTA has been reduced.

The United States has raised with the Government of Mexico the concerns of suppliers with regard to additional fees that PEMEX includes in procurement for offshore platforms. PEMEX applies supervision fees to bids for platforms to be built outside of Mexican territory and assesses transportation fees on a nautical mile that disadvantage suppliers based outside of Mexico. These fees significantly diminish U.S. suppliers’ access and raise concerns under NAFTA.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Under NAFTA and the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Mexico is obligated to implement certain standards for the protection of intellectual property and procedures to address infringement such as piracy and counterfeiting. Although Mexican legislation on IPR matters is quite comprehensive, the enforcement of these IPR laws is limited and sporadic. Monetary sanctions and penalties are minimal and generally ineffective in deterring these illegal activities. The United States remains concerned about the continuing high levels of piracy and counterfeiting in Mexico and closely monitors how the Mexican Government is addressing these problems. Mexico was taken off the Special 301 Watch List in 2000, but put back on in 2003 due to enforcement concerns.

Copyright Protection

Copyright piracy remains a major problem in Mexico, with U.S. industry loss estimates growing each year. Although enforcement efforts by the Mexican government are improving, piracy levels continue to rise, resulting in closures of legitimate copyright-related businesses, according to industry sources. Counterfeit sound and motion picture recordings are widely available throughout Mexico, crippling the Mexican music industry. The International Intellectual Property Alliance (IIPA) estimates that trade losses due to copyright piracy in Mexico totaled \$718 million in 2002. Piracy levels in some industries have declined since 1996. For instance, industry estimates that the business software piracy level decreased from 67 percent in 1996 to 55 percent in 2002. Although levels of music piracy are down from last year, dropping from 68 percent in 2002 to 60 percent in 2003, the music industry in Mexico suffered

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one of its worst years in recent history. Of all pirated music sales in Mexico in 2003, 90 percent were of Spanish speaking artists. Industry associations report that piracy has begun to shift from traditional formats to optical discs (CD, DVD, CD-ROM). This is particularly troubling, as content in digital form is easier to reproduce on a large scale.

In July 2003, the Mexican Congress amended the Mexican copyright law. These amendments fail to address the comprehensive reforms needed by Mexico to: (1) effectively implement the obligations of the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty (Mexico is a party to both agreements); and (2) correct existing incompatibilities in the law with Mexico's obligations under the NAFTA IPR Chapter and the WTO TRIPS Agreement. Implementing regulations that Mexico has indicated would address these concerns were to have been published by the end of October 2003 but as of January 2004 have not yet been made available. The United States has been urging Mexico to meet its various obligations by issuing satisfactory implementing regulations.

Mexican law enforcement agencies have conducted hundreds of raids on pirates. In 2003, the Attorney General's Office created an IPR enforcement unit, which combines federal prosecutors and police to make the enforcement regime more effective and efficient. Industry representatives report that raids against counterfeiting operations have improved from 2002 and there has been improved access to prosecutors. Despite increased raids and seizures of counterfeit material, only three of the 900 counterfeiters who were arrested in 2002 and 2003 received sentences greater than one year, thus undercutting the deterrent effect of the raids and arrests. Very few IPR violations result in prison terms. As a result, counterfeiters are often released and return to the street.

Patent, Trademark, Pharmaceutical and Agricultural Chemical Protection

Patents and trademarks are under the jurisdiction of the Mexican Institute of Industrial Property (IMPI), an independent agency that operates under the auspices of the Secretary of Economy. Some U.S. trademark holders have encountered difficulties in enjoining former subsidiaries and franchisees from continued use of their trademarks.

U.S. companies holding trademarks in Mexico have cited problems with trademark enforcement and administration. When counterfeit items are discovered, injunctions against trademark violators are often unenforceable and are consistently challenged before the courts. Although federal administrative actions are supposed to be completed within four months, actions related to trademark enforcement often take as long as 18 months. The time can be lengthened by jurisdictional and procedural disputes within the Mexican government, as well as by internal coordination problems within IMPI. Trademark applications in Mexico are not subject to opposition. Registrations are issued and can only be canceled post-registration. On average, it takes two and a half years to cancel a trademark registration, and the registrant is allowed to continue using the mark for one year following cancellation.

U.S. pharmaceutical and agricultural/chemical companies are concerned about the lack of coordination between IMPI and other Mexican agencies with regard to government procurement of copies of patented pharmaceuticals. In 2003 the Mexican Ministry of Health agreed that starting with purchases scheduled for delivery on January 1, 2003, IMSS (Mexican Social Security Institute) and possibly ISSSTE (Social Security Institute for Government Workers) would purchase only patented products where a patent already exists in Mexico.

In the past, the Mexican Ministry of Health granted health registrations to generic products without verifying with IMPI whether a patent already existed for such products. In September 2003, the Ministries of Health and Economy implemented a Presidential decree that requires applicants for safety and health registrations to show proof of patent and proof that test data was obtained in a legitimate

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matter. According to the regulation, failure to present proof of patent and test data will result in denial of the registration. Also, submitting companies can now be subject to both civil and criminal proceedings for false submissions.

Border Enforcement of IPR

NAFTA Article 1718 and Article 51 of the TRIPS Agreement obligate Mexico to allow U.S. intellectual property rights holders to apply to Mexican authorities for suspension of release of goods with counterfeit trademarks or pirated copyright goods. Intellectual property rights owners seeking to use the procedure must obtain an order from a competent authority that directs customs officials to detain the merchandise. Companies requesting such actions report positive outcomes.

SERVICES BARRIERS

Telecommunications

Mexico's former state-owned telecommunications monopoly (Telmex) continues to dominate Mexico's telecom sector. Competition in the sector has been hampered by the inability of Mexico's telecommunications regulator (Cofetel) to enforce its own regulatory findings. Enforcement authority resides with the Secretariat of Communications and Transportation (SCT), which has been slow to act against Telmex. Telmex competitors complain of inaction by both Cofetel and the SCT in resolving disputes, resulting in many cases lingering for months or years without resolution. Failure to ensure non-discriminatory quality of service for interconnection, highlighted by a Cofetel report documenting the inferior quality Telmex provided to competitors, is particularly troubling. In cases where the government has taken action, Telmex has successfully used court-ordered injunctions to prevent enforcement against it. For example, an injunction has prevented the SCT from enforcing a regulatory ruling requiring Telmex's wireless affiliate (Telcel) to adopt competitively neutral numbering rules. Legislation to reform the telecommunications sector is pending in the Mexican Congress. Meanwhile, the Fox Administration is expected to issue Executive Orders reorganizing the regulatory structures and transferring enforcement authority from SCT to Cofetel.

Mexico has also failed to address much-needed reform to its international rules. Mexico's international long distance rules grant Telmex the exclusive authority to negotiate interconnection rates for cross-border traffic on behalf of all Mexican carriers and prevent foreign carriers from using leased lines to bring calls directly into the domestic network. The United States has repeatedly raised concerns regarding the WTO-consistency of Mexico's international telecom regime and on February 13, 2002, the United States requested formation of a WTO dispute settlement panel arguing that Mexico has failed to fulfill its WTO obligations to ensure that international interconnection rates are cost-oriented and that leased lines are available. The WTO panel issued its final report in March 2004. The panel found that Mexico breached its commitment to ensure that U.S. carriers are afforded cost-based interconnection and that Mexico failed to prevent its dominant carrier from engaging in anti-competitive practices.

INVESTMENT BARRIERS

Ownership Reservations

Mexico's Constitution and Foreign Investment Law of 1992 reserve ownership of certain sectors, such as oil and gas extraction, to the state; other laws limit activities to Mexican nationals, such as forestry exploitation, and domestic air and maritime transportation. This reservation is incorporated into the NAFTA. In addition, only Mexican nationals may own gasoline stations. Gasoline is supplied by PEMEX, the state-owned petroleum monopoly, and gasoline stations sell only PEMEX lubricants,

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although other lubricants are manufactured and sold in Mexico. A national foreign investment commission decides questions of foreign investment in Mexico. Investment restrictions prohibit foreign ownership of residential real property within 50 kilometers of the nation's coasts and 100 kilometers of its borders. However, foreigners may acquire the effective use of residential property in the restricted zones through trusts administered by Mexican banks.