November 18, 2021, President Joe Biden, Canadian Prime Minster Justin Trudeau and Mexico President Andrés Manuel López Obrador, walk through the White House. Photo courtesy of: The White House/flickr

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Further Integration with North America is Beneficial for Mexico:

Looking at Foreign Direct Investment in Mexico

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Over the past few years investment conditions in Mexico have been increasingly questioned by analysts and the media, citing decisions such as the cancellation of the Constellation Brands plant in Mexicali and of the Mexico City international airport that was being constructed in Texcoco.

Is it possible that adequate conditions for investment do not exist in Mexico? What does this mean for economic cooperation and integration in North America?

On the positive side, the negotiation and launch of the US, Mexico and Canada trade agreement (USMCA) provided firms with a renewed opportunity and motivation to move their operations to Mexico to benefit from the proximity to the other North American countries, Mexico's comparative advantages, and the rules and provisions of the modernized trade agreement.

Recent cases abound of companies making major investments to produce in Mexico, for example,

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Construction workers are welding the steel frame for a skyscraper in Mexico City. Photo courtesy of: Luxbox/shutterstock.com

LG-Magna's 300-million-dollar investment for an electric vehicle manufacturing facility. It is important to understand that these new investments have been focused on key sectors and select regions. Regionally, most foreign investment has been concentrated in the North and Center of Mexico. Perhaps even more telling are the industries involved, with automotive topping the list in 2021, followed by mining, tourism, natural gas pipelines, and manufacturing. All these industries are closely connected to the U.S. market.

Both statistical and anecdotal evidence point to Mexico increasing its popularity with firms that serve or want to serve the broader North American Market. Mexico saw industrial park demand surge 70% in 2021, with the North of the country surpassing the Center in terms of investment—even when some of the investors are registered and headquartered in Mexico City skewing the figures towards the Center. This new investment is due partly to the disruption of supply chains because of the pandemic with firms looking to reduce supply chain lengths, increase transportation alternatives (diversity), and avoid the risk of increased trade disputes between the U.S. and China ("nearshoring"). More recently, firms are also seeking to further reduce geopolitical risk, responding to the war in Ukraine and sanctions against Russia. The fallout from that conflict has reinforced the rationale for choosing Mexico for new investments ("friendshoring").

Serious challenges for potential and current investors in Mexico remain. First, political risk remains serious. The recent debate on constitutional reforms in the energy sector, changes in the mining law nationalizing lithium, and the government's discourse regarding private sector investments have sent warning signals to investors.

Second, the fall in total investment since 2018 is unquestionable. This is due partly to political risk and partly to the pandemic. Some sectors have been more affected than others, e.g., electricity, oil, and infrastructure, with worsening operating conditions expected for those sectors in the short-term.

Third, the USMCA has become a key tool for firms and for Canada and the US to seek redress from

policies and decisions that they believe undercut their rights under that agreement. This has increased tensions with the Mexican government and is an important action agenda in diplomatic relations, mainly with the U.S. Under USMCA, as well as the US-Mexico High Level Economic Dialogue and the North American Leaders Summit agenda, topics like climate change and sustainability, availability of clean energy, as well as the rules of origin of key products like vehicles, are examples of how North American cooperation is not only about the terms of trade, but also about the confidence that investments will be safe and productive over the long-term.

The fourth challenge is that investments in Mexico are still accentuating regional inequalities. Addressing these challenges requires redistributive policies and incentives that can help spread the benefits of investment to poorer and less developed parts of Mexico, enhancing employment availability, job quality, and physical, social, and communal infrastructure.

There are many ways to foster cooperation and reassure investors. For example, a strong defense of the rule of law in both speech and action would go a long way to reduce uncertainty among investors. Increased public investment would also provide a better investment environment, especially in electricity transmission and grid maintenance, as would support for renewable energy, which is a top priority for many firms concerned with sustainability and ESG goals. Such steps could be taken to help address regional imbalances and to leverage advantages of areas needing more investment.

Mexico's overall balance between benefits and challenges is rather good, favoring continued new investment flows to Mexico. We can expect to see continued nearshoring, "friend-shoring," and new opportunities for Mexico to promote active economic development addressing regional inequalities as well as promoting overall growth.

The potential benefits for Mexico signal clearly why furthering ties with North America as a region is beneficial. Public policies should be improved, for example providing short-term fiscal stimulus to encourage relocating to Mexico, particularly less developed regions as well as providing more public investment in infrastructure and economic promotion. There also should be better communication by both government and firms about how these steps can spur broad development, benefiting many via job creation and fiscal contributions as well as poorer communities. Such messages could even provide political returns. All in all, working for closer ties across North America continues to have a strong positive effect in Mexico and, if handled well, could be the key to increasing growth in Mexico and the whole region.

Magdalena Carral is a Founding Partner of Carral, Sierra y Associados. Previously, she was CEO of Olgivy Public Relations Mexico, served as CEO of the Mexico Tourism Board; Commissioner of Immigration; and President and CEO of Edelman México, among other positions.

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