LATIN AMERICA ADVISOR

A DAILY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

Tuesday, September 12, 2023

FEATURED Q&A

Why Is Mexico Lagging Behind in Attracting FDI?

Foreign direct investment in Latin America reached $225 billion in 2022, a record high. However, Mexico attracted only 17 percent of that total. Mexico City is pictured. // File Photo: Mexican Government.

Q Foreign direct investment in Latin America hit a record high in 2022, with $225 billion committed from investors to Latin America and the Caribbean—55 percent more than 2021, according to the U.N. Economic Commission for Latin America and the Caribbean, or ECLAC, the Financial Times reported Aug. 30. Yet Mexico, which accounts for nearly a quarter of the region's economic activity, secured only 17 percent of its total foreign investment last year. What accounts for the investment boom in the region, and why is Mexico lagging behind? What factors would make Mexico more attractive in the nearshoring trend? Will Mexico's prospects change after the 2024 election?

A Arturo Sarukhan, board member of the Inter-American Dialogue and former Mexican ambassador to the United States: "Mexico has been underperforming in terms of growth, inclusion and poverty reduction as compared to similar countries. Its economic growth averaged just above 2 percent a year between 1980 and 2022, limiting progress in convergence relative to high-income economies. But now it has also been walking backward into the political patterns under which it lived before 2000. As the United States recalibrates its ties with China and reshoring to North America rears its head, Mexico faces the proverbial gap between promise and reality. The promise: by virtue of geography, its four-decade-long trade and economic integration with the United States, the modernizing of the NAFTA—now USMCA—and the consolidation of the key paradigm prevalent among the three trading partners of integrated supply chains and joint production platforms,

Continued on page 3

TODAY'S NEWS

ECONOMIC

Dominican Gov't May Close Border With Haiti Over Water Dispute

The Dominican Republic's president said the country may close its border with Haiti amid a dispute over water from a shared river.

Page 2

BUSINESS

Tesla, Suppliers to Invest $15 Billion in Mexico's Nuevo León: Governor

Tesla and its suppliers are to invest some $15 billion over two years in Mexico's Nuevo León, the state's governor said Monday.

Page 2

POLITICAL

Colombia's Coca Cultivation Hits All-Time High

Colombia's amount of land under coca cultivation rose 13 percent last year to a record high, a U.N. office said Monday. Colombian Justice Minister Néstor Osuna said coca cultivation is growing at a slower pace than in the past.

Page 2

Osuna // File Photo: Colombian Government.

POLITICAL NEWS

Colombia's Coca Cultivation Reaches All-Time High: U.N.

Colombia's level of coca cultivation grew 13 percent last year to an all-time high, according to a report by the United Nations Office on Drugs and Crime, the Associated Press reported Monday. Coca, which is used to produce cocaine, was planted on 230,000 hectares (nearly 570,000 acres) of farmland in the South American country. Potential cocaine output in Colombia also rose 24 percent last year to 1,738 metric tons, a level not seen in more than 20 years, according to the U.N. office, Reuters reported. "It is worrying that each year there is an increase in coca crops in the country," Candice Welsch, the regional director of the U.N. office, said in presenting the report, Reuters reported. The increase in coca cultivation was the result of a rise in crops in Putumayo province, along Colombia's border with Ecuador, said Welsch. Production in other parts of Colombia was relatively stable, she added. Colombia's government said Monday that the amount of land under coca cultivation is increasing at a slower pace than in past years, the AP reported. "We are flattening the curve," Colombian Justice Minister Néstor Osuna said at a news conference, referring to the 13 percent rise in coca crops last year. He said that cultivation rose more than 40 percent between 2020 and 2021. On Saturday, President Gustavo Petro criticized U.S.-led efforts to fight illegal drugs by eradicating coca crops, saying the approach has failed, the AP reported. During a conference on drug policy, Petro urged neighboring countries to change their drug policies. Drug use should be tackled as a "public health problem," not a military issue, he said. "We have to end the disastrous policy that blames farmers [for cocaine production] and doesn't ask why in some societies people consume drugs until they kill themselves," said Petro. "Drugs are replacing the lack of affection and loneliness," he added. Colombia's coca cultivation fell slightly from 2017 to 2020 after the government struck a peace deal with the Revolutionary Armed Forces of Colombia, or FARC, rebels, the AP reported. However, the country's coca crop has increased since 2020 as smaller armed groups have taken over territory that the FARC abandoned, the AP reported.

> **It is worrying that each year there is an increase in coca crops in the country."**
> **— Candice Welsch**

ECONOMIC NEWS

Dominican Republic May Close Border Over Water Dispute

The Dominican Republic's president announced Monday that he has suspended issuing visas to Haitians, and the country will seal its border with Haiti in Dajabón province if a conflict over access to water from a shared river is not resolved, the Associated Press reported. A final decision of the border closure will not come before Thursday, President Luis Abinader said at a news conference, Reuters reported. Dominican authorities said in a statement that construction of a canal in Haiti will divert water from the Massacre River, and that the project was launched unilaterally by Haitians without government support, the wire service reported. "There is no doubt that this unilateral project is promoted by Haitian agents with the intention of harming their own government and generating a conflict with our country," the statement added. The Dominican government closed the border in a preliminary move last week, while it enters talk to find a solution. "If the conflict is not resolved before Thursday, [officials will] completely close the border to air, sea and land commerce," the government said in a statement. The Dominican Republic has been tightening its border security amid worsening gang warfare in Haiti. Dajabón has one of the

NEWS BRIEFS

Guyana's Economy Expected to Soar 38% This Year Amid Oil Boom: IMF

Guyana's economy is forecast to expand by 38 percent this year amid "unparalleled" growth of its oil industry, the International Monetary Fund said Monday, Reuters reported. The country's economy soared 62 percent last year, the highest growth level in the world. The South American country has found huge amounts of oil and gas off its shore and now has reserves of approximately 11 billion barrels, BBC News reported.

Colombia May Make State Oil Company a Mandatory Partner in Wind Projects

Colombia's government is considering revising rules to make state-owned oil company Ecopetrol a mandatory partner in every offshore wind project, people familiar with the matter said, Reuters reported Monday. The Ministry of Mines and Energy will invite input from businesses interested in the country's first offshore win auction. President Gustavo Petro is looking to wean the country from its dependence on fossil fuel and move toward renewable energy, while ensuring energy self-sufficiency.

U.S., Peru Reach $20 Million Debt-for-Nature Swap Deal

The United States and Peru have reached a deal to help protect and restore part of the Latin American country's rain forest in exchange for a $20 million reduction in its debt, Reuters reported Monday. The debt-for-nature swap will go toward conservation efforts, improving natural resource management and promoting sustainable livelihoods for communities in the Amazon, the U.S. Treasury said in a statement. The agreement is the third of its kind between the two countries and took two years to finalize.

few remaining functioning borders between the two countries.

BUSINESS NEWS

Tesla, Suppliers to Invest $15 Billion in Nuevo León: Governor

Electric vehicle maker Tesla and its suppliers are to invest some $15 billion in Mexico's Nuevo León state, its governor said Monday, Reuters reported. Earlier this year, Tesla Chief Executive Officer Elon Musk said the company would open a large factory in Nuevo León, the country's industrial cluster hub close to the Texas border. At the time, Mexican officials had estimated an investment of $5 billion.

García // File Photo: Facebook Page of Samuel García.

Mexican President Andrés Manuel López Obrador had hailed the company's decision to build a "gigafactory" in the country as evidence that Mexico is, "if not the first, among the three countries with more opportunities for foreign investment," Bloomberg News reported. "Just Tesla and its suppliers will generate an investment of $15 billion in two years," Nuevo León Governor Samuel García said at an event, adding that more state funding will have to go toward building infrastructure and public works including highways, Reuters reported. Other major automakers, such as BMW and General Motors, had previously said that they were expanding electric vehicle production in Mexico, which boasts an established automaking sector. Tesla has not said when production would begin in Mexico, nor when the start date for the construction of the plant would start.

FEATURED Q&A / Continued from page 1

Mexico could be poised to singularly reap the benefits of a strategic sea-change and a once-in-a-generation opportunity. The reality: the country is unable to fully capitalize these trends because of López Obrador's current policies. As nearshoring is increasingly being re-tweaked conceptually in Washington as ally-shoring or friend-shoring for essential supply chains, López Obrador, whether it's on regional democracy and human rights, boycotting the Summit of the Americas, his posture on Russian aggression or his habit of poking his finger in Biden's eye at every opportunity, is behaving as anything but a friend or ally of the United States. And while expanding insecurity and the growing shadow of organized crime might also play a role in current FDI flows, his energy and renewables policy paradigm, a key component for the success of nearshoring in North America and the transition to a digital economy, and his habit of extorting foreign companies operating in Mexico to do his bidding, are taking a toll. Regardless of who wins in 2024, a U-turn is urgently needed if Mexico City is serious about tapping into this potential."

A **Lucinda Vargas, college professor of economics at New Mexico State University:** "The dynamics of foreign direct investment in Mexico are best analyzed by looking at the performance of its maquiladora export manufacturing industry. This industry has two characteristics that are especially conducive to growth in the context of nearshoring: maquiladoras are largely located in Mexico's northern border right next to the United States, and its top foreign direct investor is the United States, the world's largest consumer market. Thus, in any nearshoring logic, the relocation of production from Asia to locations nearer to the United States, there are none nearer than Mexico from both a world and Latin American perspective, and none even nearer than locations on Mexico's northern border. Indeed, in 2022, investment in the maquiladora industry reached a record high of $14 billion, chiefly the result of the nearshoring impetus. Three of the top five destinations of foreign direct investment in Mexico in 2022 were border states—Nuevo León, Tesla's chosen site for a new megaplant; Baja California and Chihuahua. Thus, while in 2022 Mexico's 17 percent share of foreign direct investment in Latin America was a distant second to Brazil's 41 percent, Mexico managed to maintain an upward trend in foreign direct investment through the pandemic in 2020, when Brazil's foreign direct investment contracted by more than 45 percent. Behind Mexico's non-stop growth in foreign direct investment in the last three years is a combination of its entrenched maquiladora industry, its next-door proximity to the United States and nearshoring trends, all factors which are likely to keep this investment growing into and past the 2024 election."

A **Diego Marroquín Bitar, senior research analyst in the global economy and development program at the Brookings Institution:** "Companies and governments across the globe now prioritize transparency and resiliency over cost reduction and efficiency in their supply chains. As production shifts away from China and closer to their consumer base, Latin America stands to win. Among its peers, Mexico appears poised to make the largest gains, with a potential $35 billion in additional exports—equivalent to half of the region's nearshoring dividends, according to IDB estimates. To date, Mexico is the United States' top trading partner, with over $1.5 million exchanged per minute (up 27 percent from 2019 levels), has solid macro fundamentals and unparalleled access to the U.S. and Canadian markets through the United States-Mexico-Canada Agreement (USMCA). However, geography and trade agreements alone fall short of fully harnessing the region's FDI boom. Significant setbacks in clean energy generation (5 percent

Continued on page 4

FEATURED Q&A / Continued from page 3

less compared to 2018 levels), high levels of hydric stress (over 45 percent across the country), violence (nine Mexican cities are among the top 10 with the most homicides worldwide) and rule of law issues (with several energy companies unable to operate due to permitting issues) discourage further investment in the country. Similarly, deficient infrastructure (Mexico ranks 66 out of 139 in the World Bank's Logistics Performance Index) inflates costs relative to other nearshoring options (for example, Vietnam) and hampers market accessibility. Mexico's first female president, whether Claudia or Xóchitl, must confront these challenges head-on if they wish to transform Mexico's current FDI stream into an FDI tsunami. Without immediate action on energy, security, infrastructure, rule of law and water management, Mexico will once again become the land of (missed) opportunities and fall short of its true potential."

A **Arnulfo Rodríguez, principal economist at BBVA research:** "Foreign direct investment (FDI) flows into Mexico in 2022 explained by nearshoring appear to be just supported by anecdotal evidence. FDI data and the negligible market share gain of Mexico in the United States imports of manufactured goods since 2018 do not seem to back up the nearshoring story. For example, after excluding the one-off investments of the Televisa-Univision merger and Aeromexico's restructuring in the first half of 2022, annual FDI flows into Mexico are still below pre-pandemic levels. Moreover, most of these flows in 2022 were profit reinvestments (56 percent) while new investments accounted for only 36 percent. Regarding the share of Mexico in the aforementioned market, the country could not take advantage of the 5.5 percentage points lost by China in the aftermath of the pandemic and trade war with the United States. Indeed, Mexico just gained 0.4 percentage points between 2018 and 2022 while Vietnam and Taiwan won 2.3 and 1.2 percentage points, respectively. To be more attractive for nearshoring opportunities and reap more economic benefits in the medium term, Mexico needs a strong rule of law along with industrial, energy and fiscal policies that promote a new wave of investments associated with electric vehicles, renewable energy and IT equipment."

> **"Annual FDI flows into Mexico are still below pre-pandemic levels."**
> **— Arnulfo Rodríguez**

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta.

LATIN AMERICA ADVISOR
is published every business day by the Inter-American Dialogue ISSN 2163-7962

Gene Kuleta
Editor

Lara Kovandova
Reporter

Nili Blanck
Reporter

Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at
1155 15th Street NW, Suite 800
Washington, DC 20005
www.thedialogue.org

