OECD GLOBAL FORUM ON INTERNATIONAL INVESTMENT

NEW HORIZONS AND POLICY CHALLENGES FOR FOREIGN DIRECT INVESTMENT IN THE 21ST CENTURY

Mexico City, 26-27 November 2001

The Importance of Foreign Direct Investment in the Economic Development of Mexico

Luis de la Calle Pardo
Undersecretary of International Trade Negotiations, Ministry of the Economy

I. Benefits of the Foreign Direct Investment (FDI)

Mexico enjoys preferential access to 850 million consumers in 32 countries thanks to the network of Free Trade Agreements (FTAs) it has in place in North America, Latin America, Europe and the Middle East[1].

Mexico has obtained market access for its exports, fostered new investment opportunities, and provided more and better paid jobs through its network of FTAs.

In addition to the FTAs, Mexico has negotiated 19 bilateral investment treaties (BITs)[2]. BITs are based on National Treatment and Most Favored Nation principles, and they contain dispute settlement mechanisms that provide legal certainty to investors.

1 Mexico has signed 11 FTAs with: Chile; Canada and the United States (NAFTA); Colombia and Venezuela (TLC G3); Bolivia; Costa Rica; the fifteen members of the European Community; Iceland, Liechtenstein, Norway and Switzerland; Guatemala, Honduras and El Salvador; Nicaragua; Israel; Uruguay.

2 Mexico has signed BITs with: Germany; Argentina; Austria; South Korea; Spain; Cuba; Denmark; Finland; France; Greece; Netherlands; Italy; Iceland; Portugal; Czech Republic; Sweden; Switzerland; Uruguay; Belgian-Luxembourg Union.

Trade and investment liberalization have greatly benefited Mexico. Exports are the driving force behind economic growth and job creation. In the last 7 years, foreign sales have more than doubled their share in Mexico's GDP from 15% in 1993 to 31% in 2000. Mexico's dynamic export performance has contributed with almost half of the growth in the GDP, and currently Mexico has become the 8th largest exporter in the world.

Mexico has also become the third largest recipient of FDI among developing countries. The network of free trade agreements and economic reform policies have made Mexico an attractive place for national and foreign investment. Since 1994[3], Mexico has received around 107 billion dollars in investment in plant and equipment. This capital inflow averages 12 billion dollars a year, three times the annual amount received in the five years prior to NAFTA.

Investments are not only greater, but also better. They translate into jobs, technology transfer, export opportunities, and training for workers and executives. Better investments contribute to increasing productivity that lead to higher wages. In the last years, the rate of employment in firms with FDI has grown twice as fast as the national average. Firms with FDI have created one out of every four new jobs since 1994, and currently retain about 20% of the formal employment. Firms with FDI also pay better than other companies. On average, firms with FDI pay salaries that are 50% higher than the national average wage.

Exports and FDI have contributed to the creation of a more integrated and competitive market. Joint ventures have stimulated a regional boom in sectors such as automotive, electronics and textiles. In fact, nearly 87% of total FDI is currently located in two of the most active sectors of the economy: financial services and manufacturing.

II. Challenges for the future

Mexico has achieved important relative preferences with respect to its competitors in foreign markets. Thanks to the NAFTA, Mexico is now fully integrated in the North American market, along with the United States and Canada. Today, Mexico is the second largest export market for US goods, and has displaced Japan as the US second largest trading partner. Mexican exports to the US have grown twice as fast as those from the rest of the world. As a result, Mexico has increased its share in total US imports from 6.8% in 1993 to 11.4% in September 2001.

Almost 94% of Mexico's exports will have duty access by 2003. However, there are decreasing returns of market access, and each percentage point increase in participation is harder to reach.

Tariff advantages are temporary, and Mexico needs to implement new programs and strategies in order to stay a step ahead of its main competitors in the global markets.

Mexico faces international competition both to sell its products abroad and to attract FDI. In the domestic market of goods it competes with imported commodities; it also competes in the markets of its main trading partners, the European Union and the US, with products that originate in these regions as well as with the suppliers from other countries. Mexico's main competitors in the goods market are Asian economies: South Korea and Chinese Taipei due to their high technological level, and China and India due to their low labor costs.

---

[3] Cumulative FDI from January 1994 to September 2001

Asian economies are also Mexico's main competitors for foreign direct investment. The two largest recipient countries are China and Brazil, which received 278 and 131 billion dollars respectively in the period from 1994 to 2000. Mexico ranks 3rd among developing countries (86 billion dollars), closely followed by Argentina and Singapore.

In order to face the competition, Mexico has to exploit its most fundamental comparative advantages:

Its young, increasingly skilled and abundant population. Mexico needs to invest in human capital: education, health and worker training. This is the highest yielding form of investment that our government can engage in, since it provides the population with the lifetime tools to succeed.

Its privileged geography. Mexico needs to exploit its location as a natural hub for trade and investment. It shares a 2000 mile border with the largest market in the world, the US. Mexico is also a gateway to the rest of Latin America and Asia. In order to take advantage of its geography, Mexico needs to invest in the creation of a world class infrastructure. This involves building roads, investing in ports and their surrounding infrastructure, as well as developing first-rate airports and industrial parks.

Its network of free trade agreements. Mexico has guaranteed market access for most of its products. Nevertheless, more than 80% of Mexico's trade continues to be with the United States. While the relationship with Mexico's northern neighbor will continue to be of supreme importance for the future of the country, Mexico must work arduously to diversify trade and take advantage of this complex web of trade agreements that is already in place.

The decision to invest in any given country is ultimately based on the combination of risk and return that the country has to offer. That is, investment flows will travel to those countries that offer an attractive combination of risk and return. An attractive risk-return combination can be reached either by increasing returns and/or by lowering risks to investment. In the case of Mexico there are several elements that contribute to the increase of the returns to investment, such as the preferential access to 32 countries, access to competitively priced and international quality inputs, Mexico's fundamental comparative advantages, among others. On the other hand, risks to investment can be diminished through guaranteeing market access; providing certainty and clear rules of operation, and by offering macroeconomic and political stability.

Attractiveness to investment is a dynamic concept. Mexico needs to constantly improve its combination of risk and return so that the country may continue to be an attractive place for foreign and national investment.