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Foreign Direct Investment and Competitiveness in Mexico

According to the United Nations Conference on Trade and Development (UNCTAD), in 2004 less developed countries increased their influx of foreign direct investment (FDI) by 40%, while in developed countries there was a decrease of 14% in the inflow of this form of capital. After having a diminishing tendency during the previous four years, Latin America received 44% more in this year. The main receptors of FDI in this region were Brazil and Mexico with a share of 27 and 25 percent of the total influx of approximately US\$67 billion. The UNCTAD also reported that the biggest transnational enterprises of Latin America are from these two countries; being the top two *Cemex* and *América Móvil* from Mexico, which also occupy the 5th and 6th places on the list of biggest transnational enterprises of less developed countries. The report states that this increase in the inflow of capitals to the region may be the result of a better macroeconomic environment and an expected economic growth of 40% in 2005, and that this scenario is likely to prevail during the following years.

Although Mexico is one of the top FDI receptors of the less developed countries, some experts think that foreign investors are less attracted to invest in Mexico due to the slow improvements on its competitiveness and, as a result, foreign capitals are flowing out to more competitive markets such as China. The UNCTAD also reports that Mexico ranks 28th out of 33 in the most attractive countries for research and development (FDI).

It also shows that only 1.5% of the world's most important transnational companies prefer Mexico as a place for investment; this preference contrasts with the 61.8 percent of enterprises favoring China.

In addition, according to the World Economic Forum (WEF), even though Mexico is the 10th world's largest economy, last year it lost 7 spots in the world's competitiveness ranking, holding the 55th place. The three factors that the WEF takes into account to qualify the performance of each observed country are: the macroeconomic environment, the quality of public institutions and the capacity to innovate and to take advantage of new technologies. This institution publishes a ranking of these variables. Out of 80 countries, in 2003, Mexico obtained the 21st, 58th and 47th place respectively. In the microeconomic competitiveness ranking, Mexico held the 55th place. As shown in Table #1, Mexico is more competitive than Brazil (its Latin American main competitor) in the growth competitiveness ranking; but less than China (its worldwide main competitor). On the other hand, Mexico placed last in micro-economic competitiveness of the three countries, while Brazil took the lead in this group. From this table, it can also be concluded that the areas of opportunity in which Mexico can develop its competitiveness are in improving public institutions and the use of technology.

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Mexico Economic Update

| | Oct 2005 | | Jan-Oct 2005 | | Financial Indicators | Oct 2004 | Oct 2005 | Economic Growth | Sep 2004 | Sep 2005 |
|----------------------|---------------|-----------------|---------------|-----------------|--------------------------------|----------|----------|---------------------------------------|----------|----------|
| | Value (US bd) | Annual Change % | Value (US bd) | Annual Change % | | | | | | |
| Foreign Trade | | | | | Inflation Rate (Annual) | 5.4 | 3.1 | Global Economic Activity Index (IGAE) | 4.6% | 3.9% |
| Exports | 19.21 | 13.6 | 173.94 | 12.0 | Interest Rate (CETES 28) | 7.8 | 8.9 | Industrial Activity | | |
| Manufacturing | 15.50 | 12.0 | 142.06 | 8.7 | Stock Market Index (IPC) | 11,137 | 15,362 | Industrial Production | 5.6% | 1.1% |
| Oil | 3.15 | 22.1 | 26.15 | 33.8 | Exchange Rate (pesos/dollar) | 11.40 | 10.83 | Manufacturing | 5.4% | 0.8% |
| Imports | 19.84 | 13.2 | 178.79 | 12.0 | International Reserves (US bd) | 58.1 | 62.3 | Mining | 3.7% | 2.3% |
| Balance | -0.63 | 3.3 | -4.85 | 15.4 | Employment | | | Construction | 8.4% | 2.2% |
| | | | | | Open Unemployment | Sep 2004 | Sep 2005 | | | |
| | | | | | | 4.01% | 3.70% | | | |

Source: Ministry of the Economy with Banxico and INEGI data.

US bd= US billion dollar



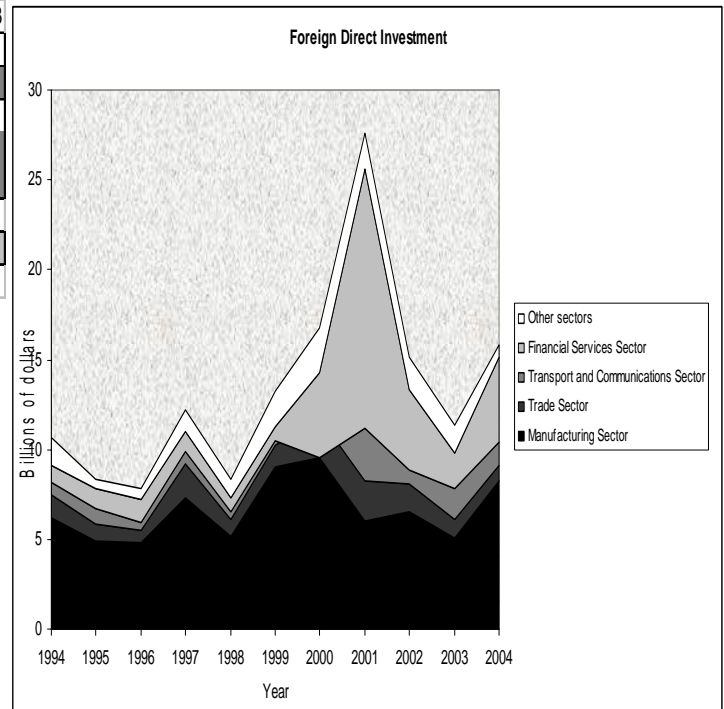
| | Mexico | Brazil | China |
|---|--------|--------|-------|
| Growth Competitiveness Rank (Out of 80 countries) | 45 | 46 | 33 |
| 3. Technology Index Rank | 47 | 35 | 63 |
| 2. Public Institutions Index Rank | 58 | 45 | 38 |
| 1. Macroeconomic Environment Rank | 21 | 67 | 8 |
| Microeconomic Competitiveness Rank | 55 | 33 | 38 |

Source: <http://www.weforum.org/site/knowledgenavigator/>

Many economic and legal reforms are needed to improve the competitiveness of the micro-economy. The Director of Foreign Direct Investment of the Mexican Ministry of the Economy, Gregorio Canales, believes that a fiscal reform would multiply the receptions of foreign capitals in the country by ten.

On the other hand, Deloitte, an international consulting group, affirms that Mexico is sub-qualified on competitiveness because the rankings are not built taking into consideration the perspective of firm executives and directors. It also argues that the published competitiveness indices are only aggregate numbers that do not reflect a sector by sector analysis. The results of the study called "Tendencies and challenges of the manufacturing industry" state that 2 out of 3 manufacturing companies affirm that they have a better performance in the manufacturing and production fields and, therefore, Deloitte assures that Mexico's manufacturing industry is one of the world's most competitive. That study also reflects the way China is affecting the Mexican manufacturing industry. China is increasing its market share and the principal effect of this is the reduction of operative margins and the profitability of Mexican firms, as well as the decrease in the prices that they can offer in the foreign markets.

Another way to see that Mexico's manufacturing industry is competitive is by looking at the data. As shown in the graph below, the share of the Manufacturing Sector of the total FDI grew 17.3% in 2004; it is the second sector that had a largest growth in its share of total FDI besides the Financial Services Sector, which grew its share 72.94%. Between 1994 and 2004, non-*maquiladora* manufacturing industry's FDI grew 16%, while *maquiladora* industry grew 176.5%. In the last eleven years, *maquiladora* industry's share of the total manufacturing sector's FDI reached 27 percentage point. During the first semester of 2005, 41.3 percent of the USD\$3.365 billions that receive the total Manufacturing Sector corresponded to the *maquiladora* industry.



Source: Mexico's Ministry of the Economy. General Administration of Foreign Investment

Even though there is some evidence that a few Mexican economic sectors are very competitive and dynamic, it is necessary to make reforms to allow Mexican firms to face the new challenges of today's business environment and attract more foreign capitals, which is one of the engines for development that Mexico needs (Such as the opening of China and the growing competitiveness of Brazil).

The Manufacturing Sector is usually divided in non-*maquiladora* manufacturing industry and *maquiladora* industry.



Diario Oficial Notices

- ◆ List of documents in review, dictated, authorized, extent and with opinion of the Federal Commission for the Betterment Regulation on September 1st through the 30th of 2005. (October 12).
- ◆ Determination that resolves the administrative procedure of revocation interposed by the Corporación Sierra Madre S.A. de C.V. and ICI Uniqema, Inc., against the resolution of the antidumping review on the importing of stearic acid, merchandise classified under tariff items 3823.11.01 and 3823.19.99 of the Mexican Tariff Schedule, originating from the United States of America regardless of the shipping country. (October 20).
- ◆ Agreement by which it is notified the quota required to import during May, 2005 through April 30, 2006 period, products from and shipped from the Federal Republic of Brazil with an established Tariff preference, and in accordance with the Complementary Economical Agreement No. 53, celebrating among Mexico and Brazil (October 25).
- ◆ Agreement by which it is modified its similar that establishes the encoding and classification of merchandises or products which importation or exportation are subject to sanitary regulation by the Department of Health (October 26).
- ◆ Agreement by which it is modified and added the similar that identifies the Tariff rates of the General Taxes Law for imports and exports in which classified merchandise is subject to follow Mexican official norms at the entrance and exit of the country (October 26).
- ◆ Decree that declares ex officio the initiation of the Subset Review of the countervailing duty imposed to steel pipes without sewing, classified under different tariff items 7304.10.01, 7304.10.02, 7304.10.03, 7304.10.99, 7304.39.05, 7304.39.06, 7304.39.07, 7304.39.99, 7304.59.06, 7304.59.07, 7304.59.08 and 7304.59.99 of the Mexican Tariff Schedule, originating from Japan, regardless of shipping country. (November 7).
- ◆ List of documents in review, dictated, authorized, extent and with the opinion of the Federal Commission for the Regulatory Betterment in the period of October 1st to the 31st of 2005. (November 9).
- ◆ Determination by which it is accepted the request of the interested party and declares the initiation of and administrative procedure for coverage on the products in connection to the final resolution by which a compensatory duty is imposed on imports of monobutyl ether of monoethylenglic classified under tariff items 2909.43.01 of the Mexican Tariff Schedule, originating from the United States, regardless of shipping country. (November 10).
- ◆ Agreement by which it is notified the diversified one which establishes the criteria for the granting of previous permissions by the Secretary of Economy, to the definite imports of fructose originating from the United States. (November 11).
- ◆ Agreement by which it is notified the quotas for importing Mexican sweets into the United States in the October, 2005 to September 2006 commercial cycle. (November 11).

Selected Readings

Clusters as a Driving Engine for FDI (Etienne B. Yehoue. International Monetary Fund, October 2005)

<http://www.imf.org/external/pubs/cat/longres.cfm?sk=18495.0>

This paper develops a model that highlights the importance of clusters for attracting foreign direct investment. It shows from a game theoretical perspective how the combination of setting up a cluster and implementing policy reforms will be a key engine for attracting FDI. Based on agglomeration externalities, the paper shows that the very emergence of clusters can make investment so profitable that investors can even afford to tolerate more policy-induced distortions than otherwise. With perfect information, it shows the existence of multiple equilibria, in which some countries attract FDI while other do not. An extension to the context of imperfect information refines the analysis to a unique equilibrium, in which some investors respond to reforms. The paper presents case studies to support the findings.

Safeguards and Antidumping in Latin American Trade Liberalization: Fighting Fire with Fire. Edited by J. Michael Finger, Julio J. Nogues (World Bank, October 2005)

Until the 1990s, the main users of safeguards and antidumping laws were Australia, Canada, the European Union, and the United States. Since then, many countries have implemented such laws, leading to a proliferation in antidumping and safeguard activity across the world. This timely book documents the political economy surrounding the implementation of these laws in seven Latin American countries and provides details on the institutions created, implementation of the laws, and subsequent activity. It finds that, in the larger political context, antidumping and safeguards are a necessary quid pro quo to certain important sectors to obtain much more liberalized trade policies for the general economy.



Tamaulipas

Capital: Victoria

Main cities: Ciudad Maderas, Altamira, Gonzalez, Aldama, Hidalgo

Population: 2,753,222 (2000)
 85% in the urban area
 60% under 30 years old
 35 people per square kilometer
 95% Literacy rate

Major exports: Manufacturing

Exports: US \$ 7,810 Millions (2004)

Imports: US \$ 6,167 Millions (2004)

Source: Ministry of the Economy

Foreign Direct Investment:

Between 1999 and June 2005, Chihuahua received US\$ 2,414 millions of dollars in foreign investment.

Main sector: Manufacturing (equipment, electronic accessories, radio, TV and communication parts) and Auto Industry

Countries with major investments in Sonora

include: USA, Canada, Spain, and Holland.

Maquiladora: There are 341 maquiladoras.

Maquiladoras Companies employs 184,022 workers.

Source: Ministry of the Economy, Government of State and INEGI.

Infrastructure:

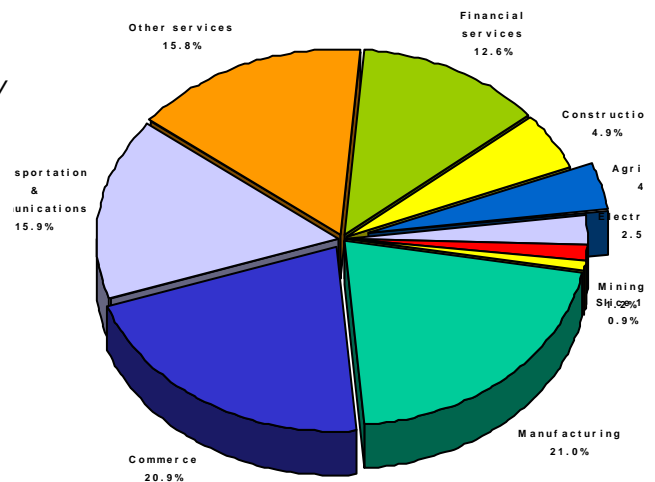
- 8,440 km of paved roads
- 297 km of highways (4 lanes)
- 4 International airport
- 165 Universities and tech institutes
- 99 Hospitals
- 427,200 Fixed telephone lines

90 Radio stations
 36 TV stations

Investment Highlights

Aid in setting up operations and training workers.

Major Economic Activity in 2002



Source: Ministry of Economy with INEGI data.

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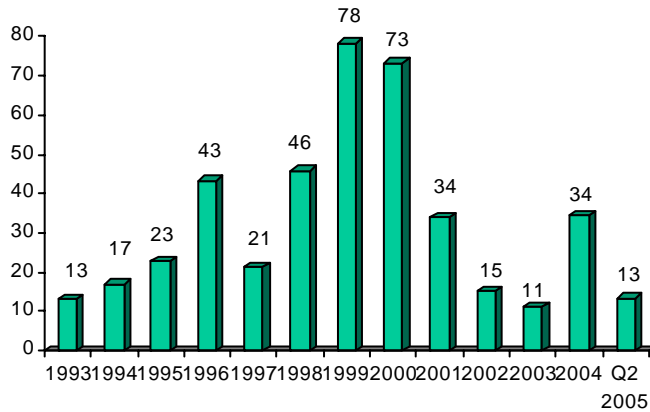
Montana

Between 1993 and 2004 Montana's exports to Mexico grew 165%

Mexico is the fiftieth largest consumer market of Montana's exports

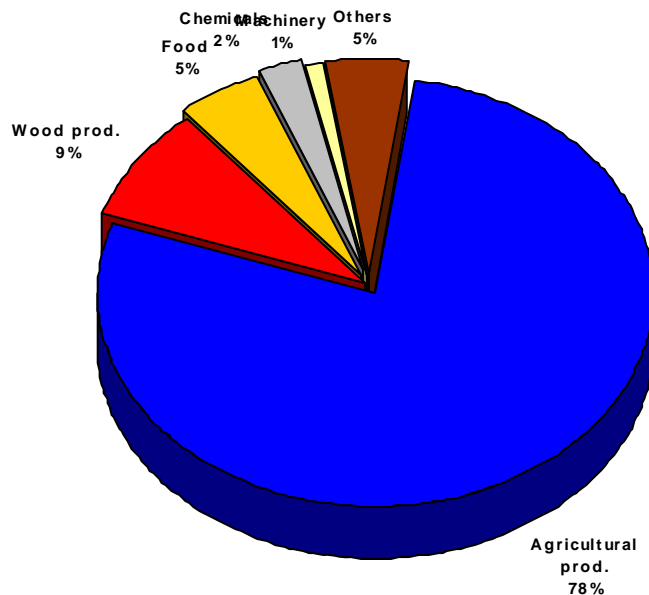
Exports to Mexico

1993-2005* (Millions of US Dollars)



Source: US Census, WISER and SE-NAFTA Series. 2000-2005, NAICS series.
* 2005 Second quarter

Exports to Mexico By Sector (NAICS) 2005 2Q



Source: US Census, WISER and SE-NAFTA.

Sony – TV maker invests in Mexico

With the massive arrival of high definition products to the U.S. and the debut in Mexico in 2006, Sony is modernizing its plants in Mexico rather than closing them said Luis Guardia, Public Relations Manager for Latin America.

Sony already invested US\$30 million in the modernization of its plants in 2004, focusing on the production of plasma TVs and LCD. Although there were rumors about Sony closing plants due to labor cuts, Sony explained that these labor cuts were the result of ending manufacturing contracts in one of the state parks, but the company was not planning to close any plants. Moreover, between July 2003 and December 2004, Sony invested US\$26 million in its plants in Pennsylvania and in order to compensate for this, the company requested financial aid to the state, which was granted with the condition of maintaining a job level of 1,800 workers in a 4 year period. Finally, Guardia added that the main purpose of the Mexican plants, the export of equipment to the U.S. and the supply of the national market, has not changed.

Xerox focus investment on color products

Xerox decided to impel the color products after an increase of 17% on global profits during the second quarter of this year. The company will maintain investing US\$1 billion annually in technological developments as programmed, but with a great propel in the color products due to the increase in global profits of this products.

At least in Mexico, the sales of multifunctional color equipment have had an increase of 54% annually while the laser equipment had an increase of just 8%. Most sales are generated in the office equipment sector with a 70% in sales of equipment such as multifunctional, laser printers, fax and copy equipment of up to 90 pages per minute. This year, equipment sales increased 7% and total revenues 2%. In the second half of this year, Xerox had increases of 69% correspondent to multifunction color systems for office and 155% in the case of color printing systems.

NAFTA WORKS FOR

NAFTA Related Events

November 15 – 16

“Vanilla 2005”

Veracruz, Veracruz – Hotel Fiesta Americana

Vanilla 2005 Mexico, the Third International Symposium on the Vanilla Business will be in Veracruz, Mexico, the cradle of *Vanilla planifolia*. The Symposium will be preceded by two pre-meeting workshops, held on November 14th, dealing with Vanilla Quality Control and Vanilla Curing Technology. The Symposium will also be followed, on November 17th, by a post-meeting field trip to a vanilla plantation and curing processing facility in the region.

<http://baktoflavors.com/vanilla2005/>

November 17 – 19

“Espacio Microempresarial 2005”

México, D.F. – World Trade Center

This Expo Conference is directed to people related to the micro-industry and those who wish to have an alternative for the self employment. Here, visitors will have the opportunity to listen lectures offered by experts in the matter and interact with those who have already been able to consolidate their company in an exhibition of 75 micro-industries.

<http://www.microempresarial.org.mx/>

http://www.exposwtc.com/Vers_en/eventos/detalles_expo.php?id=516

November 29

“Mexico & China Conference”

Monterrey, Nuevo León – Presidente InterContinental Hotel

December 01

“Mexico & China Conference”

México, D.F. – Camino Real México

Sets of conferences on offshore manufacturing that give participants the opportunity to listen to lectures about Mexico's and China's industrial policies, China's economic environment, the state of the maquiladora industry and comparison with China, China and Mexico manufacturing cases, and legal structures and taxes for foreign direct investors in Mexico and China, etc.

<http://www.mexico-now.com/2005/conf-mtymx05.htm>

<http://www.maquilaportal.com/public/navegar/nav9.htm>

December 02

“TPM Road Map Implementation”

México, D.F. – World Trade Center

The TPM Seminary is focused on people working in the areas of maintenance, production, manufacture and planning. It offers integral knowledge of TPM, route of implementation, practical approach and plan for implementation.

<http://www.streamtech.com.mx>

http://www.exposwtc.com/Vers_en/eventos/detalles_expo.php?id=520

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