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# Mexico: a “new” leading actor on the global stage?

By Davide Serraino

## Executive summary

- **The second largest Country of Latin America by population (130 million of inhabitants) and economic size, Mexico is the only nation of its region that is truly embedded in regional and global value chains. The first Country of Latin America to join the OECD in 1994,** Mexico has solid macroeconomic fundamentals and stable institutions despite the great challenges posed by the fight against drug trafficking, corruption, high social and regional inequalities.

- **In recent decades the economic performance of Mexico has not been particularly strong and the Country has moved away from convergence with advanced economies. Nonetheless, the Country’s potential remains significant considering its complex economic structure and the ample availability of a young and medium-skilled workforce. The current Obrador government focused heavily on social measures and on the recovery of the most backward areas of the Country, mainly through big infrastructural projects.** However, the attraction of more foreign investments remains necessary to enable Mexico to move forward on the technological frontier, succeeding in combining economic development and sustainability.

- **Mexico has the most advanced manufacturing sector of all Latin America and is considered the only large open economy of the region.** The Country has a favourable geographical location and a high number of free trade agreements in force, covering more than 60% of global GDP. This could be a means to go beyond the essential link with the US.

- **The current international environment offers Mexico an important opportunity for nearshoring.** However, Mexico needs a change of pace to seize the momentum and position itself at a higher level in the value chains. **The 15th largest economy in the world, Mexico, which could play a greater geopolitical role equal to its economic weight, now has the opportunity to become a major player on the global stage in the coming years. For the European Union and for Italy it is important to increase institutional and commercial relations with Mexico:** strengthening ties with a target Country for the Italian system, which is also a gateway to the American continent, can be a winning choice both in the short-term and in the medium-term.

- **Italian exports to Mexico have shown an important growth trend in the last decade**: thanks to the historical record of about €5 billion of goods exported this year, Mexico will once again become the leading destination in Latin America after 4 years. **In 2023 and 2024, SACE forecasts show further growth (+4.5% and +4%, respectively), which will allow Italy to consolidate its second place among European suppliers, behind Germany. At sector level, exports of intermediate goods will increase above all**: chemicals (+5.2% on average per year in the two-year period 2023-2024), rubber and plastic (+4.1%) and metals (+4.3%), **in line with the expected strengthening of the local manufacturing sector. Machinery will also perform well** (+3.7%).

- **It will therefore be important not only to manage to enter more and more into the supply chains of Mexican corporates, but also to increasingly consider Mexico as a nation for long-term productive investments. SACE has supported and continues to support Italian companies starting from the more traditional products of export credit insurance, passing through untied products, such as the Push Strategy, up to the insurance of political risks in FDI transactions.**

## A stable Country in a troubled region

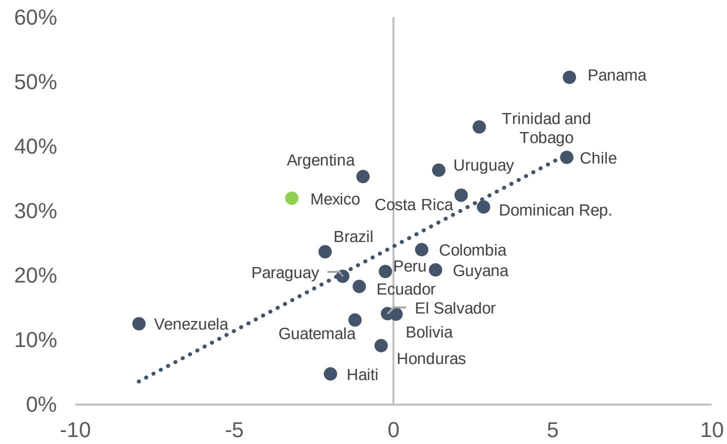
**In Latin America, the region that in the collective imagination recalls *coups d'état* and dictatorships, nowadays fortunately largely a memory of past times, Mexico stands out as a bright spot.** In more than a century from the end of the *Revolución*, the first large-scale social uprising of the 20th century, Mexico has represented an anchor of stability from a political and institutional point of view. Led without interruption for more than 70 years, until 2000, by the Partido Revolucionario Institucional (PRI), the second Latin American nation has experienced from then to 2018 the alternation in power with the other movement that has its roots in the first half of the 20th century, the Partido Acción Nacional (PAN). In July 2018, the Movimiento Regeneración Nacional (Mo.Re.Na.), founded in 2011 and led by the former mayor of Mexico City (better known as AMLO) achieved a landslide victory in general elections and managed to undermine a well-established party system. Today Mo.Re.Na. holds power in 20 out of 32 States[1] of the Federation and is in good position to bring one of its members to rule the Country from 2024 to 2030. Obrador, who managed to attract the preferences of a vast electorate dissatisfied with the answers of traditional parties through an anti-establishment political platform, continues to enjoy a high popularity rate after more than four years in office, but cannot run again in 2024[2].

**Mexico as we know it today covers an area almost seven times bigger than Italy and is the third largest Country in Latin America after Brazil and Argentina.** The geographical location is one of the main strengths of the Country: in addition to sharing almost 3.200 km of land border with US, Mexico stands between the Pacific Ocean and the Atlantic one. **If geography places Mexico in North America and projects it towards Central America and the Caribbean, history makes it a Latin American Country from a cultural, social and religious perspective.**

## A relevant economic potential, only partially exploited

**Endowed with the best age structure[3] among the six major Latin American economies[4], Mexico has so far only partially exploited the available potential** (Fig.1), progressively moving away from convergence with respect to the benchmark represented by the US GDP.

**Figure 1 - Mexican per capita income increasingly distant from that of the US (1980-2019)**




Note: on the vertical axis ratio of GDP per capita in PPP of the individual Latin American Country to that of US in 2019 (%); on the horizontal axis average differences between the four decades from 1980 to 2019 of the average ratios per decade between GDP per capita of the individual Country and US GDP per capita (given in percentage points).

Source: SACE elaborations on IMF data

[1] 31 States plus the Federal District which includes Mexico City.
[2] The Mexican presidential term lasts six years without direct re-election.
[3] For more info, see: SACE, *Getting old before getting rich, una trappola per l'America Latina?*, Sasso nello stagno, March 2019.
[4] By economic size Brazil, Mexico, Argentina, Colombia, Chile and Peru (GDP 2021 at purchasing power parity, PPP, in US dollars, source IMF World Economic Outlook database, October 2022).

Why did this happen? The answer is not easy and many causes lie behind. **Among the emerging economies, Mexico stands out as one of the greatest examples of a middle-income trap**, an uncomfortable limbo for some Countries which experienced sustained growth which made them lose the cost advantages typically triggering the outsourcing of productions from high income Countries to poorer ones[5]. Likewise, Mexico has only partially the technical skills typical of advanced Countries which allow them to stay on the technological frontier. Moreover, as far as funding sources are concerned, becoming an upper middle-income Country means to give up concessional sources disbursed by Multilaterals at low rates and long maturities and to look much more to financial capital markets in order to cover the financing needs, with higher risks (and costs).

**The problem, however, is to understand why Mexico underperformed in recent decades even compared to other Countries in a similar situation,** either in Eastern Europe or South-East Asia**.** According to the most popular economic theory[6], success stories in terms of catching-up with rich Countries refer more to i) manufacturing economies than those dependent on the exploitation of natural resources and ii) export-oriented nations rather than Countries with tariff and non-tariff barriers that limit trade with the rest of the world while protecting domestic productions. Mexico, unlike other major Latin American Countries - including, for example, Chile which despite being a case of sustained growth has failed to fully break free from mining - meets both criteria. Yet, Mexican growth performance in the last decades has been only moderately satisfactory. What is more, the geographical proximity to the United States and the signing of the NAFTA in 1994 (North American Free Trade Agreement, since 2020 United States Mexico Canada Agreement, USMCA) should have further benefited Mexico but empirical evidence shows that this did not happen.

**In the end, what lies behind the sluggish Mexican growth? Perhaps heterodox fiscal and monetary policies? Since the well-known Tequila crisis of 1994,** a currency crisis that marked the start of a series of similar setbacks in other emerging markets in the following years, Mexico, the first Latin American Country to join the OECD in the spring of 1994, represented a stable macroeconomic environment, following prudent fiscal and monetary policies, often perfectly aligned with the Washington Consensus. **The most obvious cause relates to the effects of drug trafficking and corruption,** pervasive phenomena in the Country albeit uneven in space and in time[7]. No doubt that this has been and continues to be an issue against investments, especially foreign ones, but the capacity of investors to distinguish between States or even within States has increased over the years. **Other typically mentioned causes are the inadequacy of infrastructures (mainly in electricity and communications sectors), the still low penetration of the banking system in the economy, Chinese competition, excessive regulation, a high share of informal economy and the presence of strong social and regional inequalities**. All these explanations are credible but there is still no definitive answer to the question and Mexico's low growth remains in some ways an enigma that continues to be investigated by economic analysis.

**Nevertheless, Mexico is still a Country with a broad and partially untapped potential, a land of risks but also of multiple opportunities**. It is important to look carefully at Mexico, beyond some headlines stopping at the most manifest aspects, negatively impacting public opinion. To unleash potential and embark on a faster but sustainable growth path, Mexico needs to upgrade its infrastructural network and capitalize on the achievements made by the manufacturing sector while trying at the same time to develop new sectors that can create qualified jobs by increasing productivity and reducing informality[8]. **Reducing inequalities, territorial, social and educational divides - fostering the creation of a true middle class - can help make Mexico a Country which in the medium term will take the road to become an advanced economy.** The alternative is a dangerous stagnation with the risk that Mexico may, slowly but surely, become a context which has missed the opportunities that history has offered it or, in the worst case, take a path of decline.

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[5] It is easy to think about the phenomenon of the well-known *maquiladoras*, which arose in Mexico in the 1960s in the cities on the US border. *Maquiladoras* are industrial zones with special incentives created to attract foreign investors, where imported materials undergo a certain degree of processing before being (re)exported again. Today, the phenomenon is still partly Mexican but has mainly spread to some Central American and Caribbean Countries.
[6] Smith, *Mexico: A development puzzle*, Nohapinion, August 2022.
[7] *Ibidem*. See also Hanson, *Why isn't Mexico rich?* National Bureau of Economic Research, October 2010.
[8] In the last Article IV by the IMF (November 2022) the share of informal workers to total workers was 55%.

## Infrastructures to fix the Country's wounds

**Since taking office in December 2018, president Obrador's strategy in the field of infrastructure has been clear: given the constraints posed by Mexico's public finances and fiscal austerity, a distinctive trait of the government[9], priority has been given to a few large infrastructure projects, mainly concentrated in the Country's southern States.** These territories are those in which relative and absolute poverty rates are historically the highest in Mexico[10] and are also at the bottom of the regional competitiveness ranking drawn up annually by the Instituto Mexicano para la Competitividad (IMCO)[11]. **Infrastructures, not only physical ones, considered as enabling factors for development, can thus be a driving force for Mexico to attain faster growth and to reduce the development gaps accumulated by the southern part of the Country**, which are also the ones with the highest concentration of indigenous populations.

Iconic projects like the Tren Maya, a 1.500 km railway to take tourists through five States (Campeche, Chiapas, Quintana Roo, Tabasco and Yucatán) and the Isthmus of Tehuantepec, an intermodal freight corridor designed to connect the State of Veracruz on the Gulf of Mexico with the State of Oaxaca on the Pacific Ocean, are all projects at the heart of Obrador's mandate agenda. These projects have absorbed significant portions of the budget dedicated to infrastructure spending in recent years. However, these projects are controversial too, raising concerns not only on the side of cost-effectiveness, because costs have often risen far above initial estimates, but also on the protection of the environment and the biosphere, and this is particularly true for the Tren Maya. The increasing deployment of military forces to supervise the progress of projects, if not directly for their implementation, is evidence of their importance, but also of the difficult relationship with local communities.

**The South and Southeast region of Mexico covers about a quarter of the Country's total area, is home to almost a third of the population and generates a fifth of the total GDP.** It is the part of Mexico with the greatest biodiversity and is the richest one in water and oil resources. If tourism is a natural strength of these territories, agriculture and fishing are equally important resources, but investments in real estate are also on the rise. **The medium-term goal of the government and of national and local leaders is to turn the area into a logistics and manufacturing hub thanks to the ongoing and planned infrastructure investments.** Already in 2019, the signing of the *Pacto Oaxaca*[12] between the local governments of nine States in the region and the Confederation of Industrial Chambers of Mexico (CONCAMIN) had laid the foundations for a wide-ranging strategy aimed at involving private forces to foster the creation of new qualified employment opportunities and attract more foreign investments.

To prevent the possibility that the growth of the area would be short-lived, considerable progress must be achieved regarding human capital, and this passes through an improvement, *in primis*, of the education system[13]. In the long run, this area could eventually become a hub serving the Central American and Caribbean economies given that trade relations with Mexico still remain limited in many cases[14].

The administration's emphasis on the recovery of the South of the Country implicitly means that less attention is paid to the rest of Mexico in terms of the need for new infrastructures and/or upgrades to existing infrastructures. **Given Mexico's low public spending on infrastructure as a percentage of GDP over the past decades** (Fig. 2), **particularly for transport, the focus in the rest of the Country is, therefore, more on the maintenance of existing works than on the construction of new ones.**

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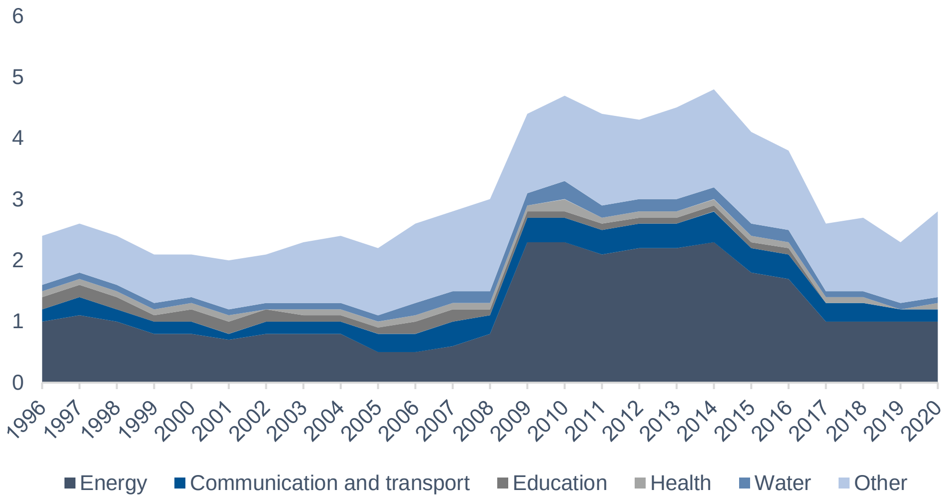
[9] Mexican public debt to GDP was 53.6% at the end of 2019 according to the IMF's definition. At the end of 2020 due to the recession caused by the pandemic the ratio raised to 60.1%, lowering to 57.6% in 2021. This ratio is lower than the average of the region, 69%.
[10] According to *Consejo Nacional de Evaluación de la Política de Desarrollo Social* (CONEVAL) at the end of 2020 (latest data available) relative poverty rate was 75.5% in Chiapas, 66.4% in the State of Guerrero, 62.4% in Puebla and 61.7% in Oaxaca compared to a national average of 43.9%.
[11] Indice de Competitividad Estatal 2022, synthetic score based on 72 indicators grouped into 10 subgroups which analyse different dimensions of competitiveness for the 32 Mexican States: at the bottom are Chiapas, Guerrero, Michoacán, Oaxaca and Zacatecas.
[12] BBVA, *Oaxaca Pact: Infrastructure for the South & Southeast*, September 2019.
[13] According to the outcomes of the last report *Censo de Población y Vivienda 2020* by the Mexican national statistical institute (INEGI), regarding the different dimensions of the education system too, the southern part of the Country is often at the bottom of the rankings.
[14] IMF's article IV reports that Mexican exports towards Central American Countries was 1.7% of the total in 2021 and imports 0.6%.

**Figure 2 – Mexican expenditure on infrastructure (% GDP)**




Source: SACE elaborations on data by Secretaría de Hacienda y Crédito Público (SHCP)

However, there has been no lack of flagship infrastructure projects in the rest of Mexico as well: one example is the new and controversial Felipe Ángeles International Airport in Mexico City, built to decongest Mexico City's international airport[15]. As the new airport is further away from the city centre than the previous one, the construction of a rail link through a public-private partnership (PPP) is underway. **Between 2010 and 2019 Mexico was the Country in the region with most PPP infrastructure projects after Brazil, with a share of 11% out of total projects[16].** The projects were mainly focused on transport and energy. The PPP law in Mexico dates back to 2012 and was updated in 2018: the quality of the Mexican regulation is considered adequate compared to international standards except with reference to the dimension of the ex-post analysis on PPP results. Further improvements of the regulation could be helpful in catalysing more private investments given the relative constraints that Mexican public finances continue to pose.

Although there have been multiple frictions with private investors during President Obrador's current term in office, aimed to some extent at reviving Mexican nationalism, the involvement of the private sector remains essential. Indeed, it is no coincidence that the $44bn *Plan de Desarollo Nacional 2019-2024*, spread over 147 infrastructure projects mainly related to transport, had already seen a significant involvement of private capital.

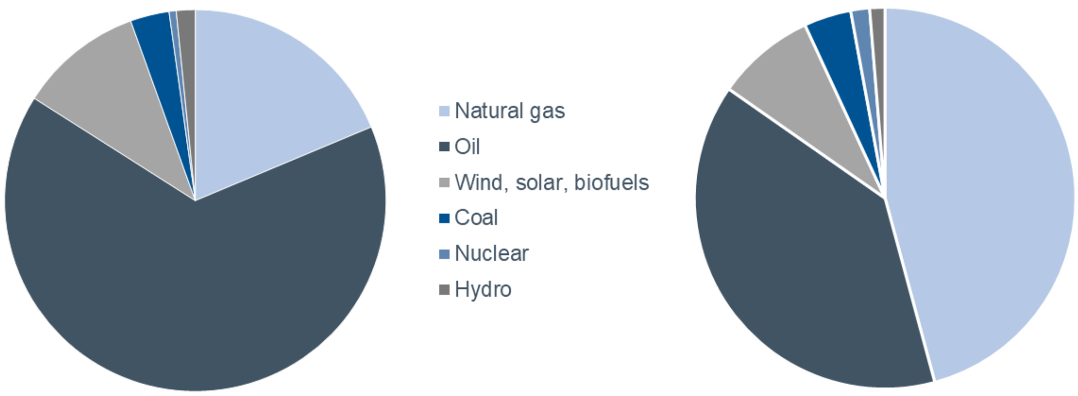
**This is even more true as far as the energy sector is concerned**: the recent statements[17] by the Minister of Foreign Affairs at COP27 in Sharm el-Sheik marked an unexpected shift in the environmental field. Mexico will, in fact, commit to reducing greenhouse gas emissions by 35% by 2030 compared to 2000 levels, a much higher target than the previous 22%, making up ground for a Country that in recent years has certainly not been at the forefront of environmental policies.

**Indeed, Mexico's energy matrix is still heavily dependent on fossil fuels, particularly natural gas,** and the last 30 years have seen a redistribution of weights within the fossil fuels rather than an increase in the penetration of renewables (Fig.3). The indicators carried out by SACE and Fondazione Enel confirm that

[15] The Felipe Ángeles airport, built by expanding the pre-existing military base of Santa Lucia, replaced the Texcoco airport, whose construction works had begun in 2014 and it was supposed to become Mexico City's new international airport. In October 2018, when the construction was at 30%, President Obrador, who had not yet taken office, called a popular referendum to demand the cancellation of the project upon allegations of corruption and extra costs. Thanks to the 69% favourable vote of only 1 million Mexicans (approx. 1% of the electorate), the cancellation was decided and this fact generated negative reactions among investors.
[16] Economist Intelligence Unit (EIU), *The 2021/22 Infrascope. Country summaries*, July 2022, study commissioned by the Inter-American Development Bank (IADB).
[17] Reuters, *Mexico vows to double renewable energy capacity by 2030*, November 2022.

Mexico's energy transition has ample room for improvement in terms of the weight of fossil fuels on energy consumption and the penetration of renewables on final consumption[18] .

**Figure 3 - Mexican energy matrix: 1990** (left) **versus 2020** (right) (energy supply by source)




Source: SACE elaborations on data by IEA

**Obrador's term, as mentioned above, has so far been characterised by the return of the State to centre stage in the energy sector**. The historic 2013 reform under AMLO's predecessor, Peña Nieto, had eliminated the monopoly of the national oil company Petróleos Mexicanos (Pemex) in the upstream segment and liberalised the electricity generation segment by opening it up to private companies, marking the end of the monopoly of Comisión Federal de Electricidad (CFE). However, AMLO's government has progressively dismantled[19] the 2013 reform but it failed to approve an amendment to the Constitution to completely return to the past in the field of electricity due to the rejection[20] by the Chamber of Deputies in April 2022.

**However, the preferential treatment of national energy champions is not only a domestic political issue since the dispute has reached the highest diplomatic levels with the United States and Canada.** On July 20th, Washington and Ottawa formally submitted an official request for consultations with their Mexican counterparts on the violation of five articles of the USMCA relating to chapters such as market access, investment, activities of publicly controlled enterprises, and impartiality of public administration[21]. According to the provisions of the treaty (Art 31.6), after 75 days of unsuccessful attempts at conciliation between the parties, a Commission (Panel) can be called to settle the dispute. The deadline, which expired on 3 October, was extended due to the change at the highest level of the Mexican Secretaría de Economia[22]: despite the resumption of the dialogue, the answers received from the Mexican side at the beginning of November were considered unsatisfactory. Therefore, Mexico might still be subject to import tariffs for sanctioning purposes totalling a minimum of $10 billion at the end of the Commission's judgement.

**Beyond the technical aspects, and with all the contradictions, what is most relevant is the fact that to meet the ambitious targets announced by the Country at COP27, huge investments in generation from renewable sources are required, and the limited national funds hinder the achievement of the goal.** The very ambitious target set by the government means reaching 40 GW of installed capacity by 2030, 25 GW more than today. The estimated investments amount to $48 bn, almost 4% of GDP. What is more, investments

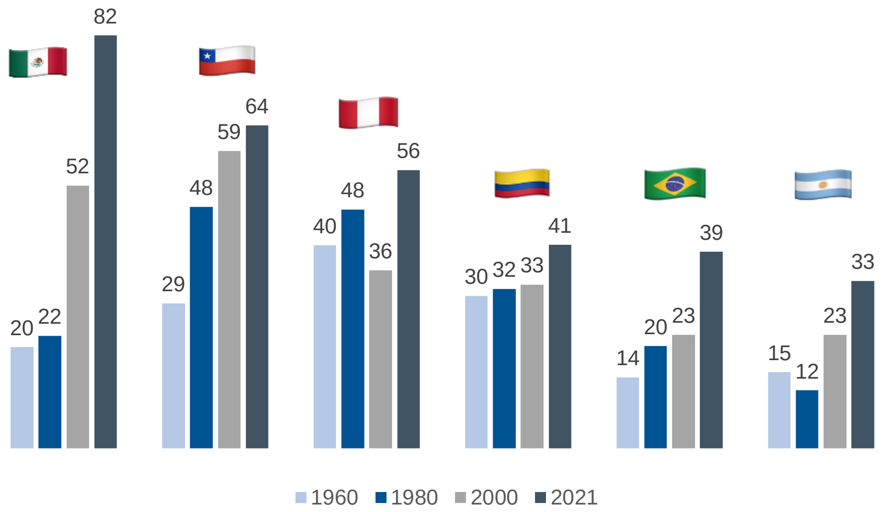
[18] SACE, Risk&Export Map, Mexico Country Profile. For the two variables mentioned, the score for the weight of fossil fuels is 44 out of 100 while that for the penetration of renewables is only 22 out of 100 (scale 0-100 where 0 is the worst result).
[19] Serraino, *Messico: Nuvole sugli investimenti esteri*, ISPI, April 2021.
[20] Reuters, *Mexican president's contentious electricity overhaul defeated in Congress*, April 2022.
[21] In particular, the articles infringed according to the counterparties are 2.3 (less favourable treatment of foreign products than domestic ones), 2.11 (prohibition or restriction on export/import of certain goods), 14.4 (discrimination of foreign investors against local ones), 22.5.2 (lack of impartial treatment by the regulator between local and foreign economic players) and 29.3 (lack of impartiality in the administration of domestic rules).
[22] The Secretaría de Economía is one of the 19 Secretarias of State reporting directly to the Presidency.

are also needed for the improvement of transmission and distribution networks as well as for the construction of new grids to ensure that areas with the greatest potential for non-traditional renewables are connected to the national grid. **Doing that in open conflict with the other USMCA members and, *lato sensu*, against foreign investors, seems unrealistic. Finally, the negative effect could also extend to other sectors of the Mexican economy, some of which form the backbone of the national manufacturing system.**

## Manufacturing: between core sectors and emerging opportunities

**Mexico is the most open economy among the six largest of the Region and has 14 trade agreements in force with 50 Countries in the world which account for more than 60% of global GDP, as well as 32 bilateral investment protection treaties, including with Italy since 1999.** However, data referring to the ratio between trade (export plus import) and GDP, reveal that this has not always been the case in the history of Latin America. Indeed, until the 80s, the degree of openness of Mexican economy was superior only to the historical strongholds of protectionism in the region, Argentina and Brazil (Fig.4).

**Figure 4 - Development of international trade openness** (trade to GDP; %)




Source: SACE elaborations on IMF data

The entry in force of NAFTA changed dramatically the picture: global cross-border sales of Mexican goods between 1994 and 2021 rose from $61bn in current values to $523bn; in the same period, Mexican exports to the US rose from $51bn to $386bn, with their share of the total only slightly decreasing (from 84% to 78%). It is therefore clear that **Mexico's increasing openness to international trade has been directed almost entirely at its North American neighbour, and this has benefited US production chains, which are now highly integrated in some sectors**. The main examples are automotive, electrical appliances and electronics[23], but the degree of integration has increased for most product categories since 1994.

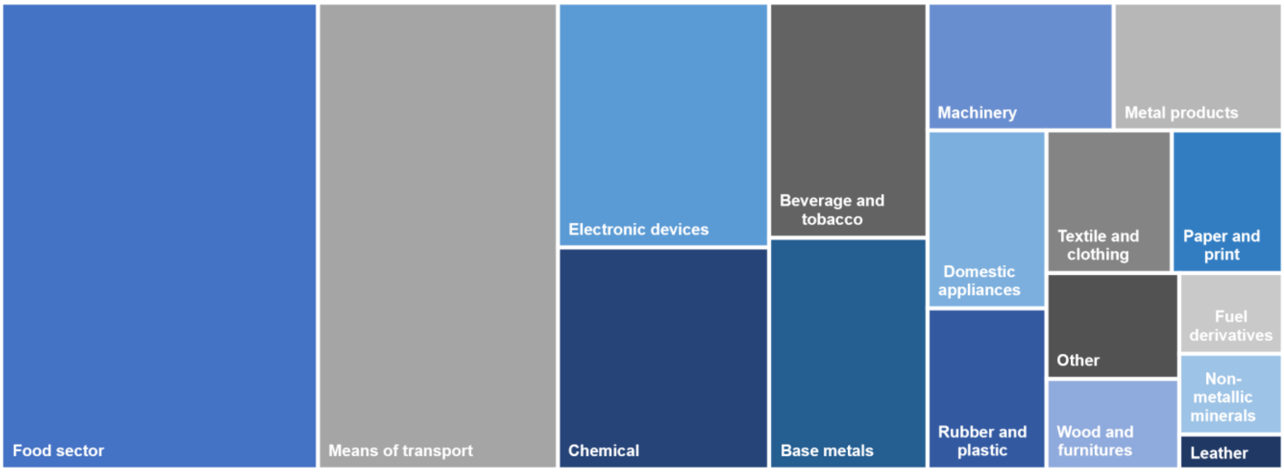
The economic complexity of the Mexican economy benefited from this phenomenon[24]: among the 133 Countries considered in the Atlas of Economic Complexity by the Center for International Development of

[23] Miguel Pérez, *Vinculos productivos en América del Norte*, Comisión Económica para América Latina (CEPAL), May 2019.
[24] The reference in this regard is the Economic Complexity Index, a holistic measured theorised in 2009 and developed by Cesar Hidalgo of MIT and Ricardo Hausmann of Harvard, who created The Observatory of Economic Complexity. An alternative methodology, developed by the Sapienza University of Rome and the Italian National Research Council (CNR), called 'International Economic Fitness Ranking', placed Mexico 32nd out of 147 countries in the last survey in 2015, still ranking it first in Latin America.

Harvard University, Mexico ranked 20th in 2020 (the last year available), not only first in Latin America but also second in the world among emerging markets only behind China, in17th place[25].

**It is no coincidence that in Mexico the ratio between value added of manufacturing sector and GDP is the highest among the largest economies of the region (18% at the end of 2021[26]) and 40% higher than the Latin American average,** a subcontinent in which most economies have maintained a strong dependence on commodities and have often not focused, or have failed to do so, on industrialisation. Mexico itself does not lack raw materials[27] but the Mexican exception has been the ability to go further and achieve a very diversified structure of the manufacturing sector (Fig.5).

**Figure 5 - Composition of Mexican manufacturing GDP in 2021** (constant values at 2013 prices)




Source: SACE elaborations on data by INEGI

**The pandemic, the bottlenecks in global value chains and now the return of inflation have severely tested the resilience of some manufacturing industries globally and Mexico was no exception: this is especially true for the automotive sector, one of the leading in Mexican economy.** The sector has been strongly affected by the shortage of semiconductors but is recovering at a fast speed and has recently reached the fourth position in the world for component supply[28]. Considering the sector's track record and the degree of development, it is not weird that Mexico is considered a top destination for investment in the development of electric vehicles. The Chinese company CATL and the American Tesla recently announced investments in the construction of gigafactories to produce batteries. Hopefully, these decisions could catalyse investments along the supply chain to achieve a circular production.

**Alongside sectors which are well-established and well-known abroad, there are others that are gaining ground: an outstanding and paradigmatic example is the industry of aerospace.** Still at an early stage until the first decade of the 21st century, this industry has grown by 15% per year over the last decade thanks to investments by large multinational groups and a fruitful local environment. Indeed, thanks to local technical skills and the possibility of doing business in the Country without too much red tape, Mexico reached the 14th position[29] worldwide in the industry with about three hundred companies operating in the Country, mainly located in five districts and with a strong focus on export.

[25] In 2000, first year available of the index, Mexico started from the 25th place. The Country attained the best rank in 2005, 2007 and 2016, 17th. In 2020 Italy ranked 16th.
[26] World Bank, Manufacturing value added (% of GDP). Construction industry excluded.
[27] Beyond hydrocarbons, Mexico has a vast endowment of several minerals on its territory (in addition to precious metals, mainly lithium, copper and zinc).
[28] Fitch Solutions, *Mexico Autos Report*, Q1 2023.
[29] SPC Pro, *La industria aerospacial en México*, September 2022.

**Another very strong sector in the Mexican economy is the food and beverage industry, which has been the main manufacturing sector from more than two decades and is the fourth largest in size worldwide behind China, United States and Japan[30].** During the pandemic, in Mexico as in the rest of the world, the sector showed good resilience compared to others. When Covid-19 subsided, the spike in inflation led to a slowdown in domestic consumption. However, this phenomenon could be short-lived thanks to the fact that food inflation is starting to cool in Mexico. Moreover, the still favourable demographic dynamics argues in favour of a further increase in domestic consumption. At the same time, the sector is adapting to the changes in the population's lifestyle and eating habits: the latest national survey on health and nutrition in 2020 showed that 72.4% of Mexicans over 20 are overweight or obese[31]. This is a major public health problem, and the Mexican government has already taken steps in this direction, introducing taxation schemes on sugary drinks, processed foods and other health-damaging products, as well as making it compulsory from 2020 for products to be labelled with excess fat, salt and sugar.

Moreover, regarding the health of Mexican citizens, the pandemic has made clear the importance of establishing and/or strengthening a supply chain of medical devices in every large Country, considering the need to ensure the certainty and speed of supplies. This sector in Mexico, which already ranked first in the area before the pandemic, is strongly oriented towards exports (80% of the turnover). Growth between 2015 and 2021 reached 50% up to a size of over $15 bn and the seventh place in the world for export performance[32].

**Automotive, aerospace, food and beverage, medical devices are just two couples of examples of established and new sectors in the Mexican economy and are evidence of how Mexico can move up in the value chains. Mexico is not only a source of low value-added productions that require cheap labour but it also proved to be able, in some cases, to do much more**. This means that the Mexican ground is quite fertile in terms of workers' skills. Thus, it means that the Country's education system has been quite successful in training citizens with adequate skills for what the labour market demands. Everything good? Of course not, or rather it depends on the point of view. If Mexico ranks well compared to the other Latin American Countries[33], the same does not happen among OECD countries. From the latest available OECD survey[34], Mexico is at the bottom of the rankings in both the PISA assessments for student and the PIAAC[35] surveys for workers. In any case, the government passed some reforms in the last decade to increase the participation rates in secondary education (higher education was made compulsory in 2012) and in tertiary education. Mexico's public spending on education in relation to GDP, which started at 4% in 2000[36], after reaching a peak of 5.3% in 2014, has embarked on a trend of conspicuous decline to 3.1% in 2022. This level is well below the OECD recommendations (between 4% and 6%) and a quick reversal is needed to limit the medium- to long-term negative effects that would be added to the damage inflicted by Covid. Like many health systems in Latin America, the education system in Mexico too suffers from a significant polarisation between public and private facilities, with the latter being in a much better situation, and this gap also weighs on the overall performance of the system.

## Nearshoring: is Mexico ready?

**The privileged geographical location of Mexico, making it the only emerging economy to share a land border with the United States, is an objective strength for a company that wants to produce in Mexico and export goods to the North American giant.** Added to this is NAFTA: the treaty in force since the

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[30] American Express (Oxford Economics data), *Alimentosy bebidas, sector dominante en México*, July 2021.
[31] Secretaria de Salud, *Encuesta Nacional de Salud y Nutrición sobre Covid-19, resultados nacionales*, August 2022.
[32] Debate.com, *México séptimo lugar en producción de dispotivos médicos a nivel mundial*, November 2022.
[33] CEPAL, *Educación en tiempos de pandemia: una oportunidad para transformar los sistemas educativos en América Latina y el Caribe*, October 2022.
[34] *OECD Skill Strategy 2019*, May 2019.
[35] PISA stands for Programme for International Student Assessment, a survey that the OECD promotes every three years to test the skills of students in member Countries. PIACC stands for Programme for the International Assessment of Adult Competencies to assess the skills of the working-age population (from 16 to 65 years) and is a survey conducted every ten years.
[36] World Bank, Government expenditure on education (% GDP).

beginning of 1994 has undergone some changes, starting with its name, but has not been overturned and represents an important anchor for Mexico, which, in addition to the good quality of its labour force, enjoys a competitive labour cost, even if the repeated increases in minimum wages, uneven in the various areas of the Country, have partly eroded the cost advantages[37].

**The 21st-century strategic confrontation between the United States and China for the world leadership, the problems of long value chains exacerbated by the pandemic and, most recently, the conflict between Russia and Ukraine are all factors that have fostered the debate on shortening production chains. What counts today is no longer related so much to labour cost advantages of outsourcing production or parts of production processes but to the security of the supplies,** a factor that has become as crucial as the reliability of suppliers**.** Finally, shortening production chains reduces transport costs and emissions and is therefore also ESG-friendly.

**Mexico is 'in the right place at the right time': the question to be asked is whether this is enough to make many companies decide to move their production site to Mexico.** There is a lot of talk about nearshoring, sometimes out of proportion, and it is not easy to quantify the size of the phenomenon[38]**.** According to IADB estimates[39], nearshoring can generate up to $78Bn annually in additional exports of goods ($64Bn) and services ($14Bn) for Latin American countries in the short to medium term, and Mexico would be the main beneficiary, with an increase in export flows of $35Bn in goods (Fig. 6). The same institute announced[40] financing over the next three years in the range of $1.75Bn to $2.25Bn between short- and medium-term finance to support production relocation projects in the Country.

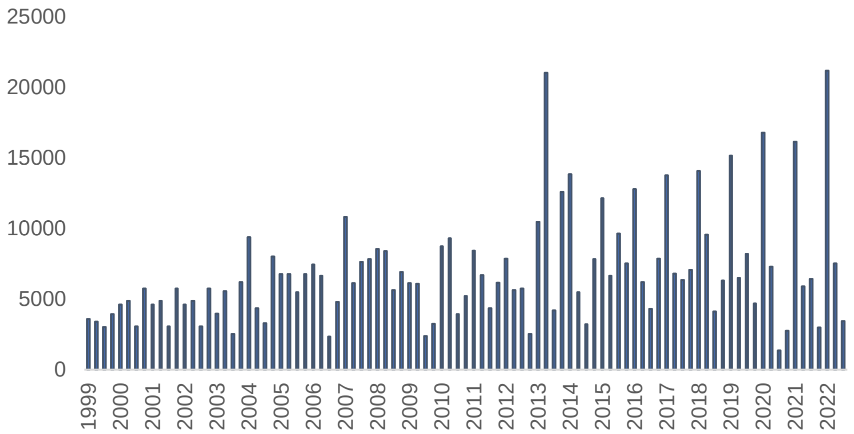
**Figure 6 - Export of additional goods of Latin American Countries through nearshoring** ($ thousands)


Source: Inter-American Development Bank (IADB)

[37] IMF, Mexico Article IV (11/2021).
[38] Within the broad debate on nearshoring about the trade-off between security and efficiency in production chains, the arguments against trade deglobalisation have important implications because, at the extreme, this would risk undermining the mechanisms that have stimulated growth and reduced poverty globally (see e.g. Guerrieri, Terzulli, *Scambi mondiali tra speranze di continuità e rischi di implosione*, Macrotrends 2022-2023, Harvard Business Review Italy, September 2022). However, Mexico could be a special case where security and efficiency reasons are not manifestly divergent.
[39] IADB, *Nearshoring can add annual $78 bln in exports from Latina America and Caribbean*, press release, June 2022.
[40] IADB, *IDB joins forces with Mexico to promote nearshoring*, July 2022.

Moreover, according to Bank of America[41] (BOFA), nearshoring can lead Mexican exports to grow by 30% within the next 10 years and represents a "unique opportunity" for the Country. Lower average labour costs compared to China, together with macroeconomic stability, are factors that can make Mexico a favoured destination in the coming years. Is there any evidence that this phenomenon is already happening? Yes, according to Barclays[42]. In 2021, the flow of foreign direct investment (FDI) into Mexico was $32bn, ranking ninth in the world, just above Germany and above the annual average of $26.6bn between 1999 and 2020[43]. In 2022, preliminary data for the first nine months of the year show that the 2021 total has essentially been reached and, according to Barclays, the target of $40bn for the whole of 2022 is within reach (Fig.7).

**Figure 7 - Foreign direct investment flows** (quarterly figure; $ thousands)




Source: SACE elaborations on Secretaria de Economia data (last data September 2022)

**The new fact of 2022**, emphasised by Barclays, **is that, compared to the previous decade, investment flows are not heavily skewed in favour of reinvesting profits, but half of them are made up of new investments, a sign that the nearshoring phenomenon is taking place, and this is happening even though the Mexican government is certainly not the most business-friendly in recent decades.** Moreover, the sectoral composition of investments confirms that these are aimed at productive purposes, as fifty percent is related to manufacturing, transport and logistics. Barclays estimate of increased Mexican exports isolates six product categories[44]: the additional export potential is an additional $147bn to the US compared to total 2021 flows ($386bn), which would translate into 38% growth.

Of course, there are also obstacles that may mean that this result will not be achieved: sub-optimal infrastructure investments, gaps on the educational side, weak rule of law and insecurity, Mexico real Achilles' heels. If it goes as predicted, 2022 will be the record year for foreign direct investment since 1999 - with the sole exception of 2013 ($48bn) - but it is too early to talk about a *Mexico moment*, because the risk is of a rude awakening as happened in the middle of last decade.

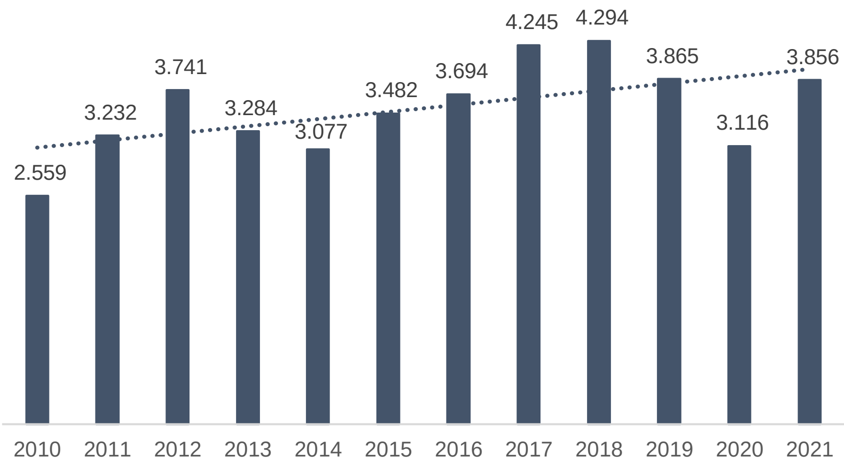
## Italy-Mexico trade (and institutional) relations: potential still partly untapped

**In 2021, Mexico was confirmed as the fourth largest destination market for Italian goods exports to the Americas, behind the United States, Canada and Brazil.** The total value of goods exported was €3.9bn, equal to 2019 levels and not far from the historical record of €4.3bn in 2018. Exports to Mexico have shown a net progression over the past decade, even considering the *annus horribilis* 2020 (Fig. 8). The data for the first

[41] Bloomberg Lìnea, *Nearshoring es una oportunidad única para México*, October 2022.
[42] Barclays, *Nearshoring: an epic opportunity for Mexico*, special report, November 2022.
[43] The starting year is 1999 because before 1999 the methodology of data collection by the Mexican authorities was different.
[44] Computers, telecommunications equipment, plastic products, footwear, clothing and furniture.

9 months of 2022 also show strong growth compared to the same period in 2021 (+48%), but in times of high inflation, comparisons should also be made in terms of volumes: the increase is confirmed, but much smaller in magnitude (+10%). If the flows of the last three months of the year confirm the rhythms of the previous months, 2022 will close with an all-time record in value for Italian exports to Mexico, around €5 billion.

**Figure 8 - Italian exports to Mexico from 2010 to 2021** (€ thousand)




Source: ISTAT

In the same period, Italian imports from Mexico did not show the same dynamics: imports started from a minimum of €0.6Bn in 2010, considering the aftermath of the Great Financial Crisis, and since then imports ranged between €0.9Bn and €1.3Bn, the maximum reached in 2015. This means that Italian trade surplus with Mexico, which was already significant in 2010, has grown further in absolute terms in recent years and now accounts for around 80% of the total trade surplus with Latin America. **Italian exports to Mexico are well diversified and this is not surprising given that the Mexican economy is the most complex on the subcontinent**. If in 2021 machinery was largely the sector in first place (31.6% of the total), many sectors were above 5% of the total: metal products, means of transport, chemical and pharmaceutical products, rubber and plastic, textiles and clothing, electrical equipment and other manufacturing. Imports from Mexico are also rather differentiated, since the largest share, belonging to machinery, is only 13%. **Compared to the other Latin American economies, towards which Italy either shows a slight trade balance surplus or deficits, Mexico does not have a strong dependence on raw materials and therefore it is not surprising that deficits are structural with a Country like Italy.** The same happens with Italian peers such as France and Germany, much less so with Spain, which has a smaller export base.

**SACE forecasts for 2023 and 2024 show further growth in our exports to Mexico, respectively +4.5% and +4%: this may contribute to the consolidation of Italy as the Country's second European supplier behind Germany**[45], a significant result considering the strong Spanish footprint in Mexico due to its colonial history and taking into account that Italian emigration to Mexico has been very limited compared to other Latin American contexts[46] .

**The further strengthening of the manufacturing sector expected in the next few years, accelerated by nearshoring, will lead to a growth in Mexican demand for intermediate goods. The main beneficiaries will be chemicals** (+5.2% on average per year in the two-year period 2023-2024), **rubber and plastics** (+4.1%) **and metals** (+4.3%). **Starting from a higher base, however, the increase expected for machinery**

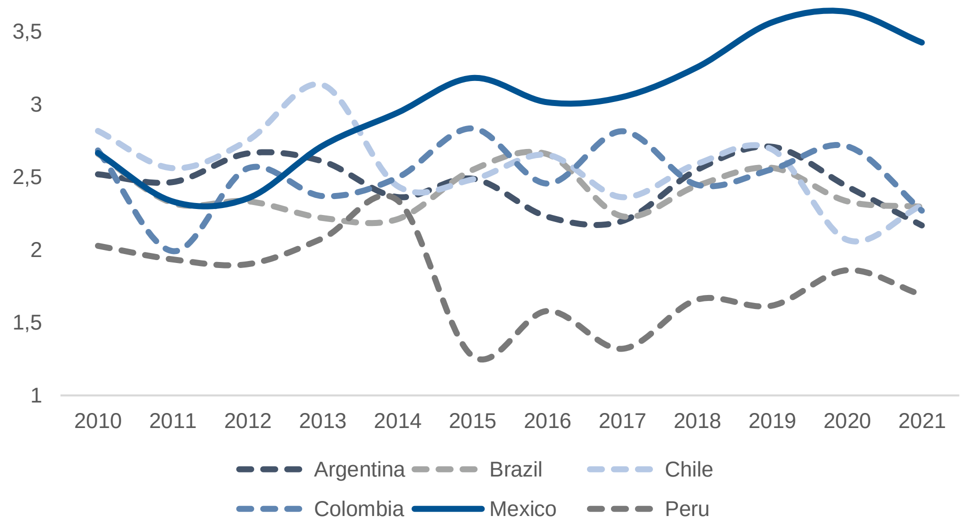
[45] See below for a comparative analysis of Italian and German export performance over the last decade.
[46] Centro Studi di Politica Internazionale (CeSPI), *America Latina: nuove tendenze in atto, vecchia e nuova emigrazione italiana*, Osservatorio di Politica Internazionale per il Parlamento italiano, March 2020.

(+3.7%) **will be significant**. The old and 'new' Mexican sectors will generate important opportunities, for example in the supply of machinery for the food industry for packaging and bottling, as well as in the supply of machine tools[47].

**Lastly, important opportunities will come from the food and beverage sector** (+4.4% on average): it is true that up to now it only accounts for 3% of Italian exports to Mexico, **but the probable forthcoming ratification of the updated free trade agreement between the EU and Mexico[48] could give a strong boost to our exports in the sector**, considering the recognition and protection of 340 typical European geographical indications (of which 64 are Italian) and the sharp cut in import duties on food and beverage products.

**Is there further room for growth? To analyse how Italy is positioned compared to its peers, we can consider the export flows from 2010 to 2021 between Italy and Germany, a Country that more than the others can be considered a benchmark at a European level for Italy because of the great similarities in their economic structure.** If we compare the export flows for the six major Latin American economies (Fig.9), we can see that, apart from Peru, which can be considered an outlier[49], in 2010 the starting point towards the other economies was between 2.5 and 3. Over the past 11 years, the ratio rose sharply only towards Mexico to 3.5 and the recovery in 2021 has been limited. It is true that in the case of Argentina and Brazil, Italy's historical and cultural ties are deeper, so a less unfavourable ratio is "natural", but in the case of Mexico the figure remains penalising. Data on the first nine months of 2022 seem to confirm a partial further reduction in the ratio, but it is too early to talk about a trend reversal.

**Figure 9 - Ratio between German and Italian exports to the six major Latin American Countries**




Source: SACE elaborations on data by ISTAT

It is therefore clear that Italy lost market share to Germany in the period under consideration while the same, if one tries to repeat the exercise, did not happen against France and Spain[50] . **How to structurally reverse this trend? One way, but not a shortcut, can be to enter more and more into the procurement of Mexican companies, especially medium-sized and large ones.** A role in this field can also be played by the financial-insurance tools made available by SACE, which has had a direct presence in the Country from the last decade (Box 1).

[47] MAECI, InfoMercatiEsteri, Country Profile Mexico, August 2022.
[48] European Commission, *The EU-Mexico agreement explained*.
[49] The lower ratio towards Peru is explained not so much by the relative strength of Italian exports but by the lower relative strength of German exports, particularly compared to Spain.
[50] The ratio between French and Italian exports to Mexico fluctuated between 0.62 and 1.01 between 2010 and 2021, without a defined trend; the ratio between Spanish and Italian exports ranged between 0.87 and 1.22 in the same period without a defined trend too.

**_SACE's role in deepening trade relations between Italy and Mexico_**

As part of the strengthening of SACE's commercial network abroad, the Mexico City commercial office was opened in 2014, the second in the Americas after the São Paulo office in Brazil, which has been operating since 2009. The stable presence in the second Latin American economy provided the opportunity to establish new relations with the local financial and entrepreneurial system as well as to create increasingly significant synergies with Italian institutional counterparts that have been present in the Country for a long time and to be able to better intercept the needs of Italian companies operating in Mexico and neighbouring geographies. In fact, the office's territorial competence is vast and does not stop at Central American and Caribbean Countries but extends to some South American economies bordering the Pacific Ocean, such as Colombia, Ecuador and Peru.

Over the years, the office has increasingly become a recognised point of reference and interlocutor for corporations from Mexico and neighbouring geographies seeking new opportunities to improve the supply chain. In addition to traditional export credit activities, SACE's Push Strategy programme, indeed, offers untied guarantees to corporate, financial or institutional entities with high creditworthiness. On the one hand, this represents an opportunity for these entities to explore new opportunities in supply chains and, on the other hand, through the business matching events organised by SACE in collaboration with Italian business associations, it facilitates the meeting between supply and demand and opens up new horizons for Italian companies, particularly SMEs.

Since 2018 to date, six transactions for total commitments exceeding €1.2bn have been finalised in Mexico with private and public counterparties, most recently, in 2022, the one with the Mexican Ministry of Finance (Secretaría de Hacienda y Crédito Publico, SHCP), the first of its kind in the Americas. In fact, in addition to transactions with private counterparties, the Push Strategy is suitable for public entities and aims to help small and medium-sized Italian companies get in touch with the vast articulation of ministries, departments, and companies controlled by and connected to central power. The aim is now to close Push transactions also in other target geographies such as Colombia and Peru.

**Lastly, even at the level of bilateral, institutional and trade relations, the presence is already important through the diplomatic network and the entities in charge on both the Italian and Mexican sides**. However, an important piece is still missing: there is no Mexican Chamber of Commerce in Italy, but not for long. Its forthcoming establishment can provide benefits to the Country's system and to Italian companies that want to seize the many opportunities that the Latin American country can offer them (Box 2).

**_The role of the Associazione Economica del Messico in Italia (AEMI)_**

AEMI was established on 28 October 2020 thanks to the efforts of the Embassy of Mexico in Italy, by a group of 9 founding members including companies and individual members. Just 24 months after its foundation, the Association boasts the support of 61 small, medium and large-sized companies from various industrial sectors ranging from energy to infrastructure, food & beverage, tourism, steel, automotive and aerospace, demonstrating that opportunities for exchange, internationalisation and cooperation between Italy and Mexico are possible for companies of all sizes and in a wide variety of sectors.

To define the Association's medium- and long-term objectives, in particular the one centred on the transformation into the first Mexican Chamber in Italy, AEMI decided to set up the tool of Thematic Commissions. These Commissions represent an instrument at the disposal of members and partners to share initiatives, projects, problems, solutions, and know-how through periodic meetings, to strengthen the bilateral relationship and provide guidance and contribution at the level of the Country System for the development of Italy-Mexico relations, also with the elaboration of *ad hoc* proposals for the Institutions. During the first two years of its life, three Commissions have been created in the areas of Technology, Agribusiness and Tourism. In 2023, the creation of the Circular Economy and Sustainability Commission is planned to help disseminate Italian corporate and industrial best practices to create synergies, new business opportunities and technological partnerships with Mexico. Among the first initiatives in this regard was the active participation in Ecomondo, the reference trade fair in Europe for circular economy and ecological transition held every year in Rimini, and which in July 2022 saw a first edition in Mexico in León, in the State of Guanajuato. AEMI is also involved in the organisation of the second edition of Ecomondo Mexico, which will take place in Guadalajara, in the State of Jalisco in April 2023.

The next goal is to set up the Chamber of Commerce of Mexico in Italy (CaMExItal) - the first in the history of Italy-Mexico relations -, a strategic tool needed to strengthen and make structural exchanges and relations between the two Countries. The CaMexItal will have the ambitious task of promoting industrial, commercial, cultural, touristic, scientific and academic ties between Italy and Mexico with a full-ranging multidisciplinary approach, and to provide guidance and contributions also with the elaboration of *ad hoc* proposals for institutions. The achievement of the goal, expected in the first quarter of 2023, represents a fundamental milestone for the development of Italy-Mexico relations at the Country System level.

*We would like to thank AEMI for its contribution and cooperation in the realisation of the Focus.*