



PIIE BRIEFING 21-4

Bringing Supply Chains Back to Mexico

Opportunities and Obstacles



Jeffrey J. Schott and Matthew P. Goodman, editors

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Foreword

John J. Hamre and Adam S. Posen

COVID-19 has reinforced a trend toward economic decoupling from China. Foreign companies operating in China face recurrent discrimination, mounting pressure from the US government to leave, and an understandable need to diversify supply chains geographically. There is also a growing desire in the business community to create more resilient supply chains, in part by expanding outside of China. This set of forces raises questions around the feasibility and benefits of nearshoring or reorienting US supply chains to North America, and whether or how that should be promoted.

The challenge in any nearshoring scenario is finding trusted partner countries that can provide an alternative to production in China and simultaneously allow for the creation of resilient supply chains. The most promising candidate for large-scale nearshoring is Mexico, due to its geography, existing high level of economic integration with the United States, and participation in the high-standards United States-Mexico-Canada Agreement.

Significant concerns remain, however, about Mexico's viability as a nearshoring location. Even before the COVID-19 pandemic buffeted Mexico's economy, an array of structural impediments—including trade barriers, regulatory rigidities, energy sector interventions, and inadequate intellectual property protection—had impeded Mexico's attractiveness as an investment destination. The Biden administration has made progress in the important area of labor reforms, thereby making an expansion of US supply chains in Mexico politically viable. The Biden administration, however, has so far shown little interest in engaging constructively with the administration of Andrés Manuel López Obrador on broader improvement of Mexico's trade and investment climate. Labor reforms are necessary but not sufficient to get the United States and Mexico to the win-win outcome on both economics and security of reshoring from China to North America.

In a collaborative effort to explore the feasibility and benefits of relocating production to Mexico, the Center for Strategic and International Studies (CSIS) and the Peterson Institute for International Economics (PIIE) organized a group of leading scholars and former officials to offer their individual perspectives in the collection of short essays that follows. The authors set out the case for a shared Mexican and US interest in building resilient supply chains in North America and prioritizing the economic policies Mexico needs to succeed as a destination for relocated production from China. The essays also explore how the United States, which has tended to focus too narrowly on border and migration issues in its bilateral agenda, can encourage the needed policy changes in Mexico. So doing would in turn deepen North American economic integration and enhance US and Mexican competitiveness.

We are delighted by the results of this collaboration and hope this collection stimulates further constructive policy debate in the United States and Mexico on these important questions. The Peterson Institute and CSIS are grateful to Chubb Ltd. for its support of this project.

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1 Can Mexico Help Bring Supply Chains Back to North America?

Jeffrey J. Schott

International trade and investment have been buffeted over the past three years by US-China trade war tariffs, high-technology export controls, and other economic sanctions targeting Chinese policies. The COVID-19 pandemic has further disrupted production and created bottlenecks transporting goods within and between countries. International businesses have had to recalibrate their supply chains to make them more resilient to these and other shocks.

Firms needing to diversify from China, in whole or part, because of rising Chinese costs and mounting trade and investment restrictions are now considering whether to reorganize production across Asia to complement continuing Chinese operations or to shift investment out of Asia to shorten supply chains serving the US market. Mexico seems like a natural choice for “nearshoring” investment, linked closely to the dominant US market by the newly minted United States-Mexico-Canada Agreement (USMCA).

But so far at least, Mexico has not lured substantial new investments that could supplant Asian production serving the US market, and the USMCA has added rather than removed concerns about investing in Mexican auto and other manufacturing sectors. The evidence cited in this Briefing suggests that Mexico faces significant competition for investments in restructured supply chains. Compared with other leading nearshoring locations in Asia and North America, Mexican policies tend to discourage new placements in manufacturing sectors. Another handicap flows from the flaws in the USMCA that work to Mexico’s disadvantage and favor new investment in US-based production of autos, trucks, and parts. As a result, Mexico cannot rely on its North American partners to finance its development and promote its effort to become a nearshoring hub for supply chains migrating from East Asia. To attract more investment diversifying out of Asia, Mexican officials need to recast domestic economic policies and recommit to combating corruption and organized crime to make Mexico more attractive to domestic and foreign investors.

BENCHMARKING MEXICO’S COMPETITIVENESS FOR FOREIGN DIRECT INVESTMENT

When companies plan their production and trade strategies, they benchmark their strengths and weaknesses against key competitors. Countries whose economic development depends on trade and foreign direct investment (FDI) should do the same. To that end, table 1 arrays Mexico’s global ranking under three separate indices compiled by the Fraser Institute in Canada, the World Intellectual Property Organization (WIPO), and Transparency International

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(TI) that assess critical factors that influence locational decisions for private investment. Each of the groups compiles data on numerous indicators covering Mexico's performance with respect to its business regulations, infrastructure, international trade ties, legal system, and corruption.

Table 1
Benchmarking Mexico's competitiveness for foreign direct investment

Country/Region	Overall Ranking		Business Regulations		
	<i>Economic Freedom of the World Index^a</i>	<i>Global Innovation Index^b</i>	<i>Credit market, labor, and business regulations^c</i>	<i>Ease of starting a business</i>	
North America	United States	6	3	5	48
	Canada	9	17	6	3
	Mexico	68	55	79	83
Asia	Malaysia	46	33	11	97
	Taiwan	16	n.a.	26	n.a.
	Thailand	88	44	105	43
	Vietnam	125	42	102	88
	China	124	14	130	25
	Infrastructure	International Trade			
	<i>Electricity output, kWh/million population</i>	<i>Freedom to trade internationally</i>	<i>Trade, competition, and market scale</i>		
North America	United States	9	62	1	
	Canada	5	48	13	
	Mexico	66	67	14	
Asia	Malaysia	38	70	28	
	Taiwan	n.a.	71	n.a.	
	Thailand	67	98	25	
	Vietnam	76	120	49	
	China	45	112	3	

		Legal System		Corruption
		<i>Legal system and property rights</i>	<i>Rule of law</i>	<i>Corruption Perceptions Index^d</i>
North America	United States	20	19	25
	Canada	11	12	11
	Mexico	93	106	124
Asia	Malaysia	62	38	57
	Taiwan	25	n.a.	28
	Thailand	116	63	104
	Vietnam	99	64	104
	China	86	72	78

n.a. = not available

a. Economic Freedom of the World Index covers 162 jurisdictions, ranked from 1 (best) to worst.

b. Global Innovation Index ranks the innovation ecosystem performance of economies using 80 indicators. It ranks them from 1 (best) to worst.

c. Simple average of three subcategory scores.

d. Corruption Perceptions Index ranks 180 countries and territories from 1 (best) to worst by their perceived levels of public sector corruption according to experts and businesspeople.

Sources: Fraser Institute, Economic Freedom of the World 2020, data for 2018 (accessed on August 15, 2021 at <https://www.fraserinstitute.org/economic-freedom/dataset?geozone=world&year=2018&page=dataset&min-year=2&max-year=0&filter=0>); Global Innovation Index, Economy Profiles (accessed on September 1, 2021 at <https://www.globalinnovationindex.org/analysis-economy>); Transparency International, Corruption Perceptions Index 2020 (accessed on September 1, 2021 at <https://www.transparency.org/en/cpi/2020/index/nzl>).

Overall, Mexico's scores place it in the middle of the pack of countries covered by the two broad indices compiled by the Fraser Institute and WIPO, but in the bottom third of countries examined in the TI Corruption Perceptions Index. Compared with its USMCA partners or key competitors in southeast Asia—the markets Mexico competes with for investments by companies that are restructuring their Asia-Pacific supply chains—Mexico does not fare very well.

In North America, commitments to support nearshoring to Mexico, discussed most recently at the September 9 High Level Economic Dialogue between senior US and Mexican officials, pale in comparison to the actions taken by US politicians to promote reshoring to the United States. Legislation in the current Congress is replete with programs designed to encourage new investment in US-based production plants through both subsidies and Buy American procurement regulations. These bills are meant to reinforce Executive Order 14017 on “America’s Supply Chains” issued by President Joseph R. Biden Jr. on February 24, 2021. Although Biden committed to “close cooperation on resilient supply chains with allies and partners who share our values”, the subsequent White House report on critical products concluded in June 2021 noted that international cooperation was only needed “to secure supplies of critical goods *that we will not make in sufficient quantities at home* [emphasis added].”

For companies diversifying some of their production or sourcing from the Chinese market, southeast Asia provides a nearby and largely welcoming investment alternative. Malaysia, Vietnam, and Thailand score higher overall than Mexico on the Global Innovation indicators; so, too, do Taiwan and Malaysia on the Economic Freedom of the World Index. Mexico's rating on business regulations and infrastructure raise yellow flags for prospective investors, as do its weak scores on legal protections, which align with its dismal TI grade on corruption. And while Mexico benefits from preferential market access to its major export markets and is highly graded for the USMCA and other free trade agreements (FTAs), its success in securing FTAs is now being matched by a wave of new intra-Asian trade pacts, including the soon-to-be implemented 15-member Regional Comprehensive Economic Partnership (RCEP).

Simply put, Mexico needs to outcompete its USMCA partners and southeast Asian competitors if it is to benefit from new investments in manufacturing shifting from Asia. Even with a labor cost advantage compared to its USMCA partners, the added production and distribution costs associated with intrusive Mexican business regulations, inadequate and irregular power supplies, and clogged road and rail networks, could well erode the benefits for those considering new investments in Mexico. Indeed, these costs already seem to be a drag on decisions to switch investments to Mexico.

FOREIGN DIRECT INVESTMENT IN MEXICO

Mexico's relatively weak standing in the Fraser Institute, WIPO, and TI indicators rating the business environment created by a country's trade and investment policies, and legal systems, seems to be reflected in inflows of FDI into Mexico over the past few years. Except in 2020, when global activity declined sharply, annual inflows of FDI in Mexican manufacturing have not grown very much, averaging about \$15.8 billion in 2018-2019 and slightly less on an annualized basis in the first half of 2021. Total FDI inflows are up on an annualized basis in the first half of 2021 due to strong catch-up growth in services (see table 2).

The majority of FDI inflows to Mexico since 2018 have been in service sectors, led by financial and insurance services. Manufacturing accounts for about 47 percent of total FDI inflows. The bulk of FDI in manufacturing is in transportation equipment (cars, trucks, parts), which covers about 46 percent of total Mexican FDI in manufacturing, much of which is from North America and Europe.

If Mexico was succeeding in nearshoring supply chains in manufacturing, it would likely be seen in supplements to sectors where Mexico already has attracted FDI, or previously had operations that subsequently moved to China or elsewhere in Asia: machinery and equipment; computer, communications, measurement devices; and transportation equipment. The machinery and equipment sector is recording FDI inflows equal to 2018 levels, and FDI in computers et al. is down by more than half. Transportation equipment FDI seemed to be recovering from sharp drops in 2020 until the second quarter of 2021, perhaps reflecting auto industry concerns about the future of Mexican-based production. If trends in FDI data for 2021 continue, concerns about increasing COVID-19 cases and restrictions on future access to the US market

resulting from US regulations interpreting the USMCA auto and truck content requirements could dampen investment in this critical sector for Mexican economic growth.

Table 2
Foreign direct investment inflows in Mexico (millions of US dollars)

Sector/subsector	Total 2018	Total 2019	Total 2020	2021Q1	2021Q2	Total 2021
Mining	1,641.9	1,899.7	1,293.4	1,651.6	845.0	2,496.6
Manufacturing	15,702.2	15,975.4	10,632.8	5,703.1	1,778.8	7,481.9
Beverage industry	783.9	1,943.0	819.8	294.2	300.3	594.5
Chemical industry	706.9	1,817.4	869.4	662.2	-224.5	437.8
Rubber and plastic industry	1,083.1	852.4	688.0	214.4	26.0	240.4
Machinery and equipment	577.4	250.0	535.5	138.5	145.0	283.5
Computer, communication, measurement, and other equipment, electronic components and accessories	1,512.0	507.9	797.7	257.4	70.6	328.0
Transportation equipment manufacturing	6,826.9	7,365.6	4,236.8	1,901.0	1,170.2	3,071.2
Commerce (wholesale/retail trade)	2,887.2	3,238.3	2,302.7	1,526.0	67.9	1,593.9
Transport, postage, and storage services	1,330.6	870.5	2,757.6	146.5	1,756.7	1,903.2
Telecommunications and other information services	1,122.1	1,808.2	1,240.0	97.4	321.2	418.6
Financial and insurance services	2,396.7	5,494.0	6,477.9	1,832.6	298.5	2,131.1
Other	8,849.0	4,921.0	2,907.4	1,520.7	887.4	2,408.1
Total	33,929.7	34,207.2	27,611.8	12,478.0	5,955.5	18,433.5

Source: "Información Estadística De La Inversión Extranjera Directa." Datos Abiertos (accessed on September 1, 2021 at <https://datos.gob.mx/busca/dataset/informacion-estadistica-de-la-inversion-extranjera-directa>).

THE USMCA DISADVANTAGE

North American economic integration has been driven for three decades by the idea that investing in Mexico and integrating production across the region would enhance the growth and international competitiveness of all three countries. The North American Free Trade Agreement (NAFTA) fell short of its promise and most of the southern Mexican states benefited very little from the increased regional trade and investment. Labor-intensive Mexican industries serving the US market decamped to Asia in NAFTA's first decade as Mexico's tight monetary policies fueled an overvalued peso and undercut competitiveness vis-à-vis China and others.

The USMCA changed the vision of deepening intraregional production networks. For political reasons, it was designed to differ markedly with its predecessor; the major change involved rules governing production of autos,

trucks, and parts, and complemented the Trump administration's efforts to reshore supply chains to US-based facilities (including some production from Mexico). Concerns about the deal, and its potential negative impact on auto sector investment in Mexico, initially were dismissed by Mexican officials. But when US regulations setting the terms for assessing domestic content requirements to qualify for USMCA preferences were issued in the summer of 2020, it became clear to auto industry and Mexican officials alike that the deal would require much more restructuring of auto and truck production, and shifting to US-based facilities, than they initially thought. The issue is in the early stages of USMCA dispute settlement; in the interim, Mexican producers face an uncertain future.

The USMCA, negotiated under the threat of US withdrawal from NAFTA, was hailed for removing the cloud of uncertainty about the future of regional economic integration. Longstanding critics of NAFTA supported the new pact whose future now seemed politically secure. Investors saw the new political support for regional integration, or rather the decline in criticism of the pact, as a positive sign that Mexico would be an attractive host for nearshoring investment from Asia. But the dispute over auto content rules, and a spate of new disputes on labor, environment, energy, and agricultural issues, brought under the USMCA's enhanced enforcement procedures, has reopened questions about the durability of the pact's political honeymoon in Mexico and the United States.

In sum, the USMCA does not seem to have accorded Mexico substantial advantages for nearshoring manufacturing investment from Asia. The pact reopens old conflicts and offers new avenues for trade retaliation. But the main obstacle to Mexico's success in attracting new investment is homemade. Mexican officials should take a closer look at how their policies compare to those of leading competitors and recalibrate to build back Mexico better.

2 Competition with China Is in the Realm of Ideas: Will Mexico Participate?

Luis de la Calle

In 2000, China became a member of the World Trade Organization (WTO) after more than fourteen years of negotiations. Many countries feared it would flood markets with low cost and low-quality consumer products, particularly in the apparel, footwear, and textile sector. Not surprisingly, Mexico was one of the countries most worried about Chinese membership in the WTO, and thus carried out tough negotiations for the accession protocol.

Exponential Chinese growth after it joined WTO increased competition with Mexico significantly, both in the goods and investment markets, not only in the United States but also in Mexico. Light manufacturing suffered the most as Mexican producers were displaced by Chinese competitors in the United States and in the domestic market (despite the tough entry conditions imposed on China). Incredibly, the original North American Free Trade Agreement (NAFTA) negotiations did not take into account the potential Chinese expansion and, for political reasons, the agreement tried to over protect light industry (textiles, apparel, footwear and others) with tough rules of origin requiring that goods be manufactured in North America to qualify for trade preferences. These rules would become a significant obstacle for North America to successfully compete with producers from across the Pacific. The rules left regional producers with scant access to the necessary inputs to develop portfolios of final goods attractive to consumers. At the same time, the reverse phenomenon happened in China, where exporters had an ample choice of inputs at very competitive prices. In this manner, these rules and countervailing duties imposed in North America against Chinese sourcing of steel, fibers, fabrics, and other inputs became a perverse incentive to integrate supply chains in China and not North America.

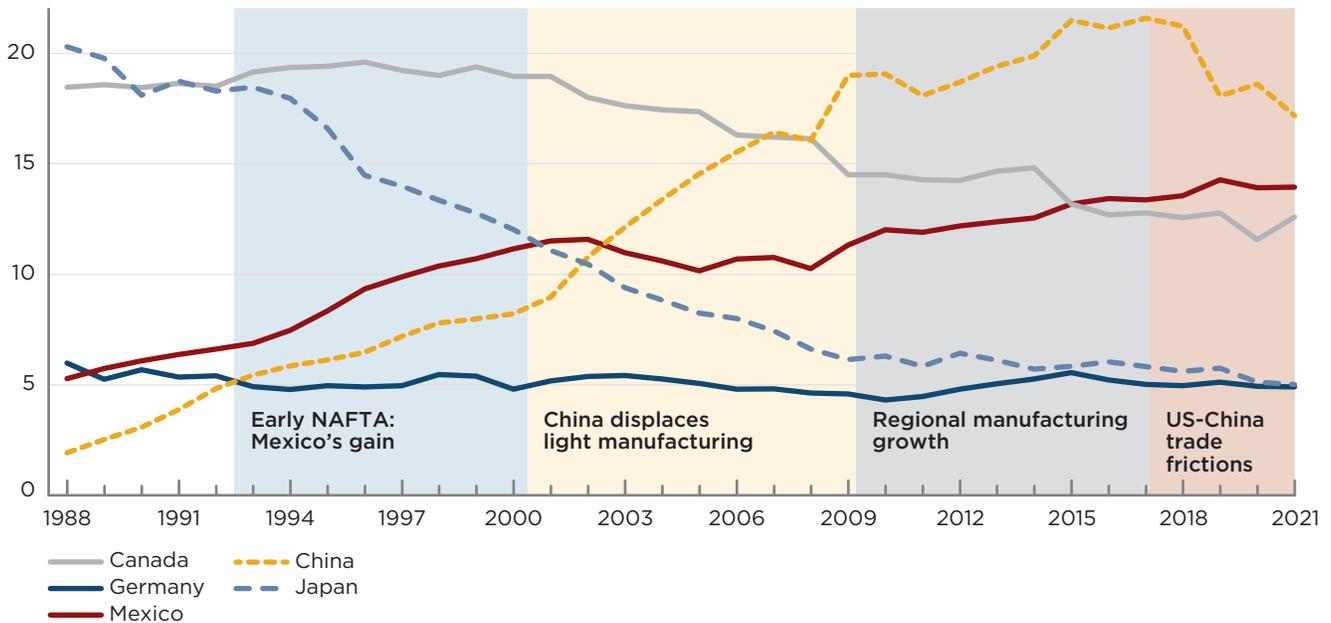
Mexico's less competitive exchange rate after 1995, combined with and China's dynamism, meant that Mexico lost market share in the United States during the first ten years after China's WTO accession. The trend began to revert to a growing Mexican market share as a consequence of the 2008–09 financial-economic crisis, which led China to complement its export-based strategy with inward sources of growth. China also accelerated its quest for technological innovation, realizing that sustainable growth could not be achieved simply by reallocating labor from rural to industrial areas. China recognized that massive investment in technology was essential to enhance productivity. This shift of priorities implied competition not only with the US Midwest, the Carolinas and Mexico for manufacturing, but also with California and other high-tech states. Figure 1 shows these trends based on market shares of total US imports. China's

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loss of market share from 2017 reflects the growing trade disputes with the United States and the search by investors for strategies to diversify exposure to Chinese risk.

Figure 1
Top trading partners' market shares in the United States

share of total US imports (percent)



Note: Figures for 2021 are cumulative until June.
Source: US Census.

Even though President Donald Trump focused the debate over China on the trade deficits, the underlying reason for the bilateral friction has been technology: brains, no longer brawn. If the success of NAFTA was opening regional trade and investment in industrial sectors and then agriculture and agro-industrial goods, the test of the new US- Mexico-Canada Agreement (USMCA) will depend on growth in the technological and digital sectors. If Mexico wants to become a preferred investment destination, it must position itself as a technological player that also offers excellence in logistics and energy.

In the last two decades, China has received a significant percentage of global foreign direct investment flows. Many companies invested resources for manufacturing in China, lured by the country's competitive costs, access to abundant and varied supply chains, a talented workforce, and growing export and domestic markets.

These large investment flows came with heightened exposure to Chinese risk, which was exacerbated by Trump's trade war. Investors realized they needed to reduce that risk by diversifying their supply chains away from China. Their motivation is not only economic, but also geopolitical. Technological competition between China and the United States is not a temporary phenomenon, but rather structural. Of course, Mexico can be one of the leading candidates to position itself as a key player in the diversification process and to signal that a deeper

North American integration is key for regional competitiveness. But the Mexican government would have to revise economic priorities to achieve that goal and successfully implement the USMCA.

Mexico should undertake strategic steps to successfully compete in the nearshoring environment and to further North American integration:

- *Investing in logistics.* Investments should include rail, airport, and port networks but also, importantly, facilities to improve efficient border crossing. Unfortunately, some of President Andrés Manuel López Obrador's decisions concerning transport infrastructure (such as the cancellation of the Mexico City airport), the frequent discouragement of private investment in the transportation sector and constant blockade of railways are not conducive to excellence in logistics.
- *Adopting a comprehensive strategy to link Mexico's southern states to the East Coast in the United States via regular maritime services* between Coatzacoalcos, Veracruz and Mobile, Alabama and between Progreso, Yucatán and Saint Petersburg, Florida. Mexican exporters have a relatively low market share in the East Coast and thus the potential for growth is significant. If President López Obrador really intends to help southern states that did not benefit from NAFTA as much as other states, developing logistic lines through the Gulf of Mexico makes eminent sense. His much-vaunted Tren Maya, the thousand-mile inter-city rail line currently under construction in the Yucatan peninsula, if used for cargo, could be a contributing factor. Longer term, an exemption from the Jones Act, which requires that only US ships conduct cabotage between US ports, could also become a huge asset for the Gulf of Mexico.
- *Investing in the digital sector.* Competition with China will depend not on which economic bloc has the absolute cost advantage, but rather on [where the products of the future will be designed](#) and their standards set. Manufacturing will not succeed if products do not incorporate the internet of things. Competitive cars, for example, will not be electric, but rather electronic—in effect, tablets on wheels that will communicate with passengers, destination points, road infrastructure, tolls, police, energy sources, other cars, complementary transportation modes, and many other digital widgets. (The stricter USMCA rules of origin for cars, requiring large percentages of cars to be made in North America to qualify for preferential trade treatment, might prove, again, an obstacle). To be successful, Mexico must invest in creative human capital as never before (engineers, programmers, doctors, nurses, designers) and embrace robotics, nanotechnology, artificial intelligence, and the digital economy. The timing of López Obrador's anti-research anti-technocratic bias is unfortunate.
- *Promoting integration of regional content in North America's supply chains through an integrated energy market.* The main manufacturing components (steel, aluminum, glass, fiber glass, petrochemicals, synthetic fibers, and others) are all energy (mostly natural gas) intensive. North America has a significant comparative advantage in this area. Moreover, a diversified

energy matrix, including a significant growing role for renewables, and the advantages of proximity will prove a significant incentive for richer supply chains better able to compete against Asia's.

- *Making rule of law a priority.* Longstanding insecurity is rooted in corruption and poor enforcement, resulting in impunity for lawbreakers. Mexico must recognize the [importance of a solid legal system](#) and the rule of law not only in terms of justice and human rights, but also as a comparative advantage vis-à-vis China and other competitors. With a proper legal environment, investment flows would be much larger and growth possibilities brighter. These goals require a commitment to invest in institutional capacity to advance Mexico's comparative advantages: municipal and state capabilities to welcome investment, protection of intellectual property to encourage creativity, transportation regulators for safe tourism, sound sanitary institutions for agro-industrial and medical devices exports as well as for medical tourism, procompetitive energy market regulators, and strong antitrust enforcement to ensure that market benefits reach everybody.

Only growth and wealth creation overcome poverty. But it is ideas and innovation, and not capital accumulation or long work hours, that make growth truly possible. And ideas flourish in an environment of freedom, equality, and [respect for others](#): precisely the competitive advantage of liberal democracies with respect to China. In the end, Mexico's contribution to itself and to North American competitiveness hinges upon establishing such an environment.

3 The US-China Tariff War Diverted Trade to Mexico, But Not By Much

Mary E. Lovely and David Xu

After undertaking significant unilateral liberalization of its trade and investment regimes, Mexico's President Carlos Salinas de Gortari stood beside US President George Bush in June 1990 to announce their intention to negotiate a free trade agreement, an effort that eventually resulted in the 1992 North American Free Trade Agreement (NAFTA). The Mexican president viewed a trade agreement with the United States as a way to attract foreign investors to Mexico (Mayer 1998). Since its signing, NAFTA did promote Mexico's integration into regional supply chains, enhancing its advantages as a lower-wage location for manufacture and assembly within a few days' drive of major American markets. Today, about 80 percent of Mexican exports are delivered to its northern neighbor.

Despite the importance of the United States for Mexican exporters, US imports from Mexico have been eclipsed by imports from China. Like many countries seeking to play larger roles in global supply chains, Mexico competes with China in most of the products that it sells to the United States. Mexico surpasses China in its US sales of transportation equipment, its second most valuable export bundle. However, Mexico's US sales of machinery and electrical equipment, the sector that provides the largest share by value of Mexican exports to the United States, are only about one-quarter of American purchases of these products from China.

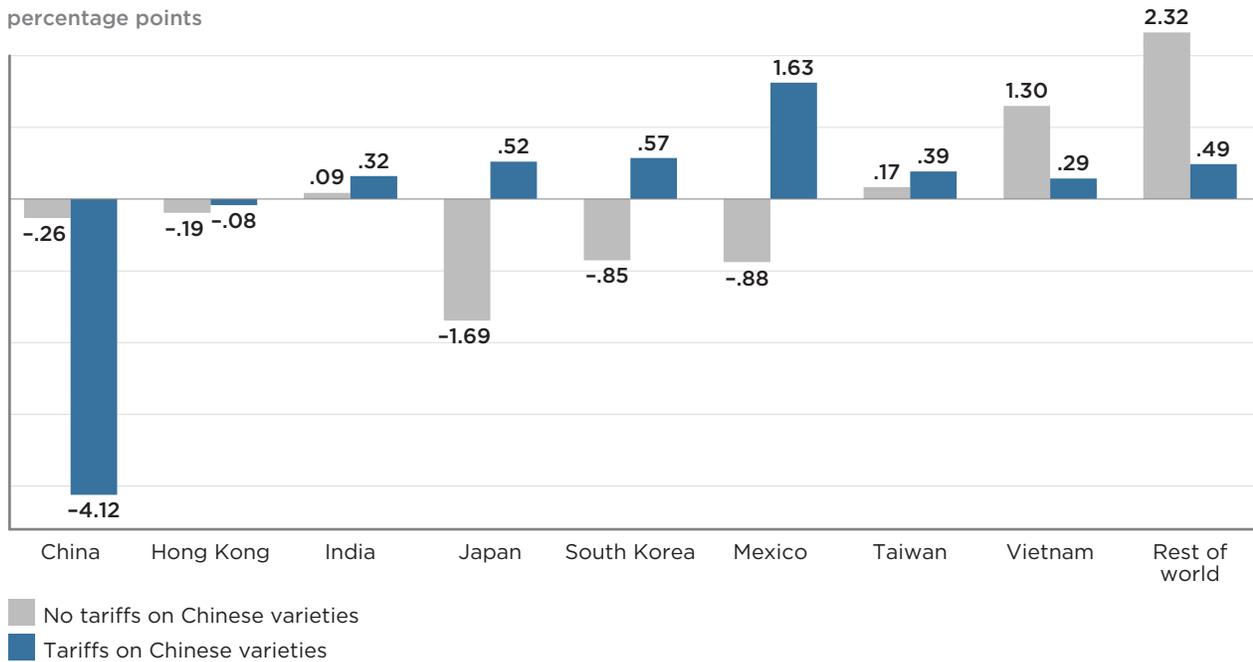
The US-China trade war provides an opening for Mexican exporters. By the end of 2019, the United States had levied average duties of almost 20 percent on almost two-thirds of its imports from China (Bown 2021). These tariffs reduced the value of US imports of taxed Chinese products by an estimated 32 percent (Fajgelbaum et al. 2020). If China's cost advantages were less than these high tariffs, Mexican exporters should have been able to catch some of the sales diverted by the high American tariffs. This chapter presents research indicating that as a result of US tariffs on goods from China, Chinese imports were partially replaced by other suppliers, with Mexican benefiting—but only marginally.

A comparison of import patterns before and after the levying of tariffs during the US-China trade war indicates significant shifts in the market shares of US trade partners. Figure 1 shows change in market share for a selected set of trading partners, dividing imports into two groups—those on which the United States levied tariffs on Chinese varieties and those on which the United States

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did not.¹ Among goods subject to trade war tariffs, China’s share of the US market fell by 4.12 percentage points. For the same set of products, Mexico’s market share rose by 1.63 points and Korea’s share rose by 0.57 points. No other partner gained more.

Figure 1
Changes in US import market share, by product group and trading partner
 percentage points



Note: Changes in market share reflect change in each partner’s average US import market share during the period July 2016–December 2017 and the period July 2018–December 2019.
 Source: Calculated by authors using data from the US Census Bureau.

Of course, this comparison does not control for any confounding trends that may drive partner market shares up or down in any given period. That market factors and shocks influence trade shares can be seen by the substantial movement in the market shares for goods not taxed during the trade war in figure 1. Simple market share averages may also hide heterogeneity in the experience of different export sectors driven by the timing and design of US tariff policy.

In related research, Lovely, Xu and Zhang (2021) use highly detailed US import and tariff data to investigate the determinants of changes in imports from alternative sources.² This research has found a statistically significant relationship

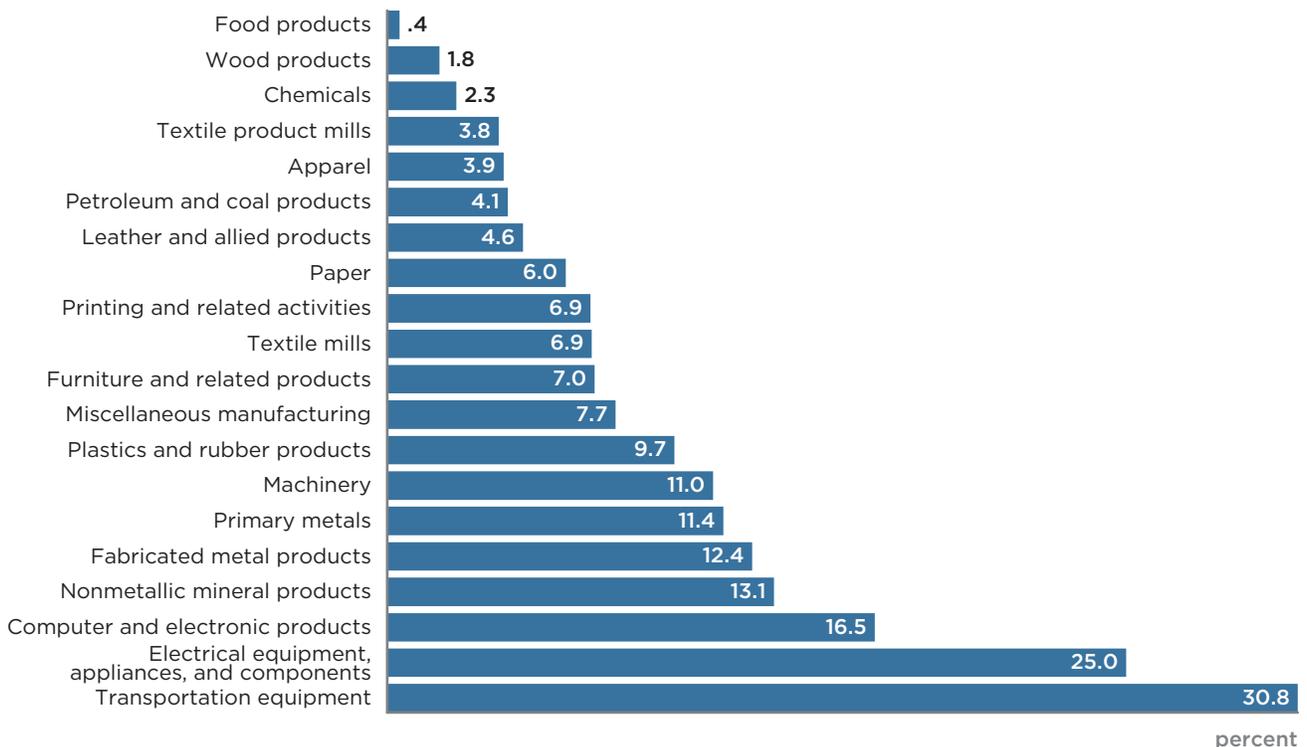
1 Figure 1 shows market share changes aggregated up from changes at the HS10 level of disaggregation. It compares market shares for the 18-month period before the start of the US-China trade war (July 2016–December 2017) with the 18-month period after the second trade battle (July 2018–December 2019). The Harmonized Commodity Description and Coding System, also known as HS codes, is an internationally standardized system of names and numbers to classify traded products. Members of the World Trade Organization apply a common 6-digit classification to facilitate cross-border monitoring, taxation, and regulation. Further disaggregation is possible at the country level, and the United States uses a 10-digit classification system in its Tariff Schedule.

2 Lovely, Xu, and Zhang (2021) examine month-to-month changes in US imports over the period 2017:1 to 2019:12, for the universe of countries and HS10 products.

between prior non-Chinese sales in the United States and subsequent increases in US imports diverted by trade war tariffs. The authors argue that a country that does not export a particular product to the United States cannot suddenly become an exporter of that good when the United States places a tariff on China. Instead, US importers switch their purchases to incumbent untaxed sources that are already active in the US market.

Because it supplied a substantial share of US imports in some sectors, Mexico was well placed to benefit from the trade war with China. Figure 2 shows the Mexican share of US manufactured goods imports by NAICS sector in 2019.³ Immediately apparent are the large import shares Mexico provides in the transportation equipment (31 percent), the electrical equipment (25 percent) sector, and the computer and electronic products (17 percent). These are sectors in which multinational firms have invested in Mexican factories and formed relationships with Mexican subcontractors. Indeed, as noted by Jeffrey J. Schott in chapter 1 of this Briefing, about 46 percent of total manufacturing foreign direct investment into Mexico since 2018 (through first half of 2021) flowed into the transportation equipment sector.

Figure 2
Mexico's share of US manufactured goods imports, by NAICS sector, 2019



NAICS = North American Industry Classification System

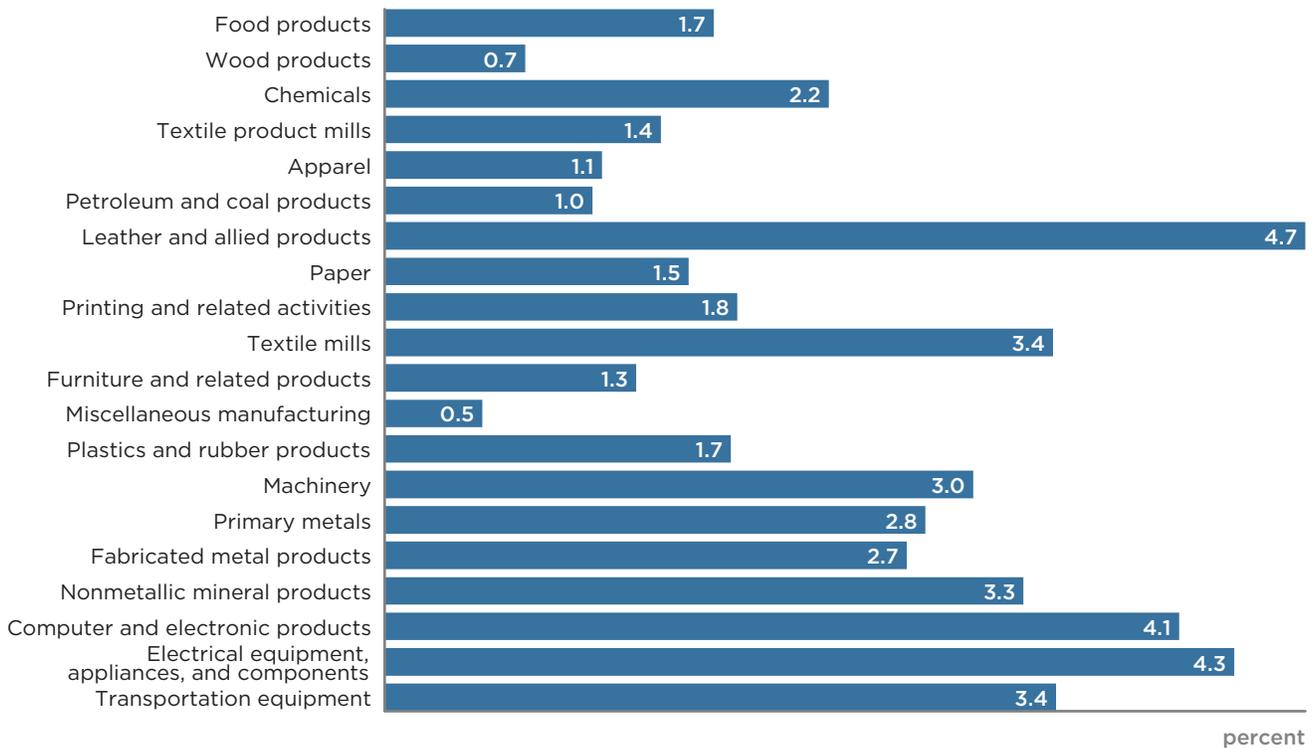
Source: Calculated by authors using data from the US Census Bureau.

³ NAICS is an acronym for the North American Industrial Classification System. It is the system used throughout North America to classify business establishments.

To estimate gains made by Mexican exporters in the US market because of US tariffs placed on Chinese exports during 2018 and 2019, the method of Lovely, Xu, and Zhang (2021) is adopted in this chapter, with the application of regression analysis to highly detailed monthly US import data. This analysis implies that if the United States raises its tariff on China by 10 percentage points, a country with a preexisting 10 percent share of the US market for that product would expect to see a 0.46 percentage point increase in the value of its exports of that product to the United States. Applying this formula to the actual tariff changes and Mexican import shares, the value of Mexico's imports to the United States is estimated to have risen 3.4 percent resulting from the China trade war.

There is substantial variation across sectors in estimated US import increases. Figure 3 provides these estimated gains in import values by NAICS sector. The sector that experiences the largest gain is leather products, with an estimated increase in the value of US imports from Mexico of 4.7 percent. As seen in figure 2, Mexico supplies less than 5 percent of American leather product imports. However, the United States applied high tariffs to all hides and skins coming from China and about half of footwear, the two main segments of this sector (Bown 2021). Some of these sales were diverted to Mexico. As expected, given their large initial presence in the US market, imports from Mexico of transportation equipment (3.5 percent), electrical equipment (4.4 percent) sector, and computer and electronic products (4.1 percent) also rose substantially.

Figure 3
Estimated monthly change in US imports from Mexico, by NAICS sector, 2019



Source: Calculated by authors using method described in Lovely, Xu, and Zhang (2021), Mexico's US import market shares, and actual tariff changes.

The analysis presented here finds that US imports from China taxed during the US-China trade war were partially replaced by other suppliers. Mexico benefited from this shift in US imports, although the sales increase was relatively small in most exporting sectors. In the aggregate, the analysis implies that Mexican sales in the US market rose by 3.4 percent, led by leather products and electrical equipment.

There are some reasons to believe that over time Mexican exporters will increase their share of the US market further. During the Trump administration, the phase one agreement with China, in which China committed itself to purchase \$200 billion worth of goods in the two-year period 2020 and 2021, gave some hope that the US tariffs on China would be rolled back. That belief or hope may have delayed movement of US importers away from their Chinese suppliers. Second, many trade relationships are based on costly investments to locate foreign suppliers and coordinate on product design and production. The longer the United States maintains its China tariffs, the more likely it is that new relationships can form. As other chapters in this Briefing suggest, however, Mexico continues to lag as a location for US investment and these structural impediments may limit its ability to make further gains in the US market.

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4 The Past Is Dragging Mexico Away from a Prosperous Future

Mariana Campero

Given Mexico's proximity to the United States, lower labor costs, existing manufacturing base, and a revamped North American Free Trade Agreement, the country should be reaping the benefits of nearshoring of production away from China. Yet, these "incentives" have not been enough for companies to include Mexico high on their list as they think about supply chain diversification and resiliency. In fact, the value of new greenfield foreign investments in 2020 **dropped** to \$13.7 billion from \$27.9 billion in 2019.

INVESTORS FEAR UNCERTAINTY

Figure 1 shows private investments dropped significantly after then president elect, Andrés Manuel López Obrador (popularly known as AMLO) canceled the Mexico City airport project, which was already under way. The new airport would have tackled shortcomings in the country's transportation and logistics systems and, some experts estimate, would have **quadrupled** Mexico's passenger capacity. Since then, private investment, amid uncertainty about the new rules of the game, has **continued to decline**, made worse by the COVID-19 health crisis, dropping to 19 percent of GDP in 2020—from 21 percent in 2019 and 23 percent in 2018.

For the second consecutive year, global consulting firm AT Kearney removed Mexico from its 2021 Kearney **Foreign Direct Investment Confidence Index** of the 25 most attractive countries in the world for foreign investors. As **Ricardo Haneine**, managing partner of AT Kearney, says, "Mexico needs to refocus its efforts to regain investor confidence." Among the key factors cited by Kearney were Mexico's low economic growth; proposal to ban outsourcing of jobs by private companies without prior government authorization; cancellation of the Mexico City airport project; prioritization of projects with limited capacity to spur economic growth or create jobs, such as the new Pemex refinery, the Santa Lucía airport terminal, and the Maya Train; and reversal of the 2013 energy reforms.

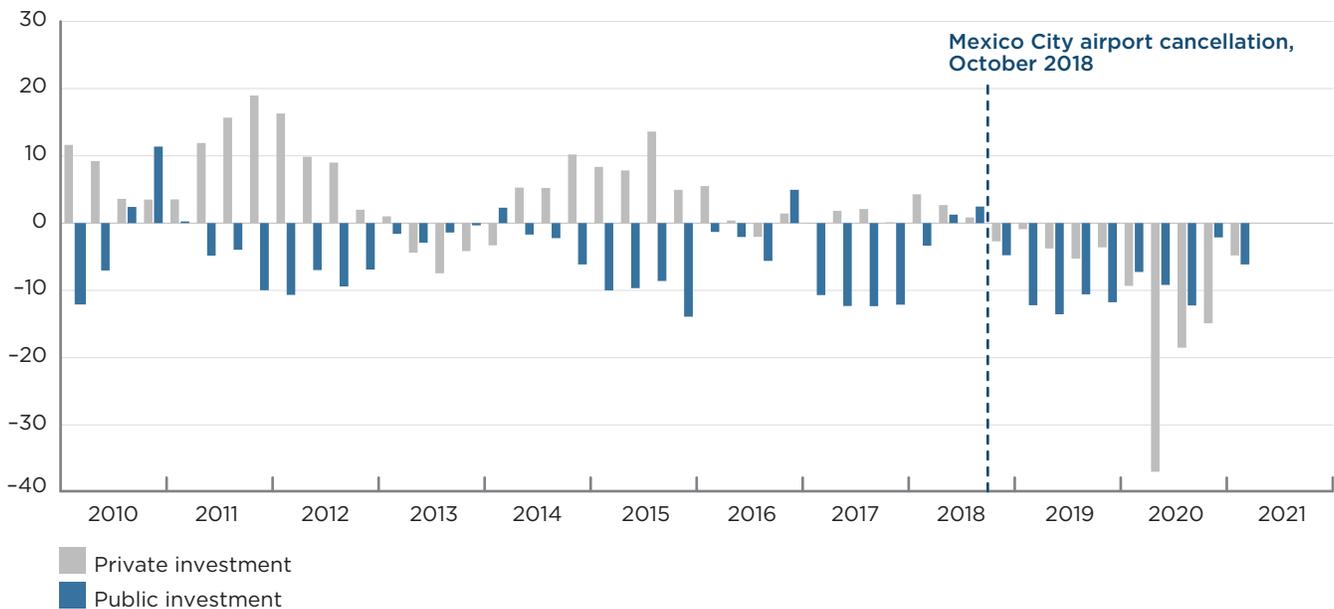
López Obrador's policy for energy self-sufficiency is particularly worrisome to national and international investors as it gives state-owned enterprises the leading role in all segments of the oil, gas, and electricity sectors. He has de facto banned private investment in hydrocarbons and is forcing the national electric grid to **prioritize electricity purchases from the CFE**, a state-owned utility—**affecting** some \$26 billion of private investment in wind and solar energy, mainly by foreign companies. The energy reforms recently proposed by López Obrador will make electricity more expensive, dirtier, and less reliable, hindering Mexican

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manufacturing competitiveness and increasing its carbon footprint. Many of the president's legislative actions are currently under judicial review and, if approved, would directly contravene the US-Mexico-Canada Agreement (USMCA).

Figure 1
Declining private investment in Mexico underscores diminished public funding

percent, year/year



Note: Data are through fourth quarter 2020.

Source: Mexico's National Institute of Statistics and Geography (INEGI) in Jesus Cañas and Chloe Smith, Investment in Mexico Falls Despite Rise in Remittances, June 29, 2021, Federal Reserve Bank of Dallas.

A SHIFT FROM THE LAST FOUR DECADES

President López Obrador describes the country's reforms since the 1980s as “a neoliberal nightmare” and has worked to reverse their course while distancing himself from a model that used US-Mexico integration as a development lever. Through his Fourth Transformation, he aims to recreate the political model that existed in Mexico back in the 1960s and 1970s, an era in which the president was the only boss and the State was the main rector of the economy.

Since his election, López Obrador has used his authority and loyalties to change laws and economic regulations and remove checks on the Executive. In addition, he has cut funding for the judiciary, independent watchdog agencies, and other autonomous institutions, including the electoral management bodies. He has cut jobs and salaries of civil servants and substituted hundreds of technocrats with party loyalists who lack institutional memory and professional skills. In tandem, he has strengthened the Armed Forces.

WALKING A THIN LINE

According to JPMorgan Chase, Mexico was able to avoid an even deeper recession in 2020 by benefiting from the United States in two important ways: the strong US economy [absorbed](#) about 80 percent of Mexican exports, which hit an all-time high; and a growing number of migrant relatives in the United States sent [\\$40 billion in remittances](#), adding [about 3.5 percent](#) to Mexico's GDP in 2020. According to the [Bank of Mexico](#), if it were not for the increase in remittances in 2020, consumption would have fallen nationwide. In addition, Mexico's high interest rates (above 4 percent) have attracted [billions of dollars](#) from portfolio investors taking advantage of carry trade. All these have contributed to strengthening the Mexican peso.

Yet, López Obrador is walking a thin line between anti-American rhetoric for domestic political gains, while steering clear of derailing the benefits that come from the northern neighbor. He welcomed the [Cuban president](#) as a guest of honor for the Independence Day celebrations while blaming the US embargo on Cuba for the recent demonstrations on the island. He hosted [Nicolás Maduro](#) and other Latin American leaders at the Mexico City summit of the Community of Latin American and Caribbean States (CELAC) and proposed that the [Organization of American States](#) be replaced by a multilateral organization that "doesn't respond to US interests," and he has publicly accused the Biden administration of [interfering](#) in Mexico's internal affairs. At the same time, many analysts believe he is using Mexico's efforts to curb migration as [leverage](#) to keep the US government from interfering in his affairs.

WHAT THE UNITED STATES CAN DO

Undoubtedly, Mexico needs the United States, but Washington also needs a stable, secure, cooperative, prosperous, and competitive Mexico. The current trajectory is not only hindering Mexico's ability to grow, offer opportunities to its people, compete, and comply with its environmental commitments. It is also impeding billions in investments and the possibility of building integrated North American supply chains that could provide a viable alternative to Chinese manufacturing and allow critical industries to move production closer to home. The United States has a unique stake in Mexico's success and is in a unique position to influence its course. It can use three simple and pragmatic tools:

- First, paraphrasing Juan Gonzalez, the US National Security Council senior director for the Western Hemisphere, during a recent Council of the Americas event, almost every agency in the US government works with Mexico, yet no one really "owns it." He cited the example of the National Economic Council, which is spending a lot of time thinking about supply chains, yet is not thinking about Mexico. An overarching strategy set by the White House, managed by a single US government agency responsible for the overall relationship, might offer better results.
- Second, Canada and Mexico have already contested the US interpretation of the USMCA rules of origin for automobiles. At the same time, the US private sector and various organizations such as the US National Foreign Trade Council, the Recording Industry Association, and the US Pharmaceutical Research and Manufacturers Association have asked the US Trade

Representative to [call Mexico to order](#) in at least 12 of the 36 chapters of the USMCA given its actions. The US International Trade Commission [highlighted](#) the importance of compliance by all governments if the benefits of USMCA are to be realized. Of course, the United States should comply and be willing to use USMCA tools to enforce compliance issues in Mexico. Unsolved disputes create uncertainty for investors.

- Third, the multi-agency dialogue restarted under the High-Level Economic Dialogue (HLED) was key to resetting economic priorities. Both countries committed to meeting annually at the cabinet level and semiannually at the sub-cabinet level. During the conference, Foreign Minister Marcelo Ebrard, said that López Obrador had [proposed to meet](#) with President Biden before the end of the year. A direct leader-to-leader conversation might just be the method necessary to articulate US concerns and offer a “quid pro quo” focused on protecting the environment, US manufacturers, and other export-related businesses, by exempting them from the new electricity bill. In exchange, the Biden administration could offer temporary work visas to Central Americans that López Obrador has requested or additional vaccine doses that are still needed in Mexico.

Mexico is at a critical turning point in its political and economic history. The prosperity train is about to leave the station. To become a valued part of the North American supply chain strategy, Mexico must temper dogma with pragmatism and reverse the current trajectory. In addition, it must address the issues hindering its ability to compete against other countries, including the rule of law, security, the informal sector, and corruption. It must also reduce its infrastructure gap, which is estimated at [\\$544 billion](#). Nostalgia will not feed 3.5 million Mexicans trying to enter the labor market each year. There is no time to waste!

5 Will Mexico's Insecurity Scuttle Its Nearshoring Moment?

Ryan C. Berg

While much has been written about Mexico's current "nearshoring" opportunity, the precarious security situation remains a major challenge to any efforts to realign supply chains. Unfortunately, President Andrés Manuel López Obrador has deprioritized security and declined to produce a credible plan for securing the country, potentially eroding Mexico's inherent nearshoring advantages. In this challenging security context, insecurity undercuts Mexico's ability to fully leverage its nearshoring opportunity with the United States.

Mexico's physical proximity to the United States and its network of highways and railways help to make it a strong case for nearshoring. The country is competitive as a manufacturing and transportation hub for products destined for the US market, especially when compared with alternative nearshoring options in Central America. Within Mexico itself, over **80 percent** of all goods are transported by road or rail. Furthermore, a relatively modernized US-Mexico land border is a competitive advantage for trucks and trains moving northward through Mexico's distribution centers. However, the advantage presented by Mexico's infrastructure and physical proximity to the United States could be eviscerated by the presence and operations of Mexican criminal cartels along highways, railways, and the border.

CRIMINAL CARTELS HAVE TIGHTENED THEIR GRIP ALONG HIGHWAYS AND RAILWAYS

Mexico's security situation has deteriorated considerably in the last few years—a major factor in its overall flagging investment climate. The 2020 Mexico Peace Index **estimates** that violence imposes an economic burden equivalent to 21 percent of Mexico's annual GDP (\$238 billion). This burden includes a significant opportunity cost that arises when the Mexican state is forced to spend vast sums of money countering violence and providing basic security—money not invested on economic development initiatives. The main drivers of insecurity in Mexico are, of course, violent and sophisticated cartels, which have expanded their tentacles throughout the country. Former US Ambassador to Mexico Christopher Landau estimates that **cartels control** 35 to 40 percent of Mexican territory. Partly as a result of the deteriorating security landscape, Mexico has **dropped out** of AT Kearney's top 25 destinations for foreign direct investment for two consecutive years.

Latin America has long been the continent most adversely affected by **transport theft**. In this category, Mexico is second only to Brazil. On average, 36 trucks a day are robbed in Mexico, to the tune of \$6 billion in losses annually. Highway robberies have **skyrocketed** over the last five years, nearly doubling from 1,782 in 2016 to 3,241 in 2019. Nearly 75 percent occur on **ten of Mexico's**

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major highways, primarily in Guanajuato, Puebla, Querétaro, the State of Mexico, and Jalisco. Unsurprisingly, these highways act as major arteries connecting Mexico to the United States and are of vital importance to investors seeking to supply the US market. Using extortion and informants within companies, criminal cartels target specific loads along highways. Trailers containing food and beverages, industrial and construction materials, and car parts are among the **most targeted**. Given that some of these represent **key sectors** in the United States-Mexico-Canada Agreement (USMCA), highway robberies **could curtail** the use of the USMCA framework to aim investments at nearshoring these critical industries.

Recent examples demonstrate how the fraying security conditions in Mexico have **negatively affected** the investment and operating climate for large companies. Because of predatory cartels operating along highways and around distribution centers, in 2018, Coca-Cola FEMSA—a joint venture between Coca-Cola and—**closed its facilities** in Ciudad Altamirano, Guerrero state, citing **economic losses** of 30 million pesos per month related to violence and extortion from cartels. A mere three months later, Grupo Gepp, a bottler and distributor for Pepsi, **followed suit** and closed its facility in Ciudad Altamirano.

Mexico's other principal mode of transporting goods—railway—is equally precarious. According to data from Mexico's Railway Security **report**, 2,990 robberies occurred on Mexican railways in 2020, roughly on par with the number committed on Mexican highways. Last year's railway robberies exacted a \$4.4 billion **economic toll**. As trains decelerate to offload cargo, cartels rob food, auto parts, and construction materials. An increasing number of **reports** indicate incidents occurring in Guanajuato and Querétaro states over the last couple of years. Mexico's northernmost states, including Coahuila, Jalisco, Nuevo León, and San Luis Potosí also experience high numbers of robberies due to the lucrative rail lines connecting Mexico to the United States. So long as both of Mexico's primary modes of transporting goods are plagued by insecurity, the costs of doing business will be elevated, presenting as a negative factor in deciding whether to invest in Mexico.

CREDIBLE SECURITY PLAN IS NEEDED TO REALIZE NEARSHORING GOALS

Regrettably, President López Obrador has **deprioritized security** and his “hugs, not bullets” philosophy to combat cartels has thus far proven insufficient at reducing violence and **homicide across Mexico**. The López Obrador administration has been eager to **declare the end of the Mérida Initiative**—the wide-ranging, bilateral security framework that guided the last 15 years of US-Mexican joint security policy. But this bilateral framework has made security cooperation with the United States more important than ever—and not just from a human security perspective, but also for the sake of Mexican and broader North American prosperity. Without a **credible security plan** coupled with the political will to dismantle cartels, investors might consider Mexico as lacking rule of law and basic security, where investments are not only undesirable but also insecure.

To a considerable degree, the success of nearshoring efforts in Mexico will depend on the **future and success of the US-Mexico security partnership**. A revived framework of cooperation would consider lessons learned over the last decade and a half of the Mérida Initiative. In this respect, President López

Obrador's desire for a less militarized approach may be a blessing in disguise—an opportunity for both countries to reorient a security strategy around building strong and resilient communities and engage in an equal-partner dialogue. The Biden administration can leverage President López Obrador's [anti-corruption rhetoric](#) to encourage a cleanup of the financial system and money-laundering that funnels cash into the pockets of criminal cartels. Cooperation on social development projects and fighting corruption could reduce the influence of drug cartels and begin to repair the damaged trust between Washington and Mexico City.

The bad news is that without signs of progress in Mexico's precarious security situation, the cost of doing business in the country will continue to rise and Mexico's gigantic nearshoring opportunity may be potentially foreclosed. The good news is that the United States and Mexico have maintained close cooperation in past years on security assistance. For better or worse, Mexico's nearshoring aims are codependent on its security efforts to a significant degree.

6 Using NADBank to Promote Regional Integration in North America

Sherman Robinson and Raul Hinojosa-Ojeda

Mexico faces many obstacles in its efforts to lure investment, expand its manufacturing base, and improve its economic integration with the rest of North America. Chief among them is Mexico's inadequate system of roads, bridges, rail lines, and digital capabilities needed to speed goods and services across the border with the United States. To address those needs, authors of the North American Free Trade Agreement (NAFTA) of 1994 set up the North American Development Bank (NADBank) to upgrade infrastructure and promote regional economic integration. The bank's activities, however, were narrowly focused on infrastructure and environmental projects on the Mexican border region. The bank was also severely undercapitalized, given its mandate and the magnitude of the infrastructure needs in and beyond the border region.

Now that NAFTA has been succeeded by the United States-Mexico-Canada Agreement (USMCA) in 2020 under the Trump administration, the time is right to increase the capital base, lending program, and scope of operations of the NADBank, which should be extended well beyond the border region. In addition, NADBank should expand into investments in financial infrastructure to bring remittance flows into the financial systems of Mexico and Central America. This reform would help channel remittances into new investment programs fostering deeper economic integration and rural development in Mexico and Central America to address issues of migration at their source rather than at the US border.

ORIGINS OF THE NADBANK

The NADBank was inspired by Europe's experience using regional development banks to integrate poorer European Union members such as Spain and Portugal into the integrated regional market. It was designed by the US and Mexican governments and private sector actors to invest in environmental and other infrastructure projects. It was a part of the labor and environmental side agreements negotiated by the Clinton administration to secure Congressional approval of the NAFTA accord.

The 2,000-mile US-Mexico border was the natural first area of focus, though many officials and others in both countries recognized that the bank should address wider cross-border issues. Such an expansion in scope of operations is currently under consideration by the US and Mexican governments.

At its inception, the United States and Mexico agreed to contribute equally to its \$3 billion capitalization, with 90 percent of resources dedicated to investment

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projects along the US-Mexico border certified by the Border Environmental Cooperation Commission (BECC). The NADBank and the commission merged in late 2017. Another separate institution, the Community Adjustment and Investment Program (CAIP), was created as part of the NADBank and operates separately in the US and Mexico with a mandate to allocate the remaining 10 percent of NADBank resources on employment-generating investment projects in the most impacted non-border communities in both countries. CAIP funds were to provide loans and technical grants to assist particular communities hurt by increased international trade by stimulating economic alternatives in the United States and Mexico. Another goal was to supplement trade adjustment assistance (TAA) for workers and help communities suffering employment displacement resulting from NAFTA. The US CAIP also supports projects in collaboration with the Small Business Administration (SBA) and the Rural Development Administration (RDA). Altogether the NADBank and CAIP have supported more than \$500 million in development loans to 1,000 US communities.

In its first 25 years of operation, the NADBank has certified and funded more than 250 completed projects addressing border environmental issues such as water conservation, solid waste infrastructure, air quality, and renewable energy. By 2019, the NADBank had placed \$3 billion in loans across 244 projects worth \$9.32 billion. Since 2018, it has issued three green bonds worth \$478 million supporting 12 projects. The bank has helped strengthen border communities' institutional capacities through its technical assistance program and the Project Development Assistance Program (PDAP), investing \$69 million in technical assistance to finance 548 project development and institutional strengthening initiatives, supporting over 160 communities on both sides of the US-Mexico border.⁴

BUILDING ON NADBANK/CAIP

Working together, the NADBank "Group" (NADBank, BECC, and CAIP) has succeeded in leveraging private and public resources for infrastructure investments at low cost to the government, while earning commendation from Wall Street rating agencies (its bonds have a Aa1 Moody's rating) and environmentalist groups.

In places where it operated, the US CAIP integrated both community development and TAA programs. In addition, the CAIP Federal Agency Program, which subsidizes fees through SBA and RDA loans, generated jobs in designated CAIP counties in the US. However, limited funding and strict eligibility requirements restricted its scope. These programs could operate only in high NAFTA-TAA impacted areas with higher unemployment rates than the national average. This restriction limited CAIP access to only 30 percent of the total NAFTA-impacted TAA eligible workers and only 27 percent of TAA eligible counties in the US. Even with these limitations, CAIP resources generated significant re-employment of TAA eligible workers in CAIP communities.

4 North American Development Bank, 2020, [25 Years of Green Investments in Communities in the U.S.-Mexico Border Region](#).

CAIP resources made the most impact in the most vulnerable of CAIP-eligible counties, i.e., those with higher poverty rates and higher shares of manufacturing employment, as well as higher concentrations of Latino and Black trade-exposed workers. The limitations on CAIP criteria focused resources on counties with highly vulnerable socioeconomic characteristics compared to all TAA certified counties.⁵

Coupled with the labor-focused TAA program and SBA/RDA loan programs, the CAIP has proved to be a cost-effective means of providing flexible technical assistance at the community/county level, addressing local adjustment issues arising from the impact of expanded trade due to NAFTA, a record of success despite the restrictions on its scope.

The Mexican CAIP program, however, was never able to achieve the programmatic robustness of the US CAIP. There was no mechanism for leveraging CAIP funding with other government resources in Mexico. Instead, it worked on establishing philanthropic partnerships through organizations focused on community employment and financial empowerment in high-migration-sending regions with high levels of poverty.

NADBANK REFORM

The NADBank 25 Year Report concluded that, given all these accomplishments, its operations needed to be scaled up. The largest failing of NADBank/US CAIP was the restrictive eligibility requirements for CAIP operations and the requirement that only 10 percent of its resources could be used for operations beyond the border region. Liberalizing these restrictions would allow the NADBank to operate more effectively in all regions that need increased infrastructure and trade adjustment assistance.

The capital stock of the NADBank should be expanded and it should extend its operations beyond the US-Mexico border. The NADBank could also address challenges beyond what was originally identified as water, wastewater, and sanitation to include broader sustainable energy and development issues. Mexico's agriculture sector and rural areas, especially in the south, are impoverished, suffering from out-migration and in need of major investments to generate growth and employment. With a broader geographic reach, NADBank could play a major role in providing additional resources to these regions. Mexico could significantly benefit from the application of the type of CAIP community-focused technical assistance and adjustment investments that have worked well in the United States.

Another area in which the NADBank could expand its assistance, to the benefit of both Mexico and the United States, is related to immigrants. Immigrants in the United States from Mexico and Central America are the source of large remittance flows back to their home countries, reaching a trillion dollars over a decade. These funds dwarf flows of foreign direct investment or official foreign aid and are largely handled outside any formal financial institutions such as banks. Immigration reform in the US, conferring legal status to undocumented

5 Raul Hinojosa-Ojeda, 2021, "Historical Trajectory and Lessons Learned: North American Development Bank and Community Adjustment and Investment Program." Mexico: El Colegio de la Frontera and Norte and Rice University.

immigrants, would lead to improved financial services for immigrant communities in the US and Mexico to facilitate remittance flows and to channel those flows to financial institutions in Mexico and Central America. The financial system could then potentially provide a new source of funds directed to productive investments in these countries. A major goal would be to direct investable resources to development projects in the poorest regions of Mexico and Central America, alleviating poverty that is a major impetus for immigration.

The United States and Mexico are considering a proposal to create a new special fund in the NADBank Group, the Immigration Root Causes Fund (IRCF), that would implement such an effort by harnessing remittance flows to foster economic development in rural Mexico and Central America. The IRCF would build on the experience of the Micro Banks and Bono Migrante model operating in thousands of communities in Mexico and the Northern Triangle countries in Central America.⁶

To create the IRCF, the US Congress will need to act, and the two countries will need to agree to extend the use of funds for projects in Central America. Resources provided to the IRCF would be used to subsidize interest rates on IRCF-endorsed NADBank loans, provide technical assistance and project development grants, direct grants to projects, and channel equity investments. This funding would leverage NADBank resources to draw in other funding resources to expand local employment and sustainable development in migrant sending regions in these countries.

6 For details, see [Asociación Mexicana de Uniones de Crédito del Sector Social](#).

7 A Revived US-Mexico Dialogue Enhances Economic Cooperation

Earl Anthony (Tony) Wayne

In a bid to revive economic relations and make Mexico and the United States more competitive with China, leaders of the two countries have [launched](#) a renewed Cabinet-level High Level Economic Dialogue (HLED), dormant since 2017. To underscore that initiative, [Vice President Kamala Harris](#) headed a US delegation consisting of the Secretaries of State, Commerce, Homeland Security, and the US Trade Representative in a meeting at the White House with Mexico's foreign and commerce ministers and others on September 9.

If done well and accompanied by Mexican moves to improve the investment climate, the HLED process can encourage more nearshoring of manufacturing and other businesses to Mexico, contributing to more resilient supply chains. Binational working groups are working to identify objectives and actions with plans to report on progress by early November.

The HLED is aimed at pursuing economic opportunities beyond the trade issues covered in the United States-Mexico-Canada Agreement (USMCA), which took effect in 2020. The USMCA calls for new consultative mechanisms on such issues as trade rules for auto production, respect for labor rights, and barriers to trade in agricultural products. As a complement to the new dialogue, the HLED can also help strengthen value chains and effective nearshoring in key sectors, generating "good" jobs on both sides of the border.

The HLED was a productive bilateral cabinet-level working process from [2013-2016](#), but it was dropped by the Trump Administration. Momentum was lost on important items, including border modernization, which was costly to economic efficiency and growth.

With USMCA implementation underway and hope growing for the end of the COVID-fueled restrictions on cross-border cooperation, President Joseph R. Biden Jr. and President Andrés Manuel López Obrador of Mexico have seen the potential benefit from collaboration to better manage cross-border supply chains and trade, address cyber threats to that trade, and strengthen investment in workers. They also agree on the need to promote targeted economic development in southern Mexico and Central America as part of broader efforts to help reduce migration.

This new HLED effort recognizes the value of learning from the pandemic economic recession that exposed weaknesses in US-Mexico cross-border supply chains and the management of border trade flows in key sectors such as autos, health supplies, electronics, and aerospace.

COVID also underscored the costs and dangers of being dependent on long supply chains to Asia, whereas shorter value chains with Mexico could provide more security in future crises as well as the potential for more efficient supply chains in such areas as semiconductors, medical devices, and pharmaceuticals.

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If you grouped together the US and Mexican border states, they would amount to the third largest economy in the world. Better facilitation of trade, investment, and development on both sides of the border could easily attract more nearshoring investment, grow jobs, and promote well-being in the cross-border production regions that are already flourishing to the benefit of the United States and Mexico.

As the US and Mexico struggle to manage migrants passing through Mexico and to the US border and to build more rational, humane and efficient systems for handling these migrants, the governments also agree on the need to promote investment and economic development in or near the home regions of these migrants that can provide good jobs and thus reduce some of the “pull” factors drawing them toward the US.

The September 9 White House meeting proposed [four pillars](#) for the initial HLED work agenda.

The first pillar is “building back together.” It could include steps to create more resilient and efficient supply chains and to plan for responses to future disruptions like those faced in the last eighteen months. This work will take up the unfinished agenda of making the US-Mexico border a modern 21st century border by improving the flows of goods and people with more efficient and secure processes and facilities. The ministers apparently agreed first to make semiconductor supply chains more resilient, and to help Mexico fill valuable [niches](#). Supply chains for electric vehicles, medical devices, and pharmaceuticals are also possibilities for reducing vulnerabilities, attracting nearshoring investment and increasing competitiveness. Specialists have also suggested “greener” technologies and adaptation to climate change as a good sector for cooperation.

Such sectoral reviews should involve private sector stakeholders sharing their perspectives on market strengths and weaknesses and inputs to facilitate investment and cross border flows. Attention to the efficiency of border crossing processes and infrastructure was largely put aside during the Trump Administration and should be renewed. Many [studies](#) have highlighted how increased investment in customs agencies, in technologies employed, and in new border infrastructure can increase competitiveness. Progress will be much more likely with regular and better organized joint work between the two federal governments, the private sector, and states and cities.

The HLED’s second pillar is “promoting sustainable economic and social development in Southern Mexico and Central America.” Identifying the right mix of economic, financial and development tools and programs to increase investment will not be easy. Despite years of US development efforts, trouble-free formulas do not exist. Many thorny issues surround proposals for the United States to allow different types of temporary work visas for individuals from these regions. Mexico has championed programs involving planting trees and providing youth apprenticeship opportunities, but both programs have been criticized as ineffective. Mexico’s [Economy](#) Minister has also mentioned potential supply chain investment in the south of Mexico, and private sector actors argue that road, port, rail, and energy infrastructure investments are vital.

The third pillar will look at “securing tools for future prosperity,” including enhanced cybersecurity cooperation and managing the evolution of information technology networks that will become increasingly important in North American trade. Once again, improved government to government dialogue should bring the private sector into the conversation.

The fourth pillar is “investing in our people,” with a focus on [workforce development](#). Workers in both countries would benefit from improving the skills of workers in industries that connect Mexico and the United States. A skilled workforce is needed to keep pace with new and enhanced technologies in the increasingly important cross-border delivery of services. Such efforts will also encourage nearshoring investments. Mexico and the United States should also try to align their recognition of the credentials that workers receive through skills and education programs, a step that can improve wages and worker mobility. Such cooperation could cover professional as well as vocation training and could be targeted to help specific groups such as women or disadvantaged communities. Focusing these efforts on [small and medium enterprises](#) to bring them into the USMCA economy and promoting basic skills in southern Mexico and Central America will help attract investment there. There are good US and Mexican examples of collaboration on workforce development that bring together national, subnational, academic, union, foundation, and private sector actors. These examples could provide valuable inspiration for pilot projects.

One of the most encouraging aspects of the HLED is its orientation toward collaboration by organizing stakeholder dialogues. Such a “democratization” of bilateral economic relations can have positive side effects. For example, the HLED could look at managing the US-Mexico border “as a whole,” rather than by geographic region or involving federal agencies alone. A more regular communication with communities on both sides of the border, perhaps scheduling annual border [summits](#) to assess progress, could uncover new ways to bolster mutual prosperity for Mexico and the United States.

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