

# Realising Mexico's potential

## INTERVIEW WITH ILDEFONSO GUAJARDO VILLARREAL

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**ILDEFONSO GUAJARDO** holds a BA in Economics from the Universidad Autónoma de Nuevo León, as well as an MA in Economics from Arizona State University, and studied his doctorate at the University of Pennsylvania. He has served as a Federal Representative in the Mexican Congress, and has long-standing experience in the public sector, heading up the NAFTA Office in Washington, in the Technical Secretariat of Planning, Communications and Liaison in Secretariat of Trade and Industrial Development, the Chief Office of Secretariat of Foreign Affairs, and has held the post of Secretary of International Affairs and Assistant General Secretary of the PRI National Executive Committee.

**Last year saw the 20th anniversary of NAFTA, the agreement that ushered-in Mexico's economic transformation of recent years. Would you say that the process of North American economic integration is finally complete? If not, which hurdles still remain to be overcome?**

NAFTA has been instrumental in advancing North American integration. In the last two decades, trade within North America multiplied by almost 4 times. In 2013 alone, around 35 per cent of the region's trade happened within it, totaling more than 1 trillion dollars. In fact, the Canadian, US and Mexican economies are so interlinked that nowadays, for every dollar Mexico exports, around 37 cents are of American content.

In spite of this, North America's integration process is an ongoing one. Our countries are constantly working on new fields of cooperation to face the ever-changing economic challenges. Particularly, we are striving to improve our trade efficiency through the harmonising of standards, expanding customs pre-clearance programmes, and reducing requirements for the faster movement of persons and goods along our borders and within the region.

Moreover, Mexico, the US and Canada are focusing much of their efforts on increasing productive integration to improve regional competitiveness. This is especially important because of the relevance of global production schemes in today's economic landscape, and the fact that sales to markets beyond NAFTA account for more than half of the region's exports.

In this sense, we have a very active trade agenda. We have free trade agreements (FTAs) with numerous countries around the world, and have many FTA partners in common. It is clear to us in NAFTA that in order to remain competitive, we need to act as a region that competes globally for production processes linked to global value chains.

This vision is precisely our motivator in participating in the ongoing Trans-Pacific Partnership (TPP) negotiations. Through this effort, not only do we diversify our exports, we also create new investment and production schemes among the NAFTA partners, consolidating our region as an export platform towards Asia-Pacific and the world. Consequently, we get closer to reaching our trilateral goal of making of North America the most competitive region in the world.

**Where do you see the next 'game changer' coming from, in terms of Mexico's economic development?**

Our two major economic assets – macroeconomic stability and the internationalisation of our economy – have not been enough to achieve a growth rate in line with the potential of our economy.

For the past 20 years, structural changes in key sectors have been necessary to advance our country. Specifically, some of the changes sought were in the finance, telecommunications and energy sectors that provide inputs to the economy, as well as in transversal areas, such as economic competition and the labour market. The absence of this process obviously has impacts on productivity.

Mexico has seen its productivity decreasing 0.7 per cent on an annual basis over the past 30 years, while having a 2.4 per cent average growth rate. Certainly, we have much space for improvement, as our competitors (like South Korea, Ireland and Chile) have increased their productivity during this same period on average between one and two per cent, with growth rates of 4 to 6 per cent.

The Reform package I mentioned earlier aims to unlock the factors that have inhibited productivity and growth during the past decades. Out of the 11 reforms, six aimed specifically at improving the productivity of the economy – labour, telecommunications, antitrust, tax, financial, and energy. With this, we have finally tackled our historically rigid labour market, low access to credit, expensive telecommunications services, inefficient public spending, highly concentrated markets, and high energy costs.

Therefore, the next game changer for the economic development of Mexico will undoubtedly derive from the implementation of these unprecedented reforms.

**Mexico's bilateral trade with the United Kingdom has doubled since the signing of the Mexico-EU FTA in 2000, and the aim is to reach £4.2 billion by the end of 2015. Is this realistic in the current economic climate? Which sectors do you expect to account for the majority of this new business?**

The development of the trade relationship between the UK and Mexico is quite encouraging. Numbers have been growing steadily over the last few years and as you rightly mentioned, our bilateral trade doubled between 2003 and 2013. Today, the UK is the 6th

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largest investor in Mexico. Over 1,500 companies with British capital are established in our country. At the moment we are witnessing positive numbers in some sectors in which we have proven to be complementary, such as in advanced manufacturing, mainly automotive and aerospace components; in renewable energy; in services, mainly creative industries such as animation and film production; in medical devices and pharmaceuticals; and in processed foods and liquors, amongst others.

And although current sluggish world growth should drive us to lean on free trade more than ever, I do not think we will reach this goal by 2015. There is still much work to do to achieve our common goal.

Updating the Free Trade Agreement between Mexico and the European Union lies at the core of our efforts to increase bilateral trade to the desired goal. Adjusting the FTA will allow Mexico and the UK to seize untapped opportunities in sectors such as agriculture, manufacturing, services and investment.

Owing to their economic importance, both the UK and Mexico need to make the development of small and medium enterprises (SMEs) a priority. The UK has had a successful experience in promoting SMEs' participation in global value chains. Mexico is very interested in learning from this practice, and adapting UK's success stories to the Mexican context. Furthermore, I would say productive alliances among Mexico's and the UK's SMEs are central to increasing bilateral trade and investment flows, perhaps more than what was originally foreseen.

Hence, it is necessary to intensify efforts in establishing cooperation schemes among both parties' SMEs, and identify feasible business opportunities in the short and medium term.

**Aside from raising awareness of opportunities among the two countries' business communities, what impact do you expect the current 'Dual Year' to have in concrete terms?**

2015 will be "The year of Mexico in the UK and the UK in Mexico". It will be the perfect showcase to increase relations across the economic and investment arenas between our countries. The Mexico-UK Dual Year is a very exciting initiative which, in economic terms, is meant to foster our ties within the business environment.

Through the Dual Year, we expect more companies will seek to establish in either Great Britain or Mexico. For instance, we have been witnessing a wave of Mexican companies from the creative industries that are looking to create joint ventures with their British counterparts. Additionally, several Mexican entertainment companies have started building facilities in the UK. We expect that some of them will

speed up their plans to open their shops during the Dual Year to use it as a powerful promotional tool.

In sum, the economic events taking place all around the United Kingdom and Mexico this year will promote business between companies on both sides of the ocean, contributing to increased bilateral investment and trade, and ultimately a strengthened bilateral relationship.

**The perception of Mexico among UK businesses is that the country has huge potential, but the security situation is an issue of concern to many people. What is the Government doing to reassure potential investors and traders that Mexico is a safe place to do business?**

Actually, the vast majority of the Mexican territory is a very safe place to do business. As all the investors know, Mexico is a wide spectrum of thirty-two federal entities. Among most of them, the development and security conditions are world-class. Proof of this are the more than US\$66,767 million in foreign investment flows Mexico received the first two years of President Peña Nieto's Administration.

Our challenge is specifically located and contained in the southern states of Guerrero, Oaxaca and some parts of Michoacán. These regions do not offer the level of security and development that the northern and central areas of the country offer. It is in the latter where the automotive and aerospace clusters have flourished. That is why last year, 89 per cent of the foreign investment received by Mexico went to the northern and central regions while the southeast only received 11 per cent of the total FDI.

To help the southeast region catch up with the rest of the country, President Peña Nieto has instructed us to establish three Special Economic Zones (SEZ) there to foster infrastructure development and expand the business opportunities of this region. We expect the launch of the SEZ will be a driving force to create a virtuous circle of growth, social development, security and wellbeing.

**One of the major outcomes of the February 2014 UK trade mission to Mexico was the decision to establish a British Business Centre to assist British SMEs in penetrating Mexican markets. Which sectors of the Mexican economy do you see as most attractive to British companies – and vice versa?**

The recently opened British Business Centre attests to the growing interest of British small and medium sized companies to seize market opportunities in Mexico. The joint efforts of UK Trade and Investment, ProMéxico, and now the British Business Centre, will definitely translate into more investment and trade between us.

One of the most attractive sectors to British companies is the telecom sector. Mexico's Telecommunications Reform is granting access to greater competition in fixed-line and mobile networks. For instance, Sir Richard Branson, CEO of Virgin Mobile, is investing in this new sector and is building a presence in the Mexican telecom industry.

Another opportunity lies in the energy sector. The UK has a particular interest in the Energy Reform, because it is one of the leading countries in the world in terms of the energy sector and oil & gas exploration. In May 2014, HSBC and the Mexican Development Bank (Nacional Financiera/NAFIN) created a fund to finance firms who want to invest in the sector. The new fund can be accessed by both domestic and foreign SMEs looking to invest and work in the Mexican energy sector.

The aerospace industry is indisputably another appealing sector for British companies. While our aerospace industry was almost non-existent a decade ago, it has increased five-fold since 2005, and currently sustains 270 companies. KPMG's Competitive Alternatives Report ranks Mexico as the most competitive country in the Americas for the aerospace industry. The degree of technological sophistication of our exports and the available engineering talent pool ranks Mexico as a world-class centre for high value-added strategic manufacturing, engineering and development. Likewise, the Wassenaar Arrangement allows us the possibility to develop and manufacture dual use technologies in Mexico.

Another opportunity is found in the Mexican creative industries. In this matter, our country could be a great ally for British companies. Mexico is a global hub for creative industries, including architecture, design, and fashion content, amongst others. We are also the largest film and videogame market in Latin America, the largest exporter of creative goods in the region, and one of the leading exporters of new media in the world.

We are also quite interested in bilateral cooperation. One example where we have worked together is Torre Bancomer, a project developed by Víctor Legorreta's studios and the British architect Richard Rogers. Other successful examples include Grimshaw Architects with the Steel Museum in Monterrey and Foster + Partners with their apartment towers in San Pedro Garza, Nuevo León. Lastly, British architect Norman Foster and Mexico's Fernando Romero studio have had their design chosen for Mexico City's new airport, one of the largest in the Americas.

Finally, we also believe in the great value of cooperation in R&D projects to increase our investment ties in the future. Our country is an important global manufacturing hub, where in fact, 93 per cent of Mexican exports to the UK are manufactured goods.

As we transition from manufacturing to more R&D, we are interested in fostering innovation through partnerships offering your country's expertise. Mexico is a fertile ground for UK companies in industries that require innovation and sophisticated manufacturing, such as aerospace, automotive and life sciences, among many others.

Our countries are natural partners in many areas. Mexico has the human capital and the infrastructure for advanced manufacturing, while the UK can provide its expertise in innovation and technology development. I am sure there is a wealth of opportunities in our renewed relationship.

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**Mexico's economic model is based on manufacturing, but it is proving hard to consolidate growth while productivity remains low. Which areas of the economy still need to be addressed in order to create sustainable, steady expansion and increase productivity?**

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Under President Peña Nieto's administration, raising productivity in Mexico is a priority. One of our five national goals is to build a "Prosperous Mexico", where our country can grow to its full potential and generate more high-quality jobs. To reach such sustainable growth, this administration is committed to provide the best conditions for our manufacturing sector to innovate, to capitalise on our dynamic export sector, and to strengthen our domestic market.

Manufacturing currently represents our motor for growth in the country. It is not unusual for plants in Mexico to exceed productivity levels when compared to the United States. These medium and large enterprises are globally integrated and are able to reap the benefits of this integration.

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Mexico is seeking to build on the strength of its existing clusters in the automotive and aerospace industries



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Notwithstanding the success seen so far in the manufacturing sector, it only represents one-third of the economy. In fact, micro, small and medium sized companies represent the main source of employment in Mexico: 7 out of 10 Mexicans work in SMEs. Unfortunately these are still economic units with very low-productivity levels, which may be up to six times lower than productivity in the manufacturing sector. Needless to say, these micro, small and medium enterprises are still disconnected from the benefits of global integration.

In this sense, the Ministry of Economy designed its policy through a sectorial and transversal approach. This allows for the coordination of actions based on the objectives of each sector or production chain, with broad guidelines such as the development of supply chains, innovation, clusters, and human capital.

Furthermore, to reduce the above-mentioned gap, our strategy considers three action lines:

1. Expanding employment in dynamic sectors. We are aiming to achieve more competitiveness through the development of suppliers by expanding the technological and productive capacity. We are also boosting our innovation efforts through the development of high-level innovation and development centres. Through these efforts, we are pushing for an expansion of the sector and ultimately increasing employment levels.

2. Modernising and innovating the commercial and service sectors. Once again, we aim to increase productivity through innovation. Our efforts vary from supporting the increase of added value in their activities, to incorporating the units to the value chains.

3. Consolidating regional clusters. Strengthening the already existing clusters, as well as those currently in development, through the linking of mature industries with dynamic industries, as well as the creation of manufacturing regions focused on defined products with common standards.

Consequently we are able to focus our efforts where it matters the most, through what we call “precision shots”. This is how we are targeting those areas of the economy that need the most support to increase their productivity levels.

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**The Trans-Pacific Partnership (TPP) has been described as potentially the most important and ambitious multilateral trade framework that exists internationally. How will the signature of the TPP economic association agreement impact Mexico’s commercial ties, and what export sectors do you feel will be growth drivers through the TPP and the Pacific Alliance?**

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Given its wide array of disciplines, and the high level of ambition sought in them, the TPP will change not

only the way Mexico trades with the world, but world trade itself by becoming the blueprint for future trade agreements.

The TPP will contribute to diversifying Mexico’s trade, and enhance its economic presence in the Asia-Pacific region, one of the most dynamic worldwide, representing important growth opportunities to increase trade, and promote new investments and technology transfer.

In particularly, the TPP will enable access to six new Asian markets, some of whose average growth rates will surpass that of the world in the next five years, according to IMF estimates . But, most importantly, those new markets are complementary to Mexico’s, since they import goods in which my country’s competitiveness has been proven worldwide.

For instance, Mexico’s manufacturing exports, a driving force behind the country’s economic growth, could benefit some TPP markets in sectors such as electrical machines and devices, aerospace, automotive, chemicals, fuels and metals. The idea is to make the most of Mexico’s strengths, create new synergies in regional production chains, and capitalise on market opportunities with TPP partners.

Thus, I foresee that, through the TPP, Mexico will consolidate its position as an ever more relevant manufacturing hub in the Asia-Pacific region, and as a more active and efficient participant in regional production schemes.

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**How do you see the general outlook for Mexico over the medium term in light of the economic reforms of the last two years, and by what benchmarks will you measure their success?**

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The Structural Reforms approved by Congress are meant to steadily increase Mexico’s growth to its full potential. As the reforms will trigger productivity, investment and promote formal employment, a positive impact on the country’s productive capacity is expected. Furthermore, barriers currently preventing the economy from reaching its potential in key sectors will be eliminated.

It is estimated that with the implementation of the Structural Reforms, the economy’s potential growth will hike from 3.5 per cent in its initial level to 5.3 per cent by 2018. As a consequence of the expected growth for this period (2015-2018), the forecast for employment generation is of more than 300 thousand formal jobs per year. This means that job generation would exceed a million jobs per year, once full potential growth is reached.

In conclusion, by fulfilling the objectives established in the structural reforms, Mexico’s outlook will be one of success that will trigger benefits for Mexican society and move the country to reach its full potential. **E**