Outsourcing and FDI in Developing Countries: The Case of the Mexican Economy

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Abstract. Due to the favorable environment generated by the economic reforms of the nineties, the remarkable ascent of MNCs' FDI developed important industrial outsourcing during this period. Highlighting this trend are the investments carried out in the automobile industry and in export-based assembly plants in Mexico. This paper studies the trajectory of these industries, showing how the absence of an endogenous base as well as wide**spread** international competition create the conditions for restarting the outsourcing process, but this time towards other countries. Also, it analyzes the scarce interaction between international financing, capital formation, export growth and economic performance.

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1. Introduction

During the 1990s there was a remarkable increase of Foreign Direct Investment (FDI) inflows. Several large companies headquartered in developed countries displaced part of their assets towards developing countries and economies in transition. In other cases, firms from such countries have assumed the process of production of certain goods. The main destination of this investment has been southern Asia and to a lesser extent some Latin America countries. For this reason the recent performance of the world economy has been characterized as a model supported by a growing international demand. UNCTAD (2004:6).

This process was preceded by economic reforms in developing countries from the 1980s onwards that promoted commercial and financial liberalization. Throughout the first half of the 1990s worldwide trade reached remarkable levels and FDI new dynamism. Nevertheless, only in the second half of 1990s and in the first years of the present century has FDI become the principle vehicle of trade expansion, with outsourcing[2] explaining a substantive part of the growth in worldwide trade in the last years. The Mexican economy also moved quickly towards commercial opening, it began with a reduction in import tariffs in 1983 and continued with the elimination of subsidies and FDI restrictions and the reduction of import tariffs. A part of these changes was negotiated in the North American free trade agreement (NAFTA) that took effect in January of 1994.

These changes in economic policy created the conditions for the increase in manufacturing exports, permitting foreign trade to become a fundamental component in the process of Mexico's economic transition. BANCOMEXT (1999). Thus, for more than twenty years various governments have prioritized private investment, and especially FDI, considering external resources indispensable for economic growth, particularly given the viewpoint that Mexico is a country with an abundance of labor and shortage of capital. It is within this framework that the outsourced investments that some multinational companies (MNC) have made in Mexico must be examined.

This paper analyzes FDI inflows during the 1990s. Its notable increase not only shifted the composition of exports towards those of the manufacturing sector, but also deepened the importance of the external sector and the already remarkable degree of openness of the economy. The facts allow us to maintain the position that a concentrated export platform in several activities of the manufacture industry was created. These activities have arisen from the investments of some of the larger MNCs, especially in the automotive and electrical and electronic equipment and apparatus industries. In this paper we maintain that the process of outsourcing investments by of a reduced group of MNCs is explained by the course of the constitution of the region of North America. Nevertheless, this export platform has one limited endogenous base. In this paper we argue that as a whole this export dynamic does not count on large domestic productive linkages; its growth has almost no ties with the performance of the domestic market; in a great number of companies inputs produced in Mexico are not used; there are not other links that allow to spread technology; and an important part of the products that the affiliates of MNCs sell in Mexico are imported. The permanence of some companies is subject to: the fiscal treatment that some of the sector's inputs and products receive in the United States (US); and, to the establishment of commercial agreements, as the elaboration of some products, as is the case of textiles, depends on cheap labor and energy. The outsourcing of investments for export – based manufacturing sector accounts for a large part of FDI inflows during the 1990s. However, this type of outsourcing assumes the form of an "enclave" and therefore does not generate the conditions to link increases in export capacity with higher levels of economic growth. Even so, new tendencies have emerged in which such investments are now leaving Mexico for other countries.

2. FDI, Domestic Market and Manufacturers' Export Platform.

As in the case of other Latin American countries, from the end of World War II until the end of the 1970s, FDI was one of the sources of capital formation in Mexico. At the end of 1980, the accumulated amount of FDI was 8,459 million dollars, of which more than 65percent came from the US and of which 75 percent was concentrated in the manufacturing industry. During those years, the presence of foreign companies was important in the manufacturing of products such as: automobiles, pharmaceuticals, industrial chemical agents, electrical apparatuses, office equipment and tobacco. Fajnzylber and Martinez Tarragó (1976). During the 1970s the valuable