

## Mexico grid modernization

Tony Payan, Rodrigo Montes de Oca, Rolando Fuentes, and Roberto Duran-Fernandez, "The Power Problem: Nearshoring and Mexico's Energy Sector" (Houston: Rice University's Baker Institute for Public Policy, July 3, 2024), <https://doi/10.25613/ZFTS-6672>.

Workshop participants explored the surge in nearshoring, which included an in-depth discussion of the forces propelling this new trend. These forces are:

This diagnostic improved the general understanding of the need to relocate supply chains closer to U.S. markets. And given that nearshoring is defined as the relocalization of investment and business operations to nearby countries, the discussion also helped place Mexico as an important piece in Washington's strategy to incentivize a manufacturing renaissance in North America, mainly because not all businesses can easily relocate back into the United States and maintain competitiveness. In addition, Mexico presents important advantages, beyond its location. These include the business environment cinched by the USMCA and decades of integration of manufacturing chains, which have resulted in a deep industrial ecosystem, well known to many American companies.

By unraveling the complexities of the present scenario, participants laid the groundwork for comprehending the role of nearshoring in enticing changes to the energy sector's trajectory in Mexico. Through interactive dialogues, participants explored the role of renewables in electricity markets and discussed the necessity of a cleaner energy matrix in Mexico to effectively capitalize on new nearshoring investments.[1] By dissecting these intertwined themes, participants theorized potential synergies between nearshoring endeavors and renewable energy initiatives, steering toward sustainable and adaptive energy systems.

The workshop argued that some larger companies with explicit international pledges to reduce their carbon footprint have also expressed concerns about Mexico's apparent lack of commitment to renewable energy sources, as the country often prefers to rely on energy that does not help them meet their ESG obligations. The challenge of attracting companies becomes even more daunting in the absence of access to clean energy, particularly when energy availability is uncertain.

The current state of Mexico's power sector, therefore, poses a formidable obstacle to nearshoring, jeopardizing the country's ability to fully capitalize on the opportunities presented by the shifting global economic landscape. Addressing these challenges is imperative to unlock Mexico's potential as a competitive destination for nearshoring and sustainable economic growth.

Workshop participants extensively deliberated on the state of Mexico's power sector. This report draws on the most important conclusions by the participants, in the understanding that Mexico requires important policy changes if it is to take full advantage of supply chain nearshoring. In this section, we encapsulate three

primary insights gleaned from these discussions:

The surge in nearshoring activities in the United States is driven by various factors, including U.S. public investment to incentivize relocation and tariffs imposed on Chinese goods. To bolster domestic manufacturing and reduce reliance on overseas production, U.S. industrial policy seeks to incentivize companies to relocate manufacturing operations, preferably back into the United States or, alternatively, closer to home. Additionally, tariffs on Chinese imports have prompted U.S. companies to seek alternative sourcing options, further fueling the nearshoring trend. Improved supply chain management strategies and growing concerns about climate change have also significantly driven nearshoring initiatives.[6]

It is worth emphasizing, however, that American industrial policy is designed to aid the relocation of companies to the United States -- reshoring. Nearshoring is an important concept in Mexico, given its proximity and access to the U.S. market. Based on this, Mexico's government has seen this as a new opportunity to propel further industrial development in the country. The 2018-24 government has also said that at least some development should be channeled to Mexico's poor southern states. However, it will be difficult or impossible to channel development to these states if the country does not implement effective public policies to incentivize industry relocation to southern Mexico -- including the provision of a sufficient, reliable, and clean energy supply.

The development of southern Mexico is in a state of historical debt, as this process has failed for, at least, the past 40 years and will unfortunately continue to fail unless the government makes massive investments in this region. The present federal administration has begun some infrastructure rail projects in the Tehuantepec Isthmus and Yucatan Peninsula. However, these are, at best, only initial steps in a long-term development program, as it has yet to be seen whether these projects will succeed. None of these current projects do anything to enhance the kind of power supply required to incentivize companies to relocate to southern Mexico.

Of course, these infrastructure projects could indeed enable development in southern Mexico if complemented by further intermodal freight infrastructure, port modernization, and investment in mobility. But even they will not solve the long-term development problem. Infrastructure alone will not be able to trigger a sustainable development process without a significant increase in the availability of sufficient, reliable, and clean electric power to encourage companies' decisions to relocate there.

To be sure, Mexico's advantages in partaking in nearshoring trends on a global scale remain important. However, even if the nearshoring narrative is part of Mexico's rhetoric, the two economies of Mexico and the United States have grown to complement each other over the life of the North American Free Trade Agreement (NAFTA), now USMCA. There is reason to assume that this trend will continue and that nearshoring-oriented policies will only accelerate this trend. Politically, it is important to note that the USMCA was approved under some of the most nationalistic administrations in both countries since World War II. This highlights the resilience of binational integration and the depth of economic ties, which can transcend political headwinds.



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