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Mexico as the Primary Beneficiary of IRA: Exploring Its Challenges

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The IRA (Inflation Reduction Act), which took effect on August 16, 2022, is accelerating the reorganization of supply chains in battery-related downstream and upstream industries worldwide. This restructuring is driven by the Battery Components Requirement, which mandates that a certain percentage of the battery components be assembled or manufactured in North America. Additionally, the Critical Minerals Requirement applies to batteries used in electric vehicles. It requires that a certain percentage of the value of the critical minerals contained in the battery be mined or processed in the United States or a country with which the United States has a free trade agreement or be recycled in North America.

The IRA's guidance, released on April 17, 2023, has created further uncertainty for South Korean battery companies as they face the challenge of responding quickly to supply chain reorganization. This uncertainty stems from the fact that the guidance does not provide standards for the foreign entities of concern. The detailed guidelines for the IRA indicate

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that from 2024 battery parts assembled or manufactured by a foreign entity of concern, and from 2025 core minerals mined or processed by the foreign entity of concern will be excluded from the electric vehicle tax credit. However, the guidance does not clarify the criteria for a foreign entity of concern.

As a result, the Korean government and companies are facing significant uncertainty as a result of the implementation of the IRA. In contrast, there is one country that has benefited greatly from the implementation of the IRA, and that is Mexico. Following the escalation of the U.S.–China competition triggered by the trade conflict in 2018, many multinational manufacturing companies have started to look for an alternative location to replace China. The term 'nearshoring' has emerged in this process, and Mexico has gained considerable attention as a potential destination.

Mexico is deeply integrated into the manufacturing sector of the United States and Canada, primarily due to NAFTA and the subsequent entry into force of the USMCA. It is widely seen as a prime candidate for nearshoring due to its proximity to the United States, robust automotive industry, and the availability of low-wage skilled labor. In particular, the Mexican state of Nuevo Leon, which borders the U.S. state of Texas and is home to the KIA Motors plant, stands out as one of the most prominent states in the country. It has recently attracted the construction of Tesla's Gigafactory. In an interview, Governor Samuel Garcia of Nuevo Leon mentioned that inward FDI for the state would double in 2023 compared to 2022, reaching $12 billion.[1] Consequently, with the entry into force of the USMCA and the implementation of the IRA, investment in Mexico, as one of the three pillars of the North American countries, would continue to increase.

This reorganization of supply chains around the United States or North America represents a major opportunity for Mexico to further enhance its integration into global value chains (GVCs) and boost economic growth. Similar to other countries in Latin America, Mexico is seeking to achieve high-value industrialization by moving away from low-value industries such as resource extraction, basic manufacturing, and assembly. In other words, Mexico is seeking to transition to high-value-added industrialization by strategically repositioning itself within the GVCs.

However, for this opportunity to really improve the structure of the Mexican industry, it is imperative that the Mexican government increases its investment in education, R&D, logistics,

[1] https://mexiconewsdaily.com/business/governor-says-nuevo-leon-will-receive-us-12b-in-foreign-investment/ (accessed February 24, 2023)

and infrastructure. In other words, Mexico should strengthen its industrial capabilities by addressing the challenges that have been raised in the past, such as fostering the development of a skilled local workforce capable of engaging in high value-added industries, investing in technology development to move beyond the mere assembly and processing of auto parts, and implementing improvements in logistics and infrastructure that are essential to attracting high value-added industries. These measures will further bolster Mexico's GVC integration by increasing the likelihood of attracting relatively high value-added sectors in the GVC into Mexico and promoting the competitiveness of Mexican companies.

Furthermore, the Sustainable Development Goals (SDGs) actively promotes the integration of developing countries into GVCs. The SDGs highlight the importance of strengthening the capabilities of small and medium-sized enterprises (SMEs) and facilitating their active participation in GVCs as a means of achieving inclusive and sustainable growth in developing countries.

The outcome of the enormous opportunities for Mexico will depend to a large extent on the strategies and policies adopted by the Mexican government over the long term. The country is at a pivotal moment, faced with the choice of either remaining a middle-income country aspiring to achieve a high value-added industry or escaping the middle-income trap and joining the ranks of a developed countries. Mexico finds itself at a crucial crossroads, and the choices will shape its future trajectory. KIEP