

**Nearshoring**

# Tax incentives for key exporting industries

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**Ten industries, among the most competitive exporting manufacturing in Mexico, are granted tax incentives to draw nearshoring related investment flows.**

## Key Points

- The tax incentives include deductions ranging from 56% to 89% in fixed assets investments and additional deductions on labor training expenses across 10 key sectors.
- 6 out of the 10 benefited sectors are among the most competitive industries according to the revealed comparative advantage (RCA) index.
- The tax incentives could have adverse effects such as lower tax revenue, unfair competition by the beneficiary sectors or violate the USMCA by discriminating between sectors.
- East Asian countries have also used in the past fiscal incentives to attract FDI, which allowed them to achieve high economic growth rates.
- The measure is positive for attracting FDI, however it should be accompanied by infrastructure development to tackle nearshoring obstacles, mainly energy supply constraints

## Act to promote investments in *nearshoring*

On October 11, the Mexican government released an [Act granting tax incentives to key sectors of the export industry](#) consisting of an immediate deduction for investment in new fixed assets and an additional deduction for training expenses.<sup>1</sup>

The act establishes tax incentives for companies willing to invest in new fixed assets anywhere in Mexico and is specifically applicable in ten key sectors for the Mexican economy. First, it will allow the immediate deduction of investments, which varies from 56% to 89% in 2023 and 2024. It also guarantees an additional deduction of 25% for three years for employee training expenses, focusing on the development of human capital.<sup>2</sup>

The act identifies 10 key sectors of the export industry with the potential to receive tax incentives considering the following four criteria: a) high productivity in the growth of the Gross Domestic Product and with the necessary competitiveness to meet the increase in the demand for products; b) export vocation; c) impact of the sector in the economy through multiplier effects; and, d) increase in exports to the United States. Thus, [companies in the following 10 sectors that are engaged in the production, processing or industrial manufacturing of goods for export are considered:](#)

<sup>1</sup> Diario Oficial de la Federación (2023), Act. [Available here](#).

<sup>2</sup> Gabriel Yorio, Deputy Secretary of Finance of Mexico (2023). [Available here](#).

- I. Products destined for human and animal feed.
- II. Fertilizers and agrochemicals.
- III. Raw materials for the pharmaceutical industry and pharmaceutical preparations.
- IV. Electronic components, such as simple or loaded cards, circuits, capacitors, condensers, resistors, connectors and semiconductors, coils, transformers, harnesses and modems for computers and telephones.
- V. Machinery for clocks, measuring, control and navigation instruments, and electronic medical equipment, for medical use.
- VI. Batteries, accumulators, batteries, electric conduction cables, plugs, contacts, fuses and accessories for electrical installations.
- VII. Gasoline, hybrid and alternative fuel engines for automobiles, vans and trucks.
- VIII. Electrical and electronic equipment, steering systems, suspension, brakes, transmission systems, seats, interior accessories and stamped metal parts for automobiles, vans, trucks, trains, ships and aircraft.
- IX. Internal combustion engines, turbines and transmissions for aircraft.
- X. Non-electronic equipment and apparatus for medical, dental and laboratory use, disposable material for medical use and optical articles for ophthalmic use.

In addition, companies producing cinematographic or audiovisual may be subject to the fiscal incentives as long as their works (films, music and others) are exported.

Article 1 of the Act describes the incentive in the [immediate deduction of the investment in new fixed assets](#), acquired from the date of entry into force of this act and until December 31, 2024, deducting in the fiscal year in which the investment is made the amount resulting from applying to the original amount of the investment. The deduction for new fixed assets will be applicable only when they are kept in use for a minimum period of two years immediately following the fiscal year in which the immediate deduction is made, and new assets are considered to be those that are used for the first time in Mexico. In order to receive this incentive, taxpayers must calculate the profit coefficient of the provisional payments to be made during the 2024 or 2025 tax year, adding the tax profit or reducing the tax loss of the 2023 or 2024 tax year, as the case may be, with the amount of the incentive deduction.<sup>3</sup>

Article 2 specifies the maximum authorized deductions and are divided by type of asset with deductions ranging from 86-89% or by type of activity of the machinery and equipment used ranging from 56-89%. The specifications of such deductions are described in the Appendix to this note.

Article 3 indicates the methodology to exercise the incentive of Article 1 in which the following three criteria must be considered:

- I. The original amount of the investment may be adjusted by multiplying it by the restatement factor corresponding to the period from the month in which the asset was acquired until the last month of the first half of the period that elapses from the time the investment was made until the end of the fiscal year in question. The above will be considered as the original amount of the investment to which the maximum authorized deduction is applied.

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<sup>3</sup> "Taxpayers must keep a specific record of the investments for which they chose to apply the immediate deduction under the terms of this article, containing the supporting documentation, describing the type of asset in question, the relationship with their main line of business or activity, the specific process or activity in which the asset was used, the percentage that corresponded to it for deduction purposes, the fiscal year in which the deduction was applied and the date on which the asset was disposed of, the specific process or activity in which the good was used, the percentage that for deduction purposes corresponded to it, the fiscal year in which the deduction was applied and the date on which the good is disposed of, is lost due to an act a fortuitous event or force majeure or ceases to be useful. "

- II. The total income received from the sale of the assets is considered as the gain obtained from the sale of the assets.
- III. When the goods are disposed of, lost or cease to be useful, a deduction may be made for the amount resulting from applying to the original amount of the investment adjusted with the restatement factor corresponding to the period from the month in which the good was acquired until the last month of the first half of the period in which the incentive was made.

Article 4 specifies the [incentive for training equivalent to the deduction of 25% of the expenses incurred by each of the employees who receive training in technical or scientific knowledge](#)<sup>4</sup> related to the taxpayer's activity. Finally, Article 5 indicates the cases in which the described incentives may not be applied, mainly because they are indicated by the Tax Administration Service or by the Federal Tax Code; and Article 6 indicates the requirements to apply the tax incentives must comply with the provisions of the tax legislation regarding the deduction of investments of the Federal Tax Code.

## Assessment: Policy toward attracting FDI, but incomplete

As mentioned in our article “Relocating of USA Value Chains, a unique opportunity”<sup>5</sup> [Mexican global manufacturing is highly competitive within international markets and is well integrated in North American value chains.](#)

We assess the competitiveness of Mexican manufacturing through the Revealed Comparative Advantage (RCA) index.<sup>6</sup> The results suggest that Mexican global manufacturing is highly competitive in Transportation Equipment manufacturing (0.93), Computer and Electronic Products (0.83), Electrical Equipment (0.79), Primary Metal (0.73), Machinery (0.57), Metal Products (0.48), Food Manufacturing (0.13) and Chemical Manufacturing (0.12). [Six out of the ten benefited sectors are among the most competitive industries.](#)<sup>7</sup>

The RCA index shows that in the manufacturing of Electronic Products (0.83), Mexico stands out as the second largest computer exporter and the 5th in electronic integrated circuits in 2018. In the manufacturing of Electrical Equipment (0.79), Mexico ranks as the 4th largest exporter of electric generators in the world in the same year. Meanwhile, in Machinery (0.57) Mexico also stands out as the 5th exporter of accessories for tractors. Finally, for the Metal Products sector (0.48), Mexico holds the place as the 6th largest exporter of padlocks, locks and bolts in 2018. Within all these sectors, Mexico is a natural candidate to attract the investments that China is currently losing.

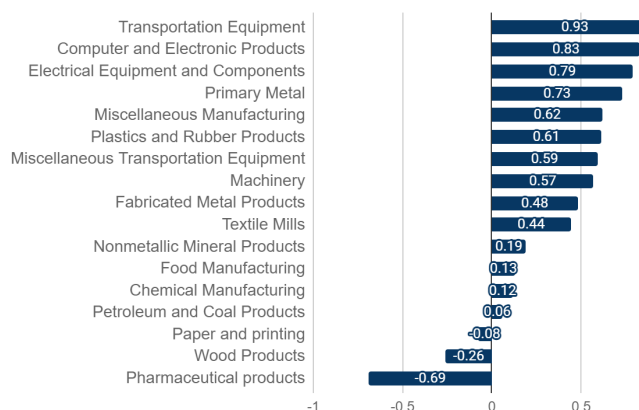
<sup>4</sup> The incentive will only be valid for employees registered with the Mexican Social Security Institute.

<sup>5</sup> Available on [Regional Sectoral Outlook 22S1](#)

<sup>6</sup> RCA compares the weight that a certain sector has in the total exports of an economy, and divides it by the weight that the same sector has in world exports. The RCA is normalized between -1 and 1, so sectors that have a comparative advantage obtain a value greater than zero.

<sup>7</sup> The 6 benefited sectors are: I. Products intended for human and animal nutrition; III. Raw materials for the pharmaceutical industry and pharmaceutical preparations. IV. Electronic components, such as simple or loaded cards, circuits, capacitors, capacitors, resistors, connectors and semiconductors, coils, transformers, harnesses and modem for computer and telephone; IV. Batteries, accumulators, cells, electrical conduction cables, plugs, contacts, fuses and accessories for electrical installations; VII. Gasoline, hybrid and alternative fuel engines for cars, vans and trucks; and, IX. Internal combustion engines, turbines and transmissions, for aircraft.

Figure 1. **REVEALED COMPARATIVE ADVANTAGE (RCA) (NORMALIZED RCA INDEX)**



Source: BBVA Research with data from OECD

Figure 2. **MEXICAN GLOBAL MANUFACTURING RCA (NORMALIZED RCA INDEX)**

Sector	Mexico: Global manufacturing		Top 1 / Top2	
	RCA	Ranking	RCA	Country
Textile Mills	0.44	9	0.9	Cambodia
Wood Products	-0.26	49	0.8	Latvia
Paper and printing	-0.08	37	0.51	Finland
Petroleum and Coal Products	0.06	20	0.64	Russia
Chemical Manufacturing	0.12	14	0.52	Singapore
Pharmaceutical products	-0.69	57	0.88	Ireland
Plastics and Rubber Products	0.61	2	0.62	China
Nonmetallic Mineral Products	0.19	6	0.5	China
Primary Metal	0.73	1	0.6	Chile
Fabricated Metal Products	0.48	2	0.49	Slovenia
Computer and Electronic Products	0.83	2	0.94	China
Electrical Equipment and Components	0.79	2	0.91	China
Machinery	0.57	2	0.66	China
Transportation Equipment	0.93	1	0.56	Czech rep
Miscellaneous Transportation Equipment	0.59	2	0.8	China
Miscellaneous Manufacturing	0.62	3	0.77	China

Source: BBVA Research with data from OECD

However, tax incentives for companies in key sectors may not be enough to counteract infrastructure-related elements that represent an obstacle to the setup of new companies as mentioned in our article *"Technological and capacity constraints in Mexico in the face of nearshoring"*.<sup>8</sup>

In that article, we pointed out as constraints that the consumption of energy inputs by the Chinese manufacturing industry is considerably higher in sectors that are key for Mexico such as Basic Metals, Transportation Equipment; Machinery and Equipment; and Electronics and Computers, which would require more infrastructure and efficient, steady and clean energy sources that would allow these sectors to expand and remain globally competitive. These limitations were reinforced through a survey with members of AMPIP's industrial parks<sup>9</sup>, in which of the total number of industrial parks surveyed: 91% report to have had impacts related to the supply of energy and 63% related to the supply of water.

Likewise, the literature points out that the effectiveness of tax incentives for investment is not necessarily an alternative to promote the attraction of new investors and, in fact, can damage the revenue base of a developing country, eroding the resources allocated to the real drivers of investment decisions, such as infrastructure, education and security.

The OECD<sup>10</sup> reports that in many cases economic entrants would have invested without the need for tax incentives and may create incentives for incumbent firms to attempt to reconstitute themselves as "new entrants". Similarly, tax incentives can artificially shift profits and deductions between entities with different tax treatments, either domestically or internationally. Other studies point to the difference between corporate tax incentives on investment and incentives targeted at more mobile assets and/or activities. In the case of mobile asset incentives, countries can save on revenue compared to the case of a uniform tax incentive.<sup>11</sup> On the other hand, a tax incentive of this

<sup>8</sup> Available on [Regional Sectoral Outlook 22S2](#)

<sup>9</sup> Available on [Nearshoring Outlook: Mexico's Industrial Parks Association survey](#)

<sup>10</sup> OECD. "Tax and development. Principles to enhance the transparency and governance of tax incentives for investment in developing countries." [Available here](#).

<sup>11</sup> Van Parys, S (2012). "The effectiveness of tax incentives in attracting investment: evidence from developing countries". [Available here](#).

type could become unfair competition for companies that are currently already established in the country, so to avoid being discriminatory it would have to be generalized, making it more costly in tax terms.

In any case, the results of a tax incentive can be reduced if the benefits of such a measure outweigh its costs. On the one hand, the benefit of such a measure can be defined as the increase in directly and indirectly attributable economic activities and its positive multiplier effect on the overall economy and government revenues. On the other hand, the cost will be the direct loss of revenue and efficiency, the increase in administrative and compliance costs, and its negative multiplier impact on the overall economy and public revenues. Although it should be mentioned that if it succeeds in attracting companies that otherwise would not have entered the country, there would be no loss of tax revenue.

Finally, consideration should be given to the possibility that this financial contribution by the government grants benefits that may have "unfavorable effects" on the interests of a member of the World Trade Organization (WTO). For example, if a country considers that there is harm to a sector of its domestic production, due to imports of goods from Mexico that were favored with the incentive, these practices can be challenged in the framework of multilateral dispute settlement or be the subject of a countervailing measure by the affected country. Moreover, other countries could adopt similar measures that would lead to a tax competition for such investments, where the economies with greater resources generally prevail. In particular, it should be evaluated whether it violates the T-MEC by discriminating between sectors and not offering national treatment; although, however, the United States also incurs in this type of incentive through the IRA and the CHIPS Act, so we consider it unlikely that they will incur in this discussion.

Therefore, the Act of fiscal incentives to key sectors of the export industry sends clear signals to the market and the investors about the sectors that the Mexican government will promote in the short term, it should be analyzed if such incentives are enough to counteract the lack of infrastructure, as previously mentioned. In conclusion, this public policy in favor of investment is positive, but it must be accompanied by other measures to resolve the energy, water and logistics restrictions that companies have pointed out as limiting factors.

## Appendix

**Table 1: Maximum percentages allowed for the immediate deduction of the investment in new fixed assets**

<b>By type of asset</b>	<b>Maximum authorized</b>
Automobiles, buses, freight trucks, tractor-trailers, forklifts and trailers, whose propulsion is through rechargeable electric batteries, electric motors that also have an electric combustion engine or hydrogen-powered engine and airplanes dedicated to agricultural aerial spraying.	86%
Personal desktop and laptop computers, servers, printers, optical scanners, chart plotters, barcode scanners, digitizers, external storage units and computer network hubs.	88%
Dies, dies, molds, matrixes and tooling.	89%
Machinery and equipment directly destined to the research of new products or technology development in the country.	89%
<b>By type of machinery and equipment activity</b>	<b>Maximum authorized</b>
Construction of facilities for the design, fabrication, manufacturing, assembly, advanced packaging testing or research for semiconductors and packaging of electronic components and semiconductors.	56%
Manufacture of pharmaceutical drugs, antiseptic products for pharmaceutical use, diagnostic substances, tablets, capsules or pharmaceutical solutions and injectable active ingredients.	56%
Manufacture of electron microscopes, medical electronic equipment, laboratory instruments and equipment, analytical equipment, laboratory tests, diagnostic and radiotherapy equipment, pacemakers or hearing aids and other implant devices.	56%
Manufacture of chemicals or materials used in the manufacture, fabrication, assembly, testing and packaging of electronic and semiconductor components.	72%
Manufacture of machinery and equipment dedicated to the design, fabrication, manufacturing, assembly, testing and packaging of electronic and semiconductor components, in categories such as deposition, thermal processing, oxidation and diffusion, lithography, photoresist processing, material cleaning and removal, doping equipment, metrology and inspection, manufacturing automation, test and related equipment, assembly and packaging equipment for the manufacturing process of the electronic and semiconductor component industry.	76%
Design, manufacture, fabrication, assembly, testing and packaging of electronic components, such as single or loaded cards, circuits, switches, capacitors, resistors, connectors and semiconductors, coils, transformers, computer and telephone modems, and harnesses.	76%
Construction and assembly of sets in forums and locations for filming and photography and investment in equipment for the production of films or audiovisual productions.	80% - 83%
Manufacturing, assembly and processing of magnetic components for hard disks and electronic boards, substrates, semiconductor packaging technologies, mechanical supplies (plastic or metal), printed circuit boards, graphics cards, solid state drives, printed circuit board assembly, power	83%

supplies/adapters, batteries for electronic equipment and liquid crystal displays for the computer industry.	
Manufacture, assembly and transformation of batteries for automobiles, vans, trucks, trains, ships and aircraft, as long as all these vehicles are electric.	86%
Manufacture of automobiles, vans, trucks, trains, ships and aircrafts, whose propulsion is by means of rechargeable electric batteries, electric motors that also have an electric combustion engine or a hydrogen-powered engine.	86%
Manufacture of gasoline, hybrid and alternative fuel engines for cars, vans and trucks.	86%
Manufacture of electrical and electronic equipment, steering, suspension and braking systems, transmission systems, seats and interior accessories, and stamped metal parts for automobiles, vans, trucks, trains, ships and aircraft.	86%
Production of products for human and animal feed.	88%

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