Perspectives

N° 25/073 - 5 March 2025

MEXICO – An overview of three decades of free trade

- **D. Trump's return to the White House and his tariff threats against Mexico and Canada, suspended until March 1, could jeopardise the USMCA (*United States-Mexico-Canada Agreement*), a trade agreement signed in 2018 that replaced the North American Free *Trade* Agreement (NAFTA) in 2020.**
- **NAFTA, the first free trade agreement between developed and emerging countries, came into force in 1994, creating the world's largest trading zone. Thirty years on, without claiming to be exhaustive, what assessment can be made of NAFTA for Mexico?**
- **It is difficult to isolate the effects of NAFTA from those of other Mexican policies and global trends, but we can attempt a rapid assessment with the help of a few key studies[1] and statistics. Assessing NAFTA's impact "fairly" also means judging it against its original objectives.**

Mexico's original intentions: laudable

Several development strategies have been successively applied in Mexico. The growth model based on import-substitution industrialisation and protectionism, which had worked fairly well between 1958 and the early 1970s, was undermined by the post-oil *boom* and the debt crisis of 1982[2] was the "coup fatal". Encouraged by the liberal wave, Mexico embarked on a path of liberalisation and deregulation, affecting all economic sectors except energy and railways. Economic policies were designed to attract foreign investment and ensure external growth. The economy experienced a period of accelerated opening to international competition, indiscriminately, without any industrial or financial policy. Then, in 1989 the expression "Washington Consensus" emerged[3], Mexico joined the GATT, signed NAFTA and joined the OECD in 1994. Although 1994 was a year of opening up full of

[1] Baylis, K., Garduño-Rivera, R., & Piras, G. *(2012). The distributional effects of NAFTA in Mexico: Evidence from a panel of municipalities. Regional Science and Urban Economics, 42(1-2), 286-296; Cámara de Diputados. (2015). Impacto del tratado de libre comercio en la economía Mexicana;* De La Cruz, J., Riker, D., & Voorhees, B. *(2013). Econometric Estimates of the Effects of NAFTA: A Review of the Literature. U.S. International Trade Commission, Office of Economics;* Delgadillo Macías, J., & Cortez, H. *(2008). Desigualdades territoriales en México derivadas del tratado de libre comercio de América del Norte. Revista de Geografía Norte Grande, (40), 35-54;* Morales Aragón, E. *(2014). El Regionalismo Estratégico En América Del Norte: México Y El Tlcan, Veinte Años Después. Economía UNAM, 11(31), 3-30; Villarreal, M. A. (2010). NAFTA and the Mexican Economy. Congressional Research Service.*

[2] On the whole, this development model has proved to be inefficient (particularly in terms of reducing inequality) and conducive to inflation. While there was a massive need for investment, low domestic savings led to external imbalances, encouraged by overvalued exchange rates. Recourse to inexpensive external financing was the greatest vulnerability: the rise in US interest rates will fully reveal this. This led to an explosion in foreign debt and the servicing of that debt, causing Mexico to default in 1982, followed by all the major Latin American countries with the exception of Colombia. Accompanied by massive depreciations, a source of inflation, the crisis was socially and economically costly. It lasted a long time, ending with the Brady Plan in 1989, which eased debts and converted them into bonds.

[3] The "*credo*" was quite simple: disengagement of the State, the privatisation/deregulation diptych, budgetary discipline, a primordial role for monetary policy, exchange rate flexibility, liberalisation of prices, interest rates and world trade in goods and capital. Latin America will be converted. The conversion will be completed later by the adoption of inflation-targeting monetary policies conducted by independent central banks, which will put an end to the monetary financing of budget deficits.

Catherine LEBOUGRE
catherine.lebougre@credit-agricole-sa.fr

Jorge APARICIO LOPEZ
jorge.apariciolopez@credit-agricole-sa.fr

promise, the hopes of the markets were such that 1994 was also the year of a new Mexican debt crisis.[4]

From the Mexican point of view, NAFTA was to be the pillar of an economic strategy focused on external demand and foreign investment. The signing of NAFTA was intended to confirm Mexico's status as an open and liberal economy and intensify trade and investment between the partners. Mexican leaders, such as Salinas (President of Mexico from 1988 to 1994), presented the agreement as a sign of Mexico's entry into modernity, promising more jobs, better pay and even greater redistribution. It was a question of "exporting products, not workers", according to Salinas. He argued that the growth offered by the agreement would enable Mexico to focus on the most disadvantaged.

The most obvious effects of free trade agreements

The thirty years of free trade in North America have obviously given rise to a very sharp increase in trade flows (*Figures 1 and 2*). Trade between Mexico and the United States has increased by more than 200% in real terms since 1994, and that with Canada by more than 350%, despite the emergence of China as a major exporter and direct competitor of Mexico. Foreign direct investment (FDI, *chart 3*) from the United States and Canada into Mexico has increased by 134% and 700% respectively in real terms between 1994 and 2024. The intensification of trade has shaped sectoral development and Mexican growth: the main sectors to benefit are the automotive industry and its derivatives, as well as electronics (*chart 4*). These sectors have benefited from US technological innovations. Agriculture, on the other hand, has been adversely affected by more technologically advanced American competition.

The free trade agreement, the close relationship with the United States and its implications (regulations, better border, and customs controls) have all helped to improve Mexico's "image". NAFTA has anchored Mexico in a model of an open market economy, from which it is extremely difficult to escape. In addition to the trade agreement, decisive changes introduced almost simultaneously (central bank autonomy in 1993) or subsequently (inflation targeting in 2001) have resulted in greater economic stability. The results have been remarkable: Mexico, which had previously experienced triple-digit inflation rates, has now enjoyed two decades of low inflation. Growth volatility has been greatly reduced (*chart 5*). The external accounts have improved and the external constraint has eased (*graph 6*). But the Mexican economic cycle has synchronised with that of the United States. The correlation between US and Mexican growth, which was insignificant before NAFTA, is now close to 0.8. Mexican monetary policy is largely conditioned by that of the Federal Reserve, whose movements in the key rate it reproduces "almost scrupulously" (*Graph 7*).

Economic and social impact: unfulfilled promises

Studies on the macro-economic impact of NAFTA all point to a moderately positive outcome. Without a relay in the form of a "proactive" public policy, the treaty alone has not been enough to stimulate Mexican economic growth: the gains have not spread. The initial conditions have had a strong influence on the current results, and Mexican growth has, in the end, been close to that of its peers. The results are far from expectations, and long-standing problems such as unemployment, poverty and social and geographical inequalities remain.

Exports to the North and US direct investment inflows have certainly risen spectacularly. But it is estimated that 51% of manufacturing exports are made by around a hundred companies, mostly foreign companies. Mexico continues to specialise in labour-intensive manufacturing sectors, so it is still largely a centre for assembly, importing intermediate goods and exporting finished products to the North. This relationship of dependence extends from trade to investment. The latter are highly concentrated in a small number of sectors (almost 50% are in the manufacturing industries; investment in the automotive sector alone accounts for 20% of foreign direct investment, FDI) and states (Mexico City and the border states account for almost 60% of FDI, rising to 75% if the central states bordering Mexico City are included). Finally, some studies suggest a crowding-out effect at the expense of non-North American investment, particularly in sectors subject to strict local content rules.

[4] The Mexican crisis of 1994/1995 inaugurated the series of emerging crises of the 1990s. These crises had their own specific triggers, but all had a common foundation, stemming *from* post-Brady Plan financialisation. Upstream, we find: macro-economic management with a reputation for orthodoxy; minor, hidden or underestimated economic imbalances (particularly external imbalances); quasi-fixed exchange rates and, above all, very easy access to foreign capital. Downstream, there is a crisis of confidence, untenable pressure on the currency, which ends up floating, contagion to other countries and then IMF aid, usually in support of debt restructuring. It is essentially the form of the capital and the nature of the debtors that differ: they are increasingly sophisticated and complex. In Mexico, the trigger was political; the debt was public, domestic, short, but indexed to the dollar and largely held by non-residents, enthusiastic about the implementation of NAFTA.

Catherine LEBOUGRE
catherine.lebougre
@credit-agricole-sa.fr

Jorge APARICIO LOPEZ
jorge.apariciolopez
@credit-agricole-sa.fr

In terms of GDP per capita, the gap has widened not only with our northern partners (*Figure 8*), but also between the Mexican states themselves (*Figure 9*). NAFTA has deepened the existing geographical divide. Investment is (obviously) concentrated in the North, where transport costs are lower and infrastructure, such as trains and public services, reduce investment costs. The southern states, historically producers of raw materials, including oil, have the highest rates of poverty and informality, collect little tax (*chart 10*), depend on government transfers of public funds (*chart 11*) and suffer from low levels of public investment (*chart 12)*. They are also often dependent on remittances from emigrants in the United States (*remesas*) and are closer to neighbouring countries to the south than to the Mexican states to the north.

As a result, the wealth and profits generated by exports and investment have not spread throughout the country. What remains is a two-speed Mexico: on the one hand, the industrial, exporting North, with Mexico City and its spillovers in the neighbouring central states; and on the other, the southern states, which are not very productive, are not integrated into the value chains and are economically stagnant. Emigration to the United States and the northern states is still rife. Lacking strategy and public investment (in infrastructure and education, in particular), committed to a laudable but "pathogenic" budgetary orthodoxy[5] , and scalded by past debt crises, Mexico has not managed to really capitalise on the gains (certainly supposed to be too easy) of the free trade agreement.

Trump's new demands and the Mexico Plan

Despite Trump's threats that any trade surplus with the United States is undue gain, the economic interdependence of the three North American countries, accentuated by the decoupling with China, gives hope for a new agreement. Mexico is also pinning great hopes on the restructuring of Sino-American trade, which would enable it to increase its market share and in *nearshoring*. However, this trend is slow and investment is struggling to take off due to the uncertainty surrounding the future of the trade agreement linking Mexico to its partners to the north, as well as institutional changes in Mexico. In the short term, the aim is to avoid offending the United States, without whose support, the Plan México[6] , which aims to achieve an investment rate of 28% of GDP (compared with an average of 23.5% since 2021), may not have the desired effect.

This plan is decisive because the (admittedly incomplete) assessment that precedes it calls for caution. Partially "delegating" its industrial development does not exempt it from public investment efforts (education, infrastructure, innovation). Otherwise, free trade (or what's left of it) and *nearshoring* will provide a sort of minimum guarantee of economic stability, but at the price of mediocre growth, little diversification, continued inequality and a geographical divide.

[5] See our publication: Mexique – Budget 2025, « raisonnable » mais réaliste ? - 08/01/2025 (French language)

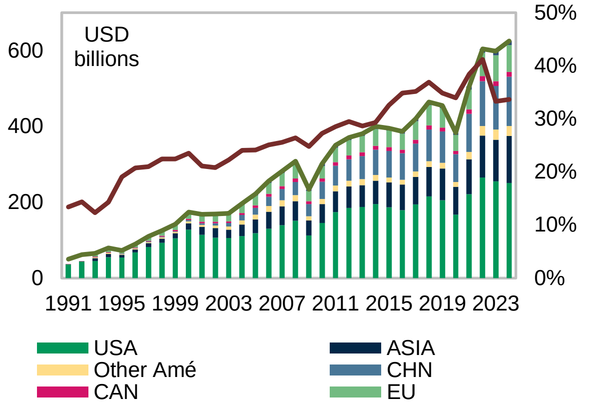
[6] See our publication: Mexique : guerre commerciale, premières salves, cessez-le-feu fragile – 12/02/2025 (French language)

Catherine LEBOUGRE
catherine.lebougre
@credit-agricole-sa.fr

Jorge APARICIO LOPEZ
jorge.apariciolopez
@credit-agricole-sa.fr

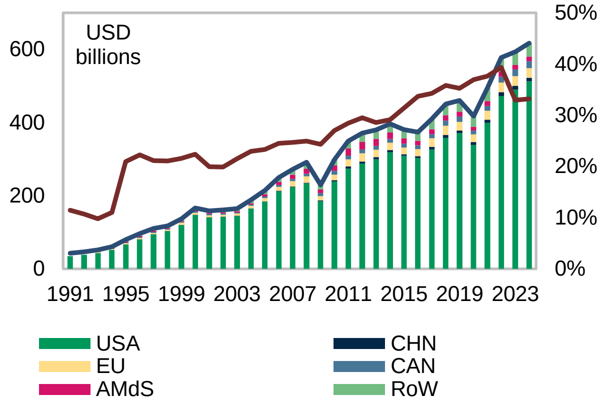
Graphics booklet

1 - Mexico: imports



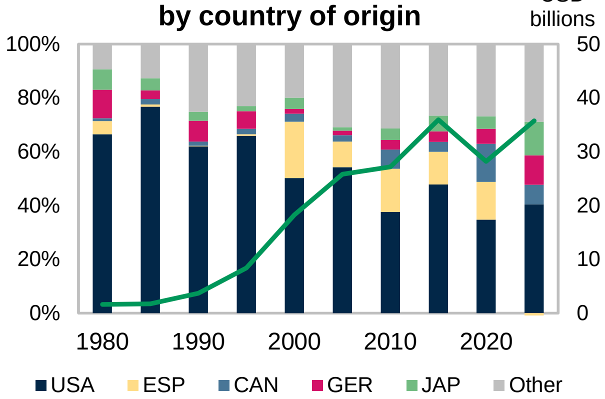
Sources: Banxico, Crédit Agricole S.A./ECO

2 - Mexico: exports



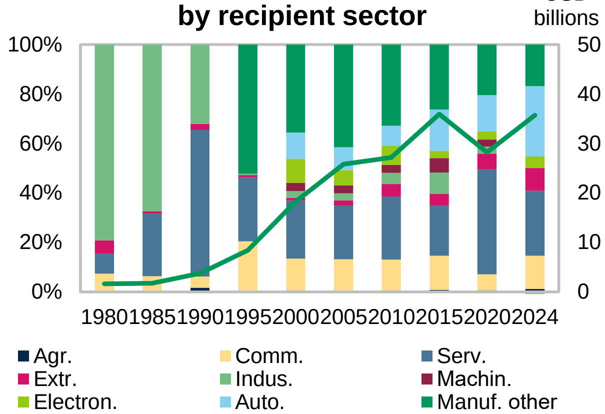
Sources: Banxico, Crédit Agricole S.A./ECO

3 - Mexico: FDI by country of origin



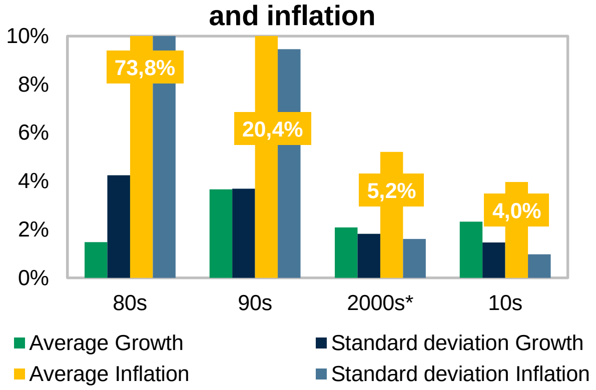
Sources: Secr. Hacienda, Crédit Agricole S.A./ECO

4 - Mexico: FDI by recipient sector



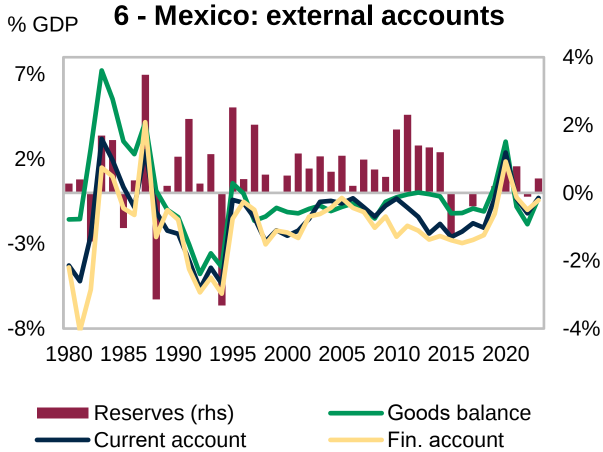
Sources: Secr. Hacienda, Crédit Agricole S.A./ECO

5 - Mexico: growth and inflation



* Excluding the 2008 crisis
Sources: Oxford Eco, Crédit Agricole S.A./ECO

6 - Mexico: external accounts

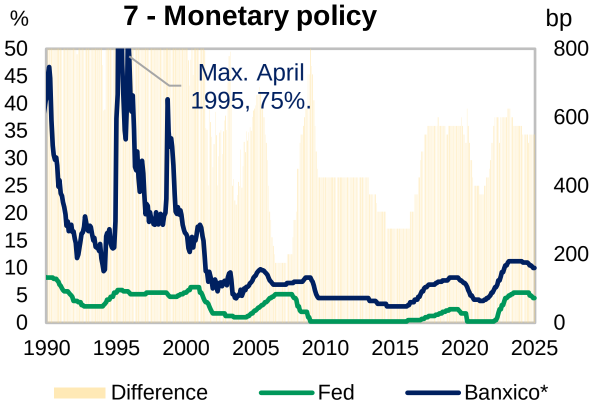


Sources: IMF, Crédit Agricole S.A./ECO

Catherine LEBOUGRE
catherine.lebougre
@credit-agricole-sa.fr

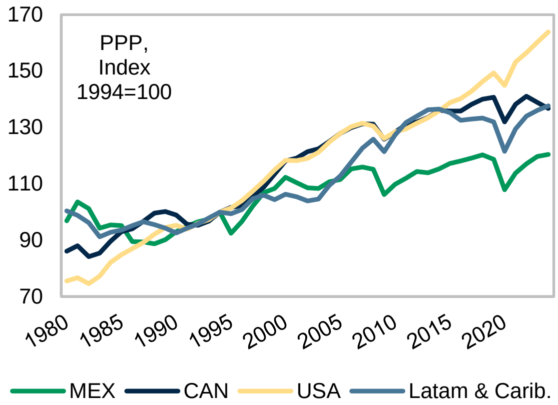
Jorge APARICIO LOPEZ
jorge.aparicioloepz
@credit-agricole-sa.fr

7 - Monetary policy



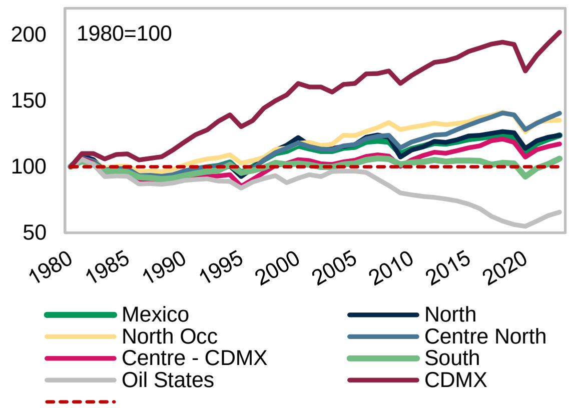
* Before 2005, CETES 28 days
Sources: Central Banks, Crédit Agricole S.A./ECO

8 - GDP per capita



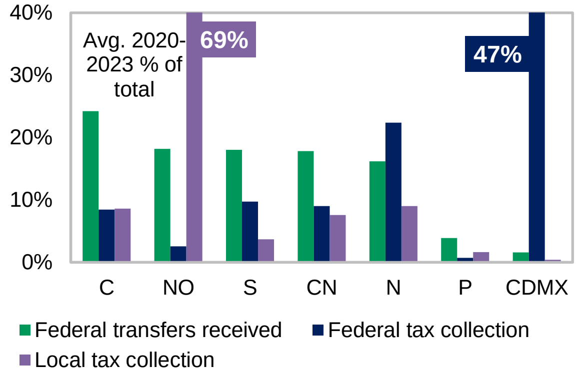
Sources: IMF, Crédit Agricole S.A./ECO

9 - GDP per capita by "region"



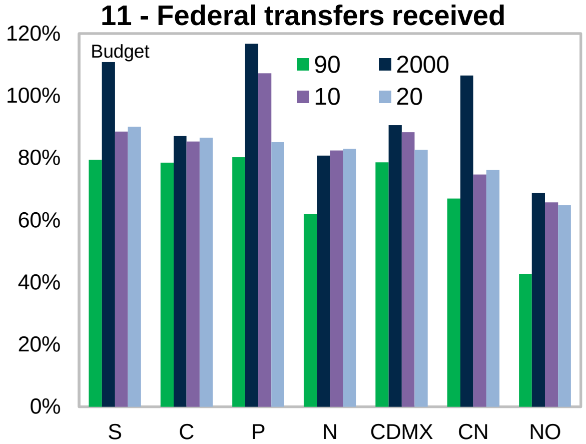
Sources: INEGI, Crédit Agricole S.A./ECO

10 - Tax collection and federal transfers



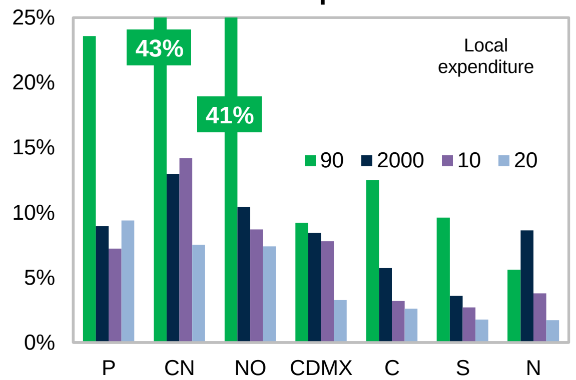
Sources: INEGI, Crédit Agricole S.A./ECO

11 - Federal transfers received



Sources: INEGI, Crédit Agricole S.A./ECO

12 - Regional public investment expenditure



Sources: INEGI, Crédit Agricole S.A./ECO

* C: Centre; CDMX: Ciudad de México; CN: Centre North; N: North; NO: North West; P: Petroleum States; S: South.

Catherine LEBOUGRE
catherine.lebougre
@credit-agricole-sa.fr

Jorge APARICIO LOPEZ
jorge.apariciolopez
@credit-agricole-sa.fr

Consult our latest publications in free access on the Internet

Date	Title	Theme
04/03/2025	China – Growth is a "positive surprise", but serious questions remain	Asia
03/03/2025	Low-code and AI: the revolution in software development	Technology/telecom
20/02/2025	China: growth is a “positive surprise” but serious questions remain (abridged version)	Asia
13/02/2025	Everything is now related…	Geopolitics
06/02/2025	France – 2025-2026 Scenario: in search of political stability, with growth weakened by uncertainty	France
06/02/2025	Slowing growth is making trade-offs more complicated in India	Asia
06/02/2025	Germany – 2025-2026 Scenario: Europe's locomotive at a standstill	Europe
31/01/2025	Italy – 2025-2026 Scenario: the curse of weak growth in an uncertain world	Italy
31/01/2025	Eurozone –2025-2026 Scenario: a sluggish recovery at a slower pace than potential	Europe
23/01/2025	Spain – 2025-2026 Scenario: Growth keeps pace	Europe
23/01/2025	United Kingdom – 2025-2026 Scenario: unwelcome policies in the autumn budget 2024 complicate the economic outlook	United Kingdom
23/01/2025	K-drama in Seoul	Asia
22/01/2025	Spain – 2025-2026 Scenario: Growth keeps pace	Europe
21/01/2025	Brazil – The shadow of fiscal imbalance looms over a fast-growing economy	Latin America
20/01/2025	Argentina – Some progress but it seems reasonable to wait	Latin America
16/01/2025	Trump and fear : the new alliance between mercantilism and geopolitics	Geopolitics
20/12/2024	World – 2025-2026 scenario: a conditional scenario, more than ever	World
17/12/2024	French growth – Starting to foot the bill of politics	France
12/12/2024	Following his failed power grab, South Korean President Yoon escapes impeachment	Asia
05/12/2024	The metaverse reborn	Technology/telecom

Crédit Agricole S.A. — Group Economic Research
12 place des États-Unis – 92127 Montrouge Cedex

Publication manager: Isabelle Job-Bazille
Chief Editor: Armelle Sarda
Information centre: Elisabeth Serreau – **Statistics:** Datalab ECO
Editor: Fabienne Pesty

Contact: *publication.eco@credit-agricole-sa.fr*

Consult Economic Research website and subscribe to our free online publications:
Website: https://etudes-economiques.credit-agricole.com/en
iPad : Etudes ECO application available on App store platform
Android : Etudes ECO application available on Google Play platform