



Norteamérica

ISSN: 1870-3550

Universidad Nacional Autónoma de México, Centro de Investigaciones sobre América del Norte

Escaith, Hubert

From NAFTA to USMCA: Can a Good Idea that Came Too Late Be Born Again?

Norteamérica, vol. 16, no. 2, 2021, July-December, pp. 317-345

Universidad Nacional Autónoma de México, Centro de Investigaciones sobre América del Norte

DOI: <https://doi.org/10.22201/cisan.24487228e.2021.2.517>

Available in: <https://www.redalyc.org/articulo.oa?id=193771604012>

- How to cite
- Complete issue
- More information about this article
- Journal's webpage in redalyc.org

UNAM  redalyc.org

Scientific Information System Redalyc

Network of Scientific Journals from Latin America and the Caribbean, Spain and Portugal

Project academic non-profit, developed under the open access initiative

# From NAFTA to USMCA: Can a Good Idea that Came Too Late Be Born Again?

## Del TLCAN al T-MEC: ¿puede renacer una buena idea que llegó muy tarde?

HUBERT ESCAITH\*

### ABSTRACT

This article analyzes from the trade perspective the lower-than-expected growth dividends of Mexico's export-led strategy adopted in the 1990s. Particular attention is given to employment, labor productivity, and regional outcomes. The North American Free Trade Agreement (NAFTA) caused Mexican exports to skyrocket in the first years of its implementation. This initial lift was quickly sapped by China's emergence after it entered the World Trade Organization in 2001. Recent years witnessed a renewed dynamism of Mexican presence in the U.S. market. In an international context marked by deglobalization and decoupling, this rebound is expected to continue under the United States-Mexico-Canada Agreement (USMCA). Yet, in order to deliver economic growth, Mexico needs to diversify the geographical location of its exporting industries. The analysis of Mexican exports shows also that idiosyncratic weaknesses, such as the low contribution of the business services sector or the deficient trade and transport infrastructure, must be addressed.

**Key words:** international trade, regional agreements, deglobalization, market share analysis.

### RESUMEN

Este artículo analiza, desde la perspectiva comercial, el crecimiento de los dividendos (menor del esperado) de la estrategia dirigida a la exportación adoptada por México en la década de los noventa. Se da particular atención al empleo, a la productividad laboral y a las ganancias regionales. El Tratado de Libre Comercio de América del Norte (TLCAN) catapultó las exportaciones mexicanas durante los primeros años de su implementación; esta alza inicial fue rápidamente interrumpida por el ascenso de China, cuando entró a la Organización Mundial de Comercio (OMC) en 2001. En años recientes, se observa un dinamismo renovado de la presencia mexicana en el mercado de Estados Unidos. En un contexto internacional marcado por la

\* Associate researcher at Aix-Marseille University (France), visiting scholar at Bournemouth University (UK). I wish to thank two anonymous reviewers for their insightful comments and suggestions for a previous version; remaining errors and shortcoming are my sole responsibility. [hubert.escaith@outlook.com](mailto:hubert.escaith@outlook.com)

desglobalización y la disgregación, se espera que continúe un repunte de aquellas exportaciones con el Tratado México-Estados Unidos-Canadá (T-MEC). México, para llegar a un crecimiento económico, necesita diversificar la ubicación geográfica de sus industrias exportadoras. El análisis de las exportaciones mexicanas también muestra las debilidades idiosincráticas, como la baja contribución del sector servicios a los negocios o la deficiente infraestructura comercial y de transporte.

**Palabras clave:** comercio internacional, acuerdos regionales, desglobalización, análisis de mercados compartidos.

## INTRODUCTION

In 1994, Mexico joined the North American Free Trade Agreement (NAFTA), a preferential trade agreement with Canada and the U.S. and the Organisation for Economic Co-operation and Development (OECD). On the domestic front, successive governments had reformed the Mexican economy, giving more say to markets in a country previously dominated by patronage and large state-owned companies. In 1997, Mexico was the first country in Latin America to sign an Economic Partnership, Political Coordination and Cooperation Agreement with the EU. As mentioned by Hanson (2010), Mexico's transformation seemed a good way forward and everything indicated that its economy was on the road to success. It wasn't.

Scores of books and articles have been written to explain why economic growth had remained sluggish in Mexico, while other developing countries that had adopted similar open-economy export-led growth strategy were more successful. Some authors emphasize external constraints; others, idiosyncratic factors. Still others more radically condemn it as a bad idea altogether.<sup>1</sup> This article contributes to the former line of research, in particular regarding the lower-than-expected growth dividends of the export-led accumulation regime adopted by Mexico. It also evaluates from this international trade perspective the export potential offered by the United States-Mexico-Canada Agreement (USMCA) in place since 2020.

After looking at the Mexican growth achievements under different accumulation regimes, the article focuses on the empirical analysis of Mexican export competitiveness in the U.S. market. The next section looks at the potentialities offered by the USMCA, considering the new international perspectives that emerged in the past

<sup>1</sup> NAFTA was a perennial target in the broader debate over free trade. It was criticized in the U.S. for contributing to job losses and the outsourcing of manufacturing. Meanwhile, many economists in Mexico considered it a bad choice compared to the more inward oriented state-led policies that delivered high growth rates in the 1960s (Ruiz Nápoles, 2017).

decades, including changes regarding the risks of supply-chain disruption after the Covid-19 pandemic. The conclusions summarize the main findings.

## NAFTA 1.0, A GOOD IDEA THAT ARRIVED TOO LATE THE ECONOMIC GROWTH PERSPECTIVE

Let's have a look at output per employed person over the 1950-2019 period (Table 1). Major time periods are based on the successive accumulation regimes of the Mexican economy: inward protectionism (from 1950 to 1970), external debt-driven economy (from 1970 to 1989), and export-led growth (from 1989 to 2019).

Accumulation Regimes and Their Sub-periods <sup>a</sup>	1950- 2019	1950-1970 Protectionism			1970-1989 Debt-driven			1989-2019 Export-led		
	Mean Growth <sup>b</sup>	Mean Growth <sup>b</sup>	1950- 1960	1960- 1970	Mean Growth <sup>b</sup>	1970- 1981	1981- 1989	Mean Growth <sup>b</sup>	1989- 1994	1995- 2019
Mexico	1.18	4.25	4.93	3.57	-0.26	1.55	-2.70	0.19	1.18	0.00
Americas (excl. Mexico)	1.08	2.94	2.84	3.04	0.45	1.18	-0.54	0.49	1.89	0.22
- Developed	1.21	2.86	3.05	2.67	1.11	1.01	1.26	1.26	1.44	1.22
- Developing	1.02	2.97	2.76	3.18	0.18	1.24	-1.26	0.18	2.07	-0.19
Others	1.75	4.05	3.72	4.05	2.29	2.23	1.73	1.62	2.74	1.63
- Developed	1.95	4.87	4.49	5.25	2.53	2.78	2.18	0.92	1.94	0.72
- Developing <sup>c</sup>	1.53	2.62	2.38	2.37	2.01	1.59	1.21	2.43	3.68	2.69

**Notes:** a/ The table presents the corresponding average results based on major developed and developing countries (the members of the G20) plus Chile, Colombia and Spain. The accumulation regimes correspond to the Mexican case and may not be relevant to other regions. b/ Mexico, average annual GDP growth per employed person, at 2017 prices over the period of reference; other regions: simple mean of countries' average annual growth; c/ Including South Korea.  
**Source:** Developed by the author using University of California, Davis, and the Groningen Growth Development Centre of the University of Groningen (n.d.).

The main policy tenets of the 1950-1970 state-led growth strategy remained the same during both decades. The 1970-1989 debt-driven cycle is split in two: the state-led external debt accumulation phase, until the balance of payment crisis of 1981;

this led to a subsequent adjustment period up to the signature of the Brady Agreements in 1989, which marked the return to a normal access to external financing. The third export-led accumulation regime is also split in two, before and after the actual implementation of NAFTA (1994).

Over the entire 1950-2019 period, Mexico's average annual growth rate of value added per employed person has been above that of other large Latin American developing countries, yet remained slightly below the Canadian and U.S. averages. In other words, there was no real income convergence within North America. Compared to other regions in the world, average growth in Mexico also remains below other large developed and developing countries.

During the accumulation regime based on state-led protectionism (1950-1970), Mexico did better than most countries, with the exception of Europe. Opting for a state-led debt-driven accumulation regime in the 1970s proved disastrous for Mexico and for many other developing countries in Latin America. When the price of commodities went down and international interest rates went up, commercial sources of financing dried up, leading to a balance-of-payments crisis in 1982. This crisis caused a forced de-leveraging of the economy until a debt settlement was found under the Brady Plan in 1989.<sup>2</sup> Yet, it is easy to criticize this decision in retrospect. What is seen today as a mistake looked reasonable at that time and in line with the Latin American heterodox mainstream (structuralist and post-Keynesian schools) emphasizing effective demand and state-led growth strategy.

The export-led accumulation regime that Mexican authorities adopted to return the economy to a macroeconomic sustainable growth pattern was not as effective as expected—to say the least. In a successful export-led accumulation regime, an increasing number of export-oriented jobs are created in a first phase, while domestic demand is expected to regain dominance afterwards. Table 2 shows that in 2015, the last year covered by the Penn Tables (University of California, Davis, and Groningen Growth Development Centre of the University of Groningen, n.d.), almost 19 percent of all (formal) jobs in the Mexican economy depended directly or indirectly on exports. The percentage reaches 49 percent in the case of manufacturing, with a maximum of 85 percent in the case of computers, electronics, and electric equipment, followed by 81 percent in the case of transportation equipment. So, the first phase seems to have been successful, but not the second.

If we compare this with other North American countries, we see that Mexican numbers have been increasing while Canada's have been dropping (no causality can

---

<sup>2</sup> Named after U.S. Treasury Secretary Nicholas Brady, the bonds were part of a debt-restructuring program created in March 1989 to convert Latin American and other developing countries' non-performing bank loans.

be inferred at this time). The U.S. numbers have remained roughly in the same range over the ten-year period, at a much lower level that reflect this economy's inward orientation. Curiously, the OECD group of advanced economies shows an increase in their reliance on exports, indicating a growing interdependence with the global economy, while the opposite is true for non-OECD (developing) economies, albeit starting from a higher share. This is true also for the other Latin American economies covered by the database (Argentina, Brazil, Chile, Costa Rica and Colombia). On average, their reliance on exports for job creation (not shown in the table) has dropped from 21 percent in 2005 to 16 percent in 2015.

Table 2 DIRECT AND INDIRECT EMPLOYMENT LINKED TO EXPORTS (percentage)			
	2005	2010	2015
Total Employment			
Mexico	14.8	15.8	18.8
Canada	24.4	19.6	20.0
United States	7.1	8.7	8.8
OECD countries	4.0	5.9	6.7
Non-OECD Economies	11.4	8.6	7.5
Manufacturing			
Mexico	37.3	39.3	48.6
Canada	48.6	42.7	45.1
United States	16.9	21.1	20.4
OECD Countries	8.7	13.9	15.2
Non-OECD Economies	28.3	21.4	18.8
<i>of which: Indirect employment</i>			
Mexico	44.8	54.9	48.8
Canada	54.0	56.0	55.9
United States	55.0	56.1	57.7
<b>Notes:</b> Based on domestic employment embodied in foreign final demand, except indirect employment, based on gross exports which may include some double counting.			
<b>Source:</b> Author, based on OECD (n.d.a).			

The share of indirect jobs generated by Mexican exports of manufactures is low compared to Canada and U.S., and it is concerning. This low value, compared with other large developed and developing countries –the G20 average was 58 percent in 2015, Mexico ranking last but one, just above Saudi Arabia at 44 percent– indicates

that the export-oriented manufacture industry is less inserted in the rest of the economy than should be expected. For an export-led growth strategy to be successful –besides removing the balance of payments constraint–, it is important to develop a domestic supply chain of first- and second-tier suppliers around the exporting firms. Even if Contreras, Carrillo, and Alonso (2012) observe the emergence of knowledge-intensive local suppliers in some sectors, the national data indicate that this remains quite limited.

Another related source of concern is the stagnation of productivity. Penn Tables (Table 3) show no impact of NAFTA on total factor productivity (TFP) for Mexico. Even if it did better than other Latin American countries in the 1995-2019 period, it remained below other developing countries. Convergence within NAFTA is far from occurring since Canada and the U.S. have systematically improved their TFP through the years.

Table 3 TOTAL FACTOR PRODUCTIVITY: AVERAGE ANNUAL GROWTH RATE (1954-2019) (percentage)											
TFP	1954- 2019	std dev	1954- 1970	1954- 1960	1960- 1970	1970- 1989	1970- 1981	1981- 1989	1989- 2019	1989- 1994	1995- 2019
Mexico	-0.33	1.27	1.06	1.50	0.80	-1.23	0.06	-2.96	-0.49	-0.31	-0.52
Americas (excl. Mexico)	-0.05	1.27	1.38	1.17	1.51	-0.67	-0.65	-0.70	-0.41	0.93	-0.67
- Developed	0.71	0.75	1.79	2.24	1.53	0.27	0.21	0.34	0.43	0.34	0.45
- Developing	-0.36	1.48	1.22	0.75	1.51	-1.04	-0.99	-1.11	-0.74	1.17	-1.12
Others	0.92	1.42	1.95	1.77	1.99	0.72	-0.34	0.21	0.22	0.87	0.27
- Developed	1.00	1.13	2.60	2.42	2.71	0.88	0.84	0.95	0.24	0.58	0.17
- Developing	0.80	1.76	1.04	0.64	0.99	0.53	-1.71	-0.64	0.20	1.20	0.39
<b>Note:</b> TFP: Total Factor Productivity at constant national prices (2017=1). <b>Source:</b> Author, based on University of California, Davis, and the Groningen Growth Development Centre of the University of Groningen (n.d.).											

Mexico's relatively large informal sector limits its capacity to improve productivity. It is generally agreed that informal employment in Mexico represents more than half of total employment, a proportion that decreases to 35 percent if one excludes agriculture (Ecorys, 2015). The weight of the informal sector in explaining the poor return to physical or human investment is an opinion shared by Levy and López-Calva (2016). They mention that while the premium paid to higher-skilled labor increased

with the take-off of NAFTA in 1994, it began to decline afterward: between 1998 and 2013 the number of formal firms declined, while that of informal ones increased. The causes and role of informality is a complex issue prone to controversy, as illustrated by the Ley-Ross debate (Levy, 2019). I leave the debate to the specialists.

From a trade perspective, several micro-economic studies indicate that trade openness has increased the productivity of the Mexican manufacturing sectors, in particular that of medium-sized and large companies. Aleman-Castilla (2006) finds that trade openness led to reductions in the likelihood of informality in the tradeable sectors, especially in export-oriented industries. Calderon-Madrid and Voicu (2004) report that enhanced access to imported inputs as a result of NAFTA had the most significant positive effect on manufacturing productivity. According to them, the efficiency gap between exporters and non-exporters and between large and small exporters grew significantly during this period. Firms, in particular exporting ones, with a high share of intermediate input in their production gained the most in terms of efficiency. On the contrary, opening the domestic market to the competition of foreign products did not entice inward-oriented firms to become more productive. Thus, producing internationally competitive intermediate products seems to be a weakness of the Mexican domestic supply chain.

More recently, De León Arias (2013) finds that the TFP contribution to growth increased significantly for the manufacturing sector between 1998 and 2008. Díaz Bautista (2017) observes a similar effect in the northern states of Mexico and West Central Region. He attributes this relative performance to the re-location of industrial activities following the opening of the economy, due to investment by foreign firms, which set up their activities toward the northern region where labor and trade costs were lower than in the old industrial zone surrounding the capital.

As usual in trade analysis, geography matters a great deal. The relationship between trade and regional development has been extensively researched in Mexico, since this country represents, together with the European Union, an excellent research laboratory. In De Leon (2019), the authors indicate that while production and employment increased in the northern states, labor productivity increased more rapidly in the central regions due to the pre-existing concentration in physical and human capital, as well as other agglomeration effects. Of particular relevance according to the authors was the industrial development in what is called “el Bajío.”<sup>3</sup> This process, albeit not directly related to export activities toward the U.S., results from the decentralization initiated with the implementation of NAFTA.

<sup>3</sup> Guanajuato, Querétaro, Aguascalientes, Eastern Jalisco, Northern Michoacán and part of San Luis Potosí. Productivity statistics referring to Mexico City are usually upwardly biased due to the so-called “headquarters effect,” large firms reporting their economic activity from their administrative head office in the capital.



Another issue directly related to trade and geography is the role of transportation costs. Mesquita Moreira et al. (2013) conclude that high domestic transportation costs and deficient infrastructure are handicaps that slowed down development convergence of Mexico's federal states. For these authors, the poor conditions of transport infrastructure is due to decades of underinvestment, particularly in railways, limiting efficient multimodal logistical arrangements. According to their calculations, an average 1-percent reduction in domestic *ad val.* transportation cost leads to a 2.6-percent increase in exports. The impact differs according to products and regions. It is 1.6 times higher for agricultural than for manufacturing or mining products. It is also five times higher for the southern regions, which record the lowest share of the country's exports and suffer the most from inadequate transport infrastructure.

In summary, the available evidence on the effect of NAFTA on TFP indicates that it remained mostly limited to firms located in the northern and Bajío regions. The free trade agreement did not have any significant impact on aggregate productivity levels and has not been able to break the vicious cycle between informality and low productivity growth in Mexico. Thus, the real question is not if NAFTA had a positive impact on TFP—the answer is yes—but why this impact remained limited to the enclave economy that developed in Mexico's northern states. Answering this question falls beyond the objective of this essay and the competence of its author.

## THE STRUGGLE TO CAPTURE U.S. MARKET SHARES IN GOODS AND SERVICES

Table 4 ORIGIN OF U.S. IMPORTS OF MERCHANDISE (1985-2020) (percentage)								
	1985	1990	1995	2000	2005	2010	2015	2020
World <sup>a</sup>	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
NAFTA	24.6	24.1	27.4	29.4	26.8	26.0	26.3	25.5
Canada	19.2	18.1	19.2	18.5	16.9	14.2	13.2	11.6
Mexico	5.4	6.0	8.1	10.9	10.0	11.8	13.1	13.9
China <sup>b</sup>	3.8	5.2	7.8	9.6	15.6	19.7	21.8	19.0
Western Hemisphere (n.e.s)	8.2	7.0	5.9	6.1	7.5	6.9	5.2	3.9
Advanced Economies (n.e.s)	56.4	53.7	48.4	42.8	35.3	31.2	33.7	36.7
Emerging and Developing Economies (n.e.s)	7.1	9.9	10.5	12.0	14.7	16.2	13.0	15.0
<b>Notes:</b> a/ Exclude re-exports and are based on their CIF valuation. b/ Includes Hong-Kong and Macao.								
<b>Source:</b> Author, based on data from USITC (n.d.).								

Trade is never purely bilateral, because exporters have to compete with products originating in other countries. The evolution of market shares (Table 4) is therefore a good indicator of the national products' attractiveness and competitiveness when facing foreign competitors. Comparative advantages may result from a series of causes, some related to natural resource endowments, others to successful business models or to competitive exchange rates, or to lower trade costs, etc. (the list is too long to mention here).

### MEXICAN GOODS EXPORTS AND THE STRUGGLE FOR U.S. IMPORT MARKET SHARE

The dynamics of Mexican exports to the U.S., which was in line with Canada's from 1985 until 1993, albeit from a much smaller starting point (one-third of the Canadian value), started diverging on the plus side with NAFTA. The value of U.S. imports from Mexico grew by an annual average of 19 percent between 1993 and 2000 (Table 5). Indeed, Mexican exports grew as fast as China's until 2000. The biggest Mexican gains (10 percentage points) in the first phase of the NAFTA implementation were registered by exports of telecommunication equipment (SITC 76), which had captured 22 percent of the corresponding market for U.S. imports in 2000. Other winners were articles of apparel and clothing (9 percentage points), beverages and tobacco (8 points), road vehicles (8 points), and office and computer machines (7 points). No Mexican products registered a net loss of market share during the 1994-2000 period.

**Table 5**  
AVERAGE ANNUAL GROWTH RATE OF U.S. IMPORTS OF MERCHANDISE  
BY ORIGIN (1993-2020) (percentage)

	1993-2020	1993-2000	2001	2002-2008	2009	2010-2020
Mexico	8.2	19.4	-3.2	8.3	-18.5	3.6
Canada	3.4	10.8	-5.4	8.0	-32.7	-0.1
China	10.2	18.0	1.9	17.8	-13.3	1.8
Rest of World	4.5	9.4	-7.9	9.8	-29.2	2.4
<b>Note:</b> Imports exclude re-exports and are based on their CIF valuation.						
<b>Source:</b> Author, based data from USITC (n.d.).						

After 2001, the growth rate slowed to 8 percent annually until 2008. The year 2001 was pivotal for two reasons: first, the 9/11 Islamist terrorist attack on the U.S.

thickened the Mexico-U.S. border, adding trade and transportation costs to bilateral trade. Longer and unpredictable wait times at the border cut away at Mexican industries' competitiveness. As a result, Mexican exports to the U.S. dropped by 3 percent. Estimates of the cost of cargo delays on the Mexico-U.S. border range from US\$5.8 billion to US\$7.5 billion per year (Fullerton and Walke, 2014). This effect was also felt by others trade partners (Canadian exports dropped by 5 percent, year by year, the rest of the world by 8 percent, and China remained barely positive at 2 percent).

The second event was China's accession to World Trade Organization (WTO). By removing uncertainty on the market access conditions offered to China's exports to the U.S., China's entry reduced trade costs, especially for trade in global value chains. The China effect and adverse real peso/dollar exchange rate dynamics in the 2000s reduced U.S. investment in Mexican manufacturing (Paus and Gallagher, 2008). China's exports to the U.S., already growing rapidly, increased markedly after its WTO accession and maintained this trend up to the global 2008-2009 crisis.

The post-2008-2009 crisis period saw U.S. demand for imported goods slowing to about 2 percent per year. In this challenging context, Mexico registered relatively good performance compared to other countries, and its exports to the U.S. surpassed Canada's in 2015 (Table 4). But Mexican exports never recuperated their 1994-2001 trend. This said, the slow-down may just result from a natural exhaustion of the NAFTA dynamics. Widodo (2010) concludes from an analysis of the Asian, European, and North American reciprocal trade agreements that the change in trade patterns takes place only at the beginning of economic integration (1990-1995 in the case of the EU, Northeast Asia and the Association of South East Asian Nations [ASEAN], and 1994-2001 in the case of the NAFTA). Indeed, there were no NAFTA dividends for Canada, which had signed a bilateral free trade agreement with the U.S. in 1988. Its exports to the U.S. moved more or less in line with the rest of the world.

## SERVICES: A QUALITATIVE WEAKNESS?

Trade in services tells an interesting and worrisome story. Mexico has not been able to harness its comparative advantages (proximity, lower cost, common language with a large proportion of U.S. residents, etc.) to improve its market position in the U.S. after NAFTA. What is worse, Mexico has been consistently losing ground compared to Canada, China, and the rest of the world. India, which was a marginal supplier in 1995, challenged China's market share in 2019 (5.1 percent compared to China's 5.4 percent), equaling Mexico's (5.1 percent). In the meantime, Brazil was almost duplicating its market share, albeit from a very low basis (0.8 percent in 1995, 1.2 percent

in 2019), while other Latin American countries also increased their presence in the U.S. market.

This says a lot in terms of lost opportunities. The detailed data (Table 6) confirm the diagnostic. Mexico's market share of the U.S. services market has remained stagnant over the 1995-2019 period at about 5 percent. Its sole strength is in the export of travel, a proxy for tourism, where it enjoys natural advantages. Transportation, closely related to trade in goods, is also greatly favored by sharing a common border and benefited to a certain degree from NAFTA. The reduced presence of Mexico in the category of "other services," which includes business services (communication, finance, IT, etc.), denotes idiosyncratic weaknesses in competing for high value-added services.

<b>Table 6</b> <b>MEXICO: EXPORTS OF COMMERCIAL SERVICES TO THE U.S. (1995-2019)</b>						
	1995	2000	2005	2010	2015	2019
Millions of US Dollars						
Total	8,096	11,252	13,678	15,891	24,398	29,813
Transport	1,169	2,216	1,761	3,538	4,435	4,850
Travel	5,949	7,638	10,310	9,289	14,514	18,947
Other commercial services	978	1,398	1,606	3,064	5,449	6,016
Market Share of Respective U.S. Imports (percent)						
Total	5.0	4.7	4.1	3.6	4.9	5.1
Transport	2.7	3.9	2.2	4.0	4.5	4.5
Travel	12.4	11.9	14.2	10.9	14.1	14.1
Other commercial services	1.4	1.2	0.9	1.2	1.8	1.7
<b>Note:</b> 1995-2005 series are established according to EBOP2002 while 2010-2019 are in EBOP2010, which tends to inflate trade in other services by incorporating some records of trade in merchandise. <b>Source:</b> Author, based on data from OECD (n.d.b).						

Computing both direct and indirect exports of services from the domestic value-chain perspective, Escaith (2017) confirms that Mexico's performance as supplier of business services to the U.S. has been relatively poor. This is worrying for several reasons. It may reflect Mexican service providers' lack of competitiveness or the low value of their products (difficulties in upgrading the quality of the offer). It may also reflect the lack of sophistication of Mexican manufacturing industries, which incorporate fewer business services in their production process than their competitors.

The role of services as a driver of export-led growth is a controverted topic. McMillan, Rodrik, and Sepulveda (2017) argue that for most developing countries, it

is more challenging to compete in trade in services than to upgrade in a narrow –but expanding– range of standardized manufacturing industries. Yet, it remains true that services are the main source of domestic employment and are expected to play a dominant role in a post-industrial economy. Moreover, incorporating upstream (that is, R&D) and downstream (marketing, after-sale) services in the manufacture value chain is understood as a key strategy for global value chain (GVC) upgrading. Mexican exports’ poor results in this field are probably linked to idiosyncratic factors that also affect its capacity to upgrade in high-skills GVC positioning and would merit a dedicated analysis, which falls outside the scope of this article.

## ATTRACTING U.S. DIRECT INVESTMENT

Because of NAFTA, Mexico represented an opportunity for U.S. multinational enterprise (MNE) investment. In 2016, Mexican workers represented 14 percent of foreign employees on U.S. manufacturing MNE payrolls, according to the OECD (Table 7).

<b>Table 7</b> <b>OFFSHORING BY U.S. FIRMS:</b> <b>OUTWARD ACTIVITY BY COUNTRY OF LOCATION (2016)</b>			
	<b>Manufacturing</b>	<b>Services</b>	<b>Total Business sector</b>
Number of employees (thsd)			
World Total	5,411.4	8,844.7	14,256.1
Canada	290.4	913.8	1,204.2
Mexico	746.1	638.2	1,384.3
China	780.6	1,110.6	1,891.2
Turnover per employee (thsd U.S.D)			
World Total	455.0	375.2	405.5
Canada	791.3	339.6	448.5
Mexico	169.7	164.3	167.3
China	316.9	208.7	253.4
Exported share (%)			
World Total	7.1	3.2	4.8
Canada	24.3	7.3	14.5
Mexico	23.7	7.6	16.4
China	4.8	2.8	3.8
<b>Note:</b> Based on figures on the activity of U.S. affiliates located abroad by host country.			
<b>Source:</b> Author, based on data from OECD (n.d. c).			

This is much higher than for Canada (5 percent) and similar to the U.S. affiliates in China, despite the much larger size of its market. Moreover, this share is rising in the case of Mexico, while it is stagnating for China and decreasing for Canada. As in Canada, a large share of the output is produced for exports (to the U.S., mainly), as differentiated from U.S. affiliates in China, which produce mainly for the domestic market.

But the concern is in the details. Mexican employees for U.S. MNEs active in business services are underrepresented (7 percent of foreign employees, against 10 percent in Canada and 13 percent in China), confirming the weakness of the Mexican services sector in high value-added occupations. Actually, Mexico represents only 1 percent of the offshored R&D budget of manufacturing and services, compared to 7 percent in the case of Canada and China. Turnover by employee, a measure of productivity, is also low: in 2016, Mexican workers in U.S. affiliate firms produced a yearly average of US\$167,300, much less than in Canada or China.

### **MISSED OPPORTUNITIES: ENTERING THE EXPORT-DRIVEN GROWTH COMMUNITY TOO LATE**

When Mexico opted for an export-led strategy at the end of the 1980s, it was too late. In retrospect, Mexico missed a great opportunity because, at the same time, the U.S. was importing more labor-intensive goods. In 1991, low-income countries accounted for just 9 percent of U.S. manufacturing imports; by 2000, this share reached 15 percent and climbed to 28 percent by 2007. China claimed the lion's share of the market, accounting for 89 percent of this growth (Redding, 2020). Mexico's exports of manufactures faced competition from China, whose abundance in low-skilled labor gave it a strong comparative advantage in labor-intensive manufacturing. By the late 1990s, export processing plants in China, which are similar to Mexico's *maquiladoras*, accounted for over half the country's manufacturing exports (Hanson, 2010).

### **COMPETING FOR A SLICE OF U.S. DEMAND: MARKET SHARE ANALYSIS**

Conditional on the commodity composition of demand for imports and its evolution, some exporters will be in a better or worse position to supply the U.S. market, depending on their comparative advantages in producing goods and their capacity to adapt to changes in demand. These changes reflect shifts in domestic supply and demand and variations in prices. But high growth in demand may not result in high

export volumes: Table 8 shows that little correspondence exists between the most dynamic products from a demand perspective and the largest market shares. Only four products (in bold in the table) belong to the “all-star” category of large, fast-growing markets that drive demand for imports. The broad category of chemical (SITC 5) tops both lists, having registered the fastest annual growth over the period (8.7 percent) and weighting almost 12 percent of total imports in 2020, compared to only 5 percent in 1993. Exporters with comparative advantages in this segment of industries should see their exports to the U.S. increasing relatively faster than others, as long as they can consolidate their relative advantage. But comparative advantages are not static and may change over time, especially for labor-intensive downstream manufacturing industries such as electric and electronic products.

<b>Table 8</b> <b>TOP 10 PRODUCTS BASED ON THEIR GROWTH OR THEIR MARKET SHARES</b> <b>IN THE U.S. IMPORT MARKET (1993-2020) (percentage)</b>							
Top 10 by 1991-2020 Growth Rate				Top 10 by Share in 2020 Imports			
SITC	Description	1993-2020	2020	SITC	Description	1993-2020	2020
50	<b>Chemicals &amp; Related Products</b>	8.7	11.7	50	<b>Chemicals &amp; Related Products</b>	8.7	11.7
82	Furniture & Parts Thereof	8.1	2.6	78	Road Vehicles	4.0	10.5
87	Professional & Scientific Instruments	7.8	2.2	77	Electrical Machinery & Appliances	5.2	7.6
81	Prefabricated Buildings & Fittings	7.5	0.5	89	Miscellaneous Manufactured	5.9	6.5
90	<b>Other Commodities &amp; Transactions</b>	7.4	0.3	76	<b>Telecommunications Equipment</b>	6.6	6.1
40	Animal & Vegetable Oils	7.4	5.8	75	Office & Data Processing Machines	4.5	5.9
74	<b>Industrial Machinery &amp; Equipment</b>	6.8	4.2	90	<b>Other Commodities &amp; Transactions</b>	7.4	5.8
76	<b>Telecommunications Equipment</b>	6.6	6.1	30	Mineral Fuels	3.0	5.4
69	Manufactures of Metals, N.E.S.	6.5	1.9	00	Food & Live Animals	6.2	5.2
65	Textile & Related Products	6.3	2.4	74	<b>Industrial Machinery &amp; Equipment</b>	6.8	4.2
<b>Notes:</b> SITC codes ending with “0” correspond to the one-digit classification; all other products are at two digits; growth rates are average annual variations over the period based on nominal U.S. dollars; products in <b>bold</b> appear in both top-10 panels. Import values include insurance and freight costs (CIF valuation). The average growth rate of total imports was 5.3 percent over the period. <b>Source:</b> Adapted from Escaith (2021), based on data from USITC (n.d.).							

This narrative draws from Escaith (2021), which applies a novel approach to constant market share analysis (CMSA) of U.S. imports of commodities. Imports are identified by origin for each main developed and developing countries from the G20 group, plus an aggregate for all other Latin American and Caribbean countries and territories. Table 9 shows the evolution of market shares for a selection of exporters and breaks down their evolution into two influences: composition and competitive effects. The former indicates the adequacy of their export structure to the evolution of U.S. demand. It measures, therefore, the impact of the exporting country's specialization in fast- or slow-growing market segments. The competitive effect measures the relative growth of individual exports, calculated by averaging the growth differential, product by product, between the exporter and the U.S. import market (Escaith, 2021).

Unsurprisingly, China appears as the big winner, having gained about 15 percentage points of market share between 1993 and 2020. The big loser is Japan, with a drop of more than 12 percentage points during the same period. But it is important to put these numbers in perspective, because the 1993-2007 period was marked by the rise of global value chains. It is probable that a significant share of Chinese manufactures includes Japanese components. Controlling for the effect of the fragmentation of production would require using trade in value-added data as in Escaith (2017), something which goes beyond the purpose of this essay.

<b>Table 9</b> CONSTANT U.S. IMPORT MARKET SHARE ANALYSIS, SELECTED COUNTRIES AND REGIONS IN THE NAFTA (1993-2020)										
	Market Share <sup>a</sup>		Composition Effect				Competitive Effect			
	1993	2020	1993-2000	2001	2002-2008	2010-2020	1993-2000	2001	2002-2008	2010-2020
Mexico	6.4	13.5	-0.01	0.00	-0.01	0.00	0.09	0.03	-0.01	0.02
Canada	18.7	12.4	-0.02	0.02	0.02	0.01	0.02	-0.01	-0.05	-0.03
China	4.8	20.3	-0.05	0.00	-0.05	0.01	0.13	0.08	0.14	-0.01
Argentina	0.3	0.2	-0.23	-0.12	-0.08	-0.13	0.25	0.15	0.09	0.10
Brazil	1.5	1.2	-0.07	0.02	-0.01	-0.02	0.04	0.09	0.03	0.01
Others_LAC	4.7	3.2	-0.15	-0.14	0.03	-0.07	0.15	0.09	0.03	0.02
Germany	5.1	5.0	0.01	0.03	-0.01	0.00	-0.02	0.04	-0.01	0.00
Japan	18.1	5.6	0.00	-0.02	-0.04	-0.01	-0.05	-0.05	-0.04	-0.01
South Korea	3.3	3.1	-0.03	-0.09	-0.05	-0.03	0.04	0.03	0.00	0.05
World_Others	37.2	35.7	0.02	...	...	...	...	...	...	...
<b>Notes:</b> a/ three-year average, all commodities. <b>Source:</b> Escaith (2021).										



Overall, the CMSA analysis confirms our previous results. Mexico appears to have benefitted from NAFTA over the 1993-2020 period while Canada has been on the losing side. Mexico received a boost just after the signing of NAFTA, with its competitive indicator rising on average nine percentage points over the 1993-2000 period, even if the structure of exports (composition) was slightly negative. Not all effects are imputable to NAFTA, as the massive devaluation of the peso in 1995 also added to Mexican exports' competitiveness.

The 1993-2000 period also saw the irruption of large developing countries onto the international trade scene. China is obviously the main example of the emergence of new competitors. Indeed, many authors have highlighted the role of China as a spoiler for the non-U.S. NAFTA participants. Readers may look at Dussel-Peters and Gallagher (2013) and Pérez-Ludeña (2019), among many dedicated investigations, for a review at the sectoral level, and at Ros (2012) for implications for Latin American export strategies.

When it comes to adapting export structure to U.S. demand, the NAFTA partners did not do particularly well. According to Escaith (2021), Mexico presents negative correlations between its revealed comparative advantages and the changing composition of U.S. imports, something that indicates missed opportunities. This is particularly puzzling, because one of the expected outcomes of NAFTA was to drive export-led industrialization in this country, with firms focused on competing to satisfy external demand.<sup>4</sup>

Moreno-Brid et al. (2005) mention that for Mexico, the NAFTA-induced export drive meant a shift toward manufacture exports, away from traditional primary commodities. Yet, the adaptation was not fully successful. Indeed, these authors mention that Mexico's export drive was highly concentrated in only a few sectors, in particular transport equipment. Table 8 indicates that this sector was not among the most dynamic on the U.S. import market.

On the contrary, China seems to have been able to produce what the U.S. market required, adapting its export basket to the changes in U.S. demand. Moreover, not only did China leapfrog over Mexico to become in 2005 the United States' second-largest trading partner, but it competed directly with several Mexican products. According to Dussel-Peters and Gallagher (2013), 36 percent of Mexican products are under direct threat from Chinese exports on the U.S. market and 20 percent are under partial threat.

<sup>4</sup> In contrast to what occurred in previous state-led accumulation regimes where, according to an old Mexican joke, public administrations and state firms were more inclined to satisfy their employees and managers than to serve their customers.

Interestingly, the most recent period (2010-2020) marked a break in this trend, China registering a drop in its competitive score that could not be compensated by better product assortment. Mexico, on the contrary, shows significant progress for beverages and tobacco (SITC 10), road vehicles (SITC 78), and, more interestingly, from a competitiveness perspective, for office and data processing machines (SITC 75), considered a Chinese stronghold. Among the possible reasons, this may simply reflect the fact that China is now a mature economy that has achieved most of its catching-up transition to become the “New Center” (Ros, 2012). This maturation is reflected in higher wages as well as some exchange-rate revaluation, albeit gains in labor productivity compensate some, if not most, of these effects and China remains a low-cost supplier.<sup>5</sup> One may also see here the effect of the change in U.S. trade policy toward China and, more generally, of a change in the perception of optimal global trade governance. This topic is analyzed in the following section.

## NAFTA 2.0 AND THE GREAT DECOUPLING

NAFTA was renegotiated in 2017 and drafted in late 2018; the revised treaty became effective in 2020 as the USMCA. But this reformulation, at the request of the U.S. administration, is part of a much larger movement, which changes the way international trade, and in particular trade within global value chains, takes place. It is possible and even probable that the so-called “hyper-globalization” phase that initiated with the fall of the Berlin Wall in 1989 reached its end. This period, often called the “flattening of the world,” witnessed the expansion of GVCs, with China commencing a rapid march toward industrialization to become the center of “Factory Asia.” A similar process took place in Europe in the early 1990s, with the extension of the European Common Market to ex-communist Eastern-European countries, and in North America with the signing of NAFTA. This situation increased economic interdependency in the world economy. This interdependency was identified by Pascal Lamy, the head of the WTO in the early 2000s, as the cornerstone of global governance: when products are “Made in the World,” each country gains by cooperating and old-style mercantilist policies become obsolete. Lamy was wrong.

The 2008-2009 global crisis changed the way governments conceived of globalization and its cost/benefit balance. Moreover, some national authorities realized that the industrial interdependency could be used to promote geo-political strategic

<sup>5</sup> Chinese factories are still dragging down manufacture prices, which declined during the Covid-19 pandemic by the most since 2016 (Bloomberg, 2019). The 2021 surge in the procurement cost of Chinese products is mainly due to bottlenecks in sea transportation.

interests when you controlled key intermediate inputs. In 2010, the threat of supply chain disruption was used in a dispute about maritime territory, when China banned rare earth exports to Japan during a diplomatic standoff after the Senkaku boat collision incident. Things took a more dramatic turn in 2018 with the bilateral trade conflict that arose between China and the U.S. The U.S. initiated the bilateral conflict because of China's treatment of intellectual property and foreign investment, but the conflict spread to bilateral trade. The tit-for-tat escalation continued during most of the year and continued into 2019 and then calmed down in 2020. Despite the "phase one" trade deal of January 2020 between China and the U.S., economic and geopolitical bilateral tensions have continued to escalate and spread to the entire Indian-Pacific region.

The Covid-19 crisis has put in evidence the risks of depending on unreliable sources of key inputs. Supply disruptions catapulted the issue of risk in GVCs to the top of policy agendas (Baldwin and Freeman, 2021). In September 2020, the U.S. administration declared that it "will end our reliance on China" through "decoupling." In June 2021, the U.S. Senate passed the US\$250 billion Innovation and Competition Act, designed to maintain the U.S. technological lead over China. Something that would have been considered a protectionist policy twenty years ago is now seen as twenty-first-century smart realpolitik.

It is not just the U.S. that is pulling away from the cooperative neo-liberal institutionalist approach to world trade governance and adopting a hard-nosed neo-realist attitude.<sup>6</sup> The EU had already adopted a series of measures to control foreign direct investment, especially from state-sponsored –read Chinese– firms or investment funds; this trend accelerated with the Covid-19 crisis. In 2020, the EU published a paper on industrial strategy, which is seen as a drive toward reducing reliance on the outside world. In 2021, UK authorities released a plan for a "Global Britain," to prepare for a new age of trade competition. The post-Brexit strategy is seen as aiming at rebalancing trade relationships with the EU and with North America and seeking to diversify GVC dependencies away from China. The Japanese minister of the economy complained in June 2020 that his country was dependent on China and needed to make supply chains more robust and diverse. In April 2021, the Australian government cancelled a Belt and Road agreement signed with China, escalating trade and diplomatic tensions between Beijing and Canberra.

<sup>6</sup> I use the term "neo-liberalism" in its academic definition, which has only a loose relationship with what is generally (mis)understood by the public. The neo-liberal institutionalist position trusts individual behavior, constrained by strong multilateral governance, to deliver harmonious international "complex interdependency." The neo-realists are more Hobbesian. For them, realpolitik dictates how national states must act given the inherently anarchical and conflictual condition of world affairs (see Elias and Sutch [2007] for an introduction).

In the neo-realist post-Covid era, the cost/benefit balance of international trade is increasingly assessed from the perspective of national geopolitical strategy. This “us vs. them” situation entails redesigning global value chain in order to be less dependent on “unreliable” countries. From a GVC trade perspective, “neo-realism” is associated with “reshoring” and “nearshoring.”

Oversimplifying, one may say that the two standard supply chain theories are “just-in-time” and “just-in-case.” The former pursues efficiency; the latter minimizes risks (Jiang, Rigobon, and Rigobon, 2021). In the presence of systemic uncertainty, the “just-in-case” option dominates. Firms concentrate on the worst-case as they cannot rule out the possibility of supply disruptions. Because systemic risks are important components in bilateral GVC trade, the search in the U.S. for more resilient international supply chain arrangements is likely to favor European and North American GVC nearshoring, away from China and toward countries perceived as “closer” not only in terms of distance, but also in terms of common institutional and political systems, as well as geo-political interests. Meanwhile, from China’s perspective, the Belt and Road initiative is aimed at creating its own economic backyard.

In the context of China-U.S. trade decoupling, the “NAFTA effect,” perceptible in the early years of the agreement, is expected to rebound under the USMCA, renegotiated during 2017-2018 and effective in 2020. As mentioned, many positive signals were already perceptible a few years ago (Escaith, 2021).

## RESHORING, NEARSHORING, AND DECOUPLING

U.S. reshoring and nearshoring offer new opportunities for Canada and Mexico. Reshoring increases the options for supplying the U.S. domestic firms with the inputs required for their production. Even more promising is the perspective that U.S.-lead firms nearshore their international supply chain in Canada and Mexico, considered less risky than China, Inc.

The Covid-19 pandemic and its supply-chain disruption could accelerate the trend of production relocation (Bacchetta et al., 2021). The consulting firm Kearney’s 2021 *Reshoring Index Report* expects that many companies will consider a “China plus” strategy in an attempt to decrease their reliance on China, while maintaining a foothold in the Chinese market (Blaesser et al., 2021). In this perspective, the decoupling will only be partial. Many firms that initially came to China motivated by low wages are expected to end up staying there to serve the large Chinese market, following the “In China, for China” strategy (Van der Veen, 2020). On the other hand, they are expected to source some of these inputs from additional trade partners, with a

view to mitigating overdependence on a single source, which is perceived as increasingly risky.

In this context, the USMCA is expected to bring more offshore production closer to the U.S. Overall, 54 percent of a sample of 120 U.S. executives surveyed by Kearney perceive nearshoring to Canada or Mexico as more advantageous than reshoring manufacturing to the U.S. This is particularly strong in large companies (72 percent) and with lead firms that already have offshore facilities (74 percent). The report mentions in particular that the U.S. demand for nearshoring manufacturing in Mexico is likely to increase. This is especially the case for industries such as automotive, aerospace, and electrical components, where Mexico has established infrastructure and a trained work force.

Van der Veen (2020) observes that Mexico has already been “eating away” at China’s market share for the last couple of years in a number of subsectors, most notably computer equipment, and it is highly likely that the U.S.-China trade war has accelerated this process. Among the most important reasons for Mexico to become increasingly attractive as a manufacturing hub for U.S. firms are old parameters, such as proximity to the U.S. market, but also new ones, such its cost competitiveness relative to China and Mexico’s enhanced appeal in the new geo-political context.

Hanson (2010) predicted that the downward pressure exerted by China on the price of manufactured goods that Mexico exports was unlikely to be permanent. This author did not link it to higher production costs –if wages in China have been going up, productivity has grown even faster–, but because China would “graduate” from the status of developing country and become what Ros (2012) called the “New Center.” In the process, it would move to specializing in more skill- and capital-intensive products. This is probably true in the long-term, but may not occur in the foreseeable future as many regions in China are still far from having reached full industrialized status.

Finally, it has to be expected –or feared, as in Bacchetta et al. (2021)– that in the aftermath of the pandemic, the global economy will move away from open trade policies (the neo-liberal institutionalist approach) to more nationalist (neo-realist) state-driven trade regimes. This new geo-political reality will add a premium to regional trade agreements such as the USMCA. Obviously, it will also put some countries like Argentina and Brazil, who depend on China for their exports of commodities but look at the EU and U.S. for buying their manufacturing exports, in a double bind.

For Mexico to make the most of its opportunities, the 2021 Kearney report cautions that the country needs to address investor concerns over political climate and economic stability. Mexico will still have to compete with low-cost Asian exporters,

in particular Vietnam.<sup>7</sup> As a Nomura investment bank reckons, Vietnam is expected to be the largest beneficiary of trade diversion out of China and may gain the equivalent of about 8 percent of GDP (Loo, Subbaraman, and Varma, 2019). Mexico appears only in sixth place in their top-10 expected beneficiaries, with Canada coming in last.

This said, decoupling is not –yet– a reality, if statistics are to be believed. Antras (2021) does not find systematic evidence indicating that the world economy has already entered an era of deglobalization. On the other hand, he recognizes that geopolitical tensions may trigger a reversal. Time will tell: supply chain relocation is not a decision that managers take lightly, as lead firms have often spent many years setting up offshore production bases, developing long-time relationships and protocols with first-tier suppliers. Moreover, it is more difficult to predict future developments in a neo-realist world, driven by fluctuating and conflictual political considerations, than in a neo-liberal world driven by uncoordinated individualistic decisions. As Petricevic and Teece (2019) mention, irrespective of one’s personal view of the ongoing structural reshaping of the global governance system away from the neo-liberal order and toward a neo-realistic one, it is clear that international trade environment is now “plagued with volatility, uncertainty, complexity, and ambiguity on an unprecedented scale” (Petricevic and Teece, 2019: 1494).

## REGIONAL DEVELOPMENT: AVOIDING PAST MISTAKES

The prospects of a reactivation of Mexican manufacturing exports to the U.S. in a context of nearshoring is a welcome perspective, but it may not deliver the higher GDP growth rates that the country needs. In order for the export-led strategy to be successful, the expected economic growth should not remain restricted to the central and northern states, as has been the case.

To illustrate this point, Table 10 shows the result of a very simple counterfactual simulation, comparing the regional GDP in 2019 with what would have occurred if all Mexican federal states had registered the same average national growth between 1994 and 2019. The difference between the leader (Baja California) and the laggard (Campeche) is larger than 100 percentage points. This huge gap shows both the success of the NAFTA strategy and its limitations.

If Levy and López-Calva (2016) are accurate, the continuation of this economic duality is a major hindrance to development that cannot be easily addressed. The

<sup>7</sup> Albeit there is some indication of relabeling of Chinese goods in Vietnam, most notably involving textiles, seafood, agricultural products, and steel and aluminum (Van der Veen, 2020).

authors do not share the common belief that investment in human capital will gradually eliminate duality and informality. Other economists, in particular Jaime Ros in his controversy with Santiago Levy (Levy, 2019), argue that informality is due to a structural weakness in effective demand, in particular fiscal austerity. Ros identifies as a priority the need to foster public investment in physical infrastructure. Without entering into this empirical debate, a strategy geared to increasing investment in domestic trade and transport infrastructure to reduce internal trade costs would satisfy everyone: the supporters of the demand-led model, the advocates of export-led growth, and the partisans of a more energetic program of regional development aimed at facilitating investment in export-oriented activities in the southern states.

<b>Table 10</b> SIMULATED GROWTH DIFFERENTIAL BY STATE (MEXICO, 1994-2019) (percentage)					
States	Winners <sup>a</sup>	States	Neutral <sup>b</sup>	States	Losers <sup>c</sup>
Baja California Sur	65.9	Zacatecas	9.8	Morelos	-10.2
Quintana Roo	63.5	Mexico	8.1	Veracruz de Ignacio de la Llave	-20.0
Aguascalientes	53.7	Tamaulipas	5.3	Guerrero	-20.5
Querétaro	50.1	Sonora	4.7	Oaxaca	-23.0
Nuevo León	38.3	Baja California	4.7	Tabasco	-29.0
Guanajuato	26.0	Jalisco	3.4	Chiapas	-33.0
Chihuahua	22.8	Michoacán de Ocampo	2.1	Campeche	-61.0
Yucatán	19.9	Mexico City	-1.0		
Coahuila de Zaragoza	19.0	Hidalgo	-1.3		
Puebla	17.9	Durango	-1.7		
San Luis Potosí	15.9	Sinaloa	-7.2		
Colima	10.0	Nayarit	-7.6		
		Tlaxcala	-9.1		
<b>Notes:</b> a/ 2019 GDP higher than 10 percent of equal growth simulation; b/ 2019 GDP differential between plus and minus 10 percent; c/ GDP differential lower than -10 percent <b>Source:</b> Author, based on data from INEGI (n.d.).					

During the current and previous Mexican administrations, numerous initiatives oriented toward more active regional development. Banco de México (2018) reports several federal initiatives between 2016 and 2018 that look at fostering setting up manufacturing and agroindustry in the poorest regions of Mexico through the creation

of special economic zones. More recently, several infrastructure and heavy industry projects have been launched, particularly in railways (the *Tren Maya* and the revitalization of the Tehuantepec interoceanic railways). But more needs to be done.

## CONCLUSIONS

NAFTA and China transformed the dynamics of Mexico-U.S. bilateral trade. The implementation of NAFTA in 1994 caused bilateral trade to skyrocket in its first years. The initial boost to Mexican manufacturing was quickly sapped by China's emergence, especially after its entry into the WTO in 2001. Moreover, bilateral trade costs rose following an increase of U.S. cross-border security checks after the terrorist attacks in September of the same year. The steep appreciation of the effective exchange rate for Mexico up to 2002 added another obstacle. The negative impacts of these external factors have been compounded by more idiosyncratic causes specific to Mexico and the growing insecurity in the northern states that affects people's living conditions and damages the business climate. As a result, Mexican exports of merchandise to the U.S. stalled after 2001, producing the feeling that the NAFTA moment has been missed. Trade in commercial services tells an even more worrisome story, showing Mexico as an underperformer in high value-added services through the whole period of analysis, most probably for idiosyncratic reasons.

As recognized by Mesquita-Moreira and Stein (2019), in Mexico as in many other Latin American and Caribbean countries, there has been a mismatch between the expectations of duplicating high East Asian or Chilean growth rates and what could realistically be delivered by export-led growth. The failure to unlock the potential benefits of trade is related to a conjunction of external and domestic factors, multiplied however by the effects of poor infrastructure. But change is in the air.

Mexico's market share in the U.S. has been on the rise during the last decade. The implementation of the USMCA takes place in an international climate very different from the neo-liberal global governance institutionalism that prevailed at the time of NAFTA. The neo-realist approach to trade and international relationships that (re) emerged after the 2008-2009 global crisis is more confrontational and tends to conform trading blocs based on geo-political considerations. The Covid-19 pandemic added momentum to this trend by showing the risks of depending on long international supply chains for critical products, promoting the reshoring or the nearshoring of the supply chains. As a result of an increased perception of geo-political risks, the "USMCA effect" is expected to induce more bilateral trade and investment. For similar reasons, the Economic Partnership, Political Coordination, and Cooperation Agreement



that came into force in 2000 between the EU and Mexico may also offer new Mexican nearshoring options to European firms.

For Mexico, this is obviously a pleasing perspective. Yet, it may not deliver the higher GDP growth rates that the country needs if the “two-speed” nature of Mexico’s economy remains in place, in which trade drives the growth of foreign investment, high-tech manufacturing, and rising wages in the central and northern states, while the largely agrarian South remains detached from this new economy. Yet, high internal transport costs in both time and money limit the possibility of developing a geographically diversified domestic value chain in Mexico. From a trade analysis point of view, harnessing the benefits of export-led growth from the USMCA perspective implies the “thinning” of Mexico’s external and internal borders.

Several initiatives have been in place for fostering the implantation of export-oriented industries in the poorest zones of Mexico. The USMCA includes a “Customs and Trade Facilitation Chapter” that delineates new provisions to reduce costs and bring greater predictability to cross-border transactions. In June 2021, the U.S. administration, together with other G7 countries, has touted a “Build Back Better World” initiative to invest in its developing-country trading partners. If ever there were a time to regain faith in export-led growth, it is now. But addressing Mexico’s behind-the-border trade costs remains a formidable endeavor considering the existing lags and even backwardness in inter-state multimodal infrastructure.

## BIBLIOGRAPHY

ALEMAN-CASTILLA, BENJAMIN

- 2006 “The Effect of Trade Liberalization on Informality and Wages: Evidence from Mexico,” CEP Discussion Papers 0763, London, Centre for Economic Performance, London School of Economics (LSE).

ANTRÀS, POL

- 2021 “De-Globalisation? Global Value Chains in the Post-Covid-19 Age,” NBER (National Bureau of Economic Research) Working Paper no. w28115.

BACCHETTA, MARC, EDDY BEKKERS, ROBERTA PIERMARTINI,

STELA RUBINOVA, VICTOR STOLZENBURG, and ANKAI XU

- 2021 “Covid-19 and Global Value Chains: A Discussion of Arguments on Value Chain Organization and the Role of the WTO,” WTO Staff Working Paper ERSD-2021-3, Geneva.

BALDWIN, RICHARD, and REBECCA FREEMAN

- 2021 "Risks and Global Supply Chains: What We Know and What We Need to Know," Staff Working Paper no. 942, London, Bank of England.

BANCO DE MÉXICO

- 2018 *Reporte sobre las economías regionales*, January-March, <http://www.anterior.banxico.org.mx/dyn/publicaciones-y-discursos/publicaciones/informes-periodicos/reportes-sobre-las-economias-regionales/%7BAA557F83-EC7C-ED27-A974-DBF0206AEF3C%7D.pdf>

BLAESSER, BRANDON, YURI CASTAÑO, KELSEY SERRANEAU, and PATRICK VAN DEN BOSSCHE

- 2021 "Global Pandemic Roils 2020 Reshoring Index, Shifting Focus from Reshoring to Right-shoring," Washington, D.C., Kearney U.S.

BLOOMBERG

- 2019 "China Factories Are Exporting Lower Prices around the World," November 8, <https://www.bloomberg.com/news/articles/2019-11-09/china-s-factories-are-exporting-lower-prices-around-the-world>

CALDERON-MADRID, ANGEL, and ALEXANDRU VOICU

- 2004 "Total Factor Productivity Growth and Job Turnover in Mexican Manufacturing Plants in the 1990s," IZA Discussion Paper no. 993, Bonn.

CONTRERAS, OSCAR, JORGE CARRILLO, and JORGE ALONSO

- 2012 "Local Entrepreneurship within Global Value Chains: A Case Study in the Mexican Automotive Industry," *World Development*, vol. 40, no. 5, pp. 1013-023, <https://doi.org/10.1016/j.worlddev.2011.11.012>

DE LEÓN ARIAS, ADRIÁN, comp.

- 2019 *El desarrollo económico regional en México: Tratado de Libre Comercio de América del Norte, exportaciones, modelos de innovación, multinacionales e inversión pública*, Editorial Universidad de Guadalajara.

DE LEÓN ARIAS, ADRIÁN

- 2013 "El desempeño productivo de las manufacturas mexicanas. Un análisis de contabilidad del crecimiento en las entidades federativas: 1970-2008," Universidad de Guadalajara, draft version, [http://adriandleon.cucea.udg.mx/docs/EL\\_DESEMPEÑO\\_PRODUCTIVO\\_DE\\_MANUFACTURAS.pdf](http://adriandleon.cucea.udg.mx/docs/EL_DESEMPEÑO_PRODUCTIVO_DE_MANUFACTURAS.pdf)

DÍAZ BAUTISTA, ALEJANDRO

- 2017 "Total Factor Productivity (TFP) in Manufacturing and Economic Growth in Mexico," *Análisis Económico*, vol. xxxii, no. 79, <http://www.analisiseconomico.azc.uam.mx/index.php/rae/article/view/2>

DUSSEL PETERS, ENRIQUE, and KEVIN P. GALLAGHER

- 2013 "NAFTA's Uninvited Guest: China and the Disintegration of North American Trade," *CEPAL Review*, August, pp. 83-108, <https://repositorio.cepal.org/handle/11362/37000>

ECORYS

- 2015 "Ex-post Evaluation of the Implementation of the EU-Mexico Free Trade Agreement, Interim Report to the European Commission," Rotterdam.

ELIAS, JUANITA, and PETER SUTCH

- 2007 "International Relations: The Basics," Oxon, Routledge.

ESCAITH, HUBERT

- 2021 "Revisiting Constant Market Share Analysis, an Application to NAFTA," Studies and Perspectives Series no. 193, Mexico, Economic Commission for Latin America and the Caribbean (ECLAC).
- 2017 "El TLCAN y la evolución de las ventajas competitivas de México en el mercado de Estados Unidos: un enfoque de valor agregado," *Boletín Techint*, no. 355, July-December, pp. 27-73, <http://www.grupotechint.com.mx/boletin/doc/BOINT2017.pdf>

FULLERTON, THOMAS, and ADAM G. WALKER

- 2014 "Freight Transportation Costs and the Thickening of the U.S.-Mexico Border," Departmental Papers (E&F) 78, University of Texas at El Paso.

HANSON, GORDON H.

- 2010 "Why Isn't Mexico Rich?" *Journal of Economic Literature*, vol. 48, no. 4, pp. 987-1004, <https://doi.org/10.1257/jel.48.4.987>

INEGI (INSTITUTO NACIONAL DE ESTADÍSTICA Y GEOGRAFÍA)

- n.d. PIB por Entidad Federativa data base, <https://www.inegi.org.mx/programas/pibent/2013/>

JIANG, BOMIN, DANIEL RIGOBON, and ROBERTO RIGOBON

- 2021 "From Just in Time, to Just in Case, to Just in Worst-Case: Simple Models of a Global Supply Chain Under Uncertain Aggregate Shocks," NBER Working Paper no. w29345.

LEVY, SANTIAGO

- 2019 "Réplica a la reseña de Jaime Ros sobre 'Esfuerzos mal recompensados,'" *Economía UNAM*, vol. 16, no. 46, January-April, pp. 284-303, <https://doi.org/10.22201/fe.24488143e.2019.46.454>

LEVY, SANTIAGO, and LUIS FELIPE LÓPEZ-CALVA

- 2016 "Labor Earnings, Misallocation, and the Returns to Education in Mexico," IDB Working Paper No. IDB-WP-671.

LOO, MICHAEL, ROB SUBBARAMAN, and SONAL VARMA

- 2019 "U.S.-China Trade Diversion: Who Benefits?" Nomura Global Research Portal, <https://www.nomuraconnects.com/focused-thinking-posts/us-china-trade-diversion-who-benefits/>

McMILLAN, MARGARET, DANI RODRIK, and CLAUDIA SEPULVEDA

- 2017 "Structural Change, Fundamentals, and Growth: A Framework and Case Studies," Policy Research Working Paper no. 8041, World Bank.

MESQUITA MOREIRA, MAURICIO, JUAN BLYDE, CHRISTIAN VOLPE, and DANIELKEN MOLINA

- 2013 *Too Far to Export: Domestic Transport Costs and Regional Export Disparities in Latin America and the Caribbean*, Washington, D.C., Inter-American Development Bank.

MESQUITA MOREIRA, MAURICIO, and ERNESTO STEIN, eds.

- 2019 *Trading Promises for Results: What Global Integration Can Do for Latin America and the Caribbean*, Washington, D.C., Inter-American Development Bank.

MORENO-BRID, JUAN CARLOS, JUAN CARLOS RIVAS-VALDIVIA, and JESÚS SANTAMARÍA

- 2005 "Mexico: Economic Growth, Exports and Industrial Performance after NAFTA," Mexico, United Nations LC/MEX/L.700, ECLAC.

OECD (ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT)

- n.d.a Trade in Employment data base, [https://stats.oecd.org/Index.aspx?DataSetCode=TIM\\_2019\\_MAIN](https://stats.oecd.org/Index.aspx?DataSetCode=TIM_2019_MAIN)
- n.d.b Balanced Trade in Services data base, <https://www.oecd.org/sdd/its/balanced-trade-in-services.htm>
- n.d.c AMNE, Activity of Multinational Enterprises data base, <https://www.oecd.org/sti/ind/amne.htm>

PAUS, EVA, and KEVIN GALLAGHER

- 2008 “Missing Links: Foreign Investment and Industrial Development in Costa Rica and Mexico,” *Studies in Comparative International Development*, vol. 43, no. 1, pp. 53-80, <https://doi.org/10.1007/s12116-007-9016-2>

PÉREZ LUDEÑA, MIGUEL

- 2019 “Vínculos productivos en América del Norte,” *Estudios e investigaciones* 44609, Mexico, Comisión Económica para América Latina y el Caribe (CEPAL).

PETRICEVIC, OLGA, and DAVID J. TEECE

- 2019 “The Structural Reshaping of Globalization: Implications for Strategic Sectors, Profiting from Innovation, and the Multinational Enterprise,” *Journal of International Business Studies*, vol. 50, no. 9, pp. 1487-1512, <https://doi.org/10.1057/s41267-019-00269-x>

REDDING, STEPHEN

- 2020 “Trade and Geography,” NBER Working Paper 27821.

ROS, JAIME

- 2012 “Latin America’s Trade and Growth Patterns, the China Factor, and Prebisch’s Nightmare,” *Journal of Globalization and Development*, vol. 3, no. 2, pp. 1-16. <https://doi.org/10.1515/jgd-2012-0031>

RUIZ NÁPOLES, PABLO

- 2017 “Neoliberal Reforms and NAFTA in Mexico,” *Economía UNAM*, vol. 14, no. 4, pp. 75-89, <https://doi.org/10.1016/j.eunam.2017.06.004>

USITC (UNITED STATES INTERNATIONAL TRADE COMMISSION)

- n.d. Data web, <https://dataweb.usitc.gov/>

UNIVERSITY OF CALIFORNIA, DAVIS and the GRONINGEN GROWTH DEVELOPMENT  
CENTRE OF the UNIVERSITY OF GRONINGEN

n.d. Penn Tables 10.0, <https://www.rug.nl/ggdc/productivity/pwt/?lang=en>

VAN DER VEEN, MICHEL

2020 "Decoupling U.S.-China Supply Chains: High Tech on the Move," July, Utrecht, Rabobank Economic Research.

WIDODO, TRI

2010 "Market Dynamics in the EU, NAFTA, North East Asia and ASEAN: The Method of Constant Market Shares (CMS) Analysis," *Journal of Economic Integration*, vol. 25, no. 3, pp. 480-500, <http://www.jstor.org/stable/23000869>