NAFTA Versus The USMCA: The Effects on Mexico

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To John and Zeli,

The reason I keep going and haven't given up.

And to Lesley Aurora,

Thank you for helping me keep going.

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Introduction

The United States, Mexico, and Canada have had a long history together and their relationship has only grown since the 1990s with the implementation of their free trade agreement. The first free trade agreement that was established between the three countries was the North American Free Trade Agreement (NAFTA) which officially took effect in 1994. While NAFTA had a good lifespan, the trade agreement was revised during the United States' Trump administration and eventually implemented in the middle of 2020. While the three countries had much to gain from the implementation of these free trade agreements, the author will focus on the Latin American country of Mexico for the purpose of this paper.

The concept of a free trade agreement in the North American region originated with United States President Ronald Reagan during his candidacy. However, given the United States was, and still is, a global powerhouse, Canada and Mexico were hesitant to enter an agreement with the U.S. A change in leadership would allow for the discussions between the U.S. and Canada to take place. Canada eventually entered into the Canada-United States Free Trade Agreement (CUSFTA) in the late 1980s after a couple of years of discussion between the two countries. Along the same line, a change in leadership was one of the reasons Mexico began discussion with its North American neighbor.

While the majority of economists in the United States and abroad have praised the free trade agreements, there are many who would argue they have not lived up to their potential. It has been almost three decades since the first free trade agreement was introduced and while the supporters praise the success of NAFTA, the critics make their opposition well known, looking pointedly at Mexico since the country's economic growth remained low long after NAFTA took effect. The author's objective for this paper is to determine whether the United States-Mexico-Canada Agreement (USMCA) will have a positive impact on the country of Mexico based on the country's previous experience with the agreement's predecessor, the North American Free Trade Agreement (NAFTA).

NAFTA began as a proposal made by Mexican President Carlos Salinas de Gortari to establish a free trade agreement with the United States, with Canada joining the discussion soon afterwards.

> The goal of NAFTA is to open markets of all types to outside investment by including special rules that insure outside investors a safe and attractive return on their money. These special rules or treaty provisions are designed to limit governmental regulations, and to require each country's legal system to protect and favor the outside investors over local governments, all to achieve the ultimate goal of allowing trade, investment and capital to flow more easily across national borders in the least restrictive and corporation friendly environment possible. (McCarty 2007, p. 106)

NAFTA was set to all but remove the trade barriers that had long been held in place by the three countries. In addition to this, the agreement drew the appeal of foreign investors since it essentially safeguarded their money and favored them over the local government. With these incentives in place, Mexico's foreign direct investment inflows increased after 1994.

The road to establishing free trade was not an easy one travelled. Like many other policies, the passing of the North American Free Trade Agreement was a long process. Mexican President Salinas presented a large gamble when introducing his idea of a free trade agreement with the country's North American neighbors. The reason for why this was a gamble will be explored in chapter one of this paper where the author will focus heavily on the background of NAFTA and its impact on Mexico. Given the extensive information that will be covered, Chapter One will consist of the different sections. Those sections are as follows: trade liberalization, President Salinas's promise regarding NAFTA, the costs and benefits, as well as the accomplishments and failures of NAFTA, and lastly the newly established trade agreement, the USMCA.

Chapter Two will contain the data gathered and analyzed by the author. There will be various variables that will be used to conduct this analysis. Among them are economic growth, foreign direct investment, external sector, exchange rate, and average annual stock index. In addition to examining these variables, the author will also look closely at the United States and Mexican economies to determine whether the two economies have become synchronized because of NAFTA. Chapter Three will discuss the USMCA's potential impact on Mexico, and how current global events have impacted the country And lastly, in the conclusion of this paper, the author will provide an answer to the question presented, will the USMCA be beneficial to Mexico based on the country's previous experience with NAFTA? Will the USMCA aid Mexico in achieving its goal of attaining a developed economy.

Chapter One

Trade Liberalization and "The Lost Decade"

Before a discussion on the North American Free Trade Agreement can begin, the author will first cover the topic of trade liberalization because it promotes free trade. Trade liberalization is when countries either remove to restrict the barriers that are in place when they exchange goods among themselves. An example of these barriers would be the tariffs countries have in place when importing goods from abroad, such as when former United States President Donald Trump imposed tariffs on Chinese goods back in 2019. Like any economic policy, there are costs and benefits, critics, and supporters, etc. Trade liberalization is no different in this regard.

When a country lessens the restrictions on these barriers, it can promote free trade agreements such as NAFTA. The removal or restriction of these barriers can be viewed as advantageous because the imported goods would be less expensive. In addition to this, another advantage is "liberalising a restrictive trade regime is conductive to more rapid growth," (Kreuger 1998, p.1513). However, while there are many people who support trade liberalization and see its potential, there are still many critics out there who would argue trade liberalization is disadvantageous because of the effect it has on jobs.

The impact on jobs can come from both imports and exports. If imported goods can be bought at a lower price, they can then be sold at a lower price compared to domestic goods. While the quality of the foreign goods may be less than the quality of the domestic goods, the foreign goods are cheaper. This causes less of those domestic goods to be sold, which leads to job loss. On the other hand, if the number of exports increases, the company that exports its goods must keep up with demand, it must make more of those domestic goods, which allows for job opportunities. However, this can only happen if the country's economy can keep up with the demand for employment. The job argument was heavily present when NAFTA was being discussed, and even prior. The effect NAFTA had on jobs will be discussed in the following section.

During the 1980s the countries of Latin America experienced a debt crisis for much of the decade, which came to be known as the Lost Decade. External shocks from developed countries left a large impact on developing countries, eventually leading to the region being unable to pay their debts. The International Monetary Fund (IMF) provided a treatment to the region's crisis which led to a financial reformation taking place in Mexico. "The 1980s witnessed the overhaul of trade and industrial policies," (Ros 1994, p. 209). Building on this, "in the mid-1980s, after more than three decades of pursuing import-substitution policies, Mexico embarked on a serious program of trade liberalization," (Pacheco-Lopez 2005, p.595). This overhaul paved the way for the policy that would become the greatest gamble that would define Carlos Salinas's presidency.

Salinas's Political Gamble & Pitch

As previously stated, the 1980s was a difficult time for the entire Latin American region, especially for Mexico since it was the first country to enter the Latin American debt crisis. During this difficult time, President Carlos Salinas de Gortari took office in 1988. There were a couple of problems surrounding his presidency from the beginning. One problem being that the election of 1988 "brought Salinas to the presidency amid charges of fraud," and there were "charges of corruption which accompanied the election," (Poitras and Robinson 1994, p. 19). The second problem was in regards to the political party President Salinas belonged to, the Partido Revolucionario Institucional (PRI), was losing favor within the country because of the debt crisis.

In addition to these problems, the country was under pressure by the International Monetary Fund to open their economies to allow in foreign investment so Mexico could begin to recover. However, it was not so simple. Investors had lost confidence in the region and were hesitant about allowing their money to enter the country once again. This left President Salinas with two problems in need of a solution upon entering office. He had to save his political party and open Mexico's economy, while remaining in good standing with the people of Mexico. This resulted in him pitching his biggest gamble, a free trade agreement with the United States.

The United States and Mexico have had a long history. The U.S. had been Mexico's enemy at one point but became an ally and remains one in the present day. Yet there was a constant fear within Mexico about the United States influence within the region, some of which also remains today. However, in June of 1990, President Salinas began the process by announcing his plan for a free trade agreement. By doing so he "thus reversed decades of inward-looking policies and, in effect, topped a wall of mistrust in U.S.-Mexican relations," (Baer 1991, p. 132). The announcement received mixed reviews which was to be expected, some of which were rooted in political views.

As mentioned above, Salinas faced more than one problem when he took office in 1988. Announcing his intention to enter a free trade agreement with the United States brought into question the actual motivation behind the plan. Sidestepping the advantages and disadvantages of implementing a free trade agreement, and disregarding the critics and supporters, President Salinas masterminded a plan to regain power for his political party.

> What supports the argument that Mexico's decision to pursue the NAFTA was heavily presidential in its origins?…[the] establishment of, and membership in, the NAFTA was critical to stimulate economic recovery and, thus, the regime's own political survival. Not only did the NAFTA serve as an essential component of the program to free up the domestic economy, but it also had the effect of reinforcing the reorganized ruling coalition in its support of the pact, lining it up behind the promise of greater benefits after a decade or more of staggering sacrificed. (Poitras and Robinson 1994, p. 9-20)

By proposing and eventually implementing NAFTA, President Salinas planned to solidify his political party's standing in Mexico.

President Salinas's proposal was meant to save his political party while at the same time changing how Mexico's economy would function.

> Salinas worked to privatize the Mexican economy and to open it to foreign investment. The capstone of his efforts was a plan that both ensured US banks would get their money and created a structure that would assure future potential for increased opportunities for investment and credit lending: NAFTA. (McCarty 2007, p. 107)

He wanted to draw in foreign investment into Mexico, but he was aware of how difficult bringing in investors would be since the country had just experienced a crisis. With NAFTA, President Salinas was able to put safeguards in place to allow American investors some protection. Having a global power like the United States invest in Mexico would then give foreign investors a type of reassurance.

When announcing his plan to enter a free trade agreement with the U.S., President Salinas and his government made many promises to the public regarding what NAFTA would accomplish for Mexico. Among them, his biggest promise was fast economic growth for the country. A promise for Mexico to be able to essentially catch up to the United States and other developed economies. That was a dream many people had within Mexico, for the country to be on relatively equal footing with its neighbors.

> [But] there is also the question of whether the Salinas strategy will actually deliver the goods. Abandoning a decade-old tradition and betting everything on a new, all-encompassing, tightly bound and inevitable subordinate relationship with the United States is a risk. The danger is that this policy will either fail, or that it will succeed, but only partially and in a divisive fashion. (Castañeda 1990, p. 419)

Here is the reason for why President Salinas's plan was a huge gamble. He pitched a free trade agreement with the United States to save his political party, making many uplifting promises to the people of Mexico when there was a huge risk present. There was absolutely no guarantee a free trade agreement would deliver on all the promises President Salinas and his government made.

The plan to establish a free trade agreement between Mexico and the United States grew to include Canada. While the government of Canada was initially hesitant to join the negotiations, they eventually did so the country's trade with the United States would not be neglected in favor of Mexico. On February 5, 1991

> The leaders of Canada, Mexico, and the United States announced they would negotiate a North American Free Trade Agreement, NAFTA, if and when completed, will reshape

> corporate strategies, redraw the mental map of citizens in each country and gradually create a North American economic identity based on global competition," (Baer 1991, p.132).

What began as a plan to regain power for a political party resulted in the implementation of the North American Free Trade Agreement in 1994. President Salinas made a huge gamble when he announced his plan for a free trade agreement, but it did work to a degree. While his political party did regain power and win the election in 1994, the promises made by the Mexican government remain unachieved. The advantages and disadvantages to the free trade agreement that were sidestepped by President Salinas will be explored in the following section.

The Debate: The Good, The Bad, and The Letdown

As mentioned in the previous section, President Salinas and his administration made promises to the people of Mexico when they announced plans for a free trade agreement. In this section, the author will explore the advantages and disadvantages that were presented after President Salinas's announcement as well as what NAFTA succeeded and failed to accomplish. Mexico had laid the groundwork for NAFTA back in the 1980s when they pushed for trade liberalization. This allowed for an easy pathway to achieving NAFTA since trade liberalization encourages free trade agreements because it removes or restricts the barriers that are in place when exchanging goods or services.

Trade agreements made between countries are always going to draw attention from supporters and opponents alike.

> International free trade agreements invoke passionate debates regarding the merits, risks, and shortcomings that are necessarily a part of any such agreement. This is understandable, given that trade liberalization creates both winners and losers, whether viewed from a short-term or long-term perspective. (Moreno-Brid, Ruiz Napoles, and Rivas Valdivia 2005, p. 1)

The free trade agreement was never going to satisfy every single person in Mexico. President Salinas made it harder by pushing heavily on NAFTA's passage. He sidestepped the arguments that were being made in order to move forward with his political agenda. To gather support for his plan he made promises that had no guarantee of being achieved.

The benefits of implementing NAFTA are associated with the benefits of trade liberalization. As mentioned in the first section of Chapter One, trade liberalization can lead to rapid economic growth. This was the biggest promise made by President Salinas, and the biggest reason presented in favor of NAFTA, that the free trade agreement would boost economic growth. This growth would allow for Mexico to become a developed economy like its North American neighbors. "Since NAFTA went into effect on January 1, 1994, however, economic growth in Mexico has averaged just 2.7 percent per year, exactly the same rate of economic growth as in the decade prior to NAFTA's birth," (Stracke 2003, p. 29). While the 2.7 percentage is as of the early 2000s it is still important to remember since the growth rate was calculated about a decade after NAFTA had taken effect. This contributes to President Salinas not delivering on his promise.

In addition to a promise of economic growth, there were two more benefits to implementing the free trade agreement. The first benefit was imports would be less expensive and exports would increase, the second was the increase of foreign direct investment. "The fiscal deficit and inflation were drastically reduced…FDI inflows increased and helped to trigger an export boom in manufacturing that transformed Mexico's insertion in the world economy," (Moreno-Brid, Santamaria, and Rivas Valdivia 2005, p. 1115). NAFTA supporters can make the case that it was because of the trade agreement that the country experienced an increase in its exports, as well as an increase in foreign direct investment.

President Salinas opened the economy to foreign investors so the Mexican economy could begin to recover. The president succeeded in his plan and foreign direct investment increased because "NAFTA contained strong protections for private investors' rights (both pecuniary and intellectual) that, in some respects, went beyond anything in existing law in any member country and that exceeded the prerequisites for free trade in the traditional sense," (Blecker 2003, p. 6). With the protections implemented through NAFTA, Mexico used it to its advantage to draw the attention of foreign investors. However, Canada and the United States were more than happy to use this protection to its advantage.

Since the Lost Decade in the 1980s, Mexico's economy has made a lot of progress. However, President Salinas's promise of economic growth fell short. While NAFTA supporters "admit that NAFTA alone cannot guarantee economic convergence in North America, they nevertheless conclude that the trade agreement helped to bring Mexico's level of development closer to that of its trading partners, (Moreno-Brid, Ruiz Napoles, and Rivas Valdivia 2005, p. 2). The Latin American country's economy is not on par with that of the United States and Canada. Mexico still has a long road to travel to be on the same level as its North American neighbors.

During the mid-1990s, about a year after NAFTA took effect, Mexico experienced another crisis, now referred to as the "Tequila Crisis," which resulted in the Mexican peso appreciating. Supporters of NAFTA "view the agreement as the fundamental reason behind the

Mexican economy's prompt recovery after the economic crisis of 1995. Without NAFTA, these advocates argue, the U.S. Treasury would not have so swiftly approved the emergency U.S. $50 billion support loan to Mexico," (Moreno-Brid, Ruiz Napoles, and Rivas Valdivia 2005, p. 2). NAFTA supporters make the case that it was because of the free trade agreement that the United States quickly provided aid to help Mexico during its crisis.

On the opposite end of the argument are those who opposed trade liberalization and NAFTA. There were many more who were against the agreement, and since it has been more than two decades since its implementation, it is easier to see in what aspects the trade agreement failed. "Notwithstanding the dynamism of exports, the Mexican economy has not grown fast enough and, thus, has not been able to create enough jobs to meet the employment demands of its increasing labour force," (Moreno-Brid, Santamaria, Rivas Valdivia 2005, p. 1115). As mentioned in the first section of this chapter, without the country's economy being able to grow rapidly, it will not be able to meet the demand for employment. This is what happened in Mexico. While exports and foreign direct investment inflow to Mexico increased, the country did not grow as much as predicted and thus was unable to meet the demands for employment.

An outcome that emerged because of NAFTA would be the close relationship Mexico's economy built with the United States. An argument can be made that Mexico's economy became dependent on the U.S.'s resulting in a synchronization. However, this is not beneficial because when the United States enters a recession the Mexican economy will suffer as a result. And it did, as was seen after the Great Recession of 2008-2009. This synchronization will be further explored in Chapter Two of this paper.

NAFTA advocates "promised that the agreement would usher in a wave of economic modernization in Mexico that would improve the productivity of Mexico's workers, raise living standards, and create a much wealthier nation of consumers ready and able to buy American-made goods," (Stracke 2003, p. 29). NAFTA supporters were ready to praise the agreement but not only was the promised economic growth not met, but there was also a demand for employment that could not be met. In addition to these problems, the wages for workers was low. NAFTA "failed to generate significant employment growth because of policy-based wage repression that constrained the domestic market," (Cypher 2011, p. 62). The low wages further contributed to the lack of employment. With low wages and an inability for Mexico to meet the demand for employment, people started to migrate.

While migration has always been a major issue, especially in recent years, it was heavily present during NAFTA years. The number of Mexican migrants moving to the United States increased in the years following NAFTA. "In spite of NAFTA, there has been little, if any, net job creation in the tradable goods-producing sectors of the Mexican economy (agricultural and manufacturing)," (Blecker 2003, p. 5). Many Mexicans lost their jobs because of the free trade agreement. Mexico's lack of economic growth could not keep up with the demand for employment caused by an increase in the export sector. Combine this with the low wages, and migration became an even bigger issue for both the United States and Mexico.

The North American Free Trade Agreement's supporters and opposers made valid arguments as to whether it should be implemented or not. However, President Salinas had his plan in place for the agreement and sidestepped the arguments. Once NAFTA had passed, people were able to draw their own conclusions regarding the trade agreement. While NAFTA did increase exports and foreign direct investment inflow to Mexico, it did not deliver on its promise of economic growth. With no rapid economic growth, more problems arose in the years following NAFTA's implementation, such as loss of jobs, low wages, and migration. Mexico's "whole economy, is at a crossroads. It can no longer base its place in the global economy on low wages….but at the same time, it has not yet successfully entered the international market through high value added processes and products," (Moreno-Brid, Santamaria, Rivas Valdivia 2005, p.1116). Mexico's economy did not grow to stand on par with the economies of the United States and Canada like the country had hoped. Instead, it remains the developing economy it was before NAFTA went into effect.

Round 2: The USMCA

The North American Free Trade Agreement was officially implemented in 1994. For more than two decades NAFTA remained in place as the free trade agreement between the three North American countries. However, that does not mean the argument for the agreement's ratification was not present. On the contrary, when United States President Barack Obama was first running for office in 2008, he said he would call the presidents of Mexico and Canada to renegotiate the terms of NAFTA. As was seen, this would not lead anywhere. It would be President Donald Trump's time in office that would lead to the renegotiation of NAFTA.

While campaigning, President Trump made the same promise as President Obama, to renegotiate the agreement. However, this time the candidate would follow through on his promise. There were a few concerns the United States had regarding NAFTA.

> Despite the positive influences, NAFTA has also been heavily scrutinized in the United States because of (1) a continued increase in the U.S. trade deficit with Mexico, (2) potential loss in employment and firm profits in import-competing sectors, and (3)

> concern about undocumented immigration from Mexico to the United States. (Zhao, Devadoss, and Luckstead 2020, p. 48)

The United States was benefiting from NAFTA policies but even at home there were concerns in place. President Trump listened to them and called for a new trade agreement. This resulted in the United States-Mexico-Canada Agreement (USMCA) which was officially implemented on July 1, 2020.

NAFTA removed almost all of the tariffs between Mexico, Canada, and the United States, and put protections in place for foreign investors. The USMCA

> Includes tighter rules of origin in the automobile, textile, and apparel sectors, a new labor value content requirement in the auto sector, higher U.S. access to Canadian supply-managed markets, further goods trade facilitation, updated provisions related to financial services, as well as a new currency provision and a provision about entering free trade agreements with non-market economies. (Burfisher, Lambert, and Matheson 2019, p.4).

The new agreement has new policies and appears to be more beneficial for both Canada and Mexico as opposed to NAFTA which worked in the United States favor. Although the United States benefited from NAFTA, it was not favorable to all Americans. The agreement had an effect on distribution. For example, the United States' southwest did well compared to the upper Midwest that lost a lot of jobs.

NAFTA has been in the free trade agreement between the United States, Canada, and Mexico for over twenty years. This gave economists well over two decades to study and analyze the impact of the agreement on the three countries. However, the USMCA was only introduced about three years ago and has been implemented for less than a year. The short time frame as well ongoing global circumstances make it more difficult to determine the current impacts of the new free trade agreement. The author will analyze different variables in the following chapter to examine what effect NAFTA has on Mexico and what potential impact the USMCA can have on the country's economy.

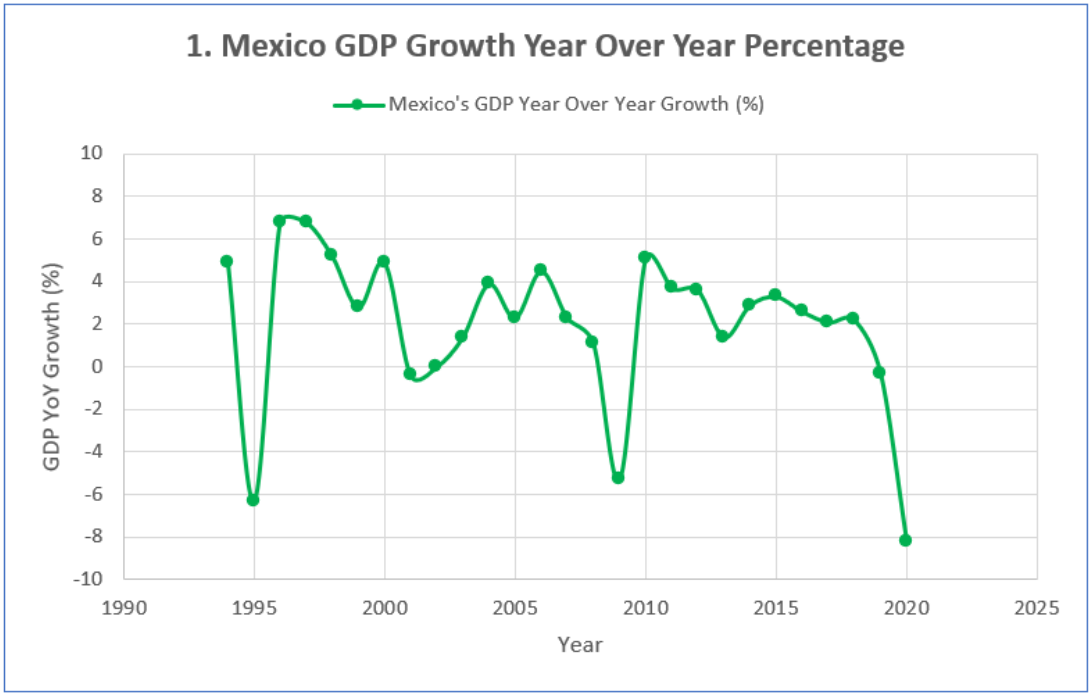
Chapter Two

In Chapter One, the author provided background regarding the North American Free Trade Agreement and the United States-Mexico-Canada Agreement. President Salinas's gamble with a free trade agreement allowed him to achieve his goal of opening the Mexican economy and regaining his political party's power. NAFTA resulted in Mexico's trade and foreign direct investment to increase, but ultimately produced lackluster results. In Chapter Two, the author will analyze different variables to determine whether the new trade agreement between the United States and Mexico will be beneficial to the Latin American country.

Economic Growth

The first variable that will be analyzed in this chapter is Mexico's economic growth. As mentioned in the previous chapter, President Salinas made a promise to the people of Mexico when he first introduced NAFTA. The promise was that the Mexican economy would rapidly grow and stand on even footing with the country's North American neighbors. Unfortunately, this promise would be broken as the Mexican economy did not perform as expected. While the country's economy has grown, it was not to the degree the former president promised it would. Mexico's growth would remain stagnant long after NAFTA's introduction and departure.

Pictured below is a graph depicting Mexico's gross domestic product (GDP) growth calculated as a year over year percentage. While the country's GDP growth percentage did increase in the years after NAFTA's implementation, the percentage fluctuates. In 2001, the GDP percentage growth decreased drastically, the same thing occurs in 2009 and 2020. These three drops are consistent with times Mexico has experienced a recession. At the same time Mexico is experiencing these recessions, the United States is experiencing one also. This will be explored in the following section.



Synchronization

The second variable to be analyzed in this chapter is synchronization. Mexico has a strong connection with the United States, this is especially true regarding Mexico's economy. Trade increase was just one aspect that resulted from the first free trade agreement. "Mexico-U.S. trade jumped from 23 percent of Mexican GDP in 1993 to over 40 percent," in the early 2000s (Bayoumi and Swiston 2008, p. 3). While Mexico benefited from this increase in trade, some economists have made an argument that Mexico's economy has become dependent on the United States', especially after NAFTA's implementation. "Results do suggest that the

Mexican business cycle has become much more synchronized with output changed in the USA than was the case before NAFTA," (Miles and Vijverberg 2011, p. 638-639).

After NAFTA took effect, the argument of the United States having a lot of influence in Mexico became much more valid. Mexico's business cycle became synchronized with that of the U.S.'s after the first trade agreement's implementation.

> With the stabilization of the Mexican economy since 1996, U.S. shocks have taken on a more influential role in driving the Mexican cycle…the U.S. economy has accounted for about one-third of the variation in Mexican GDP at business cycle frequencies since NAFTA implementation, and the spillovers have been transmitted through both trade and financial channels. (Bayoumi and Swiston 2008, p. 16)

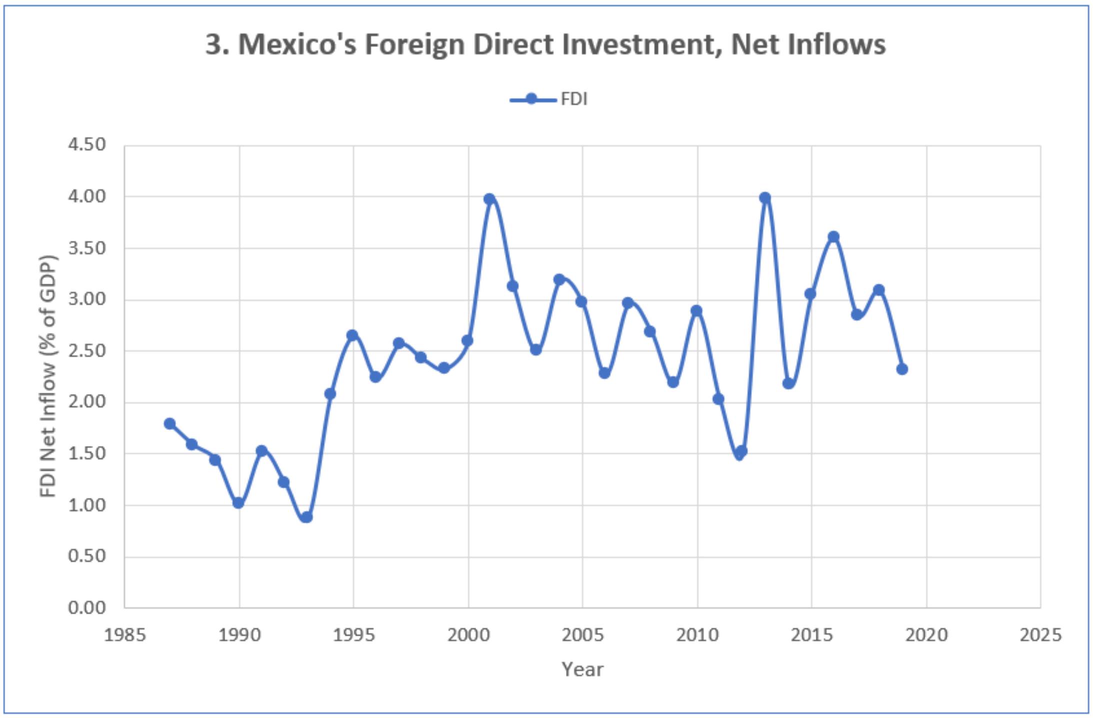
After 1994, Mexico's economy became sensitive to the United States economy. Due to the country's strong connection to the U.S., shocks to the U.S. economy would cause shocks to the Mexican economy. This is the reason Mexico suffered the most out of the Latin American countries during the Great Recession.

The graph below is similar to the graph from the previous section, except this one includes the GDP growth year over year percentage of the United States. The author has included both countries in the same graph so the reader can view the consistencies of both countries. When the United States experiences a recession, it is a shock that is felt and experienced more by Mexico because the Latin American country has become sensitive to the U.S. economy. When the United States' GDP growth percentage decreases, the same event occurs for Mexico. The drastic decrease in GDP growth percentage Mexico experienced in 2001, for example, was a shock caused by the U.S. because they went through the dotcom recession.

The most recent decrease in both Mexico and the United States occurred in 2020, which left a detrimental impact on much of the global economy. While one can argue this decline was due to a global pandemic, to say the United States' suffering economy did not contribute to Mexico's would not be entirely true. The best example of Mexico's synchronization to the United States economy would be the GDP growth decline from 2008 to 2009. The United States was going through the Great Recession at the time. As mentioned earlier, Latin American managed to not be as impacted by the U.S. recession of 2008. However, Mexico was not as fortunate, as can be seen in the graph above.

Foreign Direct Investment

The next variable that will be discussed in this chapter is foreign direct investment. Trade was not the only aspect that increased in Mexico, the amount of foreign direct investment inflow to Mexico also increased. When President Salinas entered office in 1988, he was under pressure by the International Monetary Fund to open the country's economy up to foreign investment so the country's economy could recover from the Lost Decade. NAFTA provided foreign investors with incentives that would protect their money, therefore giving them the confidence and reassurance to invest. As a result, foreign direct investment inflow increased.

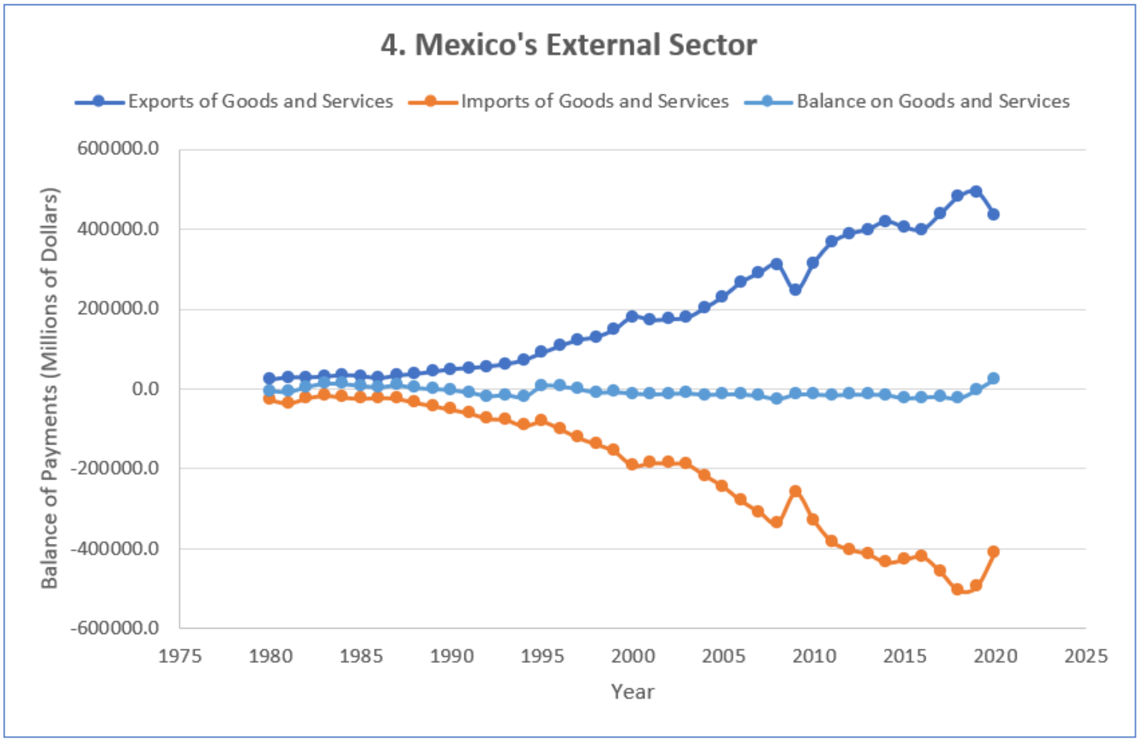


The graph pictured above depicts Mexico's foreign direct investment, net inflows as a percent of GDP. As can be seen from the graph, in the early 1990s, foreign direct investment began to heavily increase. While FDI inflow to the country has fluctuated, it has overall maintained a higher value than prior to 1994, the year NAFTA was officially implemented. The foreign direct investment inflow to Mexico dropped in 2019 from 2018. The reason for this can be associated with both the pandemic's appearance in 2019 as well as the relationship between the economies of Mexico and the U.S. Afterall, the United States is Mexico's biggest foreign domestic investor.

External Sector

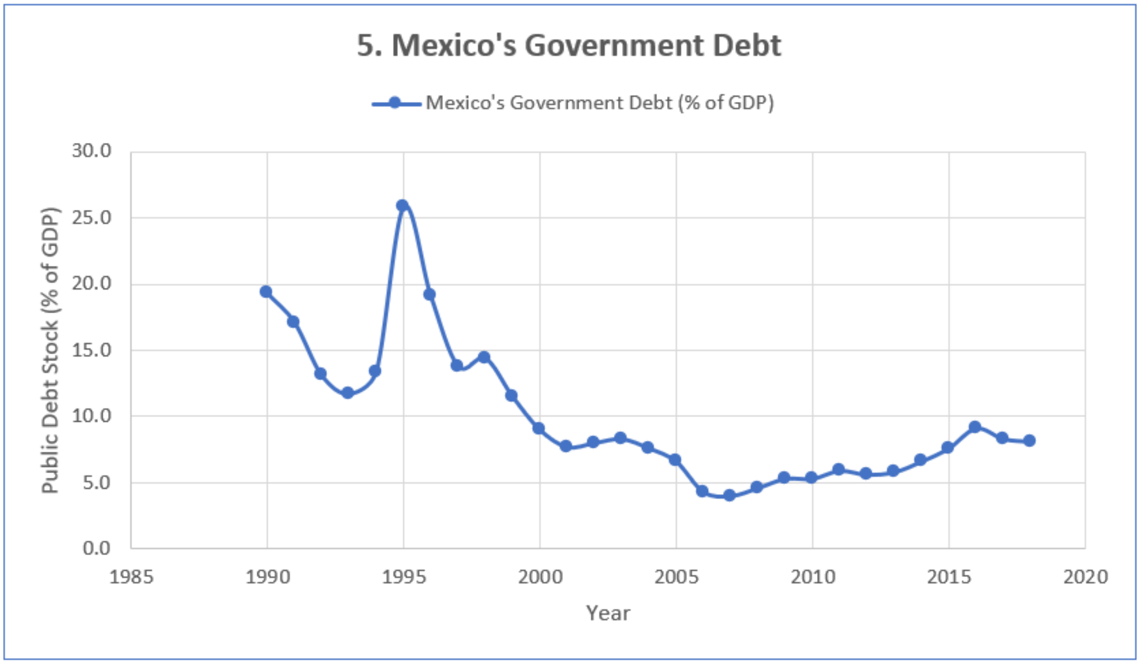
The free trade agreement between the three North American countries was only the beginning of Mexico's pursuit of trade liberalization. After NAFTA was implemented in 1994, Mexico looked for other countries to establish free trade agreements with and succeeded. Currently, Mexico has a total of twelve free trade agreements with over forty-six countries around the world. Some of these countries include Japan, the European Union, and almost one dozen Latin American countries. This has contributed to Mexico having an export economy. However, Mexico's relationship with the United States is once again making its presence known. The U.S. is not only Mexico's biggest foreign direct investor, but it is also Mexico's biggest trading partner.

The graph below depicts Mexico's external sector, containing the balance of payments, in millions of dollars, of Mexico's exports and imports of goods and services. The data ranges from 1980 to 2020, and one can see that prior to the mid-1990s Mexico's exports were slowly increasing. However, afterwards the exports began to increase more drastically. This change can be attributed to Mexico's free trade agreement with its North American neighbors. Once again, the decline in exports from 2008 to 2009, and 2019 to 2020, are due to the Great Recession and COVID-19 respectively.



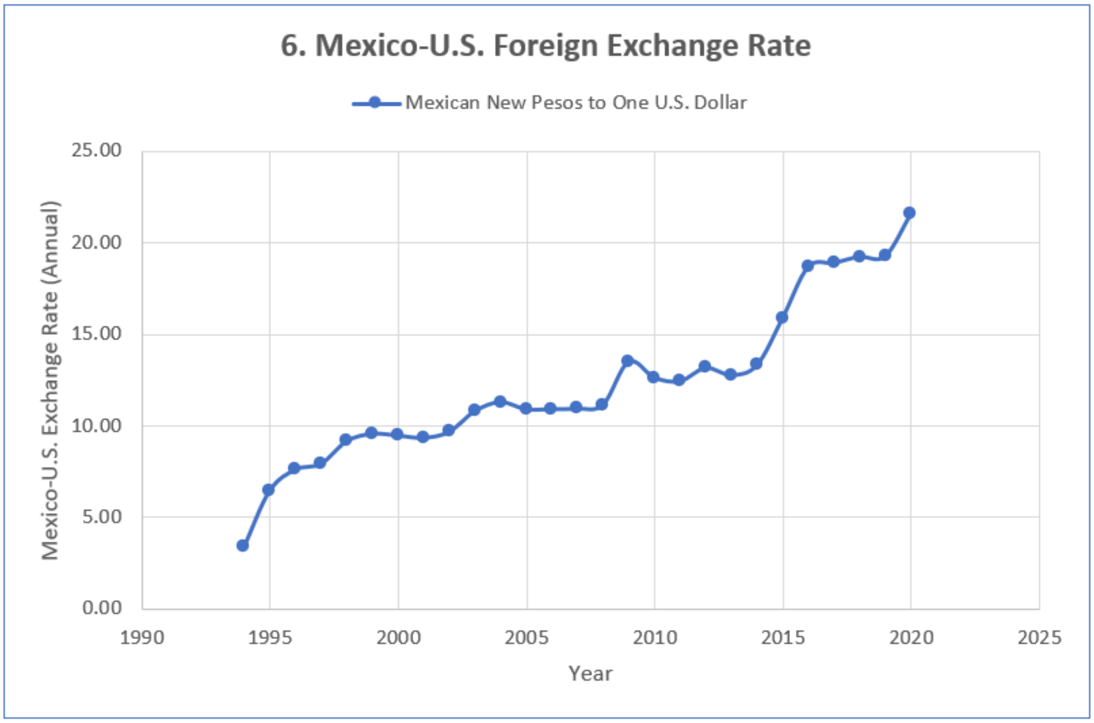
Government Debt

The following graph, provided below, depicts Mexico's government debt, which is calculated as a percentage of GDP. The government debt is how much a country, in this case Mexico, owes its foreign or domestic lenders at a period in time. In the early 1990s, the government debt was decreasing but it rose drastically from 1994 to 1995, the reason being the Tequila crisis. Mexico took on so much debt that it eventually defaulted and was bailed out by the United States, the bailout was then administered by the International Monetary Fund. After the Tequila crisis, the government debt of the country has been declining. Since then, there has been no drastic increase in Mexico's government debt.



United States – Mexico Exchange Rate

Graph number six, provided below, demonstrates the average annual exchange rate between the United States and Mexico since the mid-1990s. Since 1994, there has been a lot of appreciation in the exchange rate. In 1994, one United States dollar would get someone 3.39 Mexican pesos, in 2020 that same dollar would get someone 21.55 Mexican pesos. As of recent years, the exchange rate has fluctuated around the twenty pesos area, with the exchange rate as of May 2021 being 19.88 Mexican pesos for one U.S. dollar. The country continues to have low-skill, low-wage jobs and their products are not expensive. Given the country's numerous free trade agreements, it does not cost a lot for countries to import Mexican goods. Given these circumstances, one can see why this is one of the reasons the country struggles with developing, a topic that will be further discussed in the following chapter.



Stock Index

For the final variable of this chapter, the author will look at Mexico's average annual stock index that was derived from data acquired on Mexico's monthly stock index, the graph is provided below. From the early 1990s to the early 2000s, the average price of stock in Mexico has stagnantly increased. However, after 2003 the average price of stock has begun to increase more drastically compared to the previous decade. This can be caused by an increase in private investment. Foreign direct investment increased after NAFTA allowing for domestic investors to regain their confidence also. In addition to this, the economy was showing signs of recovering. This could have been one of the reasons for an increase in the stock index as seen in the final graph.

The biggest outcome of NAFTA was the greater connection between the United States and Mexican economies. This will remain an important fact to keep in mind when analyzing the data from this chapter. This is especially evident during the years of the Great Recession since Mexico was more severely impacted than the rest of Latin American because of the economy's sensitivity to U.S. economic shocks. Mexico's increased dependency on the United States will be further explored in the final chapter.

Chapter Three

In Chapter Two, the author discusses different variable that will help answer the question presented in the introduction of this paper, whether the USMCA will be beneficial to Mexico based on the country's previous experience with NAFTA. The latter was a trade agreement that was in effect for over two decades, while the former is a newly implemented free trade agreement less than one year old. NAFTA began as Mexican President Carlos Salinas's plan for free trade liberalization. When he was first introducing the idea of free trade liberalization, the promise he made was that Mexico would experience rapid economic growth, enough that Mexico would be able to stand on even footing with the United States and Canada. While the promise made the passage of NAFTA successful, it was ultimately unaccomplished and remains so presently. Rapid economic growth to become a developed economy was the primary goal Mexico tried to achieve, and it is one Mexico continues to strive toward today.

The Outcome of NAFTA

After NAFTA was implemented in 1994, Mexico did experience a couple of benefits that came from the free trade agreement such as an increase in exports and foreign direct investment. However, like any agreement between countries there are drawbacks.

> Liberalized trade and investment flows have not brought the promised developmental benefits to Mexico or led to its convergence with its richer northern neighbors. Ironically, the most painful adjustment costs have been felt in Mexico, and there is no single greater indicator of the failure of NAFTA (and related free-market reforms in Mexico) to solve that country's economic problems than the fact that an estimated 4 to 5 million Mexicans

> migrated to the United States during the 1990s. NAFTA did not cause this massive migration, but it also did not boost employment or wages in Mexico enough to prevent it (as many NAFTA promoters claimed it would, prior to 1994). (Blecker 2003, p.21)

The Latin American country has not experienced its promised economic growth, instead it has remained stagnant, as can be seen in the previous chapter. Instead Mexico has been left with low wages for workers and a demand for job employment the country is unable to meet. This has led to migrants leaving Mexico to search for job opportunities in the United States, adding to one of the major sources of conflict between the two countries.

Mexico is a developing economy with low wages, low education, and a lot of the country's citizens struggle to escape poverty. It is easy to see why the people were willing to trust their president, ignore decades of mistrust between the two countries, and establish a free trade agreement. However, in addition to a stagnant economic growth, Mexico has become increasingly dependent on the United States. The U.S. is Mexico's biggest trading partner, and biggest source for foreign domestic investment inflows. This has resulted in Mexico's economy becoming sensitive to economic shocks from the United States. The author of this paper found a New York Times headline that best describes this situation, "when the U.S. sneezes, Mexico catches a cold." This is evident when Mexico experiences a recession in its economy because a connection can usually be made to a recession occurring in the United States at the same time.

The U.S. has experienced a few recessions in the past couple of decades. In the early 2000s there was the dotcom recession, the Great Recession of 2008, and most recently the COVID-19 pandemic caused a recession in the United States in 2020. These downturns made their presence known in Mexico due to the country's synchronization to the United States economy, particularly when looking at the Great Recession. While the rest of Latin American was able to escape the worst of the 2008 to 2009 recession, Mexico was not as fortunate. During this time the country's economic growth and exports decreased, as well as the average annual price of stock decreased.

The USMCA And What Should Be Done

When U.S. President Trump was on the campaign trail, he was pushing for a new trade deal, having been quoted saying NAFTA "was the worst trade deal ever made." He said NAFTA caused a loss of American jobs and factories, as well as the cause of the country's trade deficit. In 2018 he threatened to pull out of NAFTA if the agreement was not renegotiated. Mexico and Canada were not as ready to renegotiate so President Trump's "administration said it would examine whether car and truck imports from around the world harm its auto industry, a move that may lead to new tariffs on exports to the world's second-largest auto market," (Stargardter and Lawder 2018, p.1). NAFTA left Mexico with much to be desired, but there is no denying that the boost in exports and foreign direct investment inflow benefited the country. While Mexico's president and Canada's prime minister were not happy about being threatened, and to a degree coerced, they did agree to the renegotiation. The result was the United States-Mexico-Canada Agreement.

It is important to remember that the USMCA was a renegotiation. Among the new terms was an increase in the percentage, from 62.5% to 75%, of manufacturing components made in North America in order to be exempted from one of the country's tariffs, as well as an increase in the copyright terms. These are only a couple of examples of the changes. The new terms of the trade agreement do not address the problems that arose in Mexico after NAFTA was implemented. To counter the effects the “exchange rates should be managed to stabilize real currency values and prevent excessive trade imbalances from arising,” and more importantly, “all three countries need to escape from the zero-sum game of competing over job opportunities through lower wages or exchange rates,” (Blecker 2003, p.22). This suggestion was presented almost twenty years ago and remains a current issue. Focusing on low wages, all three countries are using it in Mexico. For example, one of the reasons U.S. companies went to Mexico was for cheap labor.

Mexico itself is not innocent in this regard either, the country uses low-skill, low-wage jobs as a way to attract foreign investment. This contributes to part of Mexico’s population having difficulty and oftentimes, inability to escape poverty. Instead of directing investment toward low-skill, low-wage job opportunities, Mexico needs to also direct it toward where it will greatly benefit the country. “Mexico desperately needs more public investment in infrastructure and education, along with internal reforms to combat corruption, strengthen financial regulation, and enhance open, democratic institutions,” (Blecker 2003, p.22). Education in Mexico remains a major issue, one that must be addressed to move the country forward. A lack of education makes people search out these low-skill, low-wage jobs, unable to escape poverty, making the cycle continue for the next generation. Infrastructure is also a current issue that must be addressed in order to move the country and its economy forward.

The president and his administration need to divert private investors, both foreign and domestic, attention toward projects that would greatly benefit Mexico. However, the current president, Andrés Manuel López Obrador entered office targeting these investors. He viewed them as corrupt and threatened to get rid of the contracts they had made under his predecessor. However, in late 2020 the president unveiled a more than $13 billion plan that will benefit the country’s infrastructure. Majority of the plan is financed by private investors, “among the private companies leading pending projects was Impulsora del Desarrollo y el Empleo en America Latina (IDEAL), a builder controlled by Mexican billionaire Carlos Slim,” (Graham 2020, p.1). This move is beneficial for both the country as well as the president himself. To further develop Mexico, President López Obrador cannot ignore, target, or threaten private investors. Instead he must use them to his advantage, just like he did with his infrastructure plan late last year.

During his campaign, President López Obrador ran as a man of the people, one who would put the interest of the people first. However, to help the people of Mexico, he has to play the same game as those he targeted, companies and investors.

> Mexico will not win in the long run by trying to play the game of offering cheap wages to attract labor-intensive FDI. By investing more in education, training, and infrastructure, Mexico can attract more skill-intensive industries with greater spillover benefits for the domestic economy. (Blecker 2003, p. 23)

The president’s infrastructure plan is a move in the right direction, and with more than three years left in office, he can still make plans that improve Mexico long after he leaves office in 2024.

COVID-19 Overstays Its Welcome

Before President López Obrador can make further plans to develop the country’s economy, he must first handle the ongoing COVID-19 virus. The COVID-19 virus first appeared in late 2019 but would make its presence highly known in 2020 when the virus reached the scale of a global pandemic. While 2021 has seen numbers lower than that of the previous year, the still ongoing pandemic harmed many economies, the United States and Mexico among them. The coronavirus took many lives around the world, leaving a high death toll with mixed governmental responses. Former United States President Donald Trump failed to react on time with an appropriate solution, leaving the U.S. with the highest number of deaths in the world.

Mexico did not escape the disaster either. Mexican President López Obrador also failed to produce an appropriate response to the pandemic as well, leaving the country with currently the fourth highest number of deaths around the world. Foreign investors have shown hesitancy to invest in Mexico amid the pandemic given the president's handling of the situation. The issue only worsened when President López Obrador displayed symptoms of the virus in January 2021 and still boarded a commercial plane, reports later surfaced that he had tested positive for the coronavirus. As of May 2020, there have been almost 2.4 million cases of COVID-19, with more than 221,000 deaths in the country.

In addition to these deaths, the COVID-19 pandemic has left Mexican citizens without jobs and the country with a suffering economy.

> Of 12 million workers that lost their jobs…over 4 million remain out of the workforce. The working poverty rate jumped to 48 percent…domestic demand is weak, as is services activity that employs most of the workforce. [IMF] Staff projects the economy to shrink by 9 percent this year, followed by a gradual recovery it could take years for employment and incomes to return to pre-crisis levels, compounding the long-standing challenge to achieving strong and inclusive growth. (IMF Country Report 2020, p.1)

Mexico's economy was growing at a stagnant rate prior to 2020, but it was still growing. However, due to the pandemic the International Monetary Fund predicts the country can take years to recover from the effect the pandemic had on the economy. The pandemic has worsened Mexico's the country's economic growth, "the gains in income and employment of the past decade are being set back, and the burden is falling disproportionately on the poor and vulnerable," (IMF Country Report 2020, p.4). The progress Mexico has made has come to a halt and unfortunately those left to pay the price are the country's most vulnerable population. President López Obrador's infrastructure plan will aid the situation but it is not a permanent solution.

The Verdict of NAFTA 2.0

The coronavirus's effect on Mexico's economy was disastrous, and amid the global pandemic the United States-Mexico-Canada Agreement was implemented on July 1, 2021. The situation has made it difficult to determine the full impact the USMCA will have on Mexico. For example, the graph of economic growth provided in Chapter Two shows a sharp decline from 2019 to 2020 that one can associate with the implementation of a new trade agreement, but the reason for this decline is due to the coronavirus. The pandemic caused Mexico's greatest economic contraction since the 1930s. If the coronavirus had not made an appearance, the data would have been more indicative of the effect the USMCA will have on Mexico.

However, the author can make inferences on the impact the new trade agreement will have on the Latin American country. The first of which is that Mexico's goal of rapid economic growth remains a distant dream. The country's economy has become heavily dependent on the United States, with shocks in the U.S. causing economic downturns in the Latin American country. This dependency and sensitivity will only grow with the USMCA.

> The gradual forces that over the past 30 years led to NAFTA could over the next 30 years lead to some additional degree of unity…Mexico is already intensely motivated to achieve inflation rates comparable to its North American neighbors, and a tax treaty among the three countries is probable. (Baer 1991, p. 148)

It has been almost three decades after NAFTA was implemented, and though it has been replaced by the USMCA, a type of unity has been achieved between the two countries. However, it is not the type of unity Baer spoke of in the early 1990s.

The USMCA is often referred to as NAFTA 2.0, a name the author agrees with. The new free trade agreement is an upgrade to NAFTA, not a brand-new agreement, and it will not have the same effect as its predecessor. NAFTA had a significant impact on the economy of Mexico, particularly with sharp increases in exports and foreign direct investment inflow. When a video game company releases an update for an already existing game, it will not have the same impact on sales than if they were to release a brand-new video game. The same concept applies here, an update to an already existing free trade agreement will not have the same effect as implementing a brand-new free trade agreement. Foreign direct investment inflows to the country, as well as exports, will increase this year as the economy begins its path to recovery. However, the government has to direct investors interests toward developing the country rather than trying to compete with its North American neighbors. Mexico also needs to slowly start separating itself from its dependency on the United States as it will also hinder the country's path towards development. Mexico wants to compete with developed countries, but it has a long path to travel before it can become developed.

Conclusion

The road to establishing the North American Free Trade Agreement began long before its announcement. Starting in the 1980s, Mexico experienced a financial crisis resulting in what is currently referred to as the Lost Decade. To stimulate the economy, trade liberalization began in the late 1980s which would encourage a free trade agreement in the following decade. President Carlos Salinas de Gortari would begin negotiating with the United States, and Canada would join the discussion soon afterwards. The talk ended successfully, resulting in the introduction and negotiation of NAFTA in 1990 and 1991. The agreement would be signed in 1992, ratified in 1993, and on January 1, 1994, the North American Free Trade Agreement would be officially implemented. NAFTA would connect the United States, Mexico, and Canada with a free trade agreement that removed almost all the tariffs on goods being traded between the three countries. The agreement would remain in place for more than two decades and encourage the creation of similar agreements in other parts of the world.

President Carlos Salinas de Gortari entered office in 1988 with two major problems in need of a solution. He had a political party that was rapidly losing influence, and an economy in need of recovery. Having been under pressure from the International Monetary Fund to open Mexico’s economy and needing to regain political power, President Salinas had to find an answer that would solve both of his problems. His solution would be a huge gamble that would come to define his presidency, a free trade agreement with the United States with a promise of rapid economic growth. “Economic liberalization could transform the Americas within a generation, NAFTA signifies that Mexico has become a North American country, ready to share Western entrepreneurial values and participate in Western capital markets,” (Baer 1991, p.147). President

Salinas promised that Mexico's economy would grow rapidly and that the country would be able to stand on an equal level as its North American neighbors.

President Salinas's biggest gamble would pay off since his political party would win the following election. However, it would become obvious after President Salinas left office that his promise would be broken and left unfulfilled. While Mexican exports boomed after NAFTA took effect, and foreign direct investment into the country also increased, the negative results would outweigh the positive. NAFTA's failure to produce beneficial results for Mexico would result in a few problems. Among them were a stagnant growth economy, high demand for employment with an economy's inability to meet it, low wages, and a growing migration problem.

> The failure of NAFTA to fulfill its promise of widespread Mexican prosperity has also meant continued illegal immigration into the United States, of both skilled and unskilled workers…Economic sluggishness in Mexico has also contributed to the trade in illegal drugs, on more point of friction between the two countries. (Stracke 2003, p.29-30).

The number of migrants leaving Mexico and entering the United States increased after NAFTA took effect. This issue brought further tension to an already major conflict between the two neighboring countries.

The three North American countries' respective economies have become tied together as a result of the free trade agreement.

> NAFTA accelerated and deepened the integration of the three member economies and, to this extent, has tied their economic futures more closely together–including by making the two smaller economies more dependent than ever on U.S. economic growth and their competitiveness in the U.S. market. (Blecker 2003, p. 7).

In particular, Mexico's economy has become especially sensitive to shocks to the United States economy. The Great Recession is the perfect example of the synchronization between the two economies. "Mexico was more severely impacted by the 2008 U.S. financial crisis than any nation in Latin America," (Cypher 2011, p.62). While the rest of Latin America did suffer because of the crisis, none was more impacted than Mexico because the economy is so closely linked with the United States.

NAFTA would remain as the free trade agreement between the three countries for over twenty years. This changed when President Donald Trump took office and started the process in ratifying the agreement. In 2018 United States President Donald Trump, Mexican President Enrique Peña Nieto, and Canadian Prime Minister Justin Trudeau signed a new trade agreement. The United States-Mexico-Canada Agreement took effect in July 2020, with new terms and policies but still largely the same as its predecessor.

After NAFTA's implementations, Mexico's economy did show signs of having benefited from the free trade agreement. The country's exports increased drastically after the mid-1990s, resulting in Mexico being a large exporting economy. Foreign direct investment inflows to the country also increased as a result of NAFTA, since the agreement included incentives for investors and provisions that would safeguard their money. The average annual stock index also increased after the mid-1990s, and the government debt has declined since 1995. Yet economic growth has remained stagnant and the country's dependency on the United States has become increasingly clear.

Mexico's economy has become sensitive to shocks from the United States, as well as developed a dependency on their economy. These issues were not addressed by the renegotiations of the free trade agreement. The USMCA provided revisions to NAFTA, such as an extension to copyright from fifty to seventy years. The new trade agreement is not going to aid Mexico in becoming a developed country. Mexico must do that itself by directing investors interests towards areas the country needs to develop, such as infrastructure. President López Obrador entered office targeting private investors. However, his view has changed since he announced a plan in late 2020 geared toward developing infrastructure, primarily funded by private investors.

While Mexico is impacted by the U.S., it is important to remember that global events also affect the country's economy. The COVID-19 virus made its appearance in late 2019 but grew to become a global pandemic the following year. President López Obrador failed to respond to the pandemic adequately which left Mexico with a suffering economy, one that the IMF predicts will take a few years to recover. The USMCA took effect the same year the coronavirus hit North America the hardest. This has made it difficult to accurately predict the effect the new trade agreement will have on Mexico. The progress the Latin American country has made has come to a halt, and the lower class is hit the hardest. The impact the USMCA could have had on Mexico is difficult to fully predict at this time given current global events. However, the author can make a few inferences based on what is presently known.

Mexico's goal is rapid economic growth to become a developed economy that can compete with countries like the United States and Canada. NAFTA certainly helped Mexico's economy, such as exports and foreign direct investment inflows. However, it resulted in the country's increasing dependency and sensitivity to the United States economy. The new trade agreement will not contribute toward rapid economic growth or aiding in the country becoming developed. It did not occur after NAFTA's implementation, and it will not occur with the

USMCA. The new trade agreement is an upgrade to NAFTA, with its nickname of NAFTA 2.0 being very accurate.

If Mexico wants to stand on equal footing as its North American neighbors, it must produce plans that will benefit the country, such as President López Obrador's infrastructure plan. In addition to this the country must begin separating its economy from the United States'. The sensitivity and dependency will only hinder Mexico's path toward achieving rapid economic growth in order to achieve a developed economy. If it cannot, becoming a developed country will remain a distant dream.

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