Nearshoring in Mexico: booming opportunity or false promise?

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Whether it's intentional or a negotiation tactic, President-elect Donald Trump's proposed 25% tariff on imports puts Mexico at a crossroads. Our North America Economist Marcos Carias shares his insights on the history of Mexico's economic development and how the U.S. plays a role in its outcome.

Mexico's status as a prime nearshoring destination has long seemed obvious. It has a large and competitive labor force, proven track record in building a strong manufacturing base, geographical proximity and, crucially, preferential access to the U.S. market. President-elect Donald Trump has announced plans to impose 25% tariffs on Mexican imports current should President Claudia Sheinbaum administration's fail to meet expectations on drug trafficking and illegal migration. Though she reiterated her willingness to cooperate, she emphasized the **steps already taken to curb the migrant flow**, and declared that retaliatory tariffs were on the table. In this context, firms are right to be concerned about the future returns of nearshoring investments.

There's been much speculation on whether tariff threats are a firm intention or a negotiation tactic. Optimists point to the precedent set during Trump's first term, where threats to impose 5% blanket tariffs were **dropped** after reaching an agreement on border security with Sheinbaum's predecessor and political mentor, Andres Manuel Lopez Obrador. Bearish observers underline Trump's stated belief that running a trade deficit is synonymous with being on the losing end of the bargain, and the U.S.'s second deepest bilateral deficit is vis-à-vis Mexico. Only time will tell which of these views proves prescient, but as long as the risk of tariffs loom, Mexico's export-led growth model will bear the weight of uncertainty.

Historical role of U.S. market in Mexico's development

To put things into perspective, we should get a measure of the historical role the U.S. market has played in Mexico's path to development. The recent history can be split into three distinctive phases:

1. **The Mexican Miracle (1940- 70s):** During this time frame, the country was one of the few in Latin America to implement industrialization through import substitution with moderate success. Tariffs, subsidies, and import quotas on strategic commodities such as textiles and automobiles were applied to facilitate the early stages of the **maquiladora boom** and enabled numerous state sponsored infrastructure projects such as hydroelectric dams, expansion of oil capacity, highways and railways. Notably, this period saw a first wave of expansion for investment from the big American car companies, with more than just an eye on the Mexican internal market. Growth was pulled forward by domestic demand, driven by dynamic population growth and public investment.
2. **The Lost Decade (early 80s – early 90s):** Public policy support did not come cheap and the state accumulated a substantial debt overhang with a growing share of foreign debt. In August 1982, the state declared default and resorted to emergency lending from the International Monetary Fund, leading to a period of austerity and high interest rates designed to restore credibility at the price of a painful depression. Investor confidence was badly

scarred and industrial expansion suffered accordingly.

3. **Trade Liberalization (mid 90s – today):** Despite a renewed episode of turbulence with the Mexican Peso in the 1994 Currency Crisis, the signing of the North America Free Trade Agreement (NAFTA) in 1992 sets the basis for an era of deeper integration with the American economy. Growth became increasingly oriented toward the U.S. market, with Mexico becoming the number one trading partner in 2023 after years of gaining market share from China. With the pandemic-induced shift towards supply chain resilience, nearshoring starts looking like the ticket out of the middle-income trap. Between August 2022 and December 2023, non-residential construction investment expanded by 57%, driven in large part by industrial facilities and warehouses (as well as large public infrastructure projects).

In the last few years, investors seem somewhat on the fence or are at the very least are adopting a more “wait and see” stance. Foreign Direct Investment (FDI) flows peaked in Q2 2022 at $42 billion USD (below the Q1 2014 $51 billion USD peak that followed the energy sector liberalization reforms), with reinvestments from firms already implanted overshadowing new flows. It seems therefore that Mexico sits at a crossroads going into 2025.

With limited options, Mexico reaches a crossroads

Returning to growth through domestic demand does not seem like a viable option with the working-age population growing at 1%, down from 3-3.5% in the 60’s and 70’s. And there’s only so much that can be done to diversify exports away from the U.S., with lackluster growth prospects clouding the outlook elsewhere in the developed world. The incentives to salvage the nearshoring project are therefore significant, and this will require a functional relationship between the heads of state, both at the very beginning of their mandates.

The United States-Mexico-Canada Agreement (USMCA), the successor treaty to NAFTA, is up for review in July 2026. This will present an opportunity to renegotiate terms and find common ground. USMCA was signed under the first term of the Trump administration in 2018 to provide assurances that a stable business environment could be expected for at least six years. Full tripartite ratification (meeting all three countries’ conditions) would send a strong and welcomed signal to the business community. If any party holds back, the treaty will be reviewed yearly, which is much less reassuring for firms looking to commit large amounts of capital. While the promise of nearshoring is still within reach, we can expect to Mexico will need an extra layer of skillful diplomacy to reach its destination.

Trade challenges in Mexico weighing on your strategy?
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