Mexico

How to rise to the China challenge

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In 2003, following two decades of rapid integration into the world economy, China became Mexico's second largest trading partner, behind only the United States. China is Mexico's new economic neighbor – and not always an entirely welcome one. The growth in the economic relationship has not been matched by growth in institutional ties. This is of particular significance because, relative to many resource-based Latin American economies, Mexico benefits less from China's commodity demand and competes directly with China in many manufactured goods sectors.

Big impacts…

The rise of China raises three major issues for the Mexican economy. First, Mexico has simply not been prepared for the massive new trade relationship with China. There is no single institution in the private, public or academic sectors specializing in China. The Mexican and Chinese governments created a Bilateral Commission in 2004, but it has produced little in the way of concrete results. The two sides cannot even agree on the level of trade between the two nations; discrepancies in official statistics are huge (Table 1).

Trading in ignorance

This lack of knowledge and institutions is surprising given the growth in bilateral trade. Mexico's imports from and exports to China increased by an average of 42 percent a year between 1995 and 2006; none of Mexico's other main trading partners have achieved even half that growth rate. In contrast to most of Latin American exports to China, Mexican manufacturing exports have accounted for an important share: electronics and auto parts accounted for 69 percent of Mexican exports to China in 2004, though the share has declined substantially since then. Raw materials such as copper and minerals have increased their share (Tables 2 and 3). Mexico's deficit with China in 2006 was US$22bn, its largest bilateral deficit with any country.

Second, China poses a profound question for Mexico's – and Latin America's – integration to the world market. From the late 1980s to 2001, Mexico was one of the "rising stars" in the emerging markets. Since then, however, neither GDP nor exports have grown substantially, thanks in large part to increasing competition in its domestic

Table 1
Mexico-China trade
US$ m

	1995	2000	2006
Chinese statistics			
Mexican imports from China	195	1,335	8,824
Mexican exports to China	195	488	2,606
Balance	-	(847)	(6,218)
Mexican statistics			
Mexican imports from China	521	2,880	24,444
Mexican exports to China	37	204	1,690
Balance	(484)	(2,676)	(22,754)

Source: Chinese and Mexican customs data market and in its main export market, the United States. For most of Mexican policy-makers since the late 1980s, China's growth is not entirely understandable, since its policy makers avoided many elements of the so-called "Washington Consensus" – in particular, by keeping a closed capital account – and yet achieved higher rates of growth in GDP per capita. Since 1980, Chinese growth in GDP per capita has been 11.3 times higher than Mexico's.

China also performs much better in standard measures of competitiveness – attractiveness to foreign direct investment (FDI), export share of GDP, and research and development. Moreover, China's trade profile is evolving more rapidly than Mexico's. Both countries export processed light manufactures, but China is increasingly competing with Mexico in third markets in higher value-added and high-technology goods, including auto parts, telecommunications equipment and vehicles. As a result, in 2003 China displaced Mexico as the second largest trading partner of the US.

Table 2
Chinese imports from Mexico, 1995-2006
% of total

	1995-2006	2006
Electronics	32.3	37.2
Auto parts	26.0	19.4
Automobiles	3.8	7.6
Minerals	6.9	7.6
Organic chemicals	5.7	5.9
Copper	3.2	4.6
Other	22.1	22.4

Source: China Customs

…weak responses
Third, China's massive exports to Mexico are generating a negative response to what is perceived as the "China threat." Several industrial sectors in Mexico suffer substantially from Chinese competition both domestically and in the US. According to Mexican textile and garment associations, up to 65 percent of Mexico's consumption in these sectors is based on imports from Asia, mainly from China – and much of the value of these exports comes through gray or illegal channels. In 2001-06, Mexico lost more than 35 percent of its employment in textiles and garments and 15 percent in manufacturing generally, creating a defensive attitude towards China in the private sector. The government tends to highlight the opportunities created by Chinese economic dynamism but offers little concrete discussion of what these opportunities might be other than traditional Mexican exports such as beer, other alcoholic beverages, electronics and auto parts.

Table 3
Chinese exports to Mexico, 1995-2006
% of total

	1995-2006	2006
Electronics	24.2	24.2
Auto parts	18.6	21.2
Garments (knit)	5.3	6.3
Iron & steel products	2.6	3.7
Garments (non-knit)	5.8	3.7
Other	56.5	40.8

Source: China customs

The bottom line is that Mexico's effort to build an export-led economy with low-cost labor has proved unable to stand up to Asian, and in particular Chinese, competition. Mexico's government policies to address the Chinese rise in global markets have mainly been reactive. Mexico has not acknowledged China as a "market economy," but in January 2008, Mexican compensatory quotas on more than 1,300 Chinese imports (negotiated as part of China's WTO entry in 2001 to compensate for reduced tariffs) will nevertheless be abolished. In February 2007, Mexico – together with the US government – initiated consultations with China at the WTO against overall subsidy schemes regarding income and value-added taxes, as well as R&D programs. But so far, constructive proposals for improving the bilateral relationship have been weak. There is some hope that the visit of Chinese Commerce Minister Bo Xilai to Mexico in May might have started a more constructive discussion.

What is to be done?
The underlying question is: what does the Mexican productive sector need to do to meet the Chinese challenge, and what complementary policies are required from the Mexican government? Simple protectionism is clearly not the answer. I propose the following items as the beginning of a positive agenda.

First, both nations need to engage in a long-term relationship. The current economic and trade relationship is beneficial neither to China nor to Mexico, and the increasing trade imbalance is quickly becoming a major political problem in Mexico. Both nations should invest substantially in their economic, trade, academic and cultural activities to get beyond sterile discussion of "the Chinese threat" or "challenges and opportunities." Bilateral opportunities have to be developed in depth and with commitments of financing and high-level support.

Strengthen the ties

It is also crucial to improve existing bilateral institutions. The Bilateral Chinese-Mexican Commission must be given stronger political support. Statistical, economic, trade, educational and cultural cooperation, which has increased in recent years, should be financed massively. Embassies in both countries need to be staffed accordingly. The Mexican legislature and executive branch need to set up working groups on China that can devise appropriate bilateral policies much more rapidly and with more thorough research than they do at present. Many details of the Sino-Mexican trade and investment relationship simply require more manpower to resolve: visas and tourism; conflicts in the yarn, garment and textile industries; electronics and auto-parts competition; and cooperation in multilateral agencies and in sectors such as construction, logistics and financing.

Finally, and most important, it is essential that Mexican businesses and policy makers recognize that most of Mexico's challenges are a result of failures of domestic policy: the lack of competitiveness, R&D, and technological upgrading is not principally a result of China's development, but rather of Mexico's lack of short-, medium- and long-term strategies. The policy framework must be improved, along with substantial investments in a long-term institutional relationship between Mexico and China. Failure on these two fronts would mean giving up the opportunity presented by Mexico's unexpected new economic neighbor and giving in to the threat.