Mexico's Export Woes Not All China-Induced

Over the past 20 years, Mexico has transformed itself into a manufacturing-for-export nation. Exports now represent 30 percent of its GDP, up from 10 percent 20 years ago. The vast majority of Mexico's exports are manufactured goods, and almost 90 percent of them are shipped to the United States.

But these days Mexico appears to be losing ground in U.S. markets. Its share of U.S. imports peaked at 11.5 percent in 2001 and has slipped since then. Meanwhile, China's share of U.S. imports has grown steadily and now exceeds Mexico's (*Chart 1*). To Mexican officials and producers, China's advance and Mexico's slide are no coincidence. China's gains, they say, are being made at Mexico's expense.

Mexico has good reason to worry about China. Both nations emphasize manufacturing exports, and China's export sector is growing at a mind-boggling rate. China's exports-to-GDP ratio has risen from 2 percent to 25 percent since 1970. While China's GDP has grown at about 10 percent a year in real terms over the past 20 years, exports have grown twice as fast. Not only is China producing more than ever for export, its access to U.S. markets is improving. This is especially true in the textile sector, where quotas on some Chinese goods are slated to expire in 2005.

Yet another reason for Mexico to worry is China's abundance of unskilled labor. Foreign manufacturers invested in Mexico in the first place because of its comparative advantage over industrialized nations in labor-intensive sectors. China seems the logical next stop for some of these manufacturers. And some have already made the move. However, there is no official tally of how many plants have moved, how many jobs have been lost in the process or, for that matter, how many jobs have come back when the grass in China proved less green than expected.

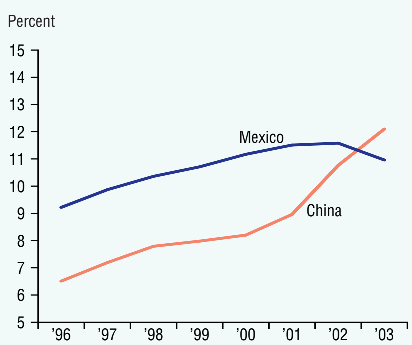
Nevertheless, Mexico's anxiety about China is understandable. But is it justified? Is China the problem? If China is the reason for Mexico's slide in the U.S. market, industries in which Mexico is losing ground should be industries in which China is making gains. Industry-level data should show some correlation between Mexico's losses and China's gains.

Chart 2 plots the changes in Mexico's and China's market share in commodities (at the three-digit level in the Standard International Trade Classification) that represented over $1 billion in Mexican exports to the United States in 1999. For instance, Mexico accounted for almost 70 percent of all U.S. imports of TV sets back in 1999. Today, that market share is about 45 percent, a 25 percentage point loss. Meanwhile, China's share in TV sets has risen by 10 points over the same period.

What can we learn from Chart 2? First, China is making strides in many areas important to Mexico. However, there is little correlation between China's gains and Mexico's losses. There are many markets in which China is gaining a lot of ground but Mexico is not losing any. In such areas as computers and electrical machinery, China's gains are

Chart 1

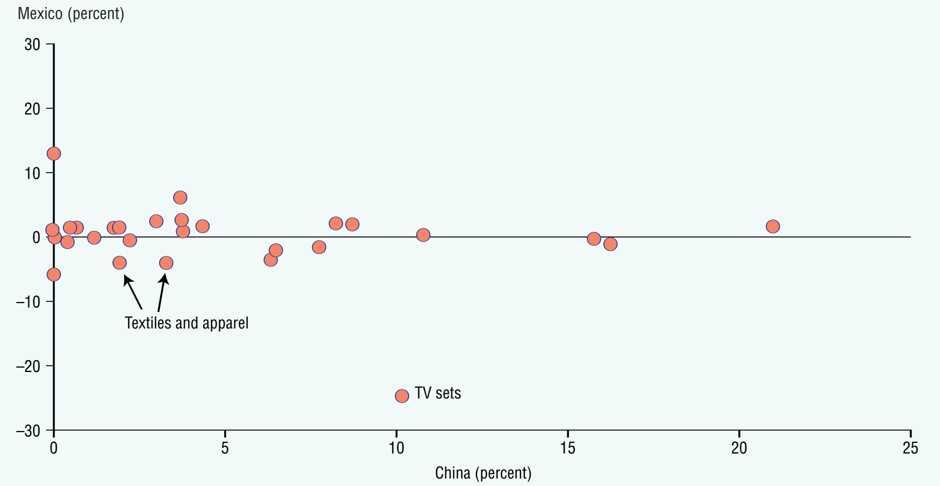
China's Share of U.S. Imports Now Exceeds Mexico's



SOURCE: U.S. International Trade Commission.

Chart 2

Change in Market Share from 1999 to 2003

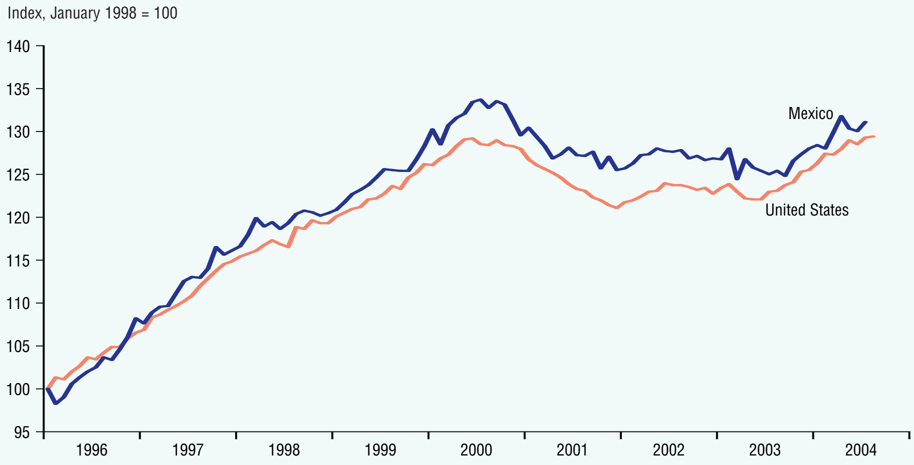


SOURCE: U.S. International Trade Commission.

Chart 3

Together, for Better or for Worse

(Industrial production, seasonally adjusted)



SOURCE: Haver Analytics.

being made at other countries' expense. There are also many industries in which China is making no gains. Whatever is happening to Mexico in those areas cannot be explained by China. Among these commodities are vehicles, vehicle engines and parts, agricultural goods and oil products.

There are, of course, industries in which China's gains are associated with Mexico's losses. These at-risk sectors, which include TV sets and textiles and apparel, have several characteristics in common. First, they are unskilled-labor-intensive, which makes China a very attractive place to produce. Second, commodities in these sectors tend to have a high value-to-weight ratio, which makes transportation costs reasonable. Third, many products in these at-risk areas are standardized and can be mass produced. But notwithstanding these sectors in which Mexico is most exposed to Chinese competition, there is overall little correlation between China's gains and Mexico's losses.

This lack of correlation begs two questions. First, China's market share gains have to be some countries' losses. If not Mexico's, whose? Second, if China's expansion does not explain Mexico's recent woes, what does?

The countries that appear to be bearing the brunt of China's competition are other Asian exporters. Japan, Korea, Taiwan, Singapore, Malaysia and Thailand have lost market share in many sectors since 1999, and the losses experienced by that group of countries have been highly correlated with China's gains. This is exactly what we would see for Mexico if China's advance were happening at Mexico's expense. But what explains Mexico's recent export difficulties is not China. It is Mexico's dependence on U.S. manufacturing activity.

When a deep manufacturing recession began in the United States in 2000, no other country was hit harder than Mexico. Intermediate and capital goods account for almost 80 percent of Mexico's exports. Mexico is a key supplier for the U.S. manufacturing sector. China, on the other hand, remains predominantly a consumption goods exporter. This greatly mitigated the impact of the recent U.S. recession on China's export sector and largely explains China's and Mexico's differing fortunes over the past three years.

Chart 3 shows the synchronicity between Mexican and U.S. industrial production. It shows clearly that it was the start of the U.S. manufacturing recession in fall 2000 that brought Mexico's six-year expansion to a halt. Now that manufacturing activity is picking up in the United States, activity is also picking up in Mexico. And although the maquiladora industry has not fully recovered from the shock that hit in 2000, it is making a brisk comeback.

So Mexico's recent downturn has very little to do with China. China, in fact, should be the least of Mexico's concerns. A quick look at the long-term evolution of the nation's real GDP per capita shows that Mexico today is no richer than it was 20 years ago. The reason for this is simple: Mexico has yet to find a way to accumulate physical and human resources the way fast-growing countries do. Its educational attainments continue to markedly lag those of industrialized nations. Its institutions do not function well, which discourages investment. What's more, Mexico's tax system raises little revenue, which makes needed infrastructure and education investments impossible. This is true, for instance, in the energy sector, where production and distribution are controlled by the government, as mandated by the constitution. Not surprisingly, because of Mexico's fiscal situation, capacity is not keeping up with demand.

The bottom line is that China does not explain Mexico's recent difficulties, except in a few specific areas. The downturn in Mexican exports results primarily from the recent manufacturing recession in the United States. And given Mexico's litany of truly pressing problems, China should be the least of the country's concerns.

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