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The Dragon in Aztec Lands

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The Chinese economic transformation has implied such a succesful process, that in aproximately 25 years the People's Republic of China has become the main foreign investment destiny –only behind the United States[1]-, the sixth largest economy and the third one in terms of commerce. Mexico, in contrast, has remained within a process initiated eleven years ago: a continous linkage with the United States and Canada through the North American Free Trade Agreement (NAFTA). The place in which the Mexican and Chinese paths cross is double: an internal one for Mexico –the continuous increase in the Chinese imports towards Mexico- and, an external but fundamental one, precisely the confrontation for the United States market. While in 1990 China only had a participation in the United States economy of 3.1%, Mexico represented almost the double with 6.1%. Nevertheless, this situation has changed substantially. China holds today the largest superavit in the world in its trade balance with the United States, while Mexico lost regardless of NAFTA, from 2000 until today, more than 270,000 manufacturing jobs in part because of the relocation of factories to countries like China.

Most of the literature found on the subject treats the Mexican situation as one in risk with the Chinese entry to the NAFTA region. Dauderstät and Jürgen (2004) make a study of the implications of the Chinese globalization and emphasize the possibilities other countries have to counteract the risks that derive from such process. On the other hand, Arellano (2005) makes a revision of the growth China has had and the areas of competitiveness the Dragon has with Mexico. Martinez and Castillo (2004) revise the relationship that each, Mexico and China, have with the United States, concluding that both can be considered their strategic partners. Chami (2005) makes an analysis of the diferent gains and losses in the U.S. market by revising who won a larger space in it, and to whom. Dussel has many essays and studies (2004; 2005) related to the

specific industries in which Mexico and China compete, as well as to the effects such overlapping has. Nevertheless, all of these studies refer only to the threat China poses to Mexico and to the losses or reactions inside the Mexican context, accompanying it in the best of cases with a series of reccomendations towards the Mexican leaders. Yet, almost none have referred to the position Mexico plays for China: is it an important ally? In this case, Cornejo (2004) and Dauderstät and Jürgen are the only ones who offer an answer: Mexico is quite relevant because of its proximity to the United States. Balderrama (2005), in his analysis of the visit Hu Jintao made to Mexico in the past September, does take in consideration and presents a proposal of the course of action and the intentions the Chinese have over Mexico.

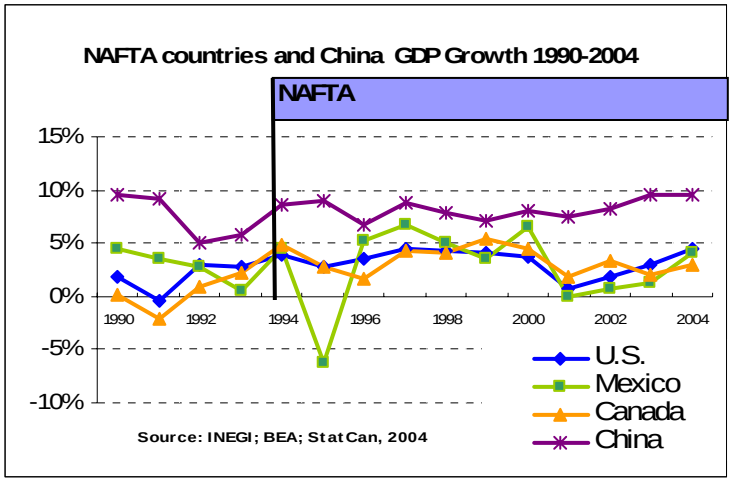
Precisely, this paper tries to go deeper in this subject, presenting a revision of the relation between China and Mexico. Beginning with a statement of the participation of the Chinese economy in the NAFTA region, mainly in its relation to the U.S. market. In this point, the direct implications for the Mexican economy will be analysed, to continue with the direct trade relation China and Mexico have had since the 1990s. Finally an evaluation of the challenges and options both, China and Mexico, have in the NAFTA region, as well as the diferent strategies that have been posed in the past months.

If we look at the GDP of the NAFTA countries since its beginning, we can see a pattern of growth that goes from 1995[2] until 2000, having a decrease period between 2000 and 2001 and recovering its growing pattern since 2002 until today. By incorporating the Chinese statistics (see Table 1), we can perceive that during all that period, China kept a growth pattern quite regular and at all times, higher than all of the countries in NAFTA. The country that got the closest to China, was Mexico, but only during the period between 1995 – 2000. After the year 2000 the

somewhat similar growth rate between Mexico and China disappears, making the latter quite predominant on this matter.

Considering this, it is possible to make a link between those patterns and the participation China has had in the NAFTA region. So, two main periods can be established in the relations Mexico – United States – China since the implementation of NAFTA: from 1994 – 2000, during which the dynamism of the Mexican foreign sales mantained a growth of 22.7%, and in result overpassed China's, who grew in a rhythm of 21.2% The second period begins in 2001, in which Mexico's participation stagnated, and at some point even diminished in contrast to the Chinese participation which kept growing. It was the year 2003 when China finally passed Mexico as the second most important partner for the USA. If we go over the main suppliers of imports to the United States, we find that Mexico is located in the third position, with US$155 843 million sold to the United States in 2004, which represents 12.9% more than in 2003. On the other hand, China sold US$196 699 million to the United States in that same year, having grown 29% in its exports since 2003.

Table 1.



We should not be confused; the fact that Mexico is in a lower step in the ladder of exports in the United States has not meant a reduction in the dependence that the mexican economy has with the U.S. Mexico mantains its position as the second most important purchaser of U.S. exports, just behind Canada, while China holds the fifth position. In 2004, Mexico bought US$110 775 million to the United States, meanwhile China only bought US$34 721 million. While Mexico's purchase increased 13.7% in the period 2003-2004, China's purchase only grew 6.1%. Furthermore, if we analyse the participation of the U.S. in the year 2000 in the exports of China and Mexico, it is possible to appreciate that while in Mexico they constituted 85% of its total exports, for China this percentage was only of 21 points.

China's trade balance with the United States gives the first one a surplus of US$124 068 million, that is, a US$21 004 million increase from 2002. Additionally, the deficit the United States holds with China is the largest in the world and it has been projected to reach US$ 160 billion this year. In contrast, the NAFTA had a surplus of only US$92 319 million in 2003, from which $51 671 belong to Canada and US$40 648 to Mexico. Canada had an increase of $3 506 and Mexico US$3 503 million.

The relevance and power of China in the US market keeps growing. Despite the fact that Mexico overpasses China in different aspects of competitiveness, like better regulation, protection of intellectual property, productivity of qualified labour, transportation costs to the United States and preferential access to that country derived from the NAFTA, China keeps penetrating the U.S. market in an unequaled pattern (Arellano, 2005: 703).

At this point is important to indicate that the Chinese participation and growth in the U.S. market is not something that suddenly happened. This has been a continuous and strong process at least since the beginning of NAFTA. Ever since 1990, when China occupied the twelfth

position in the ranking of U.S. trade partners, it has followed a growth pattern that smoothly but decisively allowed China to establish itself as a fundamental partner por the United States. Even in the period of 1993 – 2000, which registered a positive outcome for Mexico in the comparison with China, the Chinese exports grew 198.6%, just below the Mexican's which grew 202%. And in these matters, the Mexican economy, eventhough had its own complications in consolidating itself in the U.S. market, has also been challenged because of the direct competition Mexico has with China in specific products.

If we take a look at the main gainers and losers of competitiveness in the US market between 1992 and 2004, Mexico has been the second gainer after having gained US$48.9 billion. But if we go through China's numbers, we find that it has been the main gainer with a US$ 134 billion gain, that is, almost three times the Mexican gains (see Table 2). Now, if we go over the Mexican changes, we see that Mexico gained his share –US$ 60.9 billion- from a series of countries, mainly Japan (28%), Canada (23%) and Taiwan (7%). But if we take a look at its losses –US$12 billion-, we see that China represented the 70% of them, which indicates a direct competition between Mexico and China (Chami, 2005).

Table 2.

Main Gainers and Losers of Competitiveness in the U.S. Market: 1992-2004 (US$ bn)						Source: Chami, 2005
Gainers	Gains		Losers	Losses		
China	134.0	46%	Japan	-112.6	38%	
Mexico	48.9	17%	Taiwan	-36.0	12%	
Ireland	17.1	6%	Canada	-27.5	9%	
Russia	9.4	3%	U.K.	-20.9	7%	
Others	83.4	28%	Others	95.8	33%	
TOTAL	292.9	100%	TOTAL	292.9	100%	

The Chinese economy has not remained the same and is walking away from the products that require almost no skill, gaining space in the high-technology sector. While primary goods

represented 25.9% of the exports in 1990, by 2000 that percentage was reduced to 10.9%. In contrast, the manufactured goods changed from representing 74.1% of the exports in 1990 to 89.1% by the year 2000. Such a modification has affected various economies, as it is the case of Mexico. Because of the increased components of manufactured goods in the Chinese exports, there was an overlap of 61% of their products by 2002. What these numbers reveal is that, if in 1990 Mexico shared one fourth of its exports towards the United States with China, this ammount has increased to almost two thirds (Romero and Molina, 2003: 1157).

From 1990 to 2003 Mexico's exports to the United States have centered in electronics, auto, and auto part products, adding up to 55% of the total sales to the northern neighbor. In all of these industries Mexico competes directly with China (see Table 3). The other exports in which China and Mexico compete consist of telecommunications equipment; professional and scientific equipment; computers and laptops; metal manufactures; textiles and dresses. In 2003, Mexico only passed China in telecommunications, electronic, professional and scientific equipiment, and the autoparts industry (Martínez y Castillo, 2004). Recent information provided by Banco de Mexico considers that Mexico has had a loss of over US$30 billion during the last four years in exports to the US market, due to Chinese competition. This means that Mexico would have had at least one extra point in its GDP growth each year. In the case of the year 2005, the loss of competitiveness by the Mexican exports has been a factor in the impediment of reaching the 5% of GDP growth (Flores, 2005).

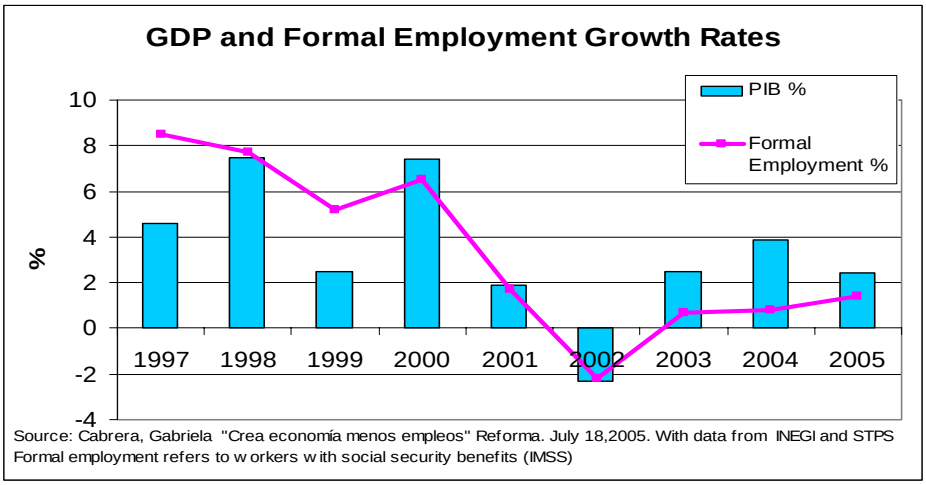
The reflection of such a process of overlapping and challenge between Mexico and China, as it was stated before, has had a negative outcome for Mexico. According to Cornejo (2004), in the maquila, one of the most important manufacturing sectors for the Mexican economy, there was a decrease of 730 establishments and 229,127 jobs between 2000 and 2003.

And, according to the Mexican Social Security Institute (IMSS), between October 2000 (when employment levels reached their peak) and April 2005, the manufacturing industry lost 824,000 jobs (see Table 4).

Table 3[3].

Branches of Mexican dominion	Chinese competition in branches of Mexican dominion	Mexican competition in branches of Chinese dominion	Branches of Chinese dominion
New and used buses	Industrial machinery	Home supplies	Travel accesories and handbags
Motors and its parts	Medition and control instruments	Writing and drawing equipment	Leather products
Processed iron and steal products	Computers	Sporting shoes	Toys and entertainment products
	Telecommunications equipment	Kitchen tools	Keyboards and typewriters
	T.V. and video		Computer accessories
	Electric generators and accessories		Furnitures
	Automobiles and autoparts		Sound equipment
	Textiles and cotton products		
	Electrical equipment		

Table 4.

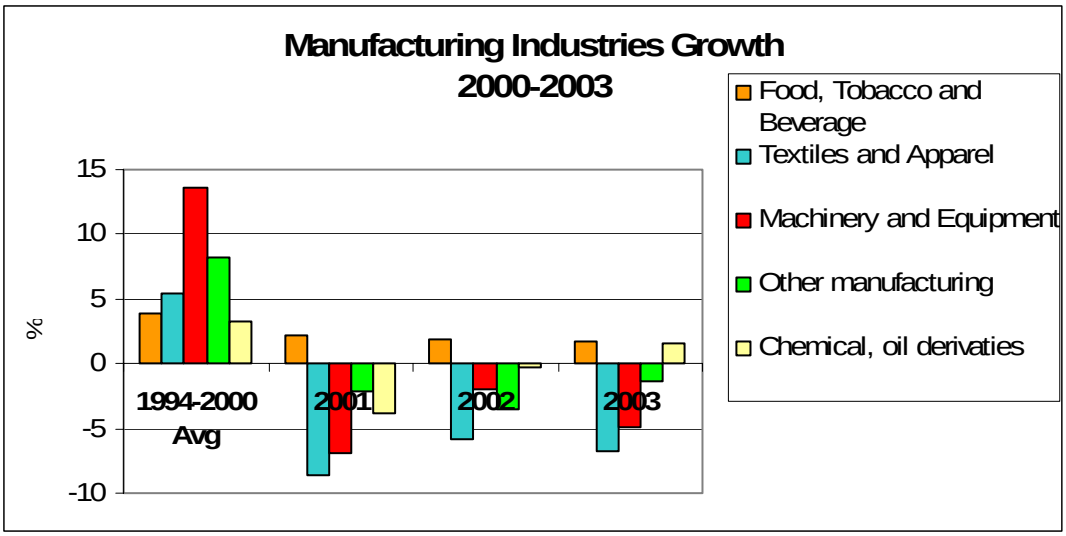


Hence, the risks in the equation Mexico – United States – China are in the further displacement of Mexican industries, products and workers. An example of the local application of this continuous confrontation can be seen in the case of Arizona. Mexico remains today as

Arizona's number one trading partner. However, Arizona's exports to China grew 168% in 2002, while the Mexicans decreased in 15%. The next year, exports to China kept growing with a strong pace, 95%, while Mexico's only grew 6%. If we should rank them, China is today the fourth partner for Arizona, when in 2001 occupied the seventeenth place (in MSI: Oak Brook, 2004).

The evolution of the Mexican economy towards a decline in its growth, even in its traditionally strong industries is yet another symptom of the effects of the Chinese involvevemnt in NAFTA and need of a change in the strategy. Ever since 2001 (see table 5), the only industry that has been able to keep up is the food, tobacco and beverage, and the chemical and oil derivates since 2003. In contrast, the textiles and apparel; and the machinery and equipment industries have dropped their growing rates in more than 5%, while the other manufacturing industries have followed the same path, with a negative growth located between 1 and 5%

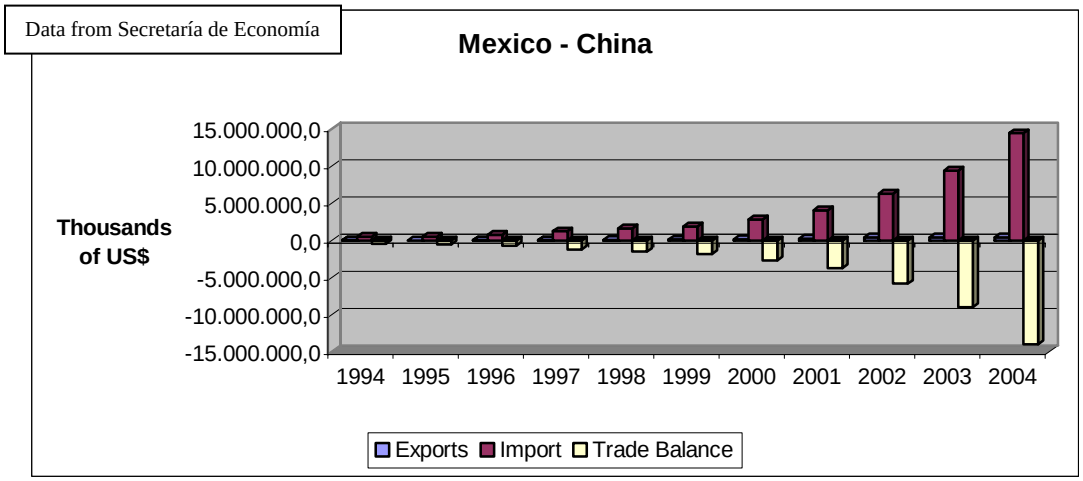
Table 5.



In fact, these elements are related to the second level of the relation between China and Mexico, that is, the confrontation in the Mexican domestic market. It is important to highlight that, ever since 2002, China has become Mexico's second most important commercial partner after surpassing Japan in the provision of imports. Having an average annual growth of 26.3% in the Chinese imports to Mexico between 1993 – 2003, these have been made specially in the autoparts, electronics, toys and shoes industries (in Dussel, 2004). In terms of exports to China, Mexico has concentrated on primary goods, and is the only country in Latin America[4] that holds a deficit in its trade balance with China (see Table 6).

Barocio (2005) states that Mexico has not adopted a clear and aggressive policy towards the promotion of business with China. Contrary to the attitude taken by Chile or Brasil, mexican's entrepeneurs, politicians and academics have been cautious and inefficient.

Table 6



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These negative indicators for Mexico cannot be attributed only to the incorporation of China to the global market. As Cornejo states, the reasons are far more complex, and involve the internal political and economical processes that Mexico has been living at least in the past two

decades. Still, this situation has an encouraging aspect because herein lies also the possibility to adopt policies from the inside to counteract the effects, or even more, to take advantage of the Chinese activities in the zone.

What can a country like Mexico do to confront the Chinese challenge? Dauderstät and Jürgen present three alternatives. The first one, to take advantage of products that have not been touched by China, as India did. The second one, is to sell China products such as coal and oil - which the Dragon needs in great ammounts; this has been the Brazilian strategy, for example. Finally, there is the possibility to benefit from China's "graduation" of its economy. That is, if China follows the model taken by Hong Kong South Corea and "off-shores" its low-skill production towards other countries.

It seems that, if Mexico has not taken any clear action and has shown no strategy towards China, it is now time for it to search the opportunities opened in this last space. It appears not only plausible but we might even say real. Looking back at the last visits of Chinese authorities to Mexico, specially to the last visit of Hu Jintao to Mexico, it is possible to appreciate a discourse focused to position Mexico as a strategic partner for China.

Where does this need of offshoring comes from? According to the authors the reason of offshoring "is a cycle of increasing labour scarcity, rising real wages and ascent up the value chain". But in the Chinese case, this situation does not appear to be happening just yet, so why would this be an opportunity to Mexico?

The deficit the United States has been holding with China for the past three decades in its trade balance, the continuous growth of its economy and the rapid diversification of its production have been read in the U.S. as a threat[5]. The Chinese economy represents an eight of the size of the U.S. economy, yet the impact of the participation of China in the U.S. market has

been the opposition agains the loss of internal jobs, the subvaluation of the Chinese currency, the abuse of workers' human rights, the security risks in China, among many others (Barocio, 2005). And, just as Balderrama argues, even if such situation has translated into cuantious profits[6] for the U.S. entrepeneurs, such a large deficit will not be tolerated for long.

In this context, what the Chinese government might be beginning to do, is to implement a strategy undertaken by Japan[7] in the seventies and eighties when it experienced a similar situation. The Japanese solution consisted of moving part of its production to the other NAFTA countries, Canada and Mexico, in order to later export them towards the United States[8]. By doing so, Japan disguised its exports and diminished the alerts derived from the statistics. If China should take that path, it might well diminsh the signaled risks and exercise a more open involvement with the NAFTA region.

So, going back to the question of the opportunity Mexico has today with China, that if the Japanese model is copied, this will translate into an increased ammount of direct investment and joint ventures in the area and would require to use the regional technology and work force for its products to keep flowing to the United States market.

A recent change of attitudes can be seen between China and Mexico in the past two years, and has increased in the past months. In 2003, for the first time, China through his President Hu Jintao declared Mexico as an strategic partner. In the Mexican discourse, this has turned into a supportive attitude towards China in the past months. When the Mexican President Fox has refered to delicate subjects of the Chinese political and economical life, it has been positive with the Dragon: such as with Taiwan, by supporting the idea of the existence of only one China or the claims on Tibet, by arguing the respect the Dragon has for other nations.

This has been translated into a number of negotiations between the two countries. In the context of the visit to Mexico by the Chinese President, Hu Jintao, in September 2005, both countries signed a number of bilateral agreements which show a clearer concern for each other, and denotes the intention to generate new channels of communication and interaction between them. Such treaties are: a) trade of agricultural products; b) cooperation in the minning sector; c) agreements to avoid double tax tributation and to work social development; d) opening of a mexican consular office in Guangzhou; e) agreement to fight piracy from china; f) cooperation in cultural affairs.

Furthermore, China has declared the year 2006 as the Mexican year, implicating a series of events –mainly cultural- dedicated to Mexico and its artists, culture and history. This includes being the gest of honour in the festival Beijing Encounter in May as well as in the Shanghai International Film Festival, which will include a special week of Mexican cinema in June.

In local examples, the government of the Estado de México has initiated a working group with the province of Guangdong in order to explore the possibilities they have for building new business. Moreover, today we can count around 160 Chinese enterprises in Mexico, while Mexico has more than 50 in China. Besides, the governor of the Estado de Mexico has declared that the Chinese enterprises will investmore than US$50 million this year only to the city of Cuautitlan.

Nevertheless, it is important for Mexico to take note of other alternatives and do not trust only in the direct investment of China. The McKinsey Global Institute (in Dauderstät and Jürgen, 2005) recently studied the Mexican consumer electronics business and identified several sources of comparative advantage, especially in relation to China, that could be exploited by shifting into product segments like peripherals, switches, computers, and refrigerators.

Finally, it is important to signal the main four ideas that can be derived from this paper. In order to have a real dimension of the role China is playing in the NAFTA context, and also to keep in mind the new spaces of action that are opening, especially for the Mexican economy:

1. There has been a misleadeing analysis regarding the Chinese competition in North America. This has been considered a new phenomennon or recent threat to many Mexican, US or Canadian industries. Nevertheless, the Chinese competition has been present in the North American region at least since the beginning of NAFTA. Part of the Asian financial crisis was due to Chinese displacements of exports coming from many ASEAN economies plus Japan, Korea and Taiwan, leading to an industrial restructuring in those economies. Now China is becoming a key market for these economies compensating it for those losses mainly at the US market. Mexico is taking big losses in the US market without having any other market compensation.
2. China is facing an intense trade friction with the US, derived from its large trade deficit. It is likely to force China to adopt new strategies in order to minimize the US political backlash. Such strategy might consist of following the Japanese pattern, adopted in the 80s to confront the so called “Japan bashing” and protectionism, which means more economic engagement with the economies of North America, establishing productive networks to conduct business directly in the NAFTA region. In this logic, Mexico and Canada could become new sites for Chinese investments.
3. Mexico needs new strategies to compete against Chinese products. It needs to develop more technological capabilities, as well as strategies for specific sectors and regions in the US.

4. Mexico is confronting the Chinese industries mainly in the US market, but the real threat to Mexico is currently located in the decrease of its manufacturing power and the low economic growth of its domestic market.

We are now facing a moment in which the established situation can be modified towards a further approachment between Mexico and China. This means that the position and opinions that Mexico had of China as nothing more than a menace to the Mexican economy could be transformed. The importance of such variation and the design of a solid and intelligent strategy towards China relies in the many characteristics in the relationship of both countries.

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Endnotes

1. In 2002, China absorbed US$53 000 millions in FDI.

2. In 1994, the Mexican crisis came as an initial blow to the NAFTA success, nevertheless, the three countries were able to cope with the challenge by the next year.

3. Completed by the author and taken from Balderrama and López V., 2004

4. Besides Costa Rica

5. For a further analysis in the attitude changes the US audience has had on this subject, at least during the Bush administration, see Balderrama (2005).

6. Many benefits has the United Status accounted from its relationship with China: the imports from China have saved over US$ 100 million to the U.S. consumers in the past 25 years and, more than replacing the U.S. production, the Chinese imports have substituted a series of products coming from other Asian countries.

7. Barocio proves that the Chinese government has been smart in keeping the manufacturing firms calmed about its economic growth, by inviting important U.S. firms, such as Motorola, General Motors or Procter & Gamble to invest large amounts in China and to enjoy of the privilege of taking shares of its markets. Yet, this doesn't seem to be sufficient when it is contrasted with the social impacts of the Chinese entrance.

8. This strategy was also implemented with its neighbours: South Korea, Taiwan, Singapore and Hong Kong.

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