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## **Implications of China's Recent Economic Performance for Mexico**

*ENRIQUE DUSSEL PETERS*

## 1 Introduction<sup>1</sup>

The socioeconomic dynamic of the People's Republic of China – henceforth referred to as China – is real and not the result of distorted statistics. In many cases, the concepts and experiences of a large part of the developing countries do not seem sufficient – or even useful – in view of China's performance. Indeed, how can we explain the dynamics and transition of a socialist country – or of a "socialist market economy" – in which the economic and political activities of the state play a dominant role, with a high degree of government intervention? What are the reasons why the Chinese economy has resumed its growth and global presence after several centuries? According to different sources and their respective methodologies, China's GDP will be higher than that of the United States between 2015 and 2041. With more than 20% of the world population – and considering its progress in its commercial integration into the world market, the changes in its rural and urban population, its achievements in terms of reducing poverty, and the internal challenges it faces – the socioeconomic and political transition that China has experienced and will continue to experience

the next few decades cannot be analyzed and evaluated as just one more such process given its major global implications.

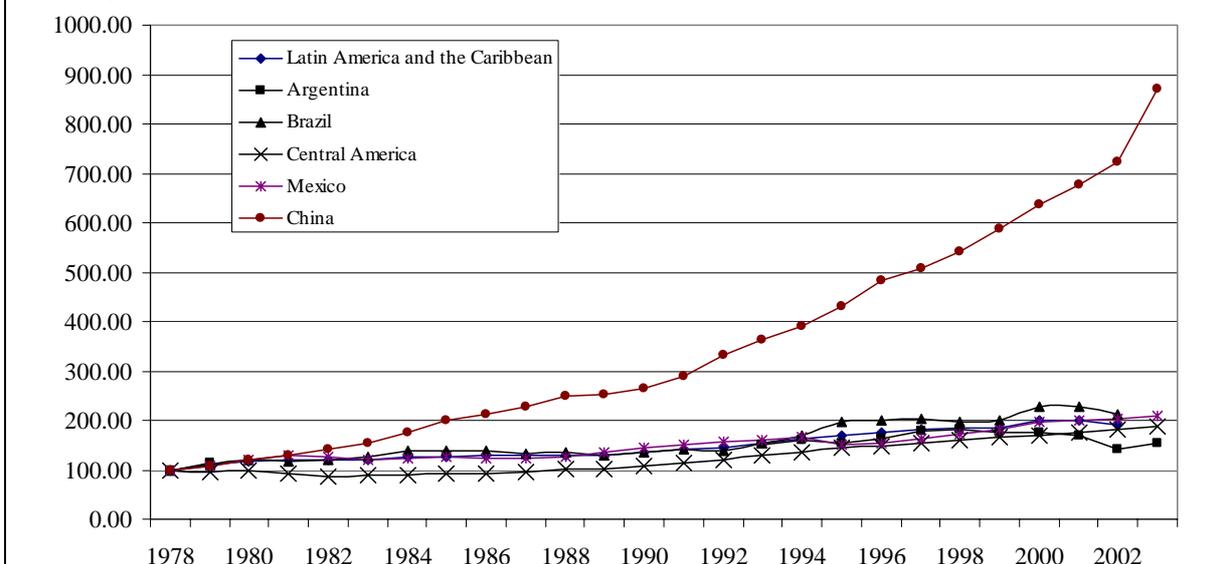
In this context, the paper highlights the implications of China's performance specifically for Mexico. In the first part, and only briefly, the paper details some of the characteristics of China's socioeconomic performance and particularly its trade structure and dynamics. In the second part, and in more detail, it analyzes specific aspects of the economic relationship between China and Mexico. The final part is a conclusion, containing some proposals focusing on policies and aspects of this relationship that should be considered in the short and medium term.<sup>2</sup>

## 2 China's Socioeconomic Performance

The socioeconomic performance of China since the beginning of the 1980s has presented highly complex and distinctive results, and cannot be explained exclusively by one factor (i.e. cheap labor). From a Latin American perspective, the comparative results of respective strategies since the 1980s are outstanding: in terms of GDP per capita, China outperforms the best case – Mexico – by a factor of almost 8 (see Graph).

### GDP per capita growth rates of selected countries (1960-2003)

(annual growth rates, constant dollars of 1995; self-compiled, based on World Bank 2004)



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<sup>2</sup> For a full discussion of some of these issues, see: Dussel Peters (2005).

In addition, several issues stand out for the period 1978-2003<sup>3</sup>:

- Significant macroeconomic stability in terms of inflation, fiscal balance, and exchange rate, particularly since the mid-1990s.
- A significant increase in the share of industry and manufacturing in overall GDP, accounting for 53% in 2003; their share in employment has remained relatively stable, accounting for around 150 million workers in industry in 2000.
- The probably most outstanding socioeconomic and political challenge facing China is its need to generate annually between 10-13 million jobs – as a result of the growing economically active population and migration from rural to urban areas – particularly in industry. This is probably the most significant “bet” for the future, one fraught with significant risks. China’s accession to the WTO – and particularly the concessions it has made in the service and agricultural sectors – reflects this strategy: the need to specialize in manufacturing and industry to generate employment.
- Parallel to this growth process, average household consumption increased substantially, by a factor of almost 8, during 1978-2003, while in Latin America Mexico has been the most successful case, with a factor of 1.01.
- Since the 1980s, and particularly since the 1990s, China has probably been the most successful case in terms of trade and foreign direct investment (FDI) growth: since 2002 China has become the main recipient of FDI on a global level and foreign trade has reflected a significant orientation toward exports, with overseas sales increasing from 4.6% of GDP in 1978 to 33% in 2003. The dynamism of Chinese exports has been much greater than that of Latin America, with Beijing’s share of global exports increasing – with Hong Kong factored in – from 1.86% in 1980 to 8.49% in 2003, while the corresponding share for Latin America fell from 4.88% to 4.64%. Several aspects are important to consider:<sup>4</sup> 1. Although in 2003

China’s export and import levels as a percentage of its GDP did not significantly differ from those of the Latin American countries, Beijing’s annual average growth in both categories from 1990-2003 was higher, with 15.5% and 17.8% increases, respectively. 2. The composition of Chinese exports reflects a process of thoroughgoing structural change, only comparable with similar change in Mexico. If up to the beginning of the 1980s, exports of raw materials and oil represented almost 50% of overseas sales, in 2002, 89.84% of exports was accounted for by manufactured goods, with an increasing share of high-technology products. 3. Although from 1990-2003 average annual growth for China’s imports of goods and services was higher than that of its exports, the country tended to generate a surplus in its balance of trade in goods and services equivalent to 2.46% of GDP and an average current account surplus of 1.8% of GDP. 4. In 2003, China’s imports topped 600 billion dollars, and they have been very dynamic since then. In fact, since the 1990s, China has become one of the most attractive markets internationally.

- China has been the most successful case of poverty reduction in the 20th century: since the end of the 1970s the country has experienced a decline in the number of those living in poverty from 490 million in 1981 to 88 million in 2002, or from 49% to 6.9% of the population (WB 2004/a).

Despite the advances achieved, it is equally important to point out some socioeconomic challenges, including a rise in overall and territorial inequality, substantial migration to cities, the ongoing reforms of state-owned enterprises (SOEs), massive environmental degradation and inefficiency in the use of energy, the exacerbation of these processes by the country’s accession to the WTO, as well as weaknesses in the financial sector as well as in development banking, among others.<sup>5</sup>

It is not the goal of this paper to discuss the sources that went into the making of this performance.<sup>6</sup> It should be highlighted, however,

<sup>3</sup> For a full discussion, see: Dussel Peters (2004); World Bank (2004);

<sup>4</sup> In addition, in 1980 75% of exports were accounted for by state-owned enterprises, while in 1998 the percentage had decreased to 25%; while 39%, 17%, and 16%, resp., involved collective, individual, and other enterprises.

<sup>5</sup> For a full discussion, see: Dussel Peters (2004, 2005); Kang and Jones 2004; Mattoo 2002; Mengkui and Zhongyuan 2003; Nolan 2003; OECD (2002).

<sup>6</sup> This paper only briefly addresses this broad international discussion. For a full discussion and references, see: Dussel Peters (2004, 2005).

that positive global conditions for integration into the world market via exports as well as the interest of the OECD member countries, and particularly the United States, played a major role. In addition, China's economy should be understood as a result of Asia's integration process, i.e. the Asian countries are the main source of China's FDI and trade. Considering the relevant role of the United States and the European Union, sectoral studies, e.g. in electronics, yarn-textile garments, as well as automobiles and auto parts, among others, show the substantial role of Asian firms and investments in China. In addition, a pragmatic long-term and dynamic vision of the economy, accompanied by instruments, mechanisms, resources, and the coordination of institutions at the local, provincial, and central level have played a prominent role (Qian 2001, 2003): reforms in the agricultural sector that allowed for continuation of reforms in other fields, the diminishing weight of SOEs, price incentives to increase production in industry and agriculture, as well as specific, substantial tax incentives and specific programs to induce industrial development, upgrading, training, education, and foreign investments, among many others, have allowed for the substantial socioeconomic transformation of China in the past three decades.<sup>7</sup>

Finally, and referring to China's trade structure, it is relevant to note that:

- China's foreign trade reflects its high degree of commercial integration with Asia, and particularly with a first circle of countries including Japan, Taiwan, South Korea, and

Hong Kong<sup>8</sup> and a second circle including Singapore, Thailand, Indonesia, and Malaysia, which in 2002 represented 41.86% and 7.22%, resp., of Beijing's total trade. The Latin American countries considered in the statistics represented less than 2% of Chinese imports and 1.5% of its exports in 2002.

- Most of China's important trade surplus is due to the United States, the European Union, and the Latin American countries considered in the statistics, particularly Mexico. At the same time, Beijing's trade balance with the first and second circles of Asian countries is negative, and particularly so with Taiwan, South Korea, and Japan, with which it has accumulated a high deficit.
- The itemized structure of Chinese foreign trade reflects a relatively high and growing degree of concentration. The five main items – at the 2-digit level of the Harmonized System – represent 50.40% and 59.48% of exports and imports in 2002, respectively.
- Exports using more intensive labor – clothing, shoes, and toys – have increased their absolute value, but with much less dynamism than Chinese overseas sales as a whole. The percentage share of total exports represented by the first three categories of products fell from 18.65% in 1996 to 14.79% in 2002, or by almost 48.17 billion dollars. Meanwhile, the export performance of electronics and auto parts has been spectacular in absolute and relative terms. In 2002, these items generated 35.60% of all overseas sales, or 115.92 billion dollars.
- In the case of imports, the itemized structure on the level of product categories reflects, on the one hand, large purchases of electronic products and auto parts, which increased their percentage share from 35.31% in 1996 to 42.48% in 2002. On the other hand, raw materials – oil and plastics, among others – represented more than 12% of total imports in 2002.

To sum up, China's commercial structure is experiencing an important transition. Products that use intensive labor continue to have a dominant

<sup>7</sup> Currently, for example, there is the Socioeconomic Development Program for 2020, in which the central government establishes general objectives and specific goals. These are important, since they allow us to understand the Program's orientation, strategies, and priorities in its specific fields. Among the most important points are: a) quadrupling GDP during the 2000-2020 period, which implies an annual GDP growth rate of 7.2%. This would bring per capita GDP to between 4,000 and 5,000 dollars; b) increasing the percentage share of high-technology exports from 25.2% to 45% in 2020; c) boosting the workforce in non-agricultural areas from 50% to 60%; d) reducing the disparities between individual income in the agricultural and non-agricultural sectors, from 1:2.8 in 2000 to 1:2.5 in 2020; and e) raising educational levels from 6.4 to 12.1 years of schooling, in addition to multiple objectives tied to the environment and the country's socioeconomic panorama. Other programs have generated massive incentives for the technological upgrading of domestic and foreign firms.

<sup>8</sup> In part because it has tariff treatment and import duties that differ from mainland China's, Hong Kong has historically been Beijing's main intermediary in international trade, and particularly for Chinese exports. Indeed, 53% of Chinese exports was re-exported from Hong Kong from 1988-1998 (Hanson and Feenstra 2001).

weight, and they currently allow the country to generate a trade surplus. Of the five main product categories based on trade surplus, all use intensive labor – although export strength is greater in electronic items and auto parts. The Chinese central government has implemented massive programs since the 1990s to enhance this technological upgrading of production and exports.

### 3 Mexico's Relationship With China: Complementarity or Competition?

The chapter will outline the economic relationship between China and Mexico in two cases: the main foreign market for Mexico, the United States, as well as its own domestic market. The goal is to show the dimensions of potential competition or complementarity between the two economies.

#### 3.1 The US market (1990-2003)

In the period 1990-2003 both Mexico and China increased their share in total US imports, displacing nations such as Japan and the European Union. If in 1990 Mexico, China, and Central America were, respectively, in third, 12<sup>th</sup>, and 32<sup>nd</sup> place in terms of US imports, in 2003 their corresponding ranking was 3, 2, and 25. That is, Mexico maintained its status, while exports from China to the US market increased substantially. Nevertheless, it should be noted that in 2002-2003 practically all these countries saw their share of US imports decline, including Central American nations and particularly Mexico, while China's share increased from 10.81% to 12.13%.<sup>9</sup>

In addition to this direct competition in the US market, it is more relevant to highlight that Mexico and China compete in the US market in similar products. It stands out that in 2003 these 10 main export product categories represented 83.77% of Mexico's foreign sales, while these same product categories represented only 52.27% for China.

Mexican exports to the United States have increasingly centered on electronic, auto, and auto-part products (product categories 85, 87, and 84), representing around 55% of such overseas sales to the US in 2003, while oil continued to account for 10% of exports from 1990-2003.

Particularly in electronics and auto parts, and increasingly in auto sales, Mexico competes directly with China in the US market. It should be pointed out that during this period Mexico and China's average annual growth rates (AAGR) were 11.8% and 23.1%, respectively. If in 1990 Mexican electronics exports represented 13.32% of US imports of such products, and they increased to 20.86% in 2003, Chinese sales rose from 3.31% to 18.26% during the same period. It should be noted in this regard that in 2003 Chinese electronic products paid a tariff that was six times higher than that charged to their Mexican counterparts. Chinese auto-parts exports (product category 84) experienced huge growth, an average annual increase of 37.6% from 1990-2003, which compares with 16.5% in the case of Mexico. Mexico's share of total US imports of auto parts grew from 3.59% to 10.18%, while for China the increase was from 0.71% to 17.52%, with China completely overtaking Mexico and other competitors in the process. In the automotive sector – product category 87 – Mexico has consolidated its position as one of the main suppliers for the United States, representing 15.46% of US imports for such items in 2003. However, China, with barely 1.41% of US automotive imports in 2003, has boosted its share by an AAGR of 31.9%, double Mexico's results from 1990-2003. Also of significance is the case of furniture – product category 94 – which in 2003 represented 3.66% of Mexican exports and 7.75% of Chinese exports. Although both economies have increased their US market share, in 2003 the Chinese completely overtook Mexican exports, with 39.78% of US imports, while the corresponding figure for Mexico was 17.02%. In garments, the competition between Central America, China, and Mexico is stiff, although since 2000 Beijing seems to have significantly increased its presence.<sup>10</sup> Finally, though not least in importance, oil and other agricultural products such as vegetables and certain roots – Chapter 7 of the Harmonized Tariff System – do not compete with Chinese products and have a major presence in the US market. In the case of vegetables and legumes, for example, Mexican exports represented more than 60% of US imports of such products between 1990-2003. In all these cases, Mexico pays tariffs very much below those of China; on vegetables and legumes, for example, import duties were 0.8% for Mexico and 8.57% for China.

<sup>9</sup> The gap in the dynamism of exports to the US increased even further, considering that in November of 2004 exports from China and Mexico increased by 29% and 12.8%, respectively.

<sup>10</sup> In November 2004 China's share in US imports accounted for 19.96%, while Mexico's fell to 9.52%.

### 3.2 Mexican trade relations with China (1990-2003)

The performance of Chinese exports to Mexico has been very dynamic, with an average annual growth rate (AAGR) of 37.6% from 1993-2003, and sales increasing from 386 million dollars in 1993 to 9.40 billion dollars in 2003.<sup>11</sup> Since 2003 China has become the second largest source of imports entering Mexico, second only to the United States. In 2003 Chinese products represented 5.50% of the total, in addition to 0.30% from Hong Kong. Thus, despite Mexico's reduced trade with China, the latter has at the same time become the main country with which Mexico has a trade deficit and its second largest trade partner.

In what product categories of the Harmonized System have Chinese imports been most prevalent? The main points to be noted are:

- A very high concentration of Chinese exports in two product categories – auto parts and electronics – with average annual growth rates of 62.1% and 49.3%, resp. This is the highest growth in the 10 main product categories from 1993-2003, and these represented 68.32% of Chinese imports in 2003. Although in the rest of the product categories the amount is significantly lower, the very high average annual growth rates for all the product categories are surprising.
- Imports from China have indeed managed to occupy a preponderant position in some product categories, particularly toys and manufactured leather goods, which in 2003 accounted, respectively, for 48.40% and 31.10% of Mexico's total imports of these items. In other product categories, such as auto parts and electronics, the share of Chinese imports is still low and does not exceed 10%, although it has been experiencing major growth.
- The two main product categories of imports from China are also the main generators of Mexico's high trade deficit. In 2003 the deficit in auto parts and electronics topped 6.00 billion dollars, or 68.08% of its trade deficit with China.

## 4 Conclusions

The recently established economic relationship between China and Mexico entails massive new challenges for Mexico. Mexico's exports have become its engine of its growth since the end of the 1980s, and this engine has eroded and been challenged significantly since the 1990s, also as a result of China's active integration into the world market through exports.

Based on commercial analysis, the performance of Chinese and Mexican exports in the United States market – 90% of Mexican exports go to the US – reflects a high level of competition. Even though they are not the only competitors – depending on the specific products concerned – they are among the most dynamic in auto parts, electronics, furniture, and garments, among others. With the exception of the automotive chapter – although China's share in this category is expected to continue to rise in the face of massive investments by foreign companies – the main chapters in the United States market appear to be affected. In the case of Mexico, companies formerly established in Mexico have made significant decisions to move to Asia and China. The big exceptions to this process of competition in the United States market are the agricultural, agro-industrial, and raw materials chapters.

As a result, unlike other Latin American countries such as Argentina, Brazil, and Chile, which have found channels for exporting agricultural and agro-industrial products to China (ECLAC 2004), Mexican exports under these categories have been minimal. This low level is due to the fact that the pattern of productive and commercial specialization during the nineties was mainly concentrated on the transformation of imported products and their export to the United States, and much less on agriculture, agro-industry, and other inputs in great demand in China.

The case of the yarn-textile-garment chain is paradigmatic for understanding the profound socioeconomic changes that China has undergone during the last decades: starting in the mid-eighties the chain became the motor of the industrialization process and the main export category in the Chinese economy, until the mid-nineties. The case of the chain in question is relevant because it manifests the depth and breadth of institutional change and the variety of instruments used by the central and provincial governments: while the Ministry of the Textile Industry, an organ of the Council of State,

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<sup>11</sup> In November of 2004 Mexican imports from China increased by 42.3%, while Mexican exports to China rose by 8.4%. As a result, in 2004 the ratio of Mexican imports from and exports to China will be around 30:1.

coordinated and assigned resources to the SOEs and coordinated industrial policy regarding this sector until the late nineties, as of 1998 the National Chamber of Exports and Imports of Textile and Garment Products, together with the central government, implemented fomentation mechanisms with greater subtlety and discretion, with the aim of avoiding controversies with the WTO and other trading partners. Nevertheless, for decades, up until 2004, the Chinese government, through different initiatives, directly provided incentives in the form of subsidies to the textile sector with the objective of promoting the yarn-textile-garment chain as a whole and creating a base of national and foreign support and supply companies; it has been successful in this endeavor according to the analyses of extremely diverse national and international institutions. One of the primary goals in this regard is the restructuring of the SOEs producing textiles.

The first part of the paper is relevant in this regard, since it shows that China's recent socioeconomic success and integration into the world market has, since the late 1970s, been a result of policies and strategy. In addition, and as a result of policies designed to enhance technological upgrading and meet domestic challenges, particularly regarding the generation of employment, it is expected that China's will continue with this productive and trade specialization at least in the short and medium term.

It is important to consider that in the current debate on the challenges posed by China for Mexico, as well as for Latin America and the Caribbean in general, China now directly participates and competes in their respective domestic markets as well as in other markets, as is detailed in this paper. In the case of Mexico, China has been its second most important trading partner since 2003. China's entry into the WTO and the elimination of quotas in the yarn-textile-garment chain strongly indicate that these tendencies will deepen the significant productive and commercial shifts at the global level and in Latin America. China's integration into the world market, and the intensification of the process, will also generate pressures towards lower prices and will affect most of the commodities exported by Mexico, particularly to the United States.<sup>12</sup> From the regional perspec-

tive it is indispensable to deepen the analysis of specific value chains and the challenges or complementary aspects generated by China, with the aim of gauging short-, medium-, and long-term policies designed to enhance competitiveness in the productive apparatus and concretize cooperative projects in the face of China's demand for specific products and the existing competition in other areas.

Both China and Latin America, and specifically Mexico and Central America, will have to boost substantially the socioeconomic "South-South" relationship and forge on with specific negotiations to increase cooperation. As with the relationship between China and the European Union and the United States, characterized as it is by constant high-level exchange and negotiations, this will also have to be the case between China and Latin America. Although the direct trade relationship between these countries is still small, the paper clearly reflects the growing dynamism of this bilateral relationship and its increasing gap or inequality; i.e. in 2004 the relationship between Mexico's imports and exports from China was 15:1, and it will continue to increase unless specific steps are taken and policies put in place. Moreover, it is not difficult to foresee that if this gap continues to grow, the result will be growing political criticism; i.e. Mexico's trade deficit with China is already the highest with respect to any country and might reach levels beyond 30:1 in 3-4 years time unless the above-mentioned cooperation mechanisms are initiated.

To begin with these "South-South" instruments, both Mexico and China will have to increase their respective knowledge and begin investing in bilateral exchange at the ministerial, private, and academic level. These mixed forums can set up the pillars for specific strategies, proposals, and instruments conceived to improve the bilateral relationship and overcome the increasing trade inequality between Mexico and China.

Finally, and specifically for Mexico, it is important to understand that export orientation is, in the best of cases, not sufficient for growth and

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and Central American – products in the yarn-textile-garment value chain against Chinese products, and also as a result of the abolition of international quotas under the OMC (or the end of the Multifiber Agreement (MFA). By January of 2005 Chinese exports to the US in this value chain increased by 75%, the corresponding figure for the EU being nearly 50%. Initial information for the first quarter of 2005 confirms massive increases in Chinese exports worldwide.

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<sup>12</sup> As discussed in Dussel Peters (2004, 2005), several international sources reckon with a massive displacement of Latin American – particularly Mexican

development, particularly if it is based on cheap labor. Up to the mid-1990s these conditions allowed for integration into the US market through exports and NAFTA. Currently, however, several Asian countries, including China, offer cheaper labor, have long-term strategies, provide a variety of incentives, and are operating active and aggressive upgrading and technology programs. Mexico, from this perspective, should, on the one hand, enhance its competitiveness through a variety of mechanisms designed to boost value added in production and exports.

On the other hand, the Mexican private and public sectors should actively search for options for cooperation with China, particularly in value chains such as textiles and electronics.

*About the Author:*

*Enrique Dussel Peters is Professor of Economics at the Graduate School of Economics, Universidad Nacional Autónoma de México.*

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