China's Impact on Mexican, Canadian, and U.S. Trade The Beginning of NAFTA's Decline?

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Undeniably, trade among Mexico, Canada, and the United States has changed over at least the last five years because of the competitiveness of Chinese manufactures. This is not limited to North America. China's commercial and industrial might has an effect on different spheres of the international scene given its undeniable role as a world player.

The unstoppable Asian locomotive expresses itself in many forms and trends, all linked in different ways to the globalization of the economy. Probably the most emblematic are the changes in the international division of labor that turned the millennia-old homeland of President Mao Zedong into the "world's factory," supplying an immense gamut of merchandise with both high and low value added, according to whether they were capital- or labor-intensive.

According to Price Waterhouse Coopers, China is the new world giant in the auto sector with a production quota of 10.98 million vehicles in 2009 and a projected output of more than 14 million by the end of 2010. Its closest competitor, Japan, coming in second worldwide, produced 7.51 million units in 2009, while the convalescent U.S. car industry put out 5.62 million. By 2014, Chinese yearly production for the world market will have reached a little over 19 million.[1]

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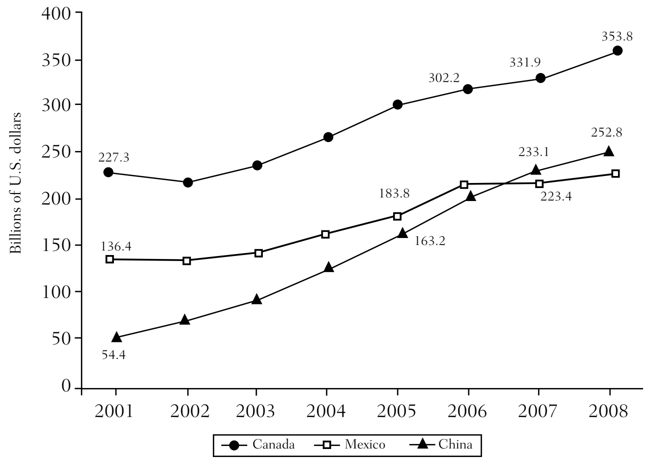
A second way the Asian power's influence can be seen is the changes in relative international market prices of tradeables. China's undeniable competitiveness also generates changes in trade patterns for the regional economic blocs, whether it be Europe, Asia, or North America. Its impact on trade among Canada, Mexico, and the U.S. is so huge that it is now creating well-founded doubts about the North American Free Trade Agreement's viability, the topic of this article.

GRAPH 1
CANADA, MEXICO AND CHINA. EXPORTS TO U.S.
2001-2008



Source: Designed by the author using data from *International Trade Statistics,* UNCTAD/WTO, 2009.

WHO WILL STOP CHINA'S COMPETITIVENESS AND ITS EFFECTS ON NAFTA?

The enormous competitiveness of China's manufactures —mainly, but not exclusively, from international corporations with plants there— has allowed it to swiftly achieve an extensive presence in NAFTA partners' markets, as well as in other regions. This has caused an effect of double substitution of Canadian and Mexican goods by Chinese goods.

Chinese merchandise continues displacing Mexican and Canadian goods in the U.S. market and even at home, in what are considered their "natural," domestic markets. This second effect also deepens unemployment and exerts downward pressure on wages in Canada, Mexico, and even in the United States.[2]

It is a good idea to look at the magnitude of the effects of Chinese competitiveness on North America's trilateral trade as a world economic trend set in motion by the Asian giant. In 2001, manufactured goods from China imported to the U.S. were valued at US$54 billion. This figure tripled by 2005, totaling US$163 billion, and the same dynamic continued so that in 2008, the number reached US$252 billion. Meanwhile, Canada's exports to the U.S. in 2008 came to US$353 billion, a considerably larger sum, but one that is continuing to decelerate (see Graph 1).

The rhythm of expansion of Chinese trade has been practically irresistible. Let's look at how it has developed. From 1994 to 2008, its exports to the U.S. grew at a rate of 20 percent a year; almost twice the average growth of Mexican exports to the U.S. in the same period (11.4 percent). Canada, the United States' first partner, had a lower growth rate, with 7.13 percent a year. Chinese exports' dynamism explains why it has captured a growing segment of imports into the U.S.[3]

In the context of the U.S. and world recession, Chinese exports continued growing albeit more slowly. However, they continued their upward trend, expanding their market segment. The long-term performance of Chinese trade, then, can be considered traumatic for U.S. preferential partners. As we have seen, a 20-percent-a-year export growth rate suggests that the advantages and tariff breaks that NAFTA offers its signers and that constitute disadvantages for other countries have by no means been an impenetrable barrier for Chinese manufactures. From this point of view, we can see that China's industrial and commercial clout may significantly impact on an initial decline of the U.S. market as a key component of the North American economic region. We should remember that the United States has been the dynamic axis of NAFTA's trilateral trade as well as that of the world.

Capital and commercial exchanges between Canada and Mexico have gradually gained in importance. However, their commercial value, nearly US$21 billion a year, is less than 10 percent of the value of Canadian exports to the U.S. (US$354 billion in 2008). This means that NAFTA's fate continues to depend on the dynamism of U.S. consumers and a sustained recovery of the economy, something by no means guaranteed, despite the advances so far.[4]

Today there is a latent risk that Canada, the United States' strategic trade partner, will be pushed out of the number-one spot by China. In fact, this is already happening. This suggests that NAFTA may be starting to become exhausted or even displaced in fulfilling its most elementary objective: intensifying trade and investments within North America.[5]

THE OTHER SIDE OF THE SAME COIN: CANADA AND MEXICO'S TRADE DEFICIT WITH CHINA

The reduction of Canada's market segment in the United States correlates to the growing weight of Chinese exports in the Canadian domestic market. This trend has increased over the last 10 years and created a negative trade balance, which in 2001 reached US$5 billion, and by 2007 had quintupled to almost US$27 billion.

Canada's trade deficit with China has been compensated by its positive trade balance with the rest of the world, especially the United States. However, the international financial crisis and the U.S. recession drastically changed this. By the end of 2009, Canada was facing a global trade deficit of US$26.92 billion, compared to its US$24.37-billion surplus in 2008, one year before the U.S. recession.[6]

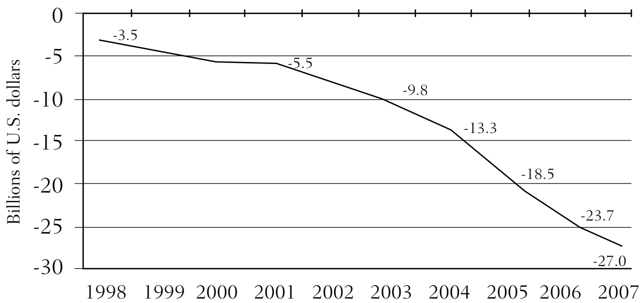
What we are seeing is Chinese exports' swift penetration of the Canadian market, with negative effects for productive sectors and unemployment levels, considered one of the Canadian economy's biggest weaknesses. Bilateral Mexico-China trade looks similar: the Mexican economy also shows an increasing deficit and competitiveness indices that in some cases are lower than Canada's (see Graph 2).

EVOLUTION OF MEXICO'S TRADE WITH THE U.S. AND CHINA

In 2007, Mexico's exports to the United States came to US$223 billion, less than China's (US$234 billion), displacing Mexico from its strategic position as the U.S.'s second trade partner, which it had consolidated under NAFTA. In this reshuffle, disadvantageous for Mexico, we can see the magnitude of the transformations in trade, capital, and technology flows worldwide.

Mexico-China bilateral trade results are also a matter for concern. This can be seen in the long-term performance of imports from China, which in 2000 were relatively low (US$2.88 billion), though in 2004, they had already skyrocketed to US$14 billion. In the following four years, purchases of goods from China continued on the rise, and by 2008 were close to US$35 billion. This figure contrasts with the value of Mexican exports to China (US$2.05 billion in 2008) and its trade deficit (US$32.71 billion). This trade gap has been financed by Mexico' trade surplus *vis-à-vis* the U.S. and Canada (see Graph 3).

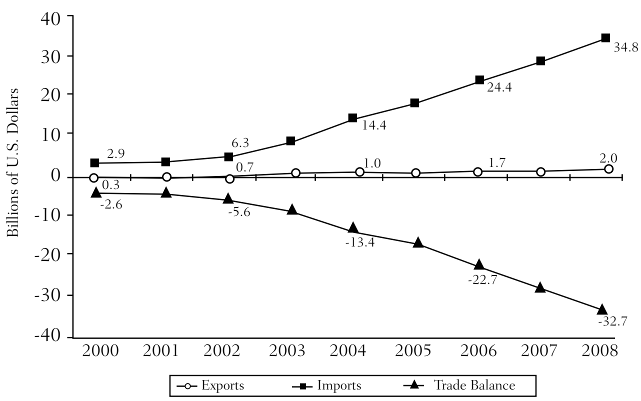
GRAPH 2
CANADA'S TRADE BALANCE WITH CHINA
(1998-2007)



Source: Designed by the author with data from Statistics Canada, www40.statcan.gc.ca/101/cst01/gblec02-eng.htm.

The countries most affected by the dual substitution effect are the ones with an export pattern similar to China's, like Mexico and Canada in some of their main sectors.

GRAPH 3
MEXICO'S TRADE BALANCE WITH CHINA (2000-2008)



Source: Designed by the author using data from Mexican Ministry of the Economy and the World Trade Organization," Estadísticas de Comercio Internacional," July 2010, www.economia.gob.mx/economia/p_Estadisticas_de_Comercio_Internacional.

This scenario poses the need for Mexico and Canada to revise trade promotion strategies and policies directed at intensifying bilateral trade and cooperation.

Why is this dual substitution of Canadian and Mexican manufactures by Chinese products happening? Both countries share a characteristic: their economies revolved largely around the U.S. economy. However, Canada has had a trade surplus with the U.S. and the rest of the world, in addition to being a net exporter of capital. Mexico's trade with Canada and the U.S. also has a surplus, but its total trade with the world shows a deficit that it finances with its position as a net receiver of foreign capital.

In this context, the countries most affected by the dual substitution effect are the ones with an export pattern similar to China's, like Mexico and Canada in some of their main sectors. In this sense, Canada, Mexico, and China are considered competing economies in the U.S. market in industries like auto, auto parts, electronics, electro-domestic appliances, and computers. In precisely these kinds of goods, Chinese industry has advantages that make it highly competitive and allow it to penetrate international markets.

Amidst intense competition in international markets, Mexico's trade position is critical. Its loss of competitiveness in manufactured goods can be explained by lags in education, training, research, infrastructure, and transportation. From the institutional standpoint, the business and investment climate is being gravely disrupted by the growing insecurity and out-of-control criminal violence, mainly in the northern and central part of the country.

Business people face an increasingly adverse climate for actually doing business, as a result of a new kind of corporation with transnational operations *protected* by a huge financial, military power. The drug traffickers have shown themselves to be highly integrated into the production, distribution, and marketing of hard and soft drugs. These corporations have the direct or indirect collaboration of groups in Mexico's police forces and very often benefit from the ineffectiveness of public administration officials on all levels, or what they simply do not do.

As we know, insecurity, criminal violence, and corruption create a severe crisis in public institutions and the federal government itself. All this accelerates the loss of the nation's economic competitiveness. In addition, companies have to make expenditures that raise their operating costs: in security technology, protection, and private security forces. This is a very sensitive topic that liberal analysts rarely consider when they look at the state of business in Mexico.

THE IMPACT OF THE U.S. RECESSION AND CHINA'S COMPETITIVENESS ON NAFTA

Canada and Mexico's big dependence on the U.S. market constitutes both a strength and a vulnerability, according to what phase of the business cycle the U.S. is in. For Canada, that market represents 78 percent of its exports, and for Mexico, 83 percent. Under these conditions, the recent U.S. recession caused a retreat in output, employment, and earnings for all NAFTA partners, but Mexico had the worst of it (see Table 1).

In 2008, Mexico's exports to the United States reached US$291 billion, but by the end of 2009, they had plummeted to US$229 billion, that is, a 30 percent drop. In turn, this spurred a contraction in production, which gave GDP a 6.5 percent negative growth rate, the lowest in the world after Russia.

Actually, Mexico's exports to the U.S. were already losing steam. From 2003 to 2008, they expanded 10.2 percent a year, while China's grew 24.12 percent a year in that same period.

The long-term decline that Canadian and Mexican products were experiencing in the U.S. market became sharper when the bottom dropped out of U.S. economic activity and consumers stopped demanding imports. This impact of the

TABLE 1
IMPACT OF THE RECESSION ON NAFTA PARTNERS

	Growth Rate (%)	2008	2009	2010*
United States	GDP	0.4	-2.5	2.7
	Inflation	3.8	-0.4	1.7
Canada	GDP	0.4	-2.6	2.6
	Inflation	2.4	0.1	1.3
Mexico	GDP	1.3	-6.8	4.0
	Inflation	5.1	5.4	3.5

* Estimates for 2010.
Source: International Monetary Fund, World Economic Fund, January 2010, http://blogimfdirect.org/tag/world-economic-outlook/.

crisis has confirmed the risks of dependence and the resulting vulnerability of the Canadian and particularly the Mexican economies *vis-à-vis* U.S. business cycles.[7]

DOES NAFTA OFFER MEXICO AND CANADA ALTERNATIVES?

Mexico and Canada have lost important market segments in the United States and domestically due to the competitiveness of Chinese exports. This trend opens up the question about the regional trade integration of North America. In fact, NAFTA's limits in fostering trilateral trade have been accentuated by the U.S. economic recession.

This scenario poses the need for Mexico and Canada to revise trade promotion strategies and policies directed at intensifying bilateral trade and cooperation. Both nations need to move ahead and diversify their markets more in Latin America and the Asian Pacific, the main driving force of world economic recovery.

For Mexico, the Canadian market is particularly interesting because of the size of the demand for goods and services generated by its ethnic and cultural diversity, plus other factors like seasonal climate variations and the population's high income levels, all of which influences consumer and preference patterns. The still low trade levels and financial flows between Canada and Mexico reveal a great deal of potential for development if we do not lose sight of the fact that both economies complement each other. VM

NOTES

[1] *Excélsior* (Mexico City), August 24, 2010, p. N-3.
[2] José Luis de la Cruz Gallegos and José Antonio Núñez Mora, "Importaciones de EUA: posibles efectos de la competencia china para México," Alfredo Sánchez Daza, comp., *Proceso de integración económica de México y el mundo* (Mexico City: UAM Azcapotzalco/Eón, 2005).
[3] *Boletín de la Secretaría de Economía* (Mexico City), August 2009, and "Asian Development Bank, Key Indicators 2009," http://www.adb.org/Documents/Books/Key_Indicators/2009/pdf/Key-Indicators-2009.pdf. [Editor's Note.]
[4] International Trade Statistics, UNCTAD/WTO, 2009, http://www.wto.org/english/res_e/statis_e/its2009_e/its09_toc_e.htm. [Editor's Note.]
[5] Ramiro de la Rosa, "Comercio e integración económica: el vínculo México-Estados Unidos y la competencia china por el mercado norteamericano," Ricardo Buzo, Enrique Pino, and Ana Teresa Gutiérrez, comps., *Enfrentando el cambio. Estrategias de inserción de los países de la Cuenca del Pacífico en la posguerra fría* (Mexico City: UAM Azcapotzalco/Eón, 2008).
[6] Statistics Canada, "International Economic Account 2009," http://www40.statcan.gc.ca/l01/cst01/gblec02a-eng.htm.
[7] Enrique Pino Hidalgo, "Tendencias del comercio y las inversiones entre Canadá y México," Gregorio Vidal and Arturo Guillén, comps., *Globalización y regionalización. Economía y sustentabilidad* (Mexico City: Miguel Ángel Porrúa/UAM Iztapalapa, 2008).

FURTHER READING

Enrique Dussel Peters, *The Implications of China's Entry into the WTO for Mexico*, Global Issue Papers no. 24, Heinrich Böll Stiftung, November 2005, http://www.boell.de/downloads/weltweit/GIP-DUSSEL-No24.pdf.