The Effects of China's Trade Expansion
on Mexican Exports

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I. Introduction

In spite of the expectation that NAFTA would boost the growth potential of Mexico, its growth rate did not increase as it was envisaged. Mexican GDP increased only at an annual rate of 2.68% during the first ten years after NAFTA came into effect. Although many observers criticized NAFTA itself for this poor performance, most economists seem to attribute this outcome to the recession of the world economy, especially the US economy, and the emergence of China.[1] Nonetheless, even with many analysts pointing out China as one of the causes for

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[1] See Tonelson(2004) or IDB(2005)

Mexico's low growth, there are only a few investigations about this subject.

Lora(2005), after analyzing the trade and FDI structures of countries concluded that China could be more of an opportunity than a threat to most Latin American countries. The exception was Mexico, which would unfortunately face fierce competition from China. However, the author failed to examine the actual impact that the emergence of China would have on Latin American economies and Mexico. Lall et al.(2005), after analyzing trade data, also mentioned that China would pose a competitive threat to Mexico, but did not show concretely how this threat would exteriorize. Mesquita(2004) contended that even if China's impact on Latin American countries was small so far, the future industrialization of the region would become much more difficult due to China. These papers mostly point out the threat posed by the emergence of the Chinese economy, but they do not touch upon its direct and indirect effects.

The objective of this paper is to investigate the direct and indirect effects of China's trade expansion on Mexico's trade, especially on Mexico's exports. In section II we investigate the effect of China's export expansion on Mexico's export. In section III we analyze the effect of Chinese trade expansion on international price. In section IV we show that Mexico's terms of trade was altered by international price changes which in turn were influenced by the Chinese trade expansion. And finally we offer a brief conclusion in section V.

II. China's export expansion and Mexico's exports

China's exports increased 16% annually from 1992 to 2003. During this period, the share of China's exports in the world export market increased from 2.29% to 5.82%, and China became the fourth largest exporting country following Germany(9.8%), the US(9.6%) and Japan

(6.3%) in 2003. The market share of Mexico also increased, especially after the establishment of NAFTA. Mexico's world market share increased from 1.43% in 1994 to 2.61% in 2000. However, Mexico's export dynamism weakened after 2000, year in which China's exports started to gain an even stronger momentum.

〈Figure 1〉 Share of China and Mexico in World Market: 1991~2003
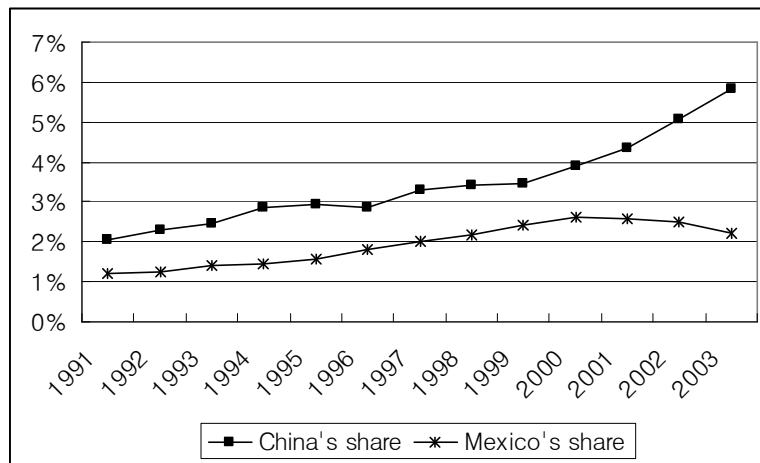
Source: own estimation from IMF DOTS

If the destination of China's export were totally different with that of Mexico's, the loss of Mexico's export dynamism would not be attributed to China's export expansion. However, the fact is that China has drastically increased its exports to Mexico's main export market: the United States. As can be seen in <Figure 2>, China's share in the US market increased from 3.99% in 1991 to 11.10% in 2002. During the same period, Mexico's share also increased from 6.26% to 11.32%. This increase can be found in the immediate years after the establishment of NAFTA. However in 2003, Mexico's share declined to 10.70% whereas China's share sharply rose to 12.51%. Chinese products seemed to be substituting Mexican products in the United States.

<Figure 2> Share of China and Mexico in US Market: 1991~2003
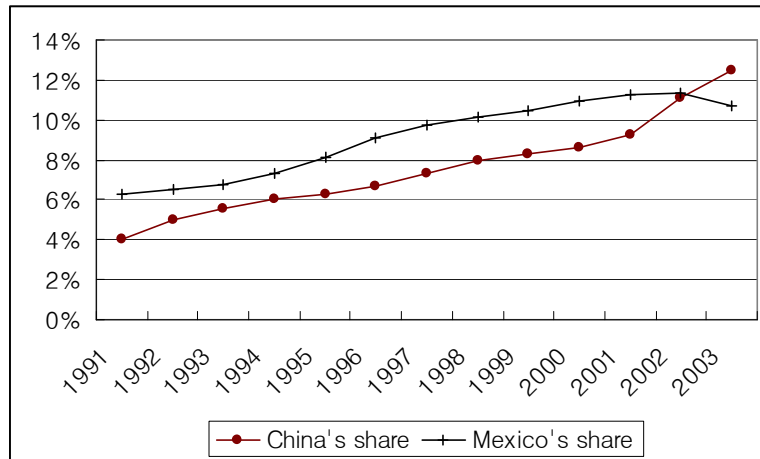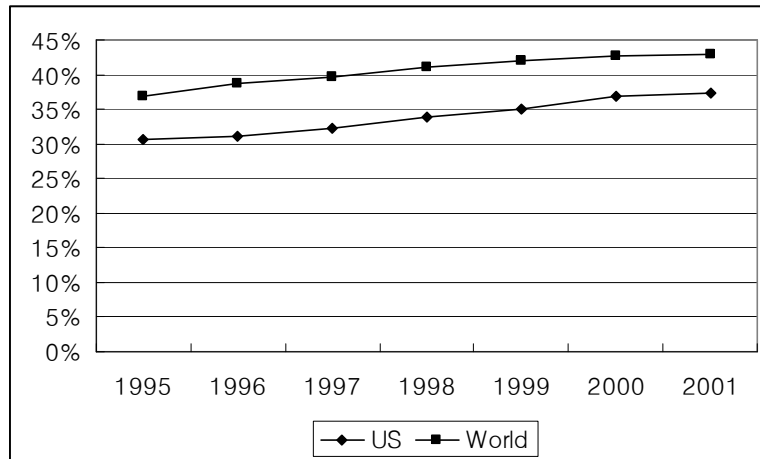

Source: own estimation from IMF DOTS

The problem is even more serious if we consider that China and Mexico are exporting increasingly similar products not only to the US market but to the world market as well. Export similarity index(ESI) between China and Mexico in the world market increased from 36.9 in 1995 to 42.8 in 2001.[2] The increase in ESI between Mexico and China in the US market was even larger. The ESI in the US market increased from 30.6 in 1995 to 37.4 in 2001.

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[2] The export similarity index(ESI), first used by Finger and Kreinin(1979), measures the competition between country a and country b in country c, and is computed as follows:

$$S(ab,c) = \left\{ \sum_i Min[X_i(ac), X_i(bc)] \right\} \times 100$$

Where $X_i(ac)$ is the share of the product i in the exports of country a to country c, and $X_i(bc)$ is the share of the product i in the exports of country b to country c.

〈Figure 3〉 Mexico－China Export Similarity Index in World and US Markets

Source: own estimation from UN COMTRADE dataset

The increase in ESI was mostly attributable to the increased export in common items. In <Table 1>, we can see the top 20 products that contributed to the increase in ESI in the US between 1997 and 2001. 16 out of 20 are items in the SITC 75, 76, 77, which correspond to information technology(IT) products. The export structure of the two countries is getting similar as both countries are exporting more IT products. Depending on the way the product contributes to the increase in ESI, these top 20 products can be divided into three types which are listed in the last column of <Table 1>. For the case of type (a) products, both China and Mexico are gaining larger shares in the United States' market. For example, between 1997 and 2001, Chinese share of Input of output units(SITC 7526) increased from 7.56% to 24.07%, whereas the Mexican share increased from 7.39% to 15.39%. As both countries export more of these products, the similarity of their export structure is continuously increasing. For type (b) products, Mexico originally had a large share, but China has been increasing exports and substituting the Mexican supply, thus increasing competition and export similarity

between the two countries. In the case of Air conditioning machines and parts (SITC 7415), Chinese share increased from 3.22% to 13.36%, whereas Mexican share did not change very much. For type (c) products, China and Mexico are maintaining their market share, but the market size is increasing, therefore the absolute amount of supply of both countries is increasing. In the case of TV radio transmitters(7643), both Chinese and Mexican shares did not change very much, but imports increased by about 290% between 1997 and 2001. This also led to higher export similarity between the two countries.

<Table 1> Top 20 products which contributed to the increase in ESI

SITC	product description	contrib. to ΔESI	Ch97	Ch01	Mex97	Mex01	Δimport	Type
7643	TV, radio transmitters etc	1.12	6.06	5.86	23.45	29.30	287.72	c
7526	Input or output units	1.11	7.56	24.07	7.39	15.39	6.91	a
7641	Line telephone etc. equip	0.84	19.15	24.71	10.39	15.73	33.15	a
8211	Convertible seats, parts	0.77	10.87	23.95	25.42	29.49	56.01	a
7843	Other parts, motor vehicle	0.46	0.93	2.29	13.95	17.12	25.06	a
7649	Parts, telecom. Equipt	0.44	5.26	8.55	17.86	18.89	58.28	a
7529	Data proc equipment, nes	0.38	2.91	5.37	2.40	31.50	105.16	a, c
7527	Storage units, data proc.	0.37	4.22	10.11	0.01	1.62	-31.95	a
7764	Electronic microcircuits	0.34	0.49	1.58	1.65	1.77	-19.99	a
7599	Parts, data proc. etc. mch	0.33	7.95	16.01	5.51	8.70	6.05	a
7415	Air conditioning mch, pts	0.33	3.22	13.36	36.55	32.37	51.18	b
7523	Digtl proc, storage units	0.27	1.32	11.36	7.76	35.92	43.11	a
7781	Batteries, accumulators	0.24	7.44	14.33	18.77	19.43	17.95	a
7731	Insultd wire,etc. condctr	0.24	6.65	8.94	65.48	59.19	25.33	b
8811	Cameras,flash equipt,etc	0.19	29.88	45.37	4.66	15.80	-0.02	a
6991	Locks, safes, strong boxes	0.17	8.33	15.64	13.23	20.19	36.13	a
8131	Lamps, light fittings nes	0.16	51.72	61.59	13.45	16.62	72.23	a
7784	Electro-mech. hand tools	0.16	30.65	52.63	16.98	14.00	56.52	c
7611	Colour televisn receiver	0.13	0.39	2.50	70.96	58.73	86.86	b
7752	Dom.refrigeratrs, freezrs	0.13	8.51	14.89	41.77	56.64	104.93	a, c

Source own estimation from UN COMTRADE dataset

The increase in the similarity of exported products between Mexico and China reflects just one side of the coin. The other side is the increased competition, and the crowding out of Mexican products. <Table 2> shows the top 20 products for which the Chinese share has increased in the US market. 13 of these 20 products are crude materials in SITC 2 (Crude materials, inedible, except fuels), or light manufactured products in SITC 6 (manufactured goods classified chiefly by material) and SITC 8 (miscellaneous manufactured articles). In 13 out of 20 products, the increase of the Chinese share was accompanied by a decrease of the Mexican share. The average decline of the Mexican share was 10.89%. Nonetheless, the opposite was not true for Mexican exports. Among the top 20 products for which the Mexican share increased, China experienced a reduction of its share in only 7 products, and the average reduction of these products was just 1.55%.[3]

<Table 2> Top 20 products with increased Chinese share in US

SITC	product description	Ch97	Ch01	ΔCh9701	Mex97	Mex01	ΔMex9701
3211	Anthracite, not agglomrtd	12.80	99.94	87.14	0.00	0.00	0.00
7935	Spec. purpose vessels etc	0.00	74.57	74.57	10.45	0.00	-10.45
2685	Horsehair, crse. anml.hair	41.55	89.69	48.14	49.24	1.07	-48.17
2658	Veg. textile fibres, nes	5.19	35.67	30.48	0.00	0.00	0.00
7852	Bicycles etc. non-motorzd	43.63	74.00	30.37	2.25	1.80	-0.45
6354	Wood, domst.use ex.furnt	31.88	56.84	24.96	13.05	9.26	-3.80
6966	Knives, forks, spoons, etc.	38.04	62.88	24.84	2.54	3.93	1.39
7863	Transport containers	2.30	27.11	24.81	60.50	16.99	-43.51
6978	H.hold appliancs, etc. nes	39.65	63.20	23.56	6.91	4.76	-2.16
7612	Black, white TV receivers	34.31	57.20	22.89	0.05	0.09	0.04
8213	Metal furniture nes	17.00	39.34	22.34	10.90	6.16	-4.74
7784	Electro-mech. hand tools	30.65	52.63	21.98	16.98	14.00	-2.98

[3] Table not shown.

8972	Imitation jewellery	35.86	57.72	21.86	3.61	3.10	-0.52
8999	Manufactured goods, nes.	49.57	71.01	21.44	0.53	1.90	1.37
3351	Petroleum jelly, wax etc	15.99	37.34	21.35	1.98	0.15	-1.83
2879	Oth. non-ferr. ore, concntr	2.20	23.36	21.16	0.94	2.96	2.01
6974	Tbl, ktchn,h.hold art.nes	23.79	44.00	20.21	3.29	2.67	-0.61
2485	Wood, non-conif. wrkd, shpd	3.10	22.87	19.78	3.59	1.11	-2.48
2733	Sands, natrl. not mtl. brng	2.54	22.25	19.71	8.97	10.29	1.32
6851	Lead, lead alloy, unwrght.	0.00	19.47	19.47	23.68	3.81	-19.86

Source: own estimation from UN COMTRADE dataset

As we could previously observe, Chinese products are substituting Mexican products in the US market, and the increase of the Chinese share is causing the decline of the Mexican share. This is shown in the regression results of <Table 3>. In these regressions, the dependent variable was the change of the Mexican share in the US market by product between 1997 and 2001 (ΔMXUS9701), and the independent variable was the change of the Chinese share (ΔCXUS9701). In the first regression, with all the observations included, the coefficient was -0.134, implying that a 1% increase in the Chinese share reduced the Mexican share by 0.134%. In the second regression, those products with zero export from China or Mexico to the US market were excluded, leading to better results. In the third regression, products in the category SITC 0 (food and live animals) were additionally excluded because China's exports in this category were minute compared to Mexico's. In this regression which consisted of only 743 observations, the coefficient was negative and highly significant. This result implies that a 1% increase in the Chinese share reduced the Mexican share by 0.185%.

<Table 3> Regression: Mexican share on Chinese share change

		ΔCXUS9701	t-value	# of obs.	R^2
(1)	ΔMXUS9701 (all)	-0.134	-3.104	1026	0.009
(2)	ΔMXUS9701 (excl. Ch, Mex=0)	-0.167	-3.766	809	0.017

(3)	ΔMXUS9701 (+ excl. SITC 0)	-0.185	-4.011	743	0.021

In summary, Mexico and China's export structure is getting more and more similar. Although Mexico was able to maintain its overall share in the US market by increasing the exports of some products, including IT products, Mexico is nonetheless facing increased competition from China. However, as it will be shown in next sections, the increased similarity also affected Mexico's exports through the international price effect, because China's trade expansion influenced international prices.

III. The Effect of Chinese Trade Expansion on International Price

In international economics, 'a small country' means a country whose imports and exports are too small, considering the world market size, to affect international prices. But in some cases, even a 'small country' can affect international prices if a number of countries increase imports and exports altogether.[4] That is, if countries increase their exports altogether, the international price of the product will fall, and if countries increase imports altogether, the international price of the product will rise. However, other countries like China, which have a large market share in the world market, can influence international prices on their own. That is why changes in prices induced by China's expansion can affect Mexico indirectly through this price effect.

The effect on Mexico depends on the similarity of Mexico and China's import and export structure. If their export structure is similar, China's export expansion will lead to the fall of international prices of Mexico's exporting products. On the other hand, if the export structure of Mexico is similar to China's import structure, Mexico can benefit

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[4] This is also called "fallacy of composition".

from the increase of exporting products' prices caused by the expansion of China's imports. If their import structure is similar, Mexico can be negatively affected using the same logic.

III.1. The Effect of China's Trade Expansion on International Prices

Because of China's rapid trade expansion, in 2003 China's market share in world exports and imports reached 5.82% and 5.24% respectively. Due to the fact that some individual products had a much higher market share than the figures above, we could not say that China is a small country that takes international prices as exogenous. On the contrary, China is a country that can directly affect international prices by expanding its exports and imports. Then, how large is the effect of China's import and export expansion on international prices?
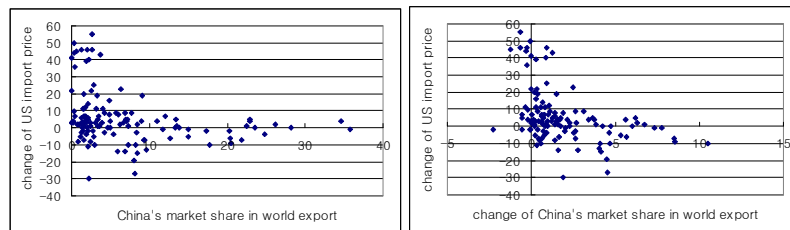
In this research, we used the US import and export price indices provided by the US Bureau of Labor Statistics as data for international prices. Although US export and import prices do not perfectly reflect international prices, considering the size of the US market and its low trade barriers, we could say they are close to the international prices. This data set provides import and export prices for 150 product categories.[5]

If China increases its exports and consequently its market share in the world, we can predict that the prices of those products will decrease because of the increase in supply in the world market. The reason is, as we have pointed out before, that China's trade is large enough to affect international prices. Among the 150 products which were included in the analysis, China had 53 products with a share of over 5%, and 26

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[5] The information is provided in SITC 1, 2, or 3 digits. Some products in SITC 3 digits are also included in SITC 2 digits. Number of products of which the export price is provided, is different from the number of products of which the import price is provided.

products with a share of over 10% in the world market.[6] The first graph in <Figure 3> shows the relationship between China's share in world export market and changes in US import prices. The second graph shows the relationship between the changes of China's share in world export market and the changes of US import prices.[7] The correlation between China's market share in world export and US's import price change is negative and significant. This reflects that if China's export increases, supply in the international market will increase, and the international price will fall. Consequently, US's import price will fall.[8]

<Figure 3> China's Export and US Import Price
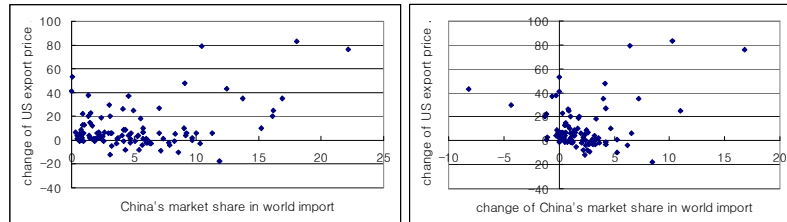

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[6] We used UN COMTRADE dataset.

[7] For China's share in world trade, we employed the data of the year 2001. The change of China's share means the change between 1997 and 2001. The changes of export and import price mean the changes from 2001 to 2004. The reason we chose the year 2001 as the starting point is, as we can see in the figure below, there was a discernible trend after 2001, but before the year 2001, there was no clear trend because of the international economic depression.

[8] The coefficient of correlation between the share of China in world export and change of US import price is -0.288, and the coefficient of correlation between the change of China's share in world export and the change of US's import price is -0.400. Both are significant at 1% level.

On the contrary, if China's import increases, the demand in the world market will increase, and this will lead to an increase in the international price of the product. China experienced a sharp increase in import, which led China to become the 3rd biggest importing country in the world, leaving Japan, the UK and France behind in 2003. And this rapid increase of imports put increasing pressure on the international price. China's imports, concentrated on raw materials, parts, and materials for economic development, caused severe increases in international prices of raw materials. The number of Chinese products with a market share higher than 5% of world imports was over 50, and 14 products had a share higher than 10%. The increase of international price reflects the increase of US's export price. As a result, China's market share in world imports and changes of US's import price had a positive correlation.[9] This is well shown in <Figure 4>.

<Figure 4> China's Import and US Export Price

III.2. Regression Analysis

Through regression analysis we examined how much China's expansion of imports and exports affected international prices. In the regression, we made use of US' export and import prices as international prices once more. However, since the data offered by the

[9] The coefficient of correlation between the China's share in world import and the change of US export price is 0.371, and the coefficient of correlation between the change of China's share in world import and the changes of US's export price is 0.243. Both are significant at 1% level.

US Bureau of Labor Statistics was divided into export prices and import prices, and since there was a difference between export products and import products, we used the average of import and export prices if both were available, and if only one of them could be obtained, we applied it. In this case, the coefficient of correlation is shown in <Table 4>.

As we can observe in <Table 4>, the coefficient of correlation of US import and export price was 0.785. This means that the price of same products moves similarly, regardless of being import or export price. Considering that both, US import and export prices, reflect international prices, this was a reasonable result. The coefficient of correlation between the new variable and export and import prices were 0.972 and 0.968, respectively. This implies that the new variable reflects very well on both, the import and export prices of the US.

<Table 4> The Coefficient Correlation of Import and Export

		Export Price	Import Price	Import and Export Price
Export Price	Coefficient correlation Significance N	1.000 . 113	0.785 0.000 88	0.972 0.000 113
Import Price	Coefficient correlation Significance N	0.785 0.000 88	1.000 . 126	0.968 0.000 126
Import and Export Price	Coefficient correlation Significance N	0.972 0.000 113	0.968 0.000 126	1.000 . 151

In the regressions, we used the changes of US export and import prices from 2001 to 2004 as dependent variables, and for independent variables, we used China's market share in world exports in 2001 (CX01), China's market share in world imports in 2001 (CM01), the changes of China's market share in world exports from 1997 to 2001(Δ

CX9701), the changes of China's market share in world imports from 1997 to 2001 (ΔCM9701), and a IT industry Dummy(D_IT). The results of the regressions are presented in <Table 5>.

<Table 5> The Effect of China's Import and Export on International Price

	Model 1	Model 2	Model 3	Model 4
Constant	0.060* (2.387)	0.113** (6.137)	0.064** (2.706)	0.111** (6.206)
CX01	-0.497* (-2.550)		-0.383* (-2.039)	
CM01	1.221** (3.663)		1.308** (4.109)	
ΔCX9701		-2.997** (-4.850)		-2.331** (-3.596)
ΔCM9701		1.077* (2.144)		1.283* (2.586)
D_IT			-0.177** (-3.961)	-0.137** (-2.819)
R^2	0.166	0.175	0.248	0.218
N	146	146	146	146
*: 5% significance **: 10% significance				

As we can see in <Table 5>, the larger China's market share in world export, the higher the decrease rate of international price, and correspondingly, the larger China's market share in world imports, the higher the increase rate of international prices. In Model 1, if China's export market share was 1% higher in 2001, the international price increase rate was negative 0.497. Moreover, if China's import market share was 1% higher in 2001, the international price increase rate was 1.221% higher. If we analyze this with the change in China's market share between 1997 and 2001, the results were more evident. In Model 2,

if the change in China's export market share was 1% higher, the international price increase rate was 2.997% lower. Also, if the change in import market share was 1% higher, the international price increase rate was 1.077% higher, which was slightly lower than in the former case.

Since China's recent increase in exports was concentrated in IT products, the decline of international prices in China's exporting products might have been rooted on a technological progress in the IT sector, leading to a fall in their product price, rather than the increase of China's supply. To examine this, we included a dummy variable for IT products. As we can see in Model 3 and 4, IT products' price fell 0.137% compared to other products. Also, when we included D_IT, the effect of China's export market share was reduced. Yet, the coefficient of the world export market share declined only from -0.497 to -0.383. For the coefficient of change in export market share, it decreased barely from -2.997 to -2.331. Therefore, the reason for the fall of China's exporting products' prices was not because they were IT products, but because China's production increase was causing excess supply in the world market.

On average, the world market share of products exported by China increased 1.54% from 1997 to 2001. Because of this, international prices must have decreased 3.59% on average, according to Model 4. Also, the world market share of China's importing products increased 1.50% during the same period, and the effect must have been a 1.93% increase in international prices.

IV. The effect of China's trade expansion on Mexico's terms of trade

If China expands its exports and international prices fall, Mexico would be affected in two ways. First, if Mexico exports the same

products, Mexico would be affected by the fall of export prices. Second, if Mexico imports these products, Mexico would benefit from the fall of import prices. Also, if China expands imports, and international prices rise, Mexico would experience both, an increase in export prices which would be an advantage, and on the other hand, an increase in import prices which would be a disadvantage.

To estimate this effect, we used regression Model 4 in <Table 5>. First, we estimated the changes of international prices using the change in China's export market share for individual products. Next, by multiplying Mexico's import and export values for the year 2001 by the international price change, we estimated the increase and decrease effect of import and export values that stemmed from price changes. The result is shown in <Table 6>. As we can see in <Table 6>, since the international price and Mexico's export price decreased as China's exports increased, Mexico's loss from 2001 to 2004 came up to 4.41% of total exports. The reason China's export had such a strong effect on Mexico's export price was because the export similarity between the two countries was very high. However, this effect was partly offset due to the price increase effect rooted on China's import expansion. For the reason that the calculation of this effect was 2.15%, Mexico's export prices decreased on average by 2.262%.

<Table 6> Terms of Trade Effect of China's Trade Expansion

| | Export price change from: | | | Import price change from: | | | Terms of Trade Effect |
	China's Export Increases	China's Import Increases	Subtotal	China's Export Increases	China's Import Increases	Subtotal	
Mexico	-4.41	2.15	-2.26	-4.03	2.72	-1.31	-0.95
Korea	-4.82	2.91	-1.92	-2.62	3.09	0.46	-2.38

From the import side, Mexico paid 4.03% less because of the price fall effect stemming from China's export expansion. However, Mexico had to pay 2.72% more due to the increase in international price resulting from China's import increase. As a consequence, Mexico's import price decreased by only 1.31%. Mexico faced a loss with respect to exports on one hand, but on the other, gained on imports due to China's trade expansion.. The total terms of trade effect was a deterioration of 0.95%.

Even if Mexico's terms of trade deteriorated because of China's trade expansion, the deterioration was smaller than that of Korea. Korea lost from both sides: exports and imports. Korea's export price declined by 1.92% whereas the import price increased by 0.46%. In total, the terms of trade deteriorated by 2.38%. The reason Mexico experienced a lower increase in the price of imported goods, was because Mexico was exporting rather than importing crude materials (SITC 2) and mineral fuels (SITC 3), which were Korea and China's principal imported goods.

Even if oil and mining sectors in Mexico have benefited from China's trade expansion, the industrial sector has been strongly affected. The fall of Mexico's export price was even larger than that of Korea's. The low growth rate of industrial value added in Mexico might be partly explained by this.

V. Conclusion

Although there was a claim that China was one of the main reasons for Mexico's recession, as Chinese products were substituting Mexican ones in the world market, and especially in the US market, there was no rigorous analysis about it. This paper provided evidence that this claim was true. We showed that the export structures of the two countries are becoming more and more similar and competition is increasing between them. The competition seemed to favor China. China's market share in

the US is continuously increasing whereas Mexico's share has been decreasing recently. A 1% increase of China's share in the US market reduced Mexico's by 0.185%. This explains most of the decline of Mexico's share in the US market between 2001 and 2003.

China's trade expansion also affected Mexico's economic performance indirectly through international prices. China's trade expansion had an effect of reducing Mexico's export prices by 2.262%, and import prices by 1.31%. Mexico lost in the side of exports but gained in the side of imports because of China's trade expansion. The total terms of trade effect was a deterioration of 0.95%. Even if the mining sector might have benefited from China's trade expansion, the manufacture sector has been seriously affected by it.

As China's trade is expected to keep expanding, at least for a while, Mexico's export decline might persist. For Mexico to reduce the negative effects stemming from China's trade expansion, it will have to differentiate its products from the Chinese ones through technological improvements. Mexico might also need to diversify the destination of its exports, reducing the share to the US market from its total exports. One option for Mexico might be to expand the exports to East Asia including China, which is the most dynamic market. By exporting more to China, Mexico would benefit not only from larger export quantity but also from better price of the exported products.

Abstract

This paper analyzes the effects of China's trade expansion on Mexican exports. The export structures of Mexico and China are becoming more and more similar and competition is increasing between them. A 1% increase of China's share in the US market reduced Mexico's by 0.185%. China's trade expansion had an effect of reducing

Mexico's export prices by 2.262%, and import prices by 1.31% between 2001 and 2004. This deteriorated Mexico's terms of trade by 0.95%. As China's trade is expected to continuously expand, at least for a while, Mexico's export decline might persist. For Mexico to reduce the negative effects stemming from China's trade expansion, it will have to differentiate its products from the Chinese ones through technological improvements or improving the composition. Mexico might also need to diversify the destination of its exports, reducing the share to the US market from its total exports.

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