How *Mexico* Got Its Lunch Back

By Daniel Rosen, Agatha Kratz, and Reva Goujon

But the new U.S.-Mexico-China connection is a mixed story.

As chronicled in "How China Is Eating Mexico's Lunch" (*TIE,* Spring 2003), China passed Mexico as a source of U.S. imports in 2002, the year following China's World Trade Organization accession. This was a sea change: through the 1990s Mexico and its maquiladora system were the vanguard of globalization, a decade China started in the throes of the Tiananmen massacre aftermath, and ended beset by the Asian financial crisis, competitive depreciations all around it, a non-performing loan crisis, and a host of new WTO obligations to implement. So getting displaced from pole position in the U.S. market was a painfully rude awakening for Mexico, as it would be for other economies unprepared for the pace of global market share growth China would achieve in the years ahead.

Twenty years later, Mexico has re-emerged as a key partner for the United States in diversification from China, increasing its share of U.S. imports by over two percentage points from 2017 to 2023—more than any other country over the same period—and displacing China as the United States' top total trade partner (exports plus imports) for the first time since 2006.

But while on the surface this seems a major de-risking feat, U.S. policymakers suspect a growing Chinese presence in the supply chains

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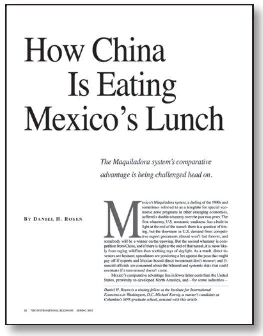
running through Mexico, and that some trade may include illegal transshipments meant to circumvent U.S. tariffs.

A review of U.S.-Mexico-China ties shows a mixed story. Mexico is attracting substantial, long-term de-risking investment—outpacing its closest diversification peer, Vietnam. And it is also attracting significant Chinese foreign direct investment interest, which will attract scrutiny from Washington as the six-year review of the United States-Mexico-Canada Agreement approaches.

Two decades ago in TIE, **Daniel Rosen** *concluded, "China is eating Mexico's lunch, but more due to the Mexican inability to capitalize on successes and induce broader reform than to China's lower-wage workers.*


How China Is Eating Mexico's Lunch

The Maquiladora system's comparative advantage is being challenged head on.

By Daniel H. Rosen

MEXICO'S COMEBACK

On the back of the U.S.-China trade war, rising geopolitical tensions, and a growing array of U.S. policies compelling firms to de-risk their China value chains, Mexico has emerged as the top U.S. diversification partner. In 2023,

Mexico has re-emerged as a key partner for the United States.

Mexico reclaimed its place as the largest source of U.S. imports, twenty-one years after it was overtaken by China (Figure 1). Mexico gained more U.S. import market share in recent years than any other country: 2.02 percentage points from 2017 to 2023 (Figure 2). Vietnam, by comparison, gained 1.74 percentage points, and Taiwan, the third-largest beneficiary of shifting U.S.-China trade ties and a leader in semiconductors and electronics, gained 1 percentage point.

Much of that growth has been driven by automotive trade. Mexico grew its share of U.S. auto imports by 5.5 percentage points over 2017–2022, and vehicles now make up almost 30 percent of Mexican exports to the United States. USMCA provisions on North American rules of origin and Mexico's abundant, skilled, and cost-efficient workforce make it extremely attractive to produce autos in Mexico for the U.S. market. Mexico has also grown its share of U.S. imports in other sectors, including consumer electronics, medical devices, and power-generating and electrical equipment.

In direct investment, Mexico maintained its share of U.S. manufacturing foreign direct investment over 2017–2022. The country landed $5.1 billion in U.S. manufacturing FDI in 2022, up more than 40 percent from the 2014–2019 average of $3.4 billion (U.S. Bureau of Economic Analysis data). This contrasts with a 0.7 percentage point drop in China's share of U.S. manufacturing FDI over the same period. With near-shoring and China diversification trends gaining traction, U.S. firms may be choosing a familiar market closer to home and ramping up existing capacity in Mexico. In addition to U.S. proximity, Mexico offers North American integration through the USMCA, physical transportation linkages with the rest of the continent, and a cost-efficient, skilled, and abundant labor force for manufacturing. Investors must of course weigh these structural advantages against concerns over Mexico's persistent security and corruption challenges, slumping private sector investment, backtracking on energy reform, and populist policy agenda under a Morena-led government. But U.S. de-risking policies targeting China appear to have nonetheless sustained and increased U.S. FDI to Mexico.

UNITED STATES THROUGH MEXICO?

Some in the United States are eying Mexico's resurgent trade status with skepticism, questioning whether it represents diversification away from China or simply a reorganization of trade, with Mexico-to-United States flows remaining deeply China-dependent. Recent academic papers have pointed out that the increase in Mexican exports to the United States has been accompanied by increased Mexican imports from China, suggesting that recent diversification

The Good and the Bad

In addition to U.S. proximity, Mexico offers North American integration through the USMCA, physical transportation linkages with the rest of the continent, and a cost-efficient, skilled, and abundant labor force for manufacturing. Investors must of course weigh these structural advantages against concerns over Mexico's persistent security and corruption challenges, slumping private sector investment, backtracking on energy reform, and populist policy agenda under a Morena-led government.

—D. Rosen, A. Kratz, and R. Goujon

is "shallow," with mostly assembly-type activities moving to Mexico to avoid U.S. trade barriers.

The rise in Mexico's share of U.S. imports is not surprising. As global manufacturers and exporters responded to hiked U.S.-China tariffs during the Trump administration, many took partial (and what they probably hoped to be temporary) steps to maintain U.S. market access with minimum capital investments. Assembly activities moved first, often to countries that either provided low-tariff access to the U.S. market (Mexico under USMCA) or low tariff barriers on imports of Chinese inputs (Vietnam and much of Southeast Asia under the ASEAN-China Free Trade Agreement). In this context, increased exports from Mexico and Vietnam to the United States were naturally accompanied by rising Chinese exports to these locations. Moving assembly activities is costly but easier than trying to replicate the whole clusters China has built.

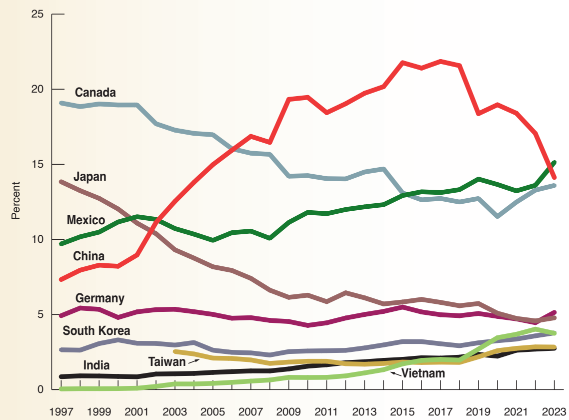
This shallow diversification, however, has raised suspicion, not only because it means that deep indirect ties to China remain despite U.S. de-risking policy, but also because some of these activities could be illegal. Mere transshipments and tariff circumvention, without substantial transformation happening in Mexico, would be in violation of U.S. law.

Proving transshipment or circumvention is challenging, particularly in a country like Mexico, which has for decades imported from China for its own use, as well as for re-export. Increased Mexican exports to the United States do correlate with increasing Chinese exports to Mexico (Figure 3), but more weakly than with other diversification partners like Vietnam (Figure 4). This suggests that Mexico's growing exports to the United States are not merely Chinese exports rerouted through Mexico.

Data on trade in value-added also shows a slow and persistent increase in embedded Chinese value-added as a share of Mexico's exports, but no sudden jumps amid the recent rise in U.S. tariffs and global trade relocation (Figure 5). The Mexican pattern is in line with China's global manufacturing value-add trend.

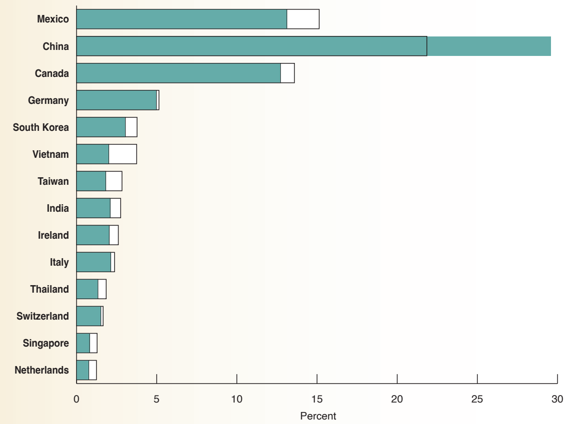
U.S. policymakers suspect a growing Chinese presence in the supply chains running through Mexico.

Figure 1 Share of U.S. imports by top trading partner, 1997–2023



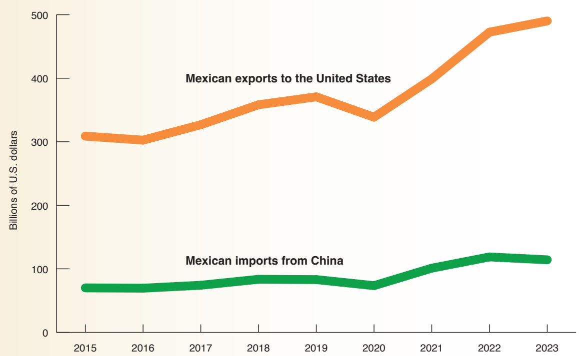
Source: U.S. International Trade Commission based on UN Comtrade and U.S. Census trade statistics.

Figure 2 Change in share of U.S. imports, 2017 and 2023



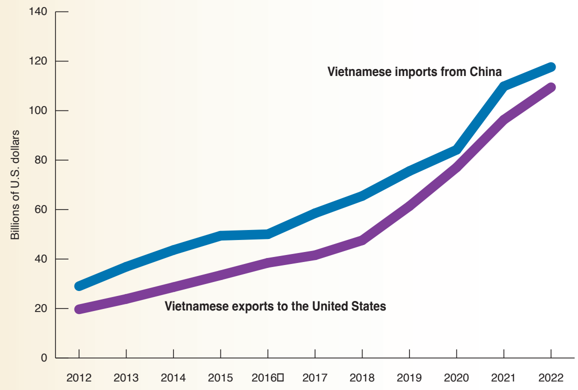
Source: U.S. International Trade Commission based on UN Comtrade and U.S. Census trade statistics.

Figure 3 Mexico's imports from China and exports to the United States



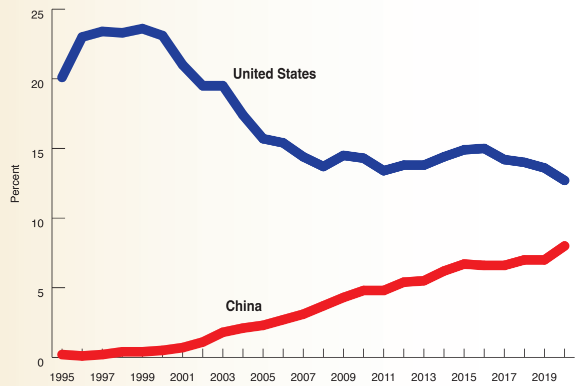
Source: Instituto Nacional de Estadística y Geografía (INEGI).

Figure 4 Vietnam's imports from China and exports to the United States



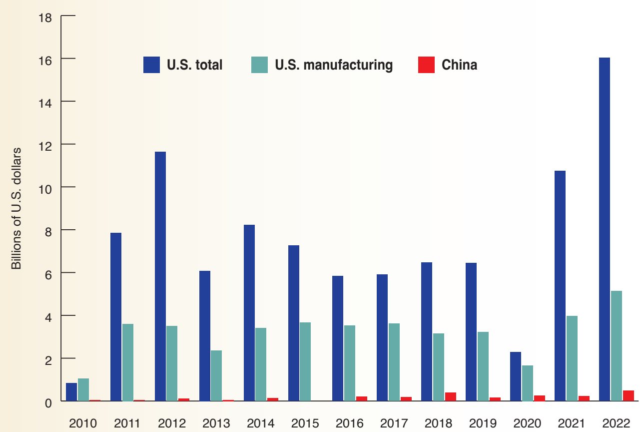
Source: UN Comtrade.

Figure 5 Chinese and U.S. value-added share of Mexico's gross exports



Sources: OECD Trade in Value-Added Database (TiVA).

Figure 6 U.S. and China FDI flows into Mexico



Sources: China Ministry of Commerce, U.S. Bureau of Economic Analysis.

CHINA IN THE FDI LEAD?

Recent political debates and media reports also suggest that much of the investment driving increased Mexico-to-U.S. trade is Chinese. Available data paint a mixed picture. Official numbers from China's Ministry of Commerce show low Chinese FDI to Mexico, consistently below half a billion dollars per year (Figure 6). Ministry of Commerce figures come with well-known caveats, and likely underestimate activity. Nonetheless, they suggest that over the past five years, U.S. diversification via Mexico has been less driven by Chinese firms than activity through Vietnam and other parts of Southeast Asia has been, where the mix of U.S. and Chinese precursor FDI is largely reversed (Figure 7). In Southeast Asian countries, Chinese firms appear to have moved quickly and substantially since the start of the trade war to relocate manufacturing, especially in electronics.

Those same Chinese firms are in Mexico's kitchen doing the cooking today.

But Ministry of Commerce data fails to capture the current reality of China-to-Mexico FDI. Rhodium Group pioneered a more complete methodology for tracking China's outbound investments into the United States and European Union more than a decade ago, which can now be used to assess global Chinese flows. Using this transaction-based approach, our data show a doubling in 2023 announced Chinese FDI in Mexico over the prior year, to an estimated $3.9 billion, eight times the past-decade annual average of about $500 million (Figure 8). The number of individual transactions was up almost 60 percent year-on-year, putting Chinese investment closer to the 2022 U.S. manufacturing FDI figure of $5.1 billion (though still far below $16 billion in total U.S. FDI that year, and miles behind the accumulated U.S. FDI stock in Mexico). Our data show the majority of China's announced FDI in Mexico since 2021 has been greenfield investment, supporting the thesis that Chinese firms are doing real value-added.

WHAT'S FOR DINNER?

Mexico has, for the moment, reclaimed the lunch that Chinese firms snatched away twenty years ago. And to some extent it is those same Chinese firms that are in Mexico's kitchen doing the cooking today.

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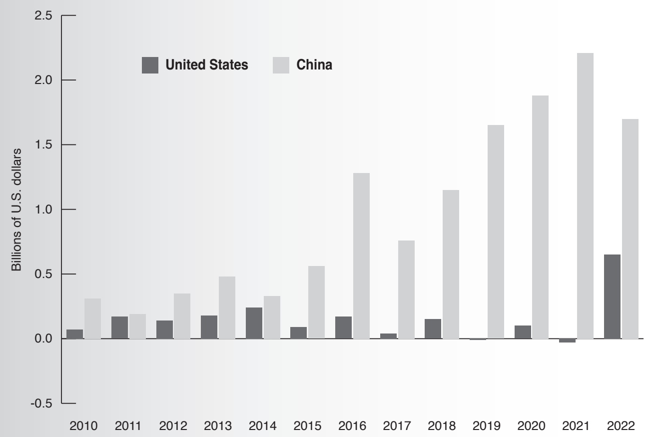
When Chinese firms bring real value-added, this is a win for Mexico. Going forward, several factors could drive Chinese firms to further expand their manufacturing footprint in Mexico. U.S.-China trade tensions remain high and are set to further intensify, pulling producers out of China in search of more favorable conditions. "Agglomeration effects" could pull more pieces of supply chains into Mexico over time. The electrification of the U.S. auto sector and the pervasiveness of Chinese firms in electric vehicle supply chains will naturally mean participants from China wherever automotive clusters form. And diversification rival Vietnam is coming under increased scrutiny from the United States over transshipment, and in any case is grappling with capacity constraints.

But the path for China's investors in Mexico is anything but smooth. Depending on how the United States' final Inflation Reduction Act implementation language shakes out, Chinese firms will need to navigate foreign entity of concern definitions if they are to qualify for subsidies and lower tariffs. Emerging U.S. cybersecurity controls may leave aside tariff and subsidy questions and keep China-related content out of the United States entirely for national security reasons. Recently expanded U.S. rules on anti-dumping and countervailing duties include authority to attack transnational subsidies, and the United States could start investigating Mexico-made inputs or products by Chinese firms if those firms receive subsidies back in China. The USMCA comes under a joint review by all parties in July 2026, and U.S. political pressure on Mexico to block Chinese investment and U.S.-bound trade in strategic industries is easy to imagine. And meanwhile, deeper structural challenges demand serious attention from Mexican policymakers, including talent availability, environmental constraints such as water scarcity, critical energy infrastructure reforms, and improvement in general political stability.

The path for China's investors in Mexico is anything but smooth.

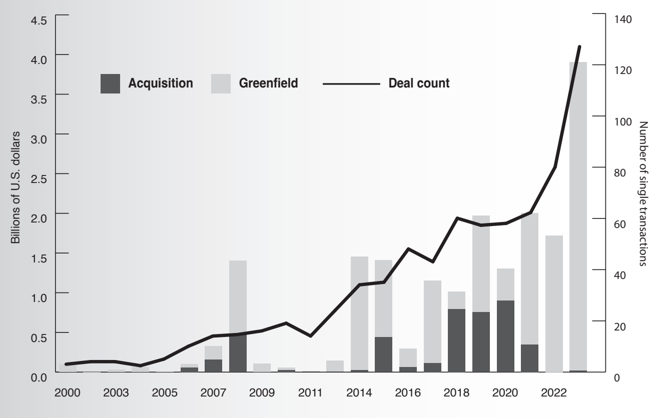
This Sino-Mexican edition of *Trading Places* is complex, and when the wildcard of U.S. policy is added, predicting long-term outcomes is difficult. But the past two decades already prove that seemingly inexorable patterns of economic evolution can change, and relatively quickly. The logic of international commerce is powerful, with its extraordinary economies of scale and scope. But realizing those economies is not a given: it is contingent on a foundation of good domestic policies and evidence that efficiency won't come at the expense of national security. The China of twenty years ago was careful not to raise national security alarms, actively marketizing, and bending over backwards to welcome foreign investors (even selling shares in national oil companies to foreigners to prove its pro-competitive mettle). Beijing today is disregarding foreign concerns in both strategic and commercial quarters, and Mexico is capitalizing on the resulting opportunities. ◆

Figure 7 U.S. and China FDI flows into Vietnam



Sources: China Ministry of Commerce, U.S. Bureau of Economic Analysis.

Figure 8 Chinese announced OFDI in Mexico, 2000-2023*



Sources: Rhodium Group.
*Preliminary data, subject to further refinement and revisions.