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Consumer Products from China: Safety, Regulations, and Supply Chains

Testimony before the U.S.-China Economic and Security Review Commission

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Thank you for the opportunity to testify on the topic of shifting global supply chains and Chinese investment in Mexico. I congratulate the Commission on an important and timely choice of topic. The United States and Mexico have an opportunity to ensure that shifting investment patterns meet shared economic goals and social, environmental and transparency standards as outlined in the United States-Mexico-Canada Agreement (USMCA). My contribution aims to help the Commission plan effectively to meet these goals.

Key Points:

- Mexico may stand to benefit from the US tariffs on Chinese goods, as the targeted manufacturing sectors are crucial for Mexico's trade relations with the US. These exports, including motor vehicle and electronics, represent the majority of Mexican exports, making Mexico well positioned to receive more Chinese and Western investment as firms reposition themselves.

- The potential impact of US tariffs on value chains has not yet taken full effect: major changes in these sectors have not appeared in Mexico-US exports. Thus, the US and Mexico have an opportunity to consider potential risks and ensure that new investment meets social, environmental and transparency standards and does not undercut the commitments embedded in the USMCA.

- USMCA includes advances on labor, environment and transparency standards in regional trade and scholars broadly agree that strengthening enforcement of these standards remains a priority. This will be an important area for regional collaboration to manage changing investment patterns.

- The US can protect the standards of USMCA in three important ways. First, the US can lead by example in promoting high-quality investment through the Group of 7 (G7) Partnership for Global Infrastructure and Investment (PGI). Second, it can encourage Chinese investors to work through established regional multilateral investment platforms with embedded high-level standards, rather than working independently. Third, the US can continue to grow the regional cooperation efforts of the US

Department of Labor and the US Environmental Protection Agency with their Mexican counterparts. In these ways, the US can protect and advance its economic interests while ensuring trade with Mexico meets USMCA labor, environment and transparency standards.

1. Introduction

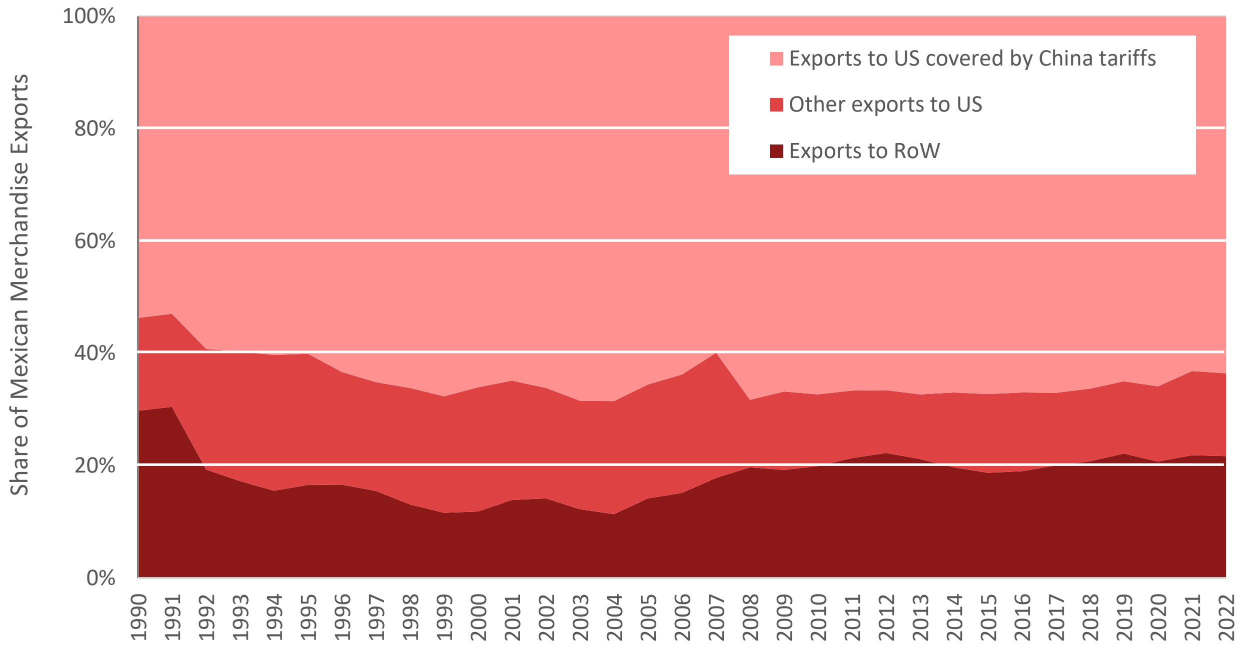
In 2018, the United States enacted a series of tariffs on Chinese products under Section 301 of the Trade Act of 1974, including tariffs between 7.5 percent and 25 percent on $370 billion in goods imported from China, or approximately two-thirds of the $563 billion imported from China in 2018 (UN Stats 2014). It is reasonable to expect these tariffs will result in changes in global value chains, with firms shifting production to third countries to avoid added expenses. In particular, Mexico may receive increased Chinese investment in the targeted sectors due to its proximity and history of free trade agreements with the US.

This testimony reviews these possibilities through three main sections. The first section explores trends in Mexico-US exports and anticipates potential future Chinese investment. The second section reviews the readiness of the United States-Mexico-Canada Agreement (USMCA) to address policy concerns that may arise from shifting value chains, especially labor, environmental and transparency performance by investors and enforcement by the Mexican state. Finally, the closing section presents evidence-based policy recommendations for the Commission's consideration.

2. Mexico-US Exports of Goods Targeted by China Tariffs

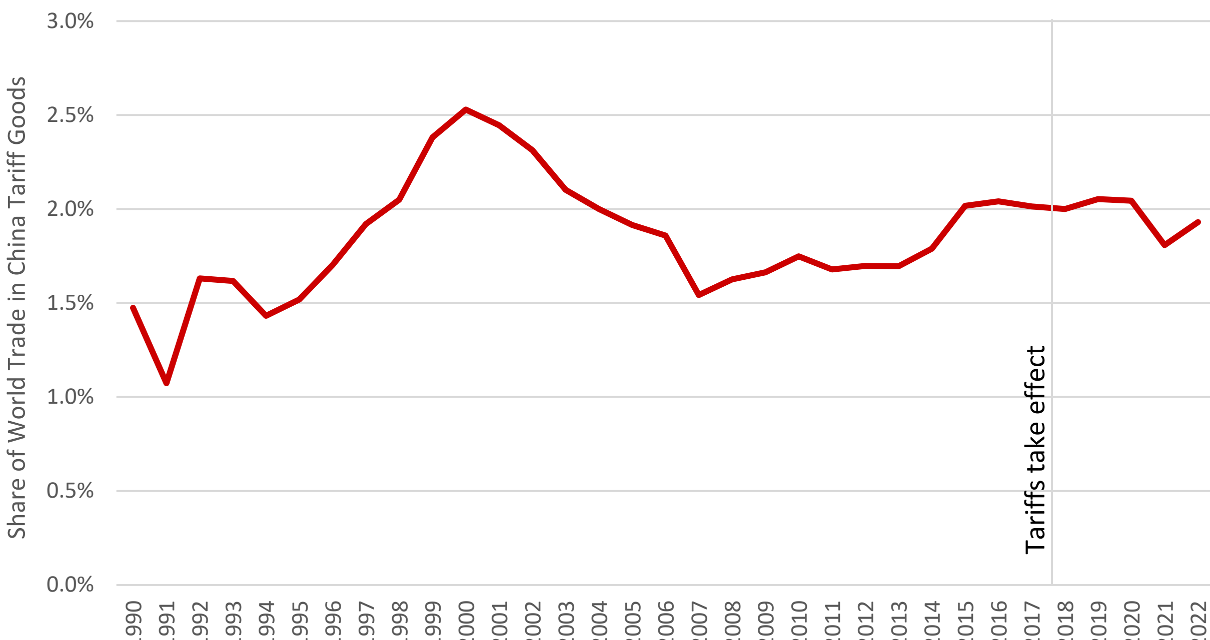
The goods targeted by US tariffs on Chinese goods are important sectors for Mexico-US exports. As Figure 1 shows, goods covered by these tariffs account for over 60 percent of overall Mexican merchandise exports as of 2022. However, their importance has not grown since the tariffs were enacted. Furthermore, as Figure 2 shows, Mexico-US exports account for less than 2 percent of global trade in these goods. Thus, any shifts in global supply chains through Mexico as a result of these tariffs has not yet taken effect. The next few years will be crucial for ensuring that the USMCA framework is capable of addressing economic, social and environmental concerns that may arise from future supply chain changes.

Figure 1: Item Categories Covered by China Tariffs as a Share of Mexico-US Exports



Note: RoW: Rest of world.
Source: Author compilation from UN Stats 2024 and USTR 2024.

Figure 2: Mexico-US Exports as a Share of World Trade in Goods Covered by China Tariffs

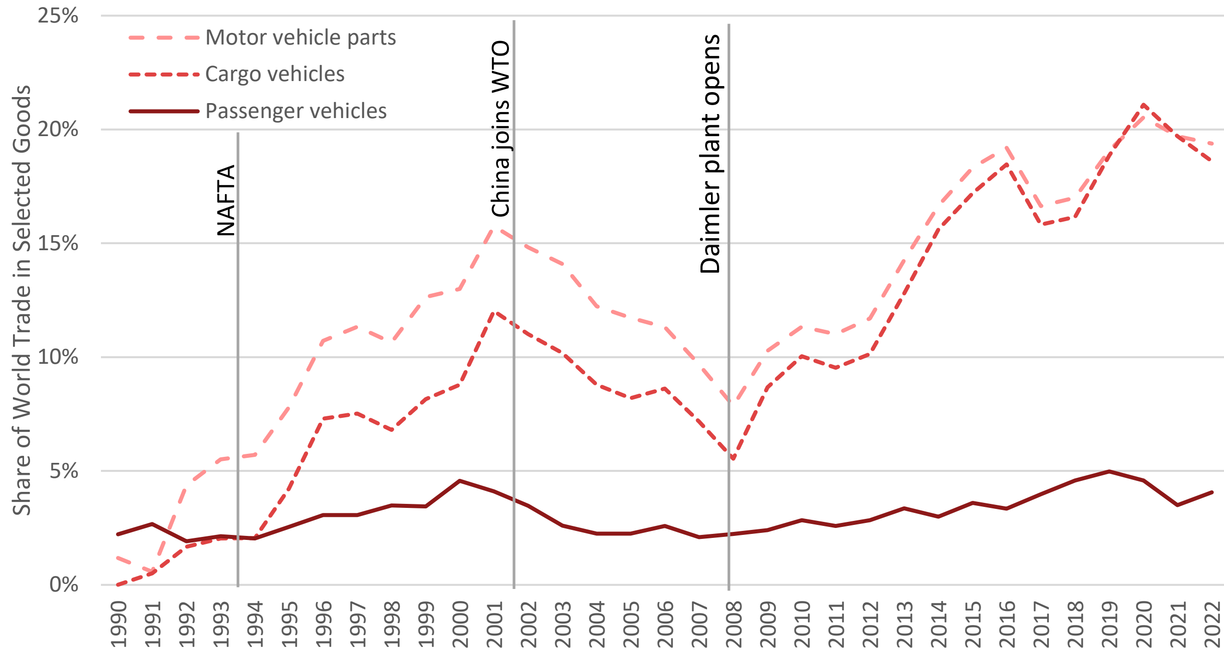


Source: Author compilation from UN Stats 2024 and USTR 2024.

A few of these merchandise categories have outsized importance in Mexico-US exports and thus merit additional discussion for their potential impacts in Mexico and the US. The most important of these sectors for Mexico-US exports are motor vehicles; motor vehicle parts; computers (also known as data processing machines); televisions and computer monitors; and telephones and modems. Together, these products accounted for approximately $152 billion in exports: 41 percent of all Mexico-US exports covered under the tariffs and 34 percent of all Mexico-US exports. The remainder of this section explores the trends in these Mexican manufacturing sectors over the last 30 years, including the potential impact of the Section 301 tariffs.

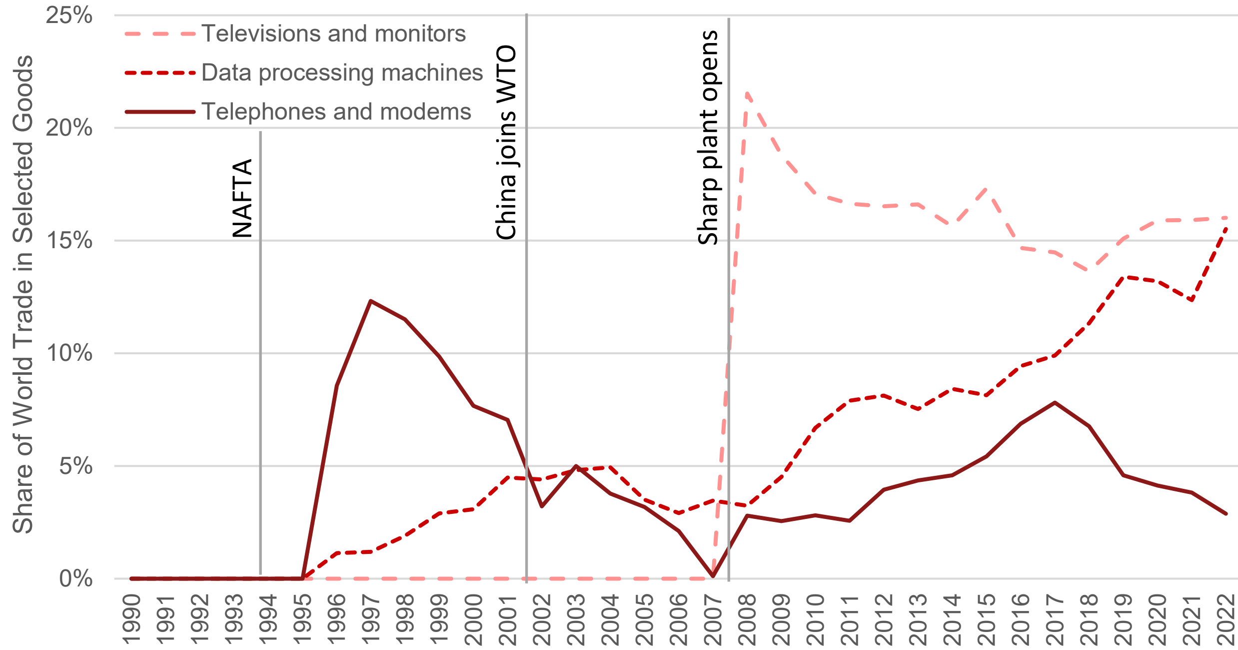
Figures 3 and 4 trace the growth of these exports as shares of world trade in each sector. Figure 3 shows the trends for motor vehicles and their parts, while Figure 4 does the same for selected electronics sectors.

Figure 3: Mexico-US Motor Vehicle Exports as a Share of World Trade



Note: HS tariff lines include targeted goods under the 8704 heading for cargo trucks, 8703 heading for passenger vehicles and 8708 and 8544.30 headings for motor vehicle parts.
Source: Author compilation from UN Stats 2024 and USTR 2024.

Figure 4: Mexico-US Electronics Exports as a Share of World Trade



Note: HS tariff lines include targeted goods under the 8471 heading for data processing machines, the 8528 heading for televisions and monitors and the 8517 heading for telephones and modems.
Source: Author compilation from UN Stats 2024 and USTR 2024.

Both figures show three significant moments in time: 1994, 2002 and 2008-2009. The first of these milestones, 1994, marks the entrance into force of the North American Free Trade Agreement (NAFTA). In 1993, Mexican exports to the US accounted for just 2.0 percent of world cargo vehicle trade and Mexico-US computer exports were non-existent. By 2001, Mexico-US exports accounted for 12 percent of world cargo truck trade and 7 percent of world trade in data processing machines. However, at the end of that year, China joined the World Trade Organization (WTO), and these trends began to reverse. A broad economic literature developed during the subsequent years charting the impact of easier trans-Pacific trade on the prospects for Mexican industrial development (see, for example, Dussel Peters and Gallagher 2013; Gallagher and Porzecanski 2010). These authors find that the availability of low-cost manufacturing in China broadly dampened the potential benefit of NAFTA for Mexican export-oriented manufacturing, as China stepped into its role as the “factory of the world.”

The next major milestone came during the global recession of 2009. While global trade suffered significant shocks due to the financial crisis, the share of that trade occupied by Mexico-US exports remained relatively strong. In fact, although other forms of private capital flows declined in 2008 and turned negative in 2009, foreign direct investment (FDI) in developing countries grew in 2008 and remained nearly constant in 2009 (UNCTAD 2009). In the case of Mexico, significant new investments in the motor vehicle and computer sectors brought Mexico-US exports back up above 10 percent of world trade, where they have remained. Significant manufacturing expansion came through a new Daimler heavy truck facility in Saltillo and a new Sharp LCD television factory near Tijuana (Daimler 2009; Sharp 2008). Since that time, Mexico-US exports have grown rapidly in relative terms, peaking at over 20 percent of world trade in both televisions and cargo trucks.

In comparison with these major shifts, the 2018-2019 US tariffs do not seem to have led to significant increases in Mexico-US exports of these products, either as a share of Mexican exports (as shown in Figure 1), or as a share of global trade in those goods (as shown in Figures 2-4). Thus, it can be inferred that supply chains have not yet shifted to account for the Section 301 tariffs on goods from China.

However, new investments take significant time to come to fruition, especially given the impact of the COVID-19 pandemic on investment and trade globally. Chinese firms' announcements of new investments in these sectors in Mexico have growth substantially since 2018, as Table 1 shows, and this may be reflected in coming years.

Table 1: Chinese Participation in Mexican FDI, Selected Sectors

	Motor Vehicles and Parts		Electronics and Parts	
	2013-2017	2018-2022	2013-2017	2018-2022
Chinese FDI in Mexico	1.9	2.2	0.3	0.8
Other FDI in Mexico	36.1	19.2	2.6	3.7
China's Share of FDI in Mexico	5.1%	10.5%	11.6%	17.9%

Source: Author analysis of *Financial Times* 2024.

Chinese firms' announced intentions to invest in new or expanded projects in Mexico's motor vehicles sector rose slightly from $1.9 billion in the 2013-2017 period to $2.2 billion in the 2018-2022 period, while other firms' FDI announcements fell by nearly one-third, from $36.1 billion to $19.2 billion. Thus, China's share of the total more than doubled, from 5.1 percent to 10.5 percent. In Mexico's electronics sector, Chinese FDI announcements more than doubled from $344 million in the 2013-2017 period to $805 million in the 2018-2022 period, while other FDI announcements rose from $2.6 billion to $3.7 billion, and China's share rose from 11.6 percent to 17.9 percent. If these announcements yield actual investment in the coming years, it is likely that the increase in Chinese investment in these sectors will bring greater exports to the US and raise important policy questions for the US and Mexico alike.

3. Readiness for Potential Policy Challenges

The introduction of tariffs on goods from China has the effect of shifting the trade and policy context partially back to its state after NAFTA came into force but before China joined the WTO. To be clear, Mexico's global market share of certain products has already rebounded beyond the level of the immediate post-NAFTA years. Of the sectors shown in Figures 3 and 4, Mexico has regained its share of global trade for all categories but telephones and modems. Thus, it has greater potential now to absorb additional FDI in these sectors than it did 30 years ago, potentially bringing benefits for the Mexican economy.

Nonetheless, important policy considerations remain, and it is an opportune time to ensure that the USMCA framework is capable of addressing any risks that may arise. Throughout the

USMCA negotiations, scholars raised three major concerns that merit revisiting in this new context, particularly focused on enforcement of labor, environmental anti-corruption mechanisms. Optimizing governance in each of these three areas is crucial for mitigating the risk of undercutting free trade by evading the spirit of the agreement. Fortunately, in all three areas, USMCA includes strengthened provisions relative to NAFTA. However, opportunities remain to mitigate risks intrinsic in any investment or trade boom.

On *labor*, scholars such as Corvaglia (2021) and Polaski (2019) note the importance of strengthened labor provisions, including a specific commitment to address violence or threats of violence faced by workers. However, Polaski (2019) also points out the practical difficulties in enforcing these provisions without significant political will from Mexican leadership, which is subject to change with elections. Scholars are in broader agreement on the *environmental* improvements in USMCA, including the incorporation of environmental provisions into the main text and thus subjecting environmental matters to the Agreement's dispute settlement process, but also the lack of interface with multilateral environmental agreements, which is where most environmental policy coordination occurs, potentially raising the risk of friction with countries' commitments on climate and biodiversity conservation (Laurens et al 2019, Vaughan 2018). Finally, while the new *anti-corruption* provisions are well received, scholars note that these provisions are rarely enforceable in multilateral agreements (Chijioke-Oforji 2019; Puig 2019). Puig (2019) notes that, in this case, enforcement likely relies on unliteral action through the US Foreign Corrupt Practices Act rather than USMCA-specific resolution, raising the risk of *ad hoc* application of these improvements. Across all three areas, a consensus has arisen that while USMCA represents a significant step forward relative to NAFTA, enforcement continues to merit special attention.

A growing body of research shows that Chinese investors in Latin America tend to perform no worse on environment, labor and transparency standards than their Western peers. Nonetheless, these scholars note that regional governments continue to face challenges in maintaining and enforcing these standards. Ray et al (2015) find that Chinese state-owned enterprises in particular tend to meet, though not necessarily exceed, local social and environmental standards. These findings are encouraging in that host countries have the policy space to set and enforce the standards that best meet their development goals. However, Ray et al (2020, 2022) subsequently find a pervasive incentive among regional governments to reduce or evade those standards in order to attract or expedite foreign investment, even without external pressure. Finally, Albright, Ray and Liu (2023) find that Chinese firms have traditionally been less likely than their Western counterparts to bring investor-state dispute settlement (ISDS) cases regarding costs associated with complying with social and environmental regulations, but that may change as China-Latin America investment trends shift away from relying on state-owned enterprises toward greater participation of private Chinese enterprises. In this context, it is crucial for the US to lead by example through high-quality investment and to collaborate proactively with Mexican policymakers on institutional capacity for enforcement.

4. Policy Recommendations

The US has ample mechanisms for reinforcing institutional capacity within the USMCA and encouraging Chinese investors in Mexico to meet high-level performance. The US can pursue proactive and effective engagement by *leading by example* through the PGI, encouraging Chinese investors' *multilateral engagement* with bodies such as the Inter-American Development Bank (IDB) and *strengthening Mexican enforcement capabilities* through the Department of Labor (DOL) and the Environmental Protection Agency (EPA).

In the last few years, the US has taken important steps to *lead by example* through the creation of the Partnership for Global Infrastructure and Investment (PGI) and through its promotion among Group of 7 (G7) countries (White House 2023). The PGI enables greater coordination between the US and G7 lenders and investors to bring high-quality investment to priority sectors in low- and middle-income countries to raise living standards and build an inclusive and sustainable future. One important way that the US can support Mexico's ability to enforce its USMCA labor, environmental and transparency commitments is by continuing to build on the successes of the PGI. As Mexico continues to attract investment in the sectors targeted by tariffs, the presence of high-quality, economically successful investment will reduce the incentives to allow weakening or evasion of social and environmental standards. Continuing to strengthen and expand the PGI will help ensure that these standards are safe.

Secondly, the US can *encourage Chinese investors' multilateral integration* into Latin American investment mechanisms to help ensure that Chinese investment in Mexico meets the performance standards embedded in the USMCA. In 2012, the Export-Import Bank of China and the IDB established a joint equity platform that would support three investment windows: the China-LAC Infrastructure Fund, the LAC-China Mid Cap Corporate Fund and the LAC-China Natural Resources Fund. Investments made through this platform were held to IDB standards, which are among the most stringent in the world of development finance institutions. These funds were initially expected to last for 10 years with the possibility of two additional years of extension (IDB 2012). Twelve years later, while the US and China have worked to maintain open lines of communication, multilateral platforms are more necessary than ever as fora for accountability. Extending these joint China-IDB investment platforms can encourage Chinese investors to work through these well-established frameworks for high-quality investment.

Finally, the US can *strengthen Mexican enforcement capacity* through direct collaboration with the US DOL and EPA staff with their Mexican counterparts. For example, the Bureau of International Labor Affairs at DOL has an ongoing cooperation project with Verité, Inc. to build Mexican corporate, civil society and policymaker capacity to prevent child and forced labor. The EPA's participation with the Latin American Network for Environmental Enforcement and Compliance can build local capacity and also strengthen collaborative ties with their peers in Latin America in order to support each other's work. Continuing to build and expand on these types of cooperative efforts can ensure that civil society and enforcement officials have the resources and information to ensure that the USMCA social and environmental standards are met amid increasing Chinese investment in key sectors.

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