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What Will Become of Globalisation?

Out of the Ashes

How Mexico Benefits from Global Trade Conflicts – and What This Means for Germany

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When North America is mentioned in Germany, many think of the US, and maybe of Canada. But the fact is that Mexico is also an integral part of the region, economically as well as geographically, and thus perhaps benefits more than any other country from the "trade war" between the US and China. German companies have taken notice, and German politics should quickly follow suit.

The past few years have witnessed grave disruptions in the global economy: trade conflicts, the pandemic, wars in Ukraine, the Middle East and elsewhere, and blockades of central trade routes such as the Suez Canal or the Panama Canal have called the idea of perpetually free global movement of goods into question and prompted structural changes.

In particular, the 2018 trade conflict between the United States and the People's Republic of China initiated in reaction to Chinese trade practices that former and potentially future US President Donald Trump perceived as unfair, resulted in a readjustment of global trade flows and investment strategies and great economic losses, at least in the short term. The repercussions of this are felt by a far larger group of nations than just the direct participants.[1] The German economy, for instance, suffered huge setbacks to its export-based approach even though trade relations with both sides of the trade conflict have remained fairly good. The global economy shrank noticeably, and direct foreign investment declined. Yet some countries, such as Mexico and Vietnam, are now experiencing a significant inflow of investment and foreign capital as part of strategic readjustments.

The outbreak of the COVID-19 pandemic just two years after the trade conflict began suddenly brought all of global trade to a virtual halt. No globalised country could avoid the effects of the pandemic, though countries in favourable financial positions were at least able to temporarily support their economies. Having said that, globally organised value-added and supply chains suffered long-term damage from lockdowns enforced at different times. The movement of goods, especially across the Pacific, suddenly proved to be a significant operating risk. Although global trade in goods recovered surprisingly quickly, some sectors will be irrecoverably affected by structural changes.

Mexico, a country of 128 million inhabitants on an area more than five times as large as Germany, emerged from these unfavourable circumstances like a phoenix rising from the ashes. At the start of the year, there was surprising news that what was once referred to as the "extended workbench" of its neighbour to the north had risen to become the most important trade partner of the US. While China's exports to the United States fell year-on-year by a whopping 20 per cent in 2023 to 427 billion US dollars, Mexico's rose by 4.6 per cent to 475 billion US dollars, making Mexico the largest exporter to the United States.[2]

This is the logical consequence of a development that has been underway for years. The escalating rivalry between the major powers has forced companies that operate internationally to anticipate such risks as a Chinese attack on Taiwan and minimise their effects on corporate business (de-risking). The experiences of the pandemic are instructive here, with one obvious approach being to diversify suppliers and supply chains. In order to avoid trade barriers such as punitive tariffs, companies are moving production facilities near to shore. This "nearshoring" dynamic ocurrs after almost four decades of unbridled globalisation that made China the world's factory and elevated it to the status of world power.[3]

Owing to its geographical location, Mexico is probably the biggest beneficiary of the trade war between the great powers and of the increasingly tense geopolitical situation.[4] As part of the near-shoring trend, billions of dollars in investment flow every quarter into a complex country with immense security and development challenges.[5]

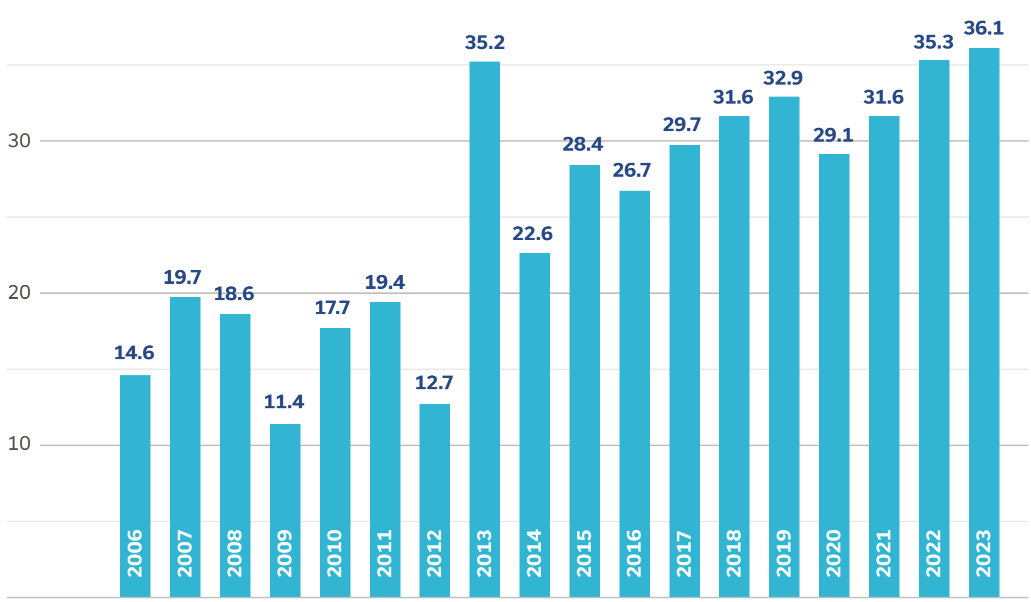
Its 3,000-kilometer-long border with the US is the most dangerous yet the most economically productive border region in the world. Each year, tens of thousands of people are killed or disappear without a trace in the unbridled drug war. At the same time, Mexico is a member of the world's most powerful free trade area.[6] It is also a G20 and OECD nation and is one of the top players in the automotive industry. It remains a country of contradictions, characterised by insecurity and a striking prosperity gap that has no counterpart in any comparably industrialised country.

Mexico as Part of North America

The histories of the United Mexican States and the United States of America are tightly interwoven with an abundance of conflict as well as economic and cultural interdependencies. In the aftermath of the Mexican-American War (1846 to 1848), Mexico, which had been independent from Spain since 1821, was forced to cede more than half of its territory to the north, and the southern US border was extended to the Rio Grande, where it still remains. Over the next century, the at times interventionist policies of the US in the Western Hemisphere would lead to a division of the New World into two parts: the Anglo-Saxons in the north and everything to the south as their Latin-American "backyard".[7]

Cooperation on equal footing was scarcely desired; instead, Spanish-speaking countries were considered notoriously unstable and incapable of making their own sovereign decisions.[8] It was merely the wealth of natural resources that aroused intense interest from US companies. The Sword of Damocles in the form of possible expropriation of American and British oil companies in the course of Mexican natural resource nationalisation was a source of frequent disquiet in the White House. Not until the triumph of the Cuban Revolution did John F. Kennedy, under great pressure, seek a "new approach" to cooperation with the America south of the US border.

Fig. 1: Foreign Direct Investment in Mexico (in Billions of US Dollars)



Source: own illustration based on Gobierno de México, Secretaría de Economía 2024, n. 21.

Tightly interwoven: Specialised clothing for NASA is manufactured in the Mexican state of Yucatán. In terms of exports to the US, Mexico has now even overtaken China. Photo: © El Universal, Zuma Press, picture alliance.

Mexico's rather protectionist approach was abandoned at the end of the 1980s.

Despite all the political disagreements, economic and migratory interdependencies between the two neighbours go back generations. Mexico was integrated economically into the North American market in the second half of the 20th century in several stages. In 1965, the Mexican government created an industrial development programme that established *maquiladoras* along the US-Mexican border for assembling sub-products. Duty-free trade with these goods, and the programme itself, put hundreds of thousands of people in structurally weak border regions to work and promoted solid economic growth over the next few decades, especially in the north of Mexico. Nevertheless, Mexican presidents regularly struggled with high inflation, unemployment and national debt. The rather protectionist approach that had been in place was abandoned at the end of the 1980s, trade barriers were dismantled, and Mexico joined the GATT, the predecessor of the World Trade Organisation. Regulations were continually removed in an effort to achieve a free trade agreement with the US and Canada that finally came into force in 1994.[9]

The conclusion of the groundbreaking North American Free Trade Agreement (NAFTA) initiated a process that eliminated duties among the three economies over the next 15 years and created one of the largest trading blocs in the world. The deal met with resistance on both sides of the border: trade unions in the north and farmers in the south fiercely opposed it. The treaty was especially helpful for Mexico when adjusting to the new circumstances of a globalised world over the long term. The country's economy had been fundamentally transformed and it opened up in the following years. Most economists believe that, despite job losses in the US and increased illegal migration from Mexico, NAFTA greatly increased trade volume in North America and thus economic growth and employment rates.

Mexico, of all places, is supposed to protect its big brother to the north from the pitfalls of globalisation.

An updated version of the trade agreement, the United States-Mexico-Canada Agreement (USMCA) or Tratado entre México, Estados Unidos y Canadá (T-MEC), came into force in 2020, stipulating, among other things, that cars had to be manufactured at least 75 per cent in North America to be duty-free. This clause is extremely relevant to the nearshoring trend. Global car manufacturers who want to sell their products cheaply on the North American market are forced to increase the proportion of production in North America. This is a key reason for the high foreign investment in Mexico and affects all major German carmakers (VW, Daimler, BMW, Audi, etc.) and their suppliers. At the same time, Chinese companies manufacturing everything from construction machinery to solar modules, and increasingly including carmakers, are moving production facilities to Mexico to circumvent potential punitive US tariffs.[10]

The new version of the free trade agreement must invariably be seen in the context of rivalry with and de-coupling from China. Moreover, the slowdown of global trade due to COVID-19 lockdowns highlighted how just-in-time manufacturing and global supply chains spanning the Pacific Ocean have glaring weaknesses. For instance, Walmart, the supermarket giant, ordered one million work uniforms from Mexico instead of China in 2022. That would have been unthinkable a short time ago.[11]

Given the region's history, there is a certain irony about Mexico, of all places, now protecting its big brother to the north from the pitfalls of globalisation. Racism in the US and arrogance towards Mexicans, who are depicted as backward, are as old as they are well-known. Trump's words, which referred to Mexican immigrants as rapists and drug addicts, went around the world. But he was by no means the first US politician to depict Mexico as a danger to US jobs, security and prosperity. Over the years, many politicians have used Mexico as a scapegoat and threatened to invade Mexico or deport all Mexicans (or Hispanics).[12] This was generally only theatrics, but had real consequences for Mexican immigrants.

Today, it is clear that trade with Mexico is more likely to create and protect US jobs than destroy them. The North American free trade area has merged supply and value-added chains so that they are almost inseparable. Each of the countries in the zone – Canada, Mexico and the US – contributes parts and raw materials that are essential for manufacturing products in each of the others. Cars are the most prominent example: vehicles manufactured in Mexico could not be built without parts and pre-production from the US. About 40 per cent of Mexican exports to the US consist of parts and components originally made in the US. This is true for about 25 per cent of Canadian, but only four per cent of Chinese exports to the US.[13] The Mexican and US economies are virtually interdependent; neither could be nearly as successful without the other. In Germany, there is still a lack of awareness of the implications of this interdependence.

Whoever ends up in the White House is not particularly relevant for trade policy. The US will pursue a protectionist policy if that proves advantageous or if external developments, such as the threatening rise of China, make it appear necessary. Mexico is being propelled by its powerful neighbour and enjoys an exceptionally favourable position thanks to its geography and membership in the free trade area.

Mexico Is the Beneficiary of Geopolitical Developments

Global trends and geopolitical conflicts, some of them independent of one another, are thus moving Mexico increasingly into the focus of the global economy. On top of that, wages and manufacturing costs in China have risen, eroding its key competitive advantage. Despite costs for goods transport across the Pacific having fallen again since the end of the pandemic, it is proving difficult to accelerate delivery times. A shipping container takes about one month to travel from China to the US – and the distance from northern Mexico is a fraction of that, while the price advantage of production in China has dwindled.

> **The government cannot assert its monopoly on the use of force in parts of the country.**

What is more, US President Joe Biden has continued his predecessor's policy of punitive tariffs to strategically contain China. At the same time, he is introducing new protectionist policies such as measures to exclude Chinese technology companies from competition in the US. Such steps are also being debated in Germany and at the European level – with respect to Huawei, a Chinese company, and the expansion of 5G networks, for instance. This is all part of the geopolitical metaconflict from which Mexico is benefitting today.

However, if companies that operate globally are to meet demand professionally, they need reliable supply chains and extensive planning security. Industry is not confident that strategic competition between the US and China, with all its secondary arenas, will disappear. If things get serious, excessive dependence on China would prove disadvantageous, so new solutions, suppliers and production locations are being sought. Mexico has the potential to fulfil many of these new requirements. In the industrialised northern territory close to the border, but also in central Mexico, there are states and industrial clusters that enjoy investment by multinational giants such as Tesla and Microsoft and can guarantee the necessary infrastructure.[14]

Even before the advantageous provisions of the USMCA treaty – as early as NAFTA's entry into force – Mexico had developed into a global car manufacturing country. The electromobility transformation is now underway, and Mexico could benefit once again. The state of Sonora, bordering the US state of Arizona, is home to Mexico's largest lithium deposits. They are to be exploited to produce batteries for electric cars and construct solar parks. BMW and Audi plan to integrate production sites in Mexico into their global electromobility networks, and German suppliers are also investing heavily.[15] Beyond that, Mexico's northern states have lots of space and sunlight, which is especially appealing for those companies whose climate and energy requirements have been established by European parent companies.

The issue of renewable energies is just one of the political areas in which foreign presence and corporate investment could have a positive impact on Mexican politics. But this has not been noticeable so far, since outgoing President López Obrador, whose term began in 2018, at least impeded the energy transition, and possibly stopped it altogether. At any rate, the relevance of a green transition was regularly emphasised during the recent presidential campaign by both of the main candidates. Adapting the structures of the energy sector to modern requirements and opportunities would provide further advantages for Mexico as a business location.

But deficits in clean energy are by no means Mexico's only structural deficit. Mexico is also characterised by ruthless, extremely violent drug cartels competing against one another, corrupt political structures, a high degree of impunity and state impotence in the face of complex security challenges. The government cannot de facto assert its monopoly on the use of force in parts of the country. Besides internal security problems, weak rule of law and social inequalities (some 40 per cent of Mexicans are below the poverty line), there are other structural deficits. The 2024 election campaign was also marked by a great deal of violence: candidates were threatened, kidnapped, murdered, or manoeuvred into specific political offices. Hundreds of candidacies were withdrawn in light of these threats.[16] Yet investors and (foreign) companies are not really deterred by these factors because they tend to be located in safer states where industrial infrastructure is already in place. They also engage private security companies for their production plants.

> **Mexico now has its choice of partners and investments.**

President-elect Claudia Sheinbaum, elected by the Mexican people on 2 June 2024, will need to chart a different course to that of her predecessor if she intends to get to grips with Mexico's various challenges. The country's potential has by no means been exhausted. It could pursue a more active industrial policy, courting investment in a targeted, strategic manner to create jobs and generate tax revenue.

It is clear that a new stage in globalisation has begun in recent years.[17] This is not necessarily a process of de-globalisation, which would involve less international trade and less foreign investment. Instead, we are seeing a kind of regionalisation. The North American free trade area; Mexico's geographical and political proximity to the United States, including shared time zones; relatively favourable climatic conditions; and the necessary infrastructure all appear to make Mexico the winner of this new stage. It remains to be seen whether Mexico will be able to exploit its opportunities, absorb the influx of capital in an expedient manner and generate sustainable economic growth combined with a more equitable distribution of wealth.[18] This could also be a key to improving Mexico's security situation.

Is Mexico Germany's Partner, or Is Germany Mexico's?

From a German perspective, the question is how to harness the opportunities that are now presenting themselves and how attractive a partner it is to Mexico. Simply picking up the phone is no longer enough – Mexico now has its choice of partners and investments.

The sociocultural and economic relations between the two countries are highly favourable. German companies enjoy an excellent reputation in Mexico. This is especially true of car manufacturers, but many other medium-sized companies are popular employers there. Mexico is home to all the big names in German industry. In all, more than 2,100 German companies provide hundreds of thousands of jobs in Mexico and greatly contribute to its socio-economic development. Besides car manufacturing, key industries include chemicals, mechanical engineering, logistics and pharmaceuticals.

For Germany, Mexico is the most important trade partner in Latin America, and for Mexico, Germany is the most important trade partner in the EU. In 2023, the volume of trade was more than 29 billion euros. The previous year, it was 25.5 billion, and in 2021, 21 billion – so there is a clear upward trend.[19] For the German economy, Mexico is an attractive export market (ranking 20th out of 239 in 2023[20]) and the most important investment location in Latin America. In 2023, seven per cent of foreign investment in Mexico, or almost 2.4 billion US dollars, came from Germany, which was the fifth-largest investor after the US (38 per cent), Spain, Canada and Japan.[21]

Culturally, relations on both sides are characterised by multi-faceted family ties due to emigration in both directions going back more than 150 years, when German-speaking families settled in Yucatán. At the beginning of the 20th century, Germans settled on coffee plantations in Chiapas. Beyond that, there is great interest in the German language, as evidenced by the 5,000 students attending five German "encounter"

A rare sight: German President Frank-Walter Steinmeier (left) during a state visit to Mexico. Usually, it is Mexican politicians who make the trip to Germany. The last visit to the North American state by a German Minister of Economic Affairs took place shortly after the turn of the millennium. Photo: © Carlos Tischler, abaca, picture alliance.

schools. According to the German Federal Foreign Office, some 3,600 Mexicans are currently studying in Germany.[22]

At a political level, relations are somewhat cooler. There are various reasons for this, but it is not an acute new development. Because of its size in terms of area, population, economy, culture, resources and biodiversity, Mexico is a regional player of outstanding importance. In Germany, on the other hand, there is often the impression that Mexico's hybrid status (not South America, not the US) prevents the country from attracting the attention it deserves. For decades, politicians have done very little to change this.

An example: the last visit by a German Federal Minister for Economic Affairs to Mexico was in 2002. Over the past 25 years, Mexican presidents, with the exception of the one currently in office, have visited Germany at least once, many of them twice, during their six-year term of office; German chancellors have visited Mexico much less frequently, however.[23]

What is more, there is the geostrategic level as outlined above. If growing systemic competition requires a search for trade partners who share the same values, as is so often emphasised, Mexico is an ideal candidate for closer cooperation – but political efforts in this regard still fall short of the mark. The discrepancy between words and actions in German policy is striking.

The German government would be well-advised to view Mexico as a strategic transatlantic partner.

The missed opportunities of the West in Latin America have become clear to see over the past 15 years. One country after another has succumbed to Chinese overtures in the form of low-interest investment in infrastructure projects without onerous environmental or human rights standards. Many countries in the region have welcomed Beijing and fallen into debt traps resulting in long-term financial dependency. Some governments are also closely cooperating on security, buying armaments and surveillance technology, or allowing China to manage their natural resources and critical infrastructure.[24] Authoritarian states such as Cuba, Nicaragua and Venezuela are especially reliant on support from Beijing (and Moscow). But partners of the West, especially Brazil, Chile and Argentina, are also massively dependent on China as a market for their goods and raw materials or as a creditor.

Mexico will not let it come to this due to the proximity and omnipresence of the United States. German and European policy therefore have excellent opportunities to deepen relations with Mexico fruitfully at various levels:

- Now that elections in Europe and Mexico have taken place, the German federal government could lobby in Brussels for a renewal or renegotiation of the **EU-Mexico Global Agreement.**[25] A renewed treaty was renegotiated in 2018 but shelved without ratification. The recent parallel elections on both sides offer political momentum, but Europe would need to scale back its overly comprehensive values agenda on trade issues to a more realistic level.

- Germany should expand economic cooperation with Mexico and design a **more active economic foreign policy** worthy of its name. German companies are very active in Mexico and have good contacts and access to business and politics. Billions in investment by the private sector must be supported and accompanied by **political presence and improved framework conditions** (legal certainty, internal security, infrastructure). This must not be limited to the automotive industry. Investment from Mexico should be equally facilitated, as should market access for companies in Germany.

- The German federal government would be well-advised to broaden its perspectives and to view Mexico as a **strategic transatlantic partner**. New forms of political cooperation should be initiated and existing formats expanded. The following areas are examples of where this could take place:

  - Renewable energies, but also LNG (liquefied natural gas);
  - Environmental and climate protection;
  - Education and research (dual vocational training, the German Academic Exchange Service, etc.);
  - Foreign and security policy.

- Primarily, the German federal government should deepen cooperation at government level, especially in **meetings of the heads of government** and important departments; a visit by the Chancellor to Mexico in connection with the conclusion of an industrial and cultural treaty would (unlike recent trips) be in line with the government's adopted strategies. In the medium term, consideration should be given to **institutionalised intergovernmental consultations** with Mexico.

- In the area of foreign and security policy, a **security dialogue** with Mexico about questions of international conflict resolution, participation in UN peace missions and the future of multilateralism could deepen relations between the two countries and give

Mexico a more active role in the international arena again.

- There are also points of cultural linkage such as book fairs in Guadalajara, Leipzig and Frankfurt; the 2026 FIFA World Cup, of which Mexico is a co-host; and increased funding for university exchange programmes.

Conclusion

No analysis of Mexico can fail to include the quote attributed to President Porfirio Díaz Mori (1830 to 1915): "Poor Mexico, so far from God and so close to the United States." Will its geography finally prove to be a blessing?

An extraordinary combination of global developments and geopolitical conflicts has enhanced Mexico's trade policy hand. It now holds many trump cards, and it could further improve its position with solid investments in infrastructure and policy. Mexico has long ceased to be a developing country. Instead, it is now an industrialised aspiring regional power in the heart of the Americas that is highly attractive to many industries in times of nearshoring.

The political players in Germany and the EU have failed to fully recognise the signs of the times, even though these signs have been repeatedly emphasised. The classical categorisation of Mexico as part of Latin America does not fully reflect reality and inevitably leads to misjudgement. Geography must be taken note of. There are 7,500 kilometres between Mexico City and São Paulo. That is twice the distance between Helsinki and Lisbon. Visits to the Brazilian rainforest or to Buenos Aires may reach the big players in South America, but inexcusably exclude Mexico. This will neither make Mexican politicians nor the people feel as though they are taken seriously by Europe and its leaders.

Officials in Berlin and Brussels must learn to understand that the USMCA free trade agreement has made Mexico geographically, economically, socially and politically de facto a part of the economic giant that is North America. For comparison: in 2023, the European Economic Area (EEA)[26] generated only 18.14 per cent of global GDP, while the US, Mexico and Canada generated 29.59 per cent.[27]

If the West, the EU and the German federal government are really hoping to win allies that share their values as strategic partners in the context of global systemic competition, they must take significant action and make political and economic investments. Mexico is ready, but will not wait for Europe forever.

– translated from German –

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3 One way of defining nearshoring is as follows: the shifting of operational activities to foreign countries that are closer to home (as opposed to "farshoring"). This is to be distinguished from friendshoring, which implies that the countries to which production facilities move have political leanings similar to those of the home country.

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18 The Konrad-Adenauer-Stiftung Mexico has published several studies about this issue in the last few years, among them De la Mora Sánchez, Luz María 2023: Nearshoring en México: oportunidades y desafíos, KAS Paper, Dec 2023, in: https://ogy.de/hyq0 [17 Jun 2024]; Téllez, Luis / Garza, Patricio 2023: "Die Integration Mexikos in globale Wertschöpfungsketten: Chancen und Herausforderungen", 8 Mar 2023, in: https://ogy.de/eg7f [17 Jun 2024].

19 GTAI 2024: Wirtschaftsdaten kompakt – Mexiko, 29 May 2024, p. 4, in: https://ogy.de/zr66 [17 Jun 2024]; Federal Foreign Office 2024: Germany and Mexico: Bilateral relations, 27 Feb 2024, in: https://ogy.de/0tm8 [17 Jun 2024].

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21 Gobierno de México, Secretaría de Economía 2024: Inversión Extranjera Directa Cierre de 2023, 15 Feb 2024, in: https://ogy.de/ut5w [17 Jun 2024].

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23 Gerhard Schröder (1998 to 2005) visited Mexico twice, Angela Merkel (2005 to 2021) three times (including a G20 summit); Olaf Scholz has yet to visit Mexico. Mexican presidents made ten visits to Germany between 1994 (Carlos Salinas) and 2018 (Peña Nieto). In contrast, Schröder, Merkel and Scholz visited Brazil seven times and Argentina four times in the same period.

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25 Since 2000, there has been a Global Agreement between Mexico and the EU that goes beyond a classic free trade agreement. In April of 2018, the two sides agreed on an update and deepening of the agreement to account for current challenges and opportunities. That treaty has yet to be ratified. Each party implicitly blames the other, but is content with the present situation. While Mexico under President Andrés Manuel López Obrador refused to accept the environmental and human rights demands from Brussels, various European heads of government (in France, Ireland and Spain, for example) came under pressure not to implement the treaty in order to protect domestic interests.

26 EEA: European Economic Area, consisting of the EU member states plus Iceland, Liechtenstein and Norway.

27 Muschter, René 2024: Welthandel: Vergleich ausgewählter Freihandelszonen weltweit nach Anteil am weltweiten Güterhandel, Bruttoinlandsprodukt und der Weltbevölkerung im Jahr 2023, Statista, 2 May 2024, in: https://ogy.de/i7y2 [17 Jun 2024].