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# Mexico manufacturing surge hides low-wage drag on economy

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MEXICO CITY (Reuters) - Abundant cheap labor has helped Mexico lure billions of dollars in foreign investment in recent years and spur a manufacturing sector so dynamic it has been likened to China.



Construction workers take a break in Mexico City in this January 25, 2011 file photo.

REUTERS/Jorge Dan

But the same low wages that help make manufacturers competitive are a long-term drag on the economy. Millions of people working off the books for paltry sums holds back private consumption, crucial for sustained growth.

The government has slashed its growth forecast for 2014 after the economy expanded by just 0.3 percent in the first quarter, well short of expectations.

It is a setback for President Enrique Pena Nieto, who has pledged to reinvigorate the economy and lift productivity by pushing through a series of structural reforms that have encouraged investors and helped fuel talk of a “Mexican moment”.

While Mexico has recaptured manufacturing business it had lost to China, especially in the U.S. market, its economy is hamstrung by chronically low pay, weak public spending and poor productivity.

Between 1992 and 2012, exports grew at 8.6 percent a year while the economy as a whole only expanded at an annual average of 2.8 percent.

Salaries are a large part of the problem. Between 2005 and 2012, real labor income per capita in Mexico fell 6 percent, the government’s social development agency Coneval says.

Lower incomes mean less private consumption, which accounts for over two thirds of gross domestic product (GDP).

Spending by wealthier Mexicans helps compensate, but falling real wages for many of those living below the poverty line - almost half the population - is dragging down retail sales, which grew just 0.1 percent in 2013.

Raul Feliz, an economist at the CIDE think tank in Mexico City, says the country fails to create enough higher quality jobs and has relied too heavily on a glut of cheap labor.

“If Mexico didn’t have population growth, economic growth would be zero,” Feliz said.

## WAGE DRAG

Mexico's proximity to the United States and a multitude of free trade deals make it an attractive investment target, in spite of security concerns about violent drug gangs.



Slideshow (3 Images)

PepsiCo [PEP.N](#), Nestle [NESN.VX](#) and Cisco ([CSCO.O](#)) this year unveiled investments of more than \$7 billion combined in Mexico. Foreign direct investment, much of which flows into manufacturing exports, hit a record \$35 billion in 2013.

Low wages are a huge incentive for both Mexican and foreign firms. One in seven Mexican workers earn the average minimum

wage of 65.58 pesos (\$5.10) a day or less, national statistics office INEGI says. The average hourly wage in Mexico - home to Carlos Slim, one of the world's richest men - is 31.3 pesos (\$2.43).

Manufacturing workers fare better with wages averaging about \$2.70 an hour but they make up only 16 percent of the labor force and their pay is way below the \$19.50 per hour in the United States, figures from INEGI and the U.S. Bureau of Labor Statistics show.

China can no longer match that. In a study last year, Bank of America Merrill Lynch found Mexico's manufacturing labor costs to be nearly a fifth cheaper than in the Asian giant.

"The previous 20 years, China ate Mexico's breakfast, lunch and dinner," former Goldman Sachs economist and emerging market expert Jim O'Neill said in an interview. "Today from a global manufacturing perspective, one could say, particularly in autos, who needs China when you've got Mexico."

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## GROWING AUTO INDUSTRY

Mexico is the world's No. 8 carmaker and companies like Ford ([F.N](#)), Audi [NSUG.AG](#)



and Nissan ([7201.T](#)) have pledged billions of dollars in investment here over the next few years. Of the top 10 carmakers, Mexico will post the fourth highest growth in capacity between 2013 and 2020, data from PWC Autofacts show.

While China's state-controlled economy has gradually allowed wages to rise, and so boosted domestic consumption, Mexico is

hard pressed to find enough jobs for a population of 119 million growing by about 1.5 million a year. And wages are stuck.

“(Politicians) have always said the same thing, that they’re helping, but we always keep seeing the minimum,” said Humberto Aburto, 44, who sells mangos on the streets of Mexico City and typically earns between \$8 and \$9 a day.

About 58 percent of the active Mexican labor force is employed off the books, meaning tax revenues are chronically weak and many workers have little power to demand higher pay.

Adjusted for inflation, wages in traditional Mexican firms with 10 or fewer employees, many of which are informal, shrank by 2.4 percent per year between 1999 and 2009 according to a study published this year by the McKinsey Global Institute.

Concern over the gap between rich and poor is prompting some governments such as Germany and the United States to look to significantly raise minimum pay levels. Mexico has been reluctant to take action in the past, but pressure is growing.

Mexico City's center-left mayor Miguel Angel Mancera has called for a national debate on how to improve wages. “Could it be that the Mexican economy doesn't grow because the level of income for workers is so low?” he said.

Editing by Dave Graham and Kieran Murray

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