



# The search for Mexico's economic progress

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# Is Mexico a fad or an economy poised to grow faster?

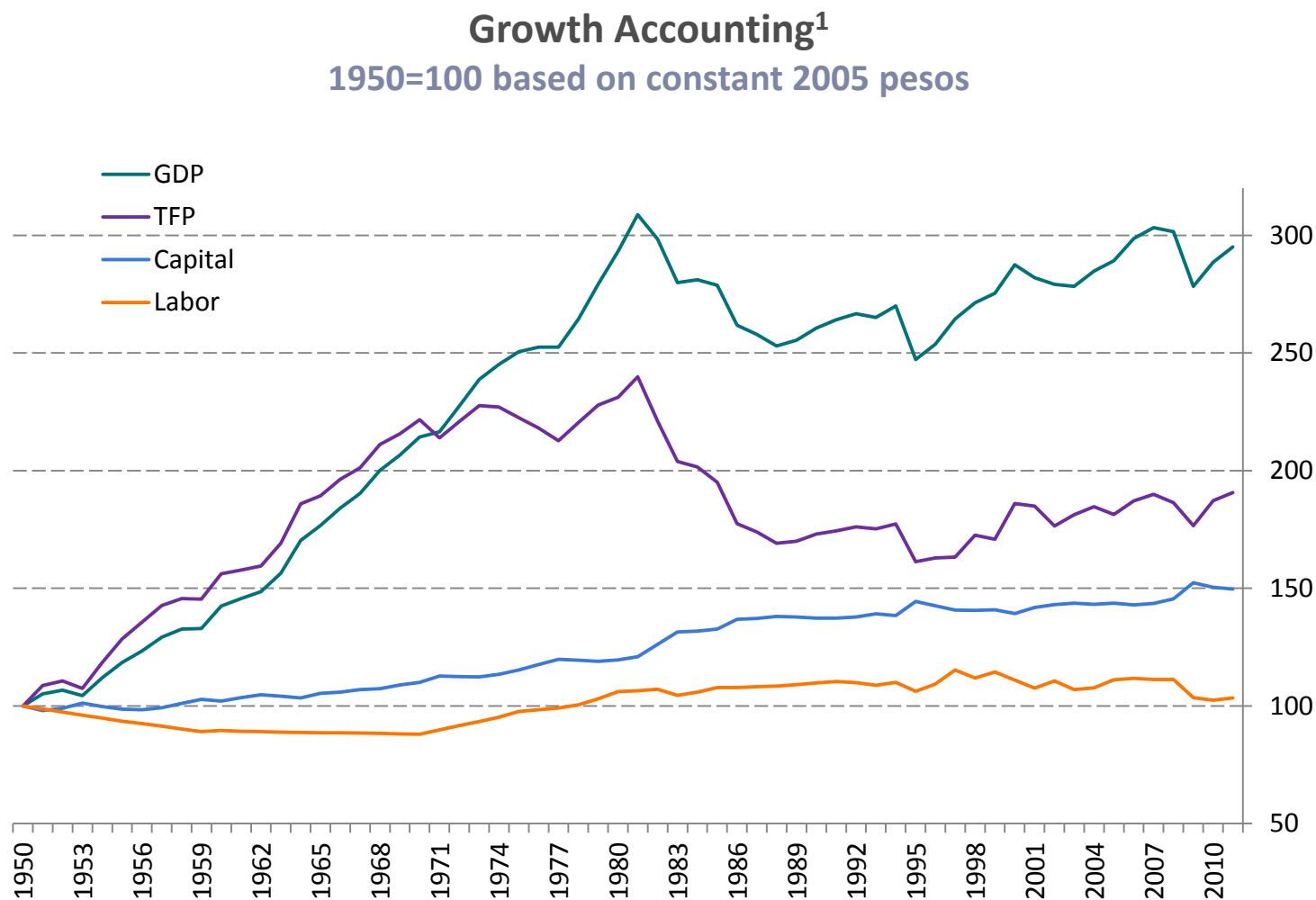
- Mexico has come back as a darling economy for investors
  - ✓ The economy is regarded as having sound macroeconomic and financial fundamentals
  - ✓ Recent growth is higher than the historical average
  - ✓ Expectations for structural reforms are higher
- As in other emerging markets, capital inflows to equity and fixed-income assets have been booming
  - ✓ Holdings of peso government securities have increased continuously since 2010
  - ✓ Inflows are related to global liquidity and may pose challenges to financial stability
- Yet, long-term economic performance has been lackluster
- Is Mexico about to take off? If so, what would the levers of higher growth be?

# Mexico's long-term economic performance has been disappointing, particularly in recent decades

- From 1950 to 2010, average annual growth in per-capita GDP was 2 percent<sup>1</sup>
  - ✓ Similar to that of the U.S.
  - ✓ Inferior to that of leading emerging economies, e.g., South Korea and Singapore
- This average growth rate includes a slowdown to 0.5 percent in the last thirty years
  - ✓ It would take about 134 years to double income at this rate
- The recent record does not improve if the unstable decades of the 1980s and 1990s are excluded
  - ✓ 0.4 percent

1/ Own calculations based on PPP-adjusted GDP per capita, Penn World Tables 7.1

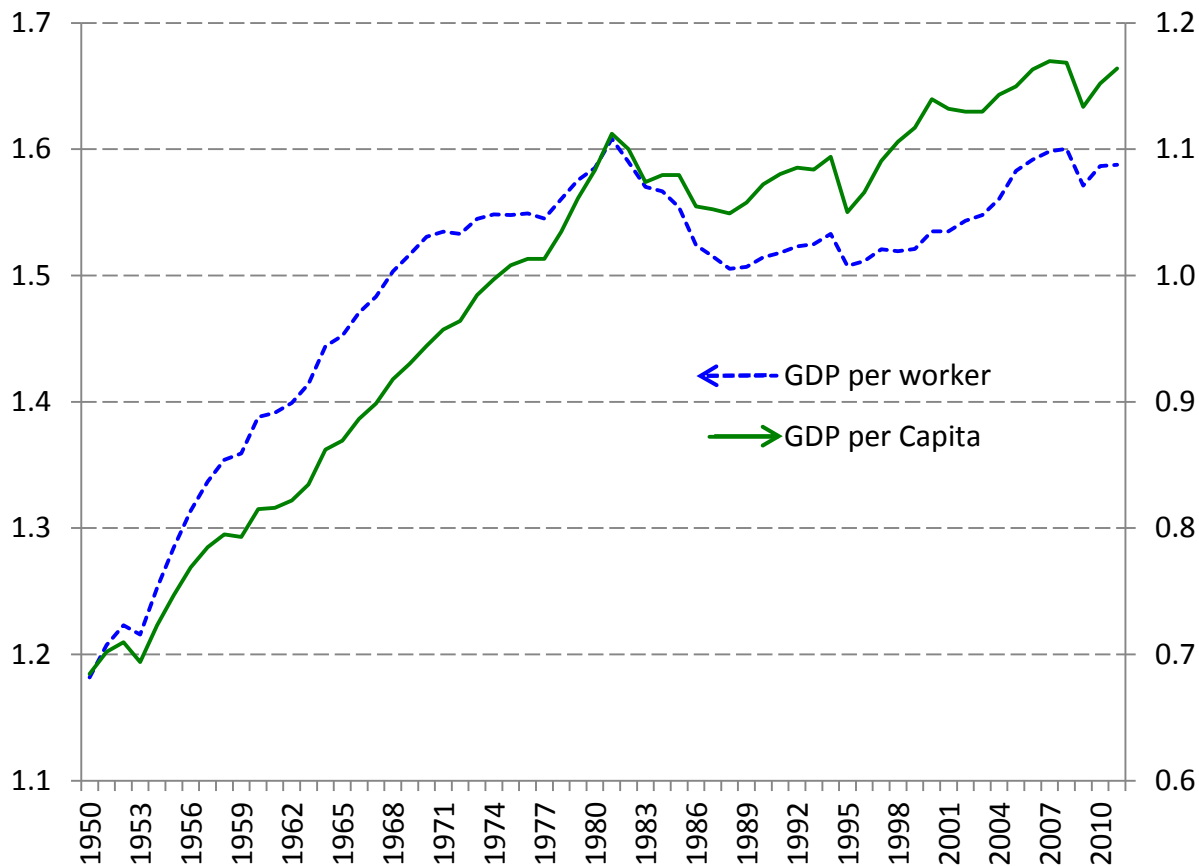
# The main factor underlying insufficient growth has been productivity, either as measured by TFP ...



1/ Based on data from the decomposition of GDP per working-age population in Kehoe, T. J. y F. Meza, (2011), "Catch-up Growth Followed by Stagnation: Mexico, 1950-2010," *Latin American Journal of Economics* 48(2): 227-268

# ... or labor productivity, the fall of which has been partially offset by the increase in workers relative to population

**GDP per capita and labor productivity<sup>1</sup>**  
Log of Thousands of Mexican pesos, 1993 prices



1/ Own calculations with data from INEGI and Groningen Growth and Development Centre 10-sector database, June 2007, <http://www.ggdc.net/>, based on García-Verdú, R. (2007), "Demographics, Human Capital and Economic Growth in Mexico: 1950-2005", Poverty Reduction and Economic Management unit Latin American and the Caribbean region, The World Bank, June

# Hence, the explanation for sluggish growth should be found mainly in sources of low efficiency

- Doubts arise on the potential long-term effects of reforms that seek primarily to enhance funding resources for spending
- Many studies pinpoint, as possible explanations of low productivity growth: poor institutions, deficient infrastructure, burdensome regulation, and lack of competition in key areas, among other factors<sup>1</sup>
- To explore the relative importance of these and other factors in Mexico, it is worthwhile to examine the behavior of sectoral labor productivity in the low-growth period

1/ See, for example Arias, J., *et.al.* (2010), "Policies to promote growth and economic efficiency in Mexico," *NBER Working Paper Series*, N° 16554, November; and Lewis, W. (2004), *The Power of Productivity: Wealth, Poverty, and the Threat to Global Stability*, University of Chicago Press

# Labor productivity has decreased in the services and non-manufacturing sectors

**Labor productivity by sector<sup>1</sup>**  
Thousands of Mexican pesos, 1993 prices

|            | Agriculture | Manufacturing | Non-manufacturing <sup>2</sup> | Services |
|------------|-------------|---------------|--------------------------------|----------|
| 1980       | 10.2        | 40.0          | 42.8                           | 55.8     |
| 2011       | 14.8        | 50.3          | 31.8                           | 42.5     |
| Difference | 4.6         | 10.3          | -11.1                          | -13.4    |

1/ Own calculations with data from INEGI and Groningen Growth and Development Centre 10-sector database, June 2007, <http://www.ggdc.net/>. Value-added in constant prices relative to the number of persons employed by industry

2/ Mining and Quarrying, Public Utilities and Construction

# Almost all labor migration was from agriculture to services

**Sectoral labor<sup>1</sup>**  
% of total labor

|            | Agriculture | Manufacturing | Non-manufacturing <sup>2</sup> | Services |
|------------|-------------|---------------|--------------------------------|----------|
| 1980       | 0.29        | 0.20          | 0.08                           | 0.43     |
| 2011       | 0.14        | 0.16          | 0.09                           | 0.60     |
| Difference | -0.14       | -0.04         | 0.01                           | 0.17     |

1/ Own calculations with data from INEGI and Groningen Growth and Development Centre 10-sector database, June 2007, <http://www.ggdc.net/>

2/ Mining and Quarrying, Public Utilities and Construction



# Manufacturing's stagnant contribution to the aggregate labor productivity rise is somewhat surprising

**Sectoral contribution to aggregate labor productivity<sup>1</sup>**  
Thousands of Mexican pesos, 1993 prices

|            | Total | Agriculture | Manufacturing | Non-manufacturing <sup>2</sup> | Services |
|------------|-------|-------------|---------------|--------------------------------|----------|
| 1980       | 38.5  | 2.9         | 8.0           | 3.5                            | 24.1     |
| 2011       | 38.7  | 2.1         | 8.0           | 3.0                            | 25.6     |
| Difference | 0.2   | -0.8        | 0.0           | -0.5                           | 1.5      |

1/ Own calculations with data from INEGI and Groningen Growth and Development Centre 10-sector database, June 2007, <http://www.ggdc.net/>. Value-added in constant prices relative to the number of persons employed in the economy

2/ Mining and Quarrying, Public Utilities and Construction

## Basic facts

- Declining labor productivity in services and non-manufacturing
  - ✓ Less productive people entering the services sector
  - ✓ Non-manufacturing exhibits mainly a pure productivity problem
- Manufacturing's stagnant contribution to the aggregate labor productivity rise is somewhat surprising
  - ✓ Why has productivity not risen faster?
- Labor productivity gains in agriculture lower than expected from emigration

# Some testable hypotheses behind these facts

- Services and non-manufacturing
  - ✓ Large sub-segments, e.g. sales and construction, are characterized by widespread informality, which may result from excessive regulation and taxation<sup>1</sup>
  - ✓ Services, such as education and health and finance, show limited competition
  - ✓ Poor contract enforcement contributes to low bank penetration
- Slow opening up to foreign competition and insufficient infrastructure may explain manufacturing's stagnant contribution to aggregate labor productivity
- Institutional rigidities inhibit scale and technological adoption in agriculture

<sup>1/</sup> For an excellent exposition of static and dynamic inefficiency arguments applied to informality, see Heckman, J. J. et al. (2010), "Policies to Promote Growth and Economic Efficiency in Mexico," *NBER Working Paper Series*, November

# What is the role of structural reforms?

- There is a wide consensus that Mexico needs structural reforms to enhance productivity growth
- The first challenge lies in measurement
  - ✓ Many studies fail to subject their hypotheses to statistical verification
  - ✓ Because of relatively richer data, much research has been devoted to scrutinizing manufacturing
  - ✓ It is necessary to quantify the intended benefits of specific structural reforms

# The recent labor reform may increase potential growth and formal employment

## Estimated effects of labor reform

| Potential GDP growth                          | Percentage points |
|---|-------------------|
| Medium-term annual effect <sup>1/</sup>       | <b>0.151</b>      |
| Test, training and temporary contracts        | 0.045             |
| Employment and wages per hour                 | 0.008             |
| Reduction of wage compensation after disputes | 0.017             |
| Elimination of the exclusion clause           | 0.012             |
| Bias towards growth in formal employment      | 0.008             |
| Increased productivity of formal employment   | 0.061             |
| Long-term annual effect                       | <b>0.10</b>       |

| Formal employment                       | Additional jobs |
|---|-----------------|
| Medium-term annual effect <sup>1/</sup> | <b>370,000</b>  |

1/ Annual effect calculated from the average growth rate over a period of five years

Source: Banco de México (2013), *Informe sobre la inflación, octubre-diciembre 2012*, pp. 60-66, February

# Conclusions

- For Mexico to take off, significant structural reforms should be implemented
- High returns may be derived from structural changes enhancing productivity, especially in the services and non-manufacturing sectors
- Likely factors behind declining labor productivity include regulation, low competition, poor contract enforcement and insufficient infrastructure
- The recently approved labor reform promotes formal employment and productivity
- Measurement of the effects of possible structural reforms is needed



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