The search for Mexico’s economic progress

Manuel Sánchez

Alamos Alliance XX, February 16, 2013
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\(^1\)
  - 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

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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 ...

Growth Accounting
1950=100 based on constant 2005 pesos

... 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

Log of Thousands of Mexican pesos, 1993 prices

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
- 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

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

### Labor productivity by sector

**Thousands of Mexican pesos, 1993 prices**

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Non-manufacturing</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>10.2</td>
<td>40.0</td>
<td>42.8</td>
<td>55.8</td>
</tr>
<tr>
<td>2011</td>
<td>14.8</td>
<td>50.3</td>
<td>31.8</td>
<td>42.5</td>
</tr>
<tr>
<td>Difference</td>
<td>4.6</td>
<td>10.3</td>
<td>-11.1</td>
<td>-13.4</td>
</tr>
</tbody>
</table>

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

<table>
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<tr>
<th>Year</th>
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<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>0.29</td>
<td>0.20</td>
<td>0.08</td>
<td>0.43</td>
</tr>
<tr>
<td>2011</td>
<td>0.14</td>
<td>0.16</td>
<td>0.09</td>
<td>0.60</td>
</tr>
<tr>
<td>Difference</td>
<td>-0.14</td>
<td>-0.04</td>
<td>0.01</td>
<td>0.17</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Sectoral contribution to aggregate labor productivity(^1)</th>
<th>Thousands of Mexican pesos, 1993 prices</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td><strong>Agriculture</strong></td>
</tr>
<tr>
<td>1980</td>
<td>38.5</td>
</tr>
<tr>
<td>2011</td>
<td>38.7</td>
</tr>
<tr>
<td>Difference</td>
<td>0.2</td>
</tr>
</tbody>
</table>

1/ Own calculations with data from INEGI and Groningen Growth and Development Centre 10-sector database, June 2007, [http://www.ggdc.net/](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\(^1\)
  - 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

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1/ 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

<table>
<thead>
<tr>
<th>Potential GDP growth</th>
<th>Percentage points</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Medium-term annual effect</strong>&lt;sup&gt;1/&lt;/sup&gt;</td>
<td><strong>0.151</strong></td>
</tr>
<tr>
<td>Test, training and temporary contracts</td>
<td>0.045</td>
</tr>
<tr>
<td>Employment and wages per hour</td>
<td>0.008</td>
</tr>
<tr>
<td>Reduction of wage compensation after disputes</td>
<td>0.017</td>
</tr>
<tr>
<td>Elimination of the exclusion clause</td>
<td>0.012</td>
</tr>
<tr>
<td>Bias towards growth in formal employment</td>
<td>0.008</td>
</tr>
<tr>
<td>Increased productivity of formal employment</td>
<td>0.061</td>
</tr>
<tr>
<td><strong>Long-term annual effect</strong></td>
<td><strong>0.10</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Formal employment</th>
<th>Additional jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Medium-term annual effect</strong>&lt;sup&gt;1/&lt;/sup&gt;</td>
<td><strong>370,000</strong></td>
</tr>
</tbody>
</table>

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

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.
Mejoran las perspectivas económicas mundiales