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Mexico's Labor Reform: Opportunities and Challenges for an Improved Nafta

"Among the flurry of statistics on USMCA, one fact stands out: Mexican workers are producing considerably more and earning considerably less than they did at the beginning of the 1980s. This combination of higher productivity and lower wages could send both U.S. jobs and wages heading south."

Does that paragraph describe the situation today? Yes, all-too-accurately. Sadly, those were the opening lines I wrote in an Op-Ed published in the Washington Post in September 1993 during the height of the Nafta debate. The only change was substituting "USMCA" for "Nafta." [1]

What does this fractured link between rising productivity and falling wages in Mexico mean for U.S. workers? Ask Dave Green, the United Auto Workers (UAW) President of Local 1112 in Lordstown, Ohio. General Motor's decision to produce the new Chevy Blazer in Ramos Arizpe, Mexico contributed to GM idling the sprawling Lordstown plant, which as recently as three years ago employed about 4,500 people. Green described the scene when managers delivered the announcement to more than 1,000 workers the Monday after Thanksgiving in November 2018. "Some people started crying, and some people turned white as a ghost and looked like they were going to throw up". [2] It's not just a lost job but hurt families and lacerated communities. *The New York Times* reported that Christina Defelice, a worker at the Lordstown transition center, "knew of a number of divorces, nervous breakdowns and even three suicides caused by such dislocation."[3]

While many considerations influenced GM's decision to make the Chevy Blazer in Mexico, Mexican wage rates were undoubtedly a key factor. A senior UAW worker at Lordstown earned $30 an hour, while a worker at GM's plant in Ramos Arizpe earned less than $3 an hour – one tenth that.[4] In spite of the fact that the productivity and quality in both plants is comparable, the rock-bottom wages in Mexico reflect the formidable obstacles for workers there to form independent unions in the export sector. The result is comparative advantage based on suppressed wages, which damages workers on both sides of the border.

Scenes such as Lordstown have played out throughout the U.S. "Stagnant or declining wages at the bottom, an eviscerated middle class, and top wages that are soaring," Joseph Stiglitz writes. [5] And, it's not just those directly impacted by the closure but those who are in its wake: workers at supplier plants, the teachers and nurses in the community, the public workers in the region, and economic activity more generally in the town or region where the plant is located.

Nafta, which promised to harmonize wages upwards across North America, instead preserved a dysfunctional labor system that caused wages to fall in Mexico and pressed down on wages in the U.S. as well. "In every manufacturing bargaining session I've been involved in, Mexico comes up," says the former United Auto Workers (UAW) President Bob King. "First, the company complains that it is impossible to compete with Mexican wages unless we lower ours, and then the company threatens to move more work to Mexico."[6]

The critical issue for the USMCA is labor: the impact of plant location and outsourcing in Mexico on U.S. workers, jobs, and wages. The problem isn't trade. A vibrant trading relationship can produce real gains for all three countries across North America. The critical question is rules of the game that ensure workers and communities share in these gains.

The USMCA as presented won't get us there. The existing labor language is vague and unenforceable. It needs to be significantly improved. Second, while better language is essential, language in a trade agreement alone is not capable of significantly changing the labor system. Only Mexico can ensure real change on the ground and the obstacles there are formidable. To its credit, the Mexican government has enacted important legislative changes and shown the intent to tackle tough challenges. What is defining, however, is what happens when the rubber hits the road.

What Nafta painfully has demonstrated is that labor reform commitments evaporate as the ink on the signing document dries. As a result, verifiable progress on labor reform must be the precondition for the agreement's ratification this time around. Mexico must demonstrate that workers can, in fact, organize independent unions in the export sector and that these unions can bargain freely. Absent these changes, the name of the trade agreement will be new but the content will be all-too-familiar.

A new trade agreement can bring real benefits to the U.S. and Mexico but rushing it will take us back to a damaging status quo. While a new agreement is being discussed and preconditions established, trade and investment with Mexico will continue and could well expand. This path isn't a delay it's insuring we get these issues right this time around.

Context

The political context today in Mexico is clearly different than 1993. The country has a new reform government reflecting a deep disillusionment with the past and a hope for the future. President Andres Manuel Lopez Obrador (AMLO) won an overwhelming electoral victory in July 2018 and his party now has a commanding majority in both houses of the Mexican Congress.

Almost immediately, AMLO put forward an ambitious reform agenda in the labor area. He increased the bottom hugging minimum wage by 16 percent nationally and doubled the minimum wage along the border with the United States. He appointed an energetic and talented labor minister, Luisa Alcalde, who takes reform seriously and wants to bring real change. And, Senator Napoleón Gomez Urrutia, the president of the independent Mineworkers Union, is Chair of the Senate Labor Committee. He has led many struggles for worker rights often with great risk. Nonetheless, as we will see, the challenges for the new government are daunting.

During the highly charged Nafta debate in 1993, most economists projected a rosy future. Trade will lift all boats was the mantra of the day. Among the most influential studies was "Nafta: An Assessment" put out by what is now the Peterson Institute for International Economics in Washington, D.C. This study predicted that the agreement would "create about 170,000 net new U.S. jobs" and also projected that "U.S. exports to Mexico will continue to outstrip Mexican exports to the United States, leading to a U.S. trade surplus with Mexico of about $7 billion to $9 billion annually by 1995." [7]

It did not turn out that way. Cross-border trade between the two countries soared far faster than either proponents or critics of the original agreement projected, rising six-fold from $101 billion in 1994 – the year NAFTA went into effect – to $615 billion in 2018. At the same time, the U.S. went from a slight trade surplus with Mexico to an $85 billion trade deficit in merchandise trade. In the auto sector – over one-third of Mexico's manufacturing exports – the trade deficit expanded to $91 billion, underscoring a highly distorted trading relationship fueled by suppressed wages.[8] In fact, the U.S. trade deficit in auto with Mexico outstrips its deficit with Japan and South Korea combined.

The fractured link between rising productivity and declining wages predates Nafta. As Mexico opened to the global economy in the 1980s – a tumultuous dark economic time known as the "lost decade" – manufacturing exports became far more important. A combination of government policy to depress wages and compliant official unions decoupled rising productivity from wages. Manufacturing productivity rose 30 percent from 1980 to 1992 (the year before Nafta was ratified) while real hourly compensation – wages and benefits – dropped 23 percent.[9]

Nafta promised to close that gap. Proponents argued at the time that rising trade would increase the demand for workers, and wages would rise in Mexico. Once again, it did not turn out that way. Mexican manufacturing productivity rose by 76 percent from 1994 (the year Nafta went into effect) to 2011, while real hourly compensation slid by 17 percent.[10] These trends have continued since. In Mexico, the near impossibility of forming independent unions in the export sector has resulted in manufacturing wages stagnating or falling. Economists have long argued that low productivity results in low wages. However, in Mexico, high productivity in the auto sector has translated into low wages because independent collective bargaining barely exists.

Economist Luis F. Munguia Corella, now head of CONASAMI (The National Commission on Minimum Wages), points out that Mexico has the lowest average salaries in the OECD and among the lowest in Latin America. He writes that the main comparative advantage of Mexico has become "a policy of the Mexican state to compete in international markets using low wages."[11] As a result the average monthly salaries in Mexico in Purchasing Power Parity (PPP) moved from 70 percent above China in 2000 to 40 percent below China in 2016.[12]

These suppressed wages have exerted an irresistible attraction for U.S. investment in manufacturing in general and in the automotive sector in particular. An expanded manufacturing base is critical for Mexico, but when it is based on distorted incentives such as suppressed wages, it is damaging to workers in both countries. If Mexican wages tracked productivity, they would create what the legendary U.S. labor leader Walter Reuther termed "high velocity purchasing power." This higher purchasing power in turn would fuel economic growth and could mean expanded cross-border trade that benefits both countries.

The auto industry dramatically illustrates these trends. In Mexico, motor vehicles comprise more than 30 percent of manufacturing exports by value. The global auto industry has built eleven new assembly plants in North America between 2009 and 2017. Eight of these were sited in Mexico, and three in the United States. Automakers committed $25 billion in new investment to Mexico during this period. The production is in Mexico, but the market is largely in the U.S.

Mexico manufactured almost 4,000,000 light vehicles in 2018, about 80 percent of which were exported to the U.S. As a result, Mexico has emerged as the seventh-largest light vehicle producer in the world and the fourth-largest exporter.[13] By 2018, Mexican hourly and nonsupervisory auto employment--763,000 workers--was headed toward surpassing U.S. employment--780,000 workers--in this sector.[14]

What does this combination of high productivity and suppressed wages look like on the ground? Consider a new billion-dollar BMW plant 45 minutes southeast of San Luis Potosí in central Mexico. The plant employs 2,500 people and began producing the BMW 3 series in 2019 for sale in the United States and throughout the world. The factory occupies only about a quarter of a 750-acre site, which allows considerable room for expansion. *Automotive News* reported that "[the plant] could match the production scale of BMW's largest plant in the world, its South Carolina factory, which has a capacity of 450,000 vehicles."[15] A new automotive engine plant and other parts operations could also be in the works for the site.

In 2014, before hiring any employees, the company selected a compliant union from a state affiliate of the Confederación de Trabajadores de México (CTM), the principal labor federation in the country. The union then agreed to a "protection" agreement that provided considerable protection for the company and little for the workers and then a Labor Ministry official notarized the sub-standard contract. Wages started at $1.10 an hour and topped out at $2.53.[16] Something is wrong with this picture: a luxury sports sedan built by workers starting at a little over $1 an hour.

What does this wage productivity disconnect look like to workers in the U.S.? These threats go well beyond the auto sector and unionized plants. In a 1997 study, Cornell University scholar Kate Bronfenbrenner documents the ways in which the threat to move production to Mexico is used to undermine union organizing campaigns. She found that threats to move production, whether the company intends to do so or not, influence both organizing and collective bargaining.[17]

Labor Reform in Mexico and the USMCA

What the original Nafta sought to do is create an investment, manufacturing, and trading community across North America. The goal was a highly favorable business climate so that investment and production in Aguascalientes would be as secure as Ohio or Ontario and Nafta moved far in that direction. The labor provisions of Nafta were included in a side annex that was weak on paper and nonexistent in practice.

While improving the labor provisions of USMCA is important, what the Mexican government itself does is defining. The government has proposed a far reaching labor reform that has two broad dimensions: first, an amendment to the labor chapter of the Mexican constitution, the first time the historic labor chapter has been amended since it was drafted and ratified in the midst of the Mexican Revolution in 1917. Second, a complex 600 page implementing legislation drafted by the new government and passed by the congress to ensure the labor system becomes more transparent and workers have a greater say in labor affairs. These changes are important but to-date they largely exist only on paper. Ultimately what happens on the ground and in what time frame is crucial.

Labor reform in Mexico under the best of circumstances will be a herculean task. Powerful, well financed, and determined forces with a vested interest in the status quo conspire against change: corrupt unions and corporations who profit from suppressed wages. In their initial onslaught against change, they have shown a willingness to work together and are adept at retaining power and profits even with new bureaucratic and legal structures.

Finally, Mexico has weak state capacity and building new capacity won't be trivial. The implementing legislation, for example, plans to eliminate the dysfunctional tripartite commissions that currently decide labor cases in favor of new labor courts. The problem is that the existing court system is very problematic and what mechanisms will ensure a new system is not more of the same? The World Justice Project, an independent presidential initiative of the American Bar Association, looked at the rule of law in 126 countries globally. Mexico ranked 99th, below Uzbekistan, Guatemala, and Sierra Leone. In terms of civil justice Mexico ranked 113 and in terms of absence of corruption it came in at 117.

The importance of strong, currently non-existent state institutions, was underscored by Mexican Senator Napoléon Gómez Urrutia who told *El Financiero* in June, 2019 "Although the labor reform in Mexico has already been approved, and of course ILO

Convention 98 that provides for freedom of association and freedom of collective bargaining [also has been ratified], they are not being respected because there are no adequate mechanisms."[18]

The New York Times gave a preview of what might come in an article on June 22, 2029. "A new law that guarantees workers the right to decide who will represent them took effect last month," Elizabeth Malkin wrote. "But independent labor leaders say that transforming a decades-old system — overcoming opposition from employers and powerful, politically favored unions, along with deep suspicion by workers — is slow and arduous work." After a mid-April vote that an independent union lost by a wide margin confronting an establishment union in a rubber plant, Patricia Juan Pineda, the lawyer representing this independent rubber worker's union, told the New York Times "Fear is hard to beat."

Does this mean that meaningful labor reform in Mexico is impossible? Not-at-all. It does mean that it is critical to understand how difficult the challenges are. Real reform will require sustained political will by the government of Mexico, support by the independent forces that exist in the labor movement and civil society, and real resources to carry out the change. There are currently 700,000 or so collective bargaining agreements in the country and an enormous bureaucracy that overseas the process. Resources reportedly won't be allocated until September, 2019. It will be costly in resources let alone political well to tear-down and rebuild this vast labor relations structured, which was assembled over 80 years. The Mexican government is cash strapped and the economic growth has skidded.

U.S. workers and unions have a direct stake in change in the export sector because they are directly impacted. Insuring that real reform in the export sector is demonstrated prior to ratification is not meant to set an impossible standard or to harm Mexico. It is meant to send a clear signal that reform is the basis for economic integration and cannot come at the expense of U.S. workers or Mexican workers.

Conclusion

In the quarter century after World War II productivity rose rapidly in the U.S, the income of most Americans grew right along with it, and the middle class expanded in an unprecedented way. Over the past four decades "growth has slowed," Joseph Stiglitz writes, "and incomes of large parts of the population have stagnated or even declined."[19] The desperation and anxiety of working Americans has become all too familiar.

The challenge for the USMCA is to foster a broadly-shared prosperity, not to undermine the gains of working Americans. Workers in the manufacturing sector—union and non-union alike—are directly in the line of fire but what happens here is soon felt throughout the rest of the economy. All workers are impacted given the importance of this sector. Manufacturing plays an outsized economic rule, unions here have often set trends in wages and benefits throughout the economy, and the linkages of manufacturing stretches from research and development to services.

A trade agreement is vital and the three countries of North America working together are stronger than each going alone. In a highly integrated economic area, however, what happens to workers in Mexico has a direct impact on workers in the U.S. Investment standards under Nafta harmonized upwards, but labor standards moved downwards channeling the gains to the top. We must insure that workers and communities are treated as well as intellectual property rights this time around.

The goal must not be the quickest route to ratification, but the best route to improving the lives of working Americans. I will conclude with the last line of the 1993 Washington Post Op-Ed I began with: "Accepting [USMCA] on [its current] terms could do more to knock U.S. workers out of the middle class than enable Mexican workers to enter it." Instead, this ratification must really be a new beginning to insuring the gains of trade are more broadly shared.

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