A Renaissance for Mexican Manufacturing? Part Two

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There are many variables involved in creating a competitive edge. It must be recognized, however, that many of those are wholly out of the control of the manufacturer. Taxes and regulations imposed by government influence how well a company does, and there are issues of tariffs and trade that impact business. The government needs to provide a safe environment within which to do business and there has to be a reasonable system for payment. All of this is crucial to the success of a given business.

The key to competitiveness lies in the decisions that an individual company can make for itself and these fall into three broad categories. The first is to continue down the path of diversification in evidence for the last few years. The recession in the U.S. was a severe blow to the Mexican manufacturer, but it also may have been a blessing in disguise as many Mexican operations found opportunities to do business with other nations.

Those trade agreements allowed expansion into other markets, but so has the increase in foreign direct investment. The advantages that Mexico has will become ever more appealing to operations in other parts of the world as production in Mexico has the added benefit of being close to the U.S. market. Shipments can be delivered at a transportation cost that is far less than from other parts of the world — and dropping.

As part of this first step toward diversification, Mexico is in a position to be at the forefront of the development taking place in other parts of the Americas. The economies in Brazil, Colombia and Chile are developing fast, and opportunities exist for the Mexican manufacturer to become fully engaged in these countries, as well as in the U.S.

The second major advantage is the skill base developing in Mexico. The country has been emphasizing education for a long time and there have been many graduates in the last 10 years. This will either become a huge problem or an advantage — depending on the reaction of the private sector.

If this young, educated population finds few opportunities to use their skills, they will become frustrated and angry, and Mexico could well experience the same challenges affecting governments in the Middle East. If the economy expands and the business community takes advantage of that talented, young population, the country stands to grow quickly.

The U.S. is rapidly coming to a crisis from the other direction as its labor pool decreases and needed skills start to vanish. The average age of a fully qualified welder in the U.S. is now 63; this points to an emerging problem. It will be next to impossible for the U.S. to address that issue in any way except through mass immigration and that is simply not politically feasible in the foreseeable future. That puts greater emphasis on production outside the U.S., and Mexico becomes the most logical candidate if there is attention to the needs of a growing industrial sector.

The third major advantage stems from proximity and the costs of providing the inputs needed for modern manufacturing. In addition to labor costs, a more important consideration may be the ongoing cost of transportation.

Trade with Asia is getting more expensive and all projections hold that this will be a greater concern in the years ahead. Currently the cost of fuel has fallen a bit, but this is a temporary situation that will reverse as the global economy begins to recover. It will become far too expensive to ship certain goods from a great distance when there is a nearby alternative.

Mexican operations will become increasingly connected to those in other nations as companies in Asia seek to reduce the costs of feeding the U.S. market. This is an opportunity for Mexican companies to tie themselves to the plans of American transportation providers.

Given the resistance to expanded truck traffic between Mexico and the U.S., the most likely area of cooperation is in the rail sector with those U.S. companies that have invested in developing their networks in Mexico. As Mexican manufacturers become more comfortable with the northern opportunities, they can start to choose expansion locations that take full advantage of new ports and rail lines.

Obviously barriers exist to these expansion plans, as they often do. There will be competitive pressures from the nations that do not wish to lose their advantage. Government decisions by both the U.S. and Mexican regimes will compromise expansion plans. A number of the social issues can't be ignored and, most of all, there is the battle over perception. Too many people in the U.S. and in Mexico are convinced the nation is in a death spiral, but the actions of the business community can challenge that assessment.

The U.S. manufacturing community is in an ideal position to link with those Mexican counterparts as both nations start to see the predicted shift in production. As the Boston Consulting Group and others have pointed out for the past couple of years, China is losing its edge and there is an opportunity for others to grow at its expense. It is not that China is doomed to decline, but the trends of the last couple of years will only accelerate. Higher wages, higher production costs and higher transportation costs will make China less competitive in the years to come, and give Mexico a distinct advantage.

Dr. Kuehl is the author of Fabrinomics*, a biweekly economic analysis e-newsletter for members of the Fabricators & Manufacturers Association. For more information, please visit* fmanet.org/fabrinomics *[1].*

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[1] http://www.fmanet.org/members/fabrinomics-form.cfm