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How the Tortilla Industry Can Help Explain Mexico’s Productivity Problem

An employee weighs a stack of corn tortillas at a tortilla factory in Mexico City, Mexico, where the industry could benefit from productivity growth (photo: REUTERS/Carlos Jasso)

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Mexico could be making more tortillas, but weak productivity growth is getting in the way.

Our latest research looked into reasons why this is happening and found that the allocation of resources—how factors of production like capital and labor are distributed among producers—across firms within the Mexican economy lies at the heart of the country’s low productivity dilemma.

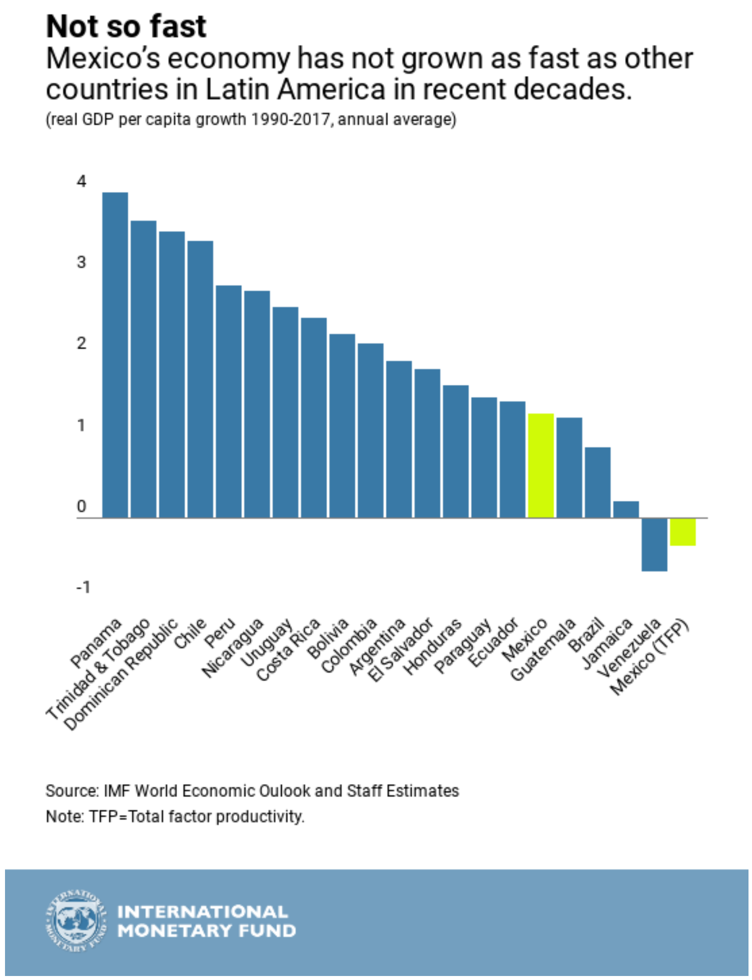
The good news is that lifting productivity growth does not require gaining access to better technologies.

Instead, policies that allow Mexico's most efficient producers to attract sufficient capital and labor—such as reducing labor informality and strengthening access to financial services—can help lift overall productivity growth, not least in Mexico's tortilla sector.

The productivity paradox

So, why are we worried about productivity in Mexico?

Beginning in the mid-1990s, Mexico implemented sweeping reforms that liberalized the economy and opened it to foreign investment and global supply chains. These policies have helped the country weather many severe economic shocks, such as the most recent uncertainty surrounding the bilateral trade relationship with the US.



Yet, Mexico has not grown as fast as other countries in the region in recent decades and has actually experienced a decline in productivity. With strong economic policies in place, it is not easy to understand why productivity growth has been so weak, leading economists to label Mexico's productivity growth a paradox.

Part of the explanation could be that Mexican firms have been slow in attracting global frontier technologies—such as best practices in managing complex operations, or the latest manufacturing machinery.

But this is unlikely to be the full story, given that Mexico has clearly proven to be an attractive destination for foreign investment since the 1990s. For example, research suggests that the North American Free Trade Agreement (NAFTA) alone may have resulted in an increase in foreign direct investment inflows—a likely vehicle for technology transfer—of some 60 percent.

A complementary explanation could be distortions and market imperfections that give rise to resource misallocation across firms within Mexico. This is a phenomenon by which market distortions allow less productive companies to gain market share at the expense of more efficient businesses. And there is growing evidence that misallocation is indeed at the core of Mexico's productivity challenge.

Making more tortillas

The tortilla industry can help to illustrate why resource allocation matters to Mexico's productivity growth.

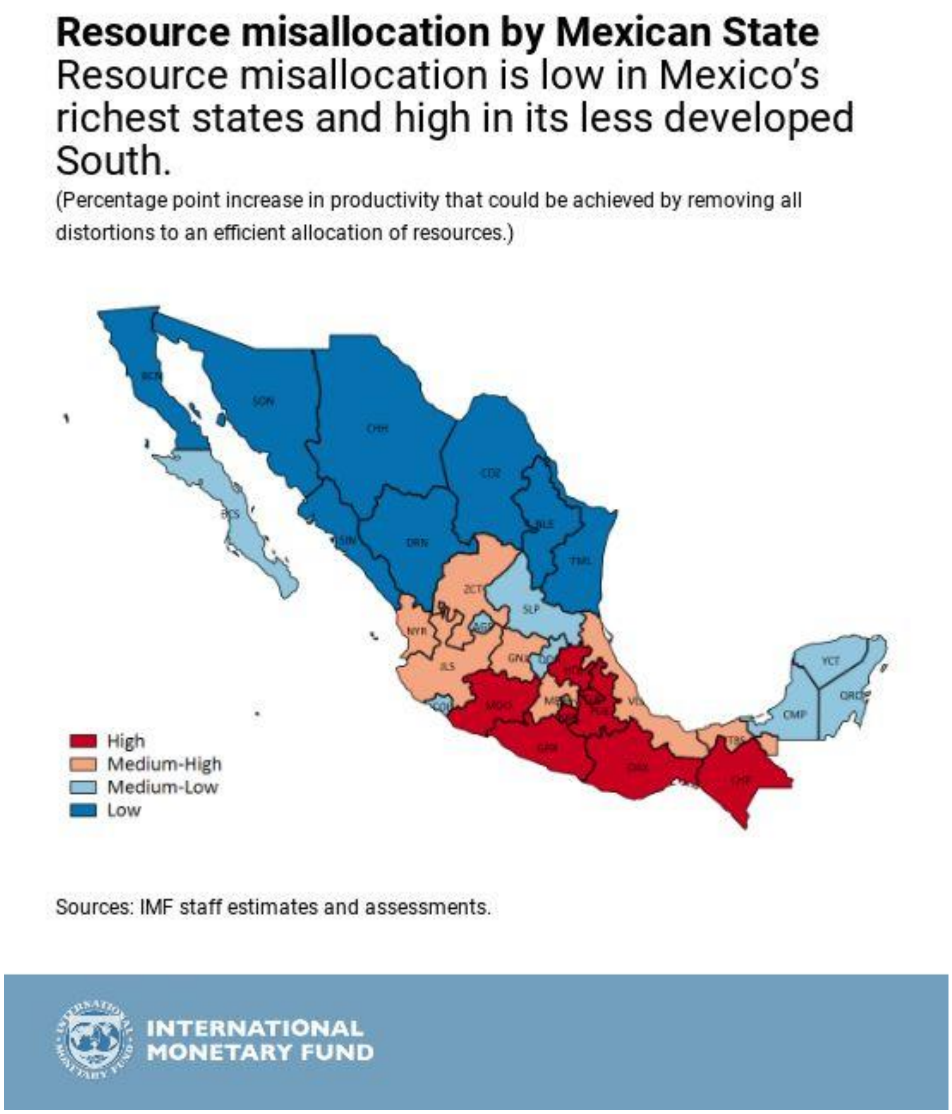
Few would argue that Mexico's most efficient tortilla producers are not employing the world's best tortilla technologies and business practices. And yet, our analysis shows that productivity in the tortilla and bakery sector could be around 150 percent higher under an efficient allocation of resources across firms.

Compare this to Sweden where the allocation of resources in the bakery and tortilla sector is much more efficient than in Mexico: using the same amount of capital and labor, and with similarly productive individual firms, Mexico would produce less bakery and tortilla goods than Sweden. This is simply because distortions permit its less productive firms to divert capital and labor away from their more productive competitors.

Improving resource allocation

Our analysis further shows that, overall, productivity could more than double in Mexico if capital and labor were distributed efficiently in the sense that an additional worker or an additional peso of capital employed by any firm would yield an identical payoff across all firms in each industry.

Moreover, resource misallocation affects productivity and growth at the subnational level. Indeed, misallocation is highly correlated with per capita incomes across states, suggesting that it not only helps explain why Mexico's overall productivity is low, but also why there are such large regional income discrepancies.



Our analysis also uncovers some of the underlying drivers of misallocation in Mexico. For example, labor informality is associated with higher levels of misallocation, likely because informal firms give themselves unfair cost advantages by not paying their fair share of taxes. These typically less productive firms will be able to sell more goods, hire more people, and attract more capital than they would if they were formal.

Another important driver is corruption since paying a bribe likewise confers an unfair advantage to a firm, such as lower tax payments or winning a public tender. And unfairly winning a public tender would in itself constitute a case of resource misallocation.

We also uncover other drivers of misallocation such as elevated levels of crime and market concentration, and a lack of broad-based access to financial and telecommunications services as well as the geographic isolation of some firms. Our analysis suggests that addressing these distortions would generate economically meaningful productivity benefits.

The way forward

Lifting Mexico's growth will require raising productivity through persistence on the structural reform agenda.

While the reformers of the 1990s began by liberalizing the economy and achieving macroeconomic stability, recently-enacted reforms as part of the Pacto por Mexico were aimed at dissolving state monopolies, promoting competition in network industries and addressing labor market, education, and governance shortcomings.

Despite these important steps, more work is needed to double down on the reform agenda.

Our analysis suggests the need to strengthen the rule of law to root out corruption and crime, lower labor informality and boost access to new transportation infrastructure as well as financial and telecommunications services.

Addressing these challenges will help to raise productivity growth, including by lowering resource misallocation, and achieve higher standards of living in Mexico.

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