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China Labor Costs Benefit Latin America

For the past thirty years China has experienced a rate of growth unparalleled in the modern world, averaging 10% over those three decades. But now China is experiencing an economic slowdown, and increased labor costs, which are making many commodity-type goods too expensive to manufacture for its global customers. Labor costs in China have increased 500% in the past 20 years, making the average laborer's wage greater than what workers many Latin American countries, including Mexico, receive. Faced with this huge increase in labor, Chinese businesses have been shifting their emphasis to the service sector, and away from manufacturing. This has created opportunities for Latin American manufacturers, particularly in Mexico and Brazil. Mexico in particular benefits from having 81% of its exports go to the United States. Concurrently, Brazil has benefitted from increasing Chinese labor costs by now exporting 17% of its goods to China.

Shipping is also a consideration in a manufacturing operation as NAFTA, the North American Free Trade Agreement (NAFTA), allows goods produced in Mexico to quickly flow northbound across the U.S. border. The shipping time from Mexico to the United States is shorter than China, the goods are duty free, and the labor on goods produced in Mexico is less or, at worst, on par with Chinese costs. When combined with a cheaper source of labor, or a negligible differential, Mexico and other Latin American countries have an advantage over China on many manufactured products.

But continued gains in the manufacturing sector, at the expense of China, can only go so far and cannot solely depend on a labor and shipping differential. Many other countries, such as Viet Nam, Malaysia, Indonesia, and the Philippines also have such a labor differential. Equally important is the huge infrastructure that China has in place. Let me explain. As an example you're building a plant to manufacture a machine in Viet Nam. The machine is quite simple to construct, using sheet steel that's easy to fabricate into the desired housing, and wiring that's fairly simplistic. The product utilizes several motors, valves, and other electronic components that are off-the-shelf items. That's where the rub comes in, and China shines. If you're a Chinese company, you have a multitude of vendors who can provide those parts to you almost immediately. If you're in Viet Nam there's few, if any, local manufacturers for all those items. Off-the-shelf means it comes from warehouses in China to you by air, rail, or on an aircraft, any of which will increase the product cost. Mexico and Brazil also have similar supply issues, although not on par with Viet Nam, and usually on large volume items that they will more-than-likely also obtain from China.

Therefore, while high labor costs in China benefit Latin American countries, and in particular Mexico, it will only do so to a certain extent because of the infrastructure differential that exists with China.

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