North American Journal of Economics and Finance 34 (2015) 364–380

Contents lists available at ScienceDirect

North American Journal of Economics and Finance

The effect of Chinese import competition on Mexican local labor markets

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ARTICLE INFO

Article history:
Available online 21 September 2015

Keywords:
Mexican manufactures
Chinese import competition
Local labor markets

ABSTRACT

This paper contributes to the literature of the effect of globalization on labor markets in developing economies by analyzing the Mexican case. I exploit variation across Mexican regions in import exposure stemming from initial differences in industry specialization in order to estimate the effect Chinese competition had on local Mexican labor markets. Also, by taking advantage of the Mexican exports' high dependence on the U.S. market, I estimate the effect that China-caused trade diversion had on Mexican labor markets. I find that the increase in competition decreased the employment share in manufacturing for the average Mexican local labor market. This effect was found to be larger for regions with high exposure to Chinese competition in the U.S. market, showing that there was a significant, negative indirect effect from China's trade growth. I also find that workers' mobility across local labor markets increased due to this negative shock. Wages remained largely unaffected.

1. Introduction

The effect of globalization on labor markets is a topic that has been studied for almost two decades now. Starting on mid-1990s, a great body of literature trying to explain what caused the marked changes in the U.S. wage structure during the 1980s and 1990s was amassed. The main findings were

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http://dx.doi.org/10.1016/j.najef.2015.09.009
1062-9408/

that, although significant, globalization in the form of trade and offshoring played a rather small role in the wage differentials in U.S. labor markets (Feenstra & Hanson, 1999; Feenstra & Hanson, 2003), with the evidence suggesting that other shocks, among which skill biased technological change stood out, were the main factors in the evolution of the U.S. wage structure in that decade (Katz & Autor, 1999). A somewhat stronger role for globalization in the rising wage inequality was found in later research involving developing countries, which in the 1980s began their opening process consisting mostly in the aggressive lowering of barriers to trade and capital flows. This openness was associated with increases in the relative demand for skilled labor in economies like Chile (Pavcnik, 2003) and Mexico (Feenstra & Hanson, 1997), with the resulting increase in wage inequality. However, as pointed out in Autor, Dorn, and Hanson (2013), a factor limiting trade's impact on labor markets is that, historically, imports from low-wage countries, a likely source of disruption to high-wage labor markets (Krugman, 2008), had been relatively small. Nonetheless, emerging economies with staggering rates of economic and trade growth, among which China stands out, have completely changed the picture. China's trade volume has grown dramatically over the last two decades. Between 1990 and 2010, China's share of the United States' total imports went from 3.1% to 18.4%. At the same time, China went from representing less than 1% of Mexico's total imports to accounting for 14% of them. Under these new circumstances, trade, particularly with low-income countries, seemed to have a clear potential to disrupt labor markets both for developed and developing countries.

Several factors account for China's trade growth: the transition to a market-oriented economy, which has involved over 150 million Chinese workers migrating from rural areas to cities; access to long banned foreign technologies, capital goods, and intermediate inputs; multinational firms allowed to operate in the country; and China's accession to the World Trade Organization. These developments made of China the primary supplier of labor-intensive type of goods to the North American market, replacing Mexico as the second biggest exporter to the United States. Several studies, some of which I mention below, have exploited these events to reassess the effect of trade on labor markets. However, recent events make us believe that China's export frenzy has reached its climax and it is now perhaps the best moment to assess its effects. Also, if, as forecasted by some studies, China's advantage is reverting, it is in the interest of every country to have an idea of what they can expect in the next few years. This is especially relevant to countries like Mexico, where the manufacturing industry is specialized in labor-intensive goods, industry in which China would be expected to experience the largest drawback. This study attempts to exploit the plausibly exogenous growth in China's exports into Mexico in order to estimate the causal impact of Chinese competition on key Mexican labor market outcomes.

My study is related to several areas of research. First, a few studies have assessed the threat that Chinese exports represent to Latin American producers. A couple of outstanding examples are Hanson and Robertson (2007, 2008) and Soloaga, Oarreaga and Lederman (2007). Other studies (Pavcnik and Goldberg, 2005 and Eslava et al., 2009 for Colombia and Brazil, respectively) evaluate the effect of Chinese import competition on wages and employment in Latin America. In a sectoral study, Iranzo and Ma (2006) find some evidence of Chinese exports diverting US imports from Mexico toward China. Some studies more closely related to mine have found evidence suggesting growth in China's trade affected negatively the performance of Mexico's manufacturing industry. For example, Shigeoka, Verhoogen, and Wai-Poi (2006) use plant-level data on Mexican maquiladora and non-maquiladora manufacturing sector to investigate the heterogeneous impact of the Chinese export expansion at the plant level within industries. They find that Chinese imports into Mexico of goods also produced by Mexican plants have a negative impact on those plants' sales. However, they leave out plenty of interesting outcomes such as wages within and outside of the manufacturing industry, employment in non-manufacturing industries, labor force mobility, among others. Also, by focusing on industry rather than on geographic subdivisions (e.g., local labor markets), they do not take advantage of variation by region in the exposure to the rise of China's trade. A very recent paper that fills some of these gaps is Autor, Dorn, and Hanson (2013). They explore the effect of import competition on U.S. local labor markets that were differentially exposed to the growth in China's trade between 1997 through 2007 due to differences in their initial patterns of industry specialization. They find that increased exposure of local labor markets to Chinese imports leads to higher unemployment, lower labor force participation, and reduced wages. They also find that exposure to Chinese trade did not have a significant effect on labor