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Economic Vulnerability of the Mexican Middle-Class

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The paper examines the economic vulnerability of Mexico's middle class through purchasing power, real wages and inequality. It argues that declining real income and debt pressures weaken a social group that is central to economic stability and growth. The study discusses heterodox wage and distribution policies, entrepreneurship and macroeconomic conditions, and proposes strengthening purchasing power as part of a broader strategy to reduce inequality and reinforce the middle class.

PALABRAS CLAVE

Mexico · middle class · real wages · purchasing power · inequality · economic vulnerability · distribution policy

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Economic Vulnerability of the Mexican Middle-Class

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Abstract

This paper examines the economic vulnerability of the Mexican middle-class in term of purchasing power. In particular we analyzed in detail the heterodox approach of real wages as a key element for a distributional policy and reducing inequality.

It is well known; a strong middle-class is one of the pillars for any successful economy from a point of view of generating wealth in a competitive economy (Pressman: 2015). Unfortunately, the middle-class vulnerability arises for the decreasing of its purchasing power and the difficulty to meet the payment commitments on debt in cash.

Under this perspective, this paper provides an analysis of the lack of economic policies in Mexico to strengthen the middle

class as an economic and social group that can contribute to the economic growth of Mexico. We highlight that income distribution only for the lower income people is important, but not sufficient without full employment and wage-led economy to the middle class

Keywords: Inequality, Wages, Skilled-Workers, Purchasing Power, Labour Market.

Introduction

Due to the complexity of the concept, there is no consensus in how we should define middle-class. However, it is important to mention that when we consider elements such as the purchasing power of income of each country, income, education, wealth, sustain conceptions, we can say that the middle class plays an important role in the economics activities of any countries and represents a pillar in the economic recovery and growth.

During the last 30 years, under the neo-liberal era, two social groups have been left behind, blue-collar workers and the other one is the middle-class. One of the consequences of this situation is the «Money of Account»[1] that middle-class has to face in order to meet the cash commitment.

Middle-income households have experienced dismal income growth or even stagnation in some countries (OECD, 2019). Furthermore, it became, indeed increasingly difficult to achieving the middle-class status. The skill bar to belong to the middle-class

[1] According to Keynes, the «money of account» is the «primary concept» of a theory of money; the money of account «comes into existence along with Debts, which are contracts for deferred payment, and Price-Lists, which are offers of contracts for sale or purchase» (Keynes quoted by L. Randall Wray: 2014).

has moved up during the last years. Indeed, since the early 1980s, there were important changes that affected the middle-class income, in particular in Mexico. For example, the mainstream economic remedy required Mexico implements a welfare state retrenchment. Thus, some negative effects on wages share.

Jan Kregel (2019) examines the real wages in a context of free international trade in emerging economies. In a context of shifting macroeconomic trends, Mexico has looked to a free international trade for attracting foreign direct investment. He noted:

> Many developing countries have attempted to expand their participation in international trade after the crises of the late 1990s by involvement in global production chains. However, for most of them the benefits have been meager because they have attracted foreign production units on the basis of extremely low domestic wages. [...] if a country's manufacturing exports are simply the assembly of imported semifinished goods, then there is little possibility of exploiting economies of scale and higher productivity, because wages have to be kept lower than in other potential assembly platforms in other countries. Thus, competition among countries to attract investment through low wages breaks the link between manufactured exports and higher domestic value added.

Evidence has shown that the decline of the real wages of the Mexican middle-class starts with the Washington Consensus (WC), where Mexico adopted a widespread of structural adjustment policies based on financial and trade liberalization. With the inclusion of the globalization era, Mexico has become an Export-driven country.

However, during the era of Stabilizing Development, we have witnessed a prosperous middle-class with a rapid economic growth and full employment policies that allowed a development of a specific social group with purchasing power. As Buffie (1989) noted:

> This period has since come to be known as the era of Stabilizing Development (SD). The main objectives of economic policy during SD were to increase private sector savings and capital accumulation, maintain price stability and a fixed parity with the dollar, and increase real wages. These goals were largely achieved, leading observers to speak of a «Mexican miracle». The exchange rate was kept fixed at 12.5 pesos per dollar and the annual inflation rate averaged 3.8 percent. Real output grew at an average rate of 6.7 percent and the share of gross fixed investment in GDP rose (at 1960 prices) from 16.2 percent in 1958 to 20.8 percent in 1970.

It is very important to point out that the stabilizing development in Mexico was not an isolate event. As Davidson (2013) wrote, «the growth of a prosperous middle class since World War II could be traced to the full employment policies started by Roosevelt and continued by both Democratic and Republican presidents—Truman, Eisenhower, Kennedy, and Johnson». The rise of this middle class was the perfect relationship between the labor union power, workers and government legislation.

In observing the economic policy of the Mexican government, where public aid is prioritized only to the low-income families and the working conditions under the banner of today's globalization, where finance now dominates trade and corporations seek the lowest-cost production platforms to maximize profits on global production (Kregel: 2019), we can argue that there is a failure in the economic debate to provide full employment and the payment of wages capable to increase the purchasing power of the middle class.

Before we start with some theories of wage-led growth, a few words on the methods used in presenting this paper will be helpful. In the pages that follow we will make use on the quantitative and qualitative methods. This means that, we will analyze the Middle-Income Thresholds from the Organization for Economic Cooperation and Development (OECD), and the National Institute Statistics and Geography (INEGI) in order to analyze the loss of purchasing power suffered by middle class. The method of qualitative in this research can be considered as the multiplier effect or rise in income for the middle class.

Few heterodox approaches on Purchasing Power Parity (PPP) and Wage-led growth

Our concern in this section, however, is not to talk about money in order to maximize profit or only as liquidity preference, but we refer to money as a store of value to preserve the purchasing power.

Empirical research on the Middle-Income Trap (MIT) has demonstrated that under this average growth rate, Mexico will not attain high income status until 2074 (Felipe, Kumar: 2012). For some post-Keynesian scholars, although not explicitly integrating middle class issues into the distribution and growth theory, Lavoie and Stockhammer (2012, p.) were well aware that an increase in wages will affect positively on the aggregate-demand and thus favorable to the economy. Therefore, considering the boundaries of the wage-led growth, they argue «larger geographical (or economic) areas are likely to be wage-led. The most recent empirical studies show that the world economy overall is in a wage-led demand regime and if all countries pursue pro-labour distributional policies simultaneously» (Lavoie and Stockhammer: 2010).

Also, given the importance of wages the most important factor for the middle-class, Goldstein and Hillard (2009) have mentioned that wage and price determination affects the profit rate which has feedback effects to aggregate demand. This approach is one of the fundamental principles of the heterodox macroeconomics, where the level of demand is a crucial point for the level of the economic activity, in the long run as well as in the short run.

At the macro level, the Neoliberal-induced policy shifts from capital controls to financial liberalization in the Mexico's economy, this policy can also help to explain the social frustration and the economic vulnerability of the Mexican middle-class. After the financial liberalization at the beginning of the nineties, the Mexican economy was dominated by enterprises with hedge financing profiles and gradually has become a Ponzi financing.

Based on Minsky's theory of Financial Instability Hypothesis (1992), the first theorem of the financial instability hypothesis is that the economy has financing regimes under which it is stable, and financing regimes in which it is unstable. The second theorem of the financial instability hypothesis is that over periods of prolonged prosperity, the economy transits from financial relations that make for a stable system to financial relations that make for an unstable system.

This financial instability has produced the so called «the Tequila Crisis» in 1994, it is well known that this crisis had have a very significant secular decline in investment, in the demand growth and its negative impacts and consequences of the decrease of real wages of the Mexican middle-class.

Nevertheless, it is very important to take a short look on the importance of Purchasing Parity Power (PPP) for the middle-class. Before talking about the PPP, it will be useful mentioning some aspect about money.

Fisher believes that the Purchasing Power of money depends on the lower or higher of price of goods. He recognized the purchasing power of money is the reciprocal of the level of prices; so that the study of purchasing power of money is identical with the study of price levels (Fisher: 1911). But that is not where this issue ends. Marshall (1920, p. 48) formulated more fully the causes determining the purchasing power of money under the economic studies, arguing that:

> Here, as elsewhere, we must bear in mind that the desire to make money does not itself necessarily proceed from motives of a low order, even when it is to be spent on oneself. Money is a means towards ends, and if the ends are noble, the desire for the means not ignoble. The lad who works hard and saves all he can, in order to be able to pay his way afterwards at a University, is eager for money; but his eagerness is not ignoble. In short, money is general purchasing power, and is sought, as a means to all kinds of ends, high as well as low, spiritual as well as material.

Following Randall Wray's interpretation of Keynes (2014), «the money of account is the primary concept of a theory of money; the money of account comes into existence along with Debts, which are contracts for deferred payment, and Price-Lists, which are offers of contracts for sale or purchase» (Keynes:1930). What is the most interesting about the contributions of Keynes is that he integrated the theory of aggregate effective demand as a meant of well-being in general and specifically for the middle-class.

According to Minsky, the problem of money-in/money-out in the evolution of the capitalist economy is linked to Financial Instability Hypothesis (FIH), that generated the necessary pre-condition for the *squeezed middle-class,* and the government is thus always in a position to prevent a financial crisis if it acts to provide cash to those institutions who need it to meet their debt commitments (Kregel, 2012).

With the rise in the cost of living, the Mexican middle class is very concerned about the inflation. According to a recent report of OECD (2019), four in ten are financially vulnerable and half struggle to make ends meet. During the last decades, the nominal wages has been increasing in Mexican labour market but could not increase the real purchasing power.

More recently, Kregel (2019) presented a view of money that is based on «Democratizing Money», with special emphasis on the financial system as the arena in which the middle-class should have access. He mentions eight basic principles to understand «Money», noting that:

> The first step in the democratization of money is to ensure equal opportunity to the ownership of property, and thus full participation in the democratic governance of society. The second should then imply equal access to the banking system, which finances the creation of capital via the creation of money. If the divergence between capital and labor -between rich and poor- is explained by the monopoly access of capitalists to finance, then reducing this divergence is crucially dependent on the democratization of money. [...] The importance of the role of money and finance in

determining inequality between capital and labor, between rich and poor, transcends any particular understanding of the process by which the creation of money leads to inequity.

Characteristics of Mexican middle-class and its economic vulnerability

For Rubio and De La Calle (2012), a middle-class household in Mexico is generally a family living in an urban context, although there is no reason to exclude the possibility that households in rural areas are also heading in this direction. The transformation from a mostly rural and mostly poor country to a less poor, mostly middle-class country occurred, in large part, thanks to the communications revolution, improved transportation, and the benefits of emigration, including remittances. According to this definition, the Mexican middle-class can be on the top decile of national income scale or below of it. The elasticity of the Mexican middle-middle is characterized by its different income level. In addition, they argue that Mexico is not a poor country anymore but not yet a developed country.

INEGI (National Institute Statistics and Geography) provides a crucial analytical foundation for explaining the vulnerability of the Mexican middle-class. Informal employment is one of the most important factors that drive the Mexican labour-market. According to INEGI (2019), the informal employment accounted for an estimated 56.9% of total employment in the first quarter 2019, representing 30.8 millions of people carry out their economic activities outside of any regulatory framework, healthcare coverage and social protection. This phenomenon makes it hard to calculate the average household income.

It is important to mention that more than two third of the OECD countries think of themselves as part of the middle class. The recent OECD middle-class report (2019) notes that half of the Mexican population think that they belong to the middle-class. As we see in the Table 1, it takes an annual income of between USD 3,800 and USD 10,000 in Mexico and between USD 26,500 and USD 70,699 in Luxembourg. The Lower and the Upper Thresholds depend on income between 75%. On this observation, an explanation of the middle-income households in Mexico emerged in the debate between on the policy strategy needed by developing countries for maximizing the benefits of international trade.

Country	Lower threshold	Upper threshold
Luxembourg	26,482	70,620
United States	23,416	62,442
Denmark	19,735	52,626
France	18,173	48,462
United Kingdom	15,856	42,283
Italy	12,206	32,549
Hungary	8,707	23,219
Mexico	3,757	10,019

Table 1. Middle-income thresholds vary largely across OECD countries

Lower and upper middle-income thresholds in USD 2010 PPPs, 2016 or latest year available

Note: Middle-incomes classes and median incomes defined based on equivalized household disposable income. The middle-income class comprises individuals in households with income between 75% and 200% of the median. Values in USD adjusted for international differences in 2010 purchasing power parities. Source: OECD, 2019.

As we can see, the Mexican middle has two specifics characteristics that make it very peculiar, first and foremost, more than half of the Mexican workers has informal jobs, which causes even more the fragility of this social group. Secondly, the middle-class aggregate income of the Upper-Income Households is three times larger than the all middle-income households, meaning a squeezed middle-class and the lack of financial resources needed to maintain a standard living. In addition to that, due to the socio-economic system in Mexico, there is a shift in the political economy to priorities interest of others social groups.

The recent OECD middle-class report (OECD, 2019) notes that Mexico is one of countries with of lower purchasing power of OECD members. When analyzing the causes and consequences the PPP in Mexico public expenditure in the region during these three decades (Table 2).

Year	PPP
2008	7.470
2009	7.429
2010	7.677
2011	7.673
2012	7.859
2013	7.884
2014	8.045
2015	8.326
2016	8.684
2017	9.041
2018	9.381

Table 2. Mexico, Purchasing Power Parities (PPP)
Source: OECD, 2019.

PPPs are the rates of currency conversion that try to equalize the purchasing power of different currencies, by eliminating the differences in price levels between countries. The basket of goods and services priced is a sample of all those that are part of final expenditures: final consumption of households and government, fixed capital formation, and net exports. This indicator is measured in terms of national currency per US dollar (OECD, 2019).

Indeed, the problem caused by the reduction of the PPP in Mexico's middle-class generated two principal negative effects in the economy: (1) both Low and High-skilled workers are moving to other countries for better wages and better lives, thus causing a decreasing of Mexico's participation in Global Value Chains (GVCs) and the difficulty for a fiscal consolidation programs, and (2) when the direct demand is taken into account, a decrease of consumptions of the middle-class will reduce investment and increase unemployment, in other word the middle-class demand is very elastic, and this elasticity depend enormously on real wages.

In particular, the Mexican labour market is facing serious dilemma for increasing real wages in the Fourth Industrial Revolution (4IR) era. The treatment of 4IR adds another degree of difficulty for strengthening the purchasing power of the middle-class. The Global Competitiveness Report (GCR) 2018, emphasizes the important role of competitiveness in the 4IR, thus provide workers good opportunities for maximizing wages. All competitiveness factors matter for all countries, regardless of their stage of development, and any pillar can be considered a potential priority. The 4IR makes it reasonable to take this more agnostic approach to income level and calls for a more encompassing approach to policy prioritization.

The Mexico's middle-class income group shrink over during the last decades and its economic influence weaken is also explicable when the shift to import-substitution to export-promotion regimes is take into account. As an emerging country, the export led-growth policy promotes by the International Monetary Fund (IMF) in the nineties, the impact of the global production chains in the globalization era, and the structural changes in the labour market, all these changes affect both the rising income inequality and the rising job insecurity, which will influence the vulnerability of the middle-class.

This gives rise to the problem commonly associated with the vulnerable employment, where middle-income jobs face high risk of automation and global supply chains, a risk closer to the middle-class. In terms of Skill-Based Technological Change (SBTC) which influence the labour market, innovation and competitiveness are central elements for economic leapfrogging. Recent studies, as Global Competitiveness Report (2018) noted the skillset of the population is another criteria of adaptability. With the right skills, workers can become the actors of the economic transformation rather than becoming victims of it, as the supply of skilled labor is determined by education (World Inequality Report, 2018). That is, the expansion of education leads to a rise in the supply of skills, while globalization and technological may change increase the demand for skills.

Conclusion

The Mexican middle-class income is increasingly uncertain in terms of wages and purchasing power. Presently, public debate focuses mainly on how to raise the minimum wage, which is very important for people's wellbeing as well for the economic activity.

The middle-class as an economic and social group represents a pillar to foster small and medium-Sized enterprises (SMEs) and innovation. In countries where the middle-class is strong, entrepreneurship activities tends to have a positive impact on GDP growth (Van Stel, et al: 2005). However, the share of benefits that the middle-class receives is much lower to the share of the population. For example, In Mexico, for example, they comprise 45% of population and 29% of benefits (OECD: 2019).

There are some alternatives approaches which need to be addressed by policy makers to reduce the economic vulnerability of the Mexican middle-class. Policy makers should ensure some better public social services; thus, the Mexican middle-class can reduce the cost of living, mainly in education and private health assurance.

Finally, at the economic level, there are several aspects that may reduce the instability and vulnerability of the Mexican middle-class. In terms of fiscal policy, one might reject the OECD (2019) argumentation, arguing: substantially reducing the tax burden on middle-income households would likely undermine the funding of some public services that they heavily rely on, or it would require more precise targeting of public expenditures to lower-income groups to reduce overall spending; to the contrary, the middle-class tax-cut should increase consumptions, thus full employment. By saying that, central bank should stop to raise the rate of interest; because the result of this policy would lead to a restrictive fiscal policy and reduce the liquidity preference. Given everything else, the decline in the purchasing power of the middle-class also discourages investment of specifics industries such as automotive industry, construction industry, among others.

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