THE MEXICAN TEXTILE INDUSTRY
- EVOLUTION OR REVOLUTION -

by
Paul A. Ruh, President
Paul Reinhart, Inc., Dallas, Texas

When Keth Henley asked me to write an article on the above subject, I told him that I could probably handle the 1960-2001 period, since during that time I was involved – in one way or another – with Mexico and the Mexican textile industry. Fortunately, my friend Buxton S. Midyette with whom I worked during his tenure at Cotton Council International, was able to help me out on the earlier times, based on his thesis presented to obtain a Master Degree of Arts at the University of Pennsylvania. I want to sincerely thank him for his contribution.

The Mexican textile industry has gone through remarkable changes. In my opinion, the changes were both revolutionary and evolutionary. Looking back over the often violent history of Mexico, there can be no question that the various political upheavals that ended with the Revolution of 1910 had a profound influence on the industry, just like on other aspects of Mexican life. On the other hand, the textile business has shown a gradual development since 1910 and then an enormous upswing when the NAFTA (North American Free Trade Agreement) treaty between the U.S., Canada and Mexico became operational early 1994.

Cotton has a very long history in Mexico. It was already being used in pre-Colombian times. For example, the Aztec warriors used heavy cotton fabrics as body armor. But the true roots of the industry go back to the days of the Spanish conquest. Starting in the 16th century, cotton was spun, knitted and woven in Mexico.

Initially, this activity took place on an artisan level. Families would set up home workshops to produce cheap cloth for the local population, while wealthier Mexicans preferred to purchase imported fabric, first from Spain, later from England. Typically, such workshops employed no more than 20 people. Production of cotton goods in Mexico tended to favor close proximity to areas where cotton was grown. This was mainly on the coast of the Gulf of Mexico, around Veracruz, and later in the Laguna (Torreón region). Cotton started to be planted also on the Pacific Coast.

As the industry expanded, foreign ownership became widespread. In earlier times, this meant Spanish ownership. Later, many of the factories were French-owned. As spinning and weaving became more mechanized, capital requirements increased. Absentee ownership contributed to recurrent labor unrest. Labor unions came into existence as early as 1800. In 1821, a liberal economic policy allowed free imports, including cheap textiles from overseas, especially England. This caused a steep decline in the local industry which could no longer compete. The government tried some protective measures, but by the end of the 1820's the existing textile industry was more or less wiped out.

Later in the 19th century, new owners and fresh capital came into the industry. In 1830, the first Mexican textile factory was established in Puebla, which became the center of the new textile activity. This was due to the proximity of cotton production and the availability of water power. By 1843, 55 textile factories existed in Mexico, of which 20 were located in Puebla, 8 in Veracruz. Beginning in 1873, railroads were built between Puebla and Veracruz, facilitating the movement of cotton from the coast and from Texas and New Orleans, making it possible to import U.S.-grown cotton at less cost. Due to the unpredictable nature of cotton production in Mexico, this was very beneficial for the spinning mills.

1910 brought the Revolution that ended the long reign of Porfirio Díaz, and 1929 started the even longer domination of Mexican politics by the PRI party. During the Revolution, many textile mills had to shut down for lack of raw material. Also, many of the foreign mill owners preferred to return to their home countries. This resulted in a "revolutionary" change in the industry. The most remarkable development was the arrival of Lebanese and Syrian immigrants who picked up the pieces. Over time, they had a leading role in the evolution of the Mexican textile industry and many of today's largest and strongest textile mills trace their origins to this group of Middle Eastern immigrants.

How did this come to pass? Remarkably, these immigrants were mostly without financial means, but they were by nature skilled traders, and they were willing to work hard to establish themselves in their new country. This included immediate assimilation to local customs, and learning to speak and write Spanish. They also had knowledge of the textile business which at the time was already well developed in Lebanon and Syria.

Initial efforts were very humble: the first step often consisted of peddling textiles door-to-door. Why was it possible for traders from the Middle East to get started and succeed in this business? Apparently direct selling to the public, especially to low-wage earners, was a market niche that had never been explored before. This modest activity also involved financing on a very limited scale and enabled the immigrants to save money and eventually made it possible to open retail stores. From that base the new textile industry developed. By the 1920's, these immigrants began to import textile machinery from the U.S. which initially consisted of used equipment, and later with increased prosperity, new spinning and weaving machinery.

The Zaga family of Mexico City is maybe the most striking example of the success of Middle Eastern immigrants, beginning with the arrival in Mexico City of Don Salomon Zaga in 1913. He came alone, leaving his family back home. Starting like others, as a traveling salesman, he was joined by his son Jacobo who arrived in 1920 with his mother and brothers. The goods they sold were all imported, and consisted of all kinds of clothing. By 1930 the family had saved enough to open a small shop in Mexico City. Three years later they teamed up with a partner to buy denim and sew pants.

After World War II, Mexico became a closed market as the government embarked on a policy of import substitution. Freed from foreign competition, the industry prospered. The Mexican textile industry experienced a first wave of rapid expansion.

Taking advantage of this policy, the Zagas later decided to expand into manufacturing rather than just merchandizing. In 1950 they purchased 40 used Willman Jacquard knitting machines in the U.S. for $100 each, and set up shop. The surging demand for textiles made it necessary to expand into spinning to assure a steady supply of yarn. The family purchased spinning equipment in England in 1953. When demand for textiles grew, they decided to divide the operation: In 1955, Don Jacobo and Rafael Zaga founded the family's first yarn mill, the first in Mexico City. Two cousins concentrated on shirts and knitting. This serves to illustrate one of the key success factors of the Mexican textile industry: extended families working together and supporting each other with work and capital.

Let us take a look at how raw cotton production developed after WW II. It increased rapidly in the 50's and 60's, partly due to new land put into production through huge irrigation projects and increased yields. The harvest produced 1.137 million bales in 1950/51, and hit its all-time high in 1965/66 with 2.578 million bales. At that time, Mexico and Central America supplied some 3.5 million bales of top quality cotton to markets around the world. But production did not hold up. Mexican raw cotton production exceeded two million bales only three times more: in 1966/67, 1968/69 and 1974/75, but then it gradually diminished to less than one million bales. High costs, insect pressure, lack of government research and subsidies, and most recently, a very strong peso forced farmers to look for alternatives.

On the other side of the coin, domestic raw cotton consumption passed the half-million bale mark in the 1960/61 season. Ten years later it had grown to 706,000 bales. But the textile industry, lacking import competition, saw no incentive in further expansion; the business was very profitable, thanks to the country's closed borders. Mill use stalled between 600,000 and 800,000 bales.

This all changed explosively with NAFTA becoming a reality in early 1994 and the successive signing of free trade agreements with a large number of other nations, including the European Union. The industry got an additional boost, as important as NAFTA, or even more so, from the undervalued peso during 1994 and 1995, by close to 20% compared to the U.S. dollar. The sudden availability of the huge U.S., Canadian and many other markets, opened up unprecedented opportunities for Mexico and the textile industry took full advantage of these new export markets. Raw cotton consumption passed one million bales in 1995/96, and shot up to 2.2 million within three years.

1994 was a decisive year for Mexico, including its textile industry. It began with a currency crisis. Incoming president Ernesto Zedillo found himself confronted with a lack of foreign exchange. The peso had to be devalued, but the crisis passed soon. The combination of an undervalued peso and no customs barriers and tariffs in the U.S. and in Canada made Mexican goods very competitive. Total Mexican exports nearly tripled from 1993 to 1999. The strong expansion of the U.S. and Mexican economies during these years added to the textile boom in both countries.

The textile industry found itself in a highly advantageous situation and embarked on a program of rapid expansion. New investments in textile machinery soared from U.S. $266 million in 1995 to over $500 million in each of the years from 1997 to 2000. A large part of these investments was used to sharply increase the production capacity of denim. Exports of Mexican-made textiles to the U.S. grew from 0.5 billion square meter equivalents in 1994 to 2.5 billion in 1999, an increase of 400%. The rapidly increasing cotton demand could not be filled from the domestic crop. Large-scale imports of raw cotton, mostly duty-free U.S.-grown, accelerated under NAFTA and reached 2.1 million bales in 1999/2000.

Raw cotton production in Mexico did not benefit from NAFTA; agriculture was somehow overlooked in the treaty negotiations. The Mexican cotton grower gets very little help from the government, and depends therefore entirely on the market price. Accordingly, the crop has varied a great deal. It reached a modern-day low in 1993/94, with just 110,000 bales. In 1996/97, the crop was back up over a million bales, but in 2000/01 the outturn was only 332,000 bales. 440,000 bales are expected to be produced in 2001/02. Mexico will continue to be the most important export market for U.S. raw cotton.

Interestingly enough, the upswing in the textile industry did not lead to a major participation by U.S. and other foreign companies. Certainly, there were some foreign investments, joint ventures and alliances, but the main investment came from within the Mexican industry which went through a major relocation in the process. Today, the center of textile production has shifted decisively from Puebla to the greater Mexico City area that includes Tepeji del Rio, Toluca, Cautitlán Izcalli and the neighboring states of Hidalgo and Morelos. The city of Parras also has maintained its long-established tradition in textiles. So have Orizaba, Guadalajara, Torreón and others. Culiacán, Ciudad Obregón, and Ciudad Victoria have developed their textile industry only very recently with investments from the Far East.

A large percentage of the cotton consumption, perhaps as much as 40% of the country's total usage today, is in the hands of three groups: The many Zaga families, the two Kalach branches (one of them is also a market leader in MMF's) and Parras (founded in 1899 and well-known for its variety of denim and other fabrics).

There has been some U.S. investment in textiles, mainly in "maquiladoras," or in-bond assembly plants. To take advantage of the much lower wages in Mexico, these were opened along the border, and later on, within Mexico, to manufacture apparel mostly from U.S.-made fabric (but also material from Asia, particularly on the Yucatan peninsula). Pay to apparel factory workers is a major factor in garment production. Daily textile wages in Mexico are still only about ten percent of labor in the U.S. and approximately 50% of developing Asian countries, but less developed countries in Asia, Central America and the Caribbean can undercut Mexico by a much wider margin.

Unfortunately, straight-line projections made in 1999 according to which Mexico's cotton consumption would reach five million bales by 2003 turned out to be overly optimistic. A number of setbacks occurred that caused the industry to stall. A consumption of 2.4 million bales during the 1999/2000 marketing year marked the high-point of Mexico's domestic use, at least so far. So what exactly has happened to the textile industry since about a year ago?

- the aftermath of the Asian crisis brought severe competition from cheap imports
- illegal imports of textiles into Mexico were rampant through November of 2000
- growing competition in U.S. markets from the Caribbean, favored by the CBI treaty
- the strong dollar and the even stronger and over-valued Mexican peso
- dumping of U.S. yarn in view of the slowdown of the U.S. textile business
- the economic down-turn in the U.S. and Mexico has affected textiles significantly

In my view, the major threat right now probably comes from the over-valuation of the Mexican peso vis-à-vis the U.S. dollar, estimated by some experts as reaching 25%. The weak currency that contributed decisively to the textile boom from 1994 onward has become extremely strong over the years and is now hurting the domestic textile production and all of Mexico's exports.

What does the future hold for the Mexican textile industry? I believe that the combination of NAFTA, the proximity to the U.S./Canadian markets and the increasing efficiency of Mexico's modern mills will assure a bright future for the industry. Obviously, there will be ups and downs. In my opinion, the Mexican mills should not try to compete with the large lowest-cost producers, such as China, Pakistan, India and Indonesia, but instead put more emphasis on quality and market niches. Vertical integration and direct access to the largest retail chains in the world, just across the border, will be the keys to the industry's success.

From here on, changes in the industry are going to be evolutionary, not revolutionary.

Published by Cotton Outlook – Special Feature
September 2001