Dynamic Growth in the Rio Grande Valley

By José Joaquín López

Its proximity to Mexico and fast-growing, binational job market are major factors in the Rio Grande Valley's economy. They're a large part of the reason employment has increased at a faster, steadier pace in the Valley than in the United States, Mexico or Texas as a whole *(Chart 1).*

Despite rapid job creation, the Valley remains relatively poor. The McAllen–Edinburg–Mission metropolitan statistical area ranks last among the nation's 361 MSAs, with a per capita income of $15,184 a year, less than half the national average of $31,472. The Brownsville–Harlingen MSA comes in next to last at $16,308.

The combination of rapid job growth and low income is unusual. In a study covering 1967 to 1997, Dallas Fed economist Keith Phillips found weak employment gains in other states' low-income counties—annual averages of 2 percent in Kentucky, 0.4 percent in West Virginia and 0.3 percent in Mississippi. Valley employment, by contrast, rose 3.4 percent a year over the three decades.

More recent data confirm that the Valley is creating jobs at an above-average rate, a trend that dates back to at least 1969. The McAllen MSA posted the strongest gains of all the Texas–Mexico border metros from 1997 to 2003, with employment growing an average 4.6 percent. Brownsville's 3.1 percent job growth was nearly twice as fast as Texas' 1.6 percent. National job creation over this period was 1.2 percent.

The years of strong job growth have whittled away at the Valley's once-high unemployment rate. McAllen's jobless rate fell from 25.1 percent in April 1990 to 6.6 percent in December 2005. Brownsville's dropped from 16.1 percent in April 1991 to 6.1 percent in December 2005.

These trends raise several questions. What sectors have contributed to the Valley's rapid job growth? How does Mexico shape the Valley's economy? Will the stripping away of trade barriers in Central America and the Dominican Republic mean new competition or new opportunities? Can the Valley continue to create jobs? Can it begin to close the income gap?

Economic Drivers

The Rio Grande Valley abuts the Gulf of Mexico at Texas' southern tip and stretches roughly 100 miles along the river that separates the United States from Mexico *(see map).* The region encompasses Cameron, Hidalgo, Starr and Willacy counties, which had a combined population of nearly 1.1 million in 2005.

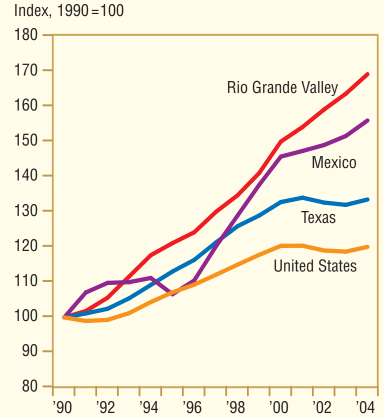
In terms of earnings, two sectors account for nearly half the area's economic activity. The largest contributor to income is government, which includes local, state and federal workers as well as public school and university employees *(Chart 2).* This sector accounted for more than a quarter of Valley earnings in 2004, well above the 18 percent state average.

The Valley's second-largest sector is health care and social assistance. At 20 percent of earnings, the 2004 share was two-thirds higher than the 12 percent of a decade earlier. Over the same period, health care's share of the national economy rose much more slowly, going from 9.5 percent to 10.8 percent. The state is slightly below the U.S. average at 10 percent.

Retail trade earnings made up almost 10 percent of the Valley economy in 2004, just about matching the state average. Mexican nationals cross the border to shop year-round. Tourist traffic includes Winter Texans, mostly retirees from the Midwest and Canada who spend several months in the Valley, attracted by warm weather and low living costs.

Spending by Mexicans and other visitors makes Valley retailing an important export sector, a rarity in nonborder cities.[1]

Chart 1
Valley Tops Texas, U.S., Mexico in Job Growth

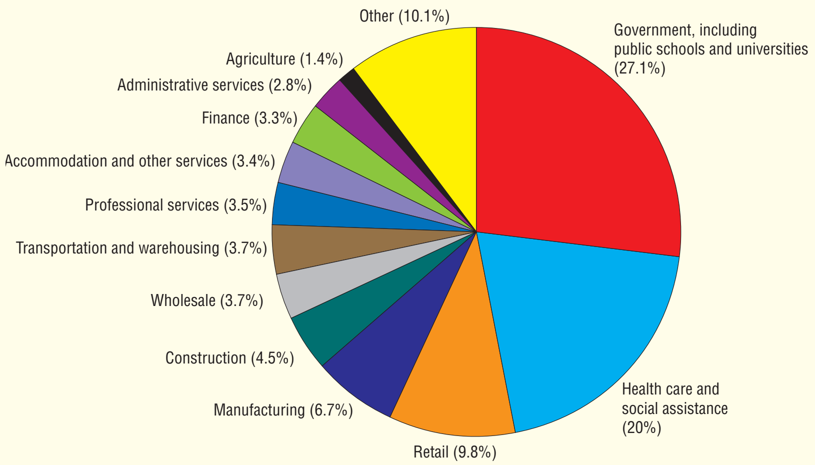


SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Dallas; Instituto Nacional de Estadística, Geografía e Informática.

Rio Grande Valley

Chart 2

Government, Health Care Biggest Sources of Valley Earnings



SOURCE: Bureau of Economic Analysis.

The percentage of sales to nonresidents averaged about 35 percent in McAllen and 26 percent in Brownsville over 1978–2001 *(Chart 3)*. This number is considerably higher for Laredo, the main port of entry for U.S.–Mexico land-borne trade, and much lower for El Paso, which relies more heavily on the maquiladora industry in Cuidad Juárez.

Agriculture has historically been one of the Valley's cultural and economic mainstays. The annual harvest remains an important source of income and jobs in rural areas, but agriculture's overall share of the Valley economy has been declining for more than three decades *(Chart 4)*. By 2004, farming accounted for less than 1.4 percent of total earnings, making it one of the smallest sectors.

Ties to Mexico and Beyond

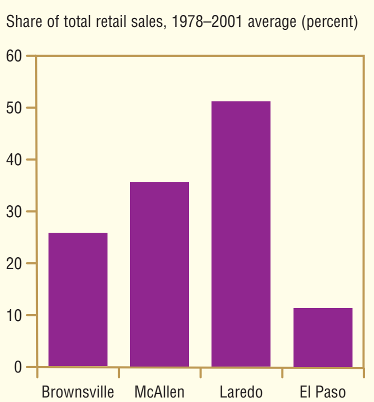
Across the Rio Grande from the Valley lies Mexico—a developing country with its most dynamic regions in the north, opposite Texas. Northern Mexico interacts heavily with the Valley, providing demand for goods and services as well as a competitive location for low-cost production. Over the years, Mexico has contributed to the Valley's booms and busts.

Spending by Mexican shoppers is well documented, but Mexico also affects the size of the government sector in the Valley. Many Mexican students attend school on the U.S. side of the border, boosting the education segment. The region, moreover, serves as a base for an extensive U.S. Customs and Border Protection presence. The agency is an important source of income because its jobs are relatively high paying. In 2003, average annual earnings for civilian federal workers in the Valley were $83,562, up 11 percent from 1998 when adjusted for inflation. By contrast, the area's overall average earnings were $26,874 in 2003, a gain of 4 percent.

Businesses on the Texas side of the border get a boost from a strong Mexican maquiladora industry, which takes advantage of duty-free imports from the United States for assembly and re-export. Reynosa, across the Rio Grande from McAllen, and Matamoros, Brownsville's sister city, are home to roughly a third of the maquiladora employment along the Texas–Mexico border. In addition, Reynosa's maquiladora industry has had the fastest job growth along the U.S.–Mexico border since 2000, and it was the only maquiladora industry that did not see employment declines during the most recent U.S. recession (*Chart 5*).

Chart 3

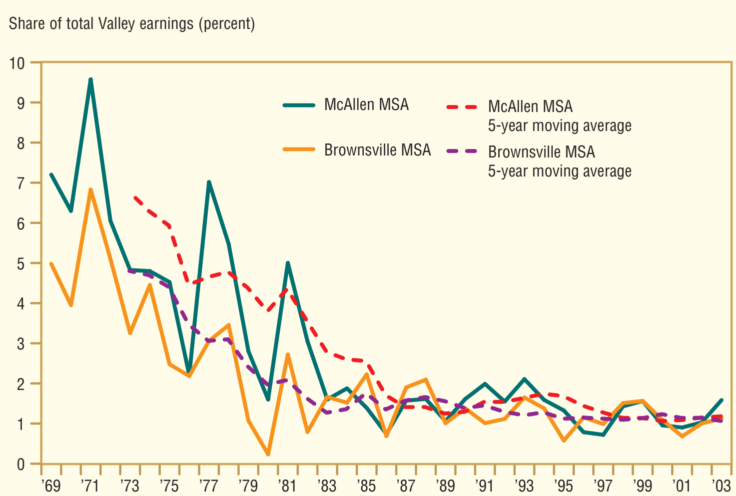
Nonresident Spending Boosts Border Retail Sales



SOURCE: "Texas Border Benefits from Retail Sales to Mexican Nationals," by Keith R. Phillips and Roberto Coronado, in *The Face of Texas*, Federal Reserve Bank of Dallas, October 2005.

Chart 4

Agricultural Earnings Share Declines



SOURCE: Bureau of Economic Analysis.

With Mexico's low-wage workers so near, the Valley's manufacturing sector has been limited. It accounts for 6 percent of employment, less than the state's 9 percent and the nation's 11 percent. The manufacturing across the border, however, beefs up transport, warehousing and other business services that supply maquiladoras. Research by Dallas Fed economists Bill Gilmer and Jesus Cañas finds that maquiladoras and their supporting industries play a key role in allocating employment across sectors in four pairs of border cities.[2]

Proximity to Mexico increases the importance of the dollar–peso exchange rate to the Valley. Fluctuations affect the purchasing power of Mexican shoppers and tourists, and sharp declines in the peso's real value have negatively impacted such sectors as retail and leisure. Valley MSAs are typical of all those along the border. They show a strong correlation between the U.S–Mexico real exchange rate and the business-cycle index, as determined by employment, jobless rates, retail sales and total wages *(Chart 6)*.

Since Mexico's adoption of floating exchange rates in early 1995, however, the peso has shown more stability, notably surviving a period of uncertainty during the 2000 presidential election. Since then, low inflation in Mexico and other factors have caused the peso to strengthen, improving its purchasing power. The Valley economy will benefit if the peso maintains its stability through this year's elections.

Although Mexico will continue to be a dominant factor for the Valley economy, new business opportunities could arise in other nations. In 2005, Congress approved the Central American Free Trade Agreement (DR-CAFTA), with Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic. The agreement will eventually eliminate tariffs and other trade barriers among the participants.

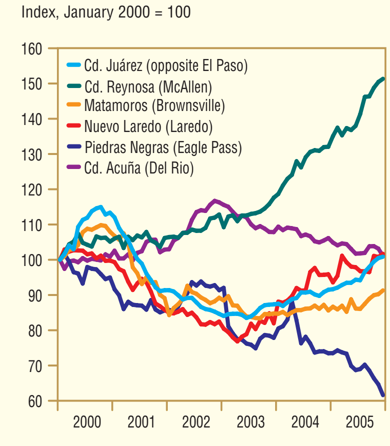
These countries' main exports include coffee, sugar, petroleum, bananas and gold. Their main imports are machinery and equipment, raw materials, consumer goods, cotton and fabrics. This pattern is consistent with trade theory, which predicts that countries will export goods produced with an abundant factor, such as low-skilled labor, while importing goods and services produced using a locally scarce input, such as capital or highly skilled labor.

As barriers between the DR-CAFTA countries fall, however, access to a larger variety of previously nontraded goods and services can redefine the pattern of imports and exports. The Valley can benefit from increasing trade with the DR-CAFTA nations by selling beef, medicinal products such as aloe vera, processed food, cotton, and unique fruits and vegetables, such as the Sweet Texas Red Grapefruit and the Texas 1015 SuperSweet Onion. The pre-CAFTA duty on such products ranged from 1 percent for cotton to 30 percent for beef.

Both the Valley and DR-CAFTA counties produce sugar, but Texas growers have little to fear from the new trade pact. The Valley's sugar industry, which represents about 10 percent of the area's agricultural output, retains substantial protection under the agreement. The quota over the next 15 years will reach 150,000 metric tons, 1.9 percent of 2004 U.S. production. Under the current farm bill, the domestic sugar program remains unaffected, while total sugar imports are kept below 1.4 million metric tons—a comfortable cushion considering the size of sugar influx from the DR-CAFTA area. The over-the-quota U.S. tariff on sugar will not change. It's currently above 100 percent, one of the highest the United States imposes.

Because imports from DR-CAFTA countries will not significantly threaten the U.S. sugar industry, Valley producers' market allotment is unlikely to decline significantly as a result of the agreement.

Chart 5
Maquiladora Job Growth Strongest in Reynosa



SOURCE: Instituto Nacional de Estadística, Geografía e Informática.

The Valley's Prospects

Overall, the Valley's short-term outlook is positive. Employment gains are likely to continue at a relatively strong pace, especially in health care, now the largest private-sector employer. Key drivers of employment will probably remain strong, and agriculture can benefit from more exports. Because the health care and federal government sectors

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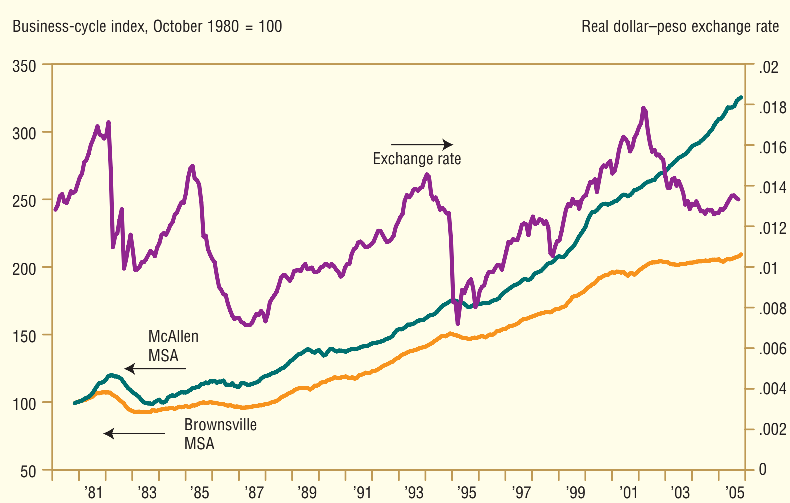
Chart 6
Business Cycles, Exchange Rates Correlate in Valley MSAs



SOURCES: Federal Reserve Bank of Dallas; Banco de México.

pay above-average wages, the growth of these industries is good for the Valley economy.

Rising maquiladora employment, especially in Reynosa, should also boost the economy over the next year or so. Steady job and population growth will continue to fuel commercial and residential construction, resulting in an optimistic forecast for this otherwise volatile sector.

Although Mexico's July presidential election may create some uncertainty, floating exchange rates and relatively stable currency-market fundamentals reduce the likelihood of a peso shock. With its strength sustained, Mexico's currency should continue to stimulate the Valley's retail and leisure sectors.

Longer term, the Valley faces challenges. Consistent and rapid job growth since the early 1990s has helped the region shed its reputation for high unemployment, but the economy hasn't been catching up with national and state levels of per capita income.

Most likely, low educational attainment lies at the heart of this. The region has been unable to improve the education level of its workforce relative to the state since the 1970s. In 2000, the percentage of the labor force with less than a high school education averaged 52 percent in the Valley and 24 percent in Texas, according to the Census Bureau. If the Valley were to reduce its high school dropout rate to the state average, income would go up an estimated $2 billion a year.[3]

Some trends are encouraging. Local university enrollment has been rising for the past four years, perhaps a sign the Valley is responding to an economic environment that rewards higher skills. In addition, increased state funding for public education during the 1990s may start having a positive impact on education, and thus, on per capita income.

In summary, fast convergence toward state and national levels of per capita income will depend mainly on the Valley's ability to improve the education of its workforce, a long-term commitment that can only succeed through the combined efforts of households, businesses and government.

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Notes

[1] Exceptions are major tourist areas, such as Las Vegas, where a large share of retail sales is to nonresidents.

[2] "Industrial Structure and Economic Complementarities in City Pairs on the Texas–Mexico Border," by Robert W. Gilmer and Jesus Cañas, Federal Reserve Bank of Dallas Working Paper no. 0503, 2005.

[3] "Secondary Education: Its Impact on Border Income," by Thomas Fullerton Jr., *The Border Economy*, Federal Reserve Bank of Dallas, June 2001.

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