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MEXICO’S LABOR LAW: A CRITICAL BUSINESS ISSUE

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Almost every U.S. apparel, textile and related-industry producer is considering doing business in Mexico. The reasons?

- The North American Free Trade Agreement (NAFTA) has opened opportunities to export fabric and textile machinery to Mexico and to set up joint ventures to source, manufacture and sell fiber, textiles and apparel. For apparel to qualify for reduced duty under NAFTA, it must be made from fabric formed and cut in a NAFTA country. As a result, exports of fabric to Mexico, as well as Mexican production of fabric, textiles and apparel, are increasing.
- Mexico’s new Foreign Investment Law makes it easier for U.S. firms to own businesses located anywhere in the country.
- The Mexican middle class has grown to 20 million consumers; they clearly prefer U.S. products, spending 70 percent of the country’s import dollars on U.S. goods and services.
- NAFTA and other factors have led many U.S. companies with established manufacturing operations in Asia to shift production to Mexico. Different factors, including the growth and proximity of South America, have led U.S. companies with less international experience to buy Mexican plants for production and export to South America.
- Mexico’s recent peso devaluation has forced many private and state-owned companies to be put up for sale, creating acquisition opportunities for U.S. firms.
- And Mexico’s low base wage (which with the peso’s fall now is even lower in dollar terms) is a factor for some businesses.

Companies should be aware, however, that Mexico’s Federal Labor Law (FLL) places burdensome restrictions on employers, which makes the low base wage somewhat deceptive. Although the minimum wage for non-skilled workers in most of Mexico is only about \$6 per day, many industrial employers pay two to three times the minimum.

But this is only the beginning. Benefits required by the FLL or typically provided by U.S.-related companies increase base wages even more. Lower productivity and quality than is customary in the United States also can be a factor. Most importantly, however, the FLL clearly favors employees and labor unions. In fact, one of the opening provisions of the FLL requires that in case of doubt in the interpretation of the FLL, the interpretation most favorable to the employee shall prevail.

Moreover, the North American Agreement on Labor Cooperation, the NAFTA side-agreement on labor demanded by President Clinton as a condition of supporting NAFTA, has led to more vigorous enforcement of the FLL. Organized labor also has made increased enforcement a top priority. And in the wake of Mexico's peso devaluation, the government has attempted to increase revenues through greater enforcement of regulations, including some labor regulations.

For these reason, U.S. executives should critically evaluate Mexican labor law issues before finalizing plans to do business there. This article summarizes the most important requirements of the FLL.

INDIVIDUAL EMPLOYMENT RELATIONS

Written Employment Agreement. Under the FLL, every employee not covered by a labor union contract is entitled to a written agreement stating the terms of employment. The agreement is signed in duplicate, and one copy is given to the employee. The agreement must contain several terms, including the work to be performed; the length of the work shift; and the salary and day and place of payment. Absence of a signed agreement does not deprive workers of rights set forth in the statute.

Job Permanency. In sharp contrast to the United States' employment at-will doctrine, employment in Mexico is for an "indefinite" period unless the agreement expressly states otherwise. In other words, a worker has the right to keep his job as long as it exists. (This is known as the principle of "job stability.") The agreement may provide for a definite period of employment only if the type of work to be performed calls for a specific activity or period of time. For example, if the worker is hired for a construction project or to temporarily replace another employee, the employer can limit the worker's duration of employment.

When a business in Mexico changes hands, the buyer and the seller are jointly liable for existing employment obligations for six months. After six months the buyer is solely liable. Under this principle, known as "employer substitution," changes in ownership do not alter previously negotiated individual employment agreements or collective bargaining agreements.

Termination Procedures. An employer can suspend an employee without incurring liability only for specific causes. For example, a worker who contracts a contagious disease or is temporarily disabled because of a non-work related accident or illness can be suspended.

An employer can terminate an employee without incurring liability only for just cause. The FLL provides specific examples of just cause, including use of false documentation to secure employment, intentionally or negligently damaging the employer's property, and disclosure of trade secrets or confidential information. Employers must give written notice of the date and cause of termination. The employer has the burden of proving just cause for dismissal.

Labor Boards. A terminated employee may appeal to the appropriate federal or state conciliation and arbitration board. Conciliation and arbitration boards are administrative/judicial bodies responsible for mediating alleged FLL violations. Federal boards have jurisdiction over certain key industries, including the apparel industry. The boards consist of three members, with one member each representing the government, business and labor sectors. The government representative presides.

State governors appoint the government representative to state boards. Therefore, even though Mexican states do not have labor laws of their own, labor practices differ from state to state, depending on the governor's reliance on labor organizations for political support. Along the U.S. border, the Western states are less closely linked to labor.

Termination Penalties. As a practical matter, it is very difficult for the employer to win a termination case. If the conciliation and arbitration board rules against the employer, as it usually does, the employee is entitled to reinstatement or an indemnification equivalent to three months' wages, whichever the employee chooses. The employee is also entitled to back pay from the date of termination until the date of the award, without offset for interim earnings.

The employer is not obligated to reinstate employees in certain cases—for example, if the employee works in direct and constant contact with the employer and a normal relationship is impossible. If the employer does not reinstate such an employee, however, it must pay an indemnification usually equivalent to 20 days' wages for each year of service, in addition to three months' wages and back pay.

Workers who are terminated with or without cause, as well as those who resign with 15 or more years of seniority, also are entitled to a seniority premium equivalent to 12 days' salary for each year of service. (For purposes of the seniority premium, the daily salary is deemed not to exceed the minimum daily wage times two.)

WAGES AND BENEFITS

Work Shifts and Overtime. Work shifts cannot exceed seven to eight hours per day, depending on the time of day worked. Employees are entitled to a rest period of at least 30 minutes per work shift. If employees cannot leave the premises during the rest period, rest period time is compensable.

The first nine hours of overtime per week are payable at twice the regular rate. Thereafter, overtime hours are payable at triple the regular rate.

Paid Days of Rest. If an employee has to work on a Sunday, he is entitled to 25 percent premium for that day. Mandatory holidays are Jan. 1; Feb. 5 (Constitution Day); March 21 (Juarez's birthday); May 1 (Labor Day); Sept. 16 (Independence Day); Nov. 20 (Revolution Day); Dec. 1 every six years (when the new president is inaugurated); and Dec. 25.

If an employee has to work on a mandatory holiday, he is entitled to double pay for that day. Businesses typically observe several additional holidays, including the Thursday and Friday of Easter week, May 5 (Battle of Puebla anniversary), Oct. 12 (Columbus Day) and Nov. 21 (All Souls' Day).

Paid Vacations. Employees are entitled to paid vacation days depending on years of service as follows: after one year, six days; after two years, eight days; after three years, 10 days; and after four years, 12 days. Thereafter, the vacation period increases by two days for every five years of service. (Thus, after nine years, 14 days; after 14 years, 16 days, etc.) Vacation pay equals regular pay plus 25 percent.

Mandatory Christmas Bonus. Employees are entitled to a Christmas bonus ("aguinaldo") equal to 15 days' wages payable prior to Dec. 20.

Minimum Wage. The average industrial daily minimum wage is approximate \$6. But many blue collar manufacturing jobs pay two to three times the minimum, depending on the level of skill required. Benefits mandated by the FLL or typically provided by U.S. subsidiaries increase the cost of labor about 100 percent. And many U.S. subsidiaries in Mexico encounter reduced productivity and quality. Programs to control turnover and absenteeism, and the need for employee training, add to labor costs.

Mandatory Profit Sharing. Mexican employees are entitled to share in their company's profits. The rate of profit sharing is determined every 10 years by a national commission. The rate is currently 10 percent of the employer's taxable income. In isolated situations, profit sharing is limited to one month's salary.

Profit sharing distributions must be made within five months of the year end. The employer is required to give employees a copy of its tax return so employees can exercise their right to object to the amount of their profit share.

Certain companies are exempt from paying profit sharing. These include newly incorporated companies during the first year of operations and newly incorporated companies engaged in making a new product during the first two years of operations.

Paid Housing. Employers must contribute an amount equivalent to 5 percent of employee wages to a national housing fund.

Paid Training. Employers are required by law to form labor-management training committees to develop programs to improve the skills of employees. The training programs must be submitted for approval to the Ministry of Labor.

Discrimination. The FLL prohibits discrimination based on race, nationality, sex, age, religion, or political affiliation. But it also requires employers to give preference to Mexicans over non-Mexicans and to union workers over non-union workers. At least 90 percent of a company's employees must be Mexicans. Executives and general managers are excluded from this percentage.

Under Mexican immigration law, expatriate executives and general managers usually can obtain temporary visas without much difficulty, but it is advisable at manufacturing plants to have Mexican plant and personnel managers. Mexican managers typically make four-fifths or more of what their U.S. counterparts earn. As in the case of employees, the cost of training Mexican managers must be taken into account.

Social Security. The Social Security Law of 1973 requires employers to make social security contributions amounting to about 20 percent of employee wages. The social security system pays for work-related accidents. The system also pays for 60 percent of required maternity leave; employers pay the balance. The system provides free medical attention, hospitalization, unemployment compensation and disability compensation.

CHILD LABOR

Employment of minors under age 14 is prohibited, and employment of minors between the ages of 14 and 16 is prohibited in certain industries considered dangerous. Also, employment of minors between the ages of 14 and 18 is prohibited in industrial night work. Employment in other industries is permitted if medical certificates and evidence of periodic medical checkups are kept.

Work shifts cannot exceed six hours per day and must be divided into periods of three hours or less, with at least one hour of rest in between. Additionally, minors between the ages of 14 and 16 cannot work overtime, on Sundays or on mandatory holidays, and they must receive 18 days of paid vacation per year.

COLLECTIVE LABOR RELATIONS

Collective Bargaining Agreements. Employers must negotiate labor contracts with unions represented at their plants upon request. Because the union need not win an election, the unionization rate is much higher than in the United States.

According to some estimates, approximately 90 percent of production workers in industrial plants of more than 20 employees are unionized. Union activity is the most aggressive in the Mexico City area. Along the U.S. border, the level of union activity decreases as one moves west.

Larger employers may have a contract with the company (single employer) or industrial (multiple employer) union having the most members in the workplace and with one or more craft unions represented in the work force.

Collective bargaining agreements must be in writing, and they must address, among other things, work shifts, paid days off, vacation days and salary ranges. The agreement usually requires a closed shop, and covers all employees, whether or not they are members of the contracting union. The agreement also can require the employer to dismiss workers who resign or are dismissed from the union. Either management or the union may request renegotiation of wage clauses yearly and all other clauses every two years.

Mass Layoffs, Reductions in Force and Plant Closings. In some cases, employers must petition the conciliation and arbitration board before carrying out a restructuring. Unions normally oppose such moves. If the board approves the company's petition, it establishes the indemnification owed the affected workers. The maximum indemnification is four months' pay and benefits, 20 days' wages for each year of service and the seniority premium discussed herein.

STRIKES

Mandatory Negotiation. Before calling a strike, a union is required to file a strike notice with the conciliation and arbitration board. Within 24 hours of receipt, the board forwards the notice, which states the union's demands and objectives, to the employer.

The strike cannot begin until the employer has had notice for six days (10 if it is a public utility). The employer has 48 hours to file a written response. Upon receiving the employer's response, the board summons the parties to a conciliation hearing. The board's settlement process usually is successful—approximately 95 percent of called strikes are settled before they begin.

Strike Arbitration. Within 72 hours after a strike begins, the employer or the union may request that the board declare the strike legally "non-existent" for various reasons. The board holds a hearing within five days to decide the issue.

The board will rule for the employer if the strike has an unlawful objective or lacks majority support. If the board rules for the employer, employees must return to work within 24 hours or risk termination. If the board rules for the union, the employer must satisfy the union's demands and pay back salaries and benefits (which are determined by the board) for the duration of the strike.

Plant Shutdown. Once a strike is recognized, a private employer cannot continue operations. The board supervises the closing of the plant, and thus there is no "striker replacement" issue.

HEALTH AND SAFETY

Under Mexican regulations, employers must meet minimum requirements of health and safety standards which are substantially equivalent to U.S. law. Labor authorities inspect employers' premises to monitor compliance, and employers must form labor-management health and safety committees to develop safety procedures and investigate causes of work-related accidents.

In sum, Mexican labor law should be examined early in any prospective business deal. Keep in mind the following points:

- The benefits of doing business in Mexico must be balanced against the true cost of labor, including required benefits, administration, training for employees and management, productivity, turnover, absenteeism, and decreased quality.
- While the FLL gives Mexican agents of U.S. exporters all rights and benefits of employees, the law does not consider distributors to be employees, and thus, does not afford them the statute's benefits upon termination.
- If you are considering a joint venture in Mexico, ask your Mexican counterpart to be responsible for labor matters.
- Finally, if you are buying an ongoing operation in Mexico, remember that certain regions have a more favorable labor climate. Travel to the area and obtain advice from other businesses there. If the employer has entered into a collective bargaining agreement, review it carefully. Also, ask the current owner to carry out any necessary painful employment moves, such as reductions in force, before you take over.