Mexico's savings problem

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Almost $45 billion in funds left Mexico during the 1980s —a colossal amount, almost all of which has yet to be repatriated. Recent political uncertainty has caused this financial hemorrhage to accelerate. If president-elect Ernesto Zedillo is to build on the successes of his predecessor, he must give high priority to addressing the Mexican savings problem.

Each sector of society must contribute to increasing net savings rates. For example, policies to allow Mexico's hard-pressed middle income groups to plan their life savings, both for their own benefit and for the greater benefit of Mexico, are sorely needed. In particular, educational and pension funding must be reformed —these are vital factors in the promotion of savings amongst comparable groups in other countries. The United States, traditionally regarded as a low-savings society, is an example. U.S. citizens are heavily invested in mortgaging their properties, educating their children and financing their own retirement. All of these microeconomic actions help make the U.S. the financial powerhouse that it is. All of these sectors are underdeveloped in Mexico —to the detriment of all Mexicans.

Pension funds, for example —since they require no intergenerational transfer of funds— are a key component of a nation's savings and are among the world's most important financial instruments. Preferential tax treatment has made them one of the best savings vehicles for companies and employees alike. Their long-term portfolio-planning horizons, resulting from their illiquidity and relatively low insolvency risk, make them vital in stabilizing a nation's capital markets —and stabilizing Mexico's financial markets is a key governmental objective.

Indeed, pension funds' hedging demands have led to a growth of new products on the international scene. The continuing growth (both in popularity and importance) of zero coupon bonds, collatoralized mortgage obligations, guaranteed investment contracts and interest rate futures contracts is largely due to pension funds' involvement in capital markets. The popularity of the recently introduced Retirement Pension Scheme *(Sistema de Ahorro para el Retiro, SAR)* has shown that Mexican workers are amenable to reforms in this important form of saving, demonstrating that they could also significantly deepen national Mexican markets as well.

Deepening Mexico's markets is vital if the savings problem is to be solved. Further, because it runs along one of the tectonic plate lines, virtually the entire western portion of Mexico is highly susceptible to earthquakes which occur with greater frequency and violence than in the (much better prepared) California earthquake belt of the U.S. This vulnerable region is also one of the fastest growing in Mexico, and the country's relatively low risk-management consciousness complicates normal insurance practice. New Mexican tariff rates, which will raise insurance premiums in high-risk areas by several hundred percent, went into effect in October 1993, and Mexico's underdeveloped markets disallow the option of effective reinsurance. In other words, a repeat of the 1985 earthquake could do untold harm to the government's economic policies —unless the net savings outflow is reversed.

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Although —thanks in large part to NAFTA-induced U.S. competition— the general Mexican insurance industry is being rapidly modernized, it still has a long way to go. Though premium per capita is only $44 — compared to $1,200 in the U.S. and $1,800 in Canada, Mexican premiums are growing at 50 percent a year. So are legal settlements; thus there is a growing need for liability coverage which, again, is possible only with increased savings.

As the smoldering strife in Chiapas amply illustrates, Mexico's lower income groups must be given the opportunity to take part in the process of economic growth as a whole and the savings process in particular. The

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economic and savings benefits of giving them increased access to land, with improved property rights, secure tenancy rights and increased access to credit (by allowing the formal savings sector to absorb the informal sector) must be stressed to the incoming government.

The best-known example of integrating formal and informal financial sectors is the Grameen Bank project of Bangladesh, replicated in part by the Massachusetts-based "Acción International" group throughout Latin America and by the government-backed Solidarity program in Mexico. ADMIC, Acción International's Mexican affiliate, provides over 20 million pesos (equivalent to over 6 million dollars) in credit annually. It is funded by a letter of guarantee signed by Acción, which is backed by a U.S. dollar deposit in an American bank. ADMIC presents this letter of guarantee to Nacional Financiera (Nafin), the Mexican government-run development bank. Nafin, by extending a line of credit up to ten times the amount of guarantee to ADMIC, thereby acts as a "second-tier" bank for Acción.

Acción-ADMIC and similar groups, such as the *Fundación Los Emprendedores* and Finca —which also operate in Mexico— have somewhat different methodologies, each catering to a different niche in the micro-enterprise lending market. However, all three overcome the usual development aid pitfalls by insisting on proper incentives for loan repayment and charging market-based interest rates on their loans. All encourage their clients to save.

Larger institutions are now beginning to take notice and to lend their expertise to these projects. Finca, for example, now receives UN funding as well as practical help from the Agency for International Development, the Ford Foundation, Citibank and the Chase Manhattan Bank. By helping to merge the formal and informal financial sectors, all of these institutions can do much to solve Mexico's savings problem.

Proper financial planning can help the rural sector as well. Agriculture adds almost $20 billion in value to the economy —more than in any country in the European Union, with the exception of France. Given that only 12 percent of Mexico's land is under cultivation, it is easy to see the possibilities for bringing more land into cultivation and increasing yield per acre. On the other hand, Venezuela's current economic quagmire illustrates the social cost of failure to implement the reforms necessary to give more people a long-term stake in the financial well-being of their country.

In other words, microeconomic reform must stress the importance of the life cycle in individuals' savings plans. Macroeconomic reform must complement the microeconomic, and it must be recognized that increased savings is dependent upon economic growth and the distribution thereof. Macroeconomic reform must augment the objectives of a country's citizenry and institutions —financial institutions in particular.

Mexico's financial institutions must, like their competitors in the developed world, be given the legal latitude to effectively contribute to solving the nation's financial problems. To avail itself of the opportunities which both NAFTA and GATT present, Mexico must abandon the constricting mercantilist capitalism which it inherited from Spain and, like modern Spain, embrace —as far as is practicable— the new commercial paradigm which is evolving in today's post-Communist world.

In conjunction with the government, the nation's financial institutions must lead this change. As the countries bordering Germany did with the Deutschmark, Mexico must recognize that the U.S. dollar is going to remain the dominant coinage of the Americas for the foreseeable future, and act accordingly. Specifically, in order to satisfy the needs of both its domestic and overseas investors, the Bolsa (stock exchange) must —independently of Mexican monetary policy— be allowed to develop new products, denominated and settled in U.S. dollars. This will necessitate greater cooperation with U.S. counterparts and, as in so many other areas, will mean importing the expertise of the U.S. and other nations which have legitimate business interests in Mexico.

"High capital costs continue to deter Mexicans from saving and investing in their own country"

Other countries —not least of them the U.S. itself— have done well over time by importing required expertise. The Netherlands, sole partner of Germany in the hard-bloc core of the European Union, is an excellent example of a country which has used its economic and geographical links to a neighboring great power to telling effect for the good of all its citizenry, while retaining its cultural sovereignty. Indeed, because of its close links with Germany, the Netherlands has Europe's healthiest economy —in better shape even than that of Germany herself.

On the other hand, as the case of coffee exemplifies, Mexico has lost heavily from not integrating more fully with her neighbors, the U.S. in particular. Though coffee prices soared on the international markets this year, Mexico, the world's fourth largest coffee producer, did not benefit from these changes. Production has fallen to 5.3 million bags (a bag holds 132 pounds of coffee) and growers' incomes have fallen to a third of 1989 levels —a factor relevant in understanding the Chiapas fracas.

Given coffee's importance to the economy, it is surprising that Mexico is not a player in the coffee futures and options markets. Indeed, the opening of a coffee trading center in Mexico, allied to similar trading institutes in New York or London, would make greater sense than some of the reforms currently being instituted.

The attempt to operate an options exchange without first having a well-developed futures market in place is an example of this failure to recognize international financial realities. If London and other well-developed trading centers could not institute such a course, it is unlikely that Mexico, with her less-developed infrastructure, can do so.

Coffee policies provide an interesting and important example of Mexico's strategic short-sightedness; precious metals provide another. Mexico is the world's largest silver producer and among the largest producers of gold. Yet it is not an important player in the international derivative markets generated by these products.

The Comex gold market, in particular, is heavily correlated with and dependent upon interest rate movements and markets. Instead of linking up and trying to develop partnerships with these already developed markets, Mexico —going against international trends— is trying to develop her own markets independent of, and therefore in competition with, these mega-markets. Indeed, the effort to build a North American interest rate futures market independently of Comex seems short-sighted, if not downright naive.

Government oil policies also need to change significantly. The era of subsidized oil consumption must be brought to an end, not only to help clear Mexico City's toxic air but to allow the general populace to benefit from the country's abundance of oil. Mexico has proven oil reserves of at least 65.5 billion barrels —the fourth largest in the world. Pemex (*Petróleos Mexicanos*), the state monopoly, controls these reserves. When we consider the fact that Pemex is not only Mexico's largest company, but that its sales are larger than those of the fifteen next largest companies combined, we can see that it exercises too much of a distorting influence. When Mexican investors are excluded from the country's dominant industry, capital flight can only be accentuated.

So too can job flight. With some effort, Mexico could boast a fully-integrated textile industry based on petrochemicals. Instead, the Mexican-sourced raw materials for such a sector travel around the world for processing, before returning to North America in the form of finished goods.

Mexico's financial institutions hold the key to reversing this sorry situation, where high capital costs continue to deter Mexicans from saving and investing in their own country. Money has traditionally flown to where both security and return are highest and, in today's financially integrated world, these havens are to be found in those markets which have the best-developed links with the financial nerve-centers of the U.S., Western Europe and the Far East.

In other words —as shown in the cases of coffee and precious metals— Mexican markets must integrate themselves more fully into the international mainstream, and must also be prepared to accept and build upon the resulting savings flows. In addition to fortifying the local market, such a policy could pay additional dividends by bringing more Latin American money into Mexican markets.

Further investment in financial infrastructure is needed if Mexico is to take full advantage of NAFTA which, at a combined GDP of $6 trillion, is the world's largest trading bloc. Mexico has only one bank branch for every 18,000 people; only 8 percent of all Mexicans have checking accounts; and only 1 percent of all the population holds mortgage accounts. This infrastructural underdevelopment must likewise change if the Mexican financial community is to be able to garner enough savings to compete effectively with the Americans and Canadians.

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Given mature thinking and correct governmental guidance, much can be done. For example, only the government can give Mexican emigrants the confidence to repatriate their funds at the levels of comparable countries. China earns a whopping 5 billion dollars in hard currency each year by renting out its work-force. Annual remittances to the Philippines approach US $2 billion —some estimates put them as high as 4 billion— which, though modest by Chinese standards, nevertheless represents a sizeable chunk of the country's annual export earnings of US $8 billion. And even this proportion is modest when one considers that Bangladesh earns over 70 percent of its export take through the remittances of its citizens. In contrast, Mexican emigrants tend to keep their savings overseas.

When Lee Kuan Yew assumed power in 1959, he said that he wanted Singapore to emulate the economic performance of Ceylon and the Philippines. Ceylon, renamed Sri Lanka, is now a byword for disaster and the Philippines is still trying to recover from the corruption of the Marcos years. In this country, the incoming Zedillo regime has been given a chance: a chance to make Mexico realize the potential which proximity to the U.S. has bequeathed her. And, as in Singapore, if the savings problem can be solved, the rest should follow