The World Economic Crisis And Job Loss in Mexico

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The crisis has caused unprecedented unemployment levels.

The Results of *Laissez Faire* in the Financial Market

Toward the end of last winter, the teacher of the psychoprophylaxis course my wife and I were taking asked me how it was possible for the world to sink into a profound crisis in only a few months if people were basically continuing to do the same kinds of things. How could an economy that was working fine be in such difficulties a short time later? This may well be the kind of questions millions of people the world over are asking themselves.

My answer was —and is— that what appeared to be working so well actually was not. Quite to the contrary, the crisis we are now experiencing has been gestating over several years. Let us see: in contrast to the blips in the 1980s and 1990s, the epicenter of the global crisis was the central economies, particularly the United States, and not the emerging economies.[1] What was happening in the United States? For a long time, household consumption increased more than incomes, and that could not continue forever. The purchase of homes, cars and even non-durable goods expanded more quickly than the value of domestic production. As Table 1 shows, private consumption surpassed gross domestic product (GDP), which is why the U.S. trade deficit was the largest in absolute terms of any economy in history.

Now, the imbalances in that economy were not only due to the behavior of individuals, but also that of the government. The ill-conceived adventure of the war in Iraq, together with the tax cut fostered by the Bush administration deteriorated U.S. public finances, creating a public deficit of US$10 trillion by the end of 2008, the highest in world history.[2]

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The growth in consumption in the U.S. was achieved through debt to a financial system that loaned out money without due caution: you want a new house but you don't have any property to put up as collateral or savings in the bank or even a job? Don't worry. The new financial instruments make a mortgage possible. Once the house was purchased with the mortgage, it belonged to the bank until the debt was covered over the next few years. But meanwhile, the mortgage-holding bank sold that asset —the amount of the debt owed— to another financial company and presented it as a safe investment because it had a piece of real estate to back up the outlay. Then, the institution that had repurchased the asset bundled it together with other similar assets and in turn sold it at a profit to another financial institution somewhere else in the world. And on and on.

In the end, the value of the house originally sold to an insolvent client had been used to create a bubble on the basis of which shareholders from very different nations thought they had safeguarded their savings, which seemed to be giving them profits over the average of successful businesses worldwide. When it was discovered that those assets were backed by homes owned by insolvent debtors, the dream fell apart: the purchasers of the homes could not pay their mortgages, and the many owners of the assets could not collect. And this set off a domino effect that exposed the existence of financial assets with no backing all over the world, the so-called toxic assets.

TABLE 1
U.S. MACROECONOMIC INDICATORS

	2000	2005	2006	2007	2008
GDP[1]	3.7	2.9	2.8	2.0	1.6
Domestic demand[1]	4.4	3.0	2.6	1.4	0.1
Private consumption[1]	4.7	3.0	3.0	2.8	0.5
Public spending[1]	1.7	0.3	1.6	1.9	2.5
Gross capital formation[1]	6.1	5.8	2.0	-2.0	-2.7
Current account balance (exports-imports)[2]	-4.4	-5.9	-6.0	-5.3	-4.6
Public balance (taxes-spending)[2]	-3.8	-3.3	-2.2	-2.7	-4.1

Source: Table developed by the author using figures from the IMF document *World Economic Outlook*, April 2009.

[1] Percent variation *vis-à-vis* the previous year.
[2] Percent of GDP.

TABLE 2
EVOLUTION OF WORLD GDP 2007-2010 (ANNUAL VARIATION)

	2007	2008	2009	2010
World	5.2	3.2	-1.3	1.9
Advanced economies	2.7	0.9	-3.8	0.0
United States	2.0	1.1	-2.8	0.0
Euro area	2.7	0.9	-4.2	-0.4
Newly industrialized Asian economies	5.7	1.5	-5.6	0.8
Emerging and developing countries	8.3	6.1	1.6	4.0
Brazil	5.7	5.1	-1.3	2.2
Mexico	3.3	1.3	-3.7	1.0

Source: IMF, *World Economic Outlook*, April 2009.

Without healthy financial institutions and, what is more, with banks that distrust their counterparts and their customers' ability to pay, credit contracted all over the world, affecting production and, with that, employment, household demand and general economic activity. In a very short time, the crisis originating in the financial sector became a debacle in the real economy (see table 2).

The crisis occurred in a context of deregulation and a lack of public supervision of the financial sector. This deregulation first started out under the administrations of Ronald Reagan in the United States and Margaret Thatcher in Great Britain,[3] and continued under the Republican administrations in the U.S. during the first eight years of the twenty-first century.

The absence of the public sector accentuated the private sector's excesses, and different historical experiences show that when a flaw in the market combines with failings in the public sector, the effect on the march of the economy can be the absolute worst.

Mexico's Crisis Did Not Come from Abroad

While the economic crisis is global, Mexico has fewer prospects for growth than other countries in Latin America. The crisis in Mexico occurred after a period of low economic growth. This implies at least two things: one, that our capacity for growth was already in decline before the world crisis broke out, and two, that Mexico has a weaker response capability in the face of adversity. Why is this?

Just as the causes of the global crisis can be found in the way the world economy has operated in recent decades, in the case of Mexico, the answers can also be found in some of the economic policy decisions that affected the fabric of national production over the last two and a half decades.

A succinct review of the aggregates that make up a national economy can explain why the crisis is so severe in this country and why a change in the design of economic policy is necessary to overcome it. The GDP of an economy, that is, national income, is made up of sales —which at the same time are purchases— by families (private consumption, which we will call C), companies (purchases of machinery, buildings, vehicles, etc., that we will call I for investment), the government (which invests in public works and makes social expenditures, and we will abbreviate G), as well as the purchases foreigners make of what the country produces (exports, or X) minus the purchases the country makes from foreign producers (imports, M). This can be summarized in the equation GDP=C+I+G+X-M.

Now, we should analyze what is happening to the variables on the right side of this equation.

Consumption. In Mexico, consumption depends in great measure on households, whose income depends on jobs. This expenditure can also happen by going into debt. In a scenario in which the capacity to create well-paying jobs is fragile, and in which the banks increase their commissions charged on consumption to cover the difficulties they have in collecting debt, households will necessarily have less available cash for spending, and therefore, private consumption in Mexico does not have a solid basis to sustain itself over time. An additional factor is that in certain regions of the country, consumption was shored up by family remittances sent by migrant workers in the United States. However, money transfers of this kind are dropping because of the contraction of the U.S. economy. These factors have joined together in such a way that, from the time the crisis broke out in the United States in October 2008 until December of that year, private family consumption in Mexico decreased 1.3 percent.[4]

Investment. Without investment, there can be no economic growth. Total investment in the Mexican economy went from the equivalent of almost one-fourth of GDP in the early 1980s to one-fifth today. According to the National Statistics and Geography Institute (INEGI), gross fixed investment (gross formation of fixed capital) was 12.1 percent lower in real terms in February 2009 than in February 2008.[5] It should also be noted that the reduction in foreign direct investment (FDI) worldwide will have the effect that foreign capital will not be available to make up for the contraction of national investment.

Public spending. Mexico has historically had very low tax revenues: in its best years, it hovers around 15 percent of GDP, one-third of which is from oil earnings, whose price is declining. States' ability to intervene in the economy depends on their capacity to amass resources. Mexico has a public expenditure capacity as a percentage of GDP that is less than half the average of the member countries of the Organization for Economic Cooperation and Development (OECD). Low tax revenues are a weak flank of the Mexican economy, perhaps the gravest side, and are not attributable to the global crisis.

The external sector. Mexico went from being one of the world's most closed economies to one of the most open. While it is not viable to think about a return to protectionism; with NAFTA, more than 90 percent of Mexican exports go to the United States, which implies that the economic cycle of our neighbor to the north is a determining factor for what happens to our economy. At the same time, Mexico is more dependent on imports, to the point that one-third of everything offered the consumer comes from abroad. This means that one-third of spending in Mexico does not translate into earnings for national producers.

Mexico is thus very vulnerable to external economic zigzags; plus, the scant cohesion of its domestic market means that it does not have sufficient tools to reverse the recession by broadening out domestic demand.

The Job Crisis

One peculiarity of the current crisis is its enormous capacity for destroying jobs on a world scale, so that the gap between employment and output has grown. In previous recessions, fulltime jobs declined less than output; but today, the opposite is happening. If this trend continues, it is feasible that employment will continue to fall after the official end of the recession.

This characteristic of the current crisis may be a reflection of flexibility policies implemented in the labor market in different countries over the last two and a half decades, which have created conditions for layoffs. So, when faced with a drop in sales, companies immediately lay off workers, "externalizing" or transferring the costs of the recession to them.

In the United States, for example, the depression has destroyed more than five million jobs since December 2007. The unemployment rate reached 9.4 percent in May 2009, the highest level in a quarter of a century, while in the Euro area it was 8.2 percent, the highest since the creation of the single currency. In Japan, it is expected to oscillate between 4.1 percent and 5.8 percent in 2009.[6]

For developing countries, the news is no more encouraging: the drop in trade and their exports will destroy jobs. Analysts estimate that there will be 32 million more unemployed in these countries, of whom 20 million will be migrant workers laid off in China, which will naturally cause the informal economy and poverty to grow.

Given this panorama, the International Labor Organization (ILO) suggests it will be necessary to create almost 90 million net jobs in 2009 and 2010 to absorb the workers who are entering the labor market and avoid a prolonged employment gap.[7]

In the case of Mexico, between October 2008 and April 2009, around 600,000 jobs (77 percent of which were permanent posts) in the formal sector were lost, while the reduction in manufacturing was 55 percent (see graph 1). This is the largest number of jobs lost in national manufacturing in all the time since the statistics began being gathered.

The INEGI's official open unemployment rate for the first quarter of 2009 surpassed the most pessimistic predictions: 2,288,000 people are actively looking for work and cannot find a job.[8] The figure is unusual because Mexico had never registered such massive unemployment: this is more than twice the number of unemployed registered at the beginning of the decade (1,290,000 more, or 130 percent). It is 540,000 more people than what this federal administration inherited, but during the course of Felipe Calderón's tenure in office, so far, the number of unemployed has grown 31 percent.

Of the entire work force, 5.1 percent is unemployed, a larger percentage than in the first quarter of 2008, when it was 3.5 percent. Even so, the figure is far from a clear expression of what is actually happening in the field of employment in Mexico: it is enough for a person to have worked one hour a week for him or her to be considered "employed." So, activities like watching over cars in the street or helping sales in street markets on the weekend are sufficient for a person not to be counted as unemployed. Therefore, when the term "unemployment" is used, it does not include workers in the informal sector or people with very precarious jobs. This means that families' insecurity in Mexico is much graver than the unemployment rate would seem to indicate.

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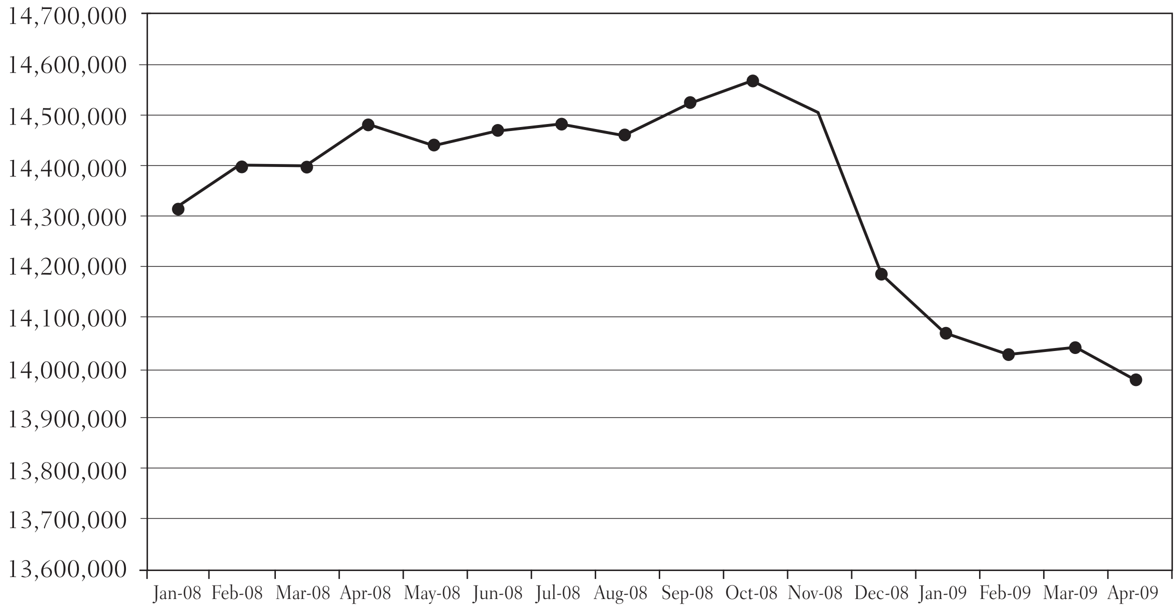
For all these reasons, it does not matter that Mexico formally has a lower unemployment rate than that of developed countries, because, in addition, those countries often have unemployment insurance. This means there is an institutional safety net that has been built to soften the negative effects of recessions.

The number of people officially recognized as openly unemployed in Mexico represents 16 percent of the formal workers registered with the Mexican Social Security Institute, which offers us an alternative indicator of the real dimension of formal unemployment. In any case, the proliferation of open unemployment indicates that our economy is incapable of creating jobs and, what is worse, that in recent months, it has been swiftly destroying them.

Unemployment not only affects the thousands of young people of working age who have to contribute to the family income, but also to a great extent involves people with experience in the labor market: of the 2.3 million unemployed, 2.08 million, that is 91 percent, have work experience. Of those, 1,217,000 (53 percent of the total) lost their jobs or their contracts ran out, and in 108,000 cases, these are people who had to close their own business.

Unemployment does not affect those with higher levels of schooling less: 31 percent of those who are openly unemployed (700,000) have high school or university educations, while 10 percent of the total (227,000) did not finish grammar school; and almost two-fifths of the unemployed (870,000) finished junior high school.

GRAPH 1
FORMAL EMPLOYMENT IN MEXICO (JANUARY 2008-APRIL 2009)



Source: Developed by the author with data from the Mexican Social Security Institute (IMSS).

These figures confirm that during employment crises like the one we are experiencing, jobs in the most dynamic areas of the economy, where the worker's schooling may be more important when hired, begin to be eliminated. This means that at times when job loss becomes generalized, high educational levels are no guarantee of keeping a job.

CONCLUSION

The world economic crisis began in the U.S. financial sector, but swiftly spread to the real economy. It emerged in a context of financial deregulation, state withdrawal from the economy and a lack of global economic coordination. It is necessary to return to the regulation of financial market functioning and build a new international financial structure.

For its part, Mexico cannot wait to grow again until the U.S. economy recovers. In the first place, because that recovery is still uncertain and remote. In the second place, because eventual U.S. recovery would not necessarily imply more growth for Mexico, since the Mexican export sector has few domestic productive chains and new actors in the world economy, especially China, have displaced Mexico in the U.S. market.

Worldwide, the crisis is proving to be unusually capable of destroying jobs. The same thing is happening in Mexico where, in addition, most of the population works in the informal sector. This means that the country must explore a growth strategy that will create jobs. Since consumption, investment and exports are far from dynamic enough to be able to pull the rest of the economy along behind them, Mexico's public sector has the responsibility of breaking the deadlock by increasing public spending and investment. VM

NOTES

[1] A. García Mora, "Una crisis diferente," *Nexos* 363, March 2008.
[2] J. Stiglitz and L Bilmes, "The $10 trillion hangover: Paying the price for eight years of Bush," *Harper's Magazine*, January 2009.
[3] E. Hobsbawm, *Age of Extremes. The Short Twentieth Century 1914-1991* (London: Abacus, 1994), pp. 248-249.
[4] INEGI, "Oferta y demanda global de bienes y servicios en México durante el cuarto trimestre de 2008," Aguascalientes, May 2009.
[5] INEGI, "Indicador mensual de la formación bruta de capital en México," Aguascalientes, February 2009.
[6] "The jobs crisis," *The Economist*, March 12, 2009, available on line at http://www.economist.com/printedition/displayStory.cfm?Story_ID=13278305.
[7] International Labour Organization, *The Financial and Economic Crisis: A Decent Work Response* (Geneva: ILO, 2009).
[8] INEGI, "Encuesta Nacional de Ocupación y Empleo," Aguascalientes, May 2009.