

The Economic Crisis Or, How President Calderón Lost The Midterm Elections

Enrique Pino Hidalgo*



Isaac Esquivel/Cuartoscuro

An unprecedented hike in unemployment is one of the most noticeable effects of the current economic crisis.

One of most important factors in the failure of the National Action Party (PAN) in last July's midterm elections (for federal deputies and six governor's seats) was President Felipe Calderón's weak response to the economic crisis and its social and political consequences. This failing can be explained by his economic cabinet's refusal to recognize first the imminence of the crisis in Mexico, and, later, its magnitude and structural causes. The administration's diagnosis is wrong and the anti-crisis policies seem slow and ineffective.

Publicists convinced the president that his party could win the 2009 elections by focusing mainly on drug traffick-

ing, violence and insecurity. However, they forgot that Mr. Calderón had run three years previously as "the employment candidate." Under those conditions, the PAN's defeat at the polls was inevitably the president's responsibility.

In an adverse macro-economic situation due to plummeting investments, job numbers and oil revenues, the PAN was going to have a very hard time winning the elections without dealing with the worst economic crisis in recent years. It lost its position as the largest minority in Congress to the Institutional Revolutionary Party (PRI). The Party of the Democratic Revolution (PRD) suffered a severe blow, barely managing to keep its position as the country's third-largest electoral force.

Official polls indicated that one of the public's main concerns was drug-trafficking-related insecurity and violence. This

* Professor and researcher at the Economics Department of the Autonomous Metropolitan University. pinohen@hotmail.com.

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is indeed the case. But, it seems difficult to accept that society was more concerned about this than about 2.5 million unemployed and declining incomes. The result was an overwhelming punishment vote for Calderón, who now has to deal with the new PRI plurality.

Surprisingly, government strategy to overcome the crisis rests mainly on the recovery of the U.S. economy, but takes no notice of the fact that Barack Obama is actually reactivating his domestic market with landmark public investments representing between 13 percent and 14 percent of his administration's deficit. The economic cabinet's conservatism prevents it from launching an anti-crisis plan centered on the recovery of domestic consumption and investment in infrastructure and manufacturing in accordance with the new institutional set-up for dealing with the recession.

In this ongoing crisis, the state and its institutions are recuperating their function as firm regulators—a compensatory role—and, if necessary, the government is expected to intervene extensively to correct the failures and insufficiencies of market economies, so prone to imbalances and social disparities. It is becoming unfashionable to rail against government spending, and concerns about budget deficits must be postponed.¹ This is the lesson of the fight against the crisis in the United States, China, Germany, South Korea, Brazil or Argentina.

PRESIDENT CALDERÓN AND HIS CABINET'S ECONOMIC ORTHODOXY

At the start of his fourth year in office, the Calderón team's initiatives, particularly its economic policy, looks slow and ineffective. This is because it lacks a long-term vision and the capacity to adapt to a changing economic and political situation; its market fundamentalism does not allow it to accept that all economies go through a sea change based on the redefinition of the market, the state and society. The crisis has re-launched the state and society as regulating bodies over the market's excesses and failures. Thus, economic lib-

eralism as an ideology, plus the executive branch's commitments to big capital, prevent the president from acting effectively and swiftly on economic issues. This is shown by the budgets he has sent to Congress.

Mexico's crisis demonstrates the economic and political autism of Finance Minister Agustín Carstens and Bank of Mexico President Guillermo Ortiz. Both have assured the public that the country was protected against the onslaught of the international crisis. At the Senate-hosted forum "Mexico in the Face of the Crisis: How to Grow?" tycoon Carlos Slim Helú predicted that in 2009, Mexico's crisis-related unemployment would be brutal and domestic production would plummet like never before. The authorities responded by heaping him with abuse and calling him a "catastrophe-monger." Time showed that the Telmex monopoly CEO—one of the main beneficiaries of the neo-liberal economic model that privatized public companies—was right.²

The authorities finally recognized the gravity of Mexico's economic crisis and formulated a diagnosis postulating that it had operated just fine until it was hit by the international financial crisis and the AH1N1 swine flu health emergency in late April 2009. Actually, however, the collapse had been brewing before the world crisis hit.

ECONOMIC STAGNATION AND VULNERABILITY DUE TO THE CRISIS

The world crisis has had a devastating effect on Mexico's economy, but its impact has been overestimated by the authorities in order to deny the vulnerability of the economy as a whole. This vulnerability can be seen in four spheres:

1. Weak public finances highly dependent on oil and therefore affected by plummeting oil production and foreign currency flows;
2. Excessive concentration of exports to the U.S. market and a growing trade balance deficit due to increased U.S. imports from China, South Korea and Japan;
3. Restrictions on financing for production imposed by an oligopolistic, dividend-hungry banking system controlled by foreign capital; and
4. The long cycle of low growth—or even stagnation—with less than 3-percent annual GDP growth (way below the historic 6 percent average).

One of the factors that explains the stagnation is that manufacturing has been dismantled because of the economy's indiscriminate opening to foreign competition. In the early 1980s, Mexican manufactured goods, as an endogenous growth factor, represented 22 percent of GDP, in contrast with the current 17 percent. This retreat is due to the disappearance of thousands of firms that had sustained productive chains created during the period of import substitution. As a corollary, the massive import of manufactured, intermediate and capital goods has demonstrated dependence on foreign technology and capital. At the same time, these items have replaced domestically produced goods and domestic jobs to the benefit of foreign companies.

FROM STARVATION WAGES TO MASSIVE UNEMPLOYMENT: CONSEQUENCES OF ECONOMIC STAGNATION

The National Statistics, Geography and Informational Institute (INEGI) recently published the main economic indicators for the second quarter of 2009: GDP dropped a dramatic 10.3 percent *vis-à-vis* the same period in 2008. It should be remembered that in the great 1994-1995 crisis, GDP contracted 9.2 percent. The monetary value of the 2009 GDP loss is predicted to be Mex\$928.2 billion (or approximately US\$68.76 billion), or the equivalent of one-third of all federal spending.³

A low-growth economy generates severe distortions reflected in the expansion of the informal economy and underemployment, massive migration to the United States and marginalization. Most of the population lives on about US\$300 a month because the productive sector cannot absorb the available work force. This indirectly sharpens the oversupply of workers willing to hire on for extremely low wages or to go into the informal sector. They have one last option, however: joining the ranks of the drug cartels and non-organized petty crime.

Officially, Mexico's unemployment rate is 5.2 percent of the workforce (2.4 million people), a number the authorities consider acceptable compared to Spain's 18 percent and the United States' 10 percent. They try to forget that in those countries the jobless have unemployment insurance and a social security safety net. That "acceptable" number affects families made up of five people on average. Absolute unemployment does not exist, and this is reflected in the rapid expansion of the underemployment rate, which now

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has reached 11.8 percent of the work force, or 4.8 million people. In 2008, there were 3 million underemployed in Mexico doing badly paid work in bad conditions.

The idea that the collapse of the Mexican economy was due to external factors is only partially true: the debacle was mainly fueled by the liberal, export-oriented manufacturing model. This means that the crisis actually had an important domestic component.⁴

THE PRESIDENTIAL DISCOURSE ABOUT PROFOUND INSTITUTIONAL CHANGE

In his third report to the nation, Felipe Calderón announced his administration was going to make a turn "given the choice between managing what has been achieved and continuing with the inertia generated or making profound changes in national institutions."⁵ This statement had a big impact on the public and spawned expectations among certain analysts. However, the discourse of change soon showed its limits, particularly with regard to the economy.

Calderón presented 10 programmatic points. One of the most important was "a profound economic reform" to make the economy more competitive and foster growth and job creation. He also proposed a reform of public finances based on austerity and a rational use of funds, the simplification of fiscal red tape, reducing tax evasion and increasing tax revenues by broadening the tax base. A few days later, the administration sent Congress its "2010 Economic Package" with its proposal for both public revenue generation and spending. The package clearly showed the limits of the discourse of institutional change: the cabinet went back to the familiar prescriptions for economic orthodoxy. The proposed fiscal reform confirmed that the president and his cabinet were willing to swim against the current of the lessons learned by other governments about how to extricate themselves from the recession. Given the crisis and the electoral defeat, a sharp turn in economic policy was expected, but it never materialized.

MORE INDIRECT TAXES
ON CONSUMPTION AND INVESTMENT

After the July 5 elections, the authorities announced a program to cut the existing budget by Mex\$85 billion in two stages (Mex\$35 billion and Mex\$50 billion), of which Mex\$13 billion were slashed out of communications and transportation. The austerity measures included closing three ministries and laying off 10,000 public employees.

Many analysts and academic observers pointed out that the deterioration of public finances expressed in a Mex\$374-billion “fiscal sinkhole” was only the tip of the iceberg if we take into account the fact that current public expenditures increased from Mex\$714 billion (about US\$52.89 billion) in 2000 to Mex\$1.84 trillion (about US\$136.30 billion) in 2009. The frenetic expansion of current expenditures is just not backed up by a slow-growing, low-tax-collecting economy (taxes represent 10 percent of the GDP).

In short, the fiscal proposal includes the creation of a 2-percent sales tax on everything, including food and medication; a new 4-percent tax on telecommunications companies, which can be transferred to cell-phone and internet-user customers; an income-tax hike for professionals and companies (ISR) from 28 percent to 30 percent, which will hit a captive tax base; and an increase in special taxes on tobacco, beer and lotteries. With these, the government would bring in Mex\$175 billion, Mex\$57 billion of which it would distribute to state governments.

Given generally declining incomes, the proposal has been rejected. Analysts from different points on the political spectrum have classified it as regressive and recessive. The 2-percent tax on the sale of goods and services is a badly disguised value-added tax (VAT) with regressive effects for low- and middle-income groups. The proposal would generate Mex\$70 billion for the federal government earmarked supposedly to fight the poverty of 34 million Mexicans.

The country’s tax system is regressive. It is structured so that wage earners and individual business people and professionals shoulder the largest part of the tax burden, while those with higher incomes (big businessmen) pay proportionately less, given their enormous capacity to influence the government and the legislature. In Mexico, of every 10 pesos the federal government spends, six pesos come from wage earners; 3.7 pesos are paid by individual business people and professionals, and only 30 cents of a peso come from large companies.

RECESSIVE EFFECTS OF CALDERÓN’S FISCAL REFORM

Though the fiscal proposal would increase government revenues, it is recessive because it would make domestic demand contract and create bigger problems for companies, whose retail sales have plummeted. Higher taxes reduce consumption, curb production and increase unemployment and the risk of sharpening the banking system’s overdue-loan-portfolio problems. An equitable fiscal reform would have to be based on direct, progressive taxes that would increase as incomes increase. For example, according to the 2006 OECD report, in Mexico, tax on business earnings is 29 percent; in the United States, it is 39 percent; in Canada 36.1 percent; and in Spain, 35 percent. In Mexico, direct taxes on income (both wages and profits) represented only 5.2 percent of GDP, compared with the 13 percent average of OECD countries (see table 1).

TABLE 1
CORPORATE TAX RATES THROUGHOUT THE WORLD (2008)

Country	Tasa (%)
India	42.2
Japan	40.7
United States	40.0
Philippines	35.0
France	33.3
Indonesia	30.0
New Zealand	30.0
Thailand	30.0
Australia	30.0
Germany	29.5
United Kingdom	28.0
South Korea	27.5
Malaysia	26.0
China	25.0
Taiwan	25.0
Singapore	18.0
Hong Kong, China	16.5

Note: The earnings used as a basis to calculate taxes due may differ from one country to another.

Source: Australian Government, *Australia’s Future Tax System 2008*, at www.business.nsw.gov.au/aboutnsw/climate/.

TAX REFORM AND THE RETURN
OF THE PRI CONGRESSIONAL PLURALITY

The PRI caucus in the Chamber of Deputies has urged the federal government to promote a reactivation of the economy and the protection of jobs. It made a public statement warning against the deterioration of the economic model, a thesis very popular in progressive academic circles and the political opposition.⁶

The PRI proposes a fight against tax evasion and the need to ensure fiscal proportionality and equity. Specifically, it rejects the 2-percent tax on food and medication. However, Manlio Fabio Beltrones, the PRI's influential Senate leader, frequently identified with former President Carlos Salinas, has stated that the importance of the 2-percent tax should be reconsidered. In the last two decades, the PRI and the PAN have shown strategic agreement on economic issues; at the same time, big corporations exercise enormous pressure on the debate and negotiations of the three branches of government.

This year's debate about the fiscal reform ended when the PRI and the PAN passed the proposals for government revenues in the Chamber of Deputies. With one exception (the 2-percent tax on medications and food, which was rejected), the decision accepted the most regressive aspects of the administration's original proposal and the fiscal system itself by placing most of the tax burden on the shoulders of the captive tax base through hikes in income tax (up 2 points from 28 to 30 percent) and VAT (up one percent from 15 to 16 percent). The Senate made only a few last-minute changes, so an already irritated citizenry will take this hit. And that is not all: cellular phone and Internet users will also pay a new three-percent tax, plus hikes in taxes levied on beer and cigarettes. ■■■

NOTES

¹ Paul Krugman, "La crisis paso a paso," Paul Krugman, *La crisis económica mundial* (Bogotá: Editorial La Oveja Negra, 2008).

² Jorge Patterson Zepeda, *Los amos de México* (Mexico City: Planeta, 2008).

³ INEGI, "Boletín trimestral de indicadores económicos" (Mexico City: INEGI, August 23, 2009).

⁴ See the interview with Mauricio de María y Campos published in the weekly magazine *Proceso* no. 1712 (Mexico City), August 23, 2009.

⁵ Felipe Calderón, "Mensaje del presidente de los Estados Unidos Mexicanos. Tercer Informe de Gobierno" (Mexico City: Gobierno Federal, September 2, 2009).

⁶ "Para enfrentar la emergencia e impulsar el crecimiento económico, el empleo y combatir la pobreza," *El Universal* (Mexico City), September 3, 2009, p. A13.

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