Mexico and the Crisis
Always Waiting for the United States

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Daniel Leclair/REUTERS

One of the main effects of Mexico`s recurring economic crises is deeper and deeper poverty.

Today, Mexico is experiencing the result of the great structural change initiated four decades ago aimed at "development with equity." This change, however, actually brought a drop in the gross domestic product (GDP), the volatility of the peso/dollar exchange rate and growing unemployment, all reflected in economic, political and social instability, followed by the current crisis, the deepest since the Great Depression of the 1930s. In addition, given the profound economic integration stemming from the North American Free Trade Agreement (NAFTA), the Mexican economy has deepened its dependence on U.S. economic cycles.

So, our country is once again immersed in another of the crises that have ocurred out since the Bretton Woods Accords were broken in 1971, resulting in erratic, volatile, weak growth both nationally and internationally.[1]

The 1976 peso devaluation was the precedent for the 1982 debt crisis. To extricate the country from that, the government resorted to nationalizing the banks and three renegotiations with our creditors until the Brady Plan was signed in 1989.[2] The October 1987 stock market crises also hit Mexican investors hard. Later, precisely in 1994, the year NAFTA came into effect, a social movement emerged in southeastern Mexico, capital flight began in the second half of the year and the government contracted considerable debt by issuing currency-linked bonds (Tesobonos) tied to U.S. pension funds. All this took place in a political and social

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panorama that marked our country's economic, social and political history.

At the end of 1994, a crisis broke out with grave consequences even beyond our borders. Once again, the government had to seek external support from the International Monetary Fund, the U.S. Federal Reserve System and the Bank for International Settlements. The reorganization and development alternative that came after this profound crisis led to the privatization of the financial system and, later, to the sale of our banks to the main Spanish and U.S. banks. Not only was the financial system privatized, but so were the large public companies, the mainstays of the import substitution economic model industrialization project.

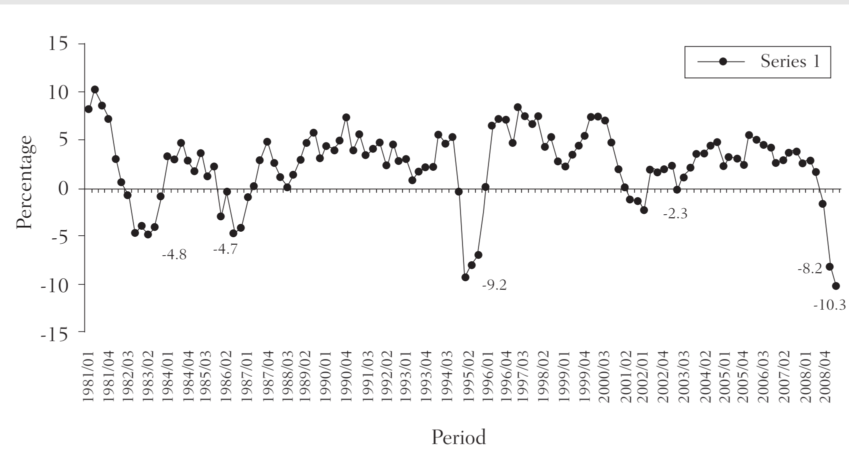
The 2001 Nasdaq crisis sank the Mexican economy in a recession for several months. In the first years of the twenty-first century, several Latin American countries had higher growth rates than Mexico because our authorities concentrated on maintaining financial stability, thus deterring growth and employment. Naturally, the mortgage crisis affected Mexico's economy starting in 2007, profoundly damaging the productive system, to the point that, the latest IMF estimates predict Mexico's GDP will drop 7.3 percent in 2009, although they project a recovery toward the end of 2010, with 3.3 percent growth.

Four decades of facing different crises made for great economic, social and political structural changes. And this is where we should ask ourselves what economic policies the Mexican authorities pursued that caused the country not to grow, in contrast with other Latin American nations. In the midst of a world crisis, why is it that countries like Brazil do not have negative growth rates?

Like all the other Latin American countries, Mexico undertook very important economic changes in the 1980s and 1990s. These great transformations were made with the consent of the leading class and the state and were not just imposed by international financial agencies. I am referring here basically to the 10 measures of the Washington Consensus. In Mexico, what were dubbed first-, second- and third-generation reforms were implemented starting at the end of the 1970s, taking the country from the import substitution model of development to a model that opened, de-regulated and liberalized the economy.

From one crisis to the next, Mexico applied economic policies that increasingly deepened its dependence on the world economy, simultaneously integrating its productive chains with those of the U.S. It is important to point out that during the import-substitution-model period, Mexico achieved growth rates of over 8 percent a year. During the 1980s, the Mexican economy crumpled because public monies were used to service its onerous foreign debt, and for that reason, average GDP growth during those years was 1.6 percent. In the

GRAPH 1
MEXICO'S GROSS DOMESTIC PRODUCT
(QUARTERLY VARIATIONS)



Source: Developed by the author using data from the National Statistics, Geography and Informational Institute (INEGI), System of National Accounts, Mexico.

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1990s, despite the 1994-1995 crisis, average growth was 3.4 percent as a result of increased exports to the United States and a flow of foreign currency due to privatizations. During the current decade, annual growth has averaged 2.2 percent. However, the crisis will cause a severe contraction in GDP in 2009 (see graph 1).

I have already mentioned that from the 1970s until now, the structural changes in our country have led to recurring crises. While it is true that they have an external component, they are also due to the economic policies implemented to be more competitive and achieve higher growth rates. However, the continual crises canceled out the future for several generations, as well as the possibility of a better distribution of income and forming human resources capable of dealing with the changes that any information society requires. Thus, the economic, political and social rights of the vast majority of the population were simply canceled: the right to a job and, in general, to a better standard of living.

The decision was to integrate Mexico more into the world economy and decrease our population's buying power. Policies to stabilize prices and the exchange rate made foreign products cheaper than domestically made ones. The government did not opt for competitiveness based on a monetary policy that would create jobs or for a fiscal policy that would increase public spending on education, housing and public health, or for an income policy that would have better redistributed profits, much less for a financial policy that could encourage saving and avert capital flight.

Each of the crises Mexico has gone through in the last four decades has its specificities. For example, the great devaluation of 1976 brought with it a 3.9 percent reduction in GDP, accompanied by 22 percent inflation. The currency, which for 22 years had been worth 12.50 pesos to the dollar, devalued 47.4 percent; unemployment went to 1.5 percent; and the treasury bills (Cetes) rate went to 10 percent. The 1982 foreign debt crisis —or as the minister of finance called it at the time, the "cash-box crisis"— caused the GDP to decrease 4.7 percent; inflation to soar to 96.8 percent; the peso to devaluate 121 percent against the dollar; unemployment to rise to 2.9 percent; and the Cetes rate to go to 57.9 percent. The 1987 world stock market crises led Mexico's GDP to contract 4.2 percent in 1988, inflation to shoot up to 159.2 percent, the peso to devaluate 65.9 percent against the dollar, unemployment to rise to 6.2 percent, and the Cetes rate to soar to 137.4 percent.

The instability in macro-economic variables pushed the Bank of Mexico to establish the basis for a financial stabilization monetary policy that discouraged economic growth and encouraged migration. People began to think that NAFTA would help solve our problems. Then came the crisis of 1994:

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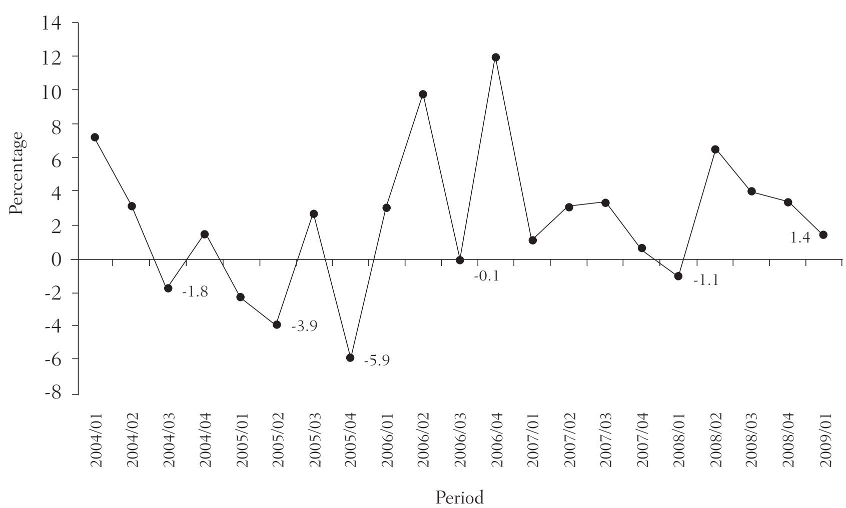
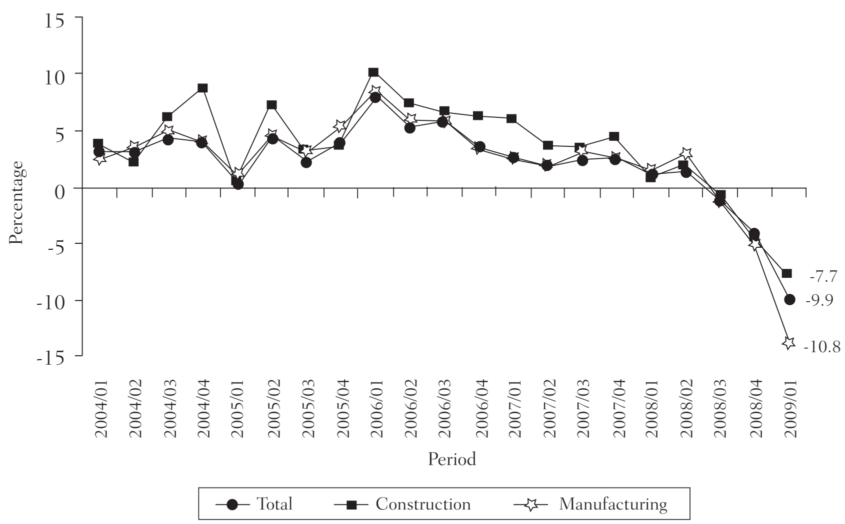
GRAPH 2
MEXICO'S PRIMARY SECTOR
(ANNUAL VARIATIONS)



Source: Developed by the author using data from the National Statistics, Geography and Informational Institute (INEGI), System of National Accounts, Mexico.

GRAPH 3
MEXICO'S SECONDARY SECTOR AND SUBSECTORS
(ANNUAL VARIATIONS)



Source: Developed by the author using data from the National Statistics, Geography and Informational Institute (INEGI), System of National Accounts, Mexico.

In 2007 and 2008, the first two years of the Calderón administration, domestic debt reached the highest level of the last three decades. Foreign banks hold an important part of Mexican government debt, demonstrating the rentier character of the financial institutions operating in Mexico.

GDP dropped 7.2 percent in 1995; inflation was 52 percent; the peso devalued 90.2 percent against the dollar; unemployment stayed at 6.2 percent; and the Cetes rate went to 47.5 percent. The current world economic and financial crisis has caused a much greater drop in GDP than previous ones (8.2 points); inflation is under control at 5.7 percent, but the peso has devalued 47 percent; unemployment is 6.1 percent, while Cetes remain at a moderate 4.5 percent.

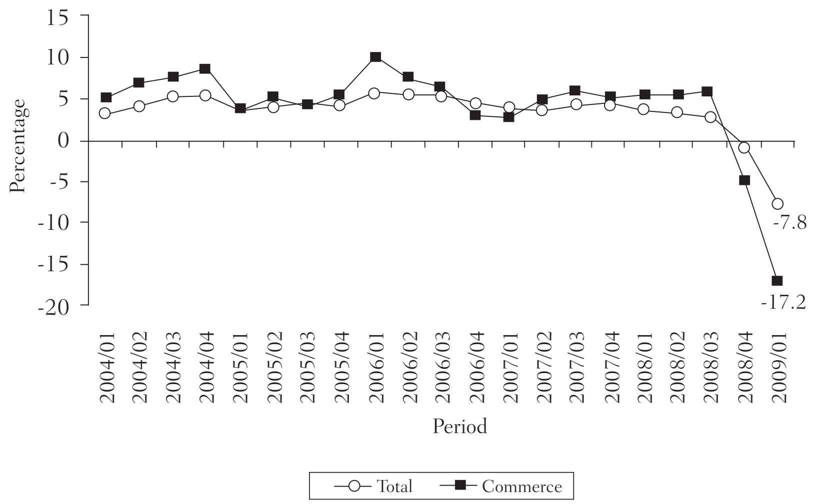
Without exception, all these crises have had an external and an internal component that reflect the vulnerability of the Mexican economy because it accentuated its integration with the United States and due to the degree of opening of both the national financial system and the productive structure, which has broken local productive chains by importing inputs needed for domestic production.

One of the most important characteristics of our country's structural change can be seen in the drop in GDP in agriculture and the secondary and service sectors. While it is fair to say that the primary sector has suffered moderate decreases (see graph 2), the secondary sector has seen drastic drops (see graph 3). During the first half of 2009, the secondary sector plunged 9.9 percent: construction fell 7.7 percent, but manufacturing plummeted 13.8 percent. Commerce took a 17.2 percent nose-dive, even more than the 7.8 average for the service sector (see graph 4). That is, commerce and manufacturing are structurally intertwined with the U.S. economy and therefore, their decline is much stronger than that of the economy as a whole.

The government has made an effort to diminish its indebtedness to achieve fiscal equilibrium, with expenditures equaling revenues, to try to have a "zero deficit." As a result, in 2008, the public sector's gross debt was the equivalent of 6 percent of GDP, a considerable reduction *vis-à-vis* the 1980s and 1990s: in 1994, for example, it was equivalent to 24 percent of GDP.

Nevertheless, in recent years, the internal debt has grown a great deal. In 2007 and 2008, the first two years of the Calderón administration, domestic debt reached the highest level of the last three decades: US$180.19 billion in 2007 and US$184.56 billion in 2008. Mexico's public debt is taken out with subsidiaries of foreign banks that, due to the crisis have been bailed out by central banks and the governments of their countries of origin. The foreign banking sector holds an important part of Mexican government debt, which also demonstrates the rentier character of the financial institutions operating in Mexico. This shows just how attractive it is, Without exception, all these crises have had an external and an internal component that reflect the vulnerability of the Mexican economy because it accentuated its integration with the United States.

GRAPH 4
MEXICO'S TERTIARY SECTOR AND COMMERCIAL SUBSECTOR
(ANNUAL VARIATIONS)



Source: Developed by the author using data from the National Statistics, Geography and Informational Institute (INEGI), System of National Accounts, Mexico.

particularly for the banking system in Mexico, to hold Mexican government debt and goes a long way toward explaining their high profits in our country. Although the foreign debt has decreased over the last two decades, going from 29 percent of GDP in 1995 to 3 percent in 2008, the internal debt came to 18 percent of GDP last year.

CONCLUSIONS

The current crisis has hit Mexican productive capacity hard and has caused a sharp drop of the peso against the dollar despite the sale of dollars by the Bank of Mexico, diminishing our reserves to the current US$75 billion. To shore up the peso, the government also resorted to requesting help from the U.S. Federal Reserve System (to the tune of US$10 billion). Mexico's lack of an appropriate economic policy response to the crisis, the composition and destination of its exports and the degree of integration into the world economy will make its recovery slower than that of the rest of the countries of Latin America according to the International Monetary Fund. Bank of Mexico figures show that in August 2009 there was a US$835 million deficit in the trade balance; however, in the same month of 2008, the deficit was US$2.28 billion. In August 2009, goods exports were US$19.40 billion (US$16.69 billion in non-oil exports and US$2.71 in oil products), 24.9 percent less than in August 2008, with oil exports dropping 50.4 percent and non-oil exports, 18.1 percent.

Mexico's situation in the crisis is a result of the failure of a contractionary monetary policy that has sparked the expulsion of labor to the United States: our country is one of the world's largest exporters of workers. The weaknesses of the financial sector are evident, just as are those of the erratic fiscal policy that serves the financial system's rentier interests and not society's well being, much less dealing with the current recession. What policy-makers are betting on is growth in the United States. VM

NOTES

[1] About Bretton Woods, see http://www.state.gov/r/pa/ho/time/wwii/98681.htm. [Editor's Note.]

[2] The Brady Plan, designed by former U.S. Treasury Secretary Nicholas F. Brady, was adopted in 1989 to restructure and reduce developing countries' debt with commercial banks. To be able to sign agreements with their creditors and qualify for the Brady Plan, debtor countries had to show a certain degree of commitment and apply the Washington Consensus guidelines. [Editor's Note.]