The Mexican Economy: Six Years into NAFTA

Featuring:

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Introductory remarks by

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Moderated by Jeff Faux, President, EPI

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1127 Connecticut Ave., NW (Between L and M Streets)
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Continental breakfast served.

When NAFTA was implemented on January 1, 1994, the conventional wisdom forecast rapid growth and broad-based prosperity for Mexico. But soon after, the country experienced a major financial crisis linked to the devaluation of its currency, the Peso. Since then, real wages in Mexico have plummeted by more than 20 percent. Inflation is skyrocketing again in the past year, increasing consumer prices by an additional 25 percent, and reducing the competitiveness of the Peso. In the wake of the crisis, economic and social disruption followed.

Despite the rebounding stock market, major financial problems remain. For example, the Mexican government has just implemented a bailout of private banks that will cost in excess of $90 billion, or roughly one quarter of Mexico’s annual economic output.

Rep. Heredia, an economist and former Ministry of Finance official, will discuss the post-NAFTA Mexican economy and its impact on the upcoming Mexican presidential election.

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The Mexican Economy:  
Six Years into NAFTA

Carlos Heredia Zubieta, Mexican economist and member of his country's lower house of Congress, the Chamber of Deputies, was guest speaker on 21 January 2000 at a forum organized jointly by The Development GAP and the Economic Policy Institute at the Mayflower Hotel in Washington, DC.

Before he entered the Congress, Carlos served as an official in the Ministry of Finance, worked with grassroots organizations in Southern Mexico, and ran the international program of the Mexican NGO Equipo PUEBLO. While at PUEBLO, he worked at The Development GAP in Washington, informing the U.S. public of Mexican perspectives during much of the NAFTA debate.

Carlos was in the States in January representing Cuauhtemoc Cardenas of the Party of the Democratic Revolution (PRD) in a forum organized in New York by Chase bank to enable investors and credit-rating agencies to hear the economic perspectives of Mexico's major presidential candidates.

Carlos spoke at the Mayflower on a range of issues related to the Mexican economy and political process. The following is a transcript of his presentation.

The State of the Mexican Economy

Let me start by putting on the table a central thesis: I think, and my party thinks, that the economic strategy that has been in place for the last 18 years is not delivering for the majority of the people in Mexico. The structural adjustment policies and trade liberalization policies have sharpened inequality and income disparity in Mexico. These policies have benefitted only a small circle of economic agents of corporations, mostly those already connected to the international economy, to the detriment of the majority of micro and small and medium businesses, workers and the average Mexican citizen. So when people say that the fundamentals are sound, that the economy is performing well, the relevant question up front is for whom? It reminds me of the saying by our Brazilian friends, when people describe the macroeconomic outlook in Brazil as working very well, they say the Brazilian economy is doing fine, it's just most Brazilians that are suffering.
The same stands true for Mexico. You look at the macro picture and you say, well, inflation is under control, the current account deficit is manageable, the fiscal and monetary policies are disciplined, exports are growing, and so forth, but then when you break down growth into different sectors, you find that it's only the economy connected to multinationals established in Mexico that is growing. In fact, you may find negative growth when it comes to Mexican companies. When you look at the export sector, it's basically the subsidiaries of multinationals that are exporting, intra-firm trade mostly to the United States. It is not the Mexican companies that are prospering along this path. That is the number one challenge for economic policy in Mexico: how to generate sufficient jobs for the 1.35 million new entrants into the labor market every year.

All three major candidates say in very general terms they want to fight poverty, they want to fight inequality, and they want to support policies that will incorporate all Mexicans into the alleged benefits of globalization. But when it comes to the compatibility of objectives and policy instruments, the differences arise. I believe that we have for too long neglected our domestic market. I believe a top priority of economic policy today in Mexico should be to take a look at what has happened to the domestic market: not only because of the lack of linkages to the export sector, but also because the purchasing power of most Mexicans has been reduced in a drastic way. The general minimum wage has fallen for 18 years with only a couple years' exceptions. The minimum wage in Mexico is now about $4 per day, which is 13 times less than that of the United States. The imbalance between those workers who earn the minimum wage and those in the top echelons has grown enormously. To give you an example of the disequilibrium between wage earners and how much the president makes, in Mexico, President Zedillo makes 127 times the minimum wage. According to my own calculations, President Clinton makes about 14 times the minimum wage in this country. So the imbalances in the Mexican economy have sharpened, have grown, in a very important way.

As you all know, Mexico has a very difficult fiscal outlook because the burden of the banking bailout on the economy is enormous. According to one of the credit rating agencies, Standard and Poors, the amount of money that has and will be devoted ultimately to the banking bailout now exceeds $100 billion. That's 18.6 percent of Mexican GDP. So you can calculate the yearly interest on that amount, and in Mexico we have had a stable real rate of interest above seven percent. That is considered a contingent liability, which means it is not formally and officially public debt, but it represents a burden on the budget. Why? Because the PAN and the PRI passed legislation that forces the Congress to allocate funds for the banking bailout every year. Every year, when we vote the budget in December, we have to approve a certain amount of money just to pay the real interest component of these liabilities. This means that money is taken out of social expenditures and is allocated to pay, ultimately, private liabilities with public funds. That's basically the equation we're looking at. It's ironic, our party has been labeled as a statist party, people who advocate a greater role for the state, but we are the only party that has advocated a market solution for the banking bailout. The other two parties said, no, no, we need public funds to pay for this. We said, let the market solve it. But of course we're talking about enormous conflicts of interest and complicities here, so they have gotten away with it so far. Anyway, whoever's president in Mexico after December 1, 2000 will have to address this issue, because it is basically taking away the money for other purposes, not only, but mainly for social expenditure. And we'll have to debate a new way to approach this.
We have a very strange situation regarding the banking sector now. Even after all of these subsidies, "subsidies" is a sinful word. There are no subsidies for tortillas, but there are subsidies for the banks. Of course, when you allocate subsidies for the banks, you call that support for healing the financial system, you call that productive investment, but when there are subsidies for tortillas, that is an economic sin.

The irony now is that the banking system is basically dysfunctional. Bank lending has collapsed; it has almost come to a halt, so the Mexican economy is working without banks. What's the mystery behind this? All big companies are funded from abroad, from their headquarters or from international capital markets, while Mexican companies are eating up their working capital or are not paying their suppliers, or are borrowing but to a much lesser extent than before because the rates are unbearable. So how can you have growth in an economy that has no banks? The answer to that is the dual economy that, once again, has become a major problem in Mexico. The fact is that only certain sectors of the economy are growing, while the domestic economy is depressed.

This fiscal fragility is also emphasized by the fact that most wage earners cannot pay taxes because they don't have enough income to even survive. The middle class is therefore crushed because monopolies earn many privileges, and wage earners do not have enough income to pay taxes, so the government has derived its fiscal income from the middle class. Multinationals pay taxes in New York or Tokyo or Stuttgart, but not in Mexico, so even if you have ever greater investment coming into the country, that doesn't translate into greater fiscal income for the government.

Since the 1995 crisis, we have had a currency floatation system, so supposedly, theoretically, the peso does not become undervalued or overvalued, it just floats freely according to the market, but in practice, right before the election, the peso becomes overvalued. Now, once again, the peso, at least for those of us who come from border states, is overvalued, the dollar is extremely cheap. People along the border are going to the supermarket in San Diego or in Brownsville and not in Tijuana or in Matamoros, because everything is cheaper in the U.S.
Many Mexicans tend to associate the end of a six-year term with an abrupt peso devaluation. Zedillo, of course, has said that it will not happen this time. Let me remind you that we have had five consecutive crises at the end of every six-year presidential term, because of this periodic overvaluation of the peso, devaluation at the beginning, overvaluation at the end. We had a major devaluation in ’76, then we had the collapse of the financial system and the privatization of the banks in ’82, we had the stock market collapse in ’87-88, and then we had what was labeled the "December mistake", the big peso crisis of ’94, so, although most international investors are saying it's not going to happen this time, we tend to be quite careful because of the prior history of the end of presidential administrations.

The Pattern of Trade

Let me move quickly to trade. The Mexican economy has experienced a surplus in its bilateral trade with the United States in recent years, although we have had a deficit in the overall trade balance. People say that when you have a trade surplus that means that NAFTA is good. And if you have a trade deficit, then NAFTA is bad. The real reason for the growth in Mexican exports has been the growth of the U.S. economy. There are some studies now that are trying to identify how much of the growth of Mexican exports can be attributed to the growth of the U.S. economy, and the correlation is very, very close. So even without NAFTA we would have had an expansion of exports. The problem is that those exports are not coming from Mexican firms but mostly from multinationals and foreign corporations established in Mexico. So the pattern of our foreign trade doesn't necessarily spell benefits for the overall Mexican population, but only for a small circle.

The maquiladoras account for 53 percent of total exports. The pattern of trade has evolved around that kind of exports. The overall economy is not really integrated into this exporting pattern, only a small fraction of companies. The assessment of NAFTA differs by who conducts it. The Mexican Chamber of Deputies, the lower house of Congress, has just published a review of six years of NAFTA which establishes how NAFTA has accelerated the imbalances between the export sector and the rest of the economy. It also describes how Mexican agriculture has suffered under trade liberalization policies.

I don't know that the report will be adopted and endorsed by the full House. It is the product of the work of the Commerce Committee. This is the first time in Mexico that the legislature has come out with a sharply different and even opposite assessment of what the Executive branch is saying about its trade policies and the results of our trade agreements.

This is especially important in light of the agreement that Mexico has just reached with the European Union and the beginning of conversations with Japan about another trade agreement. Although the design of those trade agreements is different than NAFTA, the economics behind those agreements are basically the same. So what does the report of the Commerce Committee emphasize? It again points out that trade liberalization sharpens structural inequalities and income disparities in the Mexican economy. This is unequivocal.

A Second Look at Privatization

Finally, let me say a couple of words about structural reforms, about the privatization of the energy and telecommunications sectors, because they are probably the last slices of the cake that are still left in the hands of the government. The investors (in New York) asked a lot about that. They're looking at PEMEX (the national oil company) and the Comisión Federal de Electricidad (the power company) as the next companies to be privatized. We still don't have an independently conducted investigation about the impact of privatization in Mexico.
But when even the World Bank is taking a second look at privatization of power facilities in other countries, we should take second look at the intention of privatizing ours. Why? Basically because in Mexico the process of privatizing the banks became an enormous burden for taxpayers. Even now, we have debates in the Congress about the fact that President Zedillo wants us to give the green light to the conversion of those private contingent liabilities into public debt, and what we say up front is, “You want us to convert private liabilities into public debt, so make all the information public. If this is to become public debt, then we have to know who benefitted from the banking bailout.” But they say no, no, no, you convert it into public debt, but we won’t give the information. The information is confidential, secret,” so that’s one more contradiction. The same thing happened with the toll roads. We privatized many roads, or the operation of them, and now we’re bailing out the companies that built those roads. So, the lesson is not only that you must have transparency, accountability, and good regulatory bodies before you privatize parastatal companies, but also the answer to the question, what is the purpose of privatizing? Is it only to raise money? To tackle the fiscal crisis? Or is it a restructuring of the economy to benefit only a handful of people?

That’s a debate that inside Mexico hasn’t even gained full strength, and outside Mexico it is taken for granted that privatization is good. It supposedly serves the people, it serves taxpayers, but that hasn’t been the case in our country, at least in those two cases that I just mentioned, and in the case of the phone company, at least for local service, we have been paying monopoly rates for the last nine years.

Resolving the Banking Crisis

What has to happen to resume bank lending, to bring down interest rates? That is a key question that all the campaigns are being asked. We need to push forward the institutional reforms, the words that I have repeatedly put on the table — transparency, accountability — which are nonexistent now. The investors want a new bankruptcy law, a new law to guarantee credit so that the banks will be able to retrieve their money in case the borrower defaults. We don’t have that kind of law in Mexico, and under the current legislation we had 20, 25 years of stable credit, a very low rate of non-performing loans, but they say that that is essential to the resumption of credit.

We also need to increase competition inside the banking system. We don’t have competition, or really very little competition. Foreign subsidiaries are entering the market, but they work with enormous margins. So there is bound to be a profound restructuring of the financial sector that includes those measures to introduce accountability and competition. As I said in the beginning, we are the ones advocating the institutional measures that should make markets work, because the Mexican economy operates according to oligopolistic rules rather than market rules. Doing away with crony capitalism is a hard job and it is one of the main challenges facing the Mexican economy and the candidates that are running for president.

Let me just finish this round and open it up to the floor by saying that the conventional wisdom on Mexico could be proven wrong once again. Investors are basically betting on a Labastida victory and on no crisis at the end of the six-year administration and they’re very upbeat about it and they’re saying that it won’t happen this time. I just told them that knowing our own history, knowing our political and social volatility, knowing the fragility of the Mexican economy to external shocks -- you tell me when the next external shock will happen on Wall Street, or a downturn in the U.S. economy -- I wouldn’t bet on permanent stability for Mexico. The outlook I think is difficult because although the macroeconomic picture may look different from that of 1994, the structural problems have not been tackled. They're there, and unless we have a totally different approach to economic policy, a totally different strategy, those problems will knock on the door and say we're still here. Don't forget about that the fact that you have 92 percent of households with a monthly income of below $500. I will cut here and thank you for your attention.
Following his presentation, Carlos was asked about the economic-policy differences among the presidential candidates, Mexican trade in the hemisphere, agricultural policy and the massive government bailout of private banks. His replies are excerpted below.

The Political Opposition

[Among the three principal presidential candidates] the main difference is that Cardenas is putting the emphasis on the domestic market, on the internal situation in Mexico, and the other two candidates are basically saying we need to go along the lines of economic globalization. Fox is saying, I'll do it with honest government officials, as opposed to the PRI government officials. We are saying there needs to be a shift in economic strategy because the current economic strategy is unsustainable. And that shift is, to begin with, not to let domestic economic policy exacerbate the problems created by the process of economic globalization. So our economic strategy is centered on the needs of the domestic market. The other economic strategies are centered on the demands of international investors, basically.

As for an alliance of the opposition, I was on the negotiating commission for the PRD in October and November. We had many meetings with the other parties in the opposition, eight political parties. The PAN and the PRD are the two major parties, but there are six other smaller parties. And we couldn't come to terms on a unified candidacy. Even though we have important differences in the economic platform that I have just outlined, people agreed that a PAN government with the social component that the PRD introduces into the overall picture would be a better government than that of the PRI, or a PRD government with the PAN component would also be better than a PRI government. I do believe that, that even though we have important differences in our economic platforms, the fact of opening up the political space is essential to introduce accountability in the Mexican economy, to introduce transparency in the markets, and then to discussing and settling our differences.

The problem right now is that in Mexico the sense of the vote doesn't necessarily translate into policy shifts. In 1997 we had a mid-term election, a congressional election in which the opposition combined got the majority, but that didn't translate at all into a policy shift. So the challenge here is, what do we do now? The polls show Labastida in the lead, then Fox and Cardenas trailing behind them. There are still five and a half months to the election and many things could happen. Had anybody said in December 1993, in a few days there's going to be an Indian uprising in southeastern Mexico, then the PRI presidential candidate is going to be assassinated, then the party secretary general is going to be assassinated as well, and then there will be a maxi devaluation of the peso, he or she would have been accused of being nuts. The control of the PRI over the electoral process is not as tight as it used to be in the past, but the machinery is still working extremely well. In the House we have tried many times to introduce what we call "locks" on the budget, mechanisms of control for government spending not to be used for partisan purposes, but the Senate has systematically blocked that. So the government and the PRI are going to use whatever they can to grab their hold on power.

Come the end of March, the beginning of April, there's going to be a lot of pressure on the opposition candidate that is below in the polls to step down in favor of the other candidate. It wouldn't be possible to do it formally, because the ballots will be printed by then and the time to do that ended on December 10, 1999. We could have, although I think it's extremely unlikely, a de facto alliance of the whole opposition. I see that the two major opposition candidates are going to go until the end, and I
don't anticipate that there will be a de facto alliance. I'm just saying that there's a remote possibility that we cannot discard, and I think that basically Fox, prior to the November 7 PRI "primary" believed that he could win on his own, and after November 7, when the PRI didn't split, Fox is having second thoughts about his ability to win on his own, so he's coming to talk to Cardenas to discuss a de facto alliance, although I sincerely don't think it will happen.

"Protecting" Mexican Agriculture

While it hasn't been noticed much yet, the Mexican Congress just established a 30 percent tariff on imports of basic grains that surpass the NAFTA quotas. That means that all corn imports from the U.S. that exceed the agreed-upon NAFTA quotas are charged a 30 percent tariff. Let me tell you that all of the parties voted for that. There's a lot of pressure from the basic-grains small farmers because corn growing has basically collapsed in Mexico. The government didn't really oppose it, and all three major parties voted for it.

When people use the word protectionism, I always feel tempted to ask for a specific definition of what protectionism is. And I think we have a lot of protectionist measures in the Mexican economy beginning with corporations and bankers. They are the ones who have enjoyed the highest degree of protectionism. I'm not referring to trade; I'm referring to the kinds of policies that are implemented in Mexico. As I said a few minutes ago, when you allocate public funds to pay for private liabilities, it is called a wise financial decision, and when you allocate funds to pay for tortillas, it's called bad economics.

The rural population in Mexico still accounts for 25 percent of the total population, and, apart from commodity exports, our family farms, our peasant agriculture, have been totally abandoned. The flood of imports of basic grains has ravaged the countryside, so the corn growers are here instead of working in the fields of Jalisco, of Chiapas, Estado de Mexico, which are the largest corn producers. The design of agricultural policy that has been followed in Mexico is basically that it is better to harvest dollars than to harvest food for our own consumption. So the areas of agriculture that are being supported are those that help us earn foreign exchange or that help the corporations established in Mexico to run their business. We do not have a strategy anymore to ensure our basic needs in terms of food supply. We do not have a strategy to support our domestic producers; that has been abandoned. So even if people call it protectionism, we think we should restore that. The problem is that the provisions in NAFTA put a lot of obstacles in the way, and that's why we envisage a different kind of agreement.

A lot of people in the Ministry of Agriculture complain about the fact that agricultural policy is decided at the Finance Ministry, so they cannot even undertake the strategies that have been designed by agricultural producers.

NAFTA

What we're saying regarding NAFTA and all trade agreements is that we need trade agreements that serve the overall economy, that serve the different sectors of the economy, not agreements that are not only geared to serve a handful of people. How is that done? Well, you know about Seattle, you know about the ongoing debate about introducing labor rights, environmental issues and especially migration into the trade agreements. Of course you can say that that will not fly in the U.S. Congress. There's no way that the U.S. Congress is going to accept in the near future the renegotiation of NAFTA or the inclusion of provisions to address migration issues inside the agreement. But the latter is a proposal that is being put forward by Cardenas. Manpower is still our main export. Hundreds of
thousands of Mexicans migrate northward every year to look for jobs, and yet that is not considered inside the trade agreement. So we're not pushing for an overall renegotiation of NAFTA; we're pushing for the inclusion of those issues inside the agreement.

Cardenas is not proposing to kill NAFTA, he is proposing to include labor rights and migration inside the agreement. Whether that's possible depends a lot on what's happening in the United States. NAFTA is a fact of life, we don't like it, we proposed a different kind of agreement. We still think we need a different kind of agreement, but we don't have the political force, nor do I see it in this country (USA), to kill NAFTA.

Mexico's Trade with Its Southern Neighbors

Mexico's total trade with Latin America is almost insignificant. We have trade agreements with Chile, Bolivia, Nicaragua, and Costa Rica, and we're in the process of ratifying a trade agreement with the triangle of northern Central America (Guatemala, Honduras and El Salvador), but total trade with Latin America right now does not exceed 5 percent of Mexico's overall international trade. So the decision to associate with the North was explicitly saying that the Mexican economy should not be associated with the South but with the North. Pedro Aspe, the former Minister of Finance, said that explicitly. The Costa Ricans, for instance, have complained that our government applied to them the same tactics that the U.S. government applied to the Mexican government. So they do see that those imbalances are embedded into the different agreements that Mexico has reached with Latin American countries, but I don't see that the pattern of Mexico's trade will change any time in the near future.

The only thing on which Latin American governments are unified is to demand access to the U.S. market. I don't see any united force saying, let's put together a coalition of countries to the south of the U.S.-Mexico border -- Latin America and the Caribbean -- and establish a firm, solid alliance to look after our own interests. I don't see it in the WTO; I don't see it in regional trade agreements. The presidents in Latin America still believe that their major achievement will be to gain access to the U.S. market. I said repeatedly here in Washington, and I say it again now, that most Latin American countries believed that Carlos Salinas would become their best ambassador to pry open the U.S. market to their products, and they ended up realizing that Salinas had become the best U.S. ambassador in Latin America.

Privatization and PEMEX

Regarding the privatization of PEMEX [the public oil company], our party stands for the energy sector staying under the control of the state, but a democratized state that is accountable to its people. We don't want a company that is just used for the benefit of a bureaucracy, be it the union bureaucracy or the government's bureaucracy, but we do need to use our energy sector as an engine for the development of the economy, which we haven't done. PEMEX is seen as a source of fiscal revenue for the government. About 32 percent of the government's fiscal revenue is derived from PEMEX, from oil exploitation and from the different taxes and contributions that PEMEX pays to the federal government. The price of gasoline in Texas is 54 percent of the price of gasoline in my home state [Tamaulipas], for example, because there are many taxes attached to every liter of gasoline that is dispensed at the pump.

We need to introduce mechanisms of accountability and we need to stop sacrificing PEMEX as a source of forced revenue for the government. The government hasn't wanted to move forward with a thorough fiscal reform. There are too many tax havens concentrated in a few hands, all cronies of the PRI, or corporations that enjoy monopoly status in certain sectors of the economy, like cement and local telephone service and television companies. Cuauhtemoc Cardenas has declared a number of
times that he and the PRD welcome private and foreign investment in new plants. He believes that the existing facilities should stay in the hands of the state, but, especially in power generation, he has welcomed private and foreign investment in new plants.

Let me tell you that no candidate, not Fox, not Labastida, has proposed privatizing PEMEX or the electricity company. They don't dare say it, even if they wanted to, because that would bring them a lot of problems. Fox is accused of coming to New York and saying, I'll privatize oil, and when he is asked about that in Mexico he always says that he has been misquoted.

**Public Debt and the Bank Bailout**

The hidden debt in the Mexican economy is enormous. The total public debt, according to official figures, is only 23 percent of GDP. When we include the contingent liabilities of the banking bailout, plus the investment projects that have been financed by the private sector and ultimately have to be paid for by the government, plus the cost of restructuring the pension system, we reach a figure of 55 percent of GDP. This is a staggering figure. Mexico's GDP is about $500 billion. So you're talking a total debt of half of that. Servicing that debt is an enormous strain on the economy. It drains a lot of resources that would have been devoted to other purposes.

Now, the debt results in a very difficult fiscal outlook. The current account deficit is growing again. It has not reached the levels of '94, but the trend is there for it to grow. The Ministry of Finance says that the forecast for 2000 is about a 15 billion dollars current account deficit, and they say that 70 percent of that is financed through foreign direct investment. In that sense, it's under control. We've heard that line before.

With the overvaluation of the peso, of at least 10 percent, I think we're going in the wrong direction. Now again, that only makes the Mexican economy all the more vulnerable to external shocks. Although Larry Summers engineered the '95 bailout for foreign investors, for foreign companies, for Mexican investors, I don't see the likelihood this time of any external rescue. And the path that our Administration has taken is that they'll just transfer the cost to taxpayers, to most Mexicans, who did not benefit from those loans but are still paying them.

The government and especially the Banco de Mexico, which is now autonomous, say that there cannot be under or overvaluation of a currency when you have a free flotation. But in practice, we see otherwise. I think that we should have a competitive exchange rate. What we have now is a "dirty" flotation in the sense that the exchange rate tends to be overvalued at the end of a six-year term. That serves the purpose of luring the votes of the middle class, people who may be not very numerous in demographic terms but are significant in terms of still remaining purchasing power. So I think the issue of capital controls is not on the table now, but it could be if we have another external shock.

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