The Failure of the Mexico Bailout

Since financial crisis hit Asia in late 1997 and the International Monetary Fund intervened in Thailand, Indonesia and then South Korea, the 1995 bailout of Mexico and of those investors holding short-term Mexican bonds has been held up by U.S. and Mexican policymakers as a successful model to be replicated. Indeed, a picture has been painted of a rapidly recovering Mexican economy that is regaining the status of a fundamentally healthy emerging market that it occupied in many quarters until the peso and the economy collapsed at the end of 1994.

The reality is quite different. From the perspective of most Mexicans, who continue to suffer under the intensified adjustment program on which the bailout was conditioned, and of Mexican economists and citizens' organizations that relate to the real economy, their country remains in serious economic straits. The best that can be said is that the level of suffering and economic insecurity of the majority of the population has stabilized for the moment. At the same time, however, the core of Mexico's economy has been gutted, the same conditions that created the 1994 crash are reappearing, and the country has been destabilized from the streets of Mexico City to the mountains of Chiapas.

*** *Domestic productive capacity has collapse d.*** Between 1995 and 1997, more than a third of Mexico's businesses -- over 20,000 small and medium-sized enterprises -- declared bankruptcy. With domestic demand still low, interest rates still high and barriers to imports falling, there has so far been no recovery in this core sector of the Mexican economy.

*** *Massive unemployment persists.*** Two million people lost their jobs in the economic collapse, leaving one third of the economically active population of nearly 30 million workers unemployed or in precarious jobs. Some 1.8 million peasants have been forced to leave their homes in search of work. The absence of unemployment benefits has exacerbated this crisis. The government recently announced the creation of a million new jobs in 1997, but with anyone working one day per month classified officially as employed, it is difficult to determine the significance of this figure.

*** *Wages have fallen precipitously.*** Over the past three years, real wages, already perilously low, have declined by almost 25 percent. Since 1982, wages have lost more than 66 percent of their purchasing power.

*** *The banking system remains virtually insolvent.*** Only periodic injections of fresh capital from the Mexican government keep the banks afloat. Since the collapse of the economy, the government has invested the equivalent of more than US$46 billion in the banking system, an amount equivalent to 12 percent of the country's GDP and twice the amount spent by the government on education and social development combined. More than 50 percent of the banks' portfolios is overdue, as most businesses and consumers cannot repay their loans.

*** *The current account is once again in deficit.*** The trade deficits in December and January were worse than expected. Virtually the only sector that has shown any growth since 1994 is export manufacturing, particularly the maquiladoras. As this sector is now highly dependent on the import of capital goods and components for assembly, the structural problem that was brought on by economic liberalization and that contributed to the 1994 crisis is reappearing.

*** *Interest payments on heavy foreign borrowing have exacerbated the current account deficit.*** In order to pay back the U.S. Treasury its bailout loan, the Mexican government borrowed extensively in international private markets. It offered rates of five percent above what is normal, taking on extensive obligations. Today, a large percentage of Mexico's reserves are borrowed monies, an extremely precarious situation, even by IMF standards.

**** Mexico will have to begin relying again on speculative capital this year to reduce the deficit.*** Its current account imbalance should increase steadily through 1998 and nearly double the size of last year's deficit. By 2000 it should be approaching 1994 levels. Direct investment would be insufficient to fill this gap even without the current insecurities being felt by emerging-market investors. Furthermore, agreements signed by the Mexican government in the context of NAFTA mean that no controls can be placed on capital flows, making the Mexican economy ever more vulnerable.

**** Increased poverty and inequality have destabilized Mexican society.*** The OECD warned this month that Mexico's economic crisis and the adjustment measures prescribed by the IMF to address it had increased social contrasts. Intense and pervasive poverty, extreme economic inequities, and a growing desperation and alienation have engendered an increasingly violent response on the part of Mexicans to their current circumstances. Crime in Mexico City and other urban centers has proliferated under the "bailout economy", making it one of the country's major preoccupations. The drug trade continues at ever expanding levels. First in Chiapas and then in other southern states, rebel movements have taken up arms to challenge the government and policies that have kept local populations in poverty.

The economic policies being imposed upon South Korea, Indonesia and Thailand are similar to the structural adjustment policies that brought the Mexican economy to the point of ruin in 1994 and that have continued to be imposed with increased intensity. Policies of austerity, wage suppression and high interest rates and the rapid opening of the economy even before Mexican enterprises and institutions had developed the capacity to compete in the global economy and to manage increased financial flows effectively have been promoted and warmly welcomed by foreign investors. These measure do not, however, enable Mexico to build the basis of a strong domestic economy and to escape the destructive cycle in which it now finds itself. This is hardly a model for Asians or anyone else to follow.

This analysis was prepared by The Development GAP in consultation with Mexican economists Alejandro Nadal (Colegio de México), Rocio Mejia (Advisor, Mexican Senate) and Carlos Heredia (Member of Congress - Cámara de Diputados) and with input provided by Mexican citizens' organizations and networks, including Equipo PUEBLO, Red Mexicana de Acción frente al Libre Comercio, and El Barzón.

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