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Review

Reviewed Work(s): Mexico's Recent Economic Transition: A Success Story? by Nora Lustig

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Source: *Economic Development and Cultural Change*, Apr., 1996, Vol. 44, No. 3 (Apr., 1996), pp. 696-700

Published by: The University of Chicago Press

Stable URL: http://www.jstor.com/stable/1154475

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contribution to understanding the relationship between Africa and the international community as it tackles the crises of debt, poverty, and underdevelopment. The book also enriches our understanding of the domestic causes of the African crisis and points to the scarce literature on African development economics as seen from an African viewpoint. It is worth reading.

Notes

1. See Jean K. Thisen, "The Projection of Africa's External Debt by the Year 2000," UNCTAD Paper Series, no. 82 (United Nations Conference on Trade and Development, Geneva, March 1994).

2. Michael P. Todaro, *Economic Development in the Third World,* 6th ed. (New York: Longman, 1986), p. 58.

3. In effect, this has always been the thesis advocated by the United Nations Economic Commission for Africa (UNECA) in its *African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation* (AAF-SAP) (Addis Ababa: UNECA, March 1989). A tentative comparison was made between this study and the orthodox International Monetary Fund and World Bank Structural Adjustment Programs (SAPs) in J. K. Thisen, "The Design of Structural Adjustment Programmes: The African Alternative Framework," *Africa Development* 16, no. 1 (1991): 115–64.

4. See Giovanni Andrea Cornia, Richard Jolly, and Frances Stewart, *Adjustment with a Human Face: Protecting the Vulnerable and Promoting Growth* (Oxford: Clarendon, for UNICEF, 1987), vols. 1 and 2.

Nora Lustig. **Mexico's Recent Economic Transition: A Success Story?** Washington, D.C.: Brookings Institution, 1993. Pp. xx + 186. $28.95 (cloth).

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The Mexican adjustment process since 1982 is one of the most interesting and significant cases for economic literature and policymakers in developing countries. After the debt-crisis of 1982, the Mexican government implemented macroeconomic adjustment in different phases, resulting, after 1987, in historically low inflation rates, in a stable exchange rate, in attracting massive foreign investment, and in the signing the North American Free Trade Agreement (NAFTA) with Canada and the United States, among others. However, recent tendencies, such as the high current-account deficit, and, more important, the Indian-peasant rebellion in Chiapas, have seriously threatened and questioned the "Mexican adjustment path."

Lustig's book is a useful contribution to the current discussion on recent economic transitions in developing countries. She examines

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Mexican economic restructuring since 1982, although the "recovery Mexico enjoyed between 1989 and 1991 . . . may take a few years" (p. 11). Inspite of the broad range of issues analyzed, she focuses on three main issues: the causes of the crisis of import substitution in 1982, the implementation of several macroeconomic stabilization programs throughout the 1980s, and the social costs of adjustment.

In Lustig's view, the Mexican state had little option but to impose radical economic reforms since 1982. The golden years of stabilizing development (1954–70) under import substitution left a paradoxical legacy: GDP increased by 6.7% annually during 1956–72, but the macroeconomic performance signaled disturbing and unsustainable conditions by the mid-1970s. Increasing public spending unaccompanied by higher government revenues led to an increasing fiscal deficit, which caused a rise in the current account deficit and in inflation rates. Furthermore, the leftist rhetoric of government officials enhanced uncertainty among private investors. During the 1970s, external borrowing and reserves allowed a stable exchange rate. However, the almost 40% devaluation of the peso in 1976 and particularly external shocks, such as the 1973 oil price increase, contributed to a severe crisis, reflected in a fall in output and accelerating inflation. Moreover, continuing mistakes by the state in the face of increasing oil revenues since the mid-1970s led to an appreciation of the exchange rate and caused the debt crisis of August 1982. Thus, in Lustig's view, macroeconomic mismanagement, enhanced by external shocks, were the main reasons for Mexico's economic turmoil (pp. 26–27).

Regarding the Mexican macroeconomic adjustment, the Administration of De la Madrid (1982–88) and International Monetary Fund programs since 1982 have focused on price and financial stability to eliminate supply rigidities. The main targets of the stabilization were fiscal austerity, indexation of nominal wages since 1987, and large devaluations, which were expected to generate a trade surplus to service external debt payments. However, as Lustig stresses, the external environment—low oil prices and limited access to external credit—was the principal constraint to successful macroeconomic adjustments. Moreover, the 1986 oil shock, high inflation rates, and the 1987 run on the peso brought about a new emphasis on and acceleration of structural reform. Since 1985, trade liberalization and privatization have become the pillars of the new development strategy. The elimination of import licensing, multilateral financing and later debt-reduction schemes, and a significant fall in real wages accompanied this process. Membership in GATT (General Agreement on Tariffs and Trade) since 1986, further unilateral trade liberalization, foreign investment rules expanding activities to 100% foreign ownership (the latter two have been in place since 1989), and seeking closer ties to the United States since 1985 have become the crucial interests of Mexico's government.

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Thus, NAFTA, unveiled in March 1990 and approved by the three governments in August 1992, is expected to "ensure future access to the U.S. market, and ensure the durability of Mexico's open economy strategy" (p. 134).

After the run on the Mexican peso in October 1987, the Economic Solidarity Pact became the main instrument to reduce inflation and to implement macroeconomic adjustment. The pact imposed the achievement of a primary surplus (fiscal balance, not including debt payments) as a crucial fiscal goal, a price and wage freeze, and further trade liberalization, combined with an appreciating exchange rate and high real interest rates to avoid capital flight. It was not until 1987 that macroeconomic adjustment began to show positive effects. After four rescheduling programs and other debt negotiations, the Brady Initiative, announced in 1989, became crucial for restoring confidence and attracting capital repatriation and new foreign investment. Finally, according to Lustig, two events became significant by the early 1990s: privatization, particularly of banks, and the announcement of NAFTA. Given overall macroeconomic stability, reflected in falling inflation rates from 159.2% in 1986 to 18.8% in 1991, capital inflows rose from US$3 billion in 1989 to US$9.7 billion in 1990.

Lustig's third relevant argument centers on the social costs of the adjustment process. In general, and in spite of the fact that large segments of Mexico's population were already living under precarious conditions before 1982, real wages fell between 40% and 50% from 1983 to 1988, although employment rose an average of 0.4% per year. On the other hand, an increase in nonwage incomes and a rise in informal-sector employment compensated somewhat for the real wage decline for all income groups. However, in order to continue with domestic and external debt servicing, social spending, particularly social programs, fell 33.1% from 1983 to 1988, although education and health expenditures were reduced by a lesser percentage than total social spending. Middle-income groups, who derive most of their income from wages in Mexico, suffered most during the adjustment programs. However, the impact of adjustment shifted during 1986–89 to the detriment of lower-income groups, particularly the agricultural sector. Thus, in spite of the higher burden carried by middle-income groups, macroeconomic adjustment has been characterized by a sharp rise in inequality: the top 10% of households increased their share in total income from 32.8% in 1984 to 37.9% in 1989.

Finally, Lustig supports Mexico's strategy of combined fiscal and monetary restraint with an income policy that reduces the negative impact on wages, partly because of the reduction of inflation. Moreover, real wage cuts were possible, without widespread unrest, because of nonwage incomes and the government's control of the labor movement. She concludes: "The Mexican case shows that, to convert

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stabilization into sustained growth, innovative institutional change is necessary. In Mexico this sort of change was expressed in the government's decision to seek a free trade agreement with the United States. This initiative, together with the reprivatization of the banks, contributed to a turnaround in business expectations. As a consequence, private investment and capital flows rose and made recovery possible'' (p. 60).

However, Lustig's arguments ignore at least three fundamental issues that have become crucial throughout the adjustment process and particularly since the late 1980s: the importance of democracy regarding the adjustment process and the distribution of income, the impact of macroeconomic adjustment on microeconomic restructuring, and the issue of employment.

In an old Friedman-like fashion—assuming that political freedom is an outcome of economic freedom, and only the latter has to be promoted—the respective administrations since 1982 have reinforced the authoritarian character of Mexico's government, assuming that economic freedom will probably lead to later political freedom.[1] They assume a ''lack of resistance to wage cuts'' (p. 71). Thus, the Economic Solidarity Pact, the crucial mechanism for redistributing the costs of the adjustment process through real wage reductions and regressive distribution of income policies, reflects the authoritarian policy style of the present administration. Since 1987, government-friendly trade unions agreed to the respective pacts, while the same trade unions have been decisive in suppressing movements of independent-minded unions. Added to Mexico's civil society's general demand for clean elections, the government has faced severe difficulties in legitimating the costs of adjustment. This has led to the exclusion of vast segments of Mexico's population from participating in the decision making process of adjustment and other related issues such as Mexico's entry into NAFTA. However, recent events, particularly the uprising in Chiapas, have shown the limitations of this policy and might indicate profound political changes that will also affect the current adjustment process and its impact on the distribution of income.

The second issue that was not discussed by Lustig has also been overlooked by government officials. Structural change is understood at a macroeconomic level, particularly regarding inflation, the fiscal balance, the privatization process, and trade and financial liberalization.[2] However, ''getting prices right'' does not provide sufficient conditions for microeconomic restructuring, as the Mexican case shows. In the case of manufacturing, for example, output, exports, and productivity have increased sharply during the boom period 1987–91, and it has become the most dynamic sector for this period. Manufacturing has increased capacity utilization, after a recession (1982–86), and new investments are scarce. Recent growth in manufacturing was concen-

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trated in a few areas (beer, glass, basic petrochemicals, and automobiles), which were also most dynamic under import substitution, while most of manufacturing industries faced severe difficulties and even termination of activities. Low and decreasing internal demand, high real interest rates, increasing competition, the strong exchange rate, and a lack of industrial policies are the other side of macroeconomic adjustment that have complicated microeconomic restructuring and have partly caused Mexico's recession since 1992.[3] It is clear that the adjustment process is in a critical stage regarding overall growth and the trade deficit, since the former has achieved a rate of 2.8% and 0.4% for 1992 and 1993, respectively, and the trade deficit has stabilized at around $20 billion for both years.

Finally, Lustig does not address the importance and dimension of employment during the adjustment process and recent boom period in manufacturing. She mentions that 1 million Mexicans, or 4.75% of the economically active population, attempt to enter the labor market annually. Moreover, trade liberalization and NAFTA will have a strong impact on Mexico's agricultural sector, populated by approximately 20 million people. However, neither the service nor the manufacturing sectors created employment during the boom period 1987–91. The employment issue will probably be the most significant issue during the 1990s and it has been neglected by most of the literature on macroeconomic restructuring. There is increasing pressure from different groups in Mexico to develop and implement clear sectoral policies; they have been neglected as the government fears that such policies might reverse the macroeconomic achievements.

Thus, Lustig's book presents the logic and successes of Mexico's macroeconomic adjustment process but it fails to point out some of the critical issues that might be significant for other nations following similar macroeconomic adjustment paths.

Notes

1. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962).

2. Pedro Aspe Armella, *El camino mexicano de la transformación económica* (The Mexican path of economic transformation) (Mexico City: Fondo de Cultura Económica, 1993).

3. Enrique Dussel Peters, "Cambio estructral y potencialidades de crecimiento del sector manufacturero mexicano (1982–1991)" (Structural change and growth potential in Mexico's manufacturing sector [1982–1991]), in *México, la nueva macroeconómica* (Mexico: The new macroeconomy), ed. Julio López (Mexico City: Centro de Estudios Para un Proyecto Nacional Alternativo/Nuevo Horizonte, 1994), pp. 147–229.

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