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ENFOQUE

[Zed]illo's economic strategy: the first three years

[...] 1994 financial crisis, Mexico [...] impressive strides toward [eco]nomic recovery. Yet significant [...] remain. The invited contribu[tors to th]is issue of *Enfoque* examine [the admin]istration's economic, poverty-[...], and employment polices.

Enrique Dussel Peters

Three years into the Zedillo administration, there has been virtually no deviation from the economic liberalization strategy put in place during the presidency of Carlos Salinas de Gortari (1988–1994), and economic policy is still guided by the same priorities. The 1995–2000 National Development Program and the recently unveiled National Development Financing Program (COFFDE, 1997–2000) confirm that controlling inflation, balancing the federal budget, and attracting foreign investment remain the centerpieces of the government's economic strategy. The assumption is that these efforts at the macroeconomic level will transfer over into structural changes at the micro level.

• Despite holding true to the Salinas economic plan, the Zedillo administration has been forced to take steps that directly contradict the market-oriented policies in place since 1988. One example is the program instituted to help the newly privatized banking sector avoid bankruptcy. Another is the government's emphasis on building up domestic savings, a reaction to the realization in 1994 that nearly half of the country's savings were held by foreigners. Yet these deviations are relatively minor, and restrictive monetary and fiscal policies, overall import and price liberalization, and a general pattern of nonintervention in certain sectors of the economy remain the foundation of Mexico's liberalization strategy.

• Ever since the December 1994 peso devaluation and the ensuing period of crisis—the worst in Mexico's history in terms of the impacts on gross domestic product (GDP), employment, and real wages—the Mexican economy

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has been in a steady recovery, and economic expectations are now extremely positive. The government predicts that the economy will continue to grow above 5 percent annually until the year 2000, and investments and savings are expected to rise from 20.9 percent of GDP in 1996 to over 25.4 percent in 2000.

- Moreover, again according to official predictions, foreign investment will grow, inflation and nominal interest rates will fall, and the fiscal deficit will be held below 1 percent of GDP. Open unemployment, which dropped from 6.3 percent in 1995 to 4 percent in 1997, is expected to decrease further, largely as a result of growth in the export sector (measured at 30 percent since 1995 and about 15 percent in 1997).
- These bright expectations mark a radical change in attitude toward the Mexican economy since December 1994, both within Mexico and in international markets. They are also the reason that the Zedillo administration has not modified Mexico's economic strategy, much less held it up for public discussion.
- Given this context, one must wonder if the 1994–1995 economic crisis offered the current administration any lessons. If so, did it heed them? And what challenges remain for Mexico's economy in upcoming years?

Structural Limitations to Mexico's Growth Path

Under Mexico's liberalization strategy, economic expansion has depended on imports. The coefficient of trade balance/GDP for the manufacturing sector (excluding *maquiladoras*) went from -14 percent in 1988 to -44 percent in 1994, putting the manufacturing sector at the center of the 1994 crisis and proving that Mexico's manufacturing firms remain basically unchanged in terms of their dependence on imported inputs.

Real Interest Rates

Independent of inflation and nominal interest rates, real interest rates have remained high since 1988, due largely to high transaction costs and the marked inefficiency of the banking sector overall. The result is quite ironic: development banks have money to lend (funds raised in international markets), but there is little demand on the part of borrowers. A further irony is that the government's core strategy to cope with the December 1994 crisis was to bail out the banking sector, at a cost of 10–12 percent of GDP, and yet bad loans as a percent of all loans continue to rise.

Capital Inflows and a[n] Overvalued Exchange R[ate]

Massive foreign investment in combination with the need to hold down inflation, leads inevitably to an overvaluation of the exchange rate. This was [the case] under Salinas, and it has remained so throughout 1996–1997.

Exports as the Engine [of] Future Growth?

A striking feature of the [liberal]izing Mexican economy is [its] reliance on exports and the [con]centration of the export se[ctor]. 300 firms account for 70 pe[rcent] of Mexico's non-*maquila* exports. But these manufa[cturers] are highly capital intensive, [add] little product value, restric[t] themselves primarily to in[tra]-industry trade, and are poo[rly] linked with the remainder of Mexico's economy. Despite [these] firms' continued high rates [of] growth, they do not hold the solution for Mexico's econo[mic] difficulties.

Employment

From 1980 to 1996 Mexico's economically active popula[tion] (EAP) *grew by 17 million*, although the economy crea[ted] only 2 million new jobs. The EAP continues to increase b[y] about 1.5 million annually. [To] *keep pace, employment wou[ld]* have had to increase by 5.2 per[]cent per year.

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• In fact, it dropped by 0.2 percent from 1988 to 1996. The manufacturing sector, the "engine of growth" for the Mexican economy, *expelled* workers during this period.

• Not only does the liberalization strategy show a perverse tendency to increase productivity by decreasing employment, but it also generates low-quality jobs. Employment, probably the most important economic and social issue in Mexico, is not being addressed and can only become more critical in the future.

Real Wages

Since Salinas implemented his liberalization strategy in 1988, real wages have plummeted (with only a few exceptions). Legal minimum and real wages in 1996 were at only 27 and 60 percent, respectively, of their 1980 levels. Consumer demand is also down, despite other signs of economic recovery beginning in 1996.

Regional Polarization

Since 1988, Mexico has increasingly separated into North and South. The North—with more foreign investment, more *maquiladoras*, and more intra-industry trade—generally performs better than the regions south of Mexico City. Although this division has attracted little academic or government attention, it holds powerful explanatory value for the country's recent social uprisings, and it will strongly influence the tenor of Mexico's economic and political debates in the future.

• The challenges that these various issues present, especially when added to others such as Mexico's foreign debt and debt service, suggest that Mexico has not heeded recent lessons in the unsustainability of economic growth under the country's current liberalization strategy. Today's euphoria over Mexico's economic performance recalls the heyday of economic hedonism under Salinas—just before the economic turmoil set loose at the end of 1994.

• The same economic trends that produced the crisis in 1994 are still in place in 1997:

• a relatively small, highly capital intensive manufacturing sector dependent for its growth on an increasing supply of imports, while generating neither sufficient employment nor value-added backward linkages to other parts of the economy.

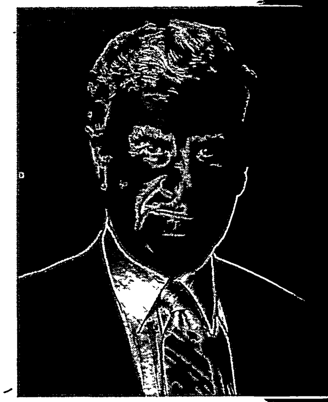
• an unbreakable cycle of inflows of speculative capital leading to an overvalued exchange rate.

• The perception in Mexico is that there is no more time for experimenting with dogmatic or orthodox economic policies, whether they are intended to attain one-digit inflation rates, a horizontal industrial policy, theoretical macroeconomic equilibrium, government interventions, reductions in the value-added tax, and so on.

• The economic challenges are enormous. We cannot rely on GDP and export growth figures to reflect the true state of the Mexican economy. These measures say nothing of the country's high regional polarization, declining rates of employment generation, worsening job quality, falling real wages, and the noninclusion of most of the Mexican economy in the supposed "recovery."

Dussel Peters is a member of the Facultad de Economía at the Universidad Nacional Autónoma de México.

Center and University Lose Valued Friend



Joseph Grunwald, long-time associate of

Joseph Grunwald, long-time associate of the Center, pa away in May 1997. Dr. Grunwald came to La Jolla the Brookings Institution in to become the first appointed president of the Institute of Americas. He later served as Dean of UCSD's Graduate School of International Rel and Pacific Studies. Before co ing to California, Dr. Grunw taught at several universities, including Yale University and Universidad de Chile. He had also served as Deputy Assista Secretary of State for Inter-American Affairs in 1976–77.

• During his tenure at UCSD, Dr. Grunwald was a member of the Center's International Advisory Council. He was also a Center Faculty Research Associate, and he regularly served on the Center's selection committee for the Summer Seminar in U.S. Studies. But more, Dr. Grunwald was an esteemed colleague and a valued friend.