

The 25 Years That Transformed Mexico

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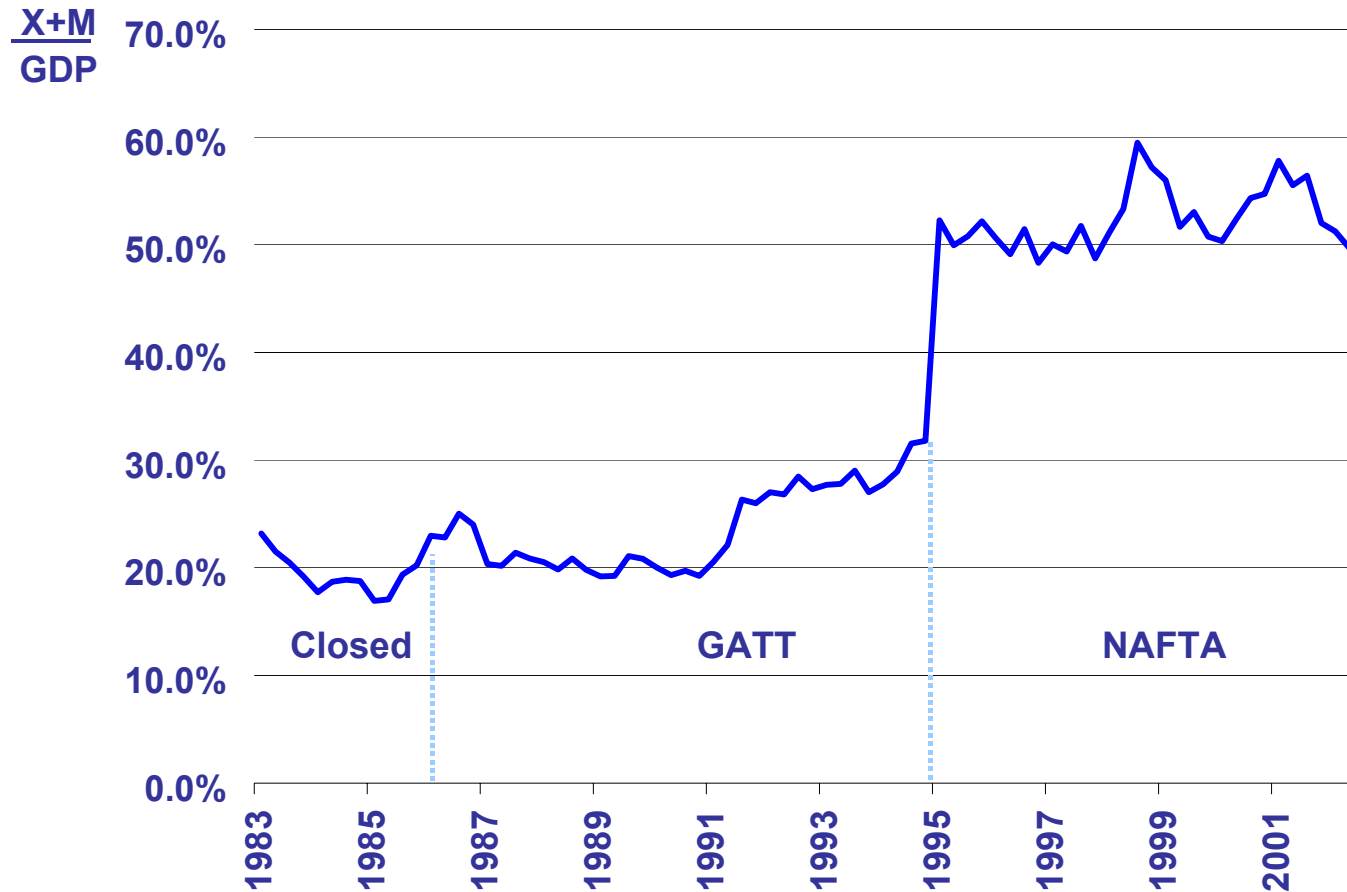
1. The whirlwind of change

It's difficult to fathom the depth of change in Mexico over the past 25 years.

But the main objective of the reforms that brought about this change, i.e. raise the standards of living of Mexicans, has not been attained

- But what has actually happened is not the result of chance, but largely of neglect.
- In one sentence, the governments from 1994 to date have not done their job, while the Salinas administration left a mine field.
- Still, change has been amazing

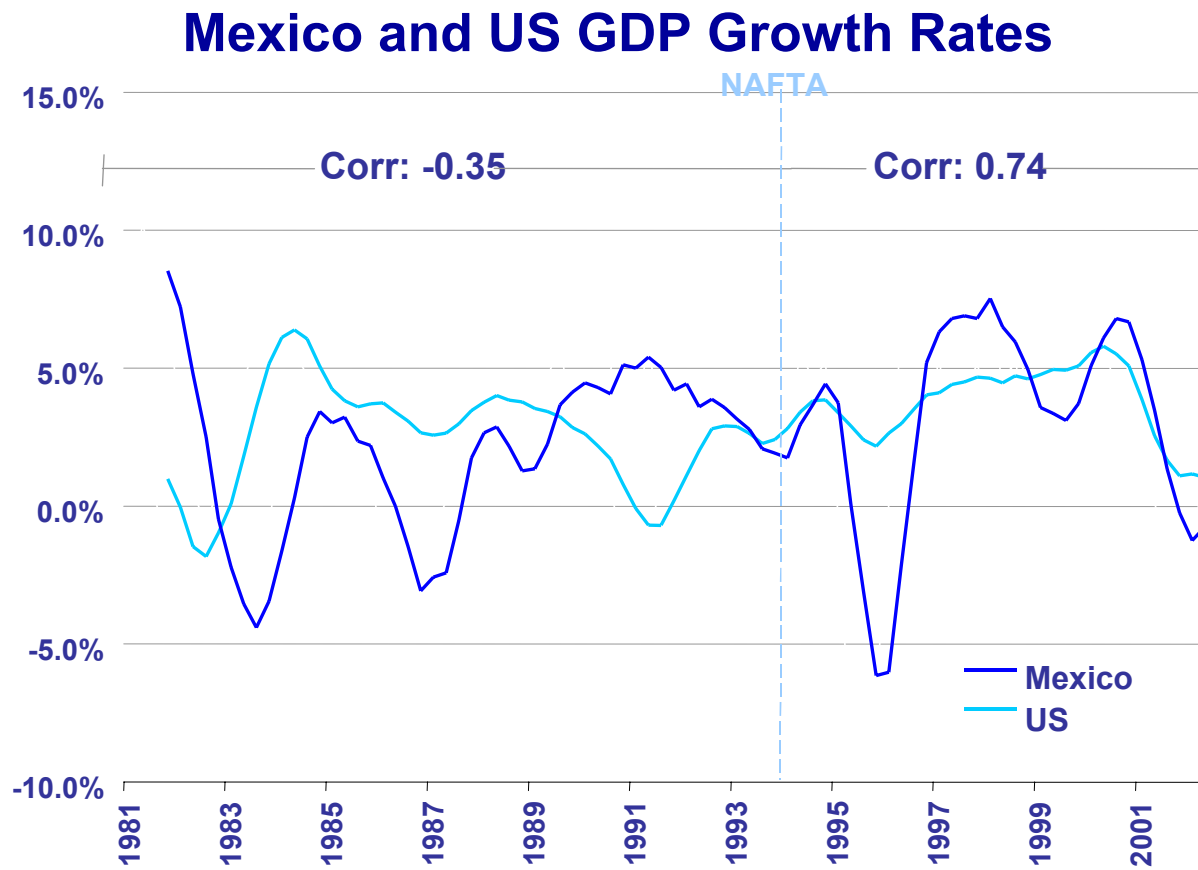
The transition from a closed to an open economy has been extraordinary...



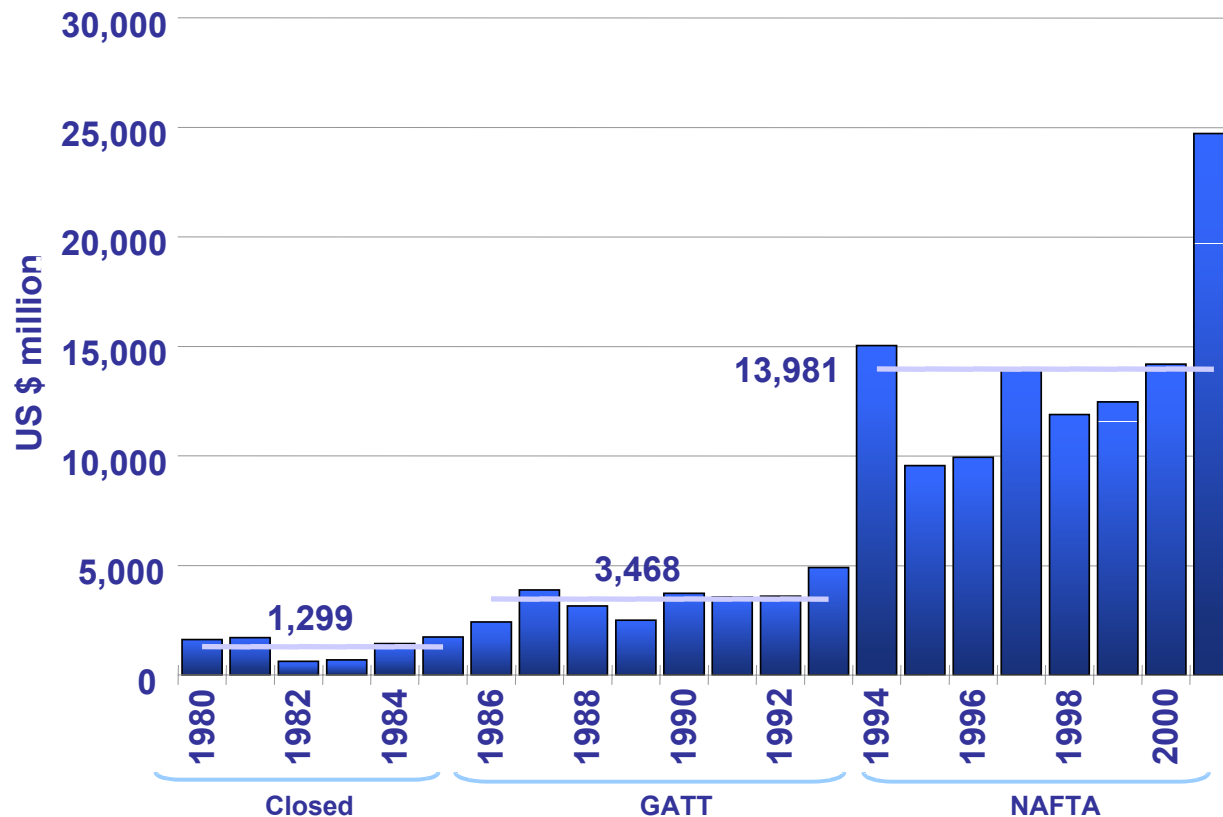
But trade, though very obvious, is but a small part of the story...

- An economy, till then heavily dependent on public spending, integrated itself into the world arena
- The banking system went through expropriation, government control, privatization, crisis and sale mostly to foreigners
- But trade has been key nonetheless

Exports have driven growth...

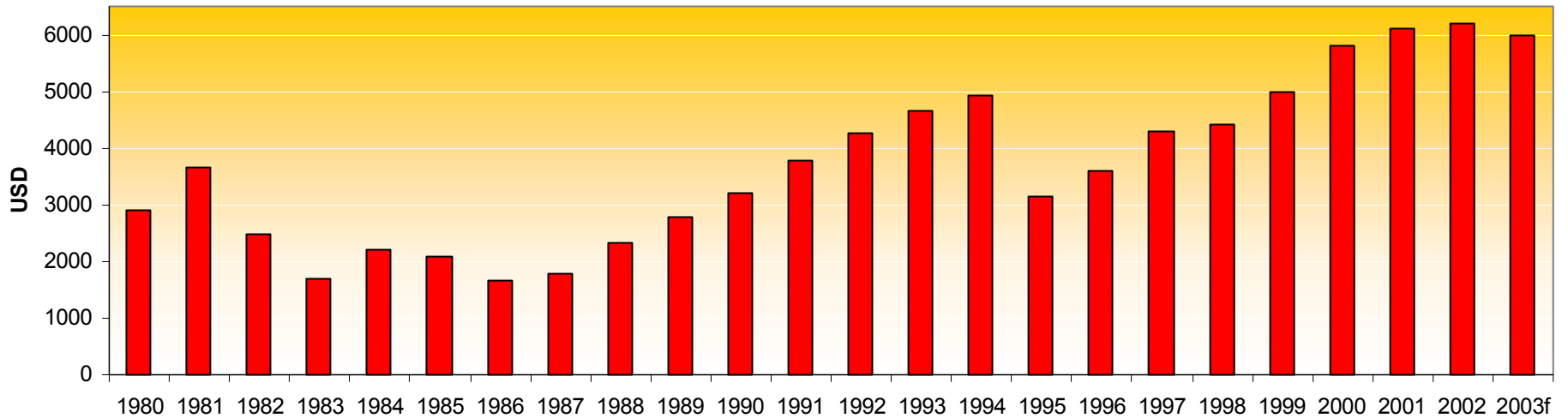


And foreign investment became crucial to the health of the economy...



Incomes have risen...

GDP per capita

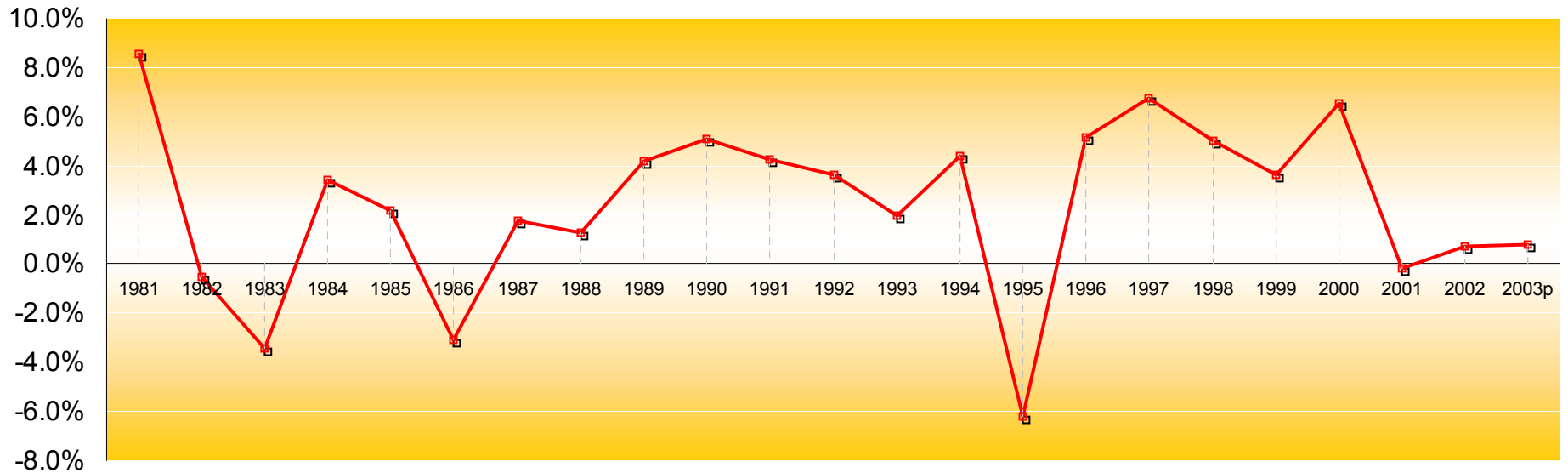


Source: Ortiz Dietz, Hugo. Banco de Datos 2001 and Review of the economic situation of Mexico.

But there are heavy clouds in the horizon and Mexicans feel cheated...

GDP Growth

(annual percentage change)



- The reforms made it possible for the structure of the economy to transform itself, but it has not succeeded in setting the foundations for long term growth and, thus, of rising standards of living.
- The question is why?

Anticipating a conclusion...

- This is a transformed economy
- That does not have a sense of purpose
- And has not shed its rent-seeking behavior

- Key questions remain to be answered:
 - Who should lead the economy?
 - How can the government help smaller businesses transform themselves?
 - What would make it possible to reach a sustained level of growth?

The very fact that these questions keep having to be asked suggests the nature of the problem.

Mexicans do not seem ready to agree on where to go or how to get there

➤ The good news is that reality keeps advancing.

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2. The rationale for reform

- The reforms of the mid 80s and early 90s changed everything
 - But nobody is happy about them
 - Nobody even claims paternity over them
 - Most important, they have not succeeded in attaining their avowed objectives.
- **Were the reforms ill conceived, insufficient or plain wrong?**

First, why reform?

- Impartial observers would not have any problem answering this question
- But reforming means, by definition, affecting vested interests
- Hence, the reforms were, above all, a political act.

A long story in short...

- Growth in the 50s and 60s averaged almost 7%, with inflation at less than 3%
- During the 70s, ill advised high-spending policies destroyed the stability of the economy
- Most of the growth during those years was due to foreign indebtedness based on the expectation of ever increasing oil prices

By 1982, the economy and the government went bankrupt...

- Unbearable foreign debt
- High and growing government spending
- A history of crises was born, with grave consequences well beyond the economic sphere...
 - Erosion of values, family, stability, discipline, etc.
 - Informal economy
 - The beginning of the end of PRI...

The reforms were born out of need, not of will...

- The technocrats began emerging in public office
- But it was the crisis of 76 and 82 that made it possible for their proposals to be heeded
- The reforms were born not because they were perceived as good in themselves, but because there was no choice.
 - **That's why nobody owns up to them or defends them today**

After three years of trying, the government in 1985 finally began to introduce mild reforms...

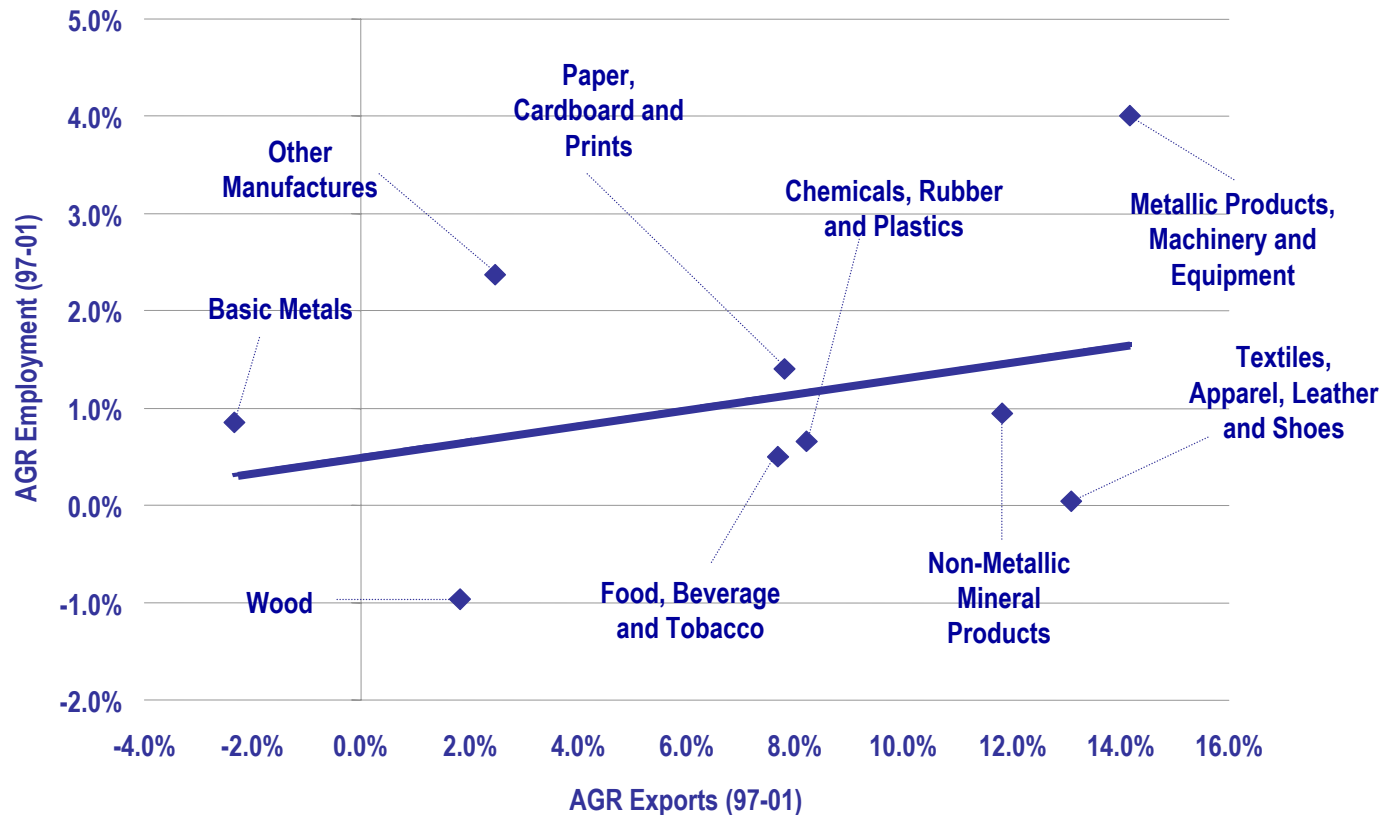
- First came GATT
- Then imports were liberalized
- A “framework” agreement for trade was reached with the US
 - The aim was to force domestic producers to increase productivity, raise levels of quality and, somehow..., cater to the consumer

The avowed goals were clear...

- The idea was to raise the rate of growth of GDP
 - But the reforms were limited by the implicit objective not to touch the structure and sources of PRI power
 - These included: sources of control, corruption and wealth of the political system
- **The results are, thus, not surprising...**

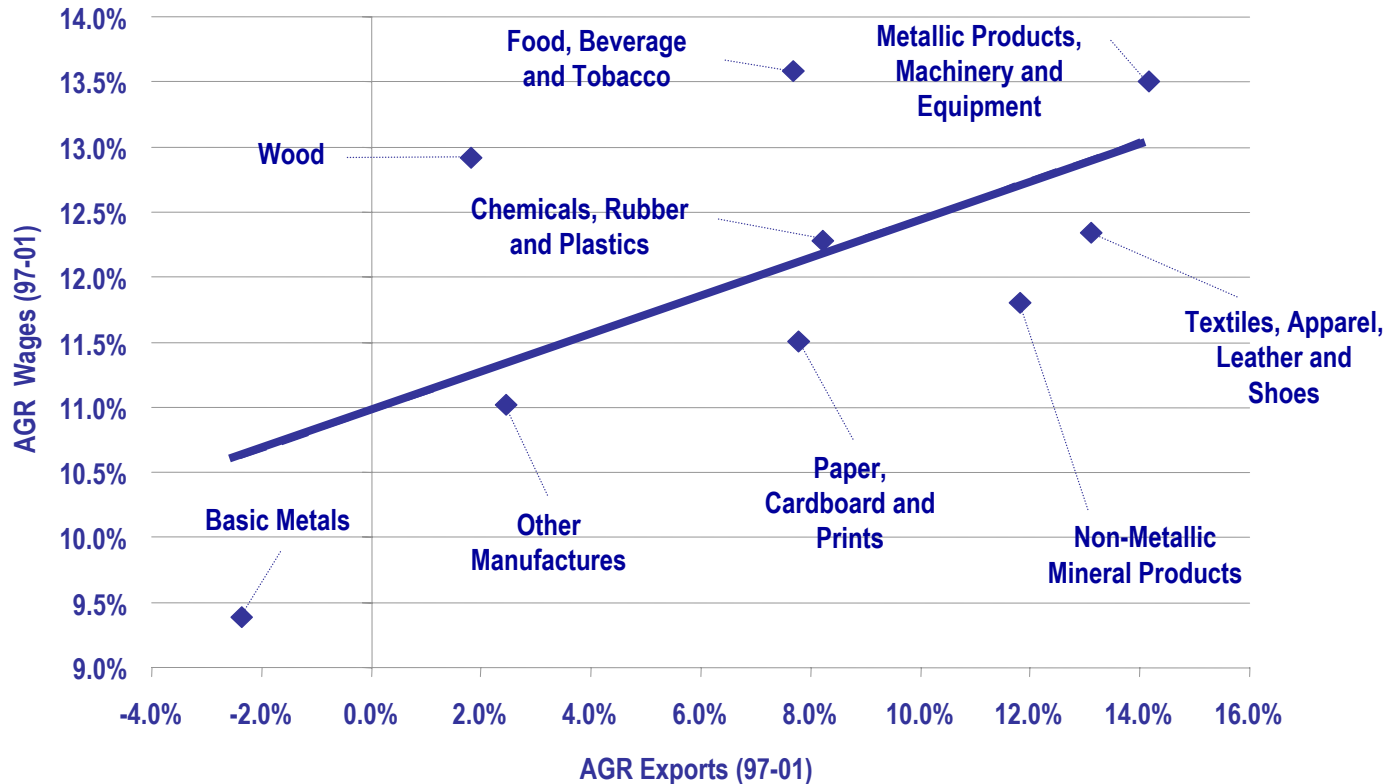
And yet, despite this shortsightedness, the success has been enormous...

Exports and blue collar employment



And, contrary to conventional wisdom, real wages have gone up...

Exports and wages



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3. Reforming but, What for?

- Despite their limitations, the reforms transformed Mexico
- Everything was altered:
 - Relations between consumers and producers
 - Government and the private sector
 - Foreign investors and the government
 - The U.S. and Mexico
- **But there is no compass as to where to go next or, worse, why...**

It's been a long trip, but where to?

- During the 90s, the economy grew largely because of investments that were made under the expectation that there would be further reforms
- But the contradictions of the early reforms and the paralysis of reform have crushed expectations, both of investors as well as of the average Mexican
- On top of this, we have an inexperienced and largely incompetent administration now.

➤ **There is no sense of direction today**

Ironically, NAFTA is part of the problem...

- From the vantage point of politicians, NAFTA was the end, rather than the beginning, of the process of reform
- Once NAFTA had been signed and sealed, politicians assumed everything else would take care of itself
- The urgency to reform died

The Mexican is far from being a market economy...

- Surely, prices rule over economic decisions
- But the structure of the economy makes it very difficult and expensive for new entrants to compete (even mighty ones...)
- The icons of economic nationalism, privilege and power remain as alive as ever...

The paradox of the reforms is that...

- They were made possible by the enormous power of the executive.
- But that power eroded as a result of the reforms...
- ...while the reforms failed to accomplish a thorough transformation

➤ **The reforms did not replace the past, but built on it**

- Some sectors were liberalized, others remained under government control
- Foreign competition was allowed in some sectors, while others remained protected
- Special arrangements made it possible for some sectors to enjoy no competition
- Despite stronger institutions (such as NAFTA), inconsistency ruled

The thrust of economic reform basically ceased after 1993...

- Later reforms dealt mostly with the distribution of political power (judiciary, the Supreme Court, electoral legislation), but including decentralization of expenditures
 - Though necessary, these reforms have had the consequence of eroding the power of the federal government and, thus, the only potential source of support for further reform

Further reforms hence depend on...

- Resolving the mismatch between the reality of power and the prevailing institutions (e.g. Congress and the Executive)
- Winning over vested interests that will defend their privileges at any cost
- And conquering domestic public opinion

None of these battles will be easy...

1. Despite the extraordinary success of NAFTA over the past decade, most Mexicans have seen their lot improve little
2. Everybody is fighting both the past and the presidency; the present and the future seem to be irrelevant...
3. Many reforms have negatively affected the interests of the average Mexican

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4. Is there a compass for the economy?

- The past decade has split Mexicans: those that understood what the reforms were about (and could do something about them), and those that have failed to adjust
- The differences after ten years are staggering...

These issues are not marginal; they are of essence...

- There has been no government policy to help businesses transform themselves
 - About 20% of firms have become competitive (or about 80% of production)
 - The rest, about 80% of firms throughout the nation, have seen their sales and profits systematically deteriorate
- And most have no clue why

At the core of the problem dwell the reforms themselves...

- The reforms were extremely partial in nature
- Import liberalization was thorough
- But competition was limited in key sectors and firms
- The impact of the latter on productivity and the competitiveness of firms has been enormous

But other factors hindered the economy from transforming itself...

- Costs of key inputs
 - Competition among suppliers
 - Limits to private (or foreign) investment
 - Legal monopolies
 - Extreme inefficiency transferred to the productive sector
- **Key paradox: one of the most open economies in the world, depending on services from some of the most protected companies in the world**

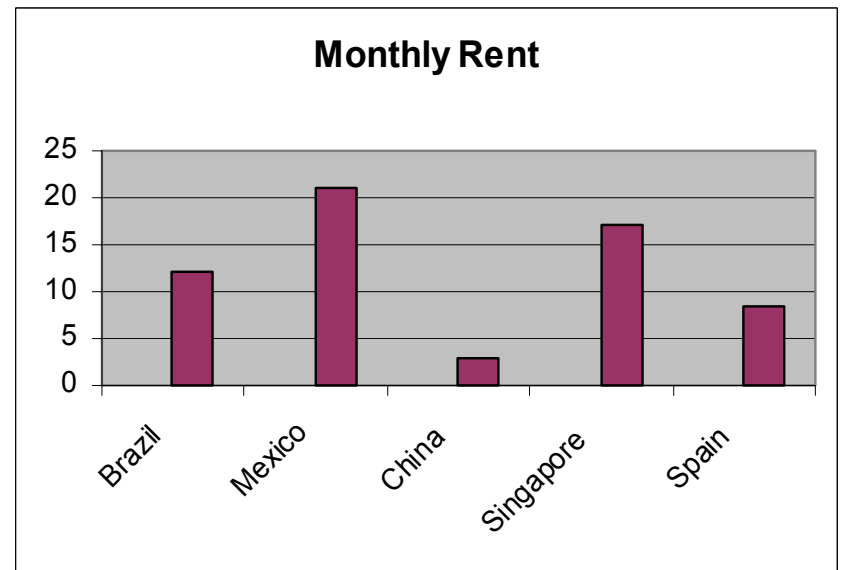
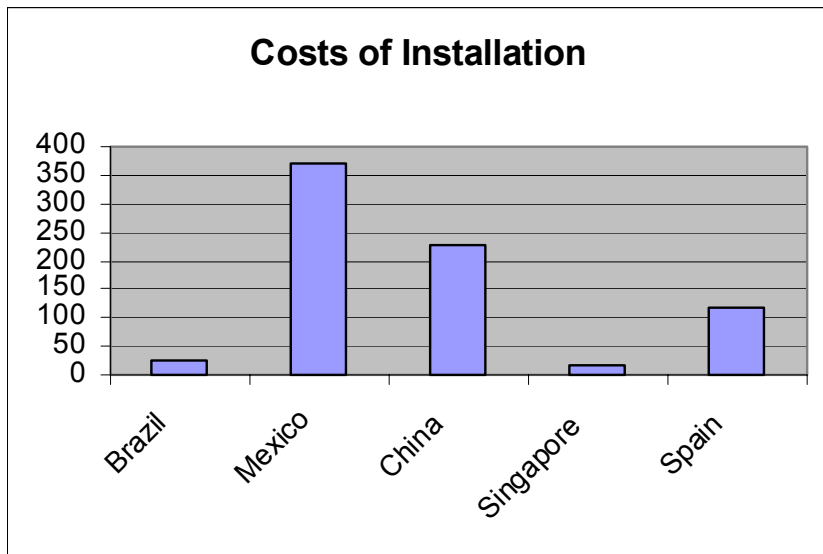
Costs of energy

Electricity			Fuel	
	Residential electricity in dollars per kWh	Industrial electricity in dollars Per kWh	Commercial diesel in dollars per liter	Regular unleaded gasoline in dollars per liter
OECD average	.105	.047	.563	.511
Mexico	.068	.051	.408	.534
United States	.082	.040	.394	.399
Canada459	.490
Argentina	.098	.075	.506	.933
Colombia	.068	.069	.253	.343
Costa Rica	.083	.068	.222	.282

Source: *Energy Prices and Taxes, 2nd Quarter 2002*, International Energy Agency, Data for 2000.

Note: For Argentina, Chile, Colombia and Costa Rica, the price for gasoline is an average of the gasoline prices for transportation.

Costs of telecommunications



Labor productivity in electricity

	Company	Gwh per worker
France	Electricite de France	28.3
Australia	Delta Electricity	27.6
Italy	Enel	21.2
Germany	EnBW	8.3
Spain	EndesaEspaña	7.0
United States (California)	EDISON	6.6
UK	Southern Electric	4.4
Mexico	CFE	2.2

Note: Productivity measured by gigawatt-hour per worker.
Source: CIDAC with data from each company's annual report 2002.

Labor productivity in telecommunications

	Company	Revenue per employee (USD)
Japan	NTT	451,272
UK	BT	291,123
United States	Verizon	272,024
Australia	Telstra	239,639
Canada	Bell Canada	210,485
France	France Telecom	181,590
Mexico	Telmex	175,882

Note: 2001 data

Source: *Communications Outlook 2003*

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- The reforms (and privatizations) have had an enormously positive impact, but they remain unfinished
- In fact, it is the inadequacy or insufficiency of many reforms that is to blame for the current morass
- ...but that is not the prevailing view in the political arena
- The question is what can be done about it

Most indicators are going in the wrong direction...

- They show how little has been done to transform the economy
- Build credibility for an open, competitive economy
- And strengthen the institutions responsible for running and regulating economic activity

Productivity of the manufacturing sector (annual percentage growth)



Source: Banco de México, www.Banco de México.org

Regulation vs. reform

- Privatization was confused with revenue
- Regulations were developed to enhance the selling price
- The government never reformed itself
- Hence, there is no clear-cut framework for businesses to develop or for investors to make decisions or, in general, to provide certainty

Most important...

- The institutional framework remains extremely weak
- There has been no “creative destruction” which is an inherent component of development
- No policy aimed at increasing productivity
 - And, therefore, the country keeps trying to compete on the basis of low wages, rather than value added.

These problems are not new...

- What is new is that the absence of a strong demand for exports
- Which has evidenced the extreme weaknesses of the domestic economy
- China has only made this problem worse
- The true issue is the lack of vision in the government and its inability to build support for further reform

The contradictions are endless...

- A nation of citizens, but also of organizations
- An open economy, with protected “strategic” sectors
- A businessman in the presidency that cannot manage a political process
- Lots of good intentions, but no capacity to deliver

In sum,

- The economic transition is unfinished
 - Market mechanisms live together with a managed economy (even if unmanaged...)
 - Paralysis in decision making has become the norm
 - NAFTA's potential will remain unfulfilled
- And Mexicans will continue to pay for the costs of partial reform for many years to come

Reform what?

- The first group of reforms addressed Mexico's relations with the rest of the world.
 - That was the easy part
- The next batch would have to deal with real, domestic, power wielders
 - Unruly unions (electricity, oil and teachers)
 - Government and private monopolies
 - Ever more powerful governors
 - Disorganized political parties

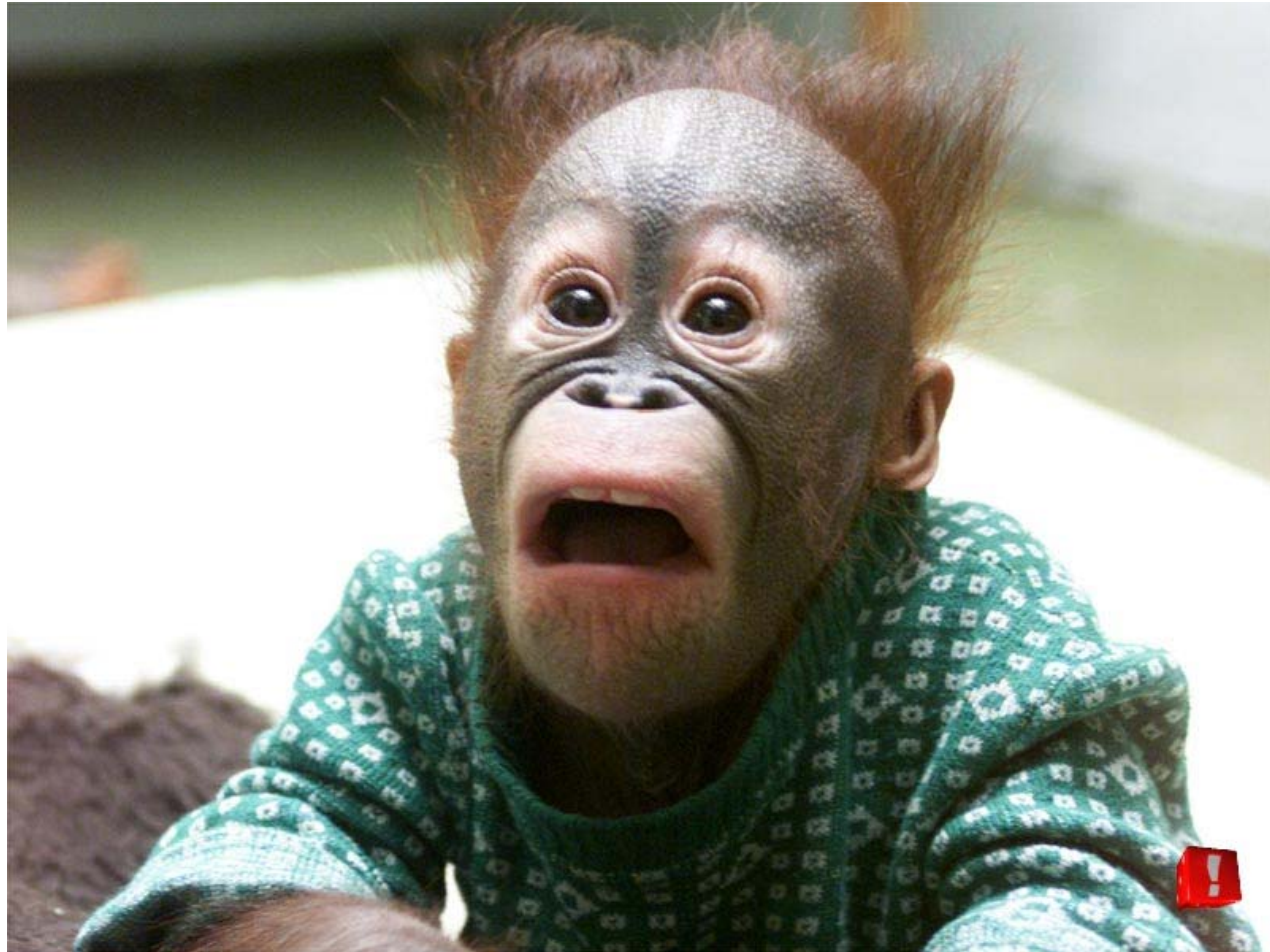
There is a future!

- Despite the extreme political temperature, there is wide recognition of the need to move forward, and even (reluctant) acceptance of the agenda:
 - Rules of cooperation: executive and legislative branches
 - Rules for making a market economy work
 - The relationship with the US
 - Rule of law
 - How to help Mexicans at large (businesses and society) successfully meet the global reality

The real question is whether, when push comes to shove, politicians will end up doing not only things right, but also the right things...

And history does not look promising...

In fact, Mexicans (and foreigners)
can be excused for being
skeptical...



The original reforms were pursued because there was no alternative

- And the government had all the instruments to pursue them at its disposal
- The next batch of reforms will require an enormous political effort and the support of major power wielders
- Along the way, Mexico's political future will be defined: will it be a consolidated democracy or just one more failed transition?

Despite everything, reality will sink
in...eventually...because there is no
choice

Every morning in Africa, a gazelle wakes up.
it knows it must run faster than the
fastest lion or it will be killed.

Every morning a lion wakes up.

It knows it must outrun the slowest
gazelle or it will starve to death.

It doesn't matter whether you are a lion or a
gazelle: when the sun comes up, you'd better
be running.

Costs of telecommunications

	International Calls (1)	Residential phone (2)	Business phone (3)	Mobile phone (4)	Internet (5)
OECD Average	1.28	488.13	1074.96	n.a.	36.31
Mexico	3.73	747.97	2189.03	227.96	32.90
United States	.97	568.92	1148.65	152.46	33.58
Canada	.92	381.96	819.15	135.71	25.34

Source: Communications Outlook 2003, OECD.

Note: 2002 data in USD

(1) Average call charge for one single residential call, weighted by traffic.

(2) OECD basket of residential telephone charges (includes international calls and calls to mobile networks)

(3) OECD basket of business telephone charges (includes international calls and calls to mobile networks)

(4) OECD basket of low user mobile telephone charges

(5) OECD internet basket for 20 hours