The Effects of Neo-liberal Policies on Trade and Investment in Mexico[1]

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In August 1982, the Mexican economy was in grave economic circumstances. The foreign debt exceeded 40 per cent of the gross domestic product (GDP), inflation approached 100 per cent, the foreign exchange reserves were nearly depleted, and the government was unable to honor external financial obligations (Teichman 1988: 154, 1989: 163). After intense negotiations, an agreement with the International Monetary Fund (IMF) in November 1982 provided some relief against foreign creditors (Rojas 1991: 168-79). In return, Mexico accepted the demands of the United States and the IMF to steer a new economic course, a course very different from its past.

For over half a century the Mexican government has played an important role in national development. As early as 1940, government policies were used to transform an agrarian economy into an industrial one. In addition, the government was careful to balance the interests and well-being of different groups as market capitalism developed. The policy of promoting social programs in conjunction with private domestic industrialization came to an end, however, with the 1982 debt crisis and the presidency of Miguel de la Madrid (1982-88). At this point, the Mexican government dramatically changed its role in economic development.

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President de la Madrid agreed with the IMF's assessment that previous government policies were responsible for Mexico's debt problem and that a new economic direction was necessary. This entailed reduced expenditure on social programs as well as a shift of emphasis from domestic investment and development to private production for export. In many ways, the plan was quite simple. The government would liberalize the Mexican economy by selling off many of its own enterprises, reducing or eliminating trade barriers, cutting real wages, devaluing the peso to encourage exports, increasing the public sector prices to better reflect market realities, and getting rid of government investment plans. Along with this, Mexico planned to carry out policies that would tie its markets into the world economy and transform itself into an efficient exporter of manufactured goods.

The task at hand was two-fold. First, stability had to be brought back to Mexico's economy, and policies leading to long term growth had to be established. Economists at the World Bank and the IMF argued that both could be achieved with the same medicine. To achieve the first goal, the IMF demanded that Mexico make substantial cuts in government spending and carry out tight monetary policies along with the devaluation of the peso. The purpose of the tight monetary and fiscal policies was to deal with the problem of Mexico's inflation, which the IMF believed created such problems as capital flight, overvaluation of the peso, erosion of Mexico's tax base, and dollarization of the Mexican economy. This meant cutting government jobs, the ending of price controls on consumer goods, and the privatization of many public companies to lower the government debt. Along side these policies was the need to devalue the peso so as to improve Mexico's current account. By having less government, stable prices, greater efficiency through privatization and balance of

payments stabilization through export promotion the World Bank and the IMF believed, besides taking care of Mexico's debt crisis, such neo-liberal policies would lead to long term growth and prosperity. An important part of this prosperity was to come from export promotion.

It appeared that Mexico found itself with a chicken and egg problem. For the private sector to make the domestic investments needed for industrial expansion, there had to be an effective demand for their goods. This demand, though, could only come about if people had jobs that provided them with the income to buy the goods, and the only way jobs can be created is for business expansion to take place first. Also, for firms to take advantage of economies of scale, a large initial investment is needed, which would not happen just from domestic consumer demand. One obvious way to increase the level of aggregate demand in order to provide incentives for long term investment is through government expenditure, which is what Mexico tried to do from the 1950s to the early 1980s. Most economists agree that government expenditure spent on infrastructure and public goods is important and complements private investment. But sustained government expenditure can only be achieved with economic growth, not by deficit expenditure, which is what happened in Mexico during the 1970s.

To support social programs, education, and industry and to finance imports over exports, Mexico borrowed heavily in the 1970s. As long as interest payments on borrowed money was financed with new lending by banks, such deficit expenditure was not a problem. But in 1981 the United States carried out tight monetary policies initiated by the Federal Reserve, which raised interest rates dramatically thereby increasing Mexico's debt. This,

coupled with the resultant worldwide recession and severe decline in oil prices which drastically reduced Mexico's import earnings, turned Mexico's foreign borrowing into a crisis. The consequence was shifts in capital markets in Mexico which accelerated capital flight, making the problem worse. In response to this crisis, the United States, the World Bank and the IMF suggested that Mexico carry out economic policies that would support export promotion as a way of generating the level of effective demand needed for manufacturing investment in the country. Besides the long term effect of capital formation, there would be the short term effect of new jobs and income that would stimulate domestic demand. Such economic policies have costs. As we mentioned, Mexico would be required to devalue its currency to stimulate demand for exports. This, in turn, increased the burden of Mexico's foreign debt, which was primarily denominated in dollars. They needed to carry out restrictive fiscal and monetary policies so as not to have a deficit that would be financed from printed money. And they needed to eliminate existing tariffs and protectionist measures to allow domestic firms to compete in world markets. Even though cutting wages and contracting government expenditures might cause a recession or hardship in the short run, economists at the IMF and the World Bank argued that in the long run the Mexican economy would see growth and, once this was achieved, the benefits of that growth would be felt by the majority of the population in all regions of Mexico.

In reality, neither sustainable economic growth nor social equity have so far been achieved through the neo-liberal policies carried out in the 1980s. Such policies have led to de-industrialization in Mexico and to financial fragility. We argue that the neo-liberal policies advocated by the IMF and the World Bank failed to address the issue that, for there to be

long term benefit from export promotion, there needs to be a well established and highly developed industrial base. The adjustment programs advocated by the IMF and World Bank simply assumed that through balance of payments stabilization there would be export savings that would lead to an increase in demand for investment following accelerator theories of investment.

This clearly did not happen, as we see in Tables 1 and 2. These tables show that, while the volume of both total and manufactured exports increased substantially in Mexico, the rate of gross domestic investment, as well as the investment-output ratios, declined during this period. The long run sustainability of exports as a way of driving the demand side of an economy depends upon the supply capabilities of that country. This can only be achieved through improved technologies, institutional factors, and marketing capabilities. What has happened in Mexico is that exports, particularly of manufactured and primary goods, have taken away resources from domestic investment. This came about through the drive to increase exports in order to repay the foreign debt. During the period of neo-liberal policies, there was an increase in exports with negative or low investment growth. This is contrary to the argument developed by the World Bank and the IMF that there might be short term supply-side shortages of capital, but in the long run, with the increase of income and higher savings from the neo-liberal policies, domestic investment would rise, leading to greater production capacities.

Looking at Table 3, we see that the export/GDP ratio increased dramatically in the early years of neo-liberalism before falling after 1988. Table 4 shows that the average annual growth rate of general government consumption decreased during the period of neo-liberal

policies along with private consumption and gross domestic investment, which took a larger percentage drop than either government consumption or private consumption. What these tables demonstrate is that initially a larger percentage of GDP was going for exports and less for government expenditures, private consumption, and much less for internal gross domestic investment, which was hurting Mexico's opportunities for sustained economic growth.

The large increase of exports in Mexico was not followed by the domestic investment needed for expansion of supply capabilities. Domestic investment is essential for developing supply capabilities to both produce more exports and to meet the demand of domestic consumption. It is also needed for expanding the productive structure and related back-up services in the manufacturing sector. For Mexico, this is especially important, given the need to develop and expand its industrial base and to make structural changes in manufacturing in order to compete in the world market.

Exports can have a positive or negative effect. Through the income effect they can raise domestic savings and stimulate demand for investment. Exports can also provide the necessary foreign exchange to purchase production inputs that can help ease supply constraints. This is actually one of the arguments given by the World Bank and the IMF for devaluing the peso, reducing export taxes and cutting wages. Such economic policies can lead to more exports, which increases foreign exchange. But during the neo-liberal period, the purchase of imported production inputs has been restricted. Through devaluation and the recession in Mexico in the early 1980s, those sectors of the economy that depend upon imports for their production processes were hurt because of the high cost of imports. These

neo-liberal policies ended up having more of an effect on imported capital goods than on imports in general (Table 5).

If Mexico's domestic investments continue to decline there is the question of whether the country will be able to sustain its exports in the future. Table 3 indicates that, as a percentage of GDP, exports have experienced negative average annual growth rates since 1988. With exports occurring at the cost of the expansion of supply capabilities and investment for structural changes in manufacturing and development of human capital, this decline in export performance is likely to continue. With the foreign exchange earned from exports being used for paying off the debt, domestic investment is affected by the availability of capital goods, intermediate goods and raw materials needed for production and economic growth (United Nations, 1990).

The neo-liberal trade policies have not led to a better economic performance for Mexico. Table 6 shows that the average annual growth rate of GDP was much lower during the years of neo-liberal policies compared to the decade before. Also, between 1983 and 1994 the per capita GDP fell at an average annual rate of 0.9 percent (López, 1996:1). Table 7 reports GDP per capita growth rates for most of this time period. The average annual rate of inflation was much higher during the period of neo-liberal policies compared to the decade before, as we see in Table 8. Also, the Gini coefficient rose from 0.429 in 1984 to 0.477 in 1994. Comparing the 1984 ratio of the average per capita income of the richest 10 percent with the poorest 40 percent of the population was 9 to 1; in 1994 the ratio was up to 12.13 to 1 (López, 1996:2).

During the time since neo-liberal policies were instituted, Mexico witnessed one period of sustained growth, between 1988 to 1994. Nevertheless, as can be seen in Table 9, the annual growth rate of GDP, compared to other recoveries like 1972-75 and 1977-81, was relatively low. More importantly, what we saw during this time was that the current account, which had been in surplus for most of the 1983-87 period turned once again into a deficit (Table 10). Bankers and politicians were able to justify the new current account deficit, and the foreign debt, with the following argument. Because of strict monetary and fiscal policies, government expenditures could not have been the cause of the external deficit, so the deficit must have been due to excess investment over private savings. Thus, the borrowed money must have been going to private investment, which would have allowed Mexico to pay off its debt from the economic growth created from private investment. The share of investment going to the tradeables sector did rise from 25.8 percent to 38.3 percent of total investment from 1987 to 1992 (López, 1996:7). The conventional wisdom was that the debt accumulation and the current account deficit were caused by different factors than in the early 1980s, and Mexico was on its way to economic recovery. In fact, many observers believed that the current account deficit was a temporary necessity, due to a "one-time" surge in imports of both capital goods and consumer durables (Lustig, 1992: 11). Table 10 shows this is clearly not the case; even the massive depreciation of the peso beginning in December 1994 could not erase the current account deficit.

The problem, as the 1994 economic crisis showed, was that continued foreign debt which is financed with short-term capital puts a country at risk, particularly the risk of not having enough foreign reserves. It was clear that prior to the 1994 crisis the peso was

overvalued. And instead of carrying out policies that were consistent with the reforms of 1982, devaluation did not take place. Part of the reason why devaluation did not take place was the belief that the neo-liberal policies were working. Tight monetary and fiscal policies in place, the growth in exports, and the passage of NAFTA were all signs of the success of the 1980s neo-liberal policies. To devalue the currency would create inflationary pressures, affect capital markets, and undermine the enactment of NAFTA. What we saw with the 1988-94 recovery is that it occurred not because of what was promised by the reformers but by reverting back to a current account deficit and to the overvaluation of the peso during this period. The current account deficit that reappeared in 1988 is a symptom of the failure of the neo-liberal policies to address the real cause of Mexico's economic problems.

There is a strong association between economic performance and capital accumulation. Also, there appears to be a correlation between supply capability and long term export performance. But in the case of Mexico, it appears that the growth in exports has been at the expense of investments and with the supply capabilities being constrained by using available foreign exchange to pay off the debt. For Mexico, the development of supply capabilities is a necessary first step before neo-liberal policies are implemented. Until Mexico is able to achieve a certain level of industrialization, government policies should be taken to allow this to happen. Otherwise, the process of de-industrialization and the accumulation crisis will only continue.

The conclusion is that such a broad program of neo-liberal reform does not fit the needs of all countries, as Mexico's experience shows. Trade policies should reflect the industrial base of the country. Another important lesson here is that the increase of exports

for debt repayment has limits. Debt relief is required to give signs of strength for future investments, but the policy of trying to achieve this through the acceleration of exports along with fiscal and monetary constraints on a country will only hurt investment. This, in the long run, will constrain exports and create financial fragility, among many other adverse effects on, in particular, the social fabric of the country.

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TABLE 1

Mexican Exports of Merchandise Goods

Total (million US$)		Manufactured (% of total)	
1980	1993	1980	1993
15,600	61,964	12	75

Source: World Bank, **World Development Report 1995**, p. 217.

TABLE 2

Average Annual Growth in the Volume of Manufactured Exports and Investment, and Investment-Output Ratios for Mexico
(Growth Rates 1980-87)

Manufactured Exports	Gross Domestic Investment	Investment/GDP Ratios		
		1969-71	1979-81	1985-87
23.8	-4.9	20.5	26.8	16.7

Source: United Nations (1990).

TABLE 3

Export/GDP Ratio
Average Annual Growth Rate (%)

1978-81	1982-87	1988-1994
0.4	12.7	-5.5

Source: Banco de México, IBAMEX (online Economic and Financial Information System), http://www.banxico.org.mx/public_html/inveco/serieci/s10312.html

TABLE 4

Mexico: Consumption and Investment Growth

Average Annual Growth Rate (%)

General Government Consumption		Private Consumption		Gross Domestic Investment	
1970-80	1980-93	1970-80	1980-93	1970-80	1980-93
8.3	1.9	5.9	2.6	8.3	0.1

Source: World Bank, **World Development Report 1995**.

TABLE 5

Total and Capital Goods Imports (Real Values)
Annual Growth Rates (%)

Year	Total Imports	Capital goods/Total imports
1984	28.77	-12.81
1985	11.38	6.64
1986	-10.25	2.11
1987	8.14	-20.55
1988	43.34	2.55
1989	18.11	- 4.35
1990	13.50	19.01
1991	15.28	5.29
1992	20.71	8.22
1993	2.15	- 9.06
1994	18.36	- 0.73
1995	-11.20	-28.50
1996	19.94	1.70
Average	13.71	- 2.35

Source: Banco de México, IBAMEX (online Economic and Financial Information System), http://www.banxico.org.mx/public_html/inveco/serieci/s29311.html and http://www.banxico.org.mx/public_html/inveco/serieci/s33498.html.

TABLE 6

Real Gross Domestic Product
Average Annual Growth Rate (%)

1970-80	1980-93
6.3	1.6

Source: World Bank, **World Development Report 1995**, p. 165.

TABLE 7

Real GDP Per Capita
Annual Growth Rate (%)

Year	Percentage Change
1983	-6.40
1984	1.30
1985	0.50
1986	-5.55
1987	0.00
1988	-0.18
1989	1.95
1990	3.22
1991	2.41
1992	1.55

Source: Banco de México, IBAMEX (online Economic and Financial Information System), http://www.banxico.org.mx/public_html/inveco/serieci/s10318.html.

TABLE 8

Average Annual Rate of Inflation (%)

1970-80	1980-93
18.1	57.9

Source: World Bank,**World Development Report 1995**, p.163.

TABLE 9

Gross Domestic Product in Mexico
(Billions of 1980 pesos)

Year	GDP	Percentage Change
1980	4470.1	
1981	4862.2	8.77
1982	4831.7	-0.63
1983	4628.9	-4.20
1984	4796.1	3.61
1985	4920.4	2.59
1986	4735.7	-3.75
1987	4823.6	1.86
1988	4883.7	1.25
1989	5047.2	3.25
1990	5271.5	4.44
1991	5462.7	3.63
1992	5616.0	2.80
1993	5649.7	0.60
1994	5857.5	3.68

Source: Banco de México, IBAMEX (online Economic and Financial Information System), http://www.banxico.org.mx/public_html/inveco/serieci/s49703.html.

TABLE 10

Current Account
(millions of US$)

Year	Deficit or surplus
1980	-10,434.1
1981	-16,240.6
1982	- 5,890.1
1983	5,859.6
1984	4,183.4
1985	799.5
1986	- 1,373.5
1987	4,239.0
1988	- 2,375.6
1989	- 5,821.2
1990	- 7,451.0
1991	-14,646.7
1992	-24,438.5
1993	-23,399.2
1994	-29,662.0
1995	- 1,421.7
1996	- 1,761.8

Source: Banco de México, IBAMEX (online Economic and Financial Information System), http://www.banxico.org.mx/public_html/inveco/serieci/s01344.html.