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THE MEXICAN ECONOMIC RECOVERY

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The title of this speech is "*The Mexican Economic Recovery.*" I had a lot of doubts about bringing my paper to this conference with that title and on that theme, but I think it is quite germane to your interest and our debate this morning. For one thing, Gary Hufbauer already has spent some time on this topic in his presentation.

I will open up with a question that I had, which I will ask in three parts, is there a recovery of the Mexican economy? Gary said the Mexican economy is recovering. One sign is the financial rescue program that was put up in early 1995 by the IMF and the U.S. Treasury. The second sign he mentioned is the flexibility of the Mexican economy. He thinks this implies that the Mexican economy is recovering.

I happen to think the opposite. I do not think we are recovering. I think we are sinking deeper into very profound distortions between sectors, between social groups, and between regions in Mexico. That is what I am going to be talking about. I think it is very important that we look at the detailed figures and go into a segregated analysis of what is going on in the Mexican economy in some key sectors.

As for the relation between the crisis and NAFTA, I think we can put that question aside. The crisis in Mexico originates in an economic model that appears flawed; that has problems; that has internal inconsistencies and contradictions. Essentially, you have a basic fundamental contradiction between internal accounts and internal adjustment in Mexico and the external accounts. You have a contradiction between two fundamental objectives that you need for an open economy, and that is what the Mexican economic model is all about.

This model, just to refresh everyone's memory, is based on large-scale privatization, economic deregulation, trade liberalization, a balanced budget, and essentially a diminished role for the state. That is the so-called Washington consensus model. I believe it indicates that Mexico is simply not working, and we should not be thinking that, if we give it

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more time, this is only a transition and it is eventually going to work.

I am going to be showing three or four tables. Using these tables, I will try to at least convey the point that there are reasons for concern. I will be happy by the end of this meeting to say there are reasons for concern, and there are reasons for doubts. Be careful and let us be more analytical and detailed in our work regarding the Mexican economy.

There are three basic reasons announced by government officials in Mexico regarding recovery. People normally say the economy is growing once again. After the big depression in 1995, when the GDP dropped by six percent, we had a negative rate of growth of six percent. In 1996, we already have a positive growth rate of 5.1%. That is the number one reason for claiming success. The number two reason is that we are back in the voluntary lending markets of the world. We are back in the financial scene, and Mexico has been able to repay the U.S. Treasury and meet its financial obligations.

Number three, inflation is down, and it is continuing in its downward trend. Inflation in 1994 was very low. In fact, in a part of 1994, we hit a one-digit level for inflation, and that was achieved through various mechanisms. One of them was the appreciation of the peso, which, of course, was linked to the crisis; therefore, the success and the anti-inflation problem was very fragile. When you had to devalue, when the time of reckoning comes, your results on the anti-inflation front simply evaporate. They disappeared in Mexico. So inflation in 1995 was, let us say, fifty percent. It was slashed down to twenty-one percent in 1996. One can reasonably expect that it will come down to fifteen percent in 1997. There are a lot of people who do not believe that. I think it is going to be in the near twenties. But in any case, between fifteen and twenty percent is a big change.

Those are three crucial reasons for claiming victory for the adjustment and stabilization program that was launched and implemented by the government in early 1995.

Very rapidly, I will say this. In spite of the massive adjustment program launched in early 1995 and implemented ever since, which implies a monetary policy and massive cuts in government spending that were already at an all time low in 1993 and 1994, and the contraction of wages, real wages falling, the main structural problems in the Mexican economy have not been solved. Let us take a look at that. The number one thing I would like to do is to point out the distortions in sectors.

Table III
Mexico: Aggregate Supply and Demand
(constant 1993 pesos)

Values	1993	1994	1995	1996	(percentages) 1993	1994	1995	1996
Total Supply	1497055.1	1602530.5	1486094.5	1619843.0	100.0	100.0	100.0	100.0
GDP	1256196.0	1312200.4	1230783.5	1293553.5	83.9	81.9	82.8	79.9
Imports (goods & services)	240859.1	290330.1	255311.0	326287.5	16.1	18.1	17.2	20.1
Total Demand	1497054.9	1602530.5	1486094.5	1619843.0	100.0	100.0	100.0	100.0
Private Consumption	903173.5	945070.2	879726.6	899960.3	60.3	59.0	59.2	55.6
Government Consumption	138564.7	142516.7	133391.3	138326.8	9.3	8.9	9.0	8.5
Gross Fixed Capital Formation	233179.4	252745.2	179129.7	210835.7	15.6	15.8	12.1	13.0
Inventory Changes	30597.4	37245.3	-13070.6	-15514.8	2.0	2.3	-0.9	-1.0
Exports (goods & services)	191539.9	224953.1	306917.5	306917.5	12.8	14.0	20.7	18.9

Annual Variation %	1994	1995	1996
Total Supply	7	-7.4	9
GDP	4.5	-6.1	5.1
Imports (goods & services)	20.5	-12.8	27.8
Total Demand	7	-7.4	9
Private Consumption	4.6	-9.5	2.3
Government Consumption	2.9	-1.3	3.7
Gross Fixed Capital Formation	8.4	-29	17.7
Inventory Changes	17.4	33	18.7
Exports (goods & services)			

Source: INEGI

If you look at aggregate supply and demand for 1993 to 1996, you will see that in the bottom part of the chart we have annual variations. In the column for 1995, you have a negative sign in every item. You have a huge negative growth rate for imports of more than twelve percent. In 1996, you restore a positive sign to every item. Yet, I would like to point out three things. First, private consumption was up by 2.3% in 1996. It was a very modest increase. In any case, it would be premature to say we are doing fine and are on the way to recovery. Nothing guarantees that, if you fall and you start recovering, you may not fall again. If you look at the absolute numbers, they are really very modest. If you look at gross fixed capital formation, again, you have a growth rate of 3.7% in 1996. If you look at the absolute value figures, the absolute numbers, we are really talking about something like four billion dollars, which is a very low figure for a country the size of Mexico. In any case, you already have the sign here of imports growing faster than exports. This is a matter of concern.

The conclusion would be that the export sector is growing, though slowly. Whether it is NAFTA or not, I will not dispute it. Certainly, exports have been growing because of NAFTA. If you look at Maquiladora exports, they have been growing. So in that sense, you may say NAFTA is somehow helping the Mexican economy. That is not the entire story, though.

Look at the table of Mexico's external accounts. I said a while ago that the model is contradictory. It does not allow you to reconcile internal adjustments with external accounts. If you look at this figure, you see the trade surplus is going down. Look at the FOB balance, the last three columns to your right in the chart, in the table. The massive trade balance we had in 1994, by the way, is another very important item for people who claim success for the adjustment program, slashing the trade deficit, the current account deficit. If you look, transforming an eighteen-billion-dollar trade deficit in 1994 into a seven-billion-dollar surplus is no little thing. It is a very important point. The way you do that is by contracting your economy. So there is a tremendous cost for the Mexican economy, for Mexican men and women, from that jump of minus-eighteen to seven billion in the surplus.

If you look at what went on in 1996, you already see the trade surplus going down. The forecast for 1997 is that it is going to go down further. And in addition to that, you have a current account deficit that is reappearing as something of a matter of concern in 1997. The forecasts are that we may be stuck with maybe a five-billion-dollar deficit in the current accounts in Mexico.

Another item of concern here is the total balance of six billion dollars. Maquiladoras' balance is 5.7 billion dollars. Ninety-five percent of the surplus is equivalent to Maquiladora surplus. If you take out maquiladoras from your external accounts, and you look at trade composition, manufacturing industries are in balance, and you are in trouble. You are putting all your eggs in one basket for maquiladoras. If you take maquiladoras and oil out, Mexico has a huge, very important trade deficit.

By way of background, maquiladoras are industries which are allowed, under certain arrangements in the United States and Mexico, and certainly now under NAFTA, to import intermediate input and process them in Mexico and re-export them back to the United States. In other words, they can import from the United States, process it on the border, and then export it back to the United States.

So there are reasons there for concern. Right now, I think that maquiladoras have been overblown and oversold. The real exports are Mexican, the net exports are Mexican. It is not the 5.7 billion dollars I just showed you. In Mexico and in the world statistics of trade, we

Table V
Mexico's Trade Balance, 1991-1996
(millions of dollars)

	Exports				Imports			FOB Balance		
	Total	Oil**	Maquiladoras	Other	Total	Maquiladoras	Other	Total	Maquiladoras	Otros
1991	42687.6	7264.8	15833.1	26854.5	49966.5	11782.4	38184.1	-7278.9	4050.7	-11329.6
1992	46195.7	7419.5	18680.1	27515.6	62129.3	13936.7	48192.6	-15933.6	4743.4	-20677.0
1993	51885.9	6485.3	21853.0	30032.9	65366.6	1644.3	48923.6	-13480.7	5410.0	-18890.7
1994	60882.2	6624.1	26269.2	3461.3	79345.9	20466.2	58879.7	-18463.7	5803.0	-24266.7
1995	79541.6	7419.6	31103.3	48438.3	72453.1	26178.8	46274.3	7088.5	4924.5	2164.0
1996*	87499.5	9696.1	33812.1	53687.4	81480.7	28085.8	53394.9	6018.8	5726.3	292.5

*November 1996 data
**Crude Oil
Source INEGI

normally take into account the gross value of maquiladoras. I do not want to go into the technicalities because we would be wasting time there. But I will say this much. If you look at exports in Mexico, a significant proportion of exports are based on industries very close to natural resources. There is nothing bad with that, but be careful. This is, again, a matter of controversy. The government in Mexico likes to say that eighty-three percent of Mexican exports are manufacturing exports. So we are almost an industrialized country. I think Japan is ninety-five percent, but Germany is not far away with eighty-six percent. I think there is an accounting exercise there that is totally false and demeaning, and you have to be careful of those statistics.

The big foreign exports are based on natural resources, like oil, for example. We are exporting more oil in volume terms than ever before in the history of Mexico, but, nevertheless, the exports are shrinking.

The other source of competitive advantage is low wages, and that is where maquiladoras again come in. Finally, again, this holds true for every country, but in the case of Mexico, it is very, very strong. Your exchange rate is the other source of competitive advantage.

I do not want to spend too much time now on foreign accounts. I just want to summarize this part by saying that we are seeing the balance of payments reappearing as they did in 1992 and 1993, and we had better brace ourselves, because if nothing is done, we may be back to where we were in May of 1994.

The budget surplus used to pay interest. Fiscal surplus is basically sustained by non-tax revenues. Tax revenues are stagnant. For example, income taxes in 1996 increased by 0.6%. I think that figure speaks for itself. And the surplus is sustained also by important expenditures. I am not going out and recommending that we have fiscal deficits. In the past we did, and certainly in 1992, a crisis was caused by irresponsible spending. I am not advocating that, but I am saying that we should not be dogmatic and religious about fiscal balances. I think we share that distinction with countries like Luxembourg.

Let us go the banking sector, because I think that is very important. The banking sector of Mexico is, I think, quite pathetic. I think it is fair to say that we do not have a banking system in Mexico. The most recent figures that have been published tell you the story. The profits of all banks are going down. We have losses and no banks. Deposits are going down or are stagnant. They went down by minus-two percent in 1996. I do not have the figure here, but it is an improvement from what happened in 1995. Still, you have a negative trend.

All banks have good and bad loans. In Mexico, we have many restructured loans which were restructured through the government rescue program for the banks. In other words, these are bad loans that have been restructured with government assistance and subsidies. If you take away the bad notes or the bad loans from the good loans, you look at what I call the viable loans.If you take away the restructured loans from the good loans, you have the set of loans over here on the viable loans. And the relevant number is the minus-forty-three percent for the Mexican banks. This means that the total amount of viable loans in Mexico's banking system was slashed almost in half between 1995 and 1996. I think that is one of the most disturbing signs about the Mexican so-called recovery story. We are simply not recovering. The bottom line is that, were it not for the massive government intervention into the banking system, which already amounts to twenty billion dollars (seventy-five to eighty percent of which which goes to the bankers, not the debtors), the banking system would be technically bankrupt.

What does the situation for the future look like? It looks very sad. The heads of the Bankers' Association in Mexico met in Cancun in late March. They announced that the restructuring of the banks is going to last at least another three to four years. There is no credit, and credit will be forthcoming only for the so-called triple-A companies, big corporations, corporate groups. They can have some access to credit. But, the future of the Mexican economy still looks dim.