Mexico: The Unknown Revolution

By Wesley R. Smith

With the collapse of Communism in Eastern Europe and the disintegration of the Soviet Union, few people have been paying attention to a more quiet but no less profound revolution south of our border. The debt crisis in the early 1980s precipitated the "lost decade" for Latin America and prompted an intellectual crisis among its elites. Latin leaders, even those on the left, started to doubt socialist economics, and looked to the Western democracies' model of economic growth based on free internal markets and free international trade. In most Latin American countries that free market model is now taking root.

The Latin American leader that most represents this new era of pragmatism is Mexico's President Carlos Salinas de Gortari. He is leading his country through the most dramatic economic revolution that will position it for decades of strong growth. This fundamental economic change in Mexico affords numerous opportunities for U.S. investors and businesses into the 21st century.

To a large extent, this transformation has gone largely unnoticed outside Mexico, especially in the United States, where the image of a corrupt and crisis-ridden country hostile to business continues. President Salinas has reversed over seven decades of socialist policies and central planning and replaced them with an unambiguous commitment to the free market. This is a commitment not only to a wholesale change of government policy, but to a thorough restructuring and modernization of the entire economy.

Mexican Reforms

Negotiations now underway for a North American Free Trade Area (NAFTA) are a culmination of efforts by the administration of President Salinas to bring economic stability and growth to Mexico. A key element of Salinas's agenda has been the opening of the Mexican economy to the world. In 1986, tariffs on U.S. exports to Mexico were as high as 100 percent. Under Salinas, Mexican import duties have fallen to a weighted average of only 11 percent. Mexico's openness, combined with its proximity to the U.S. has helped Mexico become America's third largest trading partner, after Canada and Japan. Total U.S.-Mexico trade in 1990 reached $59 billion. Over two-thirds of Mexican trade—both imports and exports—is with the United States.

Foreign investment in Mexico now is strongly encouraged. Mexican firms and industries, long shielded by protectionist policies are being forced to adapt to world standards and international competition. Most important, Salinas has ended Mexico's traditional hostility toward the United States, which has always limited Mexico's ability to grow. Salinas is seeking permanent economic integration with the United States through the NAFTA now being negotiated. Mexico has waged a dramatic comeback from the credit crisis in 1982, and shown its ability to recover from near economic ruin to become one of the most dynamic economies in the world today.

Since Salinas came to power state enterprises have been sold off, including Mexico's eighteen commercial banks, *Telefonos de Mexico*, Mexicana Airlines—in all, over 900 of the 1,200 state-owned industries. Centralized planning and regulation of the economy have been reduced

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radically. The quasi-socialist agricultural system of communal farming is being dismantled and replaced with a new emphasis on private credit and private ownership of agricultural production.

The result of these changes has been strongly positive. Mexico has drastically reduced inflation, from 159 percent in 1987 to 20 percent last year. In 1991 Mexico's federal budget was balanced for the first time in fifty years.

Salinas is only halfway through his reform agenda. His first priority is negotiation and passage of the NAFTA that likely will be approved by the U.S. Congress in the spring of 1993. Following that will be continued liberalization of Mexico's foreign investment laws, a further reduction in corporate and income taxes, labor reform, a greater opening to foreigners in the financial services sector, and the promotion of small and medium-sized businesses.

Nacional Financiera, Mexico's development bank, is dedicating massive resources to creating a more stable business environment for U.S. businesses and investors. This year it announced plans to spend over $6 billion to develop a more sophisticated financial system for the country's medium to small businesses that comprise close to 80 percent of Mexico's market, and to promote development of the small and medium sized business sector. These efforts will bring stability to the market, diversify Mexico's economy, and give Mexico one of the most modern economic systems in the world.

Opportunities for U.S. Companies and Investors

Given Mexico's firm commitment to free-market reforms, and the strong influence of the U.S. economy on the Mexican economy, opportunities in Mexico for U.S. investors in both the short term and long term look good. Mexican reforms are guaranteed to succeed because of its proximity to the U.S., providing Mexico with the largest market in the world and virtually unlimited sources of investment.

In the 1990s Mexico will experience an enormous diversification of its economy. Among the key trends:

- ✓ **Growth in medium-sized companies.** Of the 200 companies listed on Mexico's stock exchange, only thirty are actively traded. There will be greater growth in this area as investors look for new opportunities.
- ✓ **Extended public/private financing.** Mexico's development bank, along with the Inter-American Development Bank and the World Bank, will play a key role in promoting small to medium-sized business growth through creative financing with both soft and hard funds.
- ✓ **Relocation from Asia.** U.S. companies will begin moving operations from Asia to Mexico in anticipation of the NAFTA, increased U.S. barriers to products made outside North America, and a better Mexican business climate.
- ✓ ***Maquiladora* growth.** The U.S.-Mexico border region will continue to grow as U.S. firms seek lower labor costs in Mexico. The short-term benefits of this growth will go to the in-bond assembly or *maquiladora* industries located along the border.
- ✓ **Expansion of the financial services sector.** Mexico will not be able to continue its growth without allowing greater competition in the financial services sector. U.S. participation will increase dramatically, providing more sophisticated and lower-cost financing to Mexican businesses and consumers that historically have lacked access Mexico's financial community.

U.S. Export Industries

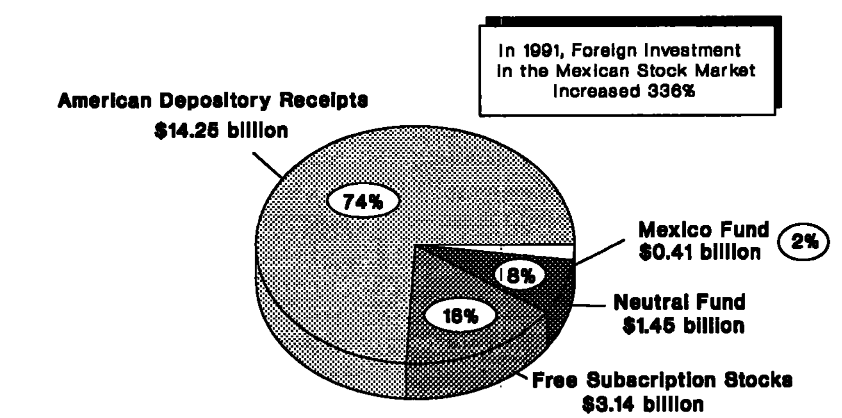
Mexico neglected investments in plant and equipment, transportation, communications, and other infrastructure from 1981 to 1988. Now it has reversed that trend and has begun pouring enormous resources into infrastructure. The cost of upgrading and expanding Mexico's telephone service alone is estimated at $14 billion, providing millions of dollars in exports for U.S. telecommunications companies. Tens of billions more will be needed to revamp an antiquated industrial base and expand new industries. This will provide numerous opportunities to U.S. capital equipment producers since over two-thirds of all U.S. imports, and over 80 percent of all capital equipment Mexico buys comes from America. U.S. and Mexican companies will see a strong market in Mexico in the following areas:

- ✗ **Oil and gas exploration and production**
- ✗ **Energy production**
- ✗ **Computer systems and software**
- ✗ **Environmental products**
- ✗ **Agriculture**
- ✗ **Construction**
- ✗ **Maquiladoras**
- ✗ **Infrastructure (especially ports, roads, and telecommunications)**

Mexico's Stock Market

The Mexican stock market has grown dramatically in the last three years, fueled mostly by foreign and repatriated capital. The index of Mexican stocks grew by 90 percent from 1990 to 1991, and market capitalization doubled to $90 billion during the same period. The value of stocks of the 22 top Mexican companies with a capitalization of $500 million increased by 144 percent last year. Mexican corporate American Depository Receipts (ADRs), in companies like *Telmex* and *Cemex*, grew by 565 percent in 1991. Less dramatic, and consequently more stable, growth in Mexico's stock market—between 30 to 60 percent on an inflation adjusted basis—is expected for 1992. This will accompany an estimated 4 percent GNP growth. U.S. investors interested in projects in Mexico should look in the following areas:

Foreign Investment in Mexican Stocks as of December 1991



Note: ADRs are dollar-denominated credits that are owned by U.S. investors and held in escrow by U.S. banks. ADRs are traded like other American stocks.
Source: *El Financero International.*

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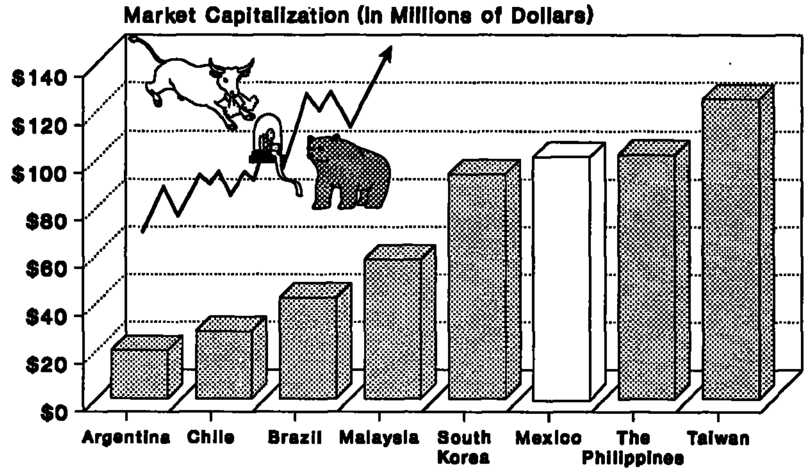
- ✗ **Country funds**
- ✗ **Mutual funds**
- ✗ **U.S.-Mexico joint-venture financing**
- ✗ **Refinancing of large Mexican companies**
- ✗ **Medium-sized business financing**

Ultimately, integration into North American markets will bring long-term stability to Mexico. James Jones, Chairman of the American Stock Exchange, believes a NAFTA will produce growth in Mexico comparable to that of Korea during the 1970s, provide U.S. companies with cheap labor and raw materials for expansion, and encourage U.S. industries to relocate to Mexico from Asia. Perhaps no other country in Latin America, save Chile, has a government whose leaders are so dedicated to adopting a free market system. While countries with similarly large deficits, such as Argentina and Brazil, have wrestled with inflation, runaway government spending, and at times disoriented leadership, Mexico has marched a straight and determined course since Salinas and his team came to office in 1988. The existence of this "new generation" in Mexico is probably Mexico's best hope for prosperity and stability into the 21st century.

Mexico's Stock Market: One of the Developing World's Top Perfromers



Source: *El Financero International.*

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