Prospects for Stability in Mexico

by Roberto Salinas

The importance of stability and prosperity in Mexico, the United States' immediate southern neighbor, has two fundamental dimensions. On the one hand, the existence of a market-oriented system in Mexico would generate the kind of sustained growth and stability that the nation enjoyed for three decades prior to the advent of populist statism in 1970, when Luis Echeverria assumed the Presidency. Economic integration and full free trade in a North American common market would thereby become a very real possibility.

A free and prosperous Mexican economy, on the other hand, would have substantial political value as well: It would help effectively neutralize a powerful and popular radical left-wing movement, led by the son of revered hero Lazaro Cardenas, who expropriated foreign oil interests and nationalized the industry in 1938. This movement is very strong, calling for a return to massive central economic planning. Were they in power, the followers of Cardenas undoubtedly would fuel the current turmoil in some Central American regions and would represent a direct threat to U.S. national security.

President Carlos Salinas de Gortari, who inherited a critically unstable and impoverished economy, ravaged by eighteen years of government intervention, is acutely aware of the need to return Mexico to the good days of stability and economic growth. To this end, he has pursued a program of economic reform based on what he calls the "disincorporation" (or privatization) of Mexico's huge parastatal (or state) sector of the economy, together with trade liberalization and commercial deregulation, specifically in sectors like secondary petrochemicals, trucking, and agriculture. The automobile industry is the most recent to join this list.

Ambitious Goals. Among other reforms, Salinas has lifted restrictions on foreign investments. He has vigorously pursued the "disincorporation of parastatal entities," which to date has reduced the number of state-owned enterprises from 1,155 in 1982 to 370. He has also privatized Mexicana Airlines, and in an unexpected but welcome surprise, ordered the privatization of the Telephone Company, TELMEX. In general, he has pledged to modernize the nation, launching a National Development Plan to that effect, which sets ambitious goals by 1994: a 6 percent growth rate, a 9 percent investment rate, and a 4 percent budgetary surplus. Finally, he has waged an open war against corruption, which has been a major destabilizing factor in Mexico for the past eighteen years.

Those of you following Mexico's progress have heard this. And you have also heard that there are encouraging signs of improvement: deficit spending has been brought under control, the growth rate has shot up to 2.5 percent this year from 1.1 percent last year, and the inflation rate has fallen from a staggering 150 percent in 1987 to a respectable 17

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percent this year. You have also heard of the foreign debt renegotiation reached in July, from which the government claims that it could save up to $3 billion annually in servicing its debt. Lastly, you have undoubtedly heard that the reforms undertaken thus far have had a real impact, that Mexico has successfully stabilized the economy, and that prosperity is soon to come.

This, I fear, is not the case. I will try to tell you what you probably have not heard, though without sounding overly pessimistic or denigrating the successful reforms made so far.

Fictitious Economy. You may not have heard that Salinas's success in revitalizing the country's economy cannot be objectively determined until the wage, price, and exchange rate controls implemented in 1987 are lifted. Right now Salinas manages a fictitious economy. The deadline for lifting the "Pact," as this control regime is called, was recently extended from March to July 1990, which seems to confirm what free-market critics have stressed: If controls are lifted, prices would shoot up and the peso could devalue by as much as 30 percent – an event that would surely generate substantial social upheaval.

You may also not have heard that deficit spending has been controlled, not through structural reform, but through the artificial impact of the debt renegotiation, a drop in domestic interest rates, and the tax revenues accrued through a 2 percent tax on corporate assets levied in January – that is, through short-term measures that produce temporary stabilizing effects but are damaging in the long run.

You have heard about the Brady Plan's objective to reduce the debt burden in the Third World, but perhaps you have not heard that in Mexico debt is not the main obstacle to economic growth, but the economic policies based on excessive government interventionism. In Mexico, if the foreign debt were forgiven, this would not solve all its problems. It would help, but it would not eradicate the root causes of stagnation.

Internal Debt. Moreover, Mexico's main problem is not its huge $100 billion external debt, the second largest in Latin America, but its pernicious internal debt, which represents the principal source of government expenditures. In 1989 alone, for every peso destined to service the debt, 22 cents went toward payments of the external debt.

The economic reforms undertaken by Salinas so far are positive and encouraging, but they are not enough. There is still much that must be done to bring about lasting structural change.

First of all, Salinas's privatization program should continue, and should extend to areas exclusively reserved for government control, the so-called "strategic and primary" sectors of the economy. These absorb a massive quantity of subsidies and are highly inefficient and wasteful. Moreover, they represent the vast bulk of the parastatal sector: the 770 disincorporated entities you hear about constitute less than 10 percent of total government assets. Recent studies claim, in fact, that the present effect of the program has been negligible. In effect, the program has produced a mere $672 million in savings over a six-year period. Compare this with the $1.9 billion in transfer subsidies absorbed by the remaining entities in the first four months of 1989 (of which 92 percent of the subsidies were used to finance the losses of five gigantic firms).

Also, those parastatals like TELMEX should be genuinely privatized: not partial privatizations, where government still retains effective control over the industry, but real transfer of assets to the productive private sector.

Unexplored Possibility. More important, government authorities have yet to employ the kind of tactics needed to make a privatization program succeed. In particular, a "spread the wealth approach," so effective in Chile and Britain, remains an unexplored possibility. Of the actual 20 percent companies sold, 15 percent of these have gone to the "social sector," which, to boot, is heavily controlled by union leaders.

Privatization can produce more than mere economic benefits: its social value is greatly underestimated in Mexico, where it is viewed as reactionary, anti-revolutionary exploitation, and symptomatic of cronyism.

The role of debt-equity swaps has also been underestimated. Swap operations in Chile have been very successful. In Mexico they could prove more so. A study done by the Center for Investigation of Free Enterprise in Mexico City suggests that parastatal assets could be exchanged for domestic debt, which if undertaken would not only solve the internal debt crisis but adopt a sound strategy in transferring the very large state-owned firms from a handful of bureaucrats to thousands of stockholders in the private sector -- all without the inflationary impact usually cited as an objection to swap operations. Finance Minister Pedro Aspe proposed a swap scheme in March, but it was dropped because of internal opposition claiming that swap operations constitute a threat to national sovereignty.

Much has been done in Mexico in the gallant name of national sovereignty, including the nationalization of the banks in 1982 and the Foreign Investment Laws enacted in 1973. But these laws have been very costly for Mexicans: real wages have lost half of their purchasing power in the last eighteen years. These laws also discourage investment. There is now more than $80 billion of flight capital overseas. Salinas must re-privatize the bank system and radically modify the Foreign Investment Law, which still limits foreign participation to a 49 percent minority holding in national companies. A climate of confidence is a prerequisite for lasting stability and true national sovereignty.

Land for the Poor. A major problem for the U.S. is the massive flow of illegal immigrants who cross the borders each year in search of survival. To solve this problem, Salinas must terminate the demagogical agrarian reform program and give the *ejido* land plots to the more than 3 million drastically poor rural peasants. Surely no cries of "social cost" would be heard if the land were given back to them to farm as they saw fit.

Finally, Salinas must modify what Peruvian economist Hernando De Soto calls the "institutional framework" of the country. You have heard of significant market-oriented changes, but you probably have not heard that Soviet-style central planning, now obsolete in U.S.S.R. itself, is enshrined in the Mexican constitution. Articles 25 and 26, modified in 1983, contain clauses virtually copied from the texts of the Cuban and Soviet constitutions. These must be eliminated to consolidate a genuine market-based reforms. Articles 27 and 28, which give the government exclusive ownership of the "strategic and primary" sectors of the economy, must also go if Salinas truly intends to honor his commitment to economic freedom and modernization.

Exaggerated Image. I have perhaps painted a grim picture. But this is necessary, as Salinas's image as a champion of economic freedom is greatly exaggerated in the U.S., and this tends to cause disturbing complacency on the part of people who should pressure Salinas to undertake substantial structural changes.

Nonetheless, there is also reason to be optimistic. The start is not great, but it does constitute a step forward. An indication of this is that, despite the overly triumphant tone of his Presidential Speech last November, Salinas is the first head of state in twenty years to recognize the real source of the Mexican seven-year crisis: the overwhelming presence of the government in the economic process – or as Salinas puts it, "statal giantism." In the past, Mexican Presidents have always sought to find a scapegoat: bankers, traitors, foreign imperialists, and earthquakes. Salinas has now reversed that trend, and that is a positive step.

Nevertheless, less talk and more action is needed. To truly consolidate his move away from statal giantism and toward the free market alternative, Salinas must overcome the myth of economic rectorship and allow the vast, politically underprivileged Mexican people to share the wealth and own the "strategic and primary" sectors like oil and electricity. Mario Vargas Llosa, presidential candidate in Peru, has done a remarkable job in marketing the public benefits of privatization, by making state-owned companies truly public – that is by turning them over to the people themselves.

Overcoming Obstacles. For this to happen, Salinas must fight very strong political and internal opposing forces and overcome a series of obstacles which have prevented him from ensuring more profound reform. But it must be done. Otherwise he faces a potentially explosive situation, where hyperinflation and stagnation could resume. This happened in Argentina under Raul Alfonsin, who significantly was very popular at the beginning of his term, but who failed to make the required structural transformations.

The U.S. cannot afford such economic instability in Mexico. It would cause great social upheaval and give considerable advantage to the populist, paternalistic socialism preached by the Left. Thus, the Bush Administration must push Salinas to deepen the process of reform and underscore the social lasting value of a nation ruled by economic democracy and individual freedom.

Salinas's pledge to modernize is laudable. But to "modernize" means to improve, re-evaluate, and above all to change. Mexico needs a fundamental change from the paternalistic but damaging role of economic statism to economic liberty and the competitive market. If Salinas makes the difficult but required structural reforms, he will meet his objective to modernize and be the first President in 24 years to leave office with an economy in better shape than the one he inherited.

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