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PRIVATIZATION IN MEXICO: ROBUST RHETORIC, ANEMIC REALITY

INTRODUCTION

Few nations are as heavily indebted or in greater need of economic reform than Mexico. The nation's total foreign debt well exceeds $100 billion, and inflation is now running at 130 percent. In exchange for promises of reform, Mexico this past year has received $14 billion in new loans from the International Monetary Fund (IMF), the World Bank, international commercial banks, and creditor governments. The conditions of the IMF and World Bank include: a small decrease in the Mexican federal budget deficit, tax reform, liberalization of trade, and increased investment in state-owned enterprises. Missing from the list of promised reforms is the measure that Mexico needs most--privatization of its bloated state sector.

Few reforms are expected from Mexican President Miguel de la Madrid, who leaves office next year. The ruling Institutional Revolutionary Party (PRI) recently announced that its candidate to succeed de la Madrid is Carlos Salinas de Gortari, the Harvard-educated Secretary of Budget and Planning credited with Mexico's recent trade reforms. Nomination by the PRI is tantamount to election to the presidency; the PRI has not lost an election in its 58 years. Salinas is expected to take office in December 1988. Though hailed as a pragmatist, his record is

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that of a statist. How he will address the need for divesting Mexico of its failing government enterprises may be the key test of his commitment to economic reform.

Mexico has no shortage of privatization targets, from small manufacturing and service industries, to newspapers, banks, transport services, and the vast oil and steel industries. Mexico's capital markets are sufficiently well developed to permit stock offerings of these concerns to the Mexican public. A central aim of U.S. policy, therefore should be to encourage the Mexican government to pursue such a program of "popular capitalism."

This means that the U.S. should:

◆◆ Tell Mexico that further World Bank and other loans will be conditional on real and demonstrable progress toward privatization.

◆◆ Reduce direct support to the Mexican public sector.

◆◆ Help Mexican educational efforts designed to spread the private sector message in Mexico.

◆◆ Provide high quality advice and technical expertise to Mexico on how to construct a large and popular privatization program.

PUBLIC AND PRIVATE IN MEXICO

The Mexican economy has become heavily socialized since the PRI assumed power in 1929. Expropriation of foreign-owned firms, nationalization of domestically owned companies, state takeovers of companies that would otherwise go bankrupt, and new public sector ventures undertaken by government all have served to build up a vast state sector of the economy.

State industries claim around 45 percent of the federal budget and contribute significantly to Mexico's debt burden. As of March 1986, Mexico's Foreign Ministry reported that state industries owed international banks $29.2 billion, a foreign debt larger than that of most governments, and twice as big as the total debt contracted by the Mexican private sector.

Public Sector Dominates. Public sector workers form an important part of the ruling PRI's political base. There are some 2.3 million unionized public sector workers formally affiliated with the PRI. Economists calculate that about 70 percent of the economy is owned or controlled by the state or by PRI-affiliated labor unions.

Capital flight is also a major problem. Between 1975 and 1985 Mexican citizens took an estimated $60 billion out of Mexico and into the United States. Billions more dollars found their way into Swiss bank accounts. Privatization could help counteract the lack of worthwhile investments inside Mexico that has caused this capital flight.

Constitutionally Set. State ownership is enshrined in the Mexican constitution. Articles 25 to 28 lay out the role of the public sector and specify the areas to be managed exclusively by the state. Article 25 sets forward the general principles and philosophy behind this state ownership, and article 28 outlines the economic areas that were originally the exclusive domain of the state (minting money, the central bank, telegraph and radiotelegraph services), plus those that have been nationalized at various times, such as electricity in 1960, and banking and credit in 1982. The nationalization of the petroleum industry in 1938 is covered separately by Article 27. Aside from these important areas of economic activity, the state also has acquired many small companies involved in all sorts of economic enterprises, including restaurants, movie theaters, a nightclub, a soft-drinks manufacturer, and a bicycle factory.

Since the accession to the Mexican presidency of Miguel de la Madrid in 1982, there seemingly have been signs that the nationalization trend may be reversing. Privatization and state sector reform supposedly have been a requirement in negotiations for new international loans, such as the $7.7 billion agreement signed on March 20, 1987. In the last four years, much attention has been given to the large numbers of public sector enterprises that the Mexican government claims to have sold or to intend to sell. There have been many stories in the press, usually prompted by an announcement from the Mexican government, of the numbers of enterprises sold or intended for disposal. Closer examination, however, reveals that these accomplishments and plans are less significant than they initially seem.

THE MEXICAN PRIVATIZATION PROGRAM

Most of Mexico's state-owned enterprises--also known as parastatals--were obtained by expropriation. Between the government's nationalization of oil in 1938 and the nationalization of the banks in 1982, Mexican presidents have nationalized electric power, mining, railroads, shipping, sugar, and most of steel and telecommunications, besides collectivizing much of agriculture. Mexican parastatals also include the national fertilizer monopoly and the state agricultural marketing board.[1]

Reducing Parastatals. The Mexican government has announced that it intends to reduce the number of its parastatals from 1,155 in December 1982 to 200 by the end of 1988. So far the number apparently has been reduced by about half to between 600 and 700. Not all have been privatized. The methods of reduction have included selling them, closing them, merging them, and transferring them to state and local governments.

The Mexican government states that one of its main economic goals is to rationalize the direct participation of the public sector in the economy. It describes this program as "restructuring of the state decentralized sector to make it smaller and more efficient," by means of "sale, liquidation, merger, or transfer of as many agencies as possible." An increase in efficiency of the sector, according to the government, also would "improve its financial condition, which would lead to a

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1. See Daniel James, "How Long Can Mexico's Authoritarian System Last?" *The World & I*, March 1987, pp. 601-617.

recovery of public sector savings. This, in turn, would contribute to the financing of future economic development."[2]

Two Phases. These reductions in the parastatal sector were carried out in two phases. In the first phase, starting in 1983, nationalized banks, which had interests, often minority interests, in 339 enterprises, sold their shares in about 200 enterprises to the private sector for about 100 billion pesos or about $300 million to $350 million at current exchange rates.

In the second phase, in early February 1985, the government decided to reduce the number of parastatal enterprises by 257, by selling 111, transferring 11 to local governments, merging 31, and liquidating the rest. Planning Minister Carlos Salinas de Gortari claimed that the companies offered would be more "attractive" than those previously put up for sale. He said that the Mexican government hoped to save up to $1 billion in subsidies by the additional sales. From February 1985 to April 1986, some 33 companies seem to have been sold for 24 billion pesos, (about $50 million). Most of the sales were achieved with special government credit facilities.

As a result of these different measures, the number of parastatal entities decreased from 1,155 at the end of 1982 to 820 at the end of 1985, and around 700 at the end of 1986.

According to the Mexican government's Secretaria de Hacienda Y Credito Publico (Ministry of Treasury and Public Loans),[3] the status of the parastatal restructuring process as of May 1986 was:

Type of Operation	Authorized	In Process	Concluded
Sale	101	67	34
Dissolution	269	193	76
Merger	58	28	30
Transfer	30	30	0
TOTAL	458	318	140

Of the 101 state enterprises approved for sale, 84 were in the industrial sector, twelve in the tourism sector, two in the agricultural sector, and three were of other types. In 80 of the 101 firms the state had majority ownership, in 21 only minority ownership.

Thus, according to the above table, only 34 enterprises had actually been sold by May 1986. There is some question, however, that even these figures exaggerate the degree of privatization. In June 1986, Mario Barreiro, deputy minister of energy and state industry, said that only 26 companies had been sold and 45 remained on

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2. *Mexico: Main Economic Issues*, Secretariade Hacienda Y Credito Publico, September 1986.

3. *Ibid.*

the auction block. More recently the Center for Economic Study of the Private Sector (CEESP), an organ of the Business Coordination Council (the umbrella organization for most of the major Mexican business organizations), released figures showing that 96 enterprises had been approved for sale, of which 72 had actually been sold.

No List. In a recent report on Mexican government efforts to reduce the size of the public sector, CEESP states that "a major difficulty in assessing these efforts is the lack of a definitive list of the parastatals." Although the Mexican government has reduced the number of parastatals, the CEESP report notes that the number of those controlled by one department, Gobernacion (the Ministry of the Interior), actually increased from 26 in 1977 to 64 in 1985. The CEESP report does not name any parastatals that have been privatized, but only lists numbers of firms.[4]

As CEESP noted, the most suspicious aspect of the Mexican privatization program is the absence of a list of public sector enterprises and a list of those companies actually sold. The few privatized companies that can be identified include the Nacional Hotelera chain of five-star hotels, Vehiculos Automotores Mexicanos (VAM) and Renault of Mexico (both sold to Renault of France), an apparently profitable soft drinks manufacturing company, Garci-Crespo, and the bicycle factory. The Mexican government paid Renault some $200 million to take over VAM and assume its debts. Renault then closed VAM down. This is not really privatization.

Still Part of State. Some enterprises, including the bicycle factory, have been sold to the so-called "social sector," namely unions, which in Mexico are very much part of the ruling machine. Meanwhile, state-owned enterprises have sold minority shareholdings. For example, Diesel Navastar, a large Mexican state concern which makes trucks, has sold 5 percent of its stock to the U.S. company Navastar. A majority remains state-owned.

It is difficult to assess Mexico's privatization program without knowing the names of the companies privatized, let alone their size and asset value. The Mexican Embassy in Washington cannot provide such a list, nor can the World Bank, the U.S. Treasury, the International Monetary Fund, or any other of the institutions arranging billion dollar loans to Mexico supposedly conditional on the fulfillment of such policy reforms as privatization.

In summer 1986, the Mexican government said it was going to produce a list of companies that it would not privatize, all others being up for sale or subject to merger or dissolution. This list has yet to appear. It is thought that many public sector enterprises are lobbying hard for inclusion on the list. The government's economic policy statement for 1987 promises that "the state will withdraw from the branches of chemicals, textiles, pharmaceuticals, and secondary petrochemicals, whose promotion no longer requires the presence of the state."[5]

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4. *Avances en la Racionalizacion de la Participacion del Gobierno en la Economia Mexicana*, CEESP, March 1987.

5. Larry Rohter, "Divestment Efforts in Mexico Debated," *The New York Times*, April 13, 1987.

Most recently, the government announced the sale of Mexicana de Aviacion, one of two state-owned airlines. However, the announcement of Mexicana's sale has been made twice before by ministers. (Indeed in February 1986, Planning Minister Salinas stated that the privatization of Mexicana was "a fact"). Recently, a formal deadline of June 30, 1987, was set for bids on the government's 60 percent stake in the airline. The ailing airline, which has now been on the auction block for two years, is still in government hands. Unlike Aeromexico, the traditional flag carrier, Mexicana was privately owned until 1982 when it was acquired by the government as part of a financial bailout. It has foreign debts of $400 million and currently runs at a loss. It remains to be seen whether it will actually be sold.

SELLING MINORITY SHAREHOLDINGS IN BANKS

This February 6th, the Mexican government sold minority shareholdings in two nationalized banks, Bancomer and Banamex, Mexico's largest banks. Mexico's private banks were expropriated by presidential decree on September 1, 1982, in a dramatic final act of the outgoing President Jose Lopez Portillo. When Miguel da la Madrid assumed office three months later he resisted pressure for reversing the expropriation, but promised to sell minority shareholdings in the banks back to the private sector. No private investor was to be allowed to buy more than 1 percent of any bank's stock. Instead of privatizing a minority stake in each bank, business leaders had unsuccessfully urged that a third of Mexico's banks should be privatized in full.

Political Patronage. Some 23 percent of Bancomer's shares were sold for 38 billion pesos (about $38 million) and 34 percent of Banamex shares were sold for 40 billion pesos. Both sets of shares were sold at far below market prices to a restricted and politically favored group of customers and employees. Twelve percent of Banamex stock was reserved for employees, and 17 percent was sold to a select list of Banamex clients. This politically chosen list was reportedly weighted toward businessmen in the provinces. The price of the shares shot up as soon as they began trading, giving gains of between 200 and 300 percent to those who were able to buy shares. Some criticized the sales as politically motivated giveaways. "This is a high-tech version of traditional PRI patronage," said one stockbroker.

On March 17, a minority stake of 34 per cent in a third state-owned bank, Bank Serfin, was sold. As with the Banamex and Bancomer issues, the stock was distributed almost solely among employees and clients. As with the previous sales, the Serfin placing was in the form of a new capital issue of share certificates, known as Certificados de Aportacion Patrimonal (CAPs). These totalled some 27 billion pesos ($25.4 million). Reflecting criticism of the giveaway nature of the Banamex and Bancomer sales, the Serfin shares were priced higher. But investors were still able to realize an appreciable profit.

These partial privatizations reveal the government's strong resistance to selling more than a minority of its shareholding. It seems clear that the state will not give up its controlling interest, despite the strong demands of the Mexican private sector for full privatization.

THE ROLE OF DEBT-EQUITY SWAPS

Although most of the enterprises that were privatized were sold to the Mexican private sector, one or two were apparently sold to foreign firms, partly through debt-equity swaps. According to the data of the Secretariat of Finance and Public Debt, would-be foreign investors buy Mexican corporate debt at 62 to 64 percent of face value, and the government accepts these at 85 to 88 percent of face value when converting into equity.

The debt-equity swaps authorized in 1986 and the first quarter of 1987 included:

Authorized Mexican Debt-Equity Swaps by Sector
(millions of U.S. dollars)[6]

	1986	1987 1st Qtr
Motor industry	449.6	20.3
Tourism	189.2	145.0
Capital goods	98.2	102.2
"Maquiladoras"*	47.1	54.8
Chemical/pharmaceutical	59.9	16.8
Electronics	9.1	19.7
Agribusiness	26.4	1.4
Textiles/shoes	0.8	20.0
Others	156.7	96.9
Total	1,037.0	477.1

*The "maquiladora" program involves the assembly of goods in Mexico from imported components and their duty free re-export.

The Mexican government has announced that it intends to limit swap deals to $100 million monthly, with a ceiling of $1.5 billion to $1.8 billion for the year. This is much lower than some U.S. bankers had hoped. Many had thought that some $20 billion of Mexican debt could be retired in this manner. Thus the Mexican program is much more limited than that of Chile, which expects swaps to reduce its public commercial debt from $13 billion today to $8 billion in four years. Citicorp, which recently announced its intention to convert billions of dollars of debt into equity, is expected to take on a major role in Mexican debt-equity swaps. According to Citicorp sources, it currently is preparing proposals to convert loans to equity shares in twelve Mexican companies, including two state enterprises. Of course, the Mexican swaps' potential is also restricted by strict limitations on foreign ownership in many sectors of the economy.

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6. National Foreign Investments Commission. Quoted in David Gardner, "Bankers Rush for Mexican Equity," *Financial Times*, June 2, 1987.

PRIVATIZATION FALLEN SHORT

To focus solely on the reduction in the total number of Mexican parastatals is misleading. Many of the privatized parastatals are very small. Some were just bankrupt shells of companies which existed only on paper. A substantial portion of them became state-owned by default, being in the portfolios of the banks that were nationalized. In fact, the sales in the first two phases of parastatal reduction account for far less than 1 percent of the total parastatal sector.

Huge Companies Remain. The biggest parastatals remain untouched. Among them are CONOSUPO, the agricultural marketing board, CFE, the federal electric company, and Fertimex, the fertilizer company. These companies are huge. CONOSUPO includes 18,000 retail stores, 32 manufacturing and food-processing plants, and 70 percent of the country's food storage space. These three, together with three other large state companies, the state sugar, steel, and railway corporations, account for more than 20 percent of the total public sector deficit.

The fertilizer, food, electricity, and steel companies were required to sell their products at low, unsubsidized prices, adding to the operating losses resulting from inefficiency and misallocation of resources. According to Jorge Tamayo, coordinator general of audits at the Mexican Comptroller General's office, which oversees state companies, "It is impossible for a state company to be profitable if it is asked to supply at a subsidy, cannot raise its prices and must generate jobs and expand services."

Many of the enterprises that have been removed from the federal government's books, moreover, have not been genuinely privatized. They have been merged with other parastatals, transferred to local governments, or closed. Closure of a loss-making enterprise is a positive move, but most of the companies existed on paper only. The only significant enterprise to be closed down was the Funditora Monterrey steel mill, with the loss of 9,000 jobs. (In 1985 its operating expenses were $414 million and sales were $185 million.)

Varying Assessments. Commentators are divided as to the sincerity and extent of the de la Madrid government commitment to privatization. On the one hand, Planning Minister Salinas sees a fundamental change in policy. "The government in Mexico will continue servicing the strategic areas through sole ownership and control," he said. "In others, we will stimulate strongly the participation of society in the process of development. This is a strong and important historical change that we are witnessing at the closing of the 20th Century." This is echoed by business leader Claudio Gonzalez. He sees "indications that we are moving in the right direction away from as much state intervention as we've had in the past. However, obviously we would like to see it move as fast as possible, because we really don't have any time to lose right now."

On the other hand, Jeno Malatinsky, a World Bank economist, doubts that the government intends to go far with privatization. He cautions: "The government does not want a sizeable reduction of the parastatal sector....What it probably wants is to streamline the parastatal sector."[7] Other observers are even less impressed. Luis Pazos, professor of economics in the Faculty of Law of the National Autonomous Mexican University, says that the announced sale of some state-owned enterprises "does not imply a fundamental change in the government's socialist tendencies. They represent a small proportion of the public sector and many of them will be sold to the so-called 'social sector,' that is businesses run by trade union leaders."[8]

Mexican Propaganda. Daniel James, who heads the United States-Mexico Institute in Washington, D.C., stresses that no basic industries have been privatized. He also warns that caution should be used regarding the Mexican government's statistics on privatization. He criticizes the U.S. government and international institutions for lending credibility to the Mexican government's statements: "The [Reagan] administration has been acting as handmaidens to Mexican propaganda--helping convince people that Mexico is going ahead with an economic reform program when in fact it is not."[9]

One possibility is that the U.S. and international financial institutions are aware that nothing much is happening in Mexico, but have mutually agreed to suspend disbelief. They apparently feel that the change in Mexican rhetoric toward reduction of state power is such a positive change that it warrants the encouragement provided by new foreign loans.

Expropriation Danger. An important obstacle to privatization in Mexico is the insecure nature of private property and danger of expropriation. President Lopez Portillo's 1982 expropriation of the banks was unconstitutional and illegal. He should have sought the approval of Mexico's Congress first, even if it is a rubber-stamp for PRI decisions. But the former bank owners were unable to find a judge willing to grant an injunction restraining the seizure, and Congress ratified the expropriation ex-post-facto. The ability of the Mexican President suddenly to expropriate a company does not encourage foreign investor confidence.

An important feature of the Mexican privatization program is its lack of transparency. The public does not know when privatization has happened or what has happened. Negotiations are carried out in secret. Successful purchasers are announced after the sale. Such lack of openness may be partially due to desire to avoid prompting leftist opposition, but is more likely part of keeping the privatized companies "in the family" by sale to PRI supporters at low prices.

It seems that the only significant privatization to date has been that of the National Hotelera hotel chain, a fairly large company that had always been owned

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7. "Information Received from Mexican Government Officials on Issues of Parastatal Industry and Increased Role of Domestic and Foreign Capital," IFC office memo of April 30, 1986 by Jeno Malatinsky.

8. Luis Pazos, "The False Austerity Policies of the Mexican Government," *Journal of Economic Growth*, Vol. 1, No. 1, 1986.

9. Telephone interview with Daniel James.

by the government. If the Mexicana airline is actually sold, it will be the second significant privatization.

Despite these meager results, the Mexican privatization is succeeding extraordinarily in public relations terms. The Mexican government has convinced many foreign observers that it is making progress in privatization. That this is not true is indicated by the continuing increase in the size of the public sector payroll in Mexico in both absolute and relative terms, in the public sector as a whole, and in government-owned industry.

FUTURE DIRECTIONS FOR MEXICAN PRIVATIZATION

Privatization could become a very important factor in Mexico. Reducing the role of the inefficient state bureaucracy and encouraging entrepreneurship are measures vital to Mexico's economic regeneration. Perhaps most important, privatization provides a means whereby the wealth of Mexico can be transferred from the hands of the few into those of the many. Capital could be spread among ordinary Mexicans, who could for the first time be given an opportunity to own a stake in their country's future.

"Popular Capitalism." In countries where privatization has worked best and proved most popular--Britain, France, and Malaysia--great efforts have been made to increase the number of individual shareholders and create a capital-owning democracy. In Britain, the percentage of the population owning stock has increased from 5 to 20 percent. This approach, known as "popular capitalism," is ideally suited to Mexico, where there is great national pride and a fear of foreign ownership.

A first step, which would signal genuine willingness to privatize on the part of the Mexican government, would be the sale of majority stockholdings in the commercial banks. The full privatization of these banks is the top priority of the Mexican private sector.

The Mexican privatization program could then be widened by selling profitable smaller state-owned companies to the Mexican public through stock offerings. Next could come stock market flotation of such large basic industries as the government fertilizer monopoly, the state steel holdings, and the oil industry. Limitations on foreign ownership could be imposed, as they have been in many other countries' privatization programs. Employee buyouts of smaller enterprises should also be encouraged.

CONCLUSION: MEXICO'S PRIVATIZATION AND THE U.S.

The role of the U.S. and international financial institutions in encouraging privatization in Mexico so far has been minimal. Despite their rhetorical commitment to privatization in Mexico, neither the U.S. Treasury, the World Bank, the IMF, nor the State Department seem to be monitoring what the Mexican government is doing. None of these institutions could produce a list of enterprises privatized in Mexico. These institutions seem to rely almost solely on the Mexican government for their information.

The essence of the Baker Plan, devised by U.S. Treasury Secretary James Baker, is to ensure that policy reforms are carried out in return for further lending. In the case of Mexico, reforms so far have been primarily empty rhetoric. If the U.S. remains serious about its commitment to the Baker Plan, then Washington must take a number of actions. Among them:

◆◆ No further U.S. loans should be made to Mexico until the Mexican government commits itself to openness and honesty in revealing what it is doing, in terms of providing full information as to what measures it is taking and then ensuring that those measures are taken in a fair and open manner. Example: state enterprises should not be sold to political cronies secretly.

◆◆ The U.S. should demand more substantive Mexican policy reforms if further U.S. loans are to be extended. Full privatization of the banks is obviously essential. Privatization must extend beyond a handful of minor enterprises.

◆◆ Fewer loans should be extended to the Mexican public sector. These only make it easier for public sector inefficiencies to continue. As part of the recent $14 billion bailout of Mexico, the World Bank extended almost $1 billion in loans for the investment programs of Mexico's state-owned enterprises, including the state steel companies and the state fertilizer monopoly. Ironically, the World Bank's conditionality is that government subsidies to these enterprises be phased out. The Bank thereby strengthened the position of these ailing public enterprises at the very time when it should have used its leverage to insist on their privatization.[10]

◆◆ The U.S. must make greater efforts to convince the Mexican public, politicians, and other opinion makers that only the free market can ensure Mexico a prosperous, stable, and free future. Mexican politicians are still overly influenced by the large leftist "intelligencia" in Mexico, when in most of the rest of the world collectivist ideas are very much out of fashion and on the decline. This means that government and private institutions in the U.S. should do more to help the spread of the private sector message in Mexico. This does not imply direct U.S. propaganda, but rather support of and cooperation with those individuals and institutions in Mexico who favor market approaches. Seminars, reports on Mexican policy issues, provision of more free market material in Spanish, articles in Mexican newspapers and magazines on market issues--all the usual means of influencing public policy--should be deployed.

◆◆ The U.S. should improve the quality of advice on privatization given to the Mexican government. Privatization is a political process above all, especially in Mexico. But practical advice on how to construct a politically popular privatization program does not seem to have been extended to Mexico. There are many experts with experience in this field. They could provide invaluable assistance to the Mexican government.

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10. Melanie Tammen, "Deja Vu of Policy Failure: The New $14 Billion Mexican Debt Bailout," Heritage Foundation *Backgrounder* No. 588, June 25, 1987, p. 9.

The U.S. government, the World Bank, and other international financial institutions so far have failed to persuade the Mexican government to undertake significant market economic reforms. Such privatization that has occurred is negligible. The continuing huge loans to Mexico serve only to avert a short-term crisis.

A more statesmanlike approach would acknowledge that only substantive reforms of Mexico's corrupt, statist economic system will avert a debt crisis in the long run. Large-scale privatization is the primary means by which the health of the economy can be restored and economic power transferred from corrupt officials to the mass of Mexican citizens. Liberated from a suffocating and backward collectivist system, a stable and prosperous Mexico could join the rest of the North American continent in providing opportunity, wealth, and good social conditions for all its citizens.

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