Mexico's Private Sector

Recent History, Future Challenges

edited by
Riordan Roett

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LYNNE RIENNER PUBLISHERS

BOULDER
LONDON

Published in the United States of America in 1998 by
Lynne Rienner Publishers, Inc.
1800 30th Street, Boulder, Colorado 80301

and in the United Kingdom by
Lynne Rienner Publishers, Inc.
3 Henrietta Street, Covent Garden, London WC2E 8LU

Library of Congress Cataloging-in-Publication Data
Mexico's private sector : recent history, future challenges / edited by Riordan Roett.
p. cm.
Includes bibliographical references and index.
ISBN 1-55587-713-3 (hardcover : alk. paper)
1. Mexico—Economic conditions—1994- 2. Mexico—Economic policy—1994- 3. Free enterprise—Mexico I. Roett, Riordan 1938- .
HC135.M569 1998
330.972'0836—dc21 98 25921
CIP

British Cataloguing in Publication Data
A Cataloguing in Publication record for this book
is available from the British Library

Printed and bound in the United States of America

The paper used in this publication meets the requirements of the American National Standard for Permanence of Paper for Printed Library Materials Z39.48-1984.

5 4 3 2 1

Foreword

The current process of economic, political, and social restructuring in Mexico has had a significant impact on the challenges and opportunities faced today by Mexico's private sector. The transition from a protective, state-directed economic model to an open one, particularly since the passage of the North American Free Trade Agreement (NAFTA), has compelled the Mexican private sector to adjust to increased competition while simultaneously undergoing a process of redefinition of business-government relations. The structural changes brought about by these reforms have also greatly affected the international business and investment communities that have benefited from new opportunities in Mexico—these opportunities, in turn, come hand in hand with increased demands for transparency and efficient business and regulatory frameworks.

This volume provides a clear picture of the recent history and future challenges of Mexico's private sector. The authors examine the goals of economic reform and evaluate the results and the effects of economic modernization on important sectors of the Mexican economy. They also evaluate the prospects and future challenges for Mexico's private sector as we approach the twenty-first century.

This is the fifth volume in the SAIS Program on U.S.-Mexican Relations series, after *The Challenge of Institutional Reform in Mexico* (1995), *Political and Economic Liberalization in Mexico* (1993), *Mexico's External Relations in the 1990s* (1991), and *Mexico and the United States: Managing the Relationship* (1988). A separate volume was released in 1996, *The Mexican Peso Crisis: International Perspectives,* which analyzes key international policy issues affected by the 1994 peso devaluation, from the perspectives of the United States, Mexico, Brazil, Argentina, and the European Union. All of these volumes have been concurrently published in Mexico in Spanish.

The SAIS Program on U.S.-Mexican Relations is sponsored by the William and Flora Hewlett Foundation. Since its creation in 1986, the program has focused its efforts toward increasing knowledge and understanding about the critical issues that shape the Mexican-U.S. bilateral agenda among an audience of policymakers and leaders in business, media, and education. This series of edited volumes is an important component of the program.

Guadalupe Paz
Assistant Director,
SAIS Latin American Studies Program

Acknowledgments

I would like to express my gratitude to the individuals who contributed to this volume and to those who made the completion of the project possible. First, I thank my fellow authors for their thoughtful essays and for the time and patience that were required of them, as is inevitable in a project of this nature. I am especially thankful to Guadalupe Paz, the SAIS Latin American Studies Program's assistant director, for her role in planning the volume and managing all the details involved from beginning to end. Others whose efforts made this publication possible are Charles Roberts, who translated the Spanish-language chapters into English, and Donna Verdier, who bravely took on the assignment of reviewing, restructuring, and editing the manuscript.

Finally, I wish to acknowledge the generous support of the William and Flora Hewlett Foundation, which has been essential in enabling the program to continue its efforts in the field of U.S.-Mexican relations.

Riordan Roett

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Introduction

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During the course of the past three presidential administrations in Mexico—Miguel de la Madrid Hurtado (1982–1988), Carlos Salinas de Gortari (1988–1994), and Ernesto Zedillo Ponce de León (1994–2000)—the country has undertaken a profound economic transition, a process that will continue into the twenty-first century. In the post–World War II period, the Mexican government, anxious to catch up with leading economies, accepted the conventional assumption of those times—notably espoused by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC)—that by adopting a policy of import-substitution industrialization (ISI), Mexico could work to overcome the perceived disadvantages of countries exporting primary products vis-à-vis countries that exported manufactured goods.

This policy was the key to the centralized industrial policies of the Mexican state during the three decades following World War II. The implications for the state's relations with Mexico's private sector are obvious. Mexican manufacturers were at once protected from foreign competition by the ISI approach, including high tariffs and nontariff barriers to trade like restrictive import licensing, but also beholden to the state and subject to be co-opted by its all-powerful governing party.

It was not until the early 1980s that the high costs of ISI policies became generally apparent. By this time the central government subsidies and related costs for supporting ISI amounted to more than 13 percent of Mexico's gross domestic product (GDP). Recurring economic crises, beginning in 1981–1982, sharpened the examination of the efficacy of the ISI approach, and the austerity measures of the De la Madrid administration included a sharp reduction in public sector expenditures, in part at the cost of central government subsidies for "infant industries." These changes in government policy, involving a more international and market-oriented approach, have had, as this book admirably demonstrates, a dramatic and probably permanent effect on the relations between Mexico's public and private sectors, and have created a whole new set of challenges and opportunities for Mexico in the new century.

The purpose of this book is to offer a diverse range of views on the history and prospects for Mexico's private sector in the year 2000 and beyond. The authors succinctly explain and analyze developments and outcomes of economic transformation in modern Mexico from their respective views as economic historians, private sector economic analysts, and academics. The authors were asked not only to describe the dramatic evolution from ISI to the current free-market government economic policies but also to assess the outlook for the field in future years.

The story begins with a commentary on the evolution of Mexico's economic modernization by Everardo Elizondo Almaguer, now deputy governor of the Banco de México, Mexico's central bank, but who comments on themes from his earlier perspective as a private sector leader. In his chapter, Elizondo makes the point that there has never been a clear-cut dichotomy between Mexico's state institutions and the private sector. The role of the state has waxed and waned in the Mexican economy but certainly must retain such vital functions to ensure that economic and social mechanisms, including the free market, operate under the rule of law. Elizondo describes the foreign trade policies, including protectionist measures, that were at the core of the state's development policy for Mexico over a period of several decades. He correctly credits the regime of President Miguel de la Madrid with initiating the foreign trade policy reforms, which were an important and necessary response to the 1982 economic crisis that was brought on during the José López Portillo period (1976–1982) by a combination of the fall in international oil prices and severe economic policy errors, including the assumption of historically high foreign indebtedness meant to be paid off by oil revenue riches. Mexico owes much, Elizondo feels, to the clear vision of President De la Madrid and his key economic advisers, who initiated the recovery of the Mexican economy in the mid-1980s. Elizondo sees for the near future a continuation of the economic and political reform process without substantial alteration, but warns that a sharp eye must be kept on the pace and extent of political reform on the road to Mexico's democratization.

The next chapter is by one of Mexico's leading economic historians, Enrique Cárdenas Sánchez, rector of the Universidad de las Américas (UDLA) in Cholula, Puebla, who provides a decades-long perspective on the evolution of Mexico's private sector during many different government regimes. Cárdenas highlights the special importance of the industrial sector as an engine of Mexican economic growth since the 1930s. During the period of transition from the traditional dependence on mining and agriculture, from the 1940s to 1980, Mexico achieved a real annual economic growth rate in the neighborhood of 6 percent. Cárdenas adds that since 1982 the Mexican economy has not been able to recover such a sustained level of real growth, although prospects currently seem brighter.

A key element in the history of the Mexican economy since the early 1980s has been the major transformation in the economy. As Cárdenas notes, "trade liberalization, privatization of public enterprises, deregulation, and openness of the financial markets are all shaping a new economic system." He links the emergence of this new economic system to the recent growth of the democratic process throughout the nation, and the weakening of the seventy-year rule of the Institutional Revolutionary Party (PRI).

Cárdenas analyzes the important role the private sector has played in financing economic growth in Mexico, but stresses the historical, sometimes shadowy, role of the state in economic affairs. Government contracts, nontariff barriers to imports for favored firms, and other means were traditionally used to support the state's influence. Thus the dramatic liberalization of the Mexican economy from 1982 to 1998 has had a powerful effect on the nature and balance of state–private sector relations in an era of regional integration and globalization.

Of particular interest to Cárdenas is industrial performance in relation to GDP with a focus on the increasing role of the maquiladoras and their impact on changing labor relations and gender issues (most maquiladora employees are women). Related productive issues, which he identifies and analyzes, are the major changes in banking and transportation sectors and the trend toward greater foreign participation. The basic course toward GDP growth is set by the soundness of the state's macroeconomic management and its attention to such structural issues as demographic growth.

Cárdenas takes a special look at the actors in this drama—the characteristics of major economic groups that participate in the process and how they interact with state institutions. He notes that "the new challenges posed by the liberalization of the economy and globalization, as well as the privatization of numerous state firms and the commercial banks . . . did have an important impact on the recomposition of the economic groups." The challenge that Mexico faces today, he concludes, is to incorporate larger segments of society into the dynamic economic process, which will lead to more broadly shared productivity gains as Mexico competes successfully in the new global environment.

Continuing on the theme of economic reforms in Mexico and their outcomes is a chapter by Jonathan Heath, a respected, independent economic analyst in Mexico City. Heath's chapter describes the rocky path that Mexico has taken as it developed toward economic modernization, including the major "stumble" of the Mexican peso crisis in 1994–1995. He describes how "reform fatigue" has set in and the withering away of popular support for reforms that have been particularly marked during the current Zedillo administration. After describing the reform measures of the De la Madrid–Salinas–Zedillo period, Heath analyzes future policy options and examines the implications of these options for the next century in terms of Mexico's original intentions and long-term goals.

Along the way, Heath describes why economic reforms were necessary; the impact of the oil boom and bust during the 1970s; De la Madrid's groundbreaking reform measures during the 1982–1988 period; and key structural changes during the Salinas period when privatization efforts intensified dramatically (more than 1,000 of the 1,200 state-owned enterprises found their ownership transferred to the private sector). He stresses that Mexico still faces many challenges, including inequitable income distribution and immense belts of poverty surrounding affluent ghettos, which he correctly describes as Mexico's most complex and important social problem.

Heath concludes that Mexico must adopt policies that will generate higher-paying jobs; restore lost purchasing power for the middle and lower classes; diversify the domestic economy; and promote sustainable and more equitable economic growth and development. These economic policies, he insists, must be joined with Mexico's evolution toward a more democratic society marked by the rule of law.

The current state of Mexico's capital markets, including private and public sector investment issues, exchange rate policies, and prospects for export growth are described in Chapter 5 in this volume by Roberto Salinas León, economic analyst and director of economic strategy at Televisión Azteca. Salinas León describes exchange-rate policy as a prominent issue since the 1994–1995 peso crisis, which will now be at the forefront of public attention as former finance minister Guillermo Ortiz takes over the reins as governor of the Banco de México and the government continues its efforts to pursue an ever more credible international monetary policy. Such a policy, Salinas León notes, is an important underpinning to the confidence of the financial sectors of the Mexican economy, particularly the stock markets, which seem "to waver between episodes of panic and euphoria," he writes. Equally important is to increase domestic savings and investment, thus dampening out foreign investment volatility.

Therefore, the central economic challenges for Mexico into the new century are investment, stability, and growth. Instead of vaguely blaming neoliberalism or market capitalism for Mexico's ills, Mexico's political leadership—from all the major parties—should focus over the coming years on how to open up private sector competition, how better to define and enforce property rights under an improved rule of law, and how to free the operation of market mechanisms while maintaining appropriate controls for the public good. Salinas León concludes that it is up to Mexico's policymakers to create a reliable regime for long-term productive investment from home and abroad.

A remarkable insight into how Mexico recovered from the 1994–1995 Mexican financial crisis and its lessons for Mexico's banking and private sector communities is offered by three officials of the Mexican National Banking and Securities Commission. They are Javier Gavito Mohar, Aarón Silva Nava, and Guillermo Zamarripa Escamilla. Their chapter examines the relationship between the private sector and official financial institutions, particularly in times of crisis. It contains an inside view of events and actions that led to the recent peso crisis, and explores the consequences of the crisis and its austere aftermath for private banks and firms and for Mexico's financial system. The authors describe the vulnerability of the financial system and how this is exacerbated by structural factors. They note that vulnerability was increased dramatically when major private firms' ratio of debt to capital climbed precipitously from 49 percent in 1991 to a shocking 83 percent in 1994, giving evidence of possible excessive risk taking by bank managers, although some banks adopted more prudent credit policies.

In any case, the National Banking and Securities Commission, in concert with other institutions, has implemented since early 1995 a series of regulatory programs aimed at supporting the health of the banking system and its borrowers. Although it is too early to evaluate the cumulative effects of these efforts, it is clear that to succeed they must encompass a fair distribution of losses among all parties and a continuing reform of the financial system, especially in the area of financial intermediation. The authors express a final caveat that private bank recovery will be gradual and heterogeneous in a time of continuing vulnerability to any future economic crises.

Raymundo Winkler, director of the Center for Economic Studies of the Private Sector (CEESP) in Mexico City, dates the beginning of the structural transformation of the Mexican economy from 1985, when Mexico sought membership in the General Agreement on Tariffs and Trade (GATT). The ongoing process involves the public and private sectors and endeavors to raise Mexico's productivity levels to make it more competitive in the global market. The beginning of the process, symbolized by entry into GATT, was marked by moving away from the protectionism of the ISI years, which in some cases quite suddenly exposed obsolescent and inefficient firms to the highly competitive global economy. The firms, now obliged to invest in improving their productivity, found that they were attempting to do so in an atmosphere of austere macroeconomic-stabilization efforts of the Mexican central government, required by a series of economic crises and setbacks. Winkler's chapter assesses the progress of efforts to achieve more productive plant operations at a time of narrow economic options.

Following a basic description of the principles, context, and rationale of Mexico's economic reform strategy, Winkler describes how the private sector undertook a generally successful reorganization and conversion of firms' equipment and machinery—necessary for the succeeding economic growth in manufacturing, export performance, and for gains in productivity and real wages. Winkler proceeds to challenge the more common criticisms made of the modernization strategy, and concludes that the liberal strategy of structural change implemented in Mexico beginning in the late 1980s has begun to produce positive results for the Mexican economy. Nevertheless, he notes, the modernization process must continue and, indeed, is crucial if the Mexican economy is to enjoy long-lasting growth, higher employment, and social progress.

In Chapter 8, Kristin Johnson Ceva, a political economist trained at Stanford and now associated with a private sector financial consulting firm, reports on the dramatic changes in the business-government relationship that have taken place since 1990 in an atmosphere of regional integration and economic crises. Her chapter contains a fascinating, detailed description of how Mexico successfully negotiated the North American Free Trade Agreement (NAFTA) in the early 1990s, with special attention to the role of the business community in the internal give-and-take as various sectoral agreements were crafted. The business-government interplay during these years was crucial to the development of a changing relationship between the private and public sectors. For example, while groups of large businesses typically played a key advisory role in the NAFTA negotiations, some smaller firms, fearing the opening of the Mexican economy to competitive forces, often joined with political and nongovernmental groups opposed to NAFTA. As Johnson Ceva notes: "Born and having prospered under the policies of protectionism and import substitution, smaller enterprises . . . had historically opposed unilateral trade liberalization and Mexico's accession to the General Agreement on Tariffs and Trade." But, finally, a strong pro-NAFTA campaign by the Mexican government, and the support of major industrial firms, prevailed. NAFTA was successfully negotiated and came into force on January 1, 1994.

Johnson Ceva also examines the political and social dynamics of groups opposed to the government's economic policies in general. One such examination is of the Barzón movement, which has grown rapidly and is now one of Mexico's best-known social actors. The Barzón, which is the Spanish word for "yoke," takes its name from a prerevolutionary song about a peasant who borrows to pay for an old *barzón* and, unable to pay for it, spends the rest of his life in debt. Originally formed by farmers in northwestern Mexico, the movement expanded rapidly to the south. The Barzón has organized innumerable protests throughout Mexico and has been effective in calling attention to the credit problems of farmers and small businesspersons. It has since expanded to include criticism of corrupt officials and bankers, and continues to be an active player on the Mexican social scene.

Partly as a result of pressures from the Barzón and other groups, the Zedillo administration has undertaken a number of new efforts to improve government–small business relations. Sectoral approaches, such as those to the shoe and textile sectors, have resulted in higher tariffs on imports from countries not covered by commercial agreements. Government programs also are making credit easier for smaller firms in such areas as textiles, leather and shoes, automotive and auto parts, electronics, steel, and chemicals.

Johnson Ceva finds that the sea change in government-business relations in Mexico has resulted in private sector demands for the correction of economic imbalances, what they call a "microrevolution" involving more attention to business sector needs, and a more efficient banking system with easier access to credit. She notes that "the previous business-government order has been shattered, but it will take time for a new order to emerge." Thus, while Zedillo appears determined to maintain the general outlines of his economic reform policies aimed at stimulating economic growth, he will have to pay ever more attention to the nation's increasingly vocal and better organized business sector.

The effects of NAFTA on the transformation of the Mexican economy over the past decade is the subject of the chapter by Deborah L. Riner, chief economist at the American Chamber of Commerce in Mexico City, and John V. Sweeney, managing director at Vector Casa de Bolsa, a financial services firm. Their analysis focuses on the private sector and foreign trade and investment since 1985, when President De la Madrid brought Mexico into GATT. This first major move reflects the fact that the most important of structural changes taking place in Mexico has been the process of opening up the country to the global economy.

Complementing the trade and investment statistics that are used in this analysis, Riner and Sweeney draw on the opinions of business leaders themselves obtained from a survey of 405 companies conducted by the American Chamber of Commerce (AmCham) in Mexico in late 1996. They argue that NAFTA has increased trade flows in almost every sector, and that larger companies, particularly in the manufacturing sector, have gained the most from the structural changes brought about by the agreement. They stress that the most wrenching changes to the economy occurred before the implementation of NAFTA, and that the agreement has only accelerated the trend of determining who the winners and losers are in a more competitive and open economy. They conclude that the implications of NAFTA go beyond trade, as the trade agreement binds governments to established