The Impact of the Global Crisis in Mexico
For Whom Does the Bell Toll?

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The crisis of Wall Street is to market fundamentalism what the fall of the Berlin Wall was to communism.
JOSEPH STIGLITZ

INTRODUCTION

Mexico's trade and financial dependency on the U.S. economy is an overwhelming reality that has become even more marked in the last 15 years given the dynamics of globalization and the rules of the North American Free Trade Agreement (NAFTA). For this simple reason, the government idea of bullet-proofing the Mexican economy *vis-à-vis* the U.S. and world crisis and recession was untenable. In just a few days, Wall Street's financial collapse made its devastating repercussions felt the world over, and Mexico could not be the exception.

With the effects of plummeting consumption and credit levels in the United States, the Mexican economy's liberal model confirms its vulnerability resulting from its exaggerated addiction to the U.S. market and capital flows from its northern neighbor. Now we can observe how the repercussions of the crisis on the exchange rate, plunging oil prices,

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and the drop in foreign direct investment are highly interrelated.

The global crisis's main impact can be seen in the loss of dynamism in exports and how that in turn will affect productive activity in Mexico. In 2009, the latter will lead to an open economic recession with a negative gross domestic product (GDP) growth rate of between one and two percent, according to estimates of the Organization for Economic Cooperation and Development (OECD) and Mexico's Finance Ministry.

The aim of this article is to examine the vulnerability of the liberal economic model adopted by authorities since the mid-1980s and their reaction to the global crisis and recession. This model is characterized by its growing gravitation toward the U.S. market and foreign capital flows. Thus, the export manufacturing sector was counted on as the dynamic factor for growth. But it was highly dependent on the import of capital and intermediary goods, and has little capacity to galvanize the entire economy, resulting in low or non-existent growth, the effects of which are transferred to employment and earnings.

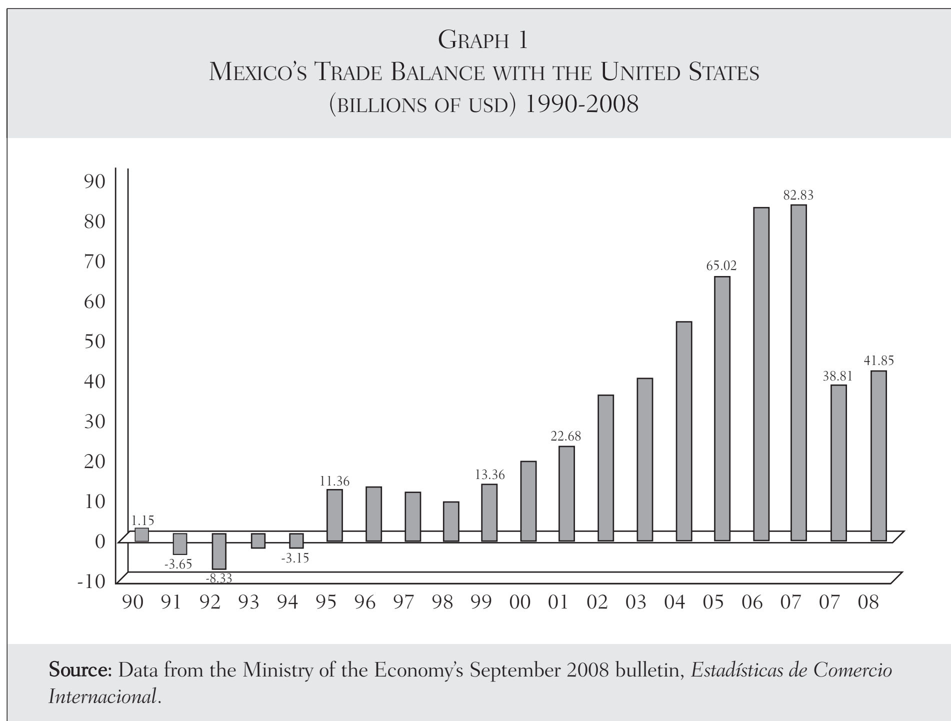
The vulnerability of the export-manufacturing model increases with the crumbling of the U.S. economy. This fragility should lead to reorienting the model and maintaining it based on endogenous sources of growth like the domestic market itself and labor-intensive import substitution, plus the diversification of exports to markets in the Asian Pacific and Latin America (see graph 1).

World Crisis: The Beginning of the End Of the Anglo-Saxon Capitalist Model?

The collapse of financial markets precipitated by the high-risk mortgage crisis in the United States is probably a sign of the beginning of the end of an era: the era of savage capitalism, a form of capitalism that favors multinational and financial corporations under the tutelage of international financial agencies like the International Monetary Fund, the World Bank, etc.

The international financial organizations made economic liberalism and the theses of the "minimal state" a dogma that raised the market to the category of a guiding, coherent

Graph 1
Mexico's Trade Balance with the United States
(billions of USD) 1990-2008



Source: Data from the Ministry of the Economy's September 2008 bulletin, *Estadísticas de Comercio Internacional*.

principle of the economic process. But recent events have revealed the liberal model's incapacity to correct the failures and abuses of the agents who act freely in the markets —whether financial, labor, or any other kind.

Contravening its own discourse, the crisis of Anglo-Saxon capitalism has shown its institutional fragility in the absence of self-correcting, self-regulating mechanisms to prevent or correct imbalances, tensions and the conflicts it creates in the economy and society.

After more than two decades, this economic model has proven that it encourages the concentration of income and wealth, promotes monopolistic tendencies and fosters social and regional disparities in development. In this context, the depth of the crisis set off by Wall Street and transmitted to both the majority of industrialized countries and emerging economies has demonstrated that the Anglo-Saxon model of contemporary capitalism has probably worn itself out.

In place since the late 1970s under the name "Reaganomics," the liberal model's breakdown shows the limits of market economies subject to institutional rules inspired in financial deregulation, free trade and hypothetically free competition. Its mode of operation has come to mean a regime of minimal —even discretionary— institutional norms for businessmen, investors, financial intermediaries, etc., with regard to trade, mergers, loans, financial transactions, etc., under the aegis of the invisible hand's supposed efficacy as the regulating, guiding principle of the economic process.

This model, attributed to differing degrees to the doctrines of Adam Smith, Friedrich Hayek and Milton Friedman, produced economies highly influenced by international finance capital and by the multinational firms that today are facing the consequences of their failings and excesses in speculative investments, the exorbitant use of credit and murky financial transactions behind the backs of investment fund savers, among other questionable activities.

Adhering to the logic of maximizing profits, these emblematic bodies' performance corroborated the adage that private interests frequently do not coincide with the general interests of society.[1]

Since the Great Depression, the U.S. government had not massively intervened in markets through purchasing the financial assets of de-capitalized, bankrupt corporations. No one would have imagined that George W. Bush would take measures like the bank bail-out, considered actions worthy of Latin American governments systematically accused of being "populist" and backward.

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International Monetary Fund Managing Director Dominique Strauss-Kahn, flying in the face of the proverbial anti-state wisdom on economic issues, has recognized that private money is scarce in the current environment, so government support is necessary to replenish the banking systems' capital.[2] Government intervention in the majority of industrialized and developing economies was inevitable and *de facto* meant the reestablishment of state economic regulation. Good-bye Mr. Hayek! Welcome back, Mr. Keynes![3]

Given the breadth and depth of the world crisis, the intervention of the state and its institutions has been the only option that could create confidence and liquidity, prerequisites for reordering the economic process and a way out of the crisis. We may well be on the threshold of a new era based on a market-directed economic system, to use the expression of Asian Pacific expert institutionalist economist Robert Wade.[4]

From Bullet-Proofing the Mexican Economy To Government Anti-cyclical Intervention

The drop in consumption in the United States, the main destination of Mexican exports, is affecting the country's GDP growth. Authorities have already reduced their growth projections for 2009. In early April 2008, they calculated an optimistic 4 percent a year. However, by October 2008, their prediction had dropped to 1.8 percent. Things got worse when the OECD estimates put the prediction at 0.4 percent for 2009, which practically implied stagnation for Mexico.[5] In this freefall, by January, conservative estimates were talking about a contraction of between one and two percent of GDP.

These figures buried government optimism about the country's bullet-proofing as promoted by Finance Minister Augustin Carstens. In just a matter of days, the early October financial collapse had serious repercussions the world over, and Mexico could not stay out of it. The sequence of negative effects began on the foreign exchange market with a

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series of speculative attacks against the peso, leading to an almost-40-percent devaluation and an instability that put the dollar exchange rate at nearly 15 pesos. Meanwhile, the drop in world demand for oil caused the price of Mexico's mix to plummet to under US$40 a barrel.

The Mexican economy's difficulties continued with the almost 11-percent annual decline in remittances from Mexican workers living in the United States, and reduced foreign currency income because of slowed tourism from abroad. The multi-million-dollar losses by Mexico's largest companies listed on the stock market and a 30-percent drop in foreign direct investment must not be left out of this mix (see graph 2).

Recent performance of the main economic and financial indicators confirm the Mexican economy's vulnerability *vis-à-vis* the United States' misfortunes. Now we can clearly see how these repercussions are highly interrelated on three levels:

The Foreign Exchange Market And the Peso Devaluation

Speculative attacks against Mexico's currency continue to create severe instability in the foreign exchange market, forcing the Central Bank to abandon its non-interventionist prescriptions and assume an active regulating role. To defend the "Mexican super-peso," authorities implemented a program of auctioning off dollars and directing intervening with sales to financial intermediaries.

These actions target increasing the supply of dollars in order to put the brakes on the deterioration of the exchange rate. Nevertheless, government intervention has not been effective if we consider that at the end of the first week of February, the dollar was tickling the underside of 15 pesos, having reached its historic high *vis-à-vis* the peso (14.719 pesos/dollar on February 4), when the average only eight months ago was 10.34 pesos to the dollar. So, by the end of January, the accumulated amount of dollars injected into the market (a minimum of US$400 million a day) was already over US$20 billion. But even that did not avert the abrupt drop of the peso *vis-à-vis* the greenback.

Given the climate of a lack of confidence, investors dealt harsh blows to the Mexican peso. Some companies, like the Comercial Mexicana retail chain, took out big international loans (US$2 billion), and others like the multinational Cementos Mexicanos (Cemex) demanded enormous quantities of dollars to cover their peso investments and their loans taken out with foreign creditors in dollars.

The failed defense of the peso implied that the central bank's international reserves dropped to under US$81 billion. Despite the fact that by the end of January, they had increased to US$83.63 billion, speculative attacks will probably deplete this amount again.[6] In this climate of exchange rate instability and distrust of Mexico's currency, the devaluation of the peso devastated one of liberal stabilization's most respected macro-economic fundamentals.

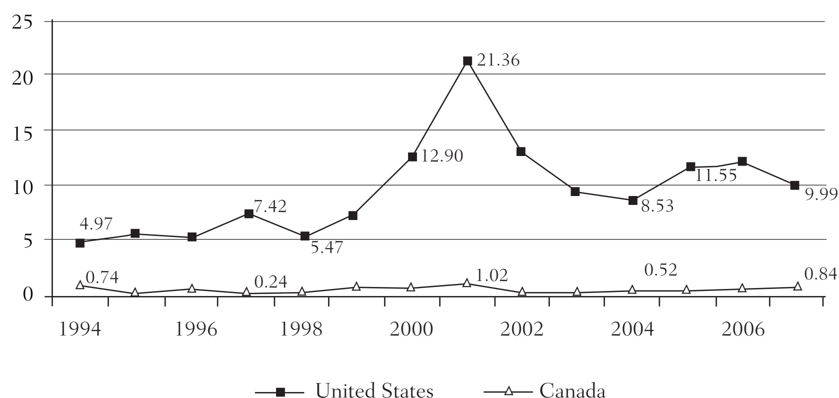
From a Slowing of the Productive Sector To an Open Recession

Low growth expectations confirm the contagion from the strictly financial sector to the real economy: that is, to output, employment, investments and consumption. For Mexico, contraction of sales in the United States has caused a drop in manufacturing production and exports, mainly in the auto industry. According to National Statistics and Geography Institute (INEGI) figures, industrial production has dropped 1.6 percent; manufactures, 2.1 percent; and construction, 1.9 percent. By the end of 2009, industry as a whole will be the most affected, with a drop of 3.82 percent.[7]

This contraction is even stronger in specific sectors like auto, which is highly dependent on the U.S. market, and to a lesser degree, on the Canadian market. The drop in demand for automobiles in the United States has already meant that by February, seven and a half months of temporary technical lock-outs and unspecified numbers of permanent lay-offs have accumulated in the strategic automobile clusters in Coahuila, Querétaro and Guanajuato where Chrysler, Ford and General Motors operate. To this string of work stoppages have to be added the massive lay-offs at the Volkswagen plant in Puebla and the Nissan plant.

In the face of overwhelming evidence, Bank of Mexico Governor Guillermo Ortiz had to recognize that the prospects

Graph 2
Foreign Direct Investment in Mexico 1994-2007
(billions of usd)



Source: Data from the Ministry of the Economy's Foreign Investment Office.

for Mexico in 2009 are "disheartening." He also accepted that the central bank's direct intervention in the foreign exchange and financial markets was due to "the financial tsunami that suddenly hit the emerging markets" that, in his opinion, had been the hope for the world market not going into a recession. In short, the Mexican economy is going through an economic deceleration with a GDP growth rate that is dropping from about 2 percent for 2008 to a probable average of minus 2 percent for 2009, signaling a profound recession in the country.

Oil Prices Drop and Public Finances Weaken

The decline of the world oil market linked to lower demand because of the international recession led to a drop in oil and gas prices, dragging down the price of Mexican crude, which in late November sank to US$34 a barrel. This price contrasts with the average US$70/barrel projected by the Mexican Congress when it passed its 2009 budget.

These zigzags in crude prices were usually reason for significant cutbacks in government revenue projections, forcing the government to cut expenditures and investments. However, the administration's anti-crisis policy called for the use of two fundamental tools to significantly diminish the impact on the budget of the drop in oil revenues.

The first one was Congress's authorization to finance deficit spending to the tune of 1.8 percent of GDP. This measure is quite a ways from the orthodox spending policy based on balancing the budget and zero deficits that predominated over the last 20 years. The second measure is the Finance Ministry buying fuel hedges to protect itself from future price drops below US$70. This assures a US$9.555 billion payout, complemented by the Mex$55-billion Oil Earnings Stabilization Fund.

Emergency Economic Plan In the Face of the Crisis

Given the impact of the crisis, the country's authorities have changed their economic strategy. President Calderón proposed a mildly Keynesian, anti-cyclical economic plan aimed at countering the effects of the international recession through government spending and investments. The Program to Foster Growth and Employment includes a series of structural and momentary measures aimed at responding to the recession.

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According to official estimates, the program would entail higher fuel subsidies, making financing available for priority sectors, and support for infrastructure projects for a total of Mex$255.3 billion, or about US$19 billion. The authorities said that the resources involved represent one percent of GDP.

In early January, authorities announced a second plan called the National Accord for Family Finances and Employment, specifically directed at saving jobs through 20-odd measures organized around five axes: support for employment, for family finances, competitiveness, small and medium-sized companies, and investment in infrastructure. In each of these categories, it puts forward actions to support temporary employment programs; a 10-percent reduction in the price of LP gas and electricity for industry; or to make 20 percent of government purchases from small and medium-sized companies and have Nacional Financiera and the Mexican Foreign Trade Bank (Bancomext) increase their number of loans by 20 percent.

Several sectors of the business community have criticized this second plan. The powerful Business Coordinating Council (CCE) stated that the amounts involved in the anticyclical plan are "minimum and deceptive," because, according to the Private Sector Studies Center, they barely represent 0.5 percent of GDP, while in other countries, 10 to 12 times the resources in relative terms have been used for this kind of plan.

Without underestimating the multiplication effect this amount of government spending will have on income and employment, some doubts have been raised about whether it is enough to reactivate the economy. One of the first criticisms of the plan involves the fact that the development banking system is not aiming to strengthen and finance small and medium-sized companies, but rather large corporations: government favorites like Cemex, with enormous debts acquired during their cycle of international expansion, and the Comercial Mexicana chain of grocery stores.

The scarcity and high cost of credit for companies at the hands of the commercial banking system is also a barrier for overcoming economic stagnation. Recent hikes in interest rates for consumer credit —on average, more than 70 percent a year— have once again brought up the question of the role of the foreign-controlled commercial banks. In effect, financing costs with active rates of over 20 percent a year confirm that the banking sector's performance does not favor investment in production, but that its business depends more on consumer credit, mortgages and the high unregulated commissions they charge for their services.

The vulnerability of the export-manufacturing model increases with the crumbling of the U.S. economy. This should lead to its reorientation based on endogenous growth sources like the domestic market itself.

President Calderón's plan suggests a timid transition from a neo-liberal policy to a different, Keynesian policy based on government spending and aggregate demand. This suggests that the conservative economists in charge of government strategy want to change the "script" without really sharing a Keynesian approach for fighting the crisis. Despite everything, they believe in price and exchange rate stability and "healthy finances" more than in growth and employment. They are suffering from chronic change-resistant fundamentalism.

The magnitude, scope and simultaneity of the crisis has thrown into relief just how urgent it is that the state and civil society organizations head up a renewed institutionality. This process will depend on the orientation governments opt for and society's ability to put forward public policies that are not limited to saving the big banks and the corporations, but that direct their efforts at rescuing the most vulnerable sectors of the population. VM

NOTES

[1] Masahiko Auki, Hyung-Ki Kim and Masahiro Okuno-Fujiwara, *El papel del gobierno en el desarrollo económico del Asia Oriental. Análisis institucional comparado* (Mexico City: Fondo de Cultura Económica, 2000).

[2] *El Economista* (Mexico City), January 22, 2009, p. 13.

[3] Héctor Guillén, *La contrarrevolución neoliberal en México* (Mexico City: Era, 1997).

[4] Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, N.J.: Princeton University Press, 1990).

[5] OCDE, *Panorama Económico* (Mexico City), November 24, 2008.

[6] Banco de México, "Saldos y flujos de activos internacionales al 30 de enero de 2009," http://www.banxico.org.mx.

[7] "Estimaciones Grupo Financiero IXE," *El Economista* (Mexico City), January 5, 2009.