MEXICO REINVENTS ITSELF

Even though its economic outlook is improving, Mexico still needs to make changes if it is to achieve sustainable growth.

Not long ago Mexico was the largest economy in Latin America, celebrating a return to full democracy after 71 years of Institutional Revolutionary Party (PRI) governance, and opening up the economy through the North American Free Trade Agreement (NAFTA), which increased trade with the United States and Canada from US$50 billion in 1994 to US$700 billion in 2011.

However, when China joined the World Trade Organization in 2001, Mexico lost U.S. markets and investment. Meanwhile, Brazil has benefited from high demand and prices for its commodities and the growth of its middle class has stimulated domestic demand. As a result, in 2011, Brazil reached twice the Mexican GDP, becoming the sixth largest economy in the world. It has also gained international influence by forming partnerships with other large emerging markets, the BRICS (Brazil, Russia, India, China, and South Africa).

But fortunes may be changing again. Today Brazil faces uncertainties about Chinese purchasing strength and its domestic economy is faltering. Meanwhile Mexico’s economic outlook is improving. Last year, Mexico’s GDP grew 3.9% compared to Brazil’s 2.7%. This year the Mexican economy is again expected to grow more (3.43%) than the Brazilian (3.22%). “The recovery of the U.S. economy and higher international oil prices are favorable factors for Mexico,” says Lia Valls, coordinator, Center for the Study of the External Sector, Brazilian Institute of Economics (IBRE).

Manuel Molano, director general, Mexican Institute for Competitiveness (Imco), adds, “There’s always a growth rebound after a major recession.” He notes that Mexico’s GDP fell by 6.2% of GDP in 2009 after the financial crisis in the United States, the destination for 80% of Mexico’s exports. Contributing to today’s rebound, says economist Renato Baumann, University of Brasilia, is that “Mexico has sought to expand its markets and now has 14 commercial treaties, a commendable effort.” But, he notes,
further growth will still depend on the performance of the U.S. economy.

**Changes**

To confront Chinese competition, Mexico had to make changes in its production base; the results have been positive. “The loss of labor-intensive maquiladora industries to China made us look for sectors with higher added value,” Imco’s Molano observes. The result was the creation of extended supply chains, as in the car parts chain that today supplies the auto industry, which in 2011 exported 2.1 million vehicles. “We gained market share with world-class products, not protectionism or local content rules,” Molano says, underlining the difference between Mexican and Brazilian industrial strategies. (Recently the Brazilian government put pressure on Mexico to limit its car exports to protect the ailing Brazilian car industry.)

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Mexico is moving fast to expand other sectors of the economy, Molano goes on: “While Mexico’s oil sector recorded a 6% increase between 1993 and 2011, its manufacturing sector grew 58%.” However, this was not enough to get Mexico’s trade balance back in the black. Even though the winds are changing, Mexicans are aware that their economic growth rate is still far from ideal. Any open economy is vulnerable to external shocks—Mexico’s international trade is about 60% of GDP—but that is not the main concern. Molano diagnoses the problem as “an incomplete transition to a market economy.” He believes the lack of political power of the National Action Party (PAN) administrations has prevented major reforms. “Today,” he says, “most modern industries have to pay toll to the old establishment, such as maintaining large public and private monopolies and property rights practices, among others, that stifle the economy and increase production costs.”

Even after speeding up the volume of its trade with the rest of the world for more than 30 years, Mexico still has the same share of global GDP. Hector Aguilar Camin, Mexican journalist, writer, and historian, asserts that the main challenge for the next president, to be elected in July, will be to escape what he calls the middle-income trap. In the prologue of his book, Future for All, which he presented to the presidential candidates in April, he wrote:

“Countries that have fallen into that trap have wages too high to be competitive in basic manufacturing associated with cheap labor, but at the same time they do not have the technological capabilities, human capital, and institutions necessary to produce more sophisticated products and compete with more advanced countries. That is, [they are] unable to
move from growth driven by commodities to one stimulated by competitiveness and productivity.”

**Problems**

José Gerardo Traslosheros Hernandez, Mexico’s consul general in São Paulo, believes that some of the weaknesses that affect Mexican competitiveness are also common in Brazil. Poor infrastructure, lack of skilled labor, a shortage of engineers, and the high price of electricity are among the issues that both countries have to address. But there are also contrasts. One is tax revenues, which in Mexico are among the lowest in the region. Not only do tax revenues there not even reach 20% of GDP, they are also heavily dependent on the tax payments of the state oil company, Pemex. Tax reform would improve fiscal management and would be an effective tool against corruption: Today, with low tax revenue and guaranteed federal transfers, local governments are not accountable and are not motivated to spend efficiently.

Businesses would also like to see more flexible labor laws and more access to credit. Both could help to reduce the informal economy, which exceeds 30% of GDP, and help mitigate such long-term problems as drug trafficking and the accompanying violence: In 2010 the 25,000 homicides in Mexico were double the number in 2003. “Studies estimate that drug trafficking carries an economic loss for the country of 3% to 10% of GDP,” says Alejandro Fonseca, professor, Egade Business School in Monterrey. Eight years ago Monterrey city was considered safe and was a pole of attraction for business; today it is recording an exodus of entrepreneurs. “The security issue is still really sensitive,” says Marcelo Ciasca, CEO for Latin America of Stefannini, a Brazilian information technology company. Ciasca, who has been working in Mexico City for eight years, nevertheless recognizes Mexico’s enormous business potential, noting that “Over the past three years, our company has grown at annual rates of 50%.”

Imco’s Molano believes it will be crucial that the next president put in place a consistent reform agenda. “Before 1970 we had already experienced a period [of high growth like] the BRICS, with growth rates that reached 9%, but we did not know how to spend the accumulated wealth: we invested poorly, and did not liberalize [the economy] as we should have.” He would like to see Mexico take the route Korea took: increase total factor productivity, savings rates, and investment—and, of course, open the economy. “Today Korea is richer and has a trade balance of 98% of GDP,” he points out. “In other words, openness helps the economy, and protectionism condemns it.”