Poverty in Mexico.
James Cypher

With the current debate in the public forum (and in the streets) over free trade policy, and the rhetoric generated about whether free trade violates "human rights," or works to the benefit of multinationals, I thought it would be instructive to get to the issue that underlies these arguments. That issue is whether or not the economic problems of developing countries are, in fact, the result of the predations of multinational corporations and the self-serving policies of the U.S. government, or whether these problems have internal causes. This is really the kernel of the issue, as free-trade opponents hold that the terms of trade *themselves* impoverish the United States' less developed trading partners. They see the world as a zero-sum game, with any increase in wealth to the United States coming at the expense of someone else. To reduce it further: because I spend money on a steak dinner, some kid in Honduras goes without breakfast.

This isn't a new set of ideas. The premise that developing countries have kept developing countries in poverty was outlined by neo-Marxist theorists in the 1960s as "dependency theory." This caught on in a big way with intellectuals in Latin America (the *dependentistas*), who echoed the charge that "capital" in the U.S. and Europe deliberately exploited Latin American labor and cheap resources, and trapped them in a cycle of poverty. While it is true that the U.S. has depended on Latin America for cheap commodity imports, these export earnings represented an *opportunity* for Latin America as much as a trap. Those earnings were appropriated, misallocated, and badly invested by the oligarchies and state bureaucracies running (and ruining) Latin American economies for most of this century. The influence or presence of multinational corporations, or the underlying terms of trade, had little to do with it.

Since I've been studying Mexico's recent history, I'd like to share some of the *internal* factors that explain Mexico's poverty over the last few decades. What the historical record shows is that Mexico's problems are largely self-inflicted, and political in nature. This not a surprise to anyone who has been studying Latin American development in the twentieth century. In fact, dependency theory has largely been replaced by development theories that are more economically informed and less dogmatic. Here is my short summary of Mexico's development problems, as an illustration of how state-domination of the economy, and NOT the influence of multinational corporations, has impoverished this resource-rich country.

The modern Mexican political system was formed period following the Mexican revolution when the men who were alive during the years of the Revolution consolidated the central government around a constitution and program based on a consensus of "revolutionary" values. In the 1920s and 1930s, this consensus became centralized in the Party - the PRM and later the PRI - and the office of the president. These were the formative years of the state-run, protectionist model of economic development that the country would pursue for the remainder of the century. This model of authoritarian government and state control of the economy is largely responsible for the character of the country's economic development, and for its deficiencies.

Protectionism and state-directed development in Mexico had the same results that protectionism had for the U.S. in the late 1920s - it discouraged competition, and made protected industries dependent on state subsidies. State subsidies, by the way, are ultimately paid for by *someone* in society: free goods for some mean slave labor for others. Ironically, "revolutionary" or populist economic policies produced unintended effects on the welfare of Mexico's popular groups, including both rural and urban laborers, eroding their wages through economic stagnation and inflation. These policies discouraged private investment, encouraged "capital flight," and fostered a "rent-seeking" ethos within the state bureaucracy. Rent-seeking being an acceptance of the idea that state service is an opportunity for self-enrichment.

Mexican presidents used their control over economic policy to do two things: promote economic growth, and distribute the resulting jobs and wealth among important constituencies. In this way, the government sought to include politically relevant sectors of society in the national growth agenda through distribution of economic benefits or by subsidizing basic services and commodities. The government nationalized strategic industries and utilities, subsidized food production and industrial inputs, and used land reform to placate the rural population when food subsidies worked to their disadvantage. Finally, in response to the growing power of the private sector, the government incorporated the heads of industry into the state-capitalist project - adding one more powerful interest group to the consensus in the process.

The state sector has grown throughout the century through public works projects, the nationalization of land, the nationalization of subsurface mineral and oil wealth and of the foreign-owned oil companies, agrarian reform, and the creation of "parastatal" companies. This represented a fulfillment of Lazaro Cárdenas's economic vision for the state as guarantor of the welfare of popular groups. Power and influence over economic policy that supposedly resided with Mexico's popular sectors actually resided with the Party, which acted as regulator of the economy as a logical extension of its role as protector of the interests of these sectors of society.

As in other state-dominated or party-dominated systems, the people whose interests were best "protected" were those who were politically well-connected. This meant that powerful industrialists, labor union leaders, and members of the state bureaucracy had influence and access to public funds for personal enrichment. This ethos was not just a matter of corruption, but a logical and natural extension of the undisciplined pursuit of short-term political goals at the expense of long-term economic policies. James Cypher,

an economist at Cal State University, and author of *State and Capital in Mexico*, discusses the rentier mentality at length in his book, and I will quote a short excerpt:
Rentier interests lived in the world of the short run and within the confines of the sphere of money and commercial capital. The question of technology, capital-labor ratios, social rates of return, long-term investment strategies of the parastatals, control of capital flight, and so on were beyond the interests and capabilities of the balance-sheet mentality of rentier policymakers... (James Cypher, *State and Capital in Mexico - Development Policy since 1940*, (Boulder: Westview Press, 1990) 67)

As with other experiments in state-run economic policy, Mexico's internal-development model could be sustained only for a limited time. It became unsustainable when the pressures from popular sectors and industry for continued subsidies kept subsidies and state protection in place long after they should have been phased out. This is a political problem, but to the extent that state-directed development models are inherently political, it is also a theoretical problem. The absence of market pressures meant that there was no incentive to match investment policy to return on equity: exactly the kind of discipline that shareholders impose on management of public corporations in order to maximize the use of their capital. In Mexico the "shareholder" was the state, and the state's monopoly power ensured that prices for domestic finished goods would remain high and the cost of inputs for those industries would remain low. The result was high real cost of production and low return on capital, masked by state-subsidized inputs, tax incentives, and price controls. Whatever their deficiencies for social policy, market-based economies do a better job of allocating resources efficiently than do command economies. Through the politicization of its economic model, Mexico attempted deliberately to avoid the discipline inherent in capitalism, and - in the words of one historian - sought a "release from the 'natural' forces of the marketplace." (Frank Brandenburg, *The Making of Modern Mexico*, (Englewood Cliffs, New Jersey: Prentice-Hall, 1964) 211

This was largely a reflection of political problems, as the Party and the presidency became increasingly reactive to political events from about the mid-1960s to the mid-1970s. Consequently, economic planning became politicized to the extent that economic policy became irrational. Rational economic policy avoids extremes that produce ironic consequences - those which impoverish the very people they were designed to protect. Mexico's economic policy became ironic not only in theory, but in implementation as the state borrowed money and invested it in subsidies to the parastatal sector, or used it to directly subsidize income and consumption. This was precisely what Louis Escheverría's Treasury Secretary, Ortiz Mena, had proposed he would *not* do with borrowed funds, but economic planning was overcome by political pressures.

Politicization of an increasing portion of the economy resulted in wage increases that surpassed productivity, and when economic growth began to slow, popular pressure for wages did not decrease. Consequently, Mexico's parastatal sector became a drain on public resources, rather than a contributor. Rather than cut back on public investment or public employment, both the Escheverría and López Portillo administrations increased it. In the nearly two decades between Escheverría's economic program, begun in 1970, and the end of Miguel de al Madrid's presidency in 1988, the number of state enterprises increased from 180 to 1,155, and the number of public sector employees doubled from 1 million to 2.2 million. (Peter S Cleaves and Charles J. Stephens, " Businessmen and Economic Policy in Mexico," *Latin American Research Review*, Vol. 26, No. 2, 1991, 188) Public spending grew from 20 percent of GNP in 1970 to 50 percent in 1986. Mexico's foreign debt, which financed public sector growth during this period, ballooned from 4.5 billion dollars to 104 billion dollars. The result was that by 1988, 70 percent of the country's savings were "being employed either to service debt or to subsidize state industries." (Peter S. Cleaves and Charles J. Stephens, 89) Although it bought a respite from political unrest, the result was disastrous in the longer term, as these populist policies subordinated "the up-to-then extremely successful economic policy to short-term political gain - with foreign bankers an oil revenue financing the whole scheme." (Luis Rubio and Roberto Blum, *Mexico's Dilemma: the Political Origins of Economic Crisis*, (Boulder: Westview Press, 1984) 181)

In the period between 1970 and 1982, the expansion of the public sector, the increase in government spending, the de-linking of monetary and fiscal policy, and the increase in foreign indebtedness created a slowly-building financial crisis. This crisis eroded the real wages of working Mexicans, undermined the value of the currency, and led to recession. As Mexico's economic crisis worsened, the government ran out of options for continuing to finance its commitments to the public and popular sectors. On February 18, 1982, in spite of public reassurances from departing president López Portillo, the *Banco de Mexico* abandoned its support of the peso and the peso suffered a devaluation "of monstrous proportions, but in order of magnitude similar to what Mexico's terms of trade imbalance required." (Luis Rubio and Roberto Blum, 223) This forced the incoming Miguel de la Madrid administration to impose an austerity program to bring down wages and public spending, and stabilize Mexico's debt.

President Salinas de Gortari, who followed Miguel de la Madrid, continued Miguel de la Madrid's privatization initiatives and redirected the focus of development away from import substitution toward export-oriented economy that challenged Mexican industry to compete internationally. (Luis Rubio and Roberto Blum, 189) Although referred to simply as "orthodox," these types of policies went hand-in-hand with fiscal and monetary policies that are rational in that they are sustainable. Not only was public spending reduced to more closely match government revenues, but state enterprises were privatized to make them more economically functional. I am afraid that this return to orthodoxy should not be taken at face value as a wholesale adoption of liberal economics, and certainly not as a return to the Porfirian model of oligarchic capitalism, or as some slavish concession to multinational corporate pressure.

The change from statism to orthodoxy has come from a realization by the government itself of the unsustainability of its own economic model. Although the state acknowledged that the private sector has a more important role to play in the private-public partnership than it has been given in the past, the state still sets the parameters for economic development. In fact, since the government remained firmly in control of economic policy, the move toward privatization and relaxed trade restrictions represented the continued use of the private sector as a tool for public policy, only with a renewed emphasis on private enterprise as the engine of growth. As one Monterrey businessman put it:

The state has favored the interests of the private sector, not because the private sector has forced them to pursue this goal, but because the interests of the private sector happen to correspond with the interests of the state. (Peter Cleaves and Charles J. Stevens, "Businessmen and Economic Policy in Mexico," *Latin American Research Review*, Vol. 26, No. 2, 1991, 191)

This source supports my own belief that Mexico's government has undergone less of a revolution than a change in its mode of operation. It retains its authority to arbitrate between political sectors, and that leaves open the option of using economic policy to manage political conflict, just as it has in the past.

As in South American countries, populist economic measures in Mexico proved unsustainable, and led to the financial crisis and loss of legitimacy of the ruling party. Unlike South American countries, Mexico did not succumb to a military dictatorship, but instead has made its authoritarian model more inclusive, in an outward attempt to become more democratic. Its approach to economic policy has become more orthodox. In the aftermath of the debt crisis of the 1980s, presidents Miguel de la Madrid, Salinas de Gortari and Ernesto Zedillo shifted the focus of economic development away from the public or "parastatal" sector, and toward the private sector. They have allowed rival parties to challenge the PRI, and to win PRI-held public offices. With the turn of the century, it is interesting to speculate whether the reforms of the 1980s have produced a fundamental change in Mexico's political and economic model, or if the inclusionary-authoritarian style of politics will persist.

(Note: Excuse the embedded footnotes. This is an HTML document, and it lost the endnotes in conversion from Word.)