MEXICO'S ECONOMIC FUTURE

Robert E. Looney

Introduction

Mexico's recent oil discoveries together with expanded production levels of hydrocarbons have and will continue to have several important impacts on Mexico: (1) it has provided the country with the means to fundamentally change the status quo between itself and the United States; (2) Mexico's economic power was suddenly increased, but its vulnerability also rapidly increased as the government became accustomed to a larger source of revenues; (3) the interdependence between the government, the private sector and various groups within the country became more unstable in both the political and economic senses as frictions developed between these groups, and (4) because of (1) through (3), the government sought a development strategy that would enable it to achieve a viable interdependence between internal groups and between itself and the United States.

Several possible strategies were both logical and feasible:

1. a rapid increase in the production of crude oil;
2. expanded crude oil production, but based largely on domestic needs;
3. a policy of diversified industrialization;
4. a policy mix consisting of moderate industrialization and development of service sectors - government employment, and
5. a high growth strategy of petroleum based industrialization combined with high and steady levels of oil exports.

Each of these strategies has certain advantages and disadvantages. Clearly, the strategy of expanding the production and export of crude would increase revenues; but at the same time it would also increase the country's external vulnerability and risk, increasing internal friction between the government and various conservationist-nationalistic groups. Likewise, a stabilization of output levels for domestic needs and supplemental foreign exchange earnings would minimize dislocations and inflationary pressures, but would not permit the government to address the country's growing unemployment problem.

Ultimately, of course, the country adopted the Industrial Development Plan with its orientation towards some sort of viable interdependencies between the U.S. and Mexico together with its implicit compromise between nationalistic and high growth oriented domestic groups. Viable interdependence whereby domestic investment of oil revenues in heavy industries (made possible by high levels of export) was seen as the best means of achieving some sort of balance between efficiency and vulnerability.[2] Through government investment of oil revenues, the authorities sought structural change capable of: (1) increasing the ability of the country to utilize more of its oil and gas resources domestically (so that the country's dependence on hydrocarbon exports could be curtailed; (2) increasing the country's ability to produce the trade products derived from hydrocarbons; (3) enabling the country to trade and bargain on relatively equal technological and economic ground, and (4) making the country less vulnerable to the effects of severe market fluctuations or sudden changes in the politics and trade policies of the U.S. and other developed countries.

United States-Mexican Relations

The forecasts in the previous chapter have a number of implications for the United States. U.S. energy difficulties have more or less coincided with: (1) the large oil discoveries in Mexico, (2) sharply rising Mexican exports of other products, e.g. agricultural items to the United States, and (3) an awareness that approximately six million Mexicans are living in the United States, many of them illegally.

It is clear from the forecasts and in light of (2) and (3) above that the scope for Mexican discretionary action in oil production and export rates is rather limited, particularly in terms of the recent fall in oil prices. The forecasts indicate that it will take increases in crude oil production rates of at least 10 percent per annum through the 1980s and into the 1990s if Mexico is to create the number of jobs sufficient to reduce and eventually eliminate the need for Mexicans to migrate to the United States in search of work.

Mutual interest over the long term is thus likely to bring an increase of pragmatism in Mexican/U.S. relations with an eventual reduction in dogmatism on the Mexican side, though this will presumably be provided by the politicians as long as their domestic audiences require it.

Present Mexican policy appears committed to maintain existing Mexican markets in the United States and open up new ones. Faced with the benefits of this increased exchange in terms of industrial and agricultural employment, any future Mexican government would have to consider carefully the implications of embarking on policies which might prove damaging to U.S. interests.

As oil wealth brings average Mexican income levels closer to those of the United States, pressures to migrate from Mexico to the United

States should lessen. By that time the Mexican American community in the United States will have become that much larger, wealthier, more respected and a more permanent feature of U.S. life. These tendencies cannot but more closely link the two countries and increase their mutual interests.

However, despite movements towards closer identity of interests, it would be erroneous for Americans to believe that increased wealth will make the Mexicans more "reasonable." They will continue to wish to preserve and develop their own very distinct traditions and institutions, many of which they consider superior to those of the United States.

Potential Development Problems

While the Mexican Industrial Development Plan envisions a growth in gross domestic product of ten percent between 1978 and 1980, it is still true that:

1. the country is becoming more and more dependent on oil exports and in the impact of these oil revenues on the domestic economy;

2. the strategy is largely a resource based, capital intensive process of industrialization, with agriculture playing a largely passive role of maintaining structural balance, and the non-economic one of insuring some level of food self-reliance;

3. the strategy requires careful preplanning and identification of profitable investments (particularly since the break with past patterns of growth has been so radical);

4. the stragegy has been deficient in assessing realistically the manpower and education requirements of such industries;

5. little attention has been given to the identification of operational means of shifting from essentially an import substitution development strategy to one more viable in terms of the country's comparative advantage.

There are several problems that are potentially serious enough to warrant government action. It is difficult to prioritize these difficulties in terms of relative importance for concern. A tentative ranking based on factors discussed in the previous chapters would be: (1) a worsening of the world food situation; (2) deterioration of the income distribution; (3) sector uncertainty as to the role of the government in the economy, and (4) those problems requiring reforms in planning procedures.

These factors are capable of creating a number of potential problems which if left unattended could undermine the country's whole development effort.

Worsening of the World Food Situation

The world food situation will continue to deteriorate over the next 20 years as population pressures begin to make themselves felt and the amount of usable land per capita declines.[3] While existing technology should be able to offset this trend, the inability of many developing countries to implement productivity increases (largely because of political reasons) will mean lagging output. The result will be increases in scarcity, food, even if available, will sell for much higher prices causing Mexico's balance of payments to deteriorate drastically.

Agriculture is surely the weak link in any chain of integrated development policies in Mexico. The Industrial Development Plan itself points out that a doubling of public investment in the sector between 1977 and 1982 will barely arrest the decline in agricultural output, and if that output grows no faster than the 3 percent minimum rate projected in the plan, food imports will require 21 percent of petroleum export revenues in 1982 and 54 percent in 1990[4].

Facing increased food imports and declining agricultural growth, Mexico can pursue one of two options. It can finance necessary food imports out of export revenues and take a chance that the world food situation will not deteriorate, or it can redirect food crop production and processing to better serve domestic needs. The first path leads to increased food dependency and the second to increased food self-reliance. Both paths will influence the long term structure of the Mexican economy and its comparative advantage in the world market.

In a major effort at modeling the overall Mexican agricultural sector, Goreoux and Manne[5] identify the slow growth of demand (domestic and export) and a serious constraint of agricultural growth contributing to low rural incomes and adverse changes in the agricultural terms of trade. Rural incomes could be increased by higher support process, administered by Conasupo, at the cost of the welfare of the consumers and growing food stockpiles, unless Conasupo also subsidized domestic sales which it does. Such funding is not offset by tax revenues. It would, however, contribute to inflation. Oil as a source of foreign exchange offers the option, but increased dependence and vulnerability toward price movements.[6]

Given the possibility of a dismal worldwide agriculture performance and the seriousness of the problem, several more direct actions should be undertaken. These include:[7]

1. improving the productivity of traditional agriculture. This will require a much higher level of support services and easier access to financial aid. Policies along these lines could substantially increase the production of corn and beans in the higher rainfall areas (where most of the traditional agriculture is located),

2. bringing more land under cultivation, particularly in the southeast which possesses water resources but is under populated, and

3. improving transportation.

The government appears to be moving in these directions. In April 1980, it announced a whole series of new measures directed towards the improvement of agriculture within the context of the Plan Global de Desarrollo 1980-82 and under the Mexican Food System. Some of the measures included under these plans are:[8]

1. encouragement of producers' cooperatives for the sale of produce and the purchasing of materials;
2. increases in research and development directed toward rain dependent agriculture;
3. improvement of water resources infrastructure in rain dependent areas;
4. concentration of cattle breeding in order to bring more grazing land under cultivation;
5. promotion of colonization of new agricultural areas, and
6. improved credit and insurance facilities for producers of essential commodities.

These measures seem long overdue. They are in a large part directed towards areas where rainfall is adequate, where the poorest traditional farmers work the land, and to regions to be opened up for futher development.

These measures are designed to raise the rate of growth of agricultural production to 4.1 percent in real terms by 1982 (at which point self-sufficiency in maize and beans would be assured). Self-sufficiency in rice, wheat, sesame, soybeans and sorghum is sought by 1985.

To achieve these objectives, it is planned to increase government investment connected with agriculture over 20 percent per annum in real terms during the period. The total expenditure earmarked for agricultural development in 1980 as a result of these plans approaches U.S. $6 billion. This compares with a total investment in the sector of around U.S. $1 billion in the mid-1970s.[9]

Despite the encouraging directions of these changes, considerable organizational difficulties are developing, not the least of which is corruption at the local level and mistrust of administrators of the program by the traditional farming community. Despite these reservations, a significant increase in the resources reaching the farmers is to be expected and with this, corresponding increases in output and productivity should come, if not by the target dates, at least by 1990.

Deterioration in Income Distribution

There is evidence that in Mexico (as with many other developing countries) rapid growth is resulting in a worsening of the already highly unequal distribution of income.[10] Unless action is taken soon, the deterioration may become even more severe in the 1980s as industrialization speeds up. As is typically the case in countries at this stage of development, gaps are appearing between various income groups and regions in the country as well as between the country's urban and rural population.[11]

The main problems preventing a better distribution of wealth appear to be:

1. inability of the rural sector to generate sufficient wealth for its population, and
2. excessive concentration of population in the largest cities making it difficult to provide adequate levels of services and to satisfy aspirations, particularly of the lowest earning categories.

Whether these shortcomings are likely to be solved by the implementation of the government's policy in relation to urban and industrial development of the government's policy in relation to urban and industrial development (which aims at spreading growth more evenly round the country) is certainly problematical. Other moves such as the Mexican Food System and the intention to provide a higher proportion of agricultural workers with regular wages appear more promising, at least in the near term.

There is no reason why a conflict between equity and efficienty has to arise[12] even though in its eagerness to promote growth the government has tended to allocate oil revenues to capital intensive industrial development capable of creating (at least directly) only a limited number of jobs. These investments have prevailed at the expense of more potentially labor intensive investments located in the more populus areas. While it is clear that it is highly inefficient to completely counter the forces of economic efficiency solely on the basis of social efficiency criteria, it is clear in light of the Iranian experience that a balance must soon be struck on both human and political grounds so as to prevent a disruption of the social fabric.

In this regard Mexico is somewhat fortunate that by developing at a later point in time Mexico can avoid many of these mistakes made by Iran. There is no question that a major lesson to be learned from Iran's development strategy is that even though the level of income for most of the population may be increasing fairly rapidly, discontent is likely to arise if the gap between regions or urban/rural or even particular groups continues to widen.[13] Adverse income distributional patterns of this sort ordinarily will not cause a problem if corrected fairly early. Increasing income disparity can, however, cause mass alienation as in the case of Iran. This is most likely to occur during periods such as the present when expectations of future living standards are accelerating (because of the knowledge of and the accumulation of that wealth in relatively few hands).

Income distribution considerations translate themselves into the setting of targets to minimize the urban/rural income gap and the achievment of better interregional balances. Investments along these lines can be easily justified given the potential social strains associated with the kingdom's present strategy. This conclusion holds even though the resulting investment pattern might reduce the country's overall economic growth potential.

Role of the Government

In order to implement efficiently its long run development strategy, it will be necessary for the authorities to define more precisely than they have so far the role of government in the economy. To be sure, the existence of a large influx of oil based revenues implies an increasing role for the public sector. On the other hand, it is not clear what will happen when the oil revenues level off (perhaps as early as 1990). Unless there is some sort of tax reform, the role of the public sector may have to decrease rapidly relative to that of the private sector.

The forecasts of the previous chapter indicate, however, that the private sector may not be in a position to generate the type of demand needed to maintain the growth rates capable of being attained in the country. This is particularly true of private investment whose rate of growth was positively affected by government investment in the forecasts.

In principle, therefore, while the government's intention of encouraging the private sector to assume wide responsibility for production is a wise one, given the inefficiencies usually associated with public sector involvement, reduction of goverment activities should not proceed too rapidly. There is a real risk of deflation if the government contracts its investment too rapidly. This problem is reinforced by the apparent accelerator mechanism underlying private investments, i.e. a reduction in the rate of growth would have a compound contracting effect on private investment.

While it is clear, therefore, that the government's overall industrial development strategy is a sound way of spending the oil revenues, this strategy must eventually rest on the abilities and dynamism of the priviate sector. The government must, therefore, clearly convey to the private sector that its continued activity in the economy is necessary for stabilization purposes. Otherwise, there may be a number of misunderstandings over the true scope of the government's economic involvement that would cause the private sector to be even more reluctant than it has been at times in the past when uncertainty over its role was present to undertake investments in manufacturing.

In any case the government should have little trouble in finding areas to spend money in directing the path of the economy toward the creation of a normal balance with the private sector. These include:

1. Investing in health and education necessary to maintain and increase the human element in the development process (while at the same time contributing to improvements in labor and managerial quality).

2. Participating initially in heavy industries where the private sector may be reluctant to venture.

3. Subsidizing regional investments in backward areas to mold the future spatial configuration of population and economic activity in a manner more compatible with existing socio-cultural factors.

Planning Reforms

There is a great need to revise the country's system of planning[14] in order to fill the current gap in decision making that exists not only between the various ministries in Mexico City, but also between the decision makers in the capital and those in the provinces. Again, the Iranian experience illustrates the ramifications of over-centralized decision making. Thus, qualified individuals at the regional and city level presumably well acquainted with local problems must be drawn·into the decision making process to an extent much greater than has been the case in the past.

The major institutional problems in this area which need to be examined by the authorities include: (1) the scope and capability of the planning system; (2) the implementation of decentralization policies involving decisions designed to increase participation of more individuals in the development process, and (3) the necessity of administrative reforms.

In view of the very high goals set for Mexico's social and economic system over the longer term, and the pressures associated with reaching these goals, it is clear that not only private sector efficiency, but also increases in public sector efficiency are of paramount importance. Despite some recent reforms along these lines, the country's overly bureaucratic planning procedures must be streamlined in order to reduce the time delays involved in project identification and the subsequent awarding of contracts. Reforms should also help reduce the duplication of effort and the numerous cost overruns that currently characterize the Mexican development effort. Better coordination of expenditure plans between ministries would also help (through stricter budgetary control) to reduce inflationary pressures.

The question of reforming the public administrative apparatus is an efficiency question which needs to be examined on a longer term basis. Eliminating red tape is important as a complementary factor in the strategy of development outlined above, especially with respect to creating private sector enthusiam and dynamism. Within the public sector, there should also be a reform in the incentive system for public employees. If the government is forced to increase its scope in the economy of activity due to the natural conservatism of the private sector, then it must be able to attract and retain highly qualified managers. Clearly, for the government to expand its capability in the economy, it must revise its incentive system to reward individuals more on the basis of ability and performance.

Conclusions

Based on the above considerations and recent trends in the economy and taking into account the experience of other oil exporting countries, it is likely that:[15]

1. Despite recent political difficulties with the United States, Mexico will increase its crude oil and natural gas exports to this country as the most readily accessible market. The ease of making delivery and the high costs of processing gas and shipping oil to other markets will make contractural agreements mutually attractive, and balance of payments considerations will also encourage exports

to the United States. The Mexican government's desire to eliminate the vestiges of the 1976 crisis and the evident expansionist leadership of PEMEX reinforce a tendency to accelerate petroleum production despite lingering efforts by some groups to return to a conservationist policy.

2. Unless measures are taken, the increased foreign exchange flow into Mexico will continue to create strong inflationary pressures. Although Mexican economists are well aware of the problem, the experience of other oil exporting countries in handling such difficulties has been been particularly encouraging.

Leopoldo Solis, subdirector general of the Banco de Mexico, has noted:[16]

> Two dilemmas are apparent. Firstly, the petroleum income has a huge inflationary potential, which would jeopardize Mexico's import substitution policy and the creation of jobs through it. Therefore, aggregate demand should be tempered by controlling PEMEX's expenditures. And, since not all of the petroleum income may be spent, because of its inflationary pressure, it will be necessary to increase the price of oil and derivatives sold domestically to complement this frozen income.
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> The second dilemma also proceeds from the inflationary pressure of petroleum income which would cause a deterioration of the exchange rate of the Mexican peso. This, in turn, would reflect unfavorably on Mexico's import substitution policy, its capa-capacity to export, and therefore diversify production and employment. The example of Iran is evident: petroleum has provoked a decline in the production of Persian carpets, which require a large amount of labor and a favorable exchange rate.

While overall Mexico's economic future seems assured, the Iranian experience has demonstrated how fragile oil-based economies really are. A charting of the country's likely growth path is quite pretentious and should only be done in the context of the caveats discussed above (plus, of course, all the political, social and military ones so often seen in the popular press).

FOOTNOTES

1. Cf. Pablo Gonzalez Casanova, "Mexico, The Most Probable Course of Development," Latin American Perspectives (Winter 1982), pp. 78-88.

2. A model along these lines is developed in Elias Tuma, "Strategic Resources and Viable Interdependence: The Case of Middle Eastern Oil," The Middle East Journal (Summer 1979), pp. 269-287.

3. Radha Sinha, "The World Food Problem: Concensus and Conflict," World Development (May-June 1977), pp. 371-382.

4. Arthur Silvers and Pierre Crossin, Rural Development and Urban-bound Migration in Mexico (Washington: Resources for the Future), pp. 53-54.

5. J. H. Duloy and R.D. Norton, "CHAC Results: Economic Alternatives for Mexican Agriculture," in L. M. Gorcux and A. S. Manne, Multilevel Planning: Case Studies in Mexico (New York: North Holland, 1973).

6. Sam LanFranco, "Mexican Oil, Export-led Development and Agricultural Neglect," Journal of Economic Development (1981), p. 138.

7. Along similar lines see Carlos Benito, "Policies for Food Production and Consumption in Underdevelopment: The Case of Mexico," Journal of Policy Modeling (1979), pp. 383-398.

8. "SAM, The Beginnings of Strategy," Comercio exterior de Mexico (July 1980), pp. 243-249.

9. Ibid., p. 248.

10. Salvatore Bizzarro, "Mexico's Poor," Current History (November 1981), pp. 370-373.

11. John Bailey, "Agrarian Reform in Mexico," Current History (November 1981), pp. 357-360.

12. See Montek Ahluwalia and Hollis B. Chenery, "A Model of Distribution and Growth," in H. Chenery, Redistribution with Growth (London: Oxford University Press, 1974), pp. 209-235, for a proof of this proposition.

13. Robert Looney, Economic Origins of the Iranian Revolution (New York: Pergamon Press, 1982), Ch. 14.

14. Given Lopez Portillo's background, a number of constructive administrative reforms have been carried out since 1976. The scope of the problem is summarized in: "Improving the Planning Process: An Imperative for Mexico at this Time," Comercio exterior de Mexico (May 1978), pp. 191-196.

15. Cf. James Street, "Prospects for Mexico's Industrial Development Plan in the 1980s," Texas Business Review (May-June 1980), p. 129.

16. Leopoldo Solis, "The Petroleum Boom in Mexico: An Opportunity for Correcting the Pattern of Economic Development," Paper Presented at the North American Economic Studies Association Meetings, Mexico City, December 28, 1978, p. 1.