

Mexico: The Cost of Outdated Nationalism

Sidney Weintraub

The subject that most caught my attention on a recent visit to Mexico was the high cost that Mexico is paying for its inability to adapt aspects of its nationalism to the current situation. The particular issue that brought on this reaction was the inability of the Fox administration, and the Zedillo administration before it, to alter the ingrained conviction that oil, natural gas, and energy production must be state-owned with little private-enterprise involvement, whether domestic or foreign. Mexico now imports natural gas, whereas there is solid evidence that, with the proper investment, the country could be self-sufficient, and also bring in rather than spend foreign exchange for this product. Electricity generation is almost exclusively in the hands of state-owned enterprises and the cost is high. The future is bleak in terms of gas-powered electric energy output, and this could severely compromise the country's future growth. Pemex lacks the funds to explore and exploit the country's gas potential, even that which is not associated with oil production. I will return to this point, but Pemex's lack of capital to further develop Mexico's oil industry points to another serious structural problem.

The situation is well known, but the combination of history, tradition, and emotion results in policy stultification. The nationalism surrounding oil and gas ownership, exploration, exploitation, and even the retail distribution of gasoline, was born in an era when the situation was radically different from what it is today. Not too many years ago, the government was unable to reclassify certain petrochemicals to permit majority foreign ownership. This was another example of oil nationalism. When the North American Free Trade Agreement was signed, Mexico for the most part chose to omit key energy issues from its provisions. Canada, by contrast, included energy, involving even a commitment to share energy with the United States at times of shortage and crisis.

Over the years, Mexico shed many of its earlier taboos. It

joined the General Agreement on Tariffs and Trade in 1986 after rejecting membership a few years earlier. The president who made the earlier rejection decision, José López Portillo, essentially opted for Mexico to be a free rider on the international trading system. Mexico entered into a free-trade agreement with the United States in 1994 after earlier categorical refusal to consider such a close economic relationship with its powerful neighbor. Mexican law and policy barely tolerated foreign direct investment for many years, but then shifted to actually seeking such investment starting in the 1980s. Mexican policy in the decades before the 1990s was to avoid any direct discussion with the United States on migration issues, despite the importance of this issue to millions of Mexicans; then there was a 180-degree shift in strategy under President Fox who, as we know, made migration the foremost issue in Mexico's relations with the United States. Mexico obviously is able to change direction on key issues, but important—indeed critical—exceptions remain.

The buildup of beliefs that have such large emotional and cultural content as to make it hard to alter attitudes is hardly unique to Mexico. Senator Trent Lott demonstrated recently that he had not really shed the social outlook of his youth. Religious zealots of many persuasions are rarely amenable to changes in their cultural outlooks. My focus here, however, is on Mexico and what it must do to further its economic growth.

As I examine the Mexican scene, the danger I see is that many of its policies risk a sacrifice of its growth potential. A highly professional team in the Treasury and the Central Bank manages Mexico's macroeconomic policy. Those who follow Latin America's financial markets give Mexico high marks for maintaining effective fiscal and monetary balance. Inflation last year exceeded its target, but only modestly—due in part to high-energy prices. The peso gained strength over the past several years and has been weakening more

recently, but there is no expectation that the peso will go off the deep end, as it did in 1994. The relatively clean float and a monetary policy based on inflation targeting inspire confidence in investors—internal and external. Mexico has become a formidable trading nation, perhaps overly reliant on the U.S. market, but its export products are much more varied than they were before the trade policy changes of the 1980s. Total exports of goods last year exceeded \$160 billion, more than 85 percent of which were manufactures. Mexico is no longer an oil economy, but oil still plays a crucial role in running the government.

The country's major economic and social problems relate to its unsatisfactory overall economic performance. Real GDP last year grew by only 1.1 percent, which translated into a decline in per capita GDP. The GDP growth estimate for this year is higher—somewhere between 2 and 3 percent—which even at the upper figure would bring only modest per capita growth. Job growth in 2002 was insufficient to satisfy all the entrants into the labor market. The official explanation for the lack of economic growth is that because of Mexico's high reliance on the U.S. market (which in 2002 took 83 percent of Mexico's merchandise exports), the slowdown in U.S. growth was the culprit. The unsatisfactory economic performance of the United States undoubtedly was and is a factor in Mexico's slow growth, but Mexico's structural problems contributed even more to the poor performance. Canada is even more reliant than Mexico on the U.S. market, but Canada grew by 3.5 percent in 2002.

Mexicans complain about high taxes, which are true on paper, but the fact is that tax collections amount to only 11–12 percent of GDP. This is not enough to run the government and meet vital social needs for education and health care. Pemex's contribution to government revenues amount to 6 percent or so of GDP—more than half as much as all other taxes together. Pemex should contribute resources to the government; all oil companies pay royalties, even government-owned oil companies. Six percent of GDP, however, is high, at least twice as high as it should be. If Pemex could keep 3 percent of GDP more for itself, its ability to finance more exploration and exploitation would be markedly improved. However, better tax collection is not easy to accomplish; it has been tried repeatedly in recent decades with little success.

The unwillingness to permit private investment in oil and gas and in most electricity generation, coupled with the inability of Pemex and the government-owned electricity companies to meet these investment needs, puts the Mexican economy between those two well-known impossible positions—a rock and a hard place. Private investment in gas generation can be accomplished either by a constitutional amendment and/or better tax collection to remove Pemex's need to fund the government. The latter requires a change in the mentality of Mexico's taxpayers. I think that a

constitutional amendment is the easier and quicker path. There are two impediments to a constitutional amendment—political game-playing in Congress and the cultural aversion to giving up the government monopoly on gas, oil, and electricity generation and distribution.

My sense is that Mexico's GDP growth potential if it retains the structural impediments discussed here—as well as others not discussed but well known, such as a more transparent justice system and a more flexible labor market—is not much more than about 3 percent a year on a sustained basis. If these rigidities were eliminated, the growth potential should be double that. These figures are orders of magnitude, but the message I took from Mexico was that the country could grow twice as fast on a sustained basis with adjustments rather than adhering to policies born a century ago and reinforced in the 1930s, but still being practiced in the radically different context of the twenty-first century.

With GDP growth at 1 percent (as it was in 2002), or even 2 percent (as it might be in 2003), there is no way that Mexico can meet its vital social needs. Poverty rates are high—in the range of 40 percent of the population—and poverty reduction requires steady GDP growth, year in and year out, particularly growth on a per capita basis. With growth at 6 percent a year, which Mexico achieved during its heyday years, social goals can be addressed. The following questions should be at the heart of Mexico's internal debate: How much growth is needed on a sustained basis to meet economic and social goals? What are the impediments to achieving this rate of growth? And how must we go about removing these impediments? I had the impression when I was last in Mexico that the internal discussion centered more on slogans and outdated nationalism than on addressing the salient, rational questions at the very heart of the problem.

Issues in International Political Economy is published by the Center for Strategic and International Studies (CSIS), a private, tax-exempt institution focusing on international public policy issues. Its research is nonpartisan and nonproprietary. CSIS does not take specific policy positions. Accordingly, all views, positions, and conclusions expressed in this publication should be understood to be solely those of the author.

© 2003 by the Center for Strategic and International Studies.