THE MEXICAN ECONOMY: Persistent Problems and New Policy Issues in the Aftermath of Market Reforms

Jaime Ros[1]
University of Notre Dame

REFORMAS ECONÓMICAS EN MÉXICO, 1982–1999. Colleción Lecturas del Trimestre Económico 92. Edited by Fernando Clavijo. (México: Estrategia y Análisis Económico, Consultores, S.C., Comisión Económica para America Latina y Caribe, Fondo de Cultura Económica, 2000. Pp. 584.)

POLARIZING MEXICO. THE IMPACT OF LIBERALIZATION STRATEGY. By Enrique Dussel Peters. (Boulder, Colo.: Lynne Rienner Publishers, 2000. Pp. 249, $49.95 cloth.)

MEXICO: A COMPREHENSIVE DEVELOPMENT AGENDA FOR THE NEW ERA. Edited by Marcelo M. Giugale, Olivier Lafourcade, and Vinh H. Nguyen. (Washington, D.C.: The World Bank, 2001. Pp. 748, $65.00 paper.)

MÉXICO: HACIA LA RECONSTRUCCIÓN DE UNA ECONOMÍA. By Nora Lustig. (México: El Colegio de México y Fondo de Cultura Económica, 2002. Pp. 200, $113.00 Mexican pesos.)

OECD ECONOMIC SURVEYS: MEXICO 2002. By the Organisation for Economic Co-operation and Development (OECD). (Paris: OECD, 2002. Pp. 200, $34.00 paper.)

Since the mid-1980s successive Mexican governments have made several attempts at macroeconomic stabilization and embarked on a path of structural reforms. Balance of payments liberalization and the North American Free Trade Agreement (NAFTA) have closely integrated the economy with that of the United States, both in terms of trade and capital flows. Restrictions on foreign ownership have been largely eliminated, and foreign participation in the economy has increased through direct investments in new plants, as well as mergers and acquisitions.

1. I am grateful to Nora Lustig and Juan Carlos Moreno for useful comments. The usual caveat applies.

Latin American Research Review, Vol. 38, No. 3, October 2003
© 2003 by the University of Texas Press, P.O. Box 7819, Austin, TX 78713-7819

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

State banks and public enterprises have, with few exceptions, been turned into private hands. Privatization revenues together with debt relief (under the 1989 Brady Plan) and fiscal adjustment have allowed the government to reduce its debt as a proportion of gross domestic product (GDP) to rather low levels by international standards. A market-oriented rural economy has emerged following far-reaching changes in the land tenure system, price policies, and the privatization or elimination of state enterprises and their substitution by a combination of subsidies and public programs.

The books reviewed in this essay examine the vast transformations brought about by the market reform process and address the problems and new policy issues that have emerged in the aftermath. The more than 700-page volume edited by Marcelo Giugale, Olivier Lafourcade, and Vinh Nguyen and institutionally housed and published by the World Bank presents an extensive assessment of the state of the Mexican economy at the end of the Zedillo government and a detailed rationale of the policy recommendations of this multilateral institution for the incoming Fox administration (2001). The OECD volume, published in 2002, is the latest country study on Mexico by this influential international organization. As a survey the OECD study is of particular interest, being the first of its kind since the Fox administration that examines the short and long-term challenges facing the current government. Fernando Clavijo's edited volume is a collection of essays that were written as part of a multi-country research project housed by the UN Economic Commission for Latin America and the Caribbean (ECLAC) (2002). Together these essays provide a comprehensive evaluation of market reforms from a perspective of "healthy skepticism" close to ECLAC. Enrique Dussel Peters presents a critical view of Mexico's liberalization strategy (2000). The author acknowledges the relative success of the strategy "on its own terms," but does not believe that export expansion in a market-friendly environment will lead to overall development. As its title indicates, the book argues that the strategy has led to an increasing polarization in household incomes, regional development, productive sectors, and firms. Nora Lustig's book is the Spanish edition of *Mexico: The Remaking of an Economy*, the second edition of which was published in 1998 (2002). The book provides a comprehensive account of the reform process since the initial steps of trade liberalization and privatization under the De la Madrid administration. This account has been updated with a detailed analysis of the 1994 crisis and the 1995 international rescue package as well as what the author sees as an unhappy ending of the reform process: the persistence of poverty and inequality.

The reading of these books suggests four key questions about Mexico's economic policy and performance over the past two decades: (1) What

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

are the clear achievements of the macroeconomic adjustment and reform processes? (2) Has economic growth fallen short of expectations? If so, in what ways and why? (3) What factors explain the persistency of poverty and inequality, and how do they relate to the reforms themselves? (4) What are the main policy challenges facing the current administration?

WHAT HAS BEEN ACHIEVED?

By and large, a consensus exists on the clear successes of the reform policies. After the policy mishandling that led to the 1994–95 currency and financial crisis and a deep recession in 1995, and with the help from a massive international rescue package and a prolonged boom of the U.S. economy, the Mexican economy rapidly recovered. Growth finally resumed at significantly high rates averaging around 5 percent from 1995 to 2000, before the U.S. recession hit, causing a slight fall in economic activity in 2001. Inflation fell below 5 percent per year in 2001. Export growth has been vibrant and has been accompanied by export diversification towards manufacturing goods, including medium and high technology manufactures. This has contributed to a substantial reduction in the dependence on oil revenues, which represented around 7 percent of total exports by 2000 (compared to close to 60 percent in 1980). The more diversified export base, the substantial reduction in the debt-export and debt-GDP ratios (now among the lowest in Latin America and lower than in most OECD countries), and the adoption of a floating exchange rate since December 1994 have all contributed toward making the economy less vulnerable to external shocks than it was just a few years ago (although, at the same time, the increase in the export-GDP ratio has made the economy's growth more dependent on export demand). The greater strength compared to 1994, when the economy was on the verge of collapse, is based also on a domestic savings rate that is some 7 percentage points of GDP higher, and a current account deficit that is less than half as percent of GDP, and financed primarily by foreign direct investment (two thirds of capital inflows compared to one third) rather than short-term inflows. The fact that the current export-driven recession has not caused a balance of payments crisis is evidence of this greater strength.

The degree of consensus in these works is more than expected from such a diverse collection of books about the fact that the success of the reforms has been limited. In several ways the results have fallen short of initial expectations. Growth remains problematic and competitiveness weak (as recognized, for example, by the World Bank). Income inequality and regional disparities have increased over the past decade. Poverty rates remain high with 23 percent of the population living on less than two dollars a day in 1998 (OECD, ch. 3). The books reviewed

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

offer different perspectives, sometimes opposing and at times complementary, on the factors accounting for these shortcomings.

A PROBLEMATIC AND DISAPPOINTING GROWTH PERFORMANCE

Trade and foreign investment liberalization have resulted in fast export and labor productivity growth in a limited number of sectors but overall economic growth has been problematic. Unlike post-reform Chile, which recorded an improvement in growth performance from 1985 to 2000 compared to historical rates, the relatively high rates of growth of the Mexican economy from 1996 to 2000 remained below those reached under the import substitution policies of the postwar period. Despite its recovery since 1995 when it fell to 14 percent, the share of investment in GDP by the end of the 1990s was much lower than in Chile and still some 8 percentage points below its peak in 1981 (when it reached around 27 percent).[2] Moreover the resumption of growth from 1996 to 2000 took place in an exceptionally favorable environment created by the 1995 rescue package, a booming U.S. economy, and a very competitive exchange rate in the first part of the period. As the abnormally rapid U.S. economic expansion of the 1990s came to an end and the peso appreciated again, the economy plunged into recession in 2001. Overall rapid, sustained, and even economic growth has yet to be seen.

INDUSTRIAL POLICIES AND THE PATTERN OF TRADE SPECIALIZATION

Why did growth fall short of expectations? Why has the private sector been unable to substitute for the retrenchment of the state and exert a leading role in a dynamic process of economic growth? Jorge Mattar in the Clavijo volume examines the limited response of private investment, focusing on the adverse effects of the elimination of sectoral incentives on manufacturing investment and the liberalization of the financial sector, which induced a consumption rather than an investment boom from 1989 to 1994. He also addresses the contraction of the domestic market brought about by import liberalization and currency overvaluation in the first part of the 1990s and the decline of public investment with its (negative) crowding-in effects on private investment. According to Mattar, the only sectors that show a dynamic response (such as autos and electronics) are those featuring a positive synergy between the strategies of multinational enterprises and economic reform.

A major theme in Dussel's book, and one that runs through the analysis of the effects of liberalization on trade, investment, and regional development (chapters 4, 5, and 7), is the inability of the new industrial

2. See figure 2, 182, in Clavijo and Moreno-Brid (1999) cited by Mattar (156–256).

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

structure to generate self-sustained growth. Dussel notes that exporting sectors and firms, while dynamic, lack domestic linkages and a number of other industries have witnessed a "disintegration of linkages."[3] According to Dussel the consequences have been negative for the trade balance, employment growth, and learning processes. Thus to address the problems and challenges posed by this emerging industrial organization requires going beyond the "horizontal" industrial policies (policies that provide neutral incentives across firms and sectors) followed by the government since 1988. Dussel favors channeling more resources to industrial and social policies, reversing the tendency to overvalue the real exchange rate and depress real wages while generating domestic linkages in export-oriented activities and incorporating the labor force into the formal job market. However, an analysis of the trade-offs involved in these different policies and objectives is for the most part left outside the scope of the book.

The fragility and shortcomings of Mexico's pattern of industrial production and trade specialization go beyond the lack of domestic linkages in export-oriented activities and the dependence of export demand on U.S. economic activity, emphasized by Mattar and Dussel. The increasing dominance of the maquiladora industry in export activities is a motive for concern. The maquiladora industry is characterized by low and stagnant labor productivity (the counterpart of its high capacity of employment absorption). As the real exchange rate has appreciated again in the recent past and dollar wages have increased, profit margins have declined. Together with the U.S. recession, this has slowed the expansion of productive capacity and output in the maquiladora sector and led to a sharp decline in employment starting in the third quarter of 2000. With little or no productivity growth, the maquiladoras constitute a sector that can only expand on the basis of low wages. Given the tendency of wages to increase in other sectors along with productivity gains, the maintenance of the "internal competitiveness" of the maquiladoras, i.e., their capacity to attract resources from the rest of the economy, would require a continuously undervalued currency.[4]

COMPETITIVENESS, THE INFRASTRUCTURE GAP, AND THE COLLAPSE OF THE FINANCIAL SECTOR

The World Bank offers a distinct perspective, not inconsistent with Mattar and Dussel but certainly with different policy implications es-

3. Chapter 7 illustrates this phenomenon with a case study of the pharmaceutical industry where the share of locally produced raw materials fell from around 80 percent in the late 1980s to around 20 percent in 1998.

4. See Frenkel and Ros (2002) for an analysis of the performance of the maquiladora industry in the 1990s.

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

pecially in terms of industrial policy. As noted by Giugale, Lafourcade, and Nguyen, Mexico ranked thirty-six among forty-seven large economies in the 2000 World Competitiveness Index produced by the International Institute of Management Development (71). By World Bank standards this lack of competitiveness is the source of the problem and in turn linked to a widening infrastructure gap in the areas of energy (electricity) and water, a financial sector that remains weak several years after the 1994 crisis, and the low productivity and lagging growth performance of the agricultural sector.

The infrastructure gap is well documented in the World Bank volume (ch. 2, sec. 3). Particularly in telecommunications and water potabilization, Mexico lags behind many comparable Latin American countries. The 1995 financial crisis left a bankrupt banking system whose bailout added some 20 percentage points of GDP to the public debt and left those households and firms, mostly small and medium enterprises (SMEs) with no access to foreign finance, virtually without access to bank credit. As a result, and somewhat ironically, the banking sector returned, as pointed out by Clavijo, to a situation of credit rationing characteristic of the era of financial repression that preceded the financial liberalization of the late 1980s. This severe rationing of domestic credit has not only been an obstacle to faster growth but has also reinforced the dual structure of the productive sector. The fact that there has been growth without commercial bank-lending already suggests how concentrated growth must have been in a few firms and sectors with access to foreign finance. The World Bank and Dussel studies document how the decline of credit affected differently large firms and SMEs as well as the large and increasing gap in export performance between these two types of enterprises (Giugale Lafourcade, and Nguyen, ch. 12, 273, 267; Dussel, ch. 4). The problems of the financial system and the fact that it is not fulfilling its role in stimulating growth are also the focus of the OECD volume, which devotes a full chapter to the analysis of the evolution of this sector since the 1994 peso crisis. The OECD assessment of the state of the financial system is the most optimistic, but the volume points out nevertheless the serious challenges still facing this sector, including the fact that at about 18 percent of GDP, commercial bank lending remains among the lowest in the OECD.

These setbacks in competitiveness (including the poor performance of the agricultural sector as we shall see later) are related to the shortcomings of past reforms and macroeconomic adjustments. The infrastructure gap is the consequence of declining public infrastructure investment, which has been the main victim of past fiscal adjustments in the context of falling oil prices. Chapter 7 in the World Bank volume strikingly illustrates the close correlation between oil price declines, fiscal deficit cuts, and public investment reductions (the correlation

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

coefficient between the last two turns out to be 0.82 from 1980 to 1997). As a result public investment was less than 2 percent of GDP at the end of the 1990s, down from 4 percent in 1994, 6 percent in 1990, and 12 percent in 1980 (Giugale, Lafourcade, and Nguyen 2001, 69). Similarly the boom and bust cycle that culminated with the banking crisis in 1994 and 1995 was a consequence at least in part of an excessive reliance on financial deregulation and capital market liberalization. Lustig (ch. 6, 215–19) and the OECD volume (ch. 4) examine, albeit briefly, the role of inadequate regulation and lack of transparency. Clavijo and Jana Boltvinik (ch. 3, 257–311) also examine the role of inadequate sequencing and the tensions between the different components of liberalization and macroeconomic stabilization at the end of the 1980s.

THE PERSISTENCY OF POVERTY AND INEQUALITY

The past two decades have left a legacy of persistent poverty and inequality. This is a major theme in all the books. Lustig shows that income inequality measured by the Gini concentration coefficient increased quite sharply from 1984 to 1989 (4 percentage points) but then fell from 1989 to 1994 (although remaining slightly above its 1984 level) (ch. 8, 243–70). From 1994 to 2000, the OECD estimates show a slight increase in income inequality (the Gini rises from 0.477 to 0.481) (ch. 3, 97–152). Both extreme and moderate poverty rates maintain similar behavior across time from 1984 to 1994 while poverty numbers show a continuous increase through 1994. In chapter 6 Dussel documents the increasing income share of the richest deciles from 1984 to 1996 and the rise in the absolute number of people living in poverty and extreme poverty over the same period (using a sui generis poverty line dependent on the minimum wage).

The increase in poverty and inequality in the 1980s reflected to a large extent the sharp fall in living standards and social spending during the recessions, triggered by the adjustment to the external shocks of that decade, such as the 1982 debt crisis and the 1986 oil price collapse.[5] The persistency of poverty and the increase in inequality after the mid-1990s, when growth resumes, raise the following issue: Have market reforms contributed to perpetuating or even increasing inequality or has this happened in spite of the reforms? Economic reforms seem to have contributed to increased inequality and, in so doing, poverty by

5. The fiscal constraints on social spending, following the 1982 crisis, and their effects are examined by Rimez and Bendesky in Clavijo (ch. 6) and by Lustig (ch. 3). As shown by Lustig (ch. 3), the fall in public spending in education and health was more the result of a decline in salaries than in the volume of public services. Nevertheless, it had, together with the fall in income levels, negative effects on nutritional and educational indicators (as well as on the crime rate).

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

increasing rural-rural disparities, widening wage inequalities, and reversing trends of regional convergence towards a divergence in living standards between the northern and central regions, increasingly urbanized and integrated to the U.S. economy and a lagging rural South.

RURAL REFORMS AND A LAGGING AGRICULTURE

After the 1992 constitutional amendment reformed the land tenure system by allowing ejido land transactions, the privatization or elimination of public enterprises (in particular CONASUPO in distribution), and the establishment of new programs such as Alianza para el Campo, agriculture continues to show poor growth performance. More precisely, clearly differentiated behavior has been noted between the modern export-oriented agriculture and ejido sectors. Agriculture has benefited from and responded positively to the reforms (exports grew by 70 percent during the first five years of NAFTA) while the *ejido* sector, largely producing importable goods, has been adversely affected by the rapid growth of imports (60 percent since the beginning of NAFTA). Today, the *ejido* sector barely survives on an increasing integration into off-farm activities (about 40 percent of its income comes from non-farm sources, including remittances (Giugale, Lafourcade, and Nguyen, ch. 15, 324).

Based on recent studies of the agricultural sector in Mexico and elsewhere, the World Bank volume relates the stagnation of agricultural output and the persistency of rural poverty to shortcomings in the reforms themselves (ch. 15). The downward trend in real agricultural prices throughout the 1990s was strengthened by the removal of trade protection (and exchange rate overvaluation in the early part of the decade). The retreat of the state from distribution was followed by the domination of marketing channels by oligopolistic intermediaries that depressed producer prices, particularly detrimental to the poorest areas.[6] The elimination of extension programs and technical assistance has affected a large proportion of small producers. In chapter 8 Lustig shows how poverty increased in the rural areas, particularly in the southeastern states, which already had the highest incidences of poverty. She also stresses the role of peso overvaluation and the decline of prices (particularly for coffee producers in Chiapas, Veracruz, and Oaxaca), and adds the role of the abandonment of old agricultural support policies (cheap credit, subsidies, and guaranteed prices), discussing the differentiated responses to these changes within the countryside.

6. According to Giugale, Lafourcade, and Ngyun (328), fruit and vegetable farmers in Mexico typically get 35 to 45 percent of the retail price of the product, compared to the 65 to 75 percent in most Central American countries.

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

The World Bank summarizes the shortcomings of agricultural reforms with the recognition that if markets are not competitive, liberalization will not yield the expected benefits. Reforms and new policies did not give proper consideration to the large regional diversity and income heterogeneity of the Mexican countryside (Giugale, Lafourcade, and Nguyen, 333). To address these shortcomings, it advocates a "battery of complementary policies" that include a renewed role of the public sector to make markets more efficient in the areas of information and regulation, provide technical assistance and infrastructure, and strengthen and differentiate policies to tackle extreme poverty. These changes are seen as increasingly compelling as we approach the elimination of all agricultural tariffs in 2008 under NAFTA.

TRADE LIBERALIZATION AND WAGE INEQUALITIES

The effects of the reform process on wage inequalities have been a major force preventing an improvement in income distribution over the past fifteen years. Unfortunately, this crucial topic is neglected except by Lustig (ch. 8) and by Rodolfo De la Torre (Clavijo 2000, ch. 7). Lustig discusses the recent literature largely in the form of journal articles published in the 1990s on how Mexico's greater integration to the world economy, contradicting the initial expectations about the effects of trade liberalization, has been accompanied by a substantial increase of the wage premium on skilled labor with a resulting decline in relative unskilled labor incomes. De la Torre argues that the "new economic model" resulted in the reduction of physical and human capital per worker at the same time that it increased the demand for skilled labor. With an unequal distribution of skills and a short-run inelasticity of human capital, the consequence has been higher inequality in the distribution of labor incomes that is closely associated to disparities in schooling.

AN UNEVEN ECONOMIC INTEGRATION ACROSS REGIONS

A third cause of widening disparities relates to the increasing polarization in regional development between a prosperous North and Center and a South that is being left behind. As documented by Godínez's contribution in Clavijo (ch. 5) and Dussel (ch. 7), general regional trends from 1970 to 1985 pointed towards the deconcentration of economic activity away from the main industrial centers in the metropolitan areas of Mexico, Nuevo León, and Jalisco and the convergence of income levels. Since 1988 a process of divergence has taken place especially as export-oriented northern states have rapidly increased their contributions to national income. By contrast the relatively poor South (with the exception of Quintana Roo that benefited from the expansion

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

of tourism) has been lagging behind.[7] As shown by Godínez, these regional trends are clearly linked to the economy's structural changes, such as the lagging cereal agriculture; expanding export sectors of agro-industrial products, fruits, and vegetables; and the rapidly growing export-oriented manufacturing activities in the northern and central areas. In chapter 8 Lustig shows how uneven regional development has been closely linked to the increase in rural poverty in the South, especially in the state of Chiapas, Guerrero, and Oaxaca.

CURRENT POLICY ISSUES

In view of the achievements and shortcomings of the reform process, what is the current policy agenda? Are the reforms themselves in need of reform, as Ricardo Ffrench-Davis (2000) puts it? I limit myself here to a short list of some of the main issues involved and the treatment of them presented in the volumes reviewed here.

Competitiveness, the Infrastructure Gap, and the Financial Sector

Various authors see the infrastructure gap as a major factor undermining economic competitiveness and growth. What exactly to do about it is, however, controversial. The debate is presented by the World Bank praising the policies of previous administrations to substitute private for public investment to modernize the infrastructure sector and privatize the electricity, and oil sectors, besides the clear need for cost-recovering tariffs. Examples cited of the public sector's retreat from these sectors are the breaking up of the Comisión Federal de Electricidad and of the PEMEX monopoly in downstream activities, including refineries. Yet, at the same time, the World Bank recognizes that the private sector failed to meet initial expectations (10). Dussel and Mattar in the Clavijo volume emphasize and document the lack of private investment response (83–114; 156–256).

The financial system, another weak link in the economy, is given special attention in the OECD volume. Chapter 4 describes the rescue package of the banking system and the 1998–1999 financial reforms. These recent measures were aimed at strengthening the supervision and regulatory framework, removing remaining barriers to foreign ownership and creating a new institute to manage the deposit insurance scheme (Institute for the Protection of Bank Savings, or IPAB). More than a ray of hope is given by the OECD survey, which concludes the

7. Dussel's book contains a less formal analysis of regional concentration than the chapter by Godínez in the Clavijo volume. On the other hand, his chapter on regional development presents two interesting case studies of the electronics industry in Jalisco and the pharmaceutical industry in Mexico City, both subject to a dramatic process of restructuring and modernization.

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

chapter by saying that the reforms and the infusion of foreign capital have put the banking sector back on its feet, as revealed by a decline of past due loans and a narrowing of the spread between lending and deposit rates. Nevertheless, serious challenges remain. As already mentioned, the OECD volume points out that commercial bank lending, as percent of GDP, remains among the lowest in the OECD.

Social and Regional Policies

As already mentioned, social policies suffered the adverse consequences of the fiscal adjustments following the 1982 debt crisis and the 1986 oil price collapse. The adjustment period was followed by a recovery of social spending accompanied by a shift in social policies from what Marc Rimez and Leon Bendesky in the Clavijo volume call "segmented universalism" (434–89). Universal transfers reach only organized segments of the population and include also "minimalist" policies, in the words of Dussel, to focus on the alleviation of extreme poverty. The new public programs, such as PRONASOL under the Salinas administration and PROGRESA under the Zedillo government, are indeed based on income-support subsidies to the extreme poor (rather than the general population) that are made conditional on investments in infrastructure and human capital. Rimez and Bendesky view this change as linked to the redefinition of government functions in the "new economic model" and the privatization of social services and pension schemes.

As discussed in the World Bank volume, the Mexican government and international organizations have positively evaluated PROGRESA (chs. 3, 25).[8] Yet, in the face of slow growth in agriculture and the expansion of the urban informal sector, these programs did not prevent as we have seen an increase in poverty or persistently high income distribution inequality. Is a new approach required? Or are more resources needed? The answer is probably yes to both questions. The current approach has already some of the key elements: the resumption of rapid economic growth to provide employment and earnings opportunities to the poor as well as additional social spending combined with less "segmented" universal policies and targeted interventions to address the hard core of extreme poverty.

Success, however, will require something that has been missing so far: a major fiscal reform and growth-oriented macroeconomic policies (such as counteracting the trend to currency appreciation in recent years and the pro-cyclical nature of fiscal policy, discussed below). Moreover,

8. Under the Fox administration PROGRESA has been renamed Programa Oportunidades and according to Fox's Second Presidential Address considerably expanded to assist 4.2 million families in August 2002 (compared to 2.4 million in 2000).

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

a more effective approach will require eliminating poverty with social policies that adopt a stronger regional dimension and for more meaningful growth in lagging regions. There is, in other words, a need for regional development policies.[9] Yet despite the amply documented regional polarization, an in-depth analysis of policy options is conspicuously absent in these books. The World Bank limits itself to a plea for greater consideration of regional diversity in the design of agricultural policies (Giugale, Lafourcade, and Nguyen, ch. 15) and the OECD to a description (ch. 3) of the new emphasis on regional development by the Fox administration, based on stimuli to small and medium enterprises in lagging regions and a better coordination of existing planning mechanisms at different government levels.

Stopping Stop-and-go, Pro-cyclical Fiscal Policies

While trade liberalization and later NAFTA led to the rapid expansion and diversification of exports that reduced the dependence of the external sector on oil revenues, the fiscal accounts continue to be highly vulnerable to changes in oil income that still represents around a third of total government revenues. This is the source of a major macroeconomic policy problem about which there is increasing consciousness and concern: the fact that it contributes not only to stop-and-go macroeconomic policies but, even worse, to pro-cyclical fiscal policies that exacerbate the negative effects of shocks on economic activity.[10] Oil price and output fluctuations have a large effect on public sector revenues forcing the government to cut spending or raise taxes at a time when the fall in overall export revenues is having a negative effect on economic activity. Two recent episodes in which falling oil revenues led the government to adopt a restrictive policy stance, thus exacerbating the weakening of economic activity, took place in 1998 and 1999 (discussed in Clavijo's conclusions, 561-–81) and 2001 (examined in the OECD survey). The topic deservedly receives attention in Giugale, Lafourcade and Nguyen (ch. 7), the OECD volume (ch. 2, fiscal policy, 39–64) and in Clavijo's conclusions. Interestingly, as noted by Clavijo,

9. The recent initiative of a Plan Puebla-Panama for the development of infrastructure in Southern Mexico and Central America and the strategy of "micro-regions" since January 2002, which identifies over 260 communities with a high incidence of extreme poverty for priority attention, appear to be steps in this direction.

10. The government's dependence on oil income is not the only source of pro-cyclical fiscal policy (the volatility of capital flows is another one) and is not the only emerging macroeconomic policy issue. In chapter 6 of the World Bank volume, the interested reader can find a good introduction to a number of monetary policy issues: the use of short-term interest-rate instruments rather than borrowed reserves (*el corto*), money anchor versus inflation targeting, and the choice of exchange-rate regime.

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

part of the problem may come from the loss of policy instruments and the reorientation of macroeconomic policy from growth towards purely stabilization objectives. In any case, together with the infrastructure gap, the need to avoid pro-cyclical fiscal policies provides the major case for a thorough fiscal reform that makes fiscal revenues less vulnerable to oil income fluctuations. Other policy proposals include an oil stabilization fund (Giugale, Lafourcade and Nguyen, ch. 6)[11] and a medium-term framework for the design of fiscal policy (OECD, ch. 2).

Tax Reform

The need to increase resources for social and infrastructure investment and to reduce the dependence of government revenues on oil income leads to the crucial issue of tax reform. This is a policy issue to which the World Bank (ch. 8) and the OECD volume (ch. 2) give a high priority with policy recommendations that have clearly influenced the Fox administration. Mexico´s tax burden is extremely low by international standards. Tax revenues (including federal and sub-national revenues but excluding social security and PEMEX revenues) were of the order of 12 percent in the late 1990s and remained broadly constant throughout the 1990s.[12] This figure is below those of Latin American countries with similar income per capita and well below those of OECD countries. If overall government revenues are distinct from those of other middle-income countries, it is because of substantial oil sector revenues. These revenues are widely fluctuating, a feature that as we have discussed contributes to the pro-cyclical nature of fiscal policy. Besides increasing the capacity of the government to spend on infrastructure and human capital, a major contribution of tax reform would be to reduce the volatility of government revenues by reducing dependence on oil revenues and attenuate the pro-cyclical nature of fiscal policy.

The causes of the low tax burden are considerable lost revenues due to the value-added tax (VAT), tax evasion (5 percentage points of GDP), a narrow tax base for corporate and personal income taxes, and inefficient VAT collection. With a standard rate of 15 percent, value added taxes represent only 3.1 percent of GDP (compared, for example, to the OECD average that features a standard rate of 17.7 percent and a tax collection of 6.7 percent of GDP). This low effectiveness is partly due to evasion but also to numerous exemptions such as a non-taxed food and medications and a tax rate of 10 percent in the border areas.

11. An oil fund was created in 2000 but with limited success so far. In 2001 funds were not drawn from it because the fall in revenues was not due to lower than assumed prices but to a reduction in output volume (see OECD, ch. 2).

12. A slight drop in import tariffs, personal income taxes, and value-added taxes was offset by an increase in excise taxes.

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press

Of course the controversial issue is the kind of reform needed. The importance given to VAT reform (along with the elimination of exemptions to the corporate and personal income taxes) by the World Bank and OECD under the banner "no privileges, better administration," converges with the priorities of the Fox government in this area. As described in the OECD volume the changes that were eventually approved by Congress in late 2001 after heated debates turned out to be, however, quite different from the presidential initiative (ch. 2). In particular, the proposal by the executive branch to widen the VAT tax base to include food and medicines was not approved, and the shortfall was compensated with an increase in excise taxes and a 5 percent luxury tax. Although the OECD still welcomes the approved package as a major step, it recognizes that it represents additional revenues for only one percentage point of GDP (plus 0.6 points from improved tax administration and compliance), which still leaves Mexico with a very low tax burden by international standards.

This review has focused on the *outcomes and current challenges* of the macroeconomic adjustment and market reform processes—a common theme in the books reviewed. Each book individually goes, however, beyond these aspects and discusses other issues. Lustig and Dussel provide the background to the reform process, that is the rise and decline of import-substitution industrialization (Lustig), the debates between advocates of import substitution, export-oriented industrialization, and neoliberalism as well as the breakdown of the corporatist political system (Dussel 2000, 39–62). Clavijo and Lustig complement each other by providing a detailed account of the content and timing of the reforms. In doing so, Clavijo thoroughly discusses the pace and sequencing of reforms while Lustig provides an engaging analysis of the policy options at different stages of the reform process, starting with a possible moratorium on external debt in the wake of the debt crisis. However, pending items in the reform agenda, such as labor market reform in the World Bank and OECD volumes, or policies towards environmental sustainability and governance issues in the World Bank volume should have been discussed.

REFERENCES

FRENCH-DAVIS, RICARDO

2000 *Reforming the Reforms in Latin America: Macroeconomics, Trade, Finance.* New York: St. Martin's Press and Palgrave.

FRENKEL, ROBERTO, AND JAIME ROS

2002 *Macroeconomic Policies, Trade Specialization, and Labor Market Adjustment in Argentina and Mexico.* Paper presented at conference "Managing Macroeconomic Volatility." CEPAL, May 2003.

MORENO-BRID, JUAN CARLOS

1999 *México: reforma macroeconómica e inversión manufacturera en México,* Serie Reformas Económicas. Santiago de Chile: CEPAL.

https://doi.org/10.1353/lar.2003.0042 Published online by Cambridge University Press