MEXICO: THE NEOLIBERAL MACROECONOMIC POLICY PACKAGE, STAGNATION AND ENVIRONMENTAL DEGRADATION

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Mexico is a megadiverse country that has a wide variety of ecosystems in its territory. From the coastal plains on the western and eastern coasts, to the central highlands, a rich tapestry of varied ecosystems covers its landscapes. The ecosystems include tropical rainforests, temperate forested areas, cloud forests, semi-arid and arid environments. Mexico’s coastline extends some 11,000 kilometres and its exclusive economic zone covers reef barriers and well endowed marine fisheries. This combination of ecosystems allows Mexico to be the home of more than 200,000 different species or approximately 10%-12% of total biodiversity. According to the National Biodiversity Commission, Mexico ranks first in biodiversity of reptiles (707 species), second in mammals (438 species), fourth in amphibians (290 species) and fourth in flora (26,000 species).

One of the most important strategic objectives of Mexico’s environmental policy is the conservation and management of this endowment in biodiversity. The most important policy instrument to attain this objective is the National System of Natural Protected Areas (NSNPA). Already more than 170,000 square kilometres are NPAs, with 34 biosphere reserves, 64 national parks, 26 areas of protected flora and fauna and 17 sanctuaries (CONABIO 2007).

This wealth of environmental diversity is at risk in Mexico today. Deforestation proceeds at a very fast rate, with an estimate one million hectares being lost every year to illegal logging and the expansion of the agricultural frontier. The loss of biodiversity that is associated with this process of loss of habitat is incalculable and its real costs will probably never be properly accounted for. In addition, soil erosion, loss of topsoil and the reduction of soil fertility continue to haunt the rural landscape. Over exploitation of aquifers is another very serious problem, with more than 35% of the country’s underground aquifers being exploited at rates that are higher than the pace of their natural replenishment. Commercial fisheries have also been taxed with very intense catch levels and some of them are on the verge of total population collapse. Pollution of soils and water bodies proceeds rapidly with no end in sight to the accumulation of toxic waste. Greenhouse gas emissions per unit of GDP were slightly reduced in the past decade, but that is due more to the collapse of the petrochemical industry than to genuine progress in productivity and energy efficiency. In summary, almost every environmental dimension is imperilled.

MACROECONOMIC POLICY AND MEXICO’S ECONOMIC PERFORMANCE
During the period 1950–1970, Mexico’s economy maintained an average yearly rate of growth above 6.3%. This allowed for a substantial increment of per capita income and was
associated (as in the case of the rest of Latin America) with an industrialization strategy based on import substitution. However, the protectionist strategy was implemented in a very inefficient and careless manner, without any consideration for accountability, strategic objectives in the area of exports and technological development. This led to high market concentration coefficients in many key industries and to sub-optimal production scales and a persistent anti-export bias.

The difficult international economic context of the 1970s, combined with several problems linked to the manner in which protectionist policies were implemented, led to drops in capital formation rates, inflationary pressures, unsustainable fiscal deficits and growing indebtedness. All of this translated into stagnant GDP growth rates. But in the second half of the 1970s new oil discoveries allowed the government to maintain the illusion that its financial situation was robust and healthy. In fact, a process of “Dutch disease” led to higher debt levels and a significant and quite detrimental appreciation of the exchange rate. The international recession of the final years in the decade, together with unacceptable inflation rates and a sudden collapse of international commodity prices, especially oil. This combination of events led to Mexico’s unilateral declaration of a moratorium in its international financial obligations. In turn, this detonated the world’s debt crisis that wrought havoc in the world economy and caused the so-called lost decade of the 1980s.

In the aftermath of this critical period, Mexico implemented a deep change in its development strategy. As the first stabilization plans of the 1980s gave way to deeper structural reforms, the country adopted a strategic course based on two crucial premises. The first was that the State would no longer provide the signals that would guide the development process. From now on, its role would be to allow markets to fulfil this mission. The second premise was that exports would become the engine for growth, and Mexico would have to unleash its export potential based on its comparative advantages.

The corollary from these two premises was that a large scale privatization process would have to take place, the complete deregulation of markets was to be implemented and macroeconomic policy would have to be organized around these strategic premises. Accordingly, the main objectives of fiscal policy would have to be redefined in order to ensure the sustainable management of public debt (both internal and external) and to maintain an open space for private investment (i.e. to prevent any so-called crowding out effect on the private sector). This meant that the primary balance would have to generate a permanent surplus in order
to guarantee a flow of resources that would allow for sustainable debt management. This redefinition culminated with a federal law that established the obligation to maintain a balanced budget. As a result, public expenditures were systematically reduced and only a modest growth rate marked the evolution of this key policy tool. As a percentage of GDP, public expenditure stagnated and remained at a very low level after 1990, as can be seen in Figure V.24. This affected all the real sectors of the economy which are related to environmental sustainability, from small scale agricultural production (which has important environmental stewardship implications) to natural protected areas (which are lacking adequate support for the development and implementation of their resource management plans). One important point here is that this approach to fiscal policy transformed it into a pro-cyclical instrument with serious effects on Mexico’s economy.

Monetary policy was also redefined along two lines of action. The first one was to provide complete autonomy for Mexico’s central bank. The

**Figure V.24**

![Graph](image)

Source: Marcos Chávez, Mexico Country Study.
main objective here was to prevent runaway fiscal deficits from being “monetized”. The second line was to define by law the main objective of monetary policy: the control of inflationary pressures. Together with these new definitions, monetary policy was charged with the task of maintaining a stable exchange rate in order to generate a favourable climate for foreign direct investment and international capital flows.

Accordingly, after 1989 Mexico underwent an intense process of privatization, deregulation of markets and the shrinking of State intervention in the economy. This was accompanied by the complete deregulation of the capital account, creating the conditions that would lead to international capital flows. This process culminated with the negotiation and completion of the North American Free Trade Agreement (NAFTA) between Mexico, the United States and Canada. Mexico was sending a clear signal to the rest of the world about its commitment to the new set of policies.

In the first few years of the 1990s there were some signs that this policy package might lead to a successful exit strategy from the crisis of the 1980s. A very rapid growth of exports from the manufacturing sector created the impression that Mexico could get away from over reliance on oil exports and continue with its industrialization strategy as it established a solid platform for export-led growth. However, the maquiladora sector that was behind this rapid expansion of industrial exports was disconnected from the rest of
the economy. Although it was able of spectacular double-digit growth rates in exports, the economy remained stubbornly fixed with very slow growth rates, incapable of generating sufficient employment to meet the demands in the job market.

This was only the first sign of the fragility of the new macroeconomic model. In fact other variables were being artificially kept in what appeared to be a healthy position. For example, inflationary pressures had subsided due to the restrictions imposed on aggregate demand through a restrictive monetary policy and the imposition of a norm for minimum wage that persistently led to a drop of real wages. This of course implied putting a brake on the role of the domestic demand as a source of GDP growth. But even more important was the role of the exchange rate which was chronically overvalued as a result of the inflow of capital. The appreciation of the exchange rate was used as an anchor for the system of relative prices and was a key instrument to control inflation. But this led, in turn, to a deterioration of the external accounts as it punished Mexico’s exporting sector. The country had to rely increasingly on capital inflows to sustain its growing trade deficit.

Capital inflows not only brought about the appreciation of the exchange rate, but they also imposed a framework that created strong inertias to maintain the overvaluation. The reason for this is that as a surplus in the capital account was required to cover the current account deficit, attempts to correct the trade balance
via devaluations were resisted by the financial community. The government and monetary authorities considered the cost of this adjustment too high. Typically, the adjustment was postponed indefinitely until expectations in the financial world led to the conviction that the host country was unable to fulfil its commitment and would have to devalue sooner or later. In December 1994 a stampede for the nearest exit exacerbated the reversal of capital flows that had been going on since March of that year. This was followed by a macro-devaluation, a decision that was implemented in complete disarray. All the temporary gains in the struggle against inflation were wiped out (see Figure V.25). As 1995 advanced, the economy went into a tailspin, with a drop of 6.5% in GDP. The severity of the crisis can be gauged by its impacts in the world’s financial markets.

In the aftermath of the 1995 crisis, the entire banking system was severely affected as the non-performing portfolio increased. The government implemented a rescue program consisting in the (illegal) purchase of these non-performing loans, replacing these liabilities in the banks’ books with government backed IOUs that had handsome interest payments. Because the new IOUs are assets, this changed dramatically the balance sheets of the banks, allowing foreign investors to purchase most of the banking industry in Mexico. In addition, in order to prevent the exchange rate from becoming seriously maladjusted, a modified floating exchange rate system was adopted (with “dirty” intervention by the central bank), but otherwise, the macroeconomic model remained essentially the same.

The economy’s performance under the neoliberal policy package has been disappointing. Not a single strategic objective has been attained. Growth remains mediocre (with an average 2.2% per year) and is insufficient to meet the requirements of the labour market. The country’s external accounts remain fragile, with an extreme concentration of trade in a single market (the United States). There is a large surplus in the country’s trade balance with the United States, but this is the result of oil and maquiladora exports, so that in the final analysis, Mexico’s trade structure is relying on cheap labour and its natural resource base. This is problematic for several reasons. One is that the maquiladora sector is not a good engine for growth. Maquiladora plants are disconnected from the rest of the economy and this is why we can observe spectacular growth rates in maquiladora exports,

83 Ironically, the banking sector had been one of the most heavily protected sectors in the NAFTA. Foreign investment in this sector was heavily regulated and was to remain as a virtually forbidden sector for ten years. In the aftermath of the 1995 crisis, authorities realized that banks had to be recapitalized and they reached the conclusion that only foreign investors were up to the task but NAFTA was an obstacle. At first, between 1995-1997 the law for the banking sector was clearly violated, but afterwards this was reformed. Today, 95% of the banking industry is foreign owned.
without any significant effects on the rest of the economy. In addition, oil exports in volume terms will likely start diminishing because of Mexico’s dwindling reserves. Finally, the important surplus observed with the United States is not enough to compensate for the deficit in Mexico’s trade with Europe and Asia (especially China). Clearly, trade liberalization simply did not allow Mexico to establish a robust foundation for export-led growth.

As a result of high oil prices and the important surplus with the United States, Mexico’s current account deficit has been stabilized in the past few years. This is also the result of slow growth rates, a fact that is seldom included in official analyses of the macroeconomic landscape. When the Mexican economy grows at rates above the average of the past twenty years, the current account deficit also increases significantly. Thus, slow growth rates also help maintain a fragile balance in the external accounts. Finally, the balance of payments is also improved by the remittances of migratory workers that have crossed the border in search for stable employment opportunities. Mexico has expelled an average of 400,000 migrant workers to the United States every year since 1994. Their remittances have been a positive contribution to the balance

**Figure V.25**

![Inflation and Money Supply](chart)

Source: Marcos Chávez, Mexico Country Study.
of payments, but their personal experience is a testimony of the failure of the Mexican economy to provide adequate job opportunities for its people.

The key problem of Mexico’s trade balance is that it relies on exports of maquiladoras and oil (the official narrative about the lack of importance of oil in total exports notwithstanding). The following exercise gives a better idea of the structure of the trade balance. In 2008 the total trade deficit amounted to USD $17 billion, or 1.5% of GDP. However, if we exclude maquiladora exports, the deficit reaches USD $42 billion, or 4.4% of GDP. And if we abstract from oil exports, the deficit reaches USD $67 billion, or 6.2% of GDP. This would of course be the worst performance of Mexico’s trade balance in decades, but this is just an exercise that shows how important oil and cheap labour is for Mexico’s exports.

In so far as the strategic objectives of maintaining equilibrium in the country’s internal macroeconomic aggregates, the picture is not very bright. Inflation has been subdued, but this is achieved at a very high cost. Figure V.25 shows how the restrictive posture in monetary policy has contributed
to the control of inflationary pressures. The main component of the anti-inflation strategy has been a restrictive monetary policy. This is translated into a contraction oriented approach to the monetary base. Interest rates have remained very high throughout the period and this has affected capital formation rates. This has acted as a powerful brake for productive investment and has slowed down economic activity.

In addition, another anti-inflation instrument has been the overvalued currency with detrimental effects on the country’s external accounts. Because imports are an important component of aggregate supply, an overvalued exchange rate is an important instrument to put a lid on inflationary pressures. Figure V.24 also shows how the exchange rate has been successfully utilized as anchor for the price system. The peak

![Gulf Offshore Platform](Credit: Coquitlam Wikimedia Commons)
in 1995 shows how a macro-devaluation can as a long period of overvaluation helps subdue inflation but leads to a severe adjustment as expectations deteriorate and capital flight takes place. Figure V.24 shows that when tension builds up and finally the exchange rate is adjusted, a macro-devaluation takes place in a very disorderly process, with extreme capital flight. As pointed out above, the positive achievements of the anti-inflation struggle are destroyed and a very unstable situation emerges. High interest rates are used to attract foreign capital, but this affects the cost of credit and leads to high non-performing portfolios.
Of course, the use of the exchange rate as an anchor for the price system presents its own problems because it impedes using the exchange rate as an adjustment instrument for the trade balance. This is a major problem in the open economy model: as capital inflows take place, the exchange rate is appreciated, with negative effects on the external sector. In addition, because these capital inflows are crucial for the country’s international balance of payments, monetary authorities are trapped into a commitment to maintain the exchange rate stable. So, even though the open economy model is based on the premise that the exchange rate must adjust with great flexibility to the results of the current account, in practice this adjustment process is impeded by financial liberalization.

Finally, minimum wages, which is a key reference for contractual wages, have been indexed with the expected inflation rates established by the central bank. Throughout the period, real inflation rates have exceeded expected inflation, leading to a systematic drop in real wages. Although this helps contain aggregate demand (and thus less inflation), it also leads to greater inequality and poverty.

Mexico’s fiscal accounts appear as a good basis for sustainable debt manageable. However, there are serious problems with this conclusion. In the
first place, as we have noted several times in this report, fiscal policy has been dominated by the central objective of generating a primary surplus. This has been achieved through the reduction of expenditure rather than through increased revenues. So the impact of this on the allocation of resources for environmental stewardship has been rather intense. Of course, social expenditures (health, education, housing, municipal services) have also been drastically affected by this approach to fiscal policy. But even this approach has not been enough to solve the problem of increased indebtedness. In 1998 the Federal government disclosed information about the true state of public finance in Mexico. The notion of the so-called Financial Requirements of the Public Sector (FRPS) was used to provide a more accurate idea of the health of public finance.

As a result of several bailout operations, first for the sugarcane industry (which went bankrupt in the 1980s), then for the failed system of privatized toll roads (early 1990s) and finally for the rescue package of the country’s banking system (1995-1997), the FRPS represented more than double the normal public balance deficit. In addition, if we add the government’s commitments associated with the reform of the pension system, the real deficit becomes significantly higher.
Today, this deficit is more than twice the size of the deficit authorized by the Mexican Congress. Servicing this deficit is a problem that remains unsolved and leads to a heavy mortgaged public resources.

The global financial crisis of 2008 is having a severe impact on Mexico’s economy. The contraction for 2009 is currently being estimated to be of the order of 6.8% by Mexico’s monetary authorities, but the International Monetary Fund is forecasting a drop of 7.3%, while several private sector rating firms, such as Moody’s, are forecasting even steeper falls in aggregate output. There are two critical reasons behind this dramatic outcome for Mexico. The first is that approximately 88% of Mexico’s total international trade is carried out with the United States. As the crisis unfolded and the US economy started to slow down, the ripple effects extended into almost every corner of Mexico’s economy. The second reason is that oil prices have collapsed and this brought about a fiscal crisis, with a gaping hole of more than 300 billion Mexican pesos. The response of the government was a pro-cyclical fiscal package that will exacerbate the effects of this crisis: taxes are being increased, while expenditures continue to be curtailed. The combined

Figure V.26

Source: Marcos Chávez, Mexico Country Study.
effects of this will have a long lasting impact on Mexico’s ability to allocate adequate resources for environmental stewardship.

STAGNATION AND ENVIRONMENTAL DEGRADATION
Mexico’s recent economic history is a picture of stagnation combined with environmental deterioration. One possible explanation for this may be found in the misallocation of resources that takes place through macroeconomic policies. In particular, fiscal policy has not been able to remedy the serious problems associated with environmental degradation through the allocation of an adequate level of financial resources. The evolution of public expenditure may be in line with a strict ideological view about the need to reduce state intervention in economic life in order to attain economic development. But it is not in accordance with historical experience (see Chang 2002), nor is it in agreement with the need to invest in environmental stewardship.

An examination of Figure V.27 reveals that net environmental costs are significant. The graph shows how net domestic product (GDP minus fixed capital depreciation and amortization) and total net ecological domestic product (which takes into the costs of account depletion and environmental deterioration) evolve as time unfolds. The ecological accounts show that these environmental costs have kept pace with the sluggish rate of growth of GDP. This almost assumes a linear relationship between GDP and environmental costs, something that is not justified by what we know about growth and stagnation. In a stagnant economy, productivity and technical change remain more or less constant. In any event, the total costs of depletion and environmental deterioration are of the order of 22% of GDP. This amount is probably underestimated (due to the coverage of the environmental accounts), but it still is quite significant and may be an indicator that if this pattern of events is not reversed, the country may well enter into a dangerous phase of environmental degradation that may be capable of threatening the future potential for sustainable development.

Figure V.27 shows that in spite of years of “responsible” budget management (i.e., generating a primary surplus and containing expenditures), the financial requirements of the public sector continue to grow. In fact, they have almost doubled since 1998 when data started to be disclosed. Clearly, there is something wrong with this approach to fiscal policy. The distraction of resources from areas related to environmental stewardship is not only substantial, but it is also useless when it comes to reducing the financial burden of the State.

It is difficult to conclude that technical progress has taken place and that this maintains environmental costs
more or less in line with the slow growth of GDP. But in fact, Figure V.27 shows a strange behaviour in the case of the curve describing the evolution of environmental deterioration costs. Until 1999-2000, the curve continues with a positive slope that reflects the growth of environmental deterioration costs. But after 2000 the curve adopts a negative slope, indicating that these costs are being reduced. This could only be the result of greater efficiency, increased productivity or a change in the output.
mix that would be accompanied by inferior environmental deterioration costs. In fact, all indicators and the output mix of the Mexican economy contribute to cast serious doubts on this conclusion.

Could it be that Mexico is investing more in remediation and control of environmental deterioration? The study of how public spending in environmental sustainability has evolved contradicts this viewpoint. **Figure V.28** shows that total public expenditure (programmable appropriations, without debt service) has increased modestly in real terms in the period 1987–2008. In these two decades, total expenditures have remained constant as a percentage of GDP (oscillating around the 16% level).

In absolute terms, the resources allocated to the Federal budget items that can be considered as close to environmental stewardship have remained at very low levels. The curve that includes regional development, municipal and housing services, also includes social expenditures related to the war on poverty campaigns. Even this amount remains at the level of 150 billion pesos, and is even showing a downward trend in 2007–2008. This means that the environmental costs that are associated with the evolution of the Mexican economy (which, as we have seen, has

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**Figure V.28**

![Graph showing public spending in environmental stewardship](source:image)

maintained a modest growth rate) are met with a more or less constant and modest level of resources.

The country study for Mexico shows that the long period of economic stagnation that has taken place in the last thirty years is accompanied by a process of constant deterioration in almost every environmental dimension. The level of public spending allocated to environmental damage remediation and prevention is not enough to compensate the total cost of depletion and environmental deterioration used to calculate the Net Ecological Domestic Product (see Figure V.27). As commented above, Mexico’s environmental accounts reveal that the total cost of depletion and deterioration is equivalent to approximately 22% of GDP. The amount of resources allocated to environmental stewardship is not more than 4% or 5% of GDP. And even this amount is overestimated because it includes expenditures that are not strictly directed towards environmental conservation and remedial actions. Clearly, if fiscal policy continues to generate a primary surplus, this negative trend in the amount of resources allocated for environmental sustainability will continue with negative consequences into the future.⁸⁴

⁸⁴ This conclusion is quite independent of any assumption on weak or strong sustainability.