Mexico: A Nation in Crisis.
A look to the forces behind
the current crisis.

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Abstract

This paper attempts to clarify the confusion surrounding Mexico's current crisis. It organizes the causes of the crisis into four areas. The first, economic factors, covers the changes in oil prices, the debt crisis, the monetary crisis, and unemployment. The second area, human factors, examines problems associated with the population explosion, public health, and education and technology. The third area of crisis is the political arena, where the ruling party has been dicredited through allegations of fraud and corruption. Fourth, the study examines U.S. influence in Mexico and how it too has caused additional problems for Mexico. By bringing these four areas together, the reader will have a framework for understanding the crisis.

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Table of Contents

Introduction

In July, 1986, Mexico reached a new agreement with the International Monetary Fund concerning the very solvency of the Latin American nation. Under the Accord, Mexico received \$12 billion USA dollars in new loans of which \$2.5 billion came from the world's private banks before the end of 1986, and \$3.5 billion before the end of 1987.(1) These fresh loans along with the more recent private debt reschedulings and debt swap program were designed to prevent the possibility that Mexico would terminate its interest payments on its foreign debt(2), which passed \$100 billion in 1986.(3) Many authors at the time of the IMF agreement felt that the Mexican agreement "reinforced confidence in the world's financial system."(4) As in many other cases, the world financial community moved from impending crisis to solution, complete with self-congratulation.(5)

Mexico`s current crisis, however, will not be solved, despite the IMF agreement's "boost" for the Baker Plan, a plan which calls for economic liberalization in debtor countries in return for increased lending to the third world.(6) Mexico`s crisis is much more profound. This paper attempts to outline the major causes of the Mexican crisis, putting the various factors into three categories. First, economic factors including the debt, capital flight and the volatility of the price of petroleum will be discussed. Second, human factors such as the population explosion, education and public health will be explored. Third, the political context will also be examined. Finally, the role of the United States will be explored. Using this framework, this study hopes to reduce the complexity of the situation into a more comprehensible set of factors which can in turn be analyzed to search for lasting solutions.

Economic Factors

The first set of factors influencing the current crisis is the set of economic causes. Several changes in key economic components have reeked havoc on the Mexican economy. Probably the most notable is the drop in the world price of oil. Other factors bringing fits to Mexican policy-makers include the debt crisis which followed the drop in oil prices, the monetary crisis, characterized by unstable exchange rates, capital flight and inflation and the relatively high level of unemployment.

The Change in Oil Prices

A leading cause of the economic crisis in Mexico can be traced to oil. During the 1970s, Mexico began to believe that oil could liberate the nation from its third world status. In 1973, the Arab oil embargo established oil as an important commodity. Prices jumped upward and the Arab states began to accumulate petrodollars which were in turn deposited in Chicago and New York.(7) Averting a petrodollar glut, the U.S. banks re-lent the petrodollars to their southern neighbor who appeared a good credit risk and wished to modernize its economy. Mexico at the time had the fourth largest proven reserves of oil in the world.(8) Thus, Mexico was simply allowed to borrow against oil that was still in the ground(9). U.S. Banks reasoned that as the price of oil goes up, the debt service ratio will fall.(10) Further, to avoid a petodollar crisis, the U.S. Treasury Department was supporting the venture. (11)

The magic seemed to work for a while. In 1980, the price of a barrel of oil climbed past the $27 mark. Forecasters predicted prices to continue upward to $40 and in one case, even to $100 a barrel.(12) Yet a year later, in the presence of decreasing demand, prices leveled out. Due to the loss in increased revenue, Mexico began to borrow still more. Later that same year, the bottom broke, as Saudi Arabia failed to agree with other OPEC nations to a reduction in production.(13) Oil prices tumbled.

On August 15, 1982, Mexico announced that it could no longer meet its foreign loan obligations.(14) This precipitated, at first, near panic on a world scale, and subsequently the the bail out efforts which continue to plague the financial community and the Mexican government.

There appear to be two effects from the drop in oil prices that confront us today. First, the drop in world oil prices seems to affirm that price-fixing schemes do not work in commodity markets. Second, Mexico now has to find alternative means to finance not only present and future spending, but also past debt. Historically, long-run price stabilization schemes have not worked.(15) Thus, stabilizing oil revenue will be an allusive task in the future for Mexico. Therefore, Mexico cannot rely on a return to the "good old days" of increasing revenue for a future stream of income, even if prices do rebound substantially in the next several years. One problem then remains; how will Mexico pay off its debt and still modernize its economy?

<u>The Debt Crisis</u>

A second cause of the economic crisis is the foreign debt. The Mexican debt crisis is ominous. There remains serious doubt as to whether it can ever be repaid. In October 1986, Mexican debt securities were being sold at a substantial discount--a bid price of 58 cents and offer price of 62 cents on the dollar--reflecting speculators lack of confidence in the troubled nation's ability to repay.(16) Interestingly, the resale has steadily increased in volume since 1982--the date of Mexico's crash(17), possibly indicating a steady decline of confidence.

At the outset of the autumn 1986 recent round of IMF negotiations, Mexico demanded that repayment schedules be pegged in some way to the changing price of oil. Yet commercial banks were reluctant to go along, fearing that other debt-ridden nations might emulate the demand of tying repayment to a single commodity.(18) However, Mexico got what it demanded. Banks are now forced to lend more if and when the price of oil again falls.(19) This leaves Mexico in a paradoxical situation: as its revenue falls, the poorer it will be, the more it will owe.(20)

The new IMF deal did not come without Mexican concessions. According to finance ministry officials in Mexico, the new arrangements call for much of the orthodox IMF restrictions.(21) Mexico will be obiligated to close some state industries and to increase prices sharply and immediately for domestic electricity, water, public transport and many other currently government subsidized services.(22) This should in turn push down the purchasing power of the average Mexican worker who has already seen his purchasing power fall a third since Mr. de la Madrid came to office.(23)

The Monetary Crisis

Another element of Mexico's economic woes is the monetary crisis. This has several key compnents. The first is the enormous amount of capital flight. The second is the seemingly perpetual devaluation of the peso relative to the dollar. The third is the break-neck inflation pace that has rocked the nation. The interaction of these components has reinforced one another to create a near uncontrollable crisis.

Over the past 10 years, $53 million has fled Mexico according to one study by the Morgan Guaranty Bank.(24) This means that that money is not available for investment and reinvestment in the domestic economy. Had the flight not transpired, the Morgan Guaranty study estimates that the foreign debt would be $12 billion, not the current $100 billion.(25)

The flight of capital is one indicator of Mexico's chronic inflation and unrealistic exchange rates. Under President Echeverria in the 1970's, the money supply grew at a rampant 20% compared with less than 5% in the U.S.(26) While the official exchange rate with the U.S. remained constant, inflation in Mexico hit double digits in 1973 and has now reached triple digits.(27) Finally, the first devaluation came in 1976 with then lame-duck President Echeverria. This introduced a floating exchange rate system.(28)

After 1976, the peso`s value began to fall. Originally pegged at 22 to the dollar, the dollar now fetches about 2300 pesos, six times as many as only two and a half years ago.(29) With the volitity of the exchange rates goes economic uncertainty, which in turn results in increased capital flight.(30)

<u>Unemployment</u>

A final component of the current economic crisis is the severe unemployment problem. In Mexico's shrinking economy, workers are being squeezed out of the system. There are roughly a million fewer jobs in Mexico today than there were only five years ago.(31) With new IMF restrictions, the present 14% unemployment and 40% underemployment are both likely to increase.

The new international labor relations further compound Mexico`s dilemna in putting its people back to work. Under the new world economic order, the productive process has become increasingly more decentralized, deskilled, nonunionized and temporary.(33) Empirically, Mutlinational corporations have eliminated more positions than they have created.(34) This has been attributed to the introduction of capital-intensive rather than labor-intensive technology.(35) In addition, under the new labor relations, multinationals often prefer to hire young, female, single workers, teaching them only the skills necessary to do highly repetitive tasks on a pay-per-unit basis.(36) Thus, the composition and quality of the labor that has retained work is changing, leaving a permanent imprint on Mexico's future capacity to industrialize. Unfortunately, Mexico's labor force is not adversely effected only by economic changes. The composition of Mexico's future workers is also being affected by several key human factors.

Human Factors

In addition to economic factors, human factors are also playing a major role in Mexico's current crisis. These human factors can be characterized by problems in three areas. First , Mexico suffers from a population explosion. Second, public health problems persist in several basic areas. Third, Mexico is on the verge of falling still further behind in education and technology.

The Popluation Explosion

One of the main human factor problems in Mexico is the population explosion. Each year there are a million more Mexicans than there were the year before.(37) In 1986, the President of Mexico's Consejo Nacional de Poblacion indicated that in the year 2000, Mexico's population will be 100 million.(38) Yet the U.S. Census Bureau pegs Mexico`s population to rise from a present 81.7 million past the 100 million to 112.8 million by the year 2000.(39) Further, Mexico City will increase from 18 million residents to 28 million by the year 2000.(40) Mexico's former minister of Science of Technology analogized the situation in Mexico and Latin America to that of modern day Calcutta.(41)

Population growth will provide fits for the government for years to come. Food, shelter, education, health care and other basic needs must be re-evaluated in the light of the explosive population. At this point, it seems the current Mexican Government would rather simply deal with the short term crisis rather than contemplate serious population control. Unfortunately, the growth in numbers itself is not indicative of an even more serious problem which has resulted from a change in composition in the population resulting from the explosion.

Demographers now assert that Mexicon's population is fundamentally young.(42) Its labor force is posed to increase at an incredible rate.(43) According to the Center for International Research, Mexico will have to create a million jobs per year simply to absorb the increase in available labor.(44) One Census Bureau demographer has noted that in the last five years of this century, Mexico`s workforce will increase by 5.3 million--an amount equal to the increase the entire U.S. will experience for the same period.(45) Yet even the U.S. estimates may be conservative, since the role of women in the Mexican labor