

IMPACT OF GLOBALIZATION: The case of Mexico

“The current economic model is based solely on profits and benefiting very few people, leaving aside the majority...is not creating jobs nor the possibilities for poor people to progress...”⁵⁰

Since the mid-1980s, Mexico embarked in an ambitious reform program, including drastic trade liberalization, privatizations and a reduction of the government’s role in the economy. By far, the deepest reforms were in trade policy, not only through a substantial reduction in tariffs but also through signing numerous free trade agreements. In addition to NAFTA (the most important for natural reasons), by 2001 Mexico had already signed 11 free trade agreements which included 31 countries in different continents.

Other reforms, like privatizations, deregulation and institutional reforms were also pursued but their scope was somewhat less far-reaching. For example, even though the number of state-owned companies significantly diminished, state monopolies still continue in key areas such as oil and energy; also, the legal system has only had minor reforms and labor market regulations continue unchanged since the 1970s.

Some benefits of these reforms are unquestionable and recognized even by their opponents, such as the impressive growth in Mexican exports. Between 1990 and 2001, Mexican exports increased at an average 17.5% per annum, from US\$26.8 billion to US\$158.5 billion (a 491% increase during this period).

However, the criticisms and general perception as to their benefits and to the integration process to the global economy closely resemble those voiced throughout Latin America. These benefits, it is argued, have been relatively small and highly uneven. Moreover, globalization has “excluded” the vast majority of population and even worsened their living standards.

⁵⁰ Vera, R. Roman Catholic Bishop at the 74th Plenary Assembly of the Mexican Bishops Conference. November 2002.

PERCEPTION.- Structural reforms and integration to the global economy have not contributed to improve the incomes and living standards of the majority of the Mexican population. In fact, it has exacerbated income disparities, marginality and poverty.

M 1. Effects on income levels and living standards

According to the latest available data, income distribution in Mexico worsened during the 1990s. In 2000, the Gini Index (which measures the degree of inequality in the distribution of incomes) was 0.503, in comparison to 0.488 five years earlier (a lower value means a more even distribution of income)⁵¹. However, total average real income rose 22%, with all income groups showing positive growth.

TOTAL HOUSEHOLD INCOME BY STRATA*, 2000

| | Average Income | 2000/1996 Real % Growth |
|--------------|----------------|----------------------------|
| Total | 7.8 | 22.2 |
| I | 1.2 | 6.4 |
| II | 2.1 | 8.1 |
| III | 2.8 | 12.8 |
| IV | 3.6 | 14.7 |
| V | 4.4 | 17.1 |
| VI | 5.5 | 19.1 |
| VII | 6.9 | 21.6 |
| VIII | 8.8 | 20.5 |
| IX | 12.6 | 23.6 |
| X | 29.7 | 27.7 |

*/ '000 Pesos / month

Source: INEGI 2001

The worsening of income distribution, therefore, was the result of the faster growth at the upper brackets (the highest income groups) of population, but the poorest groups also improved their absolute income levels.

⁵¹ INEGI. (2001).

Is this a “proof” that the benefits of globalization are biased towards the rich? To answer this, it is necessary to look at the factors explaining these trends. Several studies have concluded that such trends are mainly determined by two factors: a) the level of education and, b) labor market regulations.

It has been demonstrated that the greatest change in income distribution is associated with wage incomes and these are highly correlated with education levels⁵². Thus, “*redistributive policies should aim at reducing educational inequalities, so as to allow a greater number of people to access the high returns derived from human capital investment*”⁵³.

As for labor market conditions, comparative studies on labor market rigidity show that Mexico has a significant disadvantage. For example, in a study on 36 countries, Mexico ranks 26 in terms of labor market rigidity. The cost of labor regulations are equivalent to 31% of wages, while in Canada and the United States they account for 12% and 19%, respectively⁵⁴.

This also explains what has occurred in NAFTA countries. During the 1990s, per-capita incomes in Canada rose 5.5% to US\$20,000 and Mexican incomes increased 6.5% to US\$5,500 per annum. However, Mexico and Canada fell behind the United States in relative terms. Since 1990, U.S. real per-capita incomes increased 17% to over US\$25,000⁵⁵.

The main factor behind this performance, again, lies in the differences between labor productivity, which in turn is directly related to labor market flexibility⁵⁶.

It is clear, therefore, that there is no inherent bias in economic liberalization policies and globalization against the majority of the population (or against

⁵² Clavijo, (2000).

⁵³ Ibid.

⁵⁴ Bancomer, (2001).

⁵⁵ Higgins. (1999).

⁵⁶ Ibid.

the poor). Rather, it is domestic constraints and shortcomings that prevent the majority of the population to benefit from them.

M 2. Effects on employment

As it could have been expected, since the trade liberalization and structural reform process began, a large share of the new jobs created in the Mexican economy were related, either directly or indirectly, to export industries.

It is estimated that between 1986 and 1996, 1.3 million new jobs were directly generated by exports, about 30% of the total new jobs created during this period. More importantly, in the 1994-2000 period the export sector accounted for more than 80% of new jobs in the manufacturing sector⁵⁷.

When considering the fact that during this period the Mexican economy suffered from a major economic crisis (1994-1995) and significant macroeconomic instability and low growth (1986-1988), it is clear that the new jobs created by the export sector helped to prevent even greater job (and income) losses in those two episodes. In fact, the fall in average real wages in manufacturing from the 1994-1995 crisis, was significantly lower in the country's northern region where the main export base is located⁵⁸.

An additional benefit has been a significant geographical decentralization of economic activity. For centuries, and until the mid-1980s, the economic activities were highly centralized in the Mexico City area. However, in the past two decades economic activity has fast moved to other regions (mainly in the northern and central parts of the country). This has gradually reduced regional disparities, both economic and social. In fact, it is estimated that, for the first time ever, by 2003 or 2004 Mexico City will be displaced by the North Eastern Region as the country's biggest employment provider⁵⁹.

⁵⁷ Clavijo. (2000).

⁵⁸ Ibid.

⁵⁹ Consultiva. (2000).

M 3. Costs of institutional constraints and benefits from opening

We have already mentioned how, despite the structural reforms and liberalization policies carried out, institutional constraints in Mexico have been the prime reason why the country has only partially benefited from them.

These domestic constraints place a heavy burden on the countries that has prevented the economy from increasing on an important and sustained basis its international competitiveness.

This is not a theoretical or conceptual conclusion. According to World Bank studies⁶⁰, the costs of existing excessive regulations in Mexico are estimated at 57.4% of average per-capita income, while the same costs in its main trading partner, the U.S., are only 1%. This means that, only by reducing these excessive regulations, per-capita income in Mexico could significantly increase. Moreover, given the existing unequal income distribution, those benefits will be proportionally much larger for the lower income population. In other words, a simple and direct way for improving income distribution would be through the removal of these constraints.

But, in addition to the very high direct cost of regulations, they also generate high indirect costs in at least two ways. On the one hand, they lead to higher transaction costs for the economy as a whole, resulting in a misallocation (and waste) of resources, which in turn reduces economic growth and incomes.

On the other hand, excessive regulations are the prime source for corruption, as a consequence of the inevitable discretionarily they create. Results from the National Survey on Corruption and Good Government carried out by Transparencia Mexicana⁶¹ in 2001 estimate that the Mexican population paid the equivalent to US\$2.5 billion in bribes. This amount

⁶⁰ Cited in Bancomer. (2001).

⁶¹ Transparencia Mexicana. (2001).

represents almost 0.5% of GDP and is higher than the government's budget for research and development activities.

Moreover, the costs of corruption are highly "regressive", as they represent a higher proportion of the poorer people incomes than of the richer. Thus, while for those households with average incomes above the minimum wage bribes are equivalent to 6.9% of their income, for households that earn the minimum wage or less, they are equivalent to 13.9%.

Finally, another critical constraint on the economy's performance and international competitiveness is the inadequate legal system and its institutions. This constraint is not exclusive of Mexico but a common feature to most Latin American countries. The relationship between the legal system and the rule of law and economic development has been clearly demonstrated by Douglas North⁶², amongst many other authors. The rule of law is an essential, if not sufficient, ingredient for a nation's development, and this is more so in a global economy.

Although it is not easy to measure the economic costs to an economy of an inadequate legal system, a number of specific case studies show impressive results (and costs). For example, in a comparative study on the effects on bank credit of the enforcement of contracts and the rights of lenders, Ross Levine found out that more than 50% of the differences among banking system's development in 42 countries can be explained by their legal and institutional system⁶³.

In the case of Mexico it was shown that for the 1976-1993 period, if legal provisions on lenders' rights and their enforcement had been "average" (i.e. in comparison to other countries), bank credit as a proportion of GDP would have been three times higher than it actually was. This, in turn, would have increased GDP's average growth rate by an additional two percentage

⁶² North, D. (1981).

⁶³ Levine, R. (1998).

points per year. This means that Mexico's GDP could have been 40% higher at the end of the period (1993)⁶⁴.

These three examples of the costs of institutional constraints and deficiencies clearly show that:

1. Economic and income growth could have been significantly higher without the constraints and deficiencies outlined.
2. The costs caused by the constraints have been proportionally higher for the less well-off members of society, whether poorer individuals or small and medium sized companies.
3. The various deficiencies have also meant a constraint on the economy's potential to benefit from globalization as they diminish international competitiveness.
4. Finally, all of these constraints are domestically made, and have nothing to do with globalization.

⁶⁴ Ibid.