CHAPTER 4

A PERSPECTIVE ON MEXICO

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BACKGROUND

Mexico, the newest free trade partner in North America, is a union of 31 states with a strong federal government (the formal political name for the country is the United Mexican States). Although the political history of Mexico is authoritarian, the country is well on its way to becoming a full western style democracy. Traditional one party rule now comes under serious challenge, and political institutions are becoming more open each day. The present government shows every sign of being committed to continuing this trend.

The country has 85 million people, 60% of whom live in urban areas. More than 20 million people live in Mexico City alone, making it one of the world's largest cities. Other major cities, such as Guadalajara and Monterrey, have over 3 million people each. Mexico is a very "young" country in terms of demographics. Forty percent of the population is under twenty years old.

Mexico's per capita GDP in 1992 was $3,600. Per capita GDP grew between one and four percent a year during the period 1990-93, a time when other global economies were in various stages of recession. GDP growth fell to 0.4% by late 1993, as the effects of the global recession started impacting Mexico's economy.

Inflation during 1994 was less than 8%, a substantial drop from the 30% levels seen a decade earlier. The drop was largely due to the government's "solidarity pact" with business and labour, which committed all parties to work towards Mexico's economic stability.

Overall, Mexico has a broad manufacturing infrastructure, and produces a wide range of goods for local consumption and export. Major exports are petroleum and petrochemicals, automobiles, automobile engines and other parts, vegetables, and raw coffee beans. Primary imports are automobile assembly material, electrical parts, chemicals, industrial equipment, textile and metalworking machinery, and computers. Mexico's major export markets are the United States, Japan, Canada, Spain, France, and Germany. Imports into Mexico come mainly from the United States.

ECONOMIC LIBERALISATION

Mexico's economic progress during the last few years has been dramatic, and in large measure has been due to the Mexican government's efforts to liberalise the economy and implement a tough anti-inflationary programme. The government's priorities were to decrease the fiscal deficit, fight inflation, open up trade and invite foreign investment. Attention was also paid to support the agricultural sector, improve infrastructure, and place greater reliance on the private sector. Many large state enterprises were privatised.

Key to this economic liberalisation and development programme was a three way pact between government, business and labour. This pact combined fiscal and monetary discipline on the part of government with a commitment by business and labour to hold down wages and prices. The exchange rate of the peso was controlled within a narrow band.

Mexico's initiatives towards liberalised trade and markets paid rich dividends, and the country was admitted to the Organisation for Economic Co-operation and Development (OECD). Joining the United States and Canada in the North American Free Trade Agreement (NAFTA) was a bold, courageous and landmark move by Mexico, and signalled the country's confidence that it could compete in an open market along with richer, more developed economies like that of the US and Canada. Mexico's view was that open trade with these countries would inevitably fuel its own progress, development and per capita income.

Despite the recent and well publicised Mexican currency crisis, Mexico's strategic objectives in joining NAFTA are being realised. There is visible progress in virtually every sector of the economy; Mexican businessmen have a greater international perspective than before; and productivity is rising. The political and economic apparatus still remains focused on rapid advancement, although it recognises that further fundamental change is necessary.

PRESENT CONDITIONS

The healthy economic growth that Mexico enjoyed in the last few years has now drawn to a close, at least temporarily, due to the drastic devaluation of the peso that began in December, 1994. In less than four months, the peso has lost over half its value. However, it is important to note that the Mexican currency crisis was not due to the government's decision to float the peso - it was the bad handling of this decision that led to a loss of investor confidence. Economists agree that in terms of fundamentals, the peso is currently discounted much too deeply. As the Mexican government regains control of the situation, the peso appears to be stabilising.

The international support package for Mexico from the United States, Canada, the International Monetary Fund, and the Bank for International Settlements amounts to one of the biggest international rescue plans ever put together for a currency. This combination of loans and loan guarantees should alleviate Mexico's short term liquidity problem and help stabilise the peso. However, the package is tied to Mexico adopting a strict programme of economic discipline, including cuts in government spending, tighter credit and no further diversion of investment funds to consumer imports.

After some initial hesitation, Mexico has responded boldly, setting up a programme that has increased consumption taxes, initiated deep spending cuts, reduced income taxes, reduced subsidies on items such as gasoline, and tightened monetary policy. As long as these measures help keep wage and price inflation under control, Mexico will in fact be able to turn its weak currency to advantage and dramatically boost its exports.

Rising Mexican exports are evidence that this medicine is working. The trade deficit is coming down, and exports are expected to grow by 27% in 1995. In February, 1995, Mexico recorded its first trade surplus in over four years.

Mexico's NAFTA partners have signalled their strong and continued support for this "second stage" leap by Mexico into a liberal, stable economic world. They recognise that the recent peso crisis is not a rerun of the debt crises of the eighties. Indeed, Mexico's troubles with its currency could have occurred in any country, rich or poor. For all the panic that shook the markets, many argue that the impact would have been far worse without NAFTA, which united three countries in striving for mutually vested interests. In essence, Mexico has become too important to be allowed to fail. The long term bet is that the country will regain its momentum and prosper.

PROSPECTS FOR EXPORTS TO MEXICO

The liberalisation of Mexico's economy, still continuing despite the currency crisis, has generally meant lower tariffs and a more open market for foreign goods. NAFTA resulted in a substantial increase in Mexican imports. With the falling peso, however, some imported products have become prohibitively expensive. Many prices have doubled in local terms. In some sectors, Mexican purchasing power has been cut by one third.

Given this situation, it is obvious that foreign companies will experience difficulties in the short term selling into Mexico. However, the effects will likely be most pronounced in consumer goods. Reacting to this expectation, many American retailers have put their Mexican expansion plans on hold. On the other hand, the currency situation appears to have had little impact on expansion and investment plans in the industrial and infrastructure sectors. Few, if any, companies have announced cutbacks in such projects.

This indicates a more reasoned confidence in Mexico's long term prospects, and augurs well for many foreign companies wishing to do business with Mexico.

As mentioned above, imports of consumer products into Mexico will fall in the short term. Consumer products related to the construction industry, in particular, will be affected as discretionary spending on home improvement falls, mortgage rates rise steeply, and construction activity slackens.

Food products will also experience reduced import demand. Mexican consumers will purchase fewer imported non-essentials in the near term, and rely on domestic products instead. Foreign processed foods will likely see far lower sales over the next year or two. Basic imported foodstuffs will be less affected, particularly those that do not have a ready domestic substitute. Exports to Mexico of exotic foods, shell fish or agricultural produce will not fare well in the short term.

Exports of industrial goods to Mexico, such as components and chemicals, will not see dramatic declines. These items are vital to the Mexican economy, and the push for economic growth will sustain their demand. Again, industrial imports without ready domestic substitutes will fare better.

In summary, the prospects for exports to Mexico vary by type of product. In the short term, there will be volatility. In the long term, the prospects for exports to Mexico are bright, since Mexico's commitment to an open, international economy is not expected to waver.

PROSPECTS FOR COMMONWEALTH EXPORTERS

For most Commonwealth countries, Mexico has not been a major export target, and the Mexican market has not been viewed as a priority. Even Canada, a neighbour and NAFTA partner, currently exports far less to Mexico than it can. There is clearly an opportunity for many Commonwealth countries to turn their attention to this market, and take advantage of "getting in on the ground floor"

The current economic downturn in Mexico offers Commonwealth exporters the time to compose their strategies for penetrating this market. Now is the time to learn about opportunities in Mexico, forge alliances and establish a presence. The commitment of the NAFTA partners for mutual growth, coupled with the potential demand generated by Mexico's very young population, suggest that Mexico has very good long-term potential as an export market. In many cases, it is even an advantageous "springboard" into the US and Canadian markets.

Commonwealth exporters should view Mexico as an excellent long term opportunity.