State Policy, Distribution and Neoliberal Reform in Mexico*

MANUEL PASTOR AND CAROL WISE

Abstract. For nearly a decade, Mexico has embraced a neoliberal development model based on liberalisation, privatisation and deregulation. Yet, contrary to longstanding claims in the economic development literature, this strategy has yet to produce the high levels of growth and income gains that policy-makers had projected at the outset of the reforms. This article suggests that the lacklustre response of the Mexican economy represents more than a longer-than-expected adjustment lag. Rather, through an analysis of state policy in the urban–industrial and rural–agricultural sectors of the economy, the authors locate the sources of slow growth and wage compression in: (1) the particular mix of policies that have been implemented under the banner of neoliberalism in Mexico; and (2) the failure to properly coordinate macroeconomic stabilisation with longer-term goals of market restructuring.

Arguments in favour of neoliberal reform have long held that an economic strategy based on liberalisation, privatisation and deregulation is the surest recipe for triggering higher levels of growth, productivity, and income equality.[1] However, despite the ambitious programmes of economic adjustment and market restructuring undertaken in Latin America since the mid-to-late 1980s, annual growth rates averaged just 3.6% during the 1991–4 period – well below the estimated 6% rate that would be required for a significant improvement in employment and social equity.[2] Indeed, only a handful of countries have seen an increase

Manuel Pastor is Professor of Latin American and Latino Studies at the University of California, Santa Cruz.
Carol Wise is Assistant Professor at the Johns Hopkins University School of Advanced International Studies, Washington, DC.

* Background research for this article was supported by the John D. and Catherine T. MacArthur Foundation, the U.S. Institute of Peace and by the William and Flora Hewlett Foundation. The authors thank Jonathan Fox, Carol Graham and Michelle Miller for their many helpful comments, and Monica Garaitonandia, Julia Holman, Grady Jackson, Karina Ramos and Walter Weaver for their highly capable research assistance. Special thanks to Lori Snyder for her significant contribution to the early research for this project.

[1] See, for example, B. Balassa et al., *Development Strategies in Semi-Industrial Economies* (Baltimore, 1982), D. Lal, *The Poverty of Development Economics* (London, 1983), and P. Bustelo, 'Neoliberalismo y nuevos paises industriales', *Revista de Economía*, no. 727 (March 1994, Madrid), pp. 77–93.

[2] These figures on growth, income shares, and productivity are cited from 'Increased Productivity, Key to Development', *CEPAL News*, vol. 16, no. 6 (June 1996), pp. 1–3, and 'Poverty in Latin America and the Caribbean is Greater Now Than in the 1980s', *CEPAL News*, vol. 16, no. 7 (July 1996), pp. 1–3.

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in *per capita* gross domestic product (GDP) since 1991 and, while total factor productivity has improved during the 1990s, Latin America has still not caught up to where it stood on this indicator in 1980.

In this article we explore this gap between the expected gains from neoliberal reform and the lacklustre results that have thus far been registered. Focusing on the case of Mexico – a country that first liberalised in 1985 and thus ranks second only to Chile in terms of the length of time that the reforms have been in place – we argue that these disappointing returns are more than just a longer-than-expected adjustment lag; rather, as policy-makers have disproportionately harnessed their neoliberal reform programme to the tasks of macroeconomic stabilisation, the tendency has been both to over-emphasise the benefits from economic opening and to ignore the accompanying microeconomic stresses – all in the name of market management. Yet, as the Mexican economy moves firmly into its second decade of neoliberal reform, there is no clear sign that the prevailing market strategy will deliver on its original goals of sustainable growth and better equity. If anything, growth rates remain erratic, the domestic distribution of income has deteriorated, and the country's labour markets have tightly contracted.

This suggests the need for an explicit and innovative set of public policies to help bridge the gap between macroeconomic stabilisation and microeconomic adjustment. In this regard, we emphasise that Chile, which displayed the highest growth and productivity rates in the 1990s, did not realise such growth and productivity gains until neoliberal nostrums were set aside in favour of a more pragmatic set of market-supporting policies in the wake of the 1982 debt crisis.[3] Although Chile's longstanding authoritarian regime (1973–90) was able to quell adjustment-related social protest until growth finally took root, Mexican policy-makers do not enjoy this same 'luxury': in the wake of the 1994 peso crisis, distributional conflicts have escalated to the extent that they now pose a serious threat to the reform process itself.[4] Thus, the problems of distribution, and a widening of the circle of winners from reform, must assume a higher priority in the coming years.

These arguments are explored in the following manner. We begin with

[3] This is a main theme of the essays in B. P. Bosworth, R. Dornbusch and R. Laban (eds.), *The Chilean Economy: Policy Lessons and Challenges* (Washington, DC, 1994). Despite the Chilean record of impressive growth, there remain problems for income distribution. See D. Raczynski and P. Romaguera, 'Chile: Poverty, Adjustment, and Social Policies in the 1980s', in N. Lustig (ed.), *Coping with Austerity* (Washington, DC, 1995), pp. 286–90.

[4] D. Solis and C. Torres, 'Libre mercado no garantiza nada', *Wall Street Journal Americas* (*El Mercurio*, Santiago, Chile), 17 June 1996, p. B8, and M. Fineman, 'Zedillo Address Touts "New Era," Targets Rebels', *Los Angeles Times*, 2 Sept. 1996, p. A1.

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a brief overview of economic performance and household income trends since the implementation of Mexico's neoliberal model in the mid-1980s. We then examine neoliberal policy directives and accompanying distributional trends within the urban–industrial and rural–agricultural sectors of the economy, as well as the government's responses to resulting sectoral pressures. A final section reviews the country's general approach to social policy, taking into account the numerous new social demands that have arisen within the context of a market-based development model. We conclude by suggesting that, despite the claims of neoliberal theorists with regard to the growth and distributional gains that can be derived from a market-oriented development approach, such gains have thus far remained elusive. Finally, we suggest that the prospects for better income equality and stronger economic growth would be greatly enhanced through the implementation of a cohesive set of market-supporting policies which more explicitly address these goals.

Economic performance and household income[5]

The Mexican debt crisis that began in 1982 marked the end of an era of state-led development based on import-substitution-industrialisation (ISI). Since then, Mexico has embraced an approach generally oriented toward liberalisation, privatisation and deregulation. Despite its basic thematic continuity, this 'neoliberal' model has undergone several important variations. The initial adjustment package prescribed by the administration of President Miguel de la Madrid (1982–8), for example, focused mainly on macroeconomic stabilisation. The principal goal was to ameliorate the external debt problem through a reduction of government spending and a large one-time devaluation of the peso. Unfortunately, the recessionary impact of this initial strategy was more severe than originally anticipated, and much of the task of economic adjustment was left to de la Madrid's successor.[6]

[5] The macroeconomic history in this section draws on N. Lustig, *Mexico: The Remaking of an Economy* (Washington, DC, 1992) and E. Buffie, 'Mexico 1958–86: From Stabilizing Development to Debt Crisis', in J. Sachs (ed.), *Developing Country Debt and the Third World Economy* (Chicago, 1989), pp. 141–68; analysis of the more recent period is drawn from M. Pastor and C. Wise, 'The Origins and Sustainability of Mexico's Free Trade Policy', *International Organization*, vol. 48, no. 3 (1994), pp. 459–89, and R. Dornbusch and A. Werner, 'Mexico: Stabilization, Reform, and No Growth', *Brookings Papers on Economic Activity*, no. 1 (1994), pp. 253–315, as well as interviews with Mexican macroeconomic policy-makers in 1992, 1993 and 1995.

[6] This first phase of adjustment failed partly because the government underestimated the extent of structural reform necessary to restore equilibrium and partly because external credit and assistance was so limited. For a more complete review of this period, see Lustig, *Mexico: The Remaking of an Economy*, especially pp. 34–8.

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The revised neoliberal model adopted by President Carlos Salinas (1988–94) was more far-reaching in its efforts to privatise state enterprises and the banks, and to liberalise domestic prices, foreign trade and investment. Of most significance, however, was the decision to stabilise the macroeconomy by combining: (1) an incomes policy (i.e. wage and price guidelines), which was codified in a series of tripartite pacts including government, business and labour;[7] (2) fiscal restraint, which removed the underlying inflationary impetus; and (3) a commitment to a stable peso with the further liberalisation of imports, the rationale being that import competition would serve as an additional brake on inflation.

Despite some initial scepticism on the part of outside policy-makers and domestic agents,[8] the strategy was successful in accomplishing its immediate goals of lowering inflation and resurrecting growth. However, as these returns began to diminish half way into the Salinas *sexenio*, policy-makers were reluctant to shift tracks and abandon the pact. First, their credibility on both the domestic and the international fronts came to hinge on their ability to produce the most favourable indicators that the Mexican economy had seen in nearly a decade. Second, as the Salinas team entered into negotiations with the United States and Canada over Mexico's entry into the North American Free Trade Agreement (NAFTA) in late 1991, the series of tripartite pacts emerged as one important venue for organising domestic support for NAFTA, particularly amongst those members of the business community that still doubted the decision to quicken the pace of trade liberalisation.[9]

The trends in Table 1 reflect the ways in which the pact both achieved its initial stabilisation goals, and over-stayed its welcome as an effective institutional mechanism for managing Mexico's rapidly changing position within foreign trade and financial markets. Economic growth during the Salinas years averaged 2.6%, and inflation dropped from 159% in 1987 to 7.1% in 1994. At the same time, one of the pact's main tenets – the use of a fixed exchange rate as a price 'anchor' – led to an increasingly overvalued real peso. As a result, the trade balance turned from a surplus of $8.8 billion in 1987 to a deficit of $18.5 billion by 1994, with rising

[7] For more detail on these pacts, see R. R. Kaufman, C. Bazdresch and B. Heredia, 'Mexico: Radical Reform in a Dominant Party System', in S. Haggard and S. B. Webb (eds.), *Voting for Reform: Democracy, Political Liberalization and Economic Adjustment* (New York, 1994), pp. 361–410.

[8] *Ibid.* pp. 381–3.

[9] Authors' confidential interviews conducted in Mexico City during 1991 and 1992 with a broad sample from within the Mexican business community concerning those factors which most influenced their support for NAFTA. As trade opening became positively linked with inflation reduction, those microeconomic losers from external competition were gradually persuaded of the merits of the overall programme.

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Table 1. *Mexican macroeconomic indicators since 1980*

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
GDP growth (annual percent)	8.4	8.8	−0.7	−4.1	3.7	2.7	−3.9	1.9	1.3	3.5	4.3	3.9	2.8	0.4	3.8	−6.2
Inflation rate (%) (Dec.–Dec.)	29.8	28.7	98.9	80.8	59.2	63.7	105.7	159.2	51.7	19.7	29.9	18.8	11.9	8.0	7.1	52.0
Trade ($US mil.)																
Exports	18,031	23,307	24,056	25,953	29,101	26,758	21,803	27,599	30,692	35,171	40,711	42,687	46,196	51,885	60,879	79,543
Imports	21,087	27,184	17,009	11,848	15,915	18,359	16,784	18,813	28,081	34,766	41,592	49,966	62,130	65,366	79,346	72,454
Trade balance	(3,056)	(3,877)	7,047	14,105	13,186	8,399	5,019	8,786	2,611	405	(881)	(7,279)	(15,934)	(13,481)	(18,467)	7,089
Investment flows ($US mil.)																
Foreign Dir. Investment	2,090	3,078	1,901	2,192	1,542	1,984	2,036	1,184	2,011	2,785	2,549	4,742	4,393	4,389	10,972	6,963
Portfolio Investment	60	996	645	(519)	(435)	(595)	(517)	(1,002)	1,001	354	3,369	12,741	18,041	28,919	8,185	(10,140)
Total Reserves less Gold ($USmil.)	2,960	4,074	834	3,913	7,272	4,906	5,670	12,464	5,279	6,329	9,863	17,726	18,942	25,110	6,278	16,847
Real Exchange Rate (1980 = 100) controlled rate	100.0	91.1	134.6	143.8	124.3	120.0	149.0	148.6	119.1	112.8	105.4	92.4	82.5	77.5	79.5	115.2

Sources: World Bank's *World Data*, 1995; and the IMF's *International Financial Statistics*, Dec. 1995, Mar. 1996, Sept. 1996 (CD-ROM versions); CEPAL's *Economic Panorama of Latin America*, 1996; and author estimates. Following the new IMF practice, trade figures include *maquila* exports and imports and so may differ from other historic tables which treated the net earning of the *maquila* sector as part of the current balance in services.

import demand driven in part by the government's decision to increase aggressively personal credit. To finance the trade imbalance, Mexico turned to foreign investment, the bulk of which consisted of highly mobile portfolio capital; in 1993, for example, portfolio capital accounted for 86.8% of total foreign investment flows to Mexico, compared to just 11.3% in 1989.

The flow of external finance began to dry up in 1994, for a number of complex economic and political reasons.[10] On the economic front, Mexico's huge current account deficit, slow growth, and declining private savings rate had begun to alarm investors by late 1993.[11] When US interest rates rose in 1994, this gave investors a rationale for acting on their concerns. Politically, investor uneasiness had been fuelled by the emergence of a guerrilla insurgency in the southern state of Chiapas in January 1994, the assassination of the ruling party's (Revolutionary Institutional Party, or 'PRI') Presidential candidate Luis Colosio just two months later, and by the kidnapping of several prominent local industrialists. Domestic investors further exacerbated the mounting pressures on foreign exchange by indulging in their old habits of capital flight. With devaluation a real possibility, Mexican authorities sought to assuage foreign investors' concerns by converting much of the government's short-term peso-denominated *Cetes* debt to dollar-denominated *Tesobonos* in mid-1994. Whereas dollar-denominated *Tesobonos* constituted only 6% of the total foreign holdings of government securities in December 1993, a year later these new financial instruments accounted for 87% of the total.

Redenominating government debt, however, did not fully temper investor fears, nor did it reverse the burgeoning trade deficit. In December 1994, foreign reserves stood at $6.3 billion, down from a high of $29.6 billion in February 1994.[12] Seeking to better manage the pressures, the government announced a modest step devaluation. But this simply provoked more investor exodus and authorities soon declared a free float, which immediately developed into a free fall. With the overshooting of the exchange rate in late December, and the continued

[10] These explanations are reviewed by J. Ros, 'Mercados financieros, flujos de capital y tipo de cambio en México', *Economía Mexicana*, vol. 4, no. 1 (1995), pp. 5–67; F. Gil-Diaz and A. Carstens, 'One Year of Solitude: Some Pilgrim Tales About Mexico's 1994–1995 Crisis', *American Economic Review*, vol. 86, no. 2 (1996), pp. 164–9; and G. A. Calvo and E. G. Mendoza, 'Petty Crime and Cruel Punishment: Lessons from the Mexican Débâcle', *American Economic Review*, vol. 86, no. 2 (1996), pp. 170–5.

[11] Private savings, for example, had dropped from 13.7% of GDP in 1980 to just 5.0% by 1992. See J. Ros et al., 'Prospects for Growth and the Environment in Mexico in the 1990s', *World Development*, vol. 24, no. 2 (1996), p. 315.

[12] See P. Leme, 'Rebuilding Confidence in Mexico.' A report of the Economic Research Division of Goldman Sachs, New York, Feb. 1995.

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Table 2. *Distribution of current monetary income by household deciles*

Household deciles*	1984 Total income to household decile (%)	1989 Total income to household decile (%)	1992 Total income to household decile (%)	1994 Total income to household decile (%)
Total	100.00	100.00	100.00	100.00
I	1.19	1.14	1.00	1.01
II	2.66	2.48	2.27	2.27
III	3.86	3.52	3.36	3.27
IV	5.01	4.56	4.38	4.26
V	6.26	5.76	5.45	5.35
VI	7.66	7.21	6.77	6.67
VII	9.68	9.02	8.62	8.43
VIII	12.42	11.42	11.22	11.19
IX	17.00	15.92	16.09	16.30
X	34.26	38.97	40.84	41.24
Gini coefficient†	0.46	0.49	0.51	0.51

* Households are ordered in terms of income (the first decile includes the poorest, the last decile the richest).

† The Gini coefficient is an aggregate measure of income inequality which ranges from zero in a completely equal society to one in a completely unequal society.

Source: Instituto Nacional de Estadística, Geografía e Informática. Encuesta Nacional de Ingresos y Gastos de los Hogares, Third Quarter, 1984, 1989, 1992 (CD-ROM); 1994 data from the hard copy version of the Encuesta.

outflow of domestic capital, the business sector itself pronounced the notion of another anti-inflation tripartite pact as 'dead'.[13]

The resulting peso crisis has seemingly returned Mexican policy to the pre-Salinas era. With the government having lost the public's confidence, an incomes policy-*cum*-social pact approach to disinflation has been ruled out; instead, the government has, as reflected in the adjustment package unveiled in March 1995, fallen back on the traditional orthodox cure of severe cuts in public spending as well as a clearly regressive increase in the value-added tax. Accelerating unemployment and falling real wages have been accepted as the economic outcomes that will 'signal' Mexico's seriousness about restoring stability.

Today's 'seriousness' about adjustment, however, has been superimposed on a social landscape scarred by longstanding inequities and the more recent hardship wrought by the economic turmoil of the 1980s and

[13] For more analysis of the peso crash, see M. Pastor, 'Pesos, Policies, and Predictions: Why the Crisis – and Why the Surprise?' in C. Wise (ed.), *The Post-NAFTA Political Economy: Mexico and the Western Hemisphere*, unpubl. manuscript, Washington, DC, 1996; N. Lustig, 'The Mexican Peso Crisis: The Foreseeable and the Surprise', Brookings Discussion Paper No. 114, Washington, DC, 1995; and J. Sachs, A. Tornell and A. Velasco, 'The Collapse of the Mexican Peso: What Have We Learned?', National Bureau of Economic Research Working Paper 5142, Cambridge, MA, 1995.

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Table 3. *Annual rate of growth of real monetary income for household deciles, 1984–9 and 1989–92*

Household deciles	1984–9	1989–92
Total	2.3	1.7
I	1.4	−2.6
II	0.9	−1.2
III	0.4	0.1
IV	0.4	0.4
V	0.6	−0.1
VI	1.1	−0.4
VII	0.9	0.2
VIII	0.6	1.2
IX	1.0	2.1
X	5.0	3.3

* Households are ordered in terms of income (the first decile includes the poorest, the last decile the richest).

Note: Real monetary income is calculated with the monthly average consumer price indices of the Bank of Mexico for the same period as the household income survey.

Source: Instituto Nacional de Estadística, Geografía e Informática. Encuesta Nacional de Ingresos y Gastos de los Hogares, Third Quarter, 1984, 1989, 1992 (CD-ROM).

the neoliberal restructuring of the Mexican economy. Between 1984 and 1994, for example, the wealthiest 10% of Mexicans saw their share of national income rise from around 34% to more than 41%, while every other income decile suffered a decline (see Table 2).[14] The pattern over various sub-periods is quite revealing: note that while much of the regressive redistribution did occur during the initial shocks of macroeconomic adjustment (1984–9), the drift upward continued in a moderated but steady fashion over the Salinas period as well (1989–92 and 1992–4).

Such a deteriorating distribution of income does not preclude welfare improvements for the poor if overall levels of income for those individuals are rising. In Table 3, we look at the annual rate of growth of real monetary income for household deciles between 1984 and 1992. Note that while all income deciles saw some gain between 1984 and 1989, several deciles, including the two poorest, experienced a decline over the

[14] Our figures on the distribution of household income are taken from the household surveys of income and spending undertaken by Mexico's National Institute of Statistics (INEGI). The national results are available for 1984, 1989 and 1992 as both raw data and a series of comparative tables on CD-ROM; the most recent survey (1994) has been in general release only as a 'hard copy' book which includes summary, but not comparative (multi-year) tables. We readily acknowledge the difficulty with which reliable and comparable household income surveys are obtained; our hope is that the use of the same source at least allows for the over-time comparisons drawn in the text. For an analysis and critique of the INEGI household survey with specific regard to its measurement of poverty, see J. Boltvinik, 'La pobreza en México 1984–1992 según INEGI-CEPAL', *Economía Informe*, no. 237 (1995).

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Table 4. *Comparison of real GNP and dollar value GNP 1982–94*

Mexico	$GNP *per capita*	Real GNP PC index	Change in $GNP *per capita* (%)	Change in real GNP PC index (%)
1982	2,840	100.0		
1983	2,280	94.6	−19.7	−5.4
1984	2,100	96.3	−7.9	1.7
1985	2,180	97.4	3.8	1.1
1986	1,980	90.5	−9.2	−7.0
1987	1,950	91.7	−1.5	1.3
1988	1,990	91.2	2.1	−0.5
1989	2,210	92.5	11.1	1.4
1990	2,570	94.3	16.3	1.9
1991	2,990	96.7	16.3	2.6
1992	3,440	97.3	15.1	0.7
1993	3,730	95.7	8.4	−1.6
1994	4,010	96.9	7.5	1.2

Source: World Bank, *World Tables*, 1995 (CD-ROM).

period 1989–92.[15] Data problems preclude an exact estimate of the evolution over 1992–4 but our best guess is that real income held more or less steady for the lower deciles, declined slightly in the middle, and improved marginally in the top two deciles.[16]

The usual adverse political effects of such distributional deterioration appear to have been offset by the overvaluation of the Mexican currency. While real Gross National Product (GNP) *per capita* grew a modest 1.0% between 1988 and 1994, dollar GNP *per capita* increased at an average rate of 12.5% over the same period (see Table 4). Such large annual increases

[15] If one focuses on the income earned solely by the head-of-household, the distributional picture under Salinas worsens; specifically, the four lowest deciles showed markedly negative growth from 1989 to 1992, suggesting that the more favourable picture reflected in the data may be largely due to the increased workforce participation of women, youths and other non-traditional wage earners.

[16] The 1984–9 and 1989–92 growth figures are taken directly from the comparative tables offered in Instituto Nacional de Estadística, Geografía e Informática (INEGI), *Encuesta Nacional de Ingresos y Gastos de los Hogares* (1994 CD-ROM). A similar figure for 1992–4 is not available directly and must be calculated by 'splicing' two different samples. The use of the method suggested by INEGI, combining reported household income and the CPI, yielded an estimate but when we tried to check the calculation procedure against the directly reported INEGI figures for the earlier time period, there were significant discrepancies. Our 'best' alternative method of linking the time periods was via the growth in real *per capita* GDP, which was 1.64 per cent over 1989–92 as against a reported 1.7 per cent increase in real monetary income for households over the same period. This standard gives the pattern reported in the text but does not use the same method and hence is not strictly comparable to the other growth figures; moreover, it may understate gains in consumer welfare since the concurrent overvaluation of the peso tended to enhance purchasing power at every level of income. Of course, as we stress below, this overvaluation prop is now gone and lower income groups are subsequently experiencing the full pain of the earlier redistribution.

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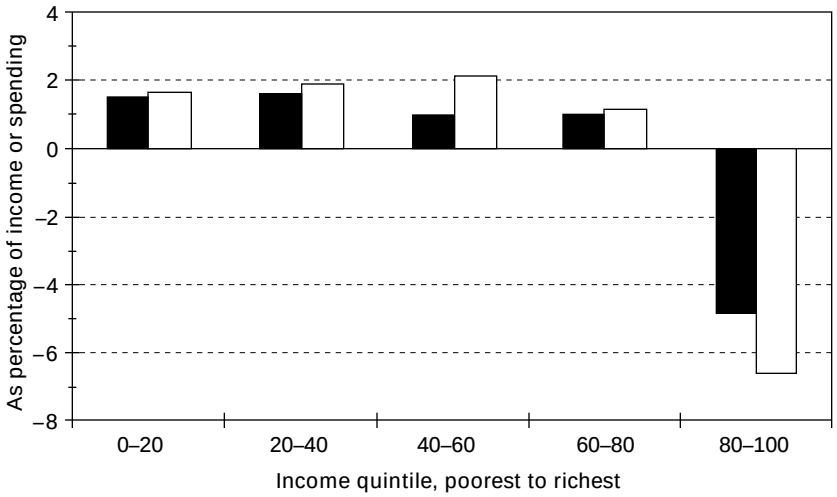


Figure 1. *Share of spending less share of income by quintile, Mexico, 1984–92.* (■), 1984; (□), 1994. *Note*: The figure measures the difference between each quintile's share of spending and its share of income in the two years considered. It is not unexpected that the poorer quintiles would have a larger share of spending than income, primarily because some households may fall in these categories due to falls in temporary and not permanent income. What is significant is that this 'excess' spending rose in all the lower quintiles but especially in the middle, a pattern which is consistent with overspending due to an increase in credit card and other consumer credit. *Source*: Instituto Nacional de Estadística, Geografía e Informática (INEGI), *Encuesta Nacional de Ingresos y Gastos de los Hogares* (*ENIGH*), Third Quarter, 1984 and 1992 (CD-ROM) and INEGI. *ENIGH-94* (1995).

in dollar GNP *per capita* encouraged a precarious pattern of overspending. This consumer boom was particularly sharp among those middle-class Mexicans enjoying their first real access to personal credit, due largely to the government's explicit encouragement of this new form of financial intermediation (see Fig. 1).[17] This over extension of short-term credit – which was facilitated by financial liberalisation, massive capital inflows and low nominal interest rates in the early 1990s – poses enormous problems now, as adjustment-related hikes in the interest rate have made it virtually impossible for individual debtors to meet their servicing obligations on credit cards, mortgages and car loans. The Salinas government's reprivatisation of the domestic banking system has turned out to be another exacerbating factor, as it is now clear that the new owners of these banks were less than prudent in their lending decisions.

The Zedillo administration (1994–) thus faces the daunting task of implementing a strict austerity plan in the wake of what was, in fact,

[17] These insights were confirmed in June 1995 during the authors' fieldwork interviews with two professional members of Mexico City's banking community: Jorge Arreola, Banco Nacional de Obras y Servicios Públicos, and Gerardo Vargas, Banco Nacional de México.

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patently regressive growth. The current scenario is complicated politically by the fact that the pre-1995 expectations for prosperity had been so high, mainly because neoliberal reform had been oversold by the Salinas team as the route to sustained and rapid growth. We turn now to a more disaggregated analysis of Mexico's neoliberal reform model, with a focus on the main policies that have prevailed in the urban–industrial and rural–agricultural sectors, the general impacts of these policies, and government efforts to address structural distortions and the social tensions triggered by reform.

The urban sector: industrial restructuring, employment and informality[18]

With the advent of the Salinas administration in 1988, the overriding policy objective became the consolidation of an export-led industrial model, driven by private investment and cheap labour inputs, which would deliver the higher growth, productivity, and income gains that had eluded Mexico since 1980.[19] Thus, the urban–industrial strategy centred mainly on the modernisation of the private manufacturing sector; the Salinas team combined liberalisation of trade with an aggressive privatisation drive – phasing out most government supports for industry and selling off nearly $24 billion in state assets from 1989 to 1993 – and a series of legal reforms which substantially deregulated Mexico's rules concerning foreign investment.

The extent to which Mexico was actually able to improve the export orientation of industry is shown in Table 5. As the data indicate, all but four subsectors of manufacturing (tobacco, leather goods, miscellaneous petroleum and coal products, and basic non-ferrous metals) have increased their export ratios since the early 1980s. Overall, non-oil exports grew by

[18] This section is based on the following sources: C. Alba Vega, 'La microindustria ante la liberalización económica y el Tratado de Libre Comercio', *Foro Internacional*, vol. 23, no. 3 (1993), pp. 453–83; Centro de Estudios Económicos del Sector Privado, 'Evolución y problemática de las empresas en 1994', *Actividad Económica*, no. 183 (1995), pp. 1–23; C. Ruiz Duran, 'México: Crecimiento e innovación en las micro y pequeñas empresas', *Comercio Exterior*, vol. 43, no. 6 (1993), pp. 525–9; F. Sanchez Ugarte, 'Acciones en favor de las micro, pequeñas, y medianas industrias en México', *Comercio Exterior*, vol. 43, no. 6 (1993), pp. 539–43; United Nations Industrial Development Organisation (UNIDO), *Mexico: The Promise of NAFTA* (Vienna, 1994); E. Dussel Peters, 'From Export-Oriented to Import-Oriented Industrialization: Changes in Mexico's Manufacturing Sector, 1988–1994', in G. Otero (ed.), *Neoliberalism Revisited* (Boulder, 1996), pp. 63–83; and, on confidential fieldwork interviews conducted by the authors within Mexico's small enterprise sector from 1991 to 1994.

[19] See J. Zabludovsky, 'Trade and Industrial Policy for Structural Adjustment in Mexico', in T. Fukuchi and M. Kagami (eds.), *Perspectives on the Pacific Basin Economy* (Tokyo, 1989), pp. 439–69.

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Table 5. *Ratio of exports to output by subsector of manufacturing, 1975, 1980 and 1990 (percentage)*

Manufacturing subsector	1975	1980	1990
Total manufacturing	3.5	3.9	23.9
Food	3.7	5.2	17.9
Beverages	1.1	1.5	6.5
Tobacco	1.1	0.6	0.7
Textiles	3.2	1.3	22.9
Clothing	2.0	1.7	23.9
Leather and substitutes	1.3	1.4	0.8
Leather footwear	1.5	1.8	19.2
Wood and cork	1.1	1.2	27.7
Furniture and fixtures	0.5	0.7	36.1
Paper and products	0.3	0.2	4.9
Printing, publishing and allied industries	3.5	3.4	12.4
Industrial chemicals	5.5	7.6	23.3
Other chemicals	3.5	2.7	8.8
Petroleum refineries	1.4	6.2	20.5
Miscellaneous petroleum and coal products	0.6	3.0	0.1
Rubber products	0.6	0.2	4.0
Plastic products	0.8	1.0	50.7
Pottery, china, earthenware	2.2	2.4	18.5
Glass and glass products	5.8	4.1	23.8
Non-metallic mineral products	1.9	1.8	10.3
Basic iron and steel	1.8	0.9	16.5
Basic non-ferrous metal industries	51.4	38.9	40.0
Metal products, excluding machinery	2.2	2.1	18.6
Non-electrical machinery	7.0	18.4	—
Electrical machinery	3.7	3.7	32.1
Transport equipment	2.8	4.4	29.2
Professional and scientific equipment	2.4	3.9	—
Other	4.9	3.7	78.0

Source: UNIDO, *Regional Database*.

Reproduced from UNIDO, Mexico *The Promise of NAFTA* (Vienna: UNIDO, 1994), p. 42.

38% from 1989 to 1992 and now comprise about 80% of Mexico's total exports. The historical concentration of manufacturing activity in the country's old industrial heartland (Mexico City, Jalisco, and Nuevo León) has also given way to a more geographically dispersed pattern (see Table 6). Since the early 1980s, the central states of Guanajuato, Hidalgo, Michoacán, Oaxaca, Puebla and Tlaxcala have increased their industrial profile, as have the border states of Chihuahua, Coahuila, Sonora and Tamaulipas. While incentives for industrial decentralisation into the former group of states have been provided to help alleviate environmental and infrastructure stresses, particularly in Mexico City, the increasing industrialisation of the latter group of border states is a reflection of the boom that has occurred in the *maquiladora* sector over the past decade.

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Table 6. *Distribution of industry by state and establishment size, 1989 (percentage)*

State	Total	Micro[a] (1–15 employees)	Small (16–100 employees)	Medium (101–250 employees)	large (> 250 employees)
Federal District	15.78	13.33	2.08	0.23	0.14
México	8.67	7.17	1.07	0.25	0.18
Puebla	8.00	7.57	0.33	0.07	0.03
Jalisco	7.37	6.52	0.75	0.06	0.03
Veracruz	6.15	6.05	0.08	0.00	0.02
Guanajuato	5.00	4.89	0.10	0.01	0.00
Michoacán	5.54	5.06	0.41	0.05	0.02
Nuevo León	4.30	3.43	0.71	0.09	0.07
Oaxaca	3.65	3.62	0.02	0.00	0.00
Chiapas	2.92	2.89	0.03	0.00	0.00
Chihuahua	2.73	2.37	0.22	0.04	0.09
Yucatán	2.57	2.44	0.12	0.01	0.00
Guerrero	2.49	2.48	0.01	0.00	0.00
San Luis Potosí	2.42	2.30	0.10	0.01	0.01
Coahuila	2.28	2.02	0.22	0.02	0.02
Tamaulipas	2.27	2.14	0.09	0.02	0.02
Sonora	1.72	1.57	0.12	0.02	0.02
Hidalgo	1.63	1.55	0.07	0.01	0.00
Sinaloa	1.60	1.52	0.06	0.01	0.01
Baja California	1.48	1.16	0.23	0.05	0.03
Durango	1.45	1.26	0.15	0.03	0.01
Morelos	1.37	1.32	0.04	0.00	0.00
Zacatecas	1.34	1.33	0.01	0.00	0.00
Nayarit	1.19	1.18	0.02	0.00	0.00
Tlaxcala	1.15	1.09	0.04	0.02	0.01
Aguascalientes	1.13	1.02	0.08	0.01	0.01
Querétaro	1.03	0.93	0.07	0.01	0.01
Tabasco	0.93	0.91	0.00	0.01	0.00
Campeche	0.61	0.59	0.02	0.00	0.00
Colima	0.47	0.46	0.01	0.00	0.00
Quintana Roo	0.39	0.38	0.01	0.00	0.00
Baja California Sur	0.39	0.38	0.01	0.00	0.00
Total	100.00	90.95	7.27	1.03	0.76

[a] Includes 'unspecified' companies.

Source: Instituto Nacional de Estadística, Geografía e Informática, *Censos Económicos 1989*.

Reproduced from UNIDO, Mexico, *The Promise of NAFTA* (Vienna: UNIDO, 1994), p. 76.

From the standpoint of job creation, food processing, textiles, metals, machinery, equipment and chemicals are now the most important industries in terms of labour absorption, accounting jointly for about 75% of total manufacturing employment. Unfortunately, the manufacturing sector as a whole accounts for just 22% of Mexican employment, and while the subsectors noted above have been high performers with

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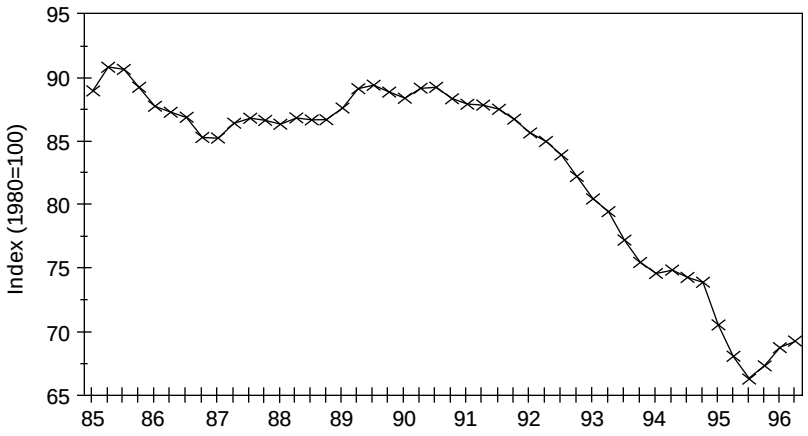


Figure 2. *Index of manufacturing employment, 1985–96. Source*: INEGI.

regard to exports, their ability to generate new jobs has been disappointing. Indeed, overall manufacturing employment actually began to decline as of mid-1991, well before the recent recession took its toll (see Fig. 2). Underpinning this trend were two factors. The first was an impressive increase in manufacturing productivity, or output per labour unit, of 6.6% annually between 1988 and 1993;[20] while this is certainly positive, it does imply a reduction in labour demanded unless sales volumes are increasing at an equally rapid pace. The second trend was a drop in the number of small and medium-sized firms registered in the manufacturing sector, from 871 in 1988 to only 401 in 1993; since such firms are usually quite labour-intensive, this meant a loss of some 43,000 jobs over the same five-year period.[21] This combination of productivity gains in the manufacturing sector, on the one hand, and the 'shake-out' of smaller firms, on the other hand, goes to the heart of Mexico's distributional challenge in the urban–industrial sector: there is no indication that the current model will generate badly needed employment opportunities in the near future.

Real wage trends since 1982 provide another angle on distributional stress within this sector. From 1982 to 1987, both the real minimum wage and the real industrial wage fell by more than 30%, reflecting the government's desire to leave wage-setting up to the market. By stabilising prices and wages simultaneously, the incomes policy instituted in late 1987 helped to moderate the downward spiral of real wages. While the real minimum wage fell 18.5% between 1988 and 1991, average real wages began rising after 1988 and were within 10% of their pre-debt crisis levels

[20] J. Heath, 'The Impact of Mexico's Trade Liberalization: Jobs, Productivity and Structural Change', in Wise (ed.), *The Post-NAFTA Political Economy*, pp. 15–16.

[21] *Ibid*., pp. 19–20.

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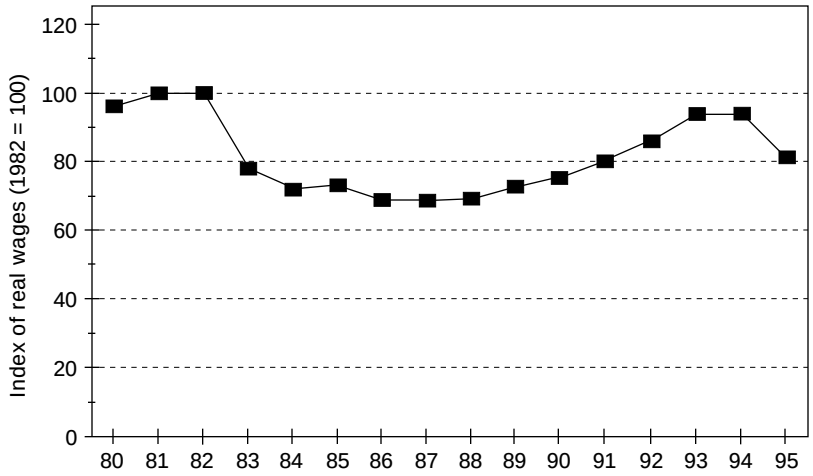


Figure 3. *Evolution of real wages in Mexico*. Real wages in manufacturing: data taken from Sebastian Edwards, *Crisis and Reform in Latin America* (Washington DC: Oxford University Press, 1995), CEPAL's *Estudio Económico de América Latina y el Caribe, 1994–1995*, and INEGI's database at http://dgcnesyp.iniegi.gob.mx.

by 1993 (see Fig. 3). However, we should recall that manufacturing was steadily shrinking over this period, implying that the wage was accruing to a smaller group. Overall, there seem to have been growing discrepancies between the wages earned by skilled and unskilled workers, a phenomenon that has exacerbated inequality and which is consistent with recent theories about the differential effects of trade liberalisation on skilled and unskilled labour.[22] Meanwhile, the high levels of unemployment in the post-crash Mexican economy (see Fig. 4) have negatively affected all wages; as Figure 3 indicates, the 1995 recession forced real manufacturing wages back to their 1991 levels and data for the first seven months of 1996 point to a further fall down nearly to the depths of the mid-1980s.

One exception to this disappointing employment picture that emerged through the 1990s has been the *maquila* or in-bond industry.[23] Once

[22] For a theoretical explanation of why liberalisation might induce a widening of wage differentials within Mexico, see E. Leamer, 'Wage Effects of a US–Mexican Free Trade Agreement', NBER Working Paper No. 3391, Cambridge, 1992. Indirect evidence for the wage dispersion effect also comes from comparing household distribution data with household income by sources; wages, salaries, and overtime actually rose slowly but steadily between 1984 and 1992 even as distribution by household decile worsened, a pattern which is consistent with rising inequality *within* labour markets.

[23] Originally launched in 1965, Mexico's *maquila* programme allows duty-free imports of capital equipment for use in manufacturing and assembly, with the stipulation that investors pay duty only on the value-added within Mexico, and that 80% of a plant's output must be exported. For more detail on the *maquila* industry, see L. Sklair, *Assembling for Development: The Maquila Industry in Mexico and the United States* (San Diego, 1993).

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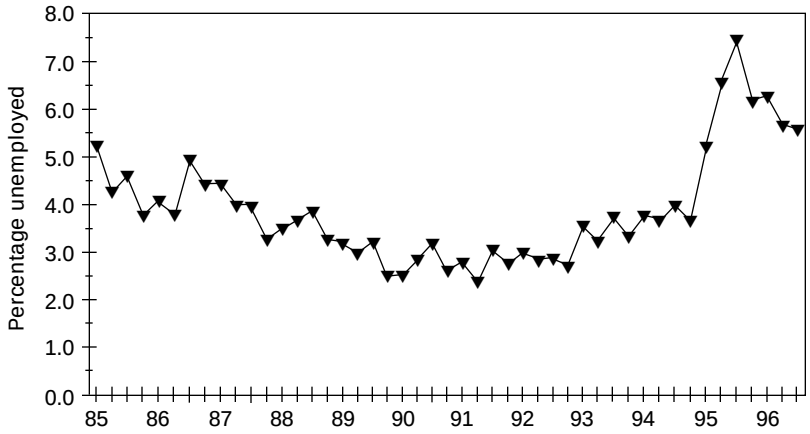


Figure 4. *Rate of open unemployment in Mexico by quarter, 1985–96. Source*: INEGI.

restricted to the border states, foreign investors (80% of whom are US majority holders) can now establish a *maquila* anywhere within Mexico, can own up to a 100% share, and under NAFTA will be able to sell a gradually increasing share of production to the local Mexican market.[24] Now comprising over 2,000 firms which account for about half a million manufacturing jobs in Mexico, the *maquila* sector has seen strong employment growth, while *maquila* exports accounted for more than 50% of the expansion of industrial exports which appears in Table 4.[25] At the same time, it is important not to exaggerate the potential of the *maquila* industries to resolve the distributional shortcomings identified here: the very logic of production in the key manufacturing sub-sectors (e.g. electronic components, transportation equipment and electrical machinery) still hinges on combining foreign investment from capital abundant nations like the USA with Mexico's abundant supply of cheap unskilled labour. Moreover, average real wages and benefits in the *maquiladoras*, while holding their value better than the average wage/benefit package in manufacturing as a whole, still remain at only half of the manufacturing average; thus, a shift towards *maquila* production may be regressive, at least until employment in that sector finally drives wages upward.[26]

[24] G. Hufbauer, *NAFTA: An Assessment* (Washington, DC, 1993), p. 152.
[25] UNIDO, *Mexico: The Promise of NAFTA*, p. 36.
[26] A comparison of the average values of the wage/benefit package in manufacturing with those of the *maquiladoras* is reported in F. Rosen, 'Is Inflation the Enemy?', *El Financiero Internacional*, 4–10 March 1996, pp. 1, 8. The article is based on data supplied by the Ministry of Labour and the Instituto Nacional de Estadística, Geografía, e Informática; the manufacturing figures square with what we report in Figure 3.

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Another aspect of distribution in urban industry has to do with the concentration of assets in this sector. Despite the ambitious programme of liberalisation, privatisation, and deregulation that has been implemented since the late 1980s, the traditionally oligopolistic ownership structure within Mexican industry has changed very little. By the end of the 1980s, the country's top ten industrial conglomerates still produced 20% of total manufacturing output, and the aforementioned export growth has been strongest in those tradeable sub-sectors that are dominated by large-scale producers with strong ties to international markets (e.g. passenger vehicles and auto parts).[27] Although these large globally integrated companies (officially defined as having 250+ employees) constitute just 2% of all manufacturing establishments in Mexico, together they account for half of manufacturing production and employment. In the post-peso crisis era of even tighter credit and stiffer competition, just 2.8% of the 27,000 firms involved in exporting in 1995 accounted for 80% of all sales.[28]

The remaining 50% of manufacturing production and employment is accounted for by some 125,000 firms which have been categorised by the Mexican government according to size as micro (1–15 employees), small (16–100 employees) or medium (101–250). Although the number of these smaller (SME) firms has increased by approximately 60% since 1982, manufacturing output and wages within this sector have stagnated. There are various explanations for the SME sector's poor performance. First, the bulk of these enterprises (about 100,000) are micro firms clustered in low value-added manufacturing branches such as printing, clay products, metal tanks, dairy and tortilla production. These micro-level firms employed 21% of the workforce in 1993, up from 14% in 1988, but this increase seems to be partly due to stagnant productivity and hence a higher relative, albeit inefficient, absorption of labour within the country's non-tradeable sectors.[29] Second, privatisation has eradicated the government contracts and support that had been so plentiful for these smaller

[27] For example, Cementos Mexicanos (CEMEX) accounts for almost 70% of national cement production, and Vitro accounts for 90% of glass output; three companies still control 75% of the country's petrochemicals market, and Grupo Industrial Maseca controls over 70% of the maize flour market. See UNIDO, *Mexico: The Promise of NAFTA*, p. 67; M. de los Angeles Pozas, *Industrial Restructuring in Mexico* (San Diego, 1993); and Dussel Peters, 'From Export-Oriented to Import-Oriented Industrialization', pp. 72–8.

[28] This information is paraphrased from Enrique Vilatela Riba, general director of the Foreign Commerce National Bank, as reported in 'Export Earnings Up From Last Year', *El Financiero Internacional*, 8–14 July 1996, and confirmed by the authors' confidential interviews in Mexico's Ministry of Economics (*Hacienda*), October 1996.

[29] Heath, 'The Impact of Mexico's Trade Liberalization', pp. 22–3.

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companies during the ISI era. Third, trade liberalisation has hurt certain sectors such as textiles; even in those SME industries which have been able to weather import competition, employment has stagnated as firms have been compelled to adopt labour-displacing production techniques.

While the combination of trade liberalisation and increased access to the US market under NAFTA should have provided some relief for SME producers on the export side, the latter claim to be hampered by capacity limitations, the lack of affordable credit, poor marketing skills, and weak external demand for their products. Revealingly, less than 10% of small and medium size producers have taken advantage of the two government-sponsored export promotion initiatives offered during the Salinas years, whereas nearly 40% of the large enterprises have benefited from the remaining forms of state support for exporters. Since the implementation of the March 1995 adjustment package, the SME sector, with its weak access to cheaper foreign financing and international export markets, has been particularly hard hit.[30]

The inability significantly to expand urban employment, and the lack of any form of unemployment insurance, has led to a rapid increase in economic activity within the country's informal sector.[31] It is now estimated that between 25 and 40% of the country's 24.1 million economically active population has sought refuge in the informal economy. In the urban areas, the typical informal venture is a micro-level business operating in sectors where the entry barriers and infrastructure needs are low, such as commerce and services; not surprisingly, income and output are often as low as the barriers, and the informal sector has quickly become Mexico's workplace for the poor. As a result, over 50% of the country's most impoverished are now employed in the informal sector.

Government policy responses

Mexican neoliberal reform did succeed in fostering a somewhat more regionally decentralised export-led model which has thus far registered some impressive productivity gains within the tradeables sector. But the social costs were mounting even prior to the December 1994 financial crisis, as manufacturing employment fell, informal activity rose, and assets became more concentrated. We have argued that these distributional

[30] Those smaller firms which are part of 'commodity chains' – i.e. linked to larger producers – will do better, but hard data on these linkages are scarce.

[31] This analysis is based on Centro de Estudios Económicos del Sector Privado, *La economía subterranea en México* (México, 1987); A. L. Ozorio, S. Graham and L. Alves, 'Poverty, Deregulation, and Informal Employment in Mexico', The World Bank, Washington, DC, July 1994, mimeo; and the authors' interviews conducted in June 1995, with top policy-makers at the Ministry of Social Development in Mexico City.

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stresses amount to more than just a longer-than-expected lag in the adjustment process; rather, they are directly related to the mix of policies that Mexico has embraced. Although the operative assumption of PRI technocrats since the mid-1980s has been that microeconomic innovation would follow naturally from macroeconomic reform, the lack of consistency and coherence within the macroeconomic reform programme, and between the chosen macro- and microeconomic policies, has stifled the potential gains from a more open economy.

Since 1982, there have been three main phases of government policy *vis-à-vis* the industrial sector. De la Madrid took the first step in dismantling the bulk of the country's old-fashioned sector-specific industrial programmes in the mid-1980s;[32] by the early 1990s, Mexico's industrial policy had been drastically pared down to just two export incentive schemes and three sectoral programmes in those industries dominated by large transnational firms (autos, computers and pharmaceuticals).[33] In mid-1996, the Zedillo administration announced a new course involving an eight-point plant to promote industrial competitiveness.[34] Of special interest is the government's acknowledgement that more must be done to facilitate the process of microeconomic adjustment, and its stated intention to pursue a more flexible and active approach to industrial development: 'competitiveness … cannot depend exclusively on the availability of low-cost production factors, the isolated efforts of firms and industries, or market forces alone. These and other factors must be coordinated and complemented through active government participation, in the form of highly effective public policies that promote industrial growth.'[35]

Will this be a case of too little, too late? In the SME sector, despite strong evidence from the East Asian experience that effective competition requires a mix of large and small firms,[36] the general approach of the Salinas technocrats was quietly to condone the collapse of small firms as an example of a 'survival-of-the-fittest' commitment to market discipline.

[32] A second phase of horizontal industrial promotion, based on policy tools that benefited the manufacturing sector as a whole and did not add to the central government's fiscal burden, was initiated by Salinas in 1989.

[33] This section draws on Lustig, *Mexico: The Remaking of an Economy*, pp. 120–5; Dussel Peters, 'From Export-Oriented to Import-Oriented Industrialization', pp. 64–72; Ros et al., 'Prospects for Growth and the Environment in Mexico', pp. 313–14; and F. Clavijo and S. Valdivieso, 'La política industrial de México, 1988–1994', in F. Clavijo and J. Casar (eds.), *La industria mexicana en el mercado mundial: Elementos para una política industrial*, vol. I (Mexico, 1994), pp. 27–92.

[34] Secretaría de Comercio y Fomento Industrial (SECOFI), 'Mexico: Programme of Industrial Policy and International Trade', Mimeo, Mexico City, May 1996.

[35] *Ibid*. p. 2.

[36] A. Fishlow et al. (eds.), *Miracle or Design? Lessons From the East Asian Experience* (Washington, DC, 1994).

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As distributional stress mounted in the early 1990s, the government did attempt to help the SME sector *via* export promotion measures and indirect support programmes for weaker industries, such as textiles. The former approach has consisted of duty-free entry of imports which are crucial for expanding export production; the latter has attempted to encourage 'internationalisation' of weaker industries through the dissemination of technology and information concerning new market opportunities. The government has also encouraged large-scale firms to enter into subcontracting and procurement agreements with their smaller counterparts and to form joint ventures with small firms in the securing of finance and technology. This programme, however, seems to have had little impact or publicity: in a 1992 survey of Mexican producers, less than one-third of the SME respondents were aware that a comprehensive industrial support programme had been established for them in 1991,[37] suggesting a failure to reach appropriately the target population.

As one symptom of the adjustment difficulties, by the early 1990s SME borrowers reported severe problems in obtaining credit, even when they were paying interest rates that were double the prevailing deposit rates in the Mexican banking system. In 1991, the government responded by directing the state development bank (NAFIN) to set up a credit card system to enable SME firms to finance their working capital and fixed asset needs. Unfortunately, this programme quickly became a magnet for complaints over long delays and insufficient loan sizes, and could not begin to meet the needs of SME producers requesting support to cope with past due loans and the exorbitant costs of financial intermediation in the wake of the 1994 peso crisis.

As for government policy responses to the severe decline in wages and jobs, labour market reform in the context of Mexico's neoliberal model has been slow and erratic. For more than a decade, the underlying structure has been one whereby wages are largely determined by the market, but entry barriers and job mobility are still highly distorted.[38] This combination has fostered an increasing trend toward wage dispersion and a widening duality between the formal and informal sectors of the economy. Meaningful labour market reform has been stunted by the PRI's reliance on non-democratic official unions to guarantee an abundant supply of cheap labour power;[39] without a serious commitment to remove these structural distortions, the government's policy response to labour

[37] The general lack of awareness of government programmes to assist smaller firms is indicated in our interviews with this sector between 1991 and 1994.

[38] S. Edwards, *Crisis and Reform in Latin America: From Despair to Hope* (Washington, DC, 1995), pp. 277–86.

[39] Dussel Peters, 'From Export-Oriented to Import-Oriented Industrialization', p. 64.

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market stress has basically been one of chipping at the margins. For example, some assistance has been provided through two separate adult education programmes, and through the Industrial Labour Force Training Programme (CIMO) some 128,000 workers have upgraded their job skills to work in SME firms that are undergoing a process of modernisation.[40] In the wake of the March 1995 stabilisation programme, the Mexican government finally stepped forward with a temporary emergency employment programme (PEE) intended to provide 840,000 jobs by the end of 1996 in the area of infrastructure projects to support private enterprise.[41]

In terms of rationalising and legalising the informal economy, government strategies to date have centred on the streamlining of procedures for obtaining legal status and the strengthening of informal microenterprises through financial support. In this regard, the government did open a 'one-stop window' in 1991, designed to enable microenterprise owners to legalise their businesses in a single transaction. However, the programme is limited to microfirms in the manufacturing sector, and there is only one such 'window' in all of Mexico City.[42] Not surprisingly, less than 1% of these manufacturing microentrepreneurs have taken advantage of this innovative regulatory reform. As for financial support, despite the opening of at least three special credit lines for microentrepreneurs at NAFIN, most of NAFIN's limited resources have been absorbed by small and medium-sized firms operating in the formal sector. Similarly, although Salinas' National Solidarity Programme (PRONASOL) offered a very small percentage of its budget for microenterprise development, the urban portion of that programme was cancelled due to the inability to maintain ongoing contact with entrepreneurs operating at the micro-level within the informal economy.[43] And since the 1994 devaluation, and the rapid multiplication of those who have literally been ejected from formal labour markets, even the informal economy is now becoming saturated as the country's workplace for the poor.[44]

In what ways might the Zedillo administration's launching of a new 'Programme of Industrial Policy and International Trade' help to alleviate

[40] Economic Commission for Latin America and the Caribbean (ECLAC), *Strengthening Development: The Interplay of Macro- and Microeconomics* (Santiago, 1996), p. 80.

[41] Authors' interview with Alberto Montoya, director of the Special Employment Programme at the Ministry of Social Development, June 1995, Mexico City.

[42] Ozorio, Graham and Alves, 'Poverty, Deregulation, and Informal Employment in Mexico', p. 36.

[43] Authors' interview with Guillermo Bernal, General Director, 'Empresas de Solidaridad', June 1995 Mexico City.

[44] Heath, 'The Impact of Mexico's Trade Liberalization', p. 24.

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the microeconomic stresses reviewed here? As noted earlier in this section, the government is now returning to the business of promoting industrial development – but in a markedly different manner.[45] With regard to the SME sector, apart from reiterating its commitment to broaden the access to financing schemes for smaller firms, the government will promote regional and sectoral business 'clusters' which focus on strengthening SME enterprises. This is to be done, for example, through tax incentives, technology training, 'efficient import-substitution', and more aggressive export promotion. The idea here is to restore the role of the SMEs in national production, and to support them from the beginning to the end of the export chain. On the human resource side, the new industrial policy offers to strengthen basic training and specialised education, and to build closer ties between the educational system and industry. These are hopeful directions, but they are being undertaken within the context of acute adjustment fatigue and continued resource shortages; moreover, it remains to be seen whether this represents a long overdue shift in the country's development strategy, or yet another instance of the PRI's repackaging of itself in order to weather the current political storm.

The rural sector: early results of a market-based agricultural policy[46]

When the Salinas team turned its attention to reform of the agricultural sector in 1990, the Mexican countryside had been struggling economically for at least three decades. The stagnation of agriculture was a consequence of a long-standing policy bias that favoured industry in the ISI-era, and was compounded by a highly distorted set of ongoing government interventions. The 1980s saw a chaotic retrenchment of state participation in agriculture, exemplified by a 76% decline in public investment from 1982 to 1989.[47] By the early 1990s, agriculture's share of GDP had

[45] SECOFI, 'Programme of Industrial Policy and International Trade', pp. 1–26.

[46] This section is based on the following background sources: M. Foley, 'Privatizing the Countryside: The Mexican Peasant Movement and Neoliberal Reform', *Latin American Perspectives*, vol. 22, no. 1 (1995), pp. 59–76; J. Fox, 'Political Change in Mexico's New Peasant Economy', in M. Cook, K. Middlebrook and J. Molinar Horcasitas (eds.), *The Politics of Economic Restructuring: State–Society Relations and Regime Change in Mexico* (San Diego, 1994); J. R. Heath, 'Evaluating the Impact of Mexico's Land Reform on Agricultural Productivity', *World Development*, vol. 20, no. 5 (1992), pp. 695–711; C. Hewitt de Alcantara (ed.), *Economic Restructuring and Rural Subsistence in Mexico: Corn and the Crisis of the 1980s* (San Diego, 1994); and G. D. Thompson and P. N. Wilson, 'Ejido Reforms in Mexico: Conceptual Issues and Potential Outcomes', *Land Economics*, vol. 70, no. 4 (1994), pp. 448–65, as well as confidential interviews with Mexican policy-makers in June 1995.

[47] A. de Janvry et al., 'NAFTA and Mexico's Maize Producers', *World Development*, vol. 23, no. 8 (1995), p. 1350.

https://doi.org/10.1017/S0022216X97004744 Published online by Cambridge University Press

dropped below 5%, down from 20% in 1950, and the balance of trade in agricultural products was negative. However, some 26% of Mexico's economically active population remains in the rural sector, as opposed to 13.7% in Argentina or 14.1% in Chile – countries with more successful track records of agricultural development.

The goals of neoliberal reformers centred on the promotion of productivity and profitability in the agricultural sector, mainly through recapitalisation and the encouragement of private initiative. However, a larger challenge loomed for Salinas as he sought the country's entry into NAFTA and membership in the OECD bloc of industrialised countries: while Mexico had registered some impressive gains in launching an export-led industrial model in the early 1990s, economic history offers few examples of countries that have successfully joined the ranks of the developed world without modernising their agricultural sector;[48] in other words, an overhaul of the rural economy, and a policy approach that cultivated more coherent linkages between agriculture and industry, was essential for both sustaining an export-led strategy and for lending credibility to the NAFTA and OECD membership applications still pending for Mexico.

Beginning in 1990, the Salinas administration swept away a complicated web of price supports that had evolved since land reform was first initiated by constitutional decree in 1917. Tariffs on most agricultural products were abruptly lowered, as were subsidies on production; the guarantee price was eliminated for all crops but corn and beans. At the same time, the government cancelled its crop insurance programme, and the rural development bank (Banrural) announced that it would now target loans only to peasant growers whose operations were deemed profitable, and only at market rates. Under NAFTA, the agricultural sector's exposure to competition has been accelerated. Tariffs on 57% of the value of US–Mexico agricultural trade were immediately eliminated in 1994, with 94% to be eliminated over the next 10 years. Tariffs on the remaining 6% of 'highly sensitive' products like corn and sugar will be done away with over fifteen years.[49]

A second bolder aspect of agricultural liberalisation has involved the reconfiguration of asset ownership. Land reform under the 1917 constitution, particularly in the 1930s, produced a dualistic rural structure, characterised on the one hand by a patchwork of small communal land holdings (*ejidos*) which suffer from poor infrastructure and irrigation and,

[48] See K. Shwedel, 'La competitividad del sector agroindustrial', in F. Clavijo and J. Casar (eds.), *La industria mexicana en el mercado mundial*, vol. II (México, 1994), pp. 7–13.
[49] Hufbauer, *NAFTA: An Assessment*, p. 126.

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on the other hand, by privately held large farms estimated to be 30–50% more productive than their *ejido* counterparts.[50] Comprehensive reform geared toward privatising the nearly 50% of arable land which comprises the *ejido* sector was undertaken by constitutional amendment in early 1992. The most radical aspect of the reform – in the sense that the new law reverses the PRI's post-revolutionary commitment to communally held land – allows for the rental or sale of parcels of communal lands, including the sale of land to both domestic and foreign corporations.[51] Moreover, the individual or group holders can offer their land as collateral for loans from certified lenders, as opposed to the past practice of depending solely on Banrural or informal markets for credit.

Policy-makers contend that this privatisation of the *ejidos*, combined with low labour costs and a growing urban consumer market, will serve as a magnet for international investment in agriculture.[52] Thus, the scenario envisioned by the designers of the reform package is one where agribusiness will be encouraged by the new opportunity to secure land tenure through joint ventures, leasing, or direct purchase. The tough competition from the liberalisation of agricultural trade is expected to be offset by productivity gains and increasing economies of scale which, in turn, should help to reverse Mexico's status as a net importer of food. Critics are less sanguine.[53] The average size of small *ejido* holdings, only two-thirds of which have electricity, is just 9.5 hectares. The bulk of these lands are rain-fed, and less than half have drinking water or ready access to a paved road. While the exposure of this much weaker element of the rural sector to the new liberal policy regime offers, in principle, new opportunities to shift crops and/or form more productive alliances with other growers, the lack of infrastructure, affordable credit, crop insurance and price supports has been a strong deterrent.

The scarcity of reliable microlevel data on the rural sector makes it difficult to specify the impact of 1980s austerity and the 1990 neoliberal

[50] The estimate is cited in Thompson and Wilson, 'Ejido Reforms in Mexico', p. 448; others, such as Heath, 'Evaluating the Impact of Mexico's Land Reform on Agricultural Productivity', argue that there is little difference between productivity rates on *ejidos* versus small private farms.

[51] The new law did leave intact legal restrictions on the size of individual and group holdings. No one company can hold more land than the equivalent of the legal limit for individuals, multiplied by the number of members; the total land holding for any single corporation cannot exceed 25 times the individual limit. For more detail, see Foley, 'Privatizing the Countryside', pp. 64–7.

[52] Confidential authors' interviews conducted with top PRI officials in Mexico City during August 1991.

[53] This viewpoint is summarized in L. Stanford, 'The "Organization" of Mexican Agriculture: Conflicts and Compromises', *Latin American Research Review*, vol. 28, no. 1 (1993), pp. 188–201.

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reform measures on the Mexican countryside. The two main areas of distributional stress which stand out in recent studies suggest: (1) that greater asset concentration seems as real a possibility in agriculture as it has been in the industrial sector; and (2) equally likely is a rise in migration from the rural sector. Certainly some of the increased social protest in the regions – such as the *Zapatista* uprising in Chiapas in January 1994, and the emergence of the '*Barzón*' debtors' movement in early 1995 to protest the astronomical interest rates and bank repossessions of land and farming equipment in the wake of the peso crisis – is related to the dramatic adjustment process now underway.[54]

The most solid evidence on asset reallocation in Mexico's rural sector stems from a country-wide survey of 1,582 households encompassing 276 *ejidos* conducted in 1990, which was then compared against a 1994 survey of 1,523 households from the same sample.[55] Although the privatisation of land tenure is just getting underway, the early results suggest the gradual consolidation of a small landholder class (2–10 hectares of farmland) in Mexico's rural economy, which increased its percentage share of land held from 46.9% in 1990 to 54.7% in 1994; over the same time span the '*minifundios*' (0–2 hectares) decreased from 27.4 to 19.4% while larger ventures (10 hectares or more) held steady at approximately 25% of land held from 1990 to 1994. Underlying this reallocation of assets during the transition to a market economy is a highly differentiated pattern of adjustment, both by region and by farm size.

Within the North, Pacific North, and Centre regions, where this emergence of a smallholder class has been most pronounced, there are some incipient signs of the modernisation of production practices and the diversification to higher-yield crops. In the Gulf and Pacific South regions, the persistence of impoverished *minifundio* holdings, many with strong indigenous ties, has been more pronounced. In the former, the smallholder class has grown at the expense of the larger farms; but in the latter, the redistribution of land ownership toward larger holdings has outpaced the emergence of a potentially productive smallholder contingent. It comes as no surprise that Chiapas and Oaxaca, two of the most socially volatile states in the 1990s, are both located in the Pacific South region.[56]

[54] This was the tone of a talk given by Jose María Imaz, Coordinator of Foreign Relations for the *El Barzón* movement, Latin American Studies Program, Johns Hopkins University, School of Advanced International Studies, Washington, DC, 18 April 1996.

[55] This paragraph and the two following it are based on the survey findings cited in A. de Janvry et al., 'Ejido Sector Reforms: From Land Reform to Rural Development', in L. Randall (ed.), *Reforming Mexico's Agrarian Reform* (New York, 1996), pp. 71–106.

[56] Because of data collection problems, Chiapas was not included in the de Janvry et al. survey.

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This pattern, whereby a smallholder sector appears to be gradually overtaking the traditionally impoverished *minifundios*, holds some promise for the eventual modernisation of Mexican agriculture. However, small producers have been faced with an overvalued peso, the further contraction of public support, and falling commodity prices – all of which have worked against the widespread adaptation of commercial farming practices and diversification to higher-yield crops. Indeed, with 78% of Mexican farmers involved in corn production at the outset of the reforms, and NAFTA's 15-year timeframe for the liberalisation of corn, the survival instinct of smaller producers has actually been to expand corn production for domestic and home consumption since 1990. In stark contrast, the larger farms, with ready access to credit, technology and irrigation, are now leading Mexico's export boom in high-yield agricultural tradeables (e.g. coffee, fruit, beverages, vegetables, sugar, livestock and cut flowers) since the 1994 devaluation.[57]

A slow and painful adjustment in the rural sector has, indeed, provoked some out-migration, although recent research contradicts earlier predictions which focused on the economically devastated *minifundio* population as the most likely group to depart the countryside in the 1990s.[58] Rather, it is the smallholder class, from farms 5–10 hectares in size, that is now the most likely to migrate. Survey data show, for example, that nearly 22% of adult family members have migrated from this smallholder sector, that these migrants have at least a medium-level education, and that around 64% of them head for the USA. For this group, many of whom are still trying to survive as farmers, remittances from the USA comprised up to 13% of household income.[59] In contrast, of the approximately 20% of the rural population that is still active in the *minifundio* sector, only 16% of family members have migrated, and of these, just 35% have gone to the USA.

One explanation for today's comparatively lower levels of migration amongst this poorest income group is that the ongoing adjustment crisis of the 1980s had already provoked a large exodus of *minifundio* dwellers into the country's urban informal economy.[60] For those remaining on rural plots of 0–2 hectares in size in the 1990s, the recently acquired right to rent out *ejido* land has provided the option to engage more actively in

[57] See 'Agriculture Leading NAFTA Trade Growth in 1996', *NAFTA Works* (SECOFI–NAFTA Office of the Mexican Embassy in Washington, DC), no. 6 (June 1996), p. 2.

[58] S. Robinson et al., 'Agricultural Policies and Migration in a United States–Mexico Free Trade Area', Working Paper no. 617, Department of Agricultural and Resource Economics, University of California at Berkeley, 1991.

[59] de Janvry et al., 'Ejido Sector Reforms', pp. 85–9.

[60] de Janvry et al., 'NAFTA and Mexico's Maize Producers', pp. 1350–1.

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off-farm work.[61] Still, there is a sizeable segment within this sector that has neither the resources to migrate to the USA, nor the ability sufficiently to defend its economic interests within local labour markets, be it rural or urban, formal or informal. Again, we argue that the alleviation of distributional stress for this particular group is more than just a matter of a longer-than-expected adjustment lag; particularly in the wake of the March 1995 austerity programme, the proliferation of extreme poverty in such *minifundio* strongholds as Oaxaca and Chiapas suggests that a more targeted set of public policies will be necessary to support the adjustment of these struggling households to a market economy.

Government policy responses

To ameliorate the distributional pressures in agriculture and discourage the outflow of migrants from the rural sector, the government offered rural producers support through two main programmes, PRONASOL and PROCAMPO. While PRONASOL offers many services which cut across the rural and urban sectors, such as infrastructure support for schools, electricity, and drinking water, economically vulnerable segments of the rural sector have also received special attention. For example, PRONASOL has provided social services to Mexico's estimated 3.6 million impoverished agricultural day labourers, support for small coffee growers, and assistance in the creation of diversified microindustrial enterprises in the countryside.[62] Since defaults in the small farming sector can now result in loss of access to land, PRONASOL has also intervened in the restructuring or cancellation of Banrural's overdue loan portfolio for low income producers.

The PROCAMPO programme was launched in October 1993 as a 15-year direct income subsidy for producers of corn and other basic crops (beans, rice, sorghum, soybeans, wheat, cotton and rye) who are likely to suffer losses due to trade-related competition.[63] In its first full year of operation, the government allocated US$3.5 billion in income subsidies to some 3.3 million farmers through PROCAMPO – a significant welfare payment for low-productivity farmers. In theory, the programme is meant to support farm income during the transition to a market-based rural economy, thus enabling those producers subsisting on peasant staple

[61] de Janvry et al., 'Ejido Sector Reforms', p. 76.

[62] For a full description of PRONASOL activities see Secretaría de Desarrollo Social (SEDESOL), *Solidarity in National Development: New Relations Between Society and Government* (Mexico, 1993).

[63] As an income subsidy rather than a price support, PROCAMPO is compatible with the rules of the World Trade Organisation (WTO) and NAFTA. See Banco de México, *The Mexican Economy, 1994* (Mexico, 1995).

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production to modernise and diversify into more commercial lines of agricultural production.

Not surprisingly, in view of the continued adjustment stress in the rural sector, both of these programmes have been the object of at least three kinds of criticism. First, and perhaps most important, is that the resources that have been made available fall far short of what would be needed to allow a potentially productive farmer to make the improvements necessary for successful operation at the internationally competitive price level for these basic crops.[64] The second criticism concerns the misallocation of funds. In the case of PROCAMPO, for example, there is some evidence that these income payments ended up in the hands of larger producers, while smaller staple farmers with under 10 hectares received as little as US$0.50 per day.[65] Similarly, although PRONASOL credits were disbursed evenly across farm sizes, they amounted to less than 10% of the loans available through Banrural or the commercial banks, and just 10% of the loans utilized by large farms.[66] While PRONASOL has distributed resources to a larger number of households (representing 61% of the credit available to small farms), the total amount of credit available to the *ejido* sector has fallen by 19%. It is this broad but shallow spending pattern that has fuelled the opposition's claim that PRONASOL has been primarily geared toward winning PRI votes and quelling political protest.

Finally, in the sense that these programmes do not begin to address long-term structural problems in the Mexican agricultural sector, they do not add up to a coherent strategy of rural integrated development. A central underlying problem is that trade liberalisation has reduced the value of rain-fed land, since the goods produced on this land are mainly NAFTA's 'losers'; conversely, the value of irrigated land, where more competitive agricultural goods such as fruits, vegetables and flowers are grown, is increasing. Income subsidies only temporarily mask this shift in asset values, and, hence, do little to prevent the likely concentration of more valuable land into fewer hands; what is needed is the implementation of a vigorous public infrastructure programme geared toward major land improvements (e.g. irrigation, drainage) and technical assistance that would help smaller farmers reorient production to higher value crops.[67] If the government does not target state resources in this direction more strategically, the *ejido* reform will fail to attract the projected new

[64] K. Appendini, 'Transforming Food Policy Over a Decade', in Hewitt de Alcantara, *Economic Restructuring and Rural Subsistence in Mexico*, pp. 155–6.

[65] M. Gates, 'The Debt Crisis and Economic Restructuring: Prospects for Mexican Agriculture', in Otero (ed.), *Neoliberalism Revisited*, p. 54.

[66] de Janvry et al., 'Ejido Sector Reforms', pp. 81–4.

[67] S. Levy and S. van Wijnbergen, 'Transition Problems in Economic Reform', Policy Research Working Papers, the World Bank, Aug. 1992, pp. 17–19.

https://doi.org/10.1017/S0022216X97004744 Published online by Cambridge University Press

Table 7. *Social spending in Mexico, 1980–90*

	Education (% of GDP)	Health (% of GDP)	Housing, social security and welfare (% of GDP)	Total (% of GDP)
1980	3.02	0.40	2.68	6.10
1985	2.87	0.34	2.41	5.62
1990	2.41	0.33	2.15	4.89
	(% of government spending)	(% of government spending)	(% of government spending)	(% of government spending)
1980	18.0	2.4	16.0	36.4
1985	11.5	1.4	9.7	22.6
1990	13.9	1.9	12.4	28.2

Derived from data in the World Bank's *World Tables*, 1995 (CD-ROM).

investment and the current trends of asset concentration and regressive distribution will continue.

The social sector: market restructuring and new demands for human capital

In the social sector, Mexico's market-based development model faces a serious disjuncture between the increasing demand for highly productive human capital which would render the country more competitive internationally, and the actual ability of the working population to rise to this occasion. The potential role of social policy for bridging this gap has not been well articulated in Mexico, or in the rest of the region for that matter.

Unfortunately, as Table 7 shows, although social spending rose as a percentage of government expenditure during the late 1980s, it fell as a percentage of GDP. While this rise in relative social spending reflects well on the government's priorities, it also suggests an increasing gap between social expenditures and the country's basic human needs. Because little progress has been made in raising the government's commitment to social spending as a percentage of GDP during the 1990s, policy-makers are hard-pressed to ensure that social spending is better targeted to the truly needy, particularly since the steep recession of 1995.[68] Below, we review the two tracks that Mexican social policy has moved on since the mid-

[68] Systematic and comparable World Bank data of the sort used in Table 7 are not available after 1990; analysis of social expenditure trends under the Salinas *sexenio* is further complicated by the considerable overlap between long-standing social spending categories and newer commitments under PRONASOL. Because of this, we base our assessment of the continued plateau in social spending as a share of GDP in the 1990s on the authors' interviews at the Ministry of Social Development, Mexico City, June 1995.

https://doi.org/10.1017/S0022216X97004744 Published online by Cambridge University Press

1980s, with an eye toward the ways in which social spending could better strengthen human capital and enhance income distribution. We begin with the traditional kinds of public goods that the state has always provided – education, housing and health; we then evaluate the costs and benefits of PRONASOL as a post-debt crisis attempt to redefine the state's role in the provision of public goods under a market-based economic model that still faces tight resource constraints.

Education

Investment in primary education has long been promoted by Mexican policy-makers for its contribution to overall worker productivity and, subsequently, to restored economic growth under Salinas. However, Mexico's investment in primary education still lags behind other Latin American countries, and this sector remains plagued by some of the following problems.[69]

(i) *Low educational achievement*. Mexican students consistently have performed below the average on standardised tests in Spanish, maths and science. The primary school repetition rate (the number of students who must repeat a grade as a percentage of the total) is 9.1% nationwide and has reached levels as high as 50% in some rural areas. Each year, 4.6% of enrolled students (some 700,000 students) drop out before they complete the third grade. At least half the attrition rate is due to poor nutrition, family economic hardship and migration.

(ii) *Poor teaching quality and teacher absenteeism*. These problems can be attributed to low salaries in the education field and to a backward incentive structure that encourages teachers to settle in teacher-rich urban areas and not in teacher-poor rural areas. Overall, teacher salaries fell 33% in real terms between 1983 and 1990; while teacher earnings have risen by 18% in real terms since 1990, they are still lower than pre-debt crisis levels. The fact that rural teachers receive even lower wages than their urban counterparts ensures that the rural areas remain short of teachers.

(iii) *Shortages of teaching materials, outdated curriculum and poor physical facilities*. Many school buildings in Mexico are in dire need of repair and almost all schools lack adequate library books and audiovisual aids – resource deficits which are considered to be a main cause of the country's low achievement test scores in Spanish and the sciences.

While educational spending recovered after 1990, rising to 4.1% of GDP in 1993, the Mexican government has still done little to rectify the above problems. This situation has been exacerbated by the decentralisation of primary and middle school management since mid-1992. Such

[69] See the World Bank, 'Mexico: Second Primary Education Project', Staff Appraisal Report (Washington, DC, 1994).

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decentralisation, while perhaps a necessary step toward fiscal reform, has greatly increased the burden on state governments which, in turn, still sorely lack the required administrative and revenue-raising capacities. Meanwhile, although recent research has shown a strong relationship between increased investment in primary education and higher levels of employment and worker productivity,[70] the Mexican government continues to spend 41% of education expenditures on university subsidies, while primary education subsidies amount to just 12% of public expenditure on education. Although a university education is also crucial to the pursuit of an economic model that demands high skills, it is not nearly as important as training an entire workforce to read, write and do simple mathematics.

Housing

The availability of adequate housing facilities, like the provision of a higher quality education, has the potential for creating large socio-economic benefits. Mexico is now experiencing a housing shortfall of at least three million units. The reasons include a growing urban population, inefficient housing regulation, poor infrastructure to support housing construction, and a general decrease in government spending on housing since the 1982 debt crisis. Moreover, the housing stock that is available to lower income groups often lacks proper sanitary and sewage facilities, and tends to be far from where jobs are located, making it geographically difficult for the poor to exploit available work opportunities. Thus, the connection between housing and productivity can be quite direct.

Both the federal and state governments have initiated serious changes in all facets of housing policy.[71] The regulation of housing construction, which in the past has added as much as 25% to the cost of a home, has been streamlined. The central government has also acted to increase the security of property rights by legalising the ownership of 1.2 million properties that had been informally occupied, mostly by families in the very lowest income deciles. In November 1992 a uniform set of building standards and codes was established, and Mexico has increased spending on infrastructure that will provide sanitary water and sewage treatment to more areas.

Other reforms include the professionalisation of FOVI, a special housing subsidy fund within the central bank for families with a monthly income below $600, which has now moved from an application process

[70] G. Psacharopoulos, 'Time Trends of the Returns to Education: Cross National Evidence', *Economics of Education Review*, vol. 8, no. 3 (1989), pp. 225–31.

[71] See T. Zearley, 'Creating an Enabling Environment for Housing: Recent Reforms in Mexico', *Housing Policy Debate*, vol. 4, no. 2 (1993), pp. 239–49.

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riddled with patronage to a more neutral auction system. Finally, in order to reduce mortgage costs and increase competition in the housing finance industry, the Central Bank, the stock exchange commission and several commercial banks are currently working to establish a secondary mortgage market. To its credit, in the wake of the peso crisis, the Zedillo administration also convinced the local private banks to collaborate with the government in rolling over the multitude of mortgages that have recently fallen into arrears. The distributional effects of this move are somewhat questionable – the bigger benefits go to middle-class home-owners – but the support of housing is welcome.

Health

In 1983, the Mexican Constitution was amended to include a guaranteed right to health care for every citizen. Despite this commendable goal, the imperatives of economic adjustment rendered the provision of universal health care impossible. By 1988, government spending on health care had increased by just 1.25% over the 1981 levels. Given this plateau in real public expenditure, policy-makers were still able to deliver some important gains in the health arena: life expectancy increased from 67.1 years in 1982 to 70.3 years in 1991; infant mortality fell, from 49 per 1000 births in 1982 to 35 per 1000 in 1991; and by 1987, 91% of the Mexican people had health insurance, compared with only 81.2% in 1982.[72]

Apart from these advances, Mexico's health care system has yet to undergo some fundamental reforms. One obstacle to better service lies in the allocation of health funding, which is still heavily skewed toward administrative (13–32%) and curative activities (59–75%), but with very little resources left over for the crucial areas of training and research. Recent studies have also found serious inequities, in the sense that even though policy-makers succeeded in improving some key social indicators since 1982, austerity budgets and the decentralisation of health care services to the states have exacerbated the disparities in the quality of care received by rich and poor, urban sector and rural.[73] For example, an analysis of health care delivery in two of the country's poorest states, Oaxaca and Guerrero, found that decentralisation had resulted in an overall decrease in the number of people receiving health care services (Oaxaca), and in reduced services to the poor (Guerrero), while the wealthier population in these states saw an increase in services.[74] It

[72] All trends cited here were drawn from the World Bank's 'World Data' CD-ROM, 1994.

[73] C. Cruz Rivera et al., 'The Impact of Economic Crisis and Adjustment on Health Care in Mexico', Innocenti Occasional Papers, No. 13, Feb. 1991.

[74] R. Gonzalez-Block et al., 'Health Services Decentralization in Mexico', *Health Policy and Planning*, vol. 4, no. 4 (1989), pp. 301–14.

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appears that attempts to improve and decentralise health care in order to make it more responsive to the needs of the local citizenry must also be combined with increased efforts by the federal government to ensure equity in funding across states, and across classes and sectors within states.

PRONASOL as a 'new' approach to social policy in Mexico

Faced with increasing distributional conflict, and with some encouragement from the multilateral lenders, countries such as Bolivia, Chile, and Mexico launched compensatory social programmes in the 1980s. To varying degrees, all of these social programmes have relied on a combination of traditional social welfare compensation and on new 'demand-based' criteria requiring that communities generate specific proposals for assistance. In all of these programmes, the funds have been primarily spent on infrastructure; other kinds of social assistance (education and school materials; vocational training and vaccinations) and production support (credit access, technology training and employment creation) have lagged far behind.[75]

Mexico's version of a social compensation programme was PRONASOL, launched by President Salinas in 1988, and now reincarnated as the 'Alliance for National Welfare' under the Zedillo administration. While all these safety net programmes are variations on a theme, PRONASOL is also very much a Mexican phenomenon in that it has involved fairly heavy-handed government participation at every level. For example, during his tenure, President Salinas himself assessed local needs in weekly visits to the countryside, after which community groups and government officials designed government-funded projects. As a result, critics suggest that the real purpose of PRONASOL was to strengthen the PRI's control over local leaders and undermine the political opposition by handing out side payments to the loudest voices of potential protest. According to this view, PRONASOL, was little more than a 'social tranquiliser', that is, an instrument of state patronage that the governing party used to mitigate the harsher effects of its economic policies.[76]

[75] See C. Graham, *Safety Nets, Politics, and the Poor: Transitions to Market Economies* (Washington, DC, 1994).

[76] See D. Dresser, *Neopopulist Solutions to Neoliberal Problems: Mexico's National Solidarity Program* (San Diego, 1991), p. 1. The structure of PRONASOL made it very open to characterisation as a social tranquiliser: since recipient communities were required to organise to articulate their demands, the most organised of the poor – i.e. those most likely to protest – were also the most likely to receive funds. At the same time, the demand-based nature of PRONASOL and its Latin American counterpart programmes could be viewed as positive in that they require grass-roots mobilisation to trigger funding.

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In fact, PRONASOL has been *both* a source of patronage for the PRI, *and* a creative social compensation scheme staffed with a cadre of highly competent policy-makers.[77] As the latter, it has faced a problem typical of many compensation programmes: the mere introduction of a social safety net has inflated popular expectations and led some to mistake it as a successful answer to the long-term structural inequalities in Mexico's rural and urban sectors. However, PRONASOL's resources were never sufficient to accomplish such a daunting task. Although the programme received an impressive-sounding $14 billion between 1988 and 1994, its annual budget never amounted to more than 1% of Mexico's GDP. As for triggering structural change in the long term, just 3% of the total PRONASOL budget went toward 'Empresas de Solidaridad' – the main PRONASOL programme that had been assigned the task of increasing productive opportunities for those on the economic margin.[78] In short, PRONASOL was similar to other compensation programmes: while effective in securing political breathing space in the wake of harsh adjustment measures, the limited resources and demand-based nature of such programmes means that they cannot be expected to do much more than that.

Conclusions: the need for a 'second phase' of reform

Despite neoliberal claims which causally link economic opening with higher levels of growth, productivity, and income equality, the Mexican case suggests that the path toward achieving these goals may be more complex than originally envisioned. In Mexico there has been a lacklustre pattern of growth, erratic productivity gains, and an increasing concentration of income held by the wealthiest groups between the mid-1980s and the early 1990s.[79] One reason for this poor performance is that Mexican policy-makers focused on macroeconomic adjustment while leaving microeconomic restructuring to the market; unfortunately, the collapse of the macroeconomy in late 1994 and the explosion of violence and social upheaval have now made evident the costs of ignoring these micro-level issues of distribution and sectoral performance.

[77] PRONASOL's mixed results and structure are discussed in the edited collection of essays on the programme by W. A. Cornelius, A. L. Craig and J. Fox, *Transforming State–Society Relations in Mexico: The National Solidarity Strategy* (San Diego, 1994).

[78] Authors' interview with Guillermo Bernal, General Director of the 'Empresas de Solidaridad' programme, Mexico City, June 1995.

[79] Mexico, whose economy is the 16th largest in the world, now has the fifth largest collection of billionaires, outranking much larger economies such as Canada, Britain, France, and Italy on that indicator. See R. Willis, 'Savings Incentives Become a Priority', *El Financiero Internacional*, 8–14 July 1996.

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Since the débâcle of 1994–5, macroeconomic stability has gradually been restored.[80] As of mid-1996, for example, growth of GDP had already surpassed the 3% level that had been projected earlier, and the recovery has been led largely by exports. In the industrial sector, exports increased by some 20% between mid-1995 and mid-1996; in agriculture, exports increased by approximately 10.5% during the same period. With these output gains, the trade balance moved from a US$18.5 billion deficit in 1994 to a $7.1 billion surplus in 1995 (See Table 1). This has enabled the Zedillo administration to quickly repay the US$12.5 billion that it had borrowed from the US government to help finance the March 1995 stabilisation programme.

Unfortunately, this impressive export-led recovery has also helped bring the underlying weaknesses and distributional stresses of the Mexican economy into stark relief. In particular, the structural heterogeneity that we described in our analysis of the urban–industrial and the rural–agricultural sectors has become even more apparent in the post-1994 period, as the top tier of tradeables producers within each sector has rapidly recovered, but the ever-widening bottom tier continues to stagnate. For this latter group, operating within the non-tradeable service, agriculture and manufacturing sectors, the neoliberal goal of achieving greater efficiency in the allocation of productive factors, and hence a more solid base for income gains, remains elusive.

Apart from long-term structural weaknesses related to low savings, investment and productivity rates, this more vulnerable segment of the domestic market has also had less insulation from the tight fiscal and monetary contraction that formed the cornerstone of the 1995 austerity plan. The post-1994 data point to a further shrinking of real wages and an absolute worsening of income shares for the country's poorest groups.[81] Meanwhile, the explosion of such social protest movements as the *Zapatistas*, *El Barzón*, and the more violent People's Revolutionary Army, suggest that an adjustment-weary populace is now much less inclined to tolerate the PRI's cynical corruption scandals and its hollow promises of future prosperity.[82]

[80] These figures on the Mexican recovery are cited from various issues of *NAFTA Works*, the economic newsletter of the SECOFI–NAFTA Office of the Mexican Embassy in Washington, DC.

[81] Based on the authors' confidential interviews within Mexico's Ministry of Economics (*Hacienda*), October 1996.

[82] See A. Guillermoprieto, 'Mexico: Murder Without Justice', *New York Review of Books*, 3 Oct. 1996, pp. 31–6. With the launching of its 'Alliance for the Recovery of Economic Growth' in October 1996, the Zedillo administration has made modest efforts to alleviate adjustment stress, including a plan to cap credit card rates and to purchase a share of troubled bank loan portfolios through the government's Deposit Insurance Fund.

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What kinds of strategies could help broaden productivity gains and economic prosperity? In the urban–industrial sectors, the fallout from the peso crisis appears to have shifted policy debate in favour of those within the President's technocratic ranks who have long argued for a more active, integrated approach to industrial policy.[83] The Zedillo administration now seems to recognise that such problems as asset concentration, the overall fragility of the small and medium firms, plummeting real wages, and the explosion of the informal economy, are endogenous to Mexican-style neoliberal reform and serious barriers to future productivity growth.

In this light, the government has renewed a number of commitments concerning economic deregulation, the upgrading of technology and human resources, the strengthening of the SME sector, and stricter enforcement of anti-monopoly legislation. More importantly, Mexican industrial policy has taken a potentially innovative turn with its stated intention to promote productivity through regional business clusters.[84] Such industrial clusters tend to encompass both large firms capable of effectively competing in world markets, and smaller companion firms which provide supply flexibility and innovative backup. The government's decision to play a more active role in promoting horizontal and vertical ties between firms operating within this mode can create important multiplier effects, such as increased labour market mobility and new kinds of technological adaptation. When combined with crucial investments in education, job training and the creation of business associations related to these regional clusters, the very logic of production can shift quickly from today's low-wage, low-skill, slow-growth dynamic to one in which growth and income gains are driven by productivity and innovation.

In the rural–agricultural sector, Mexico City technocrats have settled for programmes like PROCAMPO which maintain an increasingly miserable *status quo* in the countryside. A more dynamic approach to incorporating the emergent class of small landholding farmers into Mexico's rural economy would include the following: the creation of rural institutions to provide more equal access to credit and to promote modernisation of farming techniques and diversification into high-yield crops; the implementation of a vigorous public infrastructure programme geared toward expanding irrigation and transportation; and a more

[83] This view is expressed, for example, in the collection of edited essays by Clavijo and Casar, *La industria mexicana en el mercado mundial*.

[84] Recent industrial analysis suggests that businesses have increasingly grouped together into multi-sectoral clusters which share similar sorts of skilled labour and technology. For a view of this process in the US, see P. Doeringer and D. Terka, 'Business Strategy and Cross-Industry Clusters', *Economic Development Quarterly*, vol. 9, no. 3 (1995), pp. 225–37.

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aggressive budgetary commitment to basic and technical education in the countryside.[85] The recent realignment of the peso has revealed Mexico's dynamic potential as an agricultural exporter under NAFTA; the buoyant recovery of agricultural exports suggests that there is both room and reason for more aggressively targeting programmes like PROCAMPO toward those who most need it, as opposed to those who are already thriving in the rural economy.

As for social policy, the period since 1988 has seen some creative innovations, albeit in an era of tighter budgets. However, the political baggage surrounding the PRONASOL safety net programme, a haphazard decentralisation of fiscal responsibilities, and the fact that social strategies to date have done little to promote long-term structural change have clearly been problems. Social policy, productivity and potential income gains can be linked; in education, for example, a major reorientation of resources into basic and technical education could foster large human capital gains. Yet, despite widespread social discontent concerning the difficulties of securing stable formal employment within Mexico's radically restructured economy, policy-makers have still not mustered the political will to shift social priorities in a manner that would more aggressively harness human resources to a neoliberal development model.

Policy-makers, in short, have thus far delivered on just half of what the neoliberal equation has to offer: markets are more open, certain economic units are more efficient, and Mexico has adjusted to the 'shock' of the peso crisis without resorting to populist strategies. Unfortunately, what is missing – wage and employment gains, improvements in income distribution, and sustainable growth – may never follow 'naturally' from the new market model. The gravity of the gap between relative macroeconomic stability and absolute microeconomic stress demands an explicit set of public policies to boost the adjustment process. Although political economy research since the debt crisis has identified an arsenal of policies that could readily jump-start the process of microeconomic adjustment in Mexico, PRI technocrats have apparently hedged their bets on a passive and downtrodden populace.

In opting for more of the same, the PRI has gambled incorrectly on two counts. First, 'voice' (*Zapatistas*, *El Barzón*) and 'exit' (migration to the USA, defection to opposition parties at the polls) have more aptly characterised civic behaviour in the 1990s and this will ultimately diminish, not enhance, the stature of the PRI. Secondly, there is increasing

[85] For an elaboration of these policies, see Levy and van Wijnbergen. 'Transition Problems in Economic Reform', de Janvry et al., 'NAFTA and Mexico's Maize Producers', and de Janvry et al., 'Ejido Sector Reforms'.

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evidence that sustainable growth may actually be induced by attention to improving distribution of income, not the reverse.[86] By overlooking these new dynamics, the Zedillo team could be condemning itself indefinitely to mediocre economic returns – not to mention a draining of scarce public resources into an expanding state security network as the social costs of neoliberalism in Mexico continue to accumulate.

[86] A. Alesina and D. Rodrik, 'Distributive Policies and Economic Growth', *Quarterly Journal of Economics*, vol. CIX, no. 436 (1994), pp. 465–90.

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