

**Confronting Human Development in Mexico**

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2000

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A radically new strategy of development has been evolving in Mexico for roughly the last two decades. The rise in oil prices in 1973 and again in 1979, on both occasions engineered by OPEC, enticed Mexico to modify its import substituting industrialization strategy, first, by giving higher priority to exports of oil and, second, by relying on foreign capital rather than domestic savings to finance its ambitious expansion program. These initial steps in the global commodity and capital markets were followed by other steps, some virtually imposed on the country by external creditors after the 1982 crisis, which cumulatively resulted in a new development strategy. This strategy is based on market liberalization and openness to the international economy. The promise of the new strategy was that it would increase prosperity, reduce poverty and create a more equitable society. Let us confront the promise with the reality and consider whether the new strategy has met with success. Our argument will be that the strategy has failed.

### **Slow and unstable growth**

The trend rate of growth of per capita output since 1980 has been very low. Indeed gross domestic product per head was virtually the same in 1998 as it was in 1980, in terms of constant pesos, and in terms of constant US dollars it was about 9.3 per cent lower.<sup>1</sup> Given the age structure of the population, this implies that the great majority of the people of Mexico, all those born after 1980, have experienced stagnation of real income throughout their entire life. The new development strategy has failed to deliver prosperity.

On two occasions growth has been punctuated by severe depressions. The first was the 1982 debt crisis in which Mexico was caught between a sharp fall in the price of oil (a major export) and a sharp rise in real interest rates on foreign borrowings used in part to finance the

expansion of the oil sector. The second was the 1994 currency crisis in which Mexico was subjected to a severe speculative attack on the peso when it became evident that the exchange rate was overvalued and devaluation was inevitable. The consequence of both these episodes was a painful decline in real incomes followed by a slow recovery after 1982 and a rapid one after 1994.

Whatever the long-term benefits of an open economy may turn out to be, experience already has shown that managing an open economy can be difficult and that policy mistakes are harshly punished. The record in Mexico so far is that the new development strategy has been associated with a reduction in the average rate of growth and an increase in the volatility of growth rates.

There is always a temptation to attribute poor performance to “bad luck” or external “shocks” rather than to misguided policies. A deterioration in the external terms of trade caused by a decline in world oil prices, or repatriation of short term capital by foreign investors, or a rise in global interest rates which increases the cost of servicing the foreign debt, or capital flight by domestic savers and investors are examples relevant to Mexico. Those looking for excuses can usually find plausible examples of negative shocks and bad luck to explain away disappointing economic performance. But it is equally easy to find examples of good luck, such as the sustained rapid growth of the US economy which provides a huge, nearby and expanding market for exports. Indeed in an open economy one should anticipate periodic external shocks (both positive and negative) and incorporate appropriate policies into the overall development strategy to cope with them. Particularly important are policies toward foreign borrowing, exchange rate policies and the size of international reserves. Mexico’s foreign exchange reserves per head of the population, for example, were only 70 per cent as large as the reserves of South Korea and Thailand in 1997, and this helps to explain why it takes Mexico somewhat longer to recover

from external shocks compared to the relatively fast recovery in South Korea and Thailand after their 1997 external financial shocks. In other words, countries can to some extent make their own luck and in the specific case of Mexico we believe that slow growth has less to do with external shocks than with domestic policy.

### **Export-led growth**

Such growth as has occurred has been export-led, and this tendency has accelerated in the 1990s. Closer integration into the world economy began before the 1982 debt crisis and was reflected in increased reliance on foreign capital to finance development and a major effort to increase oil production for export. More general market liberalization however began in earnest after the 1982 debt crisis and was carried further after the 1994 currency crisis.<sup>2</sup> Tariff rates today, for example, are between two and six per cent on average and because of the change in the structure of incentives favoring international trade, the expansion of exports accounts for a half or more of the growth in GDP.<sup>3</sup> Exports in 1980 represented only 11 per cent of GDP; in 1997 they were nearly three times higher, namely, 30 per cent of GDP.

The volume of exports increased nearly five per cent a year between 1980 and 1996, with growth being two and a half times as fast during the period 1990-1996 as during 1980-1990. Because of deterioration in Mexico's terms of trade, however, the value of exports increased much less rapidly than the volume. Over the entire period, 1980-1996, the value of exports grew only 2.25 per cent a year, with growth being much slower during 1980-90 (1.2 per cent a year) than in 1990-96 (4.0 per cent a year).

In per capita terms, export earnings increased only 0.25 per cent a year. Thus, while foreign trade undoubtedly was the engine of growth, it was a rather feeble engine. This does not imply that it was a mistake for Mexico to seek greater integration with the global economy, but it

does suggest that market liberalization and openness do not suffice to produce a successful development strategy.

### **Increased disarticulation of the economy**

The structure of the economy has become increasingly disarticulated. One would anticipate that as development proceeds, changes in the composition of output and the allocation of labor would result in a narrowing of differences in factor productivity among sectors and greater uniformity within sectors. This has not happened in Mexico.

The share of total output originating in agriculture has been falling for decades and agriculture now accounts for only five per cent of GDP.<sup>4</sup> Similarly, the share of the labor force employed in agriculture has been falling steadily, but agriculture still absorbs 28 per cent of the labor force. The productivity of labor in agriculture has been falling relative to the productivity of labor in the non-agricultural sectors. In 1997, the productivity of agricultural labor was only 13.5 per cent as high as average productivity in the rest of the economy whereas in 1970 it was 17.3 per cent as high. In other words, agriculture is falling behind, the allocation of labor is increasingly inefficient and the disarticulation of the economy is rising over time.

The same is true of the rest of the economy. Throughout the 1990s, output per head continued to fall in agriculture whereas in industry there was some increase in per capita production and in the production of services there was essentially stagnation. Within the non-agricultural activities, however, disarticulation has increased. One symptom of this is the growing “informalization” of the economy, i.e., an increase in the proportion of the urban labor force that is self-employed or working in very small enterprises.<sup>5</sup> Another symptom is the relative success of large enterprises, domestic and foreign, producing for the export market as compared to the relative failure of small and medium local enterprises producing for the domestic market. Non-agricultural enterprises in Mexico are becoming increasingly polarized

and the degree of concentration appears to be rising.<sup>6</sup> Yet another symptom is the great contrast between the strong growth of exports of manufactured goods and the weak growth of employment in the manufacturing sector, especially in large enterprises apart from maquiladora firms.<sup>7</sup>

Something similar also seems to be occurring within agriculture. Although the sector as a whole is depressed, the large agricultural corporations producing export products have done well whereas small farmers producing for self-consumption or the domestic market have become impoverished. These patterns of structural disarticulation are of course related to changes in the distribution of income and wealth, which we will discuss below.

### **Soft state**

The revenue and expenditure policies of the central government have contributed neither to growth nor to equity. The state has abdicated responsibility for ensuring rapid economic growth, improving the distribution of income and wealth and promoting human development. In this sense Mexico has suffered from a soft state<sup>8</sup> and the new development strategy seems to be based on an assumption, rhetoric notwithstanding, that a change in the structure of incentives and privatization of state enterprises are the core reforms. The implication is that the private sector with minimal support from the state can achieve the country's development objectives. The evidence so far indicates that the assumption is wildly optimistic.

The resources available to the government for development and other purposes are low. Central government revenue in 1996 was only 15.4 per cent of GDP in Mexico.<sup>9</sup> This is below the average for countries classified by the World Bank as middle income (17.4%) and is well below the revenues available to governments in more successful developing countries in east and southeast Asia. For example, government revenue accounted for 21.3 per cent of GDP in South Korea in 1996, for 24.9 per cent in Malaysia and for 29 per cent in Singapore.<sup>10</sup> That is,

government revenues in these three countries, relative to GDP, are between 38 and 88 per cent higher than in Mexico. This is one indication of the inability of the Mexican state to mobilize resources for development. Tax reform should be high on the agenda of a revised development strategy. This is especially important because resources available from state owned enterprises have diminished as a result of privatization.<sup>11</sup>

Turning to the expenditure side of the government accounts, the proportion of central government expenditure allocated to capital formation in Mexico has fallen dramatically from 32 per cent in 1980 to 12 per cent in 1996. The state no longer assumes responsibility for promoting growth through government investment. Again, there is a stark contrast with the more successful states in east and southeast Asia. In South Korea in 1996, capital expenditure accounted for 23 per cent of all government spending, in Malaysia it was 19 per cent and in Singapore it was 29 per cent.<sup>12</sup> In other words, the state in Mexico devotes a much lower proportion of its resources to financing investment than is the case in several other “open economy” countries.

The withdrawal from investment does not mean that the state has instead given higher priority to direct transfer payments and other programs intended to reduce poverty and improve the distribution of income. While anti-poverty programs have been much publicized, the fact remains that “general government consumption” in Mexico – the category that includes expenditures on anti-poverty programs – has fallen from 10 per cent of GDP in 1980 to only 8 per cent in 1997. Given that per capita GDP was stagnant or falling during this period, it is obvious that real government expenditure fell substantially, indeed by about 20 per cent. Liberalization has been accompanied by a shrinking state. Something similar, but on a larger scale, has occurred in many “transition economies”, with devastating effects.<sup>13</sup>

## **High and increased inequality**

Mexico, like much of Latin America, has a very unequal distribution of income. This is not new. Indeed one of the unfortunate consequences of the strategy of import substituting industrialization that was followed until the 1980s was a high degree of inequality.<sup>14</sup> The new strategy was expected to reduce inequality; instead it has increased.

According to World Bank estimates, in 1984 the poorest 20 per cent of the population received 4.1 per cent of total income and the richest 20 per cent received 55.9 per cent of total income. The quintile ratio was therefore 13.6. By 1995 the share of the bottom quintile had fallen to 3.6 per cent of total income and the share of the top quintile had risen to 58.2 per cent. The quintile ratio in that year was 16.2, or 19 per cent higher than in 1984.<sup>15</sup> Moreover, the degree of inequality is much higher in Mexico than in east and southeast Asia. The Gini coefficient in Mexico is about 53.7 whereas in Malaysia it is 48.4, in Indonesia it is 36.5 and in South Korea (in 1982) it was 36.

The conclusion is inescapable: Mexico's new development strategy has been a disappointment because of its failure to raise average incomes over a period of nearly two decades and because of its failure to reduce inequality in the distribution of income. A highly unequal distribution of income among persons and households can be analyzed from other perspectives. Rural-urban inequalities are very great, largely because the poor are disproportionately located in the countryside while the rich are concentrated in the cities. Similarly, regional inequality is high, although possibly diminishing somewhat.<sup>16</sup> There are sharp inequalities among ethnic groups and the indigenous population in particular is a victim of persistent discrimination.

Finally, there is gender inequality. One overall measure that is increasingly used is the "gender related development index" (GDI) developed by the UNDP. According to this measure,

discrimination against women in Mexico is less than in the median Latin American country, but Mexico's record is less good than that of Argentina and Chile while being better than that of Brazil. Perhaps more illuminating is the fact that the GDI in Malaysia, South Korea and Singapore is higher than in Mexico; indeed in the case of Singapore it is 9.6 per cent higher.<sup>17</sup>

Moreover, the available evidence suggests that the economic position of women in Mexico has deteriorated, relative to men, during the period 1984 to 1994.<sup>18</sup> In the urban areas, the ratio of female-to-male wages declined from 77.1 per cent in 1984 to 72.8 per cent in 1994. Women became more concentrated in low-wage sectors of the economy and in low-wage jobs within sectors. This occurred, furthermore, at a time when women had more technical training than men and the gap in general education favoring women actually increased. In the rural areas, female wage differentials were narrow and declined only modestly, but earnings differentials declined sharply, namely, from 85.1 per cent in 1984 to 62.4 per cent in 1994. The new development strategy, in other words, has been a disaster for women.

### **Severe and increased poverty**

Slow growth, greater inequality in the distributions of income and wealth, informalization of the economy in a context of stagnation, rising wage inequality in non-agricultural activities<sup>19</sup> and a decline in agricultural output per head have combined to produce a high incidence of poverty and, in addition, an increase in the absolute number of people and the proportion of the population living in poverty. Whatever the precise figures may be, the new development strategy has failed to keep its promise to the poor.

There are numerous studies of poverty in Mexico. They differ in the details but are in agreement on the broad conclusions. In summarizing our story we shall rely on data from the National Income and Expenditure Surveys of 1984, 1989, 1992 and 1994, although to simplify presentation the figures reported will be limited to 1984 and 1994. The concept of poverty we

use is the conventional one of income poverty and the threshold, which is nutritionally based, is equivalent to an expenditure in September 1989 prices of \$25 per month per person. Those living below this threshold are said to be in “extreme poverty”.<sup>20</sup>

The number of persons living in extreme poverty in Mexico increased from 13.1 million in 1984 to 18.2 million in 1994, or by nearly 39 per cent. Most of the poor (79 per cent in 1994) live in rural areas.<sup>21</sup> Moreover, the number of extremely poor rural people increased by 58 per cent in just one decade, 1984 to 1994. In the urban areas there was actually a slight decline in the number of poor over the same period and as a result, poverty in Mexico has increasingly become a rural phenomenon, in contrast to other parts of Latin America. (See Table 1.) For example, in Venezuela rural poverty accounts for only nine per cent of the total number of poor people; in Chile rural poverty accounts for 17 per cent of the total; in Peru, 35 per cent and in Colombia 46 per cent.<sup>22</sup> The data we have cited for Mexico almost certainly understate the extent to which the number of poor people has increased, since poverty in the year of the baseline study (1984) surely had already increased compared to 1980 or 1982 (the year the debt crisis erupted). Furthermore, the data for 1994 cannot have captured the increase in poverty that occurred after the currency crisis of that year.

Of course some of the increase in poverty can be attributed to demographic expansion, but there was also an increase in the incidence of poverty. Between 1984 and 1994 the proportion of the population living in extreme poverty rose from 18.3 per cent to 20.3 per cent. This represents an increase in the incidence of poverty of 10.9 per cent. Once again, the heart of the problem is located in the countryside. In the rural areas, the incidence of extreme poverty rose from 34.5 to 38.4 per cent, an increase of 11.3 per cent in one decade. In the urban areas, in contrast, the incidence of extreme poverty declined from 9.0 per cent in 1984 to 7.3 per cent in

**TABLE 1**

**NUMBER OF PEOPLE LIVING IN EXTREME POVERTY**  
(millions)

	Rural	Urban	Total
1984	9.1	4.0	13.1
1994	14.4	3.9	18.2
Change, 1984-94	+5.3	-0.1	+5.1

Source: Thomas Kelly, The Effects of Economic Adjustment on Poverty in Mexico, Aldershot: Ashgate Press, 1999, Table 4.5, p. 58.

1994. (See Table 2.) This is an aspect of the increased disarticulation of the economy mentioned earlier.

**TABLE 2**

**PERCENTAGE OF THE POPULATION LIVING IN**  
**EXTREME POVERTY**

	<u>Rural</u>	<u>Urban</u>	<u>Total</u>
1984	34.5	9.0	18.3
1994	38.4	7.3	20.3
Per cent change, 1984-94	+11.3	-30.0	+10.9

Source: Thomas Kelly, The Effects of Economic Adjustment on Poverty in Mexico, Aldershot: Ashgate Press, 1999, Table 4.1, p. 52.

Once again, the data in the Table understate the severity of the problem because the incidence of poverty in the base year (1984) already was higher than in the years immediately prior to the change in economic strategy. In other words, the change in the incidence of extreme

poverty in Mexico probably was somewhat greater than our data indicate. Finally, the depth of poverty, as measured by the proportional poverty gap, increased between 1984 and 1994 both in the country as a whole (from 5.7 to 6.2 per cent) and in the rural areas (from 11.5 to 12.3 per cent); in the urban areas, however, the depth of poverty declined (from 2.3 to 1.8 per cent).<sup>23</sup> That is, in general not only were the poor more numerous, absolutely and relatively, they were also poorer at the end of the period than at the beginning.

### **The policy posture**

The increases in inequality and poverty that have occurred in Mexico during the last two decades were not inevitable but were the result of policy choices that were made in the context of the liberalization strategy. While it could be argued that there was a need to cut public expenditures in the immediate aftermath of the 1982 debt crisis, the cuts that actually occurred were extreme. The reduction in investment expenditure not only lowered the overall rate of growth, it also made structural adjustment much more difficult, since the resources needed to exploit opportunities in newly profitable activities were not available in sufficient volume. The change in the structure of incentives thus led to adjustment through contraction rather than adjustment through growth. To add insult to injury, there was a reduction in the level of social expenditure, although social expenditure as a percentage of a contracting GDP actually increased during the period 1989-1996. But what matters is the level of expenditure and its decline meant that those harmed by adjustment through contraction had the social safety net removed from under them.

Even if one argues that the government was unable to increase the level of expenditure on social protection substantially, it would have been possible to reallocate public expenditure so as to accommodate a greater concern for reducing poverty and inequality. For example, in Mexico in 1996, expenditure per primary school student was the equivalent of 11.9 per cent of the

average income (or GNP per capita, to be precise) whereas expenditure per tertiary school student was equivalent to 46.9 per cent of the average income. Compare this with South Korea where expenditure per primary school student was equivalent to 18.8 per cent of the average GNP per capita while expenditure per tertiary school student was equivalent to 6 per cent of the average income.<sup>24</sup> That is, in South Korea public expenditure on primary school students was three times more than public expenditure on tertiary school students whereas in Mexico public expenditure on each primary school student was roughly a quarter of public expenditure on each tertiary school student. Not only does the pattern of spending in Mexico worsen inequality, it also is rather inefficient because there is strong evidence that the returns to expenditure on primary and secondary education are higher than the returns on tertiary education.<sup>25</sup>

The “pactos economicos” made by President Salinas in 1987-88 effectively acted to repress wages and hence the real incomes of low-skilled workers in the manufacturing sector. Rather than constituting a short-term emergency measure designed to keep inflation under control during a particularly vulnerable time, the “pactos” appear to have become a semi-permanent incomes policy designed to lower the level and then the rate of increase of real wages. Indeed one study estimates that real wages for blue collar workers fell by 30 per cent between 1980 and 1994.<sup>26</sup> The real minimum wage fell by 65 per cent between 1980 and 1995, while during this same period, the wages for skilled workers rose slightly.<sup>27</sup> Thus wage inequality increased. Over time, as its economic situation failed to improve, labor became increasingly reluctant to tolerate the unequal distribution of the burden of structure adjustment. In 1995, for the first time since 1987, organized labor refused to endorse another “pacto economico”.

While the impact of the “pactos” was to increase inequality by reducing incomes of those at the bottom of the pyramid, the massive privatization of state owned enterprises increased inequality by raising the incomes of those at the top. The number of state owned enterprises

decreased from 1155 in the mid-1980s to 200 in 1994. Over this same period, the number of Mexican billionaires increased from one to 24.<sup>28</sup> The privatization process was hastily implemented and poorly regulated and the result was an “undesirable concentration of wealth and ownership in some of the privileged areas”.<sup>29</sup>

The liberalization of Mexico’s financial markets in 1989-90 probably also increased inequality both directly and indirectly through the crisis that ensued. The ostensible justification for opening financial markets was to gain greater access to foreign capital in order to supplement domestic savings and increase investment. The increased investment was intended to accelerate growth and bring prosperity for all. In practice however most of the capital inflows appear to have supplemented consumption rather than raise investment. In fact “commercial bank lending for consumption grew in real terms by 457.7 per cent over the period 1987-1994....By contrast, lending for the manufacturing industry grew by 130.6 per cent.”<sup>30</sup> This change in the pattern of bank lending made the financial system, and hence the economy as a whole, vulnerable to shocks.

The desire to attract foreign capital generally puts pressure on a country to adopt anti-inflationary policies and maintain high rates of interest. The high interest rates, in turn, tend to discourage productive investment in plant and equipment and encourage speculative activities.<sup>31</sup> This is precisely what has occurred in Mexico. In such an environment it is the small and medium sized enterprises that encounter the most difficulties in obtaining credit. This not only results in greater inequality, it also reduces efficiency in the allocation of resources.

The currency crisis of 1994 was the well known result of financial liberalization. While the benefits of financial liberalization appear to have accrued to the members of the Mexican elite who participated in the stock market boom, the costs of liberalization were socialized. The Mexican government is estimated to have spent 15 per cent of gross national product in 1998 on

rescue programs for financial institutions.<sup>32</sup> One of the consequences of the currency crisis was the near-collapse of the Mexican financial system. While the system did survive, credit to the private sector as a whole fell by 25 per cent in real terms between the second quarter of 1995 and the first quarter of 1999.<sup>33</sup> Moreover, even in the pre-crisis years lending to small and medium enterprises was low, but since the crisis, when credit is severely rationed, the problem has become even more serious. That is, the already under-financed Mexican small and medium enterprises have seen a further reduction in the availability of credit.

The reform of the ejido sector that began in 1992, combined with other institutional changes in the rural economy, is yet another example of the policy posture that is leading to increased inequality. Although there were many things wrong with the state's policies towards the ejido sector in the past, the solution adopted is not one which will reduce extreme poverty or inequality. While it is true that the relationship between the state and the ejidos has been complex and not always unequivocally beneficial for the ejidos, the state at least did provide some institutional support through the Banrural and through its agricultural pricing policies. From the 1980s onwards, however, institutional support has declined and in effect the ejidos have been abandoned. The agricultural reforms have reduced the availability and increased the cost of credit, insurance and essential inputs. Today, "only commercial farmers are obtaining loans in amounts sufficient to induce experimentation with productivity-enhancing technologies. The vast majority of basic grains producers have been abandoned by the Mexican rural financial system."<sup>34</sup> This is resulting in a process of social differentiation with a small group of producers able to take advantage of market reforms and the great majority of ejidatarios lagging behind. "The successful entrepreneurs tend to be those who either have more land or more access to credit and irrigation, that is, the relatively better off. On the other end of the spectrum are the

small farmers and indigenous community members who find it difficult to modernize and diversify because of the limited access to investable funds and institutional services.”<sup>35</sup>

It is unclear whether the reforms are leading to a further concentration of land ownership, but they certainly will not reduce the concentration of ownership. While the Mexican land reform that occurred after the revolution as codified in Article 27 of the constitution did improve the distribution of land in the country, the reforms none the less fell short of ensuring an equitable distribution of land. The Gini coefficient for land distribution declined from 0.78 in 1923 to 0.58 in 1970 and thus there clearly was a significant improvement.<sup>36</sup> A Gini coefficient of 0.58, however, is still indicative of a substantial degree of inequality. Moreover, several recent studies have found a negative relationship between asset inequality and growth.<sup>37</sup> And many have claimed that part of the explanation for the exemplary performance of the South Korean and Taiwanese economies is their high degree of equity in the distribution of productive assets. The implications for Mexico are obvious. While Mexico’s Gini coefficient for land distribution was roughly 0.58, the Gini coefficient for South Korea (in 1980) was 0.33. Instead of taking steps to remedy existing land ownership inequalities, the Mexican government has unfortunately adopted policies that are likely to exacerbate them.

If the reforms begun in 1992 had been accompanied by measures to enable ejidatarios and small farmers to make their existing assets more productive, then perhaps their overall impact would not be detrimental to income inequality even if they were to worsen asset inequality. One of the main reasons used to justify the reforms was that they would enable ejidatarios to use their land as collateral and thereby improve their access to credit which, in turn, would facilitate the purchase of essential inputs and the adoption of better technologies. This however has not occurred. The state has withdrawn from providing institutional support such as loans to small farmers and the private sector has not moved in to fill the vacuum. This is hardly

surprising since the agricultural sector in Mexico, as in most developing countries, is riddled with market imperfections and in such circumstances a laissez faire policy posture is unlikely to be efficient.

### **Comparative poverty**

It is instructive to compare poverty in Mexico with that in other broadly similar countries. In order to do this we have selected, somewhat arbitrarily, nine other countries for which comparable data are available, five in Latin America (Brazil, Chile, Colombia, Costa Rica and Venezuela) and four in Asia (Indonesia, Malaysia, Philippines and Sri Lanka). Two rather different notions of poverty are employed. The first is income poverty. Here we use the World Bank's standard of one US dollar per day (in purchasing power parity terms). In the Mexican context this is a very low poverty threshold, only slightly more generous than the "extreme poverty" threshold used in the previous section, and hence one should be careful in interpreting the results.

Measures of income poverty are sensitive to the poverty line adopted and to the distribution of income in the neighborhood of the poverty line. They are also sensitive to the unit of observation (the household, household income per capita, income per adult equivalent) and to the concept of "income" used (total expenditure, income net of subsidies and taxes, income including the imputed value of self-provided goods, etc.). International or cross-country comparisons of the incidence of poverty in addition have to confront the problem of selecting an international poverty line that is universally applicable and makes sense in countries which differ greatly in terms of average income per head. This universal poverty line then has to be expressed in a common currency (say, the US dollar) either by using market exchange rates or, as in the World Bank's standard, purchasing power parity prices. There are thus numerous points at which estimates of income poverty can be challenged and hence poverty estimates

should be used only for making broad comparisons in changes over time and across countries. There is a further problem, to which we now turn, that alternative notions of poverty may not be highly correlated.

The second notion of poverty we use is “human poverty” as measured in the UNDP’s Human Poverty Index (HPI-1). The Human Poverty Index is a simple average of three components: (i) the percentage of the population not expected to live to age 40; (ii) the adult illiteracy rate; and (iii) the percentage of the population that does not enjoy a decent standard of living. This last component, again, is a simple average of (a) the percentage of people without access to safe water, (b) the percentage without access to health services and (c) the percentage of underweight children under five.<sup>38</sup> Note that the HPI attempts to measure deprivation directly and does not rely on a money metric.

The results are presented in Table 3 below. The countries are ranked in descending order of GNP per capita. The range is between \$5020 a head in Chile and \$800 a head in Sri Lanka. Mexico ranks fourth, at \$3680 per head. As regards income poverty, using the World Bank’s standard, the range is between 4.0 per cent of the population in poverty (in Sri Lanka) and 28.6 per cent (in the Philippines). Mexico ranks sixth, at 14.9 per cent. The rank ordering of countries under the Human Poverty Index differs considerably from the ordering under income poverty. According to the HPI, Costa Rica has the lowest incidence of poverty and Indonesia the highest; Mexico ranks fourth, after Costa Rica, Chile and Colombia.

It is evident from glancing at the Table that income poverty and human poverty are not as closely correlated as one might imagine. Sri Lanka, which ranks tenth in terms of per capita income and ninth in terms of human poverty, ranks first in terms of income poverty. Chile, which ranks first in terms of per capita income and second in terms of human poverty, ranks only

**TABLE 3****COMPARISONS OF INCOME AND HUMAN POVERTY  
AMONG TEN COUNTRIES, 1990s**

	<u>GNP per capita (US\$)</u>	<u>Percent of population with less than \$1 per day</u>		<u>Human Poverty Index Rank</u>
		<u>%</u>	<u>Rank</u>	
1. Chile	5020	15.0	7	2
2. Brazil	4720	23.6	9	7
3. Malaysia	4680	5.6	2	6
4. Mexico	3680	14.9	6	4
5. Venezuela	3450	11.8	=4	5
6. Costa Rica	2640	18.9	8	1
7. Colombia	2280	7.4	3	3
8. Philippines	1220	28.6	10	8
9. Indonesia	1110	11.8	=4	10
10. Sri Lanka	800	4.0	1	9

Sources: GNP per capita and income poverty: World Bank, World Development Report 1998/99, New York: Oxford University Press, 1999; human poverty: UNDP, Human Development Report 1999, New York: Oxford University Press, 1999.

seventh in terms of income poverty. A country (such as Sri Lanka) may have a low average income and be unsuccessful in eliminating the most serious forms of deprivation and yet succeed in ensuring that almost everyone has an income of at least \$365 a year. Another country (such as Costa Rica) may have a relatively low income by Latin America standards and a high incidence of income poverty and yet succeed in minimizing the extent of human poverty. This suggests that differences in policies account for differences in outcomes.

Although Mexico ranks fourth in the Table in terms of average income, it has a higher percentage of the population suffering from income poverty than four of the six countries in the Table that are poorer on average than Mexico, namely, Venezuela, Colombia, Indonesia and Sri Lanka. On the other hand, Mexico has done much better than Brazil. Turning to human poverty, Mexico's relative performance improves. It ranks fourth in terms of average income and human poverty. Even so, Mexico has done less well than Costa Rica and Colombia, both of which have a lower average income than Mexico. Hence one is forced to conclude that Mexico's performance is not particularly good when viewed in international perspective. Indeed, market liberalization and openness to the international economy have yet to fulfill the promise of less poverty and greater prosperity for all.

### **Conclusions**

Mexico has adopted and gradually implemented over a period of two decades a new strategy of development based on market liberalization and openness to the international economy. This strategy has been a failure whether viewed in international comparative perspective or from the perspective of Mexico's past achievements. Mexico's rate of growth since 1980 has been well below that of the rest of Latin America and the Caribbean or, for that matter, the 156 other low and middle-income countries taken as a whole.<sup>39</sup> The growth rate also is lower and more volatile than it was in the pre-reform period. Indeed the average person in Mexico has experienced no increase in real income since the new strategy was adopted.

Mexico is however a relatively rich country. The UNDP estimates that in terms of real GDP per capita (measured in purchasing power parity terms), Mexico ranks 47 out of the 174 countries for which data are available. One should not take such estimates too seriously, but the fact remains that Mexico is a member of the OECD, sometimes referred to as the Rich

Countries' Club, and could reasonably aspire to become a high-income country. Human development, unfortunately, has lagged behind material progress. According to the UNDP's Human Development Index, Mexico ranks 50 out of 174 countries. That is, in relative terms, Mexico has been somewhat more successful in generating income for its people than in achieving human development.

One reason for this has to do with the high degree of inequality. The World Bank publishes data on the distribution of income in 96 countries.<sup>40</sup> Using the Gini coefficient as an indicator of overall inequality, it appears that only 12 countries have a distribution of income more unequal than Mexico's. Most of these countries are in Latin America and the rest are in sub-Saharan Africa, two regions which have disappointing development records. Mexico thus finds itself in unsavory company. Moreover, since the introduction of the new development strategy, inequality in Mexico has increased.

So, too, has poverty, as we have seen in some detail. Sadly, Mexico has been even less successful in reducing human poverty than in increasing human development. The UNDP has compiled a human poverty index for 97 developing countries.<sup>41</sup> Among these 97 countries, Mexico ranks tenth on the Human Development Index but only 13<sup>th</sup> on the Human Poverty Index. Thus in terms of relative success, Mexico has been most successful in achieving a high average real income, somewhat less successful in pursuing human development and least successful in reducing human poverty.

Among all the problems Mexico faces, it would be relatively easy to eliminate income poverty, particularly extreme poverty. All that is needed is some combination of faster growth in average income and a modest redistribution of income in favor of the poor. Consider the growth rate. During the period 1990-97, GDP per capita in Mexico increased only 0.2 per cent per annum; in the developing countries as a whole the rate of growth was six times faster, namely,

1.2 per cent per annum. If Mexico could achieve and then sustain even such a meager growth rate, poverty would decline slowly but steadily. Next consider the distribution of income. If Mexico could raise the share of the poorest 20 per cent of the population from its current share of about 3.6 per cent of total income to the share enjoyed by the bottom quintile in, say, Tunisia, viz., 5.9 per cent, the average income of the poor would rise 63.8 per cent. This alone would suffice to eliminate poverty. Neither of these objectives is terribly ambitious; both are perfectly feasible; the obstacles to achievement are political, not economic.

We have emphasized the slow and unstable growth Mexico has experienced, the feebleness of the export-led strategy, the increased disarticulation of the economy, the withdrawal of the state from responsibilities to promote investment and social equity, the high and rising inequality and the increase in severe poverty. These are the economic manifestations of a society in distress, operating well below its potential. There are of course many other symptoms of disarray, including deeply imbedded corruption that extends from the police to the highest levels of government, massive illegal drugs trafficking, widespread and rising crime and general lawlessness, rural unrest and even rebellion in Chiapas, disrespect for human rights and weakness of democratic institutions.

Not all of these problems can be blamed on the new development strategy: some antedate the strategy and others are only loosely connected to the strategy. The new economic policies however have made many problems worse and have failed to deliver on their promises. The fundamental error, we believe, was an error of omission rather than of commission. That is, it surely was correct to liberalize many markets and place greater reliance on the price mechanism in allocating resources. Similarly, it was sensible to reduce the degree of autarky and take advantage of opportunities arising from closer integration into the world economy. These things

were necessary, but they were not sufficient and the minimalist approach of the government resulted in a development strategy that was full of holes.

If liberalization and openness are to succeed in Mexico, they will have to be complemented by:

- Credible interest rate and exchange rate policies which reduce the vulnerability of the economy to macroeconomic disturbances;
- A structure of incentives for both the private and public sectors that encourages a high level of savings and an efficient allocation of investment among physical, human and natural capital;
- A more prudent approach to foreign borrowing;
- Better arrangements for supervising and regulating the banking system;
- Mechanisms for controlling large movements of short-term capital;
- A stronger and more competent state which is committed to remedying the disarticulation of the economy; and
- Redistributive policies which seriously address problems of poverty and inequality.

This list is neither exhaustive nor sufficiently detailed to provide practical help to policy makers, but it does indicate which areas of economic policy merit high priority. A minimalist approach of market liberalism and an open economy is never likely to produce satisfactory results. Mexico's own experience and that of many other countries provides abundant evidence of this. If Mexico is to confront human development, an activist but focused state is essential.

## NOTES

\* We are grateful to Diana Alarcon and Steven Helfand for comments on an early draft of this paper.

<sup>1</sup> Victor Urquidi, “Mexico’s Development Challenges: A Comprehensive View,” paper presented at the conference on Confronting Development: Assessing Mexico’s Economic and Social Policy Challenges, 4-5 June 1999, Table 1. (Henceforth references to papers presented at this conference will be referred to as Conference Paper.)

<sup>2</sup> Gustavo Vega and Luz Mariá de la Mora, “Trade Policy, Financial Crisis and Economic Recovery: Mexico in the 1990s,” Conference Paper.

<sup>3</sup> Ibid.

<sup>4</sup> World Bank, World Development Indicators 1999, Washington D.C.: World Bank, 1999, Table 4.2, p. 193. The other figures in this paragraph are authors’ calculations based on World Bank data.

<sup>5</sup> Carlos Salas, “How Long Can A Society Endure Inmiserizing Jobs?,” Conference Paper.

<sup>6</sup> See Eduardo Zepeda Miramontes and David Castro Lugo, eds., Reestructuración Económica y Empleo en México, Universidad Autónoma de Coahuila, 1999.

<sup>7</sup> Diana Alarcon and Eduardo Zepeda, “Employment Trends in the Mexican Manufacturing Sector,” North American Journal of Economics and Finance, Vol. 9, 1998.

<sup>8</sup> The concept of the “soft state” was first introduced by Gunnar Myrdal in his Asian Drama: An Inquiry into the Poverty of Nations, New York: Pantheon, 1968, Vol. II, Ch. 18, Section 14, pp. 895-900. We are using the term in a restricted sense to describe a state which has not created a structure of incentives or used its tax and expenditure policies or its power to regulate the private sector to promote equitable and sustainable development.

<sup>9</sup> Central government revenue in 1980 was about the same proportion of GDP as it was in 1996. The big difference was in the role of state owned enterprises. The share of GDP accounted for by state enterprises declined sharply, as did investment in state enterprises as a percentage of total investment. Between 1985-90 and 1990-96, for example, the share of state enterprises in GDP fell by nearly 27 per cent and the share of state enterprise investment in total investment fell by 28 per cent. Privatization of state owned enterprises greatly reduced the resources under the direct control of the government.

<sup>10</sup> World Bank, World Development Indicators 1999, Washington D.C.: World Bank, 1999, Table 4.13, p. 234.

<sup>11</sup> Enrique Dussel Peters, "Industrial Policy, Structural Change in Mexico's Manufacturing Sector and Economic Sustainability," Conference Paper.

<sup>12</sup> World Bank, op. cit., Table 4.14, p. 238.

<sup>13</sup> See UNDP, The Shrinking State: Governance and Sustainable Human Development, Regional Bureau for Europe and the CIS, New York, July 1997.

<sup>14</sup> For a general analysis of the import substituting industrialization strategy see Keith Griffin, Alternative Strategies for Economic Development, New York: St. Martin's Press, 2<sup>nd</sup> ed., 1999, Ch. 5

<sup>15</sup> The data for 1984 were taken from World Bank, World Development Report 1993, New York: Oxford University Press, Table 30, p. 297 and the data for 1995 came from World Bank, World Development Indicators 1999, Washington D.C.: World Bank, 1999, Table 2.8, p. 71.

<sup>16</sup> Gustavo Garza, "Dialectics of Urban and Regional Disparities in Mexico, 1970-1996," Conference Paper.

- <sup>17</sup> See UNDP, Human Development Report 1998, New York: Oxford University Press, 1998, Table 2, p. 131 and Table 4, p. 137.
- <sup>18</sup> Diana Alarcon and Terry McKinley, “The Adverse Effects of Structural Adjustment on Working Women in Mexico,” Latin American Perspectives, Vol. 26, No. 3, May 1999.
- <sup>19</sup> Carlos Salas, op.cit.
- <sup>20</sup> The data we use are taken from Thomas Kelly, The Effects of Economic Adjustment on Poverty in Mexico, Aldershot: Ashgate Press, 1999.
- <sup>21</sup> For a detailed analysis of the structure of poverty in the countryside in 1989 see Terry McKinley and Diana Alarcon, “The Prevalence of Rural Poverty in Mexico,” World Development, Vol. 23, No. 9, September 1995.
- <sup>22</sup> Keith Griffin, “Rural Poverty in Latin America,” INDES Working Papers, Inter-American Development Bank, April 1999, Table 1.
- <sup>23</sup> Thomas Kelly, op. cit., Table 4.1, p. 52.
- <sup>24</sup> World Bank, World Development Indicators 1999, loc.cit.
- <sup>25</sup> See, for example, George Psacharopoulos, “Returns to Investment in Education: A Global Update,” World Development, Vol. 22, 1994.
- <sup>26</sup> Diana Alarcon, “Mexico’s Income Distribution and Poverty Alleviation Policies in Comparative Perspective,” Conference Paper.
- <sup>27</sup> Statistical Abstract of Latin America, Los Angeles: UCLA, 1997..
- <sup>28</sup> John Summa, “Mexico’s New Super-Billionaires,” Mutinational Monitor, Vol. 15, No. 10, November 1994, p. 24.
- <sup>29</sup> Nora Lustig, Mexico: the Remaking of an Economy, Washington D.C.: Brookings Institution Press, 1998, p 153.

<sup>30</sup> Rogelio Ramirez de la O, “The Mexico Peso Crisis and Recession of 1994-5: Preventable Then, Avoidable in the Future?”, in Riordan Roett, ed., The Mexican Peso Crisis, Boulder: Lynne Rienner Publishers, 1996, p. 13.

<sup>31</sup> Ilene Grabel, “Speculation-led Economic Development: A Post-Keynesian Interpretation of Financial Liberalization Programmes in the Third World,” International Review of Applied Economics, Vol. 9, No. 2, 1995, pp. 127-49.

<sup>32</sup> Enrique Dussel Peters, op.cit.

<sup>33</sup> Ignacio Trigueros, “Mexico’s Recent Economic Performance and Policy Challenges”, Conference Paper.

<sup>34</sup> David Myhre, “The Achilles’ Heel of the Reforms: The Rural Finance System,” in Wayne Cornelius and David Myhre, eds., The Transformation of Rural Mexico, San Diego: Center for U.S.-Mexican Studies, 1998, pp. 61-2.

<sup>35</sup> Nora Lustig, op.cit., pp. 207-8.

<sup>36</sup> Idriss Jazairy, Mohiuddin Alamgir and Theresa Panuccio, The State of World Rural Poverty: An Inquiry Into Its Causes and Consequences, New York: New York University Press for the International Fund for Agricultural Development, 1992, Appendix Table 10, p. 414.

<sup>37</sup> See for example Nancy Birdsall, David Ross and Richard Sabot, “Inequality and Growth Reconsidered: Lessons for East Asia,” World Bank Economic Review, Vol. 9, No. 3, 1995 and Keith Griffin and Amy Ickowitz, “The Distribution of Wealth and the Pace of Development,” in Keith Griffin, Studies in Development Strategy and Systemic Transformation, London: Macmillan, forthcoming 2000.

<sup>38</sup> For details of the calculations see UNDP, Human Development Report 1999, New York: Oxford University Press, 1999, p. 163.

<sup>39</sup> World Bank, World Development Indicators 1999, loc.cit., Table 4.1, pp. 188-190.

<sup>40</sup> World Bank, ibid., Table 2.8, pp. 70-72.

<sup>41</sup> UNDP, Human Development Report 1999, loc. cit., Table 4, pp. 146-148.