Mexican economy in free-fall

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The Mexican economy shrank at an annual rate of 10.3 percent in the second quarter of 2009. This is the worst economic performance since the National Statistics Institute (INEGI) began issuing quarterly numbers in 1981. This statistic signals a continuing deceleration for the economy, an increase over the six-month average decline of 9.2 percent for the first half of 2009.

Were one to predict a 7 percent decline for the entire year—a wildly optimistic estimate, given the above figures—Mexico would have faced its worst year since the Great Depression. Among the worlds' major economies, only that of Russia has contracted more than Mexico's, about 10.9 percent.

The third second quarter contraction follows a drop of 8 percent in the first quarter and 1.6 percent in the fourth quarter of 2008. So-called secondary activities—construction, manufacturing, mining and utilities—fell by 11.5 percent. Tertiary activities, such as transportation and storage, fell by 10.4 percent. A somewhat positive result was generated in the primary sector—agriculture, forestry, animal husbandry, and fishing—which rose by 1.1 percent of GDP.

By far the largest drop was in services associated with tourism, 17.1 percent, followed by manufacturing, 16.4 percent. This grim statistic is a direct result of a slowdown affecting the most industrialized parts of the country.

The drop in GDP has been accompanied by a crisis in the peso/dollar exchange rate. The rate changed from approximately 11 pesos to the dollar at the beginning of 2008 to 15.50 at the beginning of 2009. Only massive intervention by the Mexican Central Bank and the fall of the dollar itself restored some value to the peso, back to about 13 per dollar.

The social consequences of this dramatic decline are being felt. Mexico City residents report increases in nearly every measure of social unrest. Youth crime, drug use and corruption—all driven by increases in youth unemployment—have escalated.

Since the imposition of the North American Free Trade Agreement in 1992, the economies of the United States and Mexico have become much more closely integrated. Mexico transformed itself from an economy that relied mostly on domestic demand—less than 10 percent of GDP was involved in foreign trade—to an export platform, with over 30 percent of its GDP involved in foreign trade. This is particularly true for northern Mexico. Sixty percent of Mexico's imports—mostly of manufactured goods—and two thirds of capital investments come from the United States. Over 90 percent of Mexico's exports go to the US. In 2008 the total value of exports fell by 34 percent, while imports fell by 33 percent. This includes a 54 percent drop in the dollar value of oil exports.

Among the commodities that Mexico exports is labor power. US corporations depend on a supply of labor power from Mexican workers for their plants in Mexico and the United States. The remittances of the latter, a major source of income for millions of Mexican families, are crucial for Mexico's GDP. Those US and foreign plants that operate on the Mexican side of the US-Mexico border, across from US cities such as Laredo, McClaren and El Paso, Texas, and San Diego, California, depend on a constant migration of low-wage workers from southern to northern Mexico. Despite the draconian controls on immigration, the integration of the labor markets is such that, according to one estimate, a 10 percent increase in wages for unskilled workers in the US over time results in a 1.8 percent rise in Mexican wages.

The impact on the border economy has been devastating. The loss of hundreds of thousands of jobs in industrial centers such as Ciudad Juarez, Laredo and Tijuana has affected the economies of the industrial corridor that stretches on both sides of the border from San Diego, California, to Brownsville, Texas.

Consequently, the current US recession had an immediate impact on the Mexican economy. Exports, investment and remittances fell. Commodity prices, including the price of oil, also fell in response to the global drop in demand.

The collapse of exports, investments and remittances, however, are only part of the story. Food prices were on the rise throughout 2007, affecting living standards.

The official rate of unemployment, 5.2 percent of the labor force, up from 3.5 percent last year, obscures the actual state of affairs. Even before the crash, the economy was unable to create enough jobs to occupy new entrants into the labor force, a chronic problem for the Mexican economy.

Those that did not emigrate found employment in the so-called informal sector, which consists of what are euphemistically called "micro-enterprises." This underground economy employs some 20 million people, 45 percent of the entire labor force of 45 million people. (Mexico has a population of 107 million; the labor force is officially defined as those over the age of 14.)

Since June 2008, the Mexican economy has lost 232,000 jobs, while the informal sector gained 99,000. If one adds this last group to the unemployed, the actual rate of unemployment would exceed 20 percent of the labor force. Such rates approach those of the 1930s and far exceed the jobless rates generated by the economic crisis of 1994.

The reaction of President Felipe Calderón's National Autonomous Party (PAN) government to the new economic news resembles that of a US state governor, rather than the leader of a sovereign state. After dismissing warnings that the Mexican economy would be hard hit by the recession as "catastrophe mongering," the Calderón administration proceeded to impose contractionary policies that reduced internal consumption and added to the unemployment rolls. The federal government will reduce spending by 85,000 million pesos, roughly US$6.5 billion, in the 2010 budget to be presented September 8.

At the same time, the Central Bank, with its policy of selling dollars to prevent the collapse of the peso, in effect has drastically reduced the money supply, increasing interest rates and further restricting economic activity. Central Bank officials have made it clear that the recovery of the Mexican economy depends on the recovery of the world economy.

The contractionary measures have been dictated by Wall Street. Last November, Fitch Ratings, a Wall Street Bond rating agency, gave a "negative" assessment of Mexican government debt. In May of this year, Standard and Poor's also gave a Mexico a negative rating. Both agencies had threatened to reduce the government's bond rating, presently at BBB+, three steps above junk bond status. In effect, the banks and the Obama administration are denying Mexico, a semi-colony of the US, the kind of bailout they have granted themselves. That the measures being imposed will result in increasing hunger and unemployment is of no consequence to the US ruling elite.

In February 2008, the corporatist Mexican Workers Confederation (CTM) and Workers Congress (CT) agreed to a pact with the Calderón administration, pledging labor peace. At a meeting at the presidential mansion, CT/CTM leader Gamboa Pascoe promised that the union bureaucracy intended to place Mexican national interests ahead of the interests of the union movement.

In the intervening months CTM leaders have had to confront the anger of the ranks, including construction workers, miners, sweatshop workers at the border, and teachers.

Wary of their ability to control the anger of the rank and file, the union bureaucracy, in the aftermath of the INEGI announcements, made public their concern with potential social conflicts generated by the current crisis. CTM leaders warned Calderón of the lessons of 100 and 200 years ago—the dates of the Mexican Revolution and the Mexican War of Independence respectively.

However, the union bureaucracy stopped short of calling on Calderón to rescind the budget cuts and to use the resources of the state to create jobs. Instead it demanded that whatever budget cuts take place be shared equally among all the government agencies. On Friday, Calderón placed a wage ceiling on government officials; from now on no government official will be allowed to earn a higher salary than the president himself. "Before we ask for further sacrifices from Mexican families, it is necessary that government officials show transparency in the efficient use of government resources," declared Calderón, signaling further cuts in living standards.