Policy Issues

The Lost Sexenio: Vicente Fox and the New Politics of Economic Reform in Mexico

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ABSTRACT

The 2000 presidential election of opposition candidate Vicente Fox signaled an end to seven decades of Mexico’s single-party regime and seemed to herald the advent of truly competitive politics. But by 2003, economic reform had largely stalled, and Fox’s party suffered a historically unprecedented midterm loss in the congress. This article analyzes the underpinnings of policy gridlock in the Fox administration. Fox inherited the need for microeconomic restructuring and increased competitiveness, more innovative and pragmatic state policies, the need to pay attention to the country’s sharp income inequalities, and the challenge of crafting a political strategy that could build a middle ground and foster policy consensus. With his party’s minority standing in the congress, Fox was constrained from the start by divided government. But more effective statecraft and coalition building would have helped. These will be essential elements for the success of any post-Fox regime.

The July 2000 election of National Action Party (PAN) presidential candidate Vicente Fox marked the first time in Mexican history that the executive torch had been passed democratically from the long-reigning Institutional Revolutionary Party (PRI) to another political contender. Fox won the election under authentically competitive conditions, and after seven consecutive decades of PRI hegemonic rule and nearly two decades of sharp economic challenges, hopes were high that the political breakthrough would be accompanied by a renewal of economic growth. With broad agreement on the issues that topped the country’s economic reform agenda (for example, fiscal, energy sector, and labor market reforms and an overhaul of human capital investments and antipoverty strategies), Fox’s victory seemed to signal a consensus on the need to move full speed ahead on a new growth-oriented agenda. However, as the Fox sexenio (or six-year presidential term) draws to a close, the gap between those earlier expectations and the Fox record could not
be wider. What went wrong? How is it that a “do-all” presidential candidate morphed so quickly into a “do-nothing” executive?

This article explores the political underpinnings of policy gridlock and halting economic performance during the Fox sexenio. To be fair, some of the shortfall can be attributed to conjunctural factors, including the slowdown of the world economy in 2000 and the September 11, 2001, terrorist attacks on the United States, events that not only strained the economy but triggered new border tensions and cast a general pall over U.S.-Mexico relations. Mexico’s halting reform progress is also typical of the disorder and heightened social demands intrinsic to transitional democracies; witness the political growing pains that continue to afflict any number of postauthoritarian regimes across the region. At the same time, however, Mexico’s stymied reform agenda can be traced to the country’s rapidly changing political institutions, the navigation of which appears to have required much higher levels of political skill and policy finesse than Fox and his team were able to muster.

This last point constitutes the main theme of this article, which interprets Fox’s “lost sexenio” as a strong symptom of the need to reconcile the emergence of competitive politics in Mexico with the continuing imperatives of economic policy reform. Probably the most binding constraint on Fox has been that of managing executive-legislative relations in a presidential system where his own party is in the minority and the congress is frequently divided. Alongside this, disarray within and between the main political parties has literally frozen the policy arena. Thus, the political stalemate and reform fatigue that have plagued the Fox sexenio readily highlight the country’s uneasy lurch toward a “new” politics of economic reform, a phase that now requires as much attention to statecraft, alliance building, and the modernization of the country’s institutions and political rules as it does the passage and implementation of concrete economic policy measures.

A brief summary of the antecedents to the Fox administration will establish a baseline for understanding the reform imperatives that Fox inherited in mid-2000. This will help to explain the kinds of structural constraints that Fox has faced, especially that of ruling from a minority position, but will also acknowledge the possibilities that might have been achieved with higher levels of statecraft. A considerable backlog of unfinished business awaits Fox’s successors, with future challenges related to the management of the Mexican political economy and reform process.

THE PRI’S POLITICAL AND ECONOMIC LEGACY

Mexico’s long-drawn-out process of political liberalization has gone hand in hand with a fundamental transformation of its economy over the past 20 years. The latter jettisoned a model based on heavy borrowing and
import substitution industrialization (ISI) in favor of one driven by markets for exports and investment. By the time of the 2000 elections, the country’s trade profile had shifted dramatically. Between 1986 and 1999, for example, manufactured goods as a percentage of all exports had risen from just below 60 percent to just below 90 percent (Banco de México 2005). Manufactured exports were also increasingly based on high technological intensity, higher value added, and sophisticated patterns of specialized production within the North American market (Gereffi 2003). Moreover, as figure 1 shows, Mexico had begun to move past the reliance on volatile portfolio investment (that is, flows into its stock market) that had rendered it so vulnerable in the 1994–95 peso crisis, and foreign direct investment was on a steady upward swing in the latter part of the 1990s.

Although some analysts have argued that the post-2001 slowdown in both economic growth and foreign investment underscored the vulnerabilities in Mexico’s post-debt crisis model of trade and financial liberalization (Dussel Peters 2003; Blecker 2004), at least since the country’s 1994 entry into the North American Free Trade Agreement (NAFTA) with Canada and the United States, few credible alternatives have been systematically articulated or embraced. Economic liberalization, in short, seems safely ensconced in the policy seat, and the sequencing of economic and political liberalization—with the long process of economic change seeming finally to yield a political transformation—has given rise to a rich literature analyzing Mexico’s democratic transition and the advent of Vicente Fox.
Many of these analyses seem to share a sense of a virtuous circle just about to be closed: economic change brought political transition, and now that political liberalization has been fully unleashed, the country’s path toward economic modernization is assured (Chand 2001; Levy and Bruhn 2001; Preston and Dillon 2004). Unfortunately, the Fox sexenio has confirmed that modernization in Mexico is anything but guaranteed. The Fox team inherited a number of constraints that stemmed from the long structural transformation of the Mexican political economy, which began with the 1982 debt shocks and which the PRI had little political incentive to tackle until it was too late to hold on to the executive office. A cluster of policy bottlenecks willed by the PRI to its PAN successors illustrates the reform gaps that existed when the PRI’s long reign ended in 2000.

Bridging the Macro-Micro Divide

The macroeconomy was, of course, the policy focus in the wake of the debt shocks of the early 1980s. Mexican policymakers sought to restore aggregate growth, secure external balance, and tame inflation. After a disastrous experiment targeting the exchange rate as a means of fighting inflation, PRI policymakers tenaciously minded the macroeconomic fundamentals throughout the 1990s. This finally paid off as the peso stabilized under a new flexible exchange rate regime, exports boomed, and real wages rose after 1997.

This relative stability meant that the need to pay more attention to the microeconomic realm (for example, credit access and support for small firms, as well as institutional reforms geared toward greater transparency, accountability, and oversight) was increasingly recognized even before Fox’s inauguration. This is not to say that the macroeconomy was ignored, but despite the economy’s slump in the wake of the U.S. slowdown in early 2001, few thought Mexico risked another significant macroeconomic crisis on the order of the debt or peso crisis (Blázquez and Santiso 2004). Instead, the risk was that delay in tackling the difficult microeconomic tasks would undermine the benefits of privileged access to the U.S. market under NAFTA, and would possibly relegate Mexico to the same underachiever status that it occupied before the 1990s.

Reviving the Mexican State

Although the explosion of Mexico’s debt-backed ISI model in the 1980s required the transition from a heavily state-sponsored development strategy to a more market-based one, most small enterprises and domestic producers still have yet to achieve the degree of competitiveness necessary to benefit from the market model.
Fox thus inherited the task of reinforcing the weaker players in the market through innovative public policy and selective state sponsorship. Seeking to straddle the market-state debate, some analysts called for Mexico to try a concerted Chilean-style public policy that promotes productivity, efficiency, skills, and export success for smaller domestic firms (Schurman 1996; Wise 2003). This, of course, requires both a change in ideology—from blind devotion to the market to a more nuanced view of market-supporting reforms—and careful attention to effective policy design. It also requires fiscal resources, and the incoming Fox team faced tight budget constraints. Creative state sponsorship also demands excellent political skills in order to forge a broad political coalition to strategize both the content of the reforms and the most equitable ways to raise tax revenues to support them. These were tall orders for any administration, particularly one taking the reins of power after seven decades of nondemocratic single-party hegemony.

**From Safety Nets to Human Capital Investment**

Long known for its “politics of future prosperity” but more immediate willingness to shift the burden of economic adjustment onto the poor, the PRI’s longstanding social strategy resulted in insufficient welfare coverage, wasted resources, and a highly skewed distributional pyramid (Rodríguez 2003). As the stringent effects of economic restructuring in the 1980s sent voters into the arms of opposition candidates and parties, the government tried a more targeted approach, under the rubric of Pronasol, which seemed aimed at quelling vocal constituencies. After the peso crash of 1994 led to a shortfall on the fiscal side, reform-minded technocrats relaunched the PRI’s earlier safety net strategy under the banner of Progresa, which more effectively addressed the needs of the country’s poorest citizens. Resources, however, remained highly limited.

By the time of the 2000 elections, the most recently available income distribution data from the government suggested the extent of relative loss and gain for the rich, the poor, and the middle. The bottom 40 percent of the population had lost 2 percent of its share of national income between 1984 and 1998; the middle 40 percent had lost 3 percent of its share, and the top 20 percent had swallowed up the additional 5 percent (INEGI 1994, 2000). The news seemed to confirm the suspicion of a disgruntled electorate that only the most well off were benefiting from Mexico’s economic transformation. The success of Fox’s campaign platform came from his vow to tackle the country’s worsening distributional situation and burgeoning social deficit, partly though investing more strategically in human capital. His predecessor, Ernesto Zedillo, had made the same promise but then had seen it derailed by the fiscal exi-
gencies of the 1994–95 peso crisis. Fox promised finally to take this on, and to raise the government revenue necessary to do the job.

**Political Statecraft Versus Technocratic Arbitrage**

During the heyday of market reforms, the PRI’s more traditional political wing was shoved aside by the party’s ascendant technocrats—Presidents Carlos Salinas de Gortari (1988–94) and Zedillo (1994–2000) being prime cases in point. As the 1990s wore on, however, it became increasingly obvious that political skills would be essential for rendering these same reforms compatible with Mexico’s increasingly competitive politics. The illustrative case here was the post–peso crash renationalization of the banks and the subsequent public absorption of their debts. This strategy saved the financial system and therefore would have received a high grade in a graduate course on public finance, but it played politically like a rescue of the rich and powerful.

Fox seemed to recognize both the challenge and the opportunity to shape a more effective policy approach by communicating directly with voters. In his campaign, he demonstrated the ability to read the public’s mood, capitalize on symbols that celebrated the country’s democratic transition, and respond to real and perceived needs (Dresser 2003). With a larger-than-life image and a towering and popular persona, he seemed well suited to the political and economic tasks required to move the country forward in its modernization drive.

**THE POLITICAL-INSTITUTIONAL LANDSCAPE SINCE 2000**

The challenges facing the Fox administration in 2000 were broad: to orchestrate microeconomic restructuring and increased competitiveness while spurring higher growth; to devise more innovative and pragmatic state policies; to respond to the country’s sharp income inequalities; and above all, to craft a political strategy that could soften the edges of technocratic formulas while also creating a middle ground on which to build a policy consensus. While this was a daunting set of tasks for any new leader, what is striking is how quickly the reform agenda bogged down, and in nearly all these areas. The damage, reflected in the PAN’s loss of 25 percent of its congressional standing in the 2003 midterm elections, was such that the president was virtually a lame duck halfway through his term. How is it that things went awry so quickly and so irrevocably?

The literature on political institutions is rife with descriptions of the perils intrinsic to the very situation in which the Fox administration found itself at the beginning of his term. It traces the concomitant shift from a seemingly omnipotent executive to a weakening presidency and
from a hegemonic party system to a multiparty and increasingly fractionalized polity. A main theme in this literature is the tendency for this particular political calculus to result in policy stalemate, especially when the executive’s party fails to capture a majority bloc in the legislature and thus constitutes a minority government (Mainwaring 1993; Stepan and Skach 1993; Linz 1994). There is more to this story, of course, and the broader literature argues that the margins for change can be quite adjustable, as can the slope of the policy learning curve (Shugart and Haggard 2001; Cheibub 2002; Morgenstern 2002; Munck 2004).

An emergent literature on the institutional foundations of Mexico’s democratization similarly suggests that the policy immobility that came to characterize the Fox sexenio was more than just structurally determined (Dresser 2003; Buendía 2004; Magaloni and Poiré 2004). Indeed, Weldon (2004) highlights the possibilities for institutional overhaul with his analysis of the vital legislative reforms triggered by the PRI’s historic loss of its majority in the Chamber of Deputies in the 1997 midterm elections. Before that time, and despite a series of complicated electoral rule changes over the previous two decades, the rules inevitably favored the election of a PRI majority bloc that faced an array of smaller parties. This, after all, was the key to the PRI’s longevity: keeping the opposition alive but at bay by condoning some minor electoral victories, upholding an image of stable democratic rotation, which, in turn, bolstered PRI hegemony (Crespo 2004, 57–59).

Although PRI stalwarts warned that chaos would follow if the party lost control of the lower house of Congress, the political dynamics that unfolded during the 1997–2000 legislative session proved otherwise. Since this was the first time in seven decades that no one party held an absolute majority in the Chamber of Deputies, longstanding rules that had been specifically tailored for unified majority (that is, PRI) governance no longer applied. As Weldon notes, this led to “a nearly complete reorganization of the lower chamber that [would] permit more efficient and equitable government” (2004, 141). This spurt of comprehensive reform encompassed everything from administrative procedures to committee structures to the legislative process—a slew of new rules for the lower chamber that were subsequently also adopted by the Mexican Senate.

This passage from a rubber stamp Congress to a more independent and active legislative body became the hallmark of the Fox sexenio. At the same time, however, this congressional coming of age threw the institutional foundations of the executive into sharper relief. Without the “metaconstitutional” trappings of a unity government led by a highly disciplined hegemonic party (Weldon 2004, 134–35), the Mexican executive’s constitutional authority over legislation turned out to be rather minimal. Gone were the days of strictly elite-level consultation and auto-
ocratic implementation of major economic initiatives, including something as fundamental as the country’s entry into NAFTA. The Mexican executive was basically exposed as an emperor with no clothes, and the country’s presidential system as one of the weakest in the region. This situation in itself need not prove fatal, but it does mean “that future presidents will have to be very effective coalition builders, given the country’s institutional tendencies toward separation of purpose and the dearth of legislative powers” (Shugart and Haggard 2001, 99). Statecraft, in short, matters now more than ever.

Indeed, there is growing evidence that throughout the post–World War II era, the legislative success rates for executives operating in presidential systems under the constraints of minority government have not differed all that much from those for executives leading majority governments: a 61 percent success rate for the former versus a 72 percent success rate for the latter (Munck 2004, 443, citing Saiegh 2002). For Mexico, this is an important data point, as it is highly probable that minority governments could prevail indefinitely; certainly, at least, through the 2006 presidential elections. This is because neither the PAN’s 2000 presidential victory nor the PRI’s 2003 midterm gains amounted to the full party realignment that would be required to restore majority governance. For example, although the probable 2006 presidential candidate of the left-leaning Party of the Democratic Revolution (PRD), Andrés Manuel López Obrador, may be the frontrunner in national opinion polls, the PRD has yet to capture more than 25 percent of the vote in any national election (Baer 2004, 104).

Any future government is therefore likely to be navigating the same structural shoals of minority power that Fox faced in 2000. In strictly functional terms, however, the Fox legislative record has not been that bad: from 2000 through 2002, Fox’s success rate for executive-sponsored bills submitted to the Chamber of Deputies was just below 86 percent (Weldon 2004, 164–65). While low compared to the PRI’s average success rate of 97.3 percent from 1988 to 2000, this is well above the 61 percent rate for the broad sample of minority presidential governments cited above. The electorate’s disappointment with Fox in 2003 was that these legislative victories did not add up to a cohesive economic reform agenda, nor did they fulfill earlier promises about growth, jobs, and distribution.

Retrospective analysis of recent voting behavior shows that in the 2000 election, voters punished the PRI for its past economic blunders while giving the PAN candidate the benefit of the doubt (Buendía 2004). This quickly changed in 2003, however, as the same pocketbook concerns and dashed expectations for prosperity resulted in the PAN’s midterm losses. At a deeper level, the specter of minority government in Mexico meant that the onus for policy efficacy had fallen on the skills of statecraft. This refers to the incumbent’s ability to negotiate on the
fine points, compromise on the larger ones, and build alliances and forge majority coalitions that can get the job done, skills that eluded the Fox administration from the start. These “new” political contingencies undermined the Fox agenda, and were compounded at times by the executive’s own self-defeating approach to politics and policy.

**THE DIFFICULTIES OF GETTING DOWN TO BUSINESS**

Looking back over the country’s recent reform trajectory, we can see that the “first phase” of macroeconomic stabilization and restructuring undertaken after the 1980s debt crisis fit the PRI’s vertical decisionmaking style and hegemonic dominance. For better or worse, this enabled the tripartite “negotiation” of wage and price controls and fiscal discipline that, in turn, stabilized inflation in the late 1980s and set the stage for restored growth. The pain of adjustment in this period was acute, but the eventual policy successes of lower inflation, higher growth, and resolution of a decadelong crisis breathed new life into the PRI, as reflected in its 1991 and 1994 electoral victories (Buendía 2004, 122–23).

Of course, before the PRI had a chance to enjoy the political fruits of this economic success, the peso crash of 1994–95 put stress on the middle class, ravaged the poor, and seemed to pull the economic rug out from under the PRI’s claim to effective governance. This put the government back in crisis management mode, and the tasks associated with what many have termed a “second phase” of reform—microeconomic restructuring, distributional improvement, and market-supporting interventions—were largely postponed (Pastor and Wise 1999). Hopes therefore were high that the incoming Fox administration would take on these issues—and optimism may have stood in the way of a hard-headed assessment by voters of the Fox team’s ability to meet the challenges.

After all, while leadership, statecraft, and coalition building are always important, they are essential for undertaking this so-called second phase of reform. First, the follow-up tasks are more microeconomic in nature, meaning that the pain of adjustment (downsizing, disclosure, retooling) is more concentrated and the gains (efficiency, transparency, competitiveness) are abstract and highly dispersed. Second, the intricacies of microeconomic restructuring are much less amenable to the formation of broad-based horizontal reform coalitions, and Mexico’s current phase of posthegemonic party politics has further exacerbated that difficulty. Since 2000, each of the three main parties has jockeyed to claim credit for the potential gains of any given reform bill while attempting to foist responsibility for the pain of adjustment onto its opponents. It may take the Mexican polity another sexenio or
longer to break through this collective action standoff unless voters heighten their demands for policy efficacy.

Economic performance is central here, as this is the variable that has consistently ranked as the top concern for Latin American voters over the past two decades (Remmer 2003; Lora and Oliveira 2004). Mexican voters came relatively late to this game, but in the 1990s they fell in step with electorates across the region in punishing incumbents and supporting their opponents according to how the economy performed. Mexico’s 2000 presidential election may seem anomalous in that the incumbent party lost despite an average annual growth rate of 5.5 percent for the period 1996 to 2000. But while some analysts have suggested that economic considerations were secondary to the historic symbolism associated with the ousting of the PRI (Magaloni and Poiré 2004), it was also the shadow of the ruling party’s past—including decades of false economic promises and the more recent self-inflicted currency crisis—that turned voters against the PRI and sent them into the ranks of the PAN and the PRD (Cameron and Wise 2004).

With the 2003 vote, economic considerations moved more visibly to center stage (Heath 2003; Lawson 2004, 140–43) and will probably remain there for 2006. This had partly to do with the abrupt onset of the 2001 economic slowdown; the 2001–3 period saw growth rates averaging less than 1 percent, nowhere near the 7 percent Fox had promised. But this disappointment also fed into a broader perception that politicians and policymakers had seriously underperformed on a variety of economic reforms.

Mexico’s post-2000 economic policies and performance depend heavily on aggregate growth, job creation, and relative (distributional) gains, the cluster of interrelated variables that are important to voters (Buendia 2004; Lora and Oliveira 2004, 19). This is not to ignore the importance of numerous other pending reforms, especially in the political arena. Nevertheless, analyzing this cluster of economic policy variables enables us to elaborate further on those substantive issues that, at least according to recent polling data, have emerged as both the cause and effect of political behavior in Mexico.

Caught in a Slow-Growth Trap

Despite Mexico’s ambitious embrace of market reforms since the 1980s and its unprecedented access to the U.S. market over the past decade, the economy has yet to land on a path of high sustainable growth. The Fox team’s initial promises to achieve 7 percent annual growth rates and to create 1.4 million jobs annually were quickly dashed by the onset of the U.S. recession. There was, however, some logic to this earlier forecast: the country had been spared the usual economic blowup that had
long marked the end of each sexenio, and the sound economic returns
during Zedillo’s last three years had instilled hope that this was more
than a passing trend. But GDP growth did not resume until 2004, when
it barely topped 4 percent and seemed to be led less by productivity
gains than by high energy prices.

Mexico’s inability to reach a sustainable high-growth, high-employ-
ment track has prompted a consensus among observers on the need for
another round of reforms, yet little agreement on how actually to pro-
ceed. At a minimum, the cumulative unfinished business from the Fox
sexenio includes the stagnation of federal tax revenues, which, for the
entire Fox period, have hovered around 11 percent of GDP (compared
with 25 percent for Chile and 25 to 30 percent for most of the OECD
countries); long-term neglect of the electricity and energy sectors; weak
domestic linkages to those dynamic export sectors where much of the
incoming private foreign investment has been concentrated; and under-
investment in human capital, including education, health, and the acquis-
tion of skills to promote upward mobility within domestic labor mar-
kets. Although little is new about these reform gaps, most of which also
frustrated the Zedillo team, it was assumed that Fox would have suffi-
cient political capital to address the reform backlog. Alas, any potential
democratic dividend dissipated under the thrust of executive-legislative
frictions and the rapidity with which intra- and interparty coalitions
formed and frayed—as evidenced in the battles over tax and energy
sector reform.

A High-Grade Fiscal Flu

Full budgetary control and the steady flow of petroleum revenues had
enabled the PRI chronically to postpone the tough fiscal tasks at hand,
but the Fox team needed to face them head-on in order to finance other
campaign promises about industrial promotion, employment creation,
and social spending. Tax reform was therefore the first item on the exec-
utive agenda at the outset of Fox’s term. Because fiscal restructuring
implies the drawing of new lines between winners and losers, it obvi-
ously renders any domestic debate about taxes especially contentious.
In a newly democratized Mexico, the quest to overhaul the tax system
also went to the heart of the executive’s legitimacy and political bro-
kering skills.

Although the three main parties had entered the tax reform debate
with a verbal commitment to overhaul and shore up Mexico’s fiscal
system, the tax bill hit a legislative impasse by mid-2001. The underly-
ing political dynamics were a display of weak policy coordination and
insufficient political consultation on the part of the executive office,
which helped catalyze an emergent obstructionist opposition bloc in the
congress, joined even by some members of the president’s own PAN party. This standoff became a template of sorts for the remainder of the sexenio—a pattern whereby political process repeatedly trumped policy substance. The battles chosen and positions adopted varied by theme, but the inevitable result was policy gridlock.

At the outset, the Fox team argued that the government would need to increase its revenue intake by 2.5 percent of GDP in 2002 and at least 4 percent per year thereafter (Latin American Regional Report: Mexico & NAFTA 2000). The executive’s proposal incorporated the obvious options—a widening of the tax base and the elimination of various loopholes—but Fox stumbled in proposing that the 15 percent value-added tax (VAT) then in effect be extended to cover food, medicine, schoolbooks, and educational fees. Not surprisingly, these proposals gave the opposition a perfect cue. The PRI and the PRD seized the moment, distanced themselves from the highly unpopular extension of the VAT, and cast the executive as a policy bungler.

The only mentionable advances on tax reform came early in the Fox sexenio, in December 2001, when Congress finally approved a uniform tax rate of 35 percent for individuals and businesses in the top tax brackets, a rate set to fall by 1 percentage point per year through 2005. But the opposition overrode other proposed measures, such as Fox’s efforts to close special tax loopholes and rein in the informal sector. Facing continued reliance on volatile oil revenues to cover the fiscal gap and the declining performance of the state oil company, Pemex, under this perpetual resource drain, the president launched a National Fiscal Convention (Convención Nacional Hacendaria, CNH) in the wake of the 2003 midterm election that brought a range of federal and local authorities together to craft a consensus agreement around fiscal reform.

After six months of consultation and the completion of some 323 agreements, which ran the gamut from fiscal accountability to new revenue opportunities to spending priorities, Congress passed just one of these CNH proposals in 2004: a further lowering of the income tax rate for individuals and companies (Economist Intelligence Unit 2004). The cumulative result of this acrimonious battle over tax reform and its generally unsatisfactory outcome partly explains the success of the political opposition over the PAN in the 2003 midterm race. The congressional opposition, it seems, still saw more benefits to policy sabotage, despite the prospect of having to assume the political costs of fiscal reform in the likely event that this obstructionist short-term strategy should succeed in 2006. The fiscal picture on the revenue side did finally brighten in 2004, but that was because of improvements in oil income. Federal tax revenues as a percent of GDP were exactly the same in 2004 as they were in 2000.
Low on Energy

The ramifications of the country’s tax stalemate have borne directly on the energy sector as badly needed modernization plans for oil and electricity have faltered under tight budget constraints and political warfare. Because both are crucial inputs for productivity and increased competitiveness, the fiscal lag has indirectly slowed efficiency gains in the energy sector and in the economy overall. It is this very bind that prompted Argentine, Peruvian, and Venezuelan policymakers, for example, to open up the energy sector to increased private investment since the 1990s. In Mexico, of course, this option is foreclosed by a constitutional provision that prohibits private participation in this sector. In the case of oil, although the state’s chronic disinvestment in exploration and development are a drag on production levels, the mere mention of liberalizing these costly endeavors provokes the wrath of a PRI-PRD legislative bloc that has yet to offer a sound alternate plan.

Meanwhile, although Pemex ranks as the world’s third-largest oil producer and accounts for at least a third of the government’s fiscal revenue, it is also the most highly taxed and indebted oil company in the world (Luhnow 2005). Current projections show that in the absence of major technology investments to replace aging oil fields, exploit new ones, and boost the output of natural gas and petrochemicals, Pemex will not be able to maintain its production levels. Already, despite high oil prices and windfall profits, Mexico is spending about US$14 billion a year to import natural gas and petrochemicals because Pemex cannot meet the growing domestic demand.

One executive proposal that sought to straddle the gap between the fierce domestic nationalism surrounding Pemex and the hefty costs of oil sector modernization was to follow the strategy of Venezuela, another highly nationalistic oil producer (Luhnow 2005), allowing private investment in the most costly endeavors, such as refining, deep-water exploration, and the exploitation of aging oil fields. But the PRI-PRD opposition in the legislature has iced even this type of strategy.

In the case of electricity, Fox’s stated intention to auction off even a small segment of this sector to private bidders elicited a similar political reaction by a PRI-led blocking coalition. At the same time, however, the Mexican private sector has aggressively lobbied against rising utility costs and warned of possible drought-related hydroelectric shortages. As did Zedillo before him, Fox sought to circumvent these various political obstacles by allowing some private companies to expand on the existing supply of electricity while leaving control of the overall sector to the state. But without a firm legal standing to invest in electricity generation, the high-risk premium for financing such private sector operations is just as prohibitive as the hostile political opposition to such proposals. The
political barriers to providing Mexican industry with sufficient power at competitive rates have prompted the unusually high turnover rate of two energy ministers since 2000, triggered a Supreme Court ruling against Fox’s efforts at back-door privatization, and drawn further attention to the executive’s inability to advance his own reform agenda.

Because movement on this front will require an amendment to the Mexican Constitution, and this is not likely in the foreseeable political environment, it seems that reform progress on this crucial input to growth has been indefinitely suspended. A collapse in oil prices or a California-style electricity brownout could perhaps bring political decisionmakers around to the realities and urgency of energy sector reform, although this is hardly the “cohesive politics of growth” strategy that the situation calls for. Fox’s performance in this area might warrant a low rating, but so too would that of his colleagues in the legislature.

Export Dynamism and (Weak) Domestic Linkages

If these tax and energy policy doldrums have been an indisputable drag on Mexican growth, they have also consumed much of the public debate and undermined Fox’s earlier commitment to strengthen those weaker producers still struggling to compete in the domestic market. Perhaps the main enticement for Mexico’s entry into NAFTA was the prospect of the development of smaller domestic firms via the forging of backward linkages from the increasingly dynamic export sector.

As Gereffi (2003) notes, Mexico has made an important structural shift to an outward-looking strategy based on a sophisticated manufacturing export sector that is spurred by private investment. One indicator of change that can be gleaned from the statistics Gereffi (2003, 206–7) offers is that while the value of exported vehicles in 1980 was about 4 percent of the value of petroleum exports in that year, the value of exported vehicles was about one-third of petro exports in 1990 and actually two-and-a-half times that of petro in 1999. While the top five export products in 1980 (in terms of dollar value) were, in order, petro, natural gas, vegetables, metals, and coffee, in 1999 the top five in order were road vehicles, electrical machinery, telecommunications equipment, petroleum, and office machines. The greater weight of certain higher value-added products (road vehicles, electrical machinery, telecommunications, and office machines) also reflects deepening supply links between Mexican and foreign (mostly U.S.) firms, both a driving reason for and a consequence of NAFTA.

Some doubters acknowledge the dramatic transformation of the export sector but point to a lack of sufficient linkages between the country’s newly modernized exporters and the local market—the kind of ties necessary for achieving a sound pattern of economic development
NAFTA was supposed to broaden Mexican manufacturing export dynamism beyond the maquila sector, and until 1998, both maquila and non-maquila manufacturing exports grew at similar rates. After that, the gap between the two widened, and has stayed large (see figure 2). As for the broader impact on economic development of export growth in either of these sectors, there is a high level of structural heterogeneity within the domestic market; that is, a gap between large, globalized companies and small, undercapitalized firms. The inability of these smaller, weaker firms to find their place in Mexico’s NAFTA-driven supply and production chain constitutes yet another impediment to job growth and a root cause of inequality.

Candidate Fox understood this less-competitive segment of the domestic industrial market as both a barrier to economic progress and a reflection of the country’s main political and economic cleavages. The small firm sector has, after all, been a key source of job creation in Mexico and the impetus for innovation and supply flexibility in countries that have succeeded in international markets. Fox therefore campaigned on a platform geared toward ameliorating structural heterogeneity and forging stronger linkages between these weaker firms and those larger exporting companies that topped the country’s productive apparatus. As one former high-ranking Fox official subsequently explained, the view had shifted from thinking about what Mexico could do for small businesses, partly for reasons of political pacification, to the notion that a prosperous small business sector was essential for the country to achieve higher growth rates (De la Calle 2001). The original goal was to help this
along by reaching at least 10 percent of those firms in need of support to foster competitiveness over the course of Fox’s term.

Because initiatives that fall within this realm of industrial policy are more specific to the operating budgets of federal and state agencies—that is, away from the glare of legislative oversight—the executive office had considerable leeway to operate here. Early on, all preexisting industrial promotion programs were united under one central office, the Intersecretarial Commission for Industrial Policy (Comisión Intersecretarial de Política Industrial, CIPI) in the Ministry of Economy (Dussel Peters 2003). Those development banks involved in lending to small firms were subjected to external audits, which made it more difficult to assign priority to certain sectors or undeserving firms (Economist Intelligence Unit 2001a). Amid tight fiscal restraints, the Fox strategy offered various indirect incentives to those companies with strong potential to modernize and participate in higher value-added export activities.

Although data are scarce on these returns, three years into the Fox sexenio, estimates showed that some three-quarters of firms classified as small were accessing credit, not through the public or private banks but from their suppliers, and at exorbitantly high interest rates (Latin American Regional Report: Mexico & NAFTA 2003a). Moreover, instead of the country’s small and large firms steadily strengthening their growth and employment-generating links, competition from highly strategic Chinese exporters has encroached on both. Whereas a decade of privileged access to the U.S. market under NAFTA enabled Mexico to become the third-largest supplier to the United States, in 2003 China overtook this position. Some of this slippage has occurred in the predictable low-wage, labor-intensive sectors like shoes and textiles, but China has also crept up on Mexican producers in the more sophisticated electronics industry, which, together with automobiles, accounts for more than 50 percent of Mexico’s higher value-added manufacturing exports to the United States (Latin American Regional Report: Mexico & NAFTA 2003b).

Certainly the sharp decline in maquila employment—22 percent between an October 2000 peak and a July 2003 nadir—may have had more to do with the U.S. recession than with competition from China and others. But considering that employment was, in December 2004, still 17 percent below the peak attained just before Fox took power suggests that the competition may be biting and that structural change in the markets is lagging. Certainly, business analysts have worried that the dynamism of this sector in terms of job growth may be a thing of the past. Indeed, the heady days of the post–peso crash period, when employment in the maquilas more than doubled over the Zedillo sexenio, have been followed by an anemic performance in which Fox will be lucky if the sector’s employment levels end up somewhere near where they were when he arrived in office (BIE 2005a).
As for bolstering domestic manufacturing—in the context of China’s hands-on industrial policies and rising competitive edge—Mexico seems to have been mostly tinkering at the margins. Mexican officials (and their U.S. counterparts) continue to harp on the unfair trade impact of China’s cheap currency and even cheaper wages, but a broader mix of policies underpins China’s growing presence beside Mexico in the U.S. market. It includes lower costs for utility inputs to industrial production, greater labor market mobility, more conducive tax incentives, and an education system that is turning out some two million engineers and other qualified professionals each year (IDB 2005). China’s relative success in the U.S. market prompted the Fox team to produce a list of targeted export industries that would receive increased tax and regulatory incentives, but this is surely a matter of too little, too late. The greater challenge will be to break out of the costly collective action gridlock that has held policymakers hostage for a full sexenio, and to orchestrate a more integrated proactive strategy that links the various macro- and microeconomic variables discussed here in ways that directly tap the country’s competitive potential.

Labor Markets and a Jobless Recovery

Like the labor market impact of previous recessions in Mexico, the 2001 slowdown triggered a wave of layoffs that were, as noted above, felt sharply in the realm of maquila employment, the leading source of formal sector job expansion until 2001. In contrast to the 1995–96 recession, however, formal sector jobs, proxied by the number of employees covered in the Mexican social security system, have been slow to rebound with the resumption of growth in 2004. Manufacturing employment posted a particularly poor performance under Fox: having grown by about 16 percent from 1995 to 2000, as the economy recovered from the currency devaluation, employment in this sector in December 2004 was hovering at just 1.5 percent above the level registered during the depths of the peso crash in late 1995 (BIE 2005b).

Although the weak methodological underpinnings of Mexican employment data make it difficult to elaborate in further detail, there is little disagreement concerning the downward pressures on manufacturing and formal sector employment or the tenacious hold that informal and underemployment still have on the economy. Higher growth will be the most essential precondition for healthy job creation. Facing the challenge of a jobless recovery, however, Fox has pushed other remedies, such as labor market reform to encourage employment opportunities and greater mobility, and guest worker schemes to regularize the migration safety valve.

On the labor reform side, given that Mexico’s labor code stands beside the energy sector’s regulations in terms of the sanctity of the 1930s
populist legislation that still governs both, Fox has pragmatically focused on achieving incremental gains. These include some modernizing of antiquated rules around severance payments, greater leeway for employers to contract temporary workers, and the encouragement of plant-level (versus sectorwide) negotiations that can help promote mobility across labor markets (Economist Intelligence Unit 2002). One key victory for Fox was a Mexican Supreme Court ruling in 2001 that prohibited companies from firing workers who chose not to belong to a union (Economist Intelligence Unit 2001b). Although important, however, these measures alone will not bridge the gap between the Fox administration’s distributional goals and everyday economic life. The efficacy of other solutions, such as beefing up guest worker programs in the United States, remains to be seen, although these, too, promise mainly peripheral relief. Meanwhile, since Fox’s election, a lobby of strong anti-immigration interests in Washington has readily rebuffed his overtures on this matter.

As reticent as the United States may be about formalizing an agreement over labor migration and the protection of rights for Mexican workers, this has not stopped the flow of workers northward or the remitting of wages back to Mexico. In 2003–4, for example, remittances back to Mexico outpaced the country’s inflows of foreign direct investment, and they continue to run at about 2.6 percent of GDP (Economist Intelligence Unit 2005). Nevertheless, Mexican workers still face high commissions and adverse exchange rates when sending funds home from the United States, and Mexico has no single institutional venue to address these issues or to help channel remittances toward productive use. In terms of these deficiencies, public policy could make a real difference. It may be a far cry from the 1.4 million jobs a year that were promised in 2000 or the long-awaited human capital shock that Mexican politicians have promised over the entire era of market reforms, but institutional strengthening along these lines could further enhance the real household income of the receiving families.

Relative Losses and the Distributional Challenge

Despite a clear worsening of Mexico’s regressive distributional curve through the 1980s, policymakers did not embrace direct programming to reduce poverty until 1997, midway through Zedillo’s term. Before that, the Pronasol safety net program, basically meant to contain social strife and garner the necessary votes for the PRI around election time, had been in place since 1988. It was only when such compensatory measures failed to accomplish even those modest goals that a small group of pro-poor technocrats was able to assert some influence over social policy and shift attention toward a more careful targeting of resources to those most in need. Motivated partly by the need to maxi-
mize scarce fiscal resources and partly by a real commitment to tackle inequality (Rodríguez 2003), this led to the launching of the Progresa program in 1997 under Zedillo, which was subsequently renamed Oportunidades and expanded under Fox.

What are the results of Mexico’s experiment in social targeting and direct programming? In the longer-term pattern of distribution (1984–2002) portrayed in figure 3, several trends are striking. First, up until 1994, distribution was shifting in the direction of the richest 20 percent of the population and away from the bottom and middle sectors. A more progressive shift toward lower-income groups was under way by 1996, but for seemingly paradoxical reasons: the 1994 peso crisis had temporarily “improved” distribution by forcing both a decline in the income of those with more assets and a devaluation-induced reduction in the demand for professional services—made more costly by the peso’s adjustment (López-Acevedo and Salinas 2000). By 1998, distribution had largely returned to the 1994 pattern, and this is what partially set the context for voter dissatisfaction and the 2000 Fox victory.

As figure 3 illustrates, however, there have been some improvements since 2000 (Pastor and Wise 2003). Some of this headway can be attributed to the synergies of strong export-driven growth between 1997 and 2001, which heightened the demand for previously underutilized low-skilled Mexican labor. But relative improvement occurred in 2002 as well, suggesting that poverty can also decline more quickly if income inequal-
ity is tackled through the direct targeting of resources to those most in need, which typified the Progresa program (IDB 1998; Behrman et al. 2000). Indeed, even in the short time that a more targeted distributional approach has been in place, the scope, scale, and effects of social targeting seem to be substantial (SEDESOL 2000; World Bank 2003; Hernández 2003; Merino 2003). It is a credit to the Fox team that this strategy was continued and expanded to cover some segments of the urban poor.

In terms of broader investments in human capital, Fox inherited a pattern of modest improvements: social spending per capita was 19 percent higher in 2001 than in 1994, despite a decline in total programmable public spending over that time period (Levy 2001). Most troublesome was the growing breach between a low-skilled workforce and the rising wage premium for skills and education, especially in those sectors that have been liberalized (Hanson 2003). These trends confirmed the oft-cited concept that those with a higher level of education are destined to earn more over the course of their lifetime (Behrman et al. 2000).

Fox’s most concrete plan to boost human capital included a comprehensive reform of Mexico’s educational system, along with a pledge to raise the average level of schooling from seven to ten years by shifting a greater share of the education budget toward basic education. The crucial category of schooling had captured about 58 percent of the education budget in 1990, a proportion that rose to 66 percent by the end of the Zedillo presidency (Levy 2001). It has been steadily rising under Fox (Chávez 2001). The more ambitious goal of a qualitative overhaul of the country’s badly tattered educational system went into the policy heap along with the various other initiatives under Fox, and this obviously dilutes the effect of increased public spending on basic education. When Mexico’s current generation looks back on its country’s gradual displacement in the U.S. market by Chinese producers, and hence the lost opportunities despite the incredible market access that Mexico has enjoyed under NAFTA, we would argue that it is the comparative neglect of human capital that will stand out as one of several key explanations for this phenomenon.

Thus, while the relative success of Progresa/Oportunidades with the poorest Mexicans indicates that there is something to build on in the social realm, the looming employment crisis for those just above the poverty line gives cause for concern. One post-midterm gesture by the Fox team was the launching of a US$10 million fund to support new startup companies, a program meant at least symbolically to address the prolonged crunch in the domestic job market and to counter Chinese competition in the same sectors of Mexican manufacturing. But moving education, skill building, and equity further forward means not simply targeting but also expanding public resources, which in turn means that Fox’s successors will have little recourse but to increase fiscal revenues.
The fiscal situation improved in 2003–4, but this occurred because of a hike in oil prices and Mexico’s increased revenues in the wake of the U.S. war in Iraq. This option may dissipate under the thrust of oil price volatility, Pemex’s production bottlenecks, or some combination of the two. Meanwhile, the political opposition, having capitalized on the theme of microeconomic hardship during the 2003 midterm elections, now stands to inherit both some inhospitable trends in employment and the need to raise taxes. The premium on statecraft and effective politicking will continue to rise, as will the political and economic stakes for policy failure in Mexico.

CONCLUSIONS

While the challenges inherited by the Fox team were significant, many observers were optimistic that the new administration would be able to make good on its promises to restore both economic growth and political confidence. Economic and political liberalization, it seemed, were on a mutually compatible course. Yet on this first lap around the democratic track, the country’s leaders were unable to rise fully to the occasion. Democratic norms regarding elections had clearly been established, but the practice of sound democratic procedures and vetting of authentic pluralist demands during these electoral interregna turned out to be another matter entirely. With party rivalries and political infighting let loose in the new era, politics stalemated, and progress on the economic reform was a casualty. The future could bring more of the same: with the prospect of indefinite minority government rule of one sort or another and a huge backlog of unfinished policy business, the Mexican political economy has been infused with a new kind of uncertainty.

At the level of policy process, Fox’s successors stand to inherit the imperative to forge ahead with microeconomic restructuring and measures that explicitly promote Mexico’s foothold in international markets; the need for more innovative and pragmatic state policies, especially in the realm of human capital; the urgency of attending to the country’s sharp income inequalities; and the continued search for a middle-ground political strategy conducive to reform consensus. In terms of the actual content of the policy tasks that still lie ahead, this essay has drawn a correlation between reform delay in such areas as fiscal, energy, and industrial policies to promote skills, jobs, and small firms, and the slippage of Mexico’s standing in a growing number of U.S. sectors where it still enjoys privileged access under NAFTA. The recent displacement of Mexico by China in the ranking of U.S. trade partners is a clear wake-up call that the benefits of privileged access to North American markets will further fade without a cohesive and consistent strategy that promotes Mexico’s competitiveness compared to Asia.
As for a straight political explanation of the dynamics that have underpinned Mexico’s “lost sexenio,” some of the reform obstacles obviously can be chalked up to the final decline of single-party hegemony, to sharp growing pains related to the emergence of a truly competitive multiparty system, and to the weak institutional foundations of the executive office once the authoritarian trappings were stripped away. Yet the comparative politics literature on divided government and minority rule also suggests that policy stalemate need not be the case. Executives operating under minority government contingencies can still perform well in advancing their reform agendas through the legislature.

But such success inevitably requires a more adept deployment of the skills of statecraft—compromise, negotiation, alliance building. Although he was handicapped by executive-legislative tensions and the absence of a working majority coalition in the legislature, some of Fox’s problems were self-inflicted, his reckless handling and early loss of control over the tax reform debate being a main case in point. This tax blunder, the backfiring of executive attempts at backdoor energy privatization, and the stunning defeat of a PAN-PRI alliance that sought to manipulate electoral rules and exclude the PRD’s 2006 presidential contender from the upcoming race all confirm that quick political fixes cannot substitute for statecraft in the wake of single-party hegemony. It seems that the earlier euphoria of the democratic transition distracted observers from the steep political learning curve that still lay ahead, and Fox’s successors would do better to have no illusions about the challenges ahead and the political skills that will be needed.

Mexico’s future hinges on the current prospects for effective governance. Unfortunately, the three main parties seem intent on waging a war of attrition right up to the eve of the July 2006 election (Alesina and Drazen 1991), and the electorate is increasingly prone to alternate between candidates and parties as an expression of voters’ key concerns (Moreno 2003; Klesner 2004). Thus, the race is on for deliverable results, be they jobs, education, infrastructure, or access to affordable working capital for small firms—the very platform that helped to unseat the PRI in 2000. The PRI’s loss of executive power has emboldened the party’s traditional wing, as old-style political bosses like Manuel Bartlett and Roberto Madrazo have flexed their muscle in thwarting many of the reform initiatives discussed here. The PRD, although it won the most congressional seats in 2003 and boasts Andrés Manuel López Obrador as the only presidential candidate with wide public appeal, has also colluded in this game of policy sabotage. At best, these tactics can catapult either party into the executive office, but with a divided legislature, which means that they, too, will have to build constructive alliances of “unusual suspects” in order to exit the growth trap.
As Mexican policymakers and politicians continue to circle the wagons, seeking solutions that offer short-term gains while inflicting the pain and blame of adjustment on their opponents, the economic risks inherent in this zero-sum strategy have become increasingly apparent. The struggles of the Fox administration suggest, in particular, that the pending development tasks—restoring growth, creating employment, ameliorating income inequality, promoting competitiveness—will remain pending in the absence of more finely honed skills of statecraft and coalition building. As political elites flirt with achieving power in ways that win elections but lose on the governance side, the majority of Mexican citizens remain eager to avoid the same underachieving economic performance that marked the prereform era. What counts now for Mexico is the mastery of a “new” mode of politics, one in which the tasks of policymaking and reform are negotiated in more competitive and complicated contexts.

**REFERENCES**


