

Mexico: Problems, Strengths and the Path

Mexico is the world's 14th largest economy¹ and a member of the OECD yet is relatively underdeveloped. It still hasn't captured its significant growth opportunities or reached the level of technology or infrastructure that other developed nations have achieved. Yet Mexico has been unable to quickly capture this growth and has suffered from slowing growth unlike many of its developing competitors.

But Mexico's problems are not all unique. While every nation has their own path, Mexico has much it could learn and adapt from other nations. Mexico has its own weaknesses and strengths that it can change or leverage to become an economic powerhouse.

Mexico's Problems

The War on Drugs: A Unique Problem

A core negative to Mexico's economic identity and makes Mexico a unique case among OECD countries is the fact that it suffers from a severe drug war that limits growth. Most of the growth cases elsewhere in the world haven't had an issue as pervasive as this drug war has had upon Mexico and the violence that effects so many aspects of growth within a nation. It is almost like a civil war, so much so that Mexico was discussed in a conference on failed states. The violence is difficult to keep under control, inhibits growth and creates some level of instability. Nigeria's civil war was fairly violent and the underlying violence created significant instability in the nation and limited growth until its resolution. The only real way to solve this problem is to win the "war" and end the reign of these drug cartels and the violence.

Poor Infrastructure: Investment, Telecoms, Politically and Legally

Mexico also suffers from a poorly structured underlying infrastructure. Compared to its faster growing competitors like Chile and China, Mexico's investment into infrastructure is at a lower rate. Mexico also wants to move up and have high tech industries, but lacks the underlying telecom infrastructure and is structured poorly with expensive rates, monopolies limiting prices, and some of the worst connection rates in the world. As shown by the success in Sweden, a strong underlying telecommunications infrastructure is necessary to become a high-tech exporter. Yet the political infrastructure blocks all attempts to try and fix this infrastructural

¹ <http://unstats.un.org/unsd/snaama/dnltransfer.asp?fID=2>

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deficiency, and the political institutions moving too slowly to react and change the system.

Legally, the structure is not particularly conducive to business either with some legal frameworks like the amparo being used to slow down or deter legal actions. All these infrastructure problems create an environment that is not conducive to business or significant growth.

Anti-competitive Business Structure

Monopolies and oligopolies are a part of the economy of Mexico. While the United States has a strong position against trust, they aren't necessarily as bad as the United States make trusts seem. But Mexico hasn't successfully used trusts to create advantages. They don't create the advantages that Germany and England have been able to capture. Germany used cartels to prevent "ruinous competition"² but in the case of Mexico, these structures are used to minimize competition and remove the necessity of improvement by competition. This creates a situation where these trusts have limited innovation and correct pricing that would better grow the economy.

NAFTA and Trade: European Union of the Western Hemisphere?

Mexico is not as committed to its region or regional institution. While the North America Free Trade Agreement (NAFTA) is a solid push in the right direction, there is much that could be gained from an infrastructure like the European Union. NAFTA promotes free trade, but Mexico and the United States have a good yet tumultuous relationship that could be helped by formalizing larger agreements with each other. As seen by the stability and strength of the European Union, there is much to be gained from a more comprehensive regional agreement yet Mexico and the United States haven't come up with an acceptable plan to grow both parties. These kind of agreements have helped vastly develop the European Union, along with Mercosur developing Chile.

Oil: Dubai, Saudi Arabia, Gazprom, Nigeria

Oil is an important revenue source for Mexico, but is mismanaged and can learn much from other oil rich nations. Mexico has moved similarly to Dubai, reducing the financial necessity of oil but Mexico has not been able to use the revenues to grow as Dubai had, nor can it in the same way because of the vastly different scale. It is more diversified than Nigeria, but is not nearly as nimble to change. It does not nearly have the amount of oil output that it can succeed as Saudi Arabia. Pemex, the state owned company lacks the efficiency of the state

² Creating Modern Capitalism

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owned oil of Dubai and Saudi Arabia, being performs more like the poorly run Gazprom in Russia. While it has removed its reliance of oil exports, it has not created compelling competitive advantage with the profits and hasn't created a properly incentivized oil sector on which to grow and provide more revenues to the state.

Political Gridlock

Politics in Mexico moves extremely slowly. Unlike many of the growing nations in the world, it doesn't have the ability to make snap decisions like dictatorships in China or South Korea or city-states like Singapore, Dubai are prone to do. While dictatorships tend to be better able to make quick decisions, democracies are also capable of growing quickly, but the legislative system isn't focused on growth and doesn't have the political will to grow like Taiwan, Hong Kong or Japan. While it can pass legislation, it does not act proactively or quickly enough to enact reforms or decisions in a timely fashion. While this is partly due to ineffective leaders, the system is so limited by terms that lock up effective legislating. There are so many reforms that leaders have needed to implement to create economic change, reforms that can make Mexico more competitive. In this way, the democratic system has limited Mexico, as "too much democracy" has limited India. Similarly to India, Mexico suffers from corruption which further exacerbates the issue an indecisive political system causes.

Labor Problems: Regulations and Unions

Labor is a serious problem within the Mexican economy. It suffers from a rigidity in the labor market that limits growth. Businesses are unwilling to hire, severances are high and unions are overly powerful. While this is not necessarily indicative of a successful or unsuccessful economy, it limits Mexico's ability to grow. This rigidity also effects how many Mexican workers will work under the system. These limitations have created a large informal sector of labor in Mexico and has also made individuals choose to go to Mexico to find employment. Unions further complicate the issue with particularly strong unions limiting the competitiveness of Mexican industries, especially for state-owned enterprises.

Fiscal Issues – Balanced Budget

A balanced budget is absolutely necessary. Mexico has already better insulated itself against crises and developed a solid financial system, but doesn't have the budget to carry on proper investment to grow. Mexico has a higher percentage of income tax revenue than both Chile and China, but significantly lower in value added taxes. Much of this is to blame the lack

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of political will to increase taxes, even though it is vital to not only balance the budget but to also fund projects that will grow Mexico. Mexico has many ambitious projects and goals it wants to take on but not the budget to fund it.

Education

Mexico's education statistics are appalling with fairly poor primary, secondary and bachelor degree rates and poor results in global standardized tests. Overall, students score lower than students in some of Mexico's main competitors such as South Korea, Chile and Taiwan. This issue is further exacerbated by the education system being largely locked up by teachers, whose union has excessive power and forced the budget to be focused on wages and not education. While this is not necessarily the worst issue as many other growing nations suffer poor education rates, higher education is important if Mexico wants to focus on high tech industries and grow in the same direction as its competitors. It can already export more high tech than the growing nations in South America, but loses when going head to head against Asian nations and will need education to close this gap.

Overall, Mexico has significant problems it needs to address that hold it back. These problems are not unique and it can pull results from other nations to address how to solve these problems and grow. But Mexico also has strengths that it can pull from and leverage to help its position.

Strengths of Mexico

Dynamic Relationship with the United States.

Mexico has one of the most important relationships with the United States, being one of the nations closest geographically and along a huge border of the United States. While it may not have always been a positive relationship, there is much to be gained from it. There are historical tensions due to the United States taking significant territories, but it should put these aside. Other nations have grown unabashedly off the United States. Many countries both developing and developed have used the United States as a springboard to grow like South Korea, Japan, Germany, China, and Taiwan. They used the United States' consumption to export their goods and grow their economies whereas Mexico moves cautiously. Even though Mexico has always had a significant trading relationship with the United States, trade was limited through significant

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tariffs that were only taken down as a result of NAFTA. Although 85% of exports go to the United States, few lasting competitive advantages has been made of a result. The list of countries above have all taken the growth given to them by the United States and have become global competitors in high tech industries and manufacturing, whereas Mexico has been lagging behind as it has not taken complete advantage of the relationship it has with the United States.

Strong Tech Exporting

Mexico has the ability to create and export high-tech equipment. They are better than several countries within Latin America, and they have the technological closeness to the United States to leverage technology advantages. Although education is a limiting factor, they can have a strong technological sector as India has. Mexico also has a strong network of universities and can use this to grow. While overall education rates are poor, they are improving with programs such as Oportunidades. Dubai lacks the educational institutions that made their tech investments lackluster but Mexico has the educational system to support a strong tech sector.

Good Credit Institutions

As a result of the multiple crises Mexico has suffered, it has developed strong credit institutions through radical reorganization. Their changes have helped them weather the financial crisis of 2008-2009 and helped the merging of banks which creates an increased sophistication of the banking sector, improved efficiency, and lowering costs. The resulting banking sector is stable enough to perform even under crises and are sophisticated enough to support Mexico's growth. While Mexico has these strong institutions, they're relatively untapped with credit to the private sector as a percentage of GDP actually declining since the late 1990s. Credit institutions are one of the most important factors of the diamond framework to enterprise systems.

Strong Labor Force

Mexico also has a labor force that is willing to work but needs the proper incentives and labor reform. Labor in Mexico is moving out to the United States, as can be seen by the remittances of emigrants sending money back to Mexico. The Mexican labor force is willing to work, but are extremely reserved about the Mexican system, with individuals within Mexico willing to work informally. With proper labor reform and incentives, hiring individuals will be more sustainable and people in Mexico will want to work for Mexico and its future. Unlike some nations such as Dubai and Saudi Arabia, the Mexican population is strong and populous enough to support the country and grow the nation.

Recommendations

Given the problems and strengths of Mexico, there are several key places where Mexico needs to hone in on to help growth. It can take from other nations problems and successes to grow.

Finish the War on Drugs

As costly as the drug war is, it needs to be finished. It is one of the few risks that is not comparable to other growth nations and actually shows economic damage. Countries such as Nigeria had limited growth as the violence limits growth, investment and stability of the nation. Ending the war would undeniably stabilize the government more and help growth. This War on Drugs is comparable to a civil war and among spectators it is a major factor that limits investment, growth and the future success of Mexico as a state.

Political Action

Mexico requires decisive political action to further develop and capture its potential growth. A consistent factor among nations that succeed is that they have to have the will from within to become successful. This is where a leader can use his charisma and political ability to create will from within the nation. Being a skilled politician and getting people to work towards economic growth is absolutely essential. Democracies like Taiwan and Japan show that a vested interest into the economic future of the nation is important to get an economy going. Likewise, the indecision of the Indian government has shown that indecision leads to lagging growth.

Address Budgetary Concerns

Mexico's taxes are among some of the lowest in the world, yet it needs the tax revenues more than many countries to fuel infrastructure investment . It is necessary to galvanize Mexico's political institution to be willing to increase taxes to create a more fiscally healthy economy and one that can invest significantly more into the infrastructure and equipment to fight the war on drugs. Without the proper infrastructure investment from the government, Mexico cannot solve several of the problems that plague the government.

Reform Oil

As much as Mexico is trying to reduce reliance on oil, it's clear that oil is going to be an important part of the growth strategy of Mexico. It is still a significant portion of Mexico's income and will continue to be so for some years to come. But it doesn't need to be as inefficient

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and can learn from the failures of Gazprom. Whether it is privatized or government owned is not terribly important. Gazprom became privatized and wasn't successful as opposed to privatizing everything. What is important is that it is run efficiently and the political institution needs to be separated from it. Gazprom failed due to corruption from government and inefficiently managing itself. It could learn from Saudi Arabia or Dubai or even Nigeria on how to better run their oil resources and use them to grow.

Labor Reform

Unions hold significant power and labor is overall a big issue. Mexico has a strong labor force that is willing to work and that can build up the nation unlike countries such as Dubai, but needs the institution backing it to work in its favor. Unions need to be slightly limited or changed to create a healthier labor and educational system. Teachers unions have a very strong stranglehold on education, taking up so much more money and limiting the amount of funds to further improve the educational statistics and state of education in Mexico.

Leverage Relationship with the United States

Mexico has a uniquely strong relationship with United States with its geographic proximity and the NAFTA treaty. It is up to Mexico to better improve its relationship and leverage it to increase growth. By working with the United States, they can better capture growth through trade as other nations before it have such as China and Japan. The United States also provides other benefits such as better technological advantages, a strong economy to export to and general economic ability to work with Mexico. The United States has superior credit market and entrepreneurial skill that can give Mexico competitive advantages through their strong ties.

Overall, while Mexico's enterprise system is unique, it has much it can learn from the example of other nations. No nation suffers the same exact problems but there is enough information to determine what way is best to grow Mexico into the next strong OECD country.

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