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INTERNATIONAL

In the shadow of China's boom

As China's economy expands, lagging Mexico looks inward and asks how it can compete

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Bustling Mexico City and Beijing showcase the fruits and flaws of globalization: streets clogged with vehicles and Starbucks Coffee shops, seemingly endless horizons of pollution, street peddlers and posh Four Seasons hotels.

But when it comes to economic performance, the paths of China and Mexico diverge.

For the past 25 years, China has delivered average annual economic growth of 9 percent - a rate unmatched by any country in modern history. Mexico, riding cycles of boom and bust, has barely eked out a 3 percent annual growth rate since 1980.

Now China's success in the world economy -- the new model for modernization -- is forcing Mexico to reevaluate its own policies and ask tough questions, such as why has the country fallen behind and what can be done?

While there are obvious differences -- China is still run by a Communist dictatorship and wages are a fraction of those in Mexico -- there are many in Mexico who think there are lessons to be learned from the Asian giant.

Mexican government officials, executives and industrialists interviewed recently in Mexico City insist on the need for economic reforms. Many point to Mexico's financial instability over the past two decades and its over-reliance on the North American Free Trade Agreement as a development policy as the big problems.

LACK OF A CONSENSUS

But unlike China, where business and the government often seem to speak in unison, Mexico lacks a consensus on the remedy.

Mexico's disappointing economic performance is hardly academic when it comes to the United States.

Because Mexico has failed to lift millions out of poverty, it has driven the flow of undocumented workers northward. Indeed, an estimated 400,000 people now cross the U.S. border each year, about twice the number slipping in when the NAFTA was launched in 1994.

Washington's efforts to deal with the immigration problem is shaping up as one of the most divisive issues of 2006, both in the United States and in relations between the United States and Mexico.

NAFTA was launched with the idea of Mexico becoming part of the First World, according to former President Carlos Salinas de Gortari.

But in the past five years, Mexicans have started measuring their country's performance against China's apparent success.

"I've been thinking about the comparison for some time," said Raul Rodríguez, a Mexican living in San Antonio. "Take a look at other examples [of successful development] around the world. The two necessary conditions are openness of the economy and economic stability," said the trade and investment consultant.

INDUSTRIAL POLICY

Some economists say that Mexico must abandon an industrial policy based on low wages since countries such as China, Honduras and Vietnam already are much cheaper alternatives.

They also fault the government for failing to break up monopolies, modernize institutions, improve education and extend the benefits of NAFTA beyond a small segment of modern Mexico to other citizens.

The solution, some say, is that Mexico must turn inward -- modernize itself -- in order to compete with the outside world.

"Given that trickle-down will never materialize, how can we increase the efficiency of investment so that the population can benefit?" asked Carlos Heredia, a former Finance Ministry official and now advisor to the state government of Michoacan.

"The answer is integration, investment in infrastructure, investment in human resources and efficient institutions," said the economist.

Rodríguez advocates streamlining the Mexican economy through "structural reforms," even though many Mexicans bristle at the thought of more government cuts, the sale of state-owned enterprises or rules that would make it easier to hire and fire workers.

"At the end of the day, that is what is needed," he said.

But sweeping reforms are far easier in China where the Communist Party can dictate policy without worries of elections -- even, for example, getting Microsoft to agree to ban the word "democracy" from its MSN website in China.

KEYS TO SUCCESS

Miami bond trader Martin Schubert traces China's success to prices, wages and policy.

"The most important aspect is the undervalued exchange rate, which makes Chinese goods competitive wherever they have to compete," Schubert said.

Low labor costs give an edge to Chinese factory goods, while the government and business class coordinate strategy. "The government policy is tilted in favor of developing Chinese competitiveness and Chinese sales abroad," Schubert said.

China also has made some key economic decisions that have enabled it to shoot ahead:

- Although Mexico's per capita income of \$9,600 is five times that of China, the Asian country is spending wisely. China, for example, invests more than double what Mexico does on research and development and graduates twice the number of engineers and scientists per 100,000 people.

Telephone and Internet use is also expanding at a faster rate, a sign of the rapid diffusion of innovation.

- China's trade is geographically diversified, while Mexico's is highly dependent on the United States, which buys 88.8 percent of Mexico's exports.
- China attracts foreign investment to serve not only its export sector but also its domestic market, which includes the largest middle class in the world, an estimated 400 million people.

SPENDING IS WEAK

The growth of consumer spending has been weak in Mexico, in contrast, so foreign investment has been almost exclusively focused on the export sector.

Mexico's middle class also has little faith in the government and Mexican institutions. Mexicans have nearly three times more money deposited in U.S. banks than the institutions have loaned to Mexico, according to the latest figures from the Federal Reserve.

"If you were looking at prospects of a growing economy in Mexico, the numbers would be reversed," said Walker Todd, a lawyer in Chagrin Falls, Ohio, and author of papers on Latin American financial history.

Capital controls in China, on the other hand, make capital flight more difficult.

"China is at a stage in its development that the most attractive investment is inward back into China," Todd said.

Still, China also faces challenges similar to those confronting Mexico: environmental damage, corruption, rural poverty and unrest, unemployment and growing inequality.

MORE GLOBALIZATION

Globalization presents an equally ruthless face for Chinese workers, according to a report on Chinese sweatshops recently published by the International Conference of Free Trade Unions.

"If you don't work hard today, tomorrow you'll have to try hard to find a new job," read a sign in a Chinese factory, according to the report.

But looming on the horizon for both Mexico and China is increased competition from India, which is poised to become the newest low-wage factory floor to the world.