How Mexico's weakness can be converted into strength

by David Goldman, Economics Editor

LaRouche-Riemann analysis of the Mexican economy was conducted by a combined EIR-Fusion Energy Foundation-Mexican Association for Fusion Energy team in New York and Mexico City under the direction of David Goldman.

Every conversation on the subject of Mexico's debt crisis, quickly approaching a moment of truth with the Nov. 23 expiration of the three-month moratorium on Mexican debt principal, seems to turn on the following question: can the International Monetary Fund, with the cooperation of the United States and other industrial nations, crush the Mexican economy and force Mexico to crawl to the IMF? Since the IMF's executive directors vetoed the package negotiated between the Mexican government and the IMF's own Mexico City team Oct. 25, the pretense of amicable negotiations has evaporated, and the question has come down to simple strategic capability. Since the question remains unresolved, credit may be given to the impression that neither the IMF (nor the U.S. administration), nor the Mexican government is entirely confident of the answer.

Last week, I reported the mood of preparations for economic war now apparent in Mexico's governing Institutional Revolutionary Party (PRI). However, the Mexican government's correct identification of the short-term origins of the crisis—the tripling of interest rates since most Mexican debt was contracted, the drop in recession-hit oil prices, the $22 billion in flight capital—still falls short of a full analysis of the weaknesses in the Mexican economy even during the late 1970s boom, and the means of correcting that weakness.

In 1980, the Mexican Association for Fusion Energy, in cooperation with its American sister organization, the Fusion Energy Foundation, and this publication, used the LaRouche-Riemann computerized economic model to project forward to the year 2000 an optimal path for the industrialization of Mexico.

Here, we apply the same methods in a critical view of the 1970-1980 period, and present a summary of our conclusions. While the criticism is devastating with respect to the investment decisions pursued during the past decade, it points to a *hidden economic potential* which might surprise even the present Mexican leadership, and decisively answers the question underlying the stand-off with the International Monetary Fund: Mexico's economy has been so distorted by the growth of consumer-goods industries feeding non-productive consumption that a total reorientation of investment policies toward basic development requirements would enable Mexico to grow even under conditions of total American trade boycott, and virtually no trade with the other nations of the Organization for Economic Cooperation and Development (OECD). Moreover, the quality of growth under the mooted transformation of investment policy would be more sound than the middle-class-oriented growth of the past ten years, and create a solid foundation for industrialization.

Leaving aside the extraordinary political nature of such a program, it is evident that the inherent growth-generating capacity of the Mexican economy can bring the economy through the present crisis. On first glance this might appear absurd, since 70 percent of Mexican industry (see *EIR*, June 29, 1982) presently assembles parts imported from the United States. Ignoring the problem of spare parts for a capital-goods base that is entirely American, cessation of American imports following a debt moratorium or similar action would imply

the cessation of 70 percent of Mexican production within days. However, assuming that Mexico could develop sources of technology, expertise, and capital goods outside the OECD area, particularly in the rest of Ibero-America, Mexico could meet this assault the way Kutuzov met Napoleon: walk away from its present industrial structure and create a new one better oriented toward its development requirements.

Before discussing the nature of such a program, let us examine the evidence generated by the LaRouche-Riemann model. The model's categories, which derive from the standard form of national-income accounting that prevailed before J. S. Mill and the marginal utilitarians, divide the physical product of the economy according to their impact on future growth potential. These are:

Tangible profit (surplus), or physical value added above the cost of labor, raw materials, and depreciation;

Variable capital, or Tangible Wage Costs, or the volume of physical commodities consumed by the goods-producing labor foce;

Capital consumption, or the depreciation cost of using a given capital stock;

Circulating constant capital, or raw-materials requirements of industry.

and the divisions of Tangible Profit:

Reinvested profit, i.e. the fund of goods consumed by the existing stock of investment, raw materials, and consumption goods, and

Overhead costs, i.e. the fund of goods consumed by the non-goods-producing section of the population, as well as administrative expenses, military expenses, etc.

Not so much the absolute growth rate of these parameters as the change in internal economic relationships defines a healthy economy, in LaRouche-Riemann analysis. The three determining ratios are:

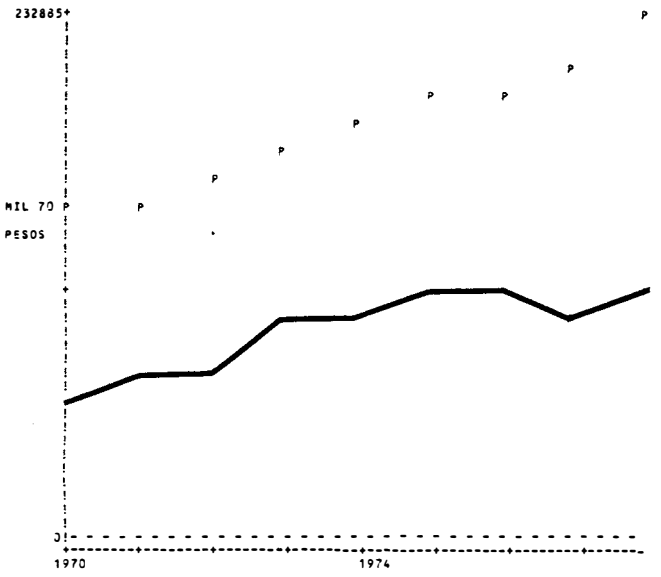
1) Surplus generated per unit of capital plus labor investment (S/C + V), the "total factor" or "thermodynamic" productivity. This measure is more useful than the conventional output-per-manhour definition, which ignores such problems as highly efficient production of totally useless items;

2) The rate of reinvested profit (S′/C + V), or the rate at which the surplus product can be ploughed back into productive activity;

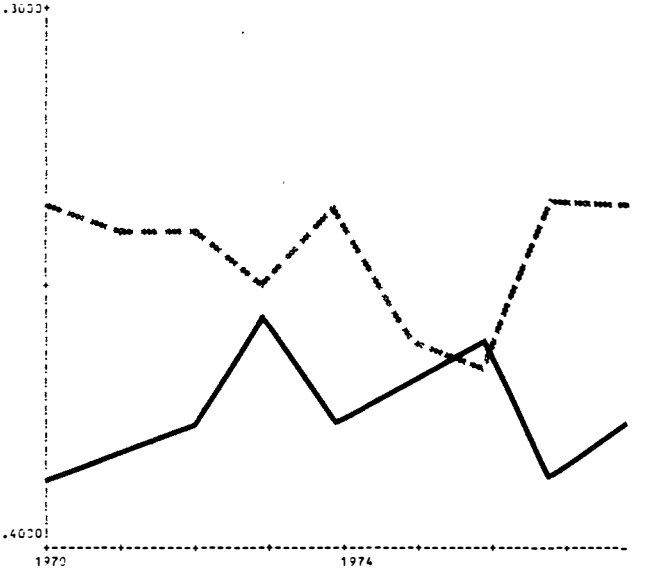
3) The capital intensity of production (C/V), or the ratio of "artificial" to human labor.

Figure 1 shows the total tangible profit of the economy and its reinvested component, in millions of 1970 inflation-adjusted pesos. Total output of the economy doubled over the decade, with a brief growth pause in the 1976-1977 period, largely due to the International Monetary Fund program accepted by the Echeverria administration. Growth picked up again dramatically after 1977 due to the boom in oil revenues. However, the component of tangible profit reinvested into goods-producing activity stagnated after 1976.

Figure 2 shows reinvested profit and profit consumed as

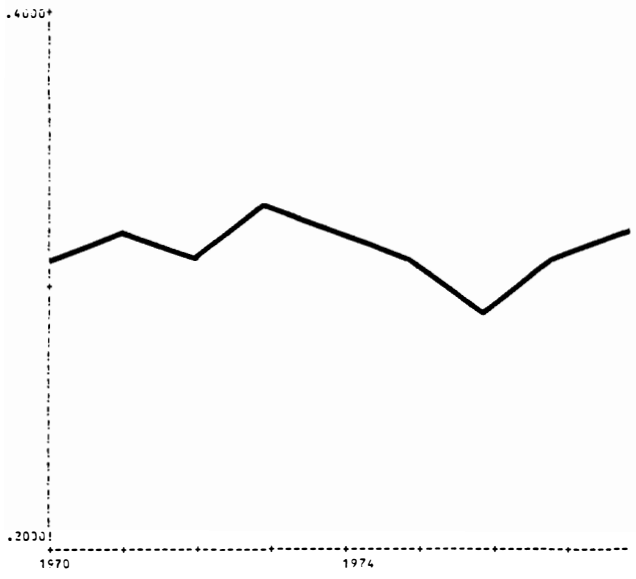


GRAPH 1: TANGIBLE PROFIT (P) AND REINVESTED PROFIT (—) OF MEXICO, 1970–1979

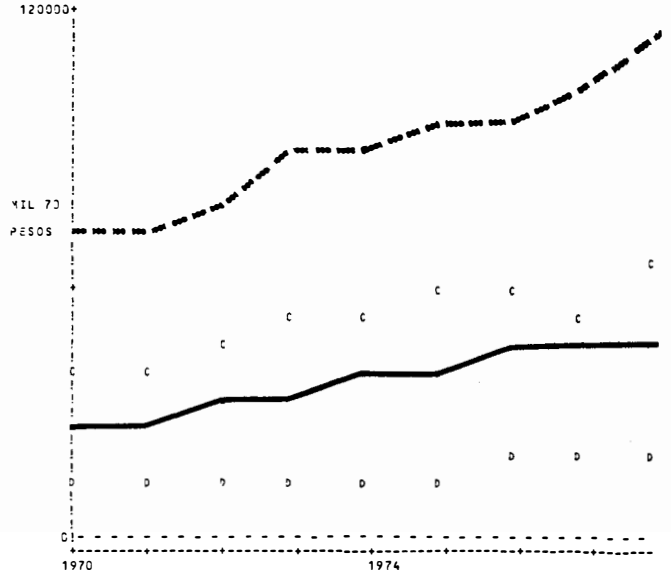


GRAPH 2: REINVESTED PROFIT (—) AND OVERHEAD COSTS (- - -) AS A PERCENTAGE OF TANGIBLE PROFIT, MEXICO 1970–1979

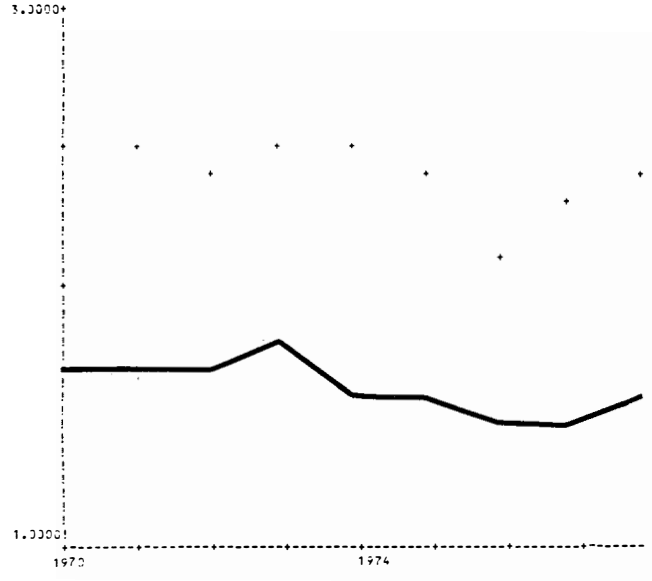
overhead on the same scale, as percentages of total profit. Except for a brief change during 1975-1977, overhead costs—overwhelmingly consumption of the non-goods-producing workforce, i. e. the middle class—consumed about 60 percent of total profit, against about 40 percent for reinvestment. By international standards, this is not bad; on the contrary, the best reinvested profit level the Untied States achieved during the past decade was one-tenth of overhead cost, and the best West German level was three-tenths of overhead costs. However, starting from Mexico's low level, the second graph shows an excessive diversion of profit into over-



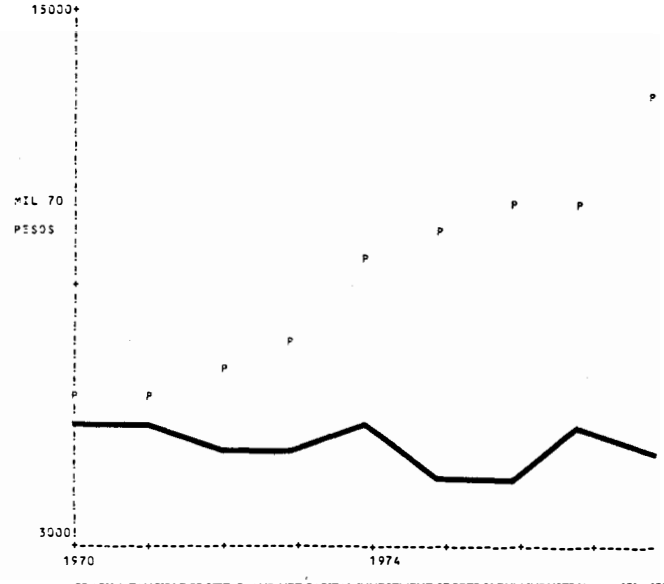
GRAPH 3: CAPITAL INTENSITY OF MEXICAN ECONOMY (DEPRECIATION COSTS OF CAPITAL STOCK LABOR COSTS, 1970–1979



GRAPH 5: TANGIBLE PROFIT (- - -), NET CAPITAL INVESTMENT (C), LABOR COSTS (—), DEPRECIATION COSTS (D); MANUFACTURING 1970–1979



GRAPH 4: TOTAL FACTOR (THERMODYNAMIC) PRODUCTIVITY (—) AND LABOR PRODUCTIVITY (+) OF MEXICO, 1970–1979



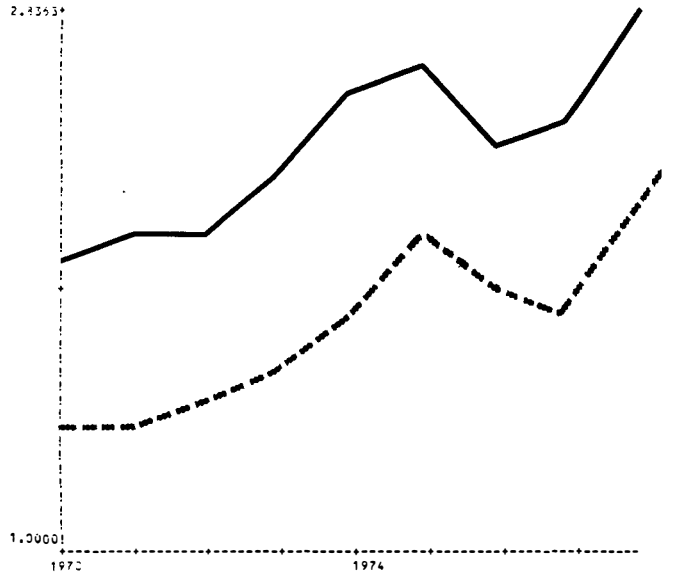
GRAPH 6: TANGIBLE PROFIT (P) AND NET CAPITAL INVESTMENT OF PETROLEUM INDUSTRY (—), 1970–1979

head expenditures. (This category does not include government-sponsored projects, which, if they produce goods or provide transport, are counted as reinvested profit; it is essentially identical to middle-class consumption in the Mexican case).

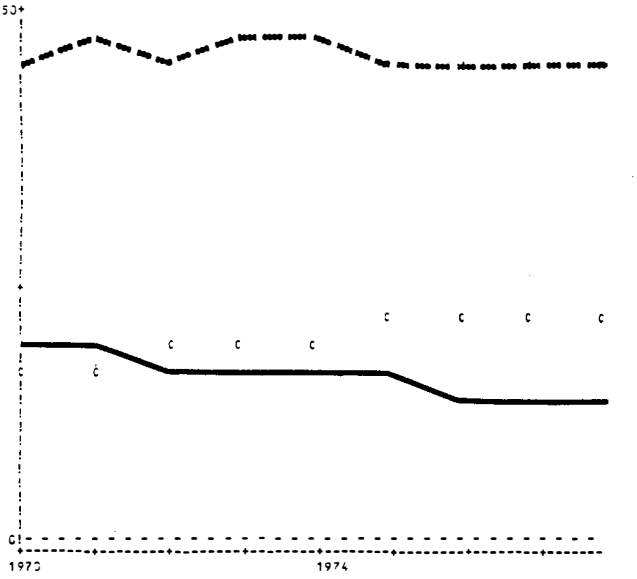
Figure 3 shows the capital intensity of production, which does not change over the decade. This is not as surprising a result as it might seem; since 70 percent of the Mexican industrial boom, which doubled the size of the economy, occured in the lower end of the technology scale of U.S. industry, assembling parts imported from the United States, there was no need for capital per worker employed to augment. However, it is a fundamental sign of stagnation.

Figure 4 shows the total-factor, or thermodynamic, productivity measure S/C + V, along with a measure of the productivity of labor S/V, or tangible profit over labor costs. Both measures actually decline over the decade, indicating a situation worse than stagnation.

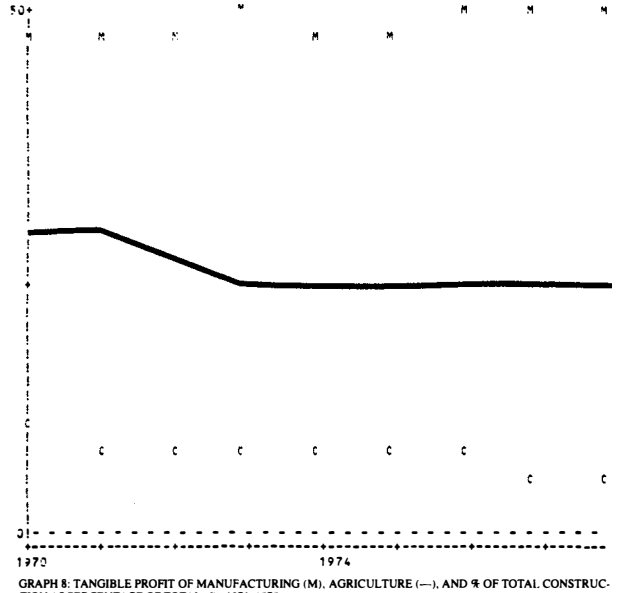
Figure 5 shows the tangible profit, net capital investment (above depreciation costs), and tangible labor costs of the economy. It is necessary to further disaggregate the economic results to locate the source of the stagnation within the



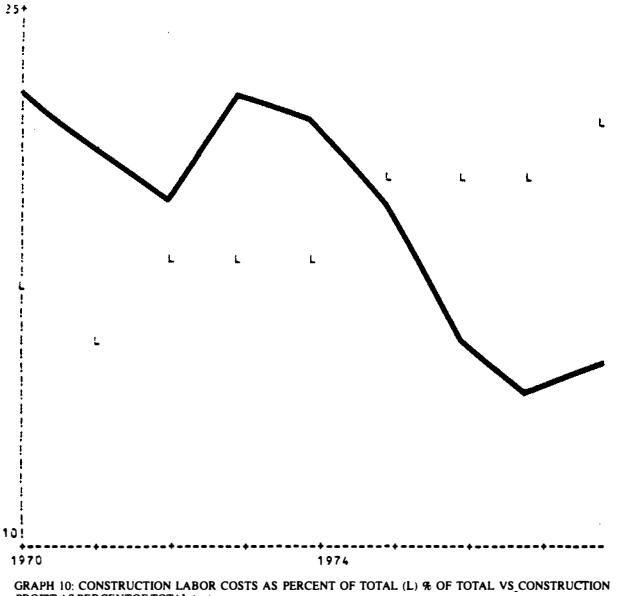
GRAPH 7: TOTAL FACTOR PRODUCTIVITY (- - -) AND LABOR PRODUCTIVITY (—) OF PETROLEUM AND MINING, MEXICO 1970–1979



GRAPH 9: TANGIBLE LABOR COSTS OF MANUFACTURING (- - -), AGRICULTURE (—), AND CONSTRUCTION AS PERCENT OF TOTAL (C), 1970–1979



GRAPH 8: TANGIBLE PROFIT OF MANUFACTURING (M), AGRICULTURE (—), AND % OF TOTAL CONSTRUCTION AS PERCENTAGE OF TOTAL (C): 1970–1979



GRAPH 10: CONSTRUCTION LABOR COSTS AS PERCENT OF TOTAL (L) % OF TOTAL VS CONSTRUCTION PROFIT AS PERCENTOF TOTAL (—)

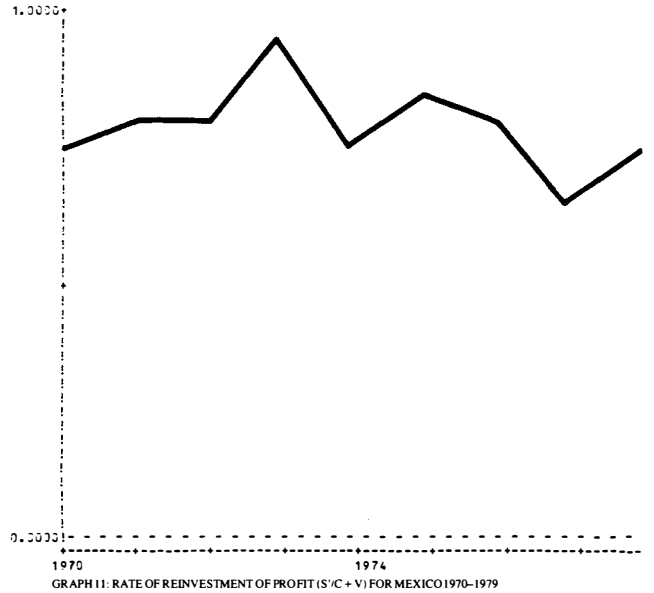
productive sector.

Figure 6 shows the rise of the tangible profit of the petroleum and mining sector of the economy, the most technologically advanced part of the Mexican economy;

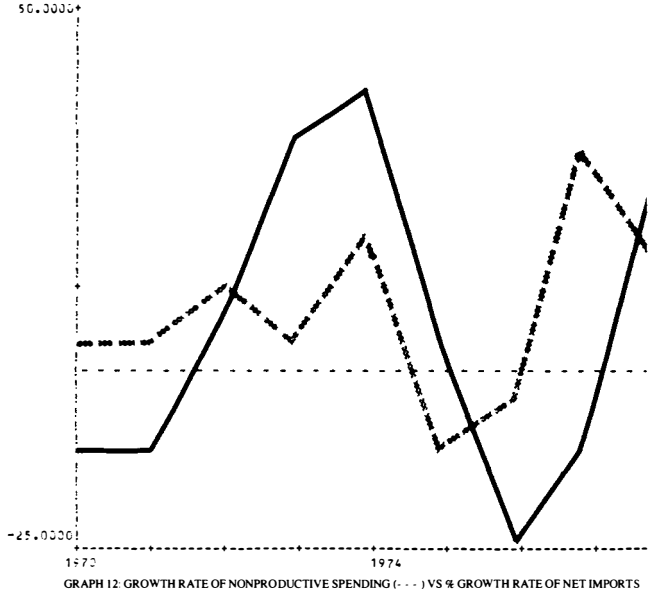
Figure 7 shows the sharp rise in its productivity. While the performance of the petroleum sector represents an unquestioned success, its share of total tangible profit—only 6 percent of the total economy—is too small to influence the results of the total.

Figure 8 shows the tangible profit of three sectors, i.e. manufacturing, agriculture, and construction, as a percent of total tangible profit. Noteworthy is that while the relationships remain fairly constant until the 1977-and-after boom period (except for an early-1970s decline in the relative share of agriculture), both agriculture and manufacturing decline at the expense of construction during the boom period. The rise of the construction sector's share of the economy is even more noticeable in **Figure 9,** which shows the portion of total tangible labor costs consumed by the three largest sectors.

Figure 10 shows what a drag on the economy this has represented; the labor cost of the construction sector has risen much faster than its profitability. In fact, the construction



GRAPH 11: RATE OF REINVESTMENT OF PROFIT (S'/C + V) FOR MEXICO 1970–1979



GRAPH 12: GROWTH RATE OF NONPRODUCTIVE SPENDING (- - -) VS % GROWTH RATE OF NET IMPORTS (—), MEXICO 1970–1979

sector's profitability collapsed during the late 1970's, as the construction labor force doubled to a peak of 1.8 million workers by 1980. The new employment was not matched by investment in capital equipment, and the already labor-intensive industry became virtually primitive in most applications.

The combination of a stagnant manufacturing industry riding the back of an oil-fed import boom; an agricultural sector that remained backward; and a labor-intensive production boom combined to outweigh the productivity growth in the efficient, but small, auto sector. Also important is the fact that the transportation sector's share of total profit rose from 8 to 13 percent of the economy during the decade, i.e. that the social cost of transportation rose by a clean 5 percent, coming out of potential growth in other areas. This reflected substitution of highly inefficient trucking for unreliable and slow rail transport, reflecting a higher average cost. The average length of a trucking haul in Mexico is several times larger than that of any other country, due to the lamentable state of the national rail system.

As noted earlier, the context for these adverse results had been a rising flow of profit into overhead consumption at the expense of productive consumption. **Figure 11** demonstrates that the rise of overhead spending led the import boom throughout the 1970s. It shows the growth rate of net imports against the growth rate of non-productive spending; the two curves are improbably similar. Since 80 percent of the import volume is listed as either "capital goods" or "intermediate" goods for industry, this relationship demonstrates what is otherwise obvious: that the growth of Mexican industry has been oriented to producing consumer-goods for the middle class.

Figure 12 summarizes all the above results in the crucial ratio $S'/C + V$, or the rate of reinvested profit; this ratio ends the decade below where it started. Despite the boom growth of the economy, the economy's *future capacity to grow* declined! This initially surprising result is not, after all, that strange; production of consumer durable goods for middle-class consumption does nothing to enhance future growth prospects, particularly when agricultural backwardness, primitive construction methods, and transportation bottlenecks continue to constrain the economy.

Nonetheless, these results have a decidedly positive content from the Mexican standpoint; read backwards, they show what the Mexican economy could do were it to do things right. First, the fact that the bulk of industrial production has serviced overhead expenditures shows that the country has much less to lose from a temporary, if massive, industrial shutdown than might seem apparent. It would mean the middle-class would have to use the same autos, refrigerators, toasters, and television sets they now own for the next several years. Second, much of the industrial base could be used for basic capital goods, e.g. construction and agricultural equipment instead of autos. Third, the major projects (e.g. the Northwestern irrigation system, or PLHINO) under construction might be accelerated and yield major productivity benefits in the next two to three years. Fourth, a really tough administrative reform of the rail system might yield impressive short-term results.

EIR will release the results of a computer-based study of the type of policy reorientation in the near future, after it leaves the domain of privileged discussions with experts now tackling the problem. However, it is worth emphasizing in conclusion that the type of errors that plague the economic methods employed by the International Monetary Fund may lead the IMF to false conclusions concerning its relative bargaining position in the case of Mexico.