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## **President Zedillo Presents Cautiously Optimistic State-of-the-Nation Address**

*by LADB Staff*

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On Sept. 1, President Ernesto Zedillo presented a cautious but optimistic state-of-the-nation address, in which he forecast moderately strong growth of 4% in 1997. Nevertheless, members of the two major opposition parties the Democratic Revolution Party (PRD) and the National Action Party (PAN) as well as several private economic analysts, have criticized Zedillo's speech as incomplete and lacking in vision. In the speech, which was broadcast live on national television, Zedillo touched on both economic and political themes. During the address, Zedillo boldly announced that Mexico had finally emerged from the economic crisis that followed the devaluation of the peso in late 1994 and was about to embark on "rapid, vigorous, and sustained" growth.

The president used the speech to underscore the economic advances attained during his administration. He mentioned a decline in the inflation rate to 18.6% for January-August of this year, compared with 38% in the same eight-month period in 1995. He also mentioned a decline in unemployment, which dropped to 5.8% of the economically active population (EAP) in July of this year, compared with 7.6% of the EAP in August 1995. And the president also emphasized a decline in interest rates, an increase in exports, and quick repayment of the debt owed to the US and multilateral institutions.

The president said his administration has now set a target for GDP growth rate of 4% in 1997, a modest increase from the official forecast of 3% GDP growth for 1996. Some administration officials have forecast a GDP increase as high as 7% this year, following a higher-than-expected GDP growth rate of 7.2% in the April-June quarter. However, most private economists say the administration's original target of about 3% growth is still the most realistic estimate for 1996. However, Zedillo offered his forecast with a note of caution. "The beginning and consolidation of the recovery will not be sufficient in the short term to repair the damage to living standards caused by the crisis, and much less to address the deficiencies that have accumulated over the years," he said. "To achieve this goal, we must turn the incipient recovery into an ongoing, sustained process to ensure that the national economy grows at considerably higher rates than population growth year after year."

Members of business organizations had mixed reactions to Zedillo's economic forecasts. For example, Carlos Abascal Carranza, president of the national employers confederation (Confederacion Patronal de la Republica Mexicana, COPARMEX), admonished Zedillo for suggesting that Mexico had fully emerged from the economic crisis. "At the macroeconomic level, there are some signs that our economy has stopped falling," he said. "Our challenge is to ensure that economic growth goes beyond rhetoric, allowing for an improvement in the well-being of each person." Abascal echoed an assessment made earlier by the finance executives institute (Instituto Mexicano de Ejecutivos de Finanzas, IMEF), which cautioned Zedillo against overreacting to the strong GDP growth of 7.2% in the second quarter of this year (see SourceMex, 08/21/96). "Even though the GDP data from the first and second quarters of the year appear relatively strong, actual

growth is insufficient to meet the employment needs of the population," said IMEF president Emilio Ilianes Diaz de Rivera.

Columnist Agustin Rodriguez Trejo of the daily newspaper Excelsior praised Zedillo for placing a high priority on increasing domestic savings. At the same time, he questioned whether the administration can succeed in boosting the savings rate under current policies. "The government appears to be pushing a very flawed concept, that fiscal discipline and economic growth will automatically result in an increase in domestic savings and healthy growth," said Rodriguez Trejo. Meanwhile, some economic observers agreed with Zedillo that the Mexican economy generated a moderate increase in employment during the past year.

But many of those observers said the job creation remains insufficient to keep pace with the rapid increase in the Mexican population. In an article in the daily newspaper la Jornada, columnist Julio Boltvinik pointed out that the government's recent optimistic economic reports do not take into account the decline of retail business in Mexico's 33 largest cities during the first half of the year, which has resulted in some job losses. "What is worse is that average wages for retail employees continue to decline," said Boltvinik. The retail sector is only one of the areas where wages have fallen. According to labor unions, during the past several months wages have not kept pace with the rate of inflation, which, in turn, has caused a drastic deterioration in the purchasing power of workers.

Indeed, in mid-August the workers congress (Congreso del Trabajo, CT) demanded an end to the salary caps established in an annual anti-inflation agreement among labor, business, and government representatives. In the past, the government, by virtue of its close relationship with labor leaders, has been able to convince the country's two largest labor organizations the CT and the workers confederation (Confederacion de Trabajadores de Mexico, CTM) to accept the salary caps. Now, however, CT president Victor Flores Morales says the labor movement will not be as accommodating with the government during the next round of negotiations, which would set the terms of the anti-inflation agreement for 1997. Flores said the CT is demanding that the government address the "alarming" problems faced by Mexican workers, such as massive unemployment and a 75% decline in purchasing power this year.

The Zedillo administration is not likely to take major actions on the demands presented by labor. In fact, during testimony before the Chamber of Deputies two days after Zedillo's address, Labor Secretary Javier Bonilla bluntly told legislators that the administration had no plans to initiate any emergency employment and wage programs. "These programs do not exist because we do not think we can implement them successfully," Bonilla said. In his state-of-the-nation speech, Zedillo said the Mexican economy will continue to rely on exports to boost growth and employment in Mexico. Indeed, the moderate GDP growth of 3% in the first half of the year was attributed, in large measure, to the continuing increase in exports, which approached US\$53.5 billion in January-July of this year. On the other hand, some economists such as Jesus Esteban Macias of the Instituto Tecnologico de Monterrey-Mexico City campus, are quick to point out that the growth in exports continues to rely extensively on the maquiladora sector and on multinational companies that have a "low impact" on the general economy.

Esteban said a handful of domestic manufacturers especially large companies have become proficient in the export market, but the vast majority of Mexican manufacturers are still not participating in the export sector. "What we're seeing is a dualization of the Mexican economy," Esteban told the Mexico City daily newspaper *The News*. "The modern sectors, including efficient globalized exporters, are...becoming even stronger, but the backward sectors are falling further behind." Still, the criticisms of Zedillo's speech are in stark contrast to opinions from some members of the business community, who suggest Zedillo may have taken an overly conservative approach in his forecast for GDP growth in 1997. "This year alone, we will experience close to 4% growth," said Claudio Xavier Gonzalez, president of the Mexican business council (*Consejo Mexicano de Hombres de Negocios, CMHN*). "We could easily surpass that growth rate in 1997."

The *News* pointed to a handful of sectors, such as the construction and automobile industries, that registered strong performances in the first half of the year. The construction sector, for example, posted a 7.8% gain in the January-June period, while the automotive sector reported an increase of 32% in sales of motor vehicles. "These numbers add up to consumer confidence, a missing element of the economy in recent times," said the newspaper. In his speech, Zedillo reiterated his commitment to follow the economic policies that helped Mexico overcome the crisis, such as tight fiscal and monetary discipline.

But some economic observers suggest that the importance of Zedillo's speech was not so much in the content of what he said, but in what was omitted from the address. "The state-of-the-nation address had no new announcements about economic matters," said Francisco Blanco, director of analysis at Arka brokerage. Blanco said the uneventful nature of the speech was especially reflected in the lack of reaction in the Mexican financial markets, which were also affected by the closure of the US markets for the Labor Day holiday. Other economists noted the one area where the speech had an impact was on interest rates. On Sept. 2, the day after the speech, the rate for short-term Treasury certificates (*Cetes*) declined to 23.2%, compared with its closing rate of 24.2% the previous Friday.

For his part, analyst Felix Boni of the James Capel brokerage company in Mexico City noted that the portion of the speech that touched on privatizations failed to mention the controversial plan to transfer operation of the country's petrochemical plants to the private sector. Zedillo's speech made specific mention of privatization of the national railroad (*FERRONALES*), power plants, distribution of natural gas, and telecommunications. The question of whether Zedillo would proceed with the privatization of petrochemical plants, which has been suspended indefinitely, was raised by members of the president's cabinet at a special hearing in the Chamber of Deputies two days after the speech. At the hearing, legislators asked four of Zedillo's cabinet members Agriculture Secretary Francisco Labastida, Finance Secretary Guillermo Ortiz Martinez, Energy Secretary Jesus Reyes Heroles, and Labor Secretary Bonilla to answer questions regarding specific portions of the speech. Addressing members of the legislature, Energy Secretary Reyes Heroles left no doubt that the administration is planning to proceed with the privatization of the petrochemicals, although he did not provide a timetable. Reyes Heroles said the administration does not have the resources to raise the funds required to modernize Mexico's petrochemical plants. "Therefore, we see an urgency in attracting complementary private capital," he said.

Many of the questions by legislators were directed at Finance Secretary Ortiz. Ortiz reiterated Zedillo's plan to continue with economic austerity measures this year, in order for Mexico to return next year to the strong growth rates of the 1960s and 1970s. "This has been a year of consolidation and the start of recovery," Ortiz told skeptical legislators. Members of the two largest opposition parties took every opportunity to criticize Zedillo's economic and political policies before, during, and after the state-of-the-nation address. In a statement after the speech, the PRD leadership in the Chamber of Deputies said Zedillo's speech presented no evidence that the government is seeking sustained economic growth. "This administration is proposing measures that would lead to a weak, unstable, and unjust recovery," the PRD said.

PRD legislative leader, Deputy Pedro Etienne Llano, said Zedillo had to take bolder action, such as a full renegotiation of the country's foreign debt. In addition, he urged the president to seek revisions in the North American Free Trade Agreement (NAFTA) to better meet the interests of Mexico. During a meeting with Zedillo before the speech, the PRD also demanded that the president cancel the privatization of the country's petrochemical plants and also scale down the sell-off of FERRONALES. In particular, the PRD called for the government to cancel privatization of the portion of FERRONALES providing service between the Gulf of Mexico and the Pacific Ocean.

The Zedillo administration and the PRD did concur on the need for the government to increase spending on social-welfare programs, but they disagreed on the amount of money and the scope of these programs. In any case, Zedillo's speech included mention of a new pilot program designed to increase public assistance in nutrition, health, and education. Notwithstanding the creation of the new pilot program, questions remained whether Zedillo's commitment to follow policies of the past would be sufficient to address growing poverty in Mexico. Critics, while admitting that poverty has resulted partly from the recession of the past two years, also pointed to the failed policies of past presidents. Coincidentally, a government report published two days after Zedillo's speech said that the structural-adjustment programs implemented during the past 16 years, have created greater economic inequities, not only among individuals, but also among regions. The report, published by the government-sponsored program to overcome poverty (Programa Integral para Superar la Pobreza), suggested that because of the economic inequities in Mexico, one in five Mexicans have fallen into poverty since 1992.

Zedillo's address and his economic policies also came under attack from the center-right, pro-business PAN. In a statement, the PAN executive committee suggested that the administration's steps to reactivate the economy were weak. "The economic recovery that this government so often mentions may be evident in some macroeconomic statistics," said the PAN executive committee. "But this recovery which has been achieved at the cost of reduced salaries, higher taxes, and increased unemployment has not reached the pockets of consumers and is not reflected in the well-being of families." Regarding higher taxes, PAN specifically referred to the Zedillo administration's decision to raise the value-added tax (impuesto al valor agregado, IVA) to 15% from a previous 10% shortly after the devaluation of the peso.

Members of the PAN in the Senate have already proposed a plan not only to reduce the IVA, but also the income tax (Impuesto sobre la Renta, ISR), to help promote economic growth. Sen. Arturo Nava told reporters that the PAN's plan proposes a reduction in the IVA to 12% or 13% from

the current 15%, and a lowering of the ISR to 30% from the existing 34%. In response to the PAN proposal, deputy finance secretary Tomas Ruiz Gonzalez said the Zedillo administration has no immediate plans to pursue any changes to the current tax structure. "We have no plans to either raise or lower taxes," said Ruiz. The PAN proposal came a day after Zedillo signed an agreement to work with state and local governments to combat tax evasion and fraud.

Spokespersons for the Finance Secretariat (SHCP) said the plan is designed to help the government increase collections of the IVA, the ISR, and the special production tax on goods and services (Impuesto Especial Sobre Produccion y Servicios, IEPS). According to SHCP statistics, evasion of IVA payments alone runs as high as 35%. Ruiz sought to reassure business leaders that the government would not use the new tax-collection incentive to persecute businesses. "This plan does not imply a new form of terrorism against businesses," he said. "Rather, we are implementing a formula to increase presence and vigilance."

Meanwhile, on the political front, Zedillo pledged to follow through on promised political reforms, and he vowed to crush a new guerrilla uprising in southern Mexico "with the full force" of the Mexican state. The president was referring to the uprising of the Popular Revolutionary Army (Ejercito Popular Revolucionario, EPR) in five southern states, particularly in Guerrero and Oaxaca. A total of 14 persons died during EPR attacks on police and military posts in six towns in those two states. The incidents were the latest in a series of surprise attacks carried out by the EPR since June 28, when the organization first announced its existence.

During the state-of-the-nation address, Zedillo said the vast majority of Mexicans "will not accept the emergence of outdated and bloody incidents of violence." Regarding political reform and democracy, the PRD, the PAN and the Labor Party (PT) gave Zedillo high marks for his efforts (see SourceMex, 07/31/96 and 08/07/96). On the other hand, representatives of all the parties suggested that the move toward reform is just beginning. They all agreed that the government and the major parties must work together to ensure that the proposed changes became permanent. (Sources: El Diario de Yucatan, 08/20/96; El Universal, 08/26/96, 08/29/96; New York Times, 09/02/96; Excelsior, 07/19/96, 08/26/96, 08/29/96, 08/30/96, 09/02/96, 09/03/96; El Financiero, 08/08/96, 08/20/96, 08/28/96, 09/02/96, 09/04/96; La Jornada, 08/20/96, 08/23/96, 08/27/96, 08/28/96, 09/02-04/96; Novedades, 08/01/96, 08/08/96, 08/23/96, 08/26-29/96, 09/03/96, 09/04/96; The News, 08/23/96, 08/26-29/96, 09/03/96, 09/04/96)

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