ECONOMIC STAGNATION AND ALTERNATIVE DEVELOPMENT STRATEGIES[**]

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## 1. *Introduction*

The focus of my paper is the presentation of some thoughts on overcoming economic stagnation, with reference to the case of Mexico. In Section 2, I will describe the reasons why the policies of financial opening based on the Washington Consensus create endogenous tendencies toward economic stagnation and overvaluation of currencies. Section 3 offers a concise outline of a possible alternative development project for Mexico. Section 4 presents some proposals regarding monetary, foreign exchange, and fiscal policy oriented toward reviving economic growth. Finally, in Section 5, I present some conclusions.

## 2. *The tendency toward economic stagnation under the parameters of the Washington Consensus*

Mexico has been the prize pupil of Washington and the multilateral organizations--jealous guardians of the "conventional wisdom"--since it decided to passively incorporate itself into neoliberal globalization after the external debt crisis. It was then that Mexico became an export "power" and opened its economy like no other country on the subcontinent. In 2008, the degree of opening reached 55.5% of GDP, compared to only 16.3% in 1981. However, the results in terms of employment and growth have been mediocre, while income has become concentrated as never before, and the informal economy and migration of workers to the United States have both mushroomed.

The negative results in economic growth cannot be attributed solely to errors of economic policy or to a mistaken application of the neoliberal model, as other countries

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that followed the guidelines of the Washington Consensus in the 1980s, like Argentina and Brazil, had similar results.

The neoliberal model is sustained financially through the opening of the capital account and the import of private flows of foreign capital. Paradoxically, proponents of the opening of the capital account offered it as the panacea for the "lost decade" and the stagnation provoked by the orthodox renegotiation of the external debt at the beginning of the 1980s. I argue that financial opening tends, in and of itself, to generate economic stagnation.

The stagnation thesis is not new in Latin America. In the mid-1960s, Celso Furtado (1965) invoked it to show the limits of import substitution industrialization (ISI) as it entered into what the structuralists identified as its "difficult stage," characterized by a growing production of intermediate and capital goods. Furtado argued that in this stage, the "external restriction" set itself up as a limit to continued capital accumulation. However, Furtado's explanation of stagnation turns out to be insufficient to explain the present-day stagnation in Latin America. Although the neoliberal model has also failed to resolve the problem of the "external restriction," and this restriction continues to be an objective obstacle to growth, the current stagnation differs in specific ways from the import substitution model.

Present-day stagnation has more to do with the opening of the capital account and with the "financialization" of the economy. Although the net inflow of foreign capital initially revived investment and economic growth, its effects have been meager and temporary. Theories as well as practice have demonstrated that the neoliberal policies of the Washington Consensus led Mexico and Latin America into a dead-end of stagnation, inequality, and poverty (Ffrench Davis, 2005; Bresser-Pereira, 2007). The entry of external savings (mainly speculative) does not create the conditions for durable economic growth. Rather than provoking an increase in investment, as the standard theory predicts, the unrestricted and indiscriminate opening of the capital account displaces external savings toward private consumption, which prevents sustained economic revival. In Mexico, private consumption as a share of GDP rose from 65 to 70% between 1980 and 2007 (Ibarra, 2009:17).

On the one hand, the influx of external savings provokes an increase in the current account deficit because of growing imports linked to private consumption, greater income concentration, and the breaking of internal production chains. On the other hand, it leads to growing external indebtedness of economic agents. The neoliberal model has allowed no significant increase in the rate of investment, and consequently none in levels of formal employment. The model rests on two fundamental pillars: a restrictive and procyclical monetary policy and an overvaluation of the exchange rate. The restrictive monetary policy, framed in terms of anti-inflationary objectives, has been a condition for attracting private foreign capital flows and avoiding capital flight. The influx of capital, in turn, causes the persistent overvaluation of the currency, which has an unfavorable impact on economic growth and job creation.

Economic growth based on external savings, like that promoted by the Washington Consensus, turned out to be unsustainable. The influx of foreign capital, within the framework of restrictive monetary policies, can have a temporary positive effect on growth, but it does not create the conditions for the significant, lasting expansion that is the basis of any authentic development policy. Indeed, foreign capital flow generally recovers after a period of cyclical crisis in which there is a high degree of idle productive capacity. The influx of capital produces a reactivating effect on aggregate demand, above all that of private consumption (spurred on by the tendency to concentration of income). Real GDP grows, but it does so below potential output, as defined by installed productive capacity. Thus, the effect of this growth on the rate of investment is marginal. At the same time, as has been noted, there are increased imports of luxury consumer goods as well as intermediate and capital goods. Then deficit in the current account tends to grow and it is financed by the surplus in the capital account.

But it is just at this point that the "virtuous" effects of economic growth based on external savings come to a halt. As Ffrench-Davis notes (2005:70), "as the recovery is completed, reaching the productive limit, any additional aggregate demand will require new productive capacity in order to be satisfied, and therefore new investment in order to generate it." In other words, in this phase of the cycle, maintaining growth would mean a substantial increase in the rate of investment. But this does not happen. The influx of foreign capital provokes a displacement of internal savings toward spending, private consumption, and financial savings, more than an increase in the rate of investment. At the same time, it causes currency appreciation, encourages speculation in stocks, and increases the external indebtedness of economic agents, thereby creating the conditions for a financial crisis.

The Mexican crisis of 1994-95, like the subsequent crises in Asia, Russia, Brazil, and Argentina, demonstrated that when globalized financial operators consider that the disequilibria--provoked in large part by their own capital manipulations--are no longer sustainable, speculative attacks begin on currencies and provoke capital flight. As I have argued in another work (Guillén, 2007, ch. 8), the disequilibrating effect of external capital flows on key economic variables is as much a feature of the period preceding the financial crisis as it is of the outbreak. In this period before the crisis, the intense influx of speculative capital generates overvaluation of the currency, increases external debt, produces excessive indebtedness, and so forth. In other words, the influx of capital affects the "fundamentals" of the economy, but in a negative sense. Once the crisis erupts, contradictory effects unfold. Capital flight to other markets precipitates the abrupt devaluation of the currency, the collapse of stock and real estate prices, the contraction of credit, and other deflationary effects that are part of all important financial crises.

The Mexican economy lacks an internal engine. Under the neoliberal export model, the dynamism of the economy depends almost entirely on external demand. More than 80 percent of export sales go to the U.S. market. The export sector is not diversified; it is limited to just a few branches and companies. Half of exports are produced by *maquilas*. There are no connections--or at least very few--between the export sector and the rest of the productive system. It is a model of accumulation highly dependent on imports, which deprives it of dynamic capacity, and is set up at a limit of its own reproduction. The import coefficient has accelerated rapidly under the neoliberal model, principally after the introduction of the North American Free Trade Agreement (NAFTA).

The Mexican export sector increasingly depends on importation of inputs, which means it must increasingly finance its reproduction through other sources of currency, such as petroleum exports or the remittances sent home by migrant laborers. Imports associated with non-petroleum exports went from 57.4% of total imports in 1995 to 63.7% in 2004. It is therefore clear that the dynamism of the Mexican economy is closely dependent on the U.S. cycle, not only in the area of manufactured exports, but also regarding remittances and income from petroleum. The export sector operates in an enclave, much like the agriculture/mining sector during the primary export model (1850-1930).

In sum, the neoliberal model did not allow Mexico to emerge from the crisis of the previous ISI model. The open-economy export model did not mean a new path to social and economic development, but rather, in many ways, a historical regression, and a detour from the road to development. The proponents of the Washington Consensus maintained that neoliberal reform would allow for the recovery of growth and that in time this would "trickle down" to the population at large. The results obtained demonstrate the futility of waiting for development simply on the basis of faith in the market, in an open economy, and in the privatization of public goods. Rather, the outcome has been what Furtado called "bad development": chronic stagnation as well as the deepening of structural heterogeneity, with growing poverty and informal economy in its wake.

### *3. Outline of an alternative national development project*

For a long time now, Mexico's economic strategy has cried out for change, not just cosmetic but fundamental change. What is required is a new model not just an adjustment to the current neoliberal model, which has demonstrated its incapacity to assure the economic development of the country and solve its acute social problems. The tired neoliberal refrain that it is necessary to finish the first generation of structural reforms and implement a second one is nothing but a deceptive strategy to keep our country shackled to a worn-out model of market fundamentalism.

At the center of an alternative national project must be the idea of *development*, which was abandoned during the three "lost decades" of neoliberalism and self-interested illusions about the virtues of the free market. Development is a multidimensional process that takes place on the level of the economy, society, politics, and culture. For that reason, it cannot be achieved through the exclusive, spontaneous action of the market; it is, rather, the result of a national, social and political project that allows for the structural transformation of the productive system, the qualitative improvement of society, and the preservation of the cultural identity of the nation. And also for that reason, the economic role of the state must be reevaluated.

The economic model must change its orientation from the logic of the *means*--that is, the accumulation of capital--to the logic of the *ends* (Furtado, 1998). And the transition from a development strategy based on the logic of capital accumulation to one rooted in the satisfaction of social needs is anything but easy. For a long time perhaps there will be two contradictory logics: the logic of capitalist accumulation and profit face to face with the logic of national development and social needs. The success of an alternative national project of development will thus demand the construction of an advanced democracy, of a political system in which the people organize themselves and participate actively in decisions, where democracy is not just reduced to an electoral procedure dominated by the owners of capital.

The Mexican economy lacks an internal engine. As I said before, the official vision, that the recovery will take place only if the so-called structural reforms (electrical reform, energy reform, fiscal reform, and labor reform) are realized, is wrong. These reforms would not translate into a significant expansion of the productive apparatus, although they would involve an irreparable loss of the little that remains of the national wealth, as well as an even more precarious labor market. The unilateral export strategy pursued under the neoliberal model will not pull Mexico out of underdevelopment. It does not bring dynamism to the economy as a whole, it dismantles the system of production and makes it more vulnerable, and it reproduces the concentration of income and social exclusion.

For large, structurally heterogeneous countries like Mexico, Brazil, and Argentina, there is no alternative but to restore the internal market as the economic engine at the center of development strategy. This does not mean turning back and recreating the conditions that made the model of import substitution possible--an impossible task in any case. Rather, it means applying a dual strategy that combines the promotion of exports and the search for external markets with import substitution and the development of the internal market. Ultimately, its objective would be to create an endogenous base of capital accumulation, able to stimulate the creation, assimilation, and diffusion of technological advances. The encouragement of exports would be an objective subordinated to a development policy dependent upon internal market.

Without minimizing the importance of an efficient export sector, the strategy of structural change must prioritize the reestablishment of internal production chains and the redeployment of processes of import substitution, as well as the reorganization of rural economies, which includes the design and implementation of programs of food self-sufficiency. Such a strategy is only feasible with the implementation of active, planned industrial and agricultural policies. This must include revisiting the trade opening and NAFTA. A review of NAFTA chapter 11 is of particular importance, for this provision blocks the imposition of regulatory norms on transnational companies, making the design or implementation of industrial policy impossible. Likewise, it is necessary to renegotiate the agricultural provisions with the purpose of advancing the strategic objectives of food self-sufficiency and the reorganization of the rural economy.

In the short run, a new strategy based on durable economic growth will not resolve the structural trend toward external disequilibrium, as this trend is a manifestation of the dismantling and extroversion of the productive system. However, the current account deficit will be decreasing and manageable if imports are substituted, if currency overvaluation is eliminated, if development is financed with internal savings, and if external and internal debt service is reduced. In other words, one of the central objectives of an alternative national project must be the creation of an endogenous base of capital accumulation and a more integrated system of production. In the absence of this objective there can be no economic development. There is no other formula for overcoming poverty and structural heterogeneity.

4. *Break the "critical knots" of neoliberal policy to overcome economic stagnation*

The recent experience of Latin America reveals that it is not enough for the left to win control of the government and apply measures of economic and social policy favorable to the most vulnerable parts of the population. Rather, it is necessary to dismantle the framework constructed over three decades by the powers benefiting from neoliberal globalization. It will be difficult to overcome the stagnation in Mexico and other Latin American countries without changing the "critical knots" of neoliberal economic policy: restrictive monetary, exchange, and fiscal policies, as well as structural trends toward concentration of income and wealth. It is necessary to replace these with active policies that are compatible with economic growth and job creation. I will now describe some ideas toward this end.

*Monetary policy*

Throughout the entire neoliberal period, a restrictive, procyclical monetary policy has prevailed. That is, in a world of globalized finance, interest rates rise during recessive phases of the cycle, with the intent of avoiding capital flight from countries on the periphery and attracting capital from the center. In "boom" phases, although nominal interest rates fall, the real rates stay high--higher than those in countries of the center--while currencies appreciate because of the influx of capital. Clearly, a situation like this is injurious to capital in the productive sphere and comes into conflict with any attempt to strengthen the internal market.

Framed in terms of anti-inflationary objects, this restrictive monetary policy has been a condition for attracting private foreign capital. In the current context of trade and financial opening, monetary policy is an instrument that favors the interests of international finance capital and the concentration of income into the hands of a few national and international “investors”. The influx of foreign capital has provoked a persistent currency overvaluation, in spite of a system of "free" flotation of currencies. High real interest rates and overvalued exchange rates are the price demanded by foreign capital for investment in the country, which in any case has an unfavorable impact on economic growth and job creation.

This restrictive monetary policy must be fundamentally changed; it must be replaced with a countercyclical policy oriented toward employment and economic growth. As the recent experience of Latin America demonstrates, restrictive, procyclical policies are unsustainable because the persistent overvaluations, combined with high levels of external debt, lead to a crisis in the external sector with negative repercussions in the real economy.

It is of particular importance to recover monetary sovereignty. As a result of the crisis of 1994-95, the Mexican financial system has been handed over to foreign capital, which controls more than 80 percent of the resources of commercial banks.

A perhaps greater danger is the "independence" of the central bank. This counter-reform, which supposedly granted technical autonomy to the central bank in order to free it from any "inappropriate use on the part of political interests" and also to avoid "populism," insures the continuity of neoliberal reforms. When central banks were no longer part of the Executive Branch, they also ceased to be part of the nation-state; they were converted into arms of the Washington Consensus (which is none other than the power of the center), exercised by means of the multilateral organizations, and the U.S. Treasury Department and Federal Reserve. It is essential to recover state control of the Bank of Mexico and abolish its autonomy through a Constitutional reform with the dual objective of preserving price and currency stability, as well as contributing to employment and economic growth, as is the case with a good number of central banks in the world.

*The end of "foreign exchange populism"*

The definition of the foreign exchange system is fundamental to the outline of a national development project. What is needed is a realistic exchange policy that contributes to the objective of durable high growth with dynamic job creation--that is, a competitive exchange rate that stimulates exports, slows down imports and makes their substitution feasible. As I mentioned, monetary policy must as far as possible stop playing the role of the sole mechanism of exchange rate and price stabilization, a policy that has translated into a pronounced overvaluation of the Mexican peso.

To allow continued overvaluation of the peso under cover of the thesis that nothing can be done about the laws of the market is to pave the way for a future financial crisis that would spell the end of any ideas about stable, sustained growth. It could be argued that the present accumulation of high reserves (which have reached US$125 billion to date) is a defense against any possible of financial crisis. There is something to this. But that does not mean that such reserves are an unbreachable defense in a situation of global crisis and uncertainty like the present, or that such reserves do not have a high cost for the national economy. Moreover, high reserves are the result of monetary restriction and the unrestricted opening of the capital account, which generates tendencies to economic stagnation via overvaluation of the exchange rate, interest rates that inhibit investment, and displacement of internal savings.

The neoliberal technocrats who are so averse to populism should admit that their own exchange rate policy is populist, given that there is no commodity more subsidized than the dollar. It is time already to bury the "exchange rate populism" that was inaugurated with the Salinas de Gortari Pact and that survives to this day, the result of the "fanatical" and self-interested observance of restrictive fiscal and monetary policies.

The establishment of a realistic and competitive exchange rate would stimulate export growth, make import substitution profitable, and strengthen the development of the internal market. At the same time, it would discourage imports as well as spending by Mexicans in foreign countries, which would avoid an unmanageable increase in the current account deficit. In the medium and long term, the correction of the disequilibrium would depend on the implementation of an agricultural and industrial policy that allowed the construction of a more coherent and articulated system of production. With the implementation of a realistic and competitive exchange rate policy, the logic of the economic model would move from a focus on the interests of investment and speculative capital to those of productive capital.

*Fiscal policy*

In another work (Guillén, 2010), I have insisted that the return to a path of durable high growth can only come from public expenditure and the boost this generates in aggregate demand. The realization of this policy requires abandoning the neoliberal myth of fiscal equilibrium--and its twin brother, the primary surplus--which sinks the Mexican state into inaction and the deterioration of its assets, which then serves as a pretext to justify the privatization and transfer of those assets to the transnationals. It is necessary to replace the concept of equilibrium with that of the "self-financing budget deficit." If this is invested in productive projects, it will generate returns in the form of greater tax revenues. It is not a matter of implementing irresponsible fiscal policies based on debt, but rather of igniting employment and growth by reorienting public expenditure from the financial to the productive. The financing of development would lie in internal savings, without contracting new external debt, and through the review of external and internal debt service programs.

A country with such high levels of income concentration urgently needs a redistributive fiscal reform based on the elimination of fiscal privileges for large companies, on taxes on wealth, and on progressive direct taxes on income, including the taxation of financial transactions as well as the establishment of taxes on the entry and exit of speculative portfolio flows.

## *5. Conclusions*

Through its very logic, the external financial opening scheme promoted by the Washington Consensus generates tendencies to economic stagnation and overvaluation of currencies, which have been made patent in the case of Mexico during the past three decades. In order to overcome this economic stagnation, it is necessary to promote an alternative national project of development supported by internal savings, and the implementation of active, countercyclical monetary, fiscal, and exchange rate policies that promote job creation and economic growth.

The establishment of a new model of development in Mexico is not a technical problem; it is fundamentally a political one. To reverse neoliberal economic policy means dismantling the political and economic power of a minuscule oligarchy in close alliance with international monopoly-finance capital, which lacks any conception of a national project and is content with reproducing its own financial income and wealth.

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