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**Working Paper**

## Foreign deficit and economic policy: The case of Mexico

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## Working Paper No. 1053

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### **Foreign Deficit and Economic Policy: The Case of Mexico**

by

**Arturo Huerta G.**

Universidad Nacional Autónoma de México

**June 2024**

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## **ABSTRACT**

The article analyzes Mexico under globalization, particularly on the free mobility of capital. It argues that globalization has detrimentally impacted the productive and external sectors, causing the economy to become excessively reliant on volatile capital inflows from abroad. The Mexican government—instead of undoing the structural problems that lead to external deficits—implements policies that resolve the short-term liquidity needs and go against economic growth, as if they are promoting capital inflows. The national currency has appreciated greatly and acts only in favor of the financial sector and in detriment of the productive and the external sector.

The Mexican economy has fallen into a context of high external vulnerability since it rests on capital inflows. Capital inflows are highly fragile and volatile. They depend not only on internal problems, but also on the world economy and expectations. For this reason, the reliance on capital inflows to appreciate the peso is unsustainable.

Given the meager growth of the world economy and trade, globalization is being questioned and various countries are implementing industrial and protectionist policies. If Mexico continues to bet on outward growth through nearshoring, it will have no chance of overcoming the problems it faces.

Mexico cannot continue with an economic policy that does not generate endogenous conditions to growth and that has made the economy dependent on the behavior of international financial markets which generate recurrent crises.

**KEYWORDS:** Capital Inflow, Capital Mobility, Exchange Rate, Foreign Investment, Free Trade, Interest Rates, International Capital Movement, Monetary Policy, Stabilization, Trade Liberalization

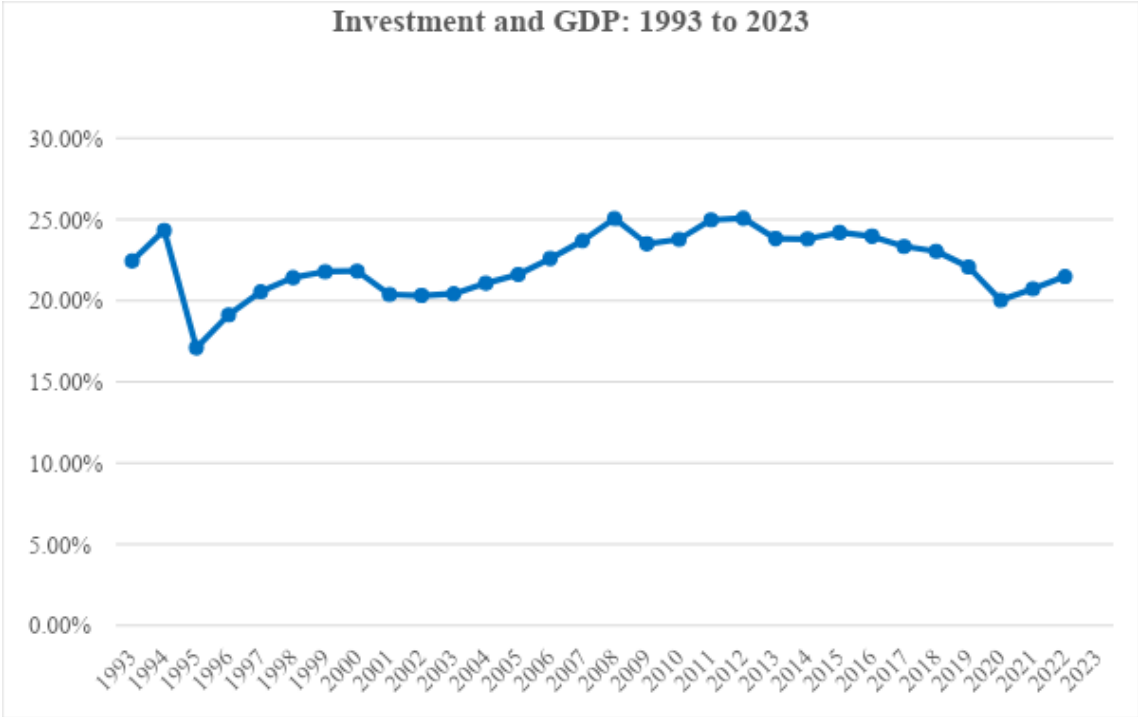
**JEL CODES:** E43, E52, F13, F21, O24

# THE PREDOMINANT POLICIES IN GLOBALIZATION

The free movement of goods and capital, as well as the accompanying macroeconomic stability policies (e.g., high interest rates, fiscal austerity, and stable exchange rates) have acted against the productive development of countries that lack the levels of productivity and competitiveness to emerge victorious from this process. In contrast, employment levels and economic activity have increased in countries whose superior productive conditions and economic policies have enabled them to cope successfully with the free movement of goods and capital.

In Mexico, the competition generated by opening trade has not driven a modernization of the nation’s productive apparatus. Instead, investment in modernization has been de-incentivized by the predominance (within Mexico) of high interest rates, rising exchange rates, reduction, or the elimination of tariffs on imported goods, and fiscal austerity (reduced public spending and the elimination of subsidies).

**Figure 1. Relationship Between Investment and GDP: 1993 to 2023**



Source: INEGI

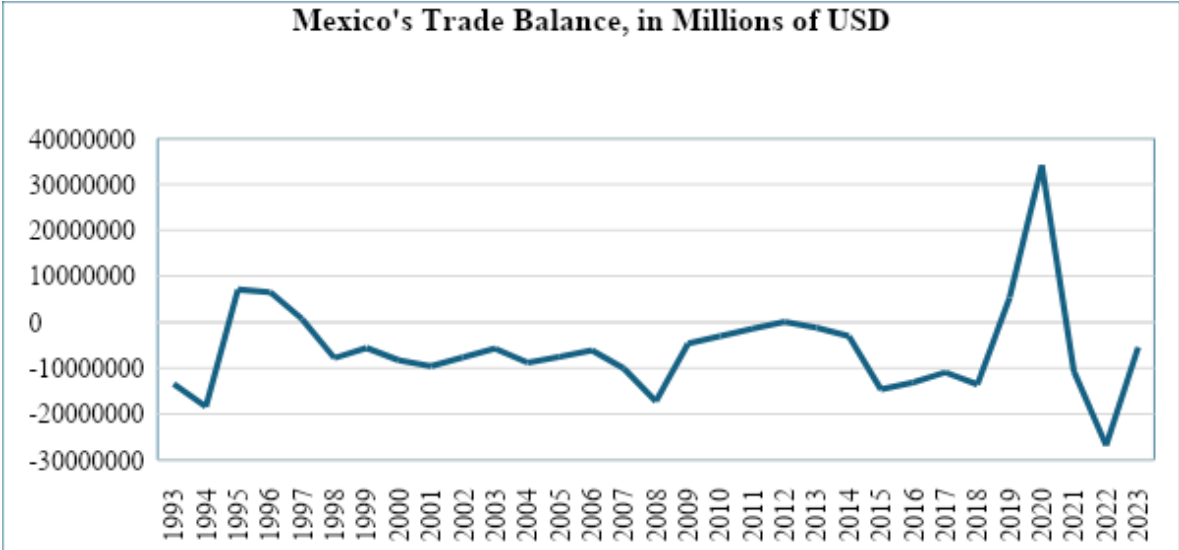
In Figure 1, we can see that investment as a percentage of Mexico's GDP began to decrease in 1994, when Mexico entered the North American Free Trade Agreement (NAFTA). As a result, the country's productive apparatus was not modernized to face competition from imports. Although investment subsequently recovered to the 1994 level (25 percentage of GDP) by 2008, it fell during the crisis of 2009. It rose again to 25 percent by 2012–13, after which the downward trend resumed. This low level of investment has resulted in lagging production, broken domestic productive processes, and increased imports (to satisfy domestic demand). Specifically, imports of manufactured goods rose from 37.8 percent of GDP in 1993 to 149.2 percent in 2023, leading to deindustrialization. During the same period, domestic manufacturing in Mexico fell from 21 percent of GDP to 18.6 percent. This decrease was accompanied by the loss of self-sufficiency in staple grains, thereby putting pressure on the foreign trade deficit and impeding domestic economic growth.

## **DISPLACEMENT OF COMMERCIAL PRODUCTION WAS NOT CAUSED BY UNFAIR TRADE PRACTICES**

On March 22, 2024, while participating in the 106<sup>th</sup> Asamblea de la Confederación de Cámaras Industriales (Concamin), Mexico's Secretary of Economy stated that "unfair trade practices have caused a displacement of some national products and have affected small and medium businesses along with consumers, who have not necessarily obtained real benefits in terms of quality and prices." The Secretary added that "the big winners in these processes have been distributors and retailers." However, contrary to the Secretary's assertions, the displacement of national production has not been caused by unfair trade practices. Instead, this displacement has endured ever since Mexico institutionalized free trade. (Note that Mexico entered in 1986 to the General Agreement on Tariffs and Trade—which is now the World Trade Organization.) This action allowed the free entry of imports with very low or no tariffs, while the exchange rate was appreciated, lowering the value of the dollar and thus making imports even more attractive to consumers. All of this occurred in a context in which national production lacked the levels of productivity to confront the competition generated by free trade. As a result, domestic production was displaced by imports, the nation's production chains have been broken, and economic

growth has been hampered. Mexico’s annual economic growth rate averaged only 2 percent between 1993 and 2023, and just 0.8 percent between 2018 and 2023 (Data from the Sistema de Cuentas Nacionales, INEGI).

**Figure 2. Mexico's Trade Balance, in Millions of USD**



Source: *Banco de México*

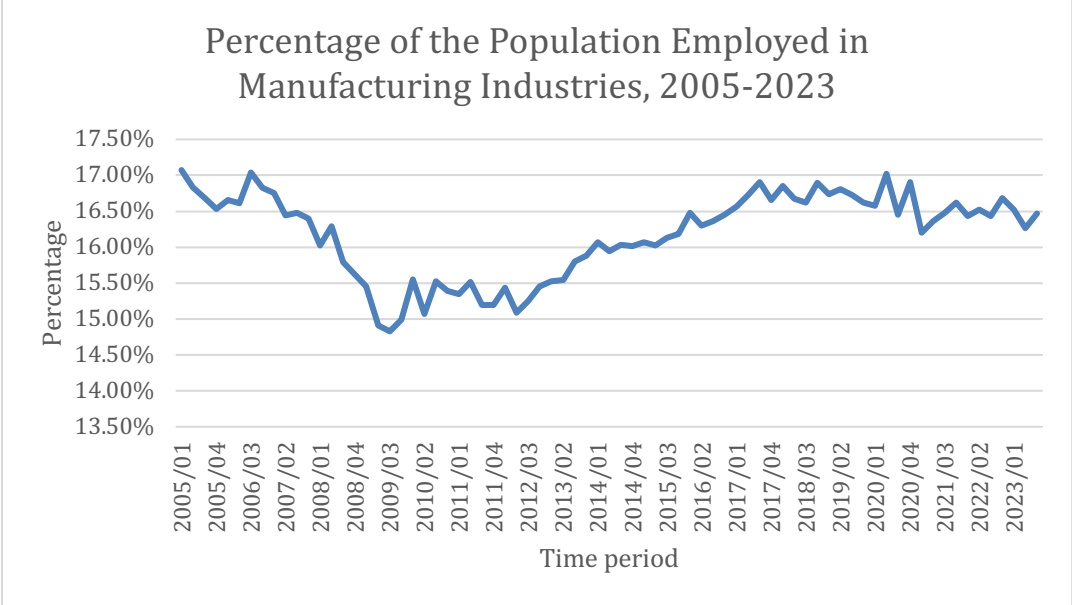
This version of “unfair trade” was institutionalized in Mexico by neoliberal governments and has been maintained by the present administration. Consequently, we continue to suffer from the displacement of small and medium businesses, and the increase of unemployment, underemployment, and informal employment. At the same time, the country’s pay structure has been pauperized: to cope with unfair competition from imported goods, businesses keep salaries low and fail to provide decent employment benefits—thus accentuating the country’s income inequalities. Finding themselves unable to compete with imports, many national businesses do not make the necessary investments to modernize their facilities and increase their productivity. Instead, they buy cheap imported goods, then distribute them at higher prices. To the detriment of consumers, these practices raise the profits of large-scale sellers of imported goods. The problem is that the government does nothing to reverse or even slow this process, but instead merely denounces it.

Government inaction continues even though recent data show that the economy is still decelerating, and the country’s persistent inflation has not fallen to the government’s goal of 3 percent. No policies have been presented to review trade openness or address appreciation of the peso as a means of boosting domestic production to increase supply, and thereby to reduce both inflation and the trade deficit. Nor has the government formulated policies to rein in speculation by certain businesses that profit from importation and product scarcity to the detriment of the public’s purchasing power and standard of living. Instead of merely denouncing such practices, it is necessary to cope with the problems associated with low domestic production, which have resulted from the great increase in imports, and have incentivized big business to increase their profit margins by increasing prices, thus preventing inflation from falling to the 3 percent goal.

**THE MANUFACTURING SECTOR NO LONGER ABSORBS THE AVAILABLE LABOR SUPPLY, AS IT DID DURING THE PERIOD OF IMPORT SUBSTITUTION**

Beginning with the opening of trade and Mexico’s entrance to free trade agreements, the breakdown of the country’s production chains has been accompanied by a reduction in the percentage of the population that works in the manufacturing sector (Figure 3).

**Figure 3. Percentage of the Population Employed in Manufacturing Industries, 2005–23**



Source: [https://www.inegi.org.mx/sistemas/olap/consulta/general\\_ver4/MDXQueryDatos\\_colores.asp?#Regreso&c=](https://www.inegi.org.mx/sistemas/olap/consulta/general_ver4/MDXQueryDatos_colores.asp?#Regreso&c=)

Due to the decline in manufacturing, the sector that now absorbs the most labor is commerce and services, which is characterized to a large extent by low-paying informal employment and a lack of job benefits. The tertiary sector employed 63.45 percent of the working population in 2023, up from 58.7 percent in 2005 (data from INEGI).

## **THE TRADE DEFICIT CAUSES THE ECONOMY TO DEPEND UPON THE ENTRANCE OF CAPITAL**

The trade deficit has been a constant issue in the national economy. When it increases, action is taken to prevent the increase from exerting pressure upon the exchange rate. Specifically, authorities promote the entrance of capital to finance the deficit—a very expensive remedy, because the necessary measures include austerity, maintaining the interest-rate differential between the US and Mexico, putting more of the economy under the control of foreigners, and increasing foreign debt. Because these policies favor the financial sector, but de-incentivize investment in production, lags in production continue, along with greater pressures upon prices, the external sector, and public and private finance. These outcomes, in turn, cause the economy to continue to depend upon the entrance of capital.

## **REQUIREMENTS FOR THE ENTRANCE AND FREE FLOW OF CAPITAL**

In order for capital to enter the national economy, it must be allowed to flow freely. Both the entrance and the free flow require a stable exchange rate: any exchange risk causes capital to cease flowing and to leave the economy, thereby causing devaluation of the national currency. Because Mexico has achieved exchange rate stability via the entrance of capital, policies are aimed at favoring its entrance and keeping it in the country. Still, financial capital can exit the economy—and thus destabilize it—whenever it might wish. For that reason, monetary authorities maintain high interest rates that offer profitability to foreign investors, so that they don't bet against the Mexican economy. The price paid by the nation is that there is no policy for growth.



Growth requires low interest rates and increased public spending, which cannot be implemented because of decision-makers' fears that these measures would cause capital flight, as well as inflationary pressures and pressures upon the external sector that would compromise exchange-rate stability and the capital market. Decision makers are even more averse to making economic policies more flexible, given the context of uncertainty faced by the economy.

This perceived need (on the part of decision-makers) for free flow of capital and its entry into the Mexican economy is the thing that stands in the way of having an economic policy that favors growth. As Josef Steindl pointed out, "without having control of the movement of capital, a nation cannot have an autonomous policy dictated by its own interests, nor can the present chaotic relations be mended" (1984).

### **Mexico, Instead of Proceeding to Implement Policies to Adjust the Foreign Trade Deficit, Has Opted to Promote the Entrance of Capital to Finance that Deficit**

Mexico's monetary and tax authorities deal with the external imbalance by promoting the entrance of capital, rather than by facing the underlying problems of policies, productivity, and competitiveness. The inflow of capital merely postpones the foreign sector adjustments that must be implemented to reduce that deficit.

The problem is that the monetary and fiscal policies implemented to attract capital increase the foreign trade deficit. To attract capital, these policies cause appreciation of the national currency. A consequence is that imports increase. In addition, the inflow of capital transfers financial obligations to the foreign sector, thus increasing pressure upon the current account deficit. That pressure is evidenced by the rising cost of servicing the foreign debt: from 9.687 billion dollars in 2020 to 12.301 billion in 2023 (data from SHCP).

In this way, policies that attempt to adjust the foreign sector via entrance of capital not only fail to solve the existing problems, but perpetuate and exacerbate them, while postponing the inevitable adjustment.

As a result, Mexico has fallen into a vicious circle, because these policies maintain pressure upon the external sector, and continue dependence upon the entrance of capital. To succeed in attracting that capital, Mexico finds itself needing to maintain the differential between its interest rate and that of the US. Since the late 1980s, Mexican governments have preferred to establish policies to promote entrance of capital rather than implementing industrial and agriculture policies to incentivize import substitution that reduces the pressures of supply upon external deficit and debt, and consequently the need for foreign capital to enter the national economy. For example, they implement import substitution policies to reduce external deficit and foreign debt, and consequently the need for foreign capital to enter the national economy.

If there is no progress in import substitution and the movement of goods and capital is not regulated, pressures on the external sector and the economy's dependence on capital inflows will continue.

Until there is progress in import substitution and regulating the movement of merchandise and capital, pressures upon the foreign sector will continue, as will the national economy's dependence upon the entrance of capital.

Relying upon the entrance of capital to maintain exchange-rate stability and adjust the foreign sector makes the country very vulnerable to changes in international financial markets and interest rates, both of which affect the movement of capital.

## **APPRECIATION OF THE PESO AS AN ANTI-INFLATIONARY POLICY HAS FAILED**

Currency appreciation, with the consequent decrease in the relative value of the dollar, contributes to reducing inflation. However, the combination of currency appreciation and high interest rates increases the foreign trade deficit by distorting relative prices in favor of imports and the financial sector, to the detriment of domestic production.

When the production sector offers few options for investment because of high interest rates, currency appreciation, and contraction of demand, capital predictably flows to profitable, liquid assets. This process drives financialization of the economy, making it more fragile and vulnerable.

Currency appreciation ends up working against price stability, because the policies that drive currency appreciation contract domestic investment and production, thus perpetuating product scarcity and the pressures upon prices.

Although the combination of a strong peso and a weak dollar can reduce inflation in the short term by making it cheaper to import goods, the resulting displacement of national production exacerbates product scarcity. Product scarcity maintains supply pressures upon prices, and on the external sector in a national context of low economic growth, that ends up putting pressure on the exchange rate.

## **ELEMENTS THAT HAVE MADE EXCHANGE RATE STABILITY POSSIBLE**

As noted earlier, one element that has contributed to appreciation of the peso is Mexico's policy of maintaining the differential between interest rates established by Mexico's central bank (Banxico) and those established by the US Federal Reserve. The purpose of this policy is to attract capital and boost Mexico's international reserves. Other elements include Mexico's access to lines of credit that Banxico has obtained from the International Monetary Fund (IMF), and Special Drawing Rights (in the amount of 12,117 million dollars) received from the IMF in 2021. In addition, Banxico and the IMF can affect so-called "swaps"—exchanges of pesos for dollars—to help stabilize exchange rates. As noted by Canuto and Amar (2024), "the only emerging economy with this type of transaction is México (\$15 billion)."

In 2017, when Banxico obtained an \$88 billion flexible line of credit from the IMF, Mexico has reduced that amount while capital has been entering the country thanks to the differential between interest rates. In 2023, the line of credit had fallen to 35 billion dollars, which was still

sufficient to make the financial sector confident in the continued stability of the exchange rate. In fact, the Secretary of Taxation stated on March 7, 2024, that “[Mexico has] 213 billion dollars in international reserves; its flexible line of credit with the FMI has reached 35 billion dollars; the stabilization funds that the government drained during its first biennium now contain 3 billion dollars; and we also have bonds and insurance against disasters” (*El Economista*).

To those rate-stabilizing elements we can add the large amount of foreign-exchange earnings from remittances (more than \$60 billion annually in recent years). Together with the inflow of other capital, remittances reduce the current account deficit and keep it manageable.

The aforementioned resources make it possible for Mexico to back the conversion of national currency to dollars at a stable exchange rate, thus providing confidence that the national currency be accepted in international currency markets. Because of that confidence, capital will continue to flow to the Mexican economy to take advantage of high interest rates. Capital that enters will tend to remain within the Mexican economy because of the profitability ensured by currency appreciation: every dollar that might leave will cost less than when it entered. For example, the dollar was worth 19.36 pesos at the end of December 2022, but only 16.72 on March 20, 2024—an appreciation of 13.6 percent. If we add to that figure the 11.5 percent that Cetes were paying at the time, we find that the financial capital that entered at the end of December 2022 and exited on March 20, 2024 would have earned a little more than 25 percent. As of the writing of this paper, Mexico still has the resources to handle the exit of capital without affecting the exchange rate.

Mexico uses swaps and credits received in dollars from the IMF as international reserves to maintain the convertibility of the national currency at the prevailing exchange rate, and to cover the payment of foreign debt. Those resources are not used to increase investment and boost the productive capacity for reducing the external trade deficit and thus the need for inflow of capital.

Mexico’s sole use of resources loaned by the IMF is to ensure the continuation of policies for free trade and exchange-rate stability to keep the economy afloat and avoid any downgrading of the country’s credit rating by international agencies. Such resources do not solve the production-

related problems behind the external deficit and external debt. Nor do they address the lack of capacity to generate endogenous conditions for paying off the debt. Instead, the result is to continue indebting us, and to make us depend upon the entry of capital. This condition is unsustainable.

If Mexico has maintained its access to these IMF credits for so many years, it is because Mexico establishes policies that are aimed at (a) generating forced savings (primary surpluses in public financing), and (b) promoting the entrance of capital to meet financial obligations that derive from them. The problem is that these policies contract economic activity, reduce competitiveness, and increase both the foreign trade deficit and the need to attract capital.

Therefore, international reserves end up being costly for Mexico because of the high interest rate that must be established so that financial capital enters and does not leave, and the reserves are invested in US Treasury bonds, which earn less than is offered by the capital that comprises those reserves.

## **ENTRY OF CAPITAL DOES NOT BOOST ECONOMIC DEVELOPMENT**

Capital that enters Mexico is recycled abroad through payment of the foreign trade deficit, as well as through transfers made for remittance of profits. Transfers are also made to pay financial obligations that derive from capital inflow and foreign debt. All these payments increase the current account deficit. Consequently, the economy becomes more dependent upon inflow of capital to cope with the external deficit. As Kregel (2020) observed, “some countries have opted to base the financing of their development on the entry of foreign capital (debt-fueled development), producing enduring external deficits.”

The inflow of capital is recycled abroad through the payment of the foreign trade deficit, as well as through transfers that are made through the remission of profits and the payment of the financial obligations that derive from said inflow and the external debt that increases the current account deficit, which leads the economy to depend more on capital inflows to address the

external deficit. Kregel (2020) notes that “some countries have chosen to finance development based on foreign capital inflows (debt-driven development), producing sustained external deficits.”

Policies aimed at attracting capital to stabilize the exchange rate end up reducing economic activity, accentuating the financial problems of the public and private sectors, and increasing the indebtedness of both sectors. Mitchell (2023) points out that “the emission of public debt is in reality only a hangover from the system of fixed exchange rates.”

The capital that enters Mexico from portfolio investment or issuance of debt is not utilized to increase productive capacity, nor is it used for technological development so that the country might produce substitutes for imports, also increase its exports of goods with high domestic contents. These uses of the capital would enable Mexico to reduce its foreign trade deficit, and to generate a surplus of resources to make payments on its debt. Because the capital is not used in this way, it is impossible to reduce the need for capital inflow. As Kalecki (1976) noted, “a loan does not solve foreign-trade problems, it merely postpones them” (76).

The direct foreign investment that enters Mexico is used to produce for export to international markets. Because those exports have a high imported content, they neither boost economic growth nor reduce the foreign trade deficit.

Although the US is promoting nearshoring, which supposedly attracts large amounts of direct foreign investment to Mexico, the US also implemented (in 2022) an industrial policy aimed at greater import substitution. In addition, the US has protectionist policies that will be strengthened if Donald Trump becomes president in 2025. Therefore, the prospects are becoming less promising for investing in exportation-oriented production. Consequently, the expected investments from nearshoring will not be in great amounts. A further difficulty is that Mexico’s problems with infrastructure, crime, and water supply do not create conditions that encourage large-scale investment. We must also remember that, during the last four decades, Mexico’s economy has grown little despite high levels of direct foreign investment.

## **THE PREDOMINANT ECONOMIC POLICIES CONTRIBUTE TO RISING PRICES, EXTERNAL IMBALANCE, INCREASING DEBT, AND INSOLVENCY**

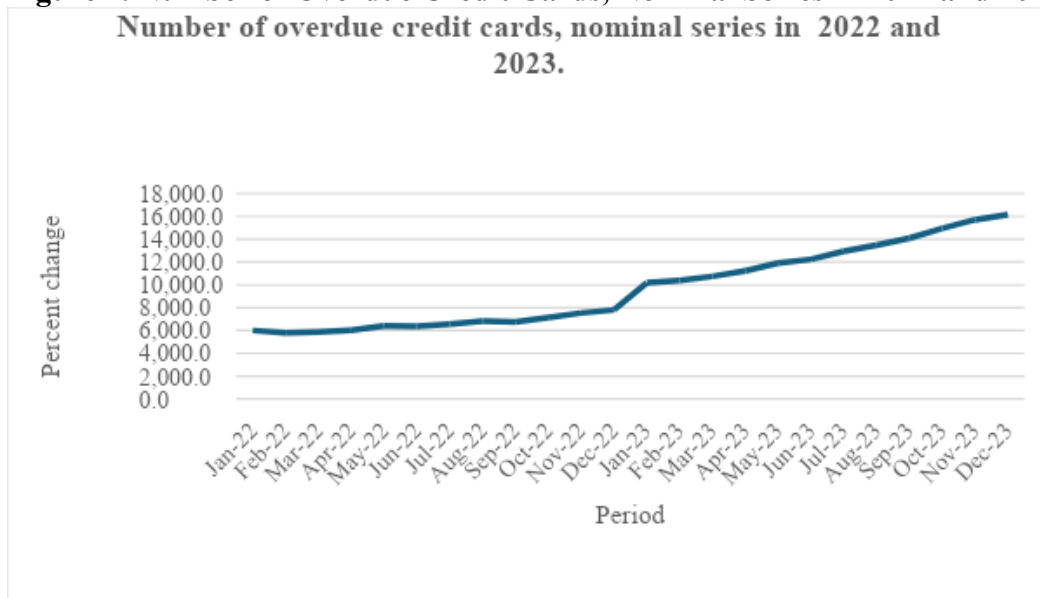
The government's policy of maintaining a budget surplus encourages capital inflow because the capital comes to be invested where the government has ceased to do so. In addition, this policy generates conditions that increase investor confidence by reducing pressures of demand upon prices and ensuring conditions for repaying the public debt.

Such inflow of capital contributes to the appreciation of the exchange rate, which increases the foreign trade deficit, coupled with the fact that budget cuts work against public and private investment, and domestic production, thus causing an increase in imports.

By reducing demand, fiscal-austerity policies lower the incomes of businesses and individuals, who then find financial problems and debt. The combination of fiscal austerity, high interest rates, and currency appreciation makes it more difficult for businesses and individuals to make debt payments, because the cost of debt rises more rapidly than the national income. If this condition persists, it will compromise banking stability.

Figure 4 shows how the number of overdue credit cards has increased because of rising interest rates.

**Figure 4. Number of Overdue Credit Cards, Nominal Series in 2022 and 2023**



Source:

<https://www.banxico.org.mx/SieInternet/consultarDirectorioInternetAction.do?sector=19&accion=consultarCuadro&idCuadro=CF766&locale=es>

Endogenous conditions do not exist for maintaining exchange rate stability, and the continued inflow of capital for maintaining it cannot be guaranteed. Mexico does not have endogenous conditions to stabilize the exchange rate, given the low productivity, the strong productive lags and the external deficit.

The policies established to encourage capital inflow increase the cost of debt and work against both domestic investment and the growth of manufacturing and agricultural production. These policies have shaped a context characterized simultaneously by economic stagnation and pressures upon prices, as well as upon public and private finances, the external sector, and the level of debt. This situation tends to increase the country and devaluation risk, which will reduce capital inflow and put pressure on the exchange rate, as well as on the capital market, as is reflected in the temporality of the strong peso. As Mexico's country risk increases, and the Mexican economy no longer offers attractive investment possibilities, capital inflow will stop coming despite the interest rate differential. The strength of the peso will thus be compromised.

An additional concern is the uncertainty of the national and world economies. Japan, Germany, and England are in near-recession. Uncertainties surrounding presidential elections in the US and



México will tend to reduce inflow of capital and thereby increase pressure upon the exchange rate, capital markets, the financial sector, and the national economy.

Financial investors are aware that the peso is overvalued, and that its present value will not be sustainable for long. They also know that Mexico's international reserves have been built via capital inflow, and that the peso's value will fall as that capital leaves the country. Sooner rather than later (as investors recognize), the exchange rate will need to be adjusted—to reduce pressure upon the external sector as much as to make fiscal and monetary policy more flexible to foster growth. Some investors, seeing that the Mexican economy is becoming increasingly fragile and vulnerable, will withdraw their capital to shelter it in safer markets. Pressure upon the exchange rate will then increase even further.

The thing that strengthens an economy is not the so-called macroeconomic stability; instead, it is the development of its productive capacity and the sovereign control of its economic policy, both of which enable the country to reduce pressure upon its external sector, and secure debt-repayment terms in a context of economic growth. That is not the present situation of Mexico's national economy.

### **As Capital Inflow Becomes Insufficient to Finance the External Debt, Mexico Will Have to Make the Corresponding Adjustments**

The foreign trade deficit tends to impede economic development if capital inflows are not secured to finance it. As we have seen, the inflow of capital postpones adjustment of the foreign debt only temporarily, because the inflows aggravate pressure upon that deficit, thus demanding an adjustment. When the capital inflows are no longer sufficient to cover the external deficit, and when the international reserves fall along with credits from the IMF, the deficit will have to be reduced. The necessary deficit-reduction measures will include adjusting the exchange rate, cutting public spending, and raising the interest rate to reduce consumption, investment, and imports.

Imports will fall as a result, but pressure upon prices will increase and economic activity will decline as internal production lags, and as domestic producers lack the inputs, raw materials, and

equipment to maintain and increase production. The cost of having marginalized national production and become dependent upon importations and inflow of capital will then be apparent.

Because the optimum adjustment of the balance-of-payments current account involves boosting import substitution, the predominant policy will need to be modified. The opening of trade will need to be re-examined, as will the exchange rate, transfers of profits from foreign investments, and payment of the external debt. Unfortunately, these measures do not occur to the country's decision makers.

As long as pressures upon the external sector are not reduced, and the economy continues depending upon capital inflows, it will not be possible to adopt a more flexible economic policy that boosts growth. The need to maintain a high interest rate to obtain capital inflow threatens economic growth. Keynes (1986, 308) points out that the interest rate is determined primarily by the balance of payments.

The predominant policies have increased the coefficients of importation and the foreign trade deficit, thus making the necessary external adjustment more difficult and costly. The problem is that the cost of such adjustments often causes higher unemployment, lower personal and business income, bankruptcy of businesses, and greater problems of insolvency—all of which destabilize the banking sector.

### **The Cost of External Adjustment Falls Upon Debtor Countries, and the Countries with Surpluses Do Not Help Them**

There is no policy for creditor countries and those with surpluses to cooperate by granting preferential credit terms to those with employment and production problems, so that such countries may cope with those problems and implement policies that favor more sustained growth, which would reduce the debtor countries' external deficits and their need for capital inflows. Instead, the individualistic mindset that prevails among the great economic powers makes them unreceptive to cooperation. As a result, the differences continue to increase between debtor nations' and creditor nations' levels of growth and development.

The trade balances of countries that run surpluses must be adjusted to bring them into equilibrium with the balances of debtor nations. Countries that run surpluses must grant favorable terms for purchasing the products of the debtors, so that the latter can reduce their deficits in a condition of growth. In addition, countries that run surpluses must transfer technology so that debtors may reduce deficits through import substitution and increased exportation.

It will be necessary to promote forms of trade that do not require the use of foreign currency. For example, Kregel (2021) advocates a “union of compensation” that “moves away from the central role of dominant national currencies, and toward the creation of global liquidity, which can be mobilized more easily to support the sustainable development of less-developed countries.” Kregel added that there would be a compensation system that retained “national currencies without requiring substitution of the dollar by other currencies, like the yuan, or a basket of national currencies like the Special Drawing Rights: -SDR.” Kregel also noted that “Schumacher (1943, 151–52) proposes a system of ‘joint compensation’ in which importers settle claims in the local currency via transfers from their own national compensation fund, which informs the national compensation of the exporter about the payment and credits the exporter in its national currency”. Furthermore, “it is clear that the office of international compensation neither requires its own financing nor needs to create a new international currency.... In this way, it might be said, every national currency is converted into a world currency, thus the creation of a new world currency becomes unnecessary. Nor does the Office of International Compensation—in this regard—require special powers; it is not an agency of control, rather a purely administrative body, the accounting center of the different Funds for National Compensation.”

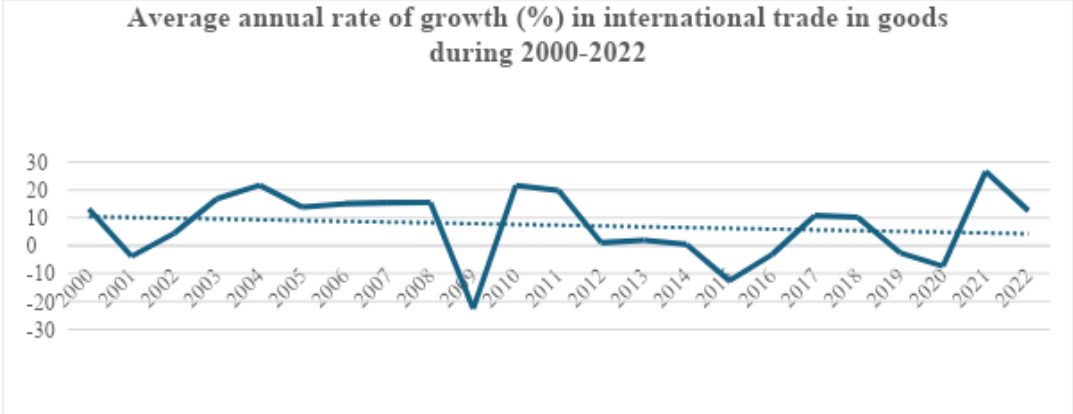
Countries must progress further in transacting foreign trade in their own currency, and cease using the dollar or any other currency that they do not emit. When a country pays for imports with its own currency, the seller is committed to using that currency to acquire products of the purchasing country, or to use it to make financial or real investments therein, or else to exchange it with other countries that desire to do so. In this way, the currency is recycled and boosts economic growth, thus allowing adjustment of the external sector. The selling country could thus avoid having to promote capital inflow or having to incur debt in order to store up currency for

making foreign commercial or financial transactions. As a result, the country would be able to make its economic policy more flexible to favor economic growth.

**Because the World Economy Grows More Slowly Every Year, International Trade Will No Longer Be an Engine of Growth for Many National Economies**

International trade has been slowing ever since the crisis of 2008–9. Specifically, international trade grew at an average annual rate of 12.4 percent during 2000 to 2008, but at only 6.1 percent during 2010 to 2022. In Figure 5, we see that after world trade fell in 2001, when the US was in recession, it recovered during 2002–8, then dropped sharply during the crisis of 2009. It recovered in 2010 but has gradually declined (on the whole) until the crisis of 2020 caused another drop. Trade grew again in 2021 but has since slowed.

**Figure 5. Average Annual Rate of Growth (%) in International Trade in Goods During 2000–22**



Source: Prepared by the author from data obtained from the UNCTAD statistics data center.

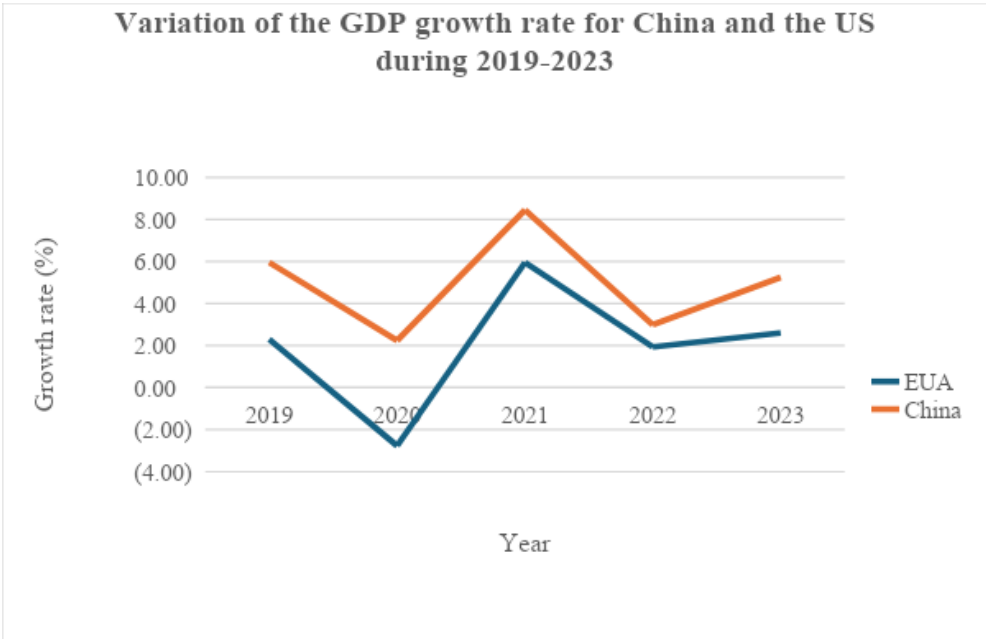
Since 2010, China has responded to the decelerating growth of international trade by targeting its own growth toward its domestic market. This strategy has led to a decline in China’s economic growth, compared to the pre-2008 level. For example, China’s annual growth rate averaged 10.18 percent between 1994 and 2008, versus only 6.8 percent during 2010 to 2022 (according to data from UNCTAD). In 2023, the rate was 5.25 percent.

The deceleration of the world economy and international trade was accentuated during the pandemic crisis in 2020, and again (in 2022) by the Russo-Ukrainian war. The shortages and

disruptions of production chains that resulted from these crises have impelled many countries to develop domestic sources of supply through import substitution.

Figure 6 shows that China has maintained its growth rate above that of the US. The US GDP fell by 2.77 percent in 2020, and although China's growth rate was below 2.24 percent during that year, it has since continued to be higher than the US rate.

**Figure 6. Variation of the GDP growth rate for China and the US during 2019–23**



Source: World Bank

The world economic slowdown sharpened international competition as countries strove to maintain their levels of participation in the world economy, and to avoid losing markets (domestic as well as foreign). Along those lines, Trump has declared that if he is elected president, he will put a 10 percent tariff on imports to protect national production and employment. Some countries will respond with similar measures to defend their own economies, and to avoid becoming the losers in this process. An additional reason is to reduce their foreign trade deficit because they are unable to finance it.

In the commercial–geopolitical conflict between the US and China, Mexico appears to have opted to preserve its alliance with the US (Dussel 2024). This decision deprives Mexico of the freedom of action to exploit advantages that derive from the competition between the two trade giants. By aligning itself with the US in a bilateral agreement, Mexico has fewer possibilities for entering into pacts with China that could be favorable to the development of Mexico’s domestic economy. For example, the USMCA contains rules and regulations for trade and investment (imposed by the US) that benefit the US while impeding Mexico to enter trade agreements with China.

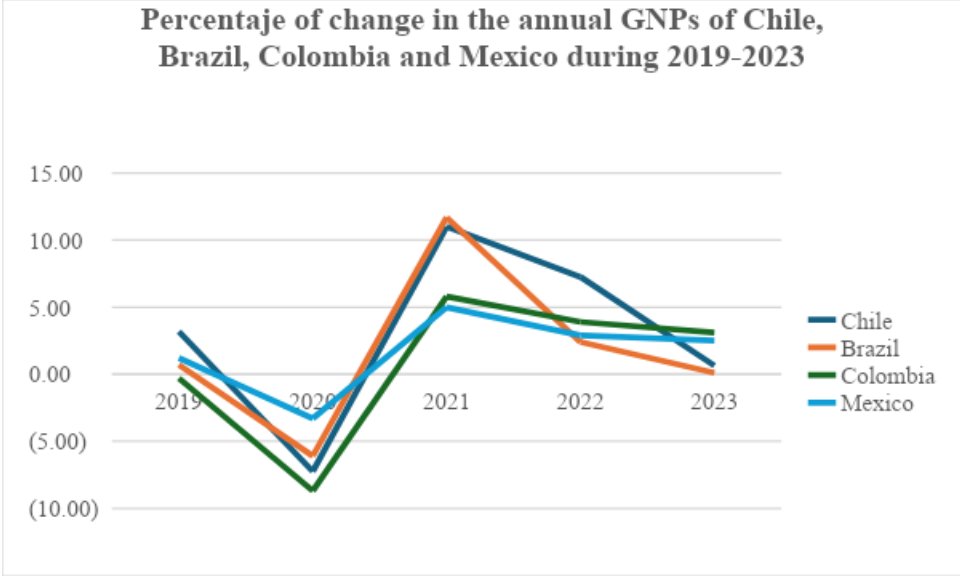
Differences between the levels of productivity and competitiveness for Mexico and the US persist despite Mexico’s favorable trade balance with its northern neighbor. This situation has resulted from triangular trade on the part of transnational exporting businesses, which import their inputs from Asia and Europe, then use those inputs to manufacture goods in Mexico for export to the US. In this way, the transnationals work with low national value added and Mexico has trade deficits with China, Southeast Asia, and Europe.

The US economy is no longer an engine of growth for the world economy, as much because of the difficulties that the US faces in boosting its own growth, as because of the Biden administration’s industrial policy that pushes import substitution while also implementing protectionist measures that reduce intake of imports—which are exports for the rest of the world. The case of Mexico’s exportations to the US is instructive: after growing by 17.8 percent in 2021, then by 18.4 percent in 2022, they grew by only 3.7 percent in 2023 (data from INEGI). At the same time, Mexico’s prospects for economic growth via production for its domestic market are not promising. That route to growth will be difficult because Mexico’s dependence upon capital inflows forces the country to maintain a stable exchange rate through high interest rates and fiscal austerity.

Gill and Kose (2024) tell us that “the World Bank’s most recent World Economic Outlooks indicate that most economies—developed as well as developing—will grow much more slowly in 2024 and 2025 than during the decade before COVID-19, which implies that progress toward many development objectives will be at risk.”

As shown in Figure 7, Mexico’s economic activity in 2020 contracted more than that of Brazil, Chile, and Colombia. All three countries recovered in 2021, after which their growth rates declined because of the anti-inflationary policies that were implemented.

**Figure 7. Percentage of change in the annual GNPs of Chile, Brazil, Colombia and Mexico during 2019–23**



Source: CEPAL

The problems of low growth that many economies are facing (because of their decreasing exports and rising pressures upon their external sectors) have made those countries unable to make payments on their debts. There is a need to revise international trade relations to prevent them from continuing to harm less-developed countries, so that the countries’ inability to make payments does not disrupt financial markets and the world economy.

**CHALLENGING GLOBALIZATION**

To make the domestic production process less dependent upon inputs from foreign sources, and less vulnerable to breakdowns in chains of production and distribution, many countries are implementing subsidies and tariff policies. These measures are also intended to protect against possible blockages of goods and inputs, and to increase domestic employment and production. This is the context in which the US put into effect the CHIPS and Science Act and the Inflation

Reduction Act (Tyson and Zysman 2023), which provide subsidies to stimulate the return (to the US) of investment and internal production that supply substitutes for strategic goods essential to industrial development. The two acts are accompanied by protectionist policies that challenge the free trade the US had promoted for decades before seeing that they were losing out to China and countries in Southeast Asia. In addition to boosting its internal production by such means, the US attempts to secure sources of supply from nearby sources, and to move away from goods made in China.

As self-supply advances worldwide, international trade will decline, and pressures on prices will intensify—such is the cost of promoting more endogenous economic growth.

This phenomenon will affect countries that have been growing their economies outward and will put pressure upon their external sectors.

The problems that many developing countries face with balance of trade and payment of debt limit those countries' economic growth and capacity to continue incurring greater debt. As exportation ceases to be the engine of growth for some countries, they will need to redirect their growth-promoting policies toward the domestic market. For that effort to succeed, these countries will need to lower their interest rates, increase public spending, work with a competitive exchange rate, and have industrial, agricultural, and commercial policies that drive productive investment. These measures will end up overhauling the countries' macroeconomic contexts.

Mexico, despite its low growth rate and productivity, continues with generalized free trade and currency appreciation, both of which reduce the country's already low competitiveness that makes it difficult for Mexico to reverse its rising level of imports. As a result, Mexico is falling behind economies which are reformulating their insertion in international trade, while also implementing policies for import substitution and reducing their vulnerability to changes in the international context.



The US is moving in that direction by implementing industrial policies and subsidizing its businesses (and placing tariffs on goods in violation of trade agreements and WTO principles), but Mexico has neither established industrial and agricultural policies nor placed tariffs to safeguard its national production and reduce its foreign trade deficit.

Given the inability to continue financing the external deficit due to insufficient capital inflow, tariffs will need to be imposed on imports to boost national production and reduce the trade deficit.

### **DEFENDERS OF FREE TRADE CRITICIZE BIDEN’S INDUSTRIAL POLICY.**

Conventional economists criticize Biden’s industrial policy as being a protectionist one that threatens markets, free trade, and the free allocation of resources (Tyson and Zysman 2023). These economists are opposed to the government either reassigning resources toward technological development, driving import substitution, or protecting domestic production. One such economist, Krueger (2023), argues that Biden’s industrial policy “increased the domestic-content threshold for government purchases, and demanded that governmental procurement both maximize the use of US inputs and support national production—and by doing so has restricted the scope of a decades-old agreement among WTO members that obligates them to not discriminate against other members’ products when making governmental purchases.” Krueger defends the WTO because it “brought about a reduction in costs for all of the signatories, saving money for all contributors;” thus Biden’s policy “is raising the cost of government procurement (including materials for investments) and making it more probable that other countries take reprisals, which will result in reduced purchases from the US.” What Krueger does not consider is that Biden’s protectionist measures will enable investment to generate a larger multiplier effect upon production and employment, while also reducing imports and the foreign trade deficit. That effect will translate into greater economic growth. Krueger also does not consider how free trade has driven the deindustrialization of the US (i.e., manufacturing’s share of US GDP, which was 20 percent in the 1980s, fell to 10.3 percent by 2023). At the same time, US economic growth is now lower than it was when industry was the engine of growth. Krueger opts for the low cost at

which imports can be purchased thanks to free trade but does not consider that this has led to deindustrialization, loss of well-paid jobs, lower economic growth, and higher levels of debt for companies and families.

## **MEXICO CANNOT CONTINUE TO FOLLOW ITS PREDOMINANT ECONOMIC POLICY**

The wide range of Mexico's socioeconomic difficulties is evidence that it cannot continue to follow the neoliberal policy that has dominated in the country since 1982, and which favors the banking/financial sector and big businesses—domestic as well as foreign. Those difficulties include the slowdown of economic activity, unemployment and subemployment, the rising dependency upon capital inflow, and a vulnerability to interruption of the same. At the same time, the country's inequality of income and wealth is increasing and crime is widespread.

It is necessary to revise the totality of the economic policy that has acted in favor of the financial sector and against domestic production and well-paying jobs. The government must retake control of its economic policy to drive a dynamic that is enduring, sustainable, equitable, and sovereign. To succeed in this effort, the government must modify the objectives of the central bank to include economic growth and high formal employment. Therefore, the bank must establish low interest rates to boost domestic investment and production.

The government must also regulate the external sector—specifically, the movement of goods and capital. Regulating the movement of goods will help to avoid acceleration of importation (which is detrimental to domestic production and employment), to stimulate domestic investment as well as production. For its part, regulation of capital movement is indispensable to avoiding capital flight, which would disrupt currency and capital markets. Capital inflow must also be regulated to avoid exchange-rate appreciation, which increases the foreign trade deficit while also being detrimental to domestic employment and production. Regulation of the external sector must be accompanied by regulation of the banking system, so that banks will extend credit to the productive sector at low cost.

## **THE SO-CALLED STRONG PESO IS UNSUSTAINABLE**

Mexico has ceased to have economic policies that favor growth. Instead, the government maintains exchange rate appreciation to create conditions of confidence and profitability for the financial sector, so that capital inflow will continue.

Exchange rate appreciation is detrimental to employment, salary levels, domestic production, economic growth, and the foreign trade deficit when (as in the case of Mexico) it is maintained in a context of low domestic productivity, wide-open trade, and an inflation rate that is higher than those of our principal trading partners.

The national economy lacks conditions to continue ensuring the levels of profitability it has been offering to foreign investors. The investor confidence that attracts capital inflow to Mexico depends upon that self-same inflow. Mexico's economy has remained entrapped by the so-called Ponzi effect, in which new debt is incurred to pay off existing debt. That practice always ends in a crisis.

The permanent inflow of capital is not guaranteed. Neither are the levels of performance and payout that Mexico offers to attract capital inflow, given the nation's combination of low economic growth and pressures upon public finances and the external sector. This situation raises the country's risk, which, in turn, will slow down capital inflows and encourage capital flight. The drying-up of capital will cause the crisis to manifest itself, thus showing the unsustainability of the strong peso.

Appreciation of the exchange rate must cease, given the harms that it has caused. The high interest rate, by stimulating capital inflow and increasing the value of the peso, has brought about a distortion of relative prices to the detriment of the productive sector, and to the benefit of the financial sector. This drives the financialization of the economy while slowing productive investment and maintaining a scarcity of domestically produced goods. That shortage continues to put pressure on prices and the foreign trade deficit, which causes the national economy to depend more heavily upon the inflow of capital. Reichlin (2024) points out that "if monetary

conditions remain strict during a prolonged period, investors may become reluctant to make long-term investments.”

Neoliberal policies—which favor only international and large national business and slow economic growth while also affecting the wellbeing of most of the population and accentuating the inequality of incomes and wealth—cannot be continued.

### **NEED TO HAVE A FLEXIBLE EXCHANGE RATE TO HAVE MONETARY AND FISCAL POLICY THAT FAVOR EMPLOYMENT AND THE ENVIRONMENT**

When working with a flexible exchange rate that responds to the movement of capital and in prices (i.e., between the internal inflation rate and that of the main trading partners), it is not necessary to establish fiscal austerity and high interest rates, as has been happening to promote capital inflow and stabilize the exchange rate.

A flexible exchange rate and the elimination of currency convertibility at a fixed exchange rate make it possible to lower the interest rate and increase public spending in favor of production and employment.

At the same time, the higher levels of public spending must be aimed at boosting technological development and productive capacity to increase production, productivity, and import substitution. This is necessary to prevent the flexible economic policy from either creating pressures upon prices and the external sector and increasing the need for capital inflow. In that way, monetary authorities will not need to re-establish high interest rates to attract capital to finance the increased external deficit.

An economy’s productive capacity and real resources are the things that determine the limits of the flexibility of its fiscal and monetary policies, because exceeding the existing productive capacity will have repercussions for the inflation rate and foreign trade balance. That is why it is also necessary to work with a flexible exchange rate in order for the fiscal and monetary policies

to succeed in boosting the national productive capacity, so that pressures on prices and imports can be avoided. Overlooking the problems with supply that underlie inflation will keep the country from reaching its goal of 3 percent inflation, and we will continue to experience the simultaneously recessive and inflationary context in which the national economy now finds itself.

However, there is no sign that the economic policy is going to change, given the predominance of neoliberal economists among the nation's decision makers. Therefore, we will continue to lack sufficient maneuvering room to make a determined push for establishing conditions for the productive development and employment that would, in turn, configure conditions for sustained growth and less dependence upon capital inflow.

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