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## The structure of industry protection in Mexico: 1960-1980

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The Structure of Industry Protection in  
Mexico: 1960-1980\*

by

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## 1. Introduction

In the 1950s, Mexico and a number of other Latin American countries opted for a strategy of inward-oriented development aimed at accelerating the pace of industrialization. This strategy relied heavily on a process of import substitution brought about by creating a protected domestic environment biased in favor of the modern manufacturing sectors. By the early 1960s, it was already becoming clear to many observers that import substitution policies were not delivering all they had promised, but rather provided a hindrance to development (Hirschman, 1968). Nevertheless, Mexico continued to pursue a highly protectionist course in subsequent years; see Balassa (1983).

A tendency toward increasingly protectionist policies has also been observed over the last decade in the industrialized countries. While the policymakers in question often proclaim their continued allegiance to free trade maxims, protectionist actions are nonetheless taken and defended as merely transient measures to ease adjustment burdens occasioned by structural changes at home or to counter unfair trading practices abroad. In developing countries, or semi-industrialized economies such as the Mexican, infant industry arguments usually constitute the official basis for trade intervention. It is claimed that satisfactory growth can only be attained through the planned protection of certain strategic industries; for otherwise, the economy would be fated to remain in the secondary role of a raw materials supplier to the already developed economies. The question addressed in this essay is whether the same factors

found useful in explaining industry protection patterns in developed economies also help to explain protection patterns in a developing economy, exemplified by Mexico, in spite of the differences in official rhetoric.

An underlying premise in the rapidly expanding literature on the political economy of protection (Bhagwati, 1982; Frey, 1984) is that the structure of trade barriers in an economy reflects a set of political bargains struck in the market for protection. This literature explicitly recognizes that in most instances of government intervention the costs and benefits attached to particular measures are generally not equally distributed across society. Rather, some members gain at the expense of others, which gives agents an incentive to further their economic interests through political action, seeking to sway politicians into adopting policies to their favor. In turn, politicians are regarded as entrepreneurs that supply protection to the highest bidders. Using this perspective, a widely pursued research objective has been to determine whether or not there exists a systematic pattern in the structure of protection, to identify which economic groups have been most successful in obtaining protection and to distinguish particular aspects of the political environment that may have encouraged that outcome.

Anderson and Baldwin (1981) provide an extensive list of factors and industry characteristics which previous studies have pointed out as potentially significant in determining patterns of industry protection. Their survey of empirical findings obtained for various industrialized countries reveals that in general it is the low-wage, labor-intensive, low value-added, declining

industries, facing strong import competition and employing large numbers of workers, who receive the most effective protection. What this essay seeks to explore next is to what extent the structure of protection in Mexico displays a similar pattern, and also how that structure has evolved, if at all, over time. A central issue is whether the political market paradigm described before can also be usefully applied to Mexico, even though the political system and channels through which protection is generated differ considerably from the pluralist political systems existing in the Western industrialized countries.

## 2. The determinants of industry protection in Mexico

To determine whether Mexican protection policy exhibits a systematic pattern, two measures of sectoral protection are regressed on various industry characteristics using cross-section data for the years 1960, 1970 and 1980. The list of explanatory characteristics consists of those variables which have received the most attention and appear most significant in previous related work that primarily concentrated on the industrialized countries. They are:

- 1) NOW, the number of workers occupied in an industry;
- 2) LSH, the labor income share of value added;
- 3) AW, the average wage paid in an industry (total wage bill divided by NOW);
- 4) VAR, the ratio of value added to total sales;
- 5) IMR, the ratio of imports to total sales;
- 6) EXR, the ratio of exports to total sales;
- 7) RC70, a measure of regional concentration of an industry, calculated for the year 1970.

Except for RC70, figures for these variables have been obtained for 1960, 1970 and 1980.<sup>1</sup>

The primary data on sectoral protection levels has been taken from Bueno (1971) for the year 1960, from Kate and Wallace (1980) for the year 1970, and from a most recent study sponsored by IMCE (1984), which provides figures on protection for the years 1979-1981. Protectionist policy in Mexico relies mainly on non-tariff barriers, through import quotas and licensing. Tariffs play a minor role, by Latin American standards, and therefore do

not adequately reflect the true levels of protection granted. Two alternative measures of protection, designed to capture both the effects of tariff and non-tariff barriers, are provided in the studies mentioned above. These are the rates of nominal implicit protection and of effective protection. Nominal implicit protection (NP) is defined as the percentage difference between domestic and foreign prices of a product. It reflects, not the amount of protection offered, but the amount domestic suppliers have chosen to exploit. Alternatively, effective protection (EP) is the percentage difference between the value-added generated in an industry using domestic prices and using foreign prices. This measure nets out the disprotection to an industry that results when intermediate inputs have to be purchased above world market prices, and therefore indicates more accurately the true rents captured by an industry.<sup>2</sup> Those figures have been calculated using the most recent input-output tables for the years in question.

The estimation results are shown in Table 1 and 2, using nominal protection rates and effective protection rates as the dependent variable. For each year, two sets of values are recorded: Pertaining to 1960 and 1970, the first column (a) presents the results for which the best fit was obtained in terms of the adjusted coefficient of determination,  $\bar{R}^2$ , using a sequential SPSS search routine. Column (b) reports the results using all exogenous variable. For the year 1980, columns (a) and (b) represent separate regressions using non-overlapping exogenous variables. This procedure was necessary because of data constraints. In some cases data was only available in 35-sector



disaggregated form, while in the other case it appears in 59-sector form. Although that procedure raises potential problems in the interpretation of the results, those do not play a crucial role in these particular experiments. Also, for 1970, an adjustment in the estimation procedure was made to account for a high collinearity between the independent variables, LSH and AW. All estimations were made using a regression constant whose value is not shown.

Before addressing the results, some comments are necessary with respect to the data sample employed. Appropriately disaggregated employment and wage data for the agricultural sectors (including livestock, fisheries and forestry) was not available prior to 1980. This meant that in most regressions for 1960 and 1970, these four industries had to be excluded from the data sample. (For 1980, however, such data was available and included in the regressions.) Furthermore, in the regressions involving effective protection (Table 2) a few additional industries are excluded from the data sample because of some extreme outlier values recorded for the effective protection rates. For 1960, the Meat and Milk products (195.7) and Automobiles (254.7) industries are excluded; the figures in parentheses refer to the recorded effective protection rate. In contrast, the mean and standard deviation of the effective protection rate sample in that year, EP60, are 34.2 and 28.7. For 1970, the mean and standard deviation of EP70 are 50.0 and 62.1, and the industry excluded is Fertilizers + Insecticides (1026.4). Finally, the mean and standard deviation of EP80 are 39.0 and 52.5, and the excluded industries are Synthetic Fibres (824.0) and Automobiles (-868.8).

The main effect of excluding these industries from the relevant regressions was to bring about a fairly significant improvement in fit.

Table 1: The determinants of nominal industry protection in Mexico. Endogenous variable = NP

Exogenous Variables	1960		1970		1980	
	(a)	(b)	(a)	(b)	(a)	(b)
NOW	- (-2.19)*	- (-1.80)*		- (0.17)		- (-0.39)
LSH	+ (1.44)	+ (1.33)	+ (1.60)	+ (1.23)		+ (1.99)*
AW	- (-2.47)*	- (-2.10)*		+ (0.68)		- (-2.14)*
VAR		- (-0.53)		- (-0.19)	- (-0.10)	
IMR		+ (0.78)	+ (1.87)*	+ (1.94)*	+ (2.00)*	
EXR	- (-3.17)*	- (-2.43)*		- (-0.75)	- (-3.92)*	
RC70		+ (0.30)	+ (3.42)*	+ (1.80)*	+ (1.95)*	
R <sup>2</sup>	.37	.39	.46	.50	.50	.12
$\bar{R}^2$	.27	.23	.40	.35	.43	.08
Number of observations	31	31	31	31	35	59

Numbers in parentheses refer to the t-values of the coefficients. The asterisk (\*) indicates significance at the 10% level.

Table 2: The determinants of effective industry protection in Mexico. Endogenous variable = EP

Exogenous Variables	1960		1970		1980	
	(a)	(b)	(a)	(b)	(a)	(b)
NOW	- (-1.40)	- (-1.59)		+ (0.59)		- (-0.10)
LSH		+ (0.82)	+ (3.91)*	+ (3.79)*		+ (0.38)
AW	- (-1.33)	- (-1.55)	+ (2.69)*	+ (2.50)*		+ (0.64)
VAR		+ (0.77)	- (-1.31)	- (-1.34)	+ (0.20)	
IMR		- (0.25)		+ (0.39)	+ (1.08)	
EXR		- (-1.04)	+ (1.60)	+ (1.20)	- (-0.79)	
RC70	+ (1.99)*	+ (0.37)	+ (3.05)*	+ (2.45)*	+ (2.07)*	
R <sup>2</sup>	.22	.28	.65	.66	.23	.02
$\bar{R}^2$	.14	.04	.58	.55	.12	-.04
Number of observations	29	29	30	30	33	57

Numbers in parentheses refer to the t-values of the coefficients. An asterisk (\*) indicates significance at the 10% level.

### 3. Discussion of the empirical results

The sign values obtained in the regressions pertaining to nominal protection (Table 1) largely conform with the results reported in Anderson and Baldwin (1981) for the industrialized countries. The labor share of income (LSH) consistently attains a positive sign, while the average wage level (AW) usually appears with a negative sign. Their ratio (AW/LSH) represents the labor productivity of an industry. Assuming that labor productivity is positively related to an industry's capital-labor ratio, it would follow that the more labor-intensive industries receive higher protection.<sup>3</sup> Furthermore, the import-ratio (IMR) attains a positive sign in the regressions, while the export-ratio (EXR) and the ratio of value-added to gross sales (VAR) always attain negative signs. The only departure from the pattern observed in the industrialized countries is given by (NOW), the number of workers employed, which attains a negative sign, although with varying significance.

A more diffuse picture emerges from the regressions in Table 2, involving effective protection. Nonetheless, the sign patterns are approximately the same as those obtained in the corresponding regressions using nominal protection. In the few instances where conflicting signs appear, the coefficients are statistically insignificant.

Overall, these results contradict the notion that developing countries behave much differently than the industrialized countries in terms of who is granted protection. One received notion, in particular, appears to be that whereas industrialized coun-

tries generally protect labor-intensive declining industries, developing countries tend to protect more capital-intensive modern manufactures, so that both are responsible for upsetting traditional comparative advantage relationships. Admittedly, a considerable amount of casual evidence seems to support this idea, in addition to having a certain, intellectually appealing symmetry to it. However, the data for Mexico, at least, does not seem to support this view as a general rule.

Perhaps the more striking observation concerns the explanatory value of the regressions. It may be interesting to note that the  $R^2$  values reported in Table 1 remain fairly constant across different periods, in contrast to the values in Table 2. Furthermore, in 1960 and 1980, a considerably better fit is obtained using nominal protection rates than when effective rates are used as dependent variables. With nominal rates, the best  $\bar{R}^2$  obtained is 0.27 and 0.43, whereas the corresponding values with effective rates are only 0.14 and 0.12. In 1970, that result is reversed, however. Although a fairly respectable fit is found using nominal rates ( $\bar{R}^2 = 0.40$ ), effective rates yielded even better results ( $\bar{R}^2 = 0.58$ ).<sup>4</sup>

These last results for 1960 and 1980 are surprising from the theoretical viewpoint that relative protection levels are determined by demand and supply in a political market dominated by rational agents. One would conjecture these agents to be mainly concerned with the net benefits of protection (i.e., effective rates), and not with the gross rates reflected in nominal rates. A different interpretation of Mexican protectionist policy would find those results less surprising. This is that protection is

consciously granted by central planners, with a deliberate development strategy in mind, but who have mistakenly chosen nominal rates as instruments without realizing that it is effective rates which have the real impact on resource allocation. The problem with that interpretation is that it cannot account for the apparently rational focus on effective rates in 1970, before the relapse into a wrong emphasis on nominal rates once again took place in 1980.

In a similar endeavor pertaining to the United States, Cheh (1974) investigated the changes in protection levels between 1964 and 1972 following from the Kennedy Round of tariff negotiations, and also arrived at the result that nominal protection rates yield a substantially better fitting equation than effective rates. He explains this result by arguing that nominal rates are the direct bargaining focus during actual tariff negotiations, and therefore reflect more accurately the distribution of political power among competing pressure groups. This argument is not supported by Riedel (1977), who conducts an identical experiment using German data and finds that effective rates outperform nominal rates. Nonetheless, there may be some truth to Cheh's argument when applied in the context of a particular negotiating round. Individual groups might lack enough information about the other rates being simultaneously negotiated, or cannot accurately gauge the total impact of changes made, taking into account all the input-output linkages, until the new structure actually takes effect. Those arguments appear less plausible in the present investigation, however, since it considers levels and not changes in protection. Moreover, Mexico is not a member of GATT so that

the ability of policymakers to maneuver in response to new protectionist demands, after the effective impact of any given revision in protection rates has been felt, is considerably less constrained.

Another reason for the comparatively low significance of the regressions using effective protection rates in 1960 and 1980 could be that the wrong independent variables were chosen to explain EP. But then it seems unlikely that the regressions involving NP would have turned out as well as they did. Also, one could mention the possibility that the results might have been distorted through erroneous data caused by inaccuracies in the input-output tables used to calculate EP.<sup>5</sup>

Finally, a different and possibly more compelling explanation for the previous results is that the market for protection in Mexico might not be functioning efficiently.<sup>6</sup> That is, policymakers may be reacting in an appeasing manner to demands by constituents seeking protection (as witnessed in the results using nominal protection), but the political process is not sufficiently competitive to discipline those policymakers into responding more effectively to those demands except in special circumstances. In contrast to the multi-party system that characterizes the industrialized nations surveyed in Anderson and Baldwin, Mexico is, in effect, a one-party state with political power highly concentrated at the top in the office of the President, and with lesser offices generally filled by appointment rather than direct representation. Mexico's ruling party, the Partido Revolucionario Institucional (PRI), coalesced during the revolutionary period in the early part of this century and re-



mains virtually unchallenged to this day. While the president can only remain in office for one six-year term, his designated successor has so far always been chosen, in elections that primarily serve a "legitimizing" function. One likely consequence of monopoly power, given by such a highly centralized political structure, is a reduced flexibility in the response to demands. Using this monopoly argument to serve as a basis for interpreting protection patterns in Mexico, then raises the question of what induced the suppliers of protection to suddenly become more responsive in 1970, when a more pronounced pattern in effective rates is observed. Before suggesting an answer, it may be worthwhile to briefly consider an additional piece of evidence.

Further evidence of a systematic pattern in protection can be obtained by regressing the structures of industry protection in different years against each other. These regression results are shown in Table 3. In view of the monopoly position enjoyed by the PRI in Mexican politics, and assuming that the configuration of interest groups seeking protection within party channels does not change drastically over time, one would expect to observe a certain continuity in the structure of protection. Table 3 supports that conjecture, most prominently in the case of nominal protection rates. In all three years considered, the structures of nominal protection are positively and significantly correlated. The structures of effective rates are also positively correlated, but not always significantly. These results, in other words, also point toward a deliberate design in the determination of nominal protection, becoming less pronounced in the case of effective protection. More interesting, however, is the fact that

Table 3: The relation between industry protection rates in Mexico over different years

I. The relation between nominal rates

1)	NP70 = 6.67 + 0.539 NP60	$R^2 = .18$	T = 35
	(2.69)*		
2)	NP80 = -0.44 + 0.660 NP70	$R^2 = .20$	T = 35
	(2.88)*		
3)	NP80 = -10.23 + 1.069 NP60	$R^2 = .32$	T = 35
	(3.95)*		

II. The relation between effective rates

1)	EP70 = 32.99 + 0.284 EP60	$R^2 = .02$	T = 32
	(0.75)		
2)	EP80 = 30.04 + 0.337 EP70	$R^2 = .10$	T = 32
	(1.85)		
3)	EP80 = 5.95 + 1.027 EP60	$R^2 = .34$	T = 32
	(3.91)*		

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Numbers in parentheses are t-values. NP60 denotes the level of nominal protection in year 1960, while EP60 denotes the corresponding level of effective protection. The same notation applies also for the years 1970 and 1980. The industry protection figures for 1980 were originally available in a 59-sector disaggregated form. They were aggregated into 35-sector form using value-added shares as weights. The sample used for the regressions involving effective rates excludes the same outliers discussed in section 2.

the protection structure in 1980 is considerably closer to the structure prevailing in 1960, than either structures are related to that existing in the intervening year of 1970. This applies to both nominal and effective protection. Observe in Table 3 that equations (I.3) and (II.3) register the highest  $R^2$  values and coefficients near 1. That result, combined with the changing  $R^2$  patterns observed in Tables 1 and 2, suggests the occurrence of a temporary change in emphasis among Mexican policymakers around 1970 in terms of granting protectionist favors. In this respect, it may be useful to point out two important developments prior to 1970 which might explain this observation.

After 1954, the Mexican economy embarked on a course that retrospectively became known as the period of "stabilized growth". During that period, there occurred a rapid urban and regional concentration of the population, which was partly induced by the import-substitution policies adopted. The share of employment in the stagnating agricultural sector declined from 50% in 1960 to 40% in 1970, while the growing industrial activity became primarily centered around the cities of Monterrey, Guadalajara and Mexico City (Fischer, Gerken, Hiemenz, 1979). Secondly, despite increases in the minimum wage (Amparo Casar, Marquéz, 1983), an increased disparity of income distribution took place, most noticeably reflected in a decline of the relative shares received by the poorest third of the population (Gallardo, 1983; Rovzar, 1983). This combination of urban overcrowding and declining income shares received by the poorer segments of society made for an incendiary mixture, most visibly manifested by the student disturbances of 1968 (Solís, 1981). Although these uprisings were

quickly suppressed, they appear to have left an imprint on the policymakers' consciousness. By 1970, with the coming into power of the Echeverria administration, social inequities became officially recognized as a target of policy, in what was heralded to be a new age of "shared growth". The results in Tables 1 and 2 reflect a policy reorientation in response to those pressures: The NOW coefficient changes from a fairly significant negative value in 1960 to a positive (or insignificant) value in 1970, and the regional concentration (RC70) coefficient becomes increasingly significant in 1970. Furthermore, a remarkable increase in the explanatory value of the regressions is observed, as previously mentioned, especially in the case of effective rates. Both suggest an increased effort to placate the demands of urban labor that provided the greatest potential for social unrest.

This policy reorientation around 1970 did not last long, however. The spectacular oil discoveries in the mid-1970s catapulted Mexico, once again, among the top oil-producing nations, and appeared to signal an end to previous economic difficulties. Pressures to implement further policy reforms consequently abated, allowing the previous status quo to reassert itself; which may explain the reappearance of a protection pattern in 1980 similar to that existing in 1960.

#### 4. Summary

The preceding investigation shows that the structure of industry protection in Mexico, when measured by nominal rates, displays a systematic pattern quite similar to that which has been observed in the industrialized countries. This would suggest that the basic motives for granting protection are the same in both instances, despite differences in political environments and in official rhetoric defending protectionist measures. With respect to effective protection rates, however, it becomes somewhat more difficult to discern a systematic pattern, even though economic reasoning tells us that it is effective rates which primarily matter in the allocation of resources and factor returns and thus should be the focus of protectionist demands and supply. One explanation suggested above for the divergent empirical results emphasizes some monopoly traits present in the Mexican party system. That is, the observed pattern in nominal rates gives evidence of some intent to further the interests of particular protection-seeking clienteles. But the amount of competition between parties representing different constituents' demands has been too small to elicit a more effective response from the suppliers of protection, except in crisis situations.

Footnotes

- 1 Figures on the average number of workers employed (NOW) and total wages paid are published by the Secretaria de Programación y Presupuesto, Manual de Estadísticas Básicas. For 1960 and 1970, however, these figures came disaggregated at the 4-digit level and had to be aggregated to a 2-digit level, for which I used the key provided by the Secretaria de Patrimonio y Fomento Industrial, Tablas de Insumo-Producto. Also, these earlier figures do not include the agricultural sectors. Figures on value-added per industry (VA), exports (EXP), and imports (IMP) are provided by the Banco de México, Informe Anual, while gross sales are published by the same office at irregular intervals. The variable RC70, as well as sectoral export and import figures for 1960 and 1970, were taken from Kate and Wallace (1980). Sometime in the late 1970's, industrial statistics appear disaggregated at a 59-sector level, not including services; previously a 35-sector disaggregation was used.
  
- 2 The idea behind these separate measures is identical to that which distinguishes ordinary nominal and effective tariff protection as discussed in Balassa (1965) and Corden (1966).
  
- 3 These results have to be qualified in one important respect, given that the agricultural sectors were omitted from the regressions for 1960 and 1970. Even though these industries are among the most labor-intensive, they received signifi-

cant disprotection over those years, suggesting that perhaps agriculture be treated as a separate case in the Mexican market for protection.

4 The values of  $\bar{R}^2$  reported in the studies surveyed by Anderson and Baldwin (1981) ranged between 0.2 and 0.5; i.e., comparable to the values obtained here.

5 There are also some methodological, econometric problems to consider. The first is simultaneity bias: If the political market analogy is taken seriously, then it is unclear whether what is being estimated here is a demand or supply curve for protection. All that can be said is that the regressions reflect a particular outcome in the market for protection, favoring certain industry characteristics. Secondly, there is a related problem that the exogenous variables may in turn be functions of the endogenous variable. For example, if export-oriented industries are effectively disadvantaged by protection, they are likely to decline, switch toward the domestic market and export less. Similarly, if small firms (in terms of NOW) were systematically advantaged by protection, they would have grown and large ones declined. In both examples, the estimated coefficient would be biased downward from the true coefficient. This last problem, however, should not be so serious in the estimations involving nominal protection rates, since economic theory tells us that it is effective rates which have a real effect on profitability and factor returns.

6 I am not attaching any normative content to the notion of efficiency in this case. A well-known proposition in pure trade theory is that unfettered free trade is best. Hence, if particular politically active groups are able to extract protection for themselves, as they arguably would in an efficiently functioning political market, their gain is offset by an even greater aggregate welfare loss. In a similar context, Bhagwati (1985, ch. 1) also notes the paradoxical situation that it may well be the most authoritarian regimes that are in the best position to adopt more welfare enhancing, outward-oriented policies.



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