BY ROBERT J. BARRO

MEXICO: DEMOCRACY IS GREAT, BUT WHAT ABOUT ECONOMIC REFORM?

NEXT: Vicente Fox has already done what seemed impossible – he got elected. Why not privatize oil and dollarize the country?

Probably no one in Mexico had more at stake in Vicente Fox's recent election as President than the outgoing President, Ernesto Zedillo. With a clean and peaceful shift in power from the incumbent party, the PRI, to the National Action Party (PAN), Zedillo can claim a true two-party competitive democracy as his main legacy to Mexico. Although the autonomous electoral oversight authority had been created by Zedillo's predecessor, Carlos Salinas, Zedillo gets credit for allowing the electoral authority to actually function freely. Zedillo also enacted campaign-finance reform (at vast taxpayer expense), introduced an open presidential primary within his party, and permitted an actual change of power through the voting process. Now that the PRI, founded in 1929, has lost an election, the world can regard Mexico as truly democratic.

The expansion of democratic rights by itself, however, provides no reason to raise one's assessment of Mexico's long-term economic prospects. These prospects depend on economic and legal reforms, which are areas in which Zedillo made little progress. Admittedly, Mexico has been growing fast since 1996—gross domestic product averaged 5% growth through 1999 and advanced to 8% in the first quarter of 2000. However, this pace of economic activity was driven mainly by export growth, which reflected slashed tariffs under the North American Free Trade Agreement and a strong U.S. economy.

It was Salinas and his Finance Minister, Pedro Aspe, who started opening Mexico in a serious way. In addition to NAFTA, there was a series of privatizations and deregulations, progress in macroeconomic stabilization, improvements in fiscal management and discipline, and the introduction of personal accounts for social insurance.

POLICY OF OMISSION. Zedillo's record of economic reform was comparatively weak. He extended the push for free trade by concluding agreements with the European Union and several countries in Latin America. Otherwise, the principal initiative was the introduction of private financial management for social-insurance accounts. In terms of omissions, Zedillo can be criticized for doing nothing for privatization, especially in the energy sector; for making no progress in reducing government corruption; for permitting crime to worsen, notably in Mexico City; and for letting the banking system become a burden on taxpayers and a nonparticipant in investment financing.

Fox looks attractive in the sense of being pro-market, but he will have to rely on strong economic advisers who have yet to be announced to generate a coherent economic program. Privatization in the electricity business is likely to be an initial priority. Even more significant would be privatization of the petroleum sector, but progress here may be extremely difficult, and Fox has already indicated his intention to maintain government control. Mexico, like Venezuela, seems to regard public ownership of oil as critical to national pride.

UNFINISHED BUSINESS. Fox plans large public expenditures on elementary education and rural infrastructure. These programs could be productive but are likely to create serious fiscal pressures. Ambitious spending plans therefore increase the importance of improving revenue collection by cutting tax evasion. Fox also has to deal with Zedillo's unfinished business with regard to corruption and crime.

Enhanced competition in Mexico's big and expanding telecommunications sector is necessary. This is an area where Zedillo failed to make much progress. In the banking sector, Fox has to encourage foreign investment and keep the government from bailing out weak and failing banks.

On the macroeconomic side, it is important that Mexico create a stable long-term approach to monetary policy. The central bank appears to want to promote price stability while allowing the exchange rate to float. However, in practice, monetary policy seems to be driven by short-run concerns involving financial-sector liquidity rather than price stabilization, exchange-rate maintenance, or targets for interest rates or money supply indicators.

Mexico would benefit by replacing its current monetary policy with a currency board linked to the U.S. dollar, along Argentinean lines. Even better would be a full-scale dollarization, in which Mexico adopted the U.S. dollar as its currency. The large and growing integration of the Mexican and U.S. economies makes Mexico an excellent candidate for dollarization. The major impediment is the national pride attached to the country's issuance of its own money.

In this respect, Mexico's reluctance to give up the peso is similar to its unwillingness to abandon public ownership of oil. If Fox could persuade Mexico to put aside its national pride to give up both, he would be making a great contribution to the future growth of the country's economy. Odds are against it, of course. But after all, a little while ago, a non-RRI President was unthinkable, too.

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