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SPECIAL REPORT
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Calderon's Challenges

Mexico's president-elect Felipe Calderon faces a series of challenges, including low competitiveness, inadequate infrastructure and inefficient energy. And last, but not least, a small mandate and a split congress.

BY CHRONICLE STAFF

While local and foreign investors were pleased that Felipe Calderon, an economist and former energy minister, was declared the official winner of Mexico's close presidential race, they also hope his presidency will be able to solve several key challenges. These include boosting competitiveness, making the energy sector more efficient, improving education and reducing poverty and income inequality, experts say.

"I think Calderon is well aware of the competitiveness challenge that Mexico faces," says Riordan Roett, director of the Western Hemisphere Program at Johns Hopkins University in Washington, DC. "He is an experienced public servant. He understands globalization."

The challenge, however, will be to convince the new congress to support the necessary measures, he says. "That is the critical variable for a Calderon sexenio," Roett says.

According to the World Economic Forum, Mexico has the sixth-most competitive economy in Latin America among 18 countries. A separate survey from Swiss business school IMD, ranks Mexico in 53rd place among 61

Mexico's New President



NEXT PRESIDENT: Felipe Calderon, a 43-year old former energy minister will become Mexico's next president in December.

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nations worldwide. Both rankings [Links](#) show Mexico behind countries like Brazil, Chile and Colombia.

The IMD survey measures competitiveness using 314 criteria, grouped into four competitiveness factors; economic performance, government efficiency, business efficiency and infrastructure. Mexico scores particularly low in criteria like scientific infrastructure (last or 61st place worldwide), technological infrastructure (60th), productivity and efficiency (59th), and societal framework (58th). It also scores low in terms of finance, business legislation, education and health and environment. The areas where Mexico did well was in employment, prices and public finances.

ENERGY PROBLEMS

While Mexico's total score improved, it posted declines in categories such as electricity costs, bureaucracy, labor regulations, implementation of government decisions and justice administration.

"Mexico desperately needs reform of its energy sector," says Jerry Haar, a professor of management and international business at Florida International University. "Rates at present are three times that of China."

International experts deem both state-owned electricity company CFE and oil Pemex as inefficient. Pemex has been plagued by inadequate equipment and corrupt unions.

Although Fox initially tried to open Pemex to significant private investment, and even talked about privatization before he became president, the oil giant only saw minor reforms during his presidency. While experts agree that Pemex urgently needs more foreign investment, any reform attempts by Calderon will likely face staunch opposition from Calderon's top rival in the election, Andres Manuel Lopez Obrador from the leftist PRD party. During the campaign, he pledged to boost spending on Pemex, while reversing the current decentralization of 17 subsidiaries.

IMD also warns against weaknesses to Mexican competitiveness such as threats from relocation of production and cyclical impacts on the economy. The cost of international fixed telephone was also a factor in the low score of Mexico. Tax and regulatory reform are also necessary in order to boost entrepreneurship and productivity, Haar says.

EDUCATION

Finally, Mexico has to boost investment in education, Roett says. "Mexico must invest in education," he says. "The amount is less important than the quality. Science and math need to be given a high priority. "

The lack of sufficient progress in creating jobs has been a key factor behind the continued wave of illegal immigration to the United States. "Rather than modernize the economy, Mexico's politicians have embraced a Tito-inspired strategy: when incapable of fostering productive jobs, export the labor force," Steve Hanke, a professor of applied economics at Johns Hopkins University, wrote in a column in *Latin Business Chronicle* last week.

However, despite the challenges, most investors agree that the alternative - Lopez Obrador as president - would have been worse. His campaign platform and rhetoric was full of attacks against private enterprise and NAFTA. He raised eyebrows by calling Mexico's top business organization, CCE, "white-collar criminals"

and opposed the NAFTA requirement that Mexico in 2008 has to open its borders to imports of corn and beans. Lopez Obrador also appeared to support the import-substitution policies that dominated Latin America in the 1970's and led to widespread economic crisis in the 1980's.

Given Lopez Obrador's ideological predilections and recent performance as mayor of Mexico City, it was almost assured that Mexico would see more public spending combined with anti-neoliberal rhetoric, Haar says. That would, in turn, create market volatility, capital outflows, and postponement of investment and reinvestment in the productive sector of the economy, he says.

GENERAL MACRO SUCCESS

Calderon will succeed Vicente Fox, who has been able to provide mixed macro economic results in his six year term.

GDP grew by 3.0 percent last year, somewhat weaker than the 4.2 percent it expanded in 2004. This year, it should grow by 3.5 percent, the International Monetary fund forecasts. If that forecast is included, the average GDP growth for the period 2001-06 will be 2.1 percent, according to a *Latin Business Chronicle* analysis of IMF data. That is weaker than the average GDP growth of 3.5 percent during the previous administration of Ernesto Zedillo (who assumed office amidst one of Mexico's worst economic crisis in modern times).

Fox has had better luck with inflation, which last year reached 4.0 percent, a decline from the 4.7 percent rate registered in 2004 and the lowest in more than 33 years, according to IMF and Mexican central bank data. This year it should fall further - to 3.0 percent, the IMF predicts. The average for the six-year period under Fox will be 4.7 percent, which compares favorably with the Zedillo administration's average of 22.0 percent.

Trade has also been a bright spot for Fox. Last year, exports grew by 11.8 percent to \$225.8 billion, while imports grew by 12.3 percent to \$241.8 billion, according to United Nations Economic Commission for Latin America and the Caribbean (ECLAC). Although Mexico's economy is 3.0 percent smaller than Brazil's, its exports are 68.7 percent higher, according to 2005 IMF and ECLAC data analyzed by *Latin Business Chronicle*. In fact, Mexico accounts for more than a third of Latin America's exports.

"The next government will .. need to address the physical infrastructure deficit in Mexico to allow exports to move more quickly and more cheaply," Roett says.

Foreign direct investment is another success area. Mexico attracted \$19 billion in foreign direct investment last year, a 14.4 percent increase from 2004, according to Bear Stearns. That was the second-highest FDI level in Latin America after Brazil. This year it will likely grow by 10.5 percent to \$21 billion, the investment bank forecasts.

Finally, Fox was able to pass legislation that gradually has reduced the corporate tax rate from 33 percent in 2004 to 29 percent today and 28 percent next year.

CONGRESSIONAL STALEMATE?

But Fox has been seen as a weak leader, unable to pass more reforms during his presidency. And there is now concern that Calderon may end up similarly.

"Fox faced six years of gridlock," says Haar. "The question is not policies but the ability to: (a) amass the political capital and design the strategy to get the unachieved Fox policies through; and (b) competently implement these policies."

Calderon's mandate is slim and his PAN party will have a minority in the national assembly, which means he will have to form alliances to get any laws approved. Calderon has vowed to form a coalition government that includes representatives from other parties as well. The final results show that Calderon received 35.89 percent of the vote, only slightly higher than the 35.31 received by Lopez Obrador.

"[Calderon] will need to be very persuasive in convincing the new Congress - and it will be all new members without much experience in public policy - of the priorities for the next sexenio. That will not be easy," Roett says. "But it will be unfortunate for Mexico if the next six years are again a period of stalemate and drift."

Jeffrey Schott, a senior fellow at the Washington, D.C.-based Institute for International Economics, agrees. "We will have to await ... the composition of the new government and Congress - as well as the external environment in which the new policies will operate in 2007 - to better judge policy directions," he says.



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