

FOREIGN DIRECT INVESTMENT AND THE MEXICAN CRISIS OF 1995: A RECENT EXPERIENCE

Alberto Calva-Mercado

Partner and General Director of Acus Consultores, S.C.
acalva@prodigy.net.mx // www.acus.com.mx

FDI in Mexico and the world

The role of Mexico in the world distribution of Foreign Direct Investment (FDI) is significant. As it can be seen in Chart 1, the accumulated inflows of FDI in Mexico for the period 1991 to 1995 was almost 32 billion USDollars. Mexico is the eighth country that received the largest inflow of FDI in that period, and represents 3.2% of the world FDI. These figures are more relevant if we compare them with Mexico's position in the world's Gross Domestic Product (GDP) classification. Mexico is the 19th largest economy in the world and represents 0.90% of the total. This means, that our importance in FDI (3.2% of the world's total FDI) is larger than our position in the GDP table (0.90% of the world's total GDP).

Concerning only the OECD members, Mexico has an equivalent of 8.3% of the total FDI inflows for the period 1991 to 1996. At last, regarding net flows, outflows minus inflows, we can see that only Spain received more net FDI in the period 1991 to 1996 (almost 47 billion USDollars) than Mexico.

As it can be seen, the role of Mexico in the world FDI, specially in what is concerned about total inflows as a host economy, or even net flows, is very important.

Chart 1: FDI in Mexico and the world (millions of USDollars)

	Total FDI inflows 1991-1995		GDP 1995		Total FDI inflows 1991-1995	
Mexico	31,991	3.2%	250,038	0.90%	34,112	8.3%
OECD					410,024	100.0%
World	1,010,506	100.0%	27,846,241	100.0%		
Position	8		19		7	

Source: OECD and World Bank

The Mexican Crisis of 1995

During 1995 Mexico suffered one of its worst economical crisis, probably the deepest in the last 60 years. As it can be seen in Chart 2, main economical indicators were dramatically affected in that year.

For example, inflation rate went up from almost 7% in the year of 1994 to almost 52% in the year of 1995. This means an increase of almost 7.4 times. Regarding GDP, this one grew up in 1994 at a rate of 4.5%, compared with a negative rate in 1995 of 6.2%. This was the worst GDP rate since 1932.

On the other side, unemployment rate went up in less than a year from 3.2% to 7.6%. This means that unemployment was increased in Mexico in this period almost 2.4 times.

At last, interest rates went up from almost 14% in November 1994 to almost 75% in April 1995. This represents an increase of almost 5.4 times in this period.

The question here is, what happened with the FDI, and the Foreign Investment (FI) in general, in Mexico during the crisis of 1995?

Chart 2: The Mexican Crisis of 1995

	1994	1995
Inflation rate (a)	7.05%	51.97%
GDP (b)	4.5%	-6.2%
Unemployment (c)	3.2% (Dec.94)	7.6% (Aug.95)
Interest rate (d)	13.74% (Nov.94)	74.75% (Apr.95)

(a) Consumer's Price Index / Banco de Mexico

(b) Gross Domestic Product / INEGI

(c) Open Unemployment Rate / INEGI

(d) Cetes / Banco de Mexico

FDI in Mexico in 1995

What happened to the total FI and the FDI in Mexico during the crisis of 1995? First, it is important to take in consideration that the total FI in Mexico is the addition of three main components: the FDI, the investment in capital market and the investment in money market (see Chart 3).

Lets start with the last one, investment in money market. This flows definitely depend on two main variables: domestic and foreign interest rates, and the level of certainty in the country. As it can be seen in column (d) in Chart 3, in 1995, in spite of the increase in domestic interest rates, the foreign investment in money market showed a decrease of almost 10 billion USDollars. This figure is relevant compared with the average inflow in the three previous years (almost 10.6 billions per year).

Regarding the net investment in capital market, in 1995 we can not say that there was an outflow, but there was not either an inflow. The net inflow in 1995 in capital market was less than one billion USDollars, which is a very low figure compared with the average net inflows of the three previous years (6.5 billion USDollars per year).

At last, FDI did not suffered any decreases because of the Mexican crisis of 1995. One of the largest inflows was perceived in that year. This means that FDI was not affected neither by interest rates, uncertainty of the country, nor unstability in its economical variables. FDI is a long range investment in the host country.

Chart 3: Recent history of FI and FDI
(net flows in millions of USDollars)

Period	(a)=(b)+(c)+(d) Foreign investment	(b) Foreign direct investment	(c) Investment in capital market	(d) Investment in money market
jan-dec 1991	13,527	4,762	N/A	N/A
jan-dec 1992	22,299	4,715	4,783	12,801
jan-dec 1993	33,082	4,532	10,717	17,833
jan-dec 1994	17,849	9,666	4,085	4,098
jan-dec 1995	(188)	9,527	519	(10,234)
jan-dec 1996	21,772	7,619	2,995	11,157
jan-jun 1997	12,723	3,940	2,328	6,455
jan-jun 1997 * 2	25,446	7,880	4,656	12,910

Source: Banco de Mexico

FDI, capital account and current account

What relationship was there with the FDI and the balance of payments in Mexico in 1995? As it can be seen in Chart 4, the current account presented a large deficit from 1991 to 1993. This deficit did not affected the Mexican economy because the capital account presented from 1991 to 1993 a greater surplus. The problem was in 1994, when the current account kept its negative trend, but inflows in capital account were interrupted.

In 1994 the current account decreased from minus 23 billion USDollars in 1993 to almost minus 30 billion USDollars. On the other hand, the capital account also decreased from almost 32 billion USDollars in 1993 to less than 15 billion USDollars in 1994. At this moment it is clear that Mexico had a problem in its balance of payments. But, what is the role of FDI in this year?

Once again, we can see in Chart 4 that FDI presented its two largest yearly inflows in 1994 and 1995. This is, the main problem was in other elements of the capital account (one of them was foreign investment in money market), but not in the stability of FDI.

Chart 4: FDI, capital account and current account
(net flows in millions of USDollars)

Period	Current account	Capital account	Foreign direct investment
jan-dec 1991	(14,893)	24,940	4,762
jan-dec 1992	(24,439)	26,573	4,715
jan-dec 1993	(23,399)	32,482	4,532
jan-dec 1994	(29,662)	14,584	9,666
jan-dec 1995	(1,577)	15,406	9,527
jan-dec 1996	(1,922)	3,323	7,619
jan-jun 1997	(1,667)	4,917	3,940
jan-jun 1997 * 2	(3,334)	9,834	7,880

Source: Banco de Mexico

Final comments

Some general ideas could be subtracted from this paper:

- There is a clear importance of Mexico in the worldwide FDI flow, specially as a host economy.
- The FDI has shown to be constant in Mexico in spite of the crisis we suffered in 1995. FDI could be considered long range sources for the host country.
- It is better to have FDI than foreign investment in money market or even in capital market.
- In countries like Mexico where investment, both foreign and domestic, are limited, an increase in FDI can help create new companies and jobs. Therefore, FDI can help in the development of the country.

< *E N D* >