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Openness and Mexico's subnational governments size: Evidence from a panel of Mexican states

Apertura y tamaño de los gobiernos subnacionales en México: evidencia de un panel de entidades federativas

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Abstract

We examine the relation between government size and economic openness employing a panel of the 32 Mexican states between 1996 and 2006. Making use of two alternative measures of capital and labor openness and employing alternative econometric specifications, we first find systematic positive effects of our openness measures on the size of states' total government spending. Thereafter, we focus on three subcategories of spending associated with social welfare: education, health and poverty alleviation. We find FDI flows are not statistically relevant determinants of social spending, but labor openness has a significant and greater impact on some of the aforementioned categories than on total spending.

JEL classification: F15; F21; F22; H11; H51; H52; H53
Keywords: Capital inflows; Migration; Globalization; Government size; Panel data methods; Mexico

Resumen

Se examina la relación entre el tamaño del sector público y la apertura económica empleando un panel de datos con las 32 entidades de la república mexicana entre 1996 y 2006. Haciendo uso de 2 medidas alternativas de apertura vinculadas al capital y al trabajo, y mediante especificaciones econométricas alternativas, encontramos en primer lugar, efectos positivos de nuestras medidas de apertura la magnitud del gasto total

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de los gobiernos estatales. Nos centramos después en 3 subcategorías de gasto asociadas al bienestar social: educación, salud y reducción de la pobreza. Encontramos que los flujos de IED no son determinantes relevantes del gasto social, pero sí que la movilidad de la mano de obra tiene un impacto significativo e incluso mayor en algunas de las categorías antes mencionadas que en el propio gasto total.

Códigos JEL: F15; F21; F22; H11; H51; H52; H53
Palabras clave: Flujos de capital; Migración; Globalización; Tamaño del gobierno; Paneles de datos; México

Introduction

Since the mid-1990s, the Mexican economy has been exposed to significant supply and demand shocks, first with the start of NAFTA in January 1994, and then with the devaluation of the Mexican peso in December of that same year. On the positive side, as a result of NAFTA, Mexico's total trade to GDP ratio increased from 34% in 1993 to 64% in 2000. Foreign Direct Investment (FDI) inflows went from 4.3 billion U.S. dollars in 1993 to 10.9 billion U.S. dollars in 1994. Between 1994 and 2006, Mexico received more than 217 billion U.S. dollars in FDI (totaling around 40% of its GDP). Nevertheless, following the devaluation of the Mexican peso, in 1995 inflation surpassed 50% and real GDP fell by 6%. In terms of international migration, and as a result of considerable job losses, the net outflow of people rose from 412 thousand in 1993 to 625 thousand by the year 2000; this is roughly about 0.5% of Mexico's total population each year.[1] All these shocks have had positive and negative effects on the aggregate economy which are considerably difficult to manage at the regional level.

According to the so-called "compensation hypothesis" proposed by Rodrik (1998), a more open economy requires a larger government capable of attenuating the effects of externally generated economic instability, which in turns prompts the demand for social security. In spite of the importance that this relation has for developing countries, only a few studies have examined it at the subnational level or by employing alternative non-trade-related openness measures more suitable for developing economies. This paper revisits the role of openness in the size of government across Mexican states and proposes the use of alternative measures of international capital and labor mobility as proxies for openness rather than more traditional trade-related measures.

We feel that the assessment proposed here is important for economic development and contributes to the existing literature in at least three important ways. First, ever since the seminal papers by Rodrik (1998) and Alesina and Wacziarg (1998), the literature has mostly employed total trade and trade volatility measures as proxies for openness in order to assess their relation to government size. While these measures are important in assessing the degree of openness of any economy, developing countries have been exposed to openness—traditionally and in recent years—in different ways than industrial economies.[2]

[1] FDI and trade figures are taken from the International Monetary Fund database International Financial Statistics. Migration Rates are calculated with data from CONAPO, the Mexican government national council of population.

[2] Abizadeh (2005), for instance, shows that small and traditionally open economies, such as Singapore and Uruguay, have increased their openness to trade and reduced the role of government in the domestic economy.