

## 2 Contextual introduction to Mexico

This section will give an introduction to the context that affected the silversmith business in Taxco since its emergence in the 1930s. As will be demonstrated in parts 4 and 6, especially political and economic developments have shaped the evolution of the silversmith artisan tradition in Taxco such as the development strategy for Mexican tourism, the development of the Social Security system as well as the overall economic situation of the country. In addition, certain socio-cultural factors have had an impact on the circumstances. Thus, this section will start with an overview over Mexico's economic history, focusing on important factors for the silversmith industry. Furthermore, the silver price development will be analyzed, since the silver represents the main input and main cost factor for the artisans. Then, the section presents a profile of the Mexican economy focusing on factors that contribute to a better understanding of the context in which the silversmith business operates. First, it is important to mention the most important sectors in terms of GDP and employment. In addition, an understanding for the predominance of microenterprises in the Mexican company landscape will be developed. Finally, it is shown that high regional discrepancies exist in terms of development, which stresses the marginalization of certain regions. The chapter concludes explaining some important socio-cultural factors.

### 2.1 Economic and political factors

#### 2.1.1 *Brief history of the Mexican economy and tourism development*

Since the revolution in 1917, the predominant ruling political party in Mexico is the *Partido Revolucionario Institucional* (PRI). “As the de facto ruling party of Mexico, the PRI has controlled both federal and state government for decades through financing party activities and the media. The party's heavy hand has come under increasing attack for influence peddling and election tampering” (Harvard Business Review, 1993, p. 38). The time after the revolution, also represents the first period of tourist flows coming to Mexico. In the late 20s, private and government actions complemented each other in order to foster foreign tourism (Aldape, 2010).

Since President Lázaro Cárdenas took office in 1934, the period of economic policy from 1934 to 1946 can be described as “industrialization with revolutionary nationalism”. The PRI communicated as its basic concept social justice and the common good. In fact, the

party represented an ideology, predominant in Mexico by that time, called “revolutionary nationalism”. It consists mainly of three symbols: First, anti-imperialism or the mistrust in foreign powers; second, support of nationalizations, e.g. of land or natural resources; third a strong and interventionist government. The PRI realized various nationalizations, e.g. for the petrol industry and started to develop strong allies with important organized groups in Mexico, such as workers and farmers organizations. The purpose of this was to foster the government’s influence by constructing a potent apparatus of power, minimizing critical voices and opposition. This form of organization encouraged populist politics and practices of favoritism within the government and with other strategic groups. Thereby especially labor unions gained a lot of power and have had high influence in the political system ever since (Derbez, 2013). This was also the time when the Mexican Institute for Social Security (*Instituto Mexicano del Seguro Social (IMSS)*) was founded in 1943. However, its foundation occurred in an unorganized way, which hemmed its operation for years (Barajas, 2009). Despite of the nationalist politics, tourism increased during the 30s and reached levels of higher economic significance. Therefore, the government created various state organs in order to organize and promote tourism to Mexico (Aldape, 2010). In addition, the Mexican Economy benefitted from World War II, by supplying the US economy (Barajas, 2009). After the war had finished, Mexico became a major destination for recreational beach tourism for the United States, which became one of the main activities of the Mexican economy. The construction of the highway during 1946 and 1952 connecting Mexico-City with Acapulco and a strategy of promotion and investment by President Miguel Alemán made Acapulco even more frequented than before, by foreign and national visitors (Aldape, 2010). Rumors about his personal financial interests in promoting Acapulco exist (Wilson-Powell, 2011). Indeed, his administration was famous for its political corruption (Watkins, 2014). President Miguel Alemán focused his attention on public works such as hydropower development, irrigation projects, road building as well as constructing new hospitals for a higher coverage of the IMSS within the country (Watkins, 2014; Barajas, 2009). Even though, continuing with nationalistic policies. The political period from 1946 to 1954 can be described as “industrialization with import substitution” (Derbez, 2013). This period was characterized by protectionism. Like most Latin American countries, Mexico followed a strategy of industrial development by protecting its economy from imports through protectionist measures like

tariffs, in order to boost the economy by increased demand for national products (Harvard Business Review, 1993). In this period, a rising trade imbalance was created that led to a devaluation of the Peso in 1954 (Banco de México, 2009).

The period culminated in the one called “stabilizing development”, which occurred from 1954 until 1970. The government maintained the protectionist politics with strong state intervention in the economy (Derbez, 2013). Through the 1950s and 1960s, these politics worked remarkably well in terms of growth, reaching annual economic growth rates of almost 7% (Harvard Business Review, 1993). However, due to the lack of foreign competition, Mexico’s economy did not become competitive in many industries and agriculture, although there were government subsidies for many sectors. The economic investments by the state were financed by international debt, as the rigid fiscal system did not provide enough financial resources for the country’s current account. Due to a closed economy, this led to a tendency towards external imbalance. In addition, monetary politics were used in an irresponsible way in order to increase the government’s liquidity. In the end of that period, the Mexican economy showed two main characteristics: First, insufficient dynamism to create jobs; second, an external disequilibrium combined with a growing public deficit (Derbez, 2013). During this time, beach tourism was identified as a main source of foreign currency. Therefore, the government made plans to develop strategic regions such as Cancun in the state Quintana Roo in order to diminish regional marginalization and to balance the external disequilibrium (Aldape, 2010).

Derbez (2013) described the following period from 1970 to 1982 as “destabilizing development with populism”. The politics during that time increased Mexico’s economic problems. Excessive public spending concluded in a large fiscal deficit. Methods of financing were still external debt and money printing. Thus, when President Lopez Portillo took office in 1976 the Mexican economy was about to collapse and a devaluation of the Mexican Peso was inevitable. Fortunately, new oil discoveries blessed the government with a rich source of income that seemed to resolve Mexico’s problems. However, López Portillo spent the money in an arbitrary way, partly in petrol infrastructure and partly in other projects, many of them resulting unproductive. This was when inflation was on the rise and the president struggled to maintain the exchange rate stable. It led to a further series of devaluations. In addition, the Mexican economy remained closed and international financing stopped, as

Mexico had failed to comply with its financial obligations. Despite of the economic problems that arose during these years, it is important to mention that private and government investment led to a significant increase in infrastructure during 1932 and 1982 (Derbez, 2013).

From 1982 to 1988, Mexico suffered a period of external debt crisis (Derbez, 2013).

In 1982, virtually all commercial banks were nationalized. Yet, this was no solution for years of government protectionism, a bloated federal budget, and the collapse of the world oil market. In the early 1980s, Mexico was left with ballooning federal deficits, crushing foreign debt, triple-digit inflation, antiquated industries, and escalating urban poverty. In 1985, President de la Madrid began the painful process of rebuilding the Mexican economy, this time based on a market orientation, not state control. When Carlos Salinas replaced him in 1988, the new PRI-sponsored president continued tearing down the old statist foundations. Thanks to the reforms of de la Madrid and Salinas, more than 80% of the 1 155 state run Mexican enterprises have been sold, merged, or closed to date (Harvard Business Review, 1993, p. 38).

However, the privatizations were not realized in a responsible way and sales under value happened to friends of the politicians (Haiek, 2004). During the 90s, the Mexican government implemented the politics of the Washington Consensus<sup>1</sup> dictated by the IMF and the World Bank, paving the way for privatization, healthier state budget, less subsidies, floating exchange rates, deregulation of markets and prices as well as liberalization of trade policy (Haiek, 2004). This led to Mexico's most important Free Trade Agreement (FTA) the North American Free Trade Agreement (NAFTA) in 1994, and a series of other FTAs, which makes Mexico in terms of trade policy one of the most open countries in the world. Almost 80% of Mexican exports go to the US, which creates a high dependency on the US economy (Villarreal, 2012). Nevertheless, in 1994 some events caused a large capital flight from

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<sup>1</sup> The Washington Consensus was a set of 10 neoliberal policies that the US government as well as the international financial institutions such as the IMF and the World Bank believed were necessary for countries in order to reach economic growth. At its heart were macroeconomic stability and integration into the international economy. The 10 policies referred to fiscal discipline, public expenditure priorities, tax reform, financial liberalization, free exchange rates, trade liberalization, increasing FDI, privatization, deregulation, secure intellectual property rights & reducing the role of the state (WHO, 2014).

Mexico, which led to the famous Tequila Crisis. It culminated in another currency devaluation that caused tremendous losses for many Mexicans. Financial support from the United States as well as neoliberal economic policies like a floating exchange rate helped the Mexican economy to recover rapidly (Haiek, 2004). Afterwards, from 2000 to 2012 followed two legislatures of the opponent liberal party *Partido Acción Nacional* (PAN) that maintained the liberal economic course and reached stable macroeconomic indicators, which created a favorable business climate in Mexico (Derbez, 2013). In 2001, there was a change in tourism development not focusing only on beach tourism, but also on tourism to natural sights and historical and patrimonial cities. In addition, there was a change in organizational structure of the organs in charge of tourism planning towards a less centralized structure, empowering states and municipalities (Aldape, 2010). This year also the government program of *pueblos mágicos* or magic villages was initiated, which will be further explained in section 3.5 (El Economista, 2013).

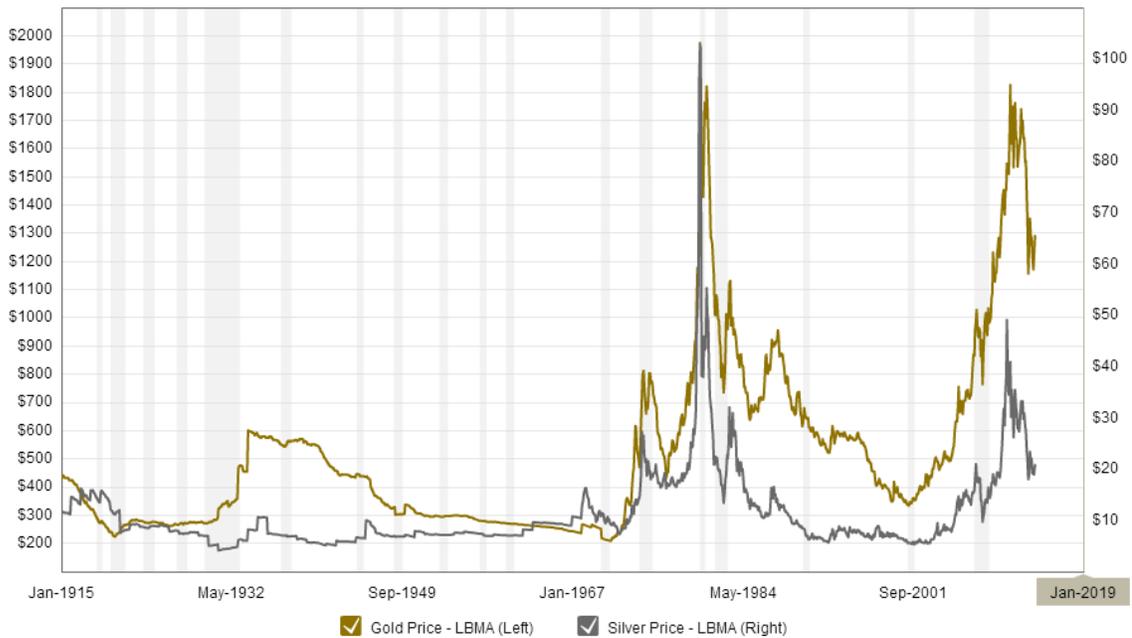
Mexico was strongly affected by the world economic crisis in 2009. Yet, the economy had a strong recovery in 2010. The new president in office Enrique Peña Nieto represents the PRI party, continuing with liberal trade policies, implementing reforms to keep on improving the business climate. Although Mexican macroeconomic policies have been stable in the last two decades, economic growth was underperforming in 2013, with only 1.1% growth, when the annual average growth rate between 2010 and 2012 was of 4.3%. This was mainly, due to a decrease in exports and domestic investment (The World Bank, 2014). However, The World Bank (2014) predicts a recovery of growth rates up to 3-4% for the following years, due to an increase of exports to the US as well as expected public investment.

### **2.1.2 Silver Price History**

This section deals with the historical development of the silver price, which is the main input for the silversmiths and represents their major costs, which is why the price and the price stability play an important role in their daily operations. Since silver is traded in US dollars on the global market, the exchange rate with the Mexican peso influences the price for the silversmiths apart from the international silver quotation.

Mexico has been a country of silver exportation since ages. Already in 1930, when the famous silver handiwork tradition in Taxco started, the price of the silver was defined by global offer and demand.

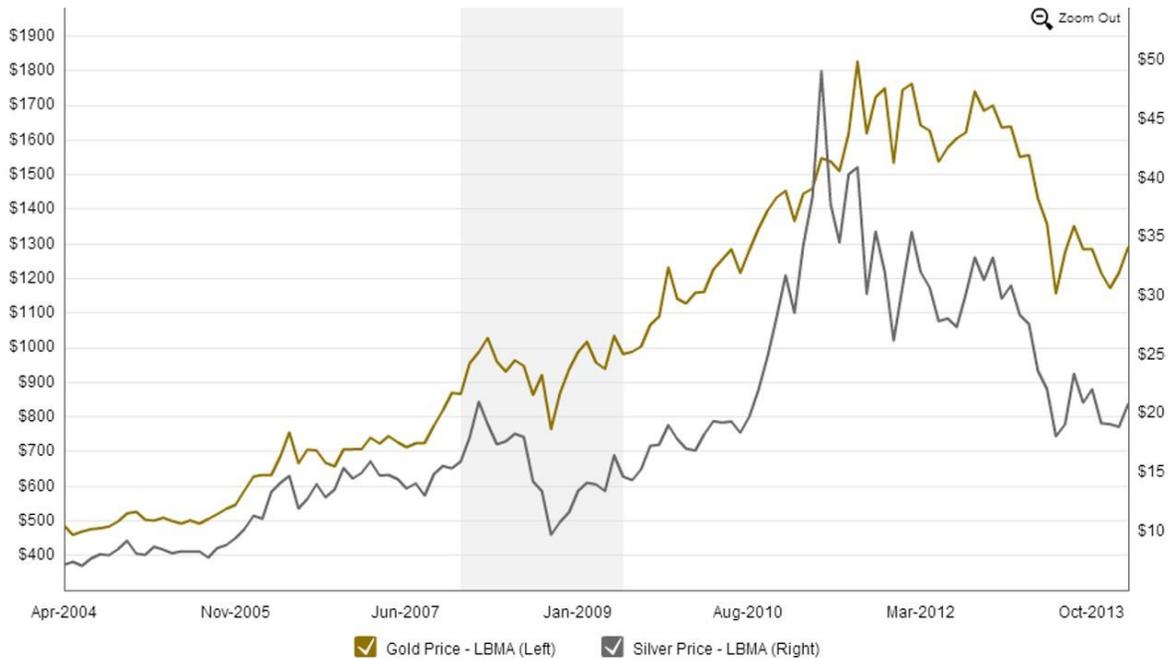
**Figure 2-1: Gold and Silver Prices: 1915 - 2014**



Source: Macrotrends, 2014

As can be recognized in the chart the silver prices remained more or less stable with a first significant rise in 1967, after which it decreased again. However, since 1971 an increased volatility of the price can be remarked with a tendency in rising. From 1979 to 1980, the silver price experienced a dramatic increase. The price collapses in February 1980 with a sharp fall and is followed by a period of high volatility during the 80s. In the 90s, the silver price stabilizes between about 6 and 9 dollars per ounce at a relatively low level. In the second half of the 2000s, it experiences a rise up to 21 dollars. In 2008, when the financial crisis hit and the dollar devaluated the price fell to 9.7\$ in order to experience a constant rise afterwards, up to 49\$ in April 2011. After that, the silver price decreased slightly, however undergoing recent years of high volatility, as can be seen in figure 2-2 (Macrotrends, 2014). Main reasons for the general rise in the price are less intervention by the US central bank, since silver was abolished in coinage, a rise of its usage in industrial production and an increased interest of financial investors. The high volatility is mainly caused by speculation and investors motivated by insecurity caused by high inflation or political events like war that could cause macroeconomic instability, as well as constant changes in silver supply (The Silver Institute, 2014).

**Figure 2-2: Gold and Silver Prices: 2004 - 2014**



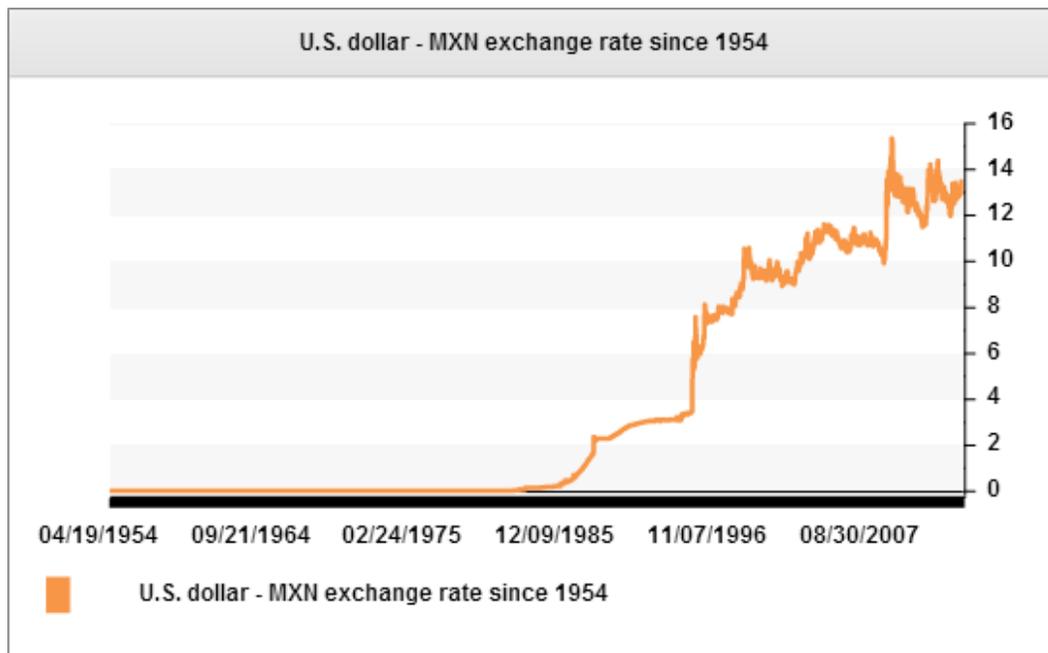
Source: Macrotrends, 2014

Since silver is traded in US dollars, it is important to take into account the exchange rate against the Mexican Peso in order to explain the prices that silversmiths in Mexico pay for their raw material. Thus, if the dollar devaluates, it is cheaper to buy silver in other currencies. On the contrary, if the Mexican peso devaluates, the silver becomes expensive from a Mexican perspective. As will be demonstrated, higher exchange rate volatility comes hand in hand with the arising economic problems in the 70s, as mentioned in chapter 2.1 as well as a more volatile silver price. This time also coincides with increasing problems in the silver industry of Taxco and its gradual downturn, as will be explained in chapter 4.

Between the 1930s and the early 50s the exchange rate was relatively stable with a slight rise over the decades (Cárdenas, 1994). As can be seen in figure 2-3, the silver price remained stable between 1954 and 1976 due to a fixed exchange rate. Because of macroeconomic problems from 1976 on, various devaluations and changes in the exchange rate system occurred. It was gradually turned to a more floating system that resulted in the appreciation of the Mexican peso as well as higher volatility in the exchange rate. Since the devaluation in 1994 the New Mexican peso and a floating system was implemented (Banco de México, 2009). Ever since, a higher volatility in the exchange rate can be noted, as demonstrated in figure 2-4. A strong appreciation of the peso against the dollar occurred during the world

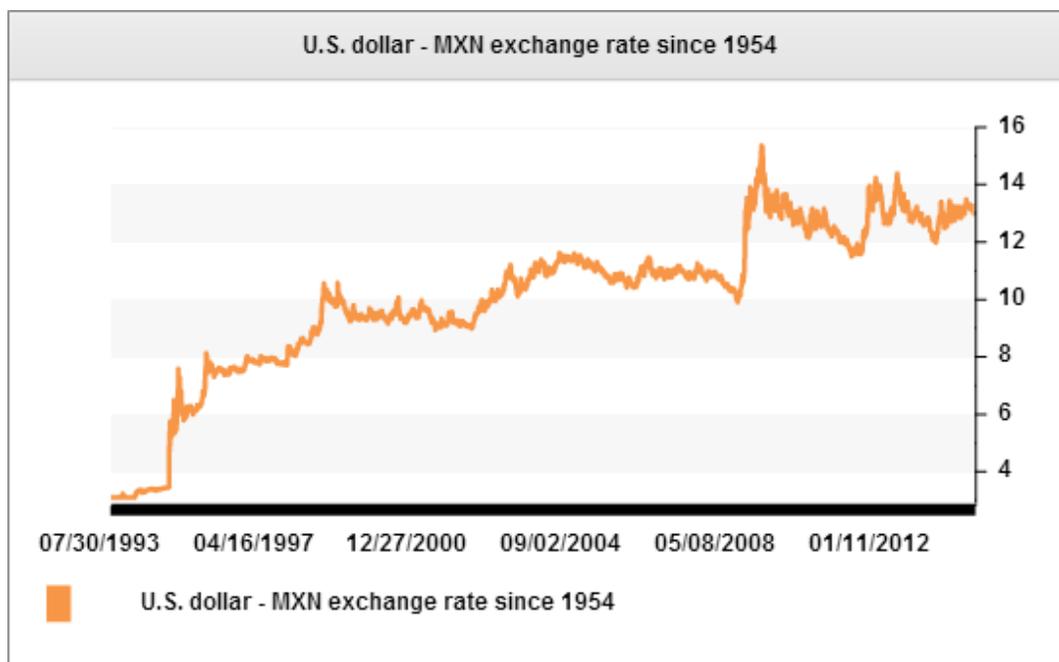
economic crisis in 2009, with its peak at 15.31 Pesos per Dollar. Throughout 2011 and 2012, high volatility was recognizable with a stabilization in recent years between 12 and 13 Pesos per Dollar.

**Figure 2-3: U.S. dollar - MXN exchange rate since 1954**



Source: Banco de México, 2014

**Figure 2-4: U.S. dollar - MXN exchange rate since 1993**



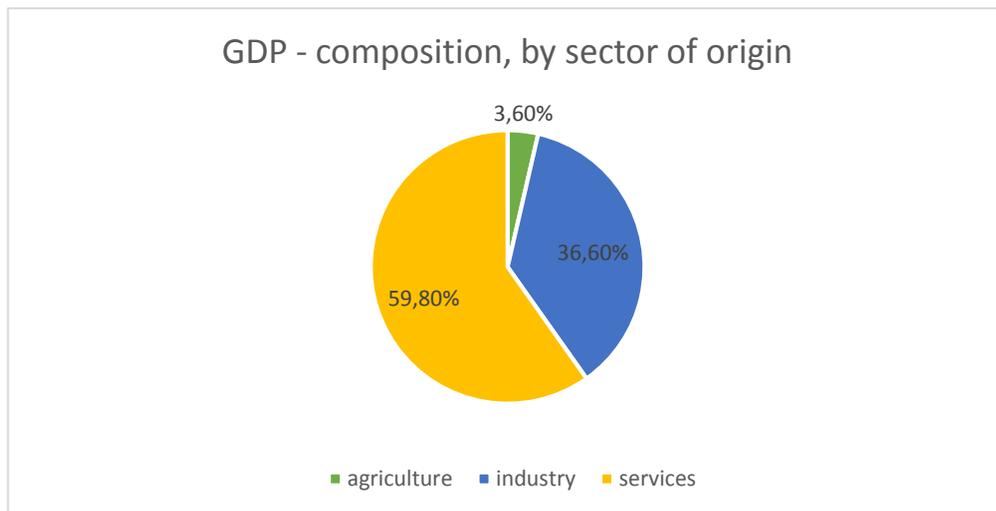
Source: Banco de México, 2014

### 2.1.3 *Economic profile of Mexico*

#### 2.1.3.1 *Economic sectors*

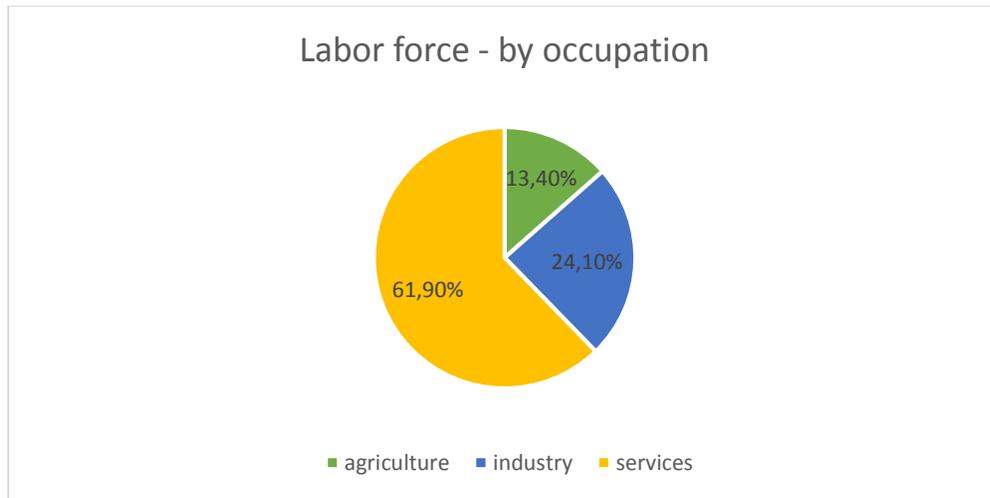
This subtopic aims to demonstrate the importance of the primary, secondary and tertiary sector in terms of GDP and employment in order to gain a better understanding of the Mexican economy and the placement of the silversmith sector in the economic structure. Mexico's GDP was 1.845 trillion US dollars in 2013. Figure 2-5 and 2-6 show that the tertiary sector of services plays the most important role in terms of GDP as well as occupation (Central Intelligence Agency, 2014). It is important to note that about half of the occupation in the service sector is created by commerce (INEGI, 2014a). It is noticeable that agriculture does not contribute a high percentage to the GDP (3.6%), however still represents a much more significant percentage of total employment with 13.4%. The industry sector accounts with 36.6 for a high contribution to GDP and with 24.10% for a significant number in terms of employment (Central Intelligence Agency, 2014).

**Figure 2-5: GDP – composition, by sector of origin**



Source: Own elaboration based on data from Central Intelligence Agency, 2014

**Figure 2-6: Labor force – by occupation**



Source: Own elaboration based on data from Central Intelligence Agency, 2014

The main source of occupation in the industry sector are manufacturing industries, where also the silversmith industry of Taxco is part of (INEGI, 2014a). However, it is an industry with local importance. On the national level, the most important sectors are food and beverages, tobacco, chemicals, iron and steel, petroleum, mining, textiles, clothing, motor vehicles, consumer durables and tourism (Central Intelligence Agency, 2014).

#### 2.1.3.2 *Company landscape and employment*

In part four, the development of the silversmith industry in Taxco will be described. The development shows that in the first decades of boom large silversmith workshops with various workers were predominant. This development culminated in structural changes towards small family workshops with only one person working. Thus, it is important to understand the predominance and importance of such microenterprises in the Mexican economy, even if they lack productivity.

In 2009, INEGI published a census on the company landscape of the following three sectors: manufacturing industries, commerce and services that account for 98.4% of the economy in terms of GDP and 90.2% in terms of occupation. It is important to note that 95.5% of all companies were micro enterprises with up to 10 people occupied and they accounted for 45.7% of employment. This stresses the relevance of such microenterprises for the Mexican economy. With reference to the manufacturing industry, where the silversmith industry in Taxco is part of, they represented 92.5% of all enterprises, 23.2% of employment

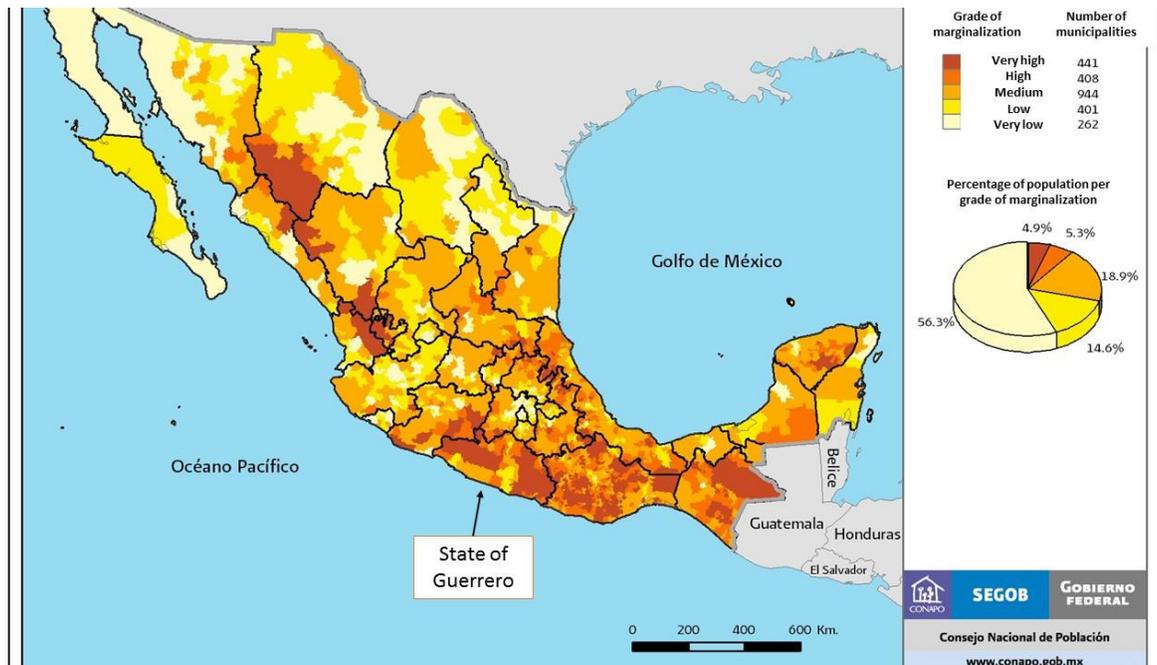
and only 2.4% of total gross production. These numbers show that the micro enterprises are an important part of the economy. However, they seem to be less productive in comparison with larger companies that only account for 0.7% of all enterprises, but for 49.7% of employment and 77.1% of total gross production (INEGI, 2009).

### *2.1.3.3 Regional discrepancies in development*

As will be further described in section three, where a profile of the city of Taxco and the state of Guerrero is presented, the region is one of the poorest and most marginalized in Mexico. Therefore, it is important to show in this subsection that enormous regional differences exist in terms of development. While some regions benefitted from the economic development of recent years, others were left behind.

In Mexico there does not exist an integral, long-term strategy for competitiveness. Instead, there have been separated efforts by region to improve their own competitiveness. This led to an unequal regional development in the country. Therefore, regions with better circumstances to produce for the export market, better infrastructure and better institutional and human capital have outpaced others in terms of development (Moreno, 2008). An indicator for the degree of regional marginalization is the Marginalization Index for federal entities and municipalities (*Índice de Marginalización por Entidad Federativa y Municipio*) that is developed by the *Consejo Nacional de Población* (CONAPO), which is part of the Department of the Interior (*Secretaría de Gobernación*). The index is based on four dimensions that contribute to the marginalization of regions and localities and that make them comparable to each other: lack of access to education, inadequate housing, insufficient monetary income and population size. The last point refers to the fact that smaller localities often lack opportunities and modernization. Instead, larger cities are performance drivers, due to economies of scale and better infrastructure, amongst others (CONAPO, 2010a). The regional differences in marginalization are shown in figure 2-7.

**Figure 2-7: Degree of Marginalization per municipality, 2010**



Source: CONAPO, 2010 with own modifications

## 2.2 Socio-cultural factors

This section is dedicated to clarify some important cultural traits that later on play an important role when the development of the silversmith industry is described. First, it is important to note the flexibility of Mexicans in daily situations and their capacity to improvise. This trait refers to the fact that today almost all silversmith workshops in Taxco are improvised family workshops. In addition, it explains why in certain years everyone, being a qualified silversmith or not, began to open a workshop in Taxco, as many Mexicans need to find improvised solutions in order to make ends meet. The description of illegality, informality and corruption refers to the lack of formal employment by which many silversmiths are affected, as they often work in unofficial workshops. Besides, there is a vast black market for the raw material silver and there have been cases of quality fraud that have prejudiced the artisan industry in Taxco. Moreover, it will become clear in further sections that the government is not making real efforts to improve the living situation of the silversmiths, which goes hand in hand with corrupt practices. The subtopic of the working context demonstrates why there is no organization amongst the silversmiths. Their efforts are isolated, which weakens their position in the market. Furthermore, it explains the phenomenon of the “patron” in the large workshops of the 30s and 40s, which makes clear

that in Mexico every kind of organization needs a strong hierarchy and strong leadership. However, this comes along with the risk of abuse of power. Finally, some characteristics in Mexican consumer behavior will be presented that help to understand, why the national market prefers cheap jewelry and is not willing to pay a higher price for good quality and handmade pieces, as it will be explained in parts 4 and 5.

### ***2.2.1 Improvisation in Mexican culture***

Many Mexicans live within a context of instability and an insecure future. Mainly economic instability causes a lack of planning and a rather short-term vision in life (Salamanca & Barragán, 2014). In addition, other factors that will be explained further in the following subtopics contribute to a lot of insecurity such as a lack of implementation of the rule of law and the common practice of informal employment. Thus, in their daily life many Mexicans are used to spontaneously improvising instead of long-term planning. This capacity of improvising derives from their necessity and concludes in a high flexibility as well as a certain form of fatalism that makes them believe that mainly outside forces have power over their lives (Salamanca & Barragán, 2014).

### ***2.2.2 Illegality, Informality and Corruption***

Unfortunately, corruption and favoritism are common practice in Mexico. The country ranks 106 out of 177 countries in the Corruption Perception Index, developed by Transparency International that measures how corrupt a country's public sector is perceived to be. In addition, it ranks a score of 34 from a scale from 0 to 100, where 0 is highly corrupt and 100 is very clean. Thus, the score indicates that Mexico is rather corrupt than clean (Transparency International, 2014). In addition, it is well known that relations are important to succeed in the business environment and it is common practice that companies get preferential treatment for contracts and permissions when supporting government agendas and political campaigns (Salamanca & Barragán, 2014). Corruption is embedded deeply in the culture at all levels of society. Courts are inefficient and open to political intervention, which means the rule of law is not in place. This context of weak institutions also encourages practices of informal employment (The Heritage Foundation, 2014). More than 60% of employment is informal in Mexico. Mostly tax evasion and inflexible labor laws lead to a preference of employing people informally (OECD, 2013).

### **2.2.3 Working context**

From the analyzed corrupt practices in Mexico derives a deep embedded mistrust in Mexican culture. It is the one country in Latin America, where the population trusts less in institutions such as the police, the army, governors and other public servants. This is due to the presence of violence, corruption, problems with drug trafficking and a general tendency to mistrust in others as part of the Mexican culture (América Economía, 2012). In fact, most Mexican citizens always fear to be deceived by others and they do not believe in solidarity amongst Mexicans. Family members are trusted a lot, while there is much less trust in work colleagues (Instituto Nacional de las Mujeres, 2008). This also reflects on the work culture in Mexico and results in a lack of teamwork and collaboration between colleagues and companies (El siglo de Torreón, 2003).

Mexicans prefer a paternalistic management style in their organizations. This means that structures are very hierarchical and top-down. Mexican workers do not appreciate a management style where they are given a lot of freedom for participation in decision-making. They rather get clear instructions and are supervised, since they do not want to take responsibility in case something goes wrong. Instead, the responsibility takes the superior. However, Mexican workers expect their superiors to show a true personal interest and demonstrate respect for them. In return, they follow instructions and show loyalty to their superior. This is interconnected with the fact that in Mexican culture rules and regulations are not taken very seriously and represent more a guideline for what ought to be done, but must not necessarily be done. This is obvious in everyday life. However, within an organization the workers follow rules out of respect to their superior, if a paternalistic relationship exists. Without that strong emotional bond, rules tend to be ignored (Schuler, Jackson, Jackofsky, & Slocum, 1996).

### **2.2.4 Towards a modern society – consumer characteristics**

Mexican culture is changing. Especially the swift from a nationalist system towards a neoliberal one has had its effects on consumerism. The upper and the middle class who are the main consuming classes in Mexico have changed their behavior towards consumerism and materialism similar to that of the United States (Salamanca & Barragán, 2014). Per capita GDP in Mexico was only 9 749 US dollar in 2012 (The World Bank, 2014). It results that in general Mexican consumers are price sensitive. Often price is the decisive factor in

purchase decisions (HKTDC research, 2011). In addition, the Mexican consumer is status oriented and fashion-conscious. Referring to that, he tends to give higher importance to appearance than functionality or quality (ITESM, n.d.).