INTER-AMERICAN ECONOMIC AFFAIRS

Vol. 37 **Summer 1983** **No. 1**

Mexican Policy Dilemmas: During the De La Madrid Presidency

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Introduction. The year 1978 represented the beginning of a period of rapid economic growth in Mexico. Fueled by rising oil revenues, foreign loans and investments, together with relative political stability, Mexican investment, consumption, and income rose at impressive rates. By the early 1980's however, the growth process had faltered. Rural emigration, rising inflation, and declining productivity were but a few of the problems which prompted a major economic crisis in February 1982. Indeed, to many observers, the phenomenal oil revenues only exacerbated many of the long standing problems facing Mexico.

On November 10, 1982, the Mexican government announced an agreement with the International Monetary Fund (IMF) on a program to ease the nation's mounting foreign debt. Under this "letter of intent" signed with the IMF, Mexico could receive a credit of up to $3.84 billion from the Fund during the next three years on the condition that the government reduce the deficit, raise taxes, and curb imports.[1]

The recent slowdown in economic growth caused by Mexico's initial austerity measures has already affected the U.S. economy. For example, in 1982 exports from the U.S. to Mexico declined by nearly $6 billion from a year earlier. It was estimated that this resulted in a loss of approximately 150,000 jobs in the U.S. and had a major impact on the economic recovery that had been predicted for the third quarter of 1982. U.S. Administration economists have recently predicted that because of the debt problems of Mexico and other developing countries, the 1983 trade deficit will be between

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[1] "IMF Austerity Prescriptions Could be Hazardous," *Business Week*, February 21, 1983, p. 112.

$10 and $20 billion larger than in 1982—a loss equal to about 0.5% of the nation's GNP.[2]

The recent avalanche of major government policy initiatives which have been published by the new administration has led many observers of the Mexican economy to look at 1983 with both caution and concern. On the one hand there is hope for a marked improvement in economic performance but on the other hand concern that the economy will continue to exhibit the customary shocks and surprises.

The purpose of this paper is to identify some of the major macroeconomic variables that should prove to be reliable indicators of the country's medium-term economic prospects. These indicators have been developed from a larger study[3] on the feasibility of the stabilization program as suggested in the letter of intent. After developing a macroeconomic model of the Mexican economy, using the procedure of optimal control, several simulations of the economy were conducted.[4] Each simulation represented a different mix of policy options available to the Mexican government or modifications to the IMF program. The effects of each program on economic variables such as inflation, growth and investment rates, and the deficit/Gross National Product ratio are examined. The main finding of the paper is that if Mexico is concerned only with meeting the narrowest of goals suggested in the IMF letter, recurring crises are quite likely to continue into the future. However, if major tax reforms are enacted at the same time, our model suggests that the Mexican economy could easily return to a high growth path by the end of the De la Madrid presidency.

The Current Crisis. Mexico's current economic problems can be traced to both external and internal factors.[5] Primary among the most recent external causes were a weakening of the world market for oil and higher international interest rates. While oil exports are still important, they only amounted to $14 billion in 1981 instead of the $20 billion anticipated by the government.[6] Furthermore, the increasing world interest rates, combined with rising debt, drove the interest burden from $5.4 billion in 1980 to $8.2 billion in 1981.

Internal policies adopted by the government tended to exacerbate the problem. While the country's ambitious growth policy resulted in average real income growth of 8.2 percent between 1978 and 1981, the long-term growth capacity of the economy was only approximately 6 percent. The result as expected was increased inflation. With an apparent unwillingness to reform the tax system, budget deficits had reached 16 percent of Gross Domestic Product (GDP) by 1982. In addition, the authorities maintained a fixed exchange rate for most of the 1977-1980 period in spite of a 23 percent anual inflation. As a result of the overvalued exchange rate non-oil exports stagnated.

In February 1982, the Bank of Mexico withdrew from the dollar market and allowed the peso to float freely. There was an immediate 30 percent depreciation of the currency followed by another 18 percent devaluation in May 1982. At the same time, the government instituted a program of "self-discipline" styled after IMF programs. The program did not, however, involve the IMF. Some of the measures enacted included: a reduction of the deficit GNP ratio, price controls on certain basic and industrial products, limits on public and private sector imports, and nationalization of banks in September 1982.

While well structured, the program was by and large unsuccessful. This was especially true in the key area of public finance since apparently the government was unwilling to sacrifice government expenditures and limit further credit expansion. Unable to raise enough capital in financial markets, the government approached the IMF in the summer of 1982 for a major loan.

On November 10, 1982, a letter of intent was signed by the

[2] As outlines in *IMF Survey* (January 28, 1983), pp. 1-2.

[3] Cf. Robert E. Looney, "The Oil Question and Policy Optimization in Mexico," Paper presented at the Eastern Economic Association Meetings, Washington, D.C. (April 29, 1982); and Robert E. Looney and P. C. Frederiksen, "Optimal Stabilization Programs for Mexico in the 1980s," Paper presented at the North American Economic Association Annual Meetings, New York (December 29, 1982).

[4] Further details of the macroeconomic model can be obtained from the authors on request.

[5] William R. Cline, "Mexica's Crisis, The World's Peril," *Foreign Policy* (Winter-Spring, 1983), pp. 107-108.

[6] Basil Caplan, "Mexico—The World's New Biggest Borrower," *The Banker* (July, 1982), p. 33.

IMF and Mexico. While only a first step in a final IMF loan package, the letter outlined a three year economic adjustment program for Mexico. The main thrust of the letter was to reduce the size of the deficit which was at its highest level ever in 1982—16.5 percent of GDP. Specifically the letter [7] called for deficit to GNP ratios of 8.5, 5.5 and 3.5 percent in 1983, 1984, and 1985-87, respectively. This of course implies major cuts in public expenditures. In addition, the country made a specific commitment that the debt, now at approximately $60 billion, would not increase by more than $5 billion in 1983. The Mexican government initially rejected the Fund's proposal to remove exchange controls, eliminate the three tier exchange rate system, or raise domestic interest rates. However, the government has now apparently agreed to a compromise on each point. Incremental movements towards the Fund's position will be implemented over time.

As of February 1983 the government was trying to put the finishing touches on a $5 billion dollar syndicated private loan, specified by International Monetary Fund as a condition for IMF assistance. For the first time in history, the IMF tied its aid to successful completion of this syndicated loan—the amount being calculated on the basis of the percentage of foreign financing the Mexican government will be allowed to apply toward its budget deficit.

Clearly what began in early 1982 as a short run liquidity problem for the country has turned into a longer term financial crisis of major magnitude with the advent of declining petroleum prices. Mexican officials conceded that, for every dollar drop in the price of oil the country stands to lose at least $500 million dollars per year in export revenues. This is a significant sum considering Bank of Mexico forecasts of total dollar trade income during 1983 around $21.5 billion dollars including $15 billion in oil revenues, $5 billion in non-oil exports and $1.5 billion net intake from tourism (due primarily to drastically reduced expenditures by Mexicans traveling abroad).

An even bleaker picture has been painted by the Finance and Public Credit Secretariat (SHCP). SHCP has estimated that foreign currency needs during 1983, including foreign

[7] As outlined in *IMF Survey*, January 28, 1983, pp. 1-2.

interest payments of $13 billion dollars owed by the public and private sector, nominal repayments on foreign loan principal and imports of essential parts and raw materials as well as foodstuffs, will amount to $31.30 billion dollars. SHCP expects net new foreign loans of $5.36 billion dollars (including the $1.3 billion dollar first installment on the three year IMF loan, the $5 billion dollar private syndicated loan, U.S. government supported commodity credits of $760 million dollars, credits from foreign suppliers of $1.19 billion dollars, and credits and financial supports from the World Bank and the Inter American Development Bank, and other world leaders worth some $600 million dollars. On the negative side of the balance sheet, the SHCP plans to repay $2.19 billion dollars against loans extended last year by the Bank of International Settlements and the U.S. Federal Reserve Bank, and to direct another $2 billion dollars to "accumulations of international reserves."

On the basis of SHCP's analysis of these trends, a "basic" foreign currency deficit of nearly $4.2 billion dollars has been budgeted for 1983. This deficit must be accommodated by private sector free market purchases of foreign currency (made outside the Mexican banking system)—or by a further reduction in anticipated private sector imports, and the production cutbacks that this implies.

Obviously, a steep drop in oil prices would severely threaten the Government's delicate current account balancing act. Government officials, however, have thus far attempted at least in public comments to downplay the possible ramifications of an oil price war. The Bank of Mexico has, for example, noted that a $3 dollar per barrel price slump would only affect 10 percent of total expected oil revenues. In this particular case, "only affecting 10 percent" would mean a drop in projected oil export revenues during 1983 of approximately $1.5 billion dollars, thus producing an extremely damaging blow to the country's overall reserves position.

On the brighter side, there is a certain margin for error in the IMF prescription for Mexico. For example, the $1.5 to $2 billion dollars designated for foreign reserve replenishment could be drawn upon in an emergency. Moreover, negotiators from the IMF and Mexico assumed that the country would pay an interest rate of 14 percent on foreign loans throughout 1983. Falling world interest rates will result in a substantially lower effective rate with each percent drop in interest rates saving the country $600 million for the year as a whole. The possibility remains that the deflationary pressures of an oil price drop will even accelerate the declining trend in interest rates.

Furthermore, early in February IMF member countries agreed to boost the organization's emergency lending fund by 47.5 percent, equivalent to some $31 billion dollars to help shore up debtor nations that could go into deflate. At least theoretically, the decision could mean additional IMF bail-out credits for Mexico, over and above those originally approved on December 23, 1982.

The De la Madrid Policy Response. The De la Madrid Administration has begun to deal with the economic crisis and in doing so, identified five major areas of priority: [8]

1. inflation;
2. balancing the country's various foreign accounts;
3. generating savings to recapitalize a financially depleted economy;
4. job creation;
5. building confidence in the government's ability to manage the present crisis and in general stabilizing the overall economic situation; and
6. defining the role of the state in Mexico's mixed economy.

The administration has moved quickly in its anti-inflation efforts—demonstrating a dogged willingness to take politically unpopular though economically necessary steps such as lifting price controls, reducing government subsidies, slowing monetary growth somewhat and adopting a conservative salary and wage policy toward government workers as well as in the official minimum wage.

An even more difficult task ahead is for the government to balance its foreign acounts in order to generate the resources needed to pay foreign debt interest payments, pay for essential imports such as foodstuffs, and begin to rebuild its international reserves. To this end, the government will have to reshuffle its mix of policies as a result of declining although yet to be determined oil export revenues. The common package of measures such as increasing export revenues, dcreasing imports, obtaining new foreign debt and restructuring overall foreign debt will be much harder to achieve than when the government had hoped would be the case at the end of 1982.

The De la Madrid administration plans to substantially increase its crude oil production and exports in 1983 although these plans could be seriously crimped by the current near term outlook for the world petroleum market.

While PEMEX is forecasting crude production in 1983 to average approximately 2.85 million barrels a day with exports averaging at least 1.5 million b/d and hopefully a bit more, actual rates may be considerably lower, particularly when member nations of OPEC are facing new world market pressures to cut back both on production volume and export prices.

Meanwhile it has been estimated that just in order to maintain planned export levels—in other words, at least 1.5 million b/d will require PEMEX capital investments of at least 240 billion (1980) pesos, in the 1983-88 period. That projection, which could translate to closer to 600 billion, measured in current pesos—compares with PEMEX capital investments totaling 344.4 billion pesos in the 1975-81 period, of which 150.1 billion (43.6 percent) was represented by imports.

Unfortunately, the decline in oil export revenues is occuring at a time when the government is still without any type of export promotional plan, and when cumbersome export procedures only act to impede rather than stimulate exports. Furthermore, having export prices transacted at an unfavorable controlled exchange rate instead of the "free" rate is another disincentive for exports, and negates the advantages that could be gained from the three major peso devaluations occurring during 1982. The ever increasing estimates for 1983 for grain imports and declining export revenues have caused public policy to shift more toward cutting non-food imports. The consequent decline in intermediate inputs will most likely cause gross domestic product growth to decline in real terms even more than the percent initially projected after the December 1982 signing of the IMF stabilization agreement.

Another key area the government was counting on to help balance their current account and restore a degree of economic stability was to secure new foreign loans above and beyond the still being negotiated $5 billion jumbo loan and restructuring overall foreign debt to win a brief respite from interest and principal payments obligations in 1983. These restructuring efforts and new loan solicitations come precisely at a time when the international financial community has begun to grow ever more nervous about the loans already made to developing countries and the declining flow of petrodollars that are normally recycled in the form of loans to these indebted nations. In other words, it is quite possible that international credit flows to Mexico could decline very quickly. At best, whatever new loans are secured will be acquired at greater financial cost as well as with stricter loan conditions.

The nationwide long term importance to "recapitalize" the financially depleted economy rests upon reattracting capital that left the country in recent years, particularly in 1982, and perhaps more importantly the ability to attract new foreign investment into the country. In fact, direct foreign investment is perhaps the only realistic source of capital and technology available that could generate enough resources for the country to satisfy population and employment needs as well as setting the stage for a new period of sustained economic growth not dependent upon foreign creditors. In this respect, however, there has been little in the way of initiatives taken in the first two months of the De la Madrid presidency.

What appears to be needed is an honest assessment of the extent of the damage suffered by Mexico since August 1982 with respect to its ability to attract foreign investment on the scale needed and desired. The taboos broken by the previous administration (nationalization of the banks, exchange controls, closing of "Mex-dollar" accounts, a tightened transfer of technology law, higher taxes and clamps on profit remittances) are factors which appear to have made a lasting impression in the minds of many corporation directeors who are now shopping around for more advantageous sites for their foreign operations. Modifications in current laws may not go far enough towards reversing the negative attitude increasingly held by many foreign investors vis a vis Mexico.

Apart from attempting to attract capital from external sources, the government has taken steps to reverse the decapitalization of the Mexican banking sector. Policies have resulted in increases in interest rates to levels that encourage savings. These policies have replaced the vague and dangerous "populist" notion in vogue during Lopez Portillo's last year of lowering interest rates in an inflationary period. The restructuring of the Value Added Tax to discourage consumption and shift personal income into savings is also a welcome albeit painful sign—although the new VAT structure has not been as tough as some observers had hoped to see.

A more subtle yet crucial challenge facing the government is its ability to instill confidence, in its efforts to come to grips with the present crisis and in general stabilize the situation for at least the remainder of 1983. To its credit, the Administration has appointed professional government officials to key posts indicating that few political compromises were likely struck. There were also symbolic positive steps in the government's efforts to inform and educate the general public of the full gravity of the country's economic and liquidity crisis.

Furthermore, a government criticized in some quarters as being cooly technocratic has demonstrated politically astute capacity to distribute the pain or austerity equally among the different economic and social groups in the country. The packaging of higher taxes, conservative wage policies and policies and other measures have caused every sector to feel the brunt of austerity without reacting by charging unfair treatment. The political astuteness of the government however will no doubt be in greater need as the country enters a sustained period of economic recession.

In the area of employment, the De la Madrid Administration hopes to create between 500,000 and 700,000 new (albeit temporary) jobs in 1983 evenly divided between rural areas and "critical urban areas." The ambitious 400 billion peso four point program also aims to protect the nation's productive plant and to create an obligatory social service system to absorb some 40,000 recent college graduates. Finally, the program extends to 6 months the amount of time unemployed workers and their families remain eligible for Social Security (IMSS) medical services and related benefits.

Up to 350,000 new jobs are to be created, at least temporarily, in depressed rural zones in 12 different states, primarily through intensified "pick and shovel" construction and maintenance of highways and rural access roads. Other projects include railway maintenance work, irrigation system expansion, reforestation efforts, maritime labor, river control and the expansion of farm sector cooperatives.

Supporting the urban and rural employment projects will be a concerted government effort to preserve the existing productive plant. In large part the underlying strategy is based on re-orienting public expenditure toward the domestic market, providing fiscal stimulants and adequate foreign currency and establishing the means to pay off private sector debt. Through those programs the De la Madrid Administration hopes to avert new bankruptcies and lay offs. Small and medium sized industries will be able to turn to the government development bank Nacional Financiera, via its specialized FOGAIN trust for low cost peso credit lines. FOGAIN hopes to make available 53 billion pesos in credit for small and medium industry in 1983 in the perhaps exaggerated hope of eventually creating 180,000 new jobs in the manufacturing sector.

The Energy Employment Program should effectively defuse social tensions caused by the drastic contraction in Mexico's economy. On the other hand, Federal employment programs of such a massive scale often lead to accelerated inflation and little GNP growth. The classic Keynesian solution of "putting some men to work digging holes, and others to work filling them" may be effective in a time of falling prices and Federal budget surpluses. With Mexico's hyperinflation and severe budget deficit however, such a program might do more harm than good, even though significant improvements in housing and in the transportation infrastructure might result.

Interestingly enough the jobs program dramatized how truly little is known about the scope and composition of Mexican unemployment. Officially, only 8 percent of the nation's work force is currently (early 1983) looking for a job; however that figure is complicated by an estimated 40 percent of the work force that is sub employed. Further clouding the issue, Mexico's diverse opposition parties and labor factions

tend to quote only figures that they find useful. Thus while the opposition parties place unemployment at more than ten million (or nearly 50 percent, assuming a theoretic labor force of 22 million), the government controlled labor confederation estimates that the 700,000 jobs to be created by the Emergency Program will represent 2/3 of those currently unemployed.

Whatever the figure, which no doubt lies somewhere between the two quoted, unemployment is certain to be a continuing issue throughout the De la Madrid presidency. What is not certain as yet is to what extent his new Emergency Jobs Program will effectively alleviate the problem.

Finally, in attempting to delineate the role and function of the state, the De la Madrid administration sponsored a bill in the Chamber of Deputies in late December 1982 granting the title "economic rector" to the Federal government. The Senate also passed the initiative which clarifies the government's activities in the country's so-called "mixed economy."

A special Chamber of Deputies Commission justified the amendments on the basis of historical precedents, as well as because of "the level of economic development and the density and complexity reached by Mexican society and by the accumulation of its contradictions." Also cited was "an economic crisis of structural dimensions—inscribed in the most profound world crisis since the depression of 1929."

The changes and amendments to the Mexican Constitution make explicit "the rectorial function of the state in development" while at the same time establishing a "national planning system to give coherence to the economic participation" in the planning, thus—at least officially—giving various sectors of society an increased voice in the economic development policy making process while also fortifying the role of the Congress. Finally, the proposed Constitutional changes "fix the bases for an integrated rural development, and for improved agrarian justice."

Given the traditionally strong—indeed heavy handed role played by the Mexican state in economic matters, some ob-

[8] Based on accounts in American Chamber of Commerce of Mexico, *Mexico Update* (December 27, 1982); January 14, 1983; January 31, 1983; and February 11, 1983).

servers have downplayed the significance of the Constitutional Reforms. They point out that ex-President Lopez Portillo nationalized the Mexican banking system first, then later modified the Constitution to legalize this action. Other government initiatives affecting the private sector have been equally abrupt—and equally binding.

Nonetheless, a constitutional reform of this magnitude and at this critical point in Mexican socio-economic history raises questions about the country's future economic and political evolution, within the Mexico economy approach. The Administration has yet to declare its intentions toward the hundreds of private companies it acquired along with bank nationalization. Nor has the Administration's specific attitude toward foreign investment been articulated. The recent Constitutional reforms, even if only symbolic in nature, are nevertheless adding to the already charged atmosphere of uncertainty.

Clearly it is too early to evaluate the effect the De la Madrid policies will have on the economy over the next few years. At present, there is however widespread concern in Mexico, especially among politicians, that the policies embodied in the IMF Program could in and of themselves lead to negative growth rates in the economy during 1983 and perhaps beyond. To examine whether or not this fear is justified, several simulations of the economy were conducted under different assumptions as to policy mix. The model and the results of the simulations are described below.

Various Stabilization Programs. The two main policy variables in the model developed for this analysis are (a) government investment (the chief instrument of fiscal policy) and (b) the Bank of Mexico credit to the government. The technique of optimal control theory was employed to derive the optimum policy mix associated with each set of predetermined targets. That is to say in each simulation an objective was specified, and policies were evaluated in terms of the trade-offs associated with their resultant growth path over the 1982-87 period.[9]

[9] The model's exogenous variables were set at the following rates to reflect in large part historical movements: (a) an exchange rate: 90 pesos to the U. S. dollar, (b) the rate of increase in the crude petroleum index: 6%, (c) growth of crude petroleum exports: 6% per annum, (d) growth of U.S. Gross Domestic Product: 2.5% per annum, and (e) growth of U.S. consumer price index: 6% per annum.

The effectiveness of each stabilization program is measured by the value of seven important economic variables. The seven variables are the average annual growth rates from 1982 to 1987 for (a) private consumption, (2) private investment, (3) total investment (private plus government investment in addition to inventory changes), (4) GDP, (5) the 1987 external borrowing requirement (exports minus imports) in billions of 1975 pesos, (6) the 1987 rate of inflation, and (7) the 1987 deficit GNP ratio.

The "baseline scenario" is the mildest option open to the government. This program assumes a *status quo* of the economy and inasmuch assumes no agreement has been reached with the IMF. Existing policies are thus extended, and deficits are not controlled. The objective is to maximize real GNP by 1978 but at the same time to reduce the inflation rate to 20 percent. The result in terms of these seven variables for the baseline scenario are presented in Column (1), Table 1.

As indicated, the inflation rate is below 18% by 1987 and at the same time the deficit/GNP ratio has stabilized at approximately 11.5 percent. However, the external "gap" (varible 5) would reach 84.1 billion pesos by 1987—clearly infeasible from Mexico's point of view.

TABLE I

Effect of Various Stabilization Programs on Selected Economic Variables

	Programs		
Economic Variable	Baseline Scenario	IMF Letter of Intent	IMF Letter with Tax Reform
(1) Private Consumption [a]	6.2	3.5	4.8
(2) Private Investment [a]	5.9	−4.1	1.4
(3) Total Investment [a]	6.4	−3.0	2.1
(4) Gross Domestic Product [a]	5.9	2.3	4.2
(5) 1987 External Borrowing Rate [b]	−84.1	0	−27.3
(6) 1987 Inflation Rate	17.4	6.0	3.9
(7) Deficit/GNP Ratio %	11.5	3.5	0.6

[a] Average Annual Growth Rate, 1981-87, Percent
[b] Billions of 1975 Pesos

The second stabilization program—the IMF Letter of Intent Program—represents a fairly severe stabilization effort. The major constraints explicitly outlined by the November 1982 letter of intent are that the deficit/GNP ratio is to be fixed at 8.5%, 5.5% and 3.5% for 1983, 1984, and 1985-87 respectively. The letter of intent was interpreted to imply an inflation goal of less than 10% by 1987 and government borrowing and Bank of Mexico credit be constrained to a 5% average annual increase between 1981 and 1987. Given these constraints, government investment is reduced by the model to a level which still maximizes the real GDP in 1987.

As can be seen Column (2), Table 1, strict adherence to the letter of intent program would represent a fairly severe shock to the Mexican economy. Despite a positive rate of growth for GDP and a 6 percent rate of inflation, both private and total investment experience negative growth rates over the time period examined. This result is due to the entire emphasis being placed on reductions in government expenditures to meet the deficit targets.

An alternative program open to the government is to introduce some form of tax reform concomitant with reductions in government expenditures. Thus the burden of reaching specified deficit targets is spread between less government spending and increases in tax revenues. Assuming that the autehorities have the political will to reform part of the tax structure, the second program outlined above was rerun with the additional constraint that government revenues were to increase at an average annual rate of 15 percent between 1982 and 1987.

The results of this program appear in Column (3), Table 1 and indicate the beneficial effects of some form of tax reform. Private investment, total investment, and GDP increase at average annual rates of 1.4, 2.1, and 4.2 percent, respectively. In addition, the inflation rate is reduced to under 4 percent. More importantly however, the external gap declines to 27.3 billion pesos—an average annual decline of approximately 11 percent since 1981. Furthermore, this program is consistent with increases in the standard of living—private consumption expands at an annual rate of 4.8 percent.

In short post-devaluation (1982) fiscal policy will require a restricted level of government expenditure. This is particularly true for current (operating) expenditures. It is also extremely important to treat investment outlays with care: substantial

and indiscriminate reductions risk would most likely jeopardize the longer term growth of the economy. It goes without saying that the government will have to install procedures to ensure that investment projects are authorized according to a strict order of priority.

In terms of taxes, one of the characteristics of the Mexican tax system until quite recently was the almost unitary elasticity of tax collection; i.e., tax revenuee fluctuated only slightly above the nominal GDP. Recent reforms have attempt to increase the rate of tax collection at a rate more rapidly than the nominal product (in order to strengthen its effect as an automatic stabilizer). Hopefully, this will give the authorities greater scope and ability to reduce inflationary pressures while providing funds to meet the priorities of the national budget.

Policy Options. Realistically, quantitative forecasts presented above are somewhat problematical. Accurate assessments concerning the country's medium term prospects will be possible only after the new administration has a year or so to outline its modifications in the country's development strategy and when the confusion generated by the recent exchange rate adjustments is dissipated.

However, the Mexican economy will probably evolve along one of three possible courses in the coming years: [10]

1. variable inflation, with slow growth and fluctuations of the "stop-go" type;

2. recession, with declining inflation and increasing unemployment, and

3. moderate growth, with stable, or perhaps even declining inflation.

Alternative three is obviously the government's choice, and one shown in the previous section to be feasible, while course 1 is more or less the current state of affairs. Alternative 2 is the presumed result of the relatively strict International Monetary Fund type program outlined above. This latter option can

[10] A similar assessment was made by L. Solis for the period following the 1976 devaluation and stabilization program. See his "The External Sector o fthe Mexican Economy," in Joseph Grunwald, ed., *Latin America and the World Economy: A Changing International Order* (Beverly Hills, California: Sage Publications, 1978), pp. 133-146.

be rejected more or less out of hand as a likely outcome simply because experience has shown that more often than not this policy mix has led to strong social tensions which in time become uncontainable producing drastic policy changes. The net result is often an unstable path of the first alternative (the "stop-go" type); i.e., it appears that in choosing voluntary deflation, countries condemn themselves to inflation; in both cases forces are unleashed which make it necessary to rectify the direction of economic policy and this leads to unstable policy impacts. Interestingly enough, it appears that from the Latin American experience at least a pattern seems to develop whereby when successive corrections are made, they generally occur within increasingly short periods of time and thus destabilize the economic indicators on which companies and investors must make decisions. Clearly, the problem becomes serious when changes of direction take place before the economic system adapts to the previously established set of conditions; i.e., an increasingly unstable situation of the "stop-go" type character is likely to occur.

The pattern Mexico seems to be currently falling into and one in which the new administration must make every attempt possible to avoid is one where credit and public expenditures rise, thus increasing the real demand pressure upon resources accelerating the rate of price increase, and increasing the balance of payments deficit. The deficit in turn eventually forces reductions in credit and public expenditures but only after the situation has reached a stage whereby only extreme contractions in expenditure will reverse the process. This in turn reduces economic activity, and the process begins again in what seems to be a vicious cycle.

Currently developing in the Mexican case are a series of conflicts: (1) foreign debt; (2) wages and other domestic income, and (3) in general, the national purchasing power, all of which threaten to set off the self-perpetuating process of "stop-go" instability outlined above. This conflict may arise because the "stop-go" process is clearly operating by modifying the consumers' real income, altering the surpluses available for export, and reducing investment. In other words, the current economic policies in Mexico are in real danger of losing any semblance of continuing. Obviously, unless reversed the resulting instability will result in lower rates of private investment and a deceleration in the long run trend of potential real GDP growth.

Whatever shortcomings "stabilizing development" had as an economic policy in its heyday between 1955 and 1970, it was a coherent strategy, enabling the private sector to adapt to the prevailing conditions. This sector did respond by undertaking long term projects (which would have most likely been impossible in the presence of a "stop-go" instability).

Given the current (1983) Mexican economic situation it is urgently necessary to reduce any incompatibility between the balance of payments and the growth of real GDP. To achieve this two associated conditions are necessary.[11]

1. The peso must not be overvalued, especially for long periods of time.

2. The level of wages and other domestic incomes must not be separated from the conditions that prevail in the markets for labor, capital, and other factors of production.

Incompatibilities in Policy Objectives. Examination of Mexico's major economic objectives has revealed a number of additional potential incompatibilities.[12] In large part resolution of the apparent trade-offs inherent in the country's development form the basis of the ongoing debate within Mexico on economic and social development in general, and on trade in particular. Growth rates of 8 percent per year have shown a tendency to cause inflation to rise significantly above the U.S. level, undermining both income distribution and manufacturing export goals (because of an increasingly overvalued peso). Mexico's inflation rate was around 30 percent in 1981

[11] Further elaboration on these points is contained in Robert Looney, "The Oil Question and Policy Optimization in Mexico," Paper presented at the Eighth Annual Convention of the Eastern Economic Association, Washington, D.C., April 29, 1982.

[12] See also Sidney Weintraub, "Case Study of Economic Stabilization: Mexico," in William R. Cline and S. Weintraub, eds., *Economic Stabilization in Developing Countries* (Washington: Brookings Institution, 1981), pp. 272-295; Laurence Whitehead, "Mexico From Bust to Boom: A Political Evaluation of the 1976-79 Stabilization Programme," World Development (November 1980); and Leopoldo Solis, "The Petroleum Boom in Mexico: An Opportunity for Correcting the Pattern of Economic Development," Paper presented at the North American Economic Studies Association Meetings, Mexico City, December 28, 1978.

probably exceeding 100 percent in 1982. Supply constraints, bottlenecks and lack of monetary controls have thus resulted in a close link between high rates of growth and rapid increases in inflation.

Rapid growth has also hampered the development of a domestic capital goods industry as the overvaluation of the peso resulting from growth induced inflation made imports of capital goods relatively attractive. Similarly, rapid growth through its inflationary and exchange rate effects significantly reduced the attractiveness of Mexican goods exports. Mexico is thus taking on many of the aspects of a mono-export economy.[13]

The trade-off between industry and agriculture implicit in the Global Development Plan (GDP), the National Industrial Development Plan (NIDP) and the Mexican Food System (SAM)[14] is still not yet fully apparent. The NIDP was drawn up without much emphasis on agriculture. On the other hand, SAM and the GDP did not fully integrate planning in all sectors when re-emphasizing agriculture. It is clear upon a careful reading of the plans, however, that they represent more of a compilation of the different perspectives of several ministries, and are not in any true sense an integration of these perspectives.

One apparent trade-off between industry and agriculture in the NIDP is a gap in projected productivity between the two sectors, with agriculture significantly lagging behind industry. This discrepancy has been addressed to some extent by the subsequent publication of the GDP and the Mexican Food System (SAM) plans.

Both the GDP and SAM emphasize agriculture to the extent that:

1. rates of 4 percent higher than that projected in the NDIP are now the official targets for the sector;

[13] Similar to the process described in Jahangir Amuzegar, "Oil Wealth: A Very Mixed Blessing," *Foreign Affairs* (Spring 1982), pp. 814-835.

[14] Cf. Calvin Blair, "Economic Development Policy in Mexico: A New Penchant for Planning," Institute of Latin American Studies, the University of Texas at Austin, *Technical Papers Series No.* 26 (1980) for an excellent summary and comparison of the plans.

[15] Carlos Benito, "Policies for Food Production and Consumption in Underdevelopment: The Case of Mexico," *Journal of Policy Modeling* (1979), pp. 383-398.

2. self-sufficiency in corn and beans by the end of 1982 is a major target;

3. an increase in agricultural investment over the period 1980-82, sufficient to bring the sector's allocation up to 22 percent of total public investment, is now a major objective;

4. self-sufficiency in other basic foods by the end of the 1980s is an explicit government objective, and

5. significant reforms in food prices, credit, packaging, transportation and tractor production are anticipated.

The resolution of priorities and the means best suited to attain the country's development objectives will sooner or later force the government to define more clearly its view of the future structure of Mexican society, the country's relationship with the U.S. and its role in the international economic system; i.e., will the country opt for a model of independent nationalist development or one of full integration into the international economic system?

The nationalist/internationalist debate stems[16] directly from the general ideological tendencies and divisions which characterize the Mexican political system. In very general terms Mexican nationalists tend to emphasize: (1) petroleum conservation; (2) diversification of markets away from the U.S.; (3) continued use of non-tariff protection methods (anti-GATT); (4) development of basic foods rather than export agriculture; (5) a relatively large government role in the economy; and (6) heavy expenditure on social programs. In sharp contrast Mexican internationalists tend to stress the desirability of: (1) high levels of petroleum production; (2) expansion rather than diversification of markets; (3) closer relationships with the U.S.; (4) opening the economy more rapidly to import competition as the best way of developing competitive industries (pro-GATT); (5) the encouragement of comparative advantage forces in agriculture; (6) reliance on the private sector for continued growth, and (7) trickle down theories of income distribution.

The internationalist position is a composite of views. The complete set of policies outlined above is not advocated by any

[16] Cf. E.V.K. Fitzgerald, "Recent Writings on the Mexican Economy," *Latin American Research Review* (1981), pp. 236-244, for a summary of this debate.

one person or group but is rather the general attitude of many leading technocrats in the government.

In practice current (1983) policy is a mix of the two themes, leading toward somewhat the nationalist side.

If things turn out well, Mexico will be able to achieve zero real growth in 1983. While an IMF Stabilization Program with tax reform would most likely return the economy to a stable, moderate growth rate, it is clear that if the unpopular reforms facing President Elect de la Madrid are delayed, watered down, or ignored, Mexico's monetary crisis will become a long term economic crisis. It is still unclear what effects Mexico's financial difficulties will have on popular action. In the United States, newspaper and television documentaries have made forecasts of convulsive, even revolutionary political events. Such predictions seem based on a misunderstanding of Mexico. Mexico may be a country of nationalists, but it is also a country of patriots. Unlike the intellectuals who attempt to speak for them, the common people of Mexico (and even much of the middle class) are quite conservative. As one observer has recently noted, "No one has made money for many decades by betting against the Mexican political elite's instinct for self-preservation. If a political change does arrive, it is more likely to come through a change of sentiment than a change of leaders. Mexico has a history of great disappointments. An interruption of the rise to mass prosperity may be among the most unnecessary of these, but it would not seem to be the most bitter." [17]

Conclusions. Traditionally, the failure of the Mexican economic growth has been analyzed from two different perspectives. On the one hand is the view held by Tello,[18] Lustig,[19] and Reynolds [20] who believe that the country suffers from a number of structural problems. These include a low quality labor force, a basically untrained entrepreneurial labor force, an inefficient public sector, an undeveloped capital market, and an inelastic tax system. In this regard, it is felt that the solutions are long-term in nature. Inasmuch, they require careful planning and a substantial resource allocation by the government to each sector of the economy.

[17] Nick Eberstadt. "La Crisis," *New Republic* (October 18, 1982), p. 21.

[18] Tello, *La Politica Economica in Mexico,* 1970-76 (Mexico City: Siglo XXI, 1979).

[19] Nora Lustig, "Characteristics of Mexican Economic Growth," *Journal of Development Economics* (1982), pp. 355-376.

[20] Clark Reynolds, *The Mexican Economy* (New Haven: Yale University Press, 1970); and C. Reynolds, "The Mexican Economy 1982-1987: Key Issues, Policy Alternatives, and Implications for International Business," in Alice Lentz, *Country Risk Analysis: Mexico* (San Francisco: FMME, 1982).

An alternative approach, which is followed in this paper, has been suggested by Beltran del Rio [21] and Looney.[22] While recognizing the longer term structural problems facing the country, they suggest that Mexico's problems should be solved through some mix of fiscal and monetary policy with a major emphasis on tax reform. Thus, the current crisis, while serious, can be viewed as a temporary financial "imbalance." The solutions are short-term in nature, and seem to be viable options for the present government. Thus, the prospects for future economic stability in Mexico depend on the willingness and ability of the government in power to enact the necessary monetary and fiscal reforms.[23]

Under the best circumstances, it will take several years for the economy to get on track again. Private investment will most likely fall below its 1981 level for two or three years, with possibly even larger declines in the living standards of wide segments of the population. And, under the best of circumstances, it would be difficult for a president in the Mexican political system to endure the costs of keeping harsh economic policies in force for several years in a row. How much more difficult it will be if these unpopular reforms are resisted by influential groups from within and demanded from aboard by unpopular foreign (IMF) powers is anyone's guess.

[21] Abel Beltran del Rio, "Mexico's Troubled Economy: Peso Prognosis," *Wharton Magazine* (Winter 1977), pp. 55-56; "Econometric Forecasting for Mexico: An Analysis of Errors in Prediction," in J. Behrman and J. Hanson, *Short Term Macroeconomic Policy in Latin America* (Cambridge: Ballinger Publishing Co., 1979); and "The Mexican Oil Syndrome: Early Symptoms, Preventive Efforts and Prognosis," in W. Braer and M. Gillis, *Export Diversification and the New Protectionism: The Experiences of Latin America* (Urbana-Champaign: Bureau of Economic and Business Research, 1981), pp. 115-130.

[22] Robert Looney, *Mexico's Economy: A Policy Analysis* (Boulder, Colorado: Westview Press, 1978).

[23] Leopoldo Solis, *Economic Policy Reform in Mexico: A Case Study for Developing Countries* (New York: Pergamon Press, 1981).

As noted, Mexico's financial crisis was caused in part by the world oil glut. The likely decline in world petroleum export prices which could represent a major obstacle to the success of the country's stabilization effort, i.e., a drop in Mexico's oil export revenues could well force a rethinking of current government austerity policies—if not the adoption of more severe measures in the areas of government spending, import reductions, dollar availability and servicing the public sector foreign debt.

The analysis above did indicate however that a new economic policy can be structured in a manner capable of establishing a pattern of growth able to overcome the limitations of the 1971-81 period of stop-go inflationary growth. While technically feasible, the success of this policy will ultimately depend on the De la Madrid Administration's political will for implementation.