Mexico's efforts and achievements since 1982

*José Angel Gurría**

Mexico's economic situation has not always been so favorable. The 1980's were, in many ways, a "lost decade" in terms of growth and development, though not, I would argue, a "wasted decade" in terms of very real and very necessary economic reforms.

Nevertheless, the 1980's were exceptional times for Mexico. In the postwar period, and right up to 1982, Mexico achieved continuous growth, bested, in my recollection, by only a handful of countries. Inflation had always been low or moderate, though rising from the mid-70's, in line with the experience of most countries.

However, while the industrialized world recovered rapidly from the recessionary impact of 1980/81 efforts to control inflation, the impact of high real rates, combined with falling oil prices and economic policy which displayed no adaptability to changing external circumstances, nor to growing domestic structural imbalances, brought Mexico to an economic, financial and political watershed in 1982. A long standing economic model, based heavily on public sector spending as the primary promoter of growth and on a protected, inward-looking industry, broke down in the face of collapsing confidence and manifestly mistaken policies, adhered to despite early warning signals indicating the need for change.

At the end of that year, Mexico found herself for the first time in modern economic history with inflation racing towards triple digit figures, unprecedented fiscal deficit, lack of confidence in a seriously devalued currency and a recently acquired mountain of external debt. A grim picture, to say the least, requiring an immense effort, clear ideas and a strong political will to turn it around.

The economic reform implemented since 1983

The most urgent priority was putting public finance on a sound footing and ensuring that fiscal discipline be the guiding principle for the future. Positive results ensued: the public sector's financial deficit dropped from 16.9% of GDP in 1982 to 3.5% in 1990, with a 1.3% deficit estimated for 1991 -though the actual figure will show a surplus of about 2.4% once divestiture proceeds are added.

If we consider the primary balance, revenues minus expenditures net of interest payments, the public sector switched from a deficit to a surplus in 1983, with the current primary surplus on the order of 6.0% of GDP (and almost 10% including divestiture proceeds).

Meanwhile, the operational balance, which excludes the inflationary component of interest payments on domestic debt, has shown a declining deficit over the last few years, to the point where in 1991 a surplus of 2.5% of GDP was obtained, with an even higher figure expected in 1992.

Strengthening of public finance has rested as much on rationalization of expenditure as on revenue growth, through actions such as the sale of non-strategic or non-priority state enterprises, elimination of non-justified subsidies and major tax reforms, which have increased the taxable base and revenues despite marginal tax rate reductions to

Mexico's economic and financial successes over the last few years garner numerous headlines, generating growing international investor interest to support continued success. The purpose of this article is to provide an overview of the bases for continued, justified interest in Mexico by the international financial and investor community.

* Undersecretary for International Financial Affairs.

Mexican Economy (Key variables)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991[e]	1992[p]
Real GDP[1]	-0.6	-4.2	3.6	2.6	-3.8	1.7	1.4	3.1	3.9	4.0	4.0
Inflation	98.9	80.8	59.2	63.7	105.7	159.2	51.7	19.7	29.9	18.5	9.7
Nominal interest rate[2]	45.3	56.6	48.6	60.2	88.5	96.0	69.2	45.0	35.0	21.3	—
Real interest rate[2]	-25.2	-3.8	1.1	9.9	14.1	-2.9	28.4	29.9	8.4	4.6	—
As % of GDP											
Fiscal deficit[3]	-16.9	-8.6	-8.5	-9.6	-15.9	-16.1	-12.4	-5.5	-3.5	-1.3	0.8
Financial savings[4]	32.1	30.3	31.5	29.7	37.2	39.9	30.9	36.1	40.6	45.0	—
Private investment	12.8	11.0	11.3	12.5	12.9	13.4	13.8	13.4	13.7	14.1	—

e Estimated.
p Proyected.
1 Growth rate.
2 28-day Treasury Bills, annual average.
3 Excluding revenue from privatizations.
4 M4 minus notes and coins in circulation.

Source: SHCP and Banco de México

internationally competitive levels. Although corporate income tax rates have been reduced from 42% to 35% and personal income tax rates from 60.5% to 35%, tax revenues have increased by 1.6% of GDP since 1987.

The correction of public finances has pursued twin objectives: first, to establish the macroeconomic foundations for sustaining and strengthening confidence and, secondly, to concentrate the State's resources and efforts on those sectors which have traditionally been considered most needy.

A strong financial position affords the public sector the maneuvering room to devote itself to projects with the greatest social impact, increase productivity and ultimately enhance the competitive position of the country. The commitment to prudence is evidenced by the decision to create a Contingency Fund from divestiture proceeds to ensure the viability of the 1991-1992 economic program in the face of any possible external shocks, instead of spending such proceeds.

In late September 1991, it was decided that the full amount of the contingency fund, equivalent to around $6.5 billion dollars, be used to reduce domestic debt, resulting in a cancellation of fully 1/8th of the public sector's gross domestic debt. This will be followed by similar steps in the future.

Behind all of these actions is a substantial redefinition of the role of the State in the economy without infringing upon its constitutionally mandated regulatory and administrative obligations. It is a fact that the public sector no longer exerts pressure on domestic financial markets today, thus providing room to channel more resources toward productive investment at lower costs.

The decline in nominal and real interest rates is a consequence both of confidence in economic policy and of the declining, or even negative, financing requirements of the public sector. This is in fact a "crowding in" of the private sector in the credit markets. Going forward, the efficiency of the public sector will be measured against results obtained in areas such as education, health, infrastructure and social security. It is in these areas that the Mexican government is seeking to make a greater impact. With regard to the external sector, important strides have been made since 1983 to correct the structural imbalances inherited from the later stages of Mexico's import-substitution era. The authorities have consistently adopted realistic foreign exchange policies, combined with measures specifically aimed at promoting exports through deregulation.

These policies allowed the value of manufactured exports to increase annually by an average 21% between 1983 and 1990. More important, exports have been diversified to the extent that manufactured exports now represent 56% of total exports against only 14% in 1982. At the same time, the importance of oil has been reduced from 78% of total exports in 1982 to 30% in the first half of 1991.

Thus Mexico no longer depends on the export of a single product, thereby reducing the economy's vulnerability to the vagaries of a volatile oil price. For instance, in 1986 the price of oil fell to around $10 dollars a barrel, reducing the value of oil exports by 57%. Nonetheless, total exports only fell by 21% as non-oil exports grew by 41% that year.

Since then, the Mexican economy has become even less vulnerable both to oil and interest rate movements, the latter as a consequence of the 1989/90 debt restructuring under which interest payments on a quarter of the nation's debt were fixed at below market rates.

Despite undeniable progress achieved in the correction of trade imbalances, its rate was hindered by an obstacle that became evident from 1983 onwards, namely that Mexico began to be a net exporter of capital in contrast to being a net importer in years before. This situation was incompatible with economic growth, since it drained the economy of savings and therefore of investment.

An excessive level of net resource transfers abroad, in the case of an industrializing country, will impede the ultimate success of any economic reform program, hindering growth and presenting an obstacle to the elimination of inflation, no matter how consistent or far-reaching the program may be.

The burden of external debt is not only financial but also psychological, since it weighs heavily on the public's perceptions of the viability of the economic program, thereby creating uncertainty. At the same time, foreign investors are daunted by the political and economic risks posed by an unsustainable level of transfers abroad.

Between 1983 and 1988, the net transfer of resources abroad represented an average 6% of Mexico's GDP. This not only choked growth but also increased the vulnerability of the economy to external shocks, which made the adjustment program even more of an uphill battle.

External debt negotiations held between 1982 and 1987 gave the economy some breathing space. Nevertheless, they were not enough to resolve the fundamental problem which consisted of reducing net external transfers as a proportion of GDP. This could only be achieved through voluntary debt or debt service reduction or "new money" flows.

A successful renegotiation of a country's external debt overhang, whether commercial or official, can only occur once it has been made manifest to all creditors that despite profound structural reforms, the country still suffers from excessive external indebtedness which will ultimately impede the recovery of growth with price stability, as became evident in Mexico by 1988-1989.

The object of the 1989-1990 debt negotiations was to achieve permanency and solidity with respect to Mexico's external debt by eliminating the debt overhang. Once such a renegotiation was concluded, it was felt there would be a catalytic effect that would "cement" the structural reforms put in place and lead to a "virtuous circle" of increased confidence, reflected in lower domestic interest rates, higher domestic and foreign investment, capital repatriation, voluntary access to international capital markets and further consolidation of public finance and inflation control.

Mexico's recent economic history has shown that this is indeed possible. In fact, the so-called "virtuous circle" arrived with greater speed than one might have expected in mid-1989 when Mexico completed its international debt agreements.

The results of the 1989-1990 negotiations with the international banking community will permit net external transfers to be reduced to a maximum yearly level of 2% of GDP on average between 1990 and 1994, low enough to allow the restoration of historical levels of investment and growth. In fact, because of the "virtuous circle", Mexico is once again a net importer of capital, as was historically the case prior to the debt crisis of the 1980's.

The "deleveraging" of the Mexican economy has been remarkable: total public sector debt has fallen sharply from 78.4% of GDP in 1987 to about 42% of GDP in 1991. While gross internal debt dropped from 23.1% of GDP in 1987 to 18.1% in 1991, net external debt[1] has shown the most impressive decrease, from 55.3% of GDP in 1987 to just 24% in 1991. Concurrently, the servicing costs of the total external debt have declined considerably, with interest payments in the first half of 1991 representing only 18.6% as a proportion of exports of goods and services, down from 43.6% in 1982. As a proportion of GDP, total interest expenditure -internal and external- by the public sector is forecast at only 4.2% of GDP for 1992, down from 16.8% as recently as 1988. These figures would lead one to the inescapable conclusion that Mexico's debt levels are now quite sound by international standards.

The lower perceived risk associated with Mexican debt instruments has not only led to a sharp decrease in domestic real interest rates, which have fallen from 45% just before the 1989 debt agreement was announced to current levels of around 5%, but also to an impressive return to the international capital markets. Since 1989, over $5 billion dollars of debt and equity instruments have been

[1] This is a contractual public sector external debt net of financial assets held abroad for collateralized purposes and debt repurchased but not yet cancelled.

floated by the public and private sector on ever improving terms.

Perhaps the best indicator, though, of the restoration of confidence in the Mexican economy is the return of flight capital, which has totalled over $9 billion dollars since July of 1989, when the external debt agreements were announced.

A thorough opening of trade has been a key component of the structural reform policies implemented. Until 1982, Mexico's economy was practically closed to external competition. Though this may have been a necessity in the initial stages of industrialization, over time it proved to be a source of major inefficiencies. In order to overcome these distortions, a policy of gradual trade liberalization was instrumented.

The value of imports subject to permits has been reduced substantially, from nearly 100% in 1982 to around 14% today. At the same time, administrative procedures relating to tariffs on imports and exports have been simplified, official reference prices for imports were eliminated and tariffs have been reduced both in number and rates, so that the maximum tariff on imports is now 20% against 100% in 1982.

The commitment to the opening of the Mexican economy has been marked not only by deregulation but also by institutional changes such as entry into the GATT in 1986 and, more recently, by negotiations to create the North American Free Trade Area (NAFTA) between Mexico, the U.S. and Canada.

Moreover, Mexico recently signed a free trade pact with Chile and negotiations are underway, parallel to the NAFTA, with Colombia, Venezuela and Central America. The institutional nature of these changes not only signifies commitment to open markets but also what I call the "irreversibility" of the course taken by the Mexican economy. This has and will continue to be reflected in heightened investor interest in Mexico.

A cornerstone in the process of inducing greater efficiency in the industrial sector. has been the divestiture of nonstrategic or nonpriority public sector enterprises. The public sector's participation in the industrial sphere had not always followed clear guidelines, since many of the enterprises acquired were the product of rescues from bankruptcy, even though the underlying viability of the project was questionable.

Divestiture seeks first to assist in the correction of public finances, eliminate unjustified subsidies and strengthen the State's ability to focus its attention on truly priority activities. The number of firms under state control has been reduced from 1,155 in 1982, to 250 by late 1991.

Deregulation has been part and parcel of economic reform and modernization. Some regulations have been eliminated and others simplified and made clearer. The changes made to foreign investment regulations now allow for automatic approval of projects in the majority of cases, portfolio investments through special trust funds and majority ownership in an expanded number of sectors.

Domestic debt (Billion pesos)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991[e]	1992[p]
Gross domestic debt[1]	2.6	4.8	6.5	11.1	25.5	64.1	113.9	132.9	166.9	139.0	108.6
Fiscal revenue	2.8	5.9	9.5	14.8	24.1	59.1	118.5	149.1	199.2	—	—
Public sector domestic interest	0.5	1.4	2.3	3.7	9.6	29.7	52.0	47.3	49.7	—	—
GDD/GDP[2]	—	20.6	19.1	18.6	23.0	23.1	22.6	24.1	22.4	18.1	12.6
Interest/GDP	5.1	7.8	7.8	7.8	12.1	15.3	13.2	9.2	7.4	—	—
Interest/fiscal revenues	17.9	23.7	24.2	25.0	39.8	50.3	43.9	31.7	24.9	—	—

[e] Estimated.
[p] Projected.
[1] Gross public sector domestic debt, defined as Federal Government and publicly controlled and non-controlled firms. Figures are for end of period.
[2] Based on average annual balance.

Sources: SHCP and Banco de México.

The international response to these changes and to the improved business climate has been very favorable: between January 1989 and June 1991, Mexico received $15.4 billion dollars of foreign investment. Moreover, the pace of investment has quickened, with $3.5 billion invested in 1989, $4.6 billion in 1990 and $7.3 billion during the first six months of l991, including portfolio investment in Mexico's securities and equity markets.

Important reforms have been implemented in the financial sector to improve the market efficiency, especially since 1988. At the end of that year, restrictions were lifted on the issuance of bankers' acceptances and high reserve requirements were replaced by a liquidity coefficient of 30%.

Shortly thereafter, in April of 1989, the government extended the elimination of controls on interest rates and maturities on all bank instruments and deposits, though the latter also became subject to the same 30% liquidity coefficient, and preferential lending to certain sectors at concessional rates was no longer required of commercial banks.

In the latest stage of liberalization, the 30% liquidity coefficient has been eliminated to allow commercial banks complete flexibility in their liquidity management. In late 1989 and early 1990, the government introduced important new legislation, passed by Congress, relating to the formation of financial holding companies in the first instance and, secondly, to the privatization of the commercial banking system. The objective here was to establish the groundwork for the creation of a "universal banking" system, which is viewed as an essential cornerstone for shaping a modern, competitive and efficient financial sector.

In 1987, the Mexican economy was on the verge of falling into a hyperinflationary spiral. This was averted through the implementation of an apparently heterodox program which has been remarkably successful, precisely because it followed on the heels of a multi-year orthodox program designed to correct the fundamental imbalances of the economy.

The *Pacto*, as the new program has become known in Mexico, consists of an accord between the government, labor and business to adhere to mutually agreed targets aimed at beating inflation. Despite the restrictive character of monetary and fiscal policy, the concerted social pact has prevented the program from adversely affecting growth. In fact, the economy has begun to grow at increasing rates, with 3.1% for 1989, 3.9% for 1990 and 4.8% during the first semester of 1991. In the meantime, inflation has dropped from 159% in 1987 to 18.8% in 1991.

An agreement was reached between the three sectors to extend the *Pacto* until January 1993. The main features of the latest extension include a reduction of the peso float from 40 to 20 centavos per day, a 12% rise in the minimum wage and, thanks to the robust condition of public finance, a reduction in the value-added tax rate from 15% to 10%. Overall, we believe that the Mexican economy has entered 1992 with strong bases for the last push towards single-digit inflation, with a Dec.'91-to-Dec.'92 target of 9.7%. For 1992, the government has set a target of a public sector financial surplus before privatizations of 0.8% of GDP (or 3.1% after), which is without precedent in Mexico's modern economic history. Notwithstanding this strict fiscal stance, expenditure on social developmentoriented programs will increase by nearly 18% in real terms.

Conclusions

In general, the results of eight years of economic reform have been quite satisfactory, which is not to say that all problems have been solved, but simply that the bases have been laid for keeping Mexico on the path of growth with price stability.

It is important to point out that the sequencing of the policy measures adopted since 1983 turned out ex-post facto to be the proper ones for the Mexican economy. The priority given to the correction of public finances provided the maneuvering room for stabilizing the economy and managing economic reform in an orderly fashion.

It is undeniable that the Mexican economy is today more solid and its potential for development greater than in the past. Inflation has been sharply reduced, due as much to sounder public finances as to the accepted social pact. State intervention in the economy is now more effective, having shed unnecessary or undesirable appendages without sacrificing its key administrative role.

Fiscal discipline has been established as a norm, yet room has been created for pursuing those objectives which truly require government promotion or intervention. The industrial sector is more competitive in response to deregulation and the commercial opening, as reflected in the performance of manufactured exports, a key source of growth now and in the future.

The optimism felt in Mexico today is thus the result of nine long years of effort. Economic restructuring has not ended, since important changes will still be forthcoming as a consequence, among others, of an even more profound opening to North America, Europe, South America and the Pacific Basin. In his last state of the nation address, the President outlined three major areas due for profound reforms: the educational system, the agricultural sector and Church-State relations. I would like to make a few comments on the second of these, particularly because the Executive launched an initiative to introduce legislation that led to a profound transformation of the agricultural sector in Mexico.

This was one of the most politically and economically significant actions taken by the Executive in recent administrations. While preserving the spirit of reform embodied in the Revolution and formalized in the 1917 Constitution, the proposed amendments fundamentally transformed patterns of ownership, association and production which had been a feature of the agricultural sector for decades.

Conscious of the fact that a quarter of Mexico's population is rural but generates only 10% of GDP, leading to a situation of poverty relative to urban Mexican standards, the government reviewed the existing legal structure with regard to land tenure and decided that, while the system of centralized distribution of land had played a just role in the decades following the Revolution, it was an impediment to modernization and growth in the agricultural sector in the recent past.

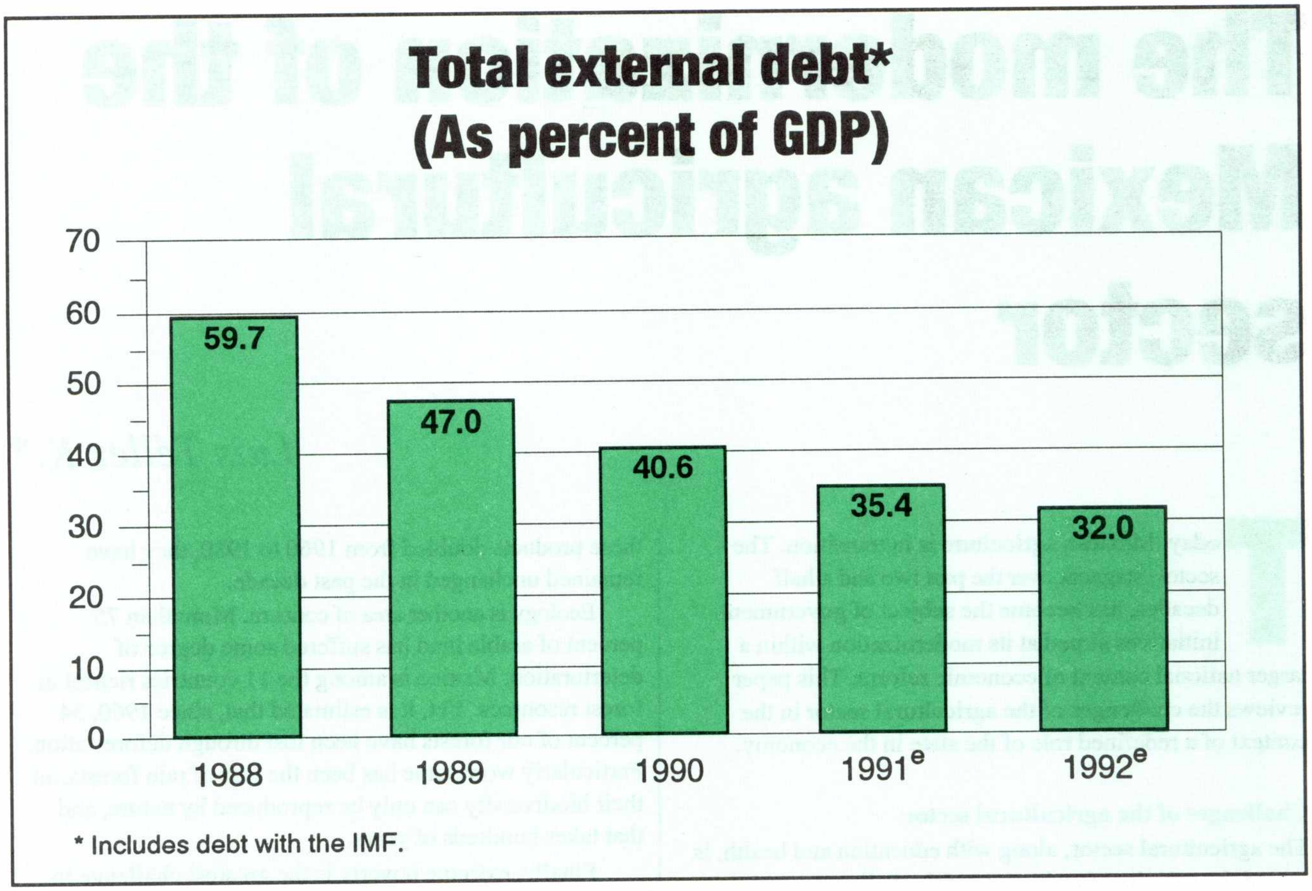
Under the existing *ejido* system, peasant farmers enjoyed the State-given right to use communal lands but not to own, rent or transfer them except to direct

External debt
(Millions of U.S. dollars)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991[e]	1992[p]
Total contractual debt*	86,179	93,000	95,264	96,566	100,991	107,469	100,914	95,114	98,173	100,270	101,470
Public sector											
-Contractual debt	58,874	62,556	69,378	72,080	75,351	81,407	81,003	76,059	77,770	78,070	80,070
-Net debt[a]								75,492	70,843	66,332	66,555
Interest payments	12,203	10,103	11,716	10,156	8,342	8,097	8,639	9,278	7,891b	7,500	—
Net external resource transfers[c]	-9,127	-11,282	-10,691	-11,462	-4,578	-3,456	-11,233	-1,494	4,568	8,000	—
As % of GDP											
Total contractual debt[1]	—	60.2	53.6	52.0	75.9	73.5	59.7	47.0	40.6	35.4	32.0
Public sector											
-Contractual debt1	—	40.8	37.6	38.4	56.7	55.3	46.5	37.7	32.3	27.8	25.1
-Net debt[a1]								37.6	30.7	24.5	21.1
Interest payments	7.2	6.8	6.7	5.5	6.4	5.7	5.0	4.4	3.3	2.7	—
Net external resource transfers[c]	-5.4	-7.6	-6.1	-6.2	-3.5	-2.4	-6.4	-0.7	1.9	2.8	—
As % of current account income											
Total contractual debt[1]	—	309.5	286.1	301.9	408.7	341.0	319.7	257.5	214.4	198.4	—
Public sector											
-Contractual debt[1]	—	209.8	200.5	222.6	305.0	256.4	249.2	206.3	170.6	155.8	—
-Net debt[a1]								205.6	162.3	137.2	—
Interest payments	43.6	34.9	35.6	33.0	34.5	26.5	26.5	24.4	17.5	15.0	—
Net external resource transfers[c]	-32.6	-39.0	-32.5	-37.2	-18.9	-11.3	-34.5	-3.9	10.1	16.0	—

* Includes public sector, private sector, banks and liabilities of Banco de México with the IMF.
e Estimated.
p Projected.
a This is public sector external debt net of financial assets held abroad, as well as of debt repurchased but not yet cancelled.
b Interest payments were 9,019 million dollars. The difference accounts for the interest rebate deriving from the retroactivity of the 1989-92 Financing Package.
c Net external resource transfers = -Current account balance + factor services balance + balance of transfers + variation of international reserves.
1 Calculated from annual average balances.

Source: SHCP and Banco de México.



descendants. Over time, due to increasing demands for land and as a consequence of the Constitutional mandate to distribute land, the ejidos became smaller and less productive. This trend towards smaller scale, inefficient production was accentuated by legal restrictions which hindered the pursuit of profitable economic association with the private sector.

To this end, and in recognition of the fact that its original purpose had now been fulfilled, land distribution has ceased; land rights over existing parcels will be formalized and the individual will now have the option of economic association or of transfer of land, along with that of maintaining his status. The *ejido*, as such, is not abolished but forms part of a wider range of possibilities from among which the individual can freely choose.

We are fully aware, however, that the consequences of this will only be realized over an extended period of time in view of the magnitude of the population affected. The legislative initiative is accompanied by a financial support package for 1992, featuring almost $3 billion for strengthening infrastructure, introducing new technology and credit supports.

It should be clear that Mexico cannot turn back from its chosen path of economic modernization. It is not possible to substitute sound economic policies for uncertainty or arbitrariness in today's world. I would go further to argue that one of the most significant by-products of the events following 1982 is that the government has become fully accountable for its actions, both domestically and externally. The government has to prove, day in and day out, that the course taken is indeed in the country's best interests. It is only results that count.

Having left behind the major clouds of the 1980's such as debt and inflation, I am looking forward to the day, soon to come, when discussion of this "virtuous circle" will also be relegated to the past, as Mexico becomes simply one more prosperous partner among the group of industrialized nations