

Seven Reason for Mexican Economic Recovery*

I wish to thank Gro Harlem-Brundtland, Prime Minister of Norway, for her kind presentation, and the organizers for their generous invitation to address this distinguished audience. I also want to express my satisfaction for being in this session in the very good company of Jim Wolfensohn, Stan Fischer and Renato Ruggiero.

It is fitting and timely to review the recent Mexican experience in the broader context of the discussion to reform the Bretton Woods institutions.

The shock that the Mexican economy endured during 1995 was unprecedented.

We suddenly lost foreign financing in the equivalent of 8 percent of our GDP. Furthermore, we also lost a substantial part of the capital which arrived over a period of years and had financed a series of large current account deficits.

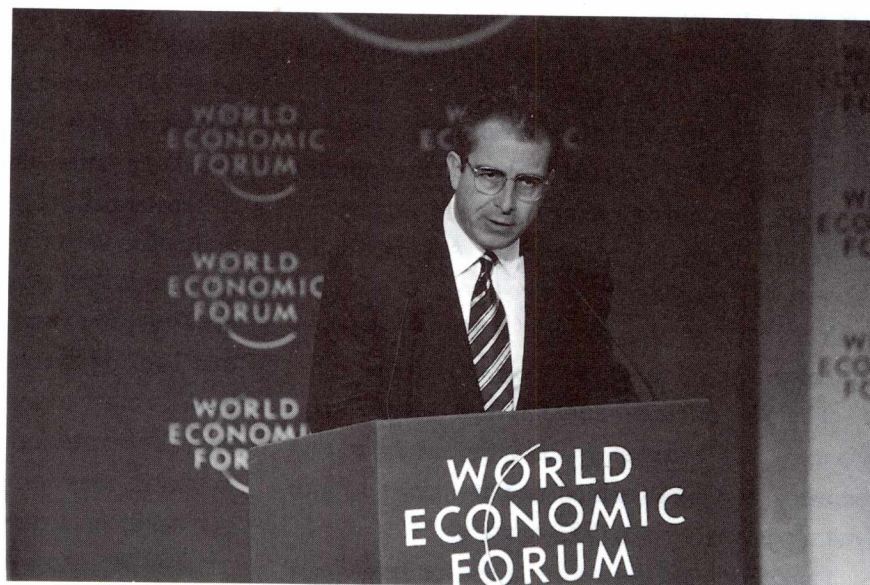
It is not an exaggeration to say that the 1995 shock was much more severe than the debt and the oil-price shocks Mexico confronted in the 1980's.

In the face of the crisis, the Mexican people and its government reacted responsibly, with resolve, and have stayed the course.

Strong fiscal and monetary adjustment —coupled with further market liberalization and structural reform— were at the heart of a policy that was not only designed to survive a difficult moment, but to prevent its recurrence and build stability for the future.

To support our own effort and to avoid conceivably serious spill-over effects throughout the international financial system, we counted on the swift action of the IMF, the World Bank, the IDB and our main trading partners, very especially the United States.

Unavoidably, the crisis imposed a very high cost on our country. In 1995, GDP fell dramatically; unemployment increased sharply; the deep devaluation of the peso fueled inflation and our banking system had to be firmly shored up against collapse.



President Zedillo speaking at the World Economic Forum.

Photos: Presidencia de la República

* Speech by President Ernesto Zedillo at Davos, Switzerland, during his European visit early this year.

Yet today I can tell you with confidence that the short-run imbalances that triggered the crisis have been substantially corrected.

At the beginning of 1995, we were burdened by a 29-billion-dollar current account deficit incurred during the previous year, as well as by short-term dollar denominated liabilities that totaled more than 40 billion dollars.

But now, due to an improvement of 26 billion dollars in our trade balance, reached largely through an increase of more than 30 percent in our exports, we have adjusted our current account to equilibrium.

This year, short-term external debt is just one tenth of what it was 12 months ago and is proving to be readily refinanciable in voluntary markets. Furthermore, despite the fact that we used only a part of the available financial support package, our foreign exchange reserves are now four and a half times what they were a year ago.

The threat of insolvency and financial collapse has vanished.

The effort is starting to pay off. Our economic program for 1996 aims quite realistically at economic recovery with reduced inflation. In the context of continued monetary and fiscal discipline, GDP will start to grow again, fueled by sustained export expansion and a gradual revival of private investment and consumption.

We have already seen encouraging evidence of recovery in key indicators. The most significant has been the reduction in the open unemployment rate, from 7.6 percent last August, to 5.2 percent in December.

The money and foreign exchange markets have also started to evolve more positively.

The key question today is not whether our economy will recover in 1996, but whether that recovery can be sustained and transformed into dynamic growth from 1997 onward.

I am convinced the answer is yes, for seven main reasons.

“In the face of the crisis, the Mexican people and its government reacted responsibly, with resolve, and have stayed the course.”

First, we will apply at all times throughout my Government, rigorous fiscal and monetary policies aimed at achieving and maintaining stability and long-run certainty.

Sound short-run macroeconomic management is always needed, both in the bad and the good times.

Second, we will continue pursuing structural reforms with renewed impetus. Even in the midst of the difficult circumstances of 1995, we have promoted regulatory, legal and even constitutional changes to liberalize a broad spectrum of economic activities.

These changes have opened to private investment important economic sectors like railroads, ports, airports, and transportation and storage of natural gas. The State-owned petrochemical plants are being privatized. We are also promoting unprecedented investment and competition in telecommunications, and we have enhanced foreign ownership possibilities in domestic financial institutions.

The third reason I have for being confident that Mexico will attain sustained economic growth is that we will continue our unshakeable adherence to free trade. NAFTA passed very successfully its most difficult test during 1995. We will continue at full steam total implementation of NAFTA as well as all of other free trade agreements signed with Latin American nations. We also look forward to substantial, progressive and reciprocal trade liberalization with the European Union.

The fourth reason is that we are taking every necessary measure to protect the soundness of our banking system. New incentives to restore banks' reserves and capital base and a wide ranging debt restructuring program whose fiscal cost is explicitly considered in our budget will soon put our banks on a truly secure footing.

The fifth, and a very important reason to be optimistic about our economy's prospects, is that we have

already taken very important steps to foster domestic savings permanently. A low savings rate has been our Achille's heel since the early 1970s.

That is why in 1995 we sought and enacted a tax reform involving a 50 percent increase in the general VAT rate, which is the most important levy on consumption.

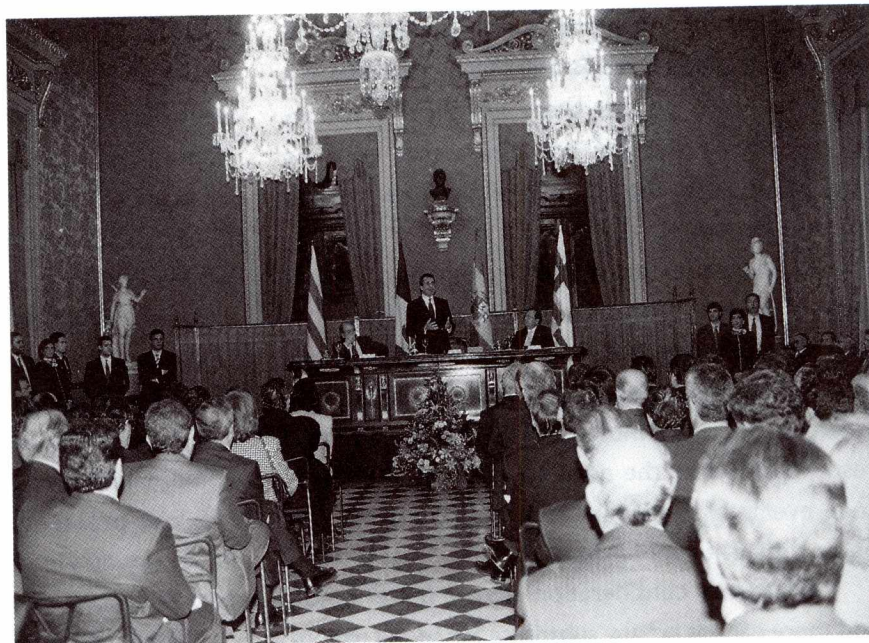
Of even greater significance is the sweeping reform of our national pension system, just approved by Congress. The new legislation mandates the transformation of our present "pay-as-you-go" system into one based on individual fully-funded capitalizing retirement accounts. These will be managed mainly by private investment funds. The new system will provide a source of long-term savings to finance investment, and it will also stimulate the development of Mexico's financial markets and institutions.

The sixth reason to expect sustained growth is that we are committed and will deliver an unprecedented effort in the education and training of our human resources. We will also enhance our human capital by fighting poverty through well focused, properly targeted and ambitious social programs.

The seventh reason for having sustained growth is that Mexico will enjoy political stability in the years to come, because we will complete the job of building democracy and will do everything necessary to guarantee the rule of law.

Through negotiation, tolerance, social policies and adherence to legality, we are clearly solving problems that have recently affected our stability.

"The future holds much promise for our country and for those who believe in it."



The president explains his economic plan in Spain.

Ladies and Gentlemen:

International capital flows are so large in scope and so sensitive to real or perceived changes in the economic or political environment that their resulting impact on the performance of national economies is greater than anyone could have imagined just a few years ago.

It is now clear that the effective, timely response that followed the Mexican crisis was remarkable. However, as we look to the future, it is evident that support packages like the one put in place then are hardly repeatable. Therefore, the international community must be ready to prevent and master other contingencies that might occur.

The Mexican experience encourages me to make five considerations which address the main topic of this Plenary Session.

The first one is that global integration of financial markets and volatility of short-term capital should be viewed as a fact of life. Capital controls are in no way the answer to the risks posed by short-run volatility.

The second one is that better consultation and early warning mechanisms must be put in place. We must acknowledge that there are serious contingencies in the national economies that at some point may affect the stability of the international financial system.

Particular attention should be given to the soundness of pension systems in several countries.

The third one is that multilateral institutions must be strengthened. Their capital base must be enlarged, and they must be fully entitled to raise resources in case the need to respond to unforeseen events that warrant such a support without being subject to moral hazard.

The fourth consideration is that there is not, and there cannot be, any substitute for sound national policies. The best inoculation against financial crises are domestic economic policies that attain macroeconomic stability and provide for well-functioning markets. It is only in this context that an international support package can be effective.

The fifth consideration is that although sound fiscal and monetary policies are necessary to achieve development, they are not sufficient. Promotion of domestic saving is the center piece of any successful economic growth.

For the reasons I have given you. I have the profound conviction that Mexico is headed in the right direction. We are making tough decisions but these are needed to open up new opportunities for the well-being of our people.

As we move ahead in the months and years to come, I invite you to play an important part in Mexico's present and future economy—to invest in our country, to manufacture and buy, to sell and engage in commerce and finance.

The future holds much promise for our country and for those who believe in it. We will continue to do what is necessary each day to be certain that the promise holds true for the benefit of all our people, and for the benefit of all our partners.

Thank you very much. *Vivi*