Mexico and Structural Adjustment

by

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Abstract

In 1982, Mexico introduced a structural adjustment program which, in the years up to 1991, appeared to have relative success. After 1991, problems did arise, however. The objective of this thesis is to investigate the underlying factors which made the program necessary in 1982, to examine and assess the policies implemented under the program, in terms both of their economic and social impacts, and to examine the degree to which the program has created a sustainable change in Mexico's economic prospects.

In assessing Mexico's success, the thesis uses a model, based on Selowsky's (1992) stages model, which sets out three stages: the achievement of macroeconomic stability; the liberalization of the incentive system; and the restoration of investment, as the necessary steps through which a country must pass for structural adjustment to be successful in a sustainable way.

Generally, one can conclude that Mexico has made it to stage 3 but did not complete or have total success at each of the preceding levels; therefore, the long term success of the program is questionable and this may explain parts of the setbacks experienced in the period 1992-1996. While Mexico's structural adjustment program was nominally successful in the

short term, its effectiveness over the long-term still remains to be determined. The analysis of the social impact of the adjustment program presented here shows that the effects of adjustment have not been that significant, except for the impact on wages. In terms of wages, there has been a negative impact on income distribution mainly as a result of a decline in real wages for the middle class.

None of the analysis presented calls into question the need for Mexico to adopt a structural adjustment program in 1982. Nor does the analysis of social impact suggest that structural adjustment per se has had significant negative social consequences, although it might still be argued that it may have retarded progress in tackling existing social ills. What the analysis shows is that the success of structural adjustment is a long term proposition and cannot and should not be judged on the basis of one or two years. It also shows that the implementation/execution of the policies matters as much as the design of the policies. Finally, it shows that structural adjustment itself must be seen as a dynamic, continuous process and not as a static, one time intervention.

Abbreviations

GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
IMF	International Monetary Fund
LFI	Law to Promote Mexican Investment and Regulate Foreign Investment
NIDP	National Industrial Development Plan
OECD	Organization for Economic Cooperation and Development
PEMEX	Petroleum Corporation of Mexico

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Dedication

This work is dedicated to my parents.

Chapter 1: Introduction

1.0 Introduction

In the early 1980s Mexico became involved in a debt crisis that had the most severe economic repercussions for the country since the Great Depression of the 1930s. As the crisis grew in intensity, it became apparent that some form of structural adjustment needed to be introduced. Structural adjustment was seen as a necessity because both internal and external factors that contributed to the debt crisis needed to be relieved or altered.

In order to better understand the role the debt crisis played in shaping Mexican economic policy over the last decade, it is important to examine the factors that led to the crisis as well as the structural adjustment program adopted in response. Through this examination, the degree to which the structural adjustment has relieved or eliminated the problems associated with the debt crisis will be assessed, as will the desirability of the overall program.

The situation in Mexico, as a result of, or at least during the time of, the structural adjustment program, has clearly improved (Aspe, 1990, 123). However, this is not the same as saying that the structural adjustment caused the improvement. Nor, even if the latter is true, does this mean that structural adjustment, on balance, has been of net benefit because there may be costs in other areas which need to be investigated. Nor even if the net benefits are positive is there any proof that the improvement can be sustained in the long run. We need to examine the pre-structural adjustment and post-structural adjustment situation to see if the conditions that created a need for structural adjustment have been altered or corrected and whether structural adjustment was the most appropriate way of responding to these conditions. We need to assess the arguments that structural adjustment has positive economic implications for Mexico to see if the results are indeed as positive as the World Bank and others say. Finally, we also need to examine the repercussions to society by examining the social impact of the structural adjustment program in Mexico.

The Implications of the Debt Crisis

A number of exogenous and endogenous factors have contributed to the 1980's debt crisis in Mexico. The Mexican crisis was like no other experienced in Latin America except for that of Brazil. The origins of the crisis go back to the Echiverria administration, perhaps resulting from the public expenditure-led growth model. This development strategy resulted in a substantial increase in the level of public spending and debt with the hope of creating an atmosphere of more social equality. Although this may have triggered Mexico's debt crisis, other factors also played a role.

> The 1982 economic crisis resulted from the interaction between a particular set of external and internal circumstances. It was also ..., the product of historical trends. Those critics who have emphasized the importance of internal factors behind the 1982 crisis have usually focused on the 'policy errors' made by the Lopez Portillo administration: a too-rapid pursuit of the petroleum export sector strategy, a failure to take adequate measures inhibiting imports, the maintenance of an over-valued peso, an uncontrolled expansion in government expenditure, and a failure to follow policies that would have maintained the confidence of the private sector or would otherwise have prevented the outflow of capital. Not only did the state fail to take decisions to alleviate the crisis, its decisions actually caused further strain(Teichman, 1988, 111-112).

The above quotation implies that the policies of the Lopez Portillo administration (1976-1982) created a situation where economic disequilibrium persisted. The policies of the Lopez Portillo administration are cited as being directly responsible for the culmination of a number of factors resulting in an economic crisis. Pursuing development based on petroleum revenue created a dependence on a single sector that if it were to fail would send the economy into a tremendous downturn.

The other "policy errors" contributed to the debt crisis because each mistake represented a strain on Mexico's financial structure. The failure of the government to take account of these problems thus intensified the debt crisis. There were other endogenous factors that contributed to the debt crisis including a declining growth rate, gaps in the availability of resources to finance the debt, and inflation.

Various exogenous factors also contributed to the debt crisis including high real interest rates, declining terms of trade, lack of capital availability, balance of payment instability and oil price fluctuations. The policies of the United States had a direct effect on Mexico because of the close trading relationship the two countries share. The ramifications of these factors made for a very negative situation, and, in combination with the internal factors, created a need for a program to relieve the situation.

Mexico undertook structural adjustment measures to open its external trade system, rationalize public sector enterprises, make the tax system more efficient, liberalize and privatize its financial system, ease restrictions on foreign investment, and deregulate specific economic activities. According to some observers (Kalter and Khor, 1990, 23) these reforms are helping to increase economic efficiency and are paving the way for medium-term growth. An examination of the economic performances indicators supports this view, for example, interest rates, debt deficit reduction, international transactions, exchange rates, inflation, balance of payments, foreign investment and public sector accounts.

The underlying principal of structural adjustment programs, as suggested by Streeten (1989), is to help countries adapt and make changes that will create economic stability. Ground (1986) suggests that the logic of the adjustment process is implacable, for it is rooted in budgetary constraints, ie., the impossibility of absorbing more goods and services than are available, including both those produced domestically and those obtainable from abroad with factor income. Ground goes further to develop what he calls an orthodox adjustment paradigm. Although it has undergone some changes over time, the orthodox approach to the causes and the process of adjustment still assigns a central role to money; in other words, it is essentially a monetarist view. According to this approach, whenever there is inflation or an unsustainable balance of payments deficit, it will invariable be due to an excessive supply of money in relation to the demand for real monetary balances.

Given the theory behind the orientation of structural adjustment programs, an analysis of the implications will be discussed below. This includes a discussion of the theory to see if the predicted results have indeed occurred.

In order to pursue examination of the structural adjustment program, Chapter Two presents an overview of the Mexican economy from the mid-1950s to the 1980s. Chapter Three examines Mexico's response to this crisis, i.e., the structural adjustment program and assesses its effectiveness in economic terms. Chapter Four examines the social effects of the adjustment process. Lastly, Chapter Five offers conclusions on the relative success of the structural adjustment program in Mexico, including a consideration of the meaning of the 1992-96 period versus the 1982-1991 period.

Chapter 2: Overview of the Mexican Economy

2.0 Introduction

From the 1940's to the 1970's Mexico experienced thirty years of relative prosperity: these years have often been called the "Miracle Years". From 1950-1970, Mexico pursued a program of import substitution industrialization; these were the easy years and nominal success came easily and quickly, despite some negative features such as inflation. However, during this time the roots of economic disequilibrium were beginning to grow. The initial section of this chapter will look at the stabilization program pursued from the 1950's to the 1970's. The second section will examine the shared development strategy of the Echeverria and Lopez Portillo administrations up to the 1982 debt crisis.

2.1 Stabilization Development

Until the late 1950's, Mexico experienced relative success with the policy of import substitution. However, this early success did not last. The import substitution industrialization stage of development sought to

> promote domestic industrialization and conserving scarce foreign exchange resources. By limiting or removing competing imports through the use of quotas, tariffs, etc., the country aimed to establish its own manufacturing industries which,

initially, can be expanded to cater for the domestic market, and at a later stage develop an export trade" Pass, Lowes, and Davies, 1988,235).

Import substitution was thought to be responsible for the narrowing of the domestic market thus preventing any growth from taking place. Another problem contributing to the issues associated with import substitution was the means by which it was financed. Financial support for the import substitution policies came from an increase in the money supply which was very inflationary.

In 1958, a new policy in the form of "stabilization" development was introduced in the hope of solving these problems. Its principal objectives were to stabilize prices and curb inflationary pressures. This was to be achieved through:

1) the maintenance of a fixed exchange rate and control of domestic inflation at rates equal to or lower than Mexico's major trading partners;

2) the maintenance of economic policies strongly conducive to the growth of private savings and investment,

3) the sectoral allocation of public resources in a way that increased the profitability, and hence stimulated the growth, of the private sector. (Looney, 1978,15)

Additionally, there are two other factors to keep in mind when examining Mexico's stabilization policy:

1) because of the need for developing countries, including Mexico, to undertake large capital investment in the public sector a large public debt is often the result;
2) the type of monetary and fiscal policy adopted in Mexico has involved a low level of direct taxation, an attempt to ensure that part of the public sector deficit is financed by the domestic banking system, and reliance on foreign loans to finance the rest of the deficit. (Griffiths,1972,6)

While the new strategy was concerned with maintaining price stability, it was also concerned with maintaining the rate of infrastructure and basic industry investment. The concept of keeping prices stable and maintaining the development of infrastructure and industry seems impossible but was made possible by obtaining new sources of funding such as private deposit banks, private financiers and external financial sources rather than public sector banks and financial institutions.

The inflationary pressure in the economy that was a result of the import substitution industrialization stemmed mainly from the manner in which the development program at the time was funded, i.e., through increasing the money supply. The Mexican government choose to finance public sector deficits via inflation rather than by direct taxation. First,

> those responsible for government policy, .. apparently felt that, at that time, increases in taxation would simply undermine all other investment incentives. Second { .. the government} at the time was committed to a program of industrialization designed to raise the rate of capital formation in the private sector through increases in the real profits of that sector. (Ramirez, 1989,62)

In any case, inflation along with the issues cited above resulted in the introduction of a stabilization development strategy in 1958.

2.1.1 Achievements of Stablization Development

Between 1950 and 1970, real gross national product in Mexico increased at an average rate of 6.5 percent per year. On a per capita basis, this translated into a nearly 3 percent growth rate.

Both agriculture and industry, as well as the other branches of the economy, shared in this rapid advance. Agricultural production increased at a rate of 3.65 percent and manufacturing output at 8.36 percent (in current prices). Among key sectors, steel production and electric energy expanded in an impressive manner. By 1970, Mexico, for the first time, came close to self-sufficiency in many branches of light to medium industry (Looney, 1978).

Table 2.1 Macroeconomic Aggregates[1] (variables expressed in 1960 prices)

Year	Real GDP (% change)	Inflation[2] (% change)	Gross Fixed Capital Formation (% change)	Real Exchange[3] Rate (1960=100)
1958	5.3	.5	-5.9	108.7
1959	3.0	3.7	1.3	104.8
1960	8.1	5.0	14.9	100.0
1961	4.9	3.4	.8	94.7
1962	4.7	2.9	5.4	92.2
1963	8.0	3.2	11.5	89.1
1964	11.7	5.9	21.8	84.7
1965	6.5	2.2	6.0	84.2
1966	6.9	4.0	8.9	83.6
1967	6.3	2.8	13.7	82.3
1968	8.1	2.4	9.6	82.6
1969	6.3	4.0	7.4	82.0
1970	6.9	4.8	8.3	81.6

[1] Real variables are expressed in terms of 1960 prices; all changes are computed based on real values.

[2] December to December change in the CPI.

[3] Calculated as the period average exchange rate multiplied by the ratio of the U.S. wholesale price index to the Mexican GDP deflator. The real exchange rate is set at 1960 = 100. A decline indicates an appreciation of the real exchange rate and an increase, a depreciation.

Capital formation rose sharply, not only in absolute terms, but also in relation to the national product. The share of government capital formation increased and remained high. Capital imports were substantial and increasing, and continued to be of decisive importance in the process of expansion. They were at about $10.6 million for the period 1955-1970, equal to about 46 percent of total imports. As to the balance of payments, the heavy increase in tourist income, mostly from the United States. The net foreign exchange earnings from tourism increased from $ 137.2 million in 1955 to $ 385.2 million in 1970 (Looney, 1978).

The sharp expansion of output, reflecting partly an increase in the economically active population from about 8.3 million in 1950 to 12.9 million in 1970, and partly an increase of productivity per person at a rate of 2.5 percent a year, was accompanied by a relatively stable price level. From 1955, wholesale price rises averaged 2.89 percent a year to 1970. These increases were well behind the rise in international price levels until the late 1960s.

The dependence of the Mexican economy on foreign trade declined slightly between 1955 and 1970; the combined share of exports and imports to GNP fell from over one-fourth to about one fifth, only half the proportion that prevailed around the turn of the century. Mexico was not as successful in reducing its dependence on capital imports. Machinery and other capital goods remained dominant at about four-fifths of total imports.

Table 2.2 Composition of Output (% of GDP - 1960 prices)

Year	Private Consumption	Government Consumption	Change in Inventories	Exports	Imports
1958	79.6	6.7	.6	11.5	14.7
1959	79.1	6.3	.4	11.4	13.2
1960	76.2	6.3	2.7	10.3	12.6
1961	75.3	6.5	3.1	10.7	11.8
1962	75.1	7.1	2.0	10.8	11.5
1963	73.6	7.4	3.1	10.5	11.6
1964	72.6	7.4	3.2	10.5	12.1
1965	71.8	7.2	4.3	10.1	11.8
1966	72.1	7.3	3.2	9.9	11.3
1967	72.5	7.4	2.5	9.1	11.4
1968	73.2	7.5	1.6	9.1	11.8
1969	71.9	7.4	1.9	10.0	11.7
1970	71.9	7.5	3.0	8.7	11.9

Source: National Accounts Data are from Indicators Economicos

Industrialization and urbanization made rapid strides. Industrial production as a share of national product increased from 21.13 percent in 1955 to 27.09 percent in 1970. Even more striking was the pace of urbanization: for example, cities of 10,000 inhabitants increased their share of the country's population from 31 percent of the entire population to 42 percent between 1950 and 1970. Largely as a result of accelerated industrialization and urbanization, there was a relative decline in rural economic activity. The share of agriculture in total employment fell from nearly 50 percent in 1950, not much below the level at the turn of the century, to approximately 40 percent in 1970.

The differences in development in the urban and rural sectors were considerable, with income per capita remaining much lower in the rural areas. In general, income grew more rapidly for those in the upper-income groups, and there was a general tendency for income to become more concentrated for the country as a whole.

During this period there was also a marked improvement in the major indicators of social welfare. Life expectancy, which had increased slowly from 33 to 38 years between 1925 and 1940, increased to 61.9 years by 1970. The death rate was halved within two decades, falling to 8.6 percent in 1970 from 16.2 percent in 1950. The percentage of illiterates declined from 42 percent to 16 percent over that same period.

The rapid expansion in real output and the substantial increase in the price level were accompanied by a commensurate increase in the size of the financial superstructure.

The positive outcomes of the stabilization development strategy were numerous and clearly showed a relatively high level of success in relation to the development strategies that followed. However, not all of the results were positive.

2.1.2 Negative Aspects of Stabilization Development

The number of successes appear to be substantial but this policy period was not without its problems. To begin with, the balance of payments was consistently running a deficit. The 1950's had been without deficits, with a few exceptions. The 1960's, however, were plagued by deficits.

Additionally, the public sector was experiencing budget deficits, therefore increasing the public sector debt. This was a result of the Mexican government expanding its public sector investment to redistribute income and promote development. This led to a restriction on the level of private investment and increased the pressure on the balance of payments.

2.3 Public Sector Revenues and Expenditures (% of GNP)

	1965	1966	1967	1968	1969	1970
Expenditure	18.8	18.4	19.7	19.6	20.0	22.3
Current	15.1	14.9	14.7	14.5	14.6	15.3
Interest on foreign debt	.4	.5	.6	.7	.7	.8
Other	14.6	14.4	14.1	13.8	13.9	14.5
Capital	3.7	3.5	5.0	5.1	5.4	7.0
Revenues	18.0	17.3	17.5	17.7	18.1	18.9
Economic Deficit	.8	1.1	2.2	1.9	1.9	3.4
Deficit on financial intermediation	.1	.1	.2	.3	.3	.3
Monetary deficit	.9	1.2	2.4	2.2	2.2	3.8

Source: Estadisticas Hacendarias del Sector Publico: Cifras Anuales, 1965 -1982.

Looney (1985) identifies five additional problems that were associated with the governments development policies in this period:

1. Industrialization policy failed to make full use of the economy's economic expansion capacity. This deficiency was due in part to insufficient and inadequate imports of production goods.

2. The focus was centred on the sector competing with imports of production goods and almost entirely neglected the export sector.

3. The import substitution strategy aimed chiefly at reducing imports of finished consumer goods, though rarely capital and intermediate goods.

4. The development strategy favoured the formation of a completely distorted market i.e., an appendage of the productive consumer structure of the Western capitalist economy, particularly the United States, was superimposed upon the Mexican economy.

5. Geographic concentration of economic activities was intensified.

These negative implications of the stabilization development programs were regarded as serious and may have led the Echeverria administration to change the approach to development in Mexico.

2.2 Shared Development

Looney (1985) suggests that the Echeverria years can be divided into three separate periods:

1) 1971-1973, the period of austerity and inflationary growth;

2) 1974-1975, the period of international crisis and deterioration; and

3) 1976, the year of devaluation and collapse.

2.2.1. Objectives of the Echeverria Administration 1971-1976

Luis Echeverria had two main objectives for his term in office: the maintenance of the fixed exchange rate inherent in the financial system of the previous administration; and the creation of a better social framework in Mexico.

Echeverria, on assuming office in 1971, announced that, "henceforth the government would take a more active role in ameliorating social ills- that is, in promoting "Shared Development." His initial economic plan proposed six measures to foster Shared Development and reduce the large current account deficit of 1970(Buffie, 1990, 417-418):

1. increase the supply of credit to, and government investment in, the agricultural sector;
2. replace licenses by tariffs, eliminate tax rebates given to the industrial sector, and redirect trade policy toward export promotion;

3. increase government revenues by raising public sector prices, by tax reform, and by a reduction in tax evasion;

4. introduce tax incentives to encourage employment growth and greater dispersion of industrial activity;

5. develop new tourist sites as an additional source of foreign exchange earnings;

6. improve the "efficiency" of government current expenditure.

More specifically, Echeverria announced that greater controls would be placed on foreign capital to ensure that it made the maximum contribution to the country's development. He stated that serious attempts would be made to alleviate the very unequal distribution of income and wealth and that a genuine popular participation in national development by all groups would be promoted. Further, new exports would be developed (Looney, 1985, 62).

Looney (1985) goes on to identify the policy directives of Echeverria as: continued high rates of non-inflationary growth; the creation of employment both to absorb new entrants and to reduce unemployment; decentralization of industry with more active rural regional development; a more equitable distribution of income and the alleviation of poverty; increase Mexican ownership and control of economic activity; and, finally, further improvement in domestic money and capital markets.

After the introduction of these new policy mechanisms, Mexico experienced its first real debt crisis. This crisis was a result of public expenditure-led growth. Public spending grew at a fast pace as a result of pressure placed on the government to increase spending.

" Total public sector expenditure represented 20.5 percent of GDP in 1971 but rose to 32 percent of GDP in 1976. Much of the increased spending took place in the parastatal sector. Between 1971 and 1975, SOEs increased their real current expenditures at an annual average rate of 18 percent and their real capital expenditure at a rate of 29.3 percent (Buffie, 1985,420).

New, large scale industrial projects accounted for most of the expansion in the parastatal sector. During this period, the steel mills of Lazaro Cardenas-las Truchan, several industrial seaports, and the petrochemicals complex of LA Cangrejera were constructed and many of the most important Pemex (Petroleum of Mexico) investments were carried out. Expenditure increased strongly in other branches of the government as well. Outside the parastatal sector, expenditure growth reflected principally the undertaking of expensive investment programs and a general policy of expanding government employment. The priority afforded to expanding government employment and investment varied over the Echeverria term (Buffie, 1990, 420- 421).

This division of the presidency of Echeverria allows one to draw the conclusion that the policy of shared development, like that of the stabilization development plan before it, had both its positive and negative implications.

2.2.2 The Achievements of the Echeverria Administration

In retrospect, it is clear that a number of policies introduced by the Echeverria Administration, together with the change in world markets, greatly weakened Mexico's ability to continue to grow at rates equal to those attained in the immediate post war period. The forces of the public sector expansion and the forces behind world inflation proved to be much stronger than the policies the Echeverria administration adopted to achieve financial stability.

Many of the accomplishments of this administration were more social in their orientation, for example, the administration was responsible for a policy of planned parenthood. The government also made some progress toward a more equitable social order, particularly in terms of institutional changes. Examples are the creation of The Workers Housing Fund, the National Fund for Workers Compensation and the National Rural Development Program.

The government introduced a new water law and land reform law and made changes in the institutional framework governing the allocation of credit. Other programs were introduced in the agriculture sector, the transportation sector, and the power generating sector.

Major strides were made to increase efficiency in the public sector. In 1971 President Echeverria ordered the establishment of programming units in all spending agencies and ministries. Under his February 1971 President's Act, working groups were set up in such public sectors as energy, transport, irrigation, and tourism to co-ordinate the government's overall investment program. The objective of the programming units was to prepare five-year investment plans, each containing a set of specific projects to be screened by the Ministry of the Presidency and the President himself. The plans included methods of project financing and recommendations on the rates and prices to be charged for public services.

2.2.3 Problems of the Echeverria Administration

During the Echeverria Administration the economy was plagued by a number of problems. First, there was a firm intention on the part of the authorities to increase public expenditures in response to what they regarded as social and economic imperatives. Second, the private sector became disinclined to continue investing as much as in the past. In part, the private sector's attitude was attributable to economic causes such as worsening inflation and balance of payments which, after two years of relative improvement, was becoming precarious by 1970. But psychosociological causes might have been equally important. After many years of privileges, the private sector found itself in a position of apparent, if not real, insecurity, facing a quickly growing public sector and mindful of the clearly less sympathetic attitude of the government toward its private interests.

Third, in the autumn of 1973, the world economy experienced the first of a series of shocks that were to disturb it in the next two years in a way it had not seen since the 1930s. Developments in the world economy had two major effects on Mexico. In 1973, Mexico, because of a lagging investment policy pursued by PEMEX, was a net petroleum importer. Not only did the country lose an opportunity to take advantage of the oil boom, but it had to incur a greater deficit in the balance of payments. Further, because the changes in the world economy had a particularly severe impact on the United States, Mexico's exports-about two thirds of which went to the United States-were adversely affected.

The introduction of such programs resulted in negative repercussions, especially long term economic problems. For example, many of the government's major projects to expand capacity in petroleum, petrochemicals, steel, fertilizers and other branches of industry were not completed until after the Echeverria administration.

During the Echeverria term the level of imports also rose, thus producing a strain on the economy. The existence and development of full capacity in certain key sectors of the domestic economy, such as steel and cement, required large volumes of foreign supplies to insure that inflation would not increase. Secondly, the government 's own investment program was import-intensive. Finally, firms in both the private and public sectors accumulated inventories in anticipation of further inflation.

In particular years, 1971-1976, a number of factors may have contributed to the problems being experienced during the Echeverria administration: the persistent rate of inflation; the fall in sales experienced by a large number of firms, necessitating large cutbacks in production; an unprecedented increase in the country's foreign debt; and an increase in the trade deficit and a relative decline in private investment. Also, Mexico began to experience an increased class struggle, partly in response to some of these other problems and interruptions to Echeverria's social program.

The major downfall of the Echeverria administration was the devaluation of the currency in 1976 resulting in the stabilization policy not performing as intended. No longer was it possible to maintain the exchange rate. Inflation, which at the time was fluctuating out of line with Mexico's trading partners, for example the United States, was a major contributing factor to the change. A response was required to address the situation of decreasing amounts of foreign and domestic investment. Also, the trend toward egalitarianism created a problem for the administration because it tended to require more public spending, and cuts in public spending therefore threatened the policy of egalitarianism (Looney, 1978).

could Mexico take for granted the relative stability it once enjoyed.

Table 2.4 Some Basic Indicators of the Echeverria Term

	1971	1972	1973	1974	1975	1976
% Real GDP Growth[a]	4.2	8.5	8.4	6.1	5.6	4.2
% Inflation[b]	5.3	5.0	12.0	23.7	15.1	15.8
Public Sector Deficit/GDP %	2.5	4.9	6.9	7.2	10.0	9.9
Pub. Expenditure/GDP %	20.9	23.6	27.0	28.3	33.2	33.6
Public Income/GDP %	18.2	18.5	19.8	20.9	23.0	23.5
Current Account Deficit (billion U.S. $)	.9	1.0	1.5	3.2	4.4	3.7

[a] Mexico's National Accounts were revised in 1980; as a consequence, GDP growth figures from 1970 onward have been adjusted upward.

[b]For 1971 onward the average annual percentage increase in the consumer price index has been used.

Sources:

Nacional Finaciera, La Economia Mexicana en cifras (Mexico, D.F. 1981); Banco de Mexico, Indicadores Economicos, Subdireccion de Invetigacion, several issues; Banco de Mexico, Indices de Precios, Subdirectiv de Investigacion Economica, several issues, Secretaria de Hacienday Credito Publico, Estaisticas Hacdarisde Secta Publico, Dirreciom General de Evaluacon Hacendaria, 1983.

2.3.1 The Policies of the Portillo Administration

The situation facing Lopez Portillo was such that he had little choice in the policies that he could adopt. This administration knew that it had to adopt a policy program that would: stabilize the peso, lower inflation, limit wage increases, control the government deficit and stimulate domestic investment (Looney, 1978).

Lopez Portillo went further to say that he felt that there was a need to create an "alliance for production", designed to combat inflation, establish a positive external balance, raise the economic growth rate and lower unemployment levels. The alliance of production consisted of a plan that sought to improve the informational basis on which public and especially private, decisions were made. By introducing this type of development planning, the state had pledged itself to public expenditure with efficiency and austerity : it began restructuring public administration, and its economic and fiscal policies were designed to give input to alliance objectives. Private enterprise was supposed to invest in socially and nationally essential branches, step up production to lower costs and create more jobs. It was further committed to cut prices on ninety commodities. Labour, for its part was to curb wage demands so as not to intensify inflationary pressures. The Alliance of Production was thus a pact among the state, the private sector and labour, a pact that formed the basis of a far reaching commitment among these groups (Looney 1978,134). This was thought to be a step in the right direction but the alliance was never set into legislation and therefore, was not binding. It consisted of a six year program involving 140 companies in ten major branches of industry including petrochemicals, capital goods, mining, cement, vegetable oils and fats, automotive industries and tourism.

The Lopez administration for the first three years of its term introduced a stabilization program with International Monetary Fund support.

> Shortly after the October devaluation, a Letter of Intent was submitted to the IMF outlining a stabilization program to be implemented in stages over the next three years. .... The program called for the standard mixture of trade liberalization and economic austerity. Public sector savings, international reserves, and net domestic assets of the Central Bank were to increase, and a 3 million dollar limit was imposed on additional foreign borrowing by the public sector. Wage restraint was to accompany monetary and fiscal restraint. ... The trade reforms were aimed at increasing the openness of the economy and rationalizing the system of incentives for exporting and import substitution. Import licences were to be progressively replaced by tariffs, granting, in most cases, a lesser degree of protection (Buffie, 1990,429).

The targets of the IMF Stabilization program were to make improvements to the balance of payments, public sector operations, savings and investment and the accumulation of international reserves.

A certain measure of success was accomplished in the areas that the IMF targeted as problem areas but a few areas did not experience any growth or private sector investment spending. However, the level of success experienced in the first year did not last. During the last two years the response to the stabilization program was curtailed because Mexico discovered that it had more oil wealth than first anticipated.

An immediate consequence of the discovery of enormous oil wealth had been the virtual disappearance of any constraints on foreign borrowing. Fierce competition was evident among foreign banks to extend new loans to Mexico. Naturally, the Mexican government took advantage of its enhanced credit rating to improve the terms of foreign debt. A second and more important repercussion of oil wealth came in the domestic policy area. Mexican officials felt that they now faced a less rigid set of constraints and that economic policy ought to be reoriented toward recovering the development momentum lost in preceding years. The Fund program, therefore, was dropped in favour of a more expansionary policy package.

With its new found wealth, the Portillo administration decided to pursue public-expenditure-led growth between 1978-1981. This type of development strategy was similar to the Echeverria era. The Echeverria development plan was rejuvenated, as a result of the following line of thinking: the new oil wealth was to finance Mexico's development in a noninflationary way. This required the expansion of public investment and it was affirmed that the government was going to activate other policy instruments. For example, the policy framework would include financial reform to restructure the banking system and modernize the instruments of monetary control making interest rate policy more flexible and attentive to real yields while developing foreign financial markets. On the fiscal side, an in depth reform was announced with the introduction of the value added tax and a rationalization of the whole structure of relative prices by eliminating quantitative restrictions on imports and simplifying fiscal incentives for industrial activities. Not only was the public sector to enhance the country's stock of capital, but private investment was to be encouraged so that a more balanced pattern of growth would evolve to reduce the intensity of the debt crisis.

Through the promotion of this development strategy, the Mexican authorities sought to achieve the following objectives: increase employment through rapid growth; increase labour participation in economic growth through significant increases in real wages; rejuvenate agriculture and achieve food self-sufficiency through government investment, tax and other incentives, and bureaucratic reforms; diversify exports away from petroleum and primary materials by increasing domestic manufacturing and by penetrating international markets; diversify export markets, thus reducing dependence on the United States; create a strong capital goods industry through selective import substitution; use petroleum as a fundamental instrument not only to achieve internal economic goals but as a key tool in international commercial and other negotiations with the United States and other industrialized countries; decentralize the economy by developing major growth in regions of the country outside Mexico City and Guadalajara region through government investment and more decentralized private investment; and use foreign investment policy and regulation of technology transfer as another fundamental instrument to achieve employment, industrialization and export goals, while maintaining indigenous managerial control over firms with foreign capital participation (Looney 1985:85).

Also, the administration at the time proposed a National Industrial Development Plan (NIDP). The principal objectives of the NIDP: were to promote employment, increase competitiveness, enhance market access, decrease centralization and encourage foreign participation through an industrial investment strategy. The strategy revised the trend of Mexican industrialization by increasing the production of basic consumer goods, developing industries capable of exporting or efficiently substituting imports, more efficient use of the country's natural resources, promoting capital goods production, decentralizing economic activities, and supporting medium and small scale enterprises. This strategy was to be initiated through three phases. The first step was to solve the 1976 crisis by lifting trade and economic restrictions. The next phase was recovery and a move toward self-sufficiency. The third and final stage was to promote economic growth.

The policies and the objectives of the Lopez Portillo administration were driven by a huge amount of public spending that was fueled by forecasted oil wealth. However, this was not to be the case and the results were far from those anticipated by the Lopez Portillo administration. The circumstances surrounding this administration and those previous to it resulted in a situation of severe debt and economic crisis that will be looked at in more detail in the next chapter.

2.3.2 Achievements of the Lopez Portillo Administration

2.3.2a *Achievements of the Adjustment Program Under the Lopez Portillo Administration*

When Lopez Portillo took over as president in 1976, the IMF had developed an adjustment program for Mexico, which proved to be short lived. The initial year of this three year program saw substantial changes in certain economic indicators, for example, the public sector deficit as a percentage of GDP fell by more than 3 percentage points. But total real investment decreased almost 7 percent from a level already depressed, although the current account deficit was reduced 60 percent (Buffie, 1989). Some economic indicators show that the economy responded favourably to this adjustment program but the success of this program was inhibited by the discovery of large oil deposits. This resulted in the government altering its approach to economic growth and pursuing a state led growth strategy similar to the Echeverria era.

Table 2.5 Public Finance During the Lopez Portillo Term (% of GDP)

	1977	1978	1979	1980	1981	1982
Total Public Expenditure	30.9	32.2	33.6	35.6	42.4	48.9
PEMEX Expenditure	3.7	4.7	5.3	5.2	7.5	7.6
Total Public Income	24.2	25.5	26.2	27.8	27.7	31.0
Income Oil Sector	4.3	5.0	6.1	8.0	8.0	12.4
Income Nonoil Sector	19.8	20.4	20.1	19.7	19.7	18.6
Financial Deficit	6.7	6.7	7.4	7.9	14.7	17.9
Internal Financial Deficit	3.1	4.0	4.5	4.9	6.2	14.4
External Financial Deficit	3.7	2.7	2.9	2.9	8.5	3.8

Source: Secretaria de Hacienda y Credito Publico, Estadisticas Hacendarieas del Sector Publico, Direcccion General de Informatica y Evaluation Hacendaria, 1983.

Table 2.5 looks at public finances during the Lopez Portillo administration. Here we see that early attempts at adjustment showed favourable results in terms of the size of the financial deficit which remained at somewhat small percentage of the GDP. However, this changed in the years directly before the crisis. In terms of responding to an early adjustment strategy the data apparently show some level of success, and spending habits represented a smaller portion of GDP in the early years of this administration.

2.3.2b *Achievements of the State Led Growth Strategy- The Echeverria Era Revived*

It is undeniable that between 1978 and 1981 the Mexican economy recorded some impressive accomplishments. The public-expenditure-led growth model performed satisfactorily for the early years. GDP growth ranged between 8.0 and 9.1 percent, employment growth in the high wage manufacturing sector and public sector increased 27.2 and 41.4 percent respectively. Both private and public sector investment spending increased rapidly. The share of public sector investment in GDP rose from 7.2 to 10.8 percent and that of the private sector increased from 11.7 to 14.1 percent. The inflation rate began creeping upward after 1978, but never exceeded 30 percent (Buffie, 1990,431). Employment increased, although the statistics on this are not particularly reliable. In addition, "on the external-debt front, some developments were also very positive up to 1980. The stock of foreign public debt grew rather conservatively during the period 1977-1980..... Other components of the country's external debt grew more dynamically. ...Yet the total external debt, when measured against the size of the economy, consistently decreased through 1980" (Zedillo, 305, 1985).

The public sector raised targeted amounts in the international capital markets as a result of the new found hydrocarbon wealth which was the fuel that changed the economic and financial outlook of Mexico. The renewed vigour was a result of the conciliatory tone of the new administration, the early adjustment program and oil wealth.

This development strategy was conducive to investment as well as job creation. At the same time, however, some fundamental disequilibria in the economy had taken renewed force and reached new and unprecedented proportions.

2.3.3 The Issues Arising from the Lopez Portillo Administration

As indicated in the previous section the adjustment process had achieved relative success and the early years (1977-1980) of the public-expenditure-led-growth model performed satisfactorily. However, this model did not perform with the success level that it previously and a number of factors contributed to its demise.

As indicated previously, the adjustment process initiated during the early years of the Lopez Portillo administration had some level of success, but it was not without its negative implications. For example, there was a huge decline in the level of real investment, and a rise in real exchange rates. The adjustment process was so short lived that it is difficult to predict the impact that it may have had on the economy. The adjustment process was pushed to the side when Mexico discovered new oil deposits.

By changing its development plan, the government participated in a public spending frenzy like that of the Echeverria years. This spending created an increased dependence on oil revenue. The government forecasted the oil wealth to be substantially greater than it actually was. Although difficult to comprehend, Mexico experienced a growing current account deficit even though it had the potential to have a current account surplus.

Spending in the early years of the Lopez Portillo term was sedate compared to the spending habits from 1980 through 1982 (Table 2.6). The current account deficit rose by 50% from 1980 to 1981 but decreased by 1982. The data depict a situation in which income was not substantial enough to meet the expenses incurred.

Table 2.6 Current Account During the Lopez Portillo Term (Billion of U.S. $)

	1977	1978	1979	1980	1981	1982
Expenses	10.6	11.7	21.1	32.2	43.4	33.4
Imports (CIF)	6.0	8.3	12.6	19.8	25.2	15.0
Interest	2.2	2.8	4.1	5.9	8.9	11.4
Services	2.5	3.2	4.5	6.5	9.3	7.0
Income	9.2	11.7	16.3	24.9	30.8	30.7
Oil Exports	1.0	1.9	3.9	9.9	14.6	16.5
Nonoil Exports	3.6	4.2	4.9	5.3	4.8	4.5
Interest	0.2	0.4	0.7	1.0	1.4	1.2
Services	4.3	5.2	6.8	8.8	10.0	8.5
Current Account Deficit	1.6	2.7	4.9	7.2	12.5	2.7

Source: Banco de Mexico, Indicadores Economicos.

Other problems that surfaced during the Lopez Portillo years included expansion of public demand, over-valuation of the peso, erratic inflation rates, and declines in non-petroleum revenue. These problems were given little or no attention even when warning signals were evident. Still in the grip of oil euphoria, the Lopez Portillo administration bulled ahead with yet more vigourous fiscal expansion, faithfully following the dictates of the political expenditure cycle (Buffie, 1989). Little concern was given to budget considerations or fiscal restraint; the government continued to spend and financed its spending habits by external sources of funds.

Table 2.7 Basic Economic Indicators During the Lopez Portillo Administration

	1977	1978	1979	1980	1981	1982
GDP Real Growth %	3.4	8.2	9.2	8.3	7.9	-.5
Inflation (Dec-Dec)	27.4	16.2	20.0	29.8	28.7	98.9
Public Investment %	8.9	10.0	11.0	11.0	--[1]	--[1]
Private Investment %	10.7	11.1	12.4	13.2	--[1]	--[1]
Total Investment %	19.6	21.1	23.4	24.2	25.7	22.7
Current Account Deficit(billions of U.S. $)	1.5	2.7	4.9	7.2	12.5	2.7
Nominal Exchange Rate[2]	22.7	22.7	22.8	23.3	26.2	122.5
Real Exchange Rate[3]	102.5	99.1	93.9	83.9	77.4	146.9

[1] Public and private investment figures unavailable as they were not broken down.

[2] Nominal exchange rate at the closing of December of each year (for 1982 it is the average of the full and controlled rates). Represents the value of money on world currency market.

[3] 1961=100. An appreciation is a decline in the index vaule and a depreciation is an incrase in the index value.

Source: Banco de Mexico, Indicatores Economicos, Subdireccion de Invetigacion, several issues.

A number of problems arose from the policies of the Lopez Portillo administration. For example, the data presented in Table 2.7 show a rise in GDP growth rates until 1979 but a steady decline in 1980-1981, and negative GDP growth in 1982. A rise in inflation came about but was not taken seriously until it was too late. By 1982 inflation had reached huge proportions thus affecting income distribution, lending, borrowing and competitiveness. There were changes in exchange rates, the peso was devalued and it became worth less and less as time went on; by 1982 this problem became increasing evident. However, during 1978 to 1981 the exchange rates remained relatively consistent but by 1982 had become more of a problem.

The problems were also intensified by external factors of which the government failed to take account. Internally Mexico looked as though everything was running smoothly. However, this was not the case as was indicated by the way the Mexican economy reacted to the fluctuations in the world economy. The situation in Mexico became extremely acute when the borrowed money was required to be paid back and Mexico could no longer meet its debt obligations. The events immediately previous to the debt crisis will be examined further in the next sections as will the internal and external factors contributing to the problem.

2.5 Summary

Mexico has had two types of development programs- stabilisation development and state-led development. Each had both negative and positive impacts on the Mexico economy. The boom years of the 1940s-1970s were, nonetheless, characterized by mismanagement and unresponsive and/or inappropriate government policy; economic disequilibrium was the result and the economy went bust. The above discussion looked at both types of development strategies and examined the repercussions of these development strategies through a historical analysis of 40 years of Mexican development. The next chapter will take a closer look at the debt crisis itself, the internal and external factors contributing to the severity of the crisis, and Mexico's solution to the problem.

Chapter 3: Mexico's Response to the Debt Crisis

3.0 Introduction

In 1982, Mexico faced an economic crisis, the magnitude of which compared to the prolonged depression of the 1930s. This crisis resulted from a mix of historical, internal and external factors. The response to the crisis was a structural adjustment program. Mexico underwent a structural adjustment program to open its external trade system, rationalize public sector enterprises, make the tax system efficient, liberalize and privatize its financial system, ease restrictions on foreign investment and deregulate specific economic activities to create a more efficient atmosphere and stimulate medium term growth (Kalter and Khor, 1990). The adjustment strategy was based on a series of stages aimed at macroeconomic stability and microeconmic efficiency. The focus was on the liberalization and decentralization of the public sector to increase external and internal competition in domestic and export markets, including the financial sector; and the attraction of national and international investment (Selowsky, 1990). It is now claimed that Mexico has reached the final stage of this adjustment process. The question arises as to how the International Monetary Fund (IMF) and the World Bank measure the success of adjustment programs and how much of Mexico's apparent adjustment success is actually linked to the program.

The initial section of this chapter examines the orientation of structural adjustment programs and the theory surrounding the adjustment process. The following section evaluates the success of Mexico's adjustment program to assess whether the long and short term objectives of the program have been met and whether they have had positive economic implications. Lastly, conclusions are drawn about Mexico's experience with structural adjustment as an approach to the debt crisis.

3.1 The Debt Crisis

The Lopez Portillo administration completed its term in 1982, with a debt crisis that far surpassed any other known in Mexico's history. The situation that faced Mexico was the result of a mix of historical, internal, and international circumstances. One prescription for Mexico was a structural adjustment plan initiated by the World Bank and a stabilization loan plan initiated by the International Monetary Fund. This section will begin with an examination of the events and causes of Mexico's debt crisis in the early 1980's.

3.1.1 Internal Factors Contributing to the Debt Crisis

Apart from the broad historical policies already noted, Mexico faced a number of other internal problems. The economic policies of Mexico were inefficient and the past administration had made a number of unwise decisions, especially in dealing with public sector spending and borrowing. Fiscal expansion was excessive, as was monetary expansion, and the growth of the public sector over at least the preceding 12 years, combined with corruption and inefficiency, had drained the economy.

The public sector deficit had reached high proportions during the presidency of Lopez Portillo. Eliminating the deficit proved difficult because of the burden of foreign debt service and the adverse impact of inflation on tax collection and the conditions for domestic borrowing. (Maddison, 1990)

The explicit decision by the state to continue the expansionist strategy in the face of increasing interest rates and falling commodity prices, and the adverse reaction of the private sector to the effects of this decision severely deepened the crisis (Teichman,1988). Indeed, it has been demonstrated that the effect of external shocks averaged less that 30% of the higher-than-trend indebtedness between 1979 and 1981. Heavy government borrowing in 1981, especially short term borrowing, was made necessary in part by the continued growth of government spending and heavy importing for the completion of major investment projects already underway (Teichman, 1988).

A program developed by the Lopez Portillo administration to promote industrialization and the public sector, known as the "alliance of production," lay behind these trends.

The public sector was weak and fragmented. Growth was deemed paramount and little or no attention was given to the deteriorating/ weak economic situation because to do so would mean scarificing the objective of growth. When a source of oil wealth was discovered in 1975-1977, the need for adjustment was put on hold, but the way the oil revenues were spent meant that they provided a short term reprieve at best. Rising debt levels combined with excessive domestic demand expansion, lack of saving incentives, an over-valued exchange rate, and poor debt management dissipated the potentially positive gains of the oil discovery. After four decades (1940-1982) of sustained, extensive growth averaging 3.1 percent a year, growth rates fell. Even before this, however, per capita product was declining on average by 1.5 percent a year (Maddison, 1990).

Inflation averaged 70 percent in the 1980s. This compares with an average inflation rate of 10 percent in the periods 1940-1980 (Maddison,1990). During the Lopez Portillo presidency, the external debt increased to massive proportions. By 1980-81, the annual burden of foreign debt service was averaging about 6 percent of GDP both because of the size of the debt and historically unprecedented real rates of interest. To meet this rising cost, Mexico borrowed even more money (Maddison, 1990). This, together with excessive expansion, added to inflationary pressures.

Resource allocation was inefficient, initially, due to excessive protection and subsidies and more recently, due to inflation and re-orientation of the productive structure. Factor productivity growth was substantially negative (Maddison, 1990). Also, there was a lack of diversity in the resources available as a result of too much emphasis being placed on the development of the petroleum sector.

These factors added to the inefficiencies and distortions within the economy of Mexico. The distortions contributed to the severity of the debt crisis of the early 1980s. In order for Mexico to take itself out of this crisis, it chose to pursue a structural adjustment plan devised by the International Monetary Fund.

3.1.2 External Factors that Contributed to Mexico's debt Crisis

The external problems confronting Mexico were a result of the changes in the world economy and global recession. These factors played a role in the debt crisis because they contributed to the downturn in the Mexican economy. One of the major external factors involved was the decline of oil prices between 1980 and 1982. Not only did the prices of crude oil and other commodities decline on the international market, but interest rates on loans contracted in the Euromarket, on a floating rate basis, increased (Teichman, 1988). This created a situation where there was a decline in available revenue combined with a significant increase in costs which precipitated a current account deficit.

The rising world interest rates put an end to the increasingly expansionary policies of the Lopez Portillo administration as well as exchange rate fluctuation. As a result of devaluations, the peso became almost worthless, making it even more costly to service the debt.

Mexico has a very close economic relationship with the United States. The United States is dominant in trade, tourism and movements of capital and labour. For a long time, the United States had expanded and run a very large trade deficit. This helped create a buoyant export market for developing countries. But after 1979, this ended.

Other industrialized countries had been cautious about the risk of inflation, keeping their economies on a slow growth track in the 1980 and running a trade surplus as a group. This brought an end to the inflation at the 1970s pace that had made foreign borrowing look so attractive to Latin America.

Three elements were important to the slowdown in industrialized countries:

> First there were the inevitable costs of adjustment to two system shocks: the collapse of the Bretton Woods Agreement in 1971 with the related resumption of free mobility of private capital and the twelvefold increases in oil prices at the end of 1973 ... The second reason for slower growth was the new consensus in economic policy ... The ideological change in industrialized countries (OECD) has been widespread and far ranging, and has made output stagnations, and increases in unemployment intended outcomes of policy. This approach had been successful in stopping inflation, and the Latin American experience of the 1980s provides confirmation that the costs of the inflation explosions are very real. The third element in the OCED slow-down after 1973 was the long run erosion of growth potential (Maddison, 1990, p. 30).

Bianchi (1987) suggests that the external factors contributing to the debt crisis were the result of excesses of external debt policies. This created a situation that resulted in the deterioration of the terms of trade; a dramatic rise in the real level of international interest rates; and, most devastating, a sharp drop in the net inflow of capital. In essence, the strategy of relying heavily on the use of foreign financing which many Latin American countries adopted in the second half of the 1970s was a function of two factors. One was the situation of abundant international liquidity, which prevailed between 1974 and 1981. The other involved the extremely expansionist policy followed during that period by the private international banks in their relations with many semi-industrialized countries.

Heavy reliance on external financing was, however a double edged sword. On the one hand, it made it possible to finance higher levels of imports and capital formation, thereby helping to maintain rates of economic growth that were higher than would otherwise have been possible. On the other hand, it helped to maintain economic policies that were bound to increase inflationary pressures and/or lead eventually to a balance of payments crisis. Bianchi (1987) goes further to say that the world recession and the deterioration of terms of trade after 1980 led to the fall of demand by industrialized countries for imports, which led, in turn, to decreases in the rates of growth and levels of international trade. These negative consequences were aggravated by the revival of protectionist practices in many of the OECD economies, a practice which became more frequent and stringent as unemploment grew and the recession continued.

The external environment had a major influence over the events in Mexico. Like the internal factors, the external ones contributed to inefficiency. Mexico did not have the ability to cope with such external shocks. In order to better cope with external equilibrium, Mexico was further pushed to pursue a structural adjustment program.

3.2 The Orientation of Structural Adjustment Programs

Structural adjustment programs are pursued by countries whose governments have realized that there is disequilibrium in the system that has created unsustainable growth. It is, therefore, imperative that each such country pursue structural reforms to realign the economy, internally and externally in order to facilitate growth and relieve poverty.

According to the World Bank and the IMF, a country's policy approach to adjustment should include the following elements: stabilization through the elimination or reduction of macroeconomic imbalances- generally though not necessarily, in association with IMF programs; shifting resources towards the tradeable sectors and consumption away from exports; efficiency improvement measured by, for example, the reduction of incremental capital output ratios, rationalization and reduction in control and regulations; and mobilization and co-ordination of internal and external resources to support these efforts.

Originally, countries adopted structural adjustment programs because of an unsustainable distortion in the balance of payments, that is, a current account deficit that cannot be financed by external credit of international assets (Ortiz,1987). The reestablishment of balance in the external accounts is a fundamental objective of structural adjustment programs. The problems of a distortion in the balance of payments was thought to be solvable through a policy mix of domestic absorption and a reduction of spending (Guitan, 1981).

The analytical basis of program design can be represented in the following equations:

$$IR = R - A(C + I) + Fe \qquad (3.1)$$

$$MI = Dm - X(b+p+ps) \qquad (3.2)$$

(Polak 1954; Robichek 1967)

IR - Change in International reserves
R - Revenue
A - Absorption
C - Consumption
I - Investment
Fe - Change in External Financing
MI - Change in International Reserves
Dm - Change in Demand for Money
X(b+p+ps) - Change in Domestic Credit from the banking system to public and private sector

Equation (3.1) is drawn from the identity of the national product with the definition of the balance of payments. Equation (3.2) is taken from the equilibrium condition in the money market. Disequilibrium in the economy is the result of a budget constraint that has been caused by a debt crisis or some major fluctuation in the world economy. Ortiz (1987) suggests that, irrespective of the economic state of a country, all adjustment programs may have stemmed from a monetary problem. Ground (1986) establishes that the process of adjustment usually assigns a central role to money even if the problems leading to adjustment are not monetary in orientation.

In recent years, structural adjustment programs have placed more emphasis on measures designed to improve resource allocation and use trade reform and price reform. The common thread that keeps these programs together is debt management. Cepal (1986) stresses that there has been a change in the focus of adjustment programs. While early attempts at adjustment were orientated around the reduction of imports and decreasing the deficit on the balance of payments current account, the recent orientation of adjustment policies is more towards reactivation and economic growth in combination with the achievement and/or maintenance of external balance. The program, instead of reducing spending, promotes exports and import substitution, growth and structural change. This would be possible through a reduction in the transfer of resources, a reorientation of domestic economic policy, promotion of the production of tradeable goods, alterations of domestic expenditures to an emphasis on quality investment, enhancement of the consumption of essential goods, and the separation of adjustment stabilization policies. The key is to make all these factors work simultaneously to reach a point of equilibrium. Equilibrium will only be successfully reached if the economy is made less sensitive to future shocks. This is possible by increased flexibility through the removal of structural rigidities.

The adjustment process that grew out of the debt crisis is categorized by Selowsky (1990) as stages of adjustment: Stage 1 is structured around the achievement of macroeconomic stability; Stage 2 deals with the liberalization of the incentive system, in order to maintain faster, efficient use of productive factors and Stage 3 centers on the restoration of investment and gives special attention to the choices that are available at each stage. His model, although questionable, is instructive.

Stage 1 of the adjustment process is the achievement of macroeconomic stability. Countries experiencing macroeconomic instability are plagued by high and fluctuating levels of inflation and interest rates, and uncertainty. These factors distort relative prices; inhibit investors, producers, and decision makers (especially in productive activities); promote low levels of saving; increase capital flight and re-direct investment towards less socially productive assets.

Stage I of the adjustment process is the achievement of macroeconomic stability. Countries experiencing macroeconomic instability are plagued by high and fluctuating levels of inflation and interest rates, excessive domestic borrowing and uncertainty. These factors distant relative prices; inhibit investors, producers, and decision-makers (especially in productive activities); promote low levels of saving; increase capital flight, and redirect investment towards less socially productive assets.

In order to create stability the adjustment process must include an increase in domestic investment, reforms in interest rate policy, tax reforms, divestiture of parastatals, financial reforms, new sources of external financing and increase in fiscal surplus. These reforms take time to engineer properly and must be done efficiently and effectively to create macroeconomic stability.

Stage II deals with the liberalization of the incentive system, in order to maintain faster, more efficient use of productive factors. At this point three sets of policies are required:

The first consists of policies that bring private incentives more in line with economic scarcities. These include: trade reforms that give equal incentives to exports and import substitution, deregulation of interest rates, and directed credit.

Trade reform is a fundamental feature of adjustment programs. Adjustment strives to remove imbalances within the economy. This is possible by creating incentives for the production of exports and the importing of competing goods. Trade reform is possible through alterations to the exchange rate, import protection and export subsidies. These policies are independent in their effects on production, trade and resource allocation.

Another factor that may contribute to better resource mobilization is price reform. It is thought that alterations to price controls will contribute to resource allocation and economic growth. Elimination of price controls may also allow for a rise in prices that are more equivalent to those on the international market. Price reforms is one part of the adjustment process and is often successful on its own but is usually introduced in connection with nonprice reforms such as reductions in import protection and export subsidies. This particular area of reform is linked to all areas of adjustment. Prices play an important role in the area of trade and resource use. Price reform may result in an increase in production by decreasing imports and increasing exports because of a possible increase in the demands for goods. In certain sectors, such as agriculture and energy, price reform has an important influence. Removal of price controls in agriculture would reduce distortions among alternative activities as well as input-output relationships. Price reform is important to the energy sector because more effective pricing may decrease inefficiencies in the production and use of energy sources and better use of existing sources of energy.

The second set of policies aims at increasing competition by eliminating barriers to entry, making labor regulations more flexible, and reducing the cost of doing business. An important objective must be to ensure that the overall incentive program is based on transparent rules and market signals, instead of discretionary allocations of resources by public officials. The third set of policies involves increasing the efficiency and equity of the use of resources within the public sector.

Most of the output growth in Stage II will come form better allocation of existing capacity. Not much additional private investment can be expected at this point, as the reforms are recent and investors, not surprisingly, cautious. External financing will be needed primarily to finance intermediate inputs, rather than capital flight, so as to enable imports to recover past levels. Stage III deals with the restoration of investment. When a country reaches this stage, the structures required for sustained growth have already been put in place. The only constraint at this stage is the lack of a supply of external financing.

The orientation of adjustment programs suggests that there are a number of economic implications that result from the adjustment process. However, these economic implications are not without social problems as well. Stage 1 suggests that there be a move towards macroeconomic stability. There will be attempts made to create economic stability, lower inflation rates and maintain consistent interest rates. This will entail changes in fiscal policy that will create changes in the banking system and the availability of capital. There will be changes to tax polices that will have an adverse effect on some members of society. Also the public sector will need to streamline, resulting in the loss of jobs and a decrease in available income.

3.3 The Adjustment Policies of Mexico

The adjustment process was initiated to change the policies being implemented in the Mexican economy. Teichman (1988) discusses the changes that took place after the shock of the debt crisis. The clearest indication of the shift in policy under de la Madrid's administration was the abandonment of the Global Development Plan of the previous administration and the adoption of the IMF austerity program (El Programa Immediato Reordennation Economica), emphasizing fiscal austerity and implementation of a program for liberalizing and restructuring the economic adjustment program. This program included:

(1) a reduction in the public sector deficit to 8.5 percent of GDP in 1983, 5.5 percent in 1984 and 3.4 percent in 1985: (2) an increase in the prices charged for a wide range of goods and services; (3) a move towards opening the economy to international competition and eventually seeking membership in the General Agreement on Tariffs and Trade (GATT);(4) a concerted effort by both the private and public sectors to promote non-petroleum exports via the further development of the maquladoras, or assembly operations, along the United States - Mexico border;(5) a more flexible interpretation of the 1973 foreign investment law to encourage foreign investment and technology; and (6) reduction by more than 40 percent of the number of public -sector firms. Privatization was expected to rid the government of inefficiently run parastatals.

3.3.1 The Adjustment Policies of Mexico for 1982 - 1985

In the early 1980's Mexico had to establish a plan that would help to relieve the economic crisis that was present. A change in economic policies was required and Mexico choose to pursue a structural adjustment plan. The policies of this plan have been summarized by Ros and Rodriguez (1987).

The first reaction to the imbalances was to introduce a number of adjustment policies which were frequently inconsistent with each other. As the situation became more difficult, awareness of its seriousness increased. Better defined and integrated sets of measures began to be formulated and implemented. Generally, the following stages can be distinguished:

1) Initial Adjustment Program

This was carried out by the government of President Lopez Portillo in early 1982 and was based on fiscal cutbacks, devaluation (80%), and higher public tariffs. A wage increase was agreed to in April of that year which ranged from 30 % to 20% and 10% depending on the existing level of earnings. There was a further devaluation in August, a dual exchange rate system was established, and payment of the debt was suspended for 90 days. The banks were nationalized in September and a comprehensive system of exchange controls was introduced.

2) The 1983 -1985 Adjustment Program

In this period, the next government, that of President de la Madrid, carried out an adjustment program which envisaged separate stages. First, shock treatment to re-establish the main balances was involved and second, a so called gradualist stage in which output was to begin to grow. Briefly, these stages may be described as follows:

a) The Shock Treatment (1983)

This consisted basically of a drastic reduction of the fiscal deficit (which was roughly equal to 50% of the gross domestic product) and an equally drastic cut in inflation (from 100% to 55% in 1983); reductions of the current account deficit of the balance of payments (about $ 2 000 billion); and suspension of growth in 1983. These measures were accompanied by a very restrictive wage policy.

b) The gradualist stage (1984-1985)

It was thought that there ought to be a recovery of economic growth (from 5% to 6% from 1985 on) in accordance with a model of long term structural change which would lead to the expansion of non-oil exports and assign greater importance to the private sector and the market.

There appears to be an overlap of the adjustment stages. Hence, the structural policies adopted from 1982 on can be characterized in accordance with their purpose:

1. To modify the price ratio of tradeable to non-tradeable goods: exchange rate changes in 1982 and 1983; replacement of import taxes by tariffs. These particular policies were introduced in 1982 but carried through to 1985.

2. Reduce the fiscal deficit: A reduction of subsides; a two percent increase in indirect taxes net of subsidies; rationalization of the public sector trade and production apparatus, which led to the sale of 236 small and medium sized enterprises; a reduction of real salaries and wages in the public sector; cutback of 32% in public sector investment, especially by public enterprises; increase of public sector oil revenues, via PEMEX, as a result of the devaluation.

3. To create an improved structure of factor prices to facilitate a more efficient allocation of resources: reduce subsidies; increase in real interest rates; and reduce state intervention and increase participation by the private sector and reliance on market mechanisms.

4. Stimulate the participation of the private sector through fiscal incentives for private investment and higher rates of accelerated depreciation.

This is a brief summary of the 1982-1985 structural adjustment policies which operated in combination with the policies of fiscal and monetary restraint and exchange rate adjustment. The program was not as successful as hoped, however, and required modification in 1986.

3.3.2 The 1986 Stabilization Program

Stoga (1987) discusses the 1986 stabilization program that was constructed as a response to both the continuing oil price collapse and the cumulative failure of the past several years. The new program sought to cushion the Mexican economy's adjustment to the drop in oil revenues through substantial new compensatory borrowing from commercial and international financial institutions, totalling some $12 billion during 1986-1987.

In terms of economic policy there are several important elements of the program:

Mexico was to maintain positive real interest rates and a realistic exchange rate.

The public-sector deficit was to be further reduced at least from what it would have been through tax increases and improved collections, subsidy reductions, and spending cuts totalling the equivalent of three percentage points of GDP by the end of 1987. However, the overall financial deficit was forecast by the Mexican authorities to be around 17 percent of GDP in 1986 and only marginally less in 1987.

The system of subsides was to be further revised, including fee increases and new delivery mechanisms that focussed subsidies on the lower income groups rather than extending them to the general population.

Foreign investment was to be more aggressively encouraged but on a case-by-case basis rather than through a change in the legislation governing such investments in general.

Privatization outside of strategic industries was to be pursued and non-economic state enterprises were to be modernized, restructured, or closed.

The shift to a trading system structured on tariffs instead of quantitative restrictions was to be completed, tariffs were to be gradually reduced, and the official pricing system was to be eliminated by the end of 1987. Considerable progress had already been made in this area, including membership in GATT, a reduction of the share of imports subject to quantitative restrictions to 80 percent in 1982 to 45 percent in 1986, and a significant reduction of average tariff barriers. Dollar indexed deposit accounts were to be introduced to discourage capital flight.

3.3.3 Post 1987 Adjustment Program

In 1987 Mexican authorities introduced an Economic Solidarity Pact because the 1986 adjustment policy, although partially successful had not helped to establish a desirable level of economic stability. Beristan and Trigeuros (1990) summarize the Pact and its potential.

The unstable situation that prevailed to the end of 1987 convinced the Mexican authorities that a monthly inflation rate of 7 percent was not sustainable. Only a far-reaching stabilization program could reduce inflation and prepare the economy for a period of sustained growth with price stability. The Economic Solidarity Pact was initiated to meet this goal.

The main strategy of the Pact included orthodox elements: tighter spending, monetary and credit controls, and greater efforts at increasing revenues.

The basic idea behind the program was to achieve a primary public sector surplus amounting to between 6 percent and 7 percent of GDP. Assuming reasonable access to foreign funds (ie. just enough to keep the real value of foreign debt constant), this surplus would give the government the margin it needed to service its foreign and domestic debts without resorting to inflationary financing. However, certain heterodox elements, arrived at by negotiations among the major sectors of the economy, were included as well.

During the first stages of the Pact the exchange rate was kept constant in order to impose discipline in other areas of public policy, such as minimum wages and fiscal policy. The prices of various goods were also kept under strict control, and at times, businesses were actually asked to lower their prices.

Under the new president, Carlos Salinas de Gortari, the administration sought to introduce some flexibility into what, at the end of 1988, had become an increasingly tight situation. Thus, while the compromise was still in place to continue with the adjustments necessary to maintain a budget compatible with price stability, some of the lags in public and user fees were corrected, price increases were authorized for some products, and the peso was devalued. This was to continue until 1990. Some increases in wages were approved.

3.3.4 Trade Liberalization 1983-1988

The second stage of the adjustment process identified by Selowsky (1990) involved the liberalization of incentive systems to make better use of productive factors. Mexico introduced a trade liberalization program (1983-1988) in the hope of finding effective and efficient means of promoting exports. Zabludovsky (1990) discusses the trade liberalization program.

Reforms to trade policies were required in order for the adjustment process to proceed at a functional rate. These reforms were initiated in both the export and import sectors of the economy.

The reforms to the export sector were limited and included the ability to remove export licenses but this was constrained because of the need to stay within export quotas set by international agreements as in the case of oil, coffee, and cocoa or to comply with import quotas imposed on Mexico by its trading partners (as in the case of textiles and steel).

The first stage of trade liberalization took place in early 1983 and continued to June, 1985. This stage was initiated by the de la Madrid administration and involved reducing import tariffs but maintaining licensing requirements. However, as import licensing was being phased out, tariffs were increased to provide a roughly equivalent amount of protection.

The second stage of trade liberalization took place from July 1985 until November 1988. In July of 1985 it was clear that the Mexican economy needed to diversify away oil in order to restore growth rates. Deterioration of the export sector resulted in a quickened response to trade reforms intended to remove the trade restraints and protection that were holding Mexico back.

July 1986 marked Mexico's entry into GATT. This obligated Mexico to continue with its plan of import license removal and tariff reduction, but allowed a system to assess anti-dumping and countervailing duties. Since, by mid-1986, Mexico had already undertaken major reforms affecting tariffs, official import reference prices and import licenses, most of the adjustment costs of joining GATT had already been met, at least for the immediate future. Further liberalization took place during 1987-1988 through the Economic Solidarity plan (examined in the previous section). The specific changes to trade were a change in the dispersion of the tariffs, elimination of import surcharges and the abolition of remaining official import prices.

The third stage of trade liberalization began in December of 1988. The next president, Salninas, took office in late 1988 and proceeded to institute a macro adjustment package of his own: the Stabilization and Economic Growth Plan. The aim of this program was to decrease inflation and to restore growth.

The trade policies of this package tried to eliminate discrimination among sectors by imposing uniform tariff protection. The government did this by closing the dispersion in minimal tariffs. In January and March of 1989, two executive decrees raised tariff rates for most goods previously exempt from import taxes or subject to a 5 percent rate. As a result of these tariff increments, by March 1989 the unweighted average tariff increased to 10 percent and tariff dispersion dropped to 4.3 percent.

The economic sectors that remained protected under the import licensing regime consisted mainly of agriculture and industries like automobiles, pharmaceuticals and electronics, the focus of specific development programs. These sectors account for approximately one-fourth of tradeable output and, according to the terms of the GATT agreement, they are permitted to retain licensing protection temporarily.

Export incentives under the trade liberalization program began in 1983. This program removed some of the anti-export bias in Mexico's commercial regime by reducing the profitability of producing import substitutes and introducing export incentives that neutralized existing trade distortions. Firms eligible for export incentives can import intermediate and capital goods without obtaining import licenses or paying import taxes. Thus, the export incentives scheme allows local firms access to tradeable factor inputs at world prices without distortion by tariffs or quotas. (Zabludovsky,1990)

3.4 Mexico's Experience with Adjustment

As outlined above, structural adjustment programs are based on certain objectives such as stabilization, a switch towards the production of exports, efficiency improvements, mobilization and co-ordination of internal and external resources, a reduction in the balance of payments deficit, increase in economic growth and structural change that would prevent future payment problems. Four areas are of importance here - trade, prices, resource mobilization and resource use. The structural adjustment program designed for Mexico has tried to achieve all these objectives and has had relative success.

The Mexican government, as well as the World Bank, suggests that the adjustment program has been successful:

> The Mexican experience suggests that countries with macroeconomic imbalances and structural rigidities can return to sustainable growth and financial stability, but only by implementing wide ranging economic and structural measures and by preserving the reform effort (Kalter and Khor, 1990).

The stages model discussed previously was compared to Mexico. Selowsky (1990) is of the opinion that Mexico has reached the third stage and has gone through the adjustment process successfully with favourable results.

3.4.1 Mexico and Macroeconomic Stability: Stage I

The underlying principle of Stage I was to achieve macroeconomic stability. This stability was thought to be possible through a reduction in spending as well as other means which will be examined. Here an attempt will be made to show that Mexico has indeed shown some success in this area of adjustment. Table 3.1 presents data on the public sector's spending habits as well as the revenue flows into that sector. The positive results of the adjustment process become apparent in the late 1980's. For example, by 1988 expenditure in the public sector had been reduced and continued to fall until 1991.

When looking at the other side of the spectrum, there is a reduction in revenue but the difference between revenue and spending is not as substantial as in previous years, therefore creating a smaller deficit.

Table 3.1 Public Sector Revenue and Expenditure* (Percentage of GDP)

	1983	1884	1985	1986	1987	1988	1989	1990	1991
Budgetary Expenditure	39.0	37.7	37.5	42.5	43.7	38.4	34.1	33.4	29.7
Current	32.7	32.0	32.3	37.8	38.8	34.8	31.0	29.4	25.5
Of Which:									
Interest Payments	12.1	11.7	11.3	16.4	19.6	16.5	12.9	9.9	5.7
Capital	6.3	5.7	5.1	4.6	4.8	3.6	3.2	4.0	4.2
Budgetary Revenue	31.7	31.3	30.4	29.4	29.5	28.7	27.6	27.5	26.2
Oil Sector	16.1	15.1	13.3	11.4	11.9	10.0	8.7	9.0	7.9
Exports	10.8	9.4	8.1	4.9	6.0	3.4	3.2	3.7	3.0
Domestic	5.2	5.7	5.2	6.5	5.9	6.6	5.4	5.3	4.9
Non-oil Sector	15.6	16.2	17.0	18.0	17.6	18.7	18.9	18.5	18.3

Sources: Secretariats of Finance and Public Credit and of Programming and Budget

* Excludes nonbudgetary operations and financial intermediation

The Government of Mexico cut the number of parastatals from 1100 in 1982 to about 350 by mid- 1990 and by 1991 the number had been lowered to 250. This was possible through a process of mergers, liquidation, debt equity swaps and sales. The targets included some of the largest enterprises in the public sector including two air lines, a truck manufacturing company, two steel companies, a copper mining company, and a telecommunications company. In May 1990, a bill was submitted to the congress in Mexico to allow for the reprivatization of commercial banks expropriated in 1982, removing the responsibility of controlling banking operations form the government to the financial sector.

In general, divestiture allowed the public sector to concentrate its limited resources on priority sectors and enabled the private sector to participate in the development of critical areas of the economy making the economy more competitive.

There was also a deregulation of certain sectors. These included the transportation, communication, petro-chemical, fishing and agricultural sectors. The deregulation of these sectors allowed for the use of foreign savings for investment. This resulted in better use of resources and made the public sector run more effectively.

Tax reform was another means by which the government pursued its adjustment path. In 1987, authorities implemented major reforms to the tax system. The reforms were designed to make the domestic tax system look more favourable to foreign investors and, also, to correct distortions and create external competitiveness. The reform was accelerated in 1989-1990 by widening the tax base and reducing marginal tax rates. Some of the tax reforms were: set a minimum tax of 2 percent on firms' assets; abolish tax exemptions granted to certain sectors of the economy; reduce the corporate tax by about 4 percent; and lower the tax rate on the highest personal income bracket to 35 percent.

Kalter (1992) suggests that the introduction of a new tax system would increase the amount of revenue and private capital entering the system resulting in an increase to the primary fiscal surplus, declining inflation and nominal interest rates, and the recovery of private sector confidence. Tax reform aided in producing a surplus of the operating balance. The usefulness of tax reform became more apparent in 1991 with declines in inflation, nominal and real interest rates, and the level of domestic debt, and increases in revenue. As the primary budget balance improved, the level of public sector investment and current expenditure were able to be expanded.

Table 3.2 Mexico: Selected Public-Sector Accounts, 1982-88
(percentages of GDP)

	1982	1983	1984	1985	1986	1987	1988
Nominal Deficit	16.3	8.6	8.5	9.6	16.0	16.1	12.3
Operational Deficit	5.5	-0.4	0.3	0.8	2.4	-1.8	3.5
Primary Deficit	7.4	-4.2	-4.8	-3.4	-1.6	-4.7	-7.4
Total Revenue	28.9	32.9	32.2	31.2	30.3	30.6	29.8
Oil Exports	8.3	10.8	9.4	8.1	4.9	6.0	3.4
Noninterest expenditures	36.3	28.7	27.4	27.8	28.7	25.9	22.4
Public Investment	10.2	7.5	6.7	6.0	6.0	5.6	4.4

Source: Banco de Mexico, September 1989

Financial liberalization was part of the first stage because it was thought to help remove distortions in the financial sector of the economy, creating a better environment for economic stability. A salient feature of the financial liberalization in Mexico was the implementation of a clearly defined strategy in gradual, well-ordered stages (Coorey, 1992, 43). To encourage savings and to improve the allocation of credit, the government of Mexico, in March 1989, removed control of interest rates and maturities for most bank instruments. In addition, the former system of bank lending to the public sector through reserve requirements was supplemented by a system of liquidity requirements and the role of open market operations for monetary control was promoted. Further, interest rate subsidies internal to some loans by national development banks were reduced. Also, in 1989, legislation was passed that strengthened the supervisory powers of the Bank of Mexico over the banking system. The majority of financial reforms took place in the period from 1989 to 1991 and coincided with the implementation of the economic adjustment program. According to Coorey (1992) in 1989 the deregulation of interest rates and lifting of credit ceilings allowed the banks to compete effectively in financial markets and encouraged private savings in financial assets. Monetary indicators (Table 3.3) show a rise in a number of the indicators presented; for example, there was a rise in the monetary base. The amount of money and quasi-money rose, indicating a rise in the level of money outside the banking system. As well, there was an increase in current account deposits. Additionally, there were increases in money in the banks. The data fluctuates yearly but the results appear to be positive. The amount of credit available to the domestic market appears to have risen, indicating that obtaining loans and deferred payments became more favourable. From 1989 - 1991 the relationship between currency and GDP remained relatively stable for the entire period, indicating that the expansion of bank deposits was mainly responsible for growth of monetary aggregates. Coorey(1992) suggests that financial liberation has had a positive impact on the money multiplier; the replacement of the high reserves requirement with a lower liquidity ratio and the removal of credit restrictions in early 1989 raised the money multiplier and permitted a greater supply response as the demand for Mexican financial assets rose with the return of confidence. Coorey (1992) suggests that Mexico has had success with financial liberalization because financial development in Mexico has included the evolution of the market for domestic public debt and the declining significance of monetary assets in relation to other financial assets.

Table 3.3 Monetary Indicators

Year	Monetary Base	Money	Quasi Money	Money Plus Quasi Money	Domestic Credit
1976	24	158	----	---	239
1977	16	280	317	525	577
1978	9	270	429	699	762
1979	15	361	588	949	1028
1980	21	477	820	1297	1429
1981	40	635	1298	1933	2126
1982	77	1031	2024	3055	4180
1983	92	1447	3498	4945	6528
1984	111	2315	6017	8332	9879
1985	142	3462	8474	11936	16767
1986	264	5790	15509	21299	33815
1987	632	12627	40029	52656	69118
1988	783	21191	22257	43448	115328
1989	875	29087	64731	93818	167930
1990	628	47439	117513	164952	237896
1991	685	105552	140196	245748	323000

Source: International Financial Statistical Yearbook, 1992

Deficit reduction was one of the main features of the structural adjustment process, with an equally drastic cut in inflation along with a reduction of the current account deficit. The need for a reduction in the deficit was stimulated by a decrease in government spending. Government spending increased to a very high degree in the early 1980's. In 1976-1989, the deficit had grown substantially, mainly as a result of increased spending, the end of the oil boom and further, the debt crisis. In Table 3.4, it can be seen that the government ran a deficit until 1990, with the magnitude of the deficit varying from 1985 until 1989.

In order to measure the subsequent decrease in the deficit, the level of reduction is measured by taking it as a percentage of GNP and GDP in Table 3.5. In some years the deficit represented a greater amount of GNP and GDP, but the data available shows that the deficit was reduced.

Table 3.4 Government Deficit (Billions of Pesos)

Year	Deficit- (or Surplus)	Revenue	Expenditure
1977	-61	241	286
1978	-63	323	367
1979	-102	439	505
1980	-134	675	750
1981	-392	894	1182
1982	-1454	1520	2829
1983	-1363	3222	4468
1984	-2094	4774	6747
1985	-3978	7820	11784
1986	-10407	12643	22800
1987	-26224	33683	59702
1988	-40343	67476	107273
1989	-26494	92841	118619
1990	5104	96407	119252

Source: International Monetary Fund

Table 3.5 Government Deficit as a Percentage of GNP and GDP
(Billions of Pesos)

Year	Gross National Product	Gross Domestic Product	Deficit/ GNP %	Deficit/ GDP %
1977	1806	1849	3.38	3.30
1978	2285	2337	2.76	2.70
1979	2990	3068	3.41	3.32
1980	4159	4276	3.22	3.13
1981	5674	5874	5.79	5.60
1982	8908	9417	16.32	15.44
1983	16100	17142	8.47	7.95
1984	27784	29472	7.67	7.11
1985	45104	47392	8.82	8.39
1986	74385	79131	13.99	13.15
1987	183455	193462	14.29	13.56
1988	--	395993	--	10.19
1989	--	494055	--	5.36
1990	--	--	--	--

Source: International Monetary Fund

The reforms that took place as the result of the structural adjustment program led to a decrease in interest rates. Data found in Table 3.6 suggest that interest rates have declined since 1987 but were high during the early 1980's. With lower interest rates, there was a decrease in the amount of interest paid. It also made it easier to gain access to capital and the capital cheaper. " The cheaper the cost of borrowing money the more money will be demanded by households and businesses for consumption and investment purposes respectively." (Pass,1988,441). Lower interest rates made conditions for investment that much more appealing, thus contributing favourably to the structural adjustment process.

Table 3.6 Interest Rates

Year	Money Market Rate	Treasury Rate	Deposit Rate	Average Cost Rate	Lending Rate
1976	--	--	--	11.83	--
1977	--	--	10.63	12.88	--
1978	--	10.53	11.17	15.13	18.20
1979	--	15.02	13.23	16.35	19.90
1980	--	22.46	20.63	20.71	28.10
1981	--	30.77	29.57	28.62	36.60
1982	45.86	45.75	43.62	40.40	45.77
1983	57.51	59.07	54.70	56.65	63.03
1984	49.94	49.32	48.36	51.08	54.73
1985	62.44	63.20	59.48	56.07	--
1986	88.01	--	84.68	80.88	--
1987	95.59	103.07	97.24	94.64	--
1988	69.01	69.15	63.65	67.64	--
1989	47.43	44.99	36.29	44.61	--
1990	37.36	34.76	31.24	37.07	--
1991	23.58	19.28	17.10	22.56	--

Source: International Monetary Fund

Mexico, in order to create macroeconomic stability, needed to reduce the size of its debt. The debt problem was associated with expansionary domestic demand management policies that caused a decline in the fiscal balance. The decline in the fiscal balance was accompanied by a sharp appreciation of the real effective exchange rate, accelerated inflation and a current account deficit. The current account deficit was the result of increased external borrowing, especially by the public sector. The claims were short-term, which became a problem when repayment was demanded and international interest rates had risen. (El-Erain, 1992)

The success of the debt restructuring in the early 1980's was questionable. After four reschedulings since 1982, Mexico's external debt burden was still quite large in 1988. The government agreed to a debt reduction package with the commercial banks in mid-1989. This new package resulted in a rise in private sector confidence. It reduced external debt by about 17 billion dollars, lessened future interest obligations and changed the maturity of the remaining commercial bank debt. (IMF Survey, 1993). In addition to the package with the banks, Mexico introduced a program that would produce a short term cash supply, a debt exchange program, debt equity program and a comprehensive debt reduction operation.

The debt reduction provisions introduced were met with a certain amount of success.

> Appropriate debt restructuring has had a dramatic impact on Mexico's economy, together with the sustained implementation of comprehensive medium-term economic adjustment and reform program. In addition to reduced debt servicing obligations, the package contributed to a sharp improvement in private sector perceptions of Mexican transfer risk. Diminished concerns about Mexican external indebtedness were reflected in a sudden and substantial fall in real domestic interest rates, a surge in domestic share prices, a recovery in secondary market prices for Mexican external bank claims , and a reduction in interest rates on foreign bond issues. These developments were associated with large private capital inflows- in

> the form of foreign direct investment and repatriation of flight capital- and the restoration of Mexico's access to voluntary international capital market financing. (El-Erain, 1992,49)

In connection with the positive aspects of debt reduction mentioned above, the discount bond option reduced 7.1 billion of Mexican debt. The par bond option reduced interest on another 22.5 billion of debts. These two options represented 16 percent of Mexico's outstanding debt at the end of 1989. The debt equity program produced the total gross effective debt reduction associated with the package amounted to 17.5 billion, equivalent to 19 percent of the external debt at the end of 1989. Also, debt reduction resulted in an increase in cash flow due to a decline in interest payments. Debt restructuring decreased Mexico's vulnerability to unfavourable movements in international interest rates. The summary of data (Table 3.7) presented shows that there was a decrease in the level of long term debt, short term debt, interest payments and the total debt serviced. The decline in interest payments further eased the burden of debt service. Decreasing short term debt allowed for the repayment to take place over an extended amount of time. Mexico's favourable results well-executed economic and financial policies, plus responsive adaptions in debt management policies, including the use of credit enhancements, hedging and other financial risk management policies. (El-Erain, 1992)

Table 3.7 Summary of Debt Data (Millions of U.S. dollars)

Year	Long Term Debt	Short Term Debt	Interest Payments	Total Debt Service
1980	41215	16163	6068	10962
1981	53232	24983	9766	14340
1982	59651	26147	11153	15684
1983	81567	10139	9994	14825
1984	86022	6440	11304	16960
1985	88448	5450	10220	15293
1986	90921	5900	8375	12946
1987	98497	5800	8325	12087
1988	86521	9456	8711	15472
1989	80030	10295	9274	14295
1990	80613	9645	7268	12121

Source: World Debt Tables

Significant attempts were made to achieve economic stability. The information presented shows that, indeed, Mexico is on the road to economic recovery. It is apparent that Mexico 's attempts at structural adjustment in the areas of debt reduction, financial liberalization, tax reform and divestiture of public enterprises had positive implications in reaching improved macroeconomic stability.

3.4.2 Mexico and Liberalization of the Incentive System: Stage II

1) Trade Reform

Mexico, according to Kalter and Khor (1990), opened up its trading system.

> The trade liberalization measures that have been implemented since 1985 have helped transform an inward looking economy characterized by high import controls into an open economy. They have increased inter-national competition in the domestic market, improved resource allocation, and increased productive efficiency, They have allowed Mexican companies to import capital and intermediate goods at international prices, thus strengthening their productivity. More generally, they have contributed to the establishment of a predictable and rational incentive structure for the private sector. (Szymczak, 1992,30-31)

Trade liberalization reduced the coverage of import tariffs. Maximum tariffs were reduced by 20 percent in 1987 and minimum tariffs were set at 10 percent, making for a uniform level of protection. Tariffs were lowered but also took the place of import quotas which " improved the fairness of the trade regime and may have allowed an increase in capacity utilization in the tradeable goods sector" (Szymczak, 1992,31). To ensure the credibility of its trade reform ethics, in 1986, Mexico joined GATT. With the joining of GATT, Mexico promised to speed up tariff reduction and to and eliminate import quotas and licenses, albeit with safeguards provided for its financial pharmaceutical and some other corporations/industries.

By opening up the barriers to trade and replacing import substitution policies and reliance on oil exports for foreign exchange earnings with policies aimed at attracting foreign investment, lowering trade barriers and generally making the country more competitive for non-oil exports Mexico has become a more open and more efficient economy with better opportunities. Table 3.8 looks at statistics that reflect production levels within the economy. All sectors showed significant rises in production since 1986.

Table 3.8 Index of Production (1985=100)

Year	Industrial	Manufacturing	Mining	Crude
1976	67.9	70.4	60.7	38.6
1977	70.3	72.9	61.2	43.8
1978	77.3	79.5	62.5	50.4
1979	85.3	86.8	65.4	57.8
1980	93.6	93.6	79.9	71.0
1981	101.8	100.5	92.2	80.3
1982	99.9	96.5	102.0	98.7
1983	91.6	89.3	97.8	96.6
1984	95.1	93.8	99.1	100.4
1985	100.0	100.0	100.0	100.0
1986	94.7	95.2	95.8	96.2
1987	98.6	98.9	99.5	102.3
1988	100.3	101.9	99.9	99.3
1989	105.5	108.7	99.5	105.1
1990	110.7	114.3	103.5	113.3
1991	--	118.5	--	120.8

Source: International Monetary Fund

A number of trade reforms were introduced to help remove some of the imbalances within the economy. These reforms were perhaps, one of the most fundamental features of the adjustment process. The overall look of the trade trends in Mexico will be examined by data acquired from the International Monetary Fund. Trade patterns had shifted more towards exports during the oil boom years. Table 3.9 examines the levels of exports and import for years 1976-1991. There appears to be an improvement in the trade balance since 1982 but more recently, the results are less favourable. During the structural adjustment years, there was a move towards increasing exports and these exports have become more diversified (Kalter, 1992).

> Moreover, the economy's productive base is being modernized as a result of access to imports at international prices and greater amounts of foreign direct investment. Mexico is currently involved in the negotiations of four free trade agreements one with the United States and Canada (see Appendix 1) and three with other Latin American countries. (Kalter, 1992,9)

The increase in exports is more important, in many ways, than the continuing trade deficit, as this has made it easier to deal with the rise in imports which are themselves important insofar as they include capital goods, to the improved growth performance of the economy.

Table 3.9 International Transactions (Billions of Pesos)

Year	Exports	Imports (cif)	Trade Balance (fob)	Exports-Imports (fob)
1976	53	91	86	- 33
1977	102	124	118	- 16
1978	136	185	176	- 40
1979	205	276	263	- 58
1980	385	447	426	- 41
1981	481	590	564	- 83
1982	1232	775	743	489
1983	2632	972	923	1709
1984	4082	2014	1920	2162
1985	5705	3598	3456	2249
1986	10150	7230	6905	3245
1987	28939	17951	17145	11794
1988	47202	44574	42573	-4629
1989	56769	60342	57633	-864
1990	76611	88058	84105	-7494
1991	82508	--	--	--

Source: International Monetary Fund
Trade Balance = Merchandise Exports, fob - Merchandise Imports, fob Service Balance

Devaluation is one of the first measures of trade reform. Although it may have short run implications, it is basically a long term solution. Table 3.10 presents the changes in exchange rates. It is difficult, given the lack of data, to determine the effects on trade but an attempt will be made to draw an analogy between the amount of trade taking place and the level of exchange rates. It is important to note that between 1958 and 1975 the exchange rate remained fixed at 12.5. However, this changed dramatically after 1975. The peso became so devalued that it was worth basically nothing in the international market as well as with Mexico's chief trading partner the United States.

Table 3.10 Exchange rates

Years	Market Rate (Pesos per SDR)	Market Rate (Pesos per U.S. $)
1976	23.2	20.0
1977	27.6	22.7
1978	29.6	22.7
1979	30.0	22.8
1980	29.7	23.3
1981	30.5	26.2
1982	106.4	96.5
1983	150.7	143.9
1984	188.7	192.6
1985	408.3	371.7
1986	1129.6	923.5
1987	3134.8	2209.7
1988	3069.5	2281.0
1989	3470.7	2641.0
1990	4190.3	2945.4
1991	4392.9	3071.0

Source: International Monetary Fund

The adjustment process at this stage set out to liberalize the incentive system of Mexico. It was important at this point to make sure that Mexico was protected from external shocks. The strategy included prearranging external assistance to compensate for unexpected events, while adjusting economic policies, saving windfall gains resulting from favourable exogenous shocks and restructuring the economy to minimize the impact of future shocks, (Kalter,1992,11).

Table 3.11 Balance of Payments of Mexico (Million of US$)

Year	Current Account	Trade Balance	Service Balance	Income Balance	Overall Balance
1976	-3409	-2296	846	-2116	-860
1977	-1854	-1021	1149	-2151	622
1978	-3171	-1745	1153	-2770	386
1979	-5459	-2830	1257	-4111	315
1980	-10750	-3385	-980	-6669	818
1981	-16061	-3846	-2236	-10282	1275
1982	-6307	6795	-951	-12454	-11635
1983	5403	13762	604	-9265	-4308
1984	4194	12941	907	-10064	-677
1985	1130	8451	578	-8899	-3706
1986	-1673	4599	967	-7703	-451
1987	3968	8433	1946	-7059	4120
1988	-2443	1668	2440	-7118	-11153
1989	-3958	-645	2490	-7797	-210
1990	-7117	-4433	1568	-7715	2219
1991	-13283	-11063	2404	-6865	7972

Source: International Monetary Fund

Data on Mexico's balance of payments is shown in Table 3.11. There were fluctuations to the overall balance from 1976-1991, but the overall balance clearly moves favourably in the latter 1980s. Szymczak (1992) says the structure of the balance of payments has changed significantly since 1985: non-oil exports have performed well and automotive products, other machinery and equipment, chemicals, iron and steel products, electrical and electronic goods and textiles and clothing have become major export items. In fact, manufactured goods replaced petroleum as Mexico's main source of foreign exchange proceeds. By creating alternative means by which to collect foreign exchange proceeds, Mexico's economy was better able to deal with changes in oil prices.

The statistics concerning the balance of trade show a deficit. This is a result of a surge of merchandise imports with a concentration on capital and intermediate goods, which may be the result of a " more appropriate incentive structure prevailing in the economy; these imports have helped to modernize Mexico's production and export bases, enhancing the country's medium term external prospects" (Syzmczk, 1992,31). Evidence suggests that although Mexico has become more outwardly orientated, the growth of exports has not kept pace with imports.

Trade reforms have made a significant contribution to macroeconomic performance. Very importantly, they shifted the orientation of growth from domestic to external markets through a restructuring of the incentive system and Mexico's productive base.

2) Price Reform

Price control was one of the areas of the adjustment process that was central to the success of the program. When prices are determined by means other than competitive market forces, for example, by the government or a monopoly, this creates distortions within the economy. Prices are a key component to the stability of an economy because the general level of prices determines the level of inflation. Inflation is important to macroeconomic policy because inflation has adverse effects on income distribution, lending and borrowing, speculation, and international trade competitiveness. The higher the price paid for goods, ceteris paribus, the lower the amount of purchasing power held by consumers, therefore making the cost of living higher and the real value of wages lower.

Table 3.12 Prices

Year	Wholesale Prices	Consumer Prices	Wages, Monthly
1976	3.9	4.1	5.7
1977	5.6	5.3	7.4
1978	* 6.4	6.3	8.6
1979	7.6	7.4	10.0
1980	9.5	9.3	12.2
1981	11.8	11.9	16.2
1982	18.4	19.0	25.9
1983	38.2	38.3	40.5
1984	65.1	63.4	62.7
1985	100.0	100.0	100.0
1986	188.4	186.2	175.7
1987	443.9	431.7	411.5
1988	922.5	924.6	873.0
1989	1070.8	1109.6	--
1990	1320.8	1405.4	--
1991	1591.9	1723.8	--

Source: International Monetary Fund

The level of prices and wages rose from 1976-1991, Table 3.12 presents data that shows this trend but also shows that wages have not risen at the same pace as wholesale and consumer prices. From Table 3.13 one can see that the price indices have all risen as well but in 1988 and 1989, the indices fell and inflation began to decline (Table 3.14).

Lizonda(1992) and Kalter(1992) examine Mexico's response to the inflation problem. Mexico pursued a wage-price pact that began in December 1987 with the freezing of minimum wages, public sector prices and tariffs until December 1988. From 1988-1991 Mexico introduced adjustment polices specifically for the reduction of inflation. These policies included the determination of certain key prices and wages in the framework of an agreement among government, labor, and business firms within the context of the overall government program aimed at economic recovery. The 1987 policy, known as PACTO (Pacto de Solidaridad Economica, was replaced by PECE (Pacto Para la Estabilida y el Crecimiento Economica) which introduced minimum wages, public sector prices and adjusted tariffs, while the peso was made subject to a preannounced schedule of deprecation against the U.S. dollar. Within this framework, a social consensus was created on a target path for exchange rates, minimum wages, and some public sector prices. This policy for the reduction of inflation met with relative success as shown by the data presented in Tables 3.13 and 3.14.

Table 3.13 Evolution of Domestic Prices

Year	Consumer Price Index	Wholesale Price Index	Producer Price Index
1976	27.2	45.9	53.3
1977	20.7	18.1	9.7
1978	16.2	15.8	14.3
1979	20.0	19.9	18.2
1980	29.8	26.4	20.5
1981	28.7	27.2	24.3
1982	98.8	92.6	93.5
1983	80.8	88.0	80.2
1984	59.2	63.2	60.1
1985	63.7	63.4	61.1
1986	105.7	101.6	102.3
1987	159.2	164.6	166.5
1988	51.7	42.6	37.4
1989	19.7	18.1	15.6

Source: Banco de Mexico

Table 3.14 Inflation Rates

Year	Actual Inflation Rate
1978	17.5
1979	18.2
1980	26.3
1981	27.9
1982	58.9
1983	101.9
1984	65.5
1985	57.7
1986	86.2
1987	131.8
1988	114.2
1989	20.0
1990	26.6

Source: Banco de Mexico

3.4.3 Mexico and Restoration of Investment: Stage III

Liberalization of foreign direct investment took precedence because of the important role it plays in the promotion of growth. In recognizing the importance of foreign direct investment, the Mexican government announced a program that would liberalize foreign investment regulation. By May 1989, Mexico had introduced substantial policy changes.

Mexico's original foreign investment policies were based on Article 27 of its Constitution which did not permit foreign control of natural resources or any material that would have already been present, and the 1973 "Law to Promote Mexican Investment and Regulate Foreign Investment (LFI)". LFI reserved certain economic activities for the government and others for Mexican nationals. This resulted in a very restrictive environment for foreign investment and prior to the mid-1980's, foreign investment played a small and declining role in the economy. The only areas that reported any significant foreign investment were the bond industry and the Maquladora program, which program allowed for one hundred percent foreign ownership. These policies created a situation where total control of certain sectors orientated around the government and Mexican nationals and when the economic crisis hit, it caused a great deal of economic upheaval and debt. (Syzmczak, 1992,31)

By 1983 the foreign direct investment regulations started to change as efforts were made to streamline approval and licensing procedures. Steps were taken to simplify the administrative procedures for initiating and approving foreign investment projects to increase the flow of foreign capital in selected sectors. Major reforms were introduced in May of 1989, with revisions of regulations regarding foreign investment, "Regulations of the Law to Promote Mexican Investment and Regulate Foreign Investment". The amendments to the laws were designed to increase the inflow of investment capital by providing legal certainty and by clarifying investment rules (Szymczak, 1992). These changes resulted in an economy open to one hundred percent foreign ownership of enterprises valued up to 100 million dollars without prior approval by the National Foreign Investment Commission, provided that certain conditions on location and net foreign exchange needs were met. Mexico also removed a law forbidding foreign control of more than forty-nine percent of a company. Mexico promoted the expansion of foreign corporations, for example Ford, Chrysler, General Motors and Nissan, by co-operating with lucrative debt-equity swaps and offering tax concessions in border zones.

Table 3.15 presents data that looks at levels of foreign assets based on data from various sources that are associated with the use of foreign assets. If the numbers are any indication, the amount of foreign assets entering the system has risen; therefore, it can be concluded that Mexico has had favourable results, except for a few exceptions, in acquiring foreign direct investment. It becomes apparent that Mexico has begun to complete the third stage of the adjustment process as based on Selowsky's model.

Table 3.15 Foreign Assets (Billions of Pesos)

Year	Monetary Authorities	Deposit Money Banks	Monetary Survey*	Other Banking Institutions*
1976	28	--	22	--
1977	45	7	41	41
1978	52	9	55	55
1979	70	16	83	83
1980	93	31	124	124
1981	132	26	158	158
1982	176	138	218	227
1983	708	313	736	784
1984	1561	367	1335	1404
1985	2168	781	1646	1782
1986	6214	1833	3854	4251
1987	30306	6241	23388	24204
1988	15027	5871	6493	7938
1989	18116	6794	7388	8476
1990	30260	10402	9868	10857
1991	55571	13316	23715	25330

Source: International Financial Statistical Yearbook, 1992

3.5 Conclusion

The debt crisis resulted form a number of historical, internal and external factors. A structural adjustment program was designed to relieve the situation. Selowsky (1992) explains and examines the adjustment process through a model based on a series of stages. An attempt has been made here to examine Mexico's success at each stage of this adjustment process.

At stage 1 the main emphasis was to create macroeconomic stability. This was thought possible through a reduction in spending. Mexico did decrease public spending but also did a number of other things to promote stability. These measures included the divestiture of public enterprises, deregulation of the public sector, tax reform, financial liberalization, deficit reduction and debt restructuring. Mexico has had positive results with most of the reforms and is well on its was to completing this initial stage of adjustment.

The second stage of Selowsky's model encourages the liberalization of the incentive system. Reforms were made to trade and prices. Reforms to the trade sector included tariff reduction, joining GATT, access to new markets, promotion of exports and diversifying the export base from oil-based products to manufactured products, creating a more diversified, outward orientated economy. Reforms to the price structure led to decreases in inflation which helped to make for a more stable economy.

Restoration of investment was the basis for Stage 3. When a country has passed though this stage, the adjustment process has done what it set out to do, Mexico has had relative success in this area. The amount of investment in the country has risen. Changes were made that allowed for increased investment by foreign sources and the number of foreign companies have grown as has the amount of foreign assets found in the economy.

In narrowly defined economic realms, Mexico has had some level of success at each stage of the adjustment process. In order for the adjustment process to have this level of success, each event at each stage must be carefully planned and executed for the stages to run concurrently without negative repercussions. The success of each stage has fuelled the success at the other stages. All aspects of the structural adjustment process are interlinked and defining it by stages makes examination of the adjustment process easier to manage. Mexico has had a positive experience in economic terms with structural adjustment and passed through each stage with relatively good results in the short term. In the next chapter, the implications of the measures on the social welfare of Mexico are explored. In the final chapter, events from 1992 to 1996 are explored and show that the relative success to 1991 has not yet provided a permanent, sustainable recovery.

Chapter 4 The Social Effects of the Adjustment Process

4.0 Introduction

This chapter examines the social impact of structural adjustment. Structural adjustment has implied a reduction in public sector spending, increases in the prices of goods and services provided by some government agencies and a reduction of state-owned operations. The focus of such policies has been to create a more efficient economy and to reduce costs. In many cases, however, the most vulnerable members of society i.e., the poor, are adversely affected. The chapter examines the social impacts of structural adjustment in Mexico.

Society is directly affected by the process of structural adjustment because economic conditions play a role in the lives of individuals, families and communities. The general policy of fiscal restraint typical of structural adjustment programs often means a decrease in funding for education, healthcare and/or the provision of basic human needs. Other reforms may create increased unemployment, loss of available income and decreases in purchasing power. Some reforms may favour better-off business owners, making the gap between classes that much more significant. On the other hand, policy changes such as a reduction in inflation, will lower the prices of goods and increase purchasing power. The point is that there are a number of economic impacts of structural adjustment that are a direct effect of individual welfare. There are also a number of impacts that will have effects on society. For example, if education spending is cut, the result chould be a labor force that is not properly trained. A lack of funding for health care may result in poor nutrition which, in turn, affects levels of labour productivity. Overall, structural adjustment can lead to a greater incidence of poverty and create a larger informal sector because of increases in unemployment.

The issues surrounding the social impct of structural adjustment thus are important, not only in terms of a concern for the welfare of individuals but also because, if they are ignored or go unrecognized, they may feed back on the economic side and undermine the economic success of the program in the process. Social stability is a necessary condition for long-term economic stability and progress.

4.1 Demographic Trends

According to Canek and Levi (1989), the presumption that structural adjustment policies implemented in Latin American nations during the 1980s had negative social impact is intuitively appealing. Unfortunately, efficient civil registration systems are uncommon in Latin America and fertility and mortality data must be interpreted cautiously.

Moreover, decreased government spending also affects collection of data on health, migration and labor force characteristics (Canak and Levi, 1989). Thus, the statistics presented in this section must be used with some caution.

4.1.1 Population

Growth in population over the four decades from 1950 to 1990 (Table 4.1) has been fairly consistent, but in the last fifteen years of the period presented, growth in population began to decrease. This may be indicative of declines in natality. The level of population growth determines the demand for education and health care, and the ability to provide basic human needs such as food and housing.

Table 4.1 Total Population Growth

Year	Population Growth
1950 - 1955	2.9
1955 - 1960	3.2
1960 - 1965	3.3
1965 - 1970	3.3
1970 - 1975	3.2
1975 - 1980	2.6
1980 - 1985	2.4
1985 - 1990	2.2

Source: Statistical Yearbook For Latin America and the Caribbean

4.2 Education

Education is important to social structure because the demand for education in most developing countries far exceeds the supply. Advanced levels of education will mean or lead to a higher level of income; however this may not be the case. Spending on education is relatively large in many countries and a large part of household and public spending is required to provide education for children. With the introduction of various structural adjustment policies, the ability to provide children with access to education becomes much more difficult.

Data presented on education in Mexico is limited but what information is available suggests that, in fact, adjustment in the 1980's has not had as negative an impact as expected.

4.2.1 Public Spending on Education

Total expenditure on education rose over the 80s, which was largely indicative of the rise in population (and the accompanying rise in enrolments) and the increase in GDP. However, the percentage of GDP spent on education fell over this same period.

Table 4.2 Public Expenditure on Education (Percentage of Gross Domestic Product in terms of real expenditure)

Year	Percentage of GDP	X	GDP (Billions of Pesos)	=	Total expenditure on Education
1980	3.1	X	4276	=	132.56
1981	3.6		5874	=	211.46
1982	3.4		9417	=	320.18
1983	2.6		17142	=	445.69
1984	2.5		29472	=	736.80
1985	2.6		47392	=	1232.19
1986	2.6		79131	=	2057.41
1987	2.0		193462	=	3869.24
1988	2.0		395993	=	7919.86

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

4.2.2 Enrollment by Levels of Education

Data in Tables 4.3 and 4.4 indicate that the level of enrollment increased over the 1980s, and the number of students involved in the initial level of education were the largest group, with almost the entire population at that level participating. The number of students in the second level has risen significantly over the last three decades, with the number passing the 50% mark by 1980, a significant rise in comparison with the enrollment rate of 10.7 in 1960 and 22.0 in 1970. The number of students at the secondary level did not decline during the adjustment years. In fact, there was a rise in the number of children at this level participating in the education system, mainly due to a rise in population. Level three remains small, but has also grown at a relatively significant pace, proportionately even more than level two.

Table 4.3 Enrollment by Education Level (Gross Enrollment Rates)

Year	Level I(6-11)	Level II(12-17)	Level III
1960	78.2	10.7	2.6
1970	87.3	22.0	5.9
1980	93.0	46.0	14.4
1981	93.9	51.3	14.7
1982	99.3	53.1	14.9
1983	100.5	53.0	15.2
1984	100.0	53.0	15.6
1985	102.0	53.0	15.6
1986	106.0	53.0	15.2
1987	-	53.0	15.7

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Table 4.4 Enrollment in Various Levels of Education (Number of Students- Millions)

Year	Level I (6-11)	Level II (12-17)	Level III
1960	4.88	.51	.08
1970	9.24	1.58	.25
1980	14.67	4.79	.90
1981	14.98	5.33	.97
1982	15.22	5.72	1.01
1983	15.38	6.06	1.12
1984	15.22	6.43	1.14
1985	15.12	6.55	1.21
1986	14.99	6.70	1.22
1987	-	-	-

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

> The impact of educational modernization can be seen in [Table 4.4] which shows recent data on the enrollment levels in the education system. Although the figures do not show marked growth, educational indicators have shown a positive trend in terms of policy goals. These include raising the quality of educational services, lowering failure and drop out rates, tackling deficiencies, encouraging better utilization of educational services, and extending coverage to dispersed communities" (Mexico, Government of, 1992, 162).

4.2.3 Enrollment by Age and Sex

To help better understand the fairness of the education system and how many opportunities are presented to both male and female students, one must examine the level of enrolments of both sexes. Certainly, there is a difference in the percentage of females versus males attending school at various age levels. However, based on Table 4.5 one could conclude that the discrepancies between the sexes in terms of enrolment have narrowed in the period shown.

Table 4.5 Enrollments of Students and Sex (Number of Students) - Millions

Year and Age	Total	Male	Female
Age 6-11			
1980	92.6	92.5	92.8
1985	100.0	100.0	100.0
1990	100.0	100.0	100.0
Age 12-17			
1980	63.8	66.6	61.0
1985	61.9	64.5	59.3
1990	68.1	69.9	66.3
Age 18-23			
1980	23.3	28.0	18.5
1985	23.4	27.4	19.2
1990	23.4	26.8	20.0
Age 6-23			
1980	64.8	67.0	62.6
1985	65.6	67.2	63.8
1990	66.2	67.6	64.7

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

4.2.4 Literacy

Table 4.6 examines the rate of illiteracy in the population for those above the age of 15. The level of illiteracy has fallen significantly from the 1960 level of 34.5 to 8.7 in 1985. This suggests that the early adjustment years did not have a negative impact on the percentage of the population who are literate. " Progress in reducing illiteracy has remained constant over the last few decades.

The average rate of illiteracy from 1941 to 1950 was 42.2%, dropping to 23.7 % in 1970, 17% in 1980 and 8% in 1989. The goal set by President Salinas de Gortiari's administration is to reduce illiteracy to 5% by 1994. " (Mexico, Government of. 1992, 161) This suggests that Mexico has made a conscious effort to decrease the level of illiteracy and has succeeded.

Table 4.6 Illiteracy (Percentage of Population over 15 years)

Year	Illiteracy Rate
1960	34.5
1970	25.8
1980	16.0
1985	9.7

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

There has been a conscious effort to promote education in Mexico as indicated by the number of students enrolled and the level of illiteracy. This trend will be pursued into the future based on a government plan to modernize basic education.

The "Mexican Agenda - The Path Towards Modernity" report on education suggests that the National Agreement reflects a joint commitment to extend educational coverage and raise its quality through a reorganization of the education system by revising academic curricula, materials and teaching methods.

It is essential to improve the graduation rates, which now stand at less that 60 % in primary and less than 75% in secondary school. These percentages reflect excessively high grade repetition and school drop-out rates. On average, Mexicans receive 6.5 years of schooling. There are a number of deficiencies in basic education: it does not provide the knowledge, skills, abilities, expertise, attitudes and values needed to educate students and enable them to contribute effectively to their own social advancement and the country's development. Hence, much remains to be done.

The dedication towards education will help establish a better foundation for the youth of Mexico. Education will help improve the economic foundation of Mexico which will improve the chances of economic growth and development.

4.3 Health and Welfare

The provision of adequate health conditions has often been ranked low on the scale of priorities for most developing countries (Gillis, et al.,1987). It was regarded as something that government would like to do if possible but not at the expense of more directly productive expenditure categories. Structural adjustment may push the importance of health and welfare of the people further down the scale and financial support of this sector may be diverted towards structural changes. The key thing to keep in mind is that, as with education, it is difficult to predict what effect structural adjustment has had on health and welfare.

4.3.1 Public Expenditure on Health

The health care system has often been neglected; it is an area where spending is required but not made a priority. The data presented in Table 4.7, is indicative of this . The amount of GDP that is spent on health care has remained very small. The level of spending has remained relatively consistent but reached a low in 1983 of 0.1 percent of GDP, while in 1981 it reached 0.5 percent of GDP. Post-1983, the relative spending on health care has remained virtually constant, while the actual level had risen considerably. It is difficult to make a sound argument here because the data presented is in current prices and not constant prices which were not available.

Table 4.7 Public Expenditure on Health (Percentage of GDP at Current Prices)

Year	Percentage of GDP	X	GDP (Billions of Pesos)	=	Total expenditure on Health
1980	0.4	X	4276	=	17.10
1981	0.5		5874	=	29.37
1982	0.3		9417	=	28.15
1983	0.1		17142	=	17.14
1984	0.3		29472	=	88.42
1985	0.3		47392	=	142.78
1986	0.4		79131	=	316.52
1987	0.3		193462	=	580.39
1988	0.3		395993	=	1187.98

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

4.3.2 Natality , Mortality, Child Mortality, Life Expectancy and Morbidity Rate

The birth rate in Mexico has declined significantly since the 1950s and 1960s. The government has instituted a national plan for control of births through contraception. Mexico appears to have entered a stage of controlled population growth. Although cuts to social spending have taken place, efforts to control the population have not been abandoned.

Table 4.8 Natality (Average Annual Rates per thousand inhabitants)

Years	Natality rate per thousand
1950 - 1955	46.6
1955 - 1960	46.1
1960 - 1965	45.5
1965 - 1970	44.5
1970 - 1975	42.6
1975 - 1980	34.4
1980 - 1985	31.7
1985 - 1990	29.0

Source: Statistical Yearbook for Latin America and the Caribbean, 1989.

The mortality rate in Mexico has declined significantly over the last three decades. The government of Mexico attributes this decline in the mortality rate to both economic and social developments and to improvements in the coverage and quality of health services.

Table 4.9 Mortality (Average Annual Rate per Thousand inhabitants)

Years	Mortality Rate per thousand
1950 - 1955	16.1
1955 - 1960	13.2
1960 - 1965	11.2
1965 - 1970	10.2
1970 - 1975	8.9
1975 - 1980	7.1
1980 - 1985	6.3
1985 - 1990	5.8

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Likewise, infant mortality has declined substantially over the last four decades. The number of deaths per thousand has been more than halved. The deaths that do occur usually result from intestinal diseases, influenza or pneumonia that take place in the first year of life.

Table 4.10 Infant Mortality Rate (per thousand live births)

Years	Infant Mortality
1950 - 1955	113.9
1955 - 1960	97.7
1960 - 1965	86.3
1965 - 1970	78.5
1970 - 1975	70.9
1975 - 1980	59.0
1980 - 1985	49.9
1985 - 1990	42.6

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

The number of years added to life expectancy has grown over time at a substantial rate. In the early 1950's life expectancy was 50.8 years. By 1990 the life expectancy has reached 72 years for women and 66 years for males. It becomes apparent that programs such as better coverage and quality of health care are part of the reason why the population is expected to live much longer. Even with the hardships of adjustment, life expectancy has not been adversely affected.

Table 4.11 Life Expectancy at Birth

Years	Age
1950 - 1955	50.8
1955 - 1960	55.4
1960 - 1965	58.6
1965 - 1970	60.3
1970 - 1975	62.6
1975 - 1980	65.4
1980 - 1985	67.4
1985 - 1990	68.9

Source : Statistical Yearbook for Latin America and the Caribbean, 1989

The Mexican government has made a conscious effort to decrease the incidence of disease. In 1973, the National Immunization Program was introduced. Now known as the National Council, it has supplied vaccines to children under the age of 5. A major immunization campaign was developed by the National Health System to eradicate the polio virus and achieve epidemiological control of measles, diphtheria, whooping cough, tetanus and menigeal tuberculosis. Mexico also launched a program to achieve universal vaccination by 1992. It sought to administer the basic vaccines to all children under 5 years of age. This move was facilitated by the "World Declaration on the Survival, Protection and Development of Children" issued by the 1990 United Nations World Summit for Children. The advances in this area are a result of a recent launching of the National System for Epidemiological Monitoring.

4.3.3 Calories and Proteins Available

Since 1969, the calories available per day have increased as have the number of grams of protein per day per capita. Perhaps better nutrition will help improve the health of the people. "In 1988, the National Nutrition Survey indicated that 2.6 million children under five suffer from a degree of malnutrition. A major cause is the shift away from breast feeding." (Mexico, Government of. 1992,172)

"At the other extreme of poor nutrition is obesity. By 1988, the incidence of obesity among child bearing age women was 14.6%, or slightly over 3 million women at the national level. In addition, 4.4% of all children under five may be considered obese." (Mexico, Government of, 1992, 173)

It is evident that good nutrition is a problem in Mexico but perhaps with more education in this area, the problems of malnutrition and obesity will decline.

Table 4.12 Calories and Proteins Available

Years	Calories and Proteins per day per capita	Grammes of Proteins per day per capita
1969 - 1971	2703	69.3
1974 - 1976	2717	67.2
1979 - 1981	3053	79.1
1983 - 1985	3147	81.3

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Table 4.13 Social Assistance in Food

Type	1990	1990-91
Distribution of food assistance rations		
School Breakfasts (Thousands)	115254	118704
Program For Food Assistance to Families (Kilos)	5795107	6260633
Nutritional Guidance		
Persons Trained	1081	1110
Seed Packets for Vegetable Gardens	182900	709499

Source: Presdensia de la Republica Direccion General de Conumication Social, 1992

The government of Mexico has introduced some programs to assist the population in its pursuit of good nutrition. Table 4.13 lists these programs and the number of people helped. However, this does not reveal the success of these programs.

4.4 Income and Employment

Structural adjustment often has a negative effect on income and employment. One of the first areas to be affected is wages as well as increases in unemployment and poverty. The lack of available employment produces a rise in unemployment and an increase in the number of individuals entering the informal sector. An attempt will be made to analyze the effects of structural adjustment on the labour force. If structural adjustment has a negative effect on society it does so at all levels and each aspect (education, health and welfare and labour), all of which are intricately intertwined. In fact, the impact of structural adjustment appears to be somewhat minor and perhaps this is the typical result for a middle income country like Mexico. It is difficult to make any solid conclusions because of the lack of data and the quality of the data that is available.

4.4.1 Incidence of Poverty

The incidence of poverty is a very difficult concept to define because it is almost impossible to establish what exactly poverty is, how to determine the number of poor and who exactly is poor. The World Development Report on Poverty (1990) suggests that poverty can be defined as the inability to attain a minimum standard of living. This definition is relatively vague and difficult to put into operational use without further examination. The World Bank suggests that in order to better understand the definition, one should determine the proper means by which to measure the standard of living. " It is suggested that household incomes and expenditures per capita are adequate yardsticks for the standard of living as long as they include own production, which is very important fro most of the world's poor" (World Bank, 1990) Neither measure, however, captures such dimensions of welfare as health, life expectancy and literacy. Many other factors play a role, for example, the level of consumption, prices, household size and composition. Table 4.14 looks at the incidence of poverty in Mexico by comparing the costs of a given food basket.

Table 4.14 Incidence of Poverty

Poor Households*	1970	1980	1984
Total	34	32	30
Urban Total	20	--	23
Metero Areas	--	--	--
Rest	--	--	--
Rural	49	--	43
Indigent Households^			
Total	12	10	10
Urban Total	6	--	6
Metero Areas	--	--	--
Rest	--	--	--
Rural	18	--	19

Source: Yearbook for Latin America and the Caribbean , 1989
* - Incomes less than twice the price of the food basket
^ - Incomes less than the price of the food basket

4.4.2 Real Minimum Salary

Table 4.15 shows that the real minimum salary declined at a steady rate over the 1980s. This means that inflationary pressures affected the wages of workers. Many people are now unable to purchase what they need in the face of rising costs of living. The years of crisis and structural adjustment have been in part responsible for the decline in wages. Inflation has had a negative impact on workers salaries. A number of sources (for example, Lustig

1990) have indicated that the middle class had been the hardest hit because of their dependence on wage income. The crisis and its initial aftermath left Mexico with a relatively impoverished middle class, an increasing number of poor households and the poor worse off than before (Lustig, 1990).

Table 4.15 Index of Real Minimum Salary Decline, 1977 - 1989
(1978 = 100)

Year	Index
1977	101.6
1978	100.2
1979	98.8
1980	91.9
1981	92.9
1982	92.9
1983	72.5
1984	66.0
1985	65.2
1986	58.4
1987	55.3
1988	49.2
1989@	45.2

@ Jan. - Oct., 1989
Source: Comision Nacional de Salarios Minimos

The decline in wages has been felt in all sectors. Table 4.16 indicates that the effects have been negative in the manufacturing sector. This supports the general proposition that structural adjustment has had a negative impact on the middle class and has increased the incidence of poverty. However, the manufacturing sector data do show an upward trend in real average wages in manufacturing in the late 1980s.

Table 4.16 Real Average Wages in Manufacturing and Percentage Variations (1980 = 100)

Year	Real Average Wages	Percentage Variations
1981	103.5	3.5
1982	102.2	0.9
1983	80.7	-22.7
1984	75.4	-6.6
1985	76.6	1.6
1986	72.3	-5.6
1987	72.8	0.7
1988	72.1	0.9
1989	75.8	5.1

Source: Statistic Yearbook for Latin America and the Caribbean, 1989

Table 4.17 Real Urban Minimum Wages and Percentage Variations (1980 = 100)

Year	Minimum Wages	Percentage Variations
1981	101.9	1.9
1982	92.7	-9.0
1983	76.6	-17.4
1984	72.3	-5.6
1985	71.1	-1.7
1986	64.9	-8.7
1987	61.7	-4.9
1988	55.2	-10.5
1989	50.8	-7.9

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Table 4.17 presents data on the real urban minimum wage. These data show that real wages in the urban setting have declined substantially, indicating that the incidence of poverty by wage earners is, in fact, on the rise. This has probably led to an increase in the number of individuals seeking employment in the informal sector. In a number of cases, this form of earning an income is all that is available to individuals.

4.4.3 Growth in Per Capita in Private Consumption

Growth per capita in private consumption (Table 4.18) was positive between 1970 and 1980, but the 1980s reversed this trend. This was due to a decline in real wages. This supports the statement that a decline in wages does, in fact, affect the private consumption of the population. In some years the decline was rather severe, while in other years, this was not the case.

Table 4.18 Growth of Per Capita Private Consumption

Year	Growth Rate
1970 - 1980	2.5
1980 - 1985	-1.1
1982	-5.9
1983	-8.4
1984	0.6
1985	3.6
1986	-5.1
1987	-4.8
1988	0.8

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

4.4.4. Participation in Economic Activity by Sex, Age and Economic Sector

Economic activity was on the increase over the years 1960 - 1985 (Table 4.19). This may be indicative of an increase in population (Table 4.20). The information presented shows that the population growth was absorbed in economic activity. However, the data in Table 4.21, which show the participation rate for both sexes, indicate little change, proportionately, for men and a slight increase for women; the gap between the two remains large.

Table 4.19 Economically Active Population (Thousands of Persons)

Year	Active Population
1960	10 856.4
1965	12 446.7
1970	14 401.1
1975	18 129.3
1980	22 863.0
1985	26 802.3

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Table 4.20 Participation in Economic Activity

Year	Both Sexes	Male	Female
1960	43.1	72.5	17.3
1970	41.4	68.2	17.8
1980	46.8	70.9	19.3
1985	46.4	68.1	21.3

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Tables 4.21, 4.22 and 4.23 look at participation in economic activity at various age levels for both males and females for selected years. In 1970, (Table 4.21), the involvement of males in economic activity is significantly higher than for females. This observation holds true for the data presented for 1980 and 1985, although the portion of the female population participating in economic activity increased over the years indicated.

Table 4.21 Participation Rates in Economic Activity by Sex and Age, 1970 (Percentage of Total Population at that Age Group)

Age	Both Sexes	Male	Female
10-14	6.2	8.7	3.5
15-19	35.2	49.9	20.9
20-24	53.6	85.7	24.1
25-29	54.9	95.0	17.4
30-34	56.0	97.1	15.7
35-39	56.2	98.0	15.8
40-44	56.7	97.7	16.2
45-49	57.6	97.8	16.4
50-54	55.9	96.8	15.9
55-59	52.6	90.6	15.1
60-64	49.5	86.1	14.1
65-plus	39.4	70.4	10.9

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Table 4.22 Participation Rates in Economic Activity by Sex and Age, 1980 (Percentage of Total Population at that Age Group)

Age	Both Sexes	Male	Female
10-14	16.6	10.0	3.0
15-19	41.1	55.9	26.8
20-24	59.6	83.4	32.3
25-29	63.6	94.2	35.0
30-34	66.7	96.1	32.5
35-39	63.0	96.2	31.3
40-44	62.7	95.2	23.9
45-49	61.5	95.3	20.6
50-54	60.0	93.8	19.0
55-59	58.6	91.4	17.6
60-64	54.0	85.6	14.1
65-plus	42.1	68.6	8.7

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Table 4.23 Participation Rates in Economic Activity by Sex and Age, 1985 (Percentage Total Population at that Age Group)

Age	Both Sexes	Male	Female
10-14	5.0	7.7	2.1
15-19	40.1	54.0	25.7
20-24	60.9	83.2	38.3
25-29	64.9	94.1	35.4
30-34	64.3	96.1	32.7
35-39	63.5	96.2	31.5
40-44	62.5	96.0	30.3
45-49	61.4	95.3	29.4
50-54	59.4	93.4	27.7
55-59	56.1	90.5	24.6
60-64	50.4	82.1	22.3
65-plus	36.6	61.7	16.1

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

4.4.5 Unemployment

Unemployment is a very serious problem in a number of developing countries. For Mexico, sources of employment may have been eliminated because of the debt crisis and structural adjustment. Because data in this area is weak, it is especially difficult to be conclusive. Data on urban unemployment, however, suggests that this is not strictly a problem that resulted from the crisis and structural adjustment. The unemployment rate in the urban setting rose during the early 1980s but in 1985, the rate began to decline and in 1989 reached a level of 2.9. Table 4.25 looks at the breakdown of unemployment rate in three major cities - Mexico City, Gaudalajara and Monterrey. The unemployment situation in each city appears to be similar, although Guadalajara appears to have overcome its unemployment problem more successfully. There is a positive trend in each of the affected cities but its appears to be "too good to be true" that the unemployment rate is as low as indicated by the data presented. Moreover, the urban unemployment rate is not necessarily indicative of the total unemployment rate. Further, the statistics may be declining because of the manner in which this data was collected. It is therefore difficult or even impossible to determine if the improvement is the result of new job creation, individuals entering the informal sector, or migration.

Table 4.24 Urban Unemployment (Average Annual Rate)

Year	Unemployment Rate
1970	7.0
1980	4.5
1981	4.2
1982	4.2
1983	6.6
1984	5.7
1985	4.4
1986	4.3
1987	3.9
1988	3.5
1989	2.9

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Table 4.25 Unemployment in Major Cities

Year	Mexico City	Guadalajara	Monterrey
1983	6.3	7.4	9.8
1984	5.8	6.1	7.5
1985	4.9	3.4	5.4
1986	5.1	3.2	5.4
1987	4.1	3.1	5.5
1988	4.4	2.6	4.1
1989	3.7	1.7	3.1

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

Employment in the manufacturing industry, like wages in this area, declined (Table 4.26) over the mid 1980s, but in 1989 it showed an increase. Like the urban sector statistics on unemployment, there was a positive response in the late 1980s. Unemployment remains a problem in the manufacturing sector as does the decrease in wages.

Table 4.26 Employment in Manufacturing Indicators and Percentage Variations (1980 = 100)

Year	Employment Indicator	Percentage Variation
1982	103.0	-2.5
1983	93.1	-9.6
1984	92.2	-1.0
1985	94.3	2.3
1986	90.5	-4.0
1987	87.4	-3.4
1988	87.5	0.1
1989	89.1	1.8

Source: Statistical Yearbook for Latin America and the Caribbean, 1989

4.5 Policies for the Poor and Adjustment

Adjustment poses problems for the poor. It threatens the well being of the poor during adjustment due to reductions in public expenditures, increases in prices and changes in employment patterns. The World Bank recognizes the problems associated with structural adjustment, but it is extremely difficult to predict the outcome that certain adjustments may have on the poor and on living standards.

The World Bank has recognized that there is a need for program redesign to lessen the impact that adjustment programs have on the poor. It has been suggested that programs should emphasize incentives for employment and income distribution. Also, an effort should be made to slow down price adjustment in the hope of preventing inflation; especially in cases where supply elasticities are low and uncertain. Another possible area for redesign is the co-ordination of agricultural subsidy removal along with producer price increases, especially in countries with a large number of farmers. Other suggestions for redesign include the reallocation of public expenditure and greater emphasis placed on subsidies for the poor.

Additionally, the World Bank suggests that target projects may be introduced to help solve the problems associated with development and the poor. These types of programs offer attractive opportunities to address the adverse impact of adjustment and are directed towards a small group who will benefit and are cost effective. Although, in theory, this type of project looks appealing, in practice, target projects have met with little success, mainly due to corruption. Other factors contributing to the lack of success are weak design, lack of commitment, insufficient funding and poor infrastructure.

Another means to involve the poor is to allow them access to land, credit and public infrastructure and services. This will allow the poor to make a conscious effort to help themselves.

4.6 Conclusion

In general, the situation in Mexico may have been adversely affected by structural adjustment. The available data does not permit a more definitive conclusion but does suggest it.

Education appears not to have been negatively affected. The data presented suggests that spending on education declined in relative terms but not significantly. Enrolment rose across all levels of education and illiteracy fell. These statistics do not depict the total situation. Rather, they simply suggest that the circumstances in the area of education are not as bleak as might have been assumed in a country undergoing structural adjustment.

Health and welfare is another area which commonly is neglected as a result of structural adjustment. However, the indicators that were examined suggest that Mexico has seen improvements in mortality, life expectancy, infant mortality and the availability of calories and proteins. Spending on health care has not risen but has remained relatively constant. This area is often neglected under structural adjustment and often is the last area to be considered in public spending budgets. Here the indicators are actually quite positive in the circumstances.

Wages have been negatively affected by structural adjustment. The real minimum wage fell significantly, creating a greater incidence of poverty in the middle class. Additionally, unemployment was relatively high during the early 1980s, although there appears to have been a turn around in the late 1980s. It is difficult to make any stronger generalizations about the employment situation in Mexico vis-a-vis the adjustment program.

To reiterate, it is important to state that data collection in this area is limited and hence, it is difficult to make definitive statements about the situation in any of the sectors examined.

Chapter 5: Conclusions

5.0 Conclusion

Mexico, by the early 1980's, had entered into a economic downturn that resulted in a debt crisis. This crisis originated with the policies of the Echeverria administration (1971-1976), where the government pursued a policy of shared development. This resulted in austerity, inflationary growth, a declining private sector, a negative balance of trade, deterioration of international relations, devaluation and ultimately collapse. This created a situation that was unresponsive to changes to the economy and ready for economic crisis.

By 1976, the Jose Lopez Portillo administration was faced with the hard task of reviving the economy of Mexico. The government needed to stabilize the peso, lower inflation, limit wage increases, control the deficit, facilitate investment, increase growth rates and lower unemployment. The government introduced a stabilization program aided by the IMF. The program's success was short-lived, however, because of the discovery of new oil reserves. The economy then became geared towards the production of oil and investment in the oil production process. Foreign borrowing escalated. The government now chose to pursue an expansionary policy, that later led to the downfall of the economy because the price of oil fell as did the revenue entering the country. Mexico found itself in the position of not being able to meet its debt payment requirements, the net result being the debt crisis.

The debt crisis not only resulted from historical factors but from internal and external sources as well, for example, public sector deficit, expansionist policy during a time of economic upheaval, weak government infrastructure, high inflation and inefficient resource allocation. External factors contributing to the debt crisis included global recession, rising international interest rates, slow growth, excessive external debt and reliance on external financing. From these factors and problems arose the need for a structural adjustment program.

A structural adjustment program was introduced in hopes of realigning an economy that was in disequilibrium. The adjustment program, according to Selowsky (1990), followed a three stage model where the initial stage was centered around the creation of macroeconomic stability, the second on the liberalization of the incentive system and the final stage on the restoration of investment. Our examination of the stages of adjustment concluded the Mexico has had relative success at each stage. The stages model appears to make a separation at each step of the adjustment process but this is not always possible because each stage is interlinked and each plays a role in the adjustment process.

Mexico began its structural adjustment program in the 1982-1985 period. During this time, Mexico took severe steps to achieve economic stability but the program at the time had little success. Changes were made to the program after 1985, however, that met with better results. The adjustment process is outlined by Selowsky's stages model. At stage one, there seemed to be a solid move towards macroeconomic stability. Reforms were made to spending, taxes, the financial sector and debt structure. The second stage dealt with the liberalization of the incentive system. Trade reforms resulted in a more outward looking economy, making Mexico more competitive and efficient. Price reforms relieved inflationary pressure which helped to improve income distribution, lending and borrowing and international trade competitiveness. The data provided indicates that Mexico had positive results at this stage. The final stage focussed on the restoration of investment. When a country enters this stage, the structural adjustment program has reached its peak. Mexico has begun to have increased foreign investment in the country because of polices geared at opening up Mexico to companies not Mexican in orientation. This stage, although not completed, appears to have had good results thus far.

Lastly, a discussion was presented on the social impact of structural adjustment. At best the discussion is sketchy because of lack of acceptable data. However, the general conclusion drawn is the that most of the social indicators examined were not adversely affected by the structural adjustment process. In terms of wages and unemployment, the situation is different. The data presented suggests that structural adjustment may have increased the incidence of poverty in the middle class. Due to the lack of definite data, conclusions are very general. It seems clear that some areas of society have been adversely affected by the adjustment process.

Mexico seems to have had a positive experience with the adjustment process and has reached partial macroeconomic stability. How long this will last, and whether, in fact, Mexico can survive another down turn in the world economy are uncertain. But at least the government has taken steps the road to recovery.

5.1 The Economic Conditions Post 1991

Mexico experienced success with the adjustment process between 1989 and 1991. Its GDP had grown at an annual average rate of 3.8 percent in real terms. The inflation rate had declined, private consumption and investment had grown, interest rates had declined, and real exports had grown.

This state of economic recovery, however, was short-lived. By 1992 the economy had begun to experience fluctuations, as reflected in various macroeconomic indicators, although the downward trend in inflation and progress in the structural transformation of the Mexican economy was maintained.

> In 1992 the delayed effects of the United States' recession combined with the over-valuation of the peso, held export growth to no more than 1.6%. Conversely, the over-valuation contributed to a 20.9% rise in real imports. The deterioration in the net balance was mainly responsible for a slow down in GDP growth to 3.6%. Nevertheless, private consumption grew by 3.9% and private investment soared by 14.4%, accelerating import growth (The Economist Intelligence Unit, 1966, 14).

In 1993, there was a further reduction of inflation, a public sector accounts surplus, a production slow down which stimulated a rise in the unemployment rate, and a slow down in economic growth. On the positive side, the trade deficit lightened and high interest rates resulted in a steady influx of foreign capital that helped to cover the trade gap and increase international reserves. Maintenance of a tight monetary policy led to moderate rates of both currency devaluation and wage increases and allowed the continued progress toward price stability.

The slow down of economic behaviour was due mainly to the uncertainty surrounding the ratification of the North

American Free Trade Act (NAFTA) and the impact of restructuring the production system to meet the demands of the new trade act. The arrival of President Clinton in the White House changed the status of the NAFTA Treaty. He suggested that the Treaty be accompanied by side agreements on labour and the environment and the escalation of opposition to the Treaty in the USA meant that NAFTA's future remained uncertain for many months. The introduction of changes that would modernize production techniques resulted in job losses as well as high interest rates. This uncertainty resulted in domestic demand contracting, the stagnation of private consumption, and declines in public sector capital formation; total demand stagnated and the growth of output was zero. Overall, Mexico continued to receive substantial inflows of capital, attracted chiefly by the high yields to be obtained and, in the last quarter of 1993, by renewed, positive expectations about NAFTA.

Government spending increased in 1994 because it was an election year and the economy needed to look prosperous and stable. But prosperity and stability proved not to be reconcilable: 1994 was plagued by uncertainty, no doubt influenced by a number of political events. Private consumption, along with public investment, grew. The introduction of NAFTA revived private investment, thus posting real exports. This had a positive effect on employment growth and real wages; as a result, private consumption grew, which, in turn, increased the level of imports, thus limiting GDP growth (Economic Intelligence Unit Country Profile, 1995-1996.) Along with the growth patterns discussed above, the rate of inflation fell, the deficit on the balance of payments current account widened, and domestic borrowing increased. Overall, in the first eleven months of 1994, Mexico experienced a successful rebound of short-term growth; the GDP growth rate was 3.5% up from 0.6% for 1993.

December proved an eventful month for Mexico. On December 1, 1994, Ernesto Zedillo Ponce de Leon formally took the presidential seat for a six-year term. By December 20th, Zedillo was forced to devalue the peso and one day later, the peso floated in the currency market. On December 22, the peso was left to float freely for 60 days and there was a wage freeze. By December 27, the peso had dropped to 5.75 pesos = $1 U.S., thus creating a severe economic crisis. The reasons behind the crisis may be summarized as follows:

> political violence kept interest rates high and the peso weak and sparked an exodus of foreign investment from March 1994 through the end of the year. (Foreign investment dropped 37.9% in 1994.) Meanwhile, an unprecedented US$28.8 billion in 1994, and the officials later admitted that "an under-estimation" of the problem inherent in financing an increasing current account deficit with largely speculative, and short term foreign

> investment was at the root of the crisis (Economist Intelligence Unit, April 1996, 5)

This financial crisis made for a bleak beginning to 1995.

> Steep interest rates, a tight monetary policy and the prevailing climate of uncertainty choked off private investment. Swinging fiscal cuts meant sharp falls in public investment and spending as well. The fall was a heavy one in terms of unemployment, government attempts to crate jobs notwithstanding ... At the same time, inflation, fuelled by peso devaluation, ate into wages, and private consumption suffered severely. The only good news has been on the external front, where a dramatic increase in exports has been accompanied by a fall in imports (Economist Intelligence Unit, Country Report, 1995-1996, 15)

During the first months of 1995, there was a disequilibrium in currency and financial markets so there was a need for a strict program of fiscal adjustment and monetary control. It became apparent that measures were needed to help bail out Mexico, the result being a package to head-off the recession.

> The programme was designed to prepare the economy for the smaller flow of external financing projected for 1995 as well as the externally-imposed conditions contained in the agreements which the country had reached with the United States and the International Monetary Fund. The program had three main objectives: to reduce the current account deficit to manageable levels; to ensure that the inflationary impact of the devaluation would be as slight and as short lived as possible; and to establish the conditions necessary for economic recovery (United Nations, 1995, 258).

This package fell far short of its intentions and was inadequate in that it did not take into consideration high inflation and recessionary pressures. For this reason there was a need for a new program that was introduced on March 9th. This program raised the value-added tax, cut net federal spending, imposed price increases and tightened monetary policy. In addition to this policy the fall of 1995 saw the introduction of a Debtor's Support Plan and the Alliance of Economic Recovery. The first program was structured to cap interest rates for consumer and business credit and the second to set new limits on increases in wages and utility prices, offer business tax incentives and limit government spending and debt.

The economic crisis created a poor environment for economic growth. The results at the end of 1995 were not favourable: unemployment was high, inflation had accelerated, GDP growth declined and there was a reduction of purchasing power. The one positive repercussion was an upturn on the current account. The weak peso resulted in cheaper exports that became attractive on international markets and growth was experienced in the export sector.

In order to rebound from this crisis, Mexico faced the necessity of a strict fiscal policy in 1996. The economic policies for 1996 set targets of 3% GDP, average exchange rates of U.S. 1$ = 7.8 Pesos, an annual inflation of 20-30%

and prime interest rates of 20-30%. The most important goals were the stabilization of the exchange rate and the stabilization of inflation and interest rates. The success of these efforts are not known as of the time of the writing of this thesis.

The success of the structural adjustment process was short-lived. By 1992 the economy began to experience fluctuations in macroeconomic indicators, and this continued in the years that followed, 1993-1995. The problems began with the uncertainty of NAFTA and the political environment of the time. This laid the foundation for the 1994 crisis, which had its most immediate roots in poor management and the economic policies pursued in the last half of the year.

In general, up to 1991, Mexico clearly made progress and the events since 1991 by no means represent a return to the pre-structural adjustment situation. What the events since 1991 do underline, especially the crisis at the end of 1994, is first the need to maintain a sound policy environment; "good" policy is not a one-time set of measures to be invoked only when the situation gets bad. Second, the post-1991 events illustrate the truism that a "small" open economy will always be vulnerable to external influences, in this case, the U.S. recession at the beginning of the '90s. Third, and finally, they demonstrate that good management is as essential as good policy; the way in which policies are implemented and carried through matters as much as the policies themselves.

Appendix 1

Main Provisions of the NAFTA

General Provision on Trade in Goods

The North American Free Trade Agreement (NAFTA) provides for the progressive elimination of all tariffs on goods qualifying as North American under ifs rules of origin. For most goods, existing customs duties would either be eliminated upon the agreement taking effect or phased out in five or ten years. Tariffs would be phased out from rates applied in effect on July 1, 1991.

All three countries are to eliminate prohibitions and quantitative restrictions applied at the border, such as quotas and import licences. Each country, however, maintains the right to impose border restrictions in limited circumstances, and special rules would apply to trade in agriculture, automotive goods, energy and textiles.

Rules of Origin

The rules of origin specify that goods originate in North America, of if the nonregional materials are sufficiently transformed in the NAFTA region so as to undergo a specified change in tariff classification. In some cases, goods must include a specified percentage of North American content in addition to meeting the tariff classification requirement.

Agriculture

When the agreement goes into effect, Mexico and the United States will eliminate immediately all nontariff barriers to their agricultural trade, generally through their conversion to either "tariff-rate quotas" (TQRs) or ordinary tariffs. Tariffs would be eliminated immediately on a board range of agricultural products. All tariff barriers between Mexico and the United States will be eliminated not later than ten years after the agreement takes effect, with the exception of duties on certain highly sensitive products. Tariff phase out on these few remaining products will be completed after five more years. Canada and Mexico will eliminate gradually all tariff and nontariff barriers on their agricultural trade, with a few exceptions.

Automotive Goods

The NAFTA would eliminate gradually barriers to trade in North America automobiles, trucks, buses, and parts within the free trade area, and eliminate investment restrictions in this sector, over a ten-year transition period. Each NAFTA country would phase out all duties on its imports of North American automotive goods during the transition period.

In order to qualify for preferential tariff treatment, automotive goods must contain a specified percentage of North American content (62.5 percent for passenger automobiles and light trucks as well as engines and transmissions for vehicles, and 60 percent for other vehicles and automotive parts) based on the net cost formula.

Energy and Basic Petrochemicals

In the NAFTA, the Mexican state retains full control of the Mexican oil, gas, refining, basic peterochemicals, nuclear and electricity sectors. The NAFTA opens new private investment opportunities in Mexico in nonbasic peterochemical goods and in electricity-generating facilities. To promote cross border trade in natural gas and basic peterochemicals, NAFTA provides that state enterprises, end users, and supplies have the right to negotiate supply contracts.

Textiles and Apparel

The three countries would eliminate either immediately or over a maximum period of ten years their customs duties on textile and apparel goods manufactured in North America that meet the NAFTA rules of origin. The rules of origin generally stipulate that apparel must be manufactured in North America form the yard spinning stage forward. The United states will immediately remove import quotas an such goods produced in Mexico.

Government Procurement

The NAFTA would open gradually a significant portion of the government procurement market in each signatory country on a nondiscriminatory basis to suppliers for other NAFTA countries for goods, services, and construction services.

Cross-Border Trade in Services

The provisions for the cross-border trade in services establish a set of basic rules and obligations to facilitate trade in services between the three countries. The agreement extends the national treatment rule to services. Under this rule, each NAFTA country would have to treat service providers of other NAFTA countries no less favourably than it treats its own service providers in like circumstances. Also, a NAFTA country could not require a service provider of another NAFTA country to establish or maintain a residence, representative office, branch, or any form of enterprise in its territory as a condition for the provision of service.

The NAFTA provides for the gradual phase out of restrictions on cross border land transportation services among the three countries.

Financial Services

Under the agreement, financial service providers of a NAFTA country may establish in any other NAFTA country banking, insurance, and securities operations, as well as other types of financial services. Each country must permit its residents to purchase financial services in the territory of another NAFTA country. Each country would provide both national treatment and most favoured nation treatment to other NAFTA financial service providers operations in its territory.

Under the agreement, Mexico would apply market share limits during a transitional period ending by the year 2000. Thereafter, temporary safeguard provisions may be applicable in the banking and securities sectors.

Investment

The NAFTA removes investment barriers, ensures basic protection for NAFTA investors, provides a mechanism for the settlement of disputes between investors and a NAFTA country. Each country would have to treat NAFTA investors no less favourably that its own investors.

Intellectual Property

NAFTA sets out specific commitments for the protection of intellectual property. Each country is to provide adequate and effective protection for intellectual property rights on the basis of national treatment and would provide effective enforcement of these rights against infringement.

Institutional Arrangements and Dispute Settlement Procedures

The NAFTA provides for the creation of a Trade Commission that would use good offices, mediation, conciliation, or other means of alternative dispute resolution to find a solution to disputes. If the Commission fails to hammer out an agreement, The NAFTA provides that a bilateral arbitral panel would be set up. Each stage of dispute will be subject to a strict time limit, ensuring a speedy resolution process.

Environment

The signatory governments have committed to implementing the agreement in a manner consistent with environmental protection and to promoting sustainable development. The agreement affirms that right of each country to choose the level of protection it considers appropriate and provides that no NAFTA country should lower its health, safety, or environmental standards for the purpose of attractive investment. Disputes regarding a country;s standards can be submitted to NAFTA dispute settlement procedures.

Source: "Description of the Proposed North American Free Trade Agreement" Prepared by the Government of Canada, the United Mexican States, and the United States of America, August 12,1992.

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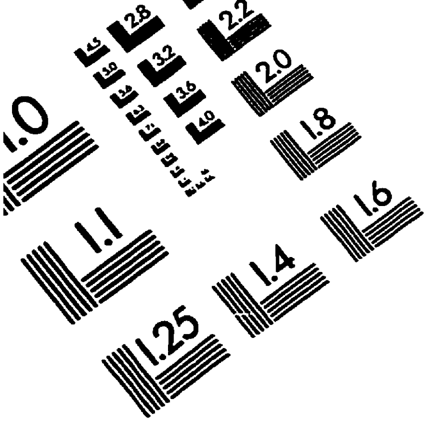
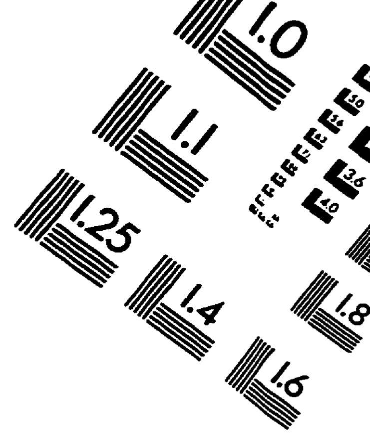
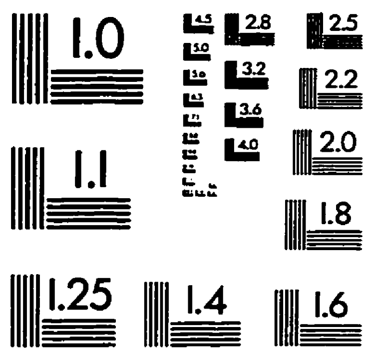
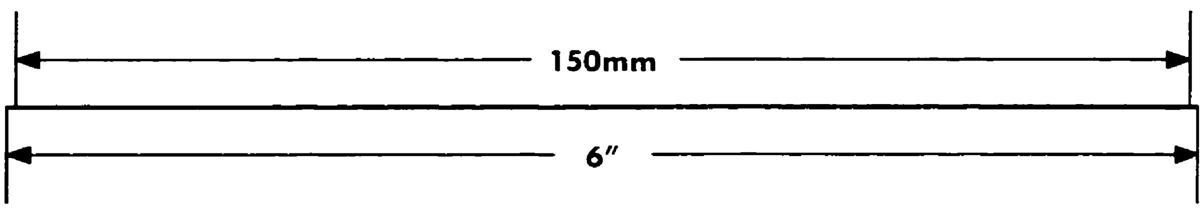

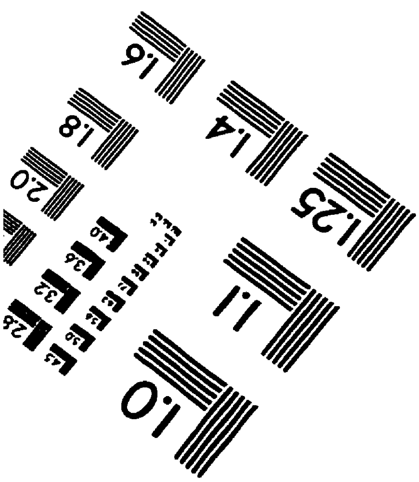
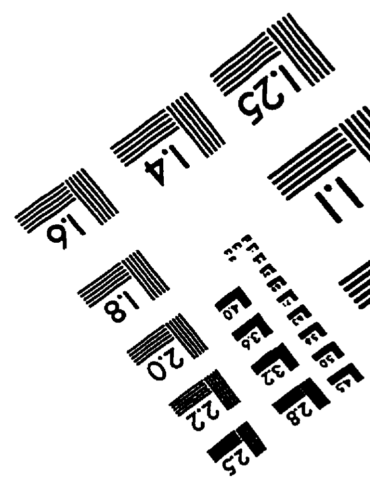

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