

The Mexican economy in 1993

Positive aspects

During 1993, the Mexican economy made great progress in the following fields: curbing inflation; structural change; labor productivity and raising average real wages; increase in financial brokerage and external accounts.

The total balance of payments surplus was much higher than in 1992 and was accompanied by more dynamic exports of non-oil products as well as a lower deficit in the trade balance and current accounts.

The considerable growth in Mexico's non-oil exports represents the continuation of the favorable trend experienced in recent years, especially since trade policy was effectively liberalized. This performance is proof of the Mexican economy's increasing competitiveness, which has placed it among the world's highest-growth exporters.

The points made in this and earlier reports, together with the country's economic history, support the conclusion that high, sustainable rates of economic growth are possible if inflation is kept at low levels. Experience also shows that income distribution worsens when prices rise very rapidly. This accounts for the emphasis given to controlling inflation in current economic policy.

For the first time in 21 years, the annual inflation rate has dropped to below 10%. Thus Mexico came closer to the goal of preventing prices from rising more rapidly than the current inflation rate in the countries which are our main trading partners.

The inflation rate was 8%, the lowest figure that the majority of the population had ever known. This result was obtained through persistent, years-long efforts at fiscal reform—making possible a surplus in the public sector and effecting a considerable reduction of that sector's internal and external debt burden—through prudent handling of monetary policy and the strengthening of exchange-rate policy within the framework of increasing liberalization of the Mexican economy.

In order to help control inflation, the Banco de México continued to seek reduction of excessive pressures on money-supply growth. It is worth noting the "monetary sterilization operations" carried out with the aim of partially compensating for the expansion of liquidity produced by monetarization of the considerable capital

inputs the Mexican economy received from abroad.

The objective was growth that would be correctly balanced between monetary-base supply and demand.

As in previous years, these resources were attracted to the country by the yields that could be obtained from direct investments and financial instruments. Similarly, monetary policy aimed at providing a buffer for erratic movements in interest rates, while at the same time avoiding interference with basic market trends.

Exchange policy continued to contribute to price stability by favoring a steady nominal exchange rate, without detriment to the flexibility required to adapt to temporary imbalances between supply and demand for hard currency. This flexibility was ensured by means of the gradually increasing range of flotation which is part of current exchange-rate strategy.

The contraction of the Banco de México's net internal credit demonstrates that, far from being a source of inflationary pressures, monetary policy has made it possible to neutralize other types of pressure. The basic middle-range goal of this policy was a growth in monetary-base supply that would—with neither surplus nor shortage—satisfy the economy's demand.

With this in mind, in recent years the bank has carried out "sterilization operations" aimed at partially compensating for the expansion of liquidity caused by considerable inflows of capital—which reached a new high in 1993.

Setting public finance on a sound footing not only helped drastically reduce inflation but also had two other highly positive effects.

First, since the government is no longer a net consumer of resources, more have been available to finance increased private investment. This is shown by rapid growth—in real terms—of the financing channelled to this sector.

Secondly, due to the considerable drop in the total amount and servicing of public debt, it has been possible to give greater attention to major social objectives, such as reduction of the tax burden for lower-income brackets and a considerable increase both in public spending on social development and support for the most underprivileged classes of Mexican society.

Thus, whereas in 1988 public spending on social development programs was 6.1% of GDP, by 1993 it had

risen to 9.2%. Spending on education, one of the most important categories, expanded considerably, from 2.6% of GDP in 1988 to 4% in 1993.

Assigning resources to education has particular importance: it helps bring about more rapid economic growth—and, consequently, an improvement in living standards; moreover, providing greater opportunities for receiving quality education is the most efficient way to achieve a fairer distribution of income.

The policy of structural change implemented in the last few years, the intense investment process carried out by both the public and private sectors, and the transformations that all this has brought about in the production system, have produced substantial increases in the overall efficiency of the Mexican economy. Greater efficiency has meant higher labor productivity; this in turn has given rise to higher average real wages.

1993's negative employment trend was not an across-the-board phenomenon. Employment in the manufacturing firms whose stocks are quoted on the

Mexican Stock Exchange remained relatively stable, and the number of workers grew significantly in firms where the pace of investment was maintained.

Certainly these firms and many others, regardless of size, are making more progress than the economy as a whole, insofar as the modernization of their production processes and their adjustment to structural change is concerned. In fact, it is the modernizing firms that, in the long run, create new job opportunities insofar as they manage to consolidate their market position.

In order to establish an institutional framework that would help macro-economic stability, the Mexican Constitution was amended to grant autonomy to the Banco de México, and a new Central Bank Act was approved, aimed at controlling credit growth and providing price stability.

Thus the Banco de México's objective is to avoid the ills brought about by inflation, which remain very vivid in Mexicans' memory: its regressive effect on income distribution, the innumerable distortions that it provokes,

its harmful impact on savings and investment, and the gradual stagnation of the economy.

Several laws governing the rest of the financial system were altered and, for the first time in many years, new banks were authorized to begin operations. These measures sought to promote efficiency and competition in the financial market, while protecting users' interests. At the same time, oversight functions were reinforced.

Policy-makers have made great efforts to ensure that the highest degree of liberalization is accompanied by an improvement in the legal framework defending Mexican productive plant from unfair trade practices, as is seen in the Foreign Trade Act of 1993. The new Foreign Investment Act makes it easier for foreign capital to participate in the economy, by simplifying

GROWTH OF GROSS DOMESTIC PRODUCT AND ITS COMPONENTS¹ In hundreds

CATEGORY	1992	1993	Variation
Growth of:			
Private consumption	3.9	—	-3.9
Government consumption	2.3	3.0	0.7
Gross capital formation	10.8	-1.4	-12.2
Inventory variation ²	—	—	—
Exports	1.6	3.5	1.9
Goods	2.0	4.2	2.2
Services	-1.0	-0.3	0.7
Imports	20.9	-1.2	-22.1
Goods	24.0	-0.2	-24.2
Services	3.6	-8.1	-11.7
Gross Domestic Product	2.8	0.4	-2.4
Contribution to GDP growth derived from variation in:			
Private consumption	2.6	—	-2.6
Government consumption	0.3	0.3	—
Gross capital formation	2.1	-0.3	-2.4
Inventory variation	0.7	-0.5	-1.2
Exports	0.3	0.7	0.4
Goods	0.3	0.7	0.4
Services	—	—	—
Imports	-3.2	0.2	3.4
Goods	-3.1	—	3.1
Services	-0.1	0.2	0.3
Total	2.8	0.4	-2.4

¹ These results are derived from national accounts measuring aggregate supply and demand at constant 1980 prices.

² Figures (whether plus or minus) not indicated due to high percentage level.

MANUFACTURING SECTOR: PRODUCTIVITY, COMPENSATION AND EMPLOYMENT IN 1993
(Annual percentage variation)

Productivity growth	Participation in mfg production	Mean productivity	Wage mass	Personnel employed	Production	Mean real comp'n
I. High	34%	19.5	-4.0	-10.3	5.5	7.4
II. Low	32%	3.1	-4.4	-7.3	-4.4	3.5
III. Negative	34%	-7.2	1.0	-4.5	-11.6	5.5

the regulatory framework and extending the number of sectors open to foreign investment.

Other structural change measures are aimed at encouraging economic efficiency. Thus, a new education act was promulgated, in which the state's obligations are more clearly defined, as are the functions of the different levels of government.

In the agricultural and stock-raising sector, the Federal Competition Act and the commission for putting it into effect were created to combat monopoly practices, encourage competition and modernize the programs which provide support for farmers, so as to capitalize on our comparative advantages and see that lower-income producers benefit from them.

Finally, the new policy on ports will make for more deregulation and a wider role for the private sector in this branch of the economy.

Without a doubt, the economic strategy and the perseverance with which it has been applied have helped eliminate the deep-seated macro-economic imbalances that existed in the early eighties, as well as providing solid groundwork for a new stage of economic growth—a growth that is satisfactory and sustainable and that goes hand in hand with a better distribution of its benefits.

Negative aspects and goals

In spite of these achievements, several factors had a negative influence on the gross formation of capital, economic growth and job creation.

- The uncertainty that began to be felt in the second quarter of 1992 as to whether the U.S. Congress would ratify NAFTA.
- An inflation lower than that predicted by the majority of economic agents. This discrepancy was the reason why real interest rates for many debtors were higher than those anticipated when their loans were taken out. Higher interest rates similarly increased the risk premium implicit in yields. A considerable number of businesses were affected by the fact that real wages also rose more than originally projected. The drop in profits, or resulting

losses, made debt service difficult; in extreme cases this forced a number of firms to reduce or suspend operations.

- A more cautious credit policy on the part of commercial banks.
- The slowing of sales, particularly in small and medium-sized firms, due to the policy of opening up to foreign trade.
- Temporary interruptions of production in a variety of industries due to restructuring of production processes.
- Lower consumer spending due to unemployment, and over-indebtedness of a considerable number of firms and private individuals.

Some of these factors are of a transitory nature, and thus their negative impact on economic activity will be temporary.

One consequence of the significant slowing of economic activity was that, for the first time in the last five years, the demographic growth rate was higher than that of the GDP. Per-capita product therefore went down.

To a large extent, the reason for this slower pace of economic expansion was the shrinking of private investment after several years of remarkable growth. Another was the considerable outlays made by private individuals to purchase banks, non-financial enterprises and other public-sector assets.

Both the new banks which have been authorized to operate and the entry of U.S. and Canadian branches, as allowed by NAFTA, meant a greater diversification of these institutions and an increase in the competition they face—to the benefit of the country's economy. Increased competition in financial markets will put pressure on them to narrow their margins, as has already begun to occur.

With NAFTA going into effect on January 1st, 1994, there will be greater liberalization of the Mexican economy, and its different sectors will face increasing competition. Mexican products will likewise have better access to U.S. and Canadian markets and foreign investment will be promoted.

Unfavorable economic developments also meant a decline in the number of jobs. Experience shows that some of the structural change measures, and the modernization

process itself, mean short-term adjustments in employment for some firms. A turn-around in the situation can, however, be predicted as improvements in efficiency and productivity consolidate and these firms begin a new period of growth.

Policy-makers have recognized that price stability is merely a middle-term —albeit essential— objective in economic strategy, oriented toward achieving more basic goals: economic growth at a satisfactory and sustainable pace, accompanied by higher income levels and more equitable income distribution.

Bringing about a suitable rate of job growth in the immediate future is one of the principal challenges facing the Mexican economy, the main objective of which is alleviating poverty and achieving decent living conditions for all Mexicans.

This process takes time; it involves improving or changing the ways workers are trained in order that they be able to undertake new tasks. The process will be more rapid if it encourages the efficiency and flexibility of labor markets and supports the mobility and retraining of labor.

The progress made in consolidating the macro-economic framework in which production evolves has been accompanied by significant improvements in micro-economic aspects. However, it should be stressed that attention to micro-economics also requires great perseverance, since it is the basis for continued increases in productivity. In the final analysis, productivity is the formula for raising Mexicans' standard of living.

The policies for perfecting the regulatory framework of economic activity increase markets' social utility, give more clarity to the signals that prices send to producers, and consequently favor the reassignment of production factors to more profitable sectors of the economy. In spite of this, it should be recognized that Mexican markets still need to combat a host of imperfections and undesirable practices.

In recent years, the agricultural and stock-raising sector has also undergone far-reaching structural change, oriented

toward modernizing agricultural activities and achieving greater productivity. It will thereby become possible for the rural population to enjoy higher levels of income. The reforms have considerably facilitated collaboration between the private and social sectors in agricultural production.

Prevalent distortions in the relative prices and inputs of several agricultural products have diminished, as has the difference between these prices and the rest of the economy. In general, such measures make for greater efficiency in the use of human, physical and natural resources, in the short, medium and long run.

However, the complexity of the changes required indicates that some difficulties will arise during this adjustment process, particularly as it involves not only the restructuring of crops and of agricultural and stock-raising production in general but also some modification in the input mix, the adoption of new technologies and better forms of association in production.

All this takes time. The pace of these transformations will no doubt be slower than in the industrial sector, given that many farmers manage their agricultural and stock-raising production the same way they did years ago. Furthermore, in some agricultural activities structural transformations have been hindered by the fact that over the last few years international prices for several products have been at a historic low.

The modernization of the agricultural and stock-raising sector is essential in view of its importance

BALANCE OF PAYMENTS CAPITAL ACCOUNT (Millions of dollars)

CATEGORY	1992	1993
CAPITAL ACCOUNT	26,542	30,882
Foreign investment	22,404	33,331
Direct	4,393	4,900
Portfolio	18,011	28,431
Stock market	4,783	10,716
Domestic currency securities	8,117	6,867
Public sector	8,117	6,485
Private sector	0	382
Foreign currency securities	5,111	10,847
Public sector	1,552	4,872
Private sector	3,559	5,975
Credits and deposits	-1,413	1,630
Public sector	-3,530	-2,209
Banco de México	-460	-1,175
Commercial banks	449	2,203
Non-banking private sector	2,128	2,810
Assets	5,552	4,079

and wide potential. This is shown by its capacity for contributing to economic development and, particularly, for improving the income and employment levels of the very large segment of the country's population that lives in rural areas. This modernization involves increasing efforts on the part of both public and private investment in this sector.

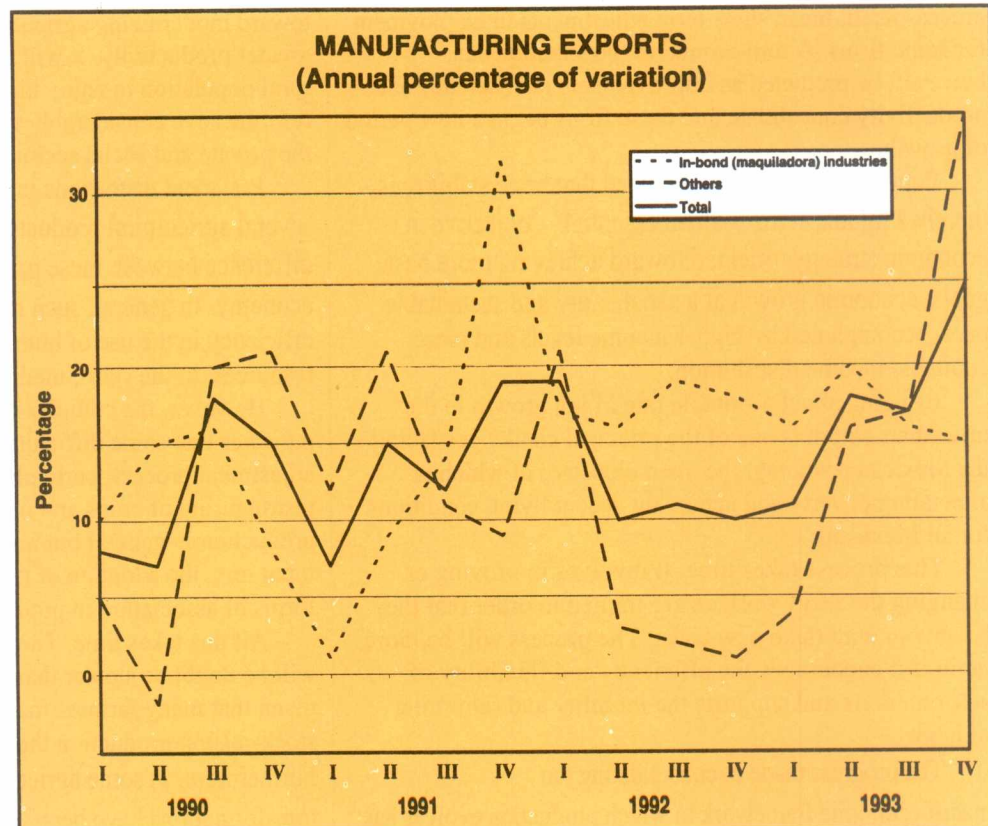
We must similarly intensify measures for facilitating the mobility of production resources between different agricultural and stock-raising activities; promoting the use of technology; increasing and perfecting the training of human resources, through both general and specialized education in agriculture and stock-raising; correcting existing imperfections in marketing and distribution mechanisms; and improving other aspects of agricultural and stock-raising policy.

Particular emphasis must be given to credit, insurance, research and technical assistance; indeed to everything which affects the well-being of the rural population, such as health care and other social services.

Investment oriented toward developing human resources plays a very important role in structural change, since it facilitates the reassignment of production factors between different sectors and productive activities. Investment in schooling, vocational and other forms of training, health, etc. —with the aim of raising human potential— is of the greatest importance for increasing the productivity of both labor and capital.

Therefore, in the Mexican economy —as in any other— assigning resources to education is one of the most profitable kinds of investment, laying the foundation for higher levels of development. Education through schooling and training, whether on or off the job, is also of great value in strengthening economic agents' capacity to adapt promptly to transformations in the economic environment.

This element is especially key in the case of an economy immersed in a deep-going process of structural adjustment. Quality education for all of society is the most efficient means of promoting equality and consolidating



economic development. Hence, Mexico must make a supreme effort in the field of education.

The benefits deriving from stabilization and structural change policies, particularly in terms of an overall increase in social well-being, take time to materialize, as shown by the economic history of many countries. However, these benefits are impossible to achieve if the country does not obtain high productivity from its available resources.

Economic policy, both in its macro- and micro-economic aspects, has been oriented toward achieving this goal. Nevertheless, given that the costs of transition appear more quickly than its benefits —particularly in a conjuncturely unfavorable situation— public opinion has tended to emphasize the former and underestimate the latter, despite the fact that the present strategy is already bringing about a number of beneficial effects that will become increasingly clear over time.

It is therefore essential to repeat that we must maintain our fiscal discipline, monetary prudence, liberalization of the economy and development of efficient markets. All this must be in conjunction with a great effort to bring about social improvement, especially in the field of education. Perseverance and coherence in these matters will lead to a reduction in the costs of restructuring and enable us to reap its benefits more quickly ✘

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