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EMPLOYMENT AND STABILISATION IN MEXICO

by

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PREFACE

This study by Leo Mertens, a staff member of the ILO with long experience in employment planning and policies in Mexico, is an outcome of the ILO's concern with the impact of stabilisation and adjustment policies on employment. Mexico has been at the forefront of the debt crisis since 1982 and the impact of the crisis in terms of low growth and high unemployment is still very severe. The principal objective of this study is to show that the current crisis, while it has its immediate origins in falling oil prices and higher interest rates, is fundamentally caused by the economic development model, and especially the industrialisation process that the country has followed over the past three or four decades. The import substitution model applied up to the 1970s aimed at securing the local production of previously imported goods. Later the strategy changed to the extent of increasing the profitability of exporting through the supply of cheap energy and other intermediate goods to larger and often foreign-owned enterprises. However, these strategies failed to integrate large and small firms in the production process and perpetuated an unequal distribution of income. It follows from this that policies of austerity, while they may be necessary to correct the balance of payments disequilibrium, will not be sufficient to put the economy on an appropriate employment-generating path. Whether more liberal and market-oriented policies will achieve this is unclear and more profound changes in the domestic economic structure may be called for.

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Introduction

During the foreign debt crisis in which various Latin American countries were enmeshed and which reached critical levels at the beginning of the 1980s, so-called stabilisation policies emerged in all these countries. As the term implies, the main objective of these policies was to stabilise those economic variables which had been altered or were in an unbalanced situation. Economic relations, however, are strongly inter-connected. Sometimes it occurs that partial measures to correct some imbalances provoke others elsewhere. Due to timelags between the initial and the secondary effects of policy measures, assessments of policy instruments and strategies normally cannot be made immediately. Nevertheless, preliminary conclusions on policy measures can be formulated, analysing the historical perspective in which economic development has taken place. It is for that reason that the present study, which aims to contribute to a base for establishing employment targets on stabilisation programmes in the case of Mexico, analyses the foreign debt crisis and the corresponding stabilisation policies in the framework of the economic development of the country during the preceding decades.

The principal challenge for the economic policy makers which are confronting the foreign debt crisis of countries like Mexico, is to design such stabilisation measures that the negative effects on the general employment situation can be kept as small as possible in the short term. In the medium term, these policies have to be made congruent with a strategy which will correct the economic structure of the country in such a way that real possibilities exist for a significantly better employment and income generation performance. In other words, the economic model to be followed up to the 1990s and 2000s in order to reach the minimum goals in employment and income, must be defined. This paper does not pretend to give alternatives to the economic strategy which presently is being carried out. It only hopes to contribute to the reflection on the economic model required for the coming years in Mexico.

In order to emphasise the structural changes in the economic development model in the past, no special reference is made to each government administration or "sexenium". Actually, there are notable differences between various administrations, yet it can be argued that there exists a marked continuity in the government, to a large extent supported by institutions, which organise the different sectors of the society (e.g. workers, professionals, employers).

The first chapter consists of a summary of the principal characteristics of the employment situation, identifying the emerging imbalances during the post-war period and analysing the emerging financial instability in the early 1970s as a consequence of the unsuccessful transition from import substitution towards export-oriented industrialisation.

In the second chapter, it is explained how the oil boom postponed the consequences of the financial collapse by several years, but also how in the 1980s this took hold, without any prospect of rescue through another oil boom. The fundamental role of government in employment generation is described and how this is immediately linked with the outstanding foreign debt.

The post collapse stabilisation policy is explained and analysed in the third chapter, which ends with the formulation of some alternative policy scenarios. The last chapter consists of general conclusions.

Chapter 1

Employment structure and dynamics in Mexico leading up to the 1970s: A global overview

1. The import substitution industrialisation model

The transformation process of the Mexican economy from about 1940 onwards brought about the first radical changes in the overall employment situation of the Mexican population. These years marked the beginning of a broad industrialisation process, built around the production of non-durable consumer goods, and aimed at supplying the protected national market with substitutes for articles previously imported. This initial phase of industrialisation was characterised by significant forward and backward linkages,[1] and by labour-intensive production processes, with the result that growth in production was quite closely paralleled by corresponding growth in employment (see table 1).

Table 1. Average annual growth rates of employment and product

Years	GDP (1)	Employment (2)	E (1)/(2)
1930-40	4.3	0.9	0.2
1940-50	6.0	3.8	0.6
1950-60	6.2	2.1	0.3
1960-70	7.0	2.4	0.3
1970-80	6.6	3.5	0.5
1930-80	6.0	2.6	0.4

Source. Calculations based on Comisión Consultiva del Empleo y la Productividad. Proyecto para la planificación de recursos humanos: La estructura ocupacional de Mexico, 1930-80 (Mexico 1982), tables II-15 and IV-4.

The second phase in import substitution industrialisation, which started in the 1950s, was geared to the production of durable consumer goods, partly as a response to increasing demand from the higher income groups. This was soon followed by an initial production of certain intermediate and capital goods. In comparison with the first period of industrialisation, the production processes of the second period had significantly fewer backward linkages towards the national economy, implying the importation of most necessary inputs. However, the inevitable pressure on the balance of payments brought about by the need to import machinery and intermediate inputs in this phase was relieved to a considerable extent by growth in exports of more traditional products (see table 2), particularly from the agricultural sector, where in the 1950s modernisation had taken place (though limited to a small segment of the sector).

Table 2. Import and export composition of Mexico, 1965 (in %)

Exports		Imports	
TOTAL	100.0		100.0
Agricultural products	50.4	Consumer goods	15.3
Coffee	(6.3)	Food	(0.4)
Cotton	(18.3)		
Tomatoes	(3.0)	Intermediate goods	39.2
Minerals	19.8	Capital goods	45.6
Hydrocarbon products	(3.5)		
Others	(16.4)		
Manufactured products	16.5		
Sugar	(5.0)		
Textiles, clothing and footwear	(2.6)		
Chemicals	(3.9)		
Iron and steel	(2.2)		
Others	13.3		

Sources. Calculations based on World Bank: Special study of the Mexican economy: Major policy issues and prospects (Washington, DC, 1979), tables 3.2 and 3.3; and World Bank: Mexico: Development strategy, prospects and problems (Washington, DC, 1981), table 18, p. 51.

The beginning of a third phase can be identified in the early 1970s. After a decade of steady overall national economic growth (averaging 7 per cent per annum) and apparent prospects of continued economic stability, the government started to intervene on an increasingly large scale in the economic development process with a view to correcting the orientation of the economic model followed until then. Notwithstanding the high growth rates it had generated in the past, the economic development pattern had also produced some fundamental imbalances in the national economy.

In the first place, the stagnation of the import substitution model, expressed by a nearly inexistent capital goods industry, the absence of an indigenous technology capacity and the lack of integration of the industries producing durable consumer and intermediate goods in the national economy, implied increasing pressure on the balance of payments. This situation was aggravated by the fact that industrial production was principally oriented to a small segment of the internal market and scarcely at all to the external market. The capacity of the traditional sector to finance the increasing external deficits had become limited, particularly because after the 1950s the prosperity of the agricultural sector had levelled off (partly because the government had reduced its support for the sector). Whereas the modern segment of agriculture was geared to the export market, the non-modernised traditional sector provided most of the national basic food production. The latter sector did not receive any significant government support, in terms of infrastructure, for instance, and moreover had not been allowed to raise prices, since that would have hampered the industrialisation process. Over the years, however, this lack of support for the traditional agricultural sector initiated a trend of steadily shrinking basic food production which has continued up to the present.

In the second place and in close relation to the first point, an important role in the lack of integration was played by the introduction of foreign capital in industry. After the period of "Cardenismo" of the 1930s and early 1940s (named after President Lazaro Cardenas, 1930-36), when the oil industry was nationalised and agrarian reform was carried out, the government adopted a more liberal policy toward foreign investments, by reducing restrictions. Foreign investment was principally concentrated in the production of finished consumer goods,[2] which meant in the case of durable consumer products, such as electric household appliances and automobiles, importing all the necessary capital goods and a considerable part of the required intermediate inputs,[3] particularly from the United States, from which most of the foreign capital derived. These investments signified also an increasing process of concentration, since they were carried out by transnational corporations which dominated these markets, most notably in the case of the automobile industry. The lack of an effective government policy in relation to product and process innovation, brought relatively obsolete international production processes into the national economic apparatus.

In the third place, economic growth was centered in a relatively small number of enterprises and economic agents, the so-called modern segment of the economy. High productivity levels, oligopolistic market structures, few and subordinated linkages to small enterprises, were some of the characteristics of this sector of the economy. At the same time, a large number of small and micro enterprises and farmers had no prospect of development.[4]

In the fourth place,. the average annual employment growth rates of 2.1 and 2.4 per cent in the 1950s and 1960s had been insufficient to cover population growth and the increase of the economically active population (see table 3). This lack of job creation was immediately related to the development of the agricultural sector. Whereas mechanisation and other technological innovations were applied by the modern segment of agriculture, the traditional segment fell into a worsening production crisis. The result was a nearly complete stagnation of employment in this sector (see table 4).

On the other hand, the high growth rate of production and employment in the secondary and also tertiary sector in the years 1950-70, were not able to counterbalance the EAP growth and the job stagnation in the agricultural sector (see tables 3 and 1). This was due to the relatively low levels from which employment growth started in these sectors, and to the character of the industrialisation process, without linkages to the national economy and dominated by final phases of production processes.[5] In 1950, the primary sector constituted 58 per cent of total national employment, while the secondary sector made up only 16 per cent and the tertiary sector 26 per cent (see table 5). In 1970, the secondary sector had increased its participation

Table 3. Population and economically active population, Mexico

Year	Population (in 000s)	Average annual growth rates (%)	EAP (in 000s)	Average annual growth rates (%)
1900	13 607	-		
1910	15 160	1.09		
1920	14 335	-0.51		
1930	16 553	1.61	5 165.8	
1940	19 654	1.73	5 858.1	1.27
1950	25 791	2.75	8 345.2	3.60
1960	34 990	3.10	11 252.3	3.03
1970	48 225	3.26	15 000.0	2.92
1980	66 847	3.32	22 066.1	3.94
1930-80	-	2.83		2.95
1950-80		3.23		3.29

Sources. Comisión Consultiva del Empleo y la Productividad, 1982, op. cit., table I-1; Roberto Tomasini: La industrialización y el empleo en México (Mexico, 1980), p. 52; Héctor Islas: "Un retrato reciente de México: El último censo", in Comercio Exterior, July 1984, p. 591; BANAMEX: Mexico social 1983, Indicadores seleccionados (Mexico, 1983), p. 201.

Table 4. Sectoral employment and productivity average annual growth rates (in %)

Sector		1940-50	1950-60	1960-70	1970-80	1930-80
Primary	Employment	2.3	0.5	1.0	1.8	1.2
	Productivity	4.2	3.8	2.9	1.7	3.1
Secondary	Employment	5.9	5.0	4.4	3.4	3.7
	Productivity	0.5	1.7	4.0	3.8	2.6
Tertiary	Employment	6.8	3.6	3.1	5.5	4.5
	Productivity	-1.1	2.8	3.7	1.2	1.7
Total	Employment	3.8	2.1	2.4	3.5	2.6
	Productivity	2.1	4.0	4.5	3.0	3.4

Source. Comisión Consultiva del Empleo y la Productividad, 1982, op. cit., table IV-11.

Table 5. Sectoral employment distribution (in %)

Sector	1930	1940	1950	1960	1970	1980
Primary	70.2	67.5	58.3	49.4	42.9	36.5
Secondary	14.4	13.2	16.0	21.0	25.4	25.1
Tertiary	15.4	19.3	25.7	29.6	31.7	38.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source. Ibid., table IV-3.

in total employment to 25 per cent, a figure which did not change until 1980. The employment growth process of the tertiary sector calls for special examination. In the first decades of industrialisation, the tertiary sector grew along with industries, because many activities of commerce, communication and services were directly related to the industrialisation process. At the same time, however, and particularly in the 1970s, the tertiary sector began to incorporate an important segment of the urban informal sector increase. The highly concentrated industrialisation process (mainly in the three urban areas of Mexico, Guadalajara and Monterrey) and the static employment creation capacity in agriculture and the rural sector provoked a strong wave of migration to the main urban centres. Whereas in 1940 about 35 per cent of the population was in urban areas, by 1980 this figure had increased to 66 per cent, signifying in absolute terms a growth of about 46 million people in urban areas. Of the urban population, 45 per cent were centered in the three above-mentioned cities.[6] Considering the global growth rates of employment of the secondary sector over the period 1930-80 and comparing these with the urban population growth rate (see table 6), it is clear that because of the large difference in "start level" (in 1930 the secondary sector constituted 14 per cent of total employment and urban sectors 33 per cent), an enormous employment problem had been created in the main urban areas. Taking into consideration the likewise limited absorption capacity of the modern tertiary sector, it can be assumed that a considerable part of employment increase in the tertiary sector was in informal activities and in conditions of underemployment. This was one of the main factors in explaining how between 1930 and 1980, about 48 per cent of new employment was concentrated in the tertiary sector, and "only" 29 per cent in the secondary (see table 7).

Table 6. Urban and rural population
(Average growth rate) (in %)

Year	Total	Urban	Rural
1930-40	1.73	2.21	1.48
1940-50	2.75	4.76	1.50
1950-60	3.10	4.89	1.52
1960-70	3.46	5.06	1.54
1970-80	3.28	4.35	1.43
1930-80	2.85	4.24	1.49

Source. Ibid., table I-3.

Table 7. Employment growth composition (in %)

Sector	1930-80	1960-70	1970-80
Total (000s)	13 134	2 774	5 313
(%)	100.0	100.0	100.0
Primary	23.2	19.0	20.8
Secondary	29.3	41.6	24.5
Tertiary	47.5	39.4	54.7

Source. Ibid., table IV-7.

This statement is reinforced by the fact that in 1930, 743,000 persons in urban areas, or 13.4 per cent of the urban population, were working in industrial activities. In 1970, this percentage had fallen to 11.1 per cent. Between 1930 and 1970, the industrial sector absorbed 35 per cent of the urban labour force increase while the tertiary sector absorbed 65 per cent (see table 8).

Informal activities were by no means restricted to the tertiary sector. A wide-ranging survey carried out in 1976 revealed that 20 per cent of urban informal employment (or underemployment) was to be found in the industrial sectors, while 58 per cent was concentrated in the tertiary sector.[7] With respect to the agricultural sector, a calculation made in 1970 revealed that about 78 per cent of the production units were producing at a subsistence

Table 8. Urban population growth and labour force

	Persons	%
Increase of urban population (1930-70)	24 216 969	
Increase of labour force (1930-70) (on a 30 per cent participation base)	7 265 090	100
Increase of industrial employment (1930-70)	2 549 598	35.1
Increase of tertiary sector employment (1930-70)	4 715 492	64.9

Source. Ibid., pp. 175-176.

level which affected approximately 64 per cent of the rural labour force.[8] Considering also that the survey gave an informal labour rate of 38 per cent in urban areas, it means that the percentage of "underemployment" of the economically active population as a whole can be estimated to have fluctuated around 47 per cent for the second half of the 1970s.[9]

In the fifth place, high levels of underemployment, mainly in the urban informal and rural traditional sectors, constitute the economic base for the unequal income distribution process which can be observed in the past few decades, and which signified that economic growth benefits did not reach the whole of the population in a broadly equitable way. From the 1940s to the 1970s, real income per capita grew at an annual level of approximately 3 per cent, which signifies that between 1930 and 1980, average income per capita increased more than four times (see table 9). In evaluating the income distribution structure, it becomes clear that the major benefits of economic growth went to the medium-high and high income groups (see table 10), whereas the families with the lowest incomes had received the fewest benefits. While the 20 per cent of total families with the lowest incomes received 6.1 per cent of total national income in 1950, their share had fallen to 4.1 per cent in 1975. On the other hand, "the families that have mainly benefited from economic growth between 1950 and 1975 are the 20 per cent richest families. Their share jumped from almost 60 per cent in 1950 to more than 66 per cent in 1975. Among this 20 per cent one finds the large-scale (owner) employers, some small-scale employers (especially in commerce and services) and some employees in the modern sector of manufacturing, commerce and services."[10]

Table 9. GDP development per capita

Year	Population (in 000s)	GDP (1970 BN pesos)	GDP per capita (1970 pesos)	GDP per capita average annual growth rate	Index 1930=100
1930	16 553	45.1	2 725		100
1940	19 654	69.0	3 511	2.6	128.8
1950	25 971	123.9	4 804	3.2	176.3
1960	34 990	225.7	6 450	3.0	236.7
1970	50 695	444.3	8 764	3.1	321.6
1980	70 000	840.3	12 004	3.2	440.5
$1930-80	(2.9%)	(6.0%)		3.0	

Source. Comisión Consultiva del Empleo, 1982, op. cit., table II-10.

Table 10. Family income distribution structure after tax (in %)

Family group	Participation in total income			
	1950	1963	1968	1975
Total	100.0	100.0	100.0	100.0
20% lowest income group	6.1	4.2	3.7	4.1
30% medium-low income group	13.0	11.5	10.7	10.1
30% medium-high income group	21.1	21.7	22.5	19.4
20% high income group	59.8	62.6	63.1	66.4
Gini index	0.50	0.55	0.56	0.58

Source. W. van Ginneken: Socio-economic groups and income distribution in Mexico (Geneva, ILO, 1980), p. 18, table 1.

These figures do not mean that the poorest families saw no improvement in their real income. This increase, however, was significantly less than that of the families belonging to the medium-high and highest income groups.[11]

The developments in income distribution have to be interpreted as a consequence of the economic policy followed. A World Bank report on Mexico summarises some characteristics of the policies:

> "The development strategy of the 60's was based on a combination of high private sector profits and Government supportive action. The former was supported by the protection available to industry through quantitative restrictions on imports during all this period, the extremely favorable tax treatment of income from capital and the inequality in income distribution, these factors contributed to abnormally high profit margins in Mexico, the major source of private savings."[12]

In addition, a fast-growing industrialisation process, concentrated in only one part of the national economy, implied a relatively high demand for qualified people at various levels of enterprises and institutions, which, given the labour force supply structure of Mexico, signified, in turn, a shortage of qualified persons. These people, who constitute an important part of the middle income groups, were thus able to considerably increase their relative income position. Furthermore, general minimum wage levels, applied normally to the organised manual labourers, who can be considered as belonging to the medium-low income group, were kept in line with the productivity increases; their "start" level, however, was relatively low.[13] On the other hand, in the expanding informal urban and traditional rural sectors, minimum wages have usually been more the exception than the rule. For instance, the already mentioned survey on informal urban labour conditions in Mexico, revealed that approximately 40 per cent of the urban informal labour force were receiving an income below half the official minimum wage.[14]

Low wages and incomes for a considerable segment of the national population not only signify an ethical and social dysfunction, but also failure to exploit internal market capacity and dynamics. While lower incomes have mainly been spent on the products of first necessity which have a small impact coefficient, the middle income groups have generated a quickly increasing demand for relatively sophisticated durable consumer products, either completely imported, or with only the final phase of production located in the country. Thus, income distribution development had not been a positive contributing factor in the import substitution strategy and, consequently, in the improvement of employment generation capacity.

2. Towards a combination of import substitution and export-oriented industrialisation: Emerging financial instability

The seeds of the financial and economic crisis which started in the early 1980s are to be found in the economic development model introduced in the early 1970s. The previous development strategy emphasised import substitution industrialisation, but, as mentioned before, this strategy was not carried out rigorously; many intermediate and capital goods, and technology in general, continued to be imported. A solid entrepreneurial industrial and financial group was nonetheless established which was among the main beneficiaries of the economic growth of this period. In the direct production sphere, the government played a relatively important role in this period of import substitution industrialisation; though occasionally acting as a direct economic agent, its activities were mainly of a supporting nature: supplying infrastructure, import restrictions, fiscal incentives, etc.

In spite of the inherent emerging constraints in the expansion of the internal market due to factors described above, after the 1960s new horizons for economic growth opened. Mexico set its sights on full integration with the world economy and commerce. With this in view, the aim became to increase the export of manufactured goods and to ensure that these exports took over the previously predominant role of raw materials and agricultural products in the composition of Mexico's exports. In order to improve advantages in prices and competitiveness on the world market and to counterbalance the negative tendencies in the balance of payments, the government considered it necessary to fill the gaps left by private investments to produce sufficient intermediate and capital goods at the national level. This led to a combination of import-substitution and export promotion strategies. Opening the economy also created the need for an adequate regulation of the entrance of foreign capital in a way that would not destroy nationally-owned enterprises but reinforce them in their growth process. And, of key importance, labour costs had to be kept relatively low.

This strategy in turn implied that the government should assume a significant and crucial place in the economy not least because imbalances produced by the economic model applied in the past had to be eliminated. The government sought, therefore, to secure an active participation in economic growth and its benefits, which would give it the role of an economic agent at the level of private national and external capital.

One of the principal challenges of government involvement in the economy in this period of the 1970s was how to confront the growing imbalances in the economic and social sphere in a global development strategy aimed at an integration process with the world economy. This was also the moment when at the international level the initial signs of serious recession were becoming visible. Given the instability of the international money markets in the early 1970s, accompanied by speculation on and dramatic price increases of raw materials, particularly of hydrocarbon derived products, and in addition an internal market which began to reach its expansion limits, the earlier private investment boom was now clearly threatened.

In light of the above, the government began an accelerated expenditure programme. The total public expenditure grew at a (real) annual rate of 16 per cent between 1970 and 1975, raising its share in GDP from 17.8 to 28.2 per cent in this period.[15] Both current and capital expenditure rose at a similar rate. Of current expenditure, however, the fastest-growing items were transfers (26.2 per cent) and interest payments (15.5 per cent), followed by wages and salaries (11.9 per cent) (see table 11). The growth in much of the current expenditure can be seen as a response of the government to social and economic imbalances. It can be observed that a considerable part of the current transfer increase, about 35 per cent[16] was channeled to agricultural trust funds and to the Compañia Nacional de Subsistencias Populares (CONASUPO), and a significant amount to educational and health services (10 per cent). The decline in production of basic food crops, such as corn and beans (the first decreased at 0.1 per cent per annum between 1965 and 1970, and the latter increased only at a rate of 1.5 per cent in the same period[17]), and the large number of families with an income below the minimum wage, began to show signs of threatening the political stability, calling with increasing urgency for specific remedial government policies. Education and health services also required urgent attention,[18] and it was in these two areas that most of the employment growth in federal government employees, and in consequence the increase in the sum of wages and salaries, took place. Of the 320,000 newly created jobs in federal government between 1970 and 1975, 73 per cent were located in the educational sector.[19]

Table 11. Government expenditure

	Real average annual growth rate (%) (1970-75)	% of GDP 1970	% of GDP 1975
Total expenditures	16.0	17.86	28.18
Current expenditure	15.7	11.71	18.28
- Wages and salaries	11.9	5.60	7.71
- Goods and services	10.1	1.22	1.49
- Interest payments	15.5	1.42	2.20
- Current transfers	26.2	2.48	5.96
Capital expenditure	16.5	6.15	9.90
Current savings		4.14	1.02
Deficit		-1.80	-8.24
- Domestic financing		1.11	5.19
- External financing		0.69	3.54

Source. Calculations based on World Bank data, 1981, op. cit., tables 5.2 and 5.3.

The growth in current expenditure was not paralleled by a corresponding growth in current revenue, particularly because tax revenues showed little increase. Current savings decreased from 4.14 per cent of GDP in 1970 to 1.02 per cent in 1975 (see table 11). At the same time, the budget deficit grew from 1.80 per cent of GDP to 8.74 per cent, and an increasing part of capital expenditure had to be financed by domestic and external borrowing. The surplus of private savings for investment in the domestic capital market[20] and the availability of Eurocredits[21] made borrowing relatively easy. The public sector external debt increased from $4,200 million in 1970 to $14,400 million in 1975; the latter figure was no less than 18 per cent of GDP (see table 12). As an alternative to increased foreign borrowing, the government contemplated introducing tax reform measures but decided against this policy in view of the political risk of dissatisfaction among the privileged section of the community.[22]

Table 12. Public sector outstanding and disbursed external debt (million US$)

	Medium and long-term	Short-term	Total	Total as % of GDP
1966	1 891.8	451.2	2 343.0	
1970	3 259.2	1 002.8	4 262.0	12.2
1973	5 731.8	1 338.6	7 070.4	14.3
1974	7 980.8	1 994.2	9 975.0	15.3
1975	11 612.0	2 837.0	14 449.0	18.0
1976	15 923.4	3°676.8	19 600.2	24.8

Source. World Bank, 1979, op. cit., table 4.6, and Comisión Consultiva, 1982, op. cit., table II-24.

A rough estimate shows that the increase in public foreign debt between 1970 and 1975 equaled 45 per cent of the increase in public fixed investment over the same period.[23] This reflects the beginning of a trend that was to continue into the late 1970s, signifying that public investment depended more and more upon the availability of foreign financing. Public investments thus became vulnerable to shifts in the international economy, creating increasing difficulties in using public investment as an instrument for anti-cyclical employment policies when the recession began.

Public fixed investments grew at a high average rate of 12.3 per cent between 1970 and 1975, whereas private investment only increased by 5.3 per cent per annum. These differences in growth rate caused the participation of the public sector in the overall national investment to grow from 35.5 to 43.2 per cent (see table 13).

Public investment growth had been evenly spread over the main budget sectors: industry, welfare, transport and communications, agriculture and rural development. Between 1971 and 1975 investments in agriculture and rural development tended to increase somewhat faster at an annual rate of 31.0 per cent (see table 14) in response to the agricultural production crisis. Within individual budget sectors there were, however, quite significant differences in investment growth. Investments in industrial

Table 13. Fixed investment development

	1970		1975		Real average annual growth rate 1970-75 (%)
	1972 Mex$ bn	(%)	1972 Mex$ bn	(%)	
TOTAL FIXED INVEST.	89.5	100.0	131.5	100.0	8.0
Public investment	31.8	35.5	56.8	43.2	12.3
Private investment	57.8	64.5	74.7	56.8	5.3
Total financing	89.5	100.0	131.5	100.0	8.0
External savings	14.8	16.5	32.3	24.6	16.9
Public savings	20.0	22.3	11.9	9.0	(-)9.9
Private savings	54.0	60.3	83.0	63.1	9.0
Inflation componant*	0.7	0.8	4.3	3.3	43.8

* Equal to inflation times the real quantity of money.

Source. Calculations based on World Bank data, 1981, op. cit., table 2.3; and World Bank, 1979, op cit, table 13.

activities were concentrated in areas of basic intermediate producing industries, such as oil and its derivatives, petrochemicals, steel and to a certain extent, sugar, and in the area of electricity generation and electrification. Beyond the import substitution character of the investment strategy, these data reflect an important division of activities between private and public sectors. The latter supplied cheap bulk-intermediate products to private industry. It was expected that this in turn would help private industry to compete in international markets. It was also hoped that the resulting import substitution would reduce inflationary pressure and reduce balance of payments deficits.

The investment share of the public sector in total investment in manufacturing rose from 19.8 per cent in 1971 to 59.0 per cent in 1975,[24] excluding investment in oil expansion. The main investment flow went to the steel producing sector, where the government had a major project for the construction of a very large steel-producing complex on the Pacific coast. The sugar industry was another important investment area. Refining capacity had reached a critically low level and Mexico, which previously had been a sugar exporting country faced the necessity of importing sugar, which indeed

Table 14. Public sector fixed investments

	1971 (1972 Mex$ bn)	1975 (1972 Mex$ bn)	Real average annual growth rate 1971-75 (%)	Composition 1975 (%)
Total	23.7	59.5	25.9	100.0
Industrial sector	9.8	23.6	24.6	39.6
Petroleum and petro-chemical			11.6	14.6
Electricity			22.4	12.4
Steel			88.0	8.4
Sugar			53.1	1.8
Welfare	5.1	12.1	24.1	20.4
Urban and rural infrastructure			8.3	7.4
Housing			34.2[1]	4.9
Hospitals and other health facilities			35.1	3.4
Schools			20.0	4.5
Transport and communications	4.8	11.7	24.1	19.7
Agriculture and rural development	3.5	10.3	31.0	17.3
Irrigation			22.1	21.7

1 1972-75 figure.

Source. Calculations based on World Bank data, 1979, op. cit., table 5.19.

occurred after 1975-76. An increasing amount of investment was channeled into oil production, but the share of this sector in public investments did not significantly outstrip the other sectors, at least before 1974-75 (see table 14).

Apart from direct state involvement in the economy, the government also executed other indirect policies designed to cope with the growing social and economic imbalances, as well as to promote the incorporation of the Mexican economy in the world economy. On the one hand, several incentives were created to stimulate the production of intermediate and capital goods and the export of manufactured products, ranging from direct fiscal incentives to low input prices of energy and commodities. On the other, export quotas were established for the industries with high import rates, such as automobiles and domestic appliances, and minimum percentages of domestic inputs were required. Furthermore, foreign investment was regulated under new legislation. A new law on foreign investment was enacted in 1973, facilitating the entrance of foreign capital subject to association with private or state national corporations or individuals, normally on the basis of majority national participation. One of the most important objectives of the new legislation was to protect national enterprises and their national character by regulating the degree of foreign investment. The legislation specifies various forms of participation of the local entrepreneur shareholders in the profits obtained.[25] In practice, it was the major financial, commercial and industrial groups which were in a position to benefit from the legislation. The impact on small entrepreneurs or small investors was, as to be expected, minimal.

The facilities given to the offshore assembly[26] activities, in the form of infrastructure, tax exemption, duty free import of intermediate inputs, constituted another policy line of the government in the context of the general strategy of export development. Whereas these activities increased very fast in the first four years of the 1970s, their subsequent level was moderate and included setbacks depending basically on the exchange rate situation, particularly in periods when the Mexican peso was overvalued.

In the context of the above-described aspects of the development strategy of the 1970s, the behaviour of some economic variables will be examined. Between 1970 and 1975 GDP grew at a relatively high annual rate of 5.7 per cent, though below the 7 per cent growth rate of the 1960s. Employment grew in the same period at 3.2 per cent per annum.[27] In absolute terms, about 2.2 million jobs were created, 12 per cent below the estimated labour force increase of 2.5 million persons in those years.[28]

At the sector level, high employment growth rates were recorded in construction, transport and communications and other services, including government (see table 15). In spite of the large government support

Table 15. Employment and productivity average annual growth rates per sector, 1970-75 (%)

	GDP	Employment	Implied productivity
Agriculture	1.6	0.7	0.9
Manufacturing	5.9	2.7	3.2
Construction	8.3	6.6	1.7
Commerce	5.2	2.2	3.0
Transport and communications	10.0	5.7	4.3
Other services	6.1	5.8	0.3
Total	5.7	3.2	2.5

Source. Calculations based on Cuentas Nacionales, 1981, op. cit., and World Bank, 1981, op. cit., table 2.7.

programmes, production and employment rose very little in the agricultural sector. The employment generation capacity of the manufacturing and commerce sector was low, mainly because production growth was achieved by increased productivity and rationalisation (replacement investments). Particularly in traditional labour-intensive branches of the manufacturing sector, such as textiles, shoes and garments, the introduction of new technologies,[29] combined with a static internal market, effectively impeded major employment absorption. Five manufacturing branches absorbed about 50 per cent of the new manufacturing labour force: the food industry, tobacco and beverages, construction of machinery, the electronics industry and the automobile industry. The increase in automobile employment can be seen to a certain extent as a result of the export quota policy of the government which implied an obligatory export increase. Since about 25 per cent of newly created manufacturing jobs were in offshore assembly activities, the overall performance of manufacturing employment generation capacity was weak. This was in part due to the ongoing deterioration of small and medium size enterprises.

At the same time, however, the increased employment in other services calls for analysis. In part, this figure reflects the government employment increase, but also indicates growth in informal urban services activities which, applying the informal/formal ratio given by the survey of 1976, signified an additional 250-300,000 persons in informal labour conditions in other service activities. It was the construction sector which, after other services, showed the highest absolute labour force absorption capacity (see table 16). The increasing participation of the public sector in national investment meant that an increasing share of new jobs were the direct or indirect result not only of government current expenditure but particularly of the investments being carried out. It also has to be underlined that the nature of the government investment in infrastructure and basic industry made it more "construction-intensive",[30] implying a higher involvement of the construction sector in the realisation of the investments: whereas in 1970, 54.2 per cent of total investment expenditure was on construction activities, in 1975 this figure rose to 58.2 per cent (see table 17). We can estimate that the share of employment in the construction sector generated by public investment expenditure increased from 35 to 45 per cent in the respective years, a figure that for 1980-81 was to rise to about 50 per cent.[31] Thus, up to the final years of the 1970s, an increasing part of employment in construction generated by public investment was consequently dependent upon foreign loans since in 1975 public sector savings could only cover 20 per cent of public investment (see table 13).

In the light of the above, a roughly calculated balance of the origin of labour force absorption in the national economy between 1970 and 1975 shows that about 50 per cent of new employment was the direct or indirect result of government expenditure.[32]

It is clear, therefore, that government expenditure became increasingly important in the generation of new employment. This might have been even higher if more capital goods could have been produced inside the country and if government funds had been used more efficiently.[33] The low level of total new employment indicates that the private sector had been very weak in generating employment. This weakness was to a large extent a result of the lack of integration of the modern growth segment within the national economy, particularly with small and micro enterprises, and of the relatively low investment rate in comparison to private sector savings. In the period 1970-75, private savings rose at an annual rate of 9 per cent, whereas

Table 16. Labour force absorption per sector, 1970-75

	(in 000s)	Employment structure (%)	
		1970	1975
Agriculture	173.9	34.7	30.5
Manufacturing	253.9	13.4	13.1
Construction	312.8	6.3	7.5
Commerce	235.5	15.6	14.8
Transport and communications	146.3	3.5	3.9
Other services	1 078.2	25.0	28.7
Non-identified		(1.5)	(1.5)
Total	2 200	100.0	100.0

Source. Calculations based on Cuentas Nacionales, 1981, op. cit.

Table 17. Fixed investment by main components (shares in %)

	1970	1975
Construction	54.2	58.2
Domestic capital goods	27.8	21.4
Imported capital goods	19.7	18.4
Other	2.2	1.6
Total	100.0	100.0

Source. World Bank, 1981, op. cit., table 2.11.

investments only at 5.3 per cent (see table 13). Both elements would have important consequences later on in the 1980s for employment generation. In addition, a significant part of the new employment depended upon the foreign borrowing increases that had taken place. In qualitative terms, the newly created employment had a tendency to be more vulnerable to international economic fluctuations, which, given the nature of the relationship, could hardly be counterbalanced through an alternative government policy. This vulnerability to external factors is also present for employment in the offshore assembly industry, which between 1970 and 1975 absorbed about 10 per cent of the national labour force.

The effects on employment have to be placed in direct relation to the disappointing immediate results of government efforts to remedy the growing imbalances in production structure. Government efforts to increase bulk and basic intermediate production, such as iron and steel and the petrochemical industry, and increased energy production and electrification, inevitably took time to show results. While necessary capital goods were imported on a very large scale in order to initiate manufacturing of these intermediate goods, there was an inevitable time lag before the importing of the latter could be substituted. In addition, the crisis in the agricultural sector implied increasing imports of basic foodstuffs such as corn and beans (see table 18).

On the other hand, no effective mechanism existed to induce the private sector enterprises, and particularly those with foreign capital participation,[34] to increase their backward linkages towards the national economy. Apart from the basic inputs already mentioned, in general intermediate inputs increased enormously, particularly imports of electronic components and automobile parts. In the case of industrial machinery and machine tool production in the capital goods sector, the import ratio in relation to the demand was respectively 56 per cent and 93 per cent.[35] At the same time, government transfers and subsidies to the economy were calculated to have reached about 17 per cent of total public sector expenditure in 1975,[36] mainly in the form of subsidies, and a fifth of this amount went to manufacturing industry. It was the modern manufacturing and the intermediate goods producing enterprises that obtained most of the effective subsidies, while traditional manufacturing had a negative effective subsidies level.[37] In certain cases, the subsidies and incentives served

Table 18. Merchandise import components
(Real average annual growth rates) (%)

	1965-70	1970-75
I. Consumption goods	7.0	1.5
- Food[1]	65.0	22.6
- Other consumption goods	2.5	-12.9
II. Intermediate goods	4.5	18.1
III. Capital goods	6.2	9.7
Total merchandise imports	5.7	10.3

1 Between 1965 and 1970, food imports grew in absolute figures, and expressed in constant 1972 US$, from US$7.6 million to US$92.9. By 1975 the figure had increased to US$216.6 million.

Source. Calculations based on World Bank data, 1979, op. cit., table 3.5; World Bank, 1981, op. cit., tables 3.5 and 3.7.

to help penetrate the external market, in other cases it improved the liquidity position of firms in the "modern" private sector, which instead of investing in plant and machinery, sometimes used their cash-flow for short-term investments in the money markets and other speculative purposes. In terms of employment promotion, we might question whether government subsidies to the modern segment of the economy were not at an unduly high cost.

With regard to exports, after a fairly stagnant period in the late 1960s, these increased anew in the early 1970s, the lead being taken by hydrocarbon derivatives. For most manufacturing products, export capacity declined, however. Increasing inflation resulting from the import structure, a spurt in demand and increase in the money supply, accompanied by an artificially stable exchange rate, made competition on the world market increasingly difficult, in spite of the government incentives for exports and increasing protectionist measures against imports. From 1970 to 1975, the relative prices of Mexican products in relation to North American products increased by some 27 per cent.[38] Manufacturing exports consequently rose more slowly than in previous years (see table 19), to which the worldwide recession was a contributing factor.

Table 19. Merchandise export components
(Real average annual growth rates) (%)

	1965-70	1970-75
I. Agriculture	-1.4	-2.6
Cotton	-11.3	-5.6
Coffee	0.7	11.4
Others	2.7	-4.9
II. Minerals	2.6	0.0
III. Hydrocarbon	-14.5	24.9
IV. Manufactured products	14.5	5.4
Sugar	5.2	-14.2
Other manufacturing	18.0	8.5
Total merchandise exports	0.6	2.5

Source. Calculations based on World Bank, 1979, op. cit., table 3.4; World Bank, 1981, op. cit., table 3.4.

As was to be expected from the interaction of the foregoing economic factors, a rapid deterioration in the balance of payments was not long in following. This appeared initially in the trade balance (see table 20). Up to 1975, the net income of the offshore assembly industry, classified as non-factor service income, broadly matched the negative merchandise balance, but this industry reached its limits of growth after 1974 (see table 21).

Net factor service income also deteriorated rapidly, particularly because of increasing interest payments on the public sector foreign debt and the continuing high rates of net investment income transfer, the latter reflecting an increasing speculative capital outflow. One positive element in the net factor service income was, with the increasing number of persons crossing the border to seek employment in the United States, a steady increase in remittances in foreign currency (see table 22).

Table 20. Trade balance components (in million US$)

Year	Merchandise balance	Non-factor services balance	Trade balance
1965	-401.	292.4	-108.6
1967	-601.3	318.3	-283.0
1970	-1 004.4	333.0	-671.4
1974	-3 093.4	1 393.1	-1 700.3
1975	-3 609.3	1054.3	-2 555.0
1977	-1 316.4	1256.5	-59.9

Source. Calculations based on World Bank, 1981, op. cit., pp. 120-121 and table 3.1.

Table 21. Non-factor service balance and offshore assembly industry

Year	Non-factor service balance (million US$ (1)	Offshore assembly industry (million US$) (2)	(2)/1 (%)
1969	387.7	0.0	0.0
1970	333.0	80.9	24.3
1974	1393.1	443.5	31.8
1975	1054.3	454.4	43.1
1976	1009.8	535.7	53.1
1977	1256.5	524.7	41.8

Source. Calculations based on World Bank, 1981, op. cit., p. 120 and table 3.1.

As a consequence, the current account balance worsened (see table 23). The growing capital outflow and the dollarisation[39] of the bank deposits, impelled the government to increase foreign debt in order to finance the current account balance. After more than 20 years of fixed parity of the dollar, in 1976 the government had to accept a floating peso and a resulting devaluation of approximately 80 per cent. It was at this point that the government applied to the International Monetary Fund (IMF) for financial

Table 22. Net factor service income composition

Year	Net factor service income (million US$)	Net interest payments		Net direct investment income (%)	Workers remittances (%)	Total (%)
		Public sector (%)	Other (%)			
1965	-273.3	22.5	24.5	52.8	0.0	100.0
1967	-389.3	30.1	21.8	48.2	0.0	100.0
1970	-451.8	49.3	18.7	59.2	(-)27.2	100.0
1974	-1288.8	54.9	14.8	42.6	(-)12.3	100.0
1975	-1749.4	59.0	13.4	37.6	(-)10.0	100.0
1977	-1961.4	78.6	13.7	20.5	(-)12.8	100.0

Source. Calculations based on World Bank, 1981, op. cit., p. 120 and table 3.1.

Table 23. Current account balance composition

Year	Current account balance (million US$)	Trade balance (%)	Net factor service income (%)	Net transfers (%)	Total
1965	-3755.5	28.9	72.8	(-)1.7	100.0
1967	-651.9	43.4	59.7	(-)3.1	100.0
1970	-1067.9	62.9	42.3	(-)5.2	100.0
1974	-2875.7	59.1	44.8	(-)2.9	100.0
1975	-4181.0	61.1	41.8	(-)2.9	100.0
1977	-1852.8	3.2	105.9	(-)9.1	100.0

Source. Calculations based on World Bank, 1981, op. cit., table 3.1.

assistance, seeking: (i) immediate assistance to replenish official foreign exchange reserves; and (ii) longer term support while it implemented a three-year economic stabilisation plan designed to restore external and internal balance to the economy.[40]

The importance of the IMF agreement was less in terms of the funds obtained than in providing an external guarantee to the private sector and for the lenders among the international banks.[41] The main targets of the stabilisation programme submitted to the IMF were as follows: the Mexican letter of intent stated that public sector deficit had to be reduced from 9.6 per cent of GDP in 1970 to 2.5 per cent in 1979;[42] limits were placed on net public sector foreign borrowing; and a maximum for wage increases was determined, to remain below the general price index. Price stability had to be attained, domestic savings stimulated, and the balance of payments equilibrium restored, especially through the overdevaluation of the peso. At the same time, the IMF also called for less price control and lower control of imports and for credit restrictions.

Increased foreign debt service payments in peso terms (due to the devaluation) and the IMF-agreed restrictions in government expenditure led to an immediate decrease in public investments of 8.7 and 6.0 per cent in 1976 and 1977 respectively, returning to the real level of 1974.[43] Private investments also declined by similar percentages. The most severe austerity years were 1976 and 1977, in which overall economic growth was a mere 2.0 and 3.0 per cent. The construction sector saw the largest contraction, followed by the automobile industry, commerce, footwear and the garment industry. Because of the increasing prices of imported intermediate inputs and the credit restrictions, contraction affected almost all areas of industry.

Employment grew in these two austerity years by about 0.9 million jobs. More than 25 per cent of this growth was, however, concentrated in agriculture and 50 per cent in the other services sector. As these two sectors reveal the highest rates of underemployment, it can be assumed moreover that a significant portion of the new jobs shared this characteristic.[44]

The leading employment generating sectors in previous years, construction and government, did not increase their hiring level in these years of recession, and the same was true of the manufacturing sector, e.g. the automobile industry which shed about 15 per cent of its employees.[45] At the end of 1977 and into 1978, it was estimated that 7 per cent of the EAP was unemployed and 47 per cent worked in conditions of underemployment.[46]

The government estimated that the real minimum wage index had increased at a rate of 1.8 per cent per annum between 1970 and 1975. Minimum wages rose in 1976 by 13 per cent. This was due to government action after devaluation of the peso, when emergency wage increases were decreed. It can be assumed that the increase of the minimum wage over the last five years of the 1970s was fully nullified by the lag between price increases and the yearly minimum wage adjustment; the increase of 1976 was overtaken after only a few months by the effects of the post-devaluation inflation period. The high level of intermediate inputs dependency from abroad at the time of devaluation was directly translated into rising domestic prices, and in 1977 when prices increased by about 20 per cent, wages were only allowed to increase to a ceiling of 10 per cent.

After the devaluation and the austerity policy of the government, the trade balance improved between 1975 and 1977, basically because imports fell in real terms by about 20 per cent, while exports increased at about the same rate. Merchandise exports, however, grew at a lower rate, 16.5 per cent, manufactured products comprising 50 per cent, oil products 30 per cent and agricultural products 20 per cent.[47] The non-factor services, particularly tourism, made the greatest contribution towards stabilising the negative trade balance. A small segment of the enterprises had developed the capacity and flexibility to expand their external markets at a moment when the internal market suffered a contraction and exchange rates were favourable. Production for export was strongly concentrated among a few large firms in each sector, reflecting a framework of intercorporate transfers, in which Mexican subsidiaries provided parent companies, particularly in the United States, with intermediate and finished goods.[48] A large segment of the enterprise universe, however, lacked the capacity to penetrate the external markets. The overall dependency on imported intermediate and capital goods meant that after devaluation and the contraction of home-market purchasing power, a downward spiral was inevitable. This took place in Mexico in 1976-77 and was to be repeated five years later even more markedly.

Notes

1 Comisión Consultiva del Empleo: Programa Nacional de Empleo, 1980/82 (Mexico, 1979). p. 26.

2 "Of the total of 399 US enterprises producing for the local market up to 1968, 88 per cent entered between 1946 and 1968, 18 per cent in the food processing sectors. Roberto Tomasini: La industrialización y el empleo en México (Mexico, 1980), p. 11. "In 1970, 35 per cent of industrial production and 62 per cent of durable consumer good production were controlled by

transnational enterprises." Cesáreo Morales and Gloria Abella: La renovación tecnológica norteamericana y sus consecuencias en los procesos de integración Mexico-Estades Unidos (Mexico, 1984), p. 6.

3 In the case of the automobile industry, the deficit of this branch in terms of balance of merchandise rose at an annual growth rate of 7.4 per cent between 1950 and 1970, and the accumulated deficit of this sector in these years constituted approximately 50 per cent of national balance of merchandise deficit. Ibid., table 2.

4 Comisión Consultiva del Empleo, 1979, op. cit., p. 26.

5 It was estimated that if extinction of small enterprises could have been avoided, industrial employment would be 19 per cent higher in 1965. See, Saùl Trejo Reyes: Industrialización y empleo en México (Mexico, 1973), p. 59.

6 The Economist Intelligence Unit: Mexico, Annual Supplement, 1984 (London, 1984), pp. 64-65.

7 See, Dirección General de Empleo and Proyecto Planificación y Políticas de Empleo (PNUD/OIT): Características de la ocupación informal urbana (Mexico, 1982), table 3, p. 24. The criteria used for identifying the informal status of the labour condition were: one basic criterion: salary below minimum wage level; at least two of the following four elements: (i) no labour contract; (ii) no membership of a trade union; (iii) absence of a determined number of normal social benefits; (iv) lack of access to the national social security medical system.

8 Comisión Consultiva del Empleo, 1979, op. cit., p. 33.

9 Ibid.

10 Wouter van Ginneken: Socio-economic groups and income distribution in Mexico (Geneva, ILO, 1980), p. 17.

11 Ibid., p. 18, table 2.

12 World Bank: Special study of the Mexican economy: Major policy issues and prospects (Washington, DC, 1979), p. 59).

13 "Between 1940 and 1952 the real wage index fell from 127 to 76 (1960=100); although it rose fairly steadily thereafter, it was kept rigidly in line with productivity until the mid-seventies." E.V.K. Fitzgerald: "A note on state capital and industrialisation in Mexico", in Jean Carrière (ed.): Industrialisation and the state in Latin America (Amsterdam, 1979).

14 Dirección General de Empleo and Proyecto Planificación y Políticas de Empleo (PNUD/ILO), 1982, op. cit., p. 14.

15 World Bank: Mexico: Development strategy - Prospects and problems (Washington, DC, 1981), p. 2.

16 Figure calculated on data provided by the World Bank, 1979, op. cit., pp. 50-54.

17 Comisión Consultiva, 1982, op. cit., table II-21.

18 "Many urgent forms of social expenditure (e.g. on primary education, or on urban water supply) had lagged behind demographic developments to an extent that was becoming politically dangerous." Laurence Whitehead: "Mexico from bust to boom: A political evaluation of the 1976-1979 stabilization programme", in World Development, 1980, Vol. 8, p. 847.

19 Calculations based on World Bank, 1979, op. cit., table 5.7.

20 Between 1971 and 1976, private fixed investments rose at an annual growth rate of 4.2 per cent, whereas private sector savings rose at 7.3 per cent. In 1976 the share of private sector investment in GDP was 12.8 per cent and that of private savings 14.5 per cent. See World Bank, 1979, op. cit., p. 43.

21 "The ready availability of Eurocredit for long-term public investment projects must have acted as a temptation to the government, offering as it did the means to expand state activities and implement cherished programmes... " Whitehead, 1980, op. cit., p. 847.

22 "Probably the most conclusive objection to the proposed tax reform is that it would be precipitated such capital flight that the government would have been forced into a devaluation before its internally relegitimising policies had even begun to take effect". Ibid.

23 Calculated on data of World Bank, 1979, op. cit., table 4.6 and World Bank, 1981, op. cit., table 2.1.

24 World Bank: Mexico - Manufacturing sector: Situation, prospects and policies (Washington, DC, 1977), table 1.5.

25 See also Laura E. Palomares: Inversión extranjera y Mexicanización (Mexico, 1984).

26 This is the term in use for industrial units, often close to the United States border, which carry out labour-intensive parts of the production process on behalf of United States manufacturers, often with little or no national intermediate inputs.

27 Based on data of the Sistema de Cuentas Nacionales de Mexico, Secretaria de Programación y Presupuesto, 1981 and 1983, and Comisión Consultiva, 1982, op. cit.

28 It is estimated that the net labour force increase per annum between 1970 and 1975 was in the area of 500,000.

29 See also Tomasini, 1980, op. cit., p. 58.

30 About 65 per cent of public investments was destined for construction activities, whereas in the case of private investments this figure fluctuated between 45 and 54 per cent depending on the economic situation. Excluding house building investments, only 8 per cent of private fixed investments were destined for construction. For public sector investment this figure, however, is similar to its general investment/construction rate of 65 per cent. See L. Mertens: Algunas tendencias actuales en el mercado de trabajo de la construcción en México (Mexico, 1982), p. 10 and table 10.

31 Ibid., pp. 11-13, and table 7.

32 About 40 per cent was generated by direct government employment and by direct and indirect construction activities through public investments. The remaining 10 per cent can be seen as indirect employment generated by purchases of domestic capital and intermediate goods. An application of input-output analysis shows for 1975 that one labour place in construction sector involved 0.43 labour places in other activities of national economy. See L. Mertens: La coyuntura en el sector de construcción en 1982 y las perspectivas para 1983 (Mexico, 1983). p. 10.

33 It can be calculated that if the share of employment generated by government had matched the increase in the share in GDP of government expenditure, about 75 per cent of the real employment increase would have derived from the public sector.

34 Importing intermediary goods was one of the ways of transferring profits out of the country.

35 See World Bank, 1977, op. cit., Annex V, tables 7 and 14.

36 See World Bank: Mexico: Future directions of industrial strategy (Washington, DC, 1983), pp. 11-14.

37 See World Bank, 1983, op. cit., table 3.7.

38 See Olga Esther Torres: Mexico: El sector público, 1970-1981 (Mexico, CEPAL, 1982), annexed table.

39 In February 1976 bank accounts in US dollars were authorised. This created the so-called Mex-dollar, with interest rates in line with the Eurodollar market. Six months later, Mex-dollars deposits were no less than US$1,800 million. See, Antonio Amerlinck Assereto: "Perfil de las crises recientes del sistema financiero Mexicano", in Comercio Exterior, Oct. 1984, p. 963.

40 See Whitehead, 1980, op. cit., p. 843.

41 Whitehead, 1980, op. cit., p. 850. "The amount of financial resources directly provided by the Fund was quite small both in relation to Mexico's balance of payments needs, and to its normally available resources."

42 Ibid., p. 851.

43 See World Bank, 1981, op. cit., tables 2.3 and 2.4.

44 The method of calculation of the Mexican employment figures via production data, implies that, at least to some extent, underemployment is taken into account.

45 See Cuentas Nacionales, 1981, op. cit., table, "Población economicamente activa remunerada".

46 See Comisión Consultiva, 1979, op. cit., p. 33.

47 See World Bank, 1981, op. cit., tables 3.4 and 3.7.

48 Ibid., pp. 51-53.

Chapter 2

The short-lived boom years of 1978-81: Preceding the financial collapse

The recession of 1976-77 would probably have resulted in a period of stagnation had it not been for the expansion in oil production. The large investments of the government in basic goods production, such as iron and steel, petrochemicals, sugar, etc., began to come onstream, but it is doubtful whether these would have triggered off corresponding export development of manufactured products. At the world level there was widespread overcapacity in the basic products sectors; the market of finished goods produced by these inputs was, moreover, highly competitive. It was the expansion in oil production and oil export alone from 1977-78 onwards which produced a boom in export revenues, and perhaps more important, gave fresh confidence to the international financial sector, which was seeking outlets for the surplus of petro-dollars.

The high price commanded by oil on the world market restored the government's confidence in the viability of continuing the development strategy started in the 1970s which could be considered as a combination of import substitution and export orientation industrialisation. The leading role in the orientation of the development process would be taken by the government.

In addition to the imbalances mentioned in the first chapter which could be corrected only to a small extent in the foregoing years, at least two additional critical elements had to be considered. First, the worsening of the state of under-production in basic food stuffs. This meant not only a loss of foreign exchange, but also extra costs arising from the importation of basic foods, e.g. differences between internal and external prices (particularly when the peso was sub-valued), transportation, storage and distribution. Moreover, because one of the traditional methods of keeping wages low without severely affecting the purchasing power of the population was by providing cheap basic foodstuffs to the population, mainly through the production and distribution organisation CONASUPO. The emerging deficits had to be covered by current government transfers. Second, the expanded foreign debt and the corresponding interest and amortisation obligations, had become a growing part of current government expenditure. Both elements implied an increasing pressure on public sector savings, and consequently, on public investments, one of the main instruments of government policy. Oil revenues, however, were seen as the mainstay of the overall transformation process of the national economy over the coming decades. The deficiencies in the production structure would be overcome and it was hoped that in the medium term the export of manufactured goods would take the place of hydrocarbon products as the main foreign currency producing sector.[1] High economic growth levels would be able to improve significantly the work and living conditions of the population.

Until 1979, general government spending policy was constrained by the three-year stabilisation programme, approved by the IMF.[2] Oil prospects apparently led to a certain loosening of the economic parameters of the programme, with the exception of wage increases; moreover after 1977 the economy entered a period of "oil boom". Whereas until 1979 current expenditure was kept within GDP growth, capital expenditure and particularly investments in oil exploration, rose about 3 percentage points of GDP. At the same time, however, the special policies for agriculture, health services and basic food supply, had suffered cuts.

It was in the years from 1979 onwards that the main part of the increase in the government expenditure share of GDP took place (see table 24), from 31 per cent in 1977 to 42 per cent in 1981. In those years, apart from ongoing public investment programmes, current expenditure also rose by 4.5 per cent, particularly in interest payments and transfers (including the "other operating expenditures"). As part of its efforts to correct the imbalances in economic performance, the government tended increasingly towards a policy of subsidies. The World Bank estimated that these subsidies and incentives totaled about 14 per cent of GDP in 1981 and 34 per cent of total government expenditure.[3]

On the revenue side, until 1979, growing petroleum income was able to finance the investment programmes. Afterwards, when extended support programmes were once again established for agricultural, industrial and social sectors, and current savings had declined significantly, domestic and foreign borrowing had to finance the growing investment expenditures. Thus, between

Table 24. Public sector income and expenditure (% of GDP)

	1977	1979	1981
Total revenue	24.20	26.30	27.70
Petroleum	3.70	5.60	7.60
Income tax	5.10	5.60	5.80
Indirect taxes	3.70	3.90	4.00
Revenue of enterprises	8.40	8.40	7.60
Total expenditure	31.10	33.10	42.50
Current expenditure	21.80	22.00	26.70
- Wages and salaries	8.10	7.70	7.60
- Interest payments	3.10	3.40	5.20
- Current transfers	3.30	3.80	4.90
- Other operating expenditures	7.30	7.10	9.10
Capital expenditure	7.40	10.00	14.00
Miscellaneous expenditure	1.90	1.10	2.10
Current savings	0.65	2.65	(-)0.82
Deficit	6.90	6.80	14.80
- Domestic financing	3.60	2.40	7.50
- External financing	3.30	4.40	7.30

Source. World Bank: Mexico: Recent economic developments and prospects (Washington, DC, 1984), tables 2 and 5.1.1.

1977 and 1979, it was possible to finance the public investment increase from current savings of the government.[4] The budget deficit, which was reduced to 6.6 per cent of GDP in 1979,[5] was financed by both external and domestic funds, the latter being increased by a growing capital flow to Mexico due to high interest rates.[6] After 1979, however, the current savings of government quickly dwindled, reaching in 1981 a negative 0.8 per cent of GDP (see table 24). Current expenditures in transfers and interest payments accelerated, whereas current revenues remained substantially unchanged. The government budget deficit grew to 14.5 per cent of GDP in 1981; this was financed to a large extent by foreign borrowing, particularly by short-term credits (see table 25). The short-term foreign credits proved very attractive to the public and particularly to the private sector. In the two years 1980-81, the private sector doubled its outstanding foreign debt. This can be explained mainly by two factors. The first was the lower interest rate at that time for foreign borrowings. The second can be seen as a consequence of the 1973 law on foreign investments, where the arrangements which permitted reimbursing manufacturing corporations for transfer of technology enabled the foreign holding companies with Mexican shareholdings to receive large payments which had to be financed in Mexico.[7] To liquidate these obligations, the enterprises sought foreign borrowing. In fact, much of the private foreign debt was in enterprises wholly[8] or partly owned by foreign investors.[9]

Table 25. Foreign debt growth

	In US$'000 million				Composition (%)		Average growth rate 1977-81 (%)
	1977	1979	1980	1981	1977	1981	
Global external debt	29.9	40.8	52.7	75.5	100.0	100.0	26.1
- Public	22.9	29.8	33.8	53.0	76.6	70.2	23.3
- Private	7.0	11.0	18.9	22.5	23.4	29.8	33.9
- Short-term	(nd)	(3.2)	(11.8)	(27.7)	-	(30.0)	-

Sources. Calculations based on PREALC: Beyond the crisis: Lessons and perspectives (Santiago, 1984), table II-1; and CEPAL: Notas para el estudio económico de América Latina y el Caribe, Mexico (Mexico, 1984), table 13.

With growing oil production as the principal accelerating factor, broadly speaking, the government maintained its strategy of integration into the world economy, with cheap energy and bulk-inputs providing the main Mexican competitive advantages, granting rebates of up to 30 per cent of the price.[10] The government began increasingly to assume the role of supplier of these comparative advantages to private industry. As was explained earlier, in some cases the government involved itself in the production process of basic and bulk products, such as iron and steel and basic petrochemicals; in others it supplied cheap inputs for the production of strategic inputs, e.g. in the cement industry, which obtained low energy prices. As part of this strategy, the government started the construction of four large industrial ports, which were to be the "bridge" to international trade, especially for Mexican exports. Newly established industries in these ports would obtain a 30 per cent reduction in energy prices for basic petrochemical inputs.[11]

The leading role of the government in the economic development process was illustrated by the fact that public investment grew significantly faster than private investment with a growth rate of 21 per cent per annum; its share in total national investment climbed to 47 per cent in 1981 (see table 26). The principal destination of the public investments was the expansion of the national state-owned oil company, PEMEX. The investments of PEMEX as a share of public investments rose from 22 per cent in 1976 to 32 per cent in 1979.[12] In absolute terms it represented a US$6,400 million investment for the year 1980 compared with US$1,500 million in 1976.[13] Whereas about 38 per cent of total increase in public investments between 1977 and 1981 were made directly through PEMEX, the true figure is higher, since a large number of infrastructure projects for PEMEX were carried out by other government secretariats, such as the Communication and Transport Ministry. Thus, about 40-50 per cent of public sector investment increase was directed to the petroleum sector.

Table 26. Fixed investments

	Real annual growth rate, 1977-81 (%)	Composition (%)	
		1977	1981
Total investments	16.0	100.0	100.0
Public investments	20.3	39.8	45.6
Private investments	12.9	60.2	54.4

Source. Calculations based on World Bank, 1984, op. cit., tables 2.2.1 and 2.2.2.

Oil production rose from 210 million barrels per year in 1974 to 932 million in 1981, and oil exports from near zero to 400 million barrels in the same period (see table 27). In the 1980s Mexico was to occupy fifth place among oil producing countries.

Table 27. Mexico: Oil production

Year	Reserves (bn-barrels)	Production (million barrels per year)	Exports (million barrels per year)
1970	5.6	157	...
1974	5.8	210	6
1975	6.3	262	34
1978	40.2	443	133
1980	60.1	779	302
1981	72.0	932	401
1982	72.0	1 096	545
1983	72.5	1 070	560
1984	71.8	1 077	556

Sources. Comisión Consultiva, 1982, op. cit., table II-20; CEPAL, 1984, op. cit., table 6; CEPAL: Notas para el estudio económico de América Latina y el Caribe, Mexico (Mexico, 1985), table 7.

Clearly an injection of US$45,000 million over the 1977-81 period was bound to fuel a general economic boom in Mexico. In the considered period, GDP showed an annual growth rate of about 8 per cent (see table 28). Although the agricultural sector had a significantly lower growth level, the 4.3 per cent increase per annum was an improvement over the previous years. It must be said that this improvement was not evenly spread over all the activities which comprise the sector, particularly not the basic need ones. In the case of crops such as beans, maize and wheat, strong fluctuations were registered in the years between 1977 and 1981. At the same time, the growth in production was mainly the result of increasing productivity, while the generation of new jobs was reduced.

Public sector investment in the expansion of the oil industry and in infrastructure for other industries, had a direct effect on the construction sector and national construction enterprises demonstrated the capacity to

Table 28. Employment and productivity growth rates per sector, 1977-81 (%)

Sector	Average annual growth rate GDP	Average annual growth rate employment	Productivity
Agriculture	4.3	1.2	3.1
Mining[1]	16.4	6.6	9.8
Manufacturing	8.7	5.5	3.2
Construction	12.4	12.8	(-)0.4
Commerce	9.0	4.0	5.0
Transport and communications	13.4	9.5	4.0
Other services	7.5	6.4	1.1
Total	8.4	5.1	3.3

1 Includes oil production.

Sources. Calculations based on World Bank, 1981, op. cit., table 2.7; and O. Torres, 1981, op. cit., annexed table.

respond as required.[14] The share of construction in public investment rose from 64 per cent in 1975 to 70 per cent in 1980, whereas this ratio in the case of private investment declined over the same period from 53 per cent to 46 per cent.[15] It was mainly through construction activities that public investment exerted an accelerator effect on the national economy, despite the fact that builders had to import nearly all the required capital goods. Although most of the intermediate inputs were provided by domestic enterprises, the construction boom reached such a pitch that inputs such as cement and steel had at times to be imported to meet the demand.

It is important to note that various sectors grew faster than the manufacturing sector, both in GDP as in productivity terms. This indicates that the manufacturing sector had been less involved in the oil-boom than others, such as construction and commerce. The initial increasing demand for intermediate and capital goods and the lack of production capacity of these goods obliged the government to lower import restrictions,[16] thus running counter to the long-term strategy planned for the sectors in question, and reducing the gains achieved in years before. Generous incentives for establishing industry in Mexico were created by the government to offset the pressure on imports. At the world level in those years an existing overcapacity in many of the required goods hampered the efforts to stimulate investment in import substitution production. On the other hand, the durable consumer goods producing firms continued to enjoy their protected market, providing high profit rates. For example, in the case of the "modern manufacturing" enterprises, it was calculated that effective subsidies, which include nominal protection and all classes of subsidy, rose from 79 per cent to 207 per cent between 1979 and 1981.[17] In other words, if modern industry in 1981 had worked only with external prices, their value added would be reduced to a third of the level it reached with the help of the effective subsidies. This explains the high profit rates obtained (which were increasingly transferred outside the country). An example "par excellence" was the automobile industry, which in an external prices approach would have obtained negative value added.[18] This indicates not only the attractive benefits which the internal Mexican market represented, but also an inputs-wasting production system, or the application of over-valued invoicing of (imported) intermediate inputs. This was combined with low productivity as a result of the lack of process innovation by national and transnational enterprises.

Another element which explains the lower growth rate of the manufacturing industry in comparison with other sectors, was the restricted expansion of the wage-goods producing industry. Whereas employment grew significantly between 1977 and 1981, real minimum wage levels remained below the base level of 1976 (see table 29), in spite of the annual productivity growth rate of 3.3 per cent which the national economy displayed during this period (see table 28). The expansion of the internal market of those products was consequently limited.

Between 1977 and 1981, employment grew by more than 3.5 million jobs, and this meant that, at the very least, unemployment could be reduced in a period of economic boom. It can be estimated that open unemployment diminished from 7.0 per cent in 1977 to 4.5 per cent in 1981, whereas the percentage of the urban labour force which was working in informal activities probably diminished by 2 or 3 percentage points, reaching a rate of 34 per cent. The general tendency, however, of informal sector activities in the service sector never declined substantially. This explains to a large extent the high level of labour force absorption of the service sector, together with fast-growing direct government employment, especially after 1979.

Table 29. Real minimum wages

Year	Average annual real wage index (1976 = 100)	Real wage index December[1] (1976 = 100)
1979	94.4	86.5
1980	88.1	78.4
1981	90.2	79.7

1 Wages were adjusted each year on 1 January.

Source. CEPAL, 1984, op. cit., table 16.

As in the early 1970s, employment development in the construction sector calls for attention.

The construction industry was working increasingly for government. Whereas in 1976, 44 per cent of construction activities were generated by the public sector, in 1980 this figure rose to 58 per cent.[19] In relative and absolute terms, employment in the construction sector increased more than in any other branch. Between 1977 and 1981 employment in this sector grew by 13 per cent a year; in absolute terms this corresponds to an increase of about 600,000 persons.[20] Of these 600,000 new jobs, approximately 83 per cent were generated by public investments.[21]

Apart from the construction sector, it was the "other services" sector which absorbed the main part of the labour force between 1977 and 1981. Nearly 40 per cent of new employment was generated by this sector (see table 30) - about 15 per cent attributable to direct government employment. Within the manufacturing sector, final consumption goods producing branches such as automobiles, electronics and some intermediate input producing sectors absorbed most of new employment. Employment in traditional branches, however, increased more slowly, due to the introduction of new technologies, and the low income elasticity of the produced goods. The oil boom produced a dramatic growth of middle and high incomes, reflected, for example, by a fast-increasing demand for automobiles. On the other hand, the higher income elasticity of the poor segment of the population in relation to basic goods, could not be completely exploited since the real income growth of this segment had been limited.

Table 30. Employment growth and labour force absorption, 1977-81

	Average annual growth rates (%)	Labour force absorption (%)	Employment structure 1981
Total	5.1	3:577.000 = (100.0)	100.0
Agriculture	1.2	7.2	25.9
Mining	6.6	1.6	1.3
Manufacturing	5.5	13.8	13.0
Construction	12.8	20.1	9.5
Commerce	4.0	11.2	13.8
Transport and communications	9.5	8.1	4.8
Other services	6.4	38.0	31.4
(Government)	(10.8)	(15.4)	

Source. Calculations based on Cuentas Nacionales, 1981-83, op. cit.

In summary, it can be estimated that about 55-60 per cent of new employment was due to increasing government expenditures.[22] Indirectly, a large part was financed by external borrowing. Taking into consideration that the level of new employment growth was just enough to absorb the increasing new labour force and to reduce open unemployment, this means that the capacity for employment generation of the economic system is weak.

The economic structure was not capable of coping with such an enormous financial impulse and obtaining all the possible benefits from it. In particular, the production of capital and intermediate goods was too weak. The result was increasing imports, stronger inflation and other forms of non-productive use of the financial resouces that were available to the country at that moment. Whereas small and micro enterprises received a general push from the economic boom, a really solid base for further high-growth industrialisation had not been created; and this would have its consequences in the 1980s when the boom reached its limits.

The expansion of oil production and the surge of demand entailed a large increase of merchandise imports (table 31). The import of intermediate and capital goods constituted in 1981 about 84 per cent of total merchandise imports. The import of consumer goods also revealed a very high growth rate, not only in basic foodstuffs but especially in other consumer products. This can be considered the result of external market-oriented demand of the growing incomes in the middle and upper class segments of the society. In the case of intermediary goods, the participation of automobile and electronic parts and components was quite significant (about 20 per cent). In terms of the merchandise trade balance, the deficits shown in these branches in 1980-81 constituted about 75 per cent of total merchandise deficits.[23] Thus, the liberal policy of incentives and subsidies to these sectors did not lead to the desired results of national integration.

Table 31. Imports components, 1977-81

	1977-81 Average annual growth rate on current US$ base (%)	1981 Structure
Total	41.9	100.0
Consumption goods	47.6	15.4
Food	39.7	(7.5)
Others	57.8	(7.8)
Intermediary goods	45.2	52.7
Automobile and electronic components		(15.8)
Capital goods	41.0	31.5

Sources. Calculations based on World Bank, 1981, op. cit., table 3.5; CEPAL, 1984, op. cit., table 11; and Morales, op. cit., tables 3 and 9.

The export structure was completely dominated by hydrocarbon products which constituted, in 1981, 72 per cent of total exports (see table 32). The low level of growth of non-oil products was to a large extent the result of the fact that the internal market proved much more attractive than the external. Whereas the external market was highly competitive and revealed serious signs of contraction, the internal market was growing very fast and remained protected. Moreover, the substantially higher inflation levels in Mexico in relation to its main trading partners, particularly the United States, and a more or less constant exchange rate between 1977 and 1981, implied an overvaluation of the national currency which in 1981 was estimated at 20 per cent.[24] This also made the exportation of non-hydrocarbon production more difficult. The strategy of integration in the world economy by increasing manufacturing exports at least at that moment was stalled by the oil boom wave, which returned the country to a raw-material exporting status, highly dependent on the fluctuating world price in raw materials.

Table 32. Merchandise export components, 1977-81

	1977-81 Average annual growth rate on current US$ base (%)	1981 Structure
Total	44.3	100.0
Hydrocarbon products	93.5	72.4
Non-petroleum products	11.4	27.5

Sources. Calculations based on World Bank, 1981, op. cit., table 3.2; and CEPAL, 1984, op. cit., table 10.

For the current account balance, although the deficit in the trade balance was important, the deficits in net factor incomes were much more significant (see table 33). In 1980 and 1981, the deficits on the current account balance increased by US$8,000 million and US$14,000 million respectively. The increasing payments on foreign borrowing were the main factor. But transfer of investment income (or profits) also increased substantially, which included payments of the private and public sector enterprises to their foreign partners (see table 34).

Table 33. Current account balance composition, 1977-81

Year	Current account balance (million US$)	Trade balance (%)	Net factor service income (%)		Net transfers (%)	Total
			Total	Interest		
1977	-1 853	3.2	105.9	(97.8)	(-)9.1	100.0
1978	-3 259	18.2	85.0	(66.6)	(-)3.2	100.0
1980	-8 306	26.8	74.7	(53.6)	(-)1.6	100.0
1981	-14 075	33.1	67.7	(49.7)	(-)0.8	100.0

Sources. Calculations based on World Bank, 1981, op. cit., table 3.1; and CEPAL, 1984, op. cit., table 12.

Table 34. Net factor service income composition, 1977-81

Year	Net factor service income (million US$)	Net interest payments (%)	Net direct investment income (%)	Work and property (%)	Total
1978	-2 771	78.3	24.4	(-)2.7	100.0
1979	-4 108	73.3	23.0	3.6	100.0
1980	-6 209	71.7	22.3	5.9	100.0
1981	-9 531	73.4	19.9	6.6	100.0

Sources. Calculations based on CEPAL, 1984, op. cit., table 12.

Until 1981 the shortage on the current account balance was covered by foreign borrowing; high interest rates contributed to attracting foreign capital flows. The overvaluation of the currency, the enormous growth in foreign debt in 1980-81, the fall in international oil prices and the threat of rising international interest rates were factors which resulted in a dollarisation of the economy, substituting the national currency. The dollarisation of financial transactions was used as a measure to avoid capital flight and at the end of 1981, the deposits in US dollars at banks in

Mexico reached the record level of US$13,000 million.[25] The pressure on the national currency became steadily stronger, and capital flight increased. In the next chapter the financial collapse of 1982 will be described with regard to the consequences for the employment situation in the near future.

Notes

1 See, Secretaria de Patrimonio y Fomento Industrial (SEPAFIN): Plan nactional de desarrollo industrial, 1979-82 (Mexico, 1979), pp. 20-21.

2 The IMF provided Mexico with a facility of US$550 million in 1976. In October 1979, the IMF agreed that Mexico had reached the objectives of its economic reactivation programme and wound up the three-year agreement. See, Uno Más Uno (Mexico City), 2 October 1979.

3 World Bank, 1983, op. cit., table 3.1

4 The increase of the value added tax and petroleum revenues were important contributing factors.

5 See World Bank, 1981, op. cit., table 5.2.

6 The policy of the stable exchange rate and the considerable higher inflation level in Mexico in comparison with, e.g. the United States implied higher interest rates in Mexico, which were an attraction to foreign capital.

7 See also Palomares, 1984, op. cit.

8 Exceptions were permitted to the 1973 law requiring Mexican part-ownership of corporations.

9 See also, World Bank, 1979, op. cit., table 4.8. Though the data that 73 per cent of foreign private debt was localised in enterprises totally or partially owned by foreign investors correspond to 1975, here it is assumed that in the later years this relation did not change in a significant way.

10 See, SEPAFIN, 1979, op. cit., p. 179.

11 Ibid.

12 See World Bank, 1981, op. cit., tables 5.6 and 2.1.

13 See World Bank, 1983, op. cit., table 3.10.

14 If national enterprises were unable to execute a job they sometimes subcontracted to foreign enterprises. See Mertens, 1982, op. cit.

15 See L. Mertens: El mercade de trabajo de la construcción en México y la recessión actual (Mexico, 1982), tables 5 and 6.

16 From 1977 to 1980, import licences and quotas were replaced by tariffs; from 1981 to 1982, import tariffs were reduced and applied more selectively. See Terry Barker and Nadimiro Brailovsky: "La política económica entre 1976 y 1982 y el Plan Nacional de Desarrollo Industrial", in Investigación Económica (Mexico), Oct.-Dec. 1983, pp. 279.

17 See, Instituto Mexicano de Comercio Exterior (IMCE): La protección efectiva en Mexico, 1979-1983 (Resumen) (Mexico, 1984), table 10.

18 Ibid., p. 25.

19 See, World Bank, 1984, op. cit., table 2.3.2.

20 Calculations based on Sistema Cuentas Nacionales de México, 1981-83, op. cit.

21 Calculations based on World Bank, 1984, op. cit., tab.e 2.3.2.

22 About 45 per cent was the result of direct government employment and direct and indirect employment generated by expenditure in constructing investments; 10-15 per cent can be seen as indirect employment from other expenditures.

23 Morales and Abella, 1984, op. cit., tables 2 and 9.

24 See CEPAL, 1984, op. cit., table 17.

25 Añtonio Amerlinck Assereto, 1984, op. cit., p. 964.

Chapter 3

Stabilisation policy and employment perspectives in the 1980s

1. Foreign debt crisis and stabilisation strategy: The interruption of the employment growth pattern

In the light of the emerging oil boom of the late 1970s an ambitious industrial development plan was elaborated. Important government investments and a gamut of policy instruments towards the private sector were established in order to correct the imbalances in economic and social structure: fiscal incentives, low energy and other basic intermediate input prices, research and development in technology.[1] This plan, however, instead of anticipating and orienting the oil boom, was launched at a moment when this had already begun to follow its own course, diverging from the trajectory designed by the plan. Supported by vast external financing, an enormous demand push was generated by the oil boom which exceeded by far the production capacity. In spite of government efforts in the early 1970s to correct the economic performance, particularly as concerned the production of capital and intermediate goods, it was insufficient to cope with the oil boom "fever". For example, there was scarcely any national production of capital goods used in the oil-exploiting industry. In order to increase oil production, the main part of the necessary equipment and machinery had to be imported. The foreign trade policy corresponded to this situation, with nearly tariff-free import possibilities for capital and intermediate goods. Taking into consideration the then-existing overcapacity at the international level of most of the needed inputs and capital goods, domestic production increase of those products was very limited. In fact, it can be assumed that the consumer goods producing industry, particularly durables, received the most government support. Protected by import tariffs and restrictions and receiving at the same time fiscal incentives, low energy prices, etc., these industries together with construction and trade corporations, attained high profit margins, which were only partially reinvested. The fast-growing internal demand for (durable) consumer goods did not cause great interest in exploring external markets.

In this context it proved impossible to improve in a structural way the economic and social imbalances accumulated in the preceding decades. Some of these were mentioned in the foregoing chapters: the lack of vertical integration of the national production apparatus and the absence of micro and small enterprise participation in the economic development process; a non-existent indigenous technology capacity, which should constitute the base of the economic integration process and of the support strategy to micro enterprises (moreover, in view of the forthcoming technological revolution, the indigenous capacity for technology development is assuming more strategic importance). The expanding situation of un- and underemployment; the unequal income distribution structure; the growing deficits in internal food supply; the increasing foreign debt and the accompanying debt service payments.

Whereas the national policy-makers had projected a GDP growth rate of 9 to 10 per cent a year up to the 1990s,[2] with corresponding employment growth levels of 5 to 6 per cent, the first signs of what would result in the worst financial and economic collapse during the last four decades, became visible in mid-1981. The biggest national enterprise, "Grupo Alfa", which had prospered under the 1973 law on foreign investments and which has to be considered one of the most important joint-venture conglomerates of foreign and domestic capital,[3] declared itself unable to fulfil its external financial obligations. The government intervened with support credit of about $750 million. Other important private enterprise groups soon followed with similar problems, and most of them had the characteristic of being associated with foreign enterprises. The government refinanced these support credits in large part with external, short-term borrowing. In fact, as was stated in a recent World Bank study, during 1981 and 1982,

> the private current deficit was combined with very large capital outflows, making the public sector provide the required foreign exchange. Since public sector account had only a relatively small surplus in those two years, large foreign borrowing ($27 billion net), much of it short-term, had to be incurred by the government to finance the private sector needs.[4]

An important factor in the capital outflows was played by capital flight.

> If the foreign loans that were contracted could be shown to be matched by productive assets, the external debt problem could be interpreted as a liquidity problem. ... capital goods imports were only a small proportion of public foreign borrowing, thus suggesting a large part of the borrowing was not directly related to investment. More significantly, foreign borrowing exceeded by a

> considerable margin total public sector imports. In any case, the great bulk of the short-term borrowing during 1981 and 1982 was dictated by the capital flight, suggesting that public sector foreign liabilities are matched to some extent by private sector foreign assets.[5]

In this way fast-growing foreign short-term debt and the expanding deficit on current account balance, combined with the other mentioned factors of decreasing oil prices, rising interest rates, overvaluation of national currency, increasing capital flight and dollarisation of internal financial transactions, led to a situation in which the Central Bank was unable to support the national currency. The Central Bank had to accept various succeeding devaluations reaching about 260 per cent in the first half of 1982, and 600 per cent in the first months of 1983, all figures in relation to the exchange rate at the end of 1981.

The option of further foreign borrowing was nearly closed. The only way out for the government to finance increasing support credits to private and public enterprises and to meet the exploding debt service payments[6] caused by devaluation and rising interest rates, was to cut all other expenditures, particularly investments. The latter depended to a large extent on foreign borrowing. In spite of the cut in most of the expenditure categories which were not related to debt service payments, the government's financial deficit increased to 17.6 per cent in 1982.[7] This deficit had to be financed mainly by domestic borrowing and in that year nearly all net domestic credit creation, which grew by about 200 per cent went to the public sector.[8] The remainder was covered by a relatively small increase in foreign debt.

In spite of the devaluation of the peso and some stabilisation measures, which should have restored the financial health of the public sector through diminishing expenditures and increasing revenues by rising public service prices, loss of confidence in the financial and economic system persisted. This not least because of the exploding inflation rate, which reduced in a short time the relative advantages reached by the preceding devaluation. In the first half of 1982, the dollarisation of the bank deposits reached its limit of US$13,500 million and an accelerating capital flight took place. The bank system could not respond to the growing withdrawals of foreign currency deposits, and the government decided to cancel the dollar accounts inside the national territory and, in fact, converted the deposits into Mexican pesos.[9] This meant an important support for the national bank system, that otherwise would have confronted even greater liquidity problems. At the same time, problems arose between the government and the private bank system, and it was supposed that the control over the Mexicanised-dollars and the role of the private banks in the capital flight, were the main issues in the struggle. But there was also the fact that the principal bankers tried to dictate loan conditions to the government, at a moment when the latter needed the financial support of these institutions in order to cover its deficits. Undoubtedly there must have existed other elements as well resulting in the government's decision to nationalise the banking system in September 1982.

For the international financial institutions the nationalisation represented less of a concern. The Mexican State as institution would cover all the risks, implying an important guarantee on the outstanding loans, especially since several banks had confronted serious liquidity problems.[10] The nationalisation of the banks afterwards proved advantageous when foreign debt had to be renegotiated and special support programmes to private enterprises co-ordinated and effectuated, particularly because the banks had a participation in almost all important domestic enterprises, a phenomenon which had increased substantially after the law on foreign investment of 1973.[11]

The nationalisation of the banking system, the frozen Mex-dollars and the general foreign exchange control gave the government a short "breather", but the financial requirements for paying the short-term credits and for guaranteeing the import of necessary intermediate inputs and of basic foodstuffs were so high (more than US$20,000 million was short-term borrowing), that more foreign borrowing was necessary. Mexico, however, had lost credit worthiness in the international finance system so new loans had to be contracted in very unfavourable conditions.[12] In order to renegotiate the foreign debt structure and to have access to additional loans, the Mexican Government started discussions with the IMF to establish an agreement, and in the meantime, asked for a 90-day moratorium on the principal of the state-sector debt.

Previously, the government had begun a programme of economic adjustment, which was readapted several times to respond to changing situations. The two basic objectives which had been formulated in this programme were the reduction of the deficit of the current account balance and the deficit of government finances.[13] The first was to be obtained through a drastic reduction in the trade deficit, in view of the fact that the factor service income deficit was a nearly unchangeable variable. The target was fixed so that in order to reduce the current account balance, by US$3-4,000 million, merchandise and non-factor services imports had to be cut by US$6,000 million,[14] while it was supposed that the exports of these categories would decline by US$2,000 million, particularly the non-oil exports (the oil exports would be increased). Both public and private sectors were to reduce imports by US$3,000 million each.

The second objective was to be reached by a reduction in public expenditure of 8 per cent (particularly in the programmable expenditure categories which include a large part of public investment) and an increase in public utility prices, such as gasoline, electricity, etc., in order to reach a reduction of 3 per cent in the budget deficit in relation to the GDP. In addition, a limit of US$11,000 million was established for net increase of public foreign debt.

In order to establish an orientation for the reductions in government expenditures and importations, it was necessary to define the national priorities in light of the scarce availability of foreign currency. The main priorities were the external private and public debt obligations and the import of such indispensable goods as foodstuffs, some intermediate goods and certain capital goods.[15] The income from oil exports and the additional foreign public debt would be channeled to these areas.

As part of the adjustment programme a support programme was announced for enterprises with liquidity problems. It consisted basically of funds for preferential credits, and a tax deduction of 50 per cent for new investments. In addition, a deduction was given on personal income taxes along with an emergency salary increase of 30 per cent after the first devaluation in order to protect the buying power of the working class.

On various occasions the programme was adjusted to cope with problems in the financial situation of the country. One of the basic objectives, the reduction in the government budget deficit by 3 per cent of GDP, could not be reached. On the contrary, in 1982 the overall budget deficit of the government rose to 17.6 per cent, in spite of the reduction in the expenditures of 8 per cent as announced in the adjustment programme. This was due to a stagnation in current income growth since support programmes for enterprises consisted mainly of fiscal incentives and deductions, and because the general economic contraction reduced tax incomes. On the other side, current expenditure on interest payments on foreign debt increased, particularly after several devaluations.[16] An overall devaluation of about 400 per cent, rising government services prices and an oligopolistic price setting structure in the private sector (with strong expectations of future price increases) were the contributory factors which caused an increase in the inflation rate from nearly 30 per cent in 1981 to 100 per cent in 1982.

The government presented the adapted programme as the framework for the negotiations which started in the second half of 1982 with the IMF,[17] with the purpose of gaining access to US$3,840 million from the Extended Fund Facility and to improve the renegotiation possibilities on the outstanding debt with the international banks. The stabilisation programme which was finally agreed on with the IMF consisted basically of the following points:[18]

1. the reduction of the public sector financial deficit as a proportion of GDP to 8.5 per cent in 1983, 5.5 per cent in 1984 and 3.5 per cent in 1985;

2. a limit of US$5,000 million for the increase of net foreign debt of the public sector in 1983, which should be reduced in subsequent years;

3. the reduction in the budget deficit was to be reached by (1) increasing government current savings, which implied (a) rationalisation and austerity in current expenditure, especially in transfers and subsidies; (b) an increase of government service prices and tariffs in accordance with the general inflation level; and (c) modification of the direct tax system and increase of indirect taxes; and (2) public investment programmes were to be evaluated in their priorities and, as a function of this, a reduction carried out in investment expenditure;

4. in the direct monetary sphere, the money supply was to be controlled in order to reduce inflation; interest rates should be attractive for the saver with the purpose of increasing internal savings (and to avoid capital flight);

5. the evolution of salaries was to correspond to the aims of employment and their increase will depend upon the productivity achieved by the productive apparatus;

6. price policy would be carried out flexibly and subsidies to production and consumers would be rationalised;

7. the policy towards the external exchange market would make the exports of goods and services more competitive;

8. the system of protectionism in relation to foreign trade and export incentives would have to be rationalised in order to avoid the oligopolistic profit rates which protection had made possible in recent years.

The general requirements in the agreed stabilisation programme with the IMF were translated into a 10-point "Programme for the Immediate Reordering of the Economy" (PIRE), announced by the new government administration, which began to operate in December 1982. Its outline was as follows:

"- A cut in growth of public spending and an austerity budget which will merely 'maintain public services at an essential minimum'.

- Protection of employment. Job-creation programmes in depressed areas. Investments channeled into labour- rather than capital-intensive projects. Priority access to credits and foreign currency for firms that maintain or increase employment. Workers and bosses to be asked for 'moderation' in wages and profits. Price controls on a basket of basic consumer goods to protect working-class living standards. Other subsidies to be diverted to this end.

- Investment to be stepped up in productive, priority projects already underway. In other cases, investment to be cut back or eliminated.

- New norms to improve discipline and honesty in public spending.

- Protection of programmes that bring basic foodstuffs to the needy. Measures to fight speculation. Rationalisation of state intervention to make sure resources are used by sectors for which they are intended.

- Increase in public-sector earnings and fiscal reforms to bring in more revenue. An increase in the prices of public-sector goods and services, particularly those used by higher-income groups.

- Credit to be channeled only to productive ends. The bank nationalisation is 'irreversible', but it should belong to the people, not to a new minority of leaders. Bank resources not to be used to further political ambitions or line the pockets of their managers. Interest rates to attract savers, and efficiency in banking to keep down the costs of credit.

- The return of the exchange market to the sovereignty and monetary authority of the state. The exchange control system to be 'realistic and functional'. Irrational subsidies to be eliminated, and strict import controls maintained.

- Restructuring of the federal public administration to make it more efficient.

- Constitutional reforms to clarify the ground rules for the mixed economy, strengthen the role of the state and enshrine a democratic planning system."[19]

The PIRE, being a short-term programme, is inserted into a general development plan that aims to obtain structural changes in economy and society in order to improve the imbalances which, up to then could not be corrected: un- and underemployment; unequal income distribution; lack of backward integration of production and in relation to this the insufficient domestic production of intermediate and capital goods; low level of export of manufactured goods; lack in production of basic food and services like potable water, etc.

It was clear, however, that it would be nearly impossible to develop a strategy which, in practice could be consistent with the correction of each of the existing imbalances. In the light of the financial situation, we may assume that priority was given to the IMF requirements. The agreed upon stabilisation programme was established for a period of three years. The IMF loan of US$3,800 million would be given in four instalments, which were conditional on Mexico meeting the policy targets set by the IMF.[20] After the agreement, new foreign loans from other international institutions to the Mexican Government were given in installments, in direct relation to the IMF disbursements. If the IMF would not effect the installment disbursement, they would suspend their part also. So, the Mexican Government was obliged to fulfil the determined targets, otherwise it would have to declare itself bankrupt.

In concrete terms, the stabilisation programme involved the following measures. The first policy was to maintain a structural undervaluation of the peso in relation to the US dollar (see table 35). A dual exchange system was established with a controlled rate for financing the import of most of the inputs needed for production and the free exchange rate for the remaining transactions. Both, however, were official exchange rates; the former remaining at a lower level than the latter, and in fact the free rate was restricted and regulated by the Central Bank. A daily "slide" in the devaluation was necessary to maintain the currency in a favourable position to the US dollar. Another stabilisation measure was the abandonment of price controls over more than 5,000 goods and their reduction over another 300. The latter, however, rose in almost the same proportion as the others, because government subsidies had fallen. At the same time, prices and tariffs of government services rose faster than the expected inflation rate.

Table 35. Evolution of foreign exchange rates and prices

Year	Exchange rate (peso per US$)		Wholesale price index		22.77x(3/4)	Under- or over-valuation of peso currency	
	Free	Controlled	Mexico	EEUU		Free	Controlled
	(1)	(2)	(3)	(4)	(5)	(1/5)	(2/5)
1978	22.77		100.0	100.0	22.77	100.0	
1979	22.80		118.3	112.6	23.92	45.3	
1980	22.95		147.2	128.4	26.10	87.9	
1981	24.51		183.3	140.2	29.77	82.3	
1982	57.18		286.1	143.0	45.56	125.5	
1983	150.29	120.17	593.2	144.8	93.28	161.1	128.8
1984	185.19	167.77	1 010.4	148.3	155.14	119.4	108.1

Source. CEPAL, 1985, op. cit., table 20.

Interest rates in bank deposits were moved upwards to a level which would imply a real benefit for the saver (after inflation) and avoid capital flight. The resulting interest rate, however, was too high for the then prevailing economic situation. The total outstanding credit of the bank system consequently declined by 20 per cent[21] in real terms in 1983, a tendency which continued and strengthened in 1984.

The economic logic behind these measures was to stimulate exports and diminish imports, producing a surplus in the trade balance which would be necessary for paying the foreign debt services. The reduction of the subsidies on consumer goods and increasing prices and tariffs should have led to a better current account in government finances. But each of these policies caused a push in the inflation dynamic (cost-inflation), and so had to be corrected by other measures. For example, the money supply was kept significantly below the increase of GDP at current prices and showed a contraction of 25 per cent in real terms in 1983 while it stayed nearly constant in 1984.[22] A minimum wage increase far below the inflation rate was another policy applied to counterbalance the cost-push the other measures were causing. In 1984 it was calculated that real minimum wages had fallen 38 per cent below the 1976 level.[23] Finally, the public sector financial deficit had to be reduced drastically (down to 3.5 per cent of GDP in 1985).

In the sphere of socio-economic relationships and power-group structure, important measures were also taken. The "old" owners of the nationalised banks were indemnified. Afterwards, in order to compensate the indemnification costs and to obtain extra revenues, the government began to sell nearly all the stocks of private enterprises which were the property of the banks and, in addition, offered shares of the nationalised banks to the public. In order to stimulate the economy, and especially exports, the regulation of foreign investments was made less strict, authorising foreign ownership of companies in Mexico up to 100 per cent, fulfilling certain requisites, as, for example, the criterion of lack of capacity by Mexican enterprises to manufacture the products foreign companies planned to produce in the country.[24]

The principal objective of all these measures ultimately was the reduction of the public sector financial deficit and a surplus in the trade balance, enough to pay the foreign debt services obligations of the country. The reduction of the public sector deficit in the proportions the IMF had required seems to have been one of the main stumbling blocks in the negotiation.[25] But the final agreed upon reduction scheme in public sector deficit in the three years of the stabilisation period and the amount of the necessary surplus in trade balance, depended not only upon domestic policy measures. On the contrary, it turned out that domestic policies had to correct more and more the consequences of the movement of (principally) three international economic variables.

The first variable was the international oil price. As more than 70 per cent of Mexican exports and 33 per cent of public sector revenue depended on the income from oil sales, decreases in the oil price immediately affected the financial situation of the country. For example, assuming a constant export volume, an oil price decline of US$1 per barrel meant a reduction of foreign currency income of about US$500 million per year. The second variable was the international interest rate (prime-and-libor rate). Since more than 80 per cent of foreign debt was contracted under fluctuating interest rates, this would have an important impact on the foreign debt service payments. It was calculated that a 1 percentage point variation in international interest rates corresponded to an amount of US$571 million annually which the country would save or have to pay according to the direction of the variation.[26] Last, but not least, the rescheduling negotiation results which were obtained in relation to the short and medium-term foreign debt and, in addition, the degree of success in bettering the debt service conditions for Mexico (e.g. grace period, commission, percentage over libor or prime rate) could be considered as the key variable, under which the results of the other variables were judged. After the last rescheduling of the foreign debt structure in March 1985, a new scheme was reached of yearly increasing service payments (see table 35). In 1983 and 1984 the scheme still had the support of new public sector foreign borrowing, which according to the IMF agreement, had to be reduced in the following years. This meant in fact, that the surplus on the trade balance should be sufficient to cover the needed foreign currency in order to pay the debt services. It was estimated that between 45 and 50 per cent of export-income would be available for this purpose in the following years. The basis for this estimate was the supposition that real exports would increase more than imports, particularly because the peso would be kept undervalued whereas the internal market would remain in a state of contraction. Both factors were expected to stimulate the export of non-oil products, including non-factor services income from tourism and offshore assembly activities. Thus, in fact, the surplus in the trade balance reached in 1983, the year of major economic decline, was taken as a base which, it was supposed, would be reached in the coming years.

Table 35. Projected service payments on external debt, April 1985 (US$ '000 million)

Year	Total debt service	Interest payments	Amortisation
1983	12.9	10.4	2.5
1984	16.4	11.9	4.5
1985	14.4	9.8	4.6
1986	15.2	15.0	0.2
1987	16.2	9.7	6.5
1988	19.7	15.6	4.1
1989	21.5	15.5	6.0
1990	23.2	15.9	7.3

Sources. Calculations based on CEPAL, 1985, op. cit., table 14; World Bank, 1984, op. cit., table 11; "El mercado de valores", 1984, 15 abril, op. cit., tables 1 and 13.

The dynamic and the correlation of the principal national and international economic variables demonstrated the expected trade surplus to be overly ambitious. It became clear that it was impossible to combine, at least in the short term, a satisfactory economic growth which would be able to absorb the yearly growth of the labour force, with the determined amounts of foreign debt services payments. International oil prices, which had begun a declining tendency from mid-1981 onwards, reached particularly low levels in the first six months of 1985. In that last half year, reduction in oil export volume and prices signified a loss of about US$1,700 million in foreign currency income for the whole of 1985, which would only to a certain extent (about US$1,000 million) be compensated by the falling international interest rates and the consequently lower foreign debt service payments.[27] As a result, the surplus of the merchandise balance which both in 1983 and 1984 had reached the considerable sum of US$14,000 million (see table 36), began to diminish from the second half of 1984 onwards. This was originated not only

Table 36. Current account balance, 1981-84 (in US$ '000 million)

	1981	1982	1983	1984
Merchandise exports	19.4	21.2	22.3	24.0
- Petroleum	(13.3)	(15.6)	(16.0)	(16.6)
- Non-petroleum	(6.1)	(5.6)	(6.3)	(7.4)
Non-factor services exports	9.7	6.0	4.9	6.0
- Assembly industry	(1.0)	(0.9)	(0.8)	(1.2)
TOTAL EXPORTS	29.1	27.2	27.2	30.0
Merchandise imports	23.9	14.4	8.6	11.3
- Consumption goods	(2.8)	(1.5)	(0.6)	(0.8)
- Intermediate goods	(13.5)	(8.4)	(5.7)	(7.8)
- Capital goods	(7.6)	(4.5)	(2.2)	(2.8)
Non-factor services imports	10.4	7.4	4.2	5.0
TOTAL IMPORTS	34.3	21.8	12.8	16.3
Trade balance	-5.2	5.4	14.4	13.7
Net factor income	-7.5	-10.6	-9.4	-10.5
- Interest	(-8.3)	(-10.3)	(-10.2)	(-11.9)
NET TRANSFERS	0.2	0.3	0.3	0.8
Current account balance	-12.5	-4.9	5.3	4.0

Sources. World Bank, 1984, op. cit., table 3.1; Banco de México, Informe anual 1984 (Mexico, 1985), tables 17 and 18.

by the decline in demand in the oil market, but also because the merchandise balance deficit (excluding oil products) began to show an enlargement at the same time. The last can be seen as an accompanying factor to the development of an economy which was struggling to recover from the low point to which it had fallen. The general contraction of the economy, the foreign exchange control and import restrictions, meant that in 1983 imports had fallen to a level which was no more than 37 per cent of the total import value in 1981 (in absolute figures this reduction was about US$11,000 million). On the other hand, the contraction of the domestic economy and the undervaluation of the peso had given a boost to the export of non-oil products, particularly in 1983 and 1984. In the latter year the export value of non-oil products had grown by more than 20 per cent in comparison with the level reached in 1981. In absolute terms, however, this percentage corresponded to "only" US$1,500 million, which was no more than a reflection of the oil-dependent export structure, created in the earlier years of the oil boom. It is important to stress that in both processes (declining imports and increasing exports) a similar explanatory variable was involved; the contraction of the domestic economy. Taking into account the high dependence of the Mexican production structure on the importing of intermediate inputs, two main effects could be observed on the trade balance, at the moment when final demand began to grow anew. On the one hand, the imports of intermediate inputs necessary for production increased, particularly the more sophisticated inputs. On the other hand, the export of some basic intermediate inputs which the country started to produce in the 1970s, such as steel, petrochemicals and cement, diminished in order to supply the newly-growing domestic demand.

These two effects on the trade balance as a result of a very weak economic recovery in the latter months of 1984 and early 1985, and in addition some negative exogenous elements, such as growing protectionism applied by some developed countries, implied a worsening of the non-oil merchandise balance, a fact which strengthened the negative effects proved by falling oil prices and demand.

The above-mentioned fluctuation in production and external commerce over 1982-84 provoked a disproportional reaction in the financial sphere. Capital flight, which in fact never disappeared after 1981, intensified and in the first months of 1985 had increased by US$2,000 million.[28] Thus, relatively small modifications in variables determining the balance of trade could not be accomodated by the economic system and, on the contrary, were highly destabilising, not only in the monetary sphere, but also in the real one. The principal reasons for the unstable economic situation were the mandated annual amount of foreign debt service payment. The "payable" amount of foreign debt services corresponded to the trade balance surplus reached at a moment of economic recession. There was no possible margin left for flexibility in the obligatory amount which could be employed if the economic situation should change. In such circumstances, a (small) contraction in trade balance surplus is immediately translated into growing speculation and capital flight, attempts to benefit from imminent currency devaluation. After devaluation, the consequent higher costs of foreign debt service payments in terms of domestic currency, have to be paid through a reduction in other expenditure categories of government, such as investments. In addition, in order to limit the devaluation caused inflation-push, outstanding credit has to be restricted.

It can be concluded that the real and monetary spheres had entered into a strong inter-relationship. On the other hand, it seemed that the only way out of the labyrinth of stagnation was in maintaining the internal demand in a contracted state, while at the same time promoting the export of non-oil products. The latter would find support in the increasing foreign investments entering the country, conditioned by an export-oriented production.

With the purpose of stimulating the export of non-oil products, several programmes and policy strategies had been formulated, from fiscal incentives and credit preferences, to the right to tariff-free merchandise importation of up to 30 per cent of export value.[29] If it is true that the plans and programmes had taken into account all aspects of existing imbalances in socio-economic structure, the hypothesis can be presented that the dominant policy line was to increase as quickly as possible the export of non-oil products. Since up to then the economic agents in international commerce had mainly been the big (multinational) enterprises, it can be supposed that they were, at least in the short term, the principal beneficiaries of these policies.[30]

As was mentioned before, one of the principal points of the IMF agreed upon stabilisation programme was the reduction in the financial deficit of the public sector from about 17 per cent of GDP in 1982 to a projected 3.5 per cent in 1985. The main arguments behind this criterion were: the necessary diminishing of government involvement in the economy in order to give more possibilities to the supposedly more efficient private sector; the reduction of the public sector share in the capital market; and the reduction of inflation by causing a contraction of demand. Complementary, public sector expenditure, especially in investments, would take place on the domestic market, trying in all cases to avoid imports.

Analysing the development of government expenditure from 1981 onwards, a considerable rise can be observed in 1982, reaching the level of 47.8 per cent of GDP (see table 37). This was caused particularly by the sharp increase of

Table 37. Public sector income and expenditure, 1982-85 (% of GDP)

	1981	1982	1983	1984	1985[1]
Total revenue (a+b)	27.7	30.2	34.4	32.2	34.3
(a) Federal government	16.9	16.3	18.6	16.8	15.8
Petroleum revenue[2]	(4.0)	(4.9)	(6.8)	(5.8)	(5.7)
Tax income	(12.1)	(10.3)	(20.7(	(10.2)	(9.7)
Non-tax		(1.1)	(1.1)	(0.8)	(0.4)
(b) State owned enterprises	11.6	13.9	15.8	15.4	15.5
Total expenditure (c+d+e)	42.5	47.8	43.3	39.3	36.4
(c) Current expenditure	26.7	34.7	34.5	31.1	29.2
Wages and salaries	7.6	8.3	7.0	6.4	5.3
Interest payments	5.2	8.7	12.7	10.5	9.6
Current transfers	4.9	6.5	3.5	2.6	4.6
Other expenditures	9.1	11.2	11.3	11.6	9.7
(d) Capital expenditure	14.0	10.8	7.7	6.4	6.2
(e) Miscellaneous expenditure	1.8	2.3	1.1	1.8	1.0
Financial intervention	1.3	1.4	0.6	1.3	1.0
Current savings	(-).8	(-)6.8	(-)1.2	(-)0.7	1.1
Deficit	14.8	17.6	8.9	7.1	5.1
Domestic financing	7.5	14.2	5.9	5.9	4.7
External financing	7.3	3.4	3.0	1.2	0.4

1 Projection of public sector budget made by the government in December 1984, without taking into consideration falling oil revenues and additional austerity measures which emerged during 1985.

2 This petroleum revenue of the Federal Government does not cover the petroleum revenue concept of table 24.

Sources. World Bank, 1984, op. cit., tables 2 and 5.1.1; Banco de México, Informe Anual (1982, 1983, 1984), op. cit.,; Comercio Exterior, Jan. 1985, pp. 15/23; El Mercado de Valores, 1984 op. cit., pp. 1252-1264.

current expenditure in interest on public debts and transfers to private and public sector enterprises to support them in the cash flow difficulties after the various devaluations. Afterwards, however, with the application of the agreed upon stabilisation programme, public sector expenditure fell to 39 per cent of GDP in 1984. Particularly in capital expenditures, considerable cuts took place in public fixed investments, reaching in 1984, in GDP terms, half of the 1981 level (6.4 per cent and 14 per cent respectively). The current expenditures, which in 1983 had suffered important increases in interest payments (from 8.7 per cent of GDP in 1982 to 12.7 per cent in 1983), in 1984 and particularly in the projected expenditures for 1985, would be reduced by more than 4 percentage points of GDP. Contributory factors had been the stabilising international interest rates and the reduction in wages and salaries by cutting more than 100,000 work places in the public sector. Additionally, current transfers to state-owned enterprises could be kept limited, mainly because the tariffs of their products and services had been increased.

On the income side, from 1981 to 1983 an important increase could be observed in public revenues, produced by increases in the prices of public sector services and production above the general inflation level. Reduction of direct tax income as a result of declining economic activity, was compensated by higher value-added tax. Finally, oil revenues received by the government fluctuated strongly. The devaluation and the undervalued peso raised these revenues; instability in the international oil market and falling prices, however, reduced the government's oil revenues by half since 1983.

The reduction of expenditures and the increase in revenues meant that the financial deficit of the public sector fell from 17.6 per cent of GDP in 1982 to 7.1 per cent in 1984. The latter, however, was higher than the IMF approved level for that year of 5.5 per cent. Whereas in the first half of 1985 international oil prices declined further, which in the public sector finances could not be compensated by the declining interest rates, additional austerity measures were declared by the government in order to reach the reduction in financial deficit of no more than 3.5 per cent of GDP in 1985. Transfer to public sector owned enterprises were to be cut further and about 100,000 jobs were to be eliminated in the public sector; 236 state-owned enterprises would be sold to the private sector. Complementary money supply was to be cut in order to reduce inflation, which in 1984 was 59 per cent, 19 percentage points above the level which was established for that year in the stabilisation programme. This, however, would give an upward push to domestic interest rates, provoking higher payments for that concept by the government. Austerity measures in the other areas mentioned had to compensate this effect.

The decline in expenditures implied an enormous reduction in the final demand exercised directly and indirectly by the public sector. However, it makes it difficult to measure exactly the net effects on national production.

The variables which table 38 contains give a first approximation and quantification of these effects. Observing public sector expenditures, excluding debt service payments, these fell to about 70 per cent of the level reached in 1981. Considering the three years 1982-84, the accumulated debt service payments corresponded to about 25 per cent of the GDP in 1984 and 17.5 percentage points of these 25 per cent were originated by the foreign debt service increase.

In the last two years, however, the internal debt service payments became more important, due to rising domestic interest rates. The latter was caused to a certain extent by a monetary policy of reducing money supply on the one hand and on the other hand, by the government policy of trying to cover a steadily larger part of its financial needs through state certificates. These certificates operate directly on the capital market and produce a significantly higher interest rate than regular bank deposits, particularly at moments when devaluations are expected. Their function was to increase the attraction of capital from the money market. So, for instance in mid-1985, differences of more than 10 percentage points[31] could be observed in favour of these certificates (CETES) representing an extra expenditure on domestic interest payments for the government.

In the light of the above, while it is true that the rise in debt service payments signified an enormous burden on government expenditures, the key discussion was not the capability of the public sector to pay the foreign debt service payments. As was mentioned before, the principal reason for the unstable economic situation was the yearly need for net foreign currency inflow in order to pay the contracted amount of debt services. Naturally, the latter had its secondary effects on the financial situation of the public sector, particularly after devaluations of the peso, which immediately increased debt service amounts in very significant proportions. This happened, for example in July 1985.

Table 38. Public sector debt service payments
(in constant 1970 bn pesos)

	1981	1982	1983	1984	Accumulated differences with the respective 1981 value[1] (1982-84)
1. GDP	908.8	903.8	856.2	885.9	(-)80.3
2. Public sector expenditure	386.2	432.0	370.7	348.2	(-)7.7
3. Debt service public sector	81.5	184.5	159.8	129.5	229.3
- Per cent of (2)	21.1	42.7	43.1	37.2	
4. Foreign debt service public sector	24.7	121.0[2]	60.4	48.4	155.7
- Per cent of (2)	6.4	28.0	16.3	13.9	
5. Public sector expenditure debt services (2-3)	304.7	247.5	210.9	218.7	-237.9
- Index	100	81	69	72	

1 Calculation formula:

$$[(Value_{82} - Value_{81}) + (V_{83} - V_{81}) + (V_{84} - V_{81})]$$

2 Thirty per cent of public sector foreign debt service in 1981 corresponded to commission and other expenditure costs in relation to foreign debt restructuring efforts.

Sources. Calculations based on: Sistema de Cuentas Nacionales de México, 1981-84; Comercio Exterior, Jan. 1981, pp. 14-19, Jan. 1984, pp. 20-27, Jan. 1985, pp. 15-23; CEPAL, 1985, op. cit., table 13.

The considerable reduction in public sector expenditure, excluding debt service payments, had its effects in nearly all expenditure categories, in spite of the fact that some of them had been given a strategic classification.[32] The cuts in the subsidies to state-owned enterprises was accompanied by rising prices in basic-needs goods. The social role of the government in providing education, health services, etc., to the population, suffered significant financial restrictions. Complementary, fixed investments in social sector benefits, communications, industrial activities, etc., made by the public sector, had fallen in 1984 by more than 40 per cent (in real terms) in comparison to the level it had reached in 1981 (see table 39). In other words, this meant a return to its 1972 level.

Table 39. Fixed investments, 1981-83 (in per cent)

	Annual growth rates			Composition	
	1981-82	1982-83	1983-84	1981	1984
Total investments	-15.9	-27.9	5.4	100.0	
Public sector investments	-14.2	-32.5	0.6	43.4	39.6
Private sector investments	-17.3	-24.2	8.8	56.6	60.4

	Index			
	1981	1982	1983	1984
Total investments	100.0	84.1	60.6	63.9
Public sector investments	100.0	85.8	57.9	58.3
Private sector investments	100.0	82.7	62.7	68.2

Source. Sistemas de Cuentas Nacionales de México, 1981-184, op. cit.

Private investments declined in nearly the same proportion as public investments, at least in the first years of the recent crisis, 1982-83. The contraction of demand in the internal market and the increased service payments on foreign debt, produced a critical cash-flow situation in many enterprises, while bank loans were nearly unavailable. Nearly all the loan capacity went to the public sector for financing its budget deficit; additionally, a restrictive money supply policy was followed. Another contributory factor to the low investments was the general political situation, which was considered unfavourable by the private sector.

It appears that the worst years of the economic and financial crisis were 1982 and 1983. Although 1984 cannot be considered as one of economic recuperation, at least the first signs had revealed stabilisation of the downward movement, particularly because the money supply had been enlarged. Private sector investments started to grow anew. But, as was explained earlier, this also meant that imports began to grow, a fact which was incongruent with the established level of foreign debt service payments. Thus, a new contraction of economic growth had to be initiated by a devaluation of the peso and a very strict money supply policy, which implied that only 10 per cent of new deposits were available to be lent to the private sector. The monetary policy, however, had less effect on foreign investments. The new confidence created by foreign investors, the "open-door" policy in terms of regulation of foreign investment and a determined strategy of the government to attract new investments from abroad, gave a new impulse to these investments. It was estimated that foreign investments would again reach in 1985, after three years of low "activity", the level of 1980-81 (about US$1,500 million). Likewise, the offshore assembly industry also began to reactivate its production, doubling its value added in Mexico between 1983 and 1985 from US$828 million to US$1,900 million.[33] Contributory factors were the devalued peso, the downward-headed salary cost, and the expanding United States economy in the past two years.

The real level of GDP reached in 1981, in the best of cases was expected to be re-attained at the end of 1986. The strong reduction in the final demand variables, such as public and private investments, public sector current expenditure, and the buying power of salaried workers, caused the decrease of GDP in 1982 and 1983 by 0.5 and 5.3 per cent respectively (see table 40). Most affected were the construction, manufacturing and commercial sectors, whereas the agricultural and other services sector still revealed some growth tendencies in 1982 and 1983. In the case of the agricultural sector, growth was particularly due to the favourable climate in those years.[34] The decrease in the manufacturing sector would have been still greater, if the government had not reduced its acquisitions from abroad to a minimum in order to support domestic enterprises.

Within the industrial sector, it could be observed that the crisis had quite different consequences at the branch level. Branches which continued to grow were petrochemicals, chemicals, mining (metallurgical) and food processing. On the other hand, those who suffered most (apart from construction) were automobiles, household electronics, textiles and garments, and footwear (see table 41). The first branches were mainly those which the

Table 40. GDP - Annual growth, 1981-84
(in per cent)

	1981-82	1982-83	1983-84
Total	-0.5	-5.3	3.5
Agriculture	-0.6	2.9	2.4
Mining	9.2	-2.7	1.6
Manufacturing	-2.9	-7.3	4.7
Construction	-5.0	-18.0	3.7
Commerce	-1.9	-10.0	2.7
Transport	-3.8	-4.8	5.7
Other services	3.8	1.0	3.0

Source. Sistema de Cuentas Nacionales de México, 1981-84, op. cit., 1985.

government had encouraged from the 1970s onwards in order to create relative (international) advantages. The latter branches enjoyed a relatively high labour-intensive production process.

As a consequence of the above-mentioned decreases in production levels in principal sectors and branches of the economy, the employment situation deteriorated considerably over the years 1982-84. In the first place, it was estimated that in the construction sector about 400,000 jobs were lost between 1981 and 1984; 350,000 more jobs fell into a situation of underemployment within the construction sector.[35] In manufacturing branches such as the automobile, domestic appliances and textiles and garments industries, a significant number of jobs were cut. In the whole manufacturing sector the number of jobs declined by 219,000, notwithstanding the fact that offshore assembly employment rose by 77,000 (see tables 42 and 43). The job losses in both the construction and manufacturing sectors were counterbalanced by increases in agriculture and service activities. These latter, however, have the characteristic that a high percentage of their occupied workforce (between 50 and 60 per cent) work in conditions of underemployment (see Chapter 1). In other words, more than half of new employment generated in these two sectors corresponded to the underemployed segment. This means that, together with the transformation in the construction sector, the underemployment category had increased by about 750,000 to 800,000 workplaces.

Table 41. Index production volume: Industrial branches, 1981-85
(1981 = 100)

Branches	1981	1982	1983	1984[1]	1985[2]
1. Continued growth					
Petroleum and petrochemicals	100	106	107	109	102
Chemical products	100	102	101	107	112
Mining - metallurgic	100	101	107	111	109
Paper	100	102	102	108	113
Food processing	100	105	102	104	108
2. Expected Recuperation in 1985					
Beverages	100	103	94	96	98
Construction materials	100	96	85	95	99
Basic metal	100	91	88	95	101
3. Recuperation after 1985					
Textiles and garments	100	91	87	85	92
Household electronics	100	89	72	60	65
Automobiles	100	79	49	62	76
Other manufacturing[3]	100	97	83	89	94
Construction	100	95	81	84	88
Total manufacturing	100	97	88	93	99
Total industry	100	98	90	95	100

1 Preliminary.

2 Estimates.

3 Includes: machinery and equipment, wood products, graphic industry, shoe and leather, etc.

Source. BANAMEX: Examen de la situación económica de México (Mexico), July 1985, table 2.

Table 42. Employment and economically active population, 1981-84 (in thousand persons)

	1981	1982	1983	1984
EAP	22 750	23 456	24 183	24 933
Salaried employment[1]	20 043	19 863	19 572	20 100
Agriculture	5 189	5 035	5 245	5 473
Mining and oil	263	270	267	270
Manufacturing	2 543	2 485	2 309	2 324
Offshore assembly	(130)	(122)	(151)	(207)
Other	(2 413)	(2 363)	(2 158)	(2 117)
Construction	1 881	1 785	1 420	1 473
Services	10 167	10 288	10 331	10 560
EAP - Salaried employment	2 707	3 593	4 711	4 833

1 Salaried employment is those jobs which generate direct income to the respective persons. The method of calculation is via an estimation of the number of workplaces (and not via the principal activity of the workers). This implies a certain level of over-calculation. On the other hand, jobs without a salary are not considered.

Source. Calculations based on CEPAL, 1985, op. cit., table 18; World Bank, 1984, op. cit., table 12.

Table 43. Employment annual growth rates and labour force absorption, 1981-84

	Growth rate (%)				Labour force growth and absorption (in '000s)
	1981	1982	1983	1984	1981-84
EAP	2.1	3.1	3.1	3.1	2 183
Salaried employment	6.6	-0.9	-1.5	2.7	57
Agriculture	5.9	-3.0	4.2	4.3	284
Mining and oil	9.7	2.6	-1.3	1.1	7
Manufacturing	5.2	-2.3	-7.1	0.6	(-)219
Offshore assembly	9.6	-5.9	23.2	37.2	(77)
Other	5.0	-2.1	-8.7	-1.9	(-)(296)
Construction	11.5	-5.1	-20.4	3.7	(-)408
Services	..	1.2	0.4	2.2	393
EAP Salaried employment	..	32.7	31.1	2.6	2 126

Source. Ibid., table 42.

Whereas the labour force absorption in these three years in net terms had not increased, on the supply side the labour force was increasing yearly by an average rate of 3.1 per cent, or about 700,000 to 800,000 persons. Over these years this meant an increase of 2.1 million. As in 1981, it was calculated that the unemployment rate had declined to 4.5 per cent of EAP with an underemployment rate of about 41 per cent,[36] in 1984 both figures might have reached the respective levels of 9 and 45 per cent. There are other estimates which calculate a higher EAP growth rate for the 1980s.[37] This implies the presence of an increasing hidden unemployment, which may have attained a 3 percentage point rise between 1981 and 1984. Independent of which of the calculations is the correct one, 55 per cent of the additional EAP are in employment conditions inadequate for a dignified living and reproduction level in the context of the possibilities of the country. In absolute terms, this percentage represented about 14 million persons in 1984, which signified an increase of about 3.5 million in comparison with 1981.

The sector which lost the highest number of jobs in this period was without doubt the construction industry. Of the 70 per cent of jobs lost in the construction industry, together with those which were transferred to the underemployment category, 75 per cent was due to the reduction in public sector investment. Private investment is less "construction-intensive", and its contraction had a relatively lower repercussion on construction activities. In view of the employment consequences of the cut in government expenditure, particularly in investments, the government began to carry out urgent employment programmes from the second half of 1983 onwards. At the same time it sought to make more labour-intensive the investments which were carried out. Although exact data are not available for evaluating the results obtained from these employment policies, a first approximation indicates that up to 1984 the net employment effects had still been limited. The general schemes of public investment are not sufficiently flexible to make them more labour-intensive: all the necessary investment in oil-exploiting activities have to be considered as fixed in their technology choice, at least in the short-term, and the main share of public investment goes to the oil sector. The emergency employment programme's fixed targets of 400,000 new jobs per year could only be carried out if the available investment amount were three or four times that which was really spent.[38]

In the manufacturing sector, particularly the durable and semi-durable consumer goods-producing branches, such as textiles and garments, shoes and leather, household electronics, automobiles, suffered important setbacks, with the exception of those enterprises which had access to the external market. The sharp drop in the internal market caused by the considerable reduction in real buying power of the mass of population (a decrease of about 40 per cent of real minimum wages) and the growing un- and underemployment, was the first reason. Another reason was the emerging liquidity problems of many enterprises after the various devaluations and the lack of available credit lines, which could have compensated up to a certain extent the difficult financial situation prevailing within the enterprises. The micro and small enterprises especially had little access to the existing credit lines. Their financial situation also worsened in relative terms in comparison with big, mostly transnational enterprises, because the new mechanisms of government support which were created in order to help the enterprises in their financial problems favoured the latter. One example was the case of the government-created system of risk-protection against devaluation of currency. Enterprises which had foreign debt could deposit their debt in the Central Bank, which transformed the debt into a peso-loan. In practice this mechanism resulted in an ongoing lending from abroad by principally transnational enterprises, which could obtain relatively easy credits from their parent-company or from the latter's related foreign banks. In fact, these enterprises did not suffer from the limits on credit granting, which the restricted money supply implied. Not so for the micro and small enterprises, which did not have these facilities. Thus, the former obtained important advantages.

The consequences of the shrinking internal market for mass products and the drastically deteriorating situation of micro and small enterprises diminished employment-generation capacity in the manufacturing sector, which is shown in tables 42 and 43.

As can be observed, it was the agricultural sector and aggregate service sector which could increase labour force absorption. The rise in employment in the former was mainly due to the favourable climatic circumstances and, additionally, because agricultural activities constitute a refugee option particularly for those people working in the construction sector.

In the "big" service sector, the various sub-branches did not experience the same movement in employment generation. The commercial branch, for instance, considerably reduced jobs, at least in the "formal" category. On the other hand, the public sector revealed an important increase in its labour force absorption,[39] which was able to counterbalance the reduction in the other service branches (at least up to 1985). In that year the austerity measures forced a reduction of about 100,000 work places. Another contributing factor in the expansion of the labour force in the service sector was the same as in agriculture: the refugee function of informal activities.

Special reference is required regarding the export promotion-related activities. As was shown in table 36, manufactured products increased their share of total exports (including non-factor services) from 6.1 per cent in 1981 to 7.4 per cent in 1984. The considerable past devaluations and the continuing devaluation of the Mexican peso, in combination with the reduction of domestic demand, were contributing factors to this behaviour. But, as became clear after the 1976 devaluation, only a small segment of the enterprises have the capacity to expand their external market. For example, the automobile industry, which suffered the contraction of the internal market, was able within two years to reorient its production to the external market.

As part of the policy strategy of export promotion, the government support to offshore assembly activities has to be mentioned. These were given the possibility of selling up to 20 per cent of their production on the domestic market. Additionally, an extensive support programme was provided in terms of providing infrastructure, special credit conditions and tax incentives, etc., to the United States border region in 1985.[40] Up to 1984, a significant increase of about 70,000 jobs was obtained in offshore assembly industry (see table 42). However, it is still not clear whether this growth in assembly activities corresponded to a change in transnational enterprise strategy in order to invest more in the border region in the near future, due to structural factors both in the Mexican economy (e.g. value of the Mex-peso) and the United States economy (e.g. restructuring from snow belt to sun belt). However, in the national context, between 1981 and 1984 direct employment was created in the assembly activities corresponding to only about 5 per cent of the EAP growth over those years, whereas the indirect employment effects on the Mexican side of the border can be estimated as relatively small.[41]

The general employment situation not only suffered a quantitative deterioration as was shown above, but also a qualitative one. The GDP per capita fell by 10 per cent between 1981 and 1984. But worse still, the participation of total salary-mass in GDP decreased from 38 per cent in 1981 to 27 per cent in 1984.[42] This decrease of salary-mass participation was mainly due to the sharp fall in real income of the working class in general and of a significant segment of the middle class.

2. Employment perspectives for the coming years

The employment perspectives for the coming years may depend to a certain extent on external variables such as international oil prices and interest rates. But also the political decisions of government have to be considered as fundamental for future employment development. Therefore, three possible political scenarios will be developed, and in each of them the employment perspectives will be analysed.

The first scenario is the continuation of the tendency of the principal policy lines followed from 1982 onwards and which can be identified as the model of economic reactivation through exportation. This model is based on the following elements: (i) the trade balance surplus has to be large enough to fulfil the foreign debt service obligations according to the negotiated rescheduling scheme; (ii) the public sector will not expand foreign loans; (iii) public sector financial deficit will be kept under 5 per cent of GDP; (iv) decrease of public sector expenditure as a percentage of GDP; (v) liberalisation of import restrictions; (vi) retirement of the government from its direct productive activities (state enterprises); (vii) free foreign currency exchange; (viii) minimum wage increases kept under the inflation rate; (ix) indiscriminate application of the foreign exchange risk security system for private enterprises; (x) elevated domestic interest rates and reduced credit availability.

This scenario demands that in coming years a growing trade balance surplus be reached in order to fulfil foreign debt-service obligations. This can only be obtained if exports grow faster than imports. Currently, these obligations correspond to 45 to 50 per cent of export income. Given the fact that international oil prices are declining and that non-oil exports are starting from a very low level, internal markets will have to be kept restricted, because the new export-oriented industries (such as automobiles) have weak backward linkages. Under these constraints, the reactivation of the national economy will be at a rate of no more than 1 or 2 per cent annually in the next five years. Additionally, if international oil prices drop or interest rates rise, it will immediately cause economic and financial instability, originating capital flight and domestic price pushes.

The other policy components (iii) to (x), have as a common element the reduction of government involvement in the economy. As was explained in Chapters 1 and 2, employment generation through the 1970s was to a large extent the result of direct or indirect government actions. This capacity will be eliminated almost completely in this scenario. At the same time, under these policy lines only a small number of enterprises will be able to increase production and employment. It is those enterprises, mainly multinationals, which have the possibility of increasing exportation. It is important to underline that "possibility" is not enough here. Exportation necessarily has to be part of enterprise strategy.[43] The other enterprises whose market is mainly or completely domestic, including the construction industry, will show hardly any growth. The domestic market will be strongly contracted because of low buying power and shrinking government expenditure, whereas competitiveness will be increased through import liberalisation. In addition, the financial liquidity position of these enterprises will be very difficult, with few possibilities of credits. Finally, the government will have very small operating margins, especially for emergency emnployment programmes.

In rough terms, the first scenario implies a satellisation process in the economy, where only a small number of enterprises in determined branches and operating in certain geographic areas, will take part in the national growth process. For example, offshore assembly industry, petrochemicals (primary and secondary), a segment of the automobile industry, mining and tourism. Most of those have very weak backward linkages to the national economy and to small and micro enterprises. Under this scenario the employment perspectives for the coming years are not very hopeful. With low economic growth rates and a reduction of the share of traditionally labour-intensive production processes such as the construction industry and small and micro enterprises, there will be relatively little net new employment generation up to 1990. Yearly, however, the labour force will increase by about 1 million young people. In qualitative terms, this scenario promises a widening of income distribution, which in Chapter 1 was qualified as still quite unequal. A growing segment of middle-class people and small entrepreneurs will probably fall to lower income classes, whereas on the other side, the highest income group of the population and especially those connected with international financial business, will be able to raise their relative position.

The second scenario can be considered as basically the same as the first, with the exception of point (i). This, however, will have important consequences for the other points. The modification consists of the fact that foreign debt service payments will be reduced to a level which is half of the actual one. This level corresponds to a trade balance surplus which can be combined with an economic growth rate of about 3 to 4 per cent annually. Additionally, foreign debt service payments of the public sector will be corrected for fluctuations in international oil prices and interest rates. If oil prices decrease or interest rates increase, debt service payments will be diminished in the same proportion. This implies a sort of international risk distribution. This model can be qualified as an economic reactivation strategy based on domestic market growth combined with export promotion.

Under this scheme, the economy can be given some breathing space and, at the same time, more stability in the foreign exchange rate, which will help to avoid capital flight. The reduction in the foreign debt service payments to a level which is nearly the same as the sum paid in 1981, does not mean that the country will refuse to pay its debts, only that it will pay a lower interest rate on it. For the national economy this presents several advantages. At first glance, monetary and minimum wage policy can be made less restrictive, maintaining an upper constraint of 4 to 5 per cent annual economic growth. Supposing the rest of the points mentioned in the first scenario do not undergo changes, this leads to a model of dualistic and unequal growth processes between productive sectors. On the one hand, we find the relatively fast-growing exportation "satellites", as was explained under scenario 1, on the other hand, the slower growing small, medium and large enterprises which are supplying the domestic market. They will not be able to benefit much from an increasing domestic market because the liberalisation of imports will affect their competitiveness. Additionally, government expenditure does not grow, implying that for sectors such as the construction industry, its reactivation will be limited.

Whereas in the 1970s, with a growth rate still higher than 5 per cent, employment generation was not adequate to absorb total new labour force, it will be doubtful if in the circumstances of scenario 2 the economy will be capable of doing so. Moreover, in the 1970s the government was the main employment generator and it is not very likely that the private sector will be able to substitute completely in this role. An employment growth rate of about 2 per cent yearly can be projected under this scenario, which will be able to cover half of the net yearly influx into the labour market.

The third scenario is based on the philosophy of government involvement in economic development, formulated at the beginning of the 1970s. The concrete reality, however, is quite different. As was mentioned in Chapter 1, the government decided to increase its involvement in the economy in order to correct the imbalances which had arisen in the years before, when it applied a model of import substitution. In this light, the government started the production of basic intermediate inputs such as steel and petrochemicals. The international production parameters, however, changed and apart from the basic intermediate inputs, other strategic inputs have now appeared, principally those with a high technology component, such as microelectronics and biotechnology products. The logical course would be an ongoing involvement of government in new strategic production areas in order to compensate for the enormous lack of national production of these inputs. Learning from the errors of the past, this scenario foresees the establishment of new production and quality norms for public sector activities. Instruments such as providing venture capital for new private enterprises should be developed. Additionally, special support programmes are contemplated in this context for micro, small and medium-sized industries. For the latter, special attention will be given to change the status of the percent offshore assembly industry. An important strategy will be to elevate the national imputs share of this sector, particularly through small and medium size enterprises.

Government's involvement also includes in this scenario the construction sector. A considerable part of machinery and equipment acquired by construction companies in the oil boom period is going to rust without any productive use given to it. The crisis originated an enormous underutilisation of these capital goods, which had nearly all been depreciated before the oil boom began to stagnate,[44] and in fact these capital goods were financed by public sector expenditures. The scenario foresees a policy line which will make use of these capital goods, paying a relatively small rent to the respective owners. This gives a new character and possibilities to the emergency employment programmes, which have to be given a special impulse in construction activities.

Government expenditure and particularly investments, will be increased. At an early moment and in order to give a boost to the economy, a small rise in public sector deficit up to 10 per cent could be tolerated. Immediately afterwards, it would have to be reduced by increasing income tax revenue. The latter, through a drastic correction of the unequal income tax system.

In order to protect and stimulate micro and small enterprises, and even small farmers, credit facilities will be given to these sectors and liberalisation of import restrictions will not take place. Instead, an active price policy will be introduced which will have to seek a median between international and domestic prices.

Minimum wages will be given the necessary increases in order to recover their real buying power. However, trying to avoid too great a pressure on imports, minimum wage increases will consist to a large extent of a sort of basic needs bonus, which corresponds to a certain number of products with high national backward linkages.

In this third scenario, the service payments obligations will be reduced in the way explained under scenario 2. The basic idea behind this scenario is to reactivate the economy principally by increasing production for the internal market and, if possible, by exportation. But, fundamental in the reactivation of the internal market is the reorientation of production structure, trying to correct the imbalances created in the past. This reorientation means increasing national backward linkages of production processes towards micro and small enterprises. To this end, the latter will receive financial and technical government support in order to be able to produce the spare parts and components under the necessary productivity and quality norms, in other words, an endogenous development strategy which does not isolate itself from the international context of production, technology and commerce. In terms of employment and production, this scenario should lead to a production growth which will be approximately the same as in scenario 2, but employment will increase with growth levels considerably closer to those of production, implying that not only the labour force increases, but also a small part of actual underemployment can be absorbed.

Clearly, the scenarios mentioned here are simplified abstractions of a complex interaction of policy variables which each scenario signifies. The developed scenarios reveal, however, that for improving the financial situation of the country, far-reaching political decisions are required. These go much further still if employment targets are considered apart from the financial ones. Only by applying profound policy measures as mentioned in scenario 3, can the critical employment situation be improved to a very small extent, and still many more years will be needed to reduce in a substantial way the underemployment in the country. If these measures are not taken, un- and underemployment will go on expanding rapidly, jeopardising the survival of a growing segment of the population.

Notes

[1] See, SEPAFIN, 1979, op. cit., p. 28.

[2] Ibid., pp. 54-56.

[3] See also, Palomares, 1984, op. cit., pp. 131-143.

[4] See, World Bank, 1984, op. cit., p. 9.

[5] Ibid., p. 15 and "There are no satisfactory estimates of the capital flight during 1981 and 1982, but it is generally believed to have amounted to several billions of dollars. One common way is to attribute to it the item "errors and omissions" in the balance of payments. According to this, the capital flight in the official accounts was $8.4 billion in 1981 and $6.6 billion in 1982." Ibid., p. 13.

[6] Whereas in 1976-77 the interest rates on the world finance market were about 6 or 7 per cent, in 1982 they increased to 15 per cent. For Mexico this meant in 1982 an extra expenditure of US$6,000 million. See, Declaration of the Minister of Finance, in El Día (Mexico City), 18 August 1982.

[7] See CEPAL, 1984, op. cit., table 20.

[8] See World Bank, 1984, op. cit., p. 123; and Antonio Amerlinck Assereto, 1984, op. cit., p. 966.

[9] Ibid., p. 964.

[10] See, for instance, the newspaper notation six days before the nationalisation of the bank system, in which reference was made to the strong decapitalisation of the principal national banks. El Dia (Mexico City), 25 August 1982.

11 A frequently used mechanism to "Mexicanise" foreign investments was through the intervention of a bank. This implied various advantages for foreign investors as guarantee and more control over Mexicanised shares. See, Palamares, 1984, op. cit., p. 68.

12 The unfavourable conditions were mainly the relatively high interest rates. But also strategic negotiations from other countries in order to obtain cheap raw materials. An example of the latter is the case of selling the finest and highest Mexican oil, type Istmo, to the Department of Energy of the United States (for the strategic reserve). In one year, Mexico should supply an average volume of 110 thousand barrels and for that, the United States would advance the payment of US$1,000 million to the Mexican Government. See El Día, 25 August 1982.

13 See Declaration of the Minister of Finance, in El Día, 18 August 1982.

14 See Declaration of the Mexican President, Diario Oficial (Mexico), 21 April 1982.

15 See Declaration of the Mexican President, in El Día, 19 August 1982.

16 See "Le Mexique et le FMI: La lettre d'intention", in Comercio exterior de Mexico, French edn., Nov. 1982, p. 412.

17 See, Declaration of the Minister of Finance, in El Dia, 18 August 1982.

18 See, "México y el FMI: La carta de intención", in Comercio Exterior de México (Mexico), Nov. 1982, pp. 1247-1251.

19 See, Plan Nacional de Desarrollo, 1983-88 (Mexico, 1983), p. 117; and LAWR, 10 December 1982, pp. 9-10.

20 See Latin American Weekly Report, (LAWR), 24 December 1982, p. 1.

21 See, CEPAL, 1984, op. cit., p. 58.

22 See, CEPAL, 1984, op. cit., p. 56; idem, 1985, op. cit., table 21.

23 Ibid., p. 47.

24 See, Lloyd's Mexican Economic Report (Mexico), Feb. 1984, p. 1.

25 "The major problem has centred on public sector deficit as a percentage of GNP. The Fund has been insisting on cutting this to 6 per cent from the 17 per cent now being forecast for this year." See, LAWR, 15 November 1982.

26 See, "El mercado de valores", Nafinsa Mexico, 15 July 1985, p. 1.

27 See, Declaration of the Minister of Finance, in "El mercade de valores", 30 July 1985, pp. 715-717.

28 Only a partial indication of capital flight volume are the Mexican deposits in United States banks. "In 1984 these deposits were US$2.3 billion, according to the US Federal Reserve. That sent the total to $12.7 billion." See, The Mexico Report (El Paso, Texas), Apr. 1985, p. 2.

29 See, Plan Nacional de Desarrollo, 1983-88; Programa Nacional de Fomento Industrial y Comercio Exterior, 1984-88; Programe Integral a las Exportaciones; Derecho a la Importación de Mercancias para Exportación.

30 Only as an example: "Gillette of the US has decided to take up the Mexican Government's offer of peso-denominated loans at an interest rate of 10 per cent for export promoting schemes." See LAWR, 5 November 1982.

31 See BANAMEX: Examen de la situación económica de Mexico (Mexico, July 1985), p. 339.

32 See, Plan Nacional de Desarrollo 1983-88, op. cit., 1983.

33 See, Lloyds's Report, Apr. 1985, op. cit.

34 See CEPAL, 1985, op. cit., p. 5.

35 See, L. Mertens: Crisis ocupacional en el sector construcción en 1983 y propuestas políticas (Mexico), 1984, p. 6. It was calculated that between 1981 and 1984, about 750,000 jobs were eliminated from the sector, or transformed into jobs in underemployment conditions.

36 See, PREALC: Dinámica del subempleo en América Latina (Santiago, 1981), table 1.

37 See, World Bank, 1984, op. cit., table 12.

38 See L. Mertens: Crisis ocupacional en el sector construcción en 1983 y propuestes políticas (Mexico, 1983), pp. 25-26.

39 It was estimated that labour force in the public sector grew by about 500,000 jobs between 1981 and 1983. See, SPP: Participación del sector público en el producto interno bruto de México, 1975-1983 (Mexico, 1984), table 6.

40 El mercado de valores (Mexico), July 1985, op. cit.

41 "About 40 percent of the money that is spent in Juarez comes right back to El Paso. The amount of money that El Paso generates as a result of the in-bond industry in Juarez is astronomical." See, Texas business prospects (Dallas), Summer 1985, p. 35.

42 See CEPAL, 1985, op. cit., p. 8.

43 A significant number of multinational enterprises have the sole purpose of conquering part of the domestic market.

44 See L. Mertens, 1984, op. cit., pp. 23-30.

Chapter 4

Concluding remarks

The principal objective of the present paper is to show that the current foreign debt crisis of Mexico, while it has its immediate origins in falling international oil prices and rising interest rates, has its fundamental basis in the economic development model, and especially in the industrialisation process, followed over the past three or four decades. The import substitution model applied up to the 1970s aimed basically to produce inside the country those products which were imported before. On the international market, these products had mostly reached their stage of full maturity; additionally, an important role in the import substitution process was played by the multinational enterprises, which in most cases, were looking for an extension of their respective "home" markets. Thus, the possibilty of exportation of non-traditional goods was very slight in this context, and in terms of the balance of payments, the economic growth of the country was supported by the export of the agricultural and mining sector. At the end of the 1960s it became clear that the exportation of these products had reached its limit, so new horizons had to be found in the international market of manufactured products, which were to stimulate the future economic growth of the country.

In order to provide a solid structure to the penetration capacity of the manufacturing sector in the external markets, government's involvement in the economy increased enormously, particularly through the production of basic inputs for industry which, together with the low labour costs and the various tax exemptions, should constitute the necessary elements establishing a real exportation platform. This increasing government involvement was financed principally by growing foreign debt, which took over the traditional role of the agricultural and mining sectors in the foregoing years. Finally, the emerging oil boom only postponed the necessary changes.

At the beginning of the 1980s it became clear that not only had the import substitution model of the 1950s and 1960s failed to facilitate penetration of the international market, but also that the model of the new international division of labour of the 1970s, based on the relative advantages which countries like Mexico could provide to multinational enterprises in terms of low input prices of energy, primary goods, combined with cheap labour, from now on could not be considered a real option for attaining satisfactory economic growth, which both in a qualitative and quantitative sense would be able to deal with the social targets of the country, concerning employment and income generation, as well as a more equal income distribution. The industrial relocation process from developed to developing countries may have reached, if not its limit, at least a significantly slower growth rate in the 1980s. One of the reasons for this stagnation of relocation has to be sought in the accelerated technological innovations in production processes in the industrialised countries. These innovations mean a tendency to produce less energy and material-intensive products, frequently combined with a less labour-intensive production process. Additionally, in various production processes important advances have been made to reach flexible automatisation levels, which correspond to a just-in-time manufacturing. That is, slashing inventories by delivering parts just before production lines need them,[1] implying that production of inputs, the assembly of the final product and the end-markets, cannot be separated by a large distance. These factors could considerably reduce some of the relative advantages countries like Mexico had in the former scheme of the new international division of labour.[2] Furthermore, the built-up production capacity of basic inputs for industry, like steel, petrochemicals, energy, etc., are confronting enormous overcapacity levels on the world market, and prices are strongly depressed.

So the conclusion can be made that, at least from the point of view of the external economic relations of the country, the economic development model for the coming years should not just be based on either the export of primary commodities or the export of those products which are intensive in cheap labour and other cheap basic inputs. Without committing itself to autarchy, Mexico needs to define in which economic branches or products it will develop production and technology capacity which will be able to compete on international markets. A stronger economic and commercial relationship with other Latin American countries will be absolutely necessary for this, particularly in order to avoid a situation where two or more countries specialise in the same areas.

A new development strategy, however, is necessary not only to reverse the collapse in the trade balance. Internally, the economy has reached critically low levels of growth, employment and income generation, and in general the economic structure has become more polarised between the oligopolistic sector on the one hand, and the micro and small enterprises on the other. The financial situation of the latter deteriorated considerably, suffering from the strong contraction in the internal market and a discriminatory credit system. In the last decade the government played a very crucial role in employment generation in the country. After the financial crisis and the applied stabilisation programmes, its role diminished enormously whereas other economic agents in the economy, which would have taken over this role, were absent.

It is clear that simple solutions do not exist. The important task remains of creating the necessary mechanisms and conditions, not only to stimulate the required economic growth, but also to work a fundamental change in economic structure. This change must provide the basis leading towards an employment and income generation capacity which can at least stop the downward tendency of recent years.

Several political scenarios were briefly described in the foregoing chapter. In the short term, the stabilisation policy has been able to fulfil the international obligations pertaining to debt service payments. So, from the point of view of the international financial institutions, the programme perhaps can be qualified as successful. Nevertheless, the results have to be seen from the point of view of the domestic economic structure and the social objectives of the nation. The stabilisation policy meant that the costs of adjustment were carried in a disproportionate way by the weakest groups in the society; in the economic sphere the danger exists that an important part of production capacity, which was producing for the domestic market, will disappear. Furthermore, reinvestment rates tend to be low and capital flight persists. The continuation of the stabilisation policy strategy applied in the past few years will result in a tremendous deterioration of the employment conditions of millions of Mexicans and as a consequence the living and survival situation of half or three-quarters of the population.

The principal conclusion of the study is that in order to include employment objectives in the stabilisation strategy, the orientation of the latter have to be modified in a qualitative sense. The starting point of analysis must be how to improve the economic performance of the country and reducing the imbalances which had been created in the foregoing decades. As a function of this strategy of restructuring in the real economic sphere, the financial capacity of the country in the short and medium term can be determined. The economic and social conditions of the majority of the population have suffered in the extreme and there is a need for an urgent reformulation of the principal policy lines. The present work has not given the details of such an alternative programme; it only hopes to contribute to the stimulation of a wider awareness of the necessity for a different stabilisation approach.

Notes

[1] See, "Just-in-time manufacturing starts paying off in US", in Electronics, 26 August 1985, p. 26.

[2] See also, G. Junne: New technologies: A threat to developing countries' exports, Seminario Revolución Tecnológica y Empleo, Mexico, 1984.

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