

TEXAS PAPERS ON LATIN AMERICA

Pre-publication working papers of the  
Institute of Latin American Studies  
University of Texas at Austin  
ISSN 0892-3507

The Outlook for the Mexican Economy

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University of Texas at Austin  
April 1987

Paper No. 87-05

## THE OUTLOOK FOR THE MEXICAN ECONOMY

To properly understand Mexico's present predicament with regard to its domestic and international economic policy, it is useful to review briefly some of the background from the 1960s and 1970s. From 1960 to 1970, the Mexican economy grew at a fairly steady rate of 7 percent per year, while population rose at 3.5 percent, thus allowing for an average annual increase in per capita GDP of almost 3.4 percent. By 1970, GDP per capita was already equivalent to some US\$500, at 1960 prices. Inflation during this period was minimal (table 1).

Table 1  
Mexico's Population, GDP per Capita, Prices, 1960-1986

Year	Midyear Population (000s)	GDP per Capita (1960 Prices)	Prices (GDP Deflator 1960=100)	%Inflation over Previous Year (annual avg.)
1960	37,073	4,308	100.0	4.9
1970	51,176	6,150	141.16	4.4
1980	69,393	8,594	717.08	28.7
1981	71,249	9,036	912.49	27.2
1982	73,122	8,757	1470.78	61.2
1983	74,980	8,089	2826.27	92.2
1984	76,791	8,189	4571.95	61.8
1985	78,524	8,224	7059.90	54.4
1986	80,200	7,754	12503.08	77.1

Sources: Banco de México, *Indicadores económicos* (May 1986); Instituto Nacional de Estadística, Geografía e Informática, *Estadísticas históricas de México* (Mexico City, 1985), converted to 1960 prices; 1986: Banco de México/CIEMEX

Real wages in the formal employment sector rose steadily. External financing was modest; total public external debt by 1970 was only US\$4.3 billion, interest on external debt was a mere \$200 million and meant allocating to it less than 1 percent of total exports of goods and services. Aggregate exports in 1970 were \$1.3 billion, and exports per capita, \$25. Food and agricultural products were the main source of foreign exchange (48 percent), followed by a rising amount of manufactured exports (34 percent) (see tables 3, 4, 5, 6, and 7). Mexican exports were barely 0.4 percent of world exports. Crude oil was hardly in the picture, except for domestic consumption.

This pattern of growth started in the 1950s, as the structure of the economy shifted toward industrialization. By 1970, 29 percent of GDP originated in manufacturing industry and construction, while agriculture's share had declined to 12.2 percent (table 2).

Table 2  
Mexico's GDP by Sector, 1960-1986  
(Millions of Dollars)

Year	Agriculture, Other Primary Activities	Industry & Construc- tion	Mining, Crude Oil & Refining Prods.	Other	GDP
1960	25,432	37,178	7,847	89,251	159,711
1970	38,242	91,197	7,927	177,263	314,729
1980	53,630	181,398	19,404	341,952	596,384
1981	56,885	195,649	22,381	368,867	643,784
1982	56,547	189,226	24,439	370,082	640,294
1983	58,183	171,733	23,773	352,838	606,527
1984	59,616	179,548	24,206	365,454	628,823
1985	60,940	189,003	24,437	371,372	645,752
1986*	59,112	181,216	22,213	359,488	621,859
Share of output (%)					
1960	15.9	23.3	4.9	55.9	100.0
1970	12.2	29.0	2.5	56.3	100.0
1980	9.0	30.4	3.3	57.3	100.0
1981	9.8	30.4	3.5	57.3	101.0
1982	8.8	29.6	3.8	57.8	100.0
1983	9.6	28.3	3.9	58.2	100.0
1984	9.5	28.6	3.8	58.1	100.0
1985*	9.4	29.3	3.8	57.5	100.0
1986*	9.5	29.1	3.6	57.8	100.0
Growth rates (avg./annum)					
1969-70	4.2	9.4	0.1	7.1	7.0
1970-80	3.4	7.1	9.4	6.8	6.6
1980-85	2.6	0.8	4.7	1.6	1.6
1986*	-3.0	-4.1	-9.1	-3.2	-3.7

Sources: Banco de México, *Indicadores económicos* (May 1986); Instituto Nacional de Estadística, Geografía e Informática, *Estadísticas históricas de México* (Mexico City, 1985), converted to 1960 prices; 1986: Banco de México and Wharton/CIEMEX.

Notes: Percentages may not add to 100 because of rounding.

\*Preliminary

Table 3  
Mexico's Exports and Average Exchange Rate  
(1960-1986)

Year	Total Exports (US\$Million)	Exports per Capita (US\$)	Annual Average Exchange Rate (Pesos/US\$)
1960	738.7	19.9	12.50
1970	1,289.6	25.2	12.50
1980	15,134.0	218.1	22.95
1981	19,419.6	272.7	24.51
1982	21,229.7	290.4	57.44
1983	22,312.0	297.5	120.17
1984	24,196.0	315.1	167.75
1985	21,866.4	278.6	256.96
1986	15,759.3	196.5	611.42

Sources: Banco de México, *Indicadores económicos*; per capita data using INEGI population estimates.  
Note: Exchange rate is average annual rate (since 1982, controlled rate applicable to trade and official transactions)

Table 4  
Mexico's Exports, 1960-1986  
(US\$Millions)

	1960	1970	1980	1981	1982	1983	1984	1985	1986
Total	739	1,290	15,307	19,420	21,006	21,399	24,196	21,866	15,759
Oil, gas	20	38	9,878	13,830	16,101	15,143	15,196	13,309	5,531
Food, agriculture	417	623	1,544	1,481	1,233	1,285	1,461	1,323	2,107
Minerals	145	184	503	677	501	447	539	510	510
Manufactures	156	444	3,379	3,427	3,167	4,519	6,986	6,721	7,609

Source: Banco de México, *Estadísticas históricas, Balanza de pagos, and Informes anuales*; 1984-85 from INEGI and *Comercio Exterior* (monthly); 1986, Wharton/CIEMEX.  
Note: Export totals include a small amount of unspecified commodities in the years indicated.

Table 5  
Mexico's Imports, 1960-1986  
(US\$Millions)

	1960	1970	1975	1980	1985	1986
Total	1,186 11,284	2,328	6,582	18,571	13,460	
Consumer goods	222	463	444	2,425	1,075	847
Intermediate goods	404	781	4,241	11,027	9,162	7,583
Capital goods	560	1,083	1,897	5,119	3,223	2,854

Source: Same as table 4.

Note: Import totals include a small amount of unspecified commodities in 1970.

Table 6  
Mexico's Exports and Destination by Region, 1960-1986

Year	Tot. Mex. Exp. (US\$ Billion)	Tot. Mex. Exp. to US (%)	Tot. Mex. Exp. to Europe (%)	Tot. Mex. Exp. to Asia (%)	Tot. Mex. Exp. to Others (%)	World Exports (US\$Billion)	Mex % of World Total
1960	0.7	61.4	11.5	7.2	19.9	114	0.6
1970	1.3	60.7	8.5	5.6	25.2	283	0.5
1980	15.1	72.7	16.5	9.9	0.9	1,845	0.8
1981	15.1	64.7	19.8	12.6	2.9	1,854	0.8
1982	21.2	53.3	22.2	12.5	12.0	1,710	1.2
1983	22.3	58.1	20.0	11.1	10.8	1,666	1.3
1984	24.1	58.8	19.4	10.8	11.0	1,767	1.4
1985	21.9	61.6	19.1	10.7	9.1	1,783	1.2
1986*	15.8	66.7	7.7	9.0	16.6	1,835	0.9

Source: INEGI; 1986: Wharton/CIEMEX and Banco Nacional de Comercio Exterior.

\*Preliminary

Table 7  
Changes in Mexico's Exports, by Main Product  
(US\$Millions)

Exports	1985	1986*	Difference	% Change
Total	21,866	15,759	-6,107	-27.9
Farm products	1,323	2,107	784	59.3
Coffee	481	823	342	71.1
Tomatoes	198	424	226	114.1
Fresh vegetables	146	203	57	39.0
Livestock	143	257	114	79.7
Other products	355	400	45	12.7
Crude petroleum	13,309	5,531	-7,778	-58.4
Minerals (metallic & nonmetallic)	510	510	0	0.0
Manufactures	6,724	7,609	885	13.2
Frozen shrimp	326	361	35	10.7
Beer	66	117	51	77.3
Artificial fibers	86	152	66	76.7
Petroleum derivatives	1,351	640	-711	-52.6
Petrochemicals	106	87	-19	-17.9
Other chemicals	676	830	154	22.8
Steel	246	447	201	81.7
Automobiles, motor, & parts	1,417	1,778	361	25.5
Electric & electronic appliances & compo- nents	285	392	107	37.5
Machinery & mis- cellaneous equipment	402	570	168	41.8
Other manufactures	1,760	2,235	475	27.0

Source: Banco Nacional de Comercio Exterior, derived from official sources.

Notes: The data do not include exports from *maquila* (border subcontracting) industries (in 1986, about US\$1,100 million).

\*Preliminary

The latter continued to fall through 1985, as the share of services rose to 57 to 58 percent. Growth, structural change, and modernization were the hallmark of Mexican development during more than two decades. Employment expanded despite rapid growth in the labor force. Educational, health, and welfare services were substantially extended.

Nevertheless, imbalances and rigidities began to appear. Modern industry and modern agriculture became highly concentrated, both regionally and in terms of enterprise size. Rural-urban migration led to explosive growth of a few large cities, while the birth rate remained at around 44 to 45 per thousand, one of the highest in the world. Large sections of farmland were untouched by modernization—were left poor and neglected—affecting the income of millions of peasants. At the same time, small and medium-sized manufacturing enterprises lagged behind, mired in low productivity. Population growth exceeded the development of basic services, especially in rural areas. Manufacturing industry became overprotected and largely inefficient. A basic source of energy—oil—was not developed fast enough to meet foreseeable medium-term needs, even for the domestic market. By 1973, at the time of the first oil shock, Mexico had become a net importer of crude oil.

During the 1970s, the administration, in an attempt to redress many backlogs within a short time span, pushed public sector expenditure, both economic and social, too far and too quickly under deficit financing (9 percent of GDP). At the same time, it discouraged domestic private investment, on which the "mixed economy" had always partially depended for growth. In addition, the administration decided to maintain an overvalued peso—held at 12.50 per US dollar, in the face of rising inflation, already two-digit in the early 1970s. A substantial balance of payments current account deficit arose, coupled with capital flight resulting from loss of confidence. On August 31, 1976, the Mexican peso plummeted by 35 percent, after twenty-two years of stability.

However, huge reserves of crude oil and natural gas had been discovered, so that the national enterprise in charge of petroleum development, Pemex, was able to start exporting surpluses at the post-oil shock prices set by OPEC. By 1978, Mexico's oil exports amounted to \$1.8 billion, and by 1980 they were \$9.9 billion (including natural gas), thus accounting already for 65 percent of aggregate exports. Output of crude petroleum more than quadrupled between 1973 and 1980, when over eight hundred thousand barrels per day were exported at an average price in excess of \$31 per barrel.

From being a country hamstrung by lack of sufficient foreign exchange resources to pay for imports, and thus one in need of moderate external borrowing, Mexico was transformed in a short period—1977 to 1980—into a major world exporter of oil, with a large surplus available for the needs of oil-hungry countries. Moreover, on the basis of its oil wealth, with reserves estimated to be the fourth - or fifth-largest in the world, Mexico was able to borrow freely in the international financial market, mainly from the commercial banks, and thus added immense foreign exchange resources to its own earnings from exports, with the avowed purpose of speeding up development, particularly in manufacturing and in the energy sector itself.

Between 1978 and 1982, GDP increased by 8 percent per year. Vast expansion took place in infrastructure for growth: electricity, ports, transportation and other public sector projects and

programs, including basic industry such as steel. Private manufacturing projects also got under way. Agriculture expanded in parallel. The private sector increased its external debt by \$15.6 billion during 1977-1981, to a total of \$21.9 billion, more than three times the 1976 level. The public sector increased its external indebtedness by \$37.5 billion, a 174 percent rise over the \$21.6 billion level of 1976. Thus the private external debt expanded more rapidly than the public sector's debt, although in 1981 alone, as the external financial crisis emerged, it was the public sector that increased its net borrowing more rapidly, largely to shore up an overvalued peso and to meet interest payments (table 8).

Table 8  
Mexico's External Debt and Debt Service, 1970-1986  
(US\$Billions)

Year	External Debt*			Interest on Total External Debt	% Interest Pay- ments on Ex- ports of Goods & Services
	Public Sector*	Private Sector	Total		
1970	4.3	n.a.	4.3	0.2	0.7
1975	14.4	5.6	20.1	2.2	34.9
1976	21.6	6.3	27.9	1.7	21.5
1977	23.9	6.4	30.3	1.9	21.5
1978	27.9	7.2	35.1	2.5	22.3
1979	31.9	10.5	42.4	3.7	23.9
1980	37.5	16.9	54.4	5.5	23.2
1981	59.1	21.9	81.0	8.4	28.1
1982	68.5	19.1	87.6	13.4	48.4
1983	74.7	19.1	93.8	10.5	36.7
1984	78.1	18.5	96.6	12.2	37.5
1985	79.8	17.5	97.3	10.4	35.0
1986**	79.6	18.2	97.8	8.7	36.1

Sources: Official data; 1986: Wharton/CIEMEX.

\*Including net debt to IMF, which was 1978, 299; 1979, 136; 1980, —; 1981, —; 1982, 220; 1983, 1,255; 1984, 2,367; 1985, 2,943; 1986, 3,358.

\*\*Preliminary

N.a.= not available

To understand the situation fully, a look at the trade figures is useful. By 1980, total exports had risen from the modest level of \$1.3 billion in 1970 to a record high of \$15.3 billion, due mainly to the expansion of oil exports. However, contrary to what is usually assumed, other exports also increased considerably. For instance, exports of food and agricultural products rose from \$0.6 billion to \$1.5 billion, and those of manufactured goods went up from \$0.4 billion to \$3.3 billion in ten years. It is true, nevertheless, that after 1980 crude oil became predominant because of both volume

and price: 1.5 million barrels per day by 1982, with an average export price of \$33 per barrel in 1981 and almost \$29 in 1982, the price having peaked at over \$36 in the first half of 1981. Thus total exports were \$19.4 billion in 1981 and \$21 billion in 1982, with oil accounting for 71 percent and 76 percent of the total in those years.

After 1980, exports of farm products declined, and exports of manufactured products stagnated (see table 4). The peso, bolstered by the inflow of foreign exchange, was maintained grossly overvalued in the face of mounting inflation. As the prospects for oil in the international markets started to narrow and the balance of payments current account deficit got out of hand with a large rise in imports, even of consumer goods (including grain), confidence was once again lost, and capital flight took place on a massive scale. Toward the end of 1981 and early 1982, Mexico found itself caught in a deep monetary and financial crisis.

Part of this crisis was due to the extremely rapid rise in external indebtedness and part to the terms under which it occurred. As has been well documented by the World Bank and the Bank for International Settlements, much of the increase in external indebtedness after 1979 was incurred at fairly short term, with minimal grace periods, and for a while at interest rates as high as 15 percent in real terms. By mid-1982, the international commercial banks stopped rolling over existing debt and cut off new lending, thus plunging Mexico into a debt service crisis of the first order, practically a state of default.

The other face of the coin was the disproportionate expansion in public and private investment during the 1978-1981 period. During those four years, public sector investment rose in real terms by a factor of two, and private investment (which includes housing and office buildings) increased by two-thirds. Thus aggregate investment grew at an average of almost 12 percent per year in real terms. The public sector deficit, in turn, rose steadily, in absolute and relative terms. In 1981 it was already 9.5 percent of GDP; it doubled to 18.4 percent in 1982. This was also partly accounted for by growing current expenditures and by nonadjustment of publicly administered prices (such as oil products, natural gas, transportation, and basic foods) to the rising general price level, thus giving rise to increasing subsidies from the overall budget.

As is well known, in 1982 the US Treasury and the IMF were instrumental in helping Mexico to negotiate a rescue package to meet debt service and reestablish liquidity. This meant, however, a further increase in total external debt, to \$87.6 billion by the end of that year. The public sector raised its indebtedness by \$9.4 billion, while that of the private sector was reduced by \$2.8 billion. Renegotiations went on in 1983, with reschedulings, and a net inflow of debt capital of \$6.2 billion actually occurred, to help with adjustment. In 1984, public external debt, with yet another rescheduling, rose by \$3.4 billion, and in 1985 by \$1.7 billion. The private sector's external debt declined after 1981 and fluctuated around \$18 billion until 1984-1985. In 1986, finally, there was a

total net increase in external debt of only \$500 million (\$700 million to the private sector offset by a net outflow of \$200 million from the public sector). (It should be noted that the outstanding debt of the public sector included, by the end of 1986, some \$3.3 billion due to IMF; see table 8.)

Thus Mexico reached almost the \$100 billion mark in 1986, that is, \$97.8 billion total, up from \$4.3 billion in 1970 and \$35.1 billion in 1978, when the oil boom got under way on a large scale.

From the balance of payments point of view, the crux of the matter is that, in the last few years, with this amount of external debt, and in spite of the reschedulings, which have been on the whole quite favorable to Mexico, interest payments have remained inordinately high however they are measured. After a peak of \$13.4 billion in 1981, when they accounted for as much as 48.4 percent of total exports of goods and services, interest payments have averaged about \$10 billion per year, equal to some 35 to 36 percent of exports of goods and services. Although interest rates have declined, and actual interest payments in 1986 were down to \$8.7 billion, the ratio has remained high because of the decline in total exports, especially in 1986 (see tables 4 and 8). Mexico has to devote more than one-third of its current foreign exchange income to meeting interest payments alone. This is the basic financial problem, which naturally has repercussions in other areas.

In 1985, Mexico earned \$13.3 billion from oil exports, \$6.7 billion from exports of manufactured goods, and \$1.8 billion from farm and mineral products. In addition, net tourist receipts were of the order of \$1.0 billion, and border subcontracting net exports (*maquila*) brought in another \$1.0 billion. Thus some \$23.8 billion were available to pay for imports, debt service, and miscellaneous outpayments. In that year, imports were \$13.5 billion, down from a peak of \$23.9 billion in 1981, but up from a low of \$8.6 billion in 1983 (this fluctuation being symptomatic of the "boom-and-bust" in that short period). The decline in imports, even from the \$18.6 billion level of 1980, must be taken as a sign of recession and crisis, not as a virtue of policy-making.

The arithmetic is simple. If to \$13.5 billion for imports is added \$10.4 billion for interest payments, the bill exceeded by \$100 million the current foreign exchange availabilities. Thus other needs, such as technology fees, dividends on foreign investment, shipping, and so forth, could not be met except by dipping into much-depleted foreign exchange reserves. This pattern over the period 1983-1985 meant, together with capital flight, that the value of the peso could not be sustained. It declined from an annual average of 57 pesos per US dollar in 1982 to 257 in 1985, with the end-of-year exchange rate in 1985 at 371 pesos for the controlled (mostly trade) transactions, and 447 per dollar in the free market. The latter was used for tourism and miscellaneous transactions.

It should be noted that Mexico got into two-digit inflation in the mid-1970s. The average annual price deflator for GDP in 1980 was 28.7 percent above the 1979 average, and inflation progressed, peaking first in 1983, when prices were 92.2 percent higher than the 1982 average. (It is

common to measure inflation in Mexico on a December to December basis; here, the *annual* average GDP deflator is used.) Efforts at reducing the rate of inflation, resulting in recession and unemployment, were partially successful in 1984 and 1985, when the annual rate declined to 61.8 percent and to 54.4 percent, respectively. However, inflation flared up again in early 1985, the currency weakened, exports declined, and only a trickle of fresh capital inflow arrived. By mid-1985, the peso had to be devalued and a new austerity program, with significant cuts in public sector expenditure, was put into effect. Needless to say, the private sector stopped investing, thereby contributing to the new recession.

In the last quarter of 1985, international oil prices weakened considerably, and by early 1986 had fallen from some \$26 per barrel to under \$10. (Mexico's average price per barrel is influenced by the fact that about 55 percent of its crude oil exports are "Maya," with higher sulfur content.) In the span of a few weeks this meant for Mexico a loss of \$7.7 billion (41 percent) in oil exports (at an annual rate), and a decline of 24 percent in tax revenue in real terms.

Table 9  
Mexico's Crude Petroleum and Natural Gas Production, 1901-1986

Year	Crude Petroleum Production (thousand metric tons)	Natural Gas Production (millions of cubic feet)
1901	1.36	
1910	496.00	
1921	26,384.00	
1940	6,009.00	32,701.2
1950	9,880.00	62,224.1
1973	22,498.00	676,746.5
1980	96,670.00	1,295,020.0
1984	139,746.00	1,369,699.0
1985*	130,961.00 <sup>a</sup>	1,315,350.5 <sup>b</sup>
1986*	120,355.00 <sup>a</sup>	n.a.

Sources: For crude petroleum: INEGI, *Estadísticas históricas de México* (Mexico City, 1985), vol. 1, table 12.1. Original data in thousands of barrels, converted to metric tons at 7.33 barrels per metric ton. For natural gas: 1940 and 1950, INEGI, *Estadísticas históricas*, table, 12.2; 1973-1985, Pemex, *Memoria de labores* (annual reports).

<sup>a</sup>Wharton/CIEMEX

<sup>b</sup>Pemex, annual report

\*Preliminary

With sustained, almost unavoidable, inertial inflation, the peso exchange rate has declined very rapidly, from 371 to the US dollar at the end of 1985 to over 1,100 recently. Inflation between December 1985 and December 1986 grew to three digits, at 105.7 percent (although the yearly average was 77.1 percent). The surge in the rate of inflation showed clearly in the January and February 1986

