PRIVATE DEFICIT, SAVINGS DEFICIT AND UNSTABILITY OF THE MEXICAN ECONOMY.

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The problem:

For over a decade Mexico has tried to transform its economy, with the aim to develop a new economic model, a new productive organization that should lead to a more competitive structure into the international economy. Nevertheless, the 1995 crisis has questioned that project. Though the views of criticism diverge, generally tend to conform arround two alternative hypothesis:

1 Either this is a financial crisis that developed out of a mis-conception of the financial model, particularly from the exchange rate and external financing policies. or

2 The current crisis reveals not just a short run financial difficulty, but a fundamental short-coming of the model and policies adopted for structural change.

Under the first hypothesis, it is possible to criticize the financial strategy from 1992 to 1994, particularly the use of the rate of exchange as an "anchor" for the level of prices, but no question is posed on the basic growth model. The second hypothesis may well be inclusive of the criticism of the exchange rates policies adopted, but states that the basic problem was engender from the pattern followed to produce structural change, on the basis of a new relationship with the world economy, particularly with the U.S. economy through NAFTA. Therefore, under the second hypothesis, criticism may not necessarily be directed to the need to induce a fundamental change in the productive structure, but to the particular model adopted to induce structural change and the pattern of adjustment followed.

This article seeks to sustain the second hypothesis in the following way: The first stance is to show that the pattern of growth rested heavily on an overvalued rate of exchange, with the aim to encourage growth in a few selected sectors, based on a privileged condition in respect to the rate of exchange. The main result of that policy has been to produce what we have labelled a "new dual economy", that shall be characterized. The pattern of growth has been unable to produce a real "export lead growth", in so far the leading exporting sectors are not capable to excert a positive effect on the rest of the economy. A second step shows thae extent of the transfers that the leading growth sectors are receiving from the rest of the economy. This fact questions the very nature of the actual model. That pattern developed a new external restriction on the public external debt: its growth was entirelly attributable to a private deficit, financed with public debt. A consideration is advanced on the relationship of growth with the finance of the "new model", particularly on the squeezing of domestic profits, and the permanence of unstability in the Mexican economy.

The new "Dual Economy".

The patern of structural change adopted during the last 14 years has produced a severe transformation of the Mexican economy. This can be observed on two grounds. The first is that the model has been extremely successful to create a new productive structure, considerably well inserted as a manufacturing exporter.[2] The success of the model of structural change can be apreciated in terms of the difference in rates of growth of the sectors with a domestic market inclination relative to those oriented to the international market. Table 1 shows that the rate of growth in GDP is no mached by a correlative increase in net exports.

[2] Sectors are: 1-4, primary; 5-10 extractive; 11-23 foods industry; 24-32 and 59 textiles and light industries; 33-42 chemicals; 43- 47 iron ore and other heavy industries; 48-58 and 61 motor cars, motor parts transportation and electricity; 68-72 services; 63-65 hotels and restaurants, 60 construction and 62 trade.

The new structure of production is such that successful exporters make profits on the basis of imported imputs. This can be assessed in terms of the change in the total linkages coefficients. Table 2 provides an estimate for the leading sectors and of the whole economy.

TABLE No. 1
RATE OF GROWTH AND NET EXPORTS. 1970 TO 1993.
SECTORAL INDEXES

	RATE OF GROWTH (1)		
SECTOR	70-76	77-81	82-87
S: 1- 4	2.61	5.08	1.4
S: 5- 10	6.7	-0.08	0.43
S: 11-23	4.55	7.54	0.85
S: 24-32,59	4.96	7.74	-1.29
S: 33-42	9.4	4.43	2.54
S: 43-47	6.65	11.62	1.62
S: 48-58,61	8.34	13.38	-0.97
S: 68-72	5.78	8.07	0.79
S: 63-65	8.82	10.91	-0.97
S: 60	6.49	14.15	-4.21
S:62	5.87	17.26	-1.8

(1) Average rate fo growth, per year, G.D.P.
(2) Average share of the trade balance, (exp -imp), to the total balance, for all
(72 sectors, NIPA). Source: N.I.P.A.. 1970-1993. INEGI.

TABLE No 2
TOTAL LINKAGE COEFFICIENTS .
MEXICAN ECONOMY . 1950 TO 1995.

Sector	1950	1960	1970	1980	1985	1988	1990	1995p
Agriculture	1.48	1.56	1.85	1.82	1.77	2.29	1.99	1.99
Oil and Gas	1.29	1.92	2.62	1.68	1.67	2.79	1.58	1.58
Food Industry	1.2	1.33	1.29	1.27	1.13	1.76	1.16	1.16
Beer			1.13	1.10	1.05	1.06	1.06	1.05
Glass			1.91	1.85	1.77	1.77	1.62	1.49
Cement			2.12	1.98	1.92	2.08	1.82	1.81
Petrochemical			3.28	2.936	4.45	4.06	2.66	2.61
Motor cars		1.18	1.12	1.12	1.08	1.064	1.038	1.02
Motor Parts			2.23	2.17	1.60	1.367	1.44	1.28
Electricity	1.10	2.02	2.24	2.385	2.49	2.86	2.49	2.63
Transport, and communicaciones.	1.17	1.51	1.52	1.44	1.49	1.20	1.406	1.40
Hotels, restaurants	1.00	1.15	1.21	1.22	1.21	1.17	1.22	1.25
Services	1.22	1.35	1.37	1.32	1.33	1.51	1.44	1.46

Retail	1.17	1.34	1.47	1.31	1.34	1.45	1.32	1.35
AVERAGE	2.31	1.69	1.80	1.745	1.71	1.84	1.627	1.61
STD DEV	1.74	0.47	0.65	0.613	0.67	0.797	0.565	0.57

SOURCE: Ortiz Etelberto, Competencia y crisis en la economía mexicana, ed. Siglo XXI, México 1994, pág 139.
p) Preliminary estimates for 1990 y 1995, STATMAT, México 1990, 1995.

The drop in linkage coeficients in the motor cars and motor parts industry and others like electronichs is remarckable. But they were an exception. It can also be observed in branches like Petrochemicals, cement and glass, that provide the bulk of export income.

The difference in productivity growth and employment can be observed in table 3, where is made evident that the leading sectors in growth and exports, partly have achieved their success reducing their employment.

TABLE No. 3
PRODUCTIVITY AND EMPLOYMENT. 1970 TO 1995.
SECTORAL INDEXES.

	PRODUCTIVITY 1980=100			EMPLOYMENT 1980= 100		
SECTOR	82-87	88-93	88-95 (1)	82-87	88-93	88-95 (1)
Total	98.10	111.74	126.64	105.7	111.6	110.2
Primary	104.31	104.73	122.71	104.44	105.01	99.3
Extractive	103.91	101.0	145.83	120.25	129.9	84.5
Food Industry	102.25	113.46	139.01	108.45	113.3	106.7
Light indust.	103.87	109.53	123.93	94.44	91.9	103.6
Chemical and petrochemical	104.58	124.15	126.45	113.79	119.25	102.9
Iron Ore..	99.34	125.59	137.84	99.62	94.9	95.0
Motor cars and others	102.76	136.35	123.92	1.0	96.9	112.9
Non-tradebles	100.06	104.64	114.97	109.0	115.7	114.0

(1) G.D.P. per worker and employment Index. 1988=100, NIPA 1988-1995
Source: N.I.P.A. 1970-1995

This section finds that it is an unavoidable conclusion that the success of structural change policies has been to create a new dual economy: With one sector based on cheap imported inputs predominantly oriented to the international market. The other, oriented to the domestic market, resting on cheap labour. The macroeconomic consequences of this fact are still to be discussed.

Private Deficit and Structural Change.

External indebtedness has been generally attributed to public deficits. That was true of the process observed during the seventies and early eighties. But that is not the case nowadays. The 1994-95 foreign exchange crisis in Mexico, was entirely attributable to a private sector trade deficit, generated by the leading growing manufacturing sector. This problem should be approached from the relationship of growth and net exports and its finance. Given that import prices grew faster than export prices,[3] and that domestic prices were kept under control, in real terms the real value of exports didn't growth as fast as the value of real imports.

The external deficit generated by the leading growing manufacturing sectors, from 1990 to 1994, was responsible for over 78 % of the trade deficit. We should stress that those sectors are at the front of the structural transformation.[4] Those sectors are among the few that show increases in productivity and output, during the last period, as can be observed in tables 1 and 3. But it can also be observed that relative to the 1985-87 period, although those sectors have been increasing their manufacturing exports at an unprecedented speed, the rate of exports and manufacturing exports on the GDP has been decreasing since 1990. The difficulty appears because from 1990, there is no doubt that the rate of increase of manufacturing exports has been achieved on the basis of a massive increase in imports, particularly of intermediate inputs.

The notion of a "private deficit" is concerned with the problem of dealing with and appraisal of real growth in those privileged sectors. The difficulty is introduced because the actual value of commodities produced with imported items is misleading. For the real price of those commodities to be properly assessed, it has to be assumed that the rate of exchange is an equilibrium rate, such that the rate of exchange expresses the actual oportunity cost of imported

[3] This fact has been documented by the Central Bank, in its anual resports. Banco de México 1993 to 1995.

[4] Include, according to NIPA accounts, INEGI: the subsector of chemicals and petrochemicals, 33 to 42, metal mechanical and transport sectors, 43 to 47 and 48 to 58.

items. In that case the value of imported inputs would correspond with its opportunity cost, that is with the value of the commodities exported, in the amount necessary to pay for those imports. This view is relevant, because we are dealing with the assessment of the long run properties of a peculiar growth model, one that rests on a critical relationship with the world economy.

Therefore, the fact that the rate of exchange in Mexico has never been an equilibrium rate, in fact actually tends to be overvalued, shows that it does not reduce the problem to a short run adjustment issue. The 1990 - 1994 experience was particularly dramatic in that respect.

The difficulty about the real value of imported inputs, is that if they are undervalued, therefore firms are not charging the real opportunity cost of the resources involved in there production. It is evident that, nevertheless, firms do not pay for the difference. For them, if someone makes their external bills smaller, in so far they do not pay the full cost of their inputs at an equilibrium rate, all the best for them, and there is no reason to reduce their imports. Evidently, to subsidize imports, pose a long run problem in terms of allocation of resources and valuation of production. But the end result may not well be all that evident. And it is that in spite of the profits made in those sectors, from the point of view of the real cost of resources, in fact we have two basic difficulties:

- There is a distortion that privileges sectors whose advantages on trade and growth are dubious, at the cost of sectors with a higher potential on growth, exports and employment. The difference rest on preserving a new duality in the economy. Some sectors will survive on the basis of low wages and not on a competitive drive.
- There is a deficit made from private decisions of production, but that private deficit does not appear in private balances. In fact they show profits, but the real deficit is turned into public debt.

In order to show the magnitude of that deficit, even as a rough proxy, if we consider sectoral imports at a constant real rate of exchange, let us say the 1986 rate, a rate that approached the external account almost to an equilibrium.[5] Table 4 presents the impacts from 1970 to 1993. We find that sectors 23 to 32, 33 to 42 and 48 to 59, produced almost 80 % of the

[5] A proper estimate on real exchange rate for that period is in Morales, Raúl (1996).

whole deficit. An it is remarkable that those sectors are coincident with those that lead growth and expanded faster.

TABLE 4

ASSESSMENT OF THE PRIVATE DEFICIT, ATRIBUTABLE TO THE RATE FO EXCHANGE.

Nominal Imports - Imports at the real rate of exchange. 1986 =100

(%) to GDP, toal and sectoral .

ON INTERMEDIATE INPUTS			ON CAPITAL AND FINAL CONSUMPTION GOODS	
AÑO	LEADING SECTORS	TOTAL ECO-NOMY	LEADING SECTORS	TOTAL ECONOMY
1970	8.01	2.33	5.49	1.60
1975	10.90	3.15	6.45	1.86
1980	9.54	2.83	6.12	1.81
1985	7.24	2.32	3.65	1.17
1988	4.99	1.04	1.68	0.44
1989	7.88	1.93	3.69	0.91
1990	8.37	1.89	4.83	1.09
1991	13.10	2.99	8.22	1.88
1992	19.59	4.33	13.34	2.95
1993	21.73	4.32	13.90	2.76
	ANUAL	AVERAGES	ANUAL	AVERAGES
70-81	8.33	2.35	5.20	1.47
82-87	2.93	0.93	1.60	0.50
88-93	12.44	2.74	7.61	1.67

SOURCE: Elaborated on the NIPA.

The last three rows present a real paradox: They show that the cost of transfers to the leading growing sectors, under the new model, presumably market oriented and absent of price distortions, instead of reducing the transfers, it increased them considerably, even over the cost observed during the period of import substituting industrialization.

From an orthodox neoclassical approach, it might be argued that under the pressure to stabilize prices and pushing for structural change through liberalization of trade, the policy adopted, particularlly fixing the rate of exchange, was the right choice. The difficulty with that policy was not just that ignored the extent of the impact of trade liberalization in terms of the needs of foreign exchange. The basic problem was that the policy mix, trade liberalization and overvaluation of the rate of exchange, distorted the whole environment for the policies of structural change to work. A far reaching consequence meant that there was no way in which the private enterprise could identify the real value of its inputs, consequently of its outputs.

The views on the rate of exchange, looked like as if there was a hidden idea in the minds of the policy makers, by the way an old idea: Trade liberalization would create a huge demand for imports at any rate of exchange, therefore the deficit of the balance of payments would persist anyway. Furthermore, the requirement of imports could not be regulated through the standard supply and demand mechanism.

Another condition encouraged that result. The way in which the process of structural change worked, particularly due to the introduction of new technologies and production processes inter-linked at world scale, conditioned that there was no way in which the domestic economy could provide for particular inputs at competitive prices. That is the condition introduced by intrafirm trade, by the way, a condition relevant for an important share of trade within the manufacturing sector, particularly for the leading growing sectors.

True, this behaviour might be attributed to the influx of an overvalued rate of exchange. Enterprises just profited out of the opportunity at hand. But it seems that the view of public officers, right from the beginning, was that stabilization of prices was priority number one. Therefore, public policy set priorities on the attack on inflation while fostering financial liberalization, ignoring the cumulative effects of the productive deficit on external debt. The 1994-95 crisis was the evidence for everybody that such view was entirely wrong on the finance of the model. Our contention, is that it also shows that the very model of structural change is not working properly.

The coincidence of both events, growth and external deficit in the same sectors, can not be interpreted as a fluke. They reflect a structural behavior that has been point out in many forms, i.e.: the impossibility of growth of the mexican economy without generating a trade deficit; the marginal propensity to import well over unity; the very small degree of integration of our industry, structural and technological dependence, etc.

The problem rests on the way the process of structural change has been conceived and constructed. The pass from a closed to an open economy, it is expected should induce that some sectors should produce an excess of exports over imports, while the lagging sectors should produce an excess of imports over exports. The "winners" might be explained either by comparative advantage or on dynamic competitive advantage.[6] But, whether resource availability or technological drive, in any case, theoretically the model works, if and only if, those sectors that take the lead in productivity and growth, are the same sectors that provide the flow of exports. Furthermore, the process is expected to work from the impulse of exports to its impact on growth. The other important effect is even more relevant. It is expected that the sectors devoid of competitive capabilities turn into "loosers", and that they should end up disappearing, or at least would turn into net importers. The model would be successful if growth induced by the first group becomes larger than losses of the second.

For the Mexican economy, evidence shows that the process has worked in reverse, particularly on the relationship of exporters and net importing sectors. It can be shown that the leading growth sectors are producing not only the current account deficit, but also that their exports are not associated to growth in the manufacturing sector. Furthermore, that the observed increase in productivity is associated with changes in relative prices, and not to the quantum of exports.[7]

Consequently, under this conditions, trade deficits in fact have a particular meaning, they correspond to an income deficit, in so far those enterprises that import more than they export, are not paying for the full cost of there inputs. The cost of that deficit is entirely transferred to the society due to the public action of taking debt to face the trade deficit.

Private deficit, external debt, and domestic savings.

Perhaps the magnitude of the present financial crisis can not be explained just on the basis of the productive behavior. Neither it is on the overvalued rate of exchange. The situation is also related to the fact that, the process of financial liberalization was a factor that did not contribute to stabilize the difficulties of management of the productive deficit. In fact the financial contour was a factor that magnified unstability. Our inquiry is directed to the fact that

[6] See Krugman (1987).

[7] Evidence on this point is presented in Ortiz (1997)

the urge to obtain short run finance to back the balance of trade deficit and honoring the external debt, worked severely against the model of structural change in another form: it destroyed domestic savings, reducing the long run capabilities of growth.

This problem has generally been reduced to the magnitude of external debt and its financial service. Our perception is that it involves other difficulties. It is evident that, in spite of the successive debt re-negotiations, the overall process is not leading to reduce the external service but to make it bigger, as can be appreciated in table 5. There, in column 4, is made evident the real impact of debt service once is evaluated with a real exchange rate.

The difficulty we are concerned with, is the relationship between the productive deficit and its financing on the basis of an ever increasing debt and its service. This phenomena pervades the whole process of growth, because the external finance of the private deficit, ends up reducing the domestic private saving.

TABLE No. 5
EXTERNAL DEBT SERVICE
SHARE TO THE NOMINAL G.D.P.
AND CORRECTED BY THE REAL EXCHANGE RATE: 1987.

YEAR	SERVICE Mill. dlls.	SHARE TO G.D.P. NOMINAL	SHARE TO GDP. AS OF RRAL RATE 1987
1980	9081	4.66	7.34
1981	13189.4	5.28	9.84
1982	17631.7	10.29	14.03
1983	14592.3	12.27	15.59
1984	14068.5	8.84	13.55
1985	13017.2	8.52	13.52
1986	11142.5	8.94	9.71
1987	11349.3	8.28	8.28
1988	11942.1	6.57	7.99
1989	12915.6	5.84	7.72
1990	12398.6	4.76	6.30
1991	15925.3	5.06	7.44
1992	20833.3	5.73	9.18
1993	22386.9	5.73	9.34

1994	27031.4	6.20	9.02
1995	44900.7	15.71	15.82
1996	27492.6	8.21	7.52

e: estimated on reports, by september 1997.
S.H.C.P., and El Banco de México.

It is well known, the recurrence of the current account deficit can not be faced exclussively on the basis of short run foreign investment. The mexican experience is illustrative that in spite of the magnitude of capital resources that ment into the country, sooner or later those capitals demand to be backed with public debt. That is evident with the sudden change in the level of external debt, generated by private enterprises and private banks, that once are on risk of default, their liabilities are very quickly converted into public debt.

The nature of the new debt is expressed not only weight on the GDP, as can be seen when we consider the adjustment of the real rate of exchange. The basic impact of the new debt can be appraised in its servicing (capital payments and interests). For 1995, the external service, if added by the conversion of tesobonos, might well be over 15 % of the new level of the GDP (considering devaluation, and a 5 % contraction in real terms). Given the schedule of payments, we know it will not be below 10 % for at least five years. Once it returns to its long run trend, until year 2000, it won't be below 10 % of GDP.

As it is well known, the extent and permanence of the external deficit from 1991 to 1994, rested not just on direct foreign investment. Furthermore, IED accounted for a smaller share of the total flow of resources. Short run funds were predominantly directed to speculative investment in the stock exchange market. The nature of that form of financing produced two impacts: The first in terms of transforming short run private debts in long run public debt. The second is very important in the analysis of the instability of the mexican economy: the destruction of private savings.

If we consider the difference between total savings, direct saving plus depreciation, and deduct external savings-including foreign investment and capital flows, and public savings[8], we obtain as a residual the amount of private domestic savings. Table 6 shows our estimation for all this variables.

[8] Adjusted for the inflation tax and seignorage.

TABLE No. 6

GROSS NATIONAL SAVINGS, EXTERNAL, PUBLIC AND EXTERNAL,
GROSS RATE OF INVESTMENT.
RATIOS TO THE G.D.P. 1980-1995.

YEAR	GROSS FIXED IN-VES-TMENT	G.N.S. SAVING 1	EXTER-NAL SAVING. FUNCTIO-NAL 2	EXTER-NAL SA-VING NET 2	PUBLIC SAVING 3	PRIVATE SAVING 4
1980	24.8	23.6	1.74	4.46	-1.1	24.16
1981	26.4	24.5	1.97	9.74	-7.5	32.00
1982	22.2	27.9	-5.79	-4.64	-0.3	28.20
1983	16.6	27.2	-10.66	-17.51	7.5	19.70
1984	17.0	26.2	-9.13	-9.28	3.3	22.90
1985	17.9	24.2	-6.27	-10.35	-0.2	24.40
1986	16.4	22.2	-5.74	-8.46	-5.3	27.50
1987	16.1	23.6	-7.51	-7.02	-4.0	27.60
1988	19.0	21.8	-2.77	-7.38	-3.8	25.60
1989	21.0	22.1	-1.10	-5.00	-3.7	25.80
1990	22.1	22.0	0.08	1.91	-1.1	23.10
1991	22.7	20.7	1.98	4.10	0.8	19.90
1992	23.1	18.6	4.44	2.81	2.0	16.60
1993	21.0	17.6	3.41	5.60	1.0	16.50
1994	21.6	16.9	4.70	-3.43	-0.1	17.00
1995	17.7	21.9	-4.24	-6.04	0.7	21.30
1996	16.1	19.2	-3.16	-6.35	0.3	19.00

p: preliminar.

(1) Source: N.I.P.A. 1980-1996, (2)Funct rate: trade deficit + net non factorial income + interest received by domestic residents. Net rate: net endebtment+foreign investment - foreign debt service. Balance of Payments, 1980 - 1996 El Banco de México. (3) Estimated as Public balance + Inflation tax, S.H.C.P. and El Banco de México. (4) Is obtained as a residual.

The dramatic drop in domestic savings responds to a twofold behavior:

- Given the small rate of investment, the economy in fact behaved as if it where in the presence of an excess of savings over investment. And

- Given the current account deficit, the economy had to reduce its rate of growth, in order to accommodate the flows of external savings.

Both phenomena are present in the increase of the average and marginal propensity to consume, observed from 1989 to 1994. But it is also evident in the way the financial sector managed to profit with the exchange of both flows, foreign exchange and financial resources available, accommodated to pay very high rates of interest.

The final result: rate of domestic savings has been reduced, as a consequence of financial liberalization. The rate of capital formation has not increased, while financial deepening increased, financial savings did not increased.

The way in which the Central Bank managed the sterilization of external savings created a massive impulse for over borrowing within the domestic financial market. The consequence was the increase of bad loans from 1993.

Financial instability or inability to induce structural change?.

A growth model essentially should have an answer about two basic issues:

- Priorities for growth: Generally means to set the sectors that will take a leading roll for growth. And
- The way in which it is to be financed.

Experience and theory show that they are not independent questions. Our query is not on the presumable advantages of "export lead growth" models. The problem is with the actual model on which the mexican economy is running. (falacy of agregation)

Trade liberalization pushed certain sectors at the lead of growth. Those sectors were also making there exports grow, by the way, faster than the rest of the economy. Nevertheless, there growth also rested on an influx of imports growing twice (17%) as fast as there own exports (8%). Such a model is untenable by all standards.

The finance of such a model demands that somebody takes the external deficit in order for those sectors to make a profit and growth. The growth of those leading sectors concerns 10 % of G.D.P. and affects an even smaller proportion of workers. Therefore it can be asserted that it is too expensive and not efficient to promote the improvement and welfare of the population.

There is a last consideration about the nature of the model and its finance. The provision of external resources to finance the balance of payments deficit demanded a profound distortion in the capital market. The price to attract 24,000 mill dlls per year, for three consecutive years, was not just a very high rate of interest. It also demanded that the economy should go into a slump process. From 1990 to 1993, the rate of growth of the economy had to be reduced, from 1990 (5%) to 1993 (1%) to keep a precarious balance between inflation and the rate of interest.

Conventional theory gives support to an interpretation where the contraction in the rate of growth of the economy might be taken as the logical result of events. Given the way in which the particular model operated in Mexico, our contention is that, ex-ante, the model worked backwards: <u>the decision was to induce a very slow growth in the economy, in order to produce the overall change associated with the financial liberalization of the economy.</u>

Structural change was displaced as a secondary policy in order to force the rate of inflation down and create a "financial paradise" for international flows of capital. The image of "modernization" through NAFTA and financial liberalization, pretended to feed one to each other, in such a way that "reputation" would do in order to attract more capitals. But the limit was imposed right from the beginning: exports lagged behind imports and the investment coefficient remained not higher than the average rate of the last ten years.

Therefore, neither on its dynamism nor on its impact on employment, could be argued that the model for structural change followed during the last twelve years is a viable project.

The result was:

- Financial instability due to the inability of producers to pay very high real rates of interest, such that the extent of bank defaults was increasing long before 1993 the crisis appeared.

- The reduction of the rate of inflation was always misleading. In fact we had a "repressed inflation". That is, agents in the economy had a considerable pressure to adjust there prices. But foreign competition frustrated their efforts to differentiate prices. The fact that the adjustment was not over, is evident by the fact that in spite of the compression of the inflation rate, efforts to differentiate prevailed ever since 1989.
- Even with the economy reducing its rate of growth from 1991 to 1993,[9] imports were consistently growing, and the trade deficit as well.
- The extent of private banks external endebtness, over-exposed there financial stability, as was evident in january 1995. Now some of those banks are taken by foreign concerns and indirectly by public capital.
- Excess profits in the banking sector were not enough to clear their need to cover its balance of capital. In fact they had to face an increassing amount of failures to pay back.

All of this events worked against the efforts of structural change. But it also has to be highlighted is working against the purpose of building a competitive financial sector, able to provide the necessary savings for growth.

It is evident the need to put together both projects: structural change and financial proficiency. The adjustment pattern adopted, doesn't necessarily approaches a consistent solution for both. The economy can not growth generating a private deficit that demands public debt. Structural adjustment has been reduced to a productive behavior that don't give a satisfactory relation to the need of inputs from abroad and the capabilities to export. It is impossible to create a healthy environment for financial development if the economy has to pay 11 % of its GDP on external debt service. The availability of resources for growth will rest very poor, in so far the economy induces a trade deficit in order to have growth.

Concluding remarks.

[9] The actual rate of growth for 1994 is ambiguous.

During the seventies and early eighties, the country took a huge increase in its external debt, due to policies of excess public expenditures and mismanagement of capital flows and rates of exchange that lead to massive capital outflows. Now we have a new process that lead to a huge increase in our external debt. But there is one difference, the present endebtness is entirely attributable to private deficits.

The present financial crisis, argues the government, is due to the fact that "private investors identified that the trade deficit could no longer be sustained on short run transfers of capital and public debt".[10] Such an argument amounts to say that, after 4 months of capital flight, everybody in the world was well aware of the situation, except the mexican government. But it also shows a total unawareness on the nature of this crisis. The policy response that have followed, clearly doesn't respond to the true nature of the private deficit.

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To be developed:
model
lines of research
adjustment..

The approach for adjustment rests on two policy instruments:

- the devaluation of the rate of exchange and consequent increase of the rates of interest, associated to a package to rescue banks from bankrupcy; and
- the contraction of the level of output and employment.

References:

Krugman, P. 1990. **Rethinking International Trade.** The MIT Press. U.S.A.

[10] See Informe sobre la situación económica, las finanzas públicas y la deuda pública". Primer trimestre de 1995. S.H.C.P.