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PREFACE

Mexico's "New" Financial Crisis of 1982 in Historical Perspective

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Dear Readers:

Here in central Mexico on Friday, a regular business day, the banks are open but are not exchanging pesos for dollars which the country badly needs to pay its foreign debt. The banker tells me that not only did the Mexican government last night freeze dollar accounts in Mexican banks but also, as of today, it has suspended indefinitely all official foreign exchange operations. He reminds me that these actions follow the Mexican government's devaluation of the peso on February 17, 1982 (from 26.5 to 40 to the dollar), and again on August 5, 1982 (after which the peso fluctuated, reaching a low of 100 to the dollar). The banker notes that I can wait with him today in the event the government reopens the official foreign exchange market, or I can change dollars into pesos on the open market. He suggests that in the meantime, I read about one of the "causes" of the fluctuating peso, that is, "Mexico's 80 billion dollar foreign debt." He hands me his copy of the mid-August issue of *Razones* recently arrived from Mexico City.

Sitting under the grand colonial arches of Pátzcuaro's central square, I compare the figures given in the magazine to data in the *Statistical Abstract of Latin America* (SALA). A few minutes of study suggest the problems of understanding the extent of government foreign debt and its relation to the dollar.

To illustrate the limitations of the data in the form generally reported by international agencies, table 1 gives four views of the cumulative disbursed foreign loans to "Mexico" since 1970. Data in the magazine (shown in table 1, column A) are incomplete except for 1980 and 1981 because they exclude debts maturing in less than one year, 10.8 billion pesos in 1981. Yet such reporting has been standard and therefore given in SALA, as seen in column B. Although short-term debt is normally not included in a country's total foreign debt figures, the expansion of short-term loans has reduced the usefulness of the traditional measurement of the total debt. To overcome this problem, column C depicts the "Mexican" foreign debt for less than as well as more than one year.

Table 1, column C, shows that the Mexican foreign debt rose from $4.3 to $19.6 billion between 1970 and 1976 and to $59.0 billion by mid-1982. These figures have limited meaning, however, because they do not account for the declining value of the dollar. Thus it appears in column C that President Luis Echeverría Alvarez (1970-76) caused the total foreign debt to increase by 360% compared to a 201% increase under President José López Portillo (1976-82).

Let us consider the changing value of the dollar by consulting column D in table 1. Here the dollar's value is defined for our purposes by the extent of change in the U.S. export price index (calculated from SALA, 22-2625). The U.S. export price index is an appropriate measure because usually about two-thirds of Mexico's trade is with the United States. The nominal foreign debt, given in column C, is converted into 1981 dollars with the price index of column D and yields the real foreign debt given in column E, that is, $57.4 million by mid-1982. It can now be seen that the real amount of Mexico's foreign debt in 1970 was $12.1 billion or $7.8 billion more than the $4.3 billion nominal dollars for 1970 shown in column C. Obviously, each dollar bought more in 1970 than in 1981, the kind of "well-known fact" rarely taken into account in financial analyses other than gross domestic product. In real terms, the Mexican government's foreign debt increased under President Echeverría not by the nominal 360% discussed above but by a real 152%, as can be calculated from column E. Under President López Portillo the real foreign debt increased not by 201% in nominal terms but by 88% in real terms.

If in mid-1982 the Mexican foreign debt stands at about $59 billion in nominal terms and approximately $57.4 billion in real terms, why did the banker here in Pátzcuaro talk to me about $80 billion dollars owed by Mexico? The answer is so simple that it confuses most U.S. news reporters: the concept of "Mexico" is too often interpreted to include the private sector external debt as well as that of the government.

The term "government" itself is problematic. Throughout the world centralized governments and decentralized governments differ in their spheres of activity. On the one hand, the centralized government includes the executive, legislative, and judicial agencies which are funded and audited through the national treasury; the decentralized government includes nationalized corporations owned by the state (including railways, airlines, oil companies, and other enterprises) which collect and disburse their own funds, frequently without any audit by an outside party such as the minister of the treasury. On the other hand, certain activities such as social security and trust fund accounts may fall into either sector of government, depending on the historical context of the country. In any case, the centralized and

Table 1
CUMULATIVE DISBURSED FOREIGN LOANS TO MEXICO'S PUBLIC SECTOR, 1970–82

	(A)	(B)	(C)	(D)	(E)
	M US			1981 = 100.0	M US of 1981
Year[1]	Nominal Debt One Year or Longer		Nominal Debt Under and Over One Year	U.S. Export Price Index	Real Debt Under and Over One Year (C/D)
1970	~	3,245	4,262	35.2	12,108
1971	~	3,523	4,546	36.3	12,523
1972	~	3,962	5,064	37.3	13,576
1973	~	5,442	7,071	43.5	16,255
1974	~	8,313	9,975	55.4	18,005
1975	11,612	11,533	14,449	61.8	23,380
1976	15,923	15,923	19,600	64.2	30,530
1977	20,185	20,784	22,912	66.7	34,351
1978	25,028	25,638	26,264	71.2	36,888
1979	28,315	28,805	29,757	82.8	35,938
1980	~	~	33,813	91.7	36,873
1981	52,000‡,c	~	52,961‡	100.0	52,961‡
1982	59,000‡,a,c	~	59,000‡,a	102.8[b]	57,393‡

1. Cf. SALA, 22-chapter 39.
a. August.
b. January to May.
c. Includes debt under one year; correct figure for 1981 is 42,207 million pesos (JLP-AE-H, 1982, p. 300).

SOURCE: A: *Razones* (Mexico City), August 9-22, 1982, pp. 17 and 19.
B: SPTF given in SALA, 22-3101, except 1971 from SALA, 21-3001.
C: SALA, 22-3900; JLP-AE-H, 1980, p. 344, and 1982, p. 300; except 1981 and 1982 from source A. The *Latin American Weekly Report*, July 30, 1982, listed the debt as $56.9 billion, presumably excluding undisbursed amounts.
D: SALA, 22-2625, base converted. Datum for 1982 is from IFS, Aug. 1982.
E: Calculated (C/D).

decentralized governments together constitute the "public sector." The latter usually receives subsidies from the former (although theoretically the reverse was supposed to occur as a result of the nationalization process); and the public sector often provides loans to the private sector in order to stimulate the national economy.

Although the public sector often subsidizes the private sector, especially in Mexico, the two are separate and their debts must not be confused. Indeed, the debts of the two sectors serve very different purposes, and the private sector external debt (about which little is known) has been estimated at about $21 billion in nominal terms or about $20.4 billion in real dollars.

By adding together the private and public sector totals, we can arrive at a "Mexican" foreign debt of $80 billion in nominal terms or $77.8 billion in real dollars, about 74% of which the president of Mexico is responsible for as director of the public sector. Of the public sector share, the centralized government (over which the president has immediate control) held only 16% in 1970 and in 1980.

This analysis is not meant to suggest that the Mexican presidency can be absolved of responsibility for the size of Mexico's public sector debt. Rather, the problem of the public debt has figured in the president's long-standing struggle to bring the decentralized agencies under greater scrutiny and control. Replacing the head of a decentralized agency can be difficult except under unusual circumstances. Such was the case of President López Portillo's dismissal of Petróleos Mexicanos director Jorge Díaz Serrano. (By June 1981 Díaz Serrano had foreseen the decline in the world price of oil and the potential for a world depression that could damage Mexico's economic well-being. Before a crisis mentality had developed in Mexico which could justify his actions, Díaz Serrano unilaterally ordered a reduction in Mexican oil prices. President López Portillo was upset that he had not even been first notified about the decision and asked Díaz Serrano to step down.)

Complicating analysis of the present conjuncture of events in Mexico, where confidence in the peso is lacking, is the fact that one year ago many believed that oil prices would again increase rapidly in view of the strong possibility of full-scale war in the Middle East. To López Portillo, then, there appeared to be little risk in taking out short-term, high-interest loans to survive a "momentary" decline in oil prices. In this scenario the $12 billion nominal dollars in interest and principal due in 1982 to the public sector's foreign credi-

tors on short- and long-term loans would be more than covered by Mexico's exports, two-thirds of which came from petroleum shipments in 1980. Too, according to a survey of 100 bankers most involved in the Euromarket loan activity, Mexico's credit rating among Latin American nations was second only to that of Venezuela in 1981 and almost tied with Venezuela in early 1982. Mexico's credit rating in 1982 was 62.8 on a scale of 100.0, compared to Venezuela's 63.3, Latin America's average of 34.5, and the world average of 45.8 (reported by *Institutional Investor* and quoted in *Latin American Market Report,* May 17, 1982).

Falling world prices for most raw materials as well as for petroleum, however, meant that by early 1982 the Mexican government was in trouble. Simultaneously, world market prices for Mexico's other important exports, including cotton, sugar, silver, and copper dropped (see SALA, 22-2627). Worse, the overvaluation of the peso discouraged exports and inhibited the entry of foreign tourists; at the same time, few pesos were needed to buy dollars and the peso's overvaluation encouraged Mexicans to import goods or to go abroad on "shopping sprees." Mexico's long-standing surplus balance of tourist spending turned against the country in the third quarter of 1981, when Mexicans spent more outside than foreigners spent inside (reported in the *Review of the Economic Situation of Mexico,* published by the Banco Nacional de México in December, 1981).

Why did not the Mexican government revalue the peso more quickly and realistically after 1976 rather than on a slowly sliding scale? Among the plausible explanations are these. First, economic growth had been achieved in spite of an overvalued peso. Second, if the government had allowed the peso to float from 27 to a more realistic figure of 80 or more to the dollar in February 1982 (instead of intervening to hold the peso below 50), the foreign debt of the public and private sectors would have increased by 196% rather than by 85% with respect to the amount of pesos necessary to pay dollars owed. Third, stability of the peso was seen as a factor in maintaining the official party's political support among the Mexican middle class, which has increased in number (see SALA, 21-3605) and which has become accustomed to living on the dollar standard. Many in the middle and upper classes had established savings accounts in the United States where the inflation rate has been much lower and interest rates at a twentieth-century high. U.S. treasury bill rates averaged more than 16% for 1981 (see SALA, 22-3215). The New York prime rate for 180 days went as high as 19.5% in mid-1981 (see SALA, 22-3216). Although Mexico's rate for 90 days reached 65% in early 1982 (higher than Chile, Colombia, Ecuador, Paraguay, Peru, and Venezuela but lower than Argentina, Brazil, and Uruguay—see SALA, 22-3216), the U.S. rates remained most attractive of all in the hemisphere because of the relatively stable U.S. dollar.

The fundamental problem of Mexico's peso valuation is revealed in table 2, which shows the relationships between money supply, inflation, and change in the country's GDP. Column A presents the cumulative currency and private sector demand deposit money supply (M_1), which corresponds to the standard definition in SALA, 22-2424. Because of the importance of the dollar in Mexico, however, column B offers the cumulative quasi-money supply available, including foreign currency bank deposits as well as time and savings deposits. (Although there is a penalty for early withdrawal of time and savings deposits, the penalty may be less severe than leaving the funds invested during periods of crisis, hence quasi-money may also be considered "money.") Adding together quasi-money and M_1 gives us the total money supply available in Mexico (M_2) shown in table 2, column C.

The nominal rise in M_2 compared to the inflation rate in Mexico (measured by change in the Bank of Mexico's wholesale price index given in table 2, column E) is portrayed in figure 1. In order to compare billions of pesos to the rate of inflation index, M_2 has also been converted to an index. The base chosen is the year 1975, the point after which Mexico's relative money supply made unparalleled increases. Prior to 1976 the percentage change in M_2 rarely exceeded 18% (about 26% in 1973 and 21% in 1974, as shown in table 3), and it averaged less than 12% between 1960 and 1972. After an increase of almost 18% in 1975, M_2 went up more than 48% in 1976 and more than 119% in 1977, the high point before falling to "only" the 36 to 37 percentiles in 1979 and 1980, respectively. In 1981 it again rose rapidly, by almost 49% before decreasing to about 22% in early 1982.

Why did the supply of money "take off" after 1975? To keep the Mexican economy afloat in 1976 following the erratic governmental policies of the early 1970s, analyzed in detail in my book *La Revolución Mexicana (1910-1976): Gasto Público y Cambio Social* (México, D.F.: Fondo de Cultura Económico, 1978, Epílogo 1), President Echeverría resorted to printing money during his last year in office. The resulting devaluation of the peso in 1976 left the new president, López Portillo, with serious problems when he took office three months later.

Facing the need to restore confidence in the economy, and the need to provide jobs for the 800,000 to one million new entrants to the labor market each year, López Portillo "resolved" the difficult situation by making a series of crucial decisions. In the psychological sphere, for example, he stopped Mexico's official rhetoric against leaders of the private sector (whom Echeverría had accused of taking money out of the country to sabotage his leftist policies), and accelerated Mexico's move to develop the family planning programs required to reduce pressure on future job markets. In the economic sphere, he benefited from the discovery of major new petroleum deposits during his first year in office, and he used this new source of wealth to attract the foreign loans needed to get oil and gas out of the ground and into the world market. The new petroleum industry (a capital-intensive operation), however, has necessitated the virtual rebuilding of Mexico's entire communication system (a labor-intensive operation).

Table 2

MEXICO'S MONEY SUPPLY, INFLATION, AND GDP, 1952–82

	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
	B NC YE			M_2 Index	Price Index[4]	Real M_2 Index (D/E)	Real GDP in 1975 Pesos[5] (B YE)	Real GDP Index	RM_2CE (Real M_2 Cost Effectiveness)[6,7] (H/F)
Year	Money[1] (M_1)	Quasi-Money[2]	Total[3] (M_2)	(1975 = 100.0)				(1975 = 100.0)	
1952	7.3	1.9	9.2	5.6	32.0	17.5	252.0	22.9	130.9
1953	8.0	2.1	10.1	6.2	31.4	19.7	252.8	23.0	116.8
1954	9.0	3.0	12.0	7.3	34.4	21.2	278.0	25.3	119.3
1955	10.8	3.4	14.2	8.7	39.1	22.3	301.7	27.4	122.9
1956	12.0	3.7	15.7	9.6	40.9	23.5	322.3	29.3	124.7
1957	12.8	4.7	17.5	10.7	42.7	25.1	346.6	31.5	125.5
1958	13.7	5.5	19.2	11.7	44.6	26.2	365.2	33.2	126.7
1959	15.9	5.3	21.2	12.9	45.1	28.6	376.0	34.2	119.6
1960	17.3	5.4	22.7	13.8	47.3	29.2	406.5	37.0	126.7
1961	18.5	6.0	24.5	14.9	47.7	31.2	426.5	38.8	124.4
1962	20.9	6.6	27.5	16.8	48.6	34.6	446.5	40.6	117.3
1963	24.3	8.1	32.4	19.7	48.8	40.4	482.2	43.8	108.4
1964	28.6	9.2	37.8	23.0	50.9	45.2	538.6	49.0	108.4
1965	30.2	10.4	40.6	24.7	51.9	47.6	573.5	52.1	109.4
1966	33.9	11.8	45.7	27.8	52.5	53.0	613.2	55.7	105.1
1967	37.0	13.1	50.1	30.5	54.0	56.5	651.8	59.3	105.0
1968	42.3	14.8	57.1	34.8	55.1	63.2	704.8	64.1	101.4
1969	48.6	16.9	65.5	39.9	56.5	70.6	749.3	68.1	96.5
1970	53.8	18.2	72.0	43.9	59.8	73.4	801.2*	72.8	99.2
1971	57.9	19.6	77.5	47.3	62.1	76.2	834.6	75.9	99.6
1972	68.2	22.9	91.1	55.5	63.8	87.0	905.4	82.3	94.6
1973	83.5	31.6	115.1	70.1	73.9	94.9	981.5	89.2	94.0
1974	100.8	38.4	139.2	84.8	90.5	93.7	1,041.6	94.7	101.1
1975	122.4	41.7	164.1	100.0	100.0	100.0	1,100.0	100.0	100.0
1976	158.0	85.0	243.0	148.1	122.3	121.1	1,146.5	104.2	86.0
1977	208.2[a]	324.5[a]	532.7[a]	324.6	172.6	188.1	1,186.0	107.8	57.3
1978	270.2	434.3	704.5	429.3	199.8	214.9	1,283.9	116.7	54.3
1979	360.9	597.2	958.1	583.9	236.4	245.0	1,401.5	127.4	52.0
1980	477.2	832.6	1,309.8	798.2	294.3	271.2	1,518.2	138.0	50.9
1981	635.0	1,314.6	1,949.6	1,188.1	367.0	323.7	1,641.2	149.2	46.1
1982[b]	643.3[b]	1,742.3	2,385.6	1,453.7	462.6	314.2	~	~	~

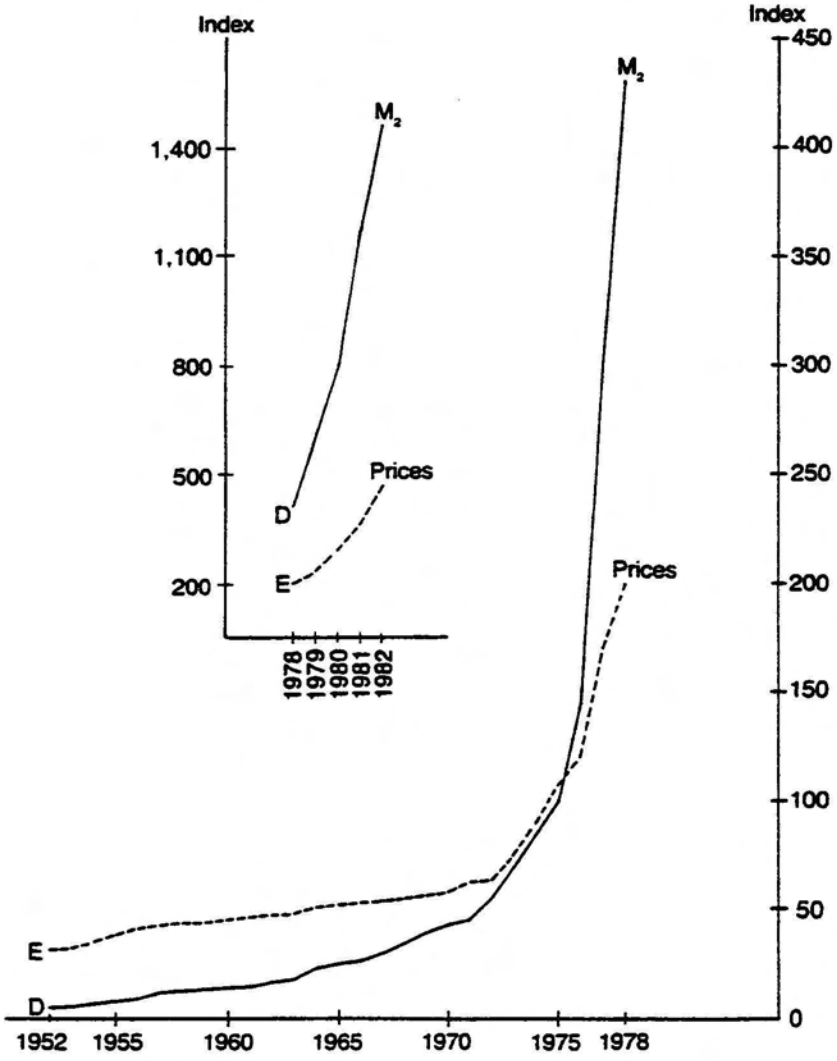
1. Sum of currency outside of banks and private sector demand deposits, source line 34.
2. Time, savings, and foreign currency deposits in Mexico by residents, source line 35. According to data calculated from Banco de México, *Indicadores Económicos*, August 1982, p. 6, foreign currency in checking accounts, liquid savings, and in time deposits made up the following % of M_4 (or IMF's M_2): 1968, 5.1%; 1969, 4.3%; 1970, 3.8%; 1971, 2.9%; 1972, 2.2%; 1973, 3.2%; 1974, 2.5%; 1975, 3.1%; 1976, 10.6%; 1977, 14.0%; 1978, 12.5%; 1979, 14.8%; 1980, 18.1%; Mar. 1982, 25.0%. Cf. Leroy O. Laney, "Currency Substitution: The Mexican Case." *Voice* (Federal Reserve Bank of Dallas), January 1981, pp. 1-10.
3. Calculated by adding columns A and B.
4. Bank of Mexico Wholesale Price Index (210 national and import goods), period average, source line 63.
5. New System of Mexican National Accounts (source line 99*b.p*) begins 1970 but link with Old System prior to 1970 (cf. NAFINEMC, 1981, p. 22) yields same percentage change from 1969 to 1970, that is, 6.9%.
6. Scores above 100.0 indicate a low cost effectiveness because real M_2 rises *less* than real GDP; scores below 100.0 indicate a high cost because real M_2 rises *more* than real GDP. With regard to the base year of 1975, the percentage change in real M_2 (6.7%) and real GDP (5.6%) were about the same (see columns F and G, table 3).
7. It should be recognized that real M_2 is not the only cause of inflation. Cf. I. M. de Navarrete and M. L. Guzmán Ferrer, "La Estabilidad Monetaria y los Desequilibrios Estructurales en el Crecimiento de la Economía Mexicana," Mexico-BNCE-CE, Dec. 1971, pp. 1104-1113.

a. Expanded coverage which approximates the Bank of Mexico's concept of M_4.
b. March.

SOURCE: A,B: 1952-74, IFS-Y, 1982; 1974-82, IFS, Aug. 1982, line 34.
C: Calculated (A + B).
D: Calculated from column C.
E: See source A, B, line 63.
F: Calculated (D/E).
G: See source A, B, line 99*b.p*, except 1981 calculated here from 1970-based data in Banco Nacional de México, S.A., *Selected Statistical Data*, July 1982, p. 218.
H: Calculated from column G.
I: Calculated (H/F).

Figure 1

MEXICO'S MONEY SUPPLY (M_2) AND INFLATION INDEXES, 1952–82
(1975 = 100)



Trajectories D and E are keyed
to columns D and E in table 2

To build the requisite industry, pipelines, roads, railroads, and telephone networks to take advantage of Mexico's re-emergence as a world oil power (a position lost after the inefficient nationalization of the foreign-owned oil industry in 1938), López Portillo pumped an enormous amount of new money into the Mexican economy, 119% more during 1977 alone. The resultant inflation rate of 41% in 1977, nearly double the high figure of 22% under Echeverría (see table 3, column E), seemed to be manageable because by 1978 the real growth of GDP reached 8% for the first time since 1973 (column G). This gain in GDP was matched or bettered during the following three years, astounding in light of the recession affecting industrial powers worldwide. Mexico's average rate of growth for 1978-81 was 8.5% compared to 4.4% for Japan and 2.5% for the United States and West Germany, depicted in figure 2.

Mexico's strong gains in real GDP, however, were achieved at a high cost in what I call the "real M_2 cost effectiveness" (RM_2CE), shown for a 31-year period in figure 3. The RM_2CE, developed in table 2, involves making for the absolute M_2 (column C) an index (column D, 1975 = 100) which is converted to real M_2 (column F) by adjusting for inflation (column E). Then, dividing the real GDP index (calculated in column H from absolute GDP in column G), we obtain the real cost effectiveness of M_2 (presented in column I). Scores above 100.0 indicate low cost of real M_2 because it rises less than real GDP; scores below 100.0 indicate high cost because real M_2 rises more than real GDP.

Figure 3 shows that because the trajectory of real M_2 was below that of real GDP until 1969, the trajectory of RM_2CE remained above 100.0. In 1969 RM_2CE (table 2, column I) fell to 96.6 and remained below 100.0 until 1974. During the post-1975 period RM_2CE had fallen to 46.1 by 1980, indicating a cost that would bear heavily on the Mexican economy by 1982 as Mexico's residents continued to abandon the peso in favor of the dollar.

The extent to which residents of Mexico shifted into dollars is suggested in figure 4. Prior to 1975 holdings of quasi-money (foreign currency in Mexican banks and also time and savings deposits) as a share of all money averaged in the mid-20 percentiles. The figure is suggestive because we can only infer that dollar holdings predominated and that time and savings deposits played a more significant role, except during times of political uneasiness as during the labor strikes of 1958 and the private sector concern over Echeverría's policies of 1973 and 1974. The importance of the dollar role in quasi-money is without question, particularly as M_2 and real M_2 rose so rapidly after 1975 (see figures 1 and 3). Hence, quasi-money was made up increasingly of dollar deposits in Mexican banks as residents sought to protect themselves against peso inflation, which was on the rise after 1972 and especially after 1975 (see figure 1).

Figure 4 reveals that after 1976 quasi-money rose above 30% of all money and by 1977 made up the majority of money. The idea of shifting to dollars caught on quickly among all sectors of Mexican society and seemed quite safe—dollar accounts had always been respected by the Mexican government and residents could change dollars into pesos as needed. By March 1982 the rise in M_2 and real M_2 seen in figures 1 and 3 meant that perhaps at least 25% of all Mexican money had been "dollarized," as is shown in figure 4.

To help explain what López Portillo has called the "dollarization" of the Mexican economy (the process of mass shift from pesos to dollars), we still need to examine other factors to which I have averred but which need more complete analysis. The first involves the official value of the peso exchange rate for dollars. The second concerns the extent and meaning of Mexico's merchandise trade deficit.

Table 3

MEXICO'S RATE OF CHANGE IN M_2, INFLATION, REAL M_2, AND REAL GDP, 1953–82

(PC Calculated from Table 2)

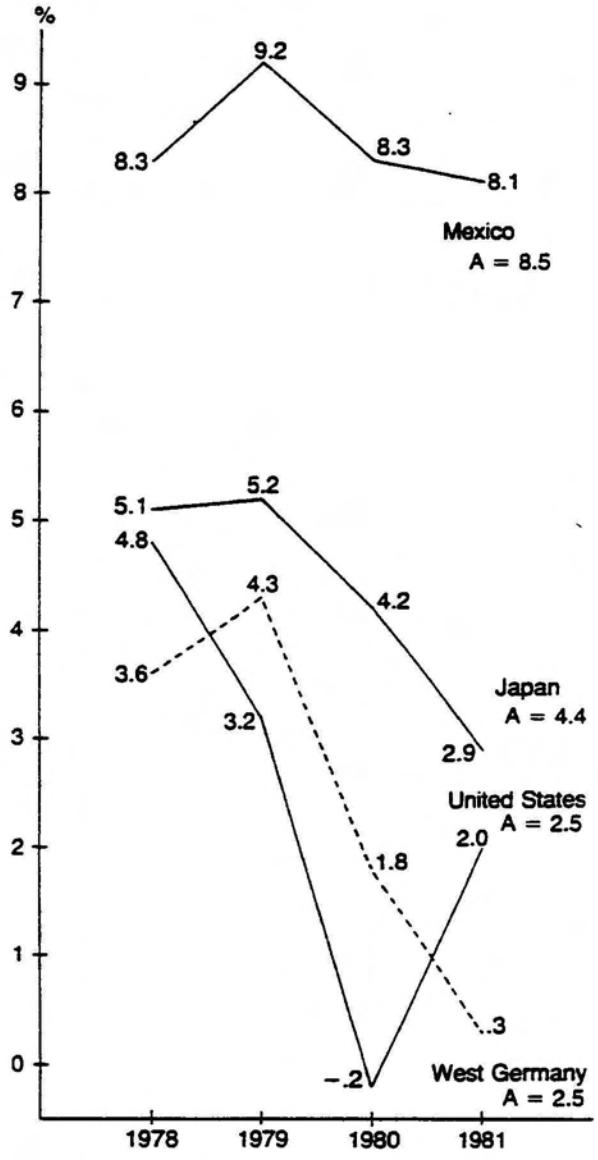
	Columns Keyed to Table 2			
Year	(D) Nominal M_2	(E) Inflation[1]	(F) Real M_2	(G) Real GDP
1953	10.7	-1.9	12.6	.3
1954	17.7	9.6	7.6	10.0
1955	19.2	13.7	5.2	8.5
1956	10.3	4.6	5.4	6.8
1957	11.5	4.4	6.8	7.5
1958	9.3	4.4	4.4	5.4
1959	10.3	1.1	9.2	3.0
1960	7.0	4.9	2.1	8.1
1961	8.0	.8	6.8	4.9
1962	12.8	1.9	10.9	4.7
1963	17.3	.4	16.8	8.0
1964	16.8	4.3	11.9	11.7
1965	7.4	2.0	5.3	6.5
1966	12.6	1.2	11.3	6.9
1967	9.7	2.9	6.6	6.3
1968	14.1	2.0	11.9	8.1
1969	14.7	2.5	11.7	6.3
1970	10.0	5.8	4.0	6.9
1971	7.7	3.8	3.8	4.2
1972	17.3	2.7	14.2	8.4
1973	26.3	15.8	9.1	8.4
1974	21.0	22.5	-1.3	6.1
1975	17.9	10.5	6.7	5.6
1976	48.1	22.3	21.1	4.2
1977	119.2	41.1	55.3	3.4
1978	32.3	15.8	14.2	8.3
1979	36.0	18.3	14.0	9.2
1980	36.7	24.5	10.7	8.3
1981	48.8	24.7	19.4	8.1
1982	22.4	26.0	-2.9	~

1. Caused in part by sizes of increase in nominal M_2 (Column D). Cf. David Barkin and Gustavo Esteva, *Inflación y Democracia: El Caso de México* (México, D. F.: Siglo XXI, 1979), pp. 24-25.

Figure 2

GDP GROWTH OF JAPAN, UNITED STATES, AND WEST GERMANY COMPARED TO MEXICO, 1978–81

(PC in Constant Prices of 1975)



SOURCE: Calculated from IFS, Aug. 1982, line 99a.r.

Perhaps to López Portillo and his advisors the peso did not seem so wrongly valued because theoretically its level, in general, had not been far out of balance with fair or real peso value over time. Such a view can be tested by utilizing ECLA methodology to determine the real value of the peso, a task complicated by the fact that we must select for comparison the year when the peso seemed to be valued "fairly" for importers and exporters as well as for the overall economic health of Mexico. (Too great an undervaluation results, for example, in foreign purchase of meat to the extent that Mexicans pay a higher price per kilo because it is in short supply.)

The two steps in arriving at fair value of the peso are as follows. The ECLA methodology for adjusting the official peso exchange rate for the dollar is presented in table 4, where Mexican and U.S. wholesale prices are taken into account for the comparison year chosen to show parity. No year is "perfect" as a base for determining fairness over time. Nevertheless, let us choose the year 1963, because it has the following characteristics: relatively low deficit of $201 million nominal dollars in merchandise trade balance (table 4, column F); low increase of .4% in the Mexican wholesale price index (table 3, column E); and a healthy real GDP gain of 8.0% (table 3, column G). We might have chosen the year 1954 because of its $92 million merchandise trade deficit and 10.0% gain in real GDP, but prices increased too greatly at 9.6% that year.

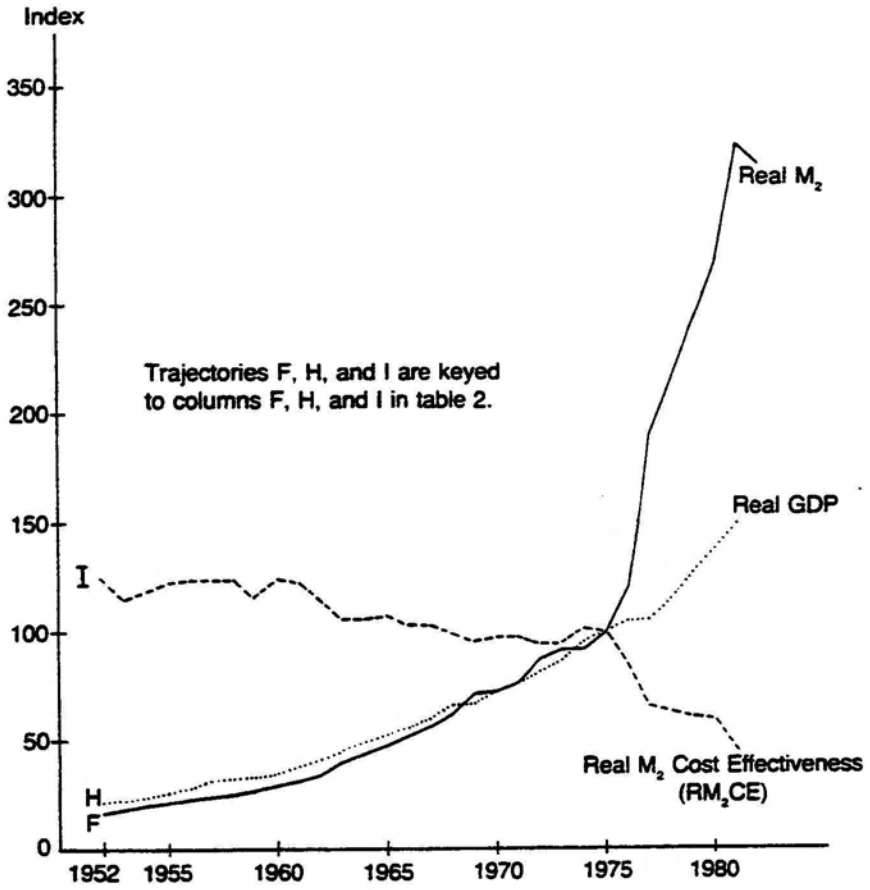
In making 1963 the base year, the index scores given in table 4, column E, have the following interpretation: 100.0 indicates complete "fairness" in peso valuation vis á vis the dollar. More than 100.0 suggests peso overvaluation which discourages exports from Mexico and foreign tourism to Mexico; and it encourages imports to Mexico, Mexican tourism abroad, and a Mexican shift from pesos to dollars which can be bought inexpensively. Scores less than 100.0 tell us that peso undervaluation tends to do the opposite of overvaluation.

According to ECLA methodology and our selection of 1963 as a basis for comparison of parity, we can see in table 4, column E, that the peso was overvalued in all years except those between 1954 and 1962, in 1977, and in early 1982. Figure 5 depicts this pattern, which reached high figures for overvaluation in 1975 (38%) and 1981 (23.6%). In the years immediately following, 1976 and 1982, devaluations took place. Although the Mexican peso valuation preceding the year 1975 tended to rise slightly above a usual 4-6% overvaluation, in the year preceding 1981 there was no such clear-cut trajectory, although in 1980 the tendency to rise was clear.

After the devaluations, the peso was undervalued. Because of the late devaluation in 1976, the undervaluation did not become apparent until 1977. Early devaluation in 1982 meant that undervaluation would show up sooner, but not soon enough or at an undervalued rate that would restore confidence in the peso or at least through high cost of dollars preclude the dollarization of the economy.

Figure 3

INDEXES OF MEXICO'S REAL TOTAL MONEY SUPPLY (M_2), REAL GDP, AND REAL M_2 COST EFFECTIVENESS, 1952-82
(An RM_2CE score of 100 or more is favorable)



With regard to the merchandise trade balance deficit, there is not much doubt that many in Mexico were concerned that the seemingly ever higher trade losses were directly related to the overvaluation of the peso—Mexico's goods were hard to sell abroad and foreign goods were inexpensive. The nominal merchandise trade balance, given in table 4, column F, reached more than $3 billion in 1975 and again in 1981. Converting the nominal deficit to index form (column G) and adjusting for inflation (column H), we can see that the real merchandise trade balance in index of 1963 reached their high (more than 820 and 878) in two of the Echeverría years (1974 and 1975) and during the year of López Portillo's presidency (when the highs did not pass 565 on the index in 1979 and 1981). The pattern under Echeverría in 1975 would be hard to reverse; and not until the peso crisis of 1982 would the solution to Mexico's overvalued peso be at hand.

Only with a big financial crisis in 1982 could the Mexican president justify revaluing the peso so as to begin to restrict the dollarized life-style of the affluent and relatively affluent. In fact, the bigger the financial crisis the better, because such a crisis would also permit a number of measures otherwise impossible to undertake without perhaps unendurable political repercussions for the official party of Mexico. The 1982 financial crisis justifies the following:

1. freezing of dollar bank accounts;
2. establishing a two-tier exchange system; one (set at 69.50 pesos to the dollar) for payment in pesos of the frozen dollars, and the second (floating) for all other activities;
3. stopping, in effect, the middle and upper classes from importing "luxury" goods and/or leaving Mexico on "shopping sprees";

4. winning a concession from labor to accept austerity rather than to demand wage increases;
5. soliciting "bail-out loans" from the IMF that involve restrictions on governmental policy which are otherwise unacceptable to Mexico's left-of-center political groups;
6. reducing low-interest loans and other subsidies to inefficient private sector and decentralized government agencies;
7. renegotiating the public sector debt with foreign banks.

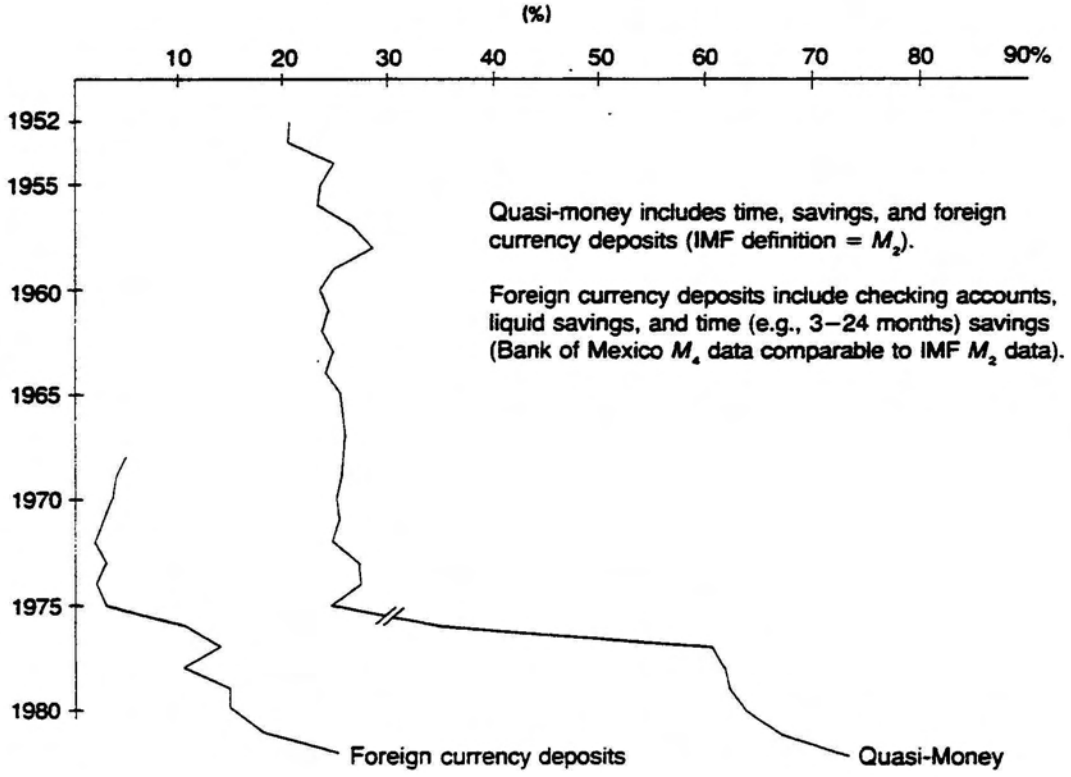
If the Mexican government had tried to carry out any of these steps without being in the midst of a "great crisis," it would have been accused at once of being "communist" and "fascist" as well as "anti-dollar" (ergo "anti-United States").

Generally omitted from financial discussion like that developed here is the fact that much of the crisis of mentality in Mexico is generated for political ends by the official party which has governed Mexico without interruption since its establishment in 1929. The official party justifies its continued government of the country by arguing that the Mexican revolution of 1910 is a continuing one which has passed through several phases: armed upheaval (1910-20); the rebuilding of war-torn Mexico (1920s); the social reforms for labor union power, land reform, and nationalization of foreign-owned oil under President Lázaro Cárdenas (1934-40); the industrial development of Mexico (1940-60); the attempt to balance political, social, and economic goals (1960-70); and the rise of statism (since 1970).

Part of the crisis of 1982 relates to the issue of presidential succession. New presidents are selected by outgoing presidents in the month of, say, September, elected the following July, and take office December 1. Once the new president is named, then, there is a period of about one year and three months during which the outgoing president loses influence. In effect, the nation (especially politicians and businessmen) put their activities "on hold" until they determine what the policies of the new president will be and how accommodation with him can be reached. To be without effective government for more than one year induces crisis, yet the president-to-be argues that he needs time to travel to

Figure 4

QUASI-MONEY AND ITS FOREIGN CURRENCY COMPONENT AS A SHARE OF TOTAL MONEY IN MEXICO, 1952-82



SOURCE: Quasi-money calculated from table 2 (column B divided by column C); foreign currency deposits are calculated from Bank of Mexico, *Indicadores Económicos*, August 1982, p. 6 (columns 4 + 8 + 12 divided by column 13).

Table 4

OFFICIAL AND REAL MEXICAN PESO VALUES COMPARED TO MEXICO'S REAL TRADE DEFICITS, 1952–82

	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
						Mexico YE		
Year	Official Peso Exchange Rate for Dollars (YA)	Mexico's Wholesale Price Index YA; 1963=100.0	U.S. Wholesale Price Index YA; 1963=100.0	Peso 1963 Parity Exchange Rate[1] 12.5 in Col. A Times (B/C)	Peso's Value Index (D/A)[2] 1963=100.0	Merchandise Trade Balance FOB M US	Trade Index 1963 Equals –100.0	Real Merchandise Balance Index[3] 1963 Equals –100 (G/C)
1952	8.650	65.6	93.9	8.7	100.6	~	~	~
1953	8.650	64.3	92.6	8.7	100.6	-169	-84.1	-90.8
1954	12.500	70.5	92.8	9.5	76.0	-92	-45.8	-49.4
1955	12.500	80.1	93.0	10.8	86.4	21	10.5	11.3
1956	12.500	83.8	96.1	10.9	87.2	-174	-86.6	-90.1
1957	12.500	87.5	98.7	11.1	88.8	-362	-180.1	-182.5
1958	12.500	91.4	100.2	11.4	91.2	-338	-168.2	-167.9
1959	12.500	92.4	100.4	11.5	92.0	-220	-109.5	-109.1
1960	12.500	96.9	100.6	12.0	96.0	-354	-176.1	-175.0
1961	12.500	97.7	100.2	12.2	97.6	-260	-129.4	-129.1
1962	12.500	99.6	100.4	12.4	99.2	-167	-83.1	-82.8
1963	12.500	100.0	100.0	12.5	100.0	-201	-100.0	-100.0
1964	12.500	104.3	100.2	13.0	104.0	-370	-184.1	-183.7
1965	12.500	106.4	102.2	13.0	104.0	-352	-175.1	-171.3
1966	12.500	107.6	105.7	12.7	101.6	-337	-167.7	-158.7
1967	12.500	110.7	105.9	13.1	104.8	-608	-302.5	-285.6
1968	12.500	112.9	108.5	13.0	104.0	-634	-315.4	-290.7
1969	12.500	115.8	112.8	12.8	102.4	-529	-263.2	-233.2
1970	12.500	122.5	116.9	13.1	104.8	-888	-441.8	-377.9
1971	12.500	127.3	120.8	13.2	105.6	-749	-372.6	-308.4
1972	12.500	130.7	126.1	13.0	104.0	-894	-444.8	-352.7
1973	12.500	151.4	142.6	13.3	106.4	-1,515	-753.7	-528.5
1974	12.500	185.5	169.4	13.7	109.6	-2,791	-1,388.6	-819.7
1975	12.500	204.9	185.2	13.8	138.0	-3,271	-1,627.4	-878.7
1976	15.426	250.6	193.7	16.2	105.0	-2,296	-1,142.3	-589.7
1977	22.573	353.7	205.6	21.5	95.2	-1,021	-508.0	-247.0
1978	22.767	409.4	221.7	23.1	101.5	-1,746	-868.7	-391.8
1979	22.805	484.4	249.4	24.3	106.6	-2,830	-1,408.0	-564.6
1980	22.951	603.1	284.4	26.5	115.5	-2,310	-1,149.3	-404.1
1981	24.515	752.0	310.2	30.3	123.6	-3,329	-1,656.2	-533.9
1982[a]	46.758	1,010.2	316.1[c]	39.9	85.3	116[b]	57.8[b]	33.9[b]

1. The year 1963 was selected for parity comparison because of the following characteristics: low increase of .4% in Mexican wholesale price index (column B); relatively low deficit of $201 million real dollars in merchandise trade balance (column F); and healthy real GDP gain of 8.0% (see table 3).
2. More than 100.0 equals peso "overvaluation" which discourages exports from Mexico and foreign tourism to Mexico; it encourages imports to Mexico, Mexican tourism abroad, and a Mexican shift from pesos into "cheap" dollars. Also in terms of 1963 value, the greater the undervaluation of the peso the greater the chances to reduce Mexico's trade deficit, to increase Mexico's money balance from tourism, and to encourage investment in pesos rather than dollars. Undervalued pesos allow foreigners to buy more goods and services in Mexico than do overvalued pesos.
3. In no years did value of exports equal that of imports (theoretically zero on the index scale). The real merchandise trade deficit of $201 million equals –100.0 on the index scale.

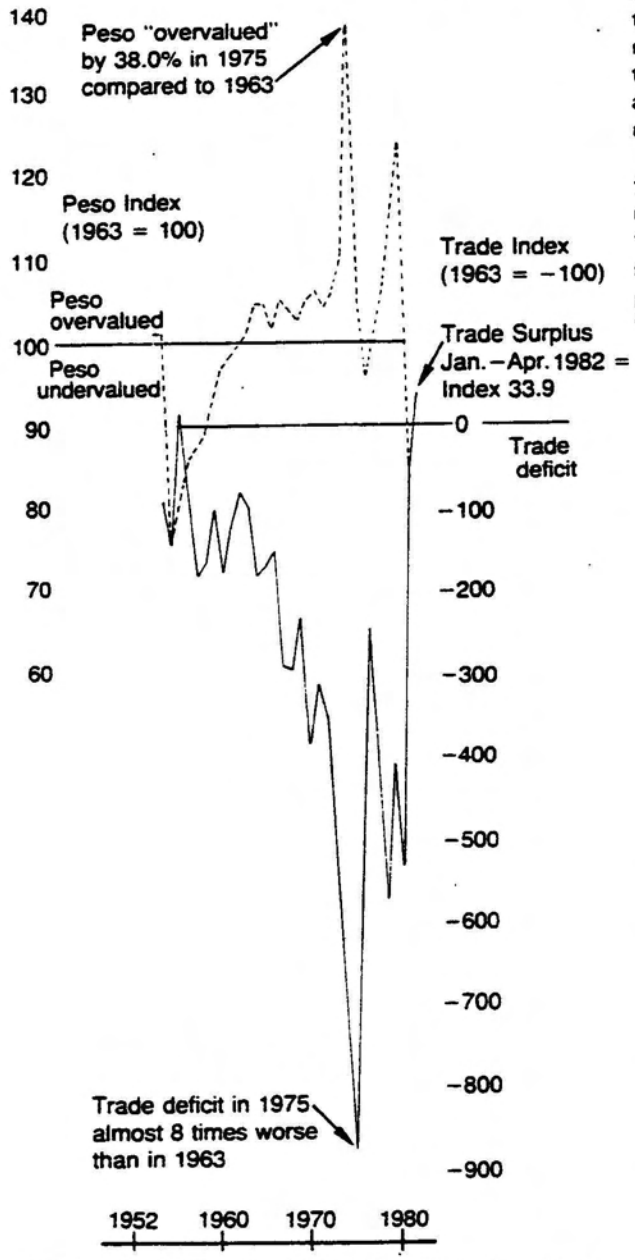
a. May.
b. January–April.
c. January–April = 170.5 U.S. wholesale price index.

SOURCE: A: 1952-74, IFS-Y, 1982; 1975-82, IFS, Aug. 1982, line *rf*.
B: Bank of Mexico 210-item wholesale price index calculated (base converted) from source A, line 63.
C: Calculated from source A, line 63.
D: Calculated (datum for 1963 in column A times B/C).
E: Calculated (A/D), according to ECLA methodology in ECLA-S2, 1980, p. 394.
F: 1952-74, IFS-Y, 1982, line 77*ad*; 1975-81, IFS, Aug. 1982, calculated from lines 77*aad* and 77*abd*; 1982 calculated from CE, Aug. 1982, p. 904.
G: Calculated from column F.
H: Calculated (G/C).

Figure 5

REAL INDEXES OF MEXICO'S PESO OVERVALUATION[1] AND TRADE BALANCE DEFICIT, 1952–82

(1963 = 100.0 for Peso and -100.0 for Trade)



1. "Overvalued" pesos allow Mexicans to buy more goods and services abroad than do undervalued pesos. Undervalued pesos allow foreigners to buy more goods and services in Mexico than do overvalued pesos. See table 4, n. 2.

SOURCE: Table 4, columns E and H.

towns, villages, factories, and farms in order to become acquainted with the people throughout the republic. Too, he argues, he needs time to determine his priorities, select his government team, and understand the issues. This rationale probably is logical given that the new president may not have served in an elected capacity previously, having risen through the official party and government posts with little public notice. Because his election is assured, however, in my view the time between his selection as president-to-be and his inauguration should be considerably shortened in order to moderate the continuing crises of Mexican development.

To ask for rational change in the time between selection and inauguration of new presidents, then, may be unrealistic. The concept under which the country lives is that of "Mexico: Permanent 'Revolution,' Permanent 'Crisis,'" (see my article in the *Los Angeles Times*, December 5, 1976, p. VIII-17). In that essay, written during Mexico's last "crisis" (and before the oil boom of the late 1970s), I said:

> In a sense, the Mexican political model encourages crisis for these reasons:
>
> —To develop a bargaining position and rise to the top within the one party that monopolizes power, new and would-be leaders must identify problems for solution, often scouring the country for social and economic issues generated by interests that may be relatively unorganized in political terms.
>
> —Past bargains between the left, center, and right wings of the party break down under the onrush of events.
>
> —Political leaders must appear to be in the forefront of changing worldwide climates of opinion—new problems demanding new solutions which entrenched leaders resist in order to implement their own promises.
>
> —In a secretive system it is possible to tell when the limits of bargaining power have been reached only when those affected by governmental decisions begin to cry out that their interests are being severely or irreparably damaged. These interest groups make their case to the government, and provide support to one or another wing of the official party by, for example, taking out full-page ads in the daily press. Such ads traditionally provide a prime means of taking the political pulse of the country. The cost of the ads, and public scrutiny and debate as to their veracity, prevent the launching of frivolous "public opinion" campaigns; the needed follow-through in money and energy are prohibitively expensive unless real issues are at stake.
>
> Thus swings of "public opinion" can indeed bring to power new sets of leaders with each six-year, nonrenewable presidency—new leaders in the sense that they become "visible"

> as representatives of the different wings of the official party. In fact, if each wing did not regularly come to the fore, the official party would break up. And each wing can govern as part of the institutionalized revolution because the Mexican constitution of 1917 was written in the spirit of compromise, calling for active state power by the left wing, and also providing for continued existence of the private sector under the right wing. . . .
>
> The possibility has always existed that a president would wreck the Mexican political model by trying to force the will of one wing on the party and the country, but so far this has not happened. Odds are still that it will not, however fragile the party appears. If we see crises coming in cycles, we can sit back and wait to see how the next one will be managed even as we watch the present one work itself out.

In the sense that crises will recur, Mexico is timeless. In the sense that the country has now developed the industrial base necessary to compete in world export markets and that it has the "black gold" of the modern era—cheap energy—Mexico is not timeless. Mexico has the capacity to recover its economic and financial strength within a few years. In the meantime, Mexico must build or rebuild its entire communication system to accommodate the new size of the GDP. Railroad systems must be "double-tracked," modern interstate highways must be constructed, oil and gas pipelines must be laid, electric and telephone lines doubled and tripled, and the development of new areas of growth ranging from Cancún in the Yucatán to San José del Cabo in Baja California must be strengthened. With the fourth largest proven reserves of petroleum in the world, and perhaps the largest in unproven reserves, Mexico may have the critical edge in producing inexpensive goods for export.

In developing this essay to suggest new ways of looking at statistics published in SALA, it is my hope that these statistical methodologies will encourage comparisons of the Mexican financial case to that of other countries in Latin America. With regard to Mexico, this twenty-second volume of SALA contains chapters by Stephen Haber and Samuel Schmidt who show, respectively, that Mexico's rural sector is not at all timeless and that the problem of the size of Mexico's debt can be examined in complex ways that complement my discussion here.

Sincerely
James W. Wilkie

P.S. Los Angeles, September 1, 1982. Today President López Portillo nationalized the Mexican banking system. With that one stroke he regained prestige in a country that will compare his act of expropriation to Cárdenas's nationalization of the petroleum industry in 1938. After the August 5, 1982, devaluation (and especially during the period from August 13 through August 18 when dollar exchange markets remained officially closed), the Mexican populace seemed to have forgotten López Portillo's performance in extracting Mexico from the financial crisis of 1976. López Portillo had looked weak at mid-month when the dollar market was reopened with three exchange rates (a preferential rate of 49.50 pesos to the dollar for essential imports such as food and medicine; a rate of 69.50 pesos for repayment of "frozen dollars"; and a free rate opening at 130 pesos to the dollar). His action today showed his determination to leave office in a position of strength rather than weakness. Further, López Portillo established foreign exchange controls and set the dollar exchange rate at 69.50 pesos for all transactions except the import of preferential goods (held at 49.50 pesos). It is too early to know if the standard rate of about 70 pesos to the dollar is properly valued. Technically, as can be calculated from table 4, column A divided by E, in May the peso should have been valued at 55 rather than 47, but the issue is more than a technical one. The issue involves psychological confidence on the part of Mexico's residents that the government knows what it is doing and is not leaderless in time of crisis. The nationalization of the banking system and the establishment of exchange controls will bring much of the Mexican populace behind the official party for a short time. The medium-term challenge must be faced by President-elect Miguel de la Madrid, who takes office December 1. The "crisis" facing him is to restore the confidence of national and international money interests in Mexico's peso and banking system.

Perhaps there is indeed a lesson from Mexican politics in the events analyzed here. That lesson is the unstated ethic (or elitelore) of Mexico's official party of permanent revolution:

> From each president of Mexico according to
> his need to create crises;
> To each president of Mexico according to
> his ability to "resolve" them.
>
> J.W.W.