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classes. But the claim that underemployment worsened is difficult to substantiate, and the data in the income-expenditure surveys contradict the notion that economic factors underlay middle class dissatisfaction. The income share of the middle classes increased in each succeeding survey (1958, 1963, 1968, 1970) and rose far more over the 1958–70 period than that of any other group.

In vigorously defending the record of SD, I am not saying that policy mistakes were not made. Tax reform, less rapid real wage growth in the industrial sector, and greater efforts at promoting agricultural development would, I believe, have led to greater reductions in underemployment and a more equitable distribution of income. Overall, however, SD worked and worked well.

3 Shared Development and the Echeverría Administration

The presidential campaign of Luis Echeverría generated great enthusiasm and high hopes among the general population. Echeverría crisscrossed the country, exhibiting a level of political energy not seen since the days of Lázaro Cárdenas in the thirties. He repeatedly stressed two basic themes in his campaign: prevention of another social conflict like that of 1968 and preservation of the fixed exchange rate of 12.5 pesos per dollar. The first objective reflected Echeverría's intention to achieve a reconciliation with the young and the middle class. The second signalled a commitment to perpetuate the successful financial system inherited from SD.

Although the Ministry of Finance and Bank of Mexico were placed under the direction of professionals who had served the two preceding administrations, the economic program of SD was rejected as having done too little to reduce underemployment and improve the distribution of income. It was announced that henceforth the government would take a more active role in ameliorating social ills—that is, in promoting "Shared Development." The initial economic program proposed six measures to foster Shared Development and reduce the large current account deficit of 1970:[1]

1. Increase the supply of credit to, and government investment in, the agricultural sector.
2. Replace licenses by tariffs, eliminate tax rebates given to the industrial sector, and redirect trade policy toward export promotion.
3. Increase government revenues by raising public sector prices, by tax reform, and by a reduction of tax evasion.

4. Introduce tax incentives to encourage employment growth and greater dispersion of industrial activity.
5. Develop new tourist sites as an additional source of foreign exchange earnings.
6. Improve the "efficiency" of government current expenditures.

This program was supported by the new Minister of Finance, Hugo Margain, but quickly came under fire from other cabinet members who felt that the pursuit of Shared Development required a more aggressive approach. Elements of the program would be resurrected and then abandoned again in 1977 and 1983 in the face of opposition from large segments of the bureaucracy, labor, and industrialists operating in the protected industrial sector.

Shared Development got off to a slow start in 1971. Contractionary fiscal and monetary measures were adopted since restoration of external balance was the paramount concern. Capital expenditures of the federal government were cut 12 percent in nominal terms, the domestic price of sugar was raised 48 percent, and a surtax on luxury goods was imposed. The nominal monetary base increased 18.8 percent, but this reflected the desired improvement in the balance of payments; Central Bank credit to the public sector actually decreased.

Contractionary policy produced a mild recession. GDP growth slowed to 4.2 percent, and excess bank reserves rose to 2.6 billion pesos. Though the recession was not particularly severe and was predictable in light of the political business cycle, it considerably strengthened the hand of those militating for a much more expansionary fiscal program. The Ministries of the Presidency and of National Patrimony vigorously attacked the restrictive monetary policy of the Central Bank and the low-level budget proposed for 1972 by the Ministry of Finance. A large increase in public investment and easier monetary policy were essential, they argued, to pull the economy out of the recession and make progress toward the goals of Shared Development. President Echeverría concurred, and starting in 1972 economic policy changed radically.

3.1 1972–76: Public-Expenditure-Led Growth and the First Debt Crisis

The Minister of Finance counseled President Echeverría that a tax reform increasing revenue growth was imperative if the ambitious investment program planned by the government was to be financed soundly. In 1972 the Undersecretary of Revenue, Gustavo Petricioli, put forward a program involving reform in three key areas:

1. Reduction of tax evasion, especially evasion of the corporation income tax. If evasion could be lessened, a cut in rates would be compatible with an increase in total revenue.

2. Definition of a broad taxable base without preferential treatment for any group or individual. The tax base would include all income regardless of its source. To solve the problem of anonymity, securities issued to the bearer would pay the maximum marginal rate. Otherwise, interest and dividend income would have to be declared and accumulated to other income.
3. Greater revenue generation by state-owned enterprises (SOEs). Many SOEs had not adjusted their prices in the last ten years. Revenue stagnation was a major problem for PEMEX (oil), CFE (electricity) and DDF (Department of the Federal District).

The underlying issues were the same as those Ortíz Mena had wrestled with in 1964–65. The private sector staunchly opposed the reform, greatly fearing the loss of anonymity and the possibility of a wealth tax. In policy circles there was apprehension that any reform would provoke capital flight and a severe devaluation and, in particular, that the elimination of bearer securities would cause financial panic and a collapse of the banking system.[2] After many heated debates, President Echeverría decided on 26 December 1972 to kill the tax reform bill. Shortly afterward, the Minister of Finance, Margain, and his Undersecretary, Petricioli, were fired. The revenue-raising effort in 1973 was limited to an increase in the excise tax rate from 2.8 to 4 percent and the imposition of a 15 percent surcharge on luxury goods.

During the same period in which it suffered defeat on tax reform, the Ministry of Finance lost a second important battle. Since the late nineteenth century, the Ministry of Finance had been responsible for monitoring both government expenditure and revenue collection. Beginning in 1973, the Ministry's responsibility for controlling outlays was limited to current expenditures. Control of public investment expenditures, and hence control over the bulk of discretionary spending, was shifted to the Ministry of the Presidency. Increasingly, the Ministry of Finance was forced to relinquish control over the spending process as more and more programs were directly approved by the president himself. There was no pretense to the contrary. After firing Margain as Minister of Finance, President Echeverría stated bluntly that "the national finances are handled from Los Pinos" (the presidential residence).[3] Under this new institutional arrangement, the limited revenue base no longer deterred expenditure growth. At the same time, Echeverría came under intense political pressure to increase spending.[4]

From the thirties onward, the presidential successor had emerged as the compromise choice of the various factions constituting the ruling political elite. By providing the new president with a solid base of political support at the beginning of his term, this consensual system made it much easier to conduct a responsible, clear-cut economic policy. The era of strong presidents came to an end in 1970. Díaz Ordaz's brutal handling of the student riots in 1968 produced a deep political schism. For the first time since the selection of Plutarcho Calles in 1924, the political elites could not agree on a compromise candidate, and Díaz Ordaz had to choose his successor unilaterally. Hence, in contrast to his predecessors, Echeverría faced the difficult task of creating his own supporting coalition *after* assuming office. The simplest method of shoring up the weakening political consensus was to spend on everyone's behalf: dole out subsidies to education and agriculture, increase government jobs for the middle classes, grant large wage increases to mollify organized labor, etc. The inflationary repercussions of greater spending were not a grave concern; reestablishing the political consensus was. The alternative, in Echeverría's view, was "fascism" (Newell and Rubio 1984, 204).

After retrenchment in 1971, succeeding years saw enormous fiscal expansion. Total public sector expenditure increased from 20.5 percent of GDP in 1971 to 32 percent in 1976. Much of the increased spending took place in the parastatal sector. Between 1971 and 1975, SOEs increased their real current expenditures at an annual average rate of 18 percent and their real capital expenditures at a rate of 29.3 percent.[5]

New, large-scale industrial projects accounted for most of the expansion in the parastatal sector. During this period, the steel mills of Lázaro Cárdenas–Las Truchas, several industrial seaports, and the petrochemical complex of La Cangrejera were constructed and many of the most important PEMEX investments were carried out.

Expenditure increased strongly in other branches of the government as well. Outside the parastatal sector, expenditure growth reflected principally the undertaking of expensive investment programs and a general policy of expanding government employment. Between 1970 and 1976, the number of federal government employees doubled and the growth rate of general government employment averaged 10.8 percent. A series of large wage hikes after 1972 further inflated the government wage bill (table 3.1). The wage hikes combined with growth in new hirings resulted in a 101 percent increase in the real public sector wage bill during the Echeverría *sexenio*. Much of the

Table 3.1 Public Sector Employment and Wage Payments

	1970	1971	1972	1973	1974	1975	1976
General government employment	100.0	109.5	123.2	134.7	149.4	168.4	185.0
% change	—	9.5	12.5	9.3	10.9	12.7	9.9
Total real public sector wages and salaries[a]	100.0	111.6	120.3	143.1	146.2	176.1	200.7
% change	—	11.5	7.9	18.9	2.2	20.4	14.0
% of GDP	5.7	6.1	6.0	6.5	6.3	7.2	7.6

Sources: For 1970–75, the data on general government employment is from the National Income Accounts (México, D.F.: INEGI), vol. 6. The 1976 figure is from the National Income Accounts, *Cuentas de Produccíon del Sector Publico* (INEGI). Public sector wages and salaries are from *Estadisticas Hacendarias del Sector Publico: Cifras Anuales, 1965–1982* (SHCP).

[a]Deflated by the period average CPI.

increase came in the administration's last four years. Even in 1976 when efforts were made to restrain spending, real public sector wage payments rose 14 percent.

The priority afforded to expanding government employment and to the investment projects of the SOEs came at the expense of investment in agriculture and social welfare. Table 3.2 shows how the sectoral composition of public investment varied over the Echeverría *sexenio*. Expenditure by CONASUPO (the agency in charge of price supports and subsidies for agriculture) and investment in agriculture increased strongly from 1973 to 1975, but when financial pressures became acute in 1976, agriculture's share of public investment funds was slashed from 18.1 to 13.9 percent. Spending on social welfare programs increased until 1973 and then declined very rapidly as expansion in the parastatal sector gathered steam. By 1976 the share of public investment allocated to social welfare was barely one-half its 1970 level. In light of table 3.2 and his unwillingness to press energetically for tax reform in 1972, it is difficult to comprehend Echeverría's reputation as a "populist." The populist image apparently derives largely from Echeverría's rhetoric and his lenient approach to public finance issues. An examination of the fiscal record reveals that Echeverría was a statist, not a populist; his main priority was to increase the role of government in the economy, both as a source of employment and as a producer of goods and services.[6]

Despite the rejection of tax reform in 1972, public sector revenue growth outpaced GDP growth during the Echeverría term (table 3.3). Direct taxes increased rapidly as inflation pushed a larger portion of the population into higher tax brackets (the phenomenon of "bracket creep"). The increase in the excise rate to 4 percent and the introduction of a 15 percent surcharge levied on luxury goods raised the average real growth rate of indirect taxes to 12.3 percent after 1972. The high growth in revenues of the SOEs, however, is deceiving, reflecting as it does simply the enormous expansion in the parastatal sector. Until 1974, public sector price increases were kept very low as part of a deliberate policy to repress inflation.

Table 3.2 **Sectoral Composition of Public Investment**

Year	Agriculture	Industry	Communications Transport	Social Welfare	Other	Total
1971	14.57	41.65	20.49	21.67	1.62	100
1972	14.85	34.47	23.65	23.07	3.96	100
1973	14.13	32.54	25.38	25.75	2.28	100
1974	16.92	36.02	23.98	20.75	2.33	100
1975	18.09	41.51	20.70	16.47	3.23	100
1976	13.89	45.99	19.17	14.51	6.44	100
1971–76	15.41	38.70	22.23	20.37	3.29	100

Source: Estadisticas Historicas de México (México, D.F.: INEGI, 1985).

Table 3.3 **Public Sector Prices and Revenues[a]**

	1970	1971	1972	1973	1974	1975	1976
Total public sector revenue	18.9	18.4	18.7	20.2	21.1	23.1	23.8
General tax revenue	8.1	8.0	8.1	8.9	8.9	9.7	10.3
Income taxes	3.5	3.5	3.7	3.8	4.0	4.5	4.9
Personal	1.5	1.6	1.7	1.7	1.7	2.0	2.3
Indirect taxes[b]	4.6	4.6	4.4	5.1	4.9	5.3	5.5
Revenues of parastatal sector[c]	9.6	9.7	9.7	11.0	11.5	13.1	12.7
Real public sector prices[d]	100.0	96.2	94.0	88.7	106.6	110.6	104.3

Sources: The real public sector price series is from Clavijo (1980). All other figures are generated from data in *Estadisticas Hacendarias del Sector Publico: Cifras Anuales, 1965–1982* (SHCP).

[a]Revenues are expressed as a percentage of GDP. General tax revenues and parastatal revenues do not sum to total revenues because of other, unclassified revenues and because some tax receipts are tax payments made by the parastatal sector.

[b]The sum of value-added taxes, taxes on production and services, taxes on foreign trade, and "other" tax revenues. Does *not* include gasoline taxes (which I classify as revenues of PEMEX).

[c]Sum of revenues (exclusive of any transfer payments received) plus taxes paid.

[d]Period average price deflated by the period average CPI.

Relatively strong revenue growth was not sufficient to prevent the fiscal deficit from rising rapidly. Enormous increases in government spending drove the consolidated public sector deficit upward from 2.5 percent of GDP in 1971 to 10 percent in 1975. As can be seen from tables 3.4 and 3.5, the loss of fiscal control was widespread. The growth in the deficit can be attributed in almost equal parts to increased losses of the non-PEMEX SOEs and larger deficits run by the nonparastatal sector ("deficit on financial intermediation" and "other").

Unlike during SD, the fiscal deficits were financed in large measure by borrowing from the Central Bank. Table 3.6 contains information on how the main monetary aggregates behaved during the Echeverría term. The growth rate of the monetary base accelerated from 19.6 percent in 1971 to 33.8 percent in 1975, and the share of seignorage in GDP rose to triple the

Table 3.4 **Public Sector Revenues and Expenditures (% of GNP)**

	1970	1971	1972	1973	1974	1975	1976
Expenditure	22.3	20.5	22.9	25.8	27.0	31.9	32.0
Current	15.3	15.3	16.2	19.0	20.6	23.7	23.6
Interest on foreign debt	.8	.8	.7	.8	1.0	1.2	1.5
Other	14.5	14.5	15.5	18.2	19.6	22.5	22.1
Capital	7.0	5.2	6.8	6.7	6.4	8.2	8.4
Revenues	18.9	18.4	18.7	20.2	21.1	23.1	23.8
Economic deficit	3.4	2.1	4.2	5.6	6.0	8.8	8.3
Deficit on financial intermediation[a]	.3	.4	.7	1.2	1.3	1.2	1.6
Monetary deficit	3.8	2.5	4.9	6.9	7.2	10.0	9.9

Source: Estadisticas Hacendarias del Sector Publico: Cifras Anuales, 1965–1982 (SHCP).

[a]Deficit of La Banca de Desarrollo.

Table 3.5 Breakdown of the Fiscal Deficit (% of GDP)

	1970	1971	1972	1973	1974	1975	1976
PEMEX							
Expenditure	2.7	3.0	2.7	3.0	3.2	4.1	3.6
Current	2.3	2.2	2.0	2.1	2.3	2.9	2.0
Capital	.4	.8	.7	.9	.9	1.1	1.6
Revenues[a]	3.3	3.2	3.1	2.8	4.0	4.1	4.0
Deficit	−.6	−.2	−.4	.2	−.8	0	−.4
Non-PEMEX parastatals[b]							
Expenditure	9.9	8.7	8.6	10.4	12.2	14.6	12.9
Current	6.3	6.9	6.8	8.5	9.4	10.2	9.9
Capital	3.6	1.9	1.8	2.0	2.8	4.4	3.0
Revenues[a]	6.8	6.7	7.0	8.0	8.3	9.0	9.1
Deficit	3.1	2.0	1.6	2.4	3.9	5.6	3.8
Other[c]							
Expenditure	9.7	8.8	11.6	12.4	11.6	13.3	15.5
Current	6.7	6.2	7.3	8.5	9.0	10.6	11.6
Capital	3.0	2.6	4.3	3.9	2.6	2.6	3.8
Revenues[a]	8.7	8.4	8.6	9.3	8.8	10.0	10.7
Deficit	1.0	.4	3.0	3.1	2.8	3.3	4.8

Source: Estadisticas Hacendarias del Sector Publico: Cifras Anuales, 1965–1982 (SHCP).

[a]Sum of revenues and taxes paid.

[b]Budget- and nonbudget-controlled parastatal enterprises.

[c]Includes DDF (Department of the Federal District).

average level of the sixties. In the last three years (1974–76), foreign debt replaced domestic debt as the main method of financing the deficit (table 3.7), but the monetary base continued to grow strongly.

A second important shift in monetary policy concerned the management of interest rates. Whereas real deposit rates were maintained at positive levels throughout SD, after 1972 this policy was allowed to lapse. Nominal interest rates were not adjusted upward in step with inflation, and as real rates turned negative, the financial miracle terminated abruptly. The total stock of real bank funds fell 13.3 percent from 1973 to 1976. Financial disintermediation, in turn, by reducing the growth of demand for bank reserves—much the largest component of the monetary base—made it far more difficult to prevent excessive growth in the high-powered money supply. The government reacted by raising the reserve ratio from 0.313 in 1970 to 0.511 in 1976. Nonetheless, real bank reserves grew at an annual rate of only 5.7 percent over 1973–76, a figure far below the 9.8 percent recorded during the preceding Díaz Ordaz administration.

For a couple of years, expansionary demand policies were successful in stimulating strong output growth (tables 3.8a and 3.8b). However, problems soon began to appear. After 1972, when recovery from the 1971 recession was complete and excess capacity had largely disappeared, inflation accelerated, rising above 20 percent in 1973 and 1974. Furthermore, while aggregate growth was high from 1972 to 1974, much of the growth was concentrated in the public sector. Private investment weakened, dropping

Table 3.6 **Monetary Aggregates and Real Interest Rates**

	1970	1971	1972	1973	1974	1975	1976
Real growth rates[a]							
Monetary base	5.6	13.8	13.5	0.2	6.0	20.5	1.9
M2	5.4	2.4	14.9	4.4	−.7	9.1	6.7
M3	5.7	7.4	13.8	−1.8	−6.9	8.7	−9.8
M4	12.9	8.3	11.7	−5.9	−2.4	14.2	−10.2
Total stock of bank funds[b]	14.1	9.1	11.0	−7.6	−3.3	14.9	−15.6
Credit to the business sector[c]	10.0	13.1	9.8	−14.8	.6	9.5	3.9
Total credit of the banking system[d]	11.0	7.8	10.3	−2.4	2.2	15.1	8.4
Percentage of GDP[e]							
Monetary base	12.2	12.8	13.1	13.1	12.6	13.6	14.3
M2	10.9	10.8	10.7	10.9	10.3	10.2	10.5
M3	22.4	22.8	23.1	22.5	20.0	19.1	18.0
M4	31.3	32.9	33.2	31.4	28.0	28.1	27.0
Total stock of bank funds	27.0	28.7	28.9	27.0	23.7	23.8	22.2
Credit to the business sector	24.6	26.1	26.6	23.7	20.5	20.4	20.9
Total credit of the banking system	40.6	42.2	42.1	40.4	37.6	38.7	41.4
Real interest rates[f]							
Average real bank deposit rate[g]	6.1	5.2	4.3	−11.3	−9.2	.7	−15.4

Sources: The bank deposit rate series is from CIEMEX-WHARTON, *Mexican Economic Outlook* (Philadelphia: Wharton Econometric Forecasting Associates, 1987), 18(4):185–86. All other data is from *Indicadores Economicos* (Bank of Mexico).

Notes: M2 = Currency held by the public + peso- and foreign-currency-denominated demand deposits. M3 = M2 + liquid savings accounts. M4 = M3 + nonliquid (i.e., fixed-term) savings accounts.

[a]Real monetary aggregates are calculated as the end-of-year balance deflated by the end-of-year CPI.

[b]M4 less currency held by the public.

[c]Total credit of the commercial and development banks less credit extended to federal, state, and municipal governments.

[d]Credit of the Central Bank, the development banks, and the commercial banks.

[e]Average of the end- and beginning-of-year monetary aggregate relative to GDP.

[f]End-of-year interest rate (December value) less the December-to-December CPI inflation rate.

[g]Weighted average of bank deposit interest rates (CPP, or *costo promedio porcentual*).

Table 3.7 **Financing the Fiscal Deficit (% of GDP)**

	1971	1972	1973	1974	1975	1976
Monetary deficit	2.5	5.0	6.9	7.2	10.0	9.9
ΔInternal debt	1.4	4.7	3.9	3.2	5.1	3.9
ΔExternal debt	1.1	.3	3.0	4.0	4.9	6.0

Table 3.8a **Macroeconomic Aggregates (% change)[a]**

	1971	1972	1973	1974	1975	1976
Real GDP	4.2	8.4	8.4	6.1	5.6	4.2
Manufacturing	3.9	9.7	10.5	6.3	5.0	5.0
Agriculture, forestry, and fisheries	5.7	.8	4.0	2.5	2.0	1.0
Inflation[b]	5.2	5.5	21.3	20.9	11.0	27.2
Real gross fixed investment	−1.7	12.2	14.7	7.9	9.3	.4
Private	8.9	2.5	3.0	11.4	2.0	6.1
Public	−23.2	40.2	39.6	2.4	21.6	−7.6

Table 3.8b **Composition of Output (% of GDP)[c]**

	1971	1972	1973	1974	1975	1976
Private consumption	72.6	71.5	70.3	69.7	69.7	69.9
Government consumption	7.7	8.1	8.2	8.2	8.9	9.0
Gross fixed capital formation	18.9	19.5	20.6	20.2	21.7	20.9
Private	14.0	13.2	12.5	13.2	12.7	12.9
Public	4.9	6.3	8.1	7.0	9.0	8.0
Change in inventories	1.9	1.7	1.9	3.9	3.0	2.3
Exports	7.7	8.3	8.7	8.2	7.1	7.9
Imports	8.8	9.0	9.7	11.0	10.4	10.1

Source: Indicadores Economicos (Bank of Mexico).

[a]Real variables are measured at 1970 prices.

[b]December-to-December change in the CPI.

[c]Output shares at 1970 prices.

from 14 percent of GDP (at 1970 prices) in 1971 to 12.7 percent in 1975. Government financial policies seem to have been at least partly responsible for the slump in private investment. Negative real deposit rates, slowing the growth of bank funds, and higher reserve requirements caused the supply of credit to the private sector to diminish sharply (see table 3.6). Lending recovered in 1975 when price controls suppressed inflation and bank deposits paid a small, positive return, but the recovery only partially offset the substantial financial disintermediation of the previous two years. At the end of the Echeverría *sexenio*, the supply of commercial and development bank real credit to the "business" sector (i.e., the private sector plus the parastatal sector) had still not regained its 1972 level.

More threatening than either the acceleration in inflation or the decline in private investment was the deterioration in the payments balance (table 3.9). As the nominal exchange rate remained pegged at 12.5 pesos per dollar, the real exchange rate fell steadily after 1970, despite rising world commodity prices. The decline in the real exchange rate and the large increase in public sector absorption set off a surge in import demand. From 1971 to 1975, the dollar value of private sector imports increased at an annual rate of 22.8 percent. In the public sector import growth was a phenomenal 53.8 percent, reflecting the high import intensity of many of the large industrial investment projects undertaken by SOEs in this period.

Table 3.9 **External Accounts**

	1971	1972	1973	1974	1975	1976
Current account (billion $)	−.93	−1.01	−1.53	−3.23	−4.44	−3.68
Merchandise exports (billion $)	1.37	1.67	2.07	2.85	3.06	3.66
Merchandise imports (billion $)	2.26	2.76	3.89	6.15	6.70	6.30
Volume of merchandise imports (% change)	−6.4	10.3	22.9	25.1	−2.6	−14.5
Intermediate inputs	−4.6	5.0	28.8	39.6	−9.7	−16.1
Consumer goods	5.1	27.1	14.1	−12.2	−13.0	−16.5
Capital goods	−13.2	14.7	15.1	9.0	20.3	−10.6
Volume of merchandise exports (% change)	2.4	13.3	8.0	3.6	−10.0	6.4
Nonoil manufactures	6.3	15.6	14.0	−.3	−15.1	10.6
Agriculture, forestry, and fisheries	−7.9	14.3	−.4	−21.5	−8.0	8.1
Real exchange rate[a]	97.3	94.4	91.4	85.8	82.2	88.7
Real price of total merchandise imports[b]	98.7	98.9	99.6	99.6	96.0	103.9
Real price of total merchandise exports[b]	97.4	98.8	100.9	109.1	105.3	120.0
Nonoil manufactures[b]	98.6	99.4	101.8	118.5	101.6	112.0

[a]1970 = 100; nominal exchange rate multiplied by the ratio of the U.S. wholesale price index (now called the producer price index) to the Mexican GDP deflator.

[b]1970 = 100; deflated by the GDP deflator.

Export promotion efforts were confined to the creation of the National Institute for Foreign Trade (inspired by Japan's JETRO) and to the granting of rebates (the CEDIs) on all indirect taxes for exporters. In response to these measures and the strong growth in worldwide trade in the early seventies, real exports increased strongly in 1972 and 1973. But as the real exchange rate continued to fall, nonpetroleum exports first stagnated in 1974 and then declined 5 percent in dollar value in 1975. Even before the deceleration in export growth, the current account deficit worsened considerably. By 1975 the deficit had reached the alarming level of $4.4 billion, a figure equivalent to 5.1 percent of GDP. The reluctance to raise domestic interest rates in the face of higher inflation and a clearly overvalued peso caused the overall payments balance to deteriorate to an even greater extent. Capital flight withdrew approximately $5.3 billion from the country over 1974–76.[7]

The large payments deficits were mirrored in a fast-mounting level of foreign indebtedness (table 3.10). From a figure of $6.6 billion at the start of 1971, the total foreign debt more than quadrupled to $27.9 billion by the end of 1976. Almost all of this debt was taken out by the public sector with the commercial banks. In 1970 the public sector external debt was $4.7 billion and 51.8 percent of the debt was held by private financial institutions. By 1976 these figures had changed to $21.6 billion and 82.7 percent.

The administration stubbornly refused to acknowledge the accumulating evidence that some adjustment was required in its macroeconomic policies. Domestic economic difficulties were attributed instead to adverse external shocks. The upsurge in world prices in 1973 was cited as the main cause of higher domestic inflation. The world recession that followed in 1974–75

Table 3.10 **Debt Burden Measures**

	1970	1971	1972	1973	1974	1975	1976
Total debt (billion $)	6.6	7.1	8.3	11.0	15.6	21.6	27.9
Total debt/GDP[a] (%)	18.4	18.2	18.3	19.9	21.7	24.5	31.4
Public sector debt service[b] (billion $)	.86	.82	.92	1.34	1.40	1.89	2.47
% of Merchandise exports	66.4	59.8	55.4	64.6	48.9	61.6	67.7
% of Current account income	26.3	23.1	21.6	24.8	20.4	26.4	29.9
% of GDP[a]	2.4	2.1	2.0	2.4	1.9	2.1	2.8
Total debt service[c] (billion $)	.98	.95	1.08	1.54	1.66	2.29	2.88
% of Merchandise exports	76.2	69.8	65.0	74.5	58.2	74.8	78.8
% of Current account income	30.2	27.0	25.3	28.6	24.3	32.1	34.8
% of GDP[a]	2.8	2.4	2.4	2.8	2.3	2.6	3.2
Total debt service #2[d] (billion $)	—	—	2.91	3.37	4.31	6.52	8.44
% of Merchandise exports	—	—	174.7	162.8	151.1	212.8	231.0
% of Current account income	—	—	68.0	62.4	63.0	91.3	102.0
% of GDP	—	—	6.4	6.1	6.0	7.4	9.5

Sources: Mexican Economic Outlook (CIEMEX-WHARTON) for data on the total debt and short-term public and private sector debt. All other data comes from *Indicadores Economicos* (Bank of Mexico).

[a]GDP measured in dollars was calculated by dividing nominal GDP by the period average controlled exchange rate.

[b]Public sector interest payments plus amortization of the medium- and long-term debt.

[c]Public sector debt service plus private sector interest payments.

[d]The sum of public and private sector interest payments, public sector amortization of the short-, medium-, and long-term debt, and amortization of the short-term private sector debt. Amortization of the short-term debt is assumed to equal the previous period's short-term debt.

was blamed for the slow growth in Mexican exports and used to justify the continuation of expansionary demand policies (needed to offset the weakening in external demand).[8]

Events proved all too soon, however, that something was amiss in domestic policy. In 1976, as the world economy began to recover, the economic program of the Echeverría administration collapsed under extreme balance of payments pressures. Extensive import controls were imposed and parastatal expenditures were sharply curtailed, but little was done to check spending by other branches of the government or to curb monetary expansion. As a result, though the burden of debt service was not exceptionally high (35 percent of current account income if short-term debts could be rolled over), the current account deficit remained sizable ($3.7 billion for the year), capital flight persisted, and the Central Bank's stock of foreign exchange reserves became severely depleted. On August 31, the peso was devalued nearly 100 percent and the economy went into a severe tailspin. One month after the devaluation, compensating wage increases averaging 23.1 percent were decreed for industrial workers. During the last four months of the year, manufacturing sector employment declined 4.2 percent, the inflation rate surged to 60 percent, and there were frequent threats of bank runs. Shortly before Lopez Portillo's inauguration, negotiations began on the terms for a standby agreement with the IMF.

3.2 Concluding Observations

The Echeverría economic program was a clear failure. For a couple of years following the 1971 recession, output grew strongly. The 1972–74 expansion was necessarily temporary, however, given the fundamental economic imbalances created by large fiscal deficits and mismanaged monetary policy. In the administration's last two years, output and employment growth slowed considerably while inflationary and balance of payments pressures became extreme.

Distributional considerations do not alter this assessment. None of the studies discussed in the previous chapter turn up any evidence that the overall distribution of income improved.[9] Nor does a less formal examination of Echeverría's policies suggest that they benefitted either the urban or rural poor. The real blue-collar manufacturing wage grew at a slower pace than during Stabilizing Development. Public investment in agriculture increased initially but was later severely reduced when budgetary problems became acute in 1975 and 1976. Overall, the agricultural sector stagnated, experiencing average annual growth of only 2.6 percent.

The Echeverría administration failed politically as well as economically. The crisis of political legitimacy that came to the fore in 1968 was never squarely faced. Echeverría made no progress toward reconstructing a stable political consensus and, at the very end of his term, in an effort to revalidate his tarnished populist credentials, he introduced new political tensions through a heavy-handed land expropriation in the northwest. Once again, the political elites could not reach agreement on a presidential successor, and Echeverría had to choose his successor unilaterally, just as he had been chosen unilaterally six years earlier by Díaz Ordaz.

4 The Lopez Portillo Administration

The Lopez Portillo administration began under difficult circumstances. In the last three years of the Echeverría administration, the economy's performance had deteriorated steadily. Real GDP growth fell for the third consecutive year in 1976, dropping to 4.2 percent, while the inflation rate rose to the relatively high level of 27 percent. Despite widespread imposition of import controls, the current account registered a deficit of $3.68 billion, and in October, after having been pegged at 12.5 pesos per dollar for twenty-two years, the currency was devalued to 23 pesos per dollar. The overall fiscal