

### III. TRENDS IN THE MEXICAN ECONOMY PRIOR TO THE EARTHQUAKES

69. Like most of the Latin American economies, during the last few years the Mexican economy has struggled under the effects of a persistent economic recession, on the one hand, and severe external and internal imbalances, on the other hand. Both the origin of these phenomena and the manner in which they have been addressed involve some features particular to Mexico. One important factor is that, by around the mid-1970s, Mexico had become such an important exporter of hydrocarbons that the external sector and public finances came to depend heavily upon this activity. Like the other countries of the region, however, and despite the authorities' determined efforts beginning in early 1982 to correct the imbalances and re-establish the basis for economic growth, when the earthquake occurred a great deal still remained to be done in order to overcome the many complex obstacles facing the economy.

70. Some of these problems were already brewing in the 1970s and even earlier, and are associated with structural factors inherent in Mexico's development style, including the shortcomings and lags of the industrial sector (a lack of interest in exporting, technological inefficiency and delays, insufficient integration, an excessive geographical concentration and the relative backwardness of the metals and metal machinery industry); inadequate insertion in the international economy; long-standing imbalances in the finances of the public sector; and the unequal distribution of the benefits of economic growth among the various strata of the population. Although one of the objectives of Mexico's economic policy has been to correct or at least mitigate these imbalances, neither the boom brought on by the exploitation of Mexico's oil deposits in 1978-1981 nor the stabilization programme that was adopted in 1983 have succeeded in bringing about any significant change in this respect.

71. The period from 1976 to 1981 provides the immediate backdrop for the present difficulties faced by the Mexican economy. Unlike many countries of the region which experienced a rapid deterioration in their terms of trade and growing external deficits (as a result, inter alia, of the need to import liquid forms of energy), Mexico took advantage of the rise in international oil prices by increasing its basic production level from 600 000 barrels per day in 1976 to over 2 300 000 barrels per day in 1981. This rapid expansion in its production volume and the leeway which it gave the Government to attack two long-standing bottlenecks in the Mexican economy --the deficit on the current account of the balance of payments and the deficit in public finances-- provided a good opportunity for dynamizing and diversifying the production apparatus. Rapid growth and an increase in the number of jobs were thus achieved on the basis of the oil boom and the high levels of public and private investment which that boom made possible. These efforts were undertaken despite the influence of adverse factors associated with the international economy, such as heavy inflationary pressures and, later, the stagnation in the volume of international trade which began to occur in 1979.

72. With the benefit of hindsight, we can now see that the authorities of the time set their sights on overly ambitious growth goals (an 8%-9% annual growth rate in the gross domestic product, in comparison to a traditional rate of 6%) and that the expansion in demand during the period from 1978 to 1981 exceeded the national

/capacity of

capacity of supply, a fact which had both domestic and external financial consequences.

73. With respect to the first factor, during the period 1978-1981 the expenditures of the public sector, whose total share in the gross domestic product was over 45%, increased at a very rapid cumulative annual rate of 13.5% in real terms, thus stimulating private investment (although this latter element behaved quite autonomously). Despite tax reforms and the greater fiscal revenue generated by the petroleum sector, the traditional gap between the public sector's expenditures and its revenue widened, thus raising the financial deficit from less than 5.5% of the gross domestic product in 1978 and 1979 to 13.5% in 1981 and to 17.6% in 1982 (see table 3).

74. In regard to the second factor, the response of supply --as was to be expected-- lagged behind the growth in demand, and the country thus resorted to an increasingly greater proportion of imports. Thus, although export performance was very dynamic, imports were even more so; the coefficient of imports of goods and services rose from less than 8% of the gross domestic product in 1978 to 17% in 1981. This was reflected by a remarkable increase in the current account deficit on the balance of payments (from US\$ 1.9 billion in 1977, it climbed to nearly US\$ 14 billion in 1981), whose cumulative balance for the four years of the boom amounted to the unheard-of figure of US\$ 30 billion. In order to deal with this deficit, as well as the public sector's financial imbalance, the country resorted to external borrowing, which was facilitated and magnified by the abundant supply of funds on international financial markets and the existence of very attractive interest rates in real terms (which, at some points, were actually negative rates). Due to the above and to the existence of structural lags in the development of the financial intermediation sector, Mexico's expansionary credit policy was insufficient to meet the needs of private enterprise, which also resorted to the expedient of obtaining large volumes of external financing.

75. Partly because of the rapid expansion in global demand and the fact that supply was not keeping up with it, inflationary pressure in Mexico was greater than it was in the international economy (between 1980 and 1981, the variation in the consumer price index was on the order of 30% per year, while the same indicator in the United States was 9%). In spite of this situation, the exchange rate was held to virtually the same level (even in 1981, the exchange rate slipped very little), causing the peso to become increasingly overvalued. This, in turn, exacerbated the external imbalance, since it encouraged imports, discouraged exports, favoured capital flight and made it necessary to obtain new lines of credit abroad. In addition, these latter phenomena were magnified during certain periods by the fact that interest rates were set at uncompetitive levels in accordance with government directives.

76. At a time when most Latin American countries were already reeling under the impact of the international recession, Mexico was able to continue its vigorous growth --but at the cost of larger and larger cumulative domestic and external financial imbalances. The external debt rose from a total of US\$ 34 billion at the end of 1978 to US\$ 75 billion in 1981.

Table 3  
MEXICO: MAIN ECONOMIC INDICATORS

	1978	1979	1980	1981	1982	1983	1984 <sup>a</sup>	1985 <sup>a</sup>
<b>Basic economic indicators</b>								
Gross domestic product at market prices (billions of 1970 dollars)	80.1	87.5	94.8	102.3	101.8	96.4	99.8	...
Population (millions of inhabitants)	65.7	67.5	69.4	71.3	73.2	75.1	77.0	78.9
Per capita gross domestic product (1970 dollars)	1 220	1 295	1 366	1 436	1 391	1 284	1 295	
<b>Growth rates</b>								
<b>Short-term economic indicators</b>								
Gross domestic product	8.1	9.2	8.4	7.9	-0.5	-5.3	3.5	...
Per capita gross domestic product	5.1	6.2	5.5	5.1	-3.1	-7.1	0.9	...
Per capita national income	5.0	6.7	6.8	4.6	-4.8	-7.5	0.6	...
Rate of unemployment <sup>h</sup>	6.9	5.7	4.5	4.2	4.2	6.8	6.0	...
<b>Consumer prices</b>								
December to December	16.2	20.0	29.8	28.7	98.8	80.8	59.2	56.1 <sup>d</sup>
Variation between annual averages	17.5	18.2	26.3	27.9	58.9	101.9	65.4	56.5 <sup>d</sup>
<b>Real wages and salaries<sup>e</sup></b>								
Money <sup>f</sup>	-3.4	-1.3	-6.7	2.4	-4.3	-23.0	-6.4	-0.1 <sup>d</sup>
	32.7	33.1	33.5	32.8	62.1	41.4	63.9	57.8 <sup>g</sup>
Current income of government	33.3	35.9	65.6	36.7	63.9	107.6	55.3	56.3 <sup>h</sup>
Total expenditure of government	27.1	57.0	56.5	62.9	101.7	73.3	45.8	50.0 <sup>h</sup>
Fiscal deficit/total expenditure of government <sup>f</sup>	19.7	20.0	16.4	30.3	44.1	30.8	25.8	17.5 <sup>h</sup>
Financial deficit of the public sector/GDP <sup>f</sup>	5.3	5.4	6.5	14.5	17.6	8.9	7.4	6.7 <sup>h</sup>
<b>Current value of exports of goods and services</b>								
Oil	37.9	40.8	55.1	23.1	-6.9	-1.8	12.0	-6.3 <sup>i</sup>
Non-oil	74.8	114.6	166.9	40.1	13.3	-2.9	3.5	-8.6 <sup>i</sup>
Current value of imports of goods and services	27.5	26.0	16.7	9.8	-27.9	0.1	24.9	-3.7 <sup>i</sup>
Terms of trade (goods and services)	47.9	47.4	53.8	30.6	-36.5	-41.0	25.6	34.7 <sup>i</sup>
	2.1	10.0	22.1	2.7	-10.0	-10.9	0.3	
<b>Millions of dollars</b>								
<b>External sector</b>								
Value of exports of goods and services	10 743	15 129	23 458	28 884	26 895	26 422	29 604	...
Oil	1 799	3 861	10 306	14 440	16 362	15 881	16 441	...
Non-oil	8 944	11 268	13 152	14 444	10 533	10 541	13 163	...
Value of imports of goods and services	11 336	16 704	25 683	33 542	21 311	12 575	15 796	...
Trade balance (goods and services)	-593	-1 575	-2 225	-4 658	5 584	13 848	13 808	...
Net factor services	2 771	4 108	6 209	9 531	11 598	8 993	10 218	...
Balance on current account	-3 259	-5 553	-8 305	-14 074	-5 922	4 966	3 725	...
Balance on capital account	3 692	5 835	9 330	14 775	1 812	-2 945	-1 484	...
Variation in international reserves	433	282	1 025	700	-4 110	2 021	3 201	...
Total external debt (balance)	33 900	39 700	50 700	74 900	88 300	92 100	95 900	...
<b>Exchange rate on 31 December</b>								
Unified	22.72	22.80	23.26	26.23				
Controlled					96.48	143.93	192.56	305.00
Free					148.50	161.35	209.97	380.00

Source: ECLAC, on the basis of official figures.

<sup>a</sup>Preliminary figures.

<sup>h</sup>Percentages

<sup>i</sup>Weighted averages for the metropolitan areas of Mexico City, Guadalajara and Monterrey

<sup>d</sup>Up to August

<sup>e</sup>Refers to minimum wages and annual averages.

<sup>f</sup>Money in circulation: bank notes and checking accounts

<sup>g</sup>Up to July

<sup>h</sup>Up to June

<sup>i</sup>Up to March.

77. In 1981, four adverse factors were to have a serious impact on Mexico's economic performance during the months which followed, and their effects continue to be felt today. Firstly, the initial signs of a contraction in the oil market began to appear precisely when the Mexican economy's dependence on oil had reached its peak. Secondly, as a reflection of the policies of the largest industrialized economy, real interest rates became extremely high, thus forcing Mexico to spend a growing share of its foreign currency export earnings on the servicing of its debt (the interest on the debt rose from US\$ 2.6 billion in 1978 to US\$ 8.4 billion in 1981). Thirdly, the pressure on the Mexican peso (which stemmed from its marked overvaluation) became overwhelming and contributed to a massive flight of foreign exchange during that year, which was compounded by private agents' belief that changes would surely be made soon in the country's economic policy. A paradoxical situation thus arose in which the flight of foreign exchange partly offset the inflows of capital from external borrowing. Finally, in the months to come the country was to find that, due to a combination of circumstances (including the Falklands /Malvinas/ war and the deterioration of the Mexican economy itself), its access to external credit had suddenly been cut off.

78. The combined effects of these four phenomena reached a crisis point in 1982. Early that year, the authorities abruptly devalued the peso and adopted other, sometimes inconsistent, measures (e.g., the measures designed to curb demand were partly cancelled out by considerable increases in minimum wages). Other measures were later taken (in August and September) with respect to foreign exchange (first the adoption of multiple rates, then a broadening of extensive exchange controls) and other matters (the nationalization of the banking system, the unilateral declaration of a ninety-day moratorium on the external debt service), all of which helped to heighten the uncertainty felt by a large segment of the private agents in the economy. Thus, when the six-year term of the Government came to an end and a new administration took office late in the year, the economy was facing a serious crisis brought on by a steep decline in economic activity (the gross domestic product dropped by 0.5% after four years of an unprecedented boom and major achievements) and its marked domestic and external imbalances.

79. Since 1 December 1982, the new authorities have been confronted by the difficult dilemma of how to reduce these imbalances while at the same time leaving the way open for an increase in production, exports and employment. Within this context, the most difficult questions of economic policy were --and continue to be-- those raised by the following problems: how to generate enough foreign exchange to permit a reasonable rate of economic expansion and to sustain the heavy burden represented by the external debt (an issue which naturally has implications for, inter alia, the design of exchange, external borrowing and export promotion policies); how to put the finances of the public sector on a sound footing (a problem which involves the relationship between the policy on spending and the policies on taxes, charges and --once again-- on the domestic and external debt); how to bring down inflation (an issue that is very closely tied to the above problems, as well as to wage policy); and how to boost savings and investment (an objective that is connected with exchange, monetary and especially interest rate policies). This situation clearly involves major combinations and trade-offs with respect to the comparative degrees to which the above-mentioned objectives can be met.

80. The new authorities addressed these problems on the basis of the "Immediate Economic Reorganization Programme" (PIRE), some of whose main objectives were the

/control of

control of inflationary pressure and public spending, the selective protection of the production apparatus and employment, and the State's recovery of its control over the exchange market. The programme was supported by the International Monetary Fund through an Extended Fund Facility agreement for US\$ 3.84 billion (covering the period 1983-1985) and supplemented by a rescheduling of liabilities deriving from the external debt.<sup>10/</sup> A medium-term development plan (1983-1988) was also prepared which called for structural changes in the production apparatus, a more efficient form of insertion in the international economy, the creation of more jobs and the establishment of conditions that would pave the way for a more egalitarian society.

81. Within this framework, the authorities took a number of specific steps to correct the country's short-term domestic and external imbalances. Firstly, they put another devaluation into effect (which resulted in a pronounced undervaluation of the Mexican peso) and established a dual exchange system, whereby a "controlled" rate was used for essential goods and a "free" rate applied to non-essential goods and most invisibles; both rates were subject to differential adjustments so that, over time, they would gradually converge. Secondly, they increased public-sector revenues by raising taxes (especially excise taxes) and revising the schedule of charges and prices for public goods and services, including fuel. In addition, an austerity policy was applied to government spending. Thirdly, discussions with external creditors were begun which culminated in the first renegotiation of public debt payments falling due within the period from August 1982 to December 1984 (US\$ 22.5 billion). A mechanism was also created --the Trust Fund for Exchange Risk Coverage-- in order to facilitate the payment of private enterprises' external debts, to protect the production apparatus from bankruptcies caused by devaluations and to expand the guarantees given to foreign banks. Over a period of four years, these measures cushioned the impact of the external debt service. Fourthly, a tight credit policy was adopted, which fit in with the effort to curb global demand, and interest rates on both deposits and loans were raised (although, as it turned out, the rates were still negative in real terms during most of the first year of their application). Fifthly, the authorities chose to pursue a restrictive wage policy. Finally, the first steps were taken towards establishing a tariff system to replace the country's system of import permits with a view to making the existing industrial concerns more competitive. This package of measures was supplemented by specific steps to eliminate the atmosphere of uncertainty that prevailed among private agents and to encourage both domestic and foreign investment.

82. These instruments of governmental action were applied with varying degrees of stringency at different times; for example, beginning in the second half of 1984, the policy on public spending became somewhat more liberal than it had been before, and wage policy was also made less restrictive in 1984 than it had been during the preceding year. The basic approaches established in December 1982 were maintained, however. The results of these policies began to be seen in 1983 and became more evident in 1984 but, as noted earlier, by mid-1985 they had become less apparent. The policies designed to curb global demand, and especially the exchange policy, quickly had an effect on the external imbalance, partly by stimulating exports (both of oil and other items) but particularly by contributing to a sharp decline in imports. Thus, the trade surplus totalled almost US\$ 14 billion both in 1983 and 1984; this was enough to pay the interest on the external debt, to create a surplus on current account of nearly US\$ 5 billion in 1983 and US\$ 3.725 billion in 1984 and to generate a substantial increase in the country's international /monetary reserves.

monetary reserves. This meant that, for the first time in many years, the country became a net exporter of capital, i.e., a process of external dissaving was set in motion, despite the fact that the pressure on the capital account was eased by the postponement of some of the amortization payments on the external debt until 1987.

83. In connection with public finances, tax measures and rate adjustments, together with the restrictive policy on spending (the relative share represented by the Federal Government's expenditures --excluding interest and amortization payments on the debt-- dropped from 28% in 1982 to less than 23% in 1985), made it possible to reduce the public sector's financial deficit from 17.6% of the gross domestic product in 1982 to 8.9% in 1983 and 7.4% in 1984.

84. As was to be expected, the progress made in correcting the external imbalance and reducing the deficit in public finances was achieved at a high social cost in terms of the level of economic activity and the well-being of a large section of the population, especially in 1983. In that year, the gross domestic product dropped sharply (by over 5% in real terms). Both open unemployment and underemployment rose, and real minimum wages fell 23%. The picture improved in 1984, especially during the second half of the year, due to the delayed effect of the upturn in exports, an increase in private investment and a less restrictive policy on public spending and credit. Nonetheless, open unemployment did not decrease, real minimum wages declined once again (this time by 6.4%) and the growth in the gross domestic product barely exceeded the natural growth of the population. Thus, per capita income at the end of 1984 was comparable to what it had been in 1979.

85. Even more significantly, inflation has not been brought down as rapidly as was called for in the Government's programme. Although inflation has definitely been slowing down, the decrease has been very slow (the December-to-December variation in the consumer price index was 98.8% in 1982, 80.8% in 1983 and 59.2% in 1984). Moreover, the nature of Mexico's inflation changed during the period in question. Whereas in 1982 and preceding years the country was faced with demand-pull inflation, this subsequently turned into cost-push inflation. Some of the significant factors in this respect have been the increase in the unit costs of production associated with a less intensive utilization of installed capacity; frequent changes in public utility prices and rates; high nominal interest rates; sliding exchange rates; and wage adjustments. The effect of these factors has been magnified by the inflationary inertia which has been inherited along with severe distortions in the relative price structure and, especially, expectations of future price increases. The slowness of the decline in inflation has given rise, in turn, to other economic policy dilemmas. For example, neither the corrections made in the exchange rate nor wage adjustments kept up with inflation in 1983 or 1984, which contributed to a progressive erosion in the peso's undervaluation, in the former case, and posed an additional obstacle to the possibility of boosting supply, in the latter.

86. On two occasions, the authorities made slight corrections in the exchange rate adjustment scale, but in both cases the correction was not enough to prevent a progressive erosion in the undervaluation of the peso. Thus, during the second quarter of 1985, the peso (at the controlled rate) reached parity with the United States dollar, and it is possible that it has even become slightly overvalued since that time. This phenomenon coincided with a downturn in external demand that can be attributed to the slowdown in the United States economy and, particularly, to a

/weakening of

weakening of the international oil market, which has forced Mexico to lower prices three times during the past seven months 11/ in addition to causing a steady decline in its terms of trade.

87. At the same time, as already noted, the economy began to make a recovery starting in mid-1984; this was reflected in a rapid increase in imports, which strengthened the trend towards an external imbalance described earlier. As a result of the combined effect of these internal and external factors, the value of exports was 14.2% lower during the first half of 1985 than during the same period of the preceding year (the size of the decrease was the same for oil and non-oil exports); in addition, the value of imports increased by 35.5%. Should these trends continue, the trade balance would show a surplus of US\$ 7 billion by the end of the year (in comparison to US\$ 14 billion in 1984) while the deficit on current account would be approximately US\$ 2 billion (compared with a surplus of US\$ 3.7 billion in 1984).

88. Moreover, the need to pursue a less restrictive policy on public spending in 1984-1985 (partially in order to pay the increasingly high service on the domestic public debt) coincided with a sluggish performance as regards public revenue. One factor was the drop in international oil prices and another, to some extent, was the lag-time involved in applying price and rate adjustments to public goods and services (another consequence of having underestimated the rate of inflation in the consolidated public budget). So, while the Federal Government's income at current prices rose by slightly over 56% during the first half of 1985 in relation to the same period of 1984, the income of State agencies and enterprises increased only 38.7%. Meanwhile, the Federal Government's current expenditures climbed approximately 50% and expenditures on investment rose nearly 90%, while total spending by public enterprises and agencies rose 53%. In sum, the drop in these types of revenue and especially in that of State agencies and enterprises, combined with a slight rise in current expenditures by enterprises and in capital expenditures by the Federal Government, were part of the reason why the budget deficit was nearly 60% higher than during the same period of the preceding year. If the deficits of the rest of the public sector and of the Government financial intermediation system are added to the above figure, then what is called the "global financial deficit" rose by 80%. This means that if this trend were to continue throughout the rest of the year, the financial deficit would total 6.7% of the gross domestic product rather than the estimated figure of 5.1% used in the budget and in the financial programme that was approved at the beginning of the year (see table 4).

89. Along with its other consequences, this recent deterioration in public finances has had a major impact on the country's monetary situation, particularly in view of its severely restricted access to external financing. During the first half of 1984, almost 30% of the public sector's deficit was financed by external resources; in the same period of 1985, however, there was a net loss of external financing, and the country turned to domestic sources to cover the entire deficit and part of its amortization payments on the external debt. This made it necessary for the Federal Government to compete actively in the intermediation system for domestic resources; the sale of securities to the public was three times greater during the first half of 1985 than it was during the same period of the preceding year. This had two immediate effects: the banking system's lack of liquidity as regards the extension of regular lines of credit to the private sector and the rise in interest rates, which is already shaping up to be one of the main causes of the lack of flexibility characterizing public spending.12/ Thus, the deterioration in the public sector's

Table 4

MEXICO: PUBLIC SECTOR FINANCES DURING THE FIRST SIX MONTHS  
OF 1984 AND OF 1985

(Billions of pesos)

	Annual allocation 1985 budget	Actual expenditures		Variation (%)
		1984	1985	
<u>Income</u>	<u>13 449</u>	<u>4 392</u>	<u>6 490</u>	<u>47.8</u>
Federal Government	7 683	2 261	3 534	56.3
Institutions and enterprises subject to budgetary control	5 766	2 131	2 956	38.7
<u>Gross expenditure</u>	<u>18 110</u>	<u>6 080</u>	<u>8 674</u>	<u>42.7</u>
Amortization payments on the debt and "adefas"	2 941	1 217	1 432	17.7
Net expenditure	15 169	4 863	7 242	48.9
Federal Government	10 195	2 487	4 043	62.6
Current expenditure	1 933	416	624	50.0
Investment	846	76	142	86.8
Transfers	3 188	712	1 345	88.8
Shares	1 290	388	594	53.2
Interest	2 938	896	1 339	49.4
Institutions and enterprises subject to budgetary control	4 974	2 376	3 199	34.6

Source: ECLAC, on the basis of official figures.

financial standing and the restrictive policy laid down by the monetary authorities tend to affect the availability of loanable funds and, hence, private companies' recovery capacity.

90. A review of the most salient aspects of the above discussion points up the fact that just as the economy was beginning to make a recovery --which coincided with a deterioration in external conditions-- the situation once again took a turn for the worse with respect to the long-standing economic imbalances that the authorities had so diligently attempted to correct. As stated earlier, by mid-1985 the economy was on its way back up (the volume of industrial production in the first half of 1985 was 7% higher than during the same period of 1984), but the external imbalance was once again a problem; the financial deficit of the public sector was also worsening; inflationary pressure did not slacken to any significant degree (the annual variation in the consumer price index for a 12-month period ranged from an annual rate of 60.8% in January to an annual rate of 56.5% in August); and the public sector's financial needs, after the flow of external savings was interrupted, prevented the private sector from gaining access to bank credit.



91. Between June and September 1985, the situation continued to deteriorate. With the public expecting an adjustment in the sliding exchange rate scale, capital flight increased; this phenomenon was reflected, inter alia, in the widening gap between the exchange rate for the peso on the controlled market and the "free" rate (over 30%), making the exchange markets increasingly difficult to manage. In order to staunch the outflow of capital, the authorities devalued the peso again in July and modified their exchange policy. The controlled exchange rate was devalued by approximately 20%, and the system for making gradual and predictable adjustments in the exchange rate was replaced by a system under which the rate on the controlled market was subject to change without prior notice, while the "free" rate was allowed to be determined by market forces (the immediate result being an initial variation of over 50%). Although the purpose of these measures was to correct the external imbalance, they nonetheless had an adverse effect on public sector finances and on inflationary expectations.

92. Along with these exchange policy measures, other provisions designed to correct macroeconomic imbalances were implemented. Firstly, modifications were made in the Federal Government's original budget, including cutbacks in investment programmes and particularly in current expenditures, in order to deal with the situation created by a lower level of revenue, higher interest payments on the domestic public debt and the need to make budgetary performance less dependent on credit. The new cuts, in conjunction with the restrictions agreed upon in earlier months, were intended to reduce budgeted expenditures by 700 billion pesos. A major administrative reform aimed at rationalizing government activities (and involving the elimination of around 15 000 government jobs) was carried out as part of this measure. Secondly, the monetary authorities decided to restrict the expansion of credit even further. By early 1984, priority had already been given to operations on the open market as a means of monetary regulation. The legal reserve requirement of 49% which had been in effect until 1984 was replaced by a marginal reserve requirement of 10% and a reserve requirement of 35% for purchases of government securities or "regulation bonds". In view of the exacerbation of financial imbalances, in June the Central Bank reached a "gentlemen's agreement" with the rest of the country's banks to refrain from channelling 90% of marginal deposits back into lines of credit. This provision was to have a considerable impact on the banks' lending capacity. Finally, under the "Integral Export Promotion Programme" (PROFLEX), the replacement of the import permits system by tariffs, which had already been decided upon, was sped up in the interest of greater efficiency and in order to encourage national enterprises to make a greater export effort.

93. In sum, throughout the entire period in question the Mexican authorities made an effort to correct the fundamental imbalances existing in the economy and, at the same time, to boost production while putting it on a new footing. Although major achievements have been made in the past three years, the same problems encountered by the administration in December 1982 were still latent in September 1985 and, in some respects, had even worsened as a result of the uncertain outlook of the international oil market. The Government's standing economic policy objectives (to bring down inflation, to gain enough leeway in the balance of payments and public finances in order to meet the needs of an expanding economy and to create the necessary conditions to ensure that this expansion will be great enough to raise the level of well-being of the majority and steady enough to sustain the country's long-term development) have caused the authorities to focus their attention on certain crucial elements (public spending, the policy on public-sector revenue,

/credit policy,

credit policy, the policy on interest rates, wage policy, pricing policy and exchange policy) which, as will soon be discussed, were either directly or indirectly affected by the earthquake.

94. Another factor is the authorities' relative lack of manoeuvring room with respect to the introduction of a new policy package. Suffice it to say that, despite the rescheduling of US\$ 48.5 billion in foreign loans falling due during the period 1985-1990 and the decrease in international interest rates seen in recent months, over 50% of the earnings on exports of goods and services is used to service the foreign debt (see table 5). In addition, more than 40% of the Federal Government's budgeted expenditures are devoted to servicing the domestic and external debts. The above situation is compounded by the fact that some crucial variables in the Mexican economy, such as the price of oil and international interest rates, are completely beyond the control of the Mexican authorities, thus introducing a degree of uncertainty into any programming exercise with respect to the economy and economic policy.

Table 5

## MEXICO: INDICATORS OF EXTERNAL INDEBTEDNESS

(Millions of dollars)

	Year-end debt balance					Scheduled amortization payments									
	1982	1983	1984	1985 <sup>a</sup>	1985	Prior to renegotiation <sup>b</sup>					payments after renegotiation <sup>b</sup>				
Total	87 608	93 779	96 651	97 019	13 322	10 831	14 813	15 744	14 215	11 119	7 038	3 736	6 670	6 266	7 863
Public sector	59 730	66 559	69 378	69 956	10 921	9 310	13 483	12 059	10 466	7 808	4 637	2 215	5 340	2 581	4 114
Commercial banks	46 386	54 090	56 866	57 361	8 585	7 345	11 879	10 478	9 531	6 779	2 301	250	3 736	1 000	3 179
Creditors	13 344	12 469	12 512	12 595	2 336	1 965	1 604	1 581	935	1 029	2 336	1 965	1 604	1 581	935
Banco Mexicano	8 531	6 909	6 340	6 130	..	..	..	..	..	..	..	..	..	..	..
Commercial banks	8 386	5 146	4 999	4 999	..	..	..	..	..	..	..	..	..	..	..
Creditors	145	1 763	1 341	1 131	..	..	..	..	..	..	..	..	..	..	..
Private sector	19 107	19 107	18 500	18 500	2 401	1 396	1 050	3 228	2 992	2 577	2 401	1 396	1 050	3 228	2 992
Commercial banks	14 557	14 557	15 415	15 415	645	894	620	3 064	2 914	2 577	645	894	620	3 064	2 914
Creditors	4 550	4 550	3 085	3 085	1 756	502	430	164	78	-	1 756	502	430	164	78
Other	240	1 204	2 433	2 433	-	125	280	457	757	734	-	125	280	457	757

Source: Ministry of Finance and Public Credit.

<sup>a</sup>Up to March. The first renegotiation of the public debt occurred in 1983 and covered short- and medium term loans in the amount of US\$ 23.6 billion, the terms were as follows: an 8 year term with a 4-year grace period, a margin of 1.88% over the LIBOR rate and 1.0% in commissions. The second renegotiation was conducted in 1985 and involved US\$ 48.5 billion over a 14-year term with a 1.13% margin over the LIBOR rate. In addition, the authorities reached an agreement in late September 1985 with major creditors to defer US\$ 950 million in amortization payments corresponding to 1985.

#### IV. PRINCIPAL REPERCUSSIONS OF THE DISASTER ON THE EVOLUTION OF THE MEXICAN ECONOMY

95. At first sight, estimates of damages caused by the earthquakes could suggest that the reconstruction effort could be borne without difficulty, particularly if the expenditure involved were spread over a two or three year period. Even though the loss in absolute terms of 1 300 billion pesos (US\$ 4 billion) is considerable (and of course the more than eight thousand people who lost their lives are irreplaceable), if the disaster is placed in a relative perspective, the value of the losses represents 2.7% of forecast gross domestic product for 1985; 13.5% of gross capital formation for the same year, or 11% of total Federal Government expenditure. Nevertheless, the effects of the disaster cannot be considered as an isolated phenomenon; as shown in the previous chapter, it took place at a time when the Mexican economy was struggling against a particularly difficult set of circumstances. The cost of reconstruction, which cannot be postponed will affect the most sensitive areas of economic policy, such as public expenditure, credit policy, the price structure and the balance of payments. Discussion of how to face these financial requirements could invoke such burning issues as whether it is possible to maintain economic policy on the same track within the context of the stabilization programme, and whether it is possible to continue servicing the public external debt in the face of the increased import requirements which are certain to follow any effort to repair the damage caused by the earthquake.

96. Repercussions of the financial implications of the disaster on the major macroeconomic aggregates are similarly felt on a microeconomic and even at the individual level. The disaster in fact occurred at a time when large sectors of the population --precisely those most affected by the earthquake-- had been the victims of a systematic erosion of their level of income. They now must bear the added burden of the loss of assets and a reduced capacity to replace them. The same may prove true of a large number of firms --many of them extremely small enterprises-- which suffered losses and which are now faced with the need to repair or reconstruct their actual factories and capital equipment. All of these elements could lead to new tensions and social demands on the public sector which would make the already complex management of economic policy even more difficult.

97. In addition, reconstruction is not restricted to the simple replacement of losses. Although the Government has not had sufficient time to draw up an overall programme to face the consequences of the earthquake, the first steps which have already been undertaken suggest that this will be done in the broader framework of urban reform for the Mexico City metropolitan area, and of a deliberate attempt to decentralize activities at the national level.<sup>13/</sup> In this sense, the investments required to recover the damaged infrastructure, relocate and house the victims, reconstruct or repair the schools and hospitals, revive the many firms which lost their premises and in general reurbanize areas within and outside the capital Federal District, may involve sums well in excess of the value of the losses themselves. It is impossible to quantify this amount, since, it must be emphasized, reconstruction programmes have not been drawn up nor have any final decisions been taken relating to the speed with which the country wishes and is able to undertake them.

/98. Nevertheless

98. Nevertheless, once the immediate emergency and rehabilitation phases are covered, reconstruction raises the need to carry out a certain number of tasks without delay. These include the need to assist and rehouse the homeless; to repair the communications infrastructure and the water supply network; to clear the rubble and demolish those buildings which represent a danger for the population and solve in whatever way possible the shortage of school and particularly hospital infrastructure which has suddenly arisen in the capital of the Mexican Republic. Of equal importance is reconstituting the hotel and productive or service infrastructure which was damaged. Without touching on the question of whether it is up to the public or private sector to assume responsibilities for these tasks --both will no doubt share the responsibility-- reconstruction has financial and material implications, and the expenditure involved will affect the construction sector, which has a high multiplier effect on the rest of the economy. On the one hand, this offers an opportunity to contribute towards reactivating productive activity by taking advantage of the considerable idle capacity both in services, and in the supply of inputs to the construction industry. Nevertheless there will also be a renewed demand for imports, not so much as a direct result of the potential investment --construction in Mexico requires few direct imported inputs (less than 5%)--, but rather as the indirect effect of even a moderate revival of demand, in view of the high marginal propensity to import, as had been amply shown in the 12 months preceding the disaster.

99. To sum up, while it is true that among its multiple consequences, the earthquake caused direct damage to a variety of sectors, the principal incidence of reconstruction will have to be assessed through its repercussions on the main macroeconomic aggregates and on the application of economic policy. The decisions taken on reconstruction will in fact affect the composition and the level of public expenditure and credit, through these variables on the balance of payments, the price structure, the level of employment and public finances. In other words, reconstruction affects precisely those areas of the economy and economic policy which were already highly sensitive before the disaster. It follows from this that neither the Mexican Government nor the international community should conceive reconstruction as an isolated activity, but rather within the overall context of economic policy which now has to assume responsibility for the reconstruction as an additional challenge among the multiple problems which were already being faced.

100. In this respect it would be as mistaken to propose an unbridled increase in public expenditure and in the extension of credit, regardless of the considerable restrictions which the Mexican economy was already facing as to consider that the stabilization programme which was being implemented could continue to be applied without any modifications whatsoever, given the enormous losses sustained and the imperative to deal with at least some of these without further delay. What is in fact required is a pragmatic approach which makes it possible to face the financial requirements of reconstruction during the remainder of 1985 and during the next biennium, introducing the necessary modifications to economic policy, while at the same time laying down the bases for reviving the economy within the context of financial stability. Such an approach would require that the international community complement domestic actions, especially by expanding net external finance to the

/country during

country during 1985-1987, in order to allow the Government to continue applying its stabilization policies, but within the framework of a programme allowing for a higher level of economic activity than originally planned. It is worth mentioning that although restructuring of present debt servicing obligations undeniably represents temporary means of lightening the burden, it could complicate the problem further on due to a potential debt accumulation in circumstances in which the capacity to provide timely servicing and maintain a normal expansion of imports would not necessarily have been recovered. Once the Mexican Government has had the opportunity to review its financial programme in the light of the new circumstances faced by the country, it will prove easier to specify the scope, nature and duration of the breathing space required by the country to make headway towards reviving the economy on a new basis which takes into account the need for reconstruction.

101. This report has not attempted to develop alternative forecasts as to how the Mexican economy would have evolved during 1985 before and after the disaster. While such an exercise does not pose any insurmountable methodological problems, it would be premature in so far as the national government has not had sufficient time to consider the options available to it to adjust economic policy to the new requirements of reconstruction. Even less has an attempt been made to formulate any forecasts about the future since, in addition to the above observations, account must be taken of the unknown factors dependent upon the future evolution of certain critical variables, and which have a decisive influence on the development of the Mexican economy (petroleum prices, interest rates, availability of fresh financing). The main thrust of the following paragraphs is to illustrate, through an analysis of the direct and indirect consequences of reconstruction, the way in which this unforeseen variable might affect the problems which economic policy already had to face, and how it may alter the behaviour of the major macroeconomic aggregates.

102. In the short term --what remains of 1985--, the most obvious direct repercussions of the after-effects of the earthquake, in addition to the losses of human lives, capital equipment and personal property referred to in chapter II, are to be found in the probable effect of reconstruction upon public sector finances; the banking system (particularly the granting of credit), the balance of payments and personal income. In addition to the above, the dynamic effects of reconstruction must be taken into account, both in the last quarter of 1985 and over the coming biennium. These effects will obviously depend upon a series of decisions to be taken by the Mexican authorities and whose scope it is too early to anticipate, but which will once again affect public finances, credit policy, employment, the global level of economic activity and consequently the balance of payments.

103. As far as direct effects are concerned, it has already been pointed out that some 150 000 people found themselves temporarily out of work, foregoing approximately 27 billion pesos in income until they manage to find a productive occupation. The effect of this contraction in overall demand will be partly counterbalanced by the assistance given to the victims during the emergency period, both by national --public and private-- and international sources. At the same time, a sharp drop will occur in the supply of goods and services produced by firms affected or destroyed by the earthquake. It is estimated that this drop may reach approximately 75 billion pesos during the rest of 1985. In any case, the relative incidence of this contraction in global supply and demand is very low; and not sufficient to have a noticeable impact upon the main macroeconomic aggregates.

104. On the other hand, the effects of the earthquake will tend to aggravate the disequilibria which were already affecting public sector finances. As far as income is concerned, the earning capacity of some public enterprises was affected by the damage to their installations; significant among these are as already mentioned, the telephone system (33 billion pesos), the Federal Electricity Commission (3.5 billion pesos) and the Federal District Water Board (1 billion pesos). At least one semi-State enterprise producing goods (the Lázaro Cárdenas steel works) will lose approximate 4 billion pesos in sales, although part of this loss might be offset by a better future use of installed capacity. In addition, many public services were provided free during the emergency --transport, communications, postal services-- and this has naturally had an impact upon the finances of the enterprises concerned (1 billion pesos). It is also to be assumed that the Federal Government will be affected by a decline in tax collection for some time, both as a result of the large number of firms affected by the earthquake and of the upheavals which the earthquake caused in the tax administration and collection systems.

105. As far as expenditure is concerned, the earthquake caused and will continue to cause undeferable expenditure both in search and rescue operations and in carrying out the first steps to meet the emergency. A very preliminary estimate sets Mexican public sector expenditure at 24 billion pesos for this type of task, including provision of means of subsistence, medical attention, provisional shelter, etc. Far greater expenditures will be required for demolition, rubble removal and cleaning-up operations which will be carried out by the Government and whose preliminary cost is estimated at almost 50 billion pesos. On balance, it appears that the public sector will lose some 43 billion pesos in income in comparison with the forecast trend of public revenue before the earthquakes, and that it will have to face unforeseen expenditure in the range of 75 billion pesos, not counting the cost of reconstruction. This will expand the public sector deficit by some 117 billion pesos, equivalent to 0.2% of gross domestic product. In other words, during the final quarter of the year the initial effects of the disaster on public finances will at least partly counteract the considerable effort carried out by the authorities during the first nine months to restrict public expenditures and reduce the financial deficit of the public sector.

106. As far as the banking system is concerned, reconstruction will not only exert unaccustomed pressure on credit --the hotel owners' association alone has already indicated the need for initial emergency financing of 15 billion pesos--, but is also likely to interrupt the normal repayment of credit granted to many firms affected by the earthquake. Consequently, unless the monetary authorities introduce greater flexibility into credit policy, the shortage of bank liquidity will tend to become more pronounced at precisely the time when demand for

/credit increases.

credit increases. It is still too early to quantify this variable, but it obviously will be necessary to take it into account in adjusting economic policy to the circumstances born out of the events which took place on 19 and 20 September.

107. While the initial impact of the earthquake upon the balance of payments will probably be neutral during the brief period under consideration, it will be extremely negative over the medium term. It is estimated that there will be a drop of some US\$ 200 million in the contribution made by international tourism during the rest of the year as a direct (the reduction of hotel infrastructure) and an indirect result (reluctance to travel to devastated areas; fear of new earthquakes) of the disaster. A decline in non-petroleum exports by industries affected by the earthquakes --essentially the clothing industry-- of US\$ 100 million is also estimated. In addition, the first emergency, repair and reconstruction measures will require imports of some US\$ 300 million. Nevertheless, as far as income is concerned, it will be necessary to take into account the contributions in financial resources and in kind which have been made to meet the emergency (these are estimated at US\$ 150 million) and especially payment of reinsurance on the claims met by national insurance companies (US\$ 300 million, if we assume that approximately 60% of total claims are met during the remainder of the year). In addition, as is known, the country's financial authorities obtained a 180 days postponement in amortization payments on US\$ 950 million corresponding to part of the public sector debt contracted in 1983 from private creditors, while various multilateral agencies have agreed to an accelerated disbursement of funds for existing loans. As pointed out further on, it is necessary to add to the effects described above, the strongly negative indirect results which reconstruction will have upon the current account of the balance of payments, both for the remainder of 1985 and in the future. This may be attributed to the repercussions of reconstruction on the level of imports.

108. Finally, in the extremely short term the consequences of the recent events may contribute to accentuating the inflationary pressures to which the Mexican economy is subject, although it may be assumed that this impact will not be of great significance, and in any case cannot be quantified. Momentary supply bottlenecks may occur for example, with their consequent impact upon prices, although it is worth mentioning that in general supplies remained within normal parameters immediately after the earthquake, despite the large number of small traders who were affected. More important may be the fact that the disturbances to some activities may augment speculative pressures present even before the disaster. In the short term, the most obvious impact of this phenomenon on prices will be represented by the trend of increases in rents on certain types of dwellings and office premises. The cost of certain services, such as health and hospital care, could also rise while the shortage of hospital beds in the Federal District persists. In the medium term, the evolution of inflationary pressures is not only linked to the behaviour of public expenditure and credit expansion, but to economic policy decisions which could affect the price structure and relative prices. Among such decisions, the possibility of eliminating or reducing

/subsidies to



subsidies to a number of public services provided to the population in the metropolitan area of the Federal District (water, transport, waste collection), within the framework of a possible policy aiming at geographic decentralization, is worth mentioning.

109. As far as the indirect effects of reconstruction are concerned, their repercussions will be most apparent in global demand, public expenditure, credit financing and the balance of payments. As has already been observed, it is impossible to quantify this impact without knowing the magnitude of the reconstruction effort --and in particular the financial implications of setting it within the framework of a national decentralization of activities-- or the period over which it is intended to replace the lost property. Based on the magnitude of the losses set out in chapter II an estimate of the potential indirect impact of reconstruction can nevertheless be made for illustrative purposes.

110. For these purposes three assumptions are adopted. First, that the cost of reconstruction will be in addition to and not in substitution of the expenditure that would have taken place in the absence of any reconstruction. Secondly that at constant prices, the reconstruction effort will be exactly equivalent to the material loss suffered; i.e., the financial implications of a more integral reconstruction effort are ignored. Thirdly, this effort will be spread over the final quarter of 1985 and the 1986-1987 biennium and thus 275 billion pesos will be invested in what remains of the present year; 540 billion in 1986 and 334 billion in 1987.<sup>14/</sup> Virtually all this expenditure gravitates around the construction sector <sup>15/</sup> (see table 6).

111. Within this context, and as a starting point, some correlations were made to measure the impact of the construction sector on the overall behaviour of the Mexican economy. On the basis of the above hypothesis, and based on the historical multiplier effect, it is estimated that additional construction in the rest of 1985 will lead to a 6.2% increase in the value added which had been forecast for this sector of activity. In 1986, the year of greatest effort, this increase will reach 14.4% and then fall to 9.1% in 1987. This would boost construction activity to the levels attained during the period of economic expansion which culminated in 1981.<sup>16/</sup> Perhaps the greatest problem which will be posed by a sharp revival of construction activity would be its effect of sharply concentrating income, precisely at a moment when the country's authorities are aiming at geographic decentralization. At the present time, 18.6% of the aggregate value of construction is produced in the metropolitan area of the Federal District. If this proportion were to be maintained over the next biennium, it would lead to an almost 80% increase in this activity in comparison to 1985.

112. At the national level, forecast expenditure on this effort would involve an increase of 179 billion pesos in gross production for the remainder of 1985, and 416 billion during 1986. In these same years, the direct and indirect contribution of 165 billion and 383.4 billion pesos to value added,<sup>17/</sup> would

Table 6

HYPOTHETICAL TABLE FOR REPLACEMENT  
(Billions of pesos at 1985 prices)

	Total	1985	1986	1987
Public sector	506.4	128.0	223.9	154.5
Construction	313.0	70.9	148.0	94.1
Equipment	193.4	57.1	75.9	60.4
Private sector	641.9	146.7	315.9	179.3
Construction	543.4	108.1	268.0	167.3
Equipment	98.5 a/	38.6	47.9	12.0
Total	1 148.3	274.7	539.8	333.8
Construction	856.4	179.0	416.0	261.4
Equipment	291.9	95.7	123.8	72.4

a/ This includes inventories worth 3.2 billion pesos.

signify a boost to gross domestic product, which would grow at a slightly higher rate in 1985 (0.6%) than it would have done in the absence of the reconstruction effort. In 1986 this same effort would add 1.3% to the growth of global value added. Another important consequence would be the creation of 83 900 jobs for the remainder of 1985 and almost 195 300 in 1986 (see table 7).

113. The increased level of economic activity which would accompany reconstruction would have as its counterpart a revival of imports. On the basis of the past behaviour of the Mexican economy,<sup>18/</sup> it is estimated that the direct and indirect effect of the import of goods and services (excluding factor payments) will cause a 4.4% increase in 1984 and a 7.4% increase in 1986. In absolute terms, additional imports worth US\$ 693 million will be required in 1985 and 1 176 million in 1986, taking into account the direct and indirect effects of reconstruction (see table 7).

114. Similarly, there would be repercussions on public finances and on credit. As far as expenditure is concerned, unforeseen expenditure has been estimated at some 248 billion pesos for the remainder of 1985 and 242.4 billion in 1986 (1985 constant prices). This represents an increase of 1.4% and 1.3% respectively over budgetary forecasts made in 1985. Not all of this expenditure would increase the fiscal deficit; it would partly be offset by the higher level of income caused by the revival of economic activity (see table 7). Nevertheless, if no new fiscal measures are taken --on income and expenditure-- a net increase in the deficit equivalent to 0.6% of gross domestic product in 1985 and 0.5% in 1986 would occur. Finally, it is anticipated that it will be necessary to increase credit financing by 38.6 billion pesos in 1985 and 89.8 billion in 1986 (1985 constant prices). These figures represent increases of 6.2% and 14.4% respectively on total credit for 1985. In this respect, the national authorities have already taken steps to liberalize monetary restrictions so as to avoid that the new emergency credit requirements lead to strong increases in interest rates.<sup>19/</sup>

Table 7

ECONOMIC EFFECTS OF THE DISASTER AND RECONSTRUCTION

(Billions of 1985 pesos)

	1985	1986	1987
<u>Immediate effects</u>			
Public sector			
Loss of income	43.0	-	-
Increased expenditure	75.0	-	-
Total	117.0	-	-
Percentage in relation to deficit			
<u>a/ 1984 c/</u>	7.3	-	-
Private sector			
Loss of income (tourism and other enterprises)	125.6		
Wages	27.0		
Total	152.6		
Percentage in relation to GDP (1984)	0.5		
Balance of payments (millions of dollars)			
Losses to tourism	200.0	200.0	-
Reduction in non-petroleum exports	100.0	-	-
Income from reinsurance	300.0	200.0	-
Donations	150.0	-	-
Additional emergency imports	300.0	-	-
Total	150.0	-	-
Percentage in relation to imports			
<u>b/ 1984 c/</u>	0.9	-	-
<u>Medium-term effects</u>			
Construction sector			
Gross production	179.0	416.0	261.4
Added value	88.8	206.4	129.7
Percentage in relation to 1984 <u>c/</u>	6.2	14.4	9.1
Indirect effect on added value from other sectors	76.2	177.0	111.2
Total effect on added value	165.0	383.4	240.9
Percentage in relation to GDP for 1984 <u>c/</u>	0.6	1.3	0.8
Employment directly created	60.8	141.5	88.5
Percentage in relation to numbers employed in construction in 1984 <u>d/</u>	8.9	20.6	12.9
Indirect creation of employment	23.1	53.8	33.8
Total creation of employment	83.9	195.3	122.6
Percentage in relation to national employment <u>d/</u> in 1984 <u>c/</u>	0.9	2.1	1.3

/Table 7 (concl.)

Table 7 (concl.)

	1985	1986	1987
<b>Fixed capital investment</b>			
Annual investment in reconstruction, including replacement of equipment	274.7	539.9	333.8
Percentage in relation to fixed investment in 1984 <u>c/</u>	5.7	11.2	6.9
<b>Public sector</b>			
Expenditure on reconstruction and replacement of equipment	128.0	223.9	154.5
Percentage in relation to public investment in 1984 <u>c/</u>	5.8	10.2	7.0
Participation in housing programmes	7.6	18.5	4.6
Percentage in relation to participation in 1984 <u>c/</u>	2.2	5.4	1.3
Immediate effects (net)	112.3	-	-
Less: increase in tax income	18.1	39.2	24.1
Net increase in deficit	229.8	203.2	135.0
Percentage in relation to deficit <u>a/</u> in 1984 <u>c/</u>	14.9	13.2	8.8
Percentage in relation to GDP for 1984 <u>e/</u>	0.6	0.5	0.3
<b>External sector (millions of dollars)</b>			
Direct imports of production	42.9	99.8	62.7
Imports of equipment	26.6	49.6	32.1
Indirect imports <u>b/</u>	473.9	1 026.7	631.8
Immediate effects (net)	150.0	- <u>f/</u>	-
Total effects	693.4	1 176.1	726.6
Percentage in relation to imports <u>b/</u> in 1984 <u>c/</u>	4.4	7.4	4.6
<b>Financial sector</b>			
Construction credit (including housing)	38.6	89.7	56.3
Percentage in relation to 1984 <u>c/</u>	6.2	14.4	9.1

a/ Budgetary deficit.

b/ Non-factor goods and services.

c/ This represents the real rate of additional growth, which will be caused by the reconstruction effort, in relation to the variable in question.

d/ Gainful employment.

e/ This represents approximately the increase which the additional deficit will add to the coefficient.

f/ During 1986 there will continue to be a loss of income from tourism (US\$ 270 million which will be offset by a similar amount of income from reinsurance).