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FORESIGHT AS A PRELUDE TO POLICY RESOLUTION: THE MEXICO STUDY

Robert Looney

Several years ago I did a forecast of the Mexican economy for the Bank of Mexico. This was at a time when Mexico experienced financial crises (perhaps approached bankruptcy) and had to declare a moratorium on debt payment and seek special assistance from the International Monetary Fund. The concerns of this conference with national planning as it relates to global foresight are extremely appropriate in the case of Mexico because Mexico has been incorporated into the world economy with the phenomenon of the oil price boom and the increases in international interest rates. I think Mexico might be said to be especially vulnerable to developments in those markets. In particular, Mexicans have been integrated into the world economy with its capital flows to the extent that interest rate increases and events in the world economy are very critical in determining the ability of the Mexican government to finance its debt and to service it. One percentage point of change costs Mexico about 800 million dollars a year, so they are quite sensitive to these types of international fluctuation.

The model that we used for the Bank of America forecast had several features; I will not dwell upon all of its technical points. Unfortunately when we were looking at general approaches, one model that wasn't mentioned was the employing of world project link models capable of linking the Mexican economy to world oil markets and capital flows. Clearly Mexican growth is also linked with other countries; for example, interactions between U.S. economic growth and Mexican exports are extremely important in assessing Mexican growth prospects. Needless to say the Bank of America forecasts were way over the mark because they could not assess what the impact of the U.S. recession was upon the Mexican economy. Another study (for the Bank of Mexico) incorporates some of the world variables into the framework. More importantly, social variables were also introduced to determine if the International Monetary Fund imposed some fairly severe austerity programs on Mexico. This marked a kind of benchmark in terms of what Mexico would agree to negotiate with the International Monetary Fund in terms of reducing government expenditures or raising taxes.

Thus the Bank of Mexico model incorporated all of these things and it marked a great event in world economy planning because it incorporated world developments from other models and feedback loops from government actions in terms of what would happen in the near term, and showed how those feedbacks affected the ability of the government to carry out an austerity program. We are all well aware that most countries were forced to austerity programs in the past by the International Monetary Fund and faced overwhelming problems: food riots in Egypt, more recent food riots in the Dominican Republic, instability and unrest in Jamaica, etc. Therefore, when it came to the case of Mexico, the International Monetary Fund and the Bank of Mexico were both interested in examining the possibility of extending the date when the austerity measures would be imposed and, more importantly, attempting to determine if some kind of compromise between the immediate need for austerity to restore financial stability and the necessity to maintain a stable internal environment could be achieved. If so, then it might be possible to proceed with the austerity program without tremendous urban unrest and serious difficulties in terms of various groups and regions being alienated from the government program, clearly increasing the likelihood of the program's success.

It was therefore decided that the optimal control program would survey alternative patterns over time--this was a five year time period--from 1983 to 1988. The objective of the model was to optimize the country's growth in the context of a series of feedback loops. Initially, therefore, we tried to visualize what the country's growth patterns would be without austerity--to see if that was a feasible growth path. Next we examined the impact of the International Monetary Fund on a normal, severe austerity program which drastically slashes government expenditure. Would there be a major fallout in the economy? Negative rates of growth for a period of time? Increasing unemployment and urban and social unrest?

Operationally, the model indicated what form of stabilization growth path would lead to inflation, increased unemployment, etc. Once political constraints were manifested in terms of some sort of minimal rate of growth with subsequent employment creation, the model examined what the political constraints were in terms of achieving some sort of agriculture production for basic food needs and the like. It also examined the limits to the short-term cutback of government expenditures for austerity purposes, while keeping the economy on a growth path which would allow (in the long run) a servicing of the debt and a return to a level of balance of payments which would again maintain the currency on an even keel, and achieve the normal objectives of IMF stabilization programs.

Interestingly enough, the model showed that if the austerity program was not implemented by the International Monetary Fund, the economy would be unable to maintain positive rates of growth over a period of time because of lack of support from the international financial community. There would be basic drying-up of loans; banks would call in loans and resort to other panic measures because of a lack of confidence in the ability of the government to keep the balance of payments within line.

One permutation of the model looked at the initial International Monetary Fund proposal, which was a cutback in the government deficit--as a proportion of GNP--of from 16% in 1983 down to 2.5% in 1985. This represented a severe cutback in government expenditure and what it displayed was a very unsatisfactory state of affairs. The prospect was that, if implemented, there would be a negative growth in the Mexican economy for about two years. Politically this was unacceptable, and once again the government was unwilling to agree to this type of program. On the other hand, the government had a difficult problem because they desperately needed IMF financial assistance. A paper presented at the conference last year by Mr. Hopkins talked about the problems associated with the basic International Monetary approach to stabilization--which is to be a massive devaluation followed by a lid on government expenditure. The usual result is along the lines outlined above: increased unemployment, reduced standards of living and finally civil unrest. This quite often results in the ultimate abandoning of the program, with no real gains to show for the economic loss imposed on the country.

In the light of the above expectations we attempted to model the economy for alternate compromises, trying to work in supply-side effects as much as possible, looking at some of the feedback from a stable-level government expenditure, and suggesting a recovery of private expenditure which would increase the level of our previous government revenues. The conclusion was obvious, the model indicated a range overlap between the priorities of the government for political-social stability with positive rates of growth, and the concern on the part of the International Monetary Fund to protect the international finance stability. The model indicated that most of these austerity programs have to be extended by the IMF over a longer period of time and that the International Monetary Fund has to be a little more flexible in terms of forcing governments to cut back on expenditures. And again, I see no reason why the two necessities cannot be accommodated. That is more or less what is going on in Mexico right now. The stabilization program probably is a little bit more severe than some of the forecasts we made, but on the other hand there is strong evidence that the economy is going to be able to come back, service its debt, and maintain a fairly stable growth pattern throughout the rest of the 1980's without experiencing political and social instability which a harsh program would have caused.

What we are looking at in this type of modeling is steering the economy so that we can develop a number of paths over time and see what mechanisms can be put into place: how can we direct the economy on a path that is agreeable not only to the political groups in the country, but also to the international lenders and other people who supply capital to Mexico? I think what you will see in the future (again this is my own speculation) is that many of the harsh International Monetary Fund type stabilization programs which have been implemented in the past, and have been fairly unsuccessful, will be made more flexible because of the political fallout and also because the results of modeling exercises of this type indicate that unless socio-political feedbacks are acknowledged, failure is likely to occur.

I think the International Monetary Fund is coming to accept the conclusion--or at least to understand it--that even problem countries like Mexico need a space of time to straighten out their economics; it cannot be done overnight. While it might be observed that Mexico is in a very special situation, the results are encouraging. They indicate that a country like Mexico, considered to be one of the most dire of the debt-burdened countries, should not have too much trouble in regaining stable growth if a longer term stabilization program can be worked out with the IMF. Indeed, Mexico may come back to a fairly high rate of growth in a short period of time.

In conclusion, the International Monetary Fund is now thinking more in terms of longer-term stabilization programs. There probably has been a shift to this thinking because models such as the one described above have shown that, in the short-run, the austerity measures usually prescribed will be unsuccessfulgiven the present state of the world economy. On the other hand, the models suggested that medium-term austerity programs have proved to be quite successful and are consistent with the political realities of debtor countries and likely developments in the world economy.