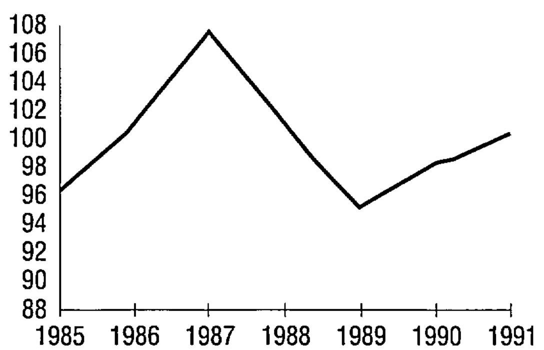
After two years of negotiation with its creditors, the Salinas administration signed a debt restructuring agreement on February 4, 1990. The arrangement relieved Mexico of $US7.2 billion in outstanding principal and reduced interest payments by $US950 million (see Figure 1.4). As a result of the agreement, the Mexican government has managed to reduce the contractual balance of the foreign debt to below 40 percent of GDP (see Figure 1.5), and it has lowered debt service costs to 6 percent of GDP. Mexican officials are confident that the net outflow of capital to service the debt can be further reduced to the equivalent of 2 percent of GDP (at interest rates of 7.5 percent) over the remaining two years of the Salinas administration.

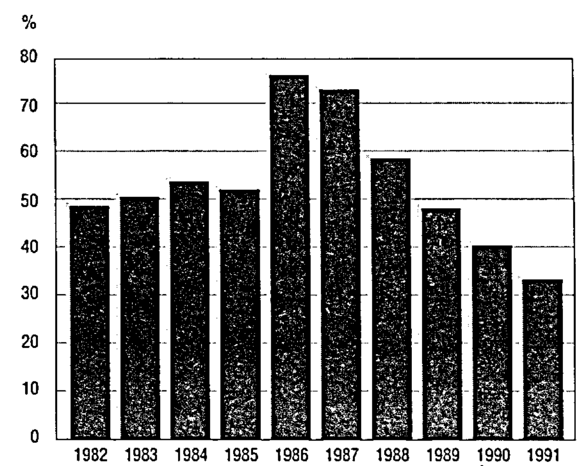
This impressive success in restructuring the debt has produced a surge of optimism among investors and creditors. Today, confidence in the Mexican economy, both at home and abroad, is at its highest in years. It is reflected in inflows of foreign investment, which reached $US9.9 billion in 1991, and in the repatriation of $US2.5 billion in capital that had once fled the country.

Figure 1.4
Total External Debt: Public Sector, Commercial Banks, Banco de Mexico and Private Sector
($ billions)



Source: The Mexican Economy, 1991.

Figure 1.5
Total External Debt as a Percentage of GDP



Source: Ministry of Finance.

Public Finances

A less visible but equally important part of the reform program has been the improvement in the management of government finances. Total public expenditure as a percentage of GDP has declined from a high of about 45 percent in 1986 to about 30 percent in 1991. Moreover, the public sector's financial deficit has declined from a record 16 percent of GDP in 1987, to only 1.5 percent of GDP in 1991. Economists estimate that if the state deficit can be kept under 2 percent of GDP over the longer term, there should be no difficulty in financing it. Another encouraging sign is the fact that interest rates on the internal public debt (what the government owes Mexican citizens) fell during the course of 1991 from 26 percent to 16.7 percent by year end.

The overall improvement in the health of public finances has been achieved through a number of parallel measures including the imposition of strict discipline in public spending, a reduction in or elimination of government subsidies, reductions in the number of people on the public payroll, and the massive privatization of state-owned industries.

At the same time, the tax system has been rationalized. For example, the highest applicable personal income tax rate has been lowered from 60.5 percent to 35.0 percent. Even so, revenues generated from taxation have actually increased because the tax base has been broadened through a redefinition of tax brackets. In addition, collection methods have been improved.