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There are many theories on whether the government's new economic emergency plan, announced in March, will succeed. But two key factors will in large part determine the program's success or failure: the government's ability to prevent massive bankruptcies, and the reaction of the general population to the extreme economic austerity measures imposed by President Ernesto Zedillo's administration. In the first case, the government must at least partially restructure most of the private sector debts in order to forestall massive bankruptcies. Toward this end, the government has already initiated a debt renegotiation program that was drawn up cooperatively with the banking industry organization (Asociacion Mexicana de Bancos, AMB). The program is aimed at assisting "viable" industries, especially small and medium-sized companies (see SourceMex, 03/15/95 and 04/05/95).

The majority of the financial resources used for the debt restructuring have originated from the World Bank and the Inter-American Development Bank (IDB). Nevertheless, the funds available under this restructuring program cover only about 65 billion nuevo pesos (US$10.36 billion), or the equivalent of only 12% of the debt owed to commercial banks. This means that the assistance will reach a very limited number of companies. Even if the debt renegotiation is successful, however, the government will still have to deal with huge social pressures generated by the economic program itself, since the economy is expected to contract by a minimum of 2% this year, and possibly up to 4% or 5%.

An estimated 1.5 million persons are expected to join the ranks of the unemployed in 1995. In addition, the recession will make it impossible for the economy to absorb the estimated 1 million new workers expected to enter the workforce during the year. Moreover, a projected inflation rate for the year of more than 42% will severely slash the purchasing power of all Mexicans. As a result, the government expects a 20% decline in real salaries even for those workers who manage to retain their jobs. Consequently, the risk of a "social explosion" is very real, and has pushed the government to take some steps to offset the impact of the economic program on low-income groups. Among other things, for example, in late March the government expanded social security benefits for newly unemployed workers, and it boosted the minimum wage by an additional 12% for this year. In early March, the government had already approved a 10% hike in the minimum wage (see SourceMex, 03/15/95).

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The bottom line, however, is that the government's economic program may yet fail given the extent of the problems facing the business sector and the immense social impact of the economic program on the country's low-income groups. The two affect one another, since the sharp decline in consumption will in turn worsen the problems faced by the business sector. If the economic plan fails, roughly 30% of all companies in Mexico could be forced into bankruptcy, according to some estimates. The direct repercussion of this scenario would be a decline of 10% to 20% in the country's GDP and the loss of 4 million jobs. Under these conditions, the population will not be able to withstand the economic pressures, and social and political conflict could be expected to explode around the country.

Still, the Zedillo administration is willing to gamble against such odds because officials are aware that an economic slowdown is not only inevitable, but necessary for the government to correct the country's soaring current account deficit. Recession appears unavoidable because Mexico is not capable of increasing its exports enough to correct the trade deficit. The country's export sector is too underdeveloped to reverse last year's trade imbalance which reached a whopping US$18 billion despite the major incentives provided by the devaluation of the peso. Rather than an increase in exports, then, Zedillo's solution focuses on a significant reduction in imports. The reduction in imports will be governed by three factors: the loss in value of the peso, which has raised the cost of foreign products; the possibility that the government may decide to raise import duties; and the contraction in economic growth, which has reduced the capacity of companies to acquire imported products.

Since the first factor kicked in automatically after the peso was devalued in December, the policies followed by the Zedillo administration are focusing on a slowdown in economic growth, which will further constrain imports. On the other hand, the 2% decline in GDP forecast by the Zedillo administration for this year will not slow down imports by an adequate rate. To achieve this slowdown, the GDP rate would have to decline by as much as 4% or 5%. The mechanisms used for economic adjustment such as a contraction of public spending and an increase in taxes and in the prices of state-supplied goods and services will foment a major reduction in demand. In effect, Mexico will be left to face what is commonly known as stagflation, whereby recession and inflation occur simultaneously. In the medium to long term, the government's policies may well manage to reduce inflation.

Nevertheless, implicit in the government's economic strategy is a recognition by the Zedillo administration that it can no longer control prices through artificial means. In fact, the new program marks a point of departure from the past, when wage and price controls were set through negotiations with business and labor. Indeed, all the economic measures unveiled by the government in March were decided unilaterally. This means that decisions are now controlled directly through monetary policy, through the restriction of the money supply. If there is not enough money in circulation, consumers will not have the ability to make purchases, and thus sellers will not be able to raise prices. The economic costs of such a program are considerable, since the contraction of the money supply has already contributed to a surge in interest rates. This, in turn, is expected to raise the cost of debt for many companies, who will be unable to pass the cost on to consumers because of the lack of demand. In this situation, businesses will have few choices: they can renegotiate their debt or they can declare bankruptcy.

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As a result, the government will be forced into tough negotiations in the coming months if it intends to keep its economic plan on track, since the pressure from business, consumer, and labor groups will be constant. The government can expect relentless protests from all sides, and will be forced into a balancing act whereby it must struggle to uphold the basic elements of its plan while staving off a breakdown in the country's social and political stability.

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