Citibank buries Brady debt plan, while debt deal buries Mexico

by Peter Rush

Citibank President John Reed rang the death knell for the ill-fated Brady debt reduction plan in remarks made Aug. 2 while on a visit to Chile. As reported in the *Financial Times* Aug. 4, Reed said that the debt accord just reached with Mexico "was a plan especially for Mexico. Personally, I don't believe there will be another of this type. Really, there won't be another. There are certain things that were done in that case I don't think the banks will do again," he told a social gathering in Santiago.

These remarks will be very poorly received in Washington, where U.S. Treasury Secretary Nicholas Brady hailed the Mexico accord as a "model" for similar agreements with Venezuela, the Philippines, and Costa Rica. Brady told the press July 24 that the Mexican deal establishes a "mind-set" for debt reduction: "A lot of people will look at the agreement as a blueprint . . . for how it might apply to them."

The *Financial Times* also reported Aug. 4 that Sir Kit McMahon, the chairman of Midland Bank, one of Britain's largest and, like Citibank, in the center of debt negotiations with Mexico, likewise opposed any debt reduction plans, including the Mexican one. "We do not believe in debt forgiveness for ongoing debtors," he said, saying it might encourage worse behavior by other countries. He called the Brady plan "ill-conceived and destabilizing."

Despite Reed and McMahon's bellyaching, the banks came out far ahead on the deal. Mexico had entered the negotiations demanding a 55% reduction in its debt payments, and new money to cover the rest of its interest due. It settled for at best a 15% reduction in interest payments on its $105 billion debt, and a probable sharp increase in total indebtedness. In exchange, Mexico agreed to hand over to the banks up to $1 billion a year worth of state-owned companies, no doubt vastly undervalued, in exchange for $1 billion of Mexican debt, at par, an almost worthless form of payment.

Moreover, as pointed out in an Aug. 2 *Washington Times* article by economics columnist Warren Brookes, the deal has been wonderful for the value of the banks' Mexico loans on the secondary market, which jumped sharply when the deal was announced. The plan even restores the debt to full value—from under 50% of par—for those banks taking the option of merely lowering interest rates, and to well above market value even for banks choosing debt reduction. And these restored values are now to be backed by the International Monetary Fund and the World Bank, i.e., in the last analysis, by taxpayers.

Far more important to the banks, Mexico, which had been at the brink of declaring a suspension of interest payments, with a majority of the economic cabinet favoring such a move, is now expending all of its remaining political capital in claiming victory in its debt negotiations, and saying that the "concessions" it claims it won from the banks, in the words of PRI party debt expert Fausto Alzati, "send the message to other countries in Latin America: If you play by the rules, there will be a light at the end of the tunnel." By this move, Mexico, which might have been forced, despite itself, to seek common cause with Brazil and Argentina on the debt issue, has been split off from the rest of Ibero-America and tied, instead, to deals with the United States.

North American Common Market by 2000?

Despite his manic selling of the debt accord as the biggest concession from the banks in Mexican history, and his claim that now, Mexico is free of the burden of excessive debt, Mexican President Carlos Salinas de Gortari revealed that Mexico got next to nothing, by refusing to tell any of the deal's details in his July 23 television address to the nation. Since the initial announcement, the Mexican government has, in the words of Jorge Castañeda, a professor of political science at the Autonomous University of Mexico, "shifted emphasis from the deal's details to its psychological impact."

"The country's authorities hope," Castañeda wrote in a July 30 commentary in the *Los Angeles Times*, "that by creating a sense of confidence, optimism and security about the short-term economic future, they can persuade foreign investors and holders of Mexican assets abroad to make up the difference between the debt deal and the nation's needs."

Desperate to transform forlorn hope into reality, the Mexican government lowered interest rates on its own debt from 60% a month before the accord was signed, down to 35% in the days following its announcement, and claimed, falsely, that this demonstrated investor confidence in the Mexican economy. In fact, the interest rate in question is not a free market rate like rates in the United States and Europe, but is

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the rate at which government sells its own paper to its own nationalized banking system.

The Mexican government has also made clear that it expects, thanks to this renewed "confidence" in the Mexican economy, that billions of dollars in flight capital will return to Mexico, and that billions of dollars more in foreign investments will begin flooding the country. Salinas hopes that by these means, a steady inflow of dollars will paper over Mexico's underlying foreign exchange crisis for at least several years. To this end, Mexico announced that repatriated flight capital will be taxed at a nominal 3-5% rate, much lower than Mexico's capital gains tax rate.

Also, the first private financing for a Mexican company in seven years came through in the wake of the announcement of the deal. Paribas bank of Paris lent the recently privatized copper company Mexcobre $210 million, collateralized by the annual shipment of 4,000 tons of copper for the next four years in a complicated commodity and debt swap arrangement. Nestlé company announced it would invest an additional $300 million in its Mexican operations.

All of this, however, is merely in service of the Salinas administration's long-term program for the Mexican economy: its virtual absorption into the U.S. economy in a projected "North American Common Market." Mexico, according to this plan, which is also being pushed by an influential circle of U.S. legislators, administration officials, and business leaders, will increasingly integrate its economy with the U.S. as trade barriers fall toward zero, and cheap Mexican labor will permit the U.S. to lower its production costs to be more "competitive" with the new European economic union set to occur in 1992. This latter objective is explicitly spelled out in a series of reports published by the Georgetown University Center for Strategic and International Studies' "Congressional Study Group on Mexico."

A just-released study entitled "The Congress and Mexico: Bordering on Change" spells out this objective. "Long-term indicators point to widening U.S.-Mexican integration into the year 2000," it states, and identifies the core of this to be the virtual elimination by Mexico of all protectionist measures in the next few years. Above all, it identifies, as have earlier volumes by the CSIS Mexico group, the central role of so-called "in-bond" (*maquiladora*) plants, namely, assembly plants of U.S. companies that have relocated just south of the border to take advantage of Mexico's dirt cheap wages. States the report, this permits "U.S. firms to use Mexican labor and improve U.S. industrial competitiveness." Not a word on the fact that wage levels in force amount to one-tenth to one-twentieth of U.S. levels, and guarantee total misery for the Mexican workers. Since the firms have special tax breaks and no tariffs, their presence in Mexico makes almost no contribution to the Mexican economy either. Salinas's game plan is to place all of Mexico into an "in-bond" relationship to U.S. companies. The debt deal for him is merely intended to buy time to carry this out.

Economy as bad as debt deal

The reality is that in the days before the deal was concluded, the Mexican economy was facing a growing foreign exchange crisis. In the event, it was not the debt deal, but the immediate proffering of a $2 billion bridge loan from the U.S. Treasury and another $1.5-2 billion from European central banks, which may have postponed Mexico's crisis. It is also these new loans, and not the debt deal, which may account for whatever degree of short-lived "confidence" may have been generated in the week following the deal's announcement.

However, as pointed out in an Aug. 4 article in the *Wall Street Journal* by Christopher Whalen of Wires, Ltd., in Washington, D.C., Mexico's worst financial crisis is its astronomical internal debt. He reported that for months, *El Norte* newspaper, which services the business capital of the country, Monterrey, has printed stories on the internal debt problem, including the fact that the government was so desperate to raise additional funds that it recently offered annual interest rates of 75% (107% if compounded monthly), from private companies. If the government has to offer interest rates like this, with official inflation at only 18%, either the real inflation rate is much higher, or investors are showing a phenomenal lack of confidence in even the medium-term prospects for the Mexican economy.

With the country running a current account deficit of $2.5 billion in the first six months of this year, food imports soaring due to collapse of domestic production, the government budget for social services still at disastrously low levels, and virtually all local finance tied up in government financing—three-quarters of all securities traded on the high-flying Mexican stock exchange is government debt—perhaps "the market" knows something Salinas de Gortari would rather it didn't.

Mexico's premier historian on the nation's financial and debt history, Lorenzo Meyer of the Colegio de Mexico, also weighed in with information Salinas no doubt would prefer nobody know anything about either. In a feature Aug. 2 in the Mexican daily *Excélsior,* Meyer demonstrated that, far from being the best deal that Mexico ever negotiated with the banks on its debt, the present deal is probably the worst. In 1942, for instance, Mexico forced the banks to settle a $500 million debt (tens of billions in today's terms) at ten cents on the dollar. For more than half of Mexico's 167 years since independence, in fact, it has been in default, and nothing very bad has happened to it.

In an editorial that also called for a debt moratorium, done in conjunction with other large Ibero-American debtors, the magazine *Siempre* seconded Meyer's analysis, pointing out that in the late 1800s, Mexico was very tough and intransigent with the United States, and as a result won both respect and a much better deal from the banks. By so strongly overselling the present lemon of a deal, Salinas may be riding for a fall—soon.