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Mexico's financial crisis: metastasis of a speculative cancer

by Carlos Cota Meza

The free-float of the Mexican peso adopted by the government of President Ernesto Zedillo on Dec. 20 brought to the surface all of the country's economic problems that have remained unresolved since the 1982 debt crisis. Fourteen years after President José López Portillo (1976-82) suspended foreign debt payments and imposed exchange controls, a policy later revoked by his successor, Miguel de la Madrid (1982-88), we find that all of the programs of "debt restructuring," "structural change," and "economic modernization" imposed by creditors to guarantee foreign debt payment were only demented efforts to try to prevent the volcano from erupting.

As the current financial debacle shows, during the government of Carlos Salinas de Gortari (1988-94), not only did this policy remain unchanged, but the looting of the Mexican economy by foreign creditors was accelerated to such a degree that by 1993 and 1994 it had reached frenzied proportions. Despite the ominous signs revealed in all economic indicators under Salinas, the "Mexican economic miracle" was praised in every speculative center of the globe.

On Dec. 22, 1994, President Zedillo stated that the previous government had underestimated the gravity of the huge current account deficit in the balance of payments. A few days later, he accepted the resignation of Finance Minister Jaime Serra Puche, who was then blamed for failing to correctly assess how to deal with the time bomb left by Salinas. The current government also pointed to the violence and political events of 1994 as influencing the financial situation.

But in confronting the crisis, the government is applying the same policies that caused the problem in the first place. President Zedillo is committing the same mistakes as De la Madrid and Salinas. On the one hand, through the Unity Agreement to Overcome the Economic Emergency, he is applying the same disastrous austerity plan imposed by the International Monetary Fund (IMF) in 1982 (budget slashing, layoffs, credit and wage restrictions, and devalued exports). On the other hand, he is maintaining the same financial formula as Salinas, which led to the current crisis by opting to reestablish the financial markets—trying to again attract "foreign investment" to the stock and money markets, through bargain-basement privatizations of ports, airports, petrochemical plants, telecommunications, etc., which, so the story goes, would contribute up to $12 billion to the financial stabilization program.

What Salinas did

In *EIR*'s June 1994 study on "Why the Debt Bomb Is about to Explode . . . Again, we forecast precisely the crisis which has just erupted. We analyzed the role of the current account deficit and how this was being financed by a highly speculative capital inflow, taken from one short-term debt market to invest in another "emerging market's" short-term debt market ("hot money" capital flows). For the first time, we also demonstrated the existence of a new category of real foreign debt, aside from the officially recognized foreign debt, whose growth has been astounding.

Through what is fallaciously called "foreign investment" or the "historic increase in foreign reserves," the Salinas government created a new debt category which would nominally be called internal or national debt, but which is de facto a foreign debt or obligation, either because its creditors are foreign investors, or because that internal debt is directly denominated in dollars. This is the case with the treasury certificates known as *Cetes,* more than two-thirds of whose total issuance is in foreign hands, and the *Tesobonos,* which are negotiated in dollars, regardless of their owners' nationality.

The current crisis began in this "foreign investment" sector and now threatens all sectors of the national as well as the international economy.

The current account deficit has become a major point of debate. President Zedillo says the problem was "underestimated." On the other hand, in his sixth State of the Nation address on Dec. 1, 1994, outgoing President Salinas affirmed that the existence of that deficit was "proof that the country is using foreign resources" to make possible expansion of its productive plant "at greater speed" than if only national resources had been used.

In fact, Salinas and the operatives of his "model," Pedro Aspe as finance minister and Miguel Mancera as president of

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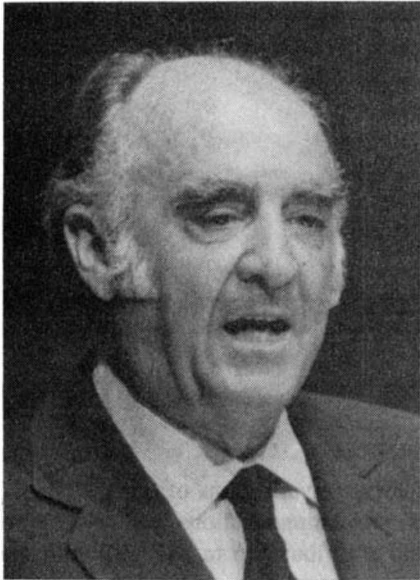
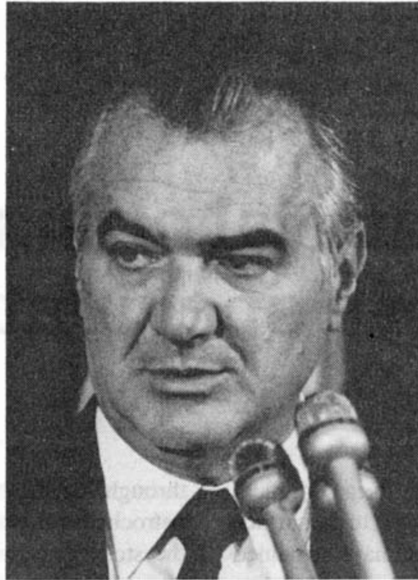
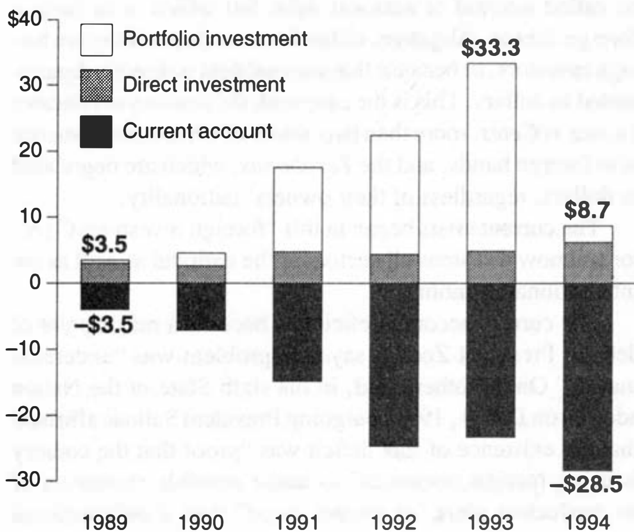



Three Mexican Presidents (left to right): José López Portillo, who suspended foreign debt payments and imposed exchange controls in 1982; Miguel de la Madrid, who revoked these measures and implemented Wall Street's policies; and Carlos Salinas de Gortari, whose programs intensified the looting of the economy to the present point of catastrophe.

the autonomous central bank, the Bank of Mexico, are lying.

As shown in **Figure 1,** the investment which could potentially give real "speed" to Mexico's economy would be direct foreign investment; but since 1991, this has become a smaller percentage relative to so-called portfolio or variable-yield investment, which is nothing more than the trading of stocks and bonds on the markets, guided by their speculative potential rather than any real dividends or profits of the companies which issue them.

FIGURE 1
Foreign investment versus Mexican current account deficit
(billions $)



Sources: Banco de México, World Bank, Inter-American Development Bank, *Summa.*

In fact, the scheme imposed by creditors foresaw foreign investment attracted to speculative markets where it would find juicy profits. At the same time, a portion of that capital would become part of Mexico's foreign reserves needed to finance the "trade opening," which would destroy national production with massive imports offered at dumping prices, thus creating the biggest trade deficit in the history of the republic.

There were several factors in 1994 which provoked the flight of this hot money, among them the country's political problems, combined with the increase in U.S. interest rates, the dollar crisis, and the Orange County, California bankruptcy, considered the beginning of the end of the era of financial derivatives. In an effort to keep the money in the country, Salinas, Aspe, and Mancera took a number of insane actions which only came to light after the eruption of the financial debacle under Zedillo.

At the beginning of the Salinas government, a mechanism called the financial "switch" was established. This presupposed that any instability in variable profit that might drive investors away could be dealt with by movement in fixed income, where investors would be offered profits higher than any other emerging market and even higher than U.S. profits. Once the instability had passed and the fixed terms matured, the investments could go back to the stock market.

As Mancera admitted before the October 1994 Banking Convention, the "switch" began between April and May (after the assassination of the presidential candidate of the

ruling PRI party, Luis Donaldo Colosio). The Bank of Mexico made unprecedented purchases of *Cetes* from the private banks, thereby transforming itself in effect into the primary creditor of the financial intermediaries. And through manipulation of interest rates, it reduced foreign investment in *Cetes* by 54% (measured from June 1992) and increased foreign investment in dollar-denominated *Tesobonos* by 1,249% (**Table 1**). The total amount of all bonds was $29.5 billion by the end of November, prior to the peso devaluation.

This relative substitution of dollar-denominated bonds for peso-denominated bonds is what the large U.S. mutual funds such as Fidelity Investments of Boston demanded of Mexico, since they didn't want to face the risk of a peso devaluation.

Salinas happily complied with their request, to the detriment of his nation.

The bulk of *Tesobonos* had 90-day maturities, coming due just one week after the Aug. 21, 1994 presidential elections. Subsequent *Tesobono* issuances had 90- and 120-day maturities—they would come due under the new government—with yields higher than U.S. notes. It is now these same pieces of paper which reflect Mexico's financial insolvency, with $16.9 billion coming due in the first six months of 1995. This is almost the entirety of the $18 billion bailout package which the Zedillo government claims to have negotiated with the international creditors and with the U.S. government.

The official calendar of *Tesobonos* coming due in 1995 is as follows (note the enormous quantities coming due in July and August):

Month (1995)	Billions of dollars
January	$ 3.6
February	3.5
March	3.2
April	1.8
May	2.7
June	1.9
July	3.7
August	4.1
September	0.7
October	0.9
November	2.2
December	0.7
Total	**$29.2**

As the new finance minister, Guillermo Ortiz, has repeatedly admitted, the value of *Tesobonos* in public hands amounts to $29 billion, much of this—$18 billion—held by foreigners. The government is desperately seeking a way to extend these maturity dates or get creditors to agree to swap this matured debt for a new longer-term, higher-yield instrument, backed by the export revenues of the state-run oil firm, Petróleos Mexicanos (Pemex).

In the composition of direct foreign investment by sector (**Figure 2**), note that the potentially productive portion of this is really smaller than it appears. Between 1989 and 1994, this amounted to $25.9 billion, but in the best of cases, something less than half of it would correspond to new and potentially productive investments.

Investment in services and trade is not productive in economic terms, yet these two categories together represent 45% of accumulated direct investment. We could identify potentially productive investment in other categories, but a good

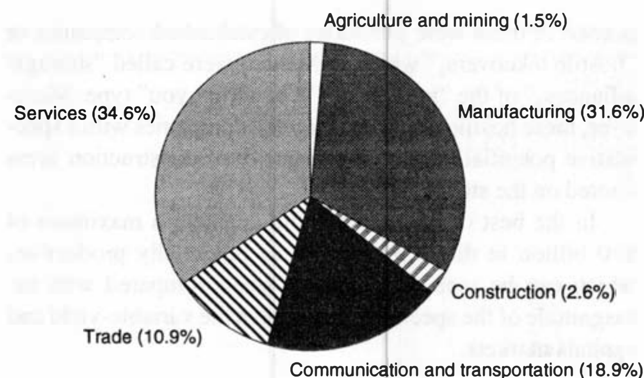
TABLE 1
Foreign holdings of Mexican government debt, 1994
(billions new pesos)

Date	Cetes	Tesobonos	Total*
January	48.8	4.5	69.5
February	54.7	5.3	77.8
March	50.8	10.3	78.1
April	38.4	23.3	73.4
May	32.8	30.3	75.6
June	30.8	35.5	78.2
July	27.4	44.0	82.4
August	25.0	56.0	87.2
September	24.2	52.6	84.3
October	25.0	50.3	83.8
November	21.9	53.8	81.0
Variation	–54%	1,249%	+19%

* The total also includes Pagafes, Bondes, and Ajustabonos.

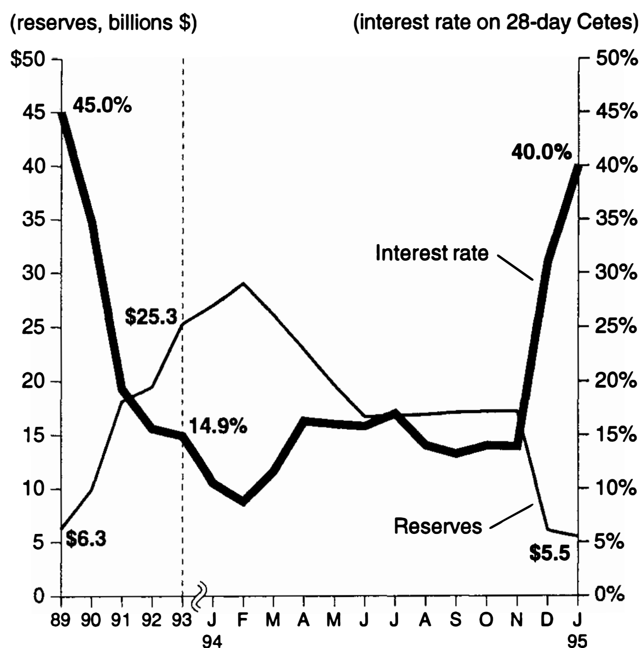
Source: Banco de México.

FIGURE 2
Direct foreign investment in Mexico, by sector, 1989-94
(percent of total)



Source: SECOFI, México.

FIGURE 3
Reserves and interest rates in Mexico



Sources: Banco de México, IMF.

portion of these were purchases of established companies or "hostile takeovers," which in Mexico were called "strategic alliances," of the "join me or I'll bankrupt you" type. Moreover, these hostile takeovers targeted companies with a speculative potential such as the majority of construction firms quoted on the stock market.

In the best of cases, we could consider a maximum of $10 billion in direct investment as potentially productive, which can be seen as laughable when compared with the magnitude of the speculative bubble in the variable-yield and capitals markets.

National bankruptcy

Note in **Figure 3** how the operatives of the Mexican "economic miracle" fell into chaos in their desperation not to devalue the peso, and to guarantee Carlos Salinas the presidency of the World Trade Organization.

In January and February 1994, foreign reserves continued to rise, reaching their historic peak of $29 billion, after which they began to fall continuously. By June, reserves had dropped by $12-13 billion.

After the murder of Luis Donaldo Colosio, internal interest rates drastically increased. Measured against the officially recognized inflation of 5%, increments were more than 200%. Interest rates increased by almost 100%, reaching above 16% for 28-day *Cetes*. Yields for *Tesobonos*, negotiated in dollars, had to compete with the increase in U.S. yields, and at the same time had to appear more attractive to variable-yield investments which were leaving the stock market.

This time bomb went off between Dec. 19 and 20, and in the days that followed, foreign reserves dropped by another $11 billion, to end up at $6 billion. This is the equivalent of six weeks of imports, and starkly represents Mexico's national financial bankruptcy. As Zedillo's government now admits, reserves were only flows of "investment in short-term financial instruments." At that moment, Zedillo had the choice of either doing what Venezuelan President Rafael Caldera had done, and impose exchange controls, or accepting bankruptcy. Unfortunately, he chose the latter.

According to preliminary data of the 1994 balance of payments, the profits paid by the government's financial instruments (*Cetes* and *Tesobonos*) to foreign investors totalled $10.329 billion as of June 1994. Taking into account the dramatic increases in interest rates, these payments will almost certainly exceed $20 billion. Who will pay them?

The insanity of the central bank's interest rate policy can be seen in the leap in interest rates for *Cetes,* instruments which now no one can or wants to buy. In the secondary markets, their rates exceed 60%. The same now applies to *Tesobonos,* whose interest rates are more than 20% for 28-day maturities. Yet even at these rates, they haven't sold. For its dollars, Mexico is paying interest rates as high as those imposed by Paul Volcker as head of the U.S. Federal Reserve during the 1970s, which eventually led to the Ibero-American debt crisis.

The banking system sinks

Apart from the insolvency of the Mexican government, the immediate effect of this situation will be the disappearance of the national private banking sector, with the potential for a chain reaction of bankruptcies. At the present time, according to reliable sources, there are already five banks considered impossible to save.

The arrears of manufacturing and agricultural producers and of the trade sector, which have threatened the banking sector for years, will now become impossible to pay with the new stratospheric interest rates. This applies to all lines of credit, from personal and business loans to mortgages, car loans, and credit cards.

According to the *official* figures of the National Banking Commission for the first half of 1993, debt arrears accounted for 6.7% of the banks' total loan portfolio, twice the safety margin established by the Bank for International Settlements (BIS) in Basel, Switzerland. But insiders estimated the *real* arrears to be as high as 20-30% of the total loan portfolio.

In 1993 alone, the real debt arrears of the agricultural sector reached $12 billion. Arrears of the manufacturing sector were assuredly much larger than the agricultural (perhaps that is why they always tried to hide it). Both economic sectors, essential to meeting Mexico's domestic needs, were

TABLE 2
Mexico's actual foreign debt
(billions $)

	1993	1994
1) Public foreign debt	$ 84	$ 85
2) Private foreign debt	35	56
—of banks	20	25
—of corporations	15	31
3) "Internationalized" internal debt	26	32
—Foreign-held Cetes	25	4
—Tesobonos	1	28
4) Cumulative foreign investment in stock market	38	40
Total	**183**	**213**

Sources: Banco de México, SHCP, BMV, EIR.

devastated by the government's "trade opening" policy, both through the rise in cost of credit and because of the overall economic stagnation that same government policy caused.

During 1993 and 1994, it was a recurring practice to refinance defaults, capitalizing the interest and adding it to the initial capital, thereby opening up a new "line of credit." Through this accounting trick, the banks turned their arrears into "performing" debt, in an attempt to meet world banking norms so that they could both qualify for foreign credit and as potential partners with the bank transnationals, the same ones that would be launching operations inside Mexico in 1995. According to sources, in the aftermath of the latest crisis, all foreign banks authorized to operate in Mexico—with the exception of Chase Manhattan—announced a suspension of any moves in this regard until June 1995.

The Mexican banking system now faces the condition of being at once insolvent creditors and delinquent debtors. As can be seen in **Table 2** and **Figure 4,** the foreign debt of the banking sector went in one year from $20 billion to $25 billion (a 25% increase). A large part of that debt was collateralized with *Tesobono* investments, which are also insolvent. According to statistics of the National Banking Commission, Mexico's private banks are currently facing payments of $8.7 billion on loans which their international creditors do not want either to renew or to renegotiate. In sum, the Mexican private banking system, privatized just 30 months ago, is in absolute bankruptcy. All that is missing is the official announcement.

Flight capital and the real foreign debt

One of the things that has most contributed to the debacle of the banking system, has been massive *illegal* flight capital, especially in 1994. This is apart from the $19 billion in reserves which "legally" abandoned the country last year. This is the surprising conclusion of a thorough study of Mexico's balance of payments accounts, but it is a fact that until today has been revealed by no one other than *EIR* (see **Table 3**).

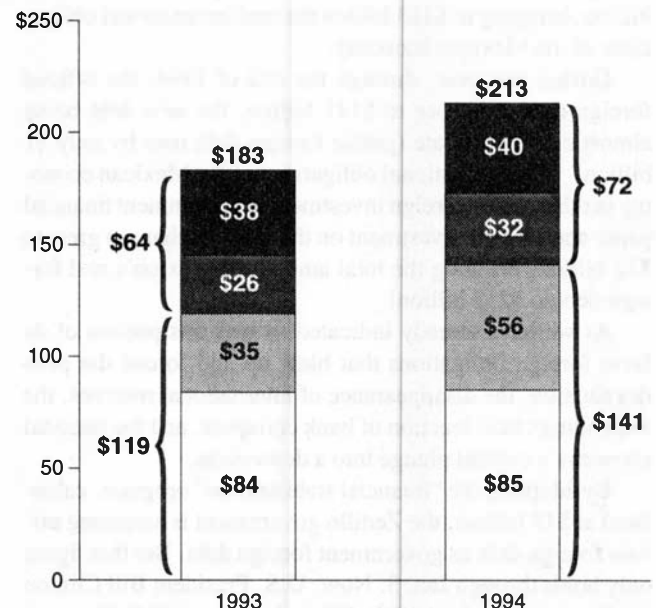
As the story goes, Mexico used up its reserves and asked for a loan from abroad to cover its current account deficit. But basic arithmetic shows that something else was going on. In 1993, for example, Mexico obtained $38.8 billion in foreign capital, but it *officially* applied only $23.4 billion of that to the current account deficit, and another $6.1 billion went to increase its foreign reserves. This left a difference of $9.3 billion in *unregistered* outflow; that is, flight capital.

The figures for 1994 are even more shocking. Last year, $30.7 billion in foreign capital entered Mexico (of which $22 billion was an increase in the official foreign debt and $8.7 billion was in "foreign investments," primarily speculative capital). Part of the total was used to pay the current account deficit of $28.5 billion, but the rest did not go to boost reserves, which in the course of the year *fell* by $19.2 billion. No one knows what that money was used for.

Stated another way, the amount of available capital which remains unaccounted for—that is, flight capital—is $21.4 billion.

Total combined flight capital for 1993 and 1994 is $30.7

FIGURE 4
Real Mexican foreign debt
(billions $)



Sources: Banco de México, SHCP, BMV, EIR.

TABLE 3

Capital flight out of Mexico

(billions $)

	1989	1990	1991	1992	1993	1994	1989-94
1) Growth of official foreign debt	$–5.4	$12.2	$ 9.3	$–1.9	$ 5.5	$ 22.0	$ 41.7
2) Foreign investment	3.5	4.6	17.5	22.4	33.3	8.7	90.0
3) Capital entry (1+2)	**–1.9**	**16.8**	**26.8**	**20.5**	**38.8**	**30.7**	**131.7**
4) Current account deficit	4.0	7.1	14.9	24.8	23.4	28.5	102.7
5) Growth of reserves	1.0	3.4	7.8	1.2	6.1	–19.2	0.3
6) Capital use (4+5)	**5.0**	**10.5**	**22.7**	**26.0**	**29.5**	**9.3**	**103.0**
7) Implicit capital flight (3–6)	**–6.9**	**6.3**	**4.1**	**–5.5**	**9.3**	**21.4**	**28.7**

Sources: World Bank, IMF, Banco de México, SHCP, *Summa*.

billion. Nothing remotely like this has happened since 1982, during the presidential term of José López Portillo, when massive capital flight led to a break with the International Monetary Fund and a debt moratorium.

Flight capital is not the only thing that has been underestimated by virtually every commentator on Mexico. It is also the case that the *real* foreign debt of Mexico is 50% higher than what is reported as the official foreign debt. As we analyzed in our May 1994 study, the official foreign debt (public and private) in 1994 added up to $119 billion, while foreign investment on the stock market equalled another $64 billion, bringing to $183 billion the real international obligations of the Mexican economy.

During one year, through the end of 1994, the official foreign debt then rose to $141 billion, the new debt being almost entirely private (public foreign debt rose by only $1 billion). The international obligations of the Mexican economy in other areas (foreign investment in government financial paper and foreign investment on the stock exchange) grew to $72 billion, bringing the total amount of Mexico's real foreign debt to $213 billion!

As we have already indicated, it was this portion of de facto foreign obligations that blew up and forced the peso devaluation, the disappearance of international reserves, the impending chain reaction of bank collapses, and the national economy's current plunge into a depression.

By adopting the "financial stabilization" program, calculated at $18 billion, the Zedillo government is assuming private foreign debt as government foreign debt. But that figure only holds through Jan. 3. Now, U.S. President Bill Clinton is offering the backing of the White House and U.S. Treasury for another $40 billion, as part of a financial rescue plan for Mexico.

It is important to note that the financial offers of the United States come, or so it is said, without demand for collateral and with interest rates equivalent to those carried by three-month U.S. Treasury bonds. This operation may perhaps alleviate speculative pressure in the short term, but in the longer term it can only aggravate the situation: If the current parameters are not completely changed, it is only the international speculators who have plundered this country who will be rescued. And if this is so, it only confirms our charges, made in an *EIR* cover story of Oct. 8, 1993, on the secret financial accords behind the North American Free Trade Agreement (NAFTA). These involve the tacit absorption of Mexico's central bank into the U.S. Federal Reserve, which would issue dollars from Mexico without going through the banking and currency controls of the U.S. Congress, in order to refloat speculative bubbles in other parts of the world.

In this dance of the billions, if the initial $18 billion emergency package is concretized, plus the $5 billion more in foreign loans of which Treasury Secretary Ortiz spoke, plus the $2.5 billion that the government is seeking in a standby loan from the International Monetary Fund, we can see that Mexico will be shouldering a real foreign debt burden of $239 billion. This is equivalent to the entire foreign debt of Ibero-America in the early 1970s. If, in addition, Mexico is forced to draw on the $40 billion proferred by the United States government, its real foreign debt will have reached by mid-1995 the stratospheric sum of $279 billion.

To the extent that other agreements are struck, the amount will steadily increase, all destined to fall into the sinkhole of insolvency in the end. The government's immediate nightmare is the next six months, when it must pay off a minimal $16.9 billion in maturing *Tesobonos*.

We ask: How will this whole new round of restructuring of debts, which have been undergoing restructuring since 1982-83, be paid?

With an eye on the oil

The answer has already been given by the creditors. On Jan. 4, the City of London's *Financial Times* commented that foreign investment will only return to Mexico with "the

A 1989 rally by Mexico's oil workers, demanding freedom for their jailed leader, Joaquín Hernández Galicia, and opposing the privatization of the national oil company Pemex. Today, the New York Times *is demanding that those who oppose the economic destruction of Mexico be subjected to the same repressive treatment that Hernández Galicia received.*

sale of existing electricity generating capacity . . . Pemex's basic petrochemicals businesses and the allowing of foreign participation in Mexican oil fields." The same newspaper proposed that payment on *Tesobonos* be backed by "longer-term bonds whose payment would be guaranteed by oil production."

Responding to the agreement for overcoming the financial emergency, the U.S. financial daily *Journal of Commerce* demanded of the Mexican government on Jan. 5: "Why not sell Pemex? . . . The time for a go-slow approach is past; Mexico's economic crisis demands bolder action."

It is clear that on the part of the international creditors, there is no discussion about restructuring debts, but rather political and financial pressure on the Zedillo government to privatize Pemex. Since Jan. 4, 1995, not a day has passed on which privatizing the oil has not either been demanded or refused. The most significant statement in this regard came from Energy Secretary Ignacio Pichardo Pagaza, who on Jan. 6 denied that the possibility of privatizing Pemex was even being considered. He was seconded by the president of the ruling PRI party, María de los Angeles Moreno.

In reaction to this "drawing of the line" by the Mexican government, the stock market plunged. Bank of Mexico Governor Miguel Mancera Aguayo reported on the flight of some $600 million, which lowered the international reserves still further and which provoked a new fall in the peso's value against the dollar. Mancera announced that the credit line from the U.S. Federal Reserve had entered into operation and the Fed began buying Mexican pesos! Apart from these "market effects," newspapers like the *New York Times* began demanding that the Zedillo government begin to jail and politically eliminate the so-called "dinosaurs" of the Mexican political elites, who are opposing (or might oppose) the privatization of Mexico's oil.

The *New York Times* dubbed such an approach a "La Quinazo," in reference to the illegal jailing by former President Salinas of oil workers union leader Joaquín Hernández Galicia ("La Quina") early in his term. That this criminal action by Salinas against "La Quina" is now urged as official policy, confirms that Hernández Galicia is a political prisoner of the international creditors, and that Salinas de Gortari was treasonously working to privatize Mexican patrimony.

How far President Zedillo will go in resisting these pressures to become another Salinas, we cannot say. What we do know is that the only alternative Mexico has to preserve its sovereignty, is to suspend payment on the public foreign debt and to establish strict exchange controls. Zedillo must also disavow any responsibility for the private foreign debt and for the obligations generated by foreign portfolio investment.

To do this, he must ally with Venezuelan President Rafael Caldera, to create a common debtors' front and to establish Ibero-American integration.