37

The Mexican Financial Imbroglio since 1982: Debt, Public Expenditure, and Nationalized Banking

JAMES W. WILKIE

James W. Wilkie and Enrique Ochoa, eds., *Statistical Abstract of Latin America*, vol. 27 (Los Angeles: UCLA Latin American Center Publications, University of California, 1989).

The ability of Mexico to overcome its economic slowdown and to begin to resolve social problems caused by deferred social expenditure since 1982 depends greatly upon the amount of discretionary funding that remains in the central government budget after payment of amortization and interest on the foreign and domestic public debt. It also depends importantly on the real value of the Mexican foreign debt and the liquidity of the country's banking system.

Debt and Mexican Government Expenditure

About payments on the debt, the Mexican presidency has been caught in a "Catch 22" situation because, on the one hand, it would like to show the international banking community that the service on the foreign debt is excessive in relation to the country's capacity for repayment. On the other hand, for domestic political purposes the government has sought to understate the importance of all public debt payments. Under President Miguel de la Madrid domestic political considerations won out and Mexico lost much of its negotiating power with the international community, including the U.S. Treasury Department.

Thus, the government has presented the share of foreign debt payments in relation to GDP rather than to central government expenditure on foreign and domestic debt. Foreign debt payments are seen, then, to be only 5 percent of GDP, which sounds manageable.

Also, the government has downplayed the share of expenditure on all of the debt by removing it from its presentations on public expenditure, further obfuscating issues. Hence, few observers inside or outside Mexico have been fully aware of the internal impact of the country's entire debt problem.

My investigation into the trend of debt payments as a share of central government expenditure shows that the percentages are not manageable and reveals the dire straits into which Mexico has fallen. I calculate the total public debt (internal + external) payments as a share of the central government outlay rather than as a share of the entire public sector expenditure (central government + parastate or decentralized expenditure) because outlays in the parastate sector are not discretionary. Most parastate agencies either lose money and require subsidies, operate with featherbedded inefficiency, or both. In any case, the important parastate agencies collect their own revenue and expend it.

Only the central government channels its tax collections into the Treasury where it is allocated by the Secretary of Planning and Budget to cover the myriad of Mexico's needs. Only the central government has discretionary spending, but that discretion also has been seriously compromised by subsidies needed to cover the deficits of most parastate agencies. To recover what discretion it has, the central government has moved to sell to the private sector many parastate enterprises, close enterprises, or merge them to cut costs.

President Carlos Salinas de Gortari's plans to reform the giant and corrupt PEMEX enterprise offer a case in point. Although PEMEX was able to end central government subsidies to it and also to pay taxes and rents to the central government since the oil boom of the late 1970s, PEMEX could have generated much more for the national treasury and for central government discretionary funding had it been run honestly and efficiently.

PEMEX corruption at all levels and especially the nefarious union veto power over management decisions, control over assignment of workers (including bribery and sale of jobs), and control of contracts (reduced from 50 percent to 2 percent under De la Madrid) by the infamous PEMEX union leader Joaquín Hernández Galicia ("La Quina") have had grave consequences for Mexico. "La Quina's" power not only damaged the government's ability to marshall national resources but hurt Mexico's image abroad.

Indeed corruption in the Third World has concerned foreign financial leaders. Foreign bankers, IMF officials, and U.S. Treasury secretaries James A. Baker III (1985–89) and Nicholas F. Brady (1989–) have argued that Third World debtors including Mexico would never clean up rampant corruption if debt relief were to come prematurely. The corruption in PEMEX, one of Latin America's largest enterprises, has preoccupied leaders concerned with establishing the basis for noncorrupt expenditure decisions.

To help convince foreign financial officials of Mexico's seriousness of purpose and to modernize the Mexican petroleum sector, Salinas determined to force "La Quina's" hand.

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Apparently Salinas met in early January 1989 with "La Quina" to tell him of his plans to divide PEMEX into three separate enterprises (exploration and drilling; distribution and sales; and secondary petrochemicals), with only exploration and drilling to be retained without private investment. "La Quina" rejected the plan and sealed his own fate.[1] On January 10 Salinas sent army troops to arrest "La Quina" and over 80 of his cronies for hoarding guns and being involved in corrupt activities; at the same time Salinas put oil refining and gas distribution under temporary military guard to prevent mysterious explosions such as that of San Juanico in 1984. (After the explosion at the San Juan Ixhuatepec gas distribution center leveled 30 acres of Mexico City and killed up to 1,000 persons, De la Madrid effectively aborted his campaign to clean up the PEMEX unions.)

Central Government Expenditure on the Public Debt

As if this context of state corruption and inefficiency were not enough, the central government has also found itself trapped in the rising share of its outlay needed to cover the foreign and domestic debt. Much of this debt was acquired in 1982 as the result of nationalizing the country's banks, an act which ironically saved the private sector from bankruptcy.

The results of my investigation into the share of central government outlay devoted to the debt are given in table 3700 and figure 37:1, which reveal the extent of Mexico's predicament. The share under Porfirio Díaz averaged about 30 percent for the years sampled. The overlapping period of Francisco Madero and Victoriano Huerta saw the average decline to about 25 percent, then go as low as 3.5 percent under Venustiano Carranza as he tried to wrap up the civil war. Alvaro Obregón and Plutarco Elías Calles kept the share in the 9 to 12 percent range before the social reformer Emilio Portes Gil cut the share to 7 percent in 1929. Depression years saw the average fall to 4.7 under Pascual Ortiz Rubio. Abelardo Rodríguez achieved the Calles level of just above 12 percent. Lázaro Cárdenas paid only 11 percent of central government expenditure on the debt, which Manuel Avila Camacho exceeded by 6 percentage points. Miguel Alemán and Adolfo Ruiz Cortines held the share to about 16 percent, or less than Avila Camacho for whom Cárdenas had served as defense minister. Adolfo López Mateos and Gustavo Díaz Ordaz saw the average rise to the Madero/Huerta level of near 25 percent, as did José López Portillo, but Luis Echeverría dramatically cut that share to about 14 percent.

López Portillo and De la Madrid put the central government budget on a disastrous course. The share of outlay devoted to debt surpassed 40 percent after López Portillo's last year in office (1982). (See table 3701 and figure 37:2.) It averaged 52 percent under De la Madrid, whose 1987 share reached 68 percent, well over twice that of Díaz, who previously held the highest average. No wonder De la Madrid drastically curtailed outlays needed for such areas as the rural sector, education, and public health.

In this difficult situation, the value of Mexico's foreign debt began to fall in the secondary market, that is, the free market or market of real value. Real value stood at 83 percent of book value by December 1984 (see table 3702 and figure 37:3). Within a year it fell to 70 percent, where it held until February 1986 when it fell to 64 percent, and to about 58 percent one month later. Although it held at about 58 percent until mid-1987, subsequently it continued downward to reach 50 percent by year's end. After hitting 49 percent in February 1988, it continued downward reaching 43 percent by last December. Early in 1989 the value fell to 38 percent.

Given the reality of the declining free-market value of the Mexican foreign debt (only about 21 percent of which is private) and the country's increasing share of outlay to support that burden, in my view we can juxtapose these two trends and suggest that to reduce the burden for Mexico and to prevent the real value of the debt from falling further for foreign bankers, the solution is to apply the vaunted Reagan/Bush free-market philosophy. By officially recognizing at the U.S. and international agency levels that the debt is worth less than half of its book value, Mexico's interest payments could be cut in half, leaving it funds to undertake economic and social recovery. And the foreign bankers could even see gains in the real value of the Mexican debt held by them.

Such a proposal to revalue Mexico's foreign debt by relying on the free market to set the debt's worth is congruent with the historical moment, and it could be combined with negotiation to set the total at 50 percent contingent upon implementing a grace period of up to ten years during which Mexico would not have to make payments on some or all of the debt service.

Foreign Debt and the U.S. Official Plans for Resolution

Under the Baker Plan, enunciated in 1985 by Ronald Reagan's Treasury Secretary James Baker, the United States officially discouraged sales of Third World loans on the free market. Rather, Baker encouraged U.S. banks to loan "new" money to countries only as reward for "structural reform," that is, limiting the role of state ownership and ending subsidies to the poor. The new money was not earmarked for investment but to permit repayment of up to 50 percent of interest payments due to U.S. banks. Baker did not offer any other incentives to encourage the banks to increase their sup-

[1] It seems that Salinas's enmity with "La Quina" was deep-rooted, dating to at least as early as 1986 when "La Quina" sponsored publication of an "underground" book telling of how as a child Salinas accidently shot and killed a Salinas family maid. Moreover "La Quina" was reputed to have less than secretly backed the candidacy of Cuauhtémoc Cárdenas for the presidency in the 1988 election, channeling money to the Cárdenas cause that ordinarily would have gone to support the Official Party candidate Salinas.

595

Table 3700

AVERAGE CENTRAL GOVERNMENT SHARES OF ACTUAL OUTLAY DEVOTED TO SERVICE THE PUBLIC DEBT,[1] BY PRESIDENT, 1900–88

President[2]	Average Percent	President[2]	Average Percent
Díaz (2)	30.1[a]	Cárdenas (6)	10.9
Madero (1)	25.5	Avila Camacho (6)	17.0
Madero/Huerta (1)	23.8	Alemán (6)	15.4
Carranza (4)[b]	3.5	Ruiz Cortines (6)	16.2
Obregón (4)	8.5	López Mateos (6)	25.7
Calles (4)	12.7	Díaz Ordaz (6)	23.5
Portes Gil (1)	7.0	Echeverría (6)	13.5
Ortiz Rubio (3)	4.7	López Portillo (6)	23.6
Rodríguez (2)	12.3	De la Madrid (6)	52.4[c]

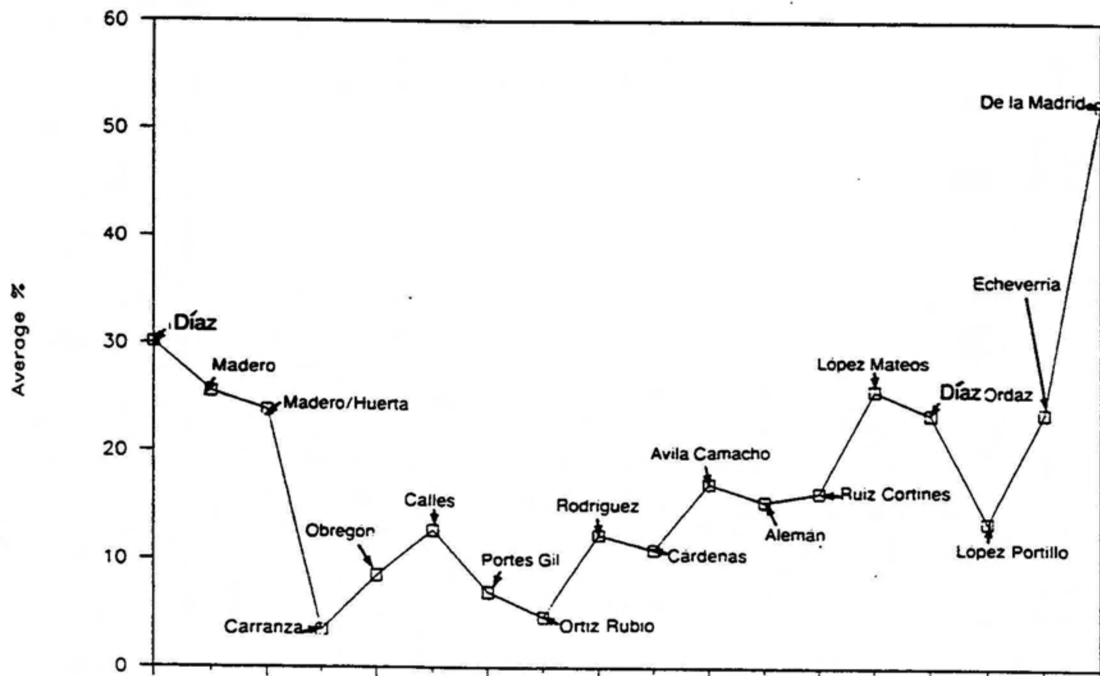
1. Amortization + interest on the foreign and domestic debt of the central government. Excludes service on the debt of the parastate sector.
2. Number in parentheses is the number of years in average.

a. Sample years for Díaz, 1900/1901 and 1910/1911.
b. Includes 1920 interim government of Adolfo de la Huerta, president for seven months.
c. Includes projected (not actual) percent for 1988.

SOURCE: James W. Wilkie, *La Revolución Mexicana (1910–1976)* (México, D.F.: Fondo de Cultura Económica, 1978), pp. 142 and 368; and since 1977, calculated from data in Miguel de la Madrid, *Quinto* and *Sexto Informe de Gobierno, Tomo Estadístico*, p. 103 and p. 55, respectively.

Figure 37:1

MEXICO AVERAGE CENTRAL GOVERNMENT SHARES OF ACTUAL OUTLAY FOR PUBLIC DEBT SERVICE, BY PRESIDENT, 1900–88



SOURCE: Table 3700.

Table 3701

ACTUAL CENTRAL GOVERNMENT EXPENDITURE ON THE PUBLIC DEBT,[1] 1977–88

Year	Percent
1977[a]	16.4
1978	22.4
1979	22.2
1980	16.9
1981	20.0
1982	43.4
1983[b]	41.5
1984	39.6
1985	41.8
1986	60.1
1987	68.0
1988[c]	63.6

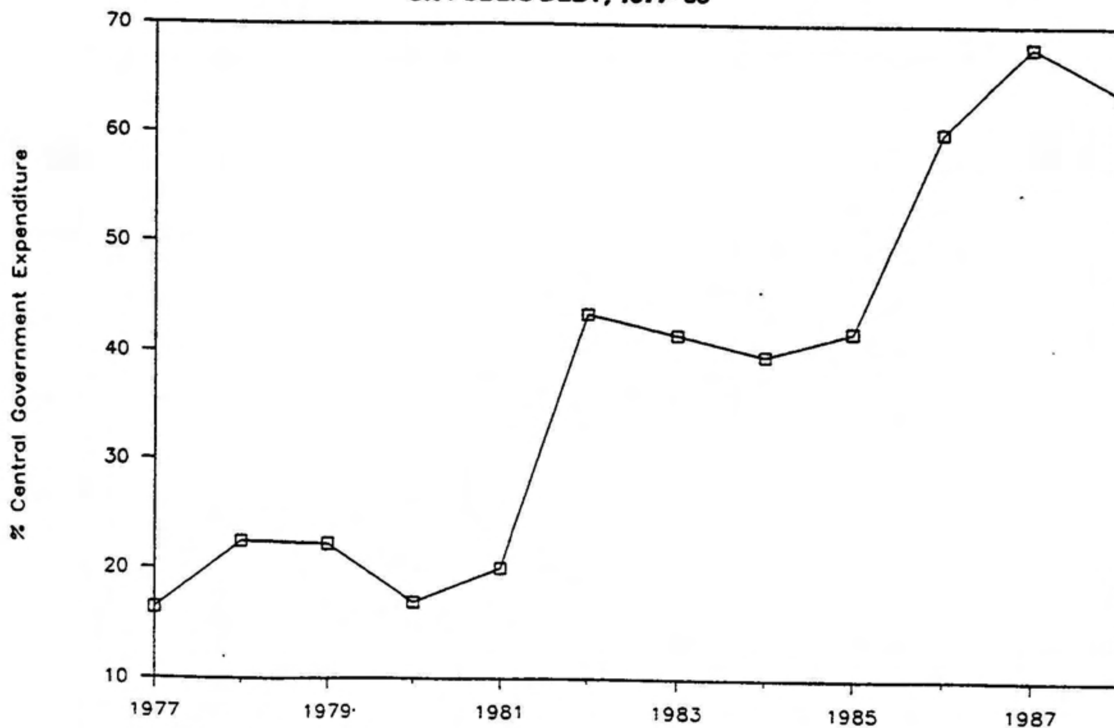
1. Excludes service on the parastate debt. (Service on the consolidated central government and parastate debt as a share of consolidated expenditure rose from 25.2 percent in 1977 to 57 percent in 1987, figures which understate the magnitude of the shortage of discretionary funds by about 10 percent.)

a. López Portillo figures cover 1977–82.
b. De la Madrid figures cover 1983–88.
c. Projected, not actual.

SOURCE: For other notes and sources, see table 3700.

Figure 37:2

MEXICO CENTRAL GOVERNMENT EXPENDITURE ON PUBLIC DEBT, 1977–88



SOURCE: Table 3701.

Table 3702

MEXICO FOREIGN DEBT: REAL PERCENT OF BOOK VALUE ON THE SECONDARY MARKET,[1] 1984–89

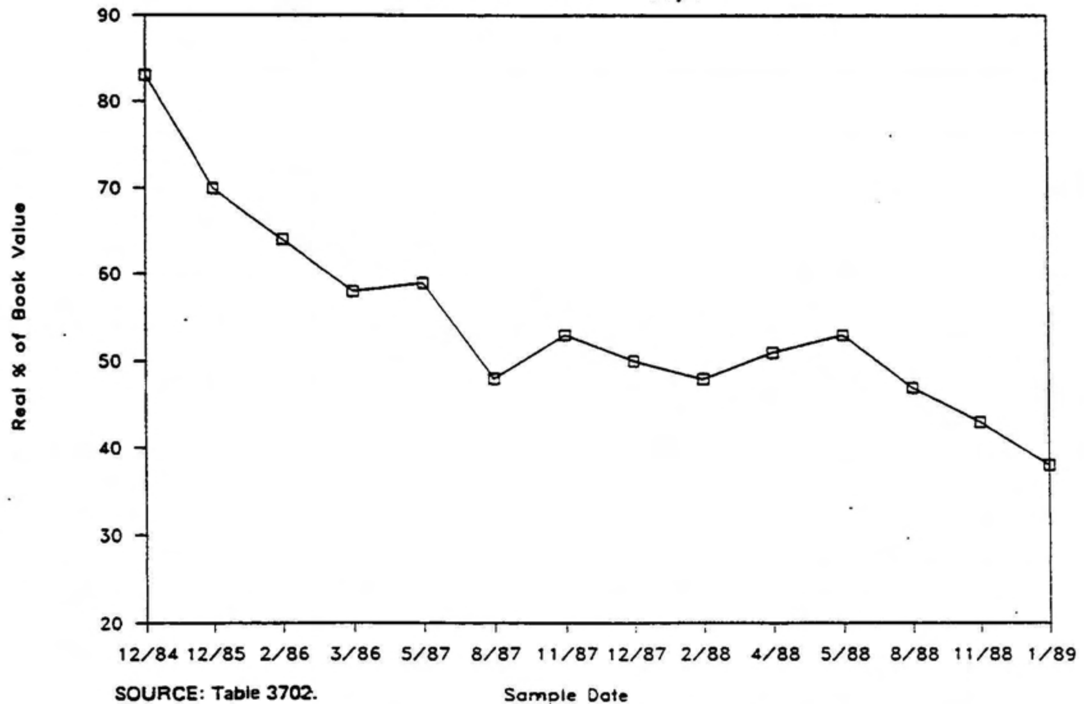
Sample Date	Percent
12/84	83
12/85	70
2/86	64
3/86	58
5/87	59
8/87	48
11/87	53
12/87	50
2/88	48
4/88	51
5/88	53
8/88	47
11/88	43
1/89	38

1. The secondary market is the free market, the primary market for "fixed-value" loans guaranteed by the government not being a viable medium on which to sell the Mexican foreign debt. In theory, government-backed loans should retain 100 percent of their value, no secondary market being operable.

SOURCE: James W. Wilkie, David E. Lorey, and Enrique Ochoa, eds., *Statistical Abstract of Latin America*, vol. 26 (1988), table 2809; Merrill Lynch, December 1988; and *El Financiero*, January 25, 1989, p. 18.

Figure 37:3

MEXICO FOREIGN DEBT: REAL PERCENT OF BOOK VALUE ON THE SECONDARY MARKET, 1984–89



SOURCE: Table 3702.

598

ply of credit in a way that would restart the engine of Third World economic growth.[2]

Baker invented and held to his plan unethically because he was an active shareholder in the Texas Commerce Bank, which was involved in loans to Latin America. In 1987 that bank merged with Chemical Bank of New York, making Baker an important shareholder in one of the five most important U.S. banks involved in credits to Latin America.[3] Baker's several million dollars worth of stock in Chemical Bank appreciated as he pursued his tainted Third World debt strategy which favored U.S. banks at the expense of Third World development.[4]

By early 1989 the Baker Plan was no longer acceptable to the Third World and an alternate plan was articulated by President Carlos Andrés Pérez of Venezuela, who argued at the World Economic Forum in Davos, Switzerland, that an international debt relief agency must be created with new funds to resolve the debt problem. Under the Pérez Plan,[5] supported by some U.S. Members of Congress, the new agency would (1) buy half of the Third World debt at its free-market value (which varies for each country); and (2) negotiate the issuance of long-term bonds and lower interest rates that each country would pay for the other half of its debt.

Recognizing that the Baker Plan had not succeeded and to short-circuit a consensus building for the Pérez Plan, in March 1989 George Bush's Treasury chief Nicholas Brady outlined a new U.S. plan to reduce the total Third World debt by an average of 20 percent, but only for countries encouraging private investment at home and stemming the flight of capital.[6] Under the "Brady Plan" (opposed by some leaders within the U.S. government, especially officials at the Federal Reserve, who fear that the plan will remove incentive to banks to loan new money as well as remove incentive to Third World countries to make structural reform), no new money would be available but countries which have made structural reforms would be eligible to reduce their foreign debt through debt swaps (discussed below) and other financial schemes that shift much of the debt relief effort to the IMF and World Bank. The IMF and World Bank would divert major shares of their stabilization and development funds to serve as collateral in cases where countries offer to give banks new government bonds in exchange for being able to buy back old debt at discounted prices and lower interest rates. This plan would at once weaken the IMF and World Bank roles in fomenting economic growth and reverse the U.S. government's earlier opposition to a role for Japan, which had sought to provide funds to Latin America with relatively few restrictions. Under the Brady Plan, Japan would make only "parallel" loans to deserving debtors funded by IMF and World Bank loans.

Because the Brady Plan as it stands does not appear to be of much help to Mexico, which has announced its intent to reduce its payments on the foreign debt by 60 percent over the next three years,[7] it is hoped that Bush will revise the scheme. Even if he continues to encourage debt swaps, Bush should recognize that the real value of the Mexican foreign debt is less—much less— than the discounts which he seems to be proposing. On secondary markets Mexico's debt is about 60 percent below its book value and that amount is far too much to be absorbed by mere debt swaps.

Debt Swaps

Debt swap arrangements, wherein non-Mexican investors buy parts of Mexico's foreign debt but do not collect it in dollars, use seven mechanisms which are intrinsically interesting. Three types carry the risk of causing inflation in debtor countries:[8]

1. Debt/equity swaps (the most widely used form of foreign debt conversion because it offers the possibility of attracting new private foreign capital and to repatriate flight capital) involve schemes by which the debtor country either buys its debts from the foreign banks at a discount or buys them from a nondomestic third party which had previously bought with U.S. dollars the debts from the banks in the secondary market. The debtor country (through its central bank) then makes payment to the foreigner at near the full amount of the non-discounted debt but in its own currency (rather than in dollars), and the local currency is then invested, as equity, in domestic firms in the debtor country, according to regulations determined by the debtor country. (A variation of the debt/equity

[2] On the Baker Plan, see Luiz Carlos Bresser Pereira, "A Brazilian Approach to External Debt Negotiation," *LASA Forum* (Latin American Studies Association), Winter 1989, p. 1.

[3] For criticism of Baker's ethical problems in dealing with the Latin American foreign debt, see *El Financiero* (Mexico City), February 17, 1989, p. 17; and February 24, 1989, p. 8.

[4] On Baker's lack of ethics, see also Kevin Phillips, "The Team of Old Pols, Pals . . . and Many Peccadilloes," *Los Angeles Times*, March 12, 1989.

[5] For the Carlos Andrés Pérez version of the plan to create an international debt relief agency, see *El Día* (Mexico City), January 29, 1989, p. 5.

[6] This discussion of the Brady Plan is drawn from *Los Angeles Times* (March 11, 1989, p. 1; March 13, 1989, p. II-4) and *Wall Street Journal* (March 16, 1989, pp. A2 and A7; March 17, 1989, p. A2).

[7] For Mexico's statement to the IMF on its intent to slash payments on the foreign debt, see *Los Angeles Times*, March 9, 1989, p. 6.

[8] On debt swaps, see *Capítulos del SELA* (Sistema Económico para Latinoamérica) 19 (1988), a special issue titled "The External Debt: Options and Prospects," including, for example, Edmar L. Bacha, "Capturing the Discount: Towards a Debt Reconstruction Facility at the World Bank and IMF," pp. 33–40; and UNCTAD Secretariat, "Debt Conversions as a Solution to the Debt Problem?" pp. 41–47. Cf. William Guttman, *Between Bailout and Breakdown: A Modular Approach to Latin America's Debt Crisis* (Washington,

swap is applied to interest rather than to principal.)[9]

2. Debt/debt swaps (a subset of debt/equity swaps) permit domestic residents in the debtor country to use flight dollars held abroad or dollars acquired in their own country's parallel market to purchase foreign debt for exchange into local currency through the central bank for investment as under the debt/equity procedures.
3. Debt/export swaps involve schemes by which a foreign importer buys a debtor country debt from the foreign banks in the secondary market with U.S. dollars and then redeems this debt in the domestic currency of the debtor country, using the proceeds to buy that country's export goods. Or the original creditor may act as an intermediary in the process by receiving the dollar payments from the foreign importer and paying the country (at least partially) by cancellation of a portion of its original debts.

These three types of swaps offer the problem to central governments of obtaining the local currency necessary to complete the swaps. This can be done by (*a*) reducing the national budget, (*b*) expanding the internal debt, or (*c*) otherwise printing local currency, which may be inflationary. Mexico's debt/equity swaps between 1986 and 1988 totaled 3.9 billion dollars before being suspended as inflationary, possibly increasing the quantity of pesos in circulation by 1.4 billion dollars.[10] (New swaps were suspended in December 1987, and are scheduled to be permitted again in 1989.)

Another type of swap would obviate the problem of obtaining local currency:

4. Debt/share swaps permit foreign banks or third parties to cancel amounts of the foreign debt through receipt of shares in public enterprises, which are thus privatized wholly or in part.

This procedure may not attract new foreign capital at first but may do so later in order to make the privatized enterprises profitable. Its immediate contribution is to assure expansion of jobs.

D.C.: Center for International and Strategic Studies, 1989).

[9] In this proposed variation, the debt/equity swap would be applied to interest payments, with the payments being recycled to finance reconstruction and development in the debtor country. See Rudiger Dornbusch and Franco Modigliani, "Easing the Mexican Interest Burden," *Wall Street Journal*, January 3, 1989.

[10] For analysis of the swaps vis-à-vis Mexico, see Francisco Javier Vidal Bonifaz, "Las Operaciones con *Swap* Totalizan 3 mil 872 mdd," *El Financiero*, January 26, 1989, p. 34, who notes that between 1986 and 1988 swaps reduced the foreign debt by only 4 percent at a cost of 56 percent of foreign investment during the period. See also Jorge González y Sergio Negrete Cárdenas, "Los *Swaps*, una Leyenda Que Se Volvió Negra," *El Economista*, February 13, 1989, p. 17, who details examples of specific debt swaps; and Enrique Quintana, "¿Qué Pasa con los *Swap*?" *El Financiero*, February 27, 1989, p. 20, who characterizes swaps as subsidies involving the potential for corruption.

Three debt swaps remain to be discussed, but they have had little acceptance to date:

5. Debt for nature swaps stimulate international ecology groups to buy a country's foreign debt and trade it for land in that country, holding the land in trust as an ecological preserve.
6. Debt buy-backs allow the debtor country to purchase its own debt at the secondary market rate.
7. Debt/security swaps allow the debtor country to exchange its debts with foreign banks for new securities with better terms and/or discount, usually denominated in the same currency as the original debt.

The last option was tried for Mexico in March 1988 under the Baker Plan in close consultation with Morgan Guaranty of New York. Under this Morgan "Exit Bond" scheme Mexico was able to retire only 3.6 billion dollars of debt against which Mexico issued 2.5 billion dollars of twenty-year bonds to participant banks at an average auction price of 70 percent of book value—a loss of 30 percent of book value but a gain of 22 percent above the secondary market value.

Because the Brady Plan seems to stress swaps 1, 6, and 7, which have already proved to be limited in acceptance, however, the Bush administration does not yet appear to realize the complexity of the problem's resolution. If IMF and World Bank funds were to be set aside to foster debt swaps, that process would decrease funds needed for existing financial and development loans. Thus a new fund or international debt agency needs be created so that funds for resolving the debt problem will increase, not decrease.

Further, if development loans to the Third World from the private banking sector are not to dry up under the Brady Plan, a distinction must be made between old, discounted loans and new loans guaranteed at book value by international agencies and/or individual countries such as Japan and the United States. Without guarantees on new loan values, few private banks will want to make fresh loans that upon signing will immediately see their book value drop to market value.

With the failure of the Reagan and Bush administrations to grasp the dimensions of the debt crisis, U.S. banks find themselves in a "Catch 22" position. Without officially approved effective methods of writing off their questionable loans (through tax credits, for example), the banks wait, then, for improvement in the value of those loan portfolios; and they see plans by individual countries to follow debt swap options as driving up the value of the loans on the secondary market. Nevertheless, because most of the original loans were made by syndicates of foreign banks which had joined forces to share risk, the loans are subject to negative pledge and sharing clauses. The negative pledge requires that all participant banks in any syndicated loan be treated equally by the borrower, this provision usually not being subject to change without approval by banks that provided two-thirds of the loan. The sharing clause commits creditors to share payments

650

on a pro rata basis,[11] if the borrower fails to fully repay debt and interest. Ironically these complexities assure that the value of Mexico's foreign debt does not gain in the secondary market, but continues to fall.

But a foreign solution will provide only part of the answer to Mexico's foreign debt problems. Domestically Mexico must face a major unresolved issue which has not only continued to encourage the flight of capital but also has discouraged the repatriation of funds.

Nationalized Banking in Mexico

Nationalized banking in Mexico has been a gigantic failure to date. Because of that fact and because Mexico's private sector does not have confidence in the system that emerged after López Portillo's seizure of the country's commercial banks on September 1, 1982, up to 50 billion dollars has fled Mexico and remains outside the country. Although De la Madrid sold 34 percent of bank shares to the private sector in 1987, he fragmented the holdings in such a way as to assure that he could use the private sector's participation without yielding any government control or influence.

In my view, Mexico should take the domestic action of completely denationalizing the commercial banking system because even the partially denationalized system has been unable to stem the collapse in deposits. De la Madrid and Salinas have attempted to privatize Mexico's economy without touching its statist-oriented banking system.

Although nationalization of the Mexican banks may have been necessary in 1982 in order to save the private sector from bankruptcy, Mexico has long since made adjustments and arrangements to cover its private sector foreign debt. In any case, other government programs also helped in delaying full repayment of the private sector debt, and those programs have now been phased out of existence. Thus the time when Mexico may have profited from bank nationalization has passed.

In the meantime, the Mexican banking system has never gained the support which it must have from the private sector, which wrongly never recognized the need for bank nationalization in the first place. But the private sector rightly has complained about the inflexibility as well as arrogance of many government banking officials who seem to run the banks not to use deposits for making economically productive loans but for making payments on the public debt.

Since 1982 traditional commercial deposits (and the consequent ability to make loans against those deposits) have fallen in real terms by nearly 71 percent, as shown in table 3703 and figure 37:4. These deposits (including time as well as demand deposits) are presented on an index (where 100 = January and August 1982) that reached a high of 114 in March 1982. Thereafter the index of deposits fell steadily (except for a slight recovery to 83 in 1984) to hit 63 in 1987.

[11]On problems of syndication, see *Wall Street Journal*, March 16, 1989, p. A7.

Table 3703

INDEXES OF MEXICO REAL COMMERCIAL BANKING DEPOSITS, 1982–88

(January and August of 1982 = 100)[1]

Dec. Year	A. All Commercial Index[2]	B. Traditional Commercial Sub-Index[3]	C. Traditional as % of All (B/A)
1982[a]	100[b]	100[c]	99.7[d]
1983	79	79	99.3
1984	85	83	97.7
1985	75	75	100.2
1986	73	65	90.9
1987	70	63	90.5
1988	61	29	46.8

1. Calculated from pesos of 1978.
2. Traditional commercial deposits plus bankers' acceptances (15–91 days).
3. Nominal data for this index are given in Banco Nacional de México, *Review of the Economic Situation of Mexico*, line 50; real percentage change data are given in line 52.

a. January and August.
b. Based on traditional commercial banking data.
c. Index figure for March reached 114.
d. December.

SOURCE: For 1982, data from Banco Nacional de México given in SALA, 26-3502; since 1983, Banco Nacional de México, unpublished computer series on Mexican banking data.

During 1988 they collapsed by over half to go as low as 29 on the index. This index is calculated from the data series used by the Banco Nacional de México to measure deposits in its monthly *Review of the Economic Situation of Mexico*.

Although traditional commercial deposits made up nearly 100 percent of all commercial bank deposits from 1982 through 1985, by 1986 and 1987 they fell to about 90 percent. By December 1988 they totaled only 47 percent of all commercial bank deposits.

Beyond traditional commercial bank deposits, the index for all commercial deposits (traditional deposits plus bankers' acceptances of 15 to 91 days) also has declined. Whereas it stood equally at 75 on the index with traditional commercial banking in 1985, it fell to 61 by the end of 1988. (See table 3703 and figure 37:5.)

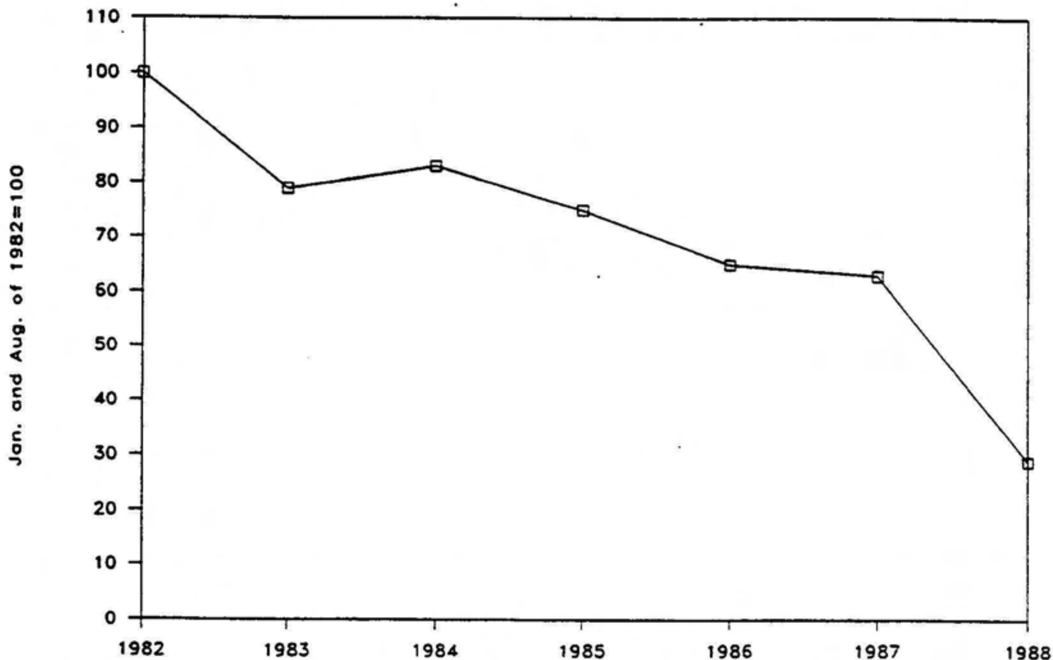
By either index shown in table 3703, Mexico's banking system is failing to gain the deposits against which loans can be made, loans needed to develop a modern economy. Deposits alone, however, do not guarantee that loans will be shifted from the public to the private sector.[12]

To expand credit in Mexico, two ideas emerged in early 1989, one presented as a plan and one as an action. Recog-

[12]With regard to competition for scarce loans between the public and private sectors as well as an analysis of the complexities of financial intermediation in Mexico especially since 1982, see an unpublished study by the Centro de Investigación para el Desarrollo (IBABIN), "Desarrollo y Evolución Financiero Mexicano, [1970–1985]."

Figure 37:4

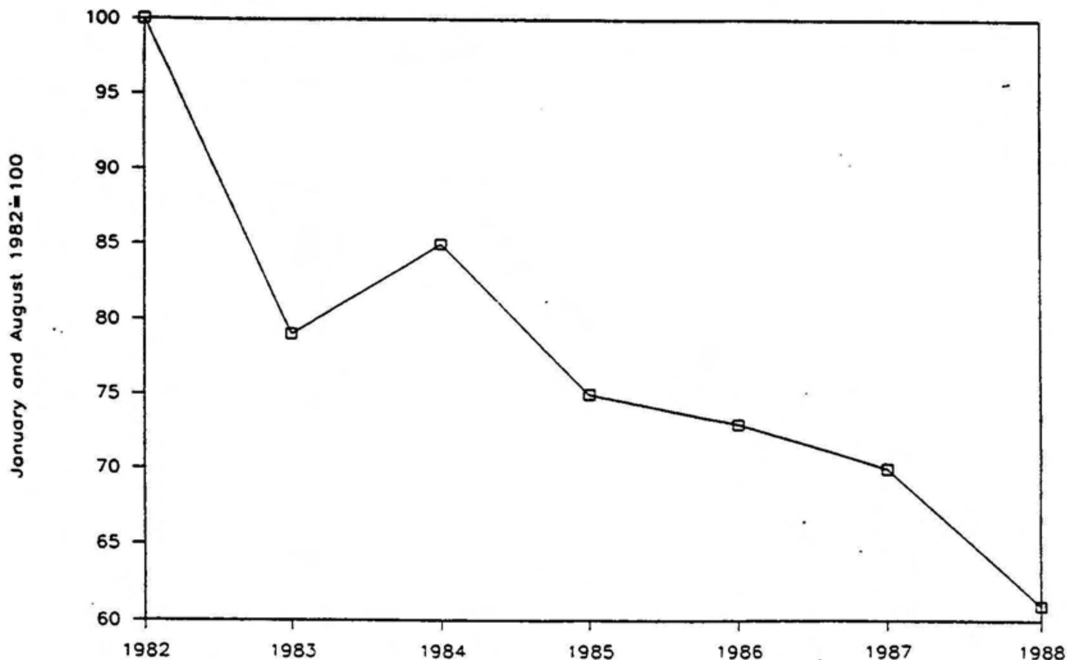
INDEX OF MEXICO TRADITIONAL COMMERCIAL BANKING DEPOSITS, 1982–88



SOURCE: Table 3703.

Figure 37:5

INDEX OF ALL COMMERCIAL BANKING DEPOSITS IN MEXICO, 1982–88



SOURCE: Table 3703.

nizing the urgency of meeting the credit needs of the lower class, the middle class, and small businesses, Antonio Ortiz Mena, president of the Banco Nacional de México, called for the creation of a new Popular Bank. Official Mexico tended to react negatively, arguing that a new government bank would expand the bureaucracy.

Official Mexico did act, however, to relieve the credit crunch by freeing interest rates to stimulate competition among government banks, and it reduced reserve requirements from 115 percent to 30 percent on deposits and holdings of credit.

Changes in the banking laws are also designed to stem the flight of capital from Mexico. Much money fled Mexico during the last months of 1988, as is shown in table 3704. In

Table 3704

MEXICO INTERNATIONAL RESERVES, 1987–88

Year	Month	Billion Dollars
1987	Dec.	13.7
1988	Jan.	13.6
	Feb.	13.8
	March	15.8
	April	16.2
	May	15.6
	June	14.4
	July	11.8
	Aug.	12.1
	Sept.	12.1
	Oct.	11.1
	Nov.	9.1
	Dec.	9.0

SOURCE: Banco Nacional de México, unpublished computer series on Mexican banking data.

December 1987 Mexico's international reserves stood at 13.7 billion dollars and reached 16.2 in April 1988, but by December 1988 they had fallen to 9.0 billion. This 44 percent decline in eight months paralleled the decline in traditional commercial bank deposits. Until Mexico resolves the linked problems of declining commercial bank deposits and unstable international reserves, its economy will not prosper over the long term. Apparently some 40 to 50 billion dollars remain outside of Mexico and will not return to an illiquid, government-run banking system.[13]

[13] This figure on flight capital that remains permanently outside of Mexico is estimated by the Partido Mexicana Socialista (see *El Universal*, January 30, 1989, p. 1). Cf. *Lloyd's Economic Report*, March 1989, which cites figures of flight capital totaling 42.5 billion. Apart from the 40 to 50 billion that Mexico's private sector permanently keeps abroad, there is perhaps 5 to 10 billion that it moves in and out of Mexico to take advantage of temporary opportunities for exchanging dollars into pesos and vice versa. To encourage movement of dollars into Mexico the government is allowing investors to convert dollars at a special peso rate under debt/debt swap provided that the investment goes to designated areas for tourist development; for example, in 1988 investors could gain double the peso conversion rate provided they put those pesos into tourist development at the Huatulco resort complex in the state of Oaxaca, showing positive construction within three years.

Conclusion

Mexico's distorted expenditures on the public debt have reached a post-Díaz high that undermines even minimal active state policy to meet the educational and public health needs of the country, let alone provide credit to the private sector for economic growth. Díaz's expenditure on the debt averaged only 30 percent compared to De la Madrid's 52 percent (68 percent in 1987), thus making the dictator's expenditure policies for national development seem benign compared with those of the president who just left office.

To rekindle economic growth, Mexico needs international help to escape from the weight of repaying foreign loans which are absorbing too great a share of funds needed for domestic social and economic expenditures. But Mexico cannot effectively undertake modernization and privatization of its economy with a statist-oriented commercial banking system which is unable to provide liquidity for the private sector, the banks serving as a collector of deposits which it channels to the state and to pay Mexico's debt. Complete denationalization of the banks is now needed to help encourage the return of funds to Mexico, funds needed for internal development. Mexico needs to recognize that while nationalization may have made sense in 1982, in 1989 it does not.

Partial denationalization has not resolved Mexico's commercial banking problems. The state neither has the ability to assess from Mexico City the banking needs of the country nor does it have the flexibility and the deposits to make loans propitiously. Nevertheless, denationalization need not mean full deregulation nor return to the pre-1982 banking system which had serious faults of its own.

Regardless of how the debt problem is resolved, if Mexico is to undertake effective national development it must become fully aware of its three interrelated expenditure and credit problems: lack of discretionary funds available to the central government, unreal value of the debt, and illiquidity of the partially nationalized banking system.

These three factors must be faced by Mexico irrespective of the governing ideology, be it privatist or statist oriented.

Postscript, April 1989

To begin implementation of the Brady Plan, the IMF has announced a three-year $3.65 billion dollar loan to Mexico. The meaning of this loan is as mixed as that of the Brady Plan. On the positive side, the loan is to be disbursed before, not after, new commercial bank loans are renegotiated. Generally IMF loans are disbursed only after commercial bank financing is in place, thus giving commercial banks enormous leverage over a borrowing country.[14]

On the negative side, the new loans by the IMF and World Bank offer no panacea. The new IMF loan will mainly cover

[14] See Matt Moffet and Peter Truell, "Mexican Loan of $3.64 Billion Slated by IMF," *Wall Street Journal*, April 12, 1989.

Mexico's repayment of loans due to the IMF over the next three years, leaving Mexico a net gain of a meaningless 600 million. The same situation exists with the World Bank, new loans barely keeping up with payments on old ones.[15]

To further complicate matters, some U.S. lawmakers threaten to hold up annual U.S. appropriation for various international development agencies unless they are assured that new loans by the IMF and World Bank are not used simply to bail out commercial banks. Given this threat, Brady cautioned Mexico that the new IMF loan will be reduced by about 1 billion if Mexico makes unreasonable demands for debt reductions with its commercial banks.[16]

Clearly Mexico faces major hurdles in negotiating with international and private bankers to ease its debt burden to the extent that it needs in order to rekindle economic growth.

[15] See Jorge Castañeda, "Mexico's IMF Credit May Only Make Things Harder Still," *Los Angeles Times*, April 16, 1989.

[16] *Wall Street Journal*, April 18, 1989.