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It's not a Mexico problem, but a New York problem

by Valerie Rush

The financial blowout currently taking place in Mexico is nothing but the collapse phase of an ongoing disintegration of the international financial and monetary system, said U.S. economist Lyndon LaRouche in a Dec. 28 radio interview. "Essentially, this should be seen as a continuation of the Orange County mess. This is not just Mexico. You have it throughout the world. . . . So, don't worry about Mexico. The whole world system is going. People have to wake up to that fact. It's not a 'Mexico problem.' It's a New York problem."

For several years, LaRouche has been comparing the world monetary system to the *Titanic*, and has warned the governments of the world that, instead of shifting their deck chairs around, they would be well-advised to abandon ship while there is yet time. LaRouche's warnings were ignored, and the *Titanic* started to take on water. Orange County is but one of the leaks, Mexico another. There will be many more. The unavoidable truth is that the *Titanic* is sinking.

Mexico's 'steam valve' blew

That Mexico was going to blow was merely a question of time. It had been the international financiers' premier model for "free trade reform," "trade liberalization," privatization, and debt reorganization since 1988, when the Harvard-trained Carlos Salinas de Gortari assumed the presidency. The North American Free Trade Agreement was to be the crowning achievement of the Salinas "economic miracle," touted as such at the Summit of the Americas held in Miami a mere three weeks before the blowout. And yet, the effect of these banker-imposed "reforms" has been a complete breakdown in Mexican manufacturing and infrastructure, a sharp increase in unemployment, a decline in food consumption; in sum, a looting of the real economy to pay Mexico's huge foreign debt.

As LaRouche describes it, "there was a blowout in Mexico in 1982, which I'd forecast, but people weren't paying attention and it hit them. They thought they put the lid on that one. People who remember the days we had steam engines will remember that the steam engine had a safety valve, and when the pressure in the tank got too high, this safety valve would let the steam out, so you wouldn't blow up your tank. What happened is that in 1982, the U.S. government and others decided to sit on the safety valve, and so Mexico has been erupting, slowly, ever since; and now the safety valve just blew."

Mexico is financially bankrupt. International reserves which stood at an estimated $27 billion in the early part of the year had consistently eroded over the past 10 months. In the days immediately preceding and following the Dec. 20 peso devaluation, reserves plunged another $4-6 billion. On Dec. 22, Treasury Secretary Jaime Serra Puche revealed that foreign reserves had fallen to the emergency level of $6.5 billion, barely enough to cover one month's imports.

Mexico's current account deficit is expected to reach a little over $29 billion for 1994. As *EIR* noted in April 1993, "The government's policy for the current account deficit is simply to keep interest rates very high. It is doubtful how long that measure alone can keep the floating crap game going. It is increasingly likely that Salinas will be forced to devalue the peso—a measure which he has desperately tried to avoid, as it will deflate the international myth of the 'Mexican model,' and bring the country's foreign debt crisis back to center stage."

As it turns out, it fell to newly inaugurated President Ernesto Zedillo to pull the plug. The Mexican peso has already been devalued an estimated 40% and is still in free-fall, as dollars flee the country. The *Wall Street Journal* moaned Dec. 27 that the devaluation risks "further sharp

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increases in the cost of servicing billions of dollars of dollar-denominated debt in the form of Brady bonds and short-term debt." Before the devaluation, Mexico was paying $7 billion a year in debt service. Whatever that figure rises to, there is little doubt that Mexico will be unable to service it.

Banks in trouble

In September 1994, *EIR* reported on the dire straits of the Mexican banking system, whose bad debt portfolio by June 1994 had surpassed the paid-in capital of the banks themselves. Their insolvency is reflected in a series of mini-crises such as the Banco Unión-Banco Cremi scandal, and in the fact that the bankers have increasingly turned into stockbrokers, spending more energy on speculation than on traditional banking activity. In the first six months of 1994, Mexican banks increased their holdings in the stock market by 33%, representing nearly 21% of the banking system's total assets. As London's *Financial Times* pointed out Dec. 28, "Much of [Mexican] banks' current capital is either in the Mexican stock market—down more than 50% in dollar terms so far in 1994—or in long-term government securities, the value of which has also fallen heavily."

Overnight interest rates on interbank loans jumped from 20 to 40% in one night. And, since most bank loans carry variable interest rates, defaults in credit cards, mortgages, and car loans are expected to soar. The *Wall Street Journal* warned, "Mexican banks are already chock full of bad debts, and can't afford many more." The *Financial Times* added that the government's bank insurance fund is undercapitalized after bailing out two banks in the past six months.

Then, of course, there is the investment question. More than two-thirds of the foreign investment that has been pouring into Mexico in the last three years has been "portfolio investment," meaning mostly stock market investment by mutual funds and private individuals, plus depository receipts—that is to say, speculative instruments that lead to the creation of no new physical wealth of any kind. All of these investments are extremely volatile and, as the *Wall Street Journal* recently noted, "allow investors to vote with their feet, quickly."

One example is the $30 billion market in Mexican *tesobonos,* or dollar-denominated treasury bonds, which are heavily foreign-owned. Approximately $5.2 billion of those bonds come due in the next six weeks, according to Salomon Brothers, and $10.5 billion come due in the next six months. The Mexican government had hoped to cover its obligations by selling new bonds. And yet, out of one recent government auction of $774 million in maturing *tesobonos,* only $27.6 million worth in short-term paper sold, about 4% of what the government needed.

A rumored plan by the Banco de Mexico to impose a three-year forced stretch-out, or roll-over, of the bonds coming due has already caused a panic among Mexican bankers, who warn that this would trigger a profound crisis in the banking system, since most foreign credits were won by the banks using their *tesobono* holdings as collateral. An enforced stretch-out on the bonds would mean that the banks' credit agreements would have to be renegotiated.

The international financial centers are pushing hard to contain the Mexican crisis, and both the International Monetary Fund and the Clinton administration are being urged to jump in with some kind of bailout. But the "solutions" involve the further ravaging of Mexico. The *Wall Street Journal* put it succinctly in its Dec. 28 editorial, when it demanded a fire-sale of national assets to restore elusive "investor confidence." The free-fall of the Mexican peso, the editorial said, will not stop until the Mexican government and central bank "make clear they will sell assets until the peso's value improves."

The *Financial Times* was even more specific in insisting that Mexico put its national oil company Pemex on the auction block if it wants to regain "credibility": "The clearest signal it could offer would be to announce plans to privatize the inefficient state-run electricity and energy monopolies."

Shock waves

While the effects of the "peso meltdown" are already being felt on the Mexican economy in the form of price and interest rate hikes, bank shutdowns, extended "holidays," and widespread panic, the impact goes far beyond Mexico.

On the U.S. side, immediate concern was focused on a possible mass liquidation of mutual funds at the close of 1994. Those funds' investments in Mexico have lost an average of 21% of their value since the Dec. 20 peso devaluation. The *New York Times* reported on Dec. 27 that U.S. investors in Mexico had lost $8-10 billion in Mexican stocks and bonds in that same time period. Further, U.S. banks hold $21 billion in loans to Mexico and bankers are chewing the rug over how Mexico will service those loans. As one U.S. economist put it, "The impact of a major fallout south of the border would be felt throughout the U.S. financial system."

But the shock waves have hit Ibero-America hard, too. Argentina, with its massive trade deficit, is suffering capital flight, a plunge on the Buenos Aires stock market, crises pending in as many as 10 banks, and rumors of a devaluation after next May's presidential election. There has been substantial panic in Brazil as well, with the central bank there forced to intervene into the exchange markets at least 10 times in order to contain a rise in the value of the dollar. An estimated $1.5 billion fled the country within days of the Mexican devaluation.

And beyond? The *Wall Street Journal* on Dec. 28 nervously commented that "the forces that pushed the Mexican government to abruptly shift economic policy and abandon the peso's peg to the dollar . . . are present, to varying degrees, in Russia, Hungary, Poland, and Turkey, as well as China, Malaysia, and other fast-growng southeast Asian economies."

As LaRouche summed up, "This is the end of a period of history. It's all over. Forget it. It's gone."