Mexico receives peanuts in latest debt swindle

by Peter Rush and Carlos Cota

Late in the evening of Sunday, July 23, Mexican President Carlos Salinas de Gortari went on national television to lie to the Mexicans that a debt agreement reached just minutes before in Washington between bank representatives and Mexican negotiators, means that Mexicans "will no longer bear the burden of excessive indebtedness." In reality, Mexico had just signed a humiliating capitulation to the demands of the banks, and totally abandoned its own demands—stated dozens of times in the last six months—for at least a two-thirds reduction in a net outflow of capital that presently totals more than $10 billion a year.

International opinion took little time to refute Salinas's rosy view. If the political "half-life" of the first U.S. government plan to deal with Third World overindebtedness, the so-called "Baker Plan" of 1985, was about three years, and that of its successor the "Brady Plan" of 1989, as many months, the political "half-life" of the latest Mexico debt package was telescoped to about as many hours. Hardly was the ink dry on whatever documents the parties may have signed, before informed opinion began pointing out that the plan will reduce Mexico's debt by little or nothing, cut its interest payments by a mere 15%, and help the average Mexican, not at all.

Rather, the extravagant claims made by Salinas, and by U.S. Treasury Secretary Nicholas Brady, were clearly intended as theater, and the agreement itself nothing more than a public relations stunt, to cover for the real content of the agreement: The U.S. will ensure a short-term bailout of Mexico's very shaky international finances, in exchange for continued steps toward integrating the Mexican economy into the U.S. economy as a pool of cheap labor and source of raw materials. However, with the U.S. economy none too secure at present, and the Mexican political situation a volcano nearing eruption, the calculations of these men are quite likely to be upset by a far more potent reality in coming months.

Salinas and Brady's myth

Concluding his Sunday evening address to the nation, President Salinas de Gortari waxed positively eloquent on the supposed new era for Mexico that the debt accord would open up. Speaking as if Mexico's six-year crisis were already solved, he said, "Solidarity permitted us to vanquish the crisis without confrontations, with social peace. . . . We can now, my fellow citizens, tell our children that the world we live in won't be easy, but it will be better, because we no longer carry the weight of excessive debt. Tell them that the enormous effort we have made was worth it," he continued, "that we form a great nation; that it is a privilege to have been born here; that we have pride in being called Mexicans. With work and effort, no doubt, but with spirit, with head held high and secure gaze, we will construct the new era of Mexico."

Toeing the official line, economic adviser to the ruling PRI party, Fausto Alzati, crowed that "It's an historic turning point. It sends a message to other countries in Latin America: If you play by the rules, there will be a light at the end of the tunnel."

And from Washington, a delirious Treasury Secretary Brady called the agreement a "major step" toward helping debt-strapped Third World nations, and a "model" for similar agreements with Venezuela, Costa Rica, and the Philippines. Saying the accord established a "mind-set" for debt reduction, he claimed that "a lot of people will look at the agreement as a blueprint . . . for how it might apply to them."

And the reality

"Now that the dust has settled a bit," wrote *New York Times* journalist Sarah Bartlett, "academicians and policy analysts who were looking for a substantial reduction in Mexico's debt are discovering that there is little of it to be found." "The significance of the weekend deal . . . is at this moment largely symbolic," wrote the *Financial Times* July 25, while Daniel James of the Mexico-U.S. Institute called it a "numbers game." The *New York Times* editorialized July 26 that "the result will be meager." The *Times* quoted Salinas calling the signing "a great moment for Mexico," appending the comment, "The moment will be fleeting."

The centerpiece of the accord was supposed to be a 35% discount taken by the banks on their $54 billion in outstanding loans to Mexico, *or the equivalent in interest rate reductions or "new money."* Even a 35% reduction of what amounts to half of Mexico's total debt (the other $53 billion is loans from

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Western governments, from multilateral agencies like the International Monetary Fund, and short-term trade credits, none of which are included), amounts to no more than a 17.5% reduction in total principal, and a corresponding reduction of interest charges, now running at more than $10 billion a year. But the key to the accord lies in the "equivalents." Banks not wishing to write off 35% of the value of their debt don't have to: They can opt for merely lowering the interest charge to 6.25%, and keeping the full value of their present debt on the books. This fixed 6.25% rate is supposed to represent a 35% reduction in interest charges from present rates.

However, it doesn't take a genius to figure out that the two options are far from equivalent. In the second option, the bank would receive about the same total interest, but would do it without the sacrifice of 35% of its principal, making it difficult to fathom why any bank would opt for the first proposal—the only route by which total debt will be reduced at all. Moreover, should the present very high interest rates fall, banks choosing the second option will find that their 6.25% will represent much less than a 35% loss of income from what it would otherwise be. Interest rates were only 7% just 15 months ago.

The banks' third option is to extend so-called "new loans" to a total of 25% of a bank's present exposure, spread evenly over three years. This "new money" is defined explicitly to be nothing but a bookkeeping device, whereby unpaid interest owed a bank would be automatically capitalized, and the total debt outstanding would then rise in the amount of the unpaid interest. This is what banks already do when countries default, such as Peru and Argentina, and is nothing but a disguised moratorium. However, for banks choosing this, it offers the attractive feature that they have to neither write off any debt, nor accept a loss, on paper, of any interest.

The '15% solution' in practice

Central to the deal is that each of the more than 500 creditor banks are free to choose any of the three options for their Mexican debt. Under the first two, their loans would be exchanged for new, 30-year bonds. These government bonds, in turn, are to be guaranteed by $3.5 billion *in new lending to Mexico by the World Bank and the IMF,* invested in 30-year, zero-coupon U.S. Treasury bonds, to be redeemed at maturity to pay off the government bonds. A second $3.5 billion is to "guarantee" interest payments, purportedly for 18 months, though 12 months appears more likely.

Consequently, no one yet has any idea of how the $54 billion involved will be be spread out among the three options. Depending on how banks ultimately choose, the effect of the deal could be anything from a 35% reduction in debt and interest, to merely a 35% decline in interest and no debt reduction, to, astoundingly, an increase in total indebtedness by up to $13.5 billion!

For reasons not made clear, the debt negotiators made the assumption that 20% of the debt would be processed under the first option, 60% under the second, interest rate reduction option, and 20% would fall into option three, providing new money. Under this scenario, total debt would fall by $3.8 billion initially, only to be counterbalanced by $6 billion in guarantee money from the IMF and World Bank, plus $1.3 billion a year for three years in capitalized interest, and interest payments would decline by $1.5 billion a year—15% of Mexico's total present interest payments.

However, many analysts believe that a large number of banks will opt for the new money route, which would reduce the interest "savings" far below $1.5 billion, and raise the total debt far above Mexico's present $107 billion.

The fine print

Salinas de Gortari had made reducing Mexico's net outflow of capital on the foreign debt account from 6% of Gross Domestic Product to 2%, from about $12 billion to $4 billion, a centerpiece of his propaganda campaign for his economic program that he claimed would finally restore growth to Mexico after six years of depression. What he got in the debt accord was no more than about $2.5 billion, one-third of his demand. He managed to have quite a case of amnesia in telling the Mexican population July 23 that "the result of the negotiation satisfies the requirements I laid down in my inaugural speech."

But he also gave away much more. The debt talks have been deadlocked for a month over two demands by the banks, one that Mexico permit debt-equity "swaps" whereby banks can cash in their loans—at face value—for shares of Mexican businesses, the other, that if Mexico should get back on its feet financially in the future, whatever "saving" Mexico reaps now in interest reduction will have to be paid back to the banks—the so-called "recapture" provision. Mexico did in fact, walk out of the talks as recently as July 20, in protest at the banks' continued demands.

But facing an imminent foreign exchange crisis, Salinas gave in. The banks won the right to "swap" $1 billion a year of Mexican government debt for equity in public sector companies to be privatized. Mexico will forego $1 billion in revenues it would have otherwise earned from sale of these companies, including much of it in foreign exchange, merely to reduce its total debt by less than 1%. This should properly be seen as the Mexican government being forced to *pay off*, at par, $1 billion a year of its foreign debt—a $1 billion *new* net outflow, counterbalancing the $1.5 billion interest "saving." Mexico also conceded a modified "recapture" provision.

The only "payoff" for Mexico was a $2 billion "bridge loan" from the U.S. Treasury, and a six-month, $2 billion loan from European central banks. Totally left out of consideration are the Mexican people, staggering under a severe depression, for whom the debt deal means nothing but continued economic disaster and misery.