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EIR Feature

Mexico's debt bomb explodes; who will follow?

by Dennis Small

> Not only has Mexico's physical economy been looted to the point of collapse, but the figures show that even the final phase of bankers' speculative gain has been reached, and a financial blow-out is imminent. Other Ibero-American economies that have followed similar regimens, such as Argentina and Brazil, are also rapidly approaching a blowout phase. . . . In short, the charade about the "Mexican success story" is about to end. Will the nations of eastern Europe, of Ibero-America, and the rest of the Third World wake up in time?
>
> —*EIR*, April 23, 1993

One year and eight months after *EIR* published those words, they came true.

On Dec. 20, less than three weeks after his inauguration as President of Mexico, Ernesto Zedillo Ponce de León widened the flotation band of the peso against the dollar, in the face of growing speculative pressure against the Mexican currency. Within hours, the pressure turned into desperation and then into hysteria, as a full-scale run against the peso developed. As Mexico's foreign reserves plummeted from $17 billion to about $6 billion in the twinkling of an eye, the Mexican President had to choose between imposing foreign exchange controls, as his Venezuelan counterpart Rafael Caldera had done six months earlier under similar circumstances, or allowing Mexico's currency to float freely against the dollar. President Zedillo, a Yale-trained economist, chose the latter, and within days, the peso had been devalued by about 40%. The Mexican stock market also crashed.

This pre-Christmas meltdown of the Mexican financial system sent shock waves throughout the international markets. But greater than the financial shock, was the psychological and political shock that coursed through Wall Street and the City of London: The international financial oligarchy's vaunted "Mexico model" was dead. The North American Free Trade Agreement (NAFTA), set into motion

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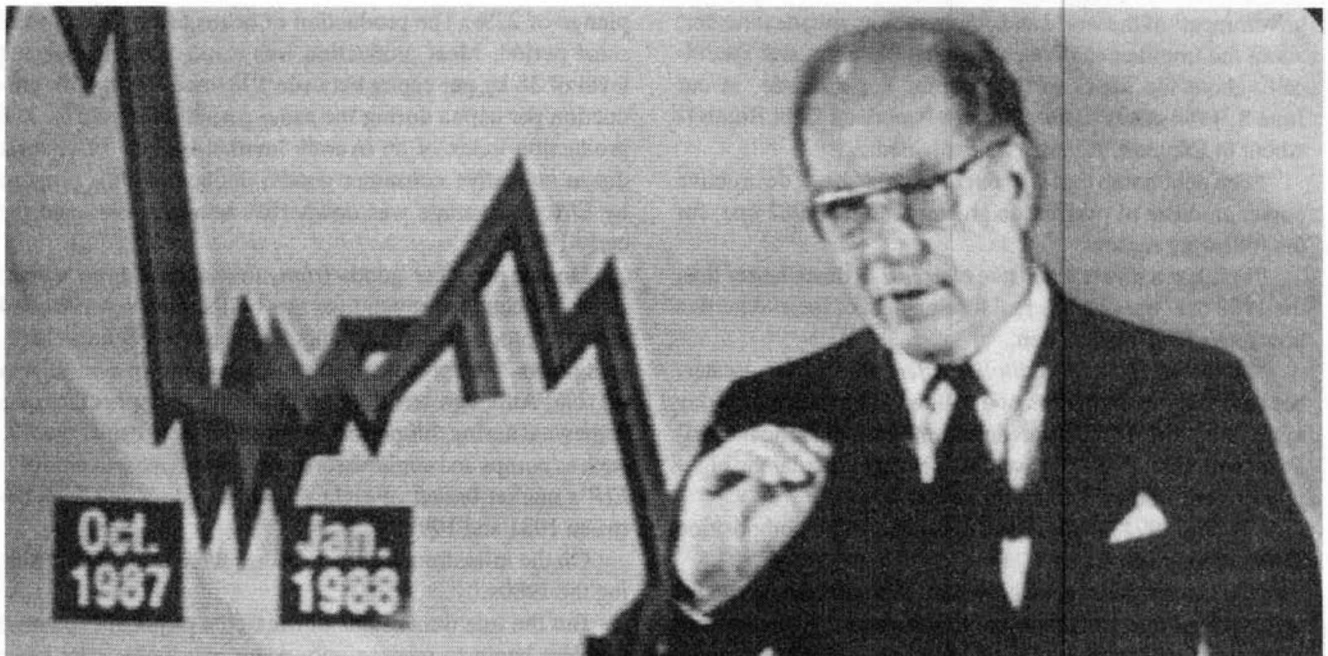


In this 1988 presidential campaign broadcast, Lyndon LaRouche forecast that the world economy would go through a "bouncing ball" pattern of collapse, with apparent, short-term fluctuations. LaRouche's record in forecasting the current explosion of the debt bomb in Mexico stands in sharp contrast to the "financial experts," who have almost unanimously touted Mexico's free-market austerity measures as a model for the developing sector.

by U.S. President George Bush, was dead. In fact, the entire British free-trade dogma that had ruled the world mercilessly for so long, was dead. The end of an era was in sight. The bankers were aghast.

The question now is: Will the people and nation of Mexico, and others like them around the world, be killed, too, as the moribund international system tries to perpetuate itself? Will the nations of Africa be annihilated on the altar of usury? Will the West continue to tolerate the imposition of International Monetary Fund (IMF) policies on Russia and the other countries of central and eastern Europe, driving that region into new wars, like that in Chechnya, and possible thermonuclear confrontation?

Or, will government and other political leaders instead seize the historic opportunity opening up, and establish a new, just international economic order premised on sovereignty and development? Will they recognize that the entire postwar financial system is finished, and must be put through bankruptcy reorganization? Will they look beyond their neighborhood, their nation, their region, to the global reality before us?

LaRouche's record

Although many have nervously compared the current explosion of the debt bomb in Mexico to the famous debt crisis of 1982, the fact is that the situation today is far worse, by an order of magnitude. As U.S. statesman Lyndon H. LaRouche has repeatedly forewarned in such documents as his June 1994 "Ninth Forecast" (see *EIR*, June 24, 1994), the world is rapidly reaching the end of a 600-year cycle of history. During this period, the fate of mankind has been shaped by a war launched by a Venice-spawned oligarchy against the cultural and scientific achievement of the European Renaissance, a war in which that oligarchy has been bent on imposing its bestial concept of man and the economic policies which spring from it: malthusianism, usury, and genocide. The free-trade doctrine of this oligarchy, today centered in Great Britain's House of Windsor, has led to the growth of a speculative monetary cancer which is now beyond all control.

The frenzied growth of the international scam known as the derivatives market is symptomatic of the problem: These Alice-in-Wonderland financial instruments today total a mind-boggling $45 trillion, and have absolutely no connection to any form of tangible production or activity. The speculative fabric of such derivatives has begun to unravel uncontrollably, as expressed in such crises as that in Orange County, California. As LaRouche has insisted since the onset of the Mexican crisis, "What's happening in Mexico is a continuation of Orange County, and there are many Orange Counties in the United States and elsewhere, but especially in the United States. . . . This should be looked at, primarily, not as a Mexico problem, though Mexico is afflicted with it; it's essentially a New York and London financial market problem."

For years, LaRouche and *EIR* have been warning the

governments of the world and others such as you, dear reader, about the imminence of such a global blowout, and specifically about the Mexican time bomb. For example, in our June 3, 1994 cover feature, "Ibero-American Debt Bomb Is About to Explode, Again," we explained:

"The debt bomb that is about to explode has a destructive power an order of magnitude greater than the 1982 one, for the following reasons:

"1) It has a *direct explosive charge* 2-3 times larger than the 1982 one, because the real foreign debt of Ibero-America now totals $700-750 billion.

"2) It will have a *multiplier effect* that is far greater, because this three-quarters of a trillion dollar cancer is today more intertwined than its predecessor with a gigantic international structure of speculative finances, in particular the highly insolvent world derivatives market. . . .

"3) The 1994 bomb is *more volatile* in its composition than a decade ago. . . .

"4) The physical economies of Ibero-America are far *less resilient* today than they were a decade ago, and cannot continue to sustain the rates of looting required to keep the speculative bubble going."

Subsequent developments during 1994 have proven *EIR* right on each of these counts.

How did LaRouche know that something like this had to happen? Why was *EIR* able to forecast a new debt bomb explosion? And why did it happen?

Physical-economic meltdown

There are no answers to be found to these questions solely within the monetary or financial sphere, either in Mexico or internationally. One has to look at the underlying *real physical economy* of Mexico to understand why the debt looting process eventually had to blow apart. As we document elsewhere in this *Feature,* Mexico achieved a period of modest growth in the 1970s, which brought the country to levels which, although still grossly inadequate by international standards, nonetheless poised it at the turn of the decade to launch in-depth industrialization. President José López Portillo correctly adopted a policy of exchanging Mexico's oil for modern technology, while rejecting the IMF's shrill demands for austerity.

But beginning in 1982, the international oligarchy pulled the plug on the Mexican economy, and then imposed IMF policies by force. The critical consumption and production parameters—*as measured not in Gross National Product or other fraudulent monetary terms, but in physical units per capita or per household, and per square kilometer*—began to atrophy and then went into decline. Mexico dropped below physical-economic breakeven.

For example, the per capita production and consumption of staples in the Mexican diet have plummeted. From 1981 to 1994, the consumption of corn (from which tortillas are made) dropped from 258 kilograms per capita to 201 kg—a plunge of 22%. The production of beans fell by 37% in the same period. Meat production was static at the inadequate level of 38 kg per capita between 1981 and 1992; milk production per capita during the same period fell by 22%. The production index of an overall "market basket" of about a dozen indicative consumer goods, defined for this purpose by *EIR,* on average was down 16% between 1981 and the early 1990s.

On the producer goods front, things were even worse. After respectable growth over the 1970s, between 1981 and 1991 the production of steel ingots, measured per household, was down 27%; processed crude oil sank 30%; cement was off 2%. Although fertilizer and tractor use per hectare rose somewhat during this period, the production of capital goods, such as pumps and compressors, almost disappeared entirely. *EIR*'s market basket of eight producers goods fell 24% between 1981 and 1991.

On the infrastructure front, things were also terrible during the 1980s.

But the true dimensions of Mexico's physical-economic problem begin to emerge only when one looks at its labor force. Real unemployment today is widely admitted to be about 50% of the labor force. Real wages dropped by half from 1982 to 1994, and can be expected to drop by at least another 25% from their current level, as a result of the insane austerity program just imposed on the Zedillo government by the Wall Street gang. That means that, by the middle of 1995, real wages for the average Mexican will be about *one-third* of what they were in 1980!

As LaRouche recently summed it up, "They were issuing milk bonds, and the cow died."

The shock wave spreads

The explosion of the debt bomb in Mexico in December sent financial shock waves out in various directions. There are three dimensions in which the impact has been strongest, and where a chain-reaction effect may well occur over the coming weeks and months: 1) laterally, to other debtor nations, especially those in Ibero-America; 2) outward, toward the financial creditors of Mexico and other nations; and 3) inward, into the banking system of Mexico itself. On any of these fronts, the entire world speculative bubble could burst in the period immediately ahead.

1) Other Ibero-American debtors. Every country of Ibero-America, with the notable exception of Venezuela, has been engaging in the same speculative frenzy, combined with destruction of its physical economy, that is evident in Mexico. They are all candidates for catching the "Mexican disease," or the "tequila effect" as some have taken to calling it.

Argentina. Probably next in line. Here the pathology of the speculative cancer is almost identical to that of Mexico—only worse. Argentina has been running a sizeable trade and current account deficit; like Mexico, it has papered this over with huge inflows of highly volatile, speculative capital; and

like Mexico, it has implemented economic policies that are shattering the country's living standard, productive base, and infrastructure. But unlike Mexico, Argentina's Harvard-trained Economics Minister Domingo Cavallo has linked the peso to the dollar *by law,* removing all possibility of sovereign national control over the domestic credit system. And also unlike Mexico, Argentina has already handed over its national oil company, YPF, to the international financial predators, through privatization. Argentina thus has even less maneuvering room within the system than Mexico had. The wild card here is that President Carlos Menem is facing reelection in May 1995, and he may come to have second thoughts about how he will fare if Argentina continues to travel down the Mexican path.

Brazil. Despite hysterical claims from most Brazilians that their situation is completely different from Mexico's ("We don't even speak Spanish here," one particularly stupid Brazilian businessman pathetically told the *Wall Street Journal*), the fact is that their policies have been very similar to Mexico's, and their much-touted foreign reserves of nearly $40 billion are volatile and could vanish virtually overnight, as Mexico's did. This fact is recognized, in private, by some among the principal economic advisers to President Fernando Henrique Cardoso, but so far the Cardoso government has pledged its allegiance to maintaining the speculative cancer. And they have already worsened matters by meeting bankers' demands to issue what are effectively *dollar*-denominated treasury bills, known as NTN-Ds. This is exactly what Mexico did beginning in the spring of 1994 with their *Tesobonos,* which have now blown up in their faces.

Peru. This is another case where the productive economy has been devastated for the last 30 years, but where the monetary side has been propped up by recent, large speculative capital inflows, for example into the Lima stock market. Peru is highly vulnerable, and even the slightest reversal of these financial flows will throw the country into a tailspin.

Venezuela. In June 1994, faced with a banking crash and massive capital flight, President Caldera wisely imposed exchange controls. This not only stopped and then reversed the looting of the country's foreign reserves, but it also showed the entire continent that there are alternatives to slavish submission to the IMF and banker-ordered national hara-kiri. While every other country of Ibero-America was being financially pummeled by the Mexican debacle, with stock market crashes and withdrawal of hot foreign funds, Venezuela alone has remained relatively calm. But the Caldera government has not yet gone beyond such defensive half-measures, to reorganize the national banking system and kick off actual economic growth, and so the country remains vulnerable to the storm surrounding it.

2) The creditor banks. Can Mexico's creditor banks, and the mutual funds and others that have invested heavily in other Mexican debt instruments, survive the explosion of the Mexican debt bomb? Given their own highly insolvent status, probably not. As *EIR* was the first to document, Mexico's *real* foreign debt today stands at about $213 billion, far more than the $141 billion reported as official foreign debt. The lion's share of this is held by U.S. banks and other financial institutions, which have been correspondingly hysterical at the prospect of a Mexican default. Fidelity Latin America Fund, for example, has a multibillion-dollar exposure in Mexican debt instruments, and it ended 1994 down −23.17% from a year earlier. Or take the case of Citibank, whose largest component of annual profits last year came from their Ibero-American operations. Or what about the dozens of other U.S. banks that hold most of the $25 billion of debt owed by Mexico's insolvent commercial banks, debt which was collateralized by the Mexican banks' holdings of now highly questionable government *Tesobonos?*

And if the creditor banks do manage to survive the Mexican mess by blackmailing the Clinton administration into bailing *them* out, by backstopping Mexican government and private debt payments, to the tune of tens of billions of dollars, what happens when Argentina blows? Or Brazil? Or when the dam gives way with another Orange County-style bankruptcy?

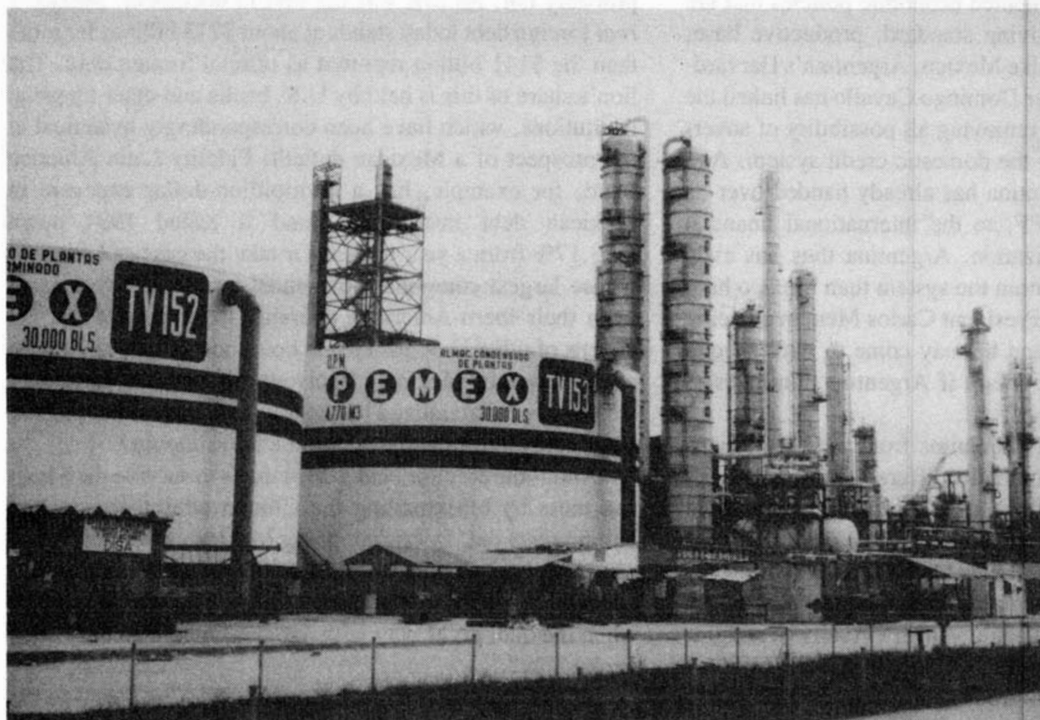
3) Mexico's own banking system. This may well be the weakest link: It is the point where the financial bubble and the physical economic collapse intersect most tangibly.

The Mexican banking system was already tottering at the edge of insolvency *before* the December meltdown began, with very high non-performing debt ratios as a result of the destruction of the country's physical economy. One of the major additional contributing factors was a massive wave of *illegal* capital flight out of the country during 1994, amounting to over $20 billion, on top of the "legal" net capital exports reflected in the run-down of foreign reserves. This is a phenomenon which has so far gone unnoticed and unreported by anyone other than *EIR,* but the numbers are unmistakeable. Such capital flight constitutes a return to a kind of outright thievery from the nation of Mexico not seen since the early 1980s, which led up to President López Portillo's mid-1982 declaration of a debt moratorium and break with the IMF.

Since the December 1994 crisis, domestic interest rates on the benchmark 28-day *Cetes* notes have zoomed from 14% up to 40% in one month, driving the "overnight" rate to 60%, and most consumer credit (mortgages, credit cards, etc.) is at that level or higher. All informed observers are predicting a wave of personal and corporate bankruptcies in Mexico, which will bring down large chunks—if not the entirety—of the banking structure as well.

The Venetian 'solutions'

The "solutions" to the Mexican crisis that have been mooted to date by Wall Street and other financial circles, are genocidal, and clinically psychotic. They are premised on the standard Venetian policy of feeding the cancer at the expense of



A Pemex plant in Veracruz, Mexico. A principal feature of the bankers' plans for Mexico, is to force the nation to privatize its national oil company, while mortgaging oil reserves in order to guarantee payment of the debt.

the patient, and generally fall into three categories:

1) Preserve the speculative bubble at all costs by feeding it further. Thus, with $213 in Mexican foreign obligations becoming insolvent, Wall Street has put together a "rescue package" of at least another $18 billion of mainly *government* monies, plus another $5 billion in loans from commercial banks and $2.5 billion from the IMF, bringing the total to $239 billion right there. On top of that, there is a possible additional $40 billion in U.S. government-backed loans, which could conceivably stabilize the peso in the short run, but would do so at the expense of an increase of the credit bubble in the medium to long term. In that way, the cancer of the Mexican debt will probably grow from $213 billion to $279 billion within the first part of 1995—an increase of over 30%. This is not a bailout of Mexico; it is a bailout of Mexico's creditors.

2) Kill off Mexico and the Mexicans to make sure that the income stream to the banks continues. This has two components. First, drastically reduce Mexicans' standard of living to Auschwitz-like levels, using IMF-brand programs of real wage reductions, government spending cuts, interest rate hikes, and credit curtailment. And second, force Mexico to turn over its national oil company, Pemex, to the banks, via "privatization," while at the same time mortgaging its huge oil deposits to guarantee debt repayments. The British intelligence-run Zapatista National Liberation Army (EZLN) in the state of Chiapas and the opposition PRD party of Cuauhtémoc Cárdenas are crucial weapons that are being deployed to achieve these bankers' goals.

3) Bail out the U.S. banks at the expense of the U.S. taxpayer and U.S. national sovereignty. Under the secret financial protocols of the NAFTA agreement, which went into effect on Jan. 1, 1994, the U.S. Federal Reserve became the lender of last resort behind all dollar-denominated obligations issued out of Mexico—a clear violation of U.S. sovereignty as well as that of Mexico. Now the banks are calling that promise in, and demanding that the U.S. government (i.e., taxpayer) make good on all of Mexico's debts, both public and private. What this amounts to is nothing less than a de facto increase of U.S. government debt by nearly $300 billion!

Time for sanity to prevail

At the time of the 1982 debt crisis, Lyndon LaRouche warned of the consequences of not defusing the debt bomb. In August of that year, he issued his historic study *Operation Juárez,* with detailed policy proposals for how to use the Ibero-American debt crisis to put the entire international financial system through bankruptcy reorganization and thus open the door for real economic growth. Those same policy proposals, including LaRouche's call for the formation of a debtors' cartel, Ibero-American integration, and the creation of an Ibero-American Common Market, remain fully valid today. They have been restated time and again by LaRouche and his associates in different locations over the intervening years. They show the way out for any nation of the world which chooses not to go under with the sinking *Titanic* of the international financial system.