Mexico financial package headed toward a blowout

by Richard Freeman

No sooner had the pens been exchanged on Feb. 21 at the signing ceremony, held at the U.S. Treasury building in Washington, for the U.S.-Mexico pact, in which the United States contributed $20 billion of a $50 billion worldwide financial stabilization package for Mexico, than the interest rate charged on Mexico's 28-day Treasury bills (called *Cetes*) zoomed from 40% to 59%. Such a rate had not been seen in Mexico since 1988.

The Clinton administration had originally intended the package as an emergency action, following the peso's devaluation on Dec. 20, to halt the bloodletting by stopping the run on the Mexican peso, and buy some time. The idea was for the United States to stand behind a plan to permit Mexico to convert its short-term debt into long-term debt, and gain some breathing room, rather than force it into the grasp of its banker creditors. Capitalizing on Mexico's distress, these creditors were trying to impose their own terms, which would have allowed them, like vultures, to pick Mexico's carcass clean.

House Speaker Newt Gingrich (R-Ga.) and Sen. Phil Gramm's (R-Tex.) Conservative Revolution wrecking crew sabotaged the Clinton plan as presented to Congress. Eventually, after five critical weeks were lost, President Clinton went around Congress and drafted an alternative plan that draws on emergency funds available at the U.S. Treasury. This is the version of the plan signed on Feb. 21. In the meantime, not only did speculators worsen the situation in Mexico, forcing the interest rate on bank paper up to 47% on Feb. 17, but various City of London and Wall Street financiers and/or incompetents around the Clinton administration began to alter a plan that was already problematic and stopgap. They inserted harsher austerity measures, and prepared to attempt to "financially administer" the crisis, while stubbornly insisting that Mexico is not part of a *systemic worldwide financial crisis* which can bring down the whole system. This stubborn refusal to admit reality, combined with the harsh conditions in the package, especially the high interest rates, will worsen, rather than improve, Mexico's dire economic situation, and may cause the package to blow out before June.

Ironically, at the very moment that some are attempting to portray Mexico's as an isolated crisis, caused by mismanagement of the country, the truth asserted itself, showing Mexico to be but the leading, aggravated branching point in the worldwide disintegration. As the U.S.-Mexico signing ceremony was under way, major financial crises erupted in every part of the world:

- In France, the government is desperately attempting to hold up its banking system by bailing out Crédit Lyonnais, one of the 25 largest banks in the world. Last year, France poured 24 billion francs into bailing out that bank, which suffers problems from real estate speculation and derivatives. This year, latest reports are that France will have to spend an additional FF 38 billion. The total two-year cost is almost $10 billion.
- The Italian lira had plunged by Feb. 17 to 1,070 to the German deutschemark, a new low. The Banca d'Italia (central bank) intervened frantically.
- In England, in February, Lord Cairns, the CEO of bankrupt S.G. Warburg, resigned. Warburg is banker to the British queen; only three years ago, the leading Euro-bond syndicator in Europe; and English representative of a 500-year-old Venetian-linked family. It is in such bad shape that even Morgan Stanley, a U.S. investment bank, backed away from a planned merger.
- In the United States, on Feb. 17, Speaker of the California Assembly Willie Brown called for bankrupt Orange County to be put into state receivership, in part to provide it

with services that otherwise would be cut. The county filed for bankruptcy on Dec. 6 after its portfolio suffered losses in derivatives now estimated at $1.69 billion. This is far from the last state or local government loss in derivatives.

The terms of the package

There are three headings to be considered about the Mexico-U.S. package: 1)the credit to be extended to Mexico; 2) the collateral that must be pledged for the loan; and 3) the internal Mexican interest rate and credit expansion terms imposed.

First, under a U.S.-Mexico Framework Agreement, the United States will make $20 billion in funds available from the U.S. Treasury's Exchange Stabilization Fund. Mexico can draw these funds either in the form of swap agreements or loan guarantees. The United States will extend such loan (swap agreements) or loan guarantees on the following schedule: $3 billion immediately, another $7 billion between now and July (if needed), and beginning in July, another $10 billion, which would be provided in stages.

The International Monetary Fund has approved up to $17.8 billion in stand-by, medium-term assistance, and the Group of 10 countries another $10 billion, which would be managed through the Bank for International Settlements.

The interest rate on borrowing on any part of the U.S. package is 2.25 to 3.75 percentage points above the interest charged on the 91-day U.S. Treasury rate.

Second, the Zedillo government of Mexico has agreed that from now on, all Mexican oil revenues—not just the percentage equivalent to credit lines drawn down by the Mexican central bank—will go directly into the U.S. Federal Reserve Bank, whether or not there has been a default on Mexico's obligations to the U.S. Treasury. The Feb. 21 *New York Times* acknowledged that "the United States would effectively control the flow of billions of dollars that Mexico earns every year from the export of its oil, starting in the next few months." The paper suggested that these new conditions "pose enormous political problems for President Ernesto Zedillo," who now must sell these conditionalities to the Mexican people.

Prescription for failure

It is the third point, the terms imposed on Mexico's produtive economy, especially on its internal credit system—in an attempt to "micro-manage" the economy—that has the greatest blowup potential.

There are two parts to this third point. According to the U.S. Treasury Department's "Summary of Economic Policy Actions," the "Bank of Mexico . . . reiterates that it will maintain an upper limit for net domestic credit expansion of 10 billion Mexican pesos for all of 1995." At the current exchange rate of 5.5 pesos to the dollar, this is $1.8 billion. Under normal conditions, Mexico would extend that much credit to its economy every two months; now it must limit credit expansion to that amount for the year. That will bring industry to a screeching halt.

Worse, according to the U.S. Treasury, the agreement stipulates that Mexico "guarantee . . . substantially positive real interest rates." A positive real interest rate means above the rate of inflation—i.e., if inflation runs at 40%, then interest rates would have to be substantially higher. In the Mexican credit system, consumer and industrial loans are usually pegged in the range of 5-15% above the rate on Mexican Treasury bills (*Cetes*). So, with the rate on *Cetes* already at 59%, the Mexican economy will function at an interest rate, effectively, of 65-75%. In fact, effective rates on credit cards have in some cases hit the 100% mark. Already, according to the Feb. 22 *New York Times*, "automobile sales dropped by 50% in January, while sales of buses and trucks fell 84%." This was before interest rates shot up.

High interest rates, combined with the parallel limit of $1.8 billion per year in credit expansion, means that the rate of failures in every sector, from steel to cars, from farms to construction, will intensify. Will that help Mexico fulfill the terms of its agreement? Further, there are austerity side agreements to cut workers' wages.

As the economy shuts down, the banking system, which is on the edge, because of non-payment of loans by the economy (called non-performing loans), will be faced with a record leap in new non-payments by companies that have ceased to function normally. Already, the $132 billion in Mexican banking system assets, as of September 1994, had non-performing loans which represented 67% of the banking system's combined equity and reserves, which are the funds that a bank puts aside to protect it against collapse. Several banks, including the nation's third and fourth largest, Serfin and Comermex, were already borrowing heavily and are on the brink of failure. Moreover, Mexican banks owe over $30 billion to foreigners, mostly to American banks. If they default in record numbers, a $20 billion hole will be punched in the American banking system, blowing it out.

Another slice of the picture, is that if one adds it up, over the course of 1995 Mexico will have to have funds—for which there is no currently identifiable source—to finance or refinance the following: $22 billion owed by Mexican banks to foreigners; $15.5 billion owed abroad by other private sector companies; $22 billion in foreign-held Mexican government *Tesobonos* and other bonds; $3.4 billion in foreign-held public sector debt; an estimated $34 billion in foreign holdings of Mexican stocks, which could be liquidated; and another $11 billion in *Tesobonos* held by Mexican banks, which they could convert into dollars for emergncy cash, and which could flee the country. Cumulatively, this could define a borrowing or replacement need of $108 billion, as against only $50 billion pledged in total, worldwide, for the Mexico financial support package.

Clearly, the proposal of American economist Lyndon LaRouche to put the U.S. financial system through bankruptcy reorganization as the indispensable first step in global reconstruction, is the way to deal with the systemic crisis.