Mexico is on course for a Salinas-style blowout

by Carlos Cota Meza

At least in economic matters, the international financial institutions have tragicallly turned Mexican President Ernesto Zedillo into another Carlos Salinas de Gortari, the discredited former President (1988-94) who today lives in exile, wandering between Dublin and Cuba. Almost at every turn, President Zedillo repeats the litany, "I will not bequeath an economic crisis to the next administration" which will take office in December 2000. That was precisely what Salinas said, when he delivered his 1994 time-bomb over to his successor.

What Zedillo is bequeathing to his successor, is an economy held together with pins, with a new huge debt, set to explode whenever the U.S. Federal Reserve decides to start raising interest rates, and/or when President Zedillo is forced to devalue the peso in the face of the current unsustainable trade deficit. This hyperinflationary time-bomb is expressed in the growing foreign debt, as well as in a domestic public debt bubble which is completely out of control.

We told you so

In March 1993, when we analyzed the crisis which the Salinas model was taking Mexico into, we stated that the economy was rapidly approaching the point where "Mexico simply cannot continue to import at the current rate. When it reaches that point, Salinas de Gortari will find himself facing impossible choices."

Excluding the *maquiladoras* sector (in-bond assembly plants mainly along the U.S. border), Mexico's trade deficit in 1992 was $20.7 billion. This imbalance was creating the conditions for a dramatic devaluation of the peso, we warned, which in turn would trigger the explosion of the financial system itself. Despite every possible warning, then President Salinas responded with his litany about the supposed "the solidity of macroindicators," measured by the current account deficit, which supposedly demonstrated investor confidence in the economy, since that deficit was being covered by an inflow (of speculative funds) on capital account.

A current account deficit is, primarily, the sum of the trade deficit (imports minus exports), plus payment of interest on the foreign debt. The way to sustain a current account deficit is through a countervailing influx of foreign capital.

Between Dec. 19 and 20, 1994, given the accumulated trade and current account deficits, the newly inaugurated Zedillo government decreed a 15% peso devaluation. What happened became colloquially known as the "December error," which unleashed the "Tequila Effect" that brought the entire world speculative financial system to the edge of disintegration. The "error," according to international bankers, was not the devaluation in itself, but the fact that they weren't apprised beforehand, so that they could both protect themselves and derive a speculative profit from the crisis—as was later to occur in January of this year, with the Brazil devaluation.

Reports have it that in attempting to assign blame, Zedillo's Finance Secretary Jaime Serra Puche, who, while serving as Salinas's Trade Secretary, at the time protested to Pedro Aspe, then Salinas's Finance Minister: "You left the economy held together with only pins." Aspe reportedly replied: "Why did you pull out the pins?" Serra Puche departed, leaving in his place Guillermo Ortiz Martínez, who had been Aspe's undersecretary.

Five years later, with President Zedillo swearing that he will not pass on a crisis to the next administration, he is also announcing that he will not pull out the pins which the international financial community is using to hold the Mexican economy together. But keeping things pinned together is hardly economic stability. Is devaluing the peso the only way to deal with the immense deficits which have once again accumulated?

At every turn, the Mexican government has taken the same approach: during the Salinas period, with the 1990 Brady rescue plan and the later North American Free Trade Agreement (NAFTA) negotiations; with Zedillo and the February 1995 bailout; and again today. They have chosen to finance the current account deficit through what is euphemistically called "foreign investment" and "historic increases in foreign reserves." But each time, the capital coming into the country is highly speculative, and short-term. Foreign capital goes into the foreign reserves, and is used to cover the trade deficit, which itself is a product of the "trade opening" that has destroyed national producers by dumping massive amounts of imports at low prices. The Salinas de Gortari government did this by attracting foreign capital with outrageously high yields, by privatizing state-owned companies, and by floating the now infamous dollar-denominated Tesobonos. The Zedillo government has offered the same menu, albeit it with slight variations.

Then, and now

Figure 1 demonstrates that the "export-oriented" model imposed on the Mexican economy by the International Monetary Fund since 1982, is a formidable looting mechanism. Each time imports exceed exports, the domestic economy is strangled to cover the deficit, since it can't be financed with stable capital in this world of purely speculative capital flows. Then the government, playing by the rules of the game, seeks to "correct" this problem with recurrent and disastrous peso devaluations. Trying to raise exports by devaluing one's currency is as healthy for an economy, as tightening the noose around a hanging man's neck.

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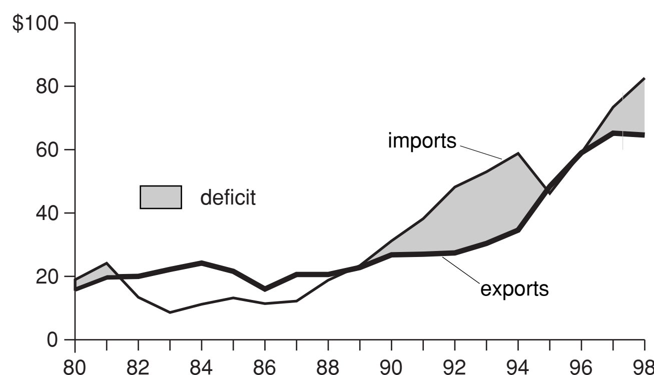
FIGURE 1
Mexico: non-maquiladora trade balance
(billions $)



Source: Banco de México

Again, leaving aside the *maquiladoras,* which we will examine later, the 1998 trade deficit was about $18 billion (see **Table 1**). Including the *maquiladoras'* surplus in the Mexican trade balance is an accounting sleight-of-hand more than anything else. This is because, in effect, the *maquiladoras* are a "manufacturing plantation" kind of enclave inside the national economy, typical of 19th-century British colonialism.

Just compare the non-*maquiladora* trade balance with the *maquiladora* trade balance. While it is true that the *maquiladoras* yield a positive trade balance, this surplus goes largely to purchases by *maquiladora* workers on the other side of the border (that is, within the United States), and in part as repatriation of profits by the *maquiladora* owners themselves. To say that this "benefits" the Mexican economy, is the equivalent of arguing that slavery was beneficial for the U.S. southern economy in the 19th century.

Apart from the accounting tricks the Mexican government is using to cover up its headlong flight into disaster, it is worth noting other elements of the Mexican trade balance which reflect the depression of the world economy.

In 1998, total non-*maquiladora* exports fell 1%, primarily due to the fall in the international price of oil. The Mexican government argues that the fall in oil export revenues was covered in part by a 6.5% increase in non-oil exports. What is not said, is that non-*maquiladora* exports have been falling since 1996.

The reality is that exports of the majority of the world's countries have fallen as an effect of the economic and financial crises sweeping Asia, Russia, eastern Europe, and Ibero-America. In addition to the fall in raw materials prices, we now also have a fall in the price of, and reduction in the demand for, manufactured products such as automobiles, chemical products, electrical and electronic goods, and so forth, all of which has begun to take a toll on the economies of developed countries highly dependent on this activity.

The market for non-oil, non-*maquiladora* Mexican exports—two-thirds of which are automobiles and auto parts, electronics, and electrical machinery and equipment—will become increasingly tight in 1999 and 2000, with the result that the non-*maquiladora* trade deficit will increase.

Chaos in foreign accounts

As expected, official figures on the balance of payments are internally, arithmetically consistent, but they don't explain what is really happening to the economy, as a result of the neo-liberal economic policies in effect (see **Table 2**).

TABLE 1
Non-maquiladora trade balance
(billions $)

	1994	1995	1996	1997	1998
Total exports	**34.6**	**48.4**	**59.1**	**65.2**	**64.6**
—Oil	7.4	8.4	11.7	11.3	7.1
—Non-oil	27.2	40	47.4	53.9	57.5
Agriculture	2.7	4	3.6	3.8	4
Extractive	0.4	0.5	0.4	0.5	0.5
Manufacturing, raw materials, and non-maquiladora intermediate goods	24.1	35.5	43.4	49.6	53.1
Total imports	**58.8**	**46.2**	**59**	**73.4**	**82.6**
—Consumer goods	9.5	5.3	6.7	9.3	11.1
—Manufacturing, raw materials, and non-maquiladora intermediate goods	36	32.2	41.4	49	54.2
—Capital goods	13.3	8.7	10.9	15.1	17.3
Balance	**–24.2**	**2.2**	**0.1**	**–8.2**	**–18**

Maquiladora trade balance
(billions $)

	1994	1995	1996	1997	1998
Exports	**26.3**	**31.1**	**36.9**	**45.2**	**52.9**
Imports	**20.5**	**26.2**	**30.5**	**36.3**	**42.6**
Balance	**5.8**	**4.9**	**6.4**	**8.9**	**10.3**

Source: Banco de México.

TABLE 2
Current account
(billions $)

	1996	1997	1998
1. Trade balance	6.5	0.6	–7.7
2. Non-factorial services	0.6	–0.5	–0.6
3. Factorial services	–13.9	–12.8	–13.5
4. Transfer payments	4.5	5.2	6
5. Current account (1+2+3+4)	–2.3	–7.4	–15.8
6. Capital account	4.1	15.4	16.2

Source: Banco de México.

TABLE 3
Balance of payments
(billions $)

	1. January-September 1997	2. January-September 1998	3. Change (2 – 1)
Current account	**–3.8**	**–11.5**	**–7.7**
Capital account	**9.3**	**7.6**	**–1.7**
—Debits	6.4	7.4	1
Loans and deposits	–10.1	0.8	10.9
Foreign investment	16.5	6.5	–10
Direct investment	10.1	6.9	–3.2
Portfolio investment	6.4	–0.4	–6.8
Stocks and bonds	3.5	–0.9	–4.4
Money market	1	–0.2	–1.2
Bonds issued abroad	1.9	0.7	–1.2
—Assets	2.9	0.2	–2.7
Errors and omissions	1.5	4.5	3
Change in net reserves	6.9	0.5	–6.4

Source: Ministry of Finance, Mexico.

According to official documents, the current account deficit is mainly a result of the trade deficit, and this latter—as we have seen—the government attributes to the fall in oil prices. This has led to such childish arguments as, "If the price of oil hadn't fallen," then the deficit would have been less. But even taking into account this estimated loss of some $4.2 billion in oil revenues, the trade balance would still have shown a deficit of $3.6 billion.

Non-factorial service payments are also in the red, due primarily to transportation, insurance, and port fees. This means that, in addition to running a trade deficit, the Mexican economy is also paying handsome sums for its transport. This amounts to more than $4 billion.

Factorial services also run a deficit, due to the payment of interest on the foreign debt, which came to $8.3 billion in 1998, and to profit repatriation by foreign companies, to the tune of another $5.2 billion.

As for transfer payments, which is the only line that shows a surplus on current account, they are entirely made up of the money sent by Mexican migrant workers (legal and illegal) to their families.

The economic reality behind these numbers begins to come into focus, once the *maquiladora* trade surplus is separated out from the totals. The *maquiladora* trade balance is positive, but—as is widely acknowledged—they are a foreign enclave which fundamentally does not affect the rest of the Mexican physical economy. Mexican involvement consists entirely of providing the abundant cheap labor power to be exploited in preassigned territories.

As for the migrant population (both legal and illegal) which generates positive transfer payments, this is labor power which the Mexican economy has been unable to employ. Thus, the two sectors which in fact are not functional parts of the Mexican national economy, are the only ones which produce a surplus on current account. The national economy proper is forced to pay a high cost: a non-*maquiladora* trade deficit, plus transport costs, foreign debt service, and repatriation of profits of foreign companies.

In 1998, the money transfers from Mexicans abroad amounted to $6 billion, nearly equal to oil export revenues ($7.1 billion); the surplus of the *maquiladoras* ($10.3 billion) is higher than oil revenues, and the gross export of the *maquiladoras* ($52.9 billion) is just 1% less than Mexico's non-oil, non-*maquiladora* exports ($57.6 billion) (see Table 1).

If the current account deficit is financed through what shows up on capital account, as the fraudulent official version of things would have it, then what you find is that, in this area of capital transfers, you have activities which have nothing to do with productive functions, but which, on the contrary, themselves generate paper claims against profits coming from a physical economy that is standing at the abyss of general bankruptcy.

To understand the Mexican conjunctural crisis, one must look not only at the collapse in oil prices, but also at the crisis that hit Russia in August 1998, and its repercussions in Brazil. These effects led the Mexican model to blow out in September-October 1998; but that model was put on a temporary artificial respirator through a desperate, hyperiniflationary policy, as part of the suicidal global policy decision of the Group of Seven governments, to pump yet more hot air into the speculative bubble.

In Mexico, the results are evident. In the January-September 1998 period, compared with the same period in 1997, the capital account surplus (the flow of foreign capital into Mexico) had fallen by $1.7 billion (see **Table 3**). Foreign direct investment was $3.1 billion less than in 1997. Foreign portfolio investment revealed a decline of $6.8 billion, of which $4.5 billion had fled the stock exchange, and $1.1 billion fled from government financial paper (domestic debt).

In the last quarter of 1998, economic "indicators" miraculously recovered. From October to December, the capital account surplus rose from $7.5 billion to $16.2 billion. Within

this, Foreign Direct Investment (FDI) closed the year at $10.2 billion—an increase of more than $3 billion in only 90 days.

The incredible thing about all these capital flows, is that they are occurring in an economy which is scarcely generating foreign exchange, but rather is living under the burden of a gigantic trade deficit. Trying to distinguish his administration from that of Salinas de Gortari's, President Zedillo has argued that the FDI figures prove that the current account deficit is being compensated with these positive flows.

But government accounting does not address the changes within the FDI category. In the face of international financial disasters, capital flows are dedicated to "acquisition of existing assets" (mergers and buy-outs of national companies or of companies which were already foreign owned). In the case of Mexico, 32% of what was defined as FDI in 1997 actually consists of buy-ups of bankrupt companies and banks. In 1998, this capital flow operated the same way, meaning that there was no economic expansion. However, this "investment" will still demand its repatriation of profits.

The foreign and domestic debt bubbles

One of the axioms of the 1995 financial rescue package was that it would be used only to finance economic activities that generated foreign exchange. However, as proven by the trade deficit, this certainly was not the case.

The companies that were supposed to bring in the foreign exchange are the so-called "High-Export Companies," some of which entered 1999 by declaring that they were in default on their foreign debts. The 1998 foreign debt of all private companies was nearly $62 billion, 17.5% higher than 1997. Nearly the entirety of the increase occurred in the non-banking sector of the High-Export Companies. In 1999, some $15.9 billion in private-sector foreign debt will need to be refinanced.

In order to keep his government's economic model afloat, President Zedillo has opted for a voracious internal and foreign indebtedness, which is reminiscent of what the Salinas de Gortari government did with the infamous Tesobonos.

According to official documents, what saved Mexico in the last quarter of 1998 were "reductions in interest rates of the main industrialized economies." In effect, Mexico fully joined the decision of the Group of Seven countries which, last October, decided to refinance the world speculative bubble with hyperinflation. As part of this, the Mexican government decided to once again create an immense debt bubble which, sooner or later, must explode.

In the last three months of 1998, the government increased its issuance of short-term domestic bonds: It eliminated six- and twelve-month terms for the Cetes and Udibonos, and increased the emission of 28- and 91-day Cetes; it reintroduced the Bonde with a 28-day "renewable coupon"; and maintained emission of the Bonde at 91 days, indexed to inflation. With these operations, the Banco of México has turned itself into the only supplier of credit to the national financial system, precisely as occurred in 1994 before the December blowout.

Although domestic debt issuance is supposedly purchased domestically, i.e. by Mexicans, when one analyzes the activities of the commercial banks, one discovers that the amounts of their deposits have hardly fluctuated, and that the volume of loans issued to the non-financial private sector has actually fallen. This has been the case since 1995 in all banking activities, with the exception of the growth of non-performing debt. So, everything indicates that the placement of government domestic debt instruments in the banking sector involves a sleight-of-hand betweeen the Banco de México and the "commercial banks" (many of which are already foreign controlled), which masks further foreign capital flows and, perhaps, money laundering.

Regarding the public foreign debt, officially this didn't grow much over the course of 1998. The main development was the refinancing of about $25 billion that came due. More than 98% of these lines of credit were shared among the central government, Petróleos Mexicanos (Pemex), the Foreign Trade Bank (Bancomext), and Nacional Financiera (Nafin).

Of the $6.8 billion for the central government, 73.4% (or $5 billion) are allocated to "refinancing of loans." Pemex contracted for $9.5 billion, using nearly all of that to "finance the export and import of crude and its derivatives," that is, to cover for lost income due to the fall in oil prices.

Bancomext contracted $5.6 billion for the "financing of export programs" of private companies. As is well known, such financing has taken the form of emergency loans to the High-Export Companies facing bankruptcy. Nafin contracted $2.8 billion "to develop small and medium companies," companies which are nowhere to be found—although Nafin did make loans to the same group of insolvent High-Export Companies, contrary to its regulations.

All of these operations were carried out so that Mexico would not go into default in 1998. Instead, it began 1999 with the "novelty" of needing new contingency loans to the tune of $13.7 billion, in order to continue paying or covering the huge deficits that the "export-oriented model" is generating. As one banker, in an unusual moment of insight, was heard to comment, the fact that Mexico did not go into default last year as a result of the acrobatics on the international markets, does not mean that this can be pulled off every year.

It is clear that President Zedillo is in a race against time, and that, just like Carlos Salinas de Gortari, is desperately trying to avoid devaluing the peso during his administration. But the blowout has already hit.

The only way to pull out the pins which have held the economy together since 1982, without everything falling apart, is to recognize that free trade has destroyed Mexico's economy and sovereignty, and that a 180 degree turn is now required. Mexico must have the right to control its own generation of credit. It must be free to develop a protectionist national economy.