Mexico's Banking System Driving Force or Brake On Economic Development?

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Over the last ten years Mexico's financial system has undergone a series of modernizing changes that have transformed its structure, mode of operating, form of ownership, instruments for attracting savings and investment, source of profits, etc. These changes have been guided by the principles of economic liberalism: opening the sector to foreign investment and deregulating financial activities to let it be ruled by market forces. The basic premise was that this deregulation and opening would stimulate technological modernization and the diversification of financial instruments.

At the time, the authorities disseminated the image of a new Mexican banking system that would appropriately fulfill the functions of encouraging domestic savings and channeling credit to companies with truly competitive costs using flexible criteria to make financing accessible. In short, the modernization of the banking system would ensure the flow of sufficient resources to back up the growth of the country's industry and commerce.[1] As we shall see, things progressed along a different road from the one promised.

The Limits Of Economic Liberalism

The financial reform, which included stock market institutions, was not a spontaneous initiative of the Mexican government. The international context marked by economic globalization and the constant pressure of multilateral financial institutions and the U.S. government played a decisive role. In the negotiation of the Brady Plan in 1989 that dealt with Mexico's foreign debt, a demand was made that was never formally admitted, but that was applied de facto by the Mexican government: the opening of the financial sector to foreign investment. This commitment was concretized in three emblematic measures:

- the elimination of governmental controls on the savings rate, the suppression of credit segments (previously, there had been percentage requirements by category of loan) and the mandatory cash reserve;
- very flexible regulation of foreign investment; and
- the opening of Mexico's stock market to foreign investment.

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The reform, oriented by market mechanisms, began in 1988 and had as its crosscutting axis the privatization of banking institutions, nationalized in the early 1980s by President José López Portillo, and the gradual opening of the financial sector to external competition in accordance with the commitments ratified in the North American Free Trade Agreement (NAFTA).[2]

In two decades of changes, the Mexican banking system has gone through traumatic episodes that include its nationalization, its reprivatization, the 1994-1995 banking crisis and the government bail-out of bankrupt banks. The cost of this operation is estimated at over U.S.$75 billion in promissory notes. The interest on this debt weighs heavily on the public pocketbook with negative effects on the yearly budgets for education, health and government investment. A little history would be useful at this point (see table 1).

The State Bail-Out Of Private Banks

The Savings Protection Bank Fund (Fobaproa) was founded in 1990 and was supposed to be funded by contributions from the banks. This did not happen, however, because the banks were already de-capitalized. After an unprecedented surge in bank credit and the stock market in the beginning of the 1990s, the banks and financial institutions went into crisis in 1994 and 1995. In only two years, the crisis sparked a more than 100 percent surge in interest rates and the hyper-devaluation of the peso, both of which worsened the problem of the banks' bad loan portfolio.[3]

Given the banking crisis and the euphoria of anti-state liberal economic policies, the government did not hesitate at all to launch a plan to save the bankrupt private banks. Fobaproa

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TABLE 1
FISCAL COST OF FINANCIAL BAIL-OUT PROGRAMS
MEXICO, 1997

PROGRAMS	BILLIONS OF DOLLARS	PERCENTAGE OF 1997 GDP
UDIs	2.85	0.9
Housing Program	3.92	1.2
FINAPE	1.58	0.5
FOPYME	0.78	0.2
ADE	0.50	0.2
Fobaproa	18.73	5.9
Capitalization Plans	7.74	2.4
Highway Construction Loans	1.88	0.6
TOTAL	**37.98**	**11.9**

NOTE: At an exchange rate of 10 pesos per dollar.

Key
UDIs: Investment Units Indexed to the Inflation Rate.
FINAPE: Financing for the Agricultural and Fishing Sector.
FOPYME: Financial Support for Micro-, Small and Medium-Sized Companies.
ADE: Bank Debtors' Support Program.
Fobaproa: Savings Protection Bank Fund.

Source: Secretaría de Hacienda y Crédito Público, *Criterios Generales de Política Económica* (México City: Secretaría de Hacienda y Crédito Público, 1998).

immediately began to take action to financially shore up banking intermediaries with state tax monies. In 1998, Fobaproa was replaced by the Bank Savings Protection Institute (IPAB), which reaffirmed the federal government's substantive functions and financial commitments to Mexico's new bankers.

At the end of that year, with the approval of the conservative National Action Party (PAN) and the Institutional Revolutionary Party (PRI), then in office, Congress fully recognized the Fobaproa's financial obligations. This increased domestic public debt since the promissory notes, originally documented as "contingency liabilities" (a governmental guarantee in the event that the banks did not cover their commitments to depositors and investors) were validated as "direct debt." As a result, these instruments were legalized as an unavoidable government obligation for more than U.S.$75 billion.

This was a drastic budgetary change because "contingency liabilities" do not earn interest, while direct debt does. Therefore, the banks' private debt was transformed into public debt. As a result, the federal government's total public debt increased from 31.4 percent to 43.3 percent of the gross domestic product. The tax burden resulting from these government obligations incurred by the bank bail-out continues to increase and has become a serious budgetary and political problem for Mexican society.[4] Between May 1999 and December 2001, the IPAB's debt has increased from U.S.$69.4 billion to U.S.$78 billion, while its net assets dropped from U.S.$12.1 billion to U.S.$7.5 billion.

LOSS OF NATIONAL CONTROL OVER THE COUNTRY'S PAYMENT SYSTEM

Mexico's old banking system has practically come completely under the control of large financial groups from Spain, the United States, Canada and Great Britain, which today manage almost 90 percent of its total assets through Bilbao Vizcaya, Santander, Citibank, Nova Scotia and Hong Kong Shanghai Bank (HSBC). The HSBC recently bought Banco Bital, which was the third largest credit institution in the country. There are a few surviving regional banks still controlled by Mexican investors: Banorte, Afirme and Inbursa have a market share of about 10 percent, but only with great difficulty will they be able to resist the weight of the oligopolistic competition in a market defined by the country's three main banks. Today, Mexico's two largest financial groups, BBVA-Bancomer and Citibank-Banamex, dominate 50 percent of the banking market.

It is significant in terms of the limits of the banking reform that the presence of "new competitors" in the national financial market did not make for an improvement in the credit supply for production in the Mexican economy. Bank financing is excessively expensive and scarce: on an average, interest on loans is higher than 20 percent, while interest on savings is even lower than the inflation rate, which in 2002 will supposedly be under 5 percent. In Mexico, small and medium-sized depositors are losing with negative real interest rates.

The banking system does not encourage savings and, in fact, bank financing for industry, commerce and the service sector has disappeared. From 1993 to 1994, Mexico's banking system provided 32 percent of the money invested in the productive sector, while in 2001, this figure was barely 6.5 percent. Currently, only one-fifth of established companies use bank credit,[5] and only 20 percent of the population has access to banking services. Today, the contribution of private banks to investment and growth is practically nil. More than a driving force behind development, the banking system has turned into a brake on overcoming the economic recession the Mexican economy has been experiencing since 2001.

Table 2
Savings Deposits in Mexican Banks (2001)

Deposits in savings accounts, in U.S. dollars	Percentage of total accounts	Cumulative percentage of accounts
$100 or less	51.70	51.70
$100 to $500	17.35	69.05
$500 to $1,000	9.36	78.41
$1,000 to $5,000	14.20	92.61
$5,000 to $10,000	3.70	96.31
$10,000 to $25,000	2.14	98.45
$25,000 to more than $100,000	1.53	100.00

Note: At an exchange rate of 10 pesos per dollar.
Source: Comisión Nacional Bancaria y de Valores y Banco de México, July 2002.

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Recession and Net Profits In Multinational Banks

It is a macroeconomic paradox that in the midst of a recession and despite its negligible contribution to financing production, in 2001 the multinational commercial banking system made spectacular profits of over U.S.$1.1 billion. For example, the Bilbao Vizcaya Argentaria-Bancomer financial group reported net accumulated profit of U.S.$691 million, an increase of 245 percent over 2000. IPAB's debt in promissory notes to this financial group comes to U.S.$12.6 billion (the equivalent of 22 percent of the bank's assets). For its part, the Grupo Financiero Santander-Serfin made U.S.$522.7 million in net profits, a 133 percent increase with regard to 2000. Santander bought Bital bank and IPAB's debt to Santander is U.S.$6.8 billion, roughly 40 percent of the financial group's assets.[6]

Just to confirm the profitability of the multinational banks, we should consider that in the first quarter of 2002, what was the Banco Nacional de México (Banamex), bought by Citibank, had profits of U.S.$280 million.

At the center of the multinational banking system's profits are speculation with the resources of third parties, the depositors, and the interest on the IPAB promissory notes from the government bail-out.

The three aforementioned financial groups benefited from the interest on the IPAB notes from the government bank bail-out, which came to more than U.S.$75 billion. The international banking system has reinforced the oligopolistic trend. This means that the market is controlled by few financial groups and is the key to explaining the wide gap between the interest rates paid to depositors (on the average, lower than the inflation rate) and the rates applied to loans, which are three to four times greater. None of this takes into account the government tax breaks given through the "Tax Payment Deferment" program that is equivalent to a virtual exemption for the banking system to the tune of almost U.S.$4.5 billion.

After the 1994-1995 financial crisis and the virtual technical bankruptcy of most of the re-privatized banks and the development banking system managed by the federal government, the idea that modernization and normalization of the sector required the presence of foreign banks to "bring in fresh resources to help recapitalize Mexico's fragile banking system" came into vogue.

With that began a wave of mergers and acquisitions of local banks by large financial consortia with worldwide presence, the results of which I have attempted to point out. However, the supposed contribution of fresh resources has been neither substantial nor evident if we consider that of all the bank assets controlled today by foreign investors, 22 percent is held in the promissory notes emitted by the old Savings Protection Bank Fund (today called the Bank Savings Protection Institute) as part of the bank bail-out.

Under these circumstances, everything seems to indicate that the international banks' real interest in investing in Mexico is not to play the role of financial intermediary and promoting bank credit in the Mexican market, but rather to get at the juicy yields generated by the promissory notes for bank recapitalization operations carried out by the federal government.

Finally, some preliminary observations should be formulated about the current performance and structure of the banking system. In the first place, it should be pointed out that in a macroeconomic environment of price and exchange-rate stability, loan rates have in effect gone down.

However, they continue to be in the two digits, which does not stimulate investment in production, at the same time that interest rates on deposits are insignificant, thus not stimulating increased domestic savings. Passive interest rates urgently need to be reset to create incentives for potential savers to increase the mass of money in the banking system and, as a consequence, open up the possibility for bolstering the amount of credit available, the banking system's most important social function.

In the second place, in the context of a recession with low growth rates for both output and investment, more decided government action in favor of financing investment in production is needed through development bank and social banking credit (the latter for micro-financing of micro-, small and medium-sized companies).

Also needed is a search for new resources that can come out of a renegotiation of the terms of the financial bail-out that would free up funds that are now earmarked for a banking system currently dedicated to speculation. Lastly, the loss of national control of the country's system of payments, today in the hands of multinational commercial banks, carries with it undeniable risks, such as less room for determining monetary and credit policies.

From the point of view of financing production, it can be said that the neoliberal financial reform has failed to the extent that the banking system is not fulfilling its function as an intermediary and reducing the cost of money for encouraging investment. In this sense, Mexico's banking system does not justify the tax and social burden that ensuring its financial health has meant. VM

Notes

[1] See the official view of the financial reform, its instruments and goals in Pedro Aspe, *El camino mexicano de la transformación económica* (Mexico City: Fondo de Cultura Económica, 1989).

[2] For an analysis of the periods of liberal modernization of Mexico's financial system, see Arturo Guillén, *El sistema financiero y la recuperación de la economía mexicana* (paper read at the Meeting on the Evaluation of the Impact of the Mexico, U.S. and Canada Free Trade Agreement, Mexico City, January 1995).

[3] Enrique Pino Hidalgo, "Economía de endeudamiento y costos del rescate gubernamental," *Crisis bancaria y carteras vencidas*, Alicia Girón and Eugenia Correa, comps. (Mexico City: Editorial *La Jornada*, 1997).

[4] Alejandro Álvarez, "La inestabilidad financiera internacional y sus implicaciones en México," *Globalización financiera e integración monetaria. Una perspectiva desde los países en desarrollo* (Mexico City: Editorial Porrúa-UNAM, 2002).

[5] http/www.jornada.unam.mex/2002/abr02/020418aleco.php consulted April 2, 2002.

[6] These figures are estimates made by the Chamber of Deputies' Finance Commission, published in *La Jornada* (Mexico City) 11 April 2002.