

# A BURDENSOME DEBT THAT JUST WON'T DISAPPEAR

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**Mexico's debt is an even greater headache after the collapse in oil prices. Here is a profile on the debt and some possibilities for its renegotiation.**

As oil prices began to plummet early this year, fears grew of a possible suspension of debt payments by Mexico. The sudden plunge in oil prices surprised observers and made the government's economic goals for 1986 seem illusory.

By the end of last year the government had drawn up a budget that was even then considered austere. Estimates for income from oil exports to be sold through the national oil company, PEMEX, were pegged at \$22.50 per barrel for 1.5 million barrels a day. Based on these premises the government had planned to request \$4 billion in loans to meet its foreign debt obligations and increase the country's foreign currency reserves. Yet a few weeks later, the new situation had totally transformed possibilities for the future. The drastic fall in the price of petroleum meant that Mexico would lose about \$6.5 billion in income and approximately 12.5% of its total tax revenues, and see the value of its total exports decrease by a third.

In view of these adverse conditions, a debt service at the rate of \$10 billion in interest and \$1.8 billion in payment on the principal seems to be an excessive burden. Overcoming the consequences of the collapse in oil prices can mean either (1) greater austerity in government spending that would free resources equivalent to the drop in income from lost oil revenue, or (2) getting additional financing from foreign sources. A combination of the two may become a realistic alternative after another round of negotiations.

Following several years of cutbacks in government spending, authorities at first rejected the option of making further internal adjustments. There had already been three consecutive years of severe decline in people's standard of living, involving a drop of more than 40% in real income -the result of austerity policies the government instituted under the auspices of the International Monetary Fund (IMF). Thus, analysts feared that a suspension of payments would be declared.

President De la Madrid, however, in a national television broadcast stated that "creditors should make a sacrifice at least equivalent to that of the Mexican people." In the same vein he emphasized the "sharing of responsibilities in the search for viable solutions." Minister of Finance Jesus Silva Herzog had previously stated that "the limits to our responsibility to our creditors are set by our responsibility to our people."

Government authorities had apparently decided to emphasize their desire to lessen the burden of debt payments in these especially difficult circumstances, but not to go any further than that. Official spokespeople have made it clear that they are not suggesting the adoption of unilateral measures like those of Peruvian President Alan Garcia, who limited debt payments to 10% of the value of the country's exports. In other words,



Mexican Finance Minister Jesús Silva Herzog. Photo by Renzo Gostoli.

Mexico seeks to establish principles for negotiations and avoid confrontation.

As Mexicans perceive the situation, the U.S. government plays a key role in their foreign debt negotiations. Many analysts believe that Mexico should rely on what they see as a long-standing privileged relationship with the U.S. This position calls for the participation of high-ranking U.S. officials as a sort of pre-condition for furthering discussions with the banks and the IMF.

The logic behind direct U.S. government intervention is based on U.S. national security interests, as well as on the profusion of business relationships between the two nations. Taking as a precedent the U.S. role in coming to Mexico's financial rescue in August 1982, analysts such as the editors of *The Economist* even suggested that the Reagan administration purchase additional oil from Mexico in order to provide foreign currency for the country without further increasing its debt. These businessmen justify their position in that a Mexican default is the only serious threat to the world banking system among the indebted oil-exporting countries.

With all of this in mind, it is rather surprising that so little

progress has been made in the renegotiation of Mexico's debt, even though several high-level meetings have taken place. The talks have included Treasury Secretary James Baker, the President of the Federal Reserve Board, Paul Volcker, and Mexican Finance Minister Silva Herzog. Only minor agreements have been reached thus far. Mexico's ambitious goal is a 6% ceiling on interest rates, in order to avoid further indebtedness. Bankers thus far have been firmly opposed to this.

Even the assessments of Mexico's financial needs have been scaled down as the talks in Washington and New York proceed. The amount Mexico needed to meet this year's payments had initially been set at \$10 billion. The figure currently under discussion is \$6 billion. This reduction is mainly due to the country's decreasing demand for foreign exchange for imports as the economy's recession deepens. This, then, "saves" \$4 billion. The reduction in foreign currency needs can also be attributed to a \$500 million increase in non-oil exports and a lower than expected interest rate that reduces debt service payments by \$800 million. Finally, in this regard, Mexico seems to have given up on the possibility of strengthening its foreign currency reserves.

So, while Mexico is close to the brink of disaster, U.S. officials continue to defy conventional wisdom that calls for emergency measures, and refuse to yield to Mexico's proposals.

### CONFLICTING STRATEGIES

Following the decision to provide \$6 billion for Mexico in 1986,\* it is estimated that at least \$3.5 billion will come from commercial banks and the rest from international financial institutions. If this amount were to be distributed proportionately, about \$1 billion would come from U.S. banks, as they are the creditors for approximately 29% of Mexico's debt. British and Japanese banks account for about 11-12% of Mexico's debt, while Germany and France hold another 6-7%. More than half of Mexico's outstanding loans with the U.S. are owed to that country's 9 largest banks, and an additional 20% to the next 15 largest.

Consideration of the strategies adopted by both parties is useful in evaluating the prospects for negotiation between Mexico and its creditors. In synthesis, Mexico's strategy for restructuring its foreign debt has unfolded in two distinct phases. The first was based on an austerity policy that assured the strict fulfillment of debt service obligations between December 1982 and April 1984. Mexican authorities met obligations for \$23 billion and obtained fresh financing for another \$8.8 billion. During this phase Mexican authorities, the banks and the U.S. government cultivated an image of Mexico as a model nation in meeting its foreign debt obligations. By September of 1984 it was possible to set up a new long term proposal.

During this second phase \$48 billion in payments due between 1985 and 1990 were rescheduled, and an agreement was reached to restructure them between 1986 and 1988. Benefits of lesser importance were also obtained. The second phase ended in August 1985, in the midst of increasing concern among bankers over Mexico's renewed economic troubles which foretold greater storms to come. In any event, the new debt schedule contained clauses that allowed the revocation of established contracts under certain conditions. In addition, the IMF was guaranteed the right to scrutinize Mexico's economic policy.

U.S. banks had adopted tactics to minimize their risks since 1982. In 1983 their loans to Latin America increased by only 0.2% and in 1984 by 2.5% -in other words, \$2.1 billion less than the average annual increases between 1978 and 1981.

This strong decrease in the lending rate was repeated in 1985. This trend, combined with the accumulation of primary capital (including reserves to back up non-performing loans), significantly reduces the risk for U.S. banks in developing countries. In Mexico, the 5 main U.S. banks have reduced their aggregate exposure for capital loans from 42% to 35%. Also, the 10 banks with the largest loans to Mexico have raised their primary capital from an average of 4.9% of their total assets in 1982 to 6.8% at the end of 1985. This puts them in a better position to absorb losses on their loans to foreign countries.

However, these strategies on the part of the banks are not the only reason they are in a better position to negotiate with their debtors. The general economic climate is also more favorable. The U.S. economy went through a deep recession in 1982 that reduced bank profits, but currently the economy is more solid, with about a 3.5% growth rate. The hoped-for reduction in interest rates will also help financial centers increase their profits. At the same time, falling oil prices benefit other large debtor nations, like Brazil, which even further relaxes pressure on the banks.

The risk situation for U.S. banks can be measured in Table 1, which presents estimates of the maximum losses the 10 banks with the greatest risks in Mexico could have if Mexico defaulted on its debt payments.

The profits of these banks would be reduced by approximately 10% if Mexico stopped paying the interest on its debt. This indicates that a temporary suspension of payments by Mexico would not spell disaster. Consequently, the suspension should not noticeably affect the banking system either. We must also keep in mind that Mexican officials have at no time suggested they will stop meeting their obligations. Their proposal is to set a ceiling on interest rates, a goal consistent with the Mexican strategy of gradually improving payment conditions. Ironically, the Mexican proposal pulls a rug out from under its stated objectives; our country loses part of its bargaining power when it accepts the bank's hypothetically low losses if Mexico defaults on its payments.

From the Mexican point of view it doesn't make sense to go deeper into debt in order to meet interest payments. Limiting interest payments, or at least capitalizing, them seems preferable. The bankers say it is not worth their while to loan money that rapidly returns to the same place via capital flight. Morgan Guaranty Trust has estimated that between 1983 and 1985 net loans to Mexico were around \$9 billion. During

TABLE 1

DECREASE IN BANKER'S PROFITS IF MEXICO STOPPED PAYING INTEREST ON ITS DEBT	
	%
FIRST CHICAGO *	33
MANUFACTURERS HANOVER *	27
BANKERS TRUST *	21
CHEMICAL BANK *	19
WELLS FARGO BANK *	19
CITICORP *	16
MELLON BANK *	16
CHASE MANHATTAN *	15
MORGAN GUARANTY TRUST *	9
BANK AMERICA *	•
AVERAGE	19
* no profits	

NOTE: The decrease in profits refers to 1985 before taxes.  
SOURCE: Keefe, Bruyette

this same period \$16.2 billion left the country in capital flight. Under these circumstances, why not accept Mexico's proposal? There are two main reasons. One is that accepting the proposal would establish a precedent that could rapidly be followed by other debtor nations. A second reason has to do with banking regulations. In terms of money flow it makes little difference whether you capitalize interest with a pre-set

\* The Institute of International Economics (Instituto de Economía Internacional) in Washington, estimates that Mexico will need roughly \$8 billion each year between 1987 and 1990.

## mexican profiles

rate and pay later when the loan has matured, or if you authorize new loans that turn over quickly in the form of interest payments. But an important difference does exist because of accounting procedures and regulations in the U.S. banking system. The difference is that deferred interest payments cannot be considered current income by the banks. So, bank profits decrease. This partly explains American bankers' opposition to the idea of capitalizing the interest on the Mexican debt.

It is also important to note that European banks have significantly different procedures. Germany, for example, would prefer to extend the loans in this way because banks can obtain tax exemptions on capitalized interest. German banks must also have reserves on hand for new loans to troubled debtors. These differences between the creditor banks makes it difficult to arrive at a satisfactory agreement with debtor nations because the banks in each country defend their own goals and their particular way of operating.

We should also keep in mind that banks defend their interests quite fiercely. Bank bonds and shares are still being negotiated with a strong discount on the stock market. This

has been so since 1982, even though banks now appear to be in much better condition. The situation on the stock market is such that dealings with the Mexican debt in the secondary market are quoted at only 80 cents to the dollar. While this makes it clear that banks can stand to suffer strong losses due to problems with debtor nations, it also points to the mistakes the banks made in their loan policy during the 1978-1981 period. Given the magnitude of these mistakes, it would seem better to acknowledge the situation, rather than to maintain a stubborn attitude regarding the foreign debt problem in developing countries.

### RENEGOTIATING THE DEBT IN THE CONTEXT OF MEXICO-U.S. RELATIONS

As we said before, the scant progress made by Mexico at the negotiating table in Washington defies conventional wisdom. This was especially apparent when, after the first rounds of discussion, the United States government rejected the possibility of a bridge loan to temporarily alleviate the problems

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The Forgotten ones. Photo by Renzo Gostoli.

due to the fall in oil prices. The U.S. government seems unwilling to make concessions unless Mexico adopts an economic policy that fully satisfies U.S. interests. What the United States wants to see in Mexico is the all-out application of a neo-liberal economic policy. This would mean significantly opening up the national economy, liberalizing foreign trade, rapidly reducing the public deficit, selling state-owned enterprises and abandoning regulation of direct foreign investment.

Miguel de la Madrid's administration has implemented all of a these policies, from formally requesting membership in G.A.T.T., to relaxing Mexican policy regarding foreign investments, to selling many public enterprises. These measures have recently accelerated as a result of U.S. pressure.

tioning in the discussions regarding foreign debt, which is that any idea of altering a liberal economic order seems foreign to U.S. sensibilities. This is especially true when the negotiators have strong neoconservative leanings and believe that this type of economic organization is the only natural one. On the other hand, Mexico's revolutionary nationalism calls for strong state intervention in the economy.

These differing conceptions make it difficult for one party to understand the other in relation to what each can consider acceptable or will regard as excessive. Whereas from the U.S. point of view it would be "logical" to include the state petroleum monopoly PEMEX among the public sector firms to be sold, from the perspective of the Mexican government, this is entirely unacceptable.



Demonstration protesting government budget cut-backs. Photo by Renzo Gostoli.

Nonetheless, in the opinion of U.S. officials, what the Mexican government has done so far is not enough.

Three powerful political reasons help explain the lack of understanding and the contrasting visions and desires of the two governments. The first is that within the logic of the U.S. political system and its conflicting internal interests, there's always something more that needs to be done before their demands are satisfied. The second reason is that, in the perception of U.S. officials, a good part of Mexico's economic problems are associated with its political system. This line of reasoning holds that it is necessary to limit the margin of freedom of Mexican executive authorities in order to avoid these problems. There is a final aspect that seems worth men-

Today we can't help but note that strong pressures are being exerted on Mexico to reshape its economic structures and organization to make them both more compatible with U.S. interests. In addition to the limits of Mexican tolerance in this situation, one must take into account the failure to date of orthodox policies in resolving the problem of the foreign debt. With the fall in oil prices, the shortcomings of this strategy are even more apparent. This situation calls for unorthodox alternatives in order to save the country's productive plant, to stem and reverse the deterioration in the people's standard of living, and to preserve national sovereignty and autonomy.★

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