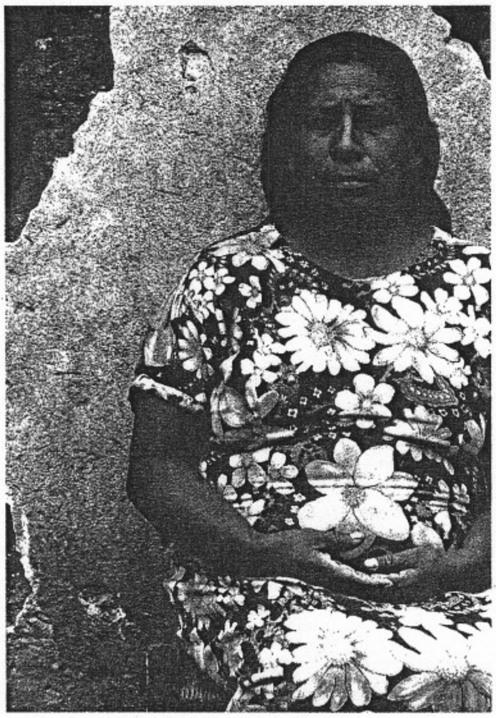
Mortgaging Mexico's Future

Since the U.S. Treasury and the IMF began their disbursement of some US$37 billion in credits to the Mexican government in February 1995 to bail out the holders of Mexican bonds in the midst of the precipitous devaluation of the peso, Mexico's economy has contracted sharply. All the official assurances of an around-the-corner recovery notwithstanding (see "Is the Worst Yet to Come in Mexico?" *BankCheck Quarterly*, September 1995), the economy remains in a dismal and deteriorating state.

During 1995, Mexico's gross domestic product fell by almost seven percent, and the first quarter of 1996 saw a continued decline. Less than a year since it received a total of $1.75 billion from the World Bank and Inter-American Development Bank to help restore solvency to the tottering banking system, the Zedillo Administration is now seeking as much as another $1 billion from the multilateral development banks in financial sector lending.

Faced with interest rates that have ranged from 40 to over 100 percent, close to one half of Mexico's businesses have gone belly up in the past year. With two million Mexicans having lost their jobs, two thirds of the country's economically active population of 34 million is now without sufficient work and earn incomes that are below the poverty line. Contributing to this severe depression is a substantial decline in wages. Since the current crisis began in December 1994, the minimum wage has lost 30 percent of its purchasing power. It now buys only a quarter of what it did 20 years ago. Contractual wages during the present period have fared even worse.

The unraveling of the Mexican economy has been devastating for virtually everyone who does not have financial ties with



the corrupt ruling party or the international community. Poor urban neighborhoods have been particularly hard hit, especially by the collapse of the construction trade. In rural areas, thousands of small farmers are selling their land – often to foreign companies supplying a foreign market – in order to survive.

Those farmers who are defaulting on their bank loans have been joined by large segments of the urban middle class that are unable to make payments on their homes, cars and businesses to form a potent, million-strong debtors' movement. By U.S. accounting measures, nearly a third of all outstanding loans are overdue, and this debt is continuing to mount. Were it not for the $26 billion already pumped in by the Mexican government – an amount equivalent to ten percent of Mexico's GDP and twice what the government received when it privatized the banks in 1991 – the country's banking system would have already collapsed.

For 14 years, Mexico, with the encouragement of the World Bank, IMF and U.S. Treasury under three U.S. presidents, has placed its fortunes increasingly in the hands of outsiders. Instead of building its economy from the bottom up, it adopted structural adjustment policies – wage suppression, high interest rates, deregulation, privatization, export promotion and austerity – designed to attract the capital and technology of foreign corporations. Along with NAFTA's removal of trade barriers, these policies have facilitated the movement of U.S. firms to Mexico and of their production back into the United States. Now, more than half of all trade between the two countries consists of intra-firm transactions that take place among the branches of U.S. corporations.

As a result, Mexico's productive capacity is disintegrating and the country has become highly susceptible to sudden outflows of capital, as evidenced by the peso's collapse when U.S. interest rates rose and political trauma hit Mexico in 1994. To sustain the economy, the Mexican government has mortgaged its future with an extraordinary round of foreign borrowing. In the past year, it has taken on $45 billion in international obligations to public and private lenders, effectively converting short-term debts on which it had been on the verge of defaulting into a massive medium-term debt that must be paid over the next five years. More specifically, the government has had to sell more bonds in private markets and offer unusually high returns and guarantees in order to make payments on the massive loans made by the U.S. Treasury and the IMF. Even then, it has been able to meet these obligations only by rescheduling payment a number of times.

The result is that the Mexican government is now in the perilous position of having a foreign debt of some $100 billion (and the private sector an additional $75 billion), while holding $16 billion in foreign reserves, 95 percent of which, according to the IMF, is borrowed money. With a declining capacity to generate new resources to pay off this debt and no change in economic policy in sight, Mexico is heading inexorably toward another serious run on the peso and an unmitigated economic and social disaster.

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