Volcker's interest-rate pressure throws Mexico into a debt squeeze

by Timothy Rush

Mexico is now close to surpassing Brazil as the Third World's most indebted nation. Finance Minister David Ibarra, in his annual presentation to congress at the end of November, announced that the 1981 current account deficit is now officially estimated at $11.0 billion, up over 65 percent from last year's already surging $6.5 billion. That $11 billion is being covered by new public sector foreign borrowing. When some additional longer-term capital account borrowing and flight capital losses are figured in, the total *net* public sector borrowing in 1981, according to World Bank estimates, will be on the order of $14 billion—something like double the previous record.

Total public and private foreign debt, long and short term, is being pegged at $64 billion—up from perhaps $47 billion a year ago.

This explosion of debt, at a moment when Mexico's oil-export revenues have hit a "ceiling" unlikely to vary for at least a year, has greatly increased Mexico's vulnerability to political pressures from international financial entities. In fact, for the first time since the 1976-77 recession, these layers have begun to talk openly about putting "conditionalities" on further Mexican borrowing, with an eye to shaping Mexico's domestic economic policies away from the country's current commitment to ambitious industrial growth. An important straw in the wind was the Nov. 29, 1981 report in the Mexican daily *El Sol* that the International Monetary Fund (IMF) is now preparing a confidential report on the Mexican economy, designed to shape domestic Mexican policy in 1982. Their hope is to significantly dictate the policies that will be adopted by Miguel de la Madrid, who will become the next President of Mexico on Dec. 1, 1982.

Mexico went to the IMF for a $3 billion bail-out in the dark days of October 1976, but made it a point of pride to end the agreement at the earliest possible moment—and in fact pre-paid its final repayments in 1979. There is no desire in Mexico to have a repeat of those days.

How did it happpen?

A pincers action—the Volckerization of international interest rates on one side, and the weakening of Mexican oil exports on the other—accounts for the debt run-up almost in its entirety.

One of the quickest ways to see the direct effects of the Volcker operation is to separate out interest payments from the rest of Mexico's foreign obligations. As can be seen in Figure 1, interest payments on the public sector foreign debt took off after 1979. The leap from 1980 to 1981 is $2.3 billion, over 60 percent in one year. On top of this $6.2 billion on the public side (which, in the Mexican case, covers both government borrowing and a large portion of private sector borrowing, backed by the government through agencies such as Nafinsa), there is the direct private sector foreign borrowing of $2.4 billion. *The charges for interest alone in Mexico's 1981 current account are $8.6 billion.* In 1979, before the Volcker run-up, they totaled $3.5 billion.

A breakdown of the current accounts shows that the interest run-up accounts for almost the entirety of the increase in the current account deficit from 1979 to 1980—the first full year of the Volcker regime—and the largest part of the increase from 1980 to 1981.

Mexico's current account deficit in 1979 was $4.9 billion; it rose to $6.6 billion in 1980, an increase of $1.7 billion. The deficit on trade account hardly changed in the two years—$3.2 billion in 1979, $3.3 billion in 1980. Likewise, items on the service account either stayed the same or cancelled each other out—except that of "net financial services," which is primarily the debt category. Here the net outflow leaped $1.5 billion—almost exactly matching the $1.7 billion increase in the current account as a whole.

The 1981 figures tell much the same story, with the $3.4 billion run-up in interest accounting for the bulk of the estimated $4.4 billion increase in the current account deficit.

The interest-rate bulge has forced two changes in the Mexican debt profile. The first is a trend toward channeling all repayment resources into meeting interest alone, while amortization is rolled over. Figure 1 shows that amortization made a sudden leap in 1979, when Mexico prepaid its IMF accounts in order to free itself from even token IMF control. After that, amortization drops back to levels lower than 1978—while interest payments surge ahead.

Figures released by Planning and Budget Minister

© 1981 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

Ramon Aguirre in his late November companion presentation to Ibarra's to the congress (Figure 2), indicate this trend continues into projections for 1982. Amortization costs are slated to increase only 12 percent; interest, 49 percent. Aguirre's figures include domestic debt, which has risen to even higher interest rates than foreign debt in order to keep capital within the country.

At the same time, there is a trend back toward short-term borrowing, after a successful refinancing effort toward longer maturities in the early part of the López Portillo administration. In 1979, Mexico's net short-term indebtedness on capital account was in fact negative. Then in 1980 it leaped to $3.3 billion, and some analysts believe it could well top $5.0 billion in 1981.

The other side of the "pincers" began to squeeze in May and June 1981, when a number of Mexico's foreign oil purchasers coordinated tactics to drive down Mexico's prices and deliver a "reverse oil shock" to the Mexican development efforts. Exports fell by a full 50 percent for several months and only regained the target 1.4-1.5 million barrels per day level in late October.

Most estimates place Mexico's lost oil revenues for this period in the $4-5 billion range. Finance Minister Ibarra reported a $7 billion loss in his November speech, a figure dismissed by IMF sources as "politically motivated," but an additional confirmation of the magnitude of the shortfall.

One of the places where the shortfall immediately shows up is in the balance of trade figures. As of now, analysts at the World Bank calculate that 1981 exports will come in at $19.8 billion, three quarters of this from oil. If there had been no interruption of contracts last summer, this figure would have moved close to the $25 billion range.

Imports are now projected for the year at $23.2 billion. Thus without the shortfall, the trade balance would have been positive, or perhaps, with somewhat higher imports, only slightly negative.

It is indicative of Mexico's basic economic health that even with the shortfalls, the projected trade deficit of $3.5 billion is approximately the same as that of 1979 and 1980. In real value terms and in percentage terms of total trade, the deficit is declining.

Figure 1

Debt service on public sector foreign debt, 1978-81

(in billions of U.S. dollars)

	1978	1979	1980	1981
Interest	2.0	2.8	3.9	6.2*
Amortization	4.2	7.3	3.7	n.a.
Total debt service	6.2	10.1	7.6	n.a.

Source: Bank of Mexico; World Bank
* Estimate

Figure 2

Total Mexican government debt service

(in billions of U.S. dollars: 25 pesos = $1)

	1981 (estimated)	1982 (projected)	Percent increase
Interest and other costs	11.5	17.1	49%
Amortization	10.5	11.8	12
Total debt service	22.0	28.9	31%

Source: Ministry of Planning and Budget (SPP).
Note: Total includes both domestic and foreign debt service.

The headache for Mexico's planners—complicated by the fact that 1982 is a presidential election year—is that the extraordinary 1981 borrowing needs are not likely to abate in 1982. Major debt service costs are already built in, even if the current trend in international rates continues slowly down. And there is almost no chance of boosting oil income above 1981 levels: intensifying depression conditions spreading worldwide from the U.S. disaster will see to that.

The "alternative" being posed by the IMF-World Bank apparatus and major New York and London international banks is for Mexico to pay increasingly onerous charges on the skyrocketing debt, thus stealing resources from imports needed for key development projects; or cut back on its domestic subsidy structure, especially in food and energy.

Already the World Bank is reportedly demanding that all future Mexican borrowing from the Bank be on the basis of more expensive co-financing from commercial lenders.

And the hatchets are out for Mexico's most important high-technology growth programs. The *Financial Times,* mouthpiece of London's monetarist banking elite, attempted to ridicule Mexico's nuclear plans, among the largest anywhere in the Third World, in a Dec. 2 feature. "The cost of the ambitious program has raised eyebrows in some quarters, since Mexico's external financial position is deteriorating in spite of its oil riches," wrote William Chislett.

The Mexican government is fighting tenaciously to maintain economic growth despite the constraints imposed from outside. The growth target announced by Ibarra and Aguirre for 1982 is a relatively high 6.5-7.0 percent—less than the remarkable 8.0 percent of the past three years but still substantially more than the 4.5 percent being demanded by the Wall Street press.

The policy questions posed to Mexico by the debt

squeeze are primarily the following:

1) What to do about internal subsidies? The stated government policy is to gradually bring Mexican domestic energy costs up closer to world costs. But an attempt to do this a year ago was abandoned at the last minute for fear that it would unleash an inflationary explosion. Talk is abroad once again that such a hike is imminent—but again the inflation problem weighs heavily. The projection is that inflation for 1981 will come in close to 28 percent—a shade less than last year's 30 percent. A reduction of subsidies in 1982 would push the inflation rate to new highs, and put more heat on the peso devaluation issue.

2) Slow down capital goods imports? As can be seen in Figure 3, Mexico slowed down the rate of growth of its imports over the first 8 months of 1981. For the year as a whole, exports should exceed the $18.6 billion of 1980 by $3.6 billion, only half the $6 billion increase registered the year before. However within the import slow-down, at least through August, the categories hardest hit were consumer and intermediate goods. Captial goods, the backbone of Mexico's industrialization programs, stayed at a healthy 50 percent increase level over the figures of a year ago.

The renewed import licensing controls slapped on by Mexico in late June will be "reinforced" and continued for at least another year, Aguirre announced. Analysts at the World Bank are insisting they will have to be aimed at capital goods now if they are going to mean anything.

3) How to limit foreign exchange outflows? There is a strong determination on the government's part not to be held hostage to the threat of flight capital and a forced "maxi" devaluation (the current float is taking the peso down at roughtly 12 percent a year). Two approaches are being studied at the highest levels of the government. The first is a "foreign exchange budget," in which limited foreign exchange will be parceled out by the government according to strict priorities—private transfer of capital out of the country not being one of them.

The second is full-scale exchange controls, in which outflows would be totally controlled—as would inflows. Though this second option is more drastic and involves more cumbersome administration, it has the substantial advantage of insulating the country against the effects of the international interest rate warfare. Mexico could set domestic rates at the level it wants to stimulate real investment and production, probably keeping high rates only on speculative uses of credit.

EIR believes some kind of economic package involving these three policy areas is likely to be announced in early 1982. The contents are now the subject of intense discussion, and cannot be predicted at this time. One key factor that will be carefully weighed by Mexico is whether the emerging clout of Japan and anti-monetarist factions in other advanced sector nations successfully move in as an alternative credit source to that of the IMF.

Japan took some important strides toward assuming this role at Cancún in late October. Now it has just agreed to increase its purchases of Mexican oil to 160,000 bpd by the end of 1982—current purchases are 100,000 bpd. Though not an enormous increase in absolute terms, it is of the utmost political significance. Japan is "delivering" on its promises to upgrade its relations with Mexico on an oil-for-technology basis. If this trend continues at its current pace, Mexico may not be prey to the IMF-led bankers to the extent that Wall Street and London desire.

Figure 3

Monthly variation in Mexican imports, 1981

(in percent above or below year-previous levels)

	Total	Consumer goods	Intermediate goods	Capital goods
January	+70.6%	+174.0%	+44.2%	+100.7%
February	+47.7	+24.1	+50.2	+49.9
March	+62.7	+53.4	+63.1	+64.6%
April	+40.9	+31.5	+33.5	+63.0
May	+24.7	+28.5	+12.8	+57.8
June	+32.6	−3.2	+26.6	+62.9
July	+17.3	−8.1	+8.8	+53.1
August	+7.4	+16.4	−0.2	+19.3

Source: Bank of Mexico

Note: Absolute levels of imports in 1980 were $2.42 billion in consumer goods, $11.03 billion in intermediate goods, and $5.12 billion in capital goods, for a total import level of $18.57 billion.