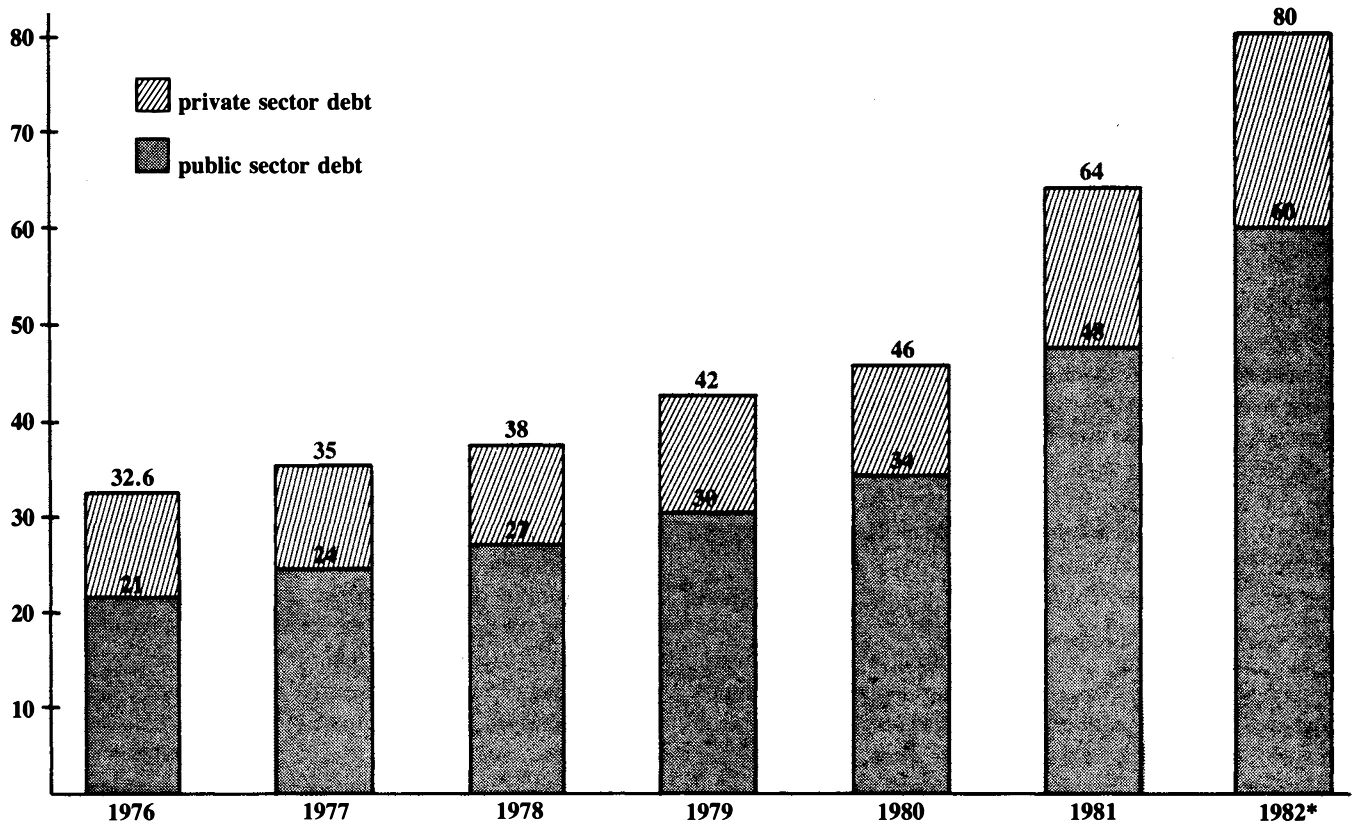
How the International Monetary Fund's debt trap was sprung against Mexico

by Timothy Rush

You would have to be a hermit in Alaska not to have heard or read that Mexico brought its current financial crisis on itself. "Mexico mismanaged its oil wealth," intone the major media of the United States, Britain, and much of continental Europe. "It attempted unrealistic growth goals and built a welfare state laced with corruption. Now it is paying the price: the largest foreign debt in the developing sector, over $80 billion, and inflation close to 100 percent per year."

To understand the viciousness of these lies, imagine U.S. Fed chief Paul Volcker approaching an industrialist whose newly expanded factory has just been foreclosed due to sky high interest rates and declining demand, or a homeowner out on the street after losing a job and not meeting his mortgage payments. "Buddy, you mismanaged your personal finances," says Volcker, flicking some ashes from his cigar in the victim's face. "Now you have to pay the piper." Mexico's

Figure 1:
Growth of Mexican foreign debt, 1976-82



Sources: Bank of Mexico; *EIR* estimates

* Jan.-Aug. estimate

problem was not that it grew too fast. In fact, *it did not grow fast enough* in those critical areas that define a "take-off" toward advanced industrial capabilities, such as those of Japan and West Germany, and the formerly industrialized United States.

Mexico did make some serious mistakes as it attempted to invest its oil wealth after 1977. It leaned too much on "import substitution," the policy of developing its consumer goods-producing sector, instead of concentrating on developing capital goods and heavy industry to the maximum. Compare the 1977-1981 cumulative investment in the oil sector (including petrochemical) of $27 billion, against the $3.8 billion invested in capital goods production, either completed 1977-1981, or to be completed 1981-1985.

However, going into 1982, Mexico presented an economic picture that put the United States and most other developed countries to shame in basic categories of increase in tangible goods production, fixed investment, and new job creation. Overall, Mexico GDP growth was 8.1 percent, manufacturing slightly higher. Over the 1977-1981 period, as López Portillo justly noted with pride in his Sept. 1 *Informe* (State of the Union address), this growth rate was 60 percent higher than the world average and 100 percent higher than that of the developed sector. The 1981 rate was eight times the world average.

Fixed capital investment in 1981 rose 15.1 percent, surpassing 1980's level of 14.9 percent. Purchases of domestically produced capital goods rose 14.2 percent on the year, as against 10.3 percent in 1980. Purchases of machinery and equipment from abroad increased 25.8 percent, as against 30.4 percent in 1980. Investment in capital-goods production increased 21.4 percent, and imports of capital goods for the production of capital goods soared 92.7 percent. For the third straight year, job creation surpassed 800,000 new jobs—approximately 40 percent more than the number of new entrants into the job market.

The debt balloon is blown up

How then did Mexico get $80 billion into hock and the Mexican peso lose two-thirds of its value "overnight" in the first eight months of this year?

The answer is twofold: first, much of the debt is fictitious in real productive terms, and second, the peso was destroyed through politically motivated flight capital operations.

From 1976, when the combined public and private foreign debt stood at roughly $30 billion, until the end of 1980, when it had risen to a combined total of some $46 billion, the debt situation was under control (Figure 1). The average new indebtedness of $3-$4 billion per year corresponded in large measure to increased imports for expanding production at home. Because of the high overall economic growth of 8 percent per year, and the surge in oil exports, foreign debt was *shrinking* relative to other measures of the economy, such as GDP.

It was in 1981 that the debt suddenly exploded. From a total $46 billion, it shot up to $64 billion, a leap of almost 40 percent, in one year. In 1982 it kept rising at the same dizzying pace, clearing $80 billion before Mexico imposed a de facto debt moratorium in late August.

Figure 2

Mexico's foreign exchange accounts

(in billions of dollars)

	1980	1981
Current account	−6.8	−11.7
Exports	15.3	19.4
Imports	18.5	23.1
Foreign financial payments	5.9	8.9
a) remittances of profits	0.5	0.7
b) interest/public debt	4.0	5.5
c) other interest	1.5	2.7
Capital account	9.8	18.2
Long-term (net)	6.5	14.1
Short-term	3.3	4.1
Errors and omissions	−2.0	−5.5

When all sub-categories in the current account are redistributed into "goods" and "services," the figures show:

	1980	1981	Percentage change
Total deficit	−6.8	−11.7	73.1
Goods	−4.1	−4.8	16.7
Services	−2.6	−6.9	161.3
a) financial	−5.0	−7.6	53.5
b) financial*	+2.3	+0.7	−69.3

*Includes tourism, border transactions, gold and silver, etc.

Did Mexico go on a buying spree, as the conventional press characterizations imply? Not at all. The 1981 Bank of Mexico figures (Figure 2) show a devastating picture of a healthy economy torn to shreds by international monetary and economic warfare. Mexico was hit by a triple whammy of 1) the direct effects of Volcker's interest rates, 2) the indirect effects of Volcker's policies, in depressing Mexico's oil markets, and 3) an unprecedented flight of capital orchestrated by partisans of Volcker's usurious world order inside Mexico, the money streaming out to the tune of $22 billion for speculative windfalls in the United States and Switzerland.

In Figure 2, taken from the 1981 Bank of Mexico annual report, three things emerge clearly:

1) The trade deficit increased a moderate 15 percent, rising to $3.7 billion from $3.2 billion. As a percentage of total trade, it declined. If the minimum $5 billion, that Mexico lost due to a mid-year cut-off of its oil contracts and pressures on its prices, is calculated in, Mexico would have had a trade surplus.

2) The ballooning in the current-account deficit was pri-

Figure 3
Mexican foreign trade
(billions of dollars)

	1981 (Jan.-July)	1982 (Jan.-July)	Difference
Imports	14.4	10.2	4.2
Exports	11.4	11.1	0.3
Balance	−3.0	+0.9	

Source: Mexican Ministry of Programming and the Budget (SPP)

marily due to a huge 161 percent increase in the deficit on services. The largest single item here was the leap of $3.0 billion in interest-rate payments, over an already inflated $5.9 billion level in 1980, the first full year of worldwide Volcker usury. For comparison, 1978 interest payments on public and private debt were $2.6 billion.

3) "Errors and omissions" is where the flight capital shows up, $5.5 billion of it in 1981.

Add to this picture the fact that international banks were willing to cover Mexico's resulting deficit only with short-term money, at least $10 billion of it in the last six months of 1981, all of it coming due at various points in 1982. Again for comparison, total public short-term debt as of the end of 1980 was $1.5 billion.

As Mexico went into 1982, its foreign debt had been turned from an instrument for industrial growth to a cancerous condition in which all new debt was going into debt service on the old. In fact, as 1982 proceeded and imports were slashed to conform to an austerity program (see Figure 3), the balance-of-trade figures turned *positive*. The additional $16 billion run up on the total debt in the first 8 months was pure financial bubble, the largest part of it interest charges that were being built back into the debt through rollovers.

Flight capital and inflation

During the same short period, the peso was devalued twice, losing 70 percent of its value before being stabilized by the President Sept. 1. No one disputes that flight capital played the decisive role in forcing through these devaluations. But many say this was a "natural response" to inflation which was "out of control." The facts prove otherwise.

Inflation in 1980 was approximately 30 percent. In 1981, despite official figures juggled to make it look like there had been a one point decline, there was in fact a small increase. Labor and business put it roughly at 34 percent. Built into the situation were artificially depressed prices for such basic items as gasoline. Long-deferred increases in gasoline and bottled gas were finally put through in late December 1981, leading to a 5 percent increase in inflation in January 1982—some two points higher than the monthly average for the year before. There was undeniably an inflationary tendency within the economy, which seemed headed for a yearly rate of perhaps 40 percent.

These rates of inflation, however, do not provoke an outflow of several tens of billions of dollars of flight capital, especially when domestic interest rates are well above the differential between internal and external rates of interest.

The government's strategy to deal with the inflation problem was to "produce its way out." This was one of the major reasons for the government's decision to resort to masses of new short-term debt in the second half of 1981, when world economic conditions began to close in: large numbers of productive investments were close to coming on stream, with significant depressive effects on inflation.

The flight of capital from the country represented precisely the margin of investible surplus which could have maintained this anti-inflation strategy, without resorting to levels of foreign indebtedness as high as the last period of 1981.

As *EIR* has previously documented, the decision to "pull the plug" on the peso was taken by oligarchic banking interests, largely in Europe in January 1982, and communicated to complicit Mexican circles at the Atalaya '82 Banamex conference in Guadalajara, among other channels. The result was the 40 percent devaluation of Feb. 17. This was the event which pushed inflation immediately into the 60 percent per year range. Gloating over this success, the same speculative, oligarchic interests then used the surge in inflation to justify even more flight capital, and by the end of August the situation was precisely the "vicious circle" of "capital flight, devaluation, inflation, more capital flight" which López Portillo denounced in his State of the Union address. The preliminary figures of the 1980-1982 flight capital spree, considered conservative by many knowledgeable analysts are: $14 billion in foreign bank accounts, $8.5 billion in payments on U.S. real estate, another $20 billion imminently due in further real estate payments, and $12 billion in domestic dollar accounts, effectively out of government reach until the August dollar freeze. More details are expected shortly, as a mission of Mexican investigators returns from examination of bank and other records in Los Angeles, Houston, New York, and elsewhere.

The fruits of the unrestrained flight capital are bitter indeed. The "free market" rate for the peso at the height of the madness soared well over 100 pesos to the dollar, up from 27 to the dollar before the February devaluation. At the new, stabilized, preferential rate of 50 to the dollar and general rate of 70 to the dollar, the peso is still one of the world's most undervalued currencies in terms of real economic potential. Inflation, according to the latest economic figures from the Bank of Mexico, was running at 54.3 percent for the first 8 months of the year. August inflation alone was 11.2 percent, due to extraordinary rises in basic food items and gasoline. If the remaining four months of the year keep to the average of the first eight months, inflation for the year will be a minimum of 80 percent—fully double the worst-case projection before the flight capital operation leaped into high gear "due to the inflation."

Two strategies

There are two ways to look at a situation in which foreign debt is manifestly out of proportion to the immediate repayment capabilities of the underlying productive economy. The International Monetary Fund and rentier banking circles call for maintaining the debt at the expense of the real economy. The Mexican government, after a period of acquiescence to an "IMF without the IMF" program, is now fighting for the contrary policy: keep production going and freeze the debt.

Mexico could not have waited much longer before deciding to stand and fight. The standard banker line is that Mexico made only half-hearted efforts at austerity in the first half of the year and now has to really take the plunge. The truth is that the Mexican economy has already gone through a hideous depressive shock. Any IMF program of the traditional variety now would create a virtually irreversible collapse, with grave economic and security implications for the United States.

As early as mid-May, after just two months of government austerity programs, Finance Minister Silva Herzog announced that growth rates would be zero percent for the April 1982 to April 1983 period. The possibility is strong that Mexico will in fact face zero growth for the 1982 calendar year—negative growth in the second half counterbalancing the positive 5 percent growth of the first quarter, a carry-forward from 1981's dynamism.

The sharpest index of the austerity is the foreign trade account (see Figure 3). Over the January-July period, imports were down 29 percent, $4.2 billion in absolute terms. The programmed reduction in imports announced in an April 20 austerity package was 25 percent, or $6 billion shaved from 1981's $24 billion. As of the first seven months of the year, this draconian goal was being met ahead of schedule.

With this tremendous deceleration of the economy, unemployment is now cutting deeply into skilled layers of the work force as well as masses of the unskilled. Total figures are unavailable, but the picture can be pieced together from scattered reports. In late July, the state-owned truck and bus manufacturer, DINA, announced a one-third cutback in production and similar levels of layoffs. In late August GM

A lever which could restart the U.S. economy

Seventy cents of every dollar of lending or other income to Mexico that Mexico puts to productive use—mainly in high-technology imports—rather than for debt payment, comes back to the United States as its share of those orders. That is the principle of how a healthy Mexican economy helps restore the health of the U.S. economy.

In 1981, this arrangement meant $18 billion in orders for the United States. For the previous three years, growth in this market averaged over 30 percent per year. With debt moratorium, return of flight capital, and a dose of new, long-term credit, Mexico could rapidly resume that rate of growth in imports.

This is good news for U.S. factory owners, and for U.S. farmers looking for a reopening of a Mexican market now shut off. It is good news for the banks, too, who would find their domestic loans suddenly moving off the "sour" list and back into the "performing" category.

What is the U.S.A. now losing due to the bankers' policy of chopping up Mexico's productive economy in order to pay the debt? In first-approximation, it is roughly $4 billion, the two-thirds U.S. share of the $6 billion in imports Mexico is axing this year. Of course, if Mexico's economy were healthy, it's foreign orders would quickly surpass last year's $24 billion in imports. The U.S. is losing even more because a number of U.S. firms, hit by the U.S. depression, have been relying on direct exports to Mexico or remittances of new investment in Mexico to offset losses elsewhere. The loss of the Mexican "margin" can mean the collapse of the firm as a whole.

Among the hardest hit industries:

- *Oil equipment, centered in Texas.* As of March 1982, the Pemex purchasing office in Houston, the largest in the world outside Mexico, had cut orders 50 percent. A June Pemex announcement of six cancelled petrochemical plants translated into $66 million in cuts of previously contracted equipment and services.
- *Nuclear.* The contract for Mexico's next nuclear plants, cancelled in early June, could have meant some $2 billion in orders for any of the three U.S. companies included among the seven bidders, General Electric, Westinghouse, and Combustion Engineering.
- *Auto.* Mexico imports over $2 billion in auto parts per year from the U.S.A. Typical of the casualties here: the VAM company in Mexico, which had been importing 120 jeep components units every week from an Ohio-based supplier. Zero imports are planned for the rest of the year.
- *Agribusiness.* U.S. farmers who had cashed in during the bonanza years of 1979-1981, when Mexican imports soared to 8 million tons of grain a year, are eagerly looking for reopened markets. Black bean producers in Nebraska report prices per hundredweight are half what they were two years ago before the shrinking of the Mexican market. Good crops have been a major factor cutting U.S. sales—but as 1982 has progressed, it's been increasingly Mexico's financial pinch.

announced a two-month shutdown of its Ramos Arizpe plant in Coahuila, idling 1,200. The same week GM's Mexico City plant laid off 1,500. In the construction industry, where several hundred thousand unskilled laborers were released early on, the unemployment is now affecting skilled layers. In August, it was revealed that ICA, the largest construction firm in the country, was planning lay-offs of 7,500 construction workers, executives, and engineers. Some one-third of Alfa's 49,000 workforce, including large numbers of white-collar workers, are looking for work. Pemex laid off 4,000 temporary workers in late June.

Perhaps most serious is the erosion of investment in the special development projects in the country which represent the foundation for a return to growth in the future:

- In June the entirety of the next stage of the nuclear program was scrapped. Existing nuclear construction at Laguna Verde has slowed to a crawl.
- In mid-June Pemex announced 18-month delays for completing petrochemical plants at two of the four giant industrial-port complexes being built by the government, Altamira and Laguna del Ostion. Alfa has already pulled out of its commitments to build a steel mill at Altamira. A refinery at the third of the ports, Lazaro Cardenas, is indefinitely postponed.
- Two extensions of the Mexico City subway are postponed, electrification of the trunk rail lines suspended after a first trial program was completed.

Mexico's three-phase program

Mexico is now proceeding with a three-phase program to reverse this process of collapse. So far it is a program too intelligent for any banker to publicly embrace.

First, Mexico is moving toward instituting a debt moratorium. It has arranged a suspension of payments on the principal component of its foreign debt until December and is reportedly seeking an extension until the end of 1983. Since early August, it has also de facto declared a moratorium on interest payments, though it continues to pledge an early resumption of payment.

Mexico's second tactic, as outlined by President López Portillo on Sept. 1, is to get the flight capital back home. He called on U.S. officials and congressmen to meet with his government to get that money back to Mexico, or to work out some other equivalent "recycling" mechanism.

Thirdly, Mexico has lowered internal interest rates and is directing credit to priority productive use.

If you put these measures together, the Mexican "nightmare" vanishes, as one would expect for an economy with Mexico's fundamental economic health. With a moratorium, virtually 100 percent of Mexico's balance of payments deficit vanishes. "Operation repatriation," even if only half successful, brings $16 billion back into productive use within Mexico. And the tightened internal dirigistic system makes sure these funds go where they are needed and not back into speculation. Mexico becomes a growth economy once again.

López Portillo tells the our healthy symbiosis

What follows is the text, in unofficial translation, of the speech by Mexican President Jose Jópez Portillo at third annual meeting of Border State Governors, Tijuana, Sept. 19, 1982.

Our border region is suffering problems which did not begin in it. Therefore, many of the questions have to be solved outside the border area; but most require the good will and understanding of good neighbors, of millions of human beings who have already learned to live together in this most interesting symbiosis which is the Mexico-U.S. border, a phenomenon unique in the world, and of which Tijuana is perhaps the most representative example. It has more crossings than any other border in the world. Therefore, it is vital that we understand what the problem is. . . . .

What's going on in Mexico? Why are we in this situation? I am going to give you enough facts and numbers to show you.

When I began my presidential term, Mexico also was in a crisis, although not as severe as this one. We solved that one largely by means of the oil boom. Giving priority to oil was one of the main planks of my administration; and we turned ourselves from an oil importer into the fourth largest exporter in the world.

Based on oil, we advanced our economy so that for three years running we achieved growth rates over 8 percent. During these years, we have been able to support ourselves with a system of development financing. But, 1981 arrived; and, the two blades of the scissors cut off our development: on the one hand, raw materials prices fell in a way they hadn't for countless years, harming all the developing countries. The price of oil fell and the price of money rose as never before in the civilized history of man.

In 1981, the combined effects of the drop in oil and raw materials prices with the increases in interest rate cost Mexico $10 billion. This took place while we were in the midst of crucial programs which we cannot interrupt. . . .We made reasonable budget reductions; but it was not enough. We already had a $10 billion income shortfall, which poisoned our development financing. We therefore were forced to stretch things out to be able to find reasonable answers. But, if that had been the whole of it, the Mexican economy would have known how to handle it.

border governors: can be restored

The consequences of capital flight

What we couldn't handle was the attack on our peso, an attack which came from within the country from the rich Mexicans themselves. They didn't act in solidarity with the country which had made them rich. Using the country's freedoms, they abused them. They abused an absolute freedom of exchange which permitted them to protect their personal security. I have stressed that they did nothing to violate the law, but everything to violate national solidarity.

No country could withstand such a capital flight. Betting against the peso became the best business there was. It had no risk; and it was certain such speculation would be profitable. Our entire struggle to bring in foreign exchange slipped away from us in what I call true economic drama.

We need dollars to buy outside what we lack inside and to pay our debts. But, for every dollar which came into Mexico, a dollar left through speculative flight.

The time came when we almost ran out of exchange, due to the world economic disorder and due to the lack of solidarity of our citizens, we were left without marbles. We can't play any more. That is my country's problem. It is a liquidity problem, a financing problem. Those of the numbers of what we faced before Sept. 1.

We have made unprecedented efforts to adjust public expenditures, to end our deficit, to adjust our balance of payments, to increase our exports. But we have been left without any chips. That was the moment in which we had to accept one of the severest challenges which a country can face: to enforce exchange controls face-to-face with the owner of all the dollars in the world.

With 3,000 kilometers of borders, with millions of human beings who trade goods and services over that border, people who during their entire lifetimes have been accustomed to taking from the two economies the best conditions, we had to take back the banking services to make the exchange controls work, to reorder our economy and to increase its potential.

How Mexico's private banks failed

Mexican banking is a public service which originally belonged to the state, but was given on concession to private entities. But the private banks stopped serving their social function, and the state took back one of its elemental functions. That's where we are, my friends.

I want to give you, honorable North American governors, an exact measure of our reality, to get out of the U.S.'s mind the idea that we are going to you for aid that it is going to cost the U.S. Taxpayers, to get rid of the idea that Mexico is a beggar country which is asking the U.S. taxpayer to solve its problem.

We are coming to negotiate with the United States because you are our top client and also our top creditor. It is up to the United States to determine how effective the negotiations to solve Mexico's temporary liquidity shortage will be.

We have to understand that if we need dollars, it is to pay debts and to buy things in the United States, to understand that health means a reciprocal flow of interests; that an economy cannot be imbalanced to the extreme degree that the Mexican has been, because when such an imbalance occurs, the relation becomes diseased, and the disease is good for no one.

The Mexican economy is healthy

Mexico wants to recover its economic health, as never before in its history, its industrial base remains intact, twice as big as it was in 1977. Immense oil potentials are still in the pipeline; but, if our liquidity problems are not solved soon, we will not be able to pay debts nor buy things in the United States, and, I ask, is it anybody's good that we push the thing to that extreme?

That is why it is important for me to talk with you, honorable governors of North America, to give you the scope of our problem. The resources with which Mexico could solve its liquidity problems are in the United States, but belong to Mexicans.

I invite you to study together the possibilities of setting up some system linking our economies. . . . to restore that symbiosis which was so splendid in the past. That was one of the most interesting borders in the world, in many respects prosperous and exemplary. It has diseased us; and this is not good for either side.

Those, my friends, are the facts, without rhetoric nor reproach. A dry example of North-South relations.

I know that the solution is no longer in the border, and no longer in the United States. I know that the whole world is involved, and precisely for that reason Mexico convoked the Cancun meeting: so that before the things which now have happened to Mexico would happen, it would be proposed that the only forum man has ever created to solve the problems of man, would deal with them; to understand that only global solutions could provide solutions to the representive case of Mexico, a country which was emerging, which was taking off, and which it is in humanity's interest that its development problems be solved, but which, abruptly, had its potential cut by a scissors.

The world has the next word. Thank you.