

South of the Bailout

The \$20 Billion Rescue Plan Won't Help the Mexican People

By Christopher Whalen

THE DECISION by the Clinton administration to make \$20 billion available to Mexico has convinced many in Washington that the peso crisis of 1995 is resolved. The Mexican currency has fallen over 40 percent since Dec. 21 and almost 50 percent since a year ago. Yet while the U.S.-led aid package will help reassure international investors, this unprecedented public guarantee for existing private offshore debts may have little effect on the brutal economic contraction now underway south of the Rio Grande.

Mexico's problem is not that it lacks the immediate cash to pay its debts, but that it has too much debt to begin with.

"This loan package does not solve our problems," warns Javier Livas, a respected Mexican commentator and conservative political leader. "This new debt just adds to our problems. Mexicans and domestic companies are drowning in a sea of bad debts."

The rescue package—totaling about \$50 billion, including contributions from other central banks and the International Monetary Fund—is, of course, directly helpful to U.S. investors and members of the Mexican business and political elite who hold short-term domestic debt. But the deal gives little aid or comfort to off-shore exporters, im-

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porters and other portfolio investors who have hard currency (dollar) claims against Mexican debtors. For example, Mexican public and private companies have issued tens of billions of dollars in Eurobonds that are not included in the Clinton deal.

Moreover, the proposed aid package will have scant effect on the deteriorating financial environment inside the Mexican banking system. Thousands of farmers, businesses and consumers in Mexico are defaulting on commercial loans, home mortgages and credit card debts. Despite the euphoria following Clinton's Jan. 31 announcement, growing numbers of credit analysts acknowledge that many Mexican commercial banks and finance companies are insolvent because of defaults on loans by Mexican citizens.

Mexico's foreign debt burden makes it difficult if not impossible to provide credit to businesses and consumers in Mexico. For example, prior to the peso devaluation on Dec. 21, annual interest rates on business loans in Mexico were in the 30 to 40 percent range. Annual interest rates charged on credit cards in Mexico were as high as 70 percent.

Today, even higher domestic rates of interest on peso loans make repayment impossible and are compelling literally millions of Mexicans to demand debt relief or even outright forgiveness. As in the case of another Latin debtor, Venezuela, the ridiculously high cost of credit threatens not only Mexican banks but finance companies, leasing firms and foreign exchange dealers.

These already insolvent Mexican financial institutions, in turn, have billions of dollars in credit lines, derivatives transactions and oth-

er types of obligations to big New York banks and investment houses—an approaching financial disaster that neither the Clinton White House nor the Treasury has fully recognized. While the largest New York banks and brokers tell investors that they are not directly exposed to the meltdown of the Mexican miracle, in fact the risks now threatening some U.S. financial institutions are larger than in 1982.

Austerity measures, adopted by President Ernesto Zedillo's government to meet the demands of the International Monetary Fund and foreign creditors, are actually accelerating the implosion of the Mexican economy. Falling purchasing power and real wages, in turn, are eroding demand for consumer products, domestic and imported automobiles and even basic necessities such as milk and other foodstuffs.

For the past five years, Mexico's ability to buy U.S. products has been a house of cards precariously funded by debt and short-term investment. If maintaining Mexico as a market for U.S. goods and services is one of Washington's chief objectives in responding to the peso crisis, the measures announced by President Clinton are woefully inadequate. Rather than increasing Mexico's foreign debt burden to prop up the bloated peso, the United States would be better served by forgiving Mexican government debts owed the U.S. and encouraging other foreign governments to do the same. In the past, the U.S. has regularly forgiven the debts of Great Britain and other countries, including most recently \$10 billion to Egypt. If real long-term help for Mexico is

the goal, the U.S. must also encourage the Mexican government to reform its tax system and end wage and price controls.

The White House claims that simply by restoring investor confidence in the peso, the United States will avoid a larger and far more costly commitment in the future. Indeed, it is said that the money made available to Mexico will not actually have to be used, once the immediate liquidity crisis is passed.

But even if a large percentage of foreign investors choose to keep their money in Mexico as a result of the rescue package, the Zedillo government still must obtain tens of billions of dollars in additional funds to service the country's more than \$166 billion in total foreign debt. Indeed, the Mexican oil revenues that Clinton says will provide security on U.S. loans are already used to service the country's \$83 billion public-sector debt. In reality, there is no free collateral available for new U.S. loans to Mexico.

Should scores of threatened private banks and commercial firms inside Mexico fail, the resulting financial black hole would dwarf the \$50 billion rescue package now being pieced together. Losses from private loan defaults and other credit problems could even exceed half of total loan portfolios or the current peso equivalent of \$100 billion to \$150 billion in the next six to 12 months.

Members of the Clinton administration and Congress must understand that approval of the aid package implies continued and increased U.S. financial support for Mexico that could cost the U.S. Treasury many times more than the \$20 billion now on the table. One immediate cost is likely to be higher U.S. interest rates should investors in Europe and Asia sell dollars for fear that Washington intends to bail out Mexico—as well as financially troubled Canada—by printing money.

"We now have a blended peso-dollar yield curve," a senior Fed official told me last

week. "The bailout for Mexico amounts to a *de facto* currency union between the dollar and peso. There has been no discussion about this monumental decision, no debate in Congress. The Canadian dollar might as well be added too. For the past 12 years, successive leaders within the Fed and Treasury have worked hard to keep Mexico's debt problems at arm's length. Now Treasury Secretary Robert Rubin and his deputy, Lawrence Summers, are throwing in the towel and surrendering U.S. monetary policy to the Mexicans and the banks.

Foreign investors understand all too well that the aid deal essentially signals Washington's capitulation to Mexican financial profligacy. Even with lower numbers for the U.S. budget deficit, the dollar remains on the defensive in world financial markets. As in the case of Mexico, the U.S. economy's prospects for growth are reduced by our own massive public debt burden.

The Clinton administration has come under justifiable criticism for papering over Mexico's difficulties until they erupted in the market-shaking peso devaluation. But it has also received justifiable praise for acting decisively when congressional intransigence and confusion threatened to exacerbate Mexico's liquidity crunch.

It would be a shame now if failure to acknowledge the continuing threats to the Mexican economy—particularly its unmanageable debt burden—led ultimately to another financial and political crisis that could severely harm both the U.S. and Mexico.

Rather than trying to force Mexico to keep making debt payments it can't afford, the U.S. should simply wipe the slate clean, forgive Mexico's public sector obligations, and tell the Zedillo government to cut its own deal with the many private creditors to whom it owes money.