

Mexico's Government Creates Another Debt Crisis

Mexico seems to be many conservatives' darling this season. Securities and Exchange Commission Chairman Richard C. Breeden sang Mexico's praises last week at a conference looking at models for economic reform in Eastern Europe. This newspaper printed an editorial Feb. 12 that argued Mexico has seen economic success because it has stood up to the IMF. But there is a problem here: Mexico's economy is far from the healthy animal its current fans would have us believe.

It's worth reviewing a few facts about Mexico's economy. Oil exports, once a minor factor, grew rapidly as a share of the

Counterpoint

By Christopher Whalen

economy in the 1970s. Today oil exports are shrinking in volume but still subsidize what remains a state-controlled economy. The situation creates what the Peruvian author Mario Vargas Llosa calls "the perfect dictatorship"—the luxury of dependence on imported food, consumer products and even rising quantities of refined petroleum products and natural gas.

Reading editorial pages like the Journal's, you get the feeling Mexico is breaking with the IMF. The facts don't bear that out. The Mexican debt crisis 75 years ago, the more recent 1982 debt default, and Mexico's situation today share one thing: dependence on foreign credit. It is true that through the mid-1980s Mexico was a client of the IMF. It then gradually became more dependent on the World Bank, both for funding and advice. The important thing, though, is that much of the World Bank "project-financing" is the functional equivalent of IMF balance-of-payments money. That is to say, this "project-financing" funds imports rather than income-producing investment.

Since 1988, Mexico has borrowed and sold equity equaling more than \$20 billion, raising funds from private sources, the World Bank, IMF and export finance agencies, again raising its total foreign debt well above \$100 billion and easily negating savings from the abortive "debt reduction" scheme engineered by Treasury Secretary Nicholas Brady.

Mexico's stock market is flying high. Commercial banks, which were badly burned in 1982, gladly place shares with small investors, all the while lauding Mexico's "economic miracle." Yet when it comes to making new loans, big banks in London, Tokyo and New York are conspicuously absent from the feast, in part because they know that "net" energy exports from oil-rich Mexico are expected to decline.

"We underwrite Mexican paper and sell it to retail investors," one senior banker in London told this writer last September. "But our parent forbids us to lend to Mexican companies without full collateral. We cannot even keep the bonds we underwrite on our books beyond month end."

The political impetus to restore Mexico access to foreign credit followed the fraud-tainted 1988 presidential election. Carlos Salinas de Gortari apparently lost to nationalist leader Cuauhtemoc Cardenas, threatening the rule of the U.S.-backed ruling party, known as the PRI. Mr. Salinas ignored the unfavorable election result and took office, and since then has focused on winning the hearts of foreign investors—his true constituents. Opposition leader Porfirio Munoz Ledo recently suggested that Mr. Salinas change his party's Spanish initials to PFMI—translated, the "Party of the International Monetary Fund."

Bridge loans from the Federal Reserve and Treasury, the Brady Plan, and now the prospect of free trade, have since 1988 carried Mexico along on a wave of borrowed money and artificial optimism. The

\$20 billion in Mexican dollar reserves illustrates the dramatic change in investor sentiment engineered by Washington, as naive investors rush to purchase once risky Mexican stocks and bonds at premium prices. And yet in both political and economic terms, Mexico's current "stability" is far more delicate than Washington or Wall Street will freely admit.

Just as a dying commercial bank or thrift uses hot, brokered money to stay afloat, the Salinas economic program is essentially a Ponzi, or pyramid, scheme, requiring Mexico to raise ever larger amounts of cash from abroad. Mexico's trade balance (excluding bond factories or maquiladoras) fell from an \$8.4 billion surplus in 1987 to a \$5 billion deficit in 1990. In 1991, the trade deficit was \$11.18 billion, or 170% above the preceding year.

More than two-thirds of "capital inflows" to Mexico are short-term investments in peso stocks and bonds, which are attracted by high current yields and a peso that in real, inflation-adjusted terms exceeds 1987 levels. The day of the abortive coup against Gorbachev, \$300 million of hot money flowed out of Mexico, twice the stock market's daily turnover, illustrating the country's vulnerability to shifting investor perception.

Dollars raised from loans, bond and equity sales, and direct investment, are generally spent to pay for imports of food and other consumables, not on creating productive, export-oriented industries. Moreover, while available cash has been drawn into the speculative frenzy in domestic financial markets, an overvalued currency, brutal internal tax and fiscal policies, and triple-digit phone and utility rate increases are choking Mexico's tiny private sector. Even with the "privatization" of hundreds of companies, less than one-quarter of total employment comes from private concerns, and the proportion of private to governmental control diminishes the farther south of the border you go.

By seeking to attract dollars rather than export goods, the Mexican economy is headed for a repeat of the 1982 "crisis." When financial inflows no longer cover rising debt-service costs and surging imports, a currency devaluation is inevitable, particularly if you remember that Mexico's seemingly impressive dollar reserves cover less than five months worth of imports, a lower "cover" ratio than in 1981.

The logic behind the current Mexican policy is the same debt-driven nonsense that allowed President Jose Lopez Portillo (1976-82) to rationalize a six-year, \$80 billion debt and spending binge, culminating in a sudden currency depreciation and the seizure of private banks. Some liberal economists believe private foreign borrowing is permissible to finance current consumption, but few routinely condone using "capital inflows" to finance imports—the economic equivalent of eating the seed corn. With a free-floating currency and a healthy trade surplus, Chile is a far better model for developing countries than Mexico or its profligate U.S. sponsor. Ironically, the great threat to Mexico's fragile stability now comes from Washington.

Mr. Salinas's political fate is tied to the peso, and he will say and do almost anything before enduring the humiliation of a devaluation. (President Portillo swore to defend the peso "like a dog" and today is greeted in public with mimicked sounds of barking.) But when the Mexican investment pyramid collapses under its own weight, Mr. Salinas's political credibility with his inflation-weary citizens will disappear, a new generation of foreign investors will discover cross-border financial risk, and Washington's man in Mexico City will learn that thralldom to foreign money has two sides.

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