# MEXICO'S ECONOMIC CATASTROPHE: AN INNOCENT VICTIM OF THE GLOBAL CRISIS OR A HOMEGROWN AFFAIR?

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# MEXICO'S ECONOMIC CATASTROPHE: AN INNOCENT VICTIM OF THE GLOBAL CRISIS OR A HOMEGROWN AFFAIR?

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## INTRODUCTION

A hypothesis frequently stated by the Mexican economic orthodoxy, the mass media and the country's authorities, is that Mexico is an innocent victim of the global economic/financial crisis. After stating that there was no imminent crisis in the wake of the first "heart attack" of the global financial system, and later that Mexico may only catch "the sniffles" as the crisis began to unfold after the collapse of Bear Stearns, those responsible for the country's economic policies have now been forced to accept the gravity of the global financial/economic crisis. However, by diagnosing the crisis as a short term phenomenon and exogenous to the country's economy, these authorities have justified actions that are deepening an already dramatic decline in the country's economic fortunes. As Mexico approaches the historically charged year of 2010, which marks the $200^{th}$ anniversary of the beginning of the country's war for independence and the $100^{th}$ anniversary of the start of the Mexican revolution, increasing unemployment, poverty and social divisions will further add to growing political instability in the country.

The goal of this article is twofold. On the one hand, we seek to establish a correct diagnosis of the Mexican crisis. Much to the contrary of the conventional wisdom that Mexico is an innocent victim of the crisis, we contend that the current crisis more accurately represents the failures of Washington Consensus policies, continuously applied in Mexico for almost 30 years, a best in Latin America. On the other hand, based on this diagnosis, we establish why the anti-cyclical policies have not only been inadequate for confronting the current crisis, but have actually substantially weakened the country's economy.

The paper is divided in several sections. First, we discuss the general nature of the crisis facing Mexico, which is further developed in the following section, which examines the evolution of Latin American economic structures, with particular emphasis given to the changes in the composition of financial systems under Washington Consensus policies. Later, several elements of the international economic and financial system during the era of financial globalization will be analyzed, with particular emphasis given to the role played by foreign owned banks and the changing structures of large Latin American companies. After considering these larger contexts, the article moves on to focus on Mexico's case in particular. Special emphasis is given to shifts in the country's financial system and the dominance of foreign owned banks as one of the principle cause of the nation's current economic crisis. The highly pro-cyclical official response to the crisis is also analyzed. Finally, we conclude with several considerations regarding Mexico's immediate future, including several pitfalls of foreign bank dominance during moments of high economic uncertainty.

## ENDOGENOUS OR EXOGENOUS CRISIS?

At face value, the argument that much of the developing world, and Mexico in particular, is an innocent victim of the global crisis is a seductive one. The financial crisis did indeed begin in the shadow banking system of the USA, as did it subsequently reverberate throughout the world. Yet it is also true that some countries have maintained economic structures that are were highly dependent on, and vulnerable to, the conditions of worldwide trade and finance. In Latin America, all major economies have suffered from severe shocks as a result of their reliance on foreign capital during the last few decades. This phenomenon has now presented itself in Mexico in the eighties, nineties, and ought years, each time with devastating results. During the era of financial globalization, financial crises have been a prevalent factor throughout the developing world. With the dangers of a strong reliance on foreign capital well known for years, can a government claim to be a innocent victim when such reliance provokes a crisis? If a person plays with a bee and gets stung, can that person blame the bee? This question will be addressed throughout the text.

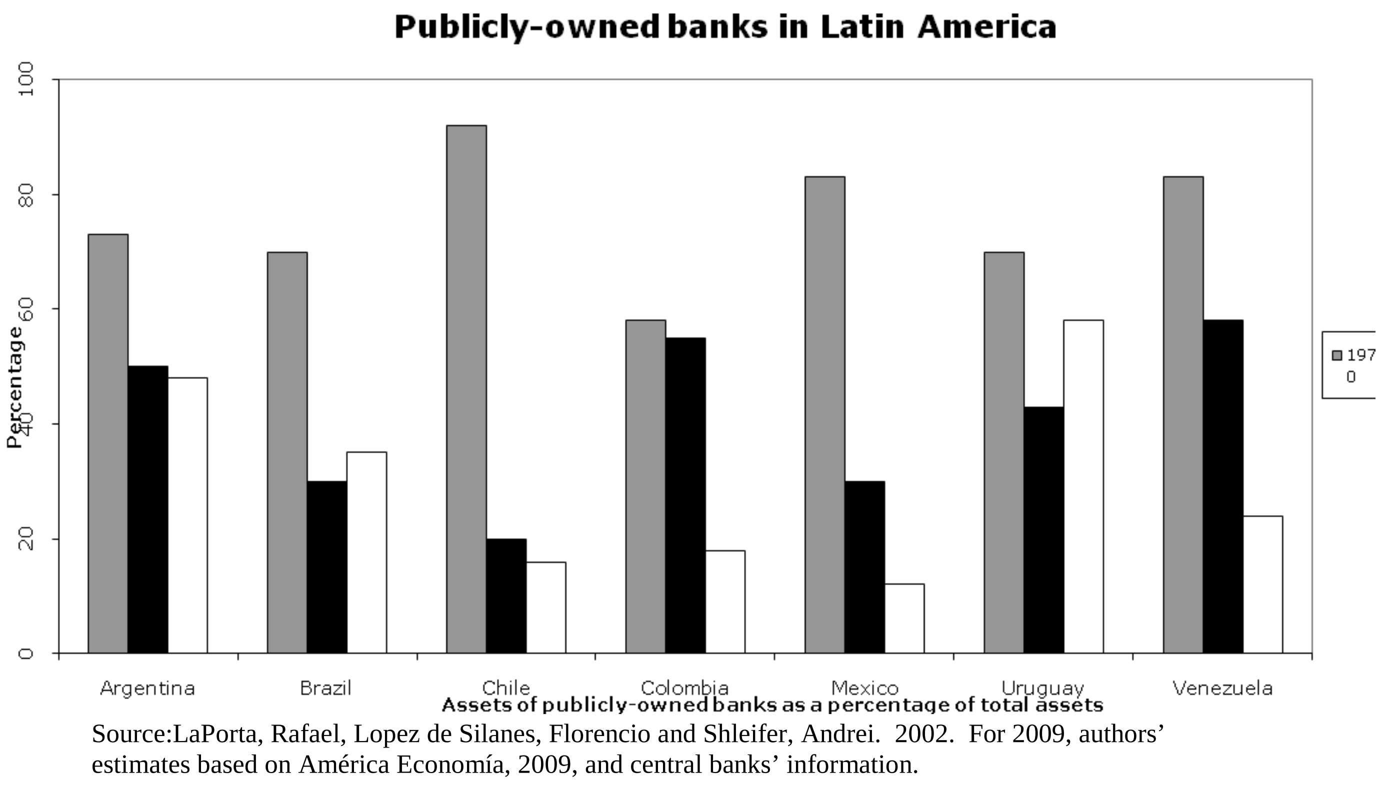
As stated, our hypothesis is that the current crisis in Mexico represents the limits of the neoliberal economic model, which is based on policies of export led growth, trade and financial opening, external financing and a reduced role of the state in economic activities, all under conditions of financial domination. A fundamental part of this economic model, which has been implemented in differing degrees in the majority of developing countries, is the systemic replacement of publicly owned banks by foreign owned ones, a tendency that has led to a shift in the structures of domestic and foreign indebtedness in developing countries.

Although this phenomenon is present in a large part of the developing world, there are indeed diverse experiences and countries that stray from the model. In the context of Latin America, in recent years Argentina has been a leader in the region in regards to the recovery of its economic sovereignty in terms of monetary, fiscal and credit policies. Other South American countries have made significant advances towards determining their own economic trajectory. Mexico represents an opposite extreme. Due in large part to the drastic changes in the composition of the country's financial system over the last decades, the global financial/economic crisis has affected Mexico with particular force, rendering the sustainability of the country's economic model highly uncertain in the near term.

## THE FINANCIAL STRUCTURE OF THE EXPORT LED GROWTH MODEL

Washington Consensus policies, established and maintained by US banks and international financial institutions such as the International Monetary Fund (IMF), with the backing of significant segments of Latin American business and banking groups, led to fundamental changes in the economic structures of the region. The most striking result of approximately three decades of structural reforms has been the loss of economic sovereignty in a large part of the region. The "independence" of central banks in the majority of the countries of the region highlights the distancing of monetary policy from the needs of national economies. At the same time, the commitment to eliminate fiscal deficits, particularly in times of crisis, represents a total abdication of fiscal policy and the elimination of the role of public spending as a guarantor of private sector profits in all of the countries of the region. Furthermore, the transformation of financial systems dominated by publicly owned banks into systems characterized by the systemic presence of foreign owned banks excludes any possibility of a coherent national credit policy. Given the serious limitations in the development of bank credit in national currencies, double monetary circuits arise in which large companies finance themselves in international markets and in foreign currencies.

**FIGURE 1**




Source:LaPorta, Rafael, Lopez de Silanes, Florencio and Shleifer, Andrei. 2002. For 2009, authors' estimates based on América Economía, 2009, and central banks' information.

The slow yet steady loss of the publicly owned banks has been a constant in the last decades in Latin America, as can been seen in Figure 1. In Mexico, the development bank Nacional Financiera, which was one of the principle driving forces behind the

"Mexican miracle", was relegated to second tier functions as part of the financial reforms implemented at the end of the eighties. In Argentina, the national development bank was shuttered in the mid nineties, and its system of publicly owned provincial banks was privatized in large part as a result of the banking crisis of 1995. Yet the Argentine publicly owned banks proved to be the most anti-cyclical agents of the financial system during the country's banking crisis of 2001- 2002. The same is true in the case of Uruguay during its 2002 crisis. Within Latin America, the largest national publicly owned bank remains is in Brazil, even though several large public banks at the state level have been privatized. The Banco Nacional de Desenvolvimiento Económico e Social and the Banco do Brasil still play fundamental roles in Brazil, one of the few countries in Latin America not to have suffered a significant banking crisis in recent decades.

The results of Washington Consensus policies on financial structures in Latin American have been clear. On the one hand, trade and financial opening have offered hefty profits for the expansive transnational corporations (TNCs) in the region, particularly in strategic sectors that were previously dominated by national states, such as hydrocarbon exploitation, the generation and distribution of electric energy, telephony, commercial banking, airports, ports, railroads and infrastructure in general. On the other hand, during this period of trade and financial opening, there has been an overwhelming and undeniable trend towards recurrent financial crises, stagnant economic growth, declines in salaries, falling formal employment with high and growing levels of underemployment and informal employment in the region.

On a more specific level, the participation and/or dominance of TNCs in non-financial sectors of the economy has not met its principal promise of greater levels of investment, nor has the greatly increased presence of international banks fulfilled its principle promises of increased savings and greater access to affordable and steady financing in the region. In the non-financial sector, combined public and private investment in infrastructure barely reaches 3 percent of GDP in the region, a level far inferior to that of the 1980s. Infrastructure investments have proven to be vastly insufficient to attend to the region's growth. A recently published study by the World Bank clearly states that for the region to maintain competitiveness with respect to East Asia and other regions, investment in infrastructure investment would have to double. According to the study, in order to lift Latin America and the Caribbean to the level of coverage of South Korea in a lapse of 20 years or to simply maintain the pace of China, infrastructure investments in the order of 4% to 6% of GDP would be necessary (Fay & Morrison, 2005), a far cry from present levels of investment in the region.[1]

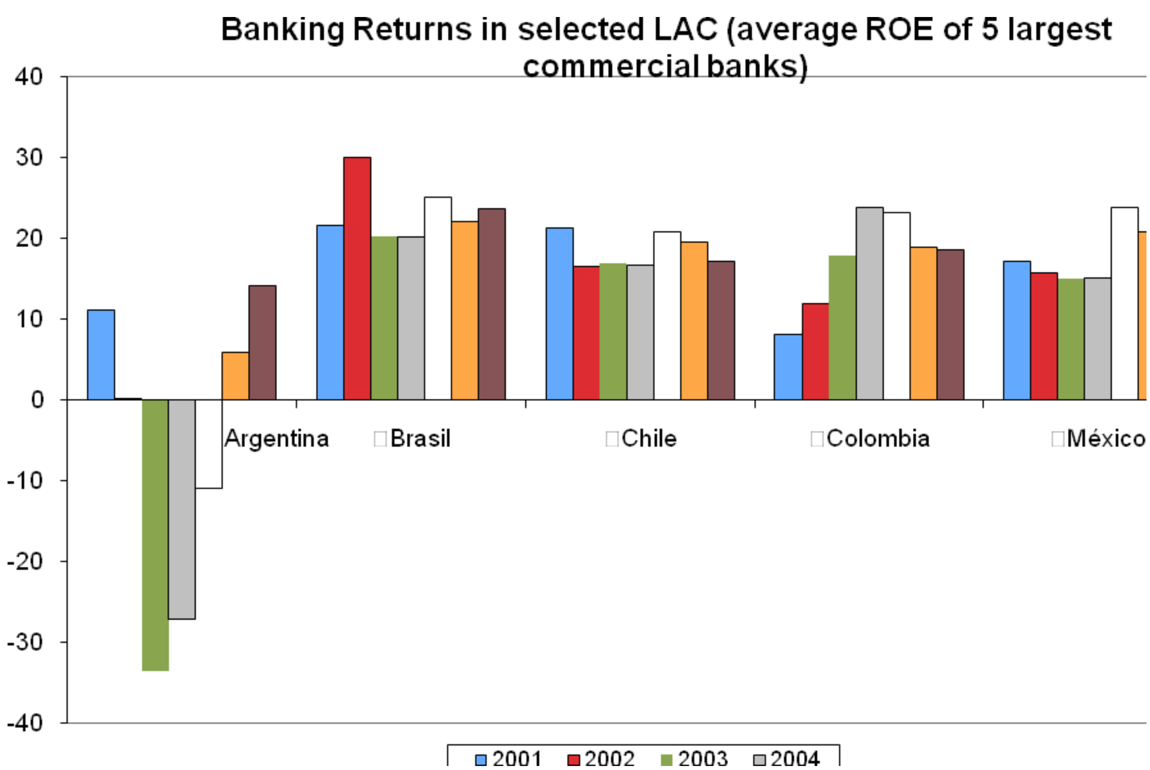
Far from the stated goals and predicted outcome of the widespread participation of TNCs in non-financial sectors, the most relevant results of TNC participation in the region has been growing capital flight in the form or repatriated earnings, intra-firm transactions, payments of royalties, interest, assets sales, etc. The coefficient of investment has not

[1] In 1980, the coverage of productive infrastructure – roads, electricity and telecomunicatios was greater in Latin America and the Caribbean than in South Korea and Southeast Asia. Today the region not only has a far smaller coverage than in these countries, but also in low and medium income countries such as China (Fay & Morrison, 2005).

risen, as the lion's share of the resources that enter the region have gone towards the acquisition of existing assets. The impact of FDI on the levels of investment is therefore very reduced (Vidal, 2001; 2005).

The opening of regional economies to foreign financial conglomerates has led to similar results. Savings rates have fallen throughout the region (Williamson y Kucynsky 2003), while bank financing has continuously fallen. During the 1990s, when global banks began their strongest push into the region, bank financing to the non-financial private sector in the region's three largest economies, Argentina, Brazil, and Mexico, averaged 17.7%, 35.6% and 23%, respectively. During the first seven years of the 2000s, these levels had dropped to 14.8%, 29.7% and 15.5%. At the same time, as can be seen in Figure 2, the banking systems of the largest Latin American countries have offered very favorable returns.

**FIGURE 2**




Source: America Economia Review.

### THE GLOBAL CONSOLIDATION OF THE ECONOMIC CYCLE

However, while the largest TNCs and financial conglomerates were conquering greater space in Latin America and other regions, the same firms and the economies of their home countries were also experiencing profound internal changes, as explored by

Guttmann (2009). The financialization of the US economy implied the hollowing out of companies with worldwide coverage such as Citigroup, General Electric and General Motors. At the same time, the financial globalization led by the US generated growing disequilibria en this country. As stated by D'Arista, the displacement of a large part of the country's productive activity to other countries, hand in hand with the growing indebtedness of the US household, created an unsustainable economic situation for the country (D'Arista 2005), even considering the enormous benefits that controlling the world's hegemonic currency and possessing the deepest and widest financial system in the world grants the US.

Before its collapse, the era of financial/economic globalization had arrived at a fairly clear division between the economic functions of the US and the rest of the world. This relationship, denominated by some as the Bretton Woods II system, signifies that the US consumes what the world produces, and that the savings or financial resources of the world are placed in financial assets denominated in dollars. By being the financial center of the world and by holding the hegemonic currency, the US finds itself in the position of being able to issue financial assets or promissory notes (dollars) for its purchases, while the rest of the world has to produce in order to consume. To buy a product made in China or Mexico, a dollar only has to be printed in the US, while in China or Mexico something must be produced to obtain the dollars necessary for the purchase. However, once the Chinese or Mexican product is sold, neither of those countries uses the dollars in their internal markets for fear of monetary punishment, particularly inflation. For this reason, surplus producing countries sterilize a large part of their capital inflows through the purchase of US dollar-based financial assets. Therefore, dollars printed in the US are exported to the world through the US's current account deficit and later return to the country via the country's capital account (Liu, 2002).

After years of implacable advances by the productive and financial interests of a relatively small number of TNCs based in an even more reduced number of countries[2], an important integration with national economies throughout the world was achieved. For a variety of reasons, some Latin American countries have tied themselves more to the fortunes of these firms and their home country's economies, manifested through the handing over of strategic economic sectors, the expansion of export sectors and increased financial dependency on the US. And it is precisely the countries that have most integrated themselves into this economic model, either in terms of their productive structures (China, Japan, Germany and Mexico) or in terms of their financial systems (Iceland, the UK, Mexico, and Ireland),that have been the most affected by the current crisis. At the same time, other countries maintained a greater degree of economic sovereignty, or in some cases even recovered what they had ceded in terms of economic self-sufficiency. In Latin America, the case of Argentina is particularly noteworthy.

As such, the hypothesis that countries whose economies were structured to export their production to the US, to transform their economic surpluses into dollar based assets, or to pump financial resources out of their country through foreign banks, are innocent victims

[2] According to the United Nations, 73% of the hundred largest TNCS are bsaed out of the US, the UK, Japan, France and Germany (UNCTAD, 2008).

of the crisis is not valid. In Mexico, the decisions made by the economic groups who have commanded the nation's capital accumulation for years have increasingly strained the domestic economy, while at the same time increasing dependency on foreign actors. As such, even though the crisis did first appear in the US, in Mexico it has come to reflect the economic model's limitations.

## THE FINANCIALIZATION OF LATIN AMERICAN TNCS

The form in which financial groups and corporations' financial gains have been constituted is at the center of the origin and development of the crisis, in the US as well as in Europe and Latin America. Finance dominated capitalism, constituting a regime of accumulation dominated by finance, has advanced for years. This classification does not refer only to the transfer of wealth through new forms of finance, such as derivative markets, which are fed by the treasuries of many TNCs, as well as investment funds, banks, and investment banks, when these still existed; it also refers to the merger and acquisitions that have predominated over investments made to increase or create new productive capacities. This point has been previously made, both to characterize FDI and its growth in recent years, as well as to explain privatization processes (Vidal, 2002; Vidal, 2008; and, Vidal, 2009). Finance dominated capitalism, among other aspects, also relates to the ability of corporations to finance themselves through sales of stock, treasury operations, the issuance of debt and various forms of securitization.

In an economy in which many large corporations are self-funding, the importance of shareholders and foreign investment funds grow, as does the financialization of the management of the firm (Plihon, 2003). Corporations have modified the composition of their shareholders, with a growing influence of investment funds and other financial companies. As Guttmann highlights in his characterization of finance led capitalism "the rapid growth of these so-called institutional investors over the last quarter of a century has turned them into the principal shareholders of large firms across the globe. They often use their ownership rights to impose a financial logic rooted in quarterly per-share earnings as defining measure of performance" (Guttmann, 2009: 22). The directors of firms often employ aggressive management of treasuries, including the issuing of debt in multiple types of paper, the monetization of assets, inventories, future sales, and as Serfati emphasizes, even intangible assets (Serfati, 2009). By merger and acquisition growth, assets can be rationalized and used as a base to generate new income.

Financialization has evolved within corporations in the US, Europe, Asia and Latin America, as a means to increase profits. Mexican-based corporations that have obeyed this logic include Cemex, Televisa, Gruma, Vitro, Grupo Alfa, Modelo, Comercial Mexicana; of Brazilian-based corporations, Vale, Votorantim, Gerdau, Sadia and Odebrecht also fall into this group. Other large corporations based in Argentina, Chile and other Latin American countries could be added to the list, as well as several state-owned enterprises in the region. Maintaining the profitability of these companies and their capacity to meet debt obligations in foreign currency has for years represented a constant and significant problem for countries in the region.

Yet with the onset of the crisis, the withdrawal investment funds' positions and the contraction of several financial markets has created a strong credit rationing toward large Latin-American corporations that finance themselves in external markets. This fundamental element of the crisis arises from the dynamic of profit formation within large corporations based in Latin America. The need for foreign currencies increases with the operations of TNCs, investment funds, pension funds, and hedge funds in the region. It is in this context that the diverse relationships between Latin American countries and other countries and regions of the world, as well as the differences between the composition of financial systems, become particularly relevant.

## FOREIGN-OWNED BANKS AND THE FALLACY OF THE IMPORTATION OF THE GLOBAL CRISIS.

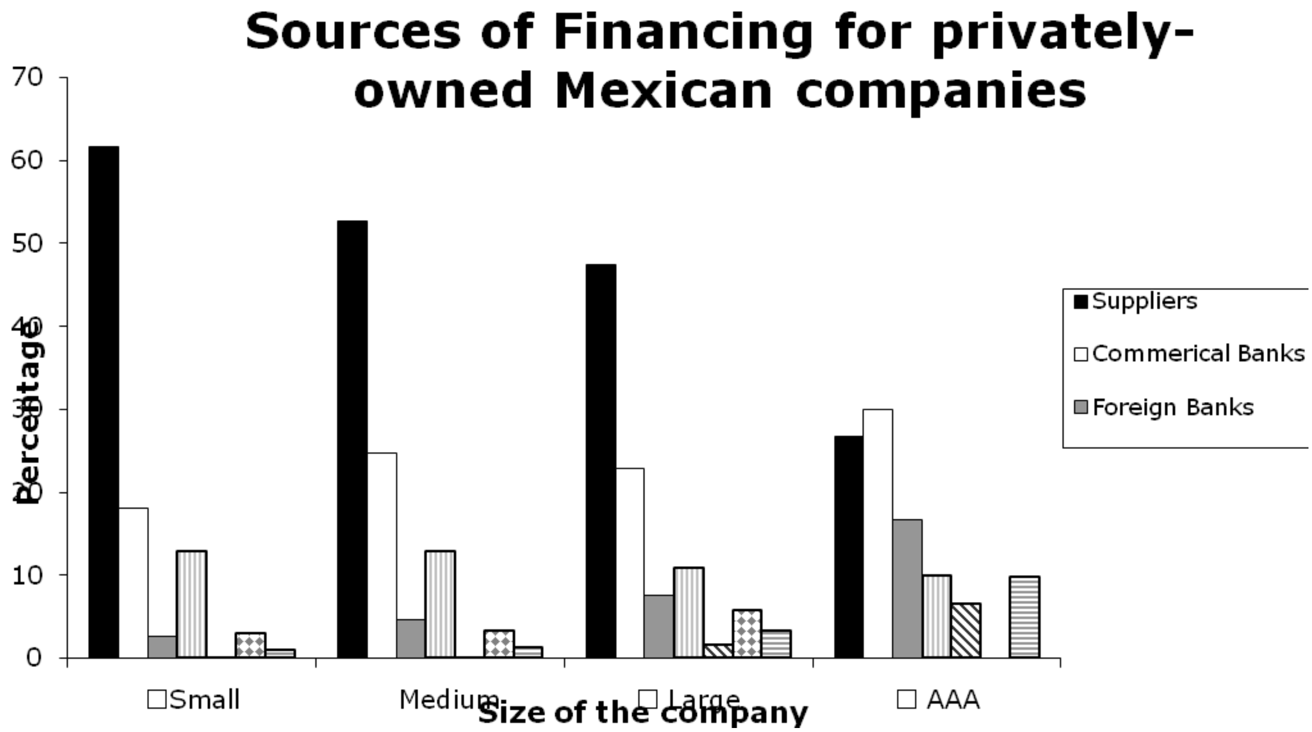
Mexico's entrusting of its economic destiny to the ebbs and flows of its neighbor to the north has always been a risky strategy. While the US economy was in expansion, the dismantling of the Mexican domestic economy eliminated any possibility of sustained growth and more plentiful and better paid employment. As much as the US economy may have continued growing, neither the relinquishing of the national system of payments to foreign actors, nor the growing dependence on crude oil exports and the remittances of workers expelled to the US, nor the dependency on the US market, both for imports and exports, would have offered greater economic gains for Mexico. However, the negative effects of the gradual hollowing out of the Mexican economy are minimal in comparison to the economic losses, particularly in employment, that the collapse of the US economy has caused, and will continue to cause in Mexico, which is highly dependent on its neighbor in areas as basic as its supply of food, credit, and employment (both directly and indirectly).

From the mid nineties to the early aught years, large global financial consortiums have made strong inroads in Latin America. While many hailed the possible benefits of the widespread participation of the foreign owned banks, even the greatest defenders of their activity, such as the IMF, have warned on the possibility of importing a financial crisis through foreign owned banks (IMF, 2007:114). According to the IMF, if there is a financial crisis in the home country of an international bank, foreign branches or subsidiaries could be affected. If one international bank has foreign entities of sufficient size, or if a number of international banks all enter into crisis in their home countries, a financial crisis could arise in a country that would otherwise not have experienced one.

The loss of the national banking system in Mexico has led to the development of the crisis in two general ways: the first takes a similar form to the IMF's warning, while the transmission of the other arises from the external debts of Mexican companies. In both cases, Mexico offers an important cautionary tale for other countries of the region. With more than 80% of the banking system in foreign hands (as measured by assets) the country's banking system is more internationalized than that of any other large economy.

During the years of the foreign owned banks' domination, all Mexican firms have suffered a notable credit rationing.

**FIGURE 3**




Source: Banco de México, 2009a

As can be in Figure 3, in the months that immediately preceded the global financial shock of the bankruptcy of Lehman Brothers in September of 2008, the financing of all sizes of national firms was highly dependent on suppliers, while the commercial banks operating in the country provided a relatively small amount of credit. However, there is a notable difference between the financing of small and medium enterprises (SMEs) and that of the largest companies. As figure 3 shows, the larger the firm, the lower the participation of suppliers and the greater the financing from commercial banks operating in the country, banks operating outside the country, capital markets (under the header of other liabilities), and from development banks.

Therefore, unlike the vast majority of national firms, the largest companies have the option of financing themselves in international and national financial markets, through the issuing of stocks bonds and other credit contracts. In recent years, these forms of financing have been less expensive and more accessible than credit from national banks, for two reasons in particular. On the one hand, foreign owned banks operating in the country haven't increased levels of credit to national firms since the crisis of 1994-1995.

In fact, in the fourth quarter of 1994, Mexican banks allotted 19.66% of GDP to commercial and industrial activities, while in the fourth quarter of 2008, this figure had shrunk to 8.93% of GDP (CNBV, 1994, 2008). Furthermore, due to the fact that international banks operating in Mexico in many cases charged higher interest rates than their own headquarters in foreign companies, many large companies opted to finance activities directly through headquarter banks.

On the other hand, during this period of financial asset price inflation, international interest rates were at historically low levels. As such, there was a correlation of forces that favored a growing external indebtedness amongst the largest Mexican firms. The combination of the rationing of credit to all Mexican firms and the lower interest rates offered by external sources of credit led to a structural change in the financing of the large national firms. Another fundamental change in this aspect has been the incursion by several of the largest national corporations into the derivatives market as a part of the general strategy to increase earnings through financial speculation, a substantive aspect of the accumulation of capital under financial dominance, as previously stated.

The collapse of the business model centered around structured finance and the fall of several of the largest global banks confirmed the fact that financial globalization always had its limits, while at the same time the protection that industrialized countries have granted to their national companies has deflated the myth of a separation between the state and firm that the promoters of globalization had defended for decades (Guillen, 2007). European and North American countries have been able to channel large quantities of resources towards their national companies through fiscal deficits for many years. During the current crisis, these deficits have grown in dramatic fashion. For example, the projected fiscal deficit for the US and the UK in 2009 is close to 12% of GDP, while the number for Mexico, Brazil and Argentina is closer to 3%, 1.5% and les than1%, respectively (FT, 2009). Although the design of the US bank rescue is condemned to failure (Marshall, 2009), it is important to recognize that industrialized countries at least have the opportunity to try to rescue their companies. On the other hand, large Mexican companies may soon be lost at sea.

## RESTRICTIVE INTERNAL POLICIES AND EXTERNAL OVER INDEBTEDNESS

In the face of a deep and prolonged crisis, the response of the Mexican authorities is reminiscent of that taken by their argentine counterparts in the years leading to the country's banking crisis of 2001-2002, the punctuating moment of the country's years long economic collapse. In both cases, national authorities attempted to ward off the collapse of Washington Consensus economic models by consolidating fiscal balances. However, in moments of increasing economic strain, such policies are highly pro-cyclical, and are incapable of meeting their core objective of servicing external debt obligations.

In the case of Mexico, a clear dynamic is emerging in which the government is cutting spending and increasing taxes, while at the same time subsidizing the external positions of large private sector companies and drastically reducing the capacities of state-owned companies. While the policies are incoherent as an anti-cyclical strategy, they are perfectly consistent with the Washington Consensus model that favors the financial interests of international banks and a small national elite over all other considerations. In the case of Mexico, these interests determine the desire to privatize the few remaining sectors of the economy in which the state still maintains a strong presence, particularly the energy sector.

The protection of the national elite has manifested itself in direct and indirect forms. The most direct form has been the bailout of large privately owned firms by state owned banks. On the one hand, the central bank (Banco de México) spent more than 30 billion dollars between October of 2008 and October of 2009, representing around a third of the international reserves at the beginning of this period (Banco de México, 2009b), in large part to guarantee the payment of these companies' debts. On the other hand, state-run banks Nafin and Bancomext also extended a credit line of 50 billion dollars to guarantee external debt payments of eight of Mexico's largest privately owned companies (El Economista, 2009). Companies such as Cemex, Vitro, Comercial Mexicana, Gruma, and Soriana (among others) have benefited from these programs.

As mentioned, large national companies maintained credit lines with the headquarters of international banks. Yet in the wake of the bankruptcy of Lehman Brothers, credit lines were cut and maturing debts were not rolled over. In addition, many large companies also held large derivative positions with international banks. Due to the approximately 30% devaluation caused in large part by the very actions of the Banco de México to bailout large domestic firms and their international creditors, bets on the stability of the Peso quickly soured. While affecting many companies, Comercial Mexicana's situation quickly arose as the most dire, with the company (Wal-Mart's main competitor in Mexico) facing imminent bankruptcy had it not been bailed out by the government.

With the easing of the international financial crisis from March through the end of 2009, such measures have allowed many of Mexico's largest companies to renegotiate debts and maintain themselves in operation. If another sharp correction occurs in international markets, it is unlikely that Mexico will be able to bail out its largest companies another time. Under the next most likely possibility that international credit markets muddle along for years on a slowly downwards trend, the debt taken on to bail out privately held companies may well come to represent a tipping point for the Mexican economy, as the debt will be compensated for by decreased fiscal spending and higher taxes, which will lead to further economic contraction and therefore higher debt premiums. Such a downward spiral was clearly witnessed in Argentina.

In the face of a protracted and deep crisis, the true beneficiaries of the bailout will be international creditors, not the large Mexican companies, and much less the overall Mexican economy. Although granted a temporary reprieve, large Mexican companies are still far from guaranteed stable financing from abroad, and domestic credit is still largely unavailable. In the initial moments of the crisis, the bailing out of these companies has directly led to a notable increase in foreign debt, a significant devaluation of the peso, the disappearance of approximately a third of the country's foreign exchange reserves, and the extension of 47 billion credit line from the IMF, in addition to an emergency 30 billion dollar Fed credit swap granted in the weeks following the Lehman Brothers bankruptcy.

### MEXICO'S PUBLIC FINANCE POLICIES IN THE CRISIS: MORE TAXES, LESS EXPENDITURE AND PRIVATIZATIONS

Instead of initiating changes in the structure of public and private sector debts in response to the drastic changes in global finance, authorities have placed all of their chips on a one-time guarantee of private sector external debt. The money spent on this bet could have been invested in new refineries to diminish the country's dependence on imported gasoline, or to capitalize a strong public bank that could finance the future of large and small Mexican companies.

Yet, as mentioned, this bet by the authorities does not only carry opportunity costs. In an attempt to guarantee the servicing of foreign private debt, the government is cutting spending on infrastructure projects, education, health, poverty alleviation and a range of other activities, all of which are already being felt in the national economy. In addition, an across the board consumer tax hike has recently been approved, while key energy prices, determined in large part by the government, have continued to rise throughout the crisis. Yet this fiscal consolidation has been undertaken with a simultaneous protection and advancement of the country's most powerful economic actors, at a great cost to the overall economy.

Mexico has traditionally had among the lowest fiscal pressures in Latin America. In 2008, Brazil maintained a fiscal pressure of 26.7%, close to European standards, while the regional average was 17%. In 2008, fiscal pressure in Mexico was 8.1%, far below that of many Central American and Caribbean countries (ECLAC, 2009). This figure is due in large part to the fact that the country's largest companies contribute less than 2% of their earnings to taxation according to recent statements by the Undersecretary of the Treasury, Alejandro Werner (La Jornada, 2009). While a value added tax has been in place for years, and the small middle class currently shoulders around half of the county's tax burden. Unless large businesses pay more taxes, it will be difficult for fiscal revenues to balance out greater levels of external debt.

The dynamic of unbalanced tax receipts and pro-cyclical fiscal policy has been relatively commonplace throughout Latin America in times of crisis. Yet in Mexico's, case, this pro-cyclical dynamic is also coupled with the Mexican government's desire to privatize the country's energy sector, which has led to extremely pro-cyclical action on behalf of the national government. The most dramatic example of such behavior was the shuttering of the state owned electricity company Luz y Fuerza by federal military police on October 10th, directly eliminating approximately 44,000 jobs, yet opening a large electrical grid to voice, video and data transmission for private exploitation.

The constant bleeding of resources from the state owned petroleum monopoly, Petroleos Mexicanos (Pemex), offers a parallel situation. Years of scant investment, elevated

external indebtedness, “endoprivatization” (Vicher, 2009), and overexploitation of oil fields has left Pemex in a highly weakened state, with crude production falling precipitously, even as energy prices enjoy a limited rebound. The decision to overexploit proven reserves while simultaneously starving the company of funds to invest towards greater refinery and exploration capacities, represents a conscious effort by successive governments to discredit the viability of the company as a condition for its privatization. Once again, the desire to privatize Pemex runs completely contrary to the interests of the national economy as a whole, as the company provides approximately 60% of all government revenue. Yet unlike other oil exporting nations, the largess of the past oil boom has not been put to any apparent good use in Mexico. While the government’s dependence on oil revenues has distorted Mexico’s tributary system, no significant domestic investments have been made, the rainy day oil surplus fund has been largely spent, the largest oil fields have been overexploited, and a lack of investment in Pemex means that company can no longer meet the country’s refinery needs. Mexico now imports approximately a third of refined gasoline, weakening the country’s trade balance and foregoing opportunities for domestic employment and profit in petroleum transformation processes.
At the same time, it is noteworthy that Pemex cannot find competitive financing in the Mexican internal market. Estimated as being the eleventh largest integrated *company* in the world (Pemex, 2008), Pemex, like its peers in the private sector, has financed itself in foreign markets for the same reasons already mentioned. It has also entered heavily into derivatives markets, with mixed results. As a public entity, public finances explicitly guarantee the external debt of Pemex, which has the relative certainty of being rescued by the government if need be. But on the other hand, the external financial position of the government could be drastically weakened if a more tenuous debt situation arises in relation to Pemex.

The external over indebtedness of the public sector was one of the principle factors behind the crises of 1982 and 1994-1995. Even though private external debt has flashed the first warning signs during the current crisis, the situation of the external public debt is also highly worrying. Public internal debt was at 313.7 billion dollars in September of 2009, while in the same month the external public debt was just over 91 billion dollars (SHCP, 2009a). Total net federal public sector debt as a percentage of GDP has grown by 75% from December 2007 to September 2009 (SHCPb). However, it is worth noting that the due to financial innovation and the pervasiveness of derivatives, the line between external and internal debt has blurred considerably. Meanwhile, the total liabilities of the *Proyectos de Impacto Diferido en el Gasto*[3] (PIDIREGAS, for its initials in Spanish) in relation to Pemex, rose to 43.5 billion dollars by the end of 2008 (SHCP, 2009c)[4]. In a continually complicated international context, a repetition of past Mexican public finance crises continues to be a strong possibility.

[3] The OECD translation for this term is ‘”investment projects with a deferred impact on the budget.”
[4] Under the Energy Reform bill of 2008, Pemex’s Pidiregas debts were incorporated into the federal public debt. As a consequence, the latter figure has risen, and Pidiregas debt was last officially reported in the 4th quarter of 2008. According to this law, Pemex´s annual investment was removed from the calculations of public debt.

However, the current and growing crisis in public finances marks an important difference between past crises, in which external financial indebtedness financed some form of economic expansion. The large-scale investments in the oil sector during the mid and late seventies and the speculative boom at the beginning of the nineties represented strategic bets by the governments in turn that soured and resulted in crises. The current public and private external over-indebtedness do not stem from any type of growth strategy (as poorly planned as they may be) for the national economy. On the contrary, it represents a complete lack of economic strategy and the total abdication of internal credit policies. Even though certain national companies have without a doubt been able to expand their international operations, the national economy has experienced an economic cycle of stagnation followed by collapse, as opposed to a more traditional cycle of boom and bust.

However, as stated, in these initial moments of the crisis, private external debt, which in the second half of 2008 reached approximately 67 billion dollars (SHCP, 2009d), has been the weakest link in Mexico's financial structure. However, the unconditional guarantee that the government has offered to the largest private-owned national companies and their foreign creditors has blurred the line between private and public debt. While the guarantees for Pemex are explicit, the recent decisions of the government signal that it is also willing to sacrifice the well being of public finances in order to rescue private enterprises.

## Foreign-owned banks: pro-cyclical agents during moments of financial crisis

As argued, the dominance of foreign owned banks in Mexico opens the possibility of a financial crisis in two ways. The first, already briefly examined, results from the obligation of large public and private companies to seek financing in international markets. The other, which will be analyzed in the following section, relates to the possibility that in moments of crisis, the interests of foreign owned banks can diverge from the interests of a national economy to the point that the interests of foreign own banks can provoke a crisis, or deepen one already in progress in the host country.

The most conventional form for the development of a crisis provoked by foreign owned banks follows the basic schematic of the IMF, already presented, and comes close to the situation that has been playing out with Citibank and its local subsidiary Banamex. In this scenario, there is a banking crisis in the US, created in part by Citibank, whose balances have been greatly weakened. In dire straits, the headquarters adopts a defensive position. On the one hand, national and international credit lines are reduced, while on the other hand, and following the same logic, the headquarters seeks to repatriate as much capital as possible that had previously been spread throughout the world in previous moments of expansion.

For their foreign subsidiaries like Banamex, this dynamic involves a reduction in credit and a rise in the funds repatriated to headquarters. Even though these actions strengthen the financial position of the headquarters, they reduce financing in the host country and decelerate the local economy. But in addition, these operations require foreign currency. In these early moments of the crisis, Mexico has now seen the consequences of both the reduction of credit lines and the repatriation of capital. In addition to the large scale capital outflows seen in Mexico after the collapse of Lehman Brothers, bank credit issued to the Mexican society, starting from a very low point, registered a year on year fall of over 6% as of August of 2009 (SHCP, 2009).

The same banks that today dominate Mexico's financial system, confronting a highly uncertain panorama during the Argentine banking crisis of 2001-2002, protected the interests of their headquarter banks at all costs, abandoning local branches and subsidiaries, completely closing credit lines and increasing earnings through derivative operations in order to repatriate large sums of dollars to their headquarters (Marshall, 2008). Even though a similar behavior has yet to present itself in Mexico, it represents one of the greatest risks to the country's economy in the case of the probable deepening of the financial crisis.

Financial structures take time to change. The transfer of the Mexican banking system to foreign actors has left public and private finances in a state of elevated external vulnerability, precisely in the moment in which the home countries of foreign banks operating in Mexico have entered into a deep and prolonged crisis. As difficult as it will be to modify the external positions of private companies, it will be much more complicated to "mexicanize" the country's banking sector, particularly in moments of crisis when foreign banks control the ever-scarcer supply of dollars. During the Argentine crisis, the foreign banks, backed by the governments of their home countries and also by the World Bank and the IMF, utilized their economic power, increased by the crisis, to close the flow of dollars into the country in an attempt to expand their presence in the local market and to impose the dollar as the national currency. Due in large part to the presence of a strong national publicly owned bank, and in spite of the grave crisis provoked in no small part by the foreign owned banks operating in the country, the Argentine government was able to resist their offensive (Marshall, 2008).
Despite the fact that the country's capability to finance itself in international financial markets was severely restricted, the Argentine government was able to channel growing amounts of credit to the strengthening of the country's publicly owned companies and their SMEs through the publicly owned banks. As such, through the recovery of the country's credit policy, denominated in Argentine pesos, national investment was lifted, the participation of national companies in the domestic economy grew, and the country was able to maintain sustained levels of employment and economic growth uncommon to the region. As can be seen in Figure 1, the age of financial globalization has corresponded to a period in which state-owned banks in Latin America were gradually dismantled, opening spaces for the subsequent entry and domination of international banks. Recent decades have represented a golden age for the largest global financial consortiums, while for Latin American countries, these years have witnessed repeated

financial crises in the context of economic stagnation and falling wages and growing income disparity.

## CONCLUSION

Mexico currently finds itself mired in what appears to be an intractable financial and economic crisis in the coming years. More than any other Latin American country, Mexico has hitched its wagon to the fortunes of the United States in terms of trade and employment, while in financial terms, Mexico has left itself extremely exposed to the volatility of international credit markets and the interests of foreign banks operating in the country. Due to these factors, Mexico has been particularly hard hit by the fist stages of the international crisis. However, the government's response to the crisis, based more on protecting and expanding the positions of a small elite than on protecting employment, have significantly aggravated a crisis that was of its own creation.
The IMF projects a 7.3% contraction in Mexico's economy in 2009, far greater than its peers in Latin America, even despite having grown less than other countries of the region in recent years. As has been noted by organisms such as the World Bank, approximately half of all people thrown into poverty in Latin America as a result of the global crisis are in Mexico (World Bank, 2009). In a country that has suffered from two devastating macroeconomic crises in the last 30 years, in which approximately 60% of the population is considered to live in poverty and 20% in extreme poverty, there is a limit to how much the average citizen will accept further reductions in their standards of living without making substantial political demands on an administration that is alone in the region in its strict adherence to Washington Consensus policies. Protecting and expanding the economic power of the country's small yet extremely wealthy elite at the cost of the rest of society will be a daunting task for the current administration. Yet it is a challenge of its own making.

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