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Financial Crisis with Global Banks

Gregorio Vidal
Universidad Autónoma Metropolitana, México
Wesley Marshall
Facultad de Economía, UNAM
Eugenia Correa [*]
Posgrado de Economía, UNAM

Abstract:
In this presentation, the authors argue that not all developing countries are *innocent victims* of the current global financial-economic crisis. In the case of Latin America, the structural transformations of the last decades have left the region highly exposed to changes in the global economy. In this sense, Mexico offers a noteworthy extreme. While many Latin American countries have made important steps towards greater economic autonomy in recent years, Mexicoøs productive structures are very closely linked with the economy of the United States. At the same time, Mexicoøs financial structures and debt relationships are also closely tied to international financial markets. As one of the most exposed countries to the global crisis, Mexico offers important lessons on the consequences of losing economic sovereignty.

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Introduction

Since late 2008, once the conventional wisdom accepted that the current financial-economic crisis is particularly grave, the hypothesis that its transmission is the principal aspect behind its extension has gained traction. According to this explanation, developing countries are submitted to various processes of crisis conveyance. In its simplest version, frequently disseminated in mass media and defended by more than one government in Latin America, developing countries are *innocent victims* of a crisis that comes from developed countries, principally the United States (US). It would seem, according to this vision, that *emerging markets* import the crisis, or, in its more radical version, that the crisis is transferred to them as a result of several aspects of their relationships and exchanges with the largest economies and specifically the US.

This paper offers a diametrically opposite hypothesis. Specifically, it poses that the current crisis in Latin America, and in Mexico in particular, is demonstrating the limits of the model of trade and financial liberation and global insertion in Latin America. A fundamental aspect of this economic model is the systemic participation of foreign-owned banks in varying degrees in the largest economies in the region. As such, a central goal of this paper is to highlight the role of the foreign-owned global banks and the external debt and the structure of financing under a double monetary circulation. Although this phenomenon is present in a large part of the developing world, different experiences abound and there are countries that have distanced themselves from this model.

In the context of Latin America, in recent years Argentina has distinguished itself as the country that has been most able to recuperate its sovereignty in terms of the presence of the foreign-owned global bank, and in the restructuring of its external debt. Yet this is a country which has only recently emerged from a situation characterized by the widespread presence of foreign-owned banks and the complete dollarization of its monetary circulation by means of a currency board. Other South American countries have made significant advances in their capacities to determine their economic trajectory, as is the case of Ecuador with the renegotiation of its external debt, although the countryøs economy is still dollarized. On the contrary, Mexico represents another extreme, due to the drastic changes in its financial system since the beginning of the nineties. As such, the global economic-financial crisis is effecting Mexico with particular strength, and as a consequence, both the servicing of the countryøs external debt and the operations with foreign actors on the liability side of banksø balances have become a grave financial problem.

The paper is divided in several parts. First, the evolution of the financial structures of Latin American countries are examined, with particular emphasis on the changes in the composition of financial systems in the years of financial globalization. Later, several characteristic elements of the dynamics of the financing process in the region are presented, showing that economic opening and the policies of structural reforms configured a new financial structure characterized by a double monetary circulation, the important role of global banks and institutional investors, and the loss of public expenditure as an important source of financing. Afterwards, the implantation of global

banks in the region is analyzed, along with the differences existing among Latin American countries, particularly in respect to the participation of publicly-owned banks. Finally, the current crisis is examined, highlighting the elements that establish the endogenous character of the crisis in the case of Latin American countries, which is complemented with the analysis of the extreme case of the Mexican financial system, with a high level of foreign-bank participation, very restricted financing of the non-financial private sector, and elevated liabilities with foreign actors among local banks, all of which have left the country more vulnerable to changes in the international environment than other developing countries. Therefore, we attempt to show that a strengthened publicly-owned bank, while not an automatic guarantee, is a fundamental support for monetary sovereignty and credit policies in Latin America.

1. Changes in Latin American financial systems and financial globalization

The processes of financial opening and de-regulation in Latin America began with varying intensity in the 1970s with the rise of external indebtedness to private banks in their push for international expansion. After the 1980s, which witnessed financial crises and high levels of capital transfers out of the region due to debt servicing, the 1990s brought new levels of expansion by external capital both in foreign direct investment, particularly in the acquisition of local publicly and privately owned companies, and in portfolio investments in domestic stock markets, which while small offered high rates of return. These investment flows and the policies of financial opening and de-regulation created new financial structures in the largest economies of the region, a change in the composition of the largest financial and economic agents, and in general, a new modality of financial insertion for the region in the financially globalized world.

The most noteworthy result of almost three decades of structural reforms has been the loss of economic and financial sovereignty in many countries of the region. The central banks autonomy in the majority of the countries in the area underlines the distancing of monetary policy from the necessities of national economies. The commitment to eliminate fiscal deficits and maintain balanced public finances and even budget surpluses, particularly in times of crisis, represents a total abdication of fiscal policy and the role of public spending. Likewise, the transformation of financial systems dominated by publicly-owned banks towards systems characterized by the systemic presence of foreign-owned banks has gradually limited or even eliminated internal monetary and credit policies. Moreover, en the extreme case of Mexico, it has brought about the loss of control over the system of payments.

Beginning with the financial opening and de-regulation of the 1990s, the competitively of the largest private banks in the region came to depend in large measure on the volume, cost and management of their international credit lines and their foreign currency flows. At the same time, both are products of the level of internationalization of their clients, of the stable behavior of inflation and exchange rates, as well as the evaluation of the rating agencies.

The financial sector was also an object of the global competitive pressure that technical modernization and financial innovation also brought, which led to mergers and acquisitions between local banks and the formation of financial consortiums, integrating diverse operations where specialized and regional banks once dominated, especially in

Brazil and in Mexico. In addition, the largest debtor countries suffered the pressure of the second generation structural reforms imposed by the IMF and WB, geared towards rapidly reduce state ownership of financial and banking services, as this type of ownership was considered to promote extra-market and disloyal competition.
The largest banking-sector privatizations were those of Mexico at the beginning of the 1990s, as practically the entirety of the banking system was nationalized as a consequence of the debt crisis of 1982 was sold to owners of investment firms and other local businessmen during 1991-1992. Other noteworthy privatization processes occurred in the fist half of the nineties in Peru, among local investors, and in Colombia, among foreign-based buyers. In the second half of the nineties, there were significant banking sector privatizations in Brazil, Argentina and Venezuela. The first two countries witnessed banking privatizations mostly among local capital, while in the latter case banks were privatized almost exclusively to foreign actors. In Brazil, between 1997 and 2000, seven of the largest banks pertaining to states were privatized, with the largest acquired by BSCH. However, even at the beginning of the present decade, two of the largest banks in Brazil and Argentina are publicly owned banks, as is the largest bank in Panama, Costa Rica and Uruguay and the third largest bank in Chile.
Financial globalization implied enormous, yet variable, competitive pressure on local banks, as their intermediation activities in foreign currencies have depended on the state of liquidity in which the international financial market finds itself, specifically on the volume and costs of the supply of funds from their very competitors. On the other hand, local businessmen and investors steadily increased their demand for financial services in foreign currency and shifted their deposits towards banks located in foreign territories. The processes of dollarization of national economies and the balances of local banks contributed in direct fashion to the increasing fragility and eventual banking crises of several countries, including the largest in the region, Argentina, Brazil and Mexico.
The banks of Latin American countries did not expand their extraterritorial activities at the rate that their economies, ever more open and with a greater presence of foreign companies, demanded of them. They required significant partners-competitors in order to satisfy the demand for financial services to deal with massive flight of local capital, in the form of flows of interest payments and earnings obtained by foreign capital through portfolio or foreign direct investment and also the many and at time stringent commitments created by foreign private and public debt.

In reality, the largest economies of the region do not possess the conditions to create and develop growing sources of foreign currency at the pace demanded by interest rates on external liabilities, the difference between relative prices between imported and exported goods, and repatriated earnings. This competitive pressure, deepened by globalization among banks operating with strong and weak currency has become internalized with the presences of branches and subsidiaries of foreign banks in the nineties, modifying the position and the relative financial capability of local public and privately-owned banks.
On the other hand, the region has witnessed a process of displacement of the publicly-owned bank that has also contributed to the fragility of financial structures. These institutions have lost market share in the economies of the region and their role in the financing of local economies have changed. Since their inception and until the 1980s, this type of bank played an important role in the regionøs financing, playing a

fundamental part in the stability of credit flows and in the financing in foreign currency that industrialization required. However, the activity of publicly-owned banks has declined dramatically, reaching levels seen in Chart 1.

Chart 1

The 100 largest banks in Latin America by assets	
(distribution by ownership, in percent)	
	2008
Publicly-owned banks	24
Foreign-owned banks	33
Locally-owned private bank	43
Source: America Economía, 2008.	

The slow but constant loss of the publicly-owned banks has been a constant in the largest Latin American economies. For example, in Mexico, Nacional Financiera (Nafinsa), the development bank that was one of the principle motors behind the õMexican miracleö, was relegated to functions of the secondary markets as a result of the financial reforms undertaken at the end of the 1980s. In Argentina, the national development bank was closed in the mid 1990s, and its system of provincial publicly-owned banks was in large part privatized, mostly as a result of the banking crisis of 1995. In Latin America, the national publicly-owned bank that has maintained the most weight within its economy is the Brazilian, even though several of the large public banks of some states were privatized. The publicly-owned Banco Nacional de Desenvolvimiento Económico e Social and the Banco do Brasil still play fundamental role in Braziløs economy.
These new conditions facing the financial systems of the region, especially in the largest economies, as will be analyzed after examining the tendencies in financing of the non-financial sectors and the implantation of the global bank in the region is being put to the test with the global economic-financial crisis, underway since 2007.

2. Financing investment and changes in financial structures

In terms of the means and conditions of financing a national economy, a series of limitations occurs when attempting to develop bank credit in national currencies, establishing a combined monetary circuit between national and foreign currencies. In some cases dollarization has been established, as was the case in Argentina during the nineties and in Ecuador and El Salvador currently.

Chart 2

Latin America: Revenues and Interest Paid

Annual Average 1990-2007

Percentage

	1990-2001		2002-2007	
	Revenues/Net Foreign-Direct Investment (a)	Interests Paid/External Debt (b)	Revenues/Net Foreign-Direct Investment (a)	Interests Paid/External Debt (b)
Total	36.6	7.4	69.8	5.5
Argentina	32.9	7.2	117.9	5.6
Brazil	27.8	8.8	100.5	3.0
Mexico	36.3	7.4	47.5	16.2

Source: Authorsø elaboration based on data from CEPAL. Anuario Estadístico, 2007 and 2008.

(a) Revenues paid as a percentage of the annual flows of net foreign direct investment in each country and the total in the region.

(b) Interests paid and accrued annually as a percentage of the accumulated gross external debt paid, in each country and the total in the region.

The growing position of the Transnational Corporation (TNC) in the region, particularly in strategic sectors previously dominated by national states, such as oil production, the generation and distribution of electric energy, telephony, commercial banking, airports, ports, railroads and all type of infrastructure, has led to a financial structure that demands significant flows of financing in foreign currency, principally directed to external payments in the form of repatriated earnings, dividends, interests, etc., as can be seen in Chart 2.

This financial structure has been conditioned by the presence of the global banks in internal markets and by the increased investment institutional investors in local stock markets, particularly in the cases of Mexico and Brazil. A double phenomenon therefore arises. On the one hand, the volume of financing for the non-banking private sector in the domestic market diminishes. On the other hand, private external debts grow rapidly, between the two countries growing from 25 billion dollars in 1990, surpassing 244 billion dollars in 2002 and reaching more than 300 billion dollars in 2008. Even though non-bank financing to the private sector has increased, this fact does not modify the downward tendency of financing for the non-banking private sector, as seen in Chart 3.

Chart 3

Financing to the Non-Financial Private Sector

(as a percentage of GDP)

	Bank Financing		Non-bank Financing	
	1990-1999	2000-2007	1990-1999	2000-2007
Argentina	17.7	14.8	n.s.	0.4
Brazil	35.6	29.7	1.1	1.5
Mexico	23	15.5	0.3	2

Source: World Bank. Financial Structure Dataset, November, 2008

Among the most noteworthy results of the participation of the TNC and global banks in the region has been the growing amount of capital flight. Significant external investments have not modified the tendency of the coefficient of investment, as the largest part of capital formation is financed with internal resources, and as capital entering into national economies is principally destined to the purchase of existing assets. The impact on levels of investment activity has been negative and therefore levels of employment have been as well (Vidal, 2001; Vidal, 2009).
Therefore, while in the nineties the figures regarding so-called external savings reached around 10% of fixed capital formation, at the end of the present decade, net transfers out of the region represent around 10% of gross capital formation (CEPAL, 2008).
The other traditional source of significant financing of investment in Latin America had been public spending, but the region as a whole witnessed the creation of balanced budget laws and the prohibition of financing public deficits through central banks. This, in addition to the substantial increase in the internal debt of governments in the region (due, amongst other causes, to the privatization of social security and the maintenance of extremely high interest rates paid on government bonds), has increased the amount of public expenditures destined to interest rate payments. This figure has averaged 14% in the region in recent years, but in Brazil it is approximately 25% (although Brazil has not imposed a obligatory privatization of social security). In real terms, public expenditure is stagnant in the largest economies of the region and is very jeopardized by the elevated financial costs of public debt.

3. Implantation and expansion of the global banking consortia in the region

Foreign-owned financial consortia have advanced their positions in diverse forms throughout the markets in the largest economies of the region, beginning with the wave of financial bankruptcies in various Latin American countries and the process of worldwide bank consolidation in the latter half of the nineties. In its ascent, the flow of external capital accompanied the peak of international credit and exchange rate overvaluation and, in its descent, accompanied the over-indebtedness of businesses, households and governments and the ruin of banking institutions, opening the possibility for systemic banking crises. In Latin America, interest rates, especially those offered for government debt, have been one of the principle instruments to stabilize exchange rates and the prices of domestic currency. In conditions of financial opening, the lowered availability of capital flows provokes exchange rate devaluation and the increase in interest rates which, depending on the duration of the period of stress and the magnitude of the increase of margins, has turned into: 1) the over-indebtedness of the non-banking private sector, increases in non-performing loans and greater reserve requirements; or 2) currency mismatching on bank balances; or 3) the transfer of said mismatch to dollarized borrowers with incomes in local currencies. The largest economies in the region recurred to these processes during the nineties, with moments of heightened dollarization and costly processes of pesification, whose most notorious recent example is Argentina.

On the other hand, in the second half of the nineties, the course of the succession of financial crises in Mexico, Southeast Asia, Russia and the US hedge fund Long Term Capital Management, unleashed a competitive storm among the most important financial

consortia of the world. Global financial consolidation allowed consortia to internalize and administer, at least in part, higher levels of risks and the increase in associated costs. At the same time, the positioning of these financial consortia towards markets deemed to be in expansion such as those of Eastern Europe, Latin America and, to a lesser degree, Asia, advanced in the search of size and competitivity. As such, foreign control of national banking markets dramatically increased in less than 5 years in countries such as the Czech Republic, Hungary, Poland, Argentina, Chile, Peru, Mexico, Colombia, Venezuela and to a lesser degree in Brazil, South Korea, Malaysia and Thailand. Citibank, BBVA, BSCH, HSBC, ABN-AMRO and Scotiabank achieved the quickest ascent in their global presence through the purchase of existing banks, principally private ones, operating as branches and assuming positions of systemic importance. Other large financial consortia gained lesser positions, creating new banks and pursuing the model of wholesale banking with little market participation.

In contrast to what occurred in the developed countries of Europe, the US and Japan in which foreign-owned banks have not reach systemic participation in domestic markets, in Bolivia, Brazil, Colombia, Costa Rica, Chile, El Salvador, Mexico, Paraguay, Peru and Venezuela, such institutions have had a growing presence since 1994. Their participation had been significant and stable in Uruguay, Panama, Aruba and the Bahamas, while it continues to be stable and limited in Cuba, Ecuador, Guatemala and Nicaragua.

In particular, the Spanish banks BBVA and BSCH found in Latin America a terrain to consolidate their process of internationalization, achieving a size and competitivity following the conditions of conglomeration in those years, which put within their reach a global exploitation of their resources and technological and organizational capacities, as well as the diversification and internalization of risks. In general, the region of Latin America offered these banks a unique opportunity, as the markets of the European Union are mature, with opportunities for acquisitions being scare and costly. During the first years of their expansion in the region foreign-owned banks came to occupy an important portion of the area. However, in 2008 their assets and earnings represented 12 and 13% percent of the region, respectively. These banks have accompanied the positioning of Spanish companies expanding n the region such as Telefónica, Repsol and Iberdrola. BBVA and BSCH administer pension funds in several of the largest countries, with more than 30% of the market in the region and 21 million clients in 2008, while in Spain they had less than 5 million clients in 1999, which grants both banks a large and constant flow of funds. As such, since the second half of the nineties, foreign-owned banks have shown rapid growth in deposits, advancing in their market positioning and displacing local public and privately owned banks, as can be seen in Chart 4.

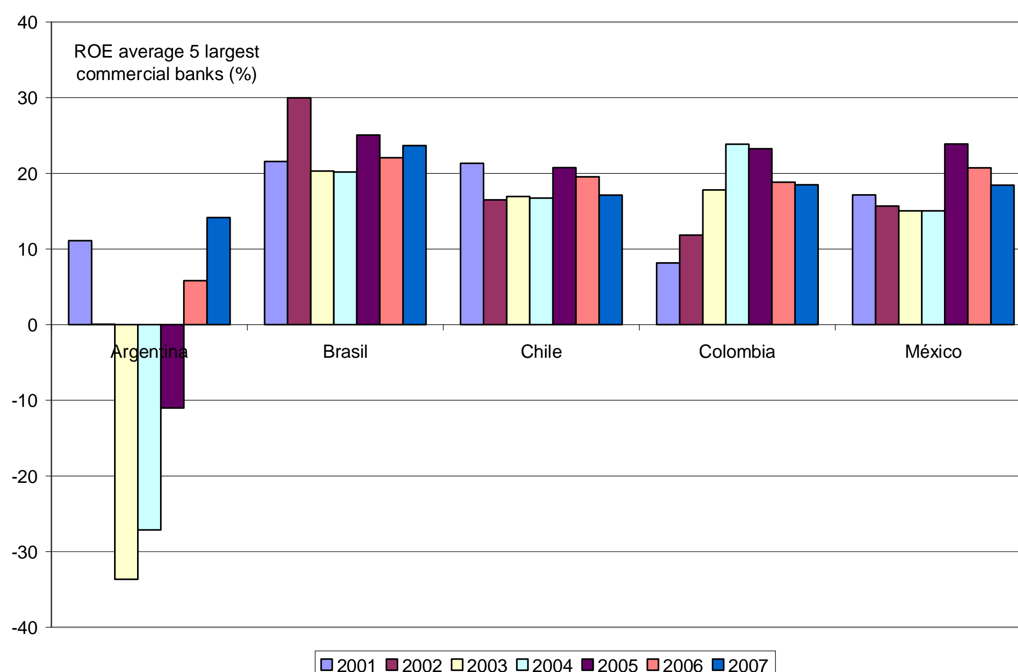
Chart 4

Publicly-owned banks in Latin America			
(assets of publicly-owned banks as a percentage of total assets)			
	1970	1995	2008
Argentina	73	50	48
Brazil	70	30	35
Chile	92	20	16

Colombia	58	55	18
Mexico	83	30	12
Uruguay	70	43	58
Venezuela	83	58	24
Source: LaPorta, Rafael, Lopez de Silanes, Florencio y Shleifer, Andrei. 2002. %Government Ownership of Banks,+ The Journal of Finance, Vol. 57, No. 1, pp 265-301. USA. For 2008, authorsq elaboration based on América Economía, 2008 and information from central banks.			

The change in ownership of financial institutions transformed large local banks into branches of foreign banks (CEPAL, 2002). Measured by assets, foreign-owned banks reached a 33% market share in the region in 2008. The earnings obtained in the region by this group of banks jumped in the last few years, going from 4.9% to 22.8% between 1998 and 2000 and reached 33% of the total earnings among the largest 100 banks in the region. However, there is no evidence to suggest that their presence has translated into a decrease in interest rate margins. In general, the profitability of banks in the region has remained high, with the exception of Argentina, as can be seen in Graph 1.

Banking Returns in selected LAC



Source: Authorsøelaboration based on America Economía, 2008

In summary: 1) local credit to the private sector and bank deposits in the largest economies have fallen, particularly in Mexico, Brazil and Argentina; 2) real interest rates on bank assets have not fallen to levels seen in the financial markets of the home countries of foreign banks operating in the region, nor have they lowered to levels offered by the headquarter banks; 3) large local companies, national or foreign-owned, have had to look to international markets to fund their activities and to refinance debts.
With the irruption of the Argentine financial crisis in 2001, the largest foreign-owned banks diminished their positions at the same time that publicly-owned banks increased theirs. Measured by the amount of its earnings in 2000, Argentina had come to represent the most lucrative market in the region for consortia such as BBVA, BSCH, HSBC and Citibank, followed by Chile. However, due in large part to the Argentine crisis and important acquisitions in Brazil and Mexico, the latter markets gained greater importance. In Brazil, local privately-owned banks have been more profitable than their foreign-owned peers in recent years (based on net results), while in Mexico the opposite has occurred, turning this country into the most profitable market of the region during the present decade. When local branches take on domestic credit risk in the region, global consortia also assume significant exchange rate risks, as headquarters consolidate their results in their own currencies, principally dollars and euros. Therefore, abrupt changes in the standing of local currencies directly affect their results in relatively short periods of time, as witnessed during the last months of 2008.
The foreign presence in the regionøs financial markets has created a growing financial delocalization (especially noticeable in Argentina), with displacements of internal savings toward financial entities located outside of national territories, falling local financing and rising external financing, within the reach of only a handful of consortia. This is particularly noteworthy in the cases of Mexico, Brazil and Argentina. The financial reforms undertaken during the 1990s, the increased inflows of capital in the form of foreign direct investment pursuing acquisitions, often in the form of privatizations, and portfolio investments, may well be an important part of the expansion of financial intermediation, but they have not been able to increase domestic savings or internal financing.

4. Latin America in the global financial crisis

The financial conglomerates and the largest MNCs that have conquered Latin American markets are the same companies that have entered into grave insolvency and/or bankrupcy, such are the noteworthy cases of Citigroup and General Motors, underlying the fact that while the US was pushing financial globalization forward, serious imbalances were growing within the countryøs economy. The displacement of the greater part of productive activities to other countries, together with the growing indebtedness of US households, created an unsustainable economic situation for the country (DøArista 2005), even considering the enormous benefits that the US enjoys as the issuer of the dominant world currency with the broadest and deepest financial system of the world.
Financial and economic globalization created an ever clearer division between the economic functions of the US and the rest of the world. This relationship, denominated Bretton Woods II by some, has meant that the US consumes what the world produces, and that the savings and financial resources of the world are placed in dollar-based

financial assets. As the financial center of the world, and possessing the global reserve currency, the US still finds itself in a position to issue promissory notes (dollars) for its purchases, while the rest of the world must produce in order to purchase goods and services or pay off debts. In other words, to acquire a product made in China or Mexico, the US only has to issue dollar bills, but China or Mexico must produce something or sell natural resources to obtain dollars. However, once the product is sold, neither China or Mexico utilizes all of the dollars produced by the transaction in the internal market; rather, they sterilize a significant part of these inflows through the purchase of US financial assets. Therefore, the dollars printed in the US are exported to the world through the USøs commercial deficit and return to the country in the form of external savings. Many Latin American countries structured their economies to export their products to the US, while a growing portion of their economic surpluses have been exported through the repatriation of earnings and dividends and interest payments. The fact that these countries have pursued such economic models precludes them from claiming that they are innocent victims of the current crisis.

While it is true that the global crisis first manifested itself within the parallel banking system of the US and Europe, the crisis has effected financial systems and economies of Latin America. Towards 2008, several tendencies could clearly be seen: 1) the rapid decline in the prices of many of the regionøs exports; 2) the reduction of the markets to which many of the regionøs exports are sent; 3) the fall in foreign direct investment and remittances of migrant workers; 4) the decrease in credit available to refinance and roll over external debts and an increase in interest rates; 5) the shrinking of internal and external credit for the productive sector, particularly among privately-owned banks; 6) the devaluation of local currencies, despite the high level of foreign exchange reserves; 7) the growing pressure to liquidate positions in derivates.

On top of all of this is the sharp fall in the rhythm of economic activity and the explosive growth of unemployment and poverty and extreme poverty. Estimates on the decrease in economic growth have been revised downwards during the last quarters. The structural deficiencies that will ensure that few countries of the region escape the crisis relatively unscathed are forming scenarios of enormous political conflict, with significant differences between countries whose governments enjoy sufficient legitimacy and those whose positions deteriorate on a daily basis.

Mexico is an extreme case within these tendencies, due to the following factors: 1) it has inserted itself into a model of export-led growth since the eighties. In large part, even before the crisis, Mexico had been substituted as a receptor of new investment due to technological changes (in both electronics goods and automobiles); 2) the most important local companies became internationalized, but at the same time have been highly dependent of external funding, as they maintain significant external liabilities; 3) the trade liberation of NAFTA destroyed a significant portion of internal productive capacity, particularly in the agricultural sector and food-based industries; 4) income distribution has been deteriorating ever since the successive economic-financial crisis of 1976, 1982, 1987 and 1994; 5) a growing part of the population is in conditions of poverty and depends on the remittances of migrant workers that are currently decreasing; 6) the lionøs share of the banking system is operated by branches of insolvent global banks, which places the Mexican banking system in a very serious possible problem; 7) various laws were adopted and are still in force in regards to the independence of the central bank

(1994) and balanced budgets, creating pro-cyclical public spending and increasing downward pressure on economic activity; 8) the most prominent local businesses have suffered a drastic economic metamorphosis; few have survived economic liberalization and opening; others have become more international in scope, and others have associated themselves with foreign-based groups; 9) the political class, including the government, congress and political parties are immersed in an internal power struggle in the midst of growing corruption and fraud; 10) the institutions fundamental to the state in terms of the application of justice are profoundly deteriorated and the mass media has lost credibility.
Under these conditions, the economic and financial crisis has continued its advance. When local banks were bailed out in the wake of the banking crisis of 1994 and their balances were wiped clean, they were sold in their majority to the afore-mentioned global banks. It has been argued that their presence would guarantee the country reasonably priced and increased credit for investment and business activity. It was also argued that these banks were large enough and well enough capitalized to save the country from another banking crisis. It was only in 2007, once the global financial crisis was well underway, that the International Monetary Fund warned that this indeed may not be the case, and that a financial crisis in the country of a bankøs headquarters could negatively effect the bankøs foreign branches, therefore producing a financial crisis in the host country, even though branches were initially well capitalized and profitable (FMI, 2007:114).
However, in the case of Mexico, the loss of the national banking system has translated into the development of the crisis in at least two general ways: that to which the IMF refers, and the other via the external indebtedness of domestic companies. In both cases, Mexico offers a clear case of a country that has lost its monetary, credit, and budgetary sovereignty. And with over 80% of the banking system in foreign hands, all Mexican companies have suffered a significant credit rationing.
On the one hand, banks operating in the country have not increased the amount of credit to nationally-owned countries since the crisis. In fact, in the fourth quarter of 1994, banks channeled the equivalent of 19.66% of GDP in credit towards commercial activity, while in the fourth quarter of 2008, this figure had lowered to 8.93% (CNBV, 1994, 2008). In addition, the foreign-owned banks operation in Mexico charge greater interest rates and commissions than their own headquarter banks in their home country. It is now the highly profitable branches in Mexico that are supporting the balance sheet diversification and price formation of toxic assets for their headquarters. The Mexican government has assumed its role in the rescue of global banks, through increasing its external debt and offering branches of foreign-owned banks the foreign currency necessary to maintain their operations and to transfer high levels of profits to home offices.
The collapse of structured finance and the fall of several of the worldøs largest banks has proven that financial globalization does indeed has its limits. Although with limited success the US, the United Kingdom and to a lesser degree Euro-zone countries, have earmarked enormous amounts of funds in an attempt to maintain the prices of the financial assets of their principle banks and other companies. In 2009, the US and UK are projected to run budget deficits of **12%,** while Mexico, Brazil and Argentina are likely to register figures closer to 3%, 1.5% and less than 1%, respectively (FT, 2009). Even though the design of the US bank bailout is destined to failure (Marshall, 2009), it

is worth noting that industrialized countries at least have the opportunity to save a part of their banks and businesses, unlike Mexican companies (and the local banking system) that are currently lost at sea.

Estimates place the amount of foreign public and private debt coming due in 2009 at 74 million dollars (Banamex, 2009). However, international banks are already curtailing their credit lines and are not rolling over existing debts. The Banco de México, together with other official financial institutions such as Nafinsa and Bancomext, have been financing shortcomings in external debt payments. Between October of 2008 and the beginning of March 2009, the Banco de México has spent 22.89 billion dollars, slightly more than a fourth of existing foreign-exchange reserves (Banco de México, 2009), in large part to cover the payment of external debts. The publicly-owned banks Nafinsa and Bancomext have established a 50 billion dollar credit line for the payment of debt owed by Mexican companies. Towards the end of 2008, eight domestically-owned companies, including Cemex, Soriana, Coppel, Banregio and Crédito Real had benefitted from tis probram, using almost 14 billion dollars (El Economista, 2009.)

During the frenetic moments of any crisis, hard information is always scarce, and for very different reasons, agents are not inclined to transparency. For example, in the discretionary foreign-exchange auctions held by the Banco de México, neither the recipients of foreign currency, nor the exchange rate at which it was granted have been made public; the conditions regarding the contracting of new lines of credit have not been revealed, nor have banks and businesses offered information as to the quantities of aid granted. The case of the supermarket chain Comercial Mexicana has received much attention. This company, one of the largest employers in the country, bet on the stability of the Mexican peso through derivative contracts. When these bets went sour and the company was saddled with an unpayable debt of approximately 1.5 billion dollars to a group of foreign banks, including JP Morgan Chase, Barclays, Merrill Lynch, Goldman Sachs, Santander y Citibank, Nafinsa guaranteed a part of Comerical Mexicanaøs debt. (El Economista, 2008; El Financiero, 2008). Even so, the debtøs restructuring continues to be deadlocked and a latent risk persists that the company will go bankrupt or will be absorbed by competitors such as Wal-Mart or Soriana. Another important case is that of Vitro, another of the largest employers in Mexico and another recipient of emergency public funding. Vitro was unable to pay a debt of 293 million dollars stemming from financial operations in derivatives to a group of four banks, for which the Swiss bank Credit Suisse has filed for legal action in a New York court. Vitro also did not pay local obligations totaling 150 million pesos, which came due February 5, 2009, and has not paid interest on its bonds that expire in 2012, 2013 y 2017 (Reuters, 2009a). New cases that arise almost daily can be added to these examples, all signaling the level of financial distress that the countryøs largest companies are facing.

Yet the partial bailout of several of the countryøs largest firms and the diversion of foreign exchange reserves does not signify a shift towards a coherent national credit policy in Mexico. To the contrary, there is still no plan on the horizon for the sustainable financing of the countryøs largest companies, nor has there been any significant attempt to financially support the greatest employers of the country, the small and medium enterprise.

Instead of initiating changes in the structure of public and private foreign debt in response to the drastic changes in global financial structures, Mexican authorities are applying

short term measures, which will not be able to be sustained throughout a crisis that will last for years (Galbraith, 2009). In addition, in the face of a prolonged crisis, the only beneficiaries of this form of bailout will be the foreign creditors that have been able to recover an appreciable portion of their outstanding loans (even while not issuing new credit), and not the large Mexican companies, which will not be able to find financing in international markets at reasonable prices in the near future, and much less in the internal market. Even though the crisis is in its initial phases, a quarter of Mexicoøs foreign exchange reserves have been spent and the peso has been significantly devalued.
The strongest evidence of the decomposition of the Mexican banking system is the fact that Pemex cannot find competitive financing in the internal banking market. Estimated as the 11th largest integrated company in the world, (Pemex, 2008), Pemex, like its peers in the private sectors, has financed its activities abroad for the same reasons mentioned. Pemex has also entered strongly into the derivatives market, with disappointing results. As a public entity, the external debt of Pemex is explicitly backed by public finances. Therefore, Pemex has the relative certainty of being bailed out by the government if necessary. But on the other hand, the external financial position of the government could be drastically weakened if Pemex becomes insolvent.

5. Conclusions

Economic structures take time to change. The handing over of the banking system to foreign agents has left public and private finances in a state of extreme external vulnerability. While this situation is grave in itself, it is even more so due to the fact that the home countries of the foreign-owned banks operating in the largest Latin American countries are entering into a long and severe crisis. Mexico unquestionably finds itself in the most delicate situation in the region, given the weight of a small handful of global banks in the financial system.
Although it will be difficult to confront and/or modify the external debt of companies in the private sector, it will be even more difficult to õMexicanizeö the countryøs banks, particularly in these moments of crisis when foreign banks control the entry of ever scarcer dollars. During the Argentine crisis, foreign banks, backed by the governments of their home countries and by the IMF and World Bank as well, employed their economic power, augmented by the crisis, to shut off the flow of dollars to 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 publicly-owned bank with a national presence, and despite the profound crisis provoked in part by foreign-owned banks, the Argentine government was able to resist the offensive (Marshall, 2008).
Even though its ability to fund itself in international markets was greatly restricted, the Argentine government was able to channel growing sums of credit to strengthen the countryøs publicly-owned companies and small and medium enterprises through the publicly-owned bank. Through the recovery of sovereign credit, denominated in Argentine pesos, rates of national investment rose, as did the participation of national firms in the domestic economy, and the country was able to sustain rates of employment and economic growth that have been extraordinary in the region.

For a developing economy to achieve sustained increases in growth and employment, it is essential to have a coherent credit policy, based on a sovereign currency and nationally-controlled banking system. In any given moment, development based on external financing is a doubtful proposition, but it is even more so in the context of the financial uncertainty that has defined the era of financial globalization. In moments of financial calm, foreign-owned banks have shown a strong historical reticence to finance domestically-owned firms, particularly to smaller firms or when investments are large and of extended duration. At the same time, the quantities of capital that are continually repatriated to foreign headquarters are equivalent to the funds that were not channeled to local productive activity. In moments of financial turbulence, external debt becomes a potential debt trap, capable of bankrupting both companies and national states. In many cases, overindebtedness increases the political control of creditors over debtors. Both in moments of crisis and financial calm, creditors (foreign-owned banks and other agents) directly benefit at the expense of unrealized economic potential in the local economy.
Without national banks large enough to act as a counterweight to foreign-owned banks, the necessary tools to recuperate the financial system and internal financing do not exist. The current crisis forces Latin American countries to consider this problem in order to stimulate economic growth and development in the region.

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