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Mexico's leadership prepares for economic confrontation

by David Goldman, Economics Editor

The International Monetary Fund, with the support of bankers who stand to lose $90 billion should the gambit backfire, decided Oct. 22 to push Mexico to the wall, confident that they can break any Mexican resistance within months. They may be unpleasantly surprised by the results.

Before Mexican Finance Minister Jesús Silva Herzog and central bank governor Carlos Tello returned from Washington Oct. 23 with no agreement from the IMF, whose approval of Mexico's economic policy supposedly would open the tap for new private credits, senior Mexican officials were hoping against hope that the IMF would grant the $5 billion, three-year loan under negotiation with attached "conditionalities" not much different from the already austere status quo of Mexican policy. Until the last minute, both President José López Portillo and the central bank chief he installed Sept. 1 to run the exchange-controls and bank-nationalization program he had announced believed that the IMF would lend on what amounted to Mexico's terms. Apparently, the IMF's negotiating team in Mexico City had tentatively agreed to such a package. But when Tello and Silva Herzog arrived in Washington, following semi-official press leaks that a package would be signed within days, the Washington staff of the Fund went back to square one: Mexico would dismantle its system of controls, or there would be no money.

A senior Mexican source close to Tello—who has been wrongly characterized as a "Marxist" in some Western press accounts—had said in a recent discussion, "The IMF is going to have to retreat. If they don't, they will push us into a debt moratorium. They can't want to blow up the world banking system. At least this seems logical. But there could be one flaw in my logic; I assume the other side is not insane."

Nonetheless, the IMF and the banks have decided to take the risk of a world banking crash, and strangle the Mexican economy by shutting off imports until López Portillo, or his successor after Dec. 1, Miguel de la Madrid Hurtado, capitulates. The reduction in imports, which provide intermediate goods for 70 percent of Mexico's manufacturing industry, has already begun widespread plant closures and layoffs, and the cumulative effects could become disastrous within weeks. In most of the country, the private industrial companies—one-third of which were owned in any event by the nationalized banks—have turned against the government, and are doing everything possible to make the economic crisis worse.

"Even if they don't come to an agreement with the IMF," a senior Federal Reserve official said, "it won't really matter. We will break them, and they will have to come crawling back to us within six months." On the surface, it would seem that the bankers have a strong hand to play: the doubling of Mexican industrial employment over the past decade was an impressive achievement, but seven-tenths of it occurred in industries which do little but import parts from the United States and assemble the final product in Mexico.

The 10 to 12 percent of Mexico's industry that reflects advanced technology and capital-intensive production methods—steel, fertilizers, petroleum, and electricity—is burdened by a swollen expansion of import-dependent, labor-intensive, consumer-oriented manufacturing. The private industrialists in the latter sectors have enjoyed 20 to 30 percent rates of return on investment, the highest in the world, and identify more with the source of their imports than the purchasers of their final product, to the extent of removing over $20 billion in flight capital in the two years up to Sept. 1. Leaning against Mexico's "Great Projects" development approach, the proprietors of the country's weakest industrial sector have been able to hold their share of the total economy for a decade, riding the back of the petroleum boom, delaying urgent infrastructural improvements to maintain the consumer-oriented expansion.

Private sector on strike

Virtually the entire private sector has gone on strike. Although the newly nationalized Mexican central bank has offered a reduction in interest rates for investment credits, there are few takers among private-sector firms. On the con-

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trary, large commercial bank depositors have been withdrawing funds from the banking system in cash, and smuggling much of that over the border to exchange for dollars at about 120 to the dollar, against the official rate of 70 (and last year's rate of 26). The refusal to invest and the withdrawals from the banking system have caused a sudden contraction of liquidity in the banking system, causing acute distress for small-business borrowers, who have had virtually no access to funds in the past month. This has happened faster than Tello's central bank has found the means to react.

I asked a top state official of the governing party, the Revolutionary Institutional Party (PRI), in a large border state city, how Mexico would respond to the banks' threat to choke the economy into submission. He responded, "You have to understand how Obregón [Alvaro Obregón, revolutionary leader and President 1920–1924 [bypassed the federal garrison in Guaymas in 1913." Obregón had to get vital railroad rolling stock around the heavily-fortified Gulf of California port, but the single rail track through the difficult surrounding terrain ran straight into the mouths of enemy cannon. Obregón's engineers diverted a section of track, leapfrogging the rails from the rear section to the front, and moving his troops and heavy equipment in a flank around the Buaymas fortifications by laying and re-laying the same rails. "And Obregón did this in 10 days," the PRI official concluded the story. "By our current work standards, the same job would have taken six months. We know that Sept. 1 was the beginning of a war. We know we have enormous problems. But we can win, if we can mobilize the population this way."

Mexico's ability to stand off the International Monetary Fund and survive depends on access to other sources of technology than the United States, especially the other Ibero-American nations, and most of all Brazil. The still-inconclusive negotiations between Brazil and Mexico over an oil-for-technology transfer denominated in pesos and cruzeiros are a critical test-case for the "Ibero-American Common Market" initiative that summarizes Mexico's best change to fight. A critical issue for the projected Common Market may be Mexico's food-import requirements for 1983; poor rainfall this year and low levels in irrigation reservoirs may imply an 8 to 10 million ton import requirement for grain, costing $3 to $4 billion that Mexico presently does not have. However, the Ibero-American continent, including grain-rich Argentina, has always been self-sufficient in food.

Dollar blockade

Mexico's economy is already reeling under the impact of a de facto blockade of foreign currency. Imports during September, following the cancellation of $18 billion of bank trade-credit lines, ran at *one-fifth* the previous year's level. Imports have fallen by much more than the country's trade deficit, because private-sector exporters are using a variety of means to keep dollars outside the country. Oil revenues expected for the last quarter were, for the most part, factored to the banks during the June-to-September period, including contracts to France, Japan, and Spain. The cash raised from the sale of oil contracts went out in the form of capital flight before the Mexican government finally stopped it with the Sept. 1 controls. According to some bankers' estimates, Mexico will receive little oil money until the March-June period of next year.

No short-term trade credits are available, following the early-September three-month moratorium on payment of principal. One West Coast banker fulminated, "It shows the irresponsibility of the Mexican government, to have let the short-term trade and credit financing situation break down. Not even Argentina has done that. Argentina has at least kept the banks current, so as not to lose the short-term lines of credit. Not even Bolivia has done what Mexico did. Only Mexico and Costa Rica pushed it to that extreme. Now it's a psychological disaster. Who will extend credit short-term if he knows he may have to face a situation where the government suddenly comes to him and says he has to agree to restructure it over a 10-year period? I see very ugly effects on world trade patterns from this kind of thing."

Although American bankers, from David Rockefeller on down, have consumed acres of Mexican newsprint in reassurances that the banks will continue to support Mexico, Mexican firms have heard a very different message in private. At a recent private meeting at the Mexican resort of Ixtapa of a hundred Mexican and American businessmen two weeks ago, one senior U.S. banker said, "The Mexican government has permanently forfeited the confidence of the business community. You have to live with it, just as you have to live with financial, political, and regulatory instability."

Mexico's enemies

Both at the national and local level, the leadership of the PRI is coming to the grim conclusion that the banks are not first interested in getting their money back, but want to break the Mexican political system—with the collaboration of considerable elements in the private sector. That adds a bitter irony to charges circulated by some U.S. "neo-conservatives" to the effect that the bank nationalization measures represented a "socialistic" attack on private enterprise.

Private enterprise in Mexico, which rode the economic boom rather than building it, scampered into the safety of Houston real estate and Swiss bank accounts, diverting profits from their enterprises and bank loans into $22 billion in flight capital; the expelled leadership of the Bank of Mexico complacently borrowed an additional $20 billion above and beyond Mexico's financing needs to finance the flight capital, ruining Mexico's credit standing. The only "irresponsibility" of the Mexican government was in delaying the actions it finally took Sept. 1, to the chagrin of the banks. American bankers' criticism of the Mexican government's handling of a problem they helped organize should not be taken seriously.

Despite the Mexican government's decision not to pub-

lish the list of *sacadólares,* or those who speculated against the peso, it is evident that the same private firms that complain most loudly against the shortage of dollars, and demand acceptance of the IMF conditions, control most of the $22 billion in bank accounts still held by Mexican citizens outside the country. If they brought these funds back into the country, they would triple their investment, since most of the dollars were bought at 26 pesos per dollar, and the current official rate of exchange is 70. However, the private sector is not disposed even to take advantage of the spectacular underdevaluation of the peso, which they could do with impunity. The business associations seem most concerned with the opportunity to clear more funds out of the country.

As President López Portillo implied in his Sept. 1 State of the Nation speech, the liquidity crisis is the result, at least in the very short term, of the private sector jumping ship. Less than a government attack on the private sector, the events of the past several weeks represent a private-sector strike against Mexico.

Polarization

The resulting level of polarization in the country's political life is unprecedented in the post-war period.

In Sonora, the northwestern state which produces the bulk of the country's protein foods, the private business sector has not only abandoned the governing PRI in favor of the neo-fascist Partido Acción Nacional (PAN); they have stopped talking to the PRI except through newspaper declarations.

The head of the local business association, PAN official Vidales Vidal, hailed the government's decision to establish exchange houses on the frontier Oct. 20 (to encourage Mexicans to return their flight capital) as "the beginning of the end of exchange controls." Vidales endorsed, in effect, the large black market in currency shipments across the border, and expressed hope that it would break the government's controls program. Meanwhile large commercial agricultural producers are offering bribes equal to 10 percent of their products' value in return for export licenses for products needed inside the country. Sonora's case, like that of other border states, is extreme; but the process is not much different elsewhere in the country.

The confrontation between Mexican officials and the International Monetary Fund the weekend of Oct. 22 may have represented a turning point for the Mexican leadership. The cost of an economic confrontation with the United States would be terrible; but if the United States supports its bankers at the expense of its own more basic economic interests, Mexico will have to deal with the confrontation forced upon it. IMF officials who believe that Mexico's leaders will pawn the country's future prospects for development in return for an indistinct promise to relieve the short-term pressure may have miscalculated badly.

Mexico is preparing for economic war.

The Mont Pelerin Society determination to crush

In a rare break from its secretive policies, the Mont Pelerin Society made its latest conference in Berlin this September a forum to announce publicly just what its members intend to force upon the world economy. The Society, founded in 1947 out of the Vienna School, is committed to forcing Malthusian economic policies on national economies under the banner of "free-market" policies, i.e., destroying the centralized generation of credit for industrial and infrastructure development that was Alexander Hamilton's American System.

The most recent "national experiment" of the Mont Pelerin Society, the fascist economics imposed in Chile on the advice of the Chicago School's Milton Friedman, vice president of the Mont Pelerin Society, ended recently with Chile's industry and labor destroyed, and the country forced to ask for a moratorium on its debt principal. Chilean dictator Pinochet has kicked his Chicago School advisers out of the country.

Although most of the presentations at the Sept. 5-10 Berlin conference were delivered in abstract jargon, their meanings would be clear to anyone with a grasp of the fundamental difference between American System and fascist economics. Lest any *EIR* reader think this publication exaggerates its characterization of Mont Pelerin policy, we present here excerpts from the speech of Prof. Herbert Giersch, president of the Institut für Weltwirtschaft of Kiel University. Giersch's speech was a task-oriented statement of what the Society wants.

We spare you the experience of the presentation by Mont Pelerin *éminence grise* Friedrich von Hayek. His "philosophical" statement bordered on outright psychosis. Giersch's speech is sufficiently damning.

Giersch spoke on "Socialist Elements as Limits to Economic Growth" during a session on "Socialist Thought as a Challenge for Western Societies." His definition of "socialist" was anything remotely related to economic leadership by a national government; Giersch made it clear that, beyond the destruction of the welfare state, the Mont Pelerin Society is looking to destroy nations themselves.