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The Economic Solidarity Pact: another still-born program

by Carlos Valdez

The latest economic program of Mexico's Miguel de la Madrid government, the so-called Economic Solidarity Pact, was a failure before it got started. The previous four programs of the government, the National Development Plan, PND; the Immediate Plan for Economic Reordering, PIRE; the Extended Plan for Economic Reordering, PERE; and the Plan for Promotion and Growth, PACAC, as well as its more than 14 sector programs, were also still-born. The cause of death of each of these programs is the same: the way in which financing the budget deficit was undertaken.

Since the beginning of his administration on Dec. 1, 1982, De la Madrid's government has financed its budget deficit with other people's money, that is, money taken from the "investing public" by soliciting speculation in a half-dozen financial instruments issued by the government itself. The most famous of these are the Treasury Certificates, known as CETES. Then there are the Pagafes (Government Promissory Notes), Petrobonds, CAPs (Certificates of Patrimonial Contribution), bankers' acceptances, etc.

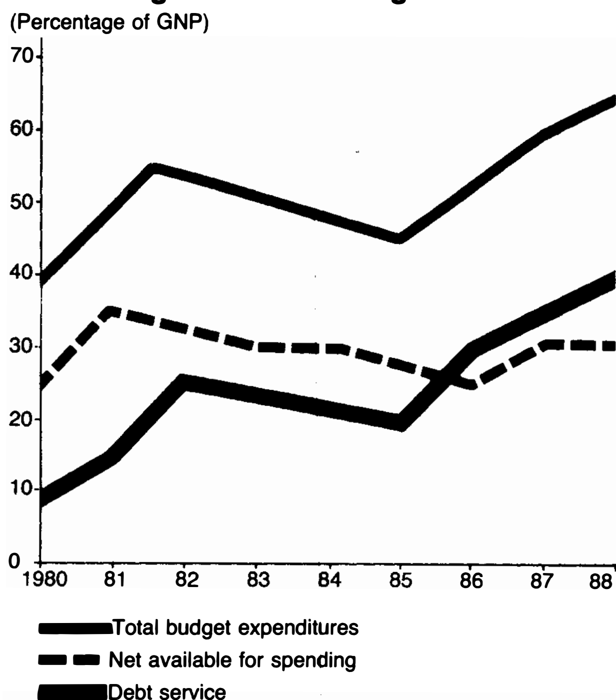
At the beginning of this administration, a scandal was fabricated around the fact that former President José López Portillo left a budget deficit that was 18% of the Gross National Product. This was blamed as the principal cause of the nation's debt crisis. What was never stated was that the López Portillo budget deficit, as with all previous governments, was the result of contracting debt to provide for the government's spending requirements: public investment, operating expenses, and contributions to the municipalities and states.

Under the technocrats of the de la Madrid government, this changed. Debt was incurred to pay off debt. They proceeded, under the supervision of the International Monetary Fund (IMF), to try to lower the budget deficit by eliminating allocations for "programmable" expenses, everything in the budget *except* debt service. From 1982 to 1986, as a percentage of Gross National Product, the net expendable budget was were reduced from 28.2% to 22.1%. In 1987, they were 22%. Public investment fell from 7.7% in 1982 to 4.3% in 1987 (see **Figure 1**).

Believe it or not, President De la Madrid has always known that the deficit could never be reduced by this route. In his Fifth Report to the Nation, on Sept. 1, 1987, the President said: "The rise in the cost of money has made servicing the internal public debt more expensive and has raised the financial deficit." At the same time, he offered as an achievement of his government the fact that for the fifth consecutive year, there had been an "operational surplus" (that is, greater income than expenditures, *before* servicing the debt). Such a "surplus" rose from 2.5% of the GNP in 1982 to 6.5% in 1987.

As the President indicated, it was the "cost of money," the policy of financing oneself with other people's money, which has prevented a reduction of the deficit. The percentage of the GNP represented by interest payments for the 1983-85 period was 11.6%. That leaped to approximately 21% in 1987. While foreign interest costs remained at a level of between 5% and 5.5%, internal interest rates rose from 6% to nearly 14% for the same period. In 1988, it is bound to jump even more sharply, as interest rates are already 130% higher than in 1987, and will surely rise much further yet.

FIGURE 1
Mexico spends more for debt service than all other categories of the budget
(Percentage of GNP)



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In terms of the federal budget, this meant that in 1986, 35% of the budget would be allocated to pay interest; in 1987, this figure was 44.5%; and in 1988, it will represent a whopping 54.4% of the total budget. In 1980, for each peso spent by the state, 25 centavos were used in servicing the debt (which represented 10% of the GNP). In 1988, of each peso spent by the state, 54.4 centavos will go to servicing the debt. And this calculation was made before the latest 47% increase in interest rates announced in early January.

The internal debt bomb

There is much more behind the numbers—the political coldness of a technocratic government.

Despite the proposal of 109 federal congressmen belonging to the ruling PRI party, that cutbacks in the 1988 budget be made in the area of payments on the foreign debt, three congressmen—representatives of PRI presidential candidate Carlos Salinas de Gortari—imposed a new cutback in the budget line for programmable expenses, from 22% to 20.5% of the budget. They also established a hypothetical reduction of payments on the internal debt, by means of an (again, hypothetical) reduction in inflation for this year. As we shall see, this will not occur.

The government's policy of financing itself with other people's money is about to explode into a thousand pieces. In January, interest rates on the government's financial instruments were hiked sharply, 32 points for CETES, and 25 points for promissory notes. The 28-day CETE is the most coveted, paying 158.7% a year. If its monthly yield is compounded, the annual interest rates actually surpass 360 points, one point per day for 365 days of the year, a rate which has no precedent in the nation's history.

Various analysts writing in the financial pages of the nation's dailies have offered the following estimates: The finance ministry recently reported that the public internal debt was 30 trillion pesos (13.3 billion dollars, at present exchange rates). This means that for each point that interest rates rise, annual payment on interest increases by 300 billion pesos. If one multiplies this amount by 25 points, one comes up with 7.5 trillion pesos, a figure higher than the 7.3 trillion pesos that were cut out of the 1988 budget.

Apart from these projections, which raise the internal debt and government budget deficit to unimaginable heights, there exists another, infinitely more dangerous dynamic that is on the verge of exploding.

Traditionally, the CETES were issued for 90 days, 60 days, and 28 days. As always, the government's preferred tonic was to issue new, more attractive issues to pay for the old. Ever since "Black Monday" on the Mexican stock exchange last Oct. 19, the government has repeatedly opted for interest rate hikes to prevent a disinvestment in CETES and a rush to gold, dollars, or other "more secure" investments. Despite this, the government has still been unable to avoid an avalanche toward the dollar—which forced the "maxi-devaluation" of Nov. 18.

However, the government has not abandoned its stupidity; rather, given that very few investors are buying the new bond issues, it has opted for the "innovative practice" of issuing 7-day, 14-day, and 21-day CETES. With the enhanced terms on these government instruments, the Mexican financial market has become an inferno, where buying and selling of government paper can be measured in mere hours.

It is here that the ticking of the internal debt bomb can be heard. The government has reached the point that it requires astronomical amounts each week merely to recycle existing CETES and pay part of the interest. At any point in which the new issues find no buyers, the government will face "zero hour": The recycling will come to a grinding halt and there will be no more income to pay interest.

If the government opts for deflation, the rush into the dollar will be such as to annihilate what remains of foreign reserves. But if the government opts to maintain the hyperinflationary policy of "recycling" internal debt, where do they think they will obtain the liquid funds from to continue to pay interest?

And they think they can reduce inflation

Any serious analyst calls this simple madness. But his astonishment increases when he hears from the government itself, that all this is a step toward reducing inflation. Despite nominal interest rates already reaching 159%, even they are negative with respect to inflation, which annualized, will hit 191%.

It is very difficult to put oneself in the shoes of a fascist, but it is not so hard to know how one thinks. The reasoning (if it can be called such) of Miguel Mancera Aguayo, director of the Bank of Mexico, and Pedro Aspe Armella, secretary of planning and budget—a veritable budgetary, and at times political, Gestapo—is more or less the following:

If we reduce the next expendable budget from 28.2% in 1982 to 24.3% in 1983, to 23.4% in 1984, to 23% in 1985, to 21.1% in 1986, to 22.0% in 1987 and to 20.5% in 1988; if private investment is paralyzed because of the effects of the soaring prices and contraction of credit, and the free importation of goods, which will increase the average capacity utilization from 50% to 70%; if wages stay frozen; then there

will be no problem if we introduce a deflationary policy toward the speculative bubble of the internal debt, exactly as occurred in the Mexican stock market.

These are the teachings of one Mr. Sanjines who is hidden in the Autonomous Technological Institute of Mexico (ITAM), and who advises Aspe Armella and Mancera Aguaya. The credentials of said Mr. Sanjines are that he "advised" the Bolivian government in the application of its "heterodox program," which "stabilized inflation."

According to reliable sources, the only thing that is worrisome about these programs of Mr. Sanjines, is "the political consequences against democracy." What this Mr. Sanjines doesn't say in his "advice" is what is now recognized in Bolivia itself: that 80% of the GNP of the Bolivian economy comes from drug trafficking.

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The real root of this entire financial and economic crisis, is that, faced with such a high mortality rate for their programs, the technocrats of the regime are out to spread the infection, and want to kill democracy.

Mexican state heads for bankruptcy

by Peter Rush

Sharp increases in interest rates on government treasury certificates called CETES, and the announcement that the government is coming out with 7-day and 14-day CETES, signal the impending bankruptcy of the Mexican state. The point is emphasized by the persistent rumor that the Bank of Mexico is heavily supporting the peso in the face of renewed strong capital flight into the dollar.

The government's latest "program," the Economic Solidarity Pact, is helping to bring the crisis on, by further destroying the country's physical economy. And the farcical "zero bond" plan concocted with Morgan Bank in New York, primarily intended as a public relations trick in any case, is already coming apart.

Interest rates and pressure on the peso are the crucial issues at present. The Nov. 7 increase of CETES rates by a nominal 32 points, from 127% to 159%, represents a real increase, on a compound basis, of 111% a year, from 234% to 345%. Reportedly, even the 159% rate was a compromise, with prospective investors initially demanding 200% (535% compounded annually).

Explaining why the upward pressure on interest rates was so severe, columnist Luis Soto explained in *El Financiero* Jan. 7 that these rates "make one think that the Bank of Mexico is willing to pay what it must to savers and investors, such that they will invest in peso instruments." The government must pay whatever rate the "market" demands, just to roll over the CETES that come due—or face immediate bankruptcy—plus it must market new CETES to pay the growing interest costs on the old. The government is hostage to whatever the so-called "investors" demand.

The other motive for the interest rate increases is to keep pesos from fleeing into dollars. Soto commented, "Everything indicates that dollarization is growing daily, before a strong demand, despite the efforts of the authorities to supply dollars to the market to control the price."

Agustín Rodríguez Trejo, the *Excelsior* columnist, reported, "A strong rumor exists that the outflow of dollars has alarmingly reduced the much-defended monetary reserves of the Bank of Mexico," although no one is willing to estimate the magnitude of their depletion since the devaluation of mid-November. But can any rate of interest keep pesos from fleeing into dollars? Soto quotes Bank of Mexico head Miguel Mancera, suggesting that the answer may be no: "There is no rate of interest that buys off fear." The announcement Jan. 8 that the government is now to issue even shorter-term CETES, of 14 days, and even 7 days, is an indication of how short a fuse remains on the financial bomb. Still, no analyst has yet appeared to draw the only possible conclusion, and utter the dread word: bankruptcy.

Foreign debt payments strangle the country

The Mexican government has been living a terrible illusion for five years, the illusion that it has managed to pay its debt service, and survive. It has not survived. Like a cancer that expands unnoticed before bursting forth in a late stage, when death is near, the effects of paying foreign debt service at the expense of the domestic economy, are only now manifest, as the government faces utter financial collapse.

For five years, the de la Madrid administration and its finance minister, Salinas de Gortari, the prospective next President, paid the debt on demand from New York, by looting living standards, looting production for the domestic market, and looting the government treasury. Domestic production has fallen by 25-30% or more. The government has thus destroyed its own tax base. Falling revenues and ever higher costs of paying foreign debt service thanks to repeated devaluations of the peso, constantly increased the government's deficit, despite brutal cuts in expenditures for services and investment. High interest rates, large government deficits, and falling purchasing power caused inflation to keep rising.

By 1987, the stock market was for many companies the only place to make a profit. Reportedly, banks even advised