Another rescue plan offered for Mexico's insolvent banks

by Carlos Cota Meza

The Debtors Assistance Accord (ADE) announced in late August by the Mexican government proves one thing: Only action by the federal government can prevent the banking system from disintegrating. That said, this latest action by President Ernesto Zedillo is precisely the opposite of what needs to be done.

Despite all the noise made in the official announcement of the ADE, the program comes down to 12 billion "new pesos" (or $2 billion, at an exchange rate of six new pesos to one dollar) to be disbursed over the 13-month life of the program. According to Finance Minister Guillermo Ortiz, the program "will cost [the government] 7 billion new pesos." The banks will contribute another 5 billion, which are to come from "further reducing the banks' interest rate spreads," according to José Madariaga Lomelín, the "former banker" who heads the Mexican Bankers Association.

Thrown into the ADE hopper as well, are 13 billion new pesos which the government has already absorbed in restructuring arrears through the so-called Investment Units, or UDIs, a program which was a complete failure within three months of its inception. According to the Finance Ministry, this expenditure will be incorporated into the ADE, and included in the "sacrifice" of public spending.

The ADE's 12 billion pesos amount to a mere 10% of the total debt arrears accumulated in the first seven months of this year, a total of 120 billion new pesos. And yet, with this 12 billion, the government intends to "benefit" 6.372 million bank users, including 4.72 million credit-card holders, 440,000 holders of personal or consumer loans, 382,000 mortgagees, and 850,000 businesses or businessmen. Since this universe of "beneficiaries" (unfortunates, some would call them) includes around 75% of the country's delinquent debtors, this means that the real problem of the banks lies in the 25% of the debtors who hold 90% of the bad debt.

This so-called debt-relief scheme functions on the basis of new federal government subsidies to the bankers. That is, the government will pay the banks the difference between current market rates, and the interest rates they are to offer debtors under the ADE. The government and bankers alike hastily insisted that "ADE rates" will in no way function as new credit during the period the program is in force, or ever, for that matter. The "adjustment" program imposed by the International Monetary Fund, which has sunk the Mexican economy in deep depression, will remain in full force.

Further, the ADE rate is premised on the supposition that market interest rates will fall, which is highly unlikely. What many are now asking is: What will happen with the ADE over the coming months, when a year-end devaluation of the peso is already being forecast, that will once again throw the financial markets into turmoil?

The ADE mechanism

The formal ADE mechanism consists of:

1) *A reduction of interest rates over the next 13 months on the different kinds of credit available*. It is stated that said rates will, in no case, be higher than those which prevailed before the crisis.

Credit cards will pay a maximum interest rate of 38.5% over the next 13 months, but only for the first 5,000 new pesos of debt; consumer loans, 34% interest rates for the first 30,000 new pesos; and business loans, a maximum interest rate of 25% for the first 200,000 new pesos of debt. The agricultural sector, apart from the 25% interest rate offered on restructured loans, will have 18-month terms. The Value Added Tax will be applied to all these operations.

As is well known in the agricultural, manufacturing, and commercial sectors, the problem of debt arrears began long before the crisis last Christmas. The root of the problem is that producers' costs of production were well above the prices paid for their products, a problem worsened by unfair competition from imports sold at "dumping" prices, a policy promoted by the Carlos Salinas de Gortari government. Interest rates in the commercial banking system were always more than 100% over the reference rate, those of 28-day treasury certificates, or CETES; the only businesses prepared to pay such rates were those which expected very high speculative yields.

As can be seen today, the main clients of the banks were the speculators who invested in risky deals, which collapsed in December 1994. It is in these sectors that the major portion of bad debt resides, along with many other bad business deals of the bankers which the government does not want to recognize. This negligence on the part of the government was what led to the failure of the debt restructuring programs of the previous government, known as Fircaven and Sireca in their first and second phases, which operated through Nov. 30, 1994.

2) *The banks will forgive the entirety of the interest arrears that they are currently collecting from their clients.* As anyone who is suffering the perversity of usury today well knows, interest arrears are those which are not yet capitalized, but which, once capitalized, will accrue ordinary interest. The problem of the insolvency of the past eight months lies in the capitalization of interest, which ADE considers as "new lines of credit" given to delinquent debtors.

The universal example is: At a monthly interest rate from November 1994 of 2.27%, a debtor would pay around 19.7% accumulated interest over the last eight months of 1995. Instead, the debtor is actually paying 52.9%. If the client paid the same as last year, because he was unable to pay more than the 2.27% monthly rate, his debt is now 33% larger, which is the portion of capitalized interest. If he could not pay anything, his debt today is 53% larger than that originally contracted.

The typical bank user now has more debt, while, thanks to the effects of inflation, he has less income to pay for it. The ADE does not consider this fact: The crisis of the debtors is not one of liquidity, but of insolvency, and in such circumstances, it matters little whether the interest rates stand at 40%, 25%, or 10%.

3) *The granting of a legal truce on the part of the banks, during which no collection actions will be undertaken in the courts, except those strictly necessary to preserve their rights.*

Because the ADE does nothing to resolve the causes which gave rise to the crisis, this amnesty on judicial actions, granted until Oct. 31, 1995, and extendable in specific cases until Jan. 31, 1996, is equivalent to putting off the execution date for a man condemned to death, without lifting the death sentence. The order that banks *not demand additional collateral* for restructuring loans is simply an imposition of minimum decency upon the bankers.

Citizens will pay

The key to understanding the Debtors Assistance Accord is found in President Zedillo's speech announcing the agreement. The President stated that the only viable accord, was one directed at strengthening "the solvency of the banking institutions. No accord which did not fulfill this condition would be acceptable to the Government of the Republic."

The President also explained who would have to pay for this "strengthening" of the banks. The implementation of the accord would only be possible through an allocation of public resources: "In order to maintain fiscal discipline, an essential basis for healthy growth, it will be indispensable to sacrifice other areas of public expenditures to back this accord."

Miguel Mancera, the governor of the autonomous Bank of Mexico, took care to specify that the Zedillo government, with this plan, "will not take recourse to public debt to support the program. . . . The adjustment will be made out of public expenditures, and could be based on the fiscal surplus." So that no doubts remained, Mancera reiterated: "The Bank of Mexico will not relax its management of monetary policy. . . . The central bank's limits on domestic credit remain unchanged."

All this means, that in order to refinance the banks under the disguise of "aiding" the debtors, there will be no budget expenditures, not even at the reduced levels which produced the surplus. Nor will there be any issuance of domestic credit, beyond that which the Bank of Mexico arranged in 1994 to refloat the bankrupt banks.

The ADE is the fifth program initiated since the failed Fircaven, Sireca I, and Sireca II programs of the previous government, and that of the illusory Investment Units. The government came up with the ADE after the government resorted to the Banking Fund for the Protection of Savings (Fobaproa) to "provide capital to the banks" in the name of "protecting depositors," and after taking on more foreign debt to refinance the banks through the Program for Temporary Capitalization (Procapte). None of these programs had succeeded in saving the corrupt bankers.

Self-loans and speculation

The Zedillo government should understand that the banks became bankrupt, not because someone stopped paying them, but because in part "they succumbed to the temptation of self-loans," when they invested resources gotten from the saving public and foreign loans, in their own, very bad deals. That is, they are the receptacles for that international speculative capital known as financial derivatives, and they intend to continue to feed this cancer from the wealth of the public treasury—that is, the Mexican population.

Take the case of Carlos Cabal Peniche, of Banco Union-Cremi, who gave himself a self-loan of seven billion new pesos, exactly the amount which the government has allocated to the ADE. Angel Rodríguez loaned himself an amount slightly under the five billion pesos which the bankers are now putting up for ADE. Together, two airline companies, Aeroméxico and Mexicana, which have merged, owe close to 12 billion new pesos to four banks (Mexicano, Inverlat, Serfin, and Bancomer), about as much as the totality of the ADE! The Banco del Centro (Bancen) went belly-up over the amount of 400 million new pesos, and the Banco del Oriente (Banorie) went bankrupt over 330 million. Who stopped paying these little banks which were last in line in capturing savings and offering credits?

What is certain, indeed, is that the ADE is a "one-time effort." What comes next, is government intervention to close the banks, and put them into bankruptcy. After this, the Zedillo government will have to establish a new system of national credit, intervening in the mother of all the banking corruption—the Bank of Mexico.