The Mexican rescue

Preface

More has probably been written about the debt-servicing difficulties of major developing countries than about any other economic problem in history. The vast bulk of this material falls into two categories: economic analysis and exhortations to policy-makers. The following report fits neither of these categories. It is a journalist's account of what actually happened after the Mexican bombshell dropped on the world’s banking system in August 1982. Based on dozens of interviews with the leading figures involved, it describes how the major institutions of the international monetary system responded to the challenge. It shows in dramatic form and perhaps for the first time the extraordinary range of difficulties, misunderstandings and personality conflicts that have to be managed in the course of such an operation. In the words of the author, Mr. Joseph Kraft, "This, as the principal actors tell it, is the story of the Mexican rescue."

No one can tell whether that rescue will prove to have paved the way to a satisfactory long-term solution to Mexico's difficulties or to those of the other major debtors. But it has bought time. Indeed, it has become a classic example of a "fire brigade" exercise — ad hoc cooperation under the pressure of crisis — which is the only kind of international monetary cooperation to have been feasible in recent years.

Thus the Group of Thirty is pleased to publish this report as a contribution to public understanding not only of the Mexican story itself but also of what actually takes place in the amorphous process so blandly labelled "international cooperation".

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Jesus Silva Herzog, the Finance Minister of Mexico, whom practically everybody calls Chucho because, as a friend once observed, "you can't address even him as Jesus," was *numero uno* among the world's financial leaders when they gathered in Washington September 1983 for the annual meetings of the International Monetary Fund and the World Bank. He gave a formal address to the Bank and Fund as spokesman for all the Latin American countries. He flew to New York for a testimonial dinner — the second in two months — offered by private banks. The *Wall Street Journal* said: "Bankers smile at the mere mention of Mexico's charismatic finance minister."

The smiles reflect the pathbreaking role played by Mexico in what has become known as the "international debt crisis." In August 1982, Mexico led the way for a dozen other major countries including Brazil, Argentina, Nigeria and the Philippines in a massive rescheduling of billions of dollars owed to several hundred banks in the U.S., Europe and Japan. The sudden nationalization of Mexican banks in September threatened to disrupt a tricky presidential succession, and blew a whiff of financial panic around the globe. The International Monetary Fund then turned the financial world upside down by imposing a forced loan to the major private banks. An austerity program, now a model for distressed debtor countries, placed heavy burdens on Mexico. But a year later, having met targets and begun to pay back debts, the once-bankrupt nation was being held up to the rest of the world as a paragon of fiscal rectitude. Jacques de Larosière, the steely Frenchman who serves as Managing Director of the IMF, paid tribute to "the remarkable progress already realized in the Mexican... position." Paul
Volcker, the Chairman of the Federal Reserve Board, saw Mexico leading the way from "fire-fighting to a multi-year solution."

Despite the success, puzzling, and in some cases cosmic questions cluster around the Mexican case. Has the adjustment program put a strain on the Mexican economy that will eventually break the country, and cause a political eruption? Does Mexico, because of its unique political system and proximity to the U.S., provide a misleading guide to countries, like Brazil and Argentina, where the political structure is shaky and the clamor of national dissidence very sharp? Are those and other countries about to bust the international financial system by forming a kind of debtors' OPEC, and declaring a joint default? Have the private banks been bailed out of bad loans, and immunized against the consequences, by backstage international arrangements? Is the need for the banks to recoup losses by big fees an element in the persistence of high interest rates? Is the whole system so ramshackle that some master global rescue scheme needs to be moved quickly into place? Does accounting legerdemain and the instinct of bankers to bluff amount, already, to a concealed default? Or is the debt crisis one of those affairs, constantly resolved by compromise at the brink, that reduce themselves to being "disastrous but not serious?"

In looking for answers to those questions, I found myself tracing exactly what happened in the case of Mexico. The quest began in Washington with talks at the IMF, the Federal Reserve Board, the Treasury and other parts of the government, including the White House. It led to New York, and the major American and foreign banks. It went to Mexico, through the offices of President Miguel de la Madrid and other officials, and on to a prison where a former head of the nationalized oil company, Pemex, Jorge Diaz Serrano, now languishes. This, as the principal actors tell it, is the story of the Mexican rescue.

No Toscanini

August 12, 1982, was D-Day. In mid-morning, Finance Minister Silva Herzog made separate telephone calls to Secretary of the Treasury Donald Regan, Chairman Volcker, and de Larosière. He told each one that Mexico had practically run out of reserves and could no longer meet payment on its debt. He said he wanted official help from governments, central banks, and international institutions. Though he didn't say it explicitly, it was also clear he would need a moratorium on payments to the commercial banks. He said he would be in Washington for meetings the following day — Friday, August 13.

In retrospect, after similar moves by many other countries, Silva
Herzog's action hardly seems singular. At the time, in fact, it was a bombshell that shook an entire universe. It was like Columbus setting out on an uncharted sea, and taking with him on the leap into the dark some of the stuffiest people in some of the world's most hidebound institutions.

"The world was different after that," Silva acknowledged. Angel Gurria, a 34-year-old financial whiz who works with Silva Herzog as director of Mexico's Department of Public Credit, and who is central to this story, explained the difference in these terms:

"We didn't crawl to the international financial community as debtors seeking relief through some minor adjustment that could be made backstage. We walked in through the front door. We said we had a major problem with a capital P. We didn't say the problem was a particular debt. We said the problem was the whole international financial structure. We said it was everybody's problem."

What followed inspired in virtually all the principal figures an air of wild surmise. Volcker called it "unprecedented." Jacques de Larosière allowed himself the term "historic." William Rhodes of Citibank, who headed the group that did most of the work for the commercial banks, spoke of his colleagues as "pioneers." Silva remarked: "The blueprints for dealing with this situation quite simply did not exist; we had to draw them up." Secretary of the Treasury Donald Regan, when asked who orchestrated the Mexican rescue, said: "There was no Toscanini. There was no Beethoven. It was more like Arnold Schonberg, improvising as he composed."

Three options

A look at what didn't happen provides, as is so often the case, a more striking measure of what did occur. With the phone calls to Washington Silva Herzog settled, temporarily at least, a debate that had been raging inside the government of President Jose Lopez Portillo for months. Mexico's gold and dollar reserves had been slipping all through 1982. Measures of many kinds — including a change in cabinet, a devaluation, a drive for government stringency, and several major loans — failed to stem the tide. By June, when the Bank of America experienced great difficulties in lining up subscribers for a $2.5 billion jumbo loan, Silva Herzog realized the battle might not be won. He established a small advisory committee to think through how Mexico would go bust. It included Gurria, central bank director Miguel Mancera, and deputy director Alfredo Phillips Olmedo. "It was crazy," Gurria says of the group. "We held in our hands the fate of Mexico, maybe the fate of the world. But we couldn't talk to anybody. We couldn't even ask lawyers what to do. If we hired an American lawyer, he'd
blab, and the banks would stop all loans. If we hired a Mexican lawyer, he'd learn the depth of the problem. Then he'd commit suicide."

Three different options emerged from the deliberations of Silva's advisory committee. One option was to stop payment and defy the creditors — default. "That was the atom bomb, the ultimate weapon," Phillips said of default. "Like most ultimate weapons, one reason we didn't use it was that you could always do it later, after something else had been tried." Silva said of the default option: "We asked ourselves the question what happens if we say, 'No dice. We just won't pay.' There were some partisans of that. But it didn't make any sense. We're part of the world. We import 30 per cent of our food. We just can't say 'Go to Hell.'"

Option two was to go for a solution at the secondary level through technical arrangements with the IMF, the central banks and the major national finance ministers. Many other countries, including Britain in 1976, had staunching a flow of reserves in that way. Mexico itself had taken the IMF cure as recently as 1976. But this time the economic problems were more intense, both in Mexico, and internationally. The debt was much larger — over $80 billion as against $20 billion in 1976. The great bulk of it was held by private banks, and it was — and remains — a question whether the national and international officials have the resources to push around the private holders of a debt that size. Furthermore, President Lopez Portillo inherited an economy straitened by the IMF when he became president in December 1976. He had moved swiftly out of the straitjacket, and he regarded any return to the IMF regime as a mark of failure. "I came in under the IMF yoke," he used to say, "and I'm not going to go out under it." Even so, when Silva Herzog became Finance Minister in March 1982 he began, in a systematic way, to edge towards option two. On repeated trips to Washington, he saw de Larosière and other officials at the IMF. He was in constant touch with the Fed, where Volcker and other officials kept pushing him toward the IMF. On July 23, Silva asked the IMF to send down a mission on an unofficial basis. By the early days of August, Mexico was on the verge of quietly slipping into option two. "We would have gone for it," Phillips said of option two. "We just ran out of time."

The Treasury off-guard

Some Americans contend bitterly that Mexico ran out of time because of the Treasury Department. In 1976 when the Mexicans started to experience trouble, the Treasury, in the person of Under Secretary Edwin Yeo, helped them to tie up a program with the IMF and the Fed. In 1982, the critics aver, the Treasury turned a deaf ear. "This whole debt crisis business
could have been avoided if the Treasury had been doing its job," says a New York lawyer who works closely with the banks. A former official in the Reagan White House concurs. "The reason Silva had to create an international crisis on debt was to get the attention of the Treasury. He had to hit them over the head to let them know something was the matter." A Treasury official at the technical level also accepts that view. "Silva Herzog kept describing the troubles to Don Regan, and Regan kept missing the message. Don was like a guy who keeps hearing the same joke over and over again, without getting the punch line."

Even when the third option — provoking a major crisis — had become official policy, Mexico was not sure how to proceed. Silva remembers that he knew he needed a very big package of help — "about $20 billion." He figured Mexico was good for about $4 billion from the IMF over a period of three years. But that would take several weeks to arrange, at least. After that he expected to tap the commercial banks. But he needed time from the banks before arrangements could be made with the IMF. He also needed money immediately, and for the next six weeks. For that he looked to the U.S. government, and various central banks led by the Fed. He hoped that the Washington visit next day would do the trick. But he wasn't sure, and he had arranged a fallback. A call list had been prepared for Lopez Portillo in the event the Washington meetings failed. It began with Ronald Reagan. It included Helmut Schmidt of Germany, Francois Mitterrand of France, Margaret Thatcher of Britain, and Zenko Suzuki of Japan. Lopez Portillo would have called them, Silva says. He would have said, in effect, "This isn't our problem. It's not the problem of the banks. It's the problem of the world."

Washington week-end

In that spirit, Silva flew to Washington on the evening of August 12. With him, among others, were Gurria of the Treasury, and Mancera and Phillips of the central bank. They spent the night at the Watergate Hotel. Next morning, Silva began making the rounds. His first call, at 9 in the morning of Friday, August 13, was on Managing Director de Larosière.

Silva told de Larosière that Mexico was aware of massive economic difficulties and wanted its maximum loan from the IMF. He said Lopez Portillo was prepared to negotiate with the IMF an austerity program that would restore Mexican finances in short order. He said he wanted the program as quickly as possible. Mexico's intent was to use the IMF agreement as a talking point in seeking help from the various central banks, governments and private banks.
De Larosière, a small, springy man of neat dress and immaculate enunciation, was more than ready. He had come to the Fund after a career as an inspecteur de finances that carried him to the inner recesses of power under President Valéry Giscard d’Estaing. Dealing with French Africa had introduced him to the plight of the poorer countries, and he was determined to help them. As a result, he found himself in a three-cornered struggle that called into question the very nature of the Fund.

The Fund was established as part of the Bretton Woods machinery in 1944 to avert the trade wars and competitive devaluations that spread the Great Depression around the world. Member countries pay in subscriptions (called quotas) mostly in their own currency. They are entitled to draw out several times the quota in hard currency loans from the Fund to meet balance-of-payments emergencies. But as a price for the loans, the Fund stipulates various conditions — including, usually, such anti-inflationary pills as budget cuts, higher taxes and reductions in subsidies and wages. In the first years, when the members were mainly developed countries, the Fund, though not much used, functioned smoothly. But in the 1950s and 1960s, many newly independent countries signed up. As they turned to the IMF for help, its conditions stimulated protests which became known as “IMF riots.” “All over the world,” a Jamaican official said in 1979, “people are speaking out against the oppressive terms and conditions of the IMF loans.” Thus one part of de Larosière’s struggle was against the concept of the IMF as a “rich man’s club.”

Precisely because of that reputation, however, many developing countries had turned away from the IMF to the commercial banks. These supplied funds at exacting rates, but without asking any embarrassing questions about economic policy. As a result the IMF share of international financing had dropped from 12 per cent in 1965 to 3 per cent in 1978. Thus a second front in the struggle involved the banks, and their lending policies. To carry weight with them, de Larosière needed to expand the Fund’s resources.

However, the main contributors — the U.S. with 20 per cent; Britain with 7; West Germany with 5; and Japan with 4 — had been obliged to place primary emphasis on fighting inflation. They had turned mean on making money available so multinational agencies could help developing countries. Thus, on top of his troubles with the developing countries and the banks, de Larosière was at odds with the industrial nations. The Mexican case — because it engaged a developing nation with heavy claims on American banks and the U.S. government — offered a way out of the bind. Especially since the Fund was full of Mexican expertise.

The IMF had tried to stay in touch with Mexico since the 1976
program. A routine study of Mexican finances initiated in 1981 had stretched out through 1982, in part because Lopez Portillo was loath to cooperate. The manager of the study — Sterie Beza, an American known as Ted, who is Associate Director of the Western Hemisphere Department for the IMF — had spent four days in Mexico beginning on August 2. He was with the Managing Director when Silva came in on the morning of August 13. Beza knew the state of Mexican finances, and had already explored, informally, the possible terms of an austerity program. But there were some points the Managing Director wanted to nail down.

First, in view of Lopez Portillo’s known antipathy to the Fund, de Larosière insisted that the Mexican government acknowledge publicly that it was seeking IMF assistance. Second, to counter some recent Mexican moves towards exchange controls, he underlined the Fund’s belief in free markets. Thirdly, he urged Silva to coordinate all his actions, including the approach to the commercial banks, in a large, interconnected package. According to one of those present, de Larosière’s parting words to Silva were: “Don’t do anything unilaterally.”

At 10 a.m., the meeting was over. The Managing Director spent much of the rest of the day going over numbers with Beza and other staff members. Late that evening, he went to the Federal Reserve Board to meet with Chairman Volcker. The Managing Director voiced the view that it would take until the end of September for the IMF to block out a program with Mexico. Three days later, on August 16, a new IMF mission — headed by Beza and including two aides — arrived in Mexico City. For the next two weeks de Larosière and the mission were in daily communication by telephone. “The IMF adjustment program,” the Managing Director said later, “was the anchor of everything else.”

At the Fed

After the IMF, Silva called on Paul Volcker, who had as much at stake in the encounter with the Mexicans as de Larosière. For Volcker was the prophet, and the Fed his Sinai, in the American quest for an end to inflation. In October, 1979, three months after Volcker became chairman, the Fed initiated a policy of holding down money supply cold turkey no matter what the consequences for the rest of the economy. Thanks to that “monetarist” approach consumer prices plunged from a 13 per cent annual rise in 1980 to under 4 per cent in 1983. In the process, though, interest rates climbed above 20 per cent, and unemployment rose about 10 per cent. Many firms went to the wall including two financial concerns — the Penn Square Bank of Oklahoma and Drysdale Securities in New York — with ties to the major
banks. There was a clear danger that recession would tip over into full-fledged depression. In July, 1982, the Fed began the expansion of money supply which eventually fueled the boom of 1983. In August, 1982, conditions were still extremely dicey. The Mexican debt problem, because it engaged most of the biggest American banks, raised the specter of financial panic in the U.S. It also gave Volcker more purchase on the economy as a whole. His foes in the Treasury claim he deliberately exaggerated the Mexican trouble as an excuse to come off the "monetarist" approach. His allies acknowledge that Mexico played an important part — "20 per cent," one says — in the Fed’s decision to unleash the money supply.

By accident, moreover, the Fed under Volcker had come to be a kind of Mexican mafia inside the government. Volcker himself had risen on the international side of the Treasury — as deputy under secretary for monetary affairs (1963-65) and as under secretary for monetary affairs (1969-74). He had been president of the New York Federal Reserve Bank, which has major international responsibilities, during the Mexican rescue of 1976. Henry Wallich, a colleague on the Fed’s Board of Governors with a special interest in international affairs, had taught Silva and Mancera at Yale. Ted Truman, the head of the Fed’s international finance division, had participated in the Mexican bail-out of 1976. Volcker’s replacement at the New York Fed was Anthony Solomon, under secretary of treasury in the Carter administration who had worked in Mexico as a private businessman. Solomon brought with him to the New York Fed Sam Cross, a former official of the Treasury and the IMF who was close to Volcker and Truman.

All through the first part of 1982, Cross was in weekly contact by telephone with Mexican officials on their financial situation. After becoming Finance Minister in March, Silva regularly lunched with Volcker on visits to Washington. Silva kept assuring Volcker that Mexico was moving as rapidly toward the IMF as Lopez Portillo would allow. Since a new president, Miguel de la Madrid, was due to take office on December 1 Volcker adopted as his policy getting Mexico through to the next president. To that end, the Fed twice (on April 30 and on June 30) arranged 24-hour currency swaps that allowed Mexico to meet legal requirements regarding reserves in month-end reports. Volcker gave Mexico a similar swap on July 30. On August 4, he allowed the Mexicans a $700 million swap for three months on the understanding, expressed in a letter from Silva, that it would serve as a bridge to the IMF. So when Silva showed up at 10 on the morning of August 13, Volcker was primed.

Silva opened with a statement on Mexico’s financial position. He indicated arrangements had been initiated for an IMF program. Meanwhile,
he needed emergency help. That meant money from the U.S. Treasury to get past the week-end. It also meant money from the Fed and other central banks to tide Mexico over the waiting period until the IMF program had been worked out. It lastly implied a moratorium on bank debt.

Exploring problems

Volcker then began doing what his aides say he does best — exploring problems. He questioned the strength of Lopez Portillo’s commitment to the IMF, and asked about possible problems of transition to de la Madrid. Silva, while generally reassuring, acknowledged there could be a change of heart by the outgoing president. He intimated that a time to watch was September 1, the date for the Mexican president’s State of the Union Message or informe.

A second problem explored by Volcker centered around the commercial banks. They had already been shaken by fears of default — by Poland in 1981, and Argentina after the war with Britain in the Falklands in July, 1982. The Mexican debt was much bigger — $80 billion as against $25 billion for Poland and $37 billion for Argentina. Moreover, the exposure of the American banks to Mexico was enormous. Mexican debt accounted for 44 per cent of the capital of the nine largest banks in the U.S. It tied up 35 per cent of the capital of the fifteen biggest regional banks. Some institutions held Mexican debt equal to their capital. Mexico’s troubles were sure to worsen the troubles of other Latin countries, including Brazil. Mexico and Brazil between them owed enough to strain the two biggest American banks — Citibank and Bank of America. The recent failures of Drysdale and Penn Square added further stress, notably on such major banks as Chase, Continental Illinois, and Crocker of San Francisco. While it was essential for Mexico to have a suspension of some debt payments to the banks, it was equally critical for the banks that Mexico keep up payments of interest as distinct from principal. For if interest payments ceased, the banks — under rules laid down by the Fed, the Comptroller of the Currency and various state agencies — would have to reclassify the loans as “non-accruing.” That would disrupt earning statements, reserve positions, and general confidence in ways likely to induce financial panic. So it was crucial that the Mexican officials get together with the commercial banks. Volcker suggested a meeting at the New York Fed. He urged Silva to be in touch with the dominant figures in the major banks, and he passed to the Mexican Finance Minister a list of private numbers where, even on vacation in the depth of an August week-end, the leading American bankers could be reached. Before the week-end was over, Silva called from
his suite at the Watergate the chairmen or presidents of Citibank, Bank of America, Chase, Chemical, Morgan Guaranty, Bankers Trust and Manufacturers Hanover. From those conversations, there emerged the idea of a small committee to represent the banks in dealing with Mexico.

A third problem addressed by Volcker was emergency financing. The $700 million swap extended by the Fed on August 4 had been expected to tide Mexico over through early September. Now it was gone. The IMF deal would bring in $4 billion over a period of three years, but only after the adjustment program had been approved. Some relief could also be expected from the private banks. But in the meantime, Mexico would need several billion dollars more. Volcker indicated that as much as $1.5 billion could come from various central banks. The U.S. was prepared to make available as much as half of that. Foreigners could supply the rest. Volcker suggested a session at the Bank for International Settlements in Basel. He then began calling the leading central bankers of the world. By the time the week-end was over, Volcker had talked by phone with the heads of the central banks of Britain, Canada, France, Germany, Japan and Switzerland. It was arranged that there would be a BIS meeting in Basel on August 18.

In the course of these discussions, a particularly close understanding was established between Volcker and Gordon Richardson of the Bank of England. One Fed official says: “The Federal Reserve’s actions and attitudes were constantly coordinated with those of the Bank of England. Gordon Richardson played a pivotal role in every aspect of the exercise. Without his leadership, the BIS package would never have been possible.”

There remained the immediate need for a bridge loan to get by the week-end. By Friday night, a figure of $2 billion had emerged. It was clear that the money would have to come through deals arranged by the U.S. government for food and oil. But the working out of the deal was the business of the Reagan administration and various different departments. Treasury was to handle the negotiations. In that affair Volcker was, in the words of one of his aides, “just a kibbitzer.” So after lunch at the Fed, Silva went to the Treasury.

**The Treasury mystery**

At the Treasury, Silva touched the heart of one of the mysteries of the Reagan administration. Secretary Donald Regan is a witty and cultivated Boston Irishman who did well at Harvard, better in the Marine Corps, where he rose to the rank of Lieutenant Colonel in World War II, and better still at Merrill, Lynch where, in 1971 he became Chairman and Chief Executive
Officer. He is used to running large organizations and working with big numbers. But there were placed under him in the Treasury outspoken partisans from the two schools of economic thought — the supply-siders and the monetarists — who found a home in the Reagan administration. Ill-equipped to judge between them, he did what came naturally to a former customer's man and Marine Corps colonel. He became a super-loyalist to the President.

Fidelity to the views of President Reagan has brought Secretary Regan into public conflict with some celebrated experts. He fought Volcker on monetary policy, and opposed his re-nomination as Chairman of the Fed. He battled with Martin Feldstein, Chairman of the Council of Economic Advisers, on taxes. On foreign economic policy he has been at odds with the Fed, the IMF, and the Treasury staff.

The regular staff at Treasury, many of them veterans of the 1976 Mexican crisis, maintained close ties with opposite numbers at the Fed and the IMF. Staff aides had been keeping a wary eye on Mexico ever since an oil price shift in June 1981 led to the loss of some $5 billion in expected foreign revenues. They had warned Secretary Regan of Mexican financial weakness when he went, along with President Reagan and a score of other heads of state, to a North-South summit meeting convoked by Lopez Portillo at Cancun in October 1981. They had repeated the assessment for the Secretary in briefings prior to meetings he held with high Mexican financial officials on an almost monthly basis beginning in April, 1982. In early July, the Treasury staff initiated discussions with other departments in the U.S. government about the possibilities of buying oil from Mexico in the event emergency help was required. The briefing paper prepared for Secretary Regan before a meeting with Silva on July 23 suggested that the Mexican might ask for help at that point. "I thought this would be it," a leading member of the staff says of the July 23 session. Instead the two ministers missed connections.

At that session, Silva laid out the Mexican economic situation in greater detail than ever. Regan said it was serious and urged the Mexicans to take corrective action, including an IMF program. As Silva prepared to go, Regan said: "See you in Toronto," a reference to the annual meeting of the Work Bank and IMF which was held that year beginning on September 5. "Maybe before then," Silva said, hinting coyly at the urgency of the problem. "Well," Regan replied, "if you're going to be coming up before, give me some advance notice."

That dialogue of the deaf averted any chance for a Mexican rescue short of a full-dress crisis. Moreover, even when Silva did telephone on
August 12 in response to the Regan invitation, the Treasury was not prepared. The Assistant Secretary for International Affairs, Marc Leland, was in London on Argentine business. Key staff people were away on vacation. So the critics who blame Treasury for being asleep at the switch have a point.

**A veto strategy**

But against that view there has to be weighed the basic strategy of the Reagan administration in foreign, and especially foreign economic, matters. The emphasis is on a negative approach — veto power. The perception is that since structures are shaky, the U.S. can exercise maximum influence by not going along, by hanging tough, and making others plead for the support of Washington. In that spirit, the Reagan administration has still not thrown in with the Law of the Sea Treaty. It fought long and hard against the West European pipeline deal with Russia. It refused to accept the Cancun formula for “global negotiations” between North and South. It resisted de Larosière and most of the other developed countries on expanding the resources of the IMF. Indeed, the Reagan administration has seen the IMF as a device for transferring American wealth to other countries. Far from wanting to rush in, it sought to stand out, and bargain for the best possible terms. Thus the Treasury, as a matter of deliberate policy, did not want to help the Mexicans until a true emergency presented itself.

The structure of the Treasury under Regan facilitates that negative approach. “The rudder on international affairs,” as one official puts it, is Beryl Sprinkel, a bank economist from Chicago who holds the post — previously held by Volcker and many other distinguished figures — of Under Secretary for Monetary Affairs. Sprinkel shares with his mentor, Professor Milton Friedman and with President Reagan, a horror of government meddling, and a nearly boundless faith in free enterprise. When a retiring official of the Carter administration gave him a list of problem debtors — including Mexico, Argentina and Poland — Sprinkel waved it aside with the comment, “the market will take care of them.”

Besides Sprinkel, Treasury has a second line of defense against claims from the rest of the world. For Sprinkel is a theoretician, unskilled at practical negotiation. Marc Leland, who was Assistant Secretary for International Affairs until January 1984, is a lawyer with limited experience in international banking. Secretary Regan himself has very little foreign experience. Neither does his deputy, R.T. McNamar, an athletic, 46-year old lawyer who had worked as a management consultant and then as an executive for a Los Angeles real estate and insurance firm. Thus moving
from the negative approach to an active policy meant a re-delegation of authority.

By 2:25 pm on Friday, August 13, when Silva arrived after lunch at the Fed, the Treasury had picked up its socks. Regan had established that Treasury would head the negotiating operation for the entire administration. He had tapped his Deputy Secretary, Tim McNamar, to handle the details while he stood aloof. Though Leland had not been called back from London, key staff members had returned from vacation. They had prepared an estimate of the Mexican financial position subsequently said by the Mexicans to be remarkably accurate. It showed that Mexico had a liquid reserve of less than $200 million. Since the country was losing dollars at a rate of at least $100 million daily, it would be broke by Monday, August 16, unless a deal was done — and, more important, announced — before the week-end was over.

Listing the loans

A first session was held with Regan and Silva in the Secretary’s office. After about an hour Regan excused himself, and the talks moved to his conference room. They went on through the afternoon and into the evening. People came and went from the Mexican side and the American side. “At one point,” a Treasury staff aide says, “I saw officials from State, Defense, the Energy Department, the National Security Council, the Office of Management and Budget — in fact most of the government.” Though it is hard to track exactly what happened, two lines of inquiry were clearly opened. First there was an effort to identify exactly what debts were coming due, when, and to whom. Gurria and various American technicians went over in detail the Mexican records of loans coming up for renewal. They looked at maturity dates, and estimated the amounts that might not be rolled over. By the end of that day there had been established a fairly clear picture of the Mexican cash flow. The understanding was that the Treasury would undertake to organize an American contribution of $2 billion as part of a $3.5 billion package thought to be required before the IMF accord could be reached at the end of September. Treasury was supposed, if everything else worked out, to make the money available by Monday — August 16.

Putting together the package required a second set of talks. Mexico was a big importer of food, and the U.S., a surplus producer, had included credits for food purchases in several earlier moves to help Mexico, including the 1976 rescue package. The Treasury staff had previously ascertained that there was surplus corn available. McNamar tied up by
telephone an understanding with Secretary of Agriculture John Block that one part of the package would be a $1 billion food credit. Then came the most difficult and controversial part of the agreement — the oil deal.

The oil deal

The idea of doing an oil deal has been credited to McNamar. In fact, the Mexicans had it in mind for a long time. “Nobody had to suggest an oil deal to us,” Gurria once exclaimed with some indignation. “We’d been doing oil deals for months.” Treasury staff people had been talking and writing of a possible pre-payment for oil since July. “McNamar gets a thousand ideas a minute,” one Treasury staff member said of the Deputy Secretary. “That’s called ‘creative thinking’ in the private sector. So in that sense you might say he thought up the idea of an oil deal.”

But putting the oil deal together was hard, and nobody denies McNamar’s prime role. First, on Friday afternoon, it was ascertained from the Department of Energy that the U.S. had a genuine need for the kind of crude which the Mexicans sell. Next came assurances that the Strategic Petroleum Reserve, whose purchases are made by the Defense Department, had available the $1 billion in cash which the U.S. proposed to make available. A technical part of the deal — an advance of $1 billion from the Exchange Stabilization Fund of the Treasury against a $1 billion payment from the Strategic Petroleum Reserve in the next five days — had to be approved by the Office of Management and Budget. OMB approved in principle, but only on condition that the terms of sale be justifiable to the Congress as a prudent use of taxpayers’ dollars which could hold up even when measured by what could be had in the private market. That meant cutting a hard deal with the Mexicans.

The original American idea was to pay about $28 per barrel for the Mexican oil — a bargain, since the going price was $32 on world markets. But as soon as that notion was broached to Silva, he pulled back. Setting a visible price per barrel posed two big problems. It would compromise Mexican relations with other oil producers who might feel undercut by the Mexicans. It also raised internal political perils because oil — and particularly the selling of oil to the Colossus of the North at cut-rate prices — is a sensitive subject with radical nationalists. Instead of going further himself, Silva called President Lopez Portillo and arranged for two other high officials with special responsibility in the oil area, to fly to Washington. Jose Andres Oteyza, the Minister of Patrimony and a darling of the nationalist left, and the Director of Pemex, Julio Rodolfo Moctezuma Cid,
flew to Washington Saturday morning, and joined the negotiations in late afternoon.

At the beginning Oteyza declared flatly that Mexico would not accept a deal denominated in dollar price per barrel. Instead it was proposed that the U.S. loan Mexico $1 billion against repayment in oil, with the understanding that the loan would bear interest charges. The Americans came up, late Saturday, with a proposal that in return for the $1 billion loan on Monday, the Mexicans pay back in oil, over a fifteen month period, the equivalent of $1.3 billion. That turned out to be an interest charge of 35 percent. Oteyza, after a telephone talk with Lopez Portillo said the Mexicans would not pay more than 20 percent, and that was an outrage. Lopez Portillo, according to some accounts, had been profane, and ordered a break in the negotiations. Some Americans clearly sympathized with the Mexicans. One very high official at the Federal Reserve accused the Treasury of doing a "chintzy deal." When the talks recessed Saturday night, there was an impasse.

At Camp David

Next morning, the Americans met at the Treasury to review the bidding. Someone suggested a tactic commonly used in private transactions to obscure the size of interest charges — namely the imposition of a negotiating fee. A fee of $100 million was suggested, and there ensued a bout of bickering among the Americans. The U.S. Ambassador to Mexico, John Gavin, a film actor and old friend of President Reagan, suggested to McNamar that they leave the bickering, and visit the Mexicans at the Watergate. The two Americans met with Silva and Oteyza at the hotel in mid-morning. McNamar unveiled the idea of the fee. It was acceptable in principle. But the $100 million amount enraged the Mexicans. Silva called Lopez Portillo and received permission to break off the talks anew. "Let Rome burn," Lopez Portillio said. Silva informed McNamar and Gavin of that decision, and said he would be going to the Mexican Embassy for lunch and then flying home. It looked like no deal, and default loomed.

In the course of the conversations, Silva had registered a flicker of interest when it was suggested that maybe the fee be cut in half. Back at the Treasury, Gavin and McNamar took up that theme with their American colleagues. The OMB stood adamantly against it. Gavin insisted that it would be absurd to wreck American relations with Mexico over a $50 million fee. At that point, at around 4 pm on Sunday afternoon, the Secretary of the Treasury stepped back into the negotiations.
Regan had spent Saturday in New York and on Sunday morning he flew by helicopter to Camp David where he met with the President and a group of Congressmen on the tax increase going through the House. After the session ended, he let the President's chief personal aide, Michael Deaver, know that he needed a few minutes to discuss with the President an urgent matter regarding Mexico. Deaver arranged the meeting. Regan summarized the Mexican problem, and asserted the need to do something about it. The President said he was not in good position to make a judgment on the details, but that if it was possible to help Mexico he would like it done. With that baton in his knapsack, Regan flew back to the Treasury.

McNamara reported his discussions with the Mexicans. Gavin ventured the thought that the issue should be taken to President Reagan. Regan said it was not the kind of issue the President should decide. He would himself take the responsibility for going back to the Mexicans with an offer to cut the fee in half. McNamara raised the question of the OMB. Regan turned very tough. "You tell them I want it," he said.

McNamara then called Silva and Oteyza at the Mexican Embassy. They had finished lunch, and, after another telephone conversation with Lopez Portillo who was said to be furious, were preparing to embark for home. After checking with Lopez Portillo again, they returned to the Treasury. From 5 through about 8 that evening, the Mexicans and the Treasury officials worked out the details of the oil deal. Drafting was done huzz-buzz-mugger with ministers and staff people alike throwing in words and phrases.

Breaking the news

Later there was bitter acrimony. The Mexicans, and in particular Oteyza, felt they had been robed. They insisted on keeping the contract secret. But it was eventually leaked to the left-wing magazine, Progresso. The final terms showed that the U.S. had bought the oil for roughly $27.40 a barrel — a discount of more than 20 percent. Judged as a pure loan, the interest came to over 30 percent. Secretary Regan said later that when he reported the deal to the President, Reagan told him: You are one hardhearted SOB." As the Secretary of the Treasury tells it, he responded: "No, Mr. President, I just want to give the American taxpayer the same kind of service I gave the stockholders of Merrill Lynch."

Late on the night of Sunday, August 15, Silva flew back to Mexico City. En route, a member of the party approached him as he was sipping a
scotch. He asked the Finance Minister if Mexico had really been prepared to break with the U.S. and the international community over the oil deal. Silva took a big gulp. Then he nodded. "We would have broken," he said.

Next day the Finance Minister laid out the details of the Washington weekend in meetings with Lopez Portillo at the President's Mexico City residence, Los Pinos. The President authorized him to go public. On the evening of August 17, Silva gave a nationally televised press conference from his office in the finance ministry. In the course of the press conference, he volunteered answers that made known to the world every major point negotiated in Washington. Here is the summary filed to Washington by the Treasury attaché in Mexico City:

Treasury Secretary Silva Herzog held a televised press conference August 17 and announced that in light of the current economic situation Mexico was (1) increasing sales of petroleum to the U.S. for which an advance payment had been credited to the Bank of Mexico August 16; (2) currently negotiating, principally with the central banks of the major industrialized countries for "lines of support" to total $1.5 billion; (3) preparing for negotiations in the next few days with the world's principal commercial banks to restructure voluntarily Mexico's public and private debt; (4) having conversations with the IMF in order to utilize IMF resources available to Mexico as a member contingent upon an economic adjustment program agreeable to Mexico; and (5) receiving $1 billion of credit from the U.S. to facilitate the importation of grains and fundamental foods.

The central banks held their first meeting on the matter next day in Basel, Switzerland, at the office of the Bank for International Settlements — an institution established in 1930 to manage Germany's World War I reparations after the crash of 1929. The BIS evolved, after World War II into a clearing house for the main European central banks, and a convenient meeting place. Though the U.S. has never joined, it enjoys associate membership status. Ever since 1960, when currency cross-rates became volatile, this country has taken the BIS seriously. The chairman of the Fed or a governor usually attends annual meetings. A designated member of the Fed's Board of Governors goes to monthly sessions of the BIS. Built around the monthly meetings are various committees which deal with general or particular issues. Of these the most important brings together the central banks of the "Group of Ten" industrial countries — Britain, Germany, France, Italy, Sweden, Belgium, Holland, the U.S., Canada, and Japan. While not counted in the ten, Switzerland sits as the host country. Discussions range from the general state of the world economy to fine points of banking practice.
Over to Basel

The BIS had held a regular monthly meeting in July, and was not due for another session until September. Under the special arrangements made by Volcker, however, a group of deputies of the G-10 countries — known as the Euro-currency Standing Committee — met at BIS headquarters on August 18. Gunther Schleiminger, who serves under Leutwiler as General Manager of the BIS, was in the chair. The American representative, Henry Wallich, had flown over from Washington. Two Mexican officials — Phillips from the Central Bank and Ariel Buira, then the Mexican representative at the IMF — had also flown from Washington. Volcker had made prior arrangements by telephone on the basic terms of the loan. It was to be for $1.5 billion. The U.S. would advance half; the rest would be split among other central banks.

Those arrangements reflected certain underlying realities. The central banks in each country are the lenders of last resort for the commercial banks. Just as the Fed was nervous about the vulnerability of the American banks on Mexican debts, the central banks of Europe and Japan were worried about their private banking systems. The U.S. had the primary exposure in Mexico and turned to the others for help. Britain was particularly concerned because London, as an international financial center, had a huge stake in the system as a whole. But the others also had problems — notably in loans to Eastern Europe on which they wanted some American support. Despite this rough community of interest, each country had special views and prejudices to indulge. These surfaced in the working out of the details at the BIS. Here, according to one of the participants, is what happened at the Basel meeting of August 18:

The Mexicans outlined their financial position, and then withdrew. The usual arguments were then advanced by the representatives of each country. The Belgians and the Germans, taking the side of the creditor countries, raised doubts as to whether the Mexicans really would settle on an adjustment program with the IMF. The French backed them up, and spoke of other difficulties. The Italians, since they may need to borrow sometime themselves, were sympathetic to the Mexican position. Britain and the U.S. expressed confidence the arrangement could be managed. In the end, the Euro-currency Standing Committee tentatively agreed to the loan as a bridge to the IMF adjustment program pending final approval by the G-10 governors. The money would be deposited with the Bank of Mexico account at the Fed in New York. It would be paid in three slices. Payment of the first slice was made conditional upon a showing that Mexico could put up something by way of collateral if the IMF negotiations fell
through. A BIS team was sent to Mexico City to work out the collateral. At the last minute, Spain, as a gesture of support for Mexico, volunteered to contribute $175 million to the pot. The U.S., working on the 50-50 principle, matched that. So the total, instead of the $1.5 billion originally sought, went up to $1.85 billion.

Enter the private banks

With the central banks in tow, it was time for the private banks. Hours after the BIS meeting adjourned on August 18, Silva flew from Mexico City to New York. On August 19, he held a round of informal meetings with top officials of many of the big U.S. commercial banks. That evening he had dinner at the New York Federal Reserve Bank. Volcker had come up from Washington along with Ted Truman. Tim McNamar from Treasury was also on hand. So were Solomon and Cross of the New York Fed. The purpose was to work out a common strategy for a session — called for the next day, August 20, in the auditorium of the New York Fed — that would formally bring the Mexicans into a new relation with the universe of the private banks.

In the 1970s, Mexico had positively glowed with features attractive to bankers on the prowl for borrowers. It had oil — a sure money machine in the world after 1973. It maintained an active commerce with the U.S. that also earned dollars. Proximity to the U.S. also meant that Washington would, in the last analysis, probably cover the worst risks. Moreover, because of the active cross-border trade, the very biggest banks could lay off participation in loans to regional banks genuinely keen on financing commerce with Mexico. Thus an official of First Interstate of California explained his bank’s participation in various government loans syndicated by Bank of America in these terms: “We loaned to the government to win favor for loans to the private sector.” Even small local banks sought a piece of the Mexican action as a safe line of access to the lucrative international field. As the manager of foreign loans for a bank in Washington, D.C. said of Mexico: “The feeling was that if you can get in there you’re in good shape.”

Events imparted added allure. Recession in the U.S., after 1979, gave the banks new reason to look abroad. The unseating of the Shah in Iran both pushed up the price of oil in general, and made Mexico, because of its proximity, that much more attractive as a supplier. Suddenly a scramble was on to make loans to Mexico. This is how it looked to one of the Mexican authorities, Angel Gurria:

The banks were hot to get in. All the banks in the U.S. and Europe and Japan stepped forward. They showed no foresight. They didn’t do any credit
analysis. It was wild. In August, 1979, for instance, Bank of America planned a loan of $1 billion. They figured they would put up $350 million themselves, and sell off the rest. As it turned out they only had to put up $100 million themselves. They raised $2.5 billion on the loan in total.

In the stampede to compete, the banks, with an assist from the Mexican authorities, proved highly inventive in circumventing burdensome rules. In the course of the Mexican debt work-out a major controversy developed regarding the financing of Pemex, the national oil company, by a huge acceptance facility arranged with the Bank of America.

Another problem grew out of the rules applied by federal and state authorities to limit the amount a bank can loan to a single customer. A "means and purpose" test allows banks to list loans to different government entities separately provided each entity has an independent financial base. But the Mexicans came into the market with so many different governmental corporations that the financial base was difficult to distinguish. There was the government itself, technically, the United Mexican States. Then there was the national oil company, Pemex. Then the Development Bank, Nafinsa. Then the Telephone Company, and the nationalized steel plant, and the fisheries, and sugar mills and so forth. In the end, the banks came to loan to the Mexican government in more than a score of different guises.

Spilling the juice

The expansion of the banks to the point of breaching the regulations was not achieved by friendly supporters of the community chest. During the 1970s bold leaders came to the fore in most of the major banks. Perhaps the best-known is Walter Wriston, the tall, witty chairman of Citibank. Wriston took over in 1971, with a vow to raise bank earnings by 15 per cent annually. By innovations in computers and by expansion abroad, he built a hundred billion dollar bank, out front of Bank of America and Chase in assets. He asserted the free enterprise creed with extraordinary vigor, and he drew around him men of similar views and equal self-confidence.

All of that history, with its personalities and problems were in the background as Silva approached the private banks in New York. Basically he wanted a voluntary postponement of debt payment. Originally he had hoped to win a stand-still for the rest of 1982. The round of informal conversations at the various banks convinced him to ask for 90 days. Silva had also thought he would not have to seek any new money for the balance of 1982. But the latest work on the numbers revealed that Mexico would
need additional financing. One of those who joined in the talks on August 19 recalls this scene:

"Silva started off very smoothly, outlining the financial situation, and saying that Mexico would need a moratorium, but no new money. As he was talking, Gurria came in and sat down. He looked terrible. His hair was unkept. His eyes were bleary. His clothes told you he had not changed them all day. His hands were shaking, and when he picked up his orange juice, he spilled it on his lap. When Silva came to the part about not needing any more money, Gurria interrupted. 'Excuse me, Minister,' he said, 'but our latest projections show we may need some new money this year. Maybe as much as a billion dollars.' Silva picked it up as though nothing had happened. From that point forward, and for the next few months, the estimate was Mexico would also want a billion in new loans."

Nobody was sure exactly how many different banks held Mexican debt. Estimates ranged from 500 to more than a thousand. Representatives of about 800 had been asked to meet Silva in the auditorium of the New York Fed next day. No matter how many eventually turned up, the number was clearly too large for comfortable working relations. The idea of a committee representing all the banks had emerged as a result, and in the course of the day, Silva had put together a list of about a dozen major banks prepared to serve on the committee. As to the leaders of the advisory committee, as it was called, Volcker personally asked Bank of America and Citibank. The two biggest banks agreed that they would take charge of the advisory committee. That action, in effect, brought the most important commercial banks on board with the central banks in the rescue effort.

Representatives of the advisory committee banks met briefly with Silva at the New York Fed early next morning, August 20. They went through a kind of dress rehearsal, with Silva speaking his piece and the bankers putting questions. Then at 11, the Mexican Finance Minister went to the auditorium to meet the other financial institutions holding Mexican debt. Of the 800 banks invited, 115 had sent representatives. They came from the ends of the earth — from Argentina to Quebec; from Tokyo to Riyadh, and from all parts of Europe.

**Cha Cha Cha**

A recording of the meeting apparently exists. So, at least, I was repeatedly told by officials of the finance ministry in Mexico City. Getting hold of it, as in so many other matters Mexican where precision is at stake, has been like running down the Nixon tapes. One transcript that was given to me as the genuine article by a Mexican official turned out, when played,
to be a recording of cha cha cha music. So in the end, I have relied on notes taken by an American participant with no axe to grind. This, according to the notes, is how the meeting went:

The head of the New York Fed, Anthony Solomon, spoke first. He alluded to the results of the Washington week-end and the BiS meeting in Basel. He said that while the meeting place was provided by the Fed, the decisions would be up to the Government of Mexico and the private bankers. But he also indicated that the authorities hoped for a constructive outcome, and for cooperation between the Mexicans and the private banks.

Silva then took the rostrum. He briefly outlined Mexico's economic and financial position. He stressed the intent to develop a program of adjustment with the IMF that, by imposing austerity measures on Mexico, would lead to a rapid improvement in balance of payments. He said that Mexico desired to maintain its relations with the international financial world, and would continue to pay interest on all outstanding loans. What he wanted was a postponement for 90 days on payment of principal on debts owed by the Mexican government and its agencies. The terms would be worked out mutually with the banks. He indicated that an advisory committee had been formed for that purpose. Then he took questions.

There were twenty-three questions — all of them, except one from a Texas bank and another from a bank in North Carolina, posed by representatives of major institutions in the money centers of the U.S. and Europe. The queries raised issues that would become increasingly difficult over the weeks ahead: What would be done about the debts of Mexico's private sector? What about government bonds? How about deposits — many of them on very short term and coming due from day to day — placed with Mexican banks by other private banks in the interbank market? Interspersed with the questions were occasional expressions of support for the Mexican effort. But the endorsements came only from major institutions — Bank of America, Citibank, Chemical, Manufacturers Hanover, Union Bank of Switzerland and the Crédit Commercial de France.

At the end, Silva put out a press release. It claimed that all the commercial banks had "accepted in principle the Mexican proposal of rolling over the maturities..." Several of those present later complained that they had only not said no. But, as a practical matter, the commercial banks, too, had been hooked.

**Rhodes takes charge**

Late that afternoon, August 20, the advisory committee held its first meeting in the Citibank building on Park Avenue. On hand were representatives of 14 banks — Chase, Chemical, Morgan Guaranty, Bank
of America, Bankers Trust, Manufacturers Hanover, Bank of Tokyo, Lloyds, Société Générale of Belgium, Bank of Montreal, Swiss Bank Corporation, Deutsche Bank, and Banamex of Mexico. The first business was designating three co-chairmen as previously arranged by Volcker. The European banks did not want to be publicly associated with the Mexican problem, so it was not until later that the Swiss Bank Corporation agreed to supply a co-chairman. Bank of America was ready to serve, but it was only after several meetings that Preston Bennet, a vice president, became a formal co-chairman. That left authority in the hands of the Citibank co-chairman, William Rhodes.

The emergence of Rhodes as leader of the advisory committee was a critical event in the Mexican rescue operation because he came to link two principal figures who otherwise communicated hardly at all. Between Paul Volcker of the Fed, the chief American financial authority on the public side, and Walter Wriston of Citibank, the chief financial authority on the private side, there exists the kind of rivalry usually associated with siblings. Both are intelligent, articulate, vigorous men of undoubted achievement and impressive physical stature. But Volcker is primarily a public servant ready to subordinate self to detached analysis of the largest good for the largest number. Wriston cares chiefly about the private enterprise system that has worked well for his bank — and in his view the US economy — and he expresses his preference in a wry, sardonic manner with an emphasis on ideological argument. The two men clash systematically on major issues of monetary policy, and bank deregulation, and the differences are personal. Wriston, in reference to Volcker’s penchant for managing things, calls the Fed chief “the big Nanny.” Volcker dismisses most of Wriston’s views, and tries to go around him in dealing with the banking community — often through Lewis Preston of Morgan Guaranty, a suave and highly intelligent banker who gets on with almost everybody. But Preston does not usually prevail when pitted against Citibank. It was only when Rhodes came on the scene that Volcker and the Fed had a sure pipeline to the bankers.

As in so many other features of the Mexican debt rescue, Rhodes came on the scene almost as much by chance as by design. He had served Citibank in Venezuela and Jamaica before being named, in 1977, officer in charge of operations in Latin America. In 1980, he became a senior vice president for Latin America in the bank’s country risk assessment group. Along the way, he had participated in two debt reschedulings of small countries — Nicaragua and Jamaica. He was known to Silva and Gurria in Mexico, and to David Finch, a veteran official of the IMF with special responsibilities for Latin America and close ties to de Larosière. So besides his utility to Volcker, Rhodes had standing with the Mexicans and the IMF. Still his weight in those quarters depended on his influence at Citibank.
Rhodes's promotion to senior vice president in 1980 made him a member of the policy committee which meets weekly on major matters. Being placed in the country risk assessment group, however, had certain drawbacks. It stands outside the major line areas of corporate lending, consumer operations, and capital development and not on the ladder of ascent to the top. Moreover, it does not have a particularly good reputation for astute pre-vision of troubles ahead. The eruption of Mexico’s difficulties, in August, 1982, took the group, and therefore the bank, by surprise.

Precisely because of these conditions, however, Rhodes had no trouble moving around the formal table of organization. He reported sometimes through corporate lending and sometimes through capital development. He developed an easy relation with Wriston personally, and through Wriston with most of the other leading bankers. In a short time he became almost the only person in the American banking community able to touch all bases. So besides leading the advisory committee for Mexico, he was named head of advisory committees formed subsequently for Brazil, Argentina, Peru, and Uruguay.

After choosing officers, the first business of the advisory committee was to alert all other banks as to the existence of the advisory committee, and thus, to draw them into the process of an accord with Mexico on rescheduling of loans. That involved some statement about the nature and size of the debts. As the advisory committee members talked, it became clear they had only the most general data. They needed exact information from the Mexican authorities — notably Gurria. But he was not around. There was a feeling of bitterness, one American present at that first session recalls. "Somebody said: 'First, the Mexicans get us together on an emergency basis. They tell us the roof is falling in. Then they walk away as if nothing had happened.'"

An urgent search for Gurria was set in motion. He was finally located in a private plane, poised on the runway at Newark Airport for flight back to Mexico City. Gurria disembarked. At about 7 that evening there got under way between Gurria and the advisory committee what turned out to be another Mexican week-end — three more days, Friday, Saturday and Sunday, of harried discussions about Mexico’s debts. This is how one of the participants later described what happened:

"We were members of an advisory committee, but we didn’t know each other, and we didn’t know the problem. Gurria had all the information, and the only thing we could do was get our arms around him and squeeze. The first thing we had to do was to get a list of what debts were maturing when. Particularly on Monday. Friday night, and Saturday morning were total chaos. Saturday afternoon, we began to get a feel. For example we
found that one financial house in London—Singer and Friedlander—had a big payment due from Mexico. We wanted them to stay calm. We didn’t know how to reach them on a week-end in August. So we called the Bank of England. The Bank called Singer and Friedlander. That did it. They stayed calm. They rolled over the debt on Monday morning."

Apart from putting in quick fixes like that, the advisory committee and Gurria worked out two telexes that were sent to the banks holding Mexican debt on Sunday, August 22. One was from Finance Minister Silva Herzog. It reviewed all previous developments beginning with the Mexican crisis, continuing through the arrangements made in Washington and with the BIS, and citing the New York meeting with 115 banks on August 20. It made reference to the advisory committee. It then reiterated the basic Mexican proposal for a postponement of all payments on principal owed by the Mexican government for 90 days, beginning August 23. It ended with a request for “your positive response.”

The second telegram came from the advisory committee. It said the committee had been formed “in connection with Mexico’s request to refinance principal payments on short and medium term public sector bank debt falling due in the 90 day period commencing August 23.” It said the Mexican proposal was “an integral part of a broadly based support program endorsed by various national and international public institutions.” It said the advisory committee banks support the Mexican proposal “and consider its acceptance by all banks to be essential...” The telex ended with a request that banks with “any questions” contact members of the advisory committee.

“We had no response to that telex,” Rhodes recalled later. “That was the best we could have done. All during this period the rumor mills were working overtime. Every day we had a story of a bank about to drop out, or a scandal in Mexico, or something else gone wrong. What that first telex did was to maintain a flow of information. It kept the lines open so that we could keep doing business.”

The interbank market

The doing of business rapidly disclosed two unanticipated problems that grew in severity to the point of threatening the whole Mexican accord. One was the problem of interbank deposits. Six private Mexican banks—Bancomer; Banamex; Banco Serfin; Commermex; Somex; and Banco Internacional had branches in London and New York with access to the interbank market. Had their accounts been frozen in the moratorium, the whole interbank market could have collapsed, with devastating impact in
London, and, perhaps New York. At the session with the banks at the New York Fed on August 20, the Mexicans had been asked about interbank deposits. Gurria had said the Mexican agency banks would do their best to honor any claims. At the time, that did not seem a particularly rash commitment. During the first meeting of the advisory committee, the interbank question did not come up. Nor was it mentioned in the telex of August 22. But that morning, Larry Miller, a vice president representing the Chemical Bank on the advisory committee, had breakfast with the head of one of the Mexican branch banks, Bancomer. The Bancomer official warned Miller that he held deposits of $50 to $60 million from other banks coming due in the next few days. He could not pay off the claims, and he anticipated difficulty in securing a roll-over. On August 23, Miller met with an official from a second branch bank — this time of Banamex — who reported the same problem. The day after that, August 24, Miller met with the heads of all six Mexican branch banks in New York. He wanted to know how much they owed to other banks, and when the debts were maturing. Since the Mexican banks were competitors, each with an interest in masking its position from the other, Miller had each bank officer write down on a blank piece of paper the total amount in outstanding debts on the interbank market, and the amount coming due in six months. It turned out that the six branch banks had obligations of $6.5 billion to other banks. About 90 per cent of that was coming due in the next six months. The branch banks themselves did not have surplus assets they could sell. Most of them, in fact, had borrowed the money, on instructions from Mexican authorities to buy Mexican government securities that could not otherwise have been sold. Since the government was not redeeming the securities, the Mexican banks had no means to pay what they owed the other banks. They would have to draw on the new funds raised by the government. So unless roll-overs could be organized, all the emergency funds the Mexicans had secured at such pain from the U.S. and the IMF and the BIS could leak out through the interbank market.

Miller duly reported the interbank situation to the advisory committee. The committee had been setting up subcommittees to deal with particular problems. A macroeconomic subcommittee had been established under James Nash of Morgan Guaranty to keep the banking community posted on the general situation in Mexico. A debt definition subcommittee had been organized under Michael Hunter of Lloyds to prepare an exact breakdown of what loans would be included, and what excluded, from the refinancing agreement. A communications network had been created through a series of regional subcommittees. Each American member of the advisory committee took responsibility for ten different regional banks.
Each regional bank took responsibility for ten smaller banks in its area, and so on down the line. The whole American network was put under the direction of Harry Taylor of Manufacturers Hanover. The foreign banks on the advisory committee were also given regional assignments — the Bank of Tokyo for Asia; Bank of Montreal for Canada; Deutsche Bank for Germany, Holland and Scandinavia; Lloyds for Britain, Ireland, India, Australia, Greece, Turkey and the Middle East; Société Générale for Belgium, France, Luxembourg, Portugal and Spain; the Swiss Bank Corporation for Austria, Hungary, Italy, Switzerland and Yugoslavia. Latin America was made the responsibility of Citibank.

An additional subcommittee to manage the interbank problem was set up under Miller and Terry Canavan of Chemical. They arranged for advance notice from the Mexican branch banks of the amount of interbank debt coming due each week. Through the regional network, they pressed banks having claims on the Mexican branches to roll over. Response was uneven. Some banks — the Mexicans have cited Flagship of Florida, Mid-Atlantic of Newark and European-American of New York — proved uncooperative. But the leakage was not very serious — at least not in the first week.

The Pemex facility

The second unexpected problem to crop up turned on the debt accumulated by Pemex, the Mexican state oil company. It amounted to $20 billion, or a quarter of the total debt. One of the biggest chunks was a Bank of America facility of $4 billion. Under the facility, Bank of America extended Pemex a $4 billion line of credit. The credit was worked off every 180 days against receipts from oil transactions. Bank of America had distributed the risk among some 80 banks in the U.S. and abroad. On August 19, as Volcker was moving to put together the advisory committee, Bank of America had raised some questions about the Pemex facility. Later other questions arose. Among other things it was not clear that the 180 day period conformed with the regulations of the Federal Reserve governing eligible acceptances. If not there were questions regarding possible violation of lending limits, which made it difficult for Bank of America to renew the facility with participating banks. At the outset that problem was met with waivers whereby Bank of America was absolved of any legal liability by the banks participating in the Pemex facility. Eventually, the Fed relaxed the regulations to let Bank of America over time bring the tenor of the acceptance in line with a strict interpretation of the rules. But long before that there came up, as an obstacle to the BIS loan, a question about
double and triple pledging of oil transactions by Pemex.

The BIS, after the Basel meeting on August 18, had dispatched a team of lawyers to Mexico to work out an arrangement for some collateral against the $1.85 billion loan. The team first discovered that it could not, as originally anticipated, take full collateral in gold; Mexico did not have enough available. A deal was then blocked out whereby Mexico pledged receipts from oil to the BIS. But before the contract could be signed, the Pemex law firm, Cleary, Gottlieb of New York, interposed objection. It developed that Pemex had already pledged huge amounts of oil sales in prepayment contracts with various banks acting on behalf of oil distributors. In the five months since April, indeed, Pemex had done ten different advance payment deals amounting to $3.1 billion. No one knew exactly what was immediately available for collateral, but clearly the BIS collateral arrangement had to be reworked. The whole messy problem was turned over to the Federal Reserve. Volcker delegated it to his general counsel, Michael Bradfield. Bradfield reached a compromise with a pair of BIS lawyers and Mark Walker from Cleary, Gottlieb. The arrangement was that the BIS would have call on Mexican oil receipts beginning in August, 1983. As it happened, Mexico paid off the BIS loan long before then. But if no bargain had been struck, there might have been a suit against the Mexican government. "I don’t know what would have happened then," one of the lawyers said. "The courts would have had to answer questions they have never answered." So when an accord was reached, in the early morning of August 28, the lawyers were jubilant. Next day, Volcker reported the agreement to his fellow governors of the G-10, and they gave final approval to the loan which had been tentatively approved on August 18. A press communiqué, put out by the BIS on August 29, made the first official announcement of the agreement to grant Mexico a credit facility of $1.85 billion. It said: "The agreement provides for drawings on the facility in three tranches in line with progress towards agreement between the Mexican Government and the International Monetary Fund on an economic stabilization program..."

The negotiations between Mexico and the IMF had been fairly bowling along. The IMF group under Ted Beza had reached Mexico City on August 16, the morrow of Silva’s Washington visit. Beza and his people had been installed at the Bank of Mexico where they worked directly with a Mexican team headed by Luis Orci of the finance ministry and Alfredo Phillips of the central bank. Each day the two sides talked over various arrangements. They separated to crunch numbers in the evening. On the week-end of August 28-29, both groups went, with Silva Herzog and Mancera of the central bank, for an uninterrupted session in the resort town of Oaxtapec.
Along with them went Carlos Salinas, a Harvard-trained economist close to the incoming president, Miguel de la Madrid.

They came, by all accounts, close to final accord. Beza says: "You never know 100 percent until a bargain has been finally sealed. Each part of a program carries implications for every other part of the program. That's why we have to keep doing the same numbers over and over again. But we were all talking the same language. We had agreed on the meaning of the different terms. We knew what possible combinations would get us to what possible results. We had agreed that the public sector deficit would have to be cut in half. We were down to three or four different possibilities on taxes, wage policies, and budget cuts."

If anything, the Mexicans were even more optimistic. Phillips says: "We knew the deal we needed to negotiate even before Beza arrived. We tied up everything at Oaxtapec. We even had the hardest part — the cut in public sector deficit from 17 per cent to 8.5 per cent of GNP. Nothing was written down because we had moved so quickly. But it was easy. We could have announced agreement at the IMF meeting. We could have signed it all in Toronto on September 5."

**Whirlpool of politics**

But on September 1, the whole business — the delicately concocted package of contingent understandings that had been piloted through the rapids of Washington, across the deep blue sea of the central banks, and around the waterfalls of the commercial banks — was suddenly wrecked on the best-marked of all the hazards. It came to grief in the whirlpool of Mexican politics.

Two unique features distinguish the Mexican political scene. First, there is a virtually omnipotent president. The leader of Mexico is elected for a six-year term, and not subject to reelection. The parliament is under his control, and so are the courts. He runs most of the economy. He appoints the cabinet, and commands the military and the police. The instruments of local government are in his hands. He has the means to dominate press and television, and even most cultural life. He practically appoints his own successor, and is not subject to serious scrutiny or sanction even after leaving office. While in power, he is a kind of temporary dictator.

The second unique feature, which makes possible the first, is the Partido Revolucionario Institucional (PRI), or Institutional Revolutionary Party. The PRI was formed in 1929 to bring order out of the chaos that followed the revolution of 1917. It groups federations of workers, peasants, and the middle class. While not the only party in Mexico, it has nominated
the winning candidate for president in the last nine elections. It controls all
the state houses, and most of the major cities. It has an absolute majority in
both the lower House and the Senate of the national legislature. The
smaller parties have representation there mainly because of an
amendment to the constitution which guarantees them a quarter of the
seats. About 200 people, the so-called "revolutionary family," run the PRI.
They share out the major offices among themselves and pass leadership
posts from generation unto generation. Most of the ministers in the present
government of President de la Madrid are sons of fathers who held high
government office before them. They speak of themselves as
"grandchildren of the revolution."

Shock of ’68

The system counts many radical defects. But these were offset — and
for several decades almost entirely eclipsed — by two spectacular
achievements. Political stability for one. Power has passed in an orderly,
constitutional fashion through nine successive presidencies. The decisive
break came in 1946, when a general, Avila Camacho, picked a civilian,
Miguel Aleman to succeed him as president. Aleman broke the power of
the army. Since then Mexico has never experienced a military coup. With
the PRI holding title deeds to the revolutionary tradition and the army
muzzled, radical protests have little to bite on. Mexico has enjoyed greater
political stability than any other country in Latin America.

Economic performance comprises the second spectacular
achievement. In the three decades after 1940, economic growth averaged
six percent annually. Inflation was kept in bounds. A flourishing private
sector developed steel, autos, textiles, tourism and, in irrigated areas, the
cultivation of fruits and vegetables. Thanks to steady growth, Mexico stands
tall in the list of the almost developed nations. As measured by GNP, it is the
tenth largest country in the world.

Like many developed countries — like the U.S., France and Japan, for
example — Mexico suffered a political shock in 1968. A series of student
protests, set against the background of the Olympic Games, culminated in
a pitched battle between the students and the army. Mexican soldiers killed
more than a hundred students. That event — The Battle of Tlatelolco Plaza
— forced sharp questioning about an economic performance that had
enjoyed wide acceptance as the "Mexican Miracle." Those in power,
especially, were put on the defensive. "We all figured something had gone
wrong," Luis Orci, a career economist at the finance ministry who now
serves as Mexico’s representative at the Inter-American Development
Bank, recently recalled. "We scratched our heads, and tried to figure out what it was."

A ready answer to that question came from a school of radical economists sometimes known in Mexico and elsewhere as structuralists. As they saw it, rapid economic growth had yielded gross structural imbalances throughout Mexican society. Inequality of wealth was egregious — some 40 per cent of the national goods was owned by only 10 per cent of the population. While cities prospered, large tracts of the countryside stagnated in a backward agriculture based on small, inefficient plots which afforded work only during planting and harvest times. Millions of low-income workers seeking escape from that deadly life migrated to the cities where they settled in shanty towns — the cuidades perdidas, or lost towns, that sprang up outside the industrial centers of Mexico City, Monterrey and Guadalajara. Even in those places much of the new industry was financed by foreigners, especially Americans, and was so heavily mechanized that it did not offer enough jobs to accommodate a rapidly expanding work force. Governments hooked on promoting growth made no address to such long-term social problems as pollution and vertiginous population growth. Much of the cream was skimmed off by pervasive corruption linking high government officials, union leaders, and the tycoons of the private sector.

As remedies, the radicals proposed direct government action to right the imbalances. They wanted the state to promote faster growth by programs aimed at creating new jobs outside the three major cities. They favored direct subsidies to poor peons working unimproved land in the countryside. They proposed social and educational programs for the millions massed in the cuidades perdidas. To pay for the programs and subsidies, they advocated heavier taxation of the private sector, and a clean-up of corruption.

Academically, the radicals enjoyed superb credentials. They derived from a socialist school of development economists which included Nicholas Kaldor of Cambridge, who had served as an economic adviser to Prime Minister Harold Wilson. They had been enshrined in the Economic Commission for Latin America (or ECLA) and the United Nations Commission for Trade and Development (or UNCTAD) which had been founded by the distinguished Argentine theorist, Raul Prebisch. But in Mexico, they encountered powerful resistance from a well-entrenched group of classical economists who fostered the spectacular growth of the previous decades.

The orthodox economists were of course not blind to the structural strains set up by rapid growth. But they questioned root and branch the
prescribed remedies. As they saw it, higher government spending would yield inflation. Inflation would price Mexican goods out of foreign markets, especially in the U.S. Mexicans would have an incentive to buy American, to take foreign trips, and to trade pesos for dollars and move them abroad. While some countries might prevent the flow through exchange controls, Mexico was too close to the U.S. for such tactics. Instead, the orthodox economists favored a continued battle against inflation, and an ending of subsidies and protective tariffs so that Mexico could become more competitive in international markets. In that way more foreign capital would be attracted, more jobs would open up, and in time the country would acquire the resources required for a direct address to the more acute social problems.

Enter the radicals

In 1968, that economic theology was too powerfully entrenched to be shaken immediately. The classical economists dominated the Ministry of Finance, or Hacienda, which had been traditionally a powerhouse in Mexican government. Antonio Ortiz Mena, Finance Minister since 1958, was a revered figure, and a leading candidate to become president in 1970. The Bank of Mexico was also dominated by the classical economists. Rodrigo Gomez, the governor since 1953, was not only venerated in his own person. He had insured a kind of posterity by establishing, for particularly promising students, a fellowship program that took them abroad for graduate study in economics. Thereafter they were part of a program which, by guaranteeing them reasonable salaries, gave them some insulation against corruption. Among those who went through that program were a future president (de la Madrid) and finance minister (Silva Herzog).

But in 1970, Luis Echeverria became President of Mexico. A lawyer with liberal ideas, he had been Minister of Interior in 1968, and blame for the massacre had fallen, perhaps unjustly since the military gave the orders, on his shoulders. On entering Los Pinos, he forced out the most powerful of the orthodox economists. Ortiz Mena, his beaten rival for the presidential office, left Hacienda for the presidency of the Inter-American Development Bank which he holds to this day. Rodrigo Gomez had died two months before Echeverria was inaugurated. Though his place was taken by another orthodox economist — Ernesto Fernandez Hurtado, the uncle of President de la Madrid Hurtado — the bank lost some prestige. Radicals took over two key economic ministries — Patrimony (Horacio
Flores de la Peña) and Labor (Porfirio Munoz Ledo). Several, including Carlos Tello and Jose Andres Oteyza, went to work in sub-ministerial posts.

In keeping with the radical prescription, Echeverria established programs to improve education and health, housing and rural development. To increase job openings he nursed tourism, and subsidized manufacturing of steel, autos, and chemicals. Growth jumped to 7 per cent in 1971 and '72. But a push for higher taxes was beaten within the PRI by opposition from the private sector. Inflation, which had stayed at about the level of that in the U.S., started to soar — up 12 per cent in 1973, 24 per cent in 1974, and 15 per cent in 1975. The worldwide recession of 1975 closed foreign markets to Mexican goods. Confidence ebbed, and Mexicans rushed to change pesos into dollars. On August 31, 1976, Mexico for the first time in two decades devalued the peso — from roughly 12.5 to 20 per dollar. It was in those conditions that Echeverria entered into a stabilization program with the IMF.

Lopez Portillo, another liberal lawyer, had served Echeverria as Finance Minister and was very much prone to favor the radical approach. As President, he weakened the finance ministry at the outset by splitting off from it the function of budgeting which he established in a new ministry of planning and budget. As head of the new ministry, he named the most intellectually potent of the radicals — Carlos Tello. Another radical, Jose Andres Oteyza, was appointed Minister of Patrimony.

A shoot-out between the radicals and the orthodox economists took place at the end of Lopez Portillo’s first year in office. In formulating the 1978 budget, Tello wanted big increases to finance social programs and projects for new jobs. The Minister of Finance, Moctezuma Cid, resisted, invoking the commitment limiting inflation and the public deficit made in the IMF program. Lopez Portillo decided not to back Tello. Tello resigned. To prevent a win for one side or the other, Lopez Portillo then asked Moctezuma Cid to step down. As the new finance minister he named David Ibarra, a disciple of Prebisch, who was at least prepared to accommodate the radicals.

Escape through oil

Oil provided Lopez Portillo an escape from the battles of the rival economic schoolmen. Mexico had become a leading world producer at the time of the first World War. The private companies turned from Mexico after oil was nationalized by Cardenas in 1938. As prices dipped in the
1960s the Mexicans themselves lost interest. In 1973, Mexico actually imported oil. But the quadrupling in prices that year and the next restored incentive. In 1974 an oil exploration drive was launched in Mexico. In 1976, on becoming President, Lopez Portillo named as head of Pemex an old school friend, Jorge Diaz Serrano, who had acquired, as a petroleum engineer working with American firms, a modest fortune and a great flair for publicity.

Diaz Serrano pushed the exploration program in reality and, even more, in perceived reality. New finds in oil and gas were trumpeted abroad. Proven reserves mounted from 6 billion barrels in 1976 to 70 billion barrels in 1981. There was talk of a “new Saudi Arabia,” and production climbed as did income in dollars. By the end of 1979, Mexico, exporting $4 billion worth of crude, was able to remove itself from the IMF program. By 1980, daily output was over 2 million barrels a day, half of it going for export, with receipts of about $80 billion. Diaz Serrano had emerged as a potent political figure, a possible successor to Lopez Portillo as president. Lopez Portillo, for his part, was using the new revenues to institute an oil boom.

During the 1978-81 period, real growth rose more than 8 percent annually. Half-a-million new jobs a year were created. Investment, by both government and private companies, rose about 20 percent annually. Inevitably, bottlenecks developed — in transportation, building materials, and skilled manpower. The combination of too much money chasing too few goods achieved its usual result — inflation, up from 15 to 35 percent in 1980. As prices climbed, holders of pesos found an incentive to change to dollars for purchases or investment in the U.S. The stage was set for trouble.

It came, in the spring of 1981, in the form of a softening in the price of oil. Diaz Serrano, in touch with buyers in the U.S., Europe and Japan, was right in step with the market. On June 1, he announced that Mexico was cutting its price for premium crude from $30 to $28 per barrel. Lopez Portillo had approved the decision, but when a storm arose in the cabinet, the president claimed his own approval was conditional on acceptance by a cabinet committee on economics. Diaz Serrano referred the price cut to the committee where he encountered almost universal opposition. Several ministers with personal hopes saw in the oil price issue a chance to cut down Diaz Serrano’s prospects to become the next president. In addition, the radicals, led by Oteyza at Patrimonio, disparaged the oil boom because it channeled money to contractors and union bosses in the petroleum field rather than to the economically needy. The orthodox economists, including Miguel de la Madrid who had become Minister of Programming and Budgeting, didn’t like the inflationary thrust of the boom.
In the face of unanimous opposition, Diaz Serrano resigned. The price cut was restored, pending further evidence of market performance. The market performed just as Diaz Serrano said it would. Orders were cancelled by major companies in the U.S., France and Japan. Exports fell from a rate of 1.5 million barrels per day to 1.1 million. By the time the price was restored in September, Mexico had lost at least a billion dollars in projected revenues. Holders of pesos, alert to the trouble ahead, stepped up their conversion to dollars or their purchase of foreign goods. The net loss in foreign exchange was some $5 billion for the year. That constituted a substantial fraction of the payments deficit during the year — $13 billion. To make good the difference, Mexico had to borrow abroad.

Into the red

The additional borrowing came with surprising ease. "We just issued promissory notes," Gurria recalls. "We were selling them like hotcakes." But, of course, the debt went up. Pemex alone borrowed $10 billion in 1981, as against a previous total debt of $5 billion. The sum of Mexican debt rose in 1981 from $55 to $80 billion. Moreover, the maturities shortened. At the beginning of the year only 5 percent of Mexico’s debt was due within a year. By the end of 1981, that figure was 22 percent. Almost all the new money was first in six month loans, and then for shorter periods. The bulk of repayment was bunched around two dates. After the oil pricing difficulty, August and February became for Mexico the cruellest months.

Even then the problem could have been eased if the government had cut expenses or raised new revenues. But action to that end required painful decisions by the president, and over the years Lopez Portillo had behaved in ways that made the decisions excruciating. A vain man, proud of his looks, his physique and his superior culture, he had become in office highly self-indulgent. He acquired a personal fortune and lavished it on palatial homes in Mexico City, Acapulco and elsewhere. He gave his wife a leading position in musical affairs. His sister became his private secretary, and he relied on his son as a leading economic adviser. He cast Mexico in a role of world leadership between East and West and North and South. He received Castro and lectured Jimmy Carter on the obligations of a good neighbor. He contrived to make the new resort at Cancun the setting for the meeting of 22 world leaders — including Reagan, Madame Gandhi, Miterrand, Thatcher, and King Khalid of Saudi Arabia — to establish a better economic dialogue between North and South. But when internal difficulties presented themselves, when it came time to face the music, it was all the harder. As one Mexican close to the President put it: "Lopez
Portillo had a very strong view of how life should be. He tried to mold events in that direction, and for a time he succeeded. But reality always mocks vision. It caught up with him, and when the time for reckoning came, Lopez Portillo grew irritable, and blamed others, and ran away."

The dismissal of Diaz Serrano was one example. It came just before a scheduled meeting with President Reagan, and enabled Lopez Portillo to put off a discussion of the economic problem at that time. Thereafter, Lopez Portillo kept reality away in a series of staggering chops and changes and turns of policy which lasted all the way to his departure from office. Cancun was scheduled for October (1981). It was crucial for the President, with the eyes of the world fixed in Mexico, that he avoid any show of internal economic weakness. Thus instead of waiting until mid-October, as he had previously asserted he would, Lopez Portillo announced his choice for the PRI nomination before Cancun. Instead of picking a close associate, he chose a person for whom he had shown little personal affection. Instead of picking a supporter of the radical line, he tapped a conservative figure likely to appeal to people with money in Mexico. On September 25, he named as the next presidential candidate of the PRI, and his virtually certain successor, Miguel de la Madrid Hurtado.

"Like a dog"

By February, 1982, with the big debt contracted in August coming up for renewal, there was another flight from the peso, and a surge in imports. Finance Minister David Ibarra and the Director of the central bank, Gustavo Romero Kulbeck, urged the president to devalue. Lopez Portillo refused defiantly. "I'll defend the peso like a dog," he said in a speech on February 5. Thirteen days later, Mexico devalued. The peso dropped from twenty to forty, and then to almost fifty per dollar. The expectation was that devaluation would be accompanied by an austerity program, but Lopez Portillo first delayed, and then blamed Ibarra and Romero Kolbeck for overshoooting in the devaluation and concealing from him true information about the flight from the peso. On March 17 they were fired. As their successors, Lopez Portillo named Silva Herzog Finance Minister, and Miguel Mancera governor of the central bank. Both were known to be orthodox economists, close to the designated presidential candidate, Miguel de la Madrid. The general theory was that Lopez Portillo was trying to shift the blame for anything further that might go wrong. Certainly neither of the new officials had felt they were in step with Lopez Portillo or on the verge of being tapped for high office. Silva learned about his appointment in Washington. Mancera was in Kuala Lumpur.
Four days later the benefits of the devaluation were wiped out by a substantial wage increase. Silva and Mancera both fought against the rise when they learned it was in the offing. But they managed only to scale it down. Clearly Lopez Portillo was making them stand up for a step recommended by his radical advisers.

On April 20, the government finally surfaced some of the austerity measures which had been promised at the time of the devaluation. They came in a seventeen-point Economic Adjustment program. It included price increases designed to cut down consumption of oil and food, a cut in public spending, and a rise in interest rates. But application of the program was never implemented.

The consequences showed up immediately in the money markets. During June the Bank of America experienced great difficulties in syndicating a jumbo loan of $2.5 billion. Though the interest rates were a point higher than in previous Mexican borrowings, the largest banks only agreed to participate after personal appeals by the Finance Minister and his deputies. Many smaller banks stayed out, and in the end, shares were picked up by American branches of Mexican banks working under pressure from the government. Six weeks later, Mexico floated a $100 million Eurodollar loan through Merrill Lynch. The interest was sky-high, 18.5 percent. That was the last unforced loan to Mexico.

A win at the polls

The election on July 4 showed remarkable success for de la Madrid. He won with over 70 percent of the vote. Turnout, which had been dropping steadily, was up from 60 percent in 1976 to 71½ percent. Lopez Portillo convinced himself that the strong showing would blow away economic doubts. Just after the vote he told an American official that there was no longer an urgent need for the austerity program. Finally, on August 1, some increases in the prices of food and gasoline were announced. But the news came not from the President, but from the ministry of commerce. “The announcement read,” an American official on the spot said later, “like an anonymous comment delivered to nobody on a brown paper bag. It lacked any official character, certainly any connection with Lopez Portillo. It signaled to those who knew, that inflation would run unchecked.”

Those who knew immediately began cashing in pesos. A number of foreign banks with loans coming to maturity refused to renew them. A series of emergency measures by Silva — the $700 million swap with the Fed on August 4; and creation of a two-tier exchange rate on August 5 — availed nothing. On August 12, exchange markets were closed, and Silva
made the calls to Washington that initiated the rescue program.

For the next two weeks — as Silva moved forward with the American government, the IMF, and the BIS — Lopez Portillo hung in the background. But all year long, he had been considering an alternate course urged upon him by the radical economists in his entourage. The radicals found the root of trouble in the disposition of Mexico's banks and rich middle class to move money out of the country. That could be stopped, it was asserted, by nationalization of the banks, and the imposition of exchange controls. The funds locked in Mexico could then be channeled by government into productive investments. With no need to compete against U.S. money markets, interest rates could be lowered, making it attractive for Mexicans to buy on credit, and for businessmen to invest in new facilities. Silva and Mancera of the central bank had opposed this view on the inside and on the outside. Mancera, indeed, published a pamphlet — *Inconveniencia del Control de Cambios*, or The Disadvantages of Exchange Controls — showing that such measures could not be made to work because of the multifold connections linking Mexico with the U.S. "Rather than stemming the flight of capital," Mancera wrote of controls, they "would actually multiply it due to the loss of confidence that would be caused by establishment of controls." Still, as the time for actually swallowing the IMF medicine drew nigh, Lopez Portillo hesitated.

**In the balance**

As he wavered, the radicals put on the pressure. The President's son, Jose Ramon Lopez Portillo, talked up the need for a reassertion of presidential authority on behalf of Mexican nationalism. To dramatize the case he brought in the Minister of Patrimony, Jose Andres Oteyza, and the former Minister of Planning and Budgeting, Carlos Tello. "Oteyza," one of his aides said, "practically moved to Los Pinos. He was with the President night and day. You've never heard anybody be persuasive until you've heard Oteyza. He's irresistible."

The decision hung in the balance until August 31. But when he finally took it, the President plunged. That night he signed two decrees. One nationalized the banks. The other ordered exchange controls. In the *Informe* next day he laid the case of "our administration" before the judgement of "history." "I await it," he said, "with anguish." He set out in elaborate detail the undoubted accomplishments — the "rapid economic growth"; the gains in employment, birth control, health care and education; the surge in oil; and a more activist foreign policy. He defended every peso of the steep rise in public outlays. "Government spending," he said, "is the most useful means for achieving the redistribution of income... There has

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been no squandering of resources. Every program has its own justification."

A modern plague

The general blame for what went wrong was pinned on the outside world — the elements. "My hand is on the helm of the ship," Lopez Portillo said, "but I cannot direct the storm." In particular he attacked the "greed" of speculators working hand in glove with the private banks. In an allusion to the pillage of the country by Cortez and the Conquistadores, he said:

I can state that in the last few years it has been a group of Mexicans . . . led and advised and supported by the private banks who have taken more money out of the country than the empires that exploited us since the beginning of time.

He attacked the speculators as "those who have rejected their identity as Mexicans." He said he would "give them one month, September, to meditate and to decide where their loyalties lie." Then, he added menacingly, "we shall take action." He called down a savage curse on the international financial system. In a veiled illusion to the IMF, he said:

The financing plague is wreaking greater and greater havoc throughout the world. As in Medieval times, it is scourging country after country. It is transmitted by rats and its consequences are unemployment and poverty, industrial bankruptcy and speculative enrichment. The remedy of the witch doctors is to deprive the patient of food and subject him to compulsory rest. Those who protest must be purged, and those who survive bear witness to their virtue before the doctors of obsolete and prepotent dogma and of blind hegemoniacal egoism.

Wild applause swept the parliament when the President finished. Next day Lopez Portillo stood on the balcony of the National Palace as half-a-million workers, peasants and civil servants brought together by the PRI in the Zocalo, or central plaza of town, cheered the President. His aides asserted confidently that he had retrieved his presidency, and that the nationalization of the banks would become as important a part of Mexican history as the nationalization of oil by Cardenas in 1938. Foreigners and recent immigrants in Mexico began feeling the backs of their necks. Jurgen Sudhoff, the West German ambassador said later that the performance, and even more its reception, reminded him of "Hitler and the Sportz-Palast."

For the negotiations between Mexico and the IMF, the Informe spelled disaster. Silva had been told of the decision only the night before. His chief associate, Mancera, was squeezed out as director of the Bank of Mexico. His replacement was the leading exponent of the radical cause, Carlos Tello. It even appeared that Silva's patron, President-elect de la Madrid,
might not make it to the inauguration set for December 1. Rumors flew of
troop movements and assassinations. There was talk of a coup d’état.

Up to Toronto

Ted Beza, the chief IMF negotiator fresh from the triumph of
Oaxtepec, had been forewarned of the turn-about by only an hour, and by a
kind of ricochet. The press in Mexico City received an advance copy of the
speech early in the morning. Dispatches to Washington were referred to
IMF headquarters for comment. Headquarters called Beza at his hotel in
Mexico City. He watched on television with a sinking heart as Lopez Portillo
cast to the winds every feature of an IMF program — free exchange,
restraint in spending and wages, solemn accords with the financial world.
Two days later, with all the rumors buzzing, Beza flew with Silva and the
Mexican delegation to the annual meeting of the IMF and World Bank in
Toronto. “I didn’t know where anything stood,” Beza said. Neither,
according to the Mexicans, did Silva.

Toronto turned out to be a salvage operation on two fronts. First came
the problem of stanching a hemmorhage of Mexican assets in the inter-
bank market. The commercial banking world had been rocked by the
Lopez Portillo speech, and the apparent disavowal of Silva. At the same
time, General Jaoa Figureido, the president of Brazil, went off to Cleveland
for exploratory surgery, and the generals running Argentina announced,
under pressure, they would hold elections in the fall. Suddenly the whiff of
panic filled the air. Walter Wriston of Citibank later offered this description
of Toronto: “We had 150-odd finance ministers, 50-odd central bankers,
1000 journalists, 1000 commercial bankers, a large supply of whiskey and
a reasonably small city that produced an enormous head of steam driving
the engine called ‘the end of the world is coming.’”

Some banks with outstanding claims on some Mexicans, however,
could do more than worry. As obligations came due, they could demand
payment. Since the thrust of the Informe had taken a couple of days to sink
home, and since September 6 was Labor Day, September 7 was the first
day available for action. It became known, to Mexico watchers, as Black
Tuesday. All day long the Mexican branch banks in New York were
besieged with demands for repayment of loans and deposits. When the day
was out about $70 million had been given back by the Mexican branch
banks. The branch banks themselves did not have enough cash to honor
the checks they had issued. The two biggest — Bancomer and Banamex
— turned to American banks which represented them in the New York
Clearing House where, at the end of each day, the banks cancel out debts
between themselves. The two American banks — Chemical and Manufacturers Hanover — came up $70 million short. Unless the loss was made good, there was a grave danger the whole clearing house system, which handles some $15 billion of business daily, would break down. Volcker was alerted. He talked to Silva. Before the day was out the Fed had deposited $70 million from the money advanced Mexico by the BIS to the accounts of Chemical and Manny Hanny. Arrangements were then made for handling the accounts of the Mexican branch banks without exposing the Clearing House operation.

"No more money"

But that save was only the thinnest of temporary fixes. For if the Mexican branch banks were forced to pay up their obligations of over $6 billion, and the Fed had to cover, all the money advanced by the BIS, and the U.S., and the IMF would be eaten away. So Volcker, with the support of other central bankers, put the heat on the Mexican authorities, and the Mexican officials put the heat on the branch banks. They were, in effect, told not to honor demands for repayment of deposits unless there was a practical certainty of a law suit. Sam Cross of the New York Fed, who acted as agent for Volcker in most of the interbank dealing, summed up what happened in these terms: "There were some heavy losses in the interbank system. At Toronto everybody was talking about it. We had to be very careful. We didn’t want to see all the money we had put together for the Mexicans run out through the interbank channel. So we had some conversations with a few banks. We talked to the Mexicans. The advisory committee told the Mexicans they had to get very tough. They had to say, ‘we’re not going to pay.’"

What Cross described so laconically was in practice extremely hard to achieve. One member of the advisory committee — an American representing a British bank — described the problem as it looked from the inside in these terms:

"The great difficulty was with the New York branches of the Mexican banks. Their employees were professionals with no special loyalty to Mexican banks or to Mexico. They had reason to doubt about the future of their present jobs. They thought they might soon have to look for other jobs — maybe even with the very banks that were calling the loans. Their futures depended upon their reputation in the banking community. So their instinct was to pay up when fellow bankers presented claims. Getting them to resist that impulse was like getting somebody to be a nice SOB. It took a lot of pressure, from the Mexican authorities, and from many of us on the advisory committee. September 7 was the low point. After that the interbank situation got steadily better. But it was touch and go until mid-November.”
“A lot of pressure” was an understatement. It took an ultimatum. Gurría described what the Mexican government did in these terms: “We said to the branch banks, if you want to pay, you find the dollars. We’re not going to. In effect, we told them, ‘No more money.’ That did worlds for their morale.”

The second salvage operation at Toronto centered around the IMF negotiations. On Sunday, September 5, Silva had breakfast with de Larosière at the Four Seasons Hotel where both were staying. Silva asked the Managing Director if the IMF could put together a memorandum that he could take back to Lopez Portillo setting forth conditions for a continuation of the negotiations for an adjustment program. The Managing Director agreed to try. Beza summoned the two aides who had been with him in Mexico to Toronto. They drafted a statement of basic principles which, while protective of IMF views, would not affront Lopez Portillo, or — if he chose to go the other way — be turned against the IMF in a calculated leak.

**The minister vanishes**

The memorandum showed a skill at deadpan writing worthy of Defoe. “This note,” it said at the beginning, “describes the group of policies necessary to correct the present situation.” It set forward in guarded terms the commitment of the Fund to free exchange markets, moderate wage and price policy, and a balance between revenues and spending in the public finances of member countries. The text was sufficiently muddy to defie exploitation. It did not include a single number. Proposals for limiting wage increases were dressed up as devices to “avoid unemployment.” The objectives of the negotiation were set out in unexceptionable generalizations. For instance, one purpose was to “increase, on a permanent basis, the competitiveness of the Mexican economy.” Another was to “reduce the rate of increase in external debt to levels sustainable in the medium term without pressure on internal prices.” The Managing Director signed the note on September 8.

Even with the letter in his pocket, Silva was not fully confident about receiving the approval of his President. Instead of heading directly back to Mexico, he hung around Toronto. The commercial bankers who wanted the IMF negotiations to get back on track immediately were puzzled, and then concerned. Their surmise — which Silva does not endorse — was that he was waiting for the formal investiture of de la Madrid as President-elect by the Mexican Congress. That event, which strengthened Silva’s hand, took place on September 10. By that time, Silva had returned to Mexico. He
received approval of the memorandum from Lopez Portillo on September 11. He relayed the news to de Larosière. In a telex to the advisory committee in New York that day Silva said: "I am pleased to advise you that conversations between Mexico and the IMF will continue." Then, suddenly, Silva disappeared.

**Search for Silva**

The disappearance of the Mexican finance minister stirred a new wave of anxiety among the commercial bankers. Members of the advisory committee had met several times with Silva in Toronto. They had reaffirmed their commitment to the 90-day moratorium. They had expressed anew a cooperative approach toward solving the problems posed by the Permex acceptances and the interbank loans. They had also begun work on a new, and very delicate problem — the definition of exactly which kinds of debt would be included in, and which exempted from, the 90-day moratorium. The committee of four headed by Michael Hunter of Lloyds had sorted through some 25 different kinds of Mexican debt. The four had compared notes with Gurria in Toronto, and while there was broad agreement, difficult problems remained.

For one thing, the bankers had questioned some of the information furnished by the Mexicans. Gurria had been insulted. More important, by far, there was a division among the bankers respecting the treatment to be accorded to Mexican bonds. The Europeans, led by the Swiss, felt the bonds should be excluded from the moratorium. They argued that the holders were widows and orphans who needed protection, not banks accustomed to taking risks. The Americans, led by Citibank, argued that the Europeans had in fact bought bonds on their own speculative accounts, not for widows and orphans; the Americans felt there was no reason to exempt the bonds except the greed of European bankers. Mexico tended to side with the Americans. But everybody felt the need for more information.

Gurria provided some reassurance when he came to meet with the advisory committee in New York on September 23. He brought with him a fresh batch of economic data prepared by the ministry of finance which the advisory committee distributed to all the banks holding Mexican debt. He also confirmed that negotiations between the Mexican government and the IMF had resumed. There was a heated discussion about whether bonds should be excluded or not from the moratorium. The American front crumbled, on the grounds that the issue was not big enough to force a rupture. The advisory committee on a preliminary vote decided that Mexico
could continue to pay out both interest and principal on bonds. But before proceeding further the bankers wanted reassurance from Silva himself, and on September 26 Rhodes flew to Mexico City. For the next three days, he searched for the finance minister. He called Silva at his various offices. He was not around. Nobody knew his whereabouts, nor did he return messages. Rhodes called the house. Same story. Rhodes became frantic. "It was like Stanley hunting for Livingston, only it was in the middle of Mexico City," he remarked later. On September 29, Silva finally called Rhodes at his hotel in Mexico City.

The finance minister had been stricken with appendicitis immediately after winning the President's approval for the IMF negotiations to go forward. He was recuperating in a private clinic. But he wanted to assure Rhodes that the reports of his demise were false. He also approved the debt definition that had been outlined earlier between Hunter and Gurria. On October 1, in fact, the Mexican finance ministry sent all the lender banks a telex confirming the status of twenty-five different kinds of loan. He promised Rhodes that Mexico would take steps to reassure the European bankers who were even more worried than their American colleagues. In keeping with that pledge, Gurria, along with three Americans working with Rhodes, visited London, Paris, Frankfurt and Zurich on successive days in early October. Gurria made available new economic data showing the strength of Mexico. He said the IMF negotiations were moving forward rapidly, and that he expected an agreement by the end of October.

**Threat of default**

The IMF negotiations were, in fact, not proceeding smoothly at all. Lopez Portillo, to be sure, had shot his bolt. "He had a catharsis with bank nationalization," a Mexican official at the Treasury said of the outgoing President, and "after that he let things slide. He was exhausted." Indeed, he told two visiting foreigners (John Turner, the former Canadian finance minister and Edwin Yeo, the former American under secretary of the Treasury) that he was resigned to an IMF accord, and had so informed de la Madrid. But nobody, including de la Madrid, had any confidence that a firm bargain had been reached between the outgoing and incoming presidents. Moreover, the Mexican team on the negotiations had been changed to include Tello, as Director of the central bank, as well as Silva and de la Madrid's representative, Carlos Salinas.

Tello, looking back on the negotiation a year later, gave the impression of a man battling, almost alone, for a good cause against the massed forces of evil. As he saw it, de la Madrid, Silva, and most of the Mexican
bureaucracy were aligned with the IMF, Volcker and the international banks. The BIS money was rationed in tiny driblets. With funds running out Mexico was under increasing pressure to accept IMF terms. The negotiations were being strung out by Silva and Beza so that an agreement would only come at the very end — with Lopez Portillo getting the blame, and de la Madrid receiving the money. Tello thought it was his office to fight the conspiracy and he shaped a bargaining strategy to that end.

From the first, he said publicly that he wanted an early agreement with the IMF. Thus he told The Wall Street Journal in an interview on September 24: "I think we should sign and the sooner the better. If possible, I don't know — 10 days, 7 days. I think we can reach, and we will definitely reach, an agreement."

But the agreement Tello had in mind was, in his words, "an anti-IMF agreement." It included acceptance of exchange controls, low interest rates, generous wage bargains, and relatively high government spending. Moreover, Tello was not only insisting on those terms in negotiations, he was also mounting outside pressures. Throughout September and much of October, rumors persisted of a debtors cartel linking Mexico with Brazil and Argentina in a coordinated default. One story specifically asserted that Lopez Portillo's son, Jose Ramon, had sounded out Buenos Aires and Brasilia on that possibility. Tello, while not confirming or denying the story, makes it plain that it was a negotiating tactic. Basically the specter of default was being raised as a form of pressure to wring from the IMF the best possible terms.

The jostling came to a head on October 22 when the main figures on the Mexican team, including Tello, Salinas, and Silva came to Washington. On that day, a Friday, there were meetings with Volcker and with Rhodes of the advisory committee. Both of them stood firmly by the IMF position. They made it clear that Mexico would not be getting any more money unless a deal was made with de Larosière.

Next day the Mexicans met, separately and as a group, with de Larosière and his aides. Tello repeated his arguments about maintaining exchange controls, and stimulating economic activity through low interest rates and government spending. De Larosière rejected that view, politely but firmly, on the grounds that exchange controls between countries as closely linked as the U.S. and Mexico could not be made to work. Silva clearly sided with the IMF. Salinas was made to see that there was no possibility of cutting a deal along the lines advocated by Tello. The Managing Director, indeed, impressed upon him that the incoming Mexican administration had to develop concrete programs for cutting the budget, and holding down nominal wages. Thus in the end, Tello was
isolated. "I had the feeling," Salinas said of the meetings, "that de Larosière came away knowing he could be tough on Tello." An official of the Mexican Treasury called the meeting with de Larosière, "Tello’s last stand." Tello said of the session: "We had a pleasant talk. But they didn’t give anything."

Letter of Intent

Two weeks later the IMF deal was finally struck. The basic terms, announced on November 10 by Silva, were along the lines sketched out before the bombshell of September 1. The Mexicans agreed to cut the budget deficit drastically — from an estimated 16.5 percent of gross national product in 1981 to 8.5 percent in 1983. Foreign borrowing was to be reduced by three-quarters — from $20 billion in 1981 to $5 billion in 1983. Inflation was to be cut from roughly 100 percent in 1982 to 55 percent in 1983. Subsidies, exports and wage hikes were to be lowered accordingly, and taxes raised. Inevitably growth would be negative for a long time to come.

Very little of this appeared in black and white in the Letter of Intent sent to de Larosière over the signatures of Silva and Tello on November 10. Tello fought to the end for rhetorical points. The Letter accepted the Lopez Portillo version of how the crisis came about: "While Mexico grew at a rapid pace, the international economy weakened and entered into a deep recession with both unemployment and inflation." The reduction of wage bargains was glossed over in these terms: "Economic policy will seek . . . wage movements geared to the . . . adequate participation by workers in the growth of income and productivity." There was no formal commitment by Tello to higher interest charges, or the lifting of exchange controls. As a policy statement, Tello said of the letter, later, it was a "black box."

But what was a black box to Tello was something very different to Silva and to de Larosière. Silva saw in the IMF accord a golden opportunity to improve Mexico’s standing with the bankers. He sent Gurría and Enriquez Savignac, a deputy minister of finance, to New York on November 12. After briefing the advisory committee on the details of the Letter of Intent, they asked the banks to extend the 90-day postponement on payment of principal granted on August 23 for another 90 days beginning November 23. They talked about making the postponement effective through all of 1983. But the banks, having been put on a roller-coaster by the Mexicans, and still not certain that de la Madrid was in control, were in a fighting mood. They refused to accede the extensions. They indicated that before settling on exact terms, there were two important claims the Mexicans had to satisfy.
First, there was the interbank problem. While hemorrhaging had declined, there was still an occasional out-payment. The banks cooperating with Mexico wanted to make sure that in the future there would be no rewarding, at their expense, of other banks. On November 12, the advisory committee entertained a motion to make the interbank market subject to the rescheduling arrangement. Such a move, since it would have been followed by similar action with respect to Brazil and Argentina, posed threats to the financial markets in London and New York. Brian Quinn, of the Bank of England, came over by Concorde to protest, and he was joined by Sam Cross of the Fed. The advisory committee relented. But the point had been made. When rescheduling terms were finally negotiated, the Mexicans agreed in writing to maintain the level of interbank deposits or risk being declared in default.

Secondly the banks raised with Gurria and Enríquez Savignac the matter of debt owed by the private sector in Mexico. The limits on currency exchange applied by Tello meant that even Mexican companies in the black were finding it impossible to find the requisite dollars to pay off debts. They not only couldn’t pay principal, but they had fallen behind in payments of interest. Since the interest arrears could force a re-classification of loans with adverse consequences on bank earnings in particular and confidence in general, the bankers were anxious for some kind of prophylactic action before they had to report non-payment of interest at the end of the year. Gurria and Enríquez Savignac said nothing could be done while Tello headed the Bank of Mexico. But the banks — particularly those in Texas and California that held large amounts of debt from Mexican companies — were not satisfied. Preston Bennett, the advisory committee co-chairman from Bank of America, went down to Mexico, and tried to bring Tello around. Without success, at the time. But later the Mexican representatives of the foreign banks worked out a scheme whereby the Mexican central bank took deposits in pesos from Mexican companies and agreed to provide dollars to the foreign creditors as soon as the dollars became available. That deposit scheme depended, of course, on both the accumulation of dollars by the Mexican central bank and the approval, for accounting purposes in the meantime, by the Fed and other regulatory agencies. Still, the banks had used the Letter of Intent to extract further concessions from Silva.

**Springing the trap**

De Larosière then turned the tables on the banks. The Managing Director found in the Letter of Intent a lever with which the IMF could move
the whole world. It would have been traditional, once the agreement was signed, simply to certify Mexico and let it go. But de Larosière had much bigger ideas. His idea was to engage the major countries, the central banks and the private banks in a continuing effort to keep Mexico and the other major debtor nations alive. In so doing, he would save the international financial system.

Working almost entirely on his own within the Fund, de Larosière had been preparing a plan of action ever since the Toronto meetings in September. He had won the cooperation of Volcker and Gordon Richardson of the Bank of England. He had consulted with the Treasury which had approved and agreed to work with other governments. With the Letter of Intent in his pocket, he invited the top executives of the banks on the advisory committee to a meeting at the New York Fed. Just before coming up, he took soundings with a selected list of the banking brass. On the afternoon of November 16, they gathered in the board room of the New York Fed — Leland Prussia of Bank of America; Walter Wriston of Citibank; Willard Butcher of Chase; C. W. Carson of Chemical; Lewis Preston of Morgan; John McGillicuddy of Manufacturers Hanover; David Sias of Bankers Trust; Norman Jones of Lloyds; Grant Reuber of the Bank of Montreal; André Braud of Société Générale; Willy Wittwer of the Swiss Bank Corporation; Yusuke Kashiwagi of the Bank of Tokyo; and Werner Blessing of the Deutsche Bank. Anthony Solomon, the president of the New York Fed, introduced de Larosière. The Managing Director stepped to the rostrum, and sprung the trap.

Forced lending

He started with a detailed account of the events leading to the signing of the Letter of Intent by Mexico. He said that the austerity measures alluded to in the Letter had the full support of the incoming president, and that Mexico’s new budget would be ready by December 15. He then presented an analysis of Mexico’s financial requirements for 1983. He said Mexico would require $1.5 billion for reserves; and $2.55 billion to pay back the BIS and Federal Reserve loans. Assuming a deficit of $4.25 billion, the total came to $8.3 billion. In meeting that deficit, de Larosière was prepared to offer $1.3 billion from the IMF. He thought another $2 billion could be advanced by the U.S. and other governments. He expected the banks to put up the remaining $5 billion.

Moreover, he wasn’t just asking. He was telling. Unless the banks came up with the money, the Managing Director would not recommend acceptance of the Mexican program by the directors of the IMF. Since his board was meeting on December 23, de Larosière told the bankers he
wanted their written commitments for that amount of new money a week in advance. The deadline was December 15.

In retrospect, the Managing Director's move was, as Lewis Preston of Morgan put it, "a major action in the history of banking." At the time, the reaction was very different. One official who was present said of the Managing Director's talk: "It caused a kind of frenzy. You could practically hear those bankers thinking, 'Jesus, who does this guy think he is?'" One of the bankers present remembers thinking that it was "not possible for the banks to raise that much money that rapidly." When the word got out to the banking community as a whole, reactions were much harsher. A California regional banker recalls, "Nobody likes to be forced into lending. Senior people especially like to think they decide what loans to make. Now we found some other people were helping us to decide. Naturally our reaction was negative."

An American official of a British bank said: "During the whole period since August, we had been waiting for something. We didn't know what we were waiting for. I think, looking back, that we were waiting for the IMF. We thought they would approve the Mexican program, and put up some money. We thought then we'd have a second shot decision as to whether we'd go along or not. When de Larosière said the whole IMF deal was conditional on the banks putting up $5 billion in new money, we were shocked. When he said we had to have the money by December 15, we were appalled."

The shock was considerably alleviated that evening by Paul Volcker who was working in tandem with de Larosière. In a speech in Boston, the Chairman of the Fed invoked the threat — "essentially without precedent in the postwar world" — posed by the "financial difficulties of much of the developing world." He asserted that "there exists the strongest kind of community of interest among borrowers and lenders, among governments and private businesses, and among the developing and the industrialized countries, in working together..." He cited the case of Mexico, and the agreement on a Letter of Intent with the IMF. He alluded to the possibility the Mexicans would need more bank credit in 1983. Then, in the most elliptical way, he indicated how the Fed would apply the regulatory rules for banks making additional funds available to Mexico and similarly placed countries. He said:

In such cases, where new loans facilitate the adjustment process and enable a country to strengthen its economy and service its international debt in an orderly manner, new credits should not be subject to supervisory criticism.

Volcker’s implied promise not to apply the regulations stringently and the fear of what would be lost if the IMF simply let the whole matter drop
worked to turn the banks around. The advisory committee met on November 17 — the day after the meeting with de Larosière and the speech by Volcker. The bankers implicitly accepted the Mexican request for a second ninety-day moratorium. They then turned to the business of how the $5 billion in new money might be raised. One possibility, favored by most of the American bankers, was to assess all participating banks an extra 7 per cent over their previous exposure. That way, everybody would be in, and no bank could cop out by saying it would come in if everybody else came in. The European bankers and de Larosière favored picking a larger target, say 9 per cent above the total. That way the whole project wouldn’t rest on bringing in every bank. There would be a margin of safety. The argument went back and forth in the advisory committee, with various banks weighing possible escape routes against the kind of fees and interest charges that might be asked for the new money.

7 per cent solution

On November 30, the advisory committee decided to go for the 7 per cent solution with all banks contributing anew that proportion of their original exposure. The basic terms still had to be negotiated with the Mexicans, and once more the bankers turned to a familiar figure. On December 1 Rhodes called Silva in Mexico City, and asked him to send Gurria. They wanted him right away. The whole deal had to be worked out in two weeks.

President de la Madrid had just been sworn into office, and a new cabinet announced. Silva was going to be continued at Hacienda — the only hold-over. Tello was out as director of the central bank, and Mancera was back in. Salinas, who had worked with Silva closely on the IMF accord, was to be minister of budget and programming. A whole set of enabling measures were ready to go. They included an easing of exchange controls (announced December 1); an increase in fuel prices (announced December 1); a rise in interest rates (announced December 6); and the deposit scheme whereby the government would make it possible for the private sector to have access to dollars for payment of interest on loans (announced December 8). With all those good things on the way, Gurria flew to New York. On December 2, he opened a double negotiation with the advisory committee — to fix the terms for $5 billion in new money, and for a rescheduling of the $20 billion in outstanding debts coming due in 1983 and 1984.

The basic lines of the bargaining quickly became evident. The Mexicans wanted to push the time of reckoning on the debt as far forward as
possible. Gurria asked for an extension of the 180-day postponement through all of 1984. He wanted an 8-year period for repayment of the $5 billion in new money, and a 10-year period for the rescheduling of the $20 billion. The advisory committee banks sought to maximize fees and interest the better to make the agreement attractive enough to keep all banks in the game. The bargaining went on round the clock with constant references to the highest bank officials, and the Mexican finance ministry. Looking back each side paid tribute to the other. A negotiator for Manufacturers Hanover said of Gurria: "There is really nobody like Angel. He is the premier negotiator. Nobody else could have done it. He went night after night and day after day. Mostly he did it all alone. There were times when he referred back to Silva. But when Angel told Silva he was against something but final decision was up to the minister, it was like telling him he had an option to commit suicide."

For his part, Gurria said: "It wasn’t really logical to charge us rates that made money at the time, but made it harder for us to pay back later. But the banks thought they could stick it to us. They had confidence their own governments wouldn’t let them down. Also they wanted to keep our rates high, so they could get high rates from Brazil and Argentina and other countries."

On December 8, the deal was concluded, and affirmed by Silva in a telex to the advisory committee. With respect to the $5 billion of new money, the agreement called for a repayment over six years with a three-year grace period at a fee of 2 1/8 per cent above the U.S. prime rate, or 2 1/4 per cent over Libor. The upfront negotiating fee was 1 1/4 per cent. As to the $20 billion in rescheduled money, the agreement extended the moratorium granted for 180 days beginning on August 23 through the end of 1984. Repayment was to be made over 8 years with a grace period of four years. The fee was 1 per cent, and the spread was 1 7/8 over Libor or 1 3/4 over the U.S. prime rate.

**Buying time**

In assessing the deal two features emerge clearly. The Mexicans bought themselves a lot of time. While they paid roughly $150 million more in interest per year for eight years, they opened the possibility of negotiating the terms down later on. The banks, in return, received very juicy rates. They raised by half a point the average interest they were receiving on the rescheduled debt. They got for the new money a half-point more in interest than they had received for the last big commercial loan to Mexico. The deal with Mexico set a precedent for similarly advantageous terms with Brazil,
Argentina and other troubled countries. Most important, it assured a public
record of higher earnings instead of the losses the banks would have had to
announce if no bargain had been struck. As one official at the Fed said of
Citibank: “With no deal the bank would have shown a serious drop in
earnings. The deal gave them an increase of earnings of about $8 million.”
Gurria himself said: “The banks did fabulously well on the deal. They played
the good Samaritan and did their best business. They made 70 to 90 per
cent on their capital. Restructuring turned out to be good business for
them.”

But what was attractive to the giant money center banks on the
advisory committee proved a very hard sell with the rest of the banking
community around the world. The list of the recalcitrants not only included
the smaller banks and many regional banks in the U.S., but whole banking
systems abroad. While reluctant to talk for publication for fear of being
made to look like welshers unresponsive to larger interests, the hard cases
had arguments aplenty when given assurances that they would not be
identified by name. Thus the whole systems of Japan, France and
Switzerland took issue with the base line of previous loans to Mexico
against which the 7 per cent increase was figured. The Japanese claimed
they had not made loans to Mexico but acquired promissory notes from US
banks. The Swiss said the Mexican numbers included many sales of bonds
which were supposed to be excluded from the rescue operation.

As to individual American banks, they proved balky about increasing
their ante for all kinds of reasons. In general the regional and local banks
were not as exposed as the big banks in New York, Chicago, and San
Francisco. The smaller banks could survive no matter what happened to
Mexican debt. “We could save ourselves without saving the whole system,”
a banker in Washington state put it. In addition, there were myriad special
conditions. Thus a major California bank wanted to participate, and agreed
to put up the extra 7 per cent on December 15. But the California State
Superintendent of Banks found that the additional loan put the bank over
the state’s legal lending limit. The bank petitioned for an exception and was
denied. Then on January 3, a change in the law made it possible to shift
accounts charged against the loan limit. On January 24, the California
bank came in with its extra loan.

A large bank in Michigan took the position that it was in a very different
position than the money center banks when it came to dealing with Mexico.
A vice president of the bank said in an interview: “We did trade financing
with Mexico and we were very careful about it. All of our loans were made to
cover transactions between American clients we knew well, and Mexican
customers whom we also knew. We never reached for deposits from the
Middle East. We never participated in jumbo loans to the Mexican

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government. So we didn’t feel we should pay for the mistakes of the money center banks. Just because they decided to put up an additional 7 per cent was no reason for us to do it. ‘Who decided what and why?’ was the question I kept raising.”

The head of a Florida bank acknowledged that he made difficulties because it suited his interest to be a nuisance. He said: “Citibank and Bank of America negotiate the deal. They tell us to go along, and if we ask a question, they get sore. We had some bad risks, and we wanted out. We made trouble for the big banks on the theory that they might let us out of all the loans just to get us out of their hair. At one point we even made noises about a law suit against some of the Mexican banks. That turned out to be unwise. The threats came to the attention of the Federal Reserve Board. The Fed is our main regulator, and in fact we need approval for a merger. The bank examiners came around and started asking questions. That was enough for us. We dropped the suit, but in the end we didn’t subscribe to the request for new money.”

Inch by inch

Against that kind of resistance, the advisory committee mustered intense pressure. In this country, the big banks leaned on the regionals, and the regionals leaned on the local banks. “One by one, we identified the hard cases,” a lawyer working with the advisory committee recalls. “We pinpointed their argument or excuse for not going along. Then we brought the appropriate pressure to bear — sometimes from state or Federal regulators; sometimes from figures in the local community; sometimes from other bankers.” Abroad, all kinds of official and unofficial pressures were mounted. The U.S. Treasury quietly prevailed upon the governments of Japan, France and Switzerland to make their banks see reason on the basic financing formula. Gordon Richardson, of the Bank of England, arranged a session for de Larosière with all the leading private bankers of Britain and the Continent. Sir Jeremy Morse of Lloyds raised contributions from British banks at a session compared by one of those present to a church charity drive. Wilfried Guth of the Deutsche Bank did the same with banks in Germany and Scandinavia. British and French bankers, with an assist from Gurria, who traveled to the Middle East, explained matters to the bankers of Kuwait and Saudi Arabia. In the end, de Larosière intervened personally in fund-raising from an Italian bank, Istituto Mobiliare Italiano. He sent a telegram to the Minister of Commerce, Nicola Capria, asking “your fullest cooperation in issuing the necessary authorization to enable IMI to have the loan documents signed…”

The arm-twisting took much longer than expected. “It’s like filling up a
tub, inch by inch," Wriston explained. "The last buck from the last bank is always the hardest." But along the way, de Larosière declared that instead of the full $5 billion in new money, he needed only a "critical mass," of 90 per cent, or $4.5 billion. Thus the December 23 deadline for IMF decision was kept alive. As that date drew close, everything came together.

The agencies regulating American banks formalized the pledge made by Volcker of an understanding attitude on actions taken within the context of the IMF program. Thus on December 8, the advisory committee reported that it had been "advised by" the Fed, the Comptroller of the Currency and the Securities and Exchange Commission that they would be "prepared before the end of the year to confirm their preliminary views that the loans ... to Mexico may be considered current." A letter from the Comptroller of the Currency to the chief lawyer for the advisory committee, Robert Carswell of Shearman & Sterling, confirmed in equally stilted language that the banks would be given ease in the application of the rules if they participated in the lending accords sought by the IMF. The date of the letter was December 15.

A critical mass

The U.S. Treasury came through with the official monéy sought by de Larosière. McNamar, Sprinkel and Leland prevailed upon the American budgetary authorities to let the Export-Import Bank and the Commodity Credit Corporation extend a billion dollars in credit to Mexico in 1983. They then squeezed a similar amount from the export promotion agencies of Britain, France, Germany and Japan. They were thus able to assure de Larosière that they had in hand the $2 billion in government money he had sought. The assurance was given on December 22.

Next day, though the banks had in fact only raised $4.3 billion of the $4.5, de Larosière proclaimed that the "critical mass" had been attained. He took the agreement with Mexico before the Executive Board of the IMF. Though grumbling a little about the short time for decision, the Board approved the program for Mexico without dissent.

The IMF certification, in effect, tied the knot that linked all participants in the Mexican rescue. What followed was largely routine, a matter of playing out the hand. The commercial banks met their obligations in three stages. In January, with the $5 billion in new money not yet fully pledged, the advisory committee banks agreed to extend Mexico a bridge loan of $434 million. On March 23, the advisory committee was finally able to announce that the full $5 billion had been subscribed, with 526 banks participating. As to the $20 billion in rescheduled loans, final agreements
began to be reached in August, 1982, and were 99% concluded as 1983 ended.

The U.S. Treasury gradually came off opposition to raising IMF contributions. In September, 1981, Secretary Regan had called an expansion of quotas "unwise." At the Toronto meeting in September, 1982, he said the proposed increase in quotas must be "adequate." At an interim meeting of the IMF in February, the other member countries favoured a 60 per cent expansion, while the U.S. held out for 40 per cent. At the full-dress IMF and World Bank session, in September, 1982, the U.S. agreed to a 47 per cent expansion of quotas. On the last day of its 1982 session, the Congress approved the new commitment after a long and bitter fight. The Democrats, by threatening to abstain, forced the Treasury to come front and center. President Reagan, in a speech on the global economy, called the IMF the "linch pin" of the international financial system.

The most important follow-through by far came in Mexico. The de la Madrid government raised taxes, and increased the prices on subsidized goods (including foodstuffs) and services (including telephone charges). It held down wages, and kept imports at a minimum. It slowly loosened controls on the peso which as of June, 1984 was trading at 180 to the dollar, a devaluation of 600 per cent since February, 1982. It established, on top of the deposit scheme for paying back arrears of interest on the private debt, another program, entitled FICORCA, for amortization of money owed by the private sector. It maintained the interbank market, and kept the Pemex acceptances rolling over smoothly. Repayment of the debt went on all through the year. Interest arrears of $864 million in private debt were paid off entirely by December, 1983. The BIS loan of $1.85 billion was repaid on August 23. On August 26, 1983, Silva returned to New York to sign the first of the agreements for rescheduling of the $20 billion in old debt — a complex accord engaging $11 billion owed by the Mexican government, Pemex and the development agency, Nafinza. There was a gala signing ceremony given at the New York State Theater. In his speech, Silva paid special tribute to the advisory committee, the Fed, the Bank of England, and the IMF. He glanced back to the beginning of the crisis, and observed that in August, 1982, there had been "no blueprints." In conclusion, he said to the bankers: "You did your share. We are doing ours and will continue to do so. We have all developed the blueprints."

No toothpaste

A few days later, on the occasion of de la Madrid’s first Informe, on September 1, 1983, I went down to Mexico City to see how the country was
far ing under the IMF program. The capital, a positive monster of urban sprawl, bustled as usual, and amidst the choking pollution and round-the-clock rush hours, it was hard to discern any change from a year before, or a year before that. My first call was on a former official under Lopez Portillo who was closely identified with the Mexican left-wing, and thought by the American Embassy to be a leading member of the Mexican Communist party. I asked him to set out the negatives against de la Madrid — what had gone wrong.

The major complaint was a decline in general economic activity because of the IMF austerity program. He thought gross national product would drop in 1983 by as much as 5 per cent. Employment had suffered, and would go down further. There was almost no investment in Mexico, either foreign or domestic. In the case of goods imported from the U.S. there were acute shortages. Auto parts were unavailable. Toothpaste was hard to find because the big American drug companies, while producing the paste in Mexican subsidiaries, imported the tubes from the U.S. Now there were no dollars to pay for the tubes, and the absence of tubes made marketing nearly impossible.

Inflation was still running high — well over 100 per cent, he thought. One consequence was disaffection among middle class professionals and business people, particularly those in the north dependent upon trade with the U.S. The PRI had lost local elections in the border towns of Durango and Chihuahua to the right-wing Catholic party, the National Action Party or PAN.

The union game

In fact, he claimed, the de la Madrid government was making the workers pay for inflation. The annual wage increase in 1983 had been around 40 per cent for the year. “That’s not belt-tightening,” he said, “that’s larceny.” As a result workers were increasingly restless and prone to strike. Normal School teachers had protested against the government in a demonstration which tied up traffic in downtown Mexico City for hours. There had been a strike by the workers in the nationalized uranium industry. Crime was rampant.

The government, he said, had cracked down hard. The police had broken up the teachers’ demonstrations. The nuclear workers had lost their jobs. He expected even further repression by the PRI, particularly in the remote southern town of Juchitán where PSUM — a left-wing front, linking the Communist and Socialist parties — had taken over. Eventually he thought there might be a reckoning. But not soon. He said, “Society in Mexico is totalitarian. The PRI is cosa nostra. If there’s a problem about

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corruption, somebody takes a fall. Except for symbolic areas like relations with Central America and denying foreigners a role in the oil industry, the Left here has no power."

Chats with officials in the government and the PRI tended to confirm that picture. On the matter of wages and labor unrest, I went to see Fidel Velazquez, the 80-odd-year-old leader of the Confederation of Mexican Workers, or CTM. Everything about Velazquez evokes the image of a labor boss. He occupies a large sparsely-furnished office, which comes last in a chain of rooms filled with tough-looking hombres who hang around doing nothing much. He wears heavy, dark glasses. He sits immobile as a Buddha as he talks. He speaks slowly, but with great authority. He is given to reminiscence, and his memory goes back past George Meany to the first head of the AFL-CIO, Sam Gompers, whom he met in 1924.

As to the present, Velazquez acknowledged that workers had received a 40 per cent pay increase in 1983 while inflation ran at around 100 per cent. It wasn’t his fault, though. He had won agreement for an increase of 25 per cent from the government in January. He had talked about a 50 per cent increase in June. But the left-wing unions had gone out ahead of him. The teachers and the nuclear workers had tried to get more. It was their right. But the government had a right to fight back, and it did. The other workers had learned the lesson. They had settled for an increase of about 15 per cent or less in June. "The workers understand the need to help the economy," he said. "They would rather settle for moderate wage increases, and hold on to their jobs. That’s how we have kept unemployment low even in the bad times."

If he had a complaint, it was about private business raising prices. But he looked to the PRI and the de la Madrid government to hold the line there. He said of the left-wing PSUM, "It commands no consensus in Mexico. It is rigid, and does not evolve in keeping with the growing strength of the country. It wants to make Mexico a mini-Soviet republic."

The right wing party, PAN, by contrast he thought "not bad." It was alright if they won an election here and there. But it was "not a threat" to the PRI. "Except among the middle classes," he said, "PAN has no following." By contrast, he said, the "PRI continues to be the most representative body in Mexico. It represents the aspirations of the peasants and the workers. It offers the best hope for realizing the aspirations of the Mexican revolution." "We may have two or three tough years ahead," he concluded. "But the PRI knows how to make a pragmatic adjustment."

Carlos Salinas, a boyish-looking 35-year-old Harvard PhD who serves de la Madrid as Minister of Budget, set forward the underlying economic logic of the government’s program. He acknowledged that the austerity program and the drop in foreign loans had reversed the gears of economic
growth. But he said Mexico was in good position to tighten the belt. The
growth of the past five years had left everybody better off. The workers
could adjust to slightly lower wage increases. The great bite came in the
countryside. But for a while, hard times only meant more and more people
staying in their villages, instead of coming to town for casual labor. The
government was channeling resources to the areas of the countryside that
had been hardest hit — notably Chiapas just north of the border with
Guatemala where there was a refugee problem. Apart from that, the
government had a strategy for slow growth that would favor employment.
He said that the IMF adjustment program had produced a "dramatic
change in relative prices." Energy prices had doubled. Interest rates were
up three times. Foreign exchange was six times more expensive. But wages
remained low. So business would have to develop labor-intensive industry.
The pick-up would come both in exports because the peso was so cheap
against the dollar, and in import substitution. He expected the turn-around
would come in mid-1984, and then continue slowly. He said: "We do not
want to break the record for growth in one year, and then the record for
recession in the next year."

From the military to the economists

The politics of the government program were outlined by the Minister
of Interior, ManueL Bartlett Diaz, a tall, dark, handsome Mexican in his mid-
forties, who is considered the main political theoretician of the PRI. He said
that the PRI had always "adjusted to conditions." In the 1930s, "the need
was for order. So the military men took over. After that, lawyers
consolidated the gains made by Cardenas, and institutionalized them. Now
Mexico plays an important part in the world economy. So we have
economists in high office." He cited de la Madrid as President, Silva as
Minister of Finance, Salinas as Minister of Programming and Budget;
Bernardo Sepulveda, the former Minister, and several others including
himself. He said the de la Madrid administration had tried to spread the
burden of austerity evenly among the population. The workers had taken
cuts in real wages. The middle class, through devaluation, had lost in the
power to buy imported goods and to travel abroad. The poorest had been
made to pay by a rise in the price of subsidized foods and services.

In keeping with the spread of sacrifice, he said, the government was
trying to "promote pluralism" so that "social pressures" would "not build
up." In that connection he mentioned the electoral victories of the PAN in
Durango and Chihuahua, and the handling of the protesting teachers. He
said that the elections had been honest, and that the police had waited for
"four hours until traffic was thoroughly clogged" until breaking up the
demonstration of the protesting teachers. He acknowledged that corruption was a difficult problem, particularly in the police. But he said that the de la Madrid government was working against it, trying to clean up the police and also trying to "make examples of some people in high places."

In the clink

The most notable example in high places is the former head of Pemex, Jorge Diaz Serrano. After resigning from Pemex in June, 1981, he served Lopez Portillo as Ambassador to Moscow. In the spring of 1982, Lopez Portillo made him a Senator. But the de la Madrid government brought corruption charges against him in a case involving an alleged kick-back of $34 million on the purchase of two ships by Pemex. In July, 1983, the Senate voted to lift his parliamentary immunity, and Diaz Serrano went to jail. I visited him at the Reclusorio Sud, a penitentiary some twenty miles south of Mexico City just off the main highway to Xochimilco and Cuernavaca.

I was brought to the prison, a bank-like building set among green hills and with a minimum of wall and watchtower, by one of Diaz Serrano's lawyers. We swept through a series of check points to a room adjoining the office occupied by the director of the prison. Diaz Serrano, dressed in a blue sweat suit, was standing in the middle of the room, surrounded by half-a-dozen lawyers. He was giving them instructions, like a basketball coach huddling with the players during a time-out. After about twenty minutes, he came over to me, shook hands, and recalled a previous meeting at Pemex headquarters. He said we could talk in the prison yard. A few minutes later I sat down with him at a wooden table in an open courtyard.

"I've relived my whole life here in prison," he said. "You know I'm an activist and an organizer. Well, here I've started a course in diesel engines. I use books friends bring from the outside. I remember almost everything from college. I've also arranged to have one of the fields converted to tennis courts. I'm the coordinator of tennis activities. That's why I wear this sweat suit. In a little while I'm going to start teaching a class in English."

In response to a puzzled question, Diaz Serrano explained the prison. It was a holding center for persons on trial but not yet judged. By Mexican standards it was extremely mild — "a model prison." There was an admission center where prisoners were held for 72 hours and classified. Then they were sent to one of nine wings. One whole wing was for former policemen who were talking, and needed to be protected. Three wings were for inmates with psychological problems. He was in wing four. "The purpose here," he said, "is to avoid conflict. They want good relations among the prisoners. So they group people who can get on with each
other. In my wing, there are two accountants, a skilled worker, a former judge, a restaurant owner and an engineer."

I turned the conversation to politics and the case against Diaz Serrano with a flood of questions. I had heard that he felt betrayed by Lopez Portillo; that he had not availed himself of many chances to flee Mexico; that he was worried about being silenced by "hit men"; that the charge against him concerned a relatively small transaction about which he knew nothing; and that the true beneficiary of the ship deal was the sister of Lopez Portillo. I asked in rapid succession about all these things.

Diaz Serrano said of Lopez Portillo, first that a "president has no friends," and next, that "when you're close friends you don't count favors." He could have escaped "but I'm not the type that runs away. I'm the type that likes to face a situation." He acknowledged that he had taken precautions against being judged a suicide, but insisted no conclusions should be drawn from that about people trying to kill him: "When a swimmer wears a life jacket in stormy seas, that doesn't mean he expects to drown."

Modern renaissance

The purchase of the ships was small potatoes. It involved "one out of a hundred thousand" deals made by Pemex, and only $34 million out of billions of dollars worth of business. He had happened to sign the order on the ship deal because the "purchasing director was ill with hepatitis." He knew Alicia Lopez Portillo very well. "She was her brother's private secretary. She called me often. We visited each other. Our children visited each other. But don't try to question me about details. I have plenty of time. But its a waste of time."

I said that in my mind the case of the two ships was a technicality. The government could charge him with negligence, he could be found guilty, and given a minor sentence. The whole issue would be closed there. But the real charge was that he had hooked Mexico and Lopez Portillo on rapid growth led by headlong development of oil. It had all gone too fast, and the boom had collapsed, and that was what his case was all about.

He thought for a moment, and then he said: "This century will go down in history as the period of a modern renaissance. The 20th century is the equivalent of the 16th century. Our artists — Picasso and Rodin and the painters of the Mexican school — are as good as those of the Quinquecento. Einstein, Planck and Madame Curie are like Copernicus, Galileo, and Giordano Bruno. Their explorers — Columbus and Magellan — discovered continents. Ours discover other planets and the inside of the human mind."
"But what do you think made all this possible? Cheap energy through oil. Oil made it possible for people to move around on the roads, and in the skies. Oil made plastics possible. Without oil, the modern renaissance wouldn’t have happened. Oil gave civilization a boost.

"So I don’t feel that I can be tried for what I did at Pemex. When I came there we imported oil. When I finished we were the fourth largest producer in the world. We didn’t have to go broke. We almost made it. Politics may not take the good things into account. But history does. You can’t try Babylon, or Egypt, or Greece or Rome, and you can’t try Mexico."

With the President

Shortly after that session, I visited President de la Madrid in his downtown office at the National Palace. He is a short, grey man of 46, who seems out of place in so splendid a position. De la Madrid’s father, a provincial lawyer, had been murdered when he was only two years old, and he had worked his way up through the Mexican bureaucracy with a slight push from the uncle who served as head of the Bank of Mexico under Echeverria. Before running for the presidency in 1982, de la Madrid had never held elective office. Caution is evident even to the casual acquaintance.

In response to a question about corruption, the President said that the "moral renovation of society must come fundamentally from the example set by the government." He did not mention either Lopez Portillo or Diaz Serrano, but he took his distances in an unambiguous way. He said his administration had initiated prosecutions in cases involving various agencies, including Pemex. He laid great stress — to the point of boasting a little — on the calibre of his cabinet.

Of the PRI and the rival political parties, he observed: "The fact that the PRI has remained in power for more than half a century is neither fortuitous nor has it been based on physical force. It is based on the party’s capacity for political integration. The minority parties lack that capacity. Some of them arouse a great deal of suspicion among the popular classes, workers and campesinos who are alarmed at the possibility that those parties — let us say, of the right — might come to power. They are parties that have historically been opposed to the Agrarian Reform and to labor unions. On the other hand, there are parties that arouse suspicion from the other side; they are parties that advocate the need for a radical change in Mexico toward socialism, and that arouses a great deal of suspicion among business executives and the middle class, and has not been able to achieve substantial political power either."

Differences of economic policy with the Lopez Portillo regime, on the
other hand, he acknowledged freely: "I understand the serious economic difficulties the country suffered in 1982 very well ... Nationalizing the banks had as its main purpose the control of the exchange situation; but the experiment undertaken in regard to controlling the rate of exchange from September to November was a failure. That is why I had to alter the system for the control of exchange and the rates of interest basically. I have no doubts about the good faith of the experiment, but reality showed its failure. On the other hand the new system, which we set in motion in December, even though it is not perfect, has shown good results."

The cooperative attitude of Fidel Velasquez and the labor unions was readily cited as one reason for the success: "I believe that the labor leaders have understood the mandate of the workers very well, and what the workers want is to keep their jobs ... they know very well that if they demand wage increases larger than companies can afford to give them, they run the risk of losing their jobs ... that explains the wage negotiations in May and June ..." 

As to the debt problem, de la Madrid clearly wanted an easing of the terms arranged with the banks by Gurria in the last, hectic days of 1982. He said:

"Mexico has the firm intention to continue fulfilling its commitments promptly; but I do believe that it would be to the common benefit of the industrialized countries and the underdeveloped countries to search for better terms of financing as regards installments and cost. I have confidence in the sense of the bankers, and believe they will always prefer to have a live client rather than a dead client."

Looking ahead

But as to the exact terms of a future rescheduling, or its implications for the rest of the world, he refused to be drawn. "I cannot venture an opinion," he said, "because I must see how the Mexican economy and the world economy will evolve. Since 1971 the world economy has been changing at a speed that nobody had been able to foresee. Whatever is valid in one year may change in the following. We must not look so far ahead."

Events confirmed the cautious judgments of de la Madrid and his associates. The austerity program applied in keeping with the IMF accord turned the tide. In 1983, imports fell to $9 billion as against $14.5 billion in 1982, and $24 billion in 1981. Exports were sustained at $20 billion — the same as in the previous two years. The trade surplus gave Mexico a current account surplus of $5.6 billion in 1983, as against a deficit of $3 billion in
1982, and $13 billion in 1981. Inflation fell from 100 percent in 1982 to 80 percent in 1983. Growth declined by 4.7 percent but the expectation is that sometime in 1984 Mexico will again be expanding its economy.

The capacity for continued sacrifice found further support in the annual wage bargain worked out in December for the first half of 1984. It calls for a rise of only 30 percent. Local elections all over the country in the last half of 1983 gave token of general approval. The PRI won tests in Baja California, Sinaloa, Puebla and Oaxaca. Success in Mexico has been rewarded in the international money markets. On December 29 of last year, Gurria concluded another marathon negotiation with the advisory committee for a new loan on much better terms than arranged at the end of 1982. The loan provided $3.8 billion for 1984. The interest is at a full point less than in the case of the $5 billion in new money loaned last year. “This demonstrates,” Rhodes said for the advisory committee, “that if a country performs, the banks will respond.” On April 27, he announced that the $3.8 billion loan of new money for Mexico had been over-subscribed. But by that time, the Mexican case had become explicitly entwined with the problems of the other Latin American debtors.

Implicitly there had been a tie from the beginning. Mexico’s troubles caused bankers everywhere to stop automatic roll-over of loans throughout Latin America. Within a year fourteen countries in South America followed the Mexican lead in rescheduling debts with the commercial banks under an adjustment program worked out with the IMF. In complying with the IMF program, Mexico possessed some special advantages — a steady income from oil; a common border with the U.S. that made the fruits of the American recovery in 1983 reach Mexico first; and a very competent team of economic managers in government. But the difference that turned out to be decisive was one of political evolution. Where Mexico enjoyed strong leadership under a unitary political system tightly integrated with the trade unions, other countries were moving from authoritarian rule by the military to more democratic regimes dominated by civilian leaders. That process invited a jockeying for position, and inevitably there came up for grabs the terms negotiated with the banks and the IMF.

Trouble struck first in Brazil, where the military regime headed by General Joao Figuereido is turning power back to a parliament. The IMF adjustment program negotiated for Figuereido originally called for cutbacks in real wages. After street demonstrations in Sao Paolo and Rio di Janeiro, the parliament refused the reductions. The IMF modified the terms. During the first quarter of 1984, pressures eased as international recovery stimulated demand for Brazilian exports, and import reductions
— notably of oil — took effect. By June, 1984, there was confidence at the IMF that the transition to civil rule could be achieved without economic disruption.

Argentina proved a more difficult case. At the end of 1983, rule passed from the military junta discredited by the Falklands war to a democratically elected government under Raul Alfonsin. In taking over, President Alfonsin had to master both the military — including extremists who once arrested a central bank governor for "treasonous" dealings with foreigners on debt — and Peronista labor unions demanding wage raises to stay ahead of inflation growing at a rate of 400 per cent per annum. With little experience in such matters, Alfonsin and some of his ministers committed themselves to budgetary outlays and wage increases that compromised the IMF austerity program. They then indicated that Argentina would no longer abide by the terms spelled out in the Letter of Intent previously negotiated between the junta and the IMF. The commercial banks stopped payment of promised loans. Argentina then stopped paying interest on its debt. As March 31, and the end of the first quarter approached, a showdown loomed. If the interest went unpaid, American banks would have to put loans in the non-performing category, and show heavy losses in earning statements. Though there was talk of adjustments by the regulators, Secretary of the Treasury Donald Regan declared the "banks would have to take the hit." As frenzied negotiations began at a session of the Inter-American Development Bank in Punta del Este on March 24, a widespread theory among Latin Americans was that Argentina, being self-sufficient in food and energy, would stand firm; that the banks, fearful of spoiling a transition to democratic rule, would cave; and that Argentina would then cut a deal which substantially modified the rescheduling terms in ways favorable to the debtors. All the other Latin American countries would then come under pressure to jump on the Argentine bandwagon.

In fact, Alfonsin did not want to fight the system. On March 26 he sent on a secret mission to Washington the venerated Argentine economist, Raul Prebisch. Prebisch saw de Larosière and Volcker, and then went up to New York for a visit with Solomon at the New York Fed. He indicated that Alfonsin wanted to play by the rules, and would reach accord with the IMF on a new Letter of Intent. With that assurance in hand, the international financial community then pulled off a breath-taking rescue operation. At Punta del Este, it was proposed that loans to Argentina would be made by Mexico ($100 million), Venezuela ($100 million), Brazil ($50 million) and Colombia ($50 million). The banks would put up another $100 million at a very low rate — ⅛ of a point above LIBOR. Argentina would throw another $100 million into the pot. The sum total — $500 million — would be
applied to the interest payments. Bank loans to Argentina would be resumed, and the U.S. would cover the four South American contributors as soon as the Letter of Intent with the IMF was signed.

The Argentine rescue proposal came from Mexico which had a major interest in heading off any break with the system. Silva Herzog unveiled the idea at Punta del Este just after noon on March 27. In fact, the idea had been discussed with de la Madrid in Mexico City a week earlier. The Mexican president played a personal role in selling the scheme to Colombia, Venezuela, Brazil and Argentina. At one point when the Argentines seemed uncertain on to how to proceed, Gurria and another deputy to Silva, Gustavo Petricioli, went to work in the central bank in Buenos Aires. But while it was essential for the Mexicans to surface the plan as an Hispanic initiative, in fact there was a deeper background. The idea had been discussed, months before Punta del Este, by Paul Volcker and Ted Truman at the Fed. Moreover, it was the Fed which made the whole deal possible by establishing in New York a special Argentine account which was payable to the commercial banks and was not to be drawn down below the $100 million. The banks put up their $100 million at the concessional rate of 1/8 above LIBOR only because they had that sure collateral at the Fed.

The Argentine caper, to be sure, did not solve anything on a permanent basis. Huge debts — $350 billion for Latin America — remain. Voluntary bank loans are way down. Growth has slowed and unemployment has risen in many countries of Latin America. Anti-IMF riots in the Dominican Republic in April cost fifty lives. Peru and some other countries have political problems that jeopardize the structure of IMF agreements. Argentina continues to experience — and to pose for the IMF — acute political problems. The pooling together of Argentina, Venezuela, Brazil, Colombia and Mexico prefigures a kind of "debtors’ club" able to confront the bankers with stronger demands for easier terms. But the Mexican role in the Argentine rescue implies that the "debtors club" is going to play by the rules and with the system — not against them.

Mexico has thus emerged as the interlocuteur valable — the useful partner — on the issue of Third World debt. The Mexican officials know the technical questions inside out. They have good relations with the other Latin American regimes. They enjoy the trust of the leading officials of the IMF, the Fed, and the American government. They are well-placed to win larger concessions from the banks for all major debtors. Working together they constitute an international network determined to make the adjustment process work.

The basic conditions of a way to live with the debt problem have been adumbrated. If growth in the industrial world can be sustained at over 3 per
cent, and interest rates held around 9 or 10 per cent, and exports from Latin America allowed to grow by about 5 per cent, then the present course can lead to a gradual easing of the debt problem. Small variations from that path can be accommodated and some are already envisioned. The Fund, the Fed, the Mexicans and some bankers are prepared to move quickly toward multi-year agreements on somewhat easier terms. The Fed has aired a scheme, which there are many variants, whereby a "cap" might be placed on interest payments by developing countries, with any excess interest due being added to principal payments made at the end of the loan. More ambitious schemes have been proposed — such as an assumption of the debt by an international lender of last resort. But that approach would involve a huge payoff by the governments of the industrialized countries. None are in the mood for that now, nor, even, for a big increase in bilateral or multilateral development aid. So for the time being, until some terrible crisis forces another approach, the Mexican model is in the saddle. The world will be trying country by country, adjustment program by adjustment program, loan by loan to work its way out of the debt problem. It is not a perfect way, but it is flexible, and it has worked so far. Looking back from his central vantage point at what has happened to date, de Larosière cites Talleyrand: "In history things get arranged . . . but badly."
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