Overview: Perspective from an American Lawyer in Mexico

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On the evening of August 5, 1982, I was inching home through the Mexico City traffic, half listening to *Radio Universidad*, musing about my trip the next morning to San Francisco for the 1982 Annual Meeting of the American Bar Association. Suddenly, the Secretary of the Mexican Treasury and the Director of the Central Bank broke into the program and announced the imposition of a system of dual peso-dollar parity. This meant not only the second major devaluation of the peso that year, but rationing for foreign exchange. Since 1976, Mexicans had become used to devaluations, but any form of control over exchange was unprecedented! On the San Francisco plane the next morning, we debated what was really going on and wondered whether we should have stayed at home.

Seven days later, the government closed the foreign exchange markets and abruptly froze some $12 billion of dollar time deposits in Mexican banks, later allowing them to be withdrawn, but only in pesos, and at a fixed rate much lower than the free rate. Historically, dollar deposits in Mexican banks had been sacrosanct. Emergency financial support was pumped in from Washington. On August 17, Mexico announced that it was negotiating with the IMF for a long-term adjustment and assistance program and that the Central Bank would meet immediately with Mexico's commercial bank creditors to restructure public and private debt estimated at some $80 billion. Foreign exchange markets were reopened August 19, but a day later, Mexico announced in New York a ninety-day suspension of official payments of principal to the commercial banks.

We know now that Mexico's "Crisis of August" was only an early,

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spectacular symptom of a similar liquidity crisis that befell the less developed countries (LDCs) in 1982. High international interest rates and the recession in the United States hurt all of the LDCs, particularly Mexico, which depends heavily on the United States for exports, capital, technology, and industrial imports. The unique causes of Mexico's own crisis are also now officially acknowledged. Its massive post-1976 developmental program was to be paid for principally by expected ever-rising income from newly discovered petroleum resources and to be principally propelled by the public and para-state sectors. When the oil market broke, Mexico, rather than cut its program, made up shortfalls by increasing borrowings from a very willing international banking community. One hundred percent inflation was only one result. The peso was kept overvalued and, as confidence declined in the Fall of 1981 and into 1982, the dollar became the best buy in town.

Mexicans are blase about the frequent quaking of their earth, but a year ago they were frightened and confused by the sudden quaking of the economy. They crowded expectantly around radios and television sets on September 1 to hear the lame-duck President, Jose Lopez Portillo, deliver his last State of the Union Message. Usually, it is just a record of accomplishments, but this year, Lopez Portillo announced that he was going to "break taboos." For the first time in the history of a dollar-oriented country, he imposed generalized exchange controls: no foreign currency except through the Central Bank. Without warning and, according to many, even without good reason, he expropriated a national banking system made up of 57 banks with assets of some $33 billion, 4,300 offices, 150,000 officers and employees, and 32,000 accounts. The bankers, he charged, were "traitors" to Mexico! Also swept into the hands of the State by the expropriation was the very substantial equity owned by the banks in many of Mexico's largest corporations, thus raising direct and indirect ownership by the State of the means of production from around 50 to, some claim, in excess of 70 percent. As he ended his three-hour address, the President was in tears. In the audience, Miguel de la Madrid, who would replace him in three months, was impassive. In one stroke, Lopez Portillo had, some observers said, saved some tottering banks, molified the Left, and created a scapegoat for his Administration.

On September 6 and 7, the government hung the Mexican flag over the entrances of the banks while occupying them. Fifty past and present government officials, many with little banking experience, became the new presidents of the nation's banks. A rueful joke had it that the elegant and exclusive Bankers Club (*Club de Banqueros*) had changed its name to the Inn of Memories (*La Fonda del Recuerdo*). Exports and imports were subjected to prior permits. On September 14, complex rules on general exchange controls became the latest chapter in what has become a vast new area of Mexican law. On September 17, Lopez Portillo sent to Congress an amendment to the Constitution making the banking business a permitted monopoly of the state; critics immediately charged that this admitted the unconstitutionality of the expropriation. In any case, they said it was an effort to render moot any constitutional attack on the expropriation in the courts. Only five days later, the former owners of the banks did challenge the expropriation by the Mexican constitutional writ of *Amparo*, arguing not only the invalidity of the Law of Expropriation, but claiming that the government's action under it violated constitutional standards; among other things, they said, there was no reason to take over the highlyregulated banking system. Already pending in the courts were various *Amparos* filed against the "peso-ization" of the $12 billion of bank deposits (the so-called "Mex-dollars") in August; depositors of Mex-dollars have also presented claims in the United States courts. An additional constitutional amendment to clarify the authority of the Congress and the Central Bank over exchange controls was sent to the Congress. Pursuant to an economic theory, which nationalistic Mexicans learned from the *New York Times* was applied by England's so-called "Cambridge Group" of economists in regular visits in Mexico, interest rates were being drastically reduced below the world rate behind what turned out to be a porous barrier of exchange controls. In October, a Registry of Foreign Debts was established, as Mexicans, under increasing pressure from foreign creditors, found it impossible to get dollars. Special rules were also published on the repatriation by foreigners of dividends and royalties. By November, the government announced agreement with the IMF on a stringent adjustment program.

The Fall of 1982 was a time of confusion, fear, anger and change. In a country of historic free convertibility, there were very few dollars. Many saw their savings disappear into the undervalued Mex-dollars, which they tried to unload in payment of dollar debts. Upper- and middle-class Mexicans—some enriched by the oil boom—could not make payments on their condominiums in Vail and La Jolla, and had to bring children home from overseas schools. Travelers had to line up at booths at the airport to get $250 for expenses when leaving the country. I saw the Mexican-issued American Express Card rejected in a hotel in Chicago; visiting Mexican counsel and his distinguished clients had to ask their negotiating opponents for a dollar loan to pay the bill. Holders of safe deposit boxes in the nationalized banks feared the contents would be investigated, if not expropriated, and hurriedly closed them out, some then to face robberies at home. People carried pesos and other valuables out of the country in suitcases. At the airport, travelers were approached by furtive figures buying and selling dollars like dirty postcards. One hapless American was arrested in Guadalajara bringing out his gold coins and was jailed for months despite the pressure of the United States ambassador.

The anger was palpable. Right after expropriation, the government organized a massive demonstration in support of the President in the huge central square. The President attacked the so-called "Saca-dolares," who had changed their money into dollars and taken it out of the country, and he delivered to the Congress for investigation and prosecution boxes of land records from Texas, Colorado and California, purporting to show who had invested on "the other side." He proposed a tax on foreign-owned assets, which was never enacted. The Mexican private sector counter-attacked by organizing meetings all over the country called "Mexico in Liberty," which were crowded by angry tradesmen and businessmen; these were suspended at the suggestion of the government. The president, usually above the fray, was the object of personal attacks more scurrilous than any I have heard in twenty years.

The Mexican Bar Association held a special meeting in its portrait-lined offices and listened to one after another paper attacking the bank expropriation as unconstitutional. Near the end, a high government official, law professor, and former justice of the supreme court rose to say that he felt like a "heretic" among his own colleagues, because in his view, the government had acted entirely in accordance with the law and the Constitution. The Bar Association had already taken full-page newspaper advertisements containing formal criticisms of the President of the supreme court and his colleagues for having lost their judicial neutrality by improperly visiting and congratulating the President following the expropriation speech. The trial lawyers handling the bank *Amparos* became heroes of the Bar. At a meeting of the National Association of Business Lawyers, and again at the Bar Association, natural law arguments were advanced: not only the bank expropriation, but also the very amendment to the constitution was itself unconstitutional, because the country's basic charter did not in the nature of things admit of an amendment turning banking over to the state, and in any event, that could be done, if at all, only by referendum. A new *Amparo* claimed the unconstitutionality of the constitutional amendment; the supreme court has dismissed it. De la Madrid later was to characterize this period very accurately: "We faced not only the crisis of the moment, but a structural one, going well beyond the economic problem into manifestations of rancor among various social classes that called into question our governing principles and, for some groups, the very organization of the nation."

Indeed, throughout that incredible Fall, everyone looked forward with hope and relief to the inauguration of de la Madrid, although rumors had it that the military would take over first, or that Lopez Portillo would not relinquish power to his successor. We had heard the same rumors six years earlier in the final months of the turbulent regime of President Echeverria, who preceded Lopez Portillo. However, on December 1, as scheduled, Mexico's first English-speaking, Harvard-educated Chief Executive put on the sash of office: the unique Mexican political system had survived the second transfer of power under crisis conditions in six years. Some observers pointed out that, starting with 1970, the end of each six-year presidential cycle had become increasingly difficult and surrounded by doubt and disorder, and they wondered what would happen in 1988. Nor could one help but recall the Aztec custom of expecting the end of the world every 52 years, worshipping amid bonfires all through the last night, waiting to see whether the sun would ever rise again. It did, at least on December 1, 1982.

De la Madrid immediately moved to quiet fears, reduce conflict, improve domestic and foreign confidence and get the economy moving, without, he emphasized, authoritarianism. He drastically cut spending by the public sector, which had been the principal expansive force in the economy the past six years; the country committed itself to the IMF to reduce public sector deficits from the colossal 18 percent of 1982 GNP to 8.5 percent of the GNP in 1983, and it has kept that commitment. Private investments, domestic and foreign, are also way down. For the first time in 39 years, economic activity contracted in 1982, producing a negative growth rate; 1983 is expected to be worse. Only 280,000 cars will be produced this year, in contrast to 472,500 in 1982 and almost 600,000 in 1981. Reduced spending has sharply decreased imports, and in some cases, parts, machinery and raw materials have not been available for the Mexican industrial system. One by-product of the reduction in imports is the first current account surplus in 39 years. Another is an absence of toothpaste; certain imported raw materials became unavailable. Unemployment is way up—the government admits to 11 percent, but many claim unemployment and underemployment are 60 percent of the working force. De la Madrid began a program to produce 700,000 jobs for the urban and rural unemployed and to continue public works already in progress; even in normal years, some 800,000 new jobs have to be created just to absorb new entrants into the work force. Several major export support programs have been commenced. Crucial, large earnings from oil exports suffered a blow when Mexico followed OPEC's price break in March, but recovered slightly in August in a unilateral raise. The prime rate is 58.7 percent. Inflation at around 80 percent is down from the 100 percent of 1982, but upward pressure continues not only from increases in prices of uncontrolled goods, but from frequent price rises of government goods and services, such as electricity and gasoline. Milk, automobiles, and finally tortillas and bread were allowed to rise. Small-denomination coins and bills are being replaced. Guaranteed prices for crops were increased up to 100 percent. Personal income taxes and the dividend tax were increased by de la Madrid, and the Value Added Tax was not only raised from 10 to 15 percent but extended—even to lawyers (although not to doctors). One significant reform is the phased abolition of the "bearer share," an institution that has made it virtually impossible to tax dividends and capital gains. Price controls still exist on many basic goods, to the annoyance of the private sector. Wage increases have been kept fairly reasonable, to the increasing annoyance of labor. The peso, substantially undervalued at the start of the de la Madrid regime, has been apparently supported at 150:1, but a program of slippage at 32 percent per annum is expected. Even this rate may not be enough to avoid another major devaluation in view of the high Mexican inflation rate compared to the very low rate in the United States, Mexico's principal trading partner.

De la Madrid abolished the hated exchange controls, fired their architect as head of the Central Bank, and reinstated his predecessor, who had all along claimed that they would never work. A very limited exchange control system is now in effect, and that, along with efforts to collect and restructure public and private debt under special government programs, has kept lawyers on both sides of the border very busy despite the decline in other economic activities. This month, the emergency loan from the Bank for International Settlements is expected to be repaid, along with a stretch out of $11.4 billion of public sector debt. One now hears little of the predictions that Mexico would, alone or together with other LDCs, take the road of repudiation. The IMF, the United States government, international banks, and the commercial banks have provided foreign exchange for 1983; indeed, some 530 commercial banks reluctantly increased their Mexican exposure about 7 percent to make available a $5 billion dollar "jumbo" line of credit. There are still shortages of foreign exchange from time to time, and the banks have to ration it.

The extent to which foreign direct investment will be encouraged by exceptions to the foreign investment restrictions is still unclear, but there are indications that the government, while not amending the Foreign Investment Law, will, using existing legal authority, permit temporary majority investments by foreigners in selected, appropriate cases and under special safeguards.

Institutionally, de la Madrid has moved the government further toward a dominating role in the economy, and he has several times predicted important structural changes, as yet unspecified. He has encouraged a slightly more independent Congress, decentralization of the federal government, strengthening of state and local governments, and reforms in the administration of justice. To the annoyance of some, he caused the constitution to be amended to institutionalize the concept of the "rectorship" of the state in economic matters and the concept of "democratic national planning." In May, the government published a National Development Plan, with sectoral plans to follow. De la Madrid has ordered a substantial reorganization of the automobile industry. Contrary to the hopes of many and the expectations of some, he confirmed the nationalization of the Mexican banking system and has been organizing and consolidating the 57 former private banks, including legislation for the payment of ten-year indemnity bonds to the former owners of the banks, also attacked by *Amparo*.

The *Amparos* of the former bank owners against the expropriation were rejected by the lower courts and are awaiting action by the Supreme Court. Shares owned by the banks in private companies have remained in the hands of the government, despite conflicting statements by high officials that the shares, or at least some of them, would be sold to private individuals. Indeed, the only clear indication of any lessened involvement of the state in the management of the economy has been the sale by the government to the French government of stock in Mexico's Renault and American Motors automobile operations. Some of the Mex-dollars *Amparos* were won in the lower courts, and the government has appealed.

This panorama of Mexico one year later should record some political, social and foreign policy developments. The political party that has governed Mexico for fifty years, the Institutional Revolutionary Party or PRI, is experiencing increasing opposition in state and local elections, first near the northern border and later elsewhere; this is doubtless the result of bearing the blame for the economic collapse and alleged massive official corruption of the last six years. Many elections have produced bitter protests of the opposing parties against alleged fraud by the PRI. The principal beneficiary has been the National Action Party (PAN), generally regarded as right wing. There have also been occasional indications of a split in the historic and crucial alliance between labor and the government as a lid is kept on wages. To meet public demand, de la Madrid has launched a campaign against governmental corruption, the most prominent target of which to date has been one of the most powerful and closest collaborators of Mr. Lopez Portillo, Jorge Diaz Serrano, former head of the state oil monopoly, Pemex, who is in jail charged with malfeasance and fraud. A number of other former Pemex officials and government employees are also being prosecuted; corruption in the Pemex union has also come under pressure. Significantly antibribery and conflict of interest legislation has been enacted. In addition, de la Madrid created a new agency charged with oversight of the huge administrative apparatus and the permanent pursuit of corruption in government. Early in his administration, he met with the principal former private bankers and received their support.

One widely expressed fear is that unemployment will grow so large that disorders will break out, as in Brazil. In fact, there have been many strikes: massive shutdowns were threatened in May to obtain a 50 percent rise in the minimum wage, but labor finally settled for 15.4 percent. A general strike sponsored by the Left fizzled out. We have, however, seen more protest demonstrations (at least in Mexico City), and occasional violence, both in the city and in the countryside; to judge from stories from friends and the recent deployment of riflemen outside the banks, there is a lot more crime.

It is an open secret that the Mexican government, one of whose greatest political achievements since the 1917 Revolution has been the subordination of the military to civil authority, has seen fit in the last couple of years to begin building up the army and other services. The good news, nevertheless, is that one year later, contrary to the predictions even of well-informed Mexicans, social disintegration is not yet with us.

Additional pressure arises these days from disorder among Mexico's neighbors to the south. Camps along the Guatemalan border house some 40,000 Central American refugees—mostly Guatemalan peasants—and military incidents are reported. Mexican troops are said to be deployed in the southern part of the country to protect the oil fields. Mexico is working actively with the Contadora Group to provide a regional alternative to unpopular direct and indirect military intervention by the United States in the Salvadorean Revolution and Nicaragua. United States Ambassador Gavin claims that Mexico is the region's "last domino."

Relations between Mexico and the United States continue to exhibit the traditional tension and ambivalence, and sometimes even hostility. Certainly, the United States promptly stepped forward to assist Mexico financially in the worst moments of the August Crisis, but some Mexicans complain bitterly over the harsh terms of the emergency purchase of Mexican oil by the United States Strategic Reserve. As Mexico tries to increase exports as a way out of its economic crisis, it complains that "protectionism" in the United States increases in more and more countervailing duty cases and in a probable reduction of the advantages enjoyed by Mexico under the Generalized System of Preferences. The North Americans argue that the Mexican market is closed, Mexican exports are unfairly subsidized by the state, and that in foreign trade, Mexico acts like Japan. Mexico retorts that it is a geographically determined, reluctant and historically unequal partner of the United States in trade and, as a less-developed and weaker neighbor, it should have special treatment. President de la Madrid has complained that Mexico has to be allowed by the United States to export more so that it can import. Indeed, the slump in Mexico has cost thousands of jobs in the United States export industries, with millions in lost sales, not to mention the collection problems of United States suppliers and bankers. Recently, the United States trucking industry has retaliated against the Mexicans for their refusal to allow United States truckers to enter Mexico. The dispute over tuna fishing also continues. The traditional "escape valve" for Mexico's urban and rural unemployed—crossing the river into the United States—may well be closed by immigration reform legislation that most Americans regard as vital but which may exacerbate the social problems south of the border, to America's longer-term detriment.

One year after the "Crisis of August," Mexico is beleaguered by low production, a shrunken internal market, rising unemployment, high although lessened inflation, political unease, and no expectations of rapid recovery. But there is domestic peace, and even the IMF has acknowledged that, among the similarly stricken LDCs, Mexico's economic reaction has been not only significant, but exemplary. Recovery of confidence in the Rule of Law, however, will be slower, and the thoughts of many leap forward four years when payments on expensive, stretched-out government debt will have to begin.