eabh Papers | No. 14-03 | March 2014

The Untold Story of the Mexican Debt Crisis: Domestic Banks and External Debt, 1977-1989

Sebastian Alvarez*
University of Geneva

Abstract:

In the years preceding the international debt crisis of the 1980s, international banks displayed a growing enthusiasm for lending to Mexico and other developing countries. During this period, Mexico's development and commercial banks got heavily involved in intermediating foreign finance with domestic final users. Although important, scholars have thus far neglected the role played by Mexican banks in international capital markets and in the country's external indebtedness process. This paper argues that the imbalances which Mexican banks incurred in running their international operations eventually brought them to the brink of bankruptcy once the crisis began. Given that the banks that were at risk represented a large share of the domestic market, this paper argues the whole Mexican banking system was threatened with collapse. The improved understanding of the banking system's exposure to and dependence on foreign finance provides new insights into Mexico's debt renegotiation outcomes and the nationalization of the banking system in the aftermath of the crisis.

JEL Classification: H63, N26, N86.

Keywords: Sovereign debt, financial crisis, Euromarkets, Latin America.

Acknowledgements: I am very grateful to Mary O'Sullivan, Juan H. Flores, Sergio Negrete Cárdenas and participants of the Financial History Seminar at New York University and the Money, History and Finance Workshop at Rutgers University for valuable comments. I also thank archivists at the Federal Reserve of New York archives, the IMF archives and the BIS archives. Financial support from the Swiss National Sciences Foundation (SNSF) is gratefully acknowledged.

* Sebastian Alvarez, Paul Bairoch Institute of Economic History, University of Geneva, Switzerland.
Email: sebastian.alvarez@unige.ch.

1. Introduction

Late August 1982, in a discussion held between Citibank executive William Rhodes and officials of the Federal Reserve Bank of New York (FRBNY), the co-chairmen[1] of the Bank Advisory Group (BAG) on Mexican debt problems stressed the Group's concern about the dollar funding needs of Mexican bank agencies in New York and London. By that time, Mexico had already announced a temporary debt moratorium on principal payments to the international financial community and, as a result, external lending to Mexican borrowers had stopped. The lack of external financing would eventually put the Mexican banking agencies into a very delicate liquidity situation.

Alerted to the bankers' concerns, FRBNY official Sam Cross phoned Angel Gurría, the external debt negotiator for Mexico, to ask about the situation and find out about how the Mexicans planned to deal with it. After confirming Rhodes' diagnosis, Gurría said that he was planning a meeting with 140 bankers in Mexico City, where "he would point out as emphatically as he could that no bank had ever been allowed to fail in Mexico,[2] and that the Government and the Bank of Mexico stood strongly behind the banks."[3] He added that, although they would be happy to support the Mexican banks, "[they were] a little short of cash". He would therefore ask the international creditor banks "not to create a problem by drawing down credit lines [with the Mexican agencies]" and the Federal Reserve to consider the possibility of granting discount facilities to them. A few days after this talk, on September 1, 1982, the Mexican government announced the nationalization of the entire banking system.

It was the time of the Third World international debt crisis and Mexico was the country (and Latin America the region) at the heart of the storm. As Bougthon (2001) observed, "although Mexico was not the first indebted economy to erupt, nor the largest, nor the one with the most serious economic or financial problems, the 1982 Mexican crisis was the one that alerted the IMF and the world to the possibility of a systemic collapse."[4] Soon after the crisis broke out in Mexico – the biggest Latin American debtor – other large borrowers, such as Brazil and Argentina, followed the same path, spreading the crisis regionally and all over the world. Serial defaults in the developing world, whose loans accounted for the bulk of international commercial banks' assets, brought the whole international banking and financial system to the brink of collapse. The strategy established to deal with the Mexican crisis was applied in every country facing debt payment difficulties until the inception of the Brady Plan in 1989. In Latin America, the debt crisis and the way it was managed plunged the region into the biggest development meltdown it had seen since the Great Depression.[5]

In studying the Mexican and broader international debt crisis of the 1980s, the literature has largely looked at the countries' external indebtedness process from a macroeconomic perspective and as a public sector issue.[6] The rationale for this approach is clear. In the first place, although both public

[1] Along with representatives of Bank of America and Swiss Bank Corporation.
[2] Up to then there had not been a bank failure since 1937.
[3] FRBNY Archive, File "C261 - Mexican Government 1917-1984," Office Memorandum, August 30, 1982.
[4] Boughton, 2001, p. 281.
[5] See Bértola and Ocampo (2012), chapter 5.
[6] See Aggarwal (1991), Dale and Mattione (1983), Cline (1984), Devlin (1989), Diaz-Alejandro (1984), Sachs (1989) and Smith and Cuddington (1985). For the case of Mexico see Green (1987, 1998), Zedillo (1981, 1985) and Solís and Zedillo (1985).

and private sectors rapidly increased their recourse to external borrowing after the oil shock of 1973, public loans dominated the portfolios of their international bank creditors.[7] Second, the debt renegotiation process that followed the outbreak of the debt crisis in the early 1980s was largely conducted between international creditors on the one side and debtor governments on the other.[8] Private debtors barely participated in these renegotiations, in many cases because their home governments had nationalized their external obligations.[9] Finally, and partly for the reasons already enumerated, the international strategy established to deal with indebted countries was conceived of solely as a means to manage balance of payments crises and the countries' sovereign debt; policymakers focused only on the macroeconomic “big picture" and eschewed microeconomic considerations..[10]

Nevertheless, a closer look at financing operations on the debtors' side, particularly for Mexico, shows that debtor countries' financial institutions were also significant borrowers from international capital markets.[11] In Mexico, as much as 30 per cent of the capital raised by Mexican borrowers in the Eurocredit markets between 1973 and 1982 went to state development banks, such as Nacional Financiera (Nafinsa), the Banco Nacional de Obras y Servicios Públicos (Banobras) and the Banco de Crédito Rural (Banrural). These banks ranked among the world's biggest international borrowers and the money they raised abroad was lent domestically to the Mexican government and public enterprises. Larger private banks, such as Banco de Comercio (Bancomer) and Banco Nacional de México (Banamex), also expanded their operations abroad during the seventies and became highly involved in channeling foreign money to local final users.

Although, initially, Mexican banks were little concerned with external finance, by the late 1970s their balance sheets exhibited an important increase in their foreign liabilities. During the period from 1977 to 1982, when external finance flowed in considerable amounts into Mexico, larger state and private banks were among the main recipients. The significance of the capital inflow lay not only in its scale, but in the fact that, as Carlos Marichal stated, banks' "objective consisted in obtaining cheap funds overseas to lend domestically at higher rates, ergo recycling them locally."[12] With inflation and nominal interest rates at double-digit levels whilst the peso-dollar nominal exchange rate was practically fixed from 1977 until early 1982, the potential for financial gain was significant. Local banks not only recycled the money they borrowed abroad through domestic loans made in Mexico, but also internationally by lending directly from their overseas branches and associated banks in London and New York. As one Mexican banker put it, "being Mexican, we've seen the Eurodollar markets from both sides of the fence."[13]

In this paper, I explore the interplay between Mexican banks’ international activities, and the country’s external indebtedness process between 1977 and 1982. I examine its implications on debt renegotiations in the aftermath of the crisis between 1982 and1989. I present evidence that shows that in intermediating foreign finance with domestic final users, large Mexican banks incurred grave

---

[7] See Friedman (1983), Lipson (1981), Lissakers (1991) and Sachs and Huizinga (1987).
[8] See Aggarwal (1996), Cline (1995), Cohen (1986), Devlin (1989), Lomax (1987), Sachs (1986) and Wellons (1987).
[9] See Altimir ad Devlin (1993) for a review of debt management in Latin American countries.
[10] See Boughton (2001), James (1996) and Volcker and Gyohten (1992).
[11] See Green, 1987, pp. 69 and 70 and Marichal, 2011, p. 118.
[12] Marichal, 2011, p. 119.
[13] Quoted in Euromoney, April 1978, p. 12.

financial mismatches. The rise of reimbursement difficulties with respect to domestic loans and a retrenchment of foreign finance by the beginning of the 1980s pushed Mexican international banks to the brink of insolvency. Faced with the risk of a generalized bankruptcy of their banks, the Mexican government and the Bank of Mexico intervened to assist the banks and stabilize Mexico's financial system. I argue that the success of the stabilization policies proved to be highly dependent on external finance, which might help to explain the weak bargaining position of the Mexican authorities during the debt renegotiation process and the banks nationalization of 1982. With a microeconomic approach based on the role of banks in Mexico's external indebtedness process, the paper contributes to the literature on the Mexican debt crisis by studying a sector that, although important, has so far been neglected by scholars. The paper also provides new insights for the analysis of the negotiations that followed the country's declaration of its debt moratorium.

The rest of the paper is organized as follows. Section 2 presents evidence showing the extent to which Mexican commercial banks were involved in the international capital markets prior to 1982. It also describes how these institutions managed to raise funds abroad, in particular from the London and New York interbank markets, and lent them in their home country to final Mexican users. In Section 3, I analyze the exposures and imbalances incurred by government-owned development banks and private and mixed commercial banks as a result of their international business model. Section 4 explores the financial and liquidity problems faced by Mexican financial institutions in the aftermath of the debt crisis as well as the way in which banks' external debt was renegotiated. In the last section I draw some brief conclusions about the implications of international activities by Mexican banks in the period from 1977 to 1989.

2. Mexican banking in world capital markets

During the crucial period from 1977 to 1982, when Mexico almost tripled its external debt levels, its banking sector became an important international debtor. On average, Mexican banks accounted for 30 per cent of the country's total outstanding external obligations during this period.[14] Mexican banks' ability to borrow in foreign capital markets reflected a broader enthusiasm among international creditors in financing developing economies during the 1970s.[15] The borrowing boom took place mainly within the Euromarkets, with Latin America attracting the lion's share of external funds. Financial institutions from the region's major countries, such as Mexico, Brazil and Argentina, but also from smaller economies, performed an important intermediating role with respect to foreign finance.

External finance became an important component of the balance sheets of Mexican banking institutions between 1977 and 1982, a period in which the Mexican banking sector recovered from a 7-year trend toward financial disintermediation.[16] By the end of 1982, obligations to the external sector totaled US$ 23,087 and US$ 8,530 million for development and commercial banks

[14] Based on data from Solís and Zedillo (1985) and Negrete (1999).
[15] See Helleiner (1996) for general overview of Euromarket financing to developing countries during those years.
[16] The ratio Total Assets/GDP for private banks in 1971, 1977 and 1982 was 35 per cent, 26 per cent and 42 per cent% respectively (del Angel, 2006, p. 637).

respectively.[17] These amounts represented as much as 62.1 per cent of state development banks' total liabilities (which amounted to US$ 37,645 million) and 20.2 per cent for commercial banks (with total liabilities of US$ 42,996 million). Foreign finance proved, therefore, to be a substantial funding source when compared to domestic sources. Overall, for every peso or dollar on the banks' assets, 46 cents came from overseas.[18]

The overwhelming part of the foreign borrowing of Mexican banks was in the form of international loans, which were mainly granted by foreign commercial banks. In December 1977, loan liabilities to foreign banks reached US$ 10,893.8 million for Mexican banks, an amount that represented as much as 94.2 per cent of their total liabilities to the external sector with the remaining 5,8 per cent consisting mostly of bonds and securities of government financial institutions which were raised abroad.[19] Until the late 1970s, state development banks were the most heavily involved in foreign borrowing, accounting for 94.3 per cent of the total foreign loans of the banking sector with only 5.7 per cent held by private and mixed commercial banks. It was only towards the end of the 1970s that commercial banks increased their relative position as international borrowers. By the end of 1980, commercial banks' external debt almost tripled compared with its level of 1977, increasing their share of total Mexican banking system's external obligations from 18.9 to 34.3 per cent over the same period.[20] Mexican commercial banks also show up as substantial international borrowers based on the 1980 Country Exposure Lending Survey: U.S. Banks reported US$ 2,992.9 million owed by commercial banks, an amount representing almost 20% of their total claims on Mexico.

External capital flows to Mexico came mainly from London and New York, the two major international financial centres at the time. London was indisputably the international centre of both investment banking and the Eurodollar markets, where foreign borrowers could benefit from a variety of financial instruments such as Euroloans, Eurobonds and interbank facilities. However, New York offered access to an alternative source of financing trough a broad and deep international money market. Since the removal of capital controls by the United States in 1974, the New York capital market had regained the attention of international borrowers and foreign financing had grown steadily in the second half of the 1970s. For Paul Volcker, then president of the New York Fed, the attraction of New York for international banking became pretty clear: "You get more direct access to this money market, which is a really big money market."[21]

2.1 London and the Euromarkets

Built up as the main financial centre of the Eurodollar market since the early sixties, London played a crucial role in the external financing of Mexico. The development and intensification in the use of the Eurocredits during the first half of the 1970s, in contrast to the evolution of Eurobonds, was for the benefit not only of Mexico but, in more general terms, of all Latin American countries. As Robert

[17] At that time, Mexico's banking system consisted of the government development banks (Banca Nacional) and a large number of commercial banks (usually referred to as private and mixed banks because the government frequently held a minority equity participation in a number of them).
[18] Data from Banco de Mexico's 1983 Annual Report, Tables 40 to 48.
[19] Data from Banco de Mexico's 1978 Annual Report, Table 17, pp. 109-110.
[20] Based on data from Zedillo (1985) and Negrete (1999).
[21] "Paul Volcker puts the case for stricter rules," Euromoney, June 1977, p. 54.

Devlin observed, "the boom in Eurocurrency lending was to a large degree a Latin American phenomenon," since, by 1981, the region had absorbed almost two-third of the loans extended to the developing world.[22] It was through Eurocurrency syndicated lending that developing countries reached the Euromarkets, because, after all, "LDCs rarely qualifi[ed] for access to the Eurobond and foreign bond markets" and therefore had "only limited access to [them]."[23]

For Mexican public borrowers, in particular, syndicated eurocredits proved an excellent source of funds when compared to Eurobonds and other financial instruments available in the international capital markets. As Negrete notes, as early as 1974 and "in just six months, with two syndicated loans, Mexico had borrowed virtually the same nominal amount accumulated through bond offerings in the 1963-72 decade."[24] Overall, between 1977 and 1982, Mexico's public sector raised US$ 41,354 million in the Eurocurrency credit markets, of which US$ 12,395 million (30 per cent) went to state development banks and through them was lent on to other domestic borrowers.[25] The three largest development banks, Nacional Financiera, Banobras and Banrural, accounted for three quarters of this total amount. As stated in *The Banker*, a leading magazine in international finance at the time, "banks borrowing from other banks in the form of medium-term syndicated Eurocurrency credits have tended to be from Eastern Europe, the developing countries and partly industrialized countries."[26]

Syndicated deals were brought to London and promoted by a large international bank, usually from the U.S. or another developed country, under a mandate granted by the borrower. The leading bank invited other banks to join the management group and then coordinated the formation of a lending syndicate with a larger group of pre-selected banks that had expressed a willingness to lend. Once the loan agreement and the participations were approved by the parties to it, the money was granted with each bank providing the amount to which it had previously committed.[27] Through their branches and associated banks in London, borrowing countries' financial institutions usually took part in these deals, thus participating in the financing of home country customers. In Latin America, that was the case for large banks from big countries such as Mexico, Brazil and Argentina.

Mexican banks arrived in London during the early 1970s. Apart from Bancomer, the largest Mexican commercial bank and a pioneer in opening its own office in the City in 1970, leading Mexican banks reached the London market through the creation of Consortium banks. The first was the Libra Bank, founded in 1972 by Bancomer itself (with 8 per cent of the shares) in joint venture with Brazilian Banco Itau and eight other developed countries' banks. The International Mexican Bank (Intermex) and the Euro-Latinamerican Bank (Eulabank), both established in 1974, completed the list of three consortium banks with Mexican ownership operating in London during the 1970. With 38 per cent of the bank's initial capital, Banamex, the Mexico's second larger commercial bank, was the main shareholder of Intermex. For its part, Banco de Londres and Mexico, later became Banca Serfin in 1977, had a small participation of 6 per cent in the Eulabank. By the end of 1974, Mexico's three

[22] Devlin, 1989, p. 39.
[23] "Eurobond Survey," The Banker, September 1977, p. 75 and p. 87 respectively.
[24] Negrete, 1999, p. 154.
[25] Based on Negrete (1999)'s database on Eurocredits to Mexico.
[26] "Banks as borrowers," The Banker, January 77, p. 61
[27] See Wood (2010) for a description of how syndicated lending worked in practice during the 1970s.

largest commercial banks were operating in the Euromarkets through associated London-based consortium banks.

The arrival of Mexican banks in London was part of a trend among a handful of developing country banks to establish consortium banks there between 1972 and 1974. As reported in *The Banker*, client nations of the international money and capital markets had been increasingly promoting, through government-controlled domestic banks or private sector banks, the creation in London of consortium banks, in partnership with European and North American banks, specialized in international banking to local customers.[28] According to Philip Wellons, these consortium banks' "function [was] to act as a go-between for domestic borrowers, including their home office, and to raise money (...) in world markets for their home countries."[29] This was the case of the Mexican owned consortium banks, whose mission actually consisted of specializing in international finance not only to Mexico but to Latin America as well.

Intermex, the main Mexican consortium bank operating in London, illustrates the pattern. As Hector Reyes, the Mexico City manager of Intermex, observed: "we first went to London to borrow Eurodollars to lend to Mexico," but by 1981 "only 55 percent [went] to Mexico, another 23 percent to Latin American and the balance to the rest of the world."[30] The bank was initially formed by Banamex in association with the Bank of America, the Union Bank of Switzerland, Deutsche Bank and Dai-Ichi Kangyo Bank of Japan. However, in 1978 the state-owned Nafinsa and Bancomer bought into Intermex, and counting Banamex's share, gave Mexico a 51 per cent controlling interest.[31] The presence of both private commercial banks and state development banks as shareholders of the same institution underscores the close ties between Mexican private bank lending to Mexico's public sector within the Euromarkets.

Although largely dominated by U.S. banks and banks from other developed countries, the Mexican syndicated banks participated in a significant number of the Euroloans granted to home country borrowers. Negrete (1999)'s ranking of the leaders in bank syndicated lending to Mexico shows Intermex and Libra Bank as ranking high on the list. With a total of 24 Eurocredits (of which 14 went to state development banks and 5 of them were actually allocated to Nafinsa), Intermex ranked 5th among the more that 250 banks of the list participating in Eurolending to Mexico during the period.[32] It ranked just behind the leaders which were the Bank of America (28), the Bank of Tokyo (28), the Bank of Montreal (27) and Citibank (27). For their part, the Libra Bank participated in 17 Euroloans to Mexicans, ranking 17th among the leaders, while the Eulabank was involved in only one loan to Mexico in 1974.

Notwithstanding their involvement in consortium banks, leading Mexican banks eventually established their own London offices towards the end of the seventies. In addition to Bancomer, as noted in the City since 1970, Banca Serfin and Banamex opened representative offices in 1977 and 1978 respectively (both upgraded to branch status in 1979), with Multibanco Comermex following suit in 1979.. As Maxfield (1992) noted: "the [Multibank] legislation passed in 1977 encouraged

[28] "Consortium banks on course," The Banker, February 1976, pp. 170-171.
[29] Wellons, 1977, p. 77.
[30] "World Push by Mexican Banks Irks Rivals," The New York Times, April 18, 1981.
[31] The share composition was: Banamex 25 per cent, Bancomer 13 per cent and Nafinsa 13 per cent.
[32] Nafinsa was therefore in the paradoxical position of being virtually both lender (creditor) and borrower (debtor) in the same financial operation.

international activity by Mexican banks by permitting them to establish foreign branches and offering tax incentives for Euromarkets transactions."[33] By the beginning of the 1980, the fourth largest Mexican commercial banks were running their own branches in London with a staff of over 15 employees on average. In the case of Banca Serfin, and certainly for the other banks too, the main reason behind the decision to open its own London-based office was to involve itself more heavily in the Euromarkets and to engage in Eurocurrency businesses on its own.[34]

Indeed, these four private banks rank on Negrete's list of syndicated banks lending to Mexico. Banamex and Bancomer were the most actively engaged in international lending, raking among the top 40 lenders to Mexico with a total of in 14 and 10 Euroloans between 1973 and 1982.[35] Thus, in parallel to lending through their associated consortium banks, the banks were also providing funds by themselves, and in many cases jointly lending in the same operation. By the beginning of the 1980s, Mexican private banks had become strong competitors of foreign banks in Eurocurrency lending. As one foreign banker recognized, although developed countries' banks "[were] not being squeezed out of the market yet, (..) the Mexicans [were] sure learning fast." And, in the eyes of Mexican bankers, "the internationalization of Mexican banking [was] a good thing because the less we depend on foreign banks the better."[36]

Most of the funding for meeting the demand for Eurocredits by Mexican international banks came from the international interbank market. As Paul Mentre emphasized in his 1985 report on the international interbank market and international bank lending during the seventies, it was by accessing the interbank market that "LDC commercial banks typically borrowed on the US domestic market or on the London dollar market to relend directly, or through offshore centers, to final borrowers."[37] In practice, the interbank market acted as a channel from banks with a domestic dollar base or an excess of deposits to direct lending towards banks for which direct lending exceeded deposits. Both Mexican commercial banks and their associated consortium banks fell into the latter group.

Consortium banks' business model relied to a very large extent on interbank market deposits as a source of funds. While interbank loans normally accounted for one fifth of the banks' assets, on the liabilities side interbank placements ranged from 40 per cent of the banks' total liabilities up to 100 per cent in a certain number of cases.[38] Thus, by borrowing more than they lent to other banks, Eurobanks were usually net taker of funds within the international interbank market. Mexican commercial banks also conformed to the same net borrowing pattern, and, as explained by Mr. Rivero for Banamex, the *modus operandi* consisted in "making placement with [creditor banks], for example, placing $10 million with an institution that is providing $20 million to Banamex."[39] As a matter of fact, by the time the crisis emerged in 1982, banks from the G10 countries reported interbank claims and liabilities of US$ 12 and US$ 7 billion on Mexican financial institutions.[40]

[33] Maxfield, 1992, p. 79.
[34] "Banca Serfin, A second VISA," The Banker, November 1980, p. 44.
[35] Banca Serfin and Multibanco Comermex granted a total of 3 and 2 eurocredits to Mexico during this period.
[36] "World Push by Mexican Banks Irks Rivals," The New York Times, April 18, 1981.
[37] FRBNY archive, Box 108403, "The International Interbank Market and International Bank Lending," p. 4.
[38] See Davis (1980) and Duffey and Giddy (1994) for a description on the balance sheet composition of Consortium Banks back then.
[39] FRBNY archive, File "BAC 1983," Office Memorandum, November 22, 1983.
[40] Figures from Mentre's report, op. cit.

Mexico, along with Brazil and the USSR, were the three largest developing country players in the international interbank market.

As the Euromarkets grew, the interbank market came to play a large role in providing financial flexibility, making funds available quickly and cheaply to banks with lending opportunities. A report of the BIS' Study Group on the international interbank market found that by 1982 up to three quarters of international lending (estimated at around US$ 1.500 billion) consisted of interbank positions.[41] Although banks seemed to have regularly lent to other banks in London or to banks of similar standing in other major financial centres or offshore centres, cross-border transactions with banks operating in remote financial centres raised more concerns. For Latin American banks, as a French report on the international interbank market observed, their presence in London may have been crucial in allowing them to benefit from international interbank liquidity:

> "It seems absolutely possible that an agency in London of a Latin-American bank participates in the London interbank market, while the parent bank would not have the freedom to undertake international operations from their home country, which may be the result of the state of affairs or because of exchange controls in their home country"[42]

The role of Mexican banks in London was also important even when they did not grant loans directly to Mexico. Santiago de Leon, the Nacional Financiera's commissioner in London to open the representative office in 1976, stated that "together with Libra [bank] we conceived the formula, participated in the formation of the management group and were very active during the syndication period."[43] Since representative offices could not engage in any local banking activity, they worked by referring businesses back to head office.

2.2. The New York international money market

During the 1970s, London's rival international financial centre, New York, also experienced an impressive growth in its foreign banking community. Up until and including 1970, 73 foreign banks were directly represented in New York, while by the end of the decade this figure had more than trebled. International banks massively increased their presence in the New York marketplace both in terms of their number and the volume of financial operations they managed. In that spirit, in a talk before the Bank Administration Institute in 1978, Muriel Siebert, the New York State Superintendent of Banks, pointed out that "the number of foreign banks branches and agencies in New York has increased from 52 ten years ago to 143 currently and their assets have risen from $6 billions to more than $56 billions."[44] Japanese, European and Canadian banks accounted for almost 93 per cent of

[41] BIS, 1983, p.4

[42] BIS archive, File "Study Group on the International Interbank Market Vol. 1," Participation des banques francaises au marché interbancaire, Banque de France, 5 Octobre 1982. In Mexico, exchange controls were reintroduced on September 1, 1982 after several decades of free exchange markets.

[43] The Banker, November 1977, p. 107.

[44] "Official viewpoint," The Banker, April 1978, p. 47.

the total foreign banking assets, with the remaining share (7 per cent) held by banks from other countries, mostly in Latin America.[45]

The rise of foreign banks in New York was part of a wider national trend in which other major U.S. money market centres also participated. The abolition of the Interest Equalization Tax (IET), along with the expiration of exchange controls in January 1974, made the U.S. capital market relevant once again for foreign borrowers and international banks. Apart from New York, though on a much smaller scale, California and Chicago also welcomed an increasing number of foreign banks during this period. However, New York had an indisputable advantage as a location for foreign banks: as Paul Volcker observed "If they have to chose of one location, they [were] going to come [to NYC], by and large. It would be a special circumstance for them to choose otherwise - a Far East bank going to California, for example."[46] As a matter of fact, by 1980 foreign banking assets in New York accounted for approximately 70 per cent of U.S. total foreign banking assets, compared with the 23 per cent of California and 3 per cent of Chicago.[47]

During these years, Mexican and Latin American banks developed a strong presence in the United States. In nine years, the number of Latin American banks in the U.S. increased from only 3 offices in 1972 to 31 by the end of December 1981, reaching an amount of US$ 11 billion in total assets.[48] With 11 U.S. offices and total assets of US$ 3.1 billion, Mexican banks were prominent Latin American actors in the U.S. market. By the beginning of the 1980s, the 6 largest Mexican commercial banks, Bancomer, Banamex, Serfin, Comermex, Somex and Banca Internacional had already established U.S. agencies and branches. With the exception of Banco Somex and Banca Internacional, these banks had opened offices not only in New York but also in Los Angeles. In terms of their total assets, approximately two thirds were held by New York agencies while the remaining third was held in Los Angeles. With total assets of US$ 1.4 billion, Bancomer was the biggest U.S. Mexican bank followed by Banamex with US$ 739 million. Together, they accounted for approximately three quarters of all U.S. Mexican banks' assets.[49]

There was a considerable overlap in the Mexican banks opening offices in the U.S. and London by that time. All Mexican commercial banks operating in the U.S., except Banco International and Somex, had offices in London from which they operated. As was also the case for banks from other Latin American countries, the presence of Mexican banks in the U.S. was much more important than in London. Whereas only the 4 largest Mexican commercial banks were present in London, there were two more in the United States. In terms of offices, compared to the 11 offices operating in the U.S. there were only 4 in London. It is noteworthy that, as was also seen in the case of London, Mexican banking in the U.S. was largely a matter of commercial banks. Nafinsa was actually the only development bank to open foreign offices. But, since the London and New York offices had both representative offices status, they couldn't conduct direct banking business and were not engaged in any local banking activity.

[45] "The Foreign Challenge of US banks," The Banker, October 1978, Table 2, p. 39.
[46] "Paul Volcker puts the case for stricter rules," Euromoney, June 1977, p. 54.
[47] The Banker February 1980, p. 87.
[48] GAO, 1979, p. 28 and 29.
[49] Data from FRBNY archive, File "C261 - Mexican Government 1917-1984."

The main reason that Mexican banks, like other foreign banks, entered New York was to access its money market and open a dollar-base funding channel. Characterized by its massive size, wide range of money market instruments, high liquidity and extensive international operations, New York was by far the largest money market in the world. By undertaking money market operations on the spot, the banks' New York offices served as a dollar base for head offices. The fact that the large majority of the offices were branches or agencies (10 of 11) and not subsidiaries (only 1 by the end of 1981), reveals that Mexican banks were not so much interested in offering a full range of banking services in the US (for which a US-chartered bank subsidiary status was needed) as in lending back home. In fact, their business model was largely based on wholesale lending to Mexican borrowers by raising funds in international money markets, activities that both agencies and branches of foreign banks were allowed to develop.[50]

Mexican branches and agencies had only limited abilities to expand the scope of their funding sources. Since they were not generally allowed to take conventional direct deposits,[51] their main sources of funds were naturally money market instruments, like Federal funds and interbank credit lines, which were available in the market place. As emphasised by Serge Bellanger, vice-president of the Institute of Foreign Bankers and Crédit Industriel et Commercial's New York branch manager, when looking at the liabilities side of overall foreign banks, the "interbank borrowings from the domestic and Eurodollar markets still remain a major component of the funding strategy."[52] As developed below, Bellanger's words perfectly fitted the situation of the Mexican banks operating in the United States.

A FRBNY's internal report,[53] prepared in immediately after Mexico's moratorium declaration, estimates that total combined liabilities of the six Mexican bank agencies in New York and the fourth in Los Angeles were approximately US$ 2.9 billion as of June 30, 1982. A breakdown by instrument shows that borrowed money reached US$ 1,068.8 million, an amount accounting for 37 per cent of total liabilities. Of this amount, approximately 99 per cent was owed to banks, with 92 per cent due to U.S. commercial banks. The second largest liability, totaling US$ 644.7 million or 22 per cent of total liabilities, were Federal funds purchased from U.S. commercial banks. Deposits and credit balances accounted for US$ 639 million or 22 per cent of total liabilities. Of this amount, U.S. branches and agencies and commercial banks accounted for 35 per cent, while foreign branches of U.S. banks and foreign banks made up the remainder. Although the report gives no information on the instruments accounting for the remaining 19 per cent of total liabilities, these figures highlight the prominent role of commercial banks as (virtually the only) suppliers of funds for Mexican agencies. It also gives a fairly clear sense of the large extent to which the funding of Mexican banking agencies based in the U.S. relied on U.S. interbank placements.

It is important to note that in addition to their U.S. liabilities, these six Mexican banks had dollar obligations of about US$ 4 billion outside the United States. They corresponded to the bank's

[50] Branches were not technically defined as banks, which raise some important differences in terms of regulation. Since they were not legally separate from their parent banks, they were not separately capitalized and were mainly supervised by their home authorities. They were not subject to host country's reserve requirements neither.

[51] They can maintain credit balances arising out of the course of the bank's American business.

[52] "The foreign challenge to US banks," The Banker, October 1978, p. 40.

[53] FRBNY archive, Files "C261 - Mexican Government 1917-1984."

agencies and branches in the Cayman Islands, Nassau, but mainly in London, the other center of Mexican international banking. As I noted in the previous section, liabilities for these agencies consisted largely of Eurodollar interbank placements arranged with some of the same banks from which the U.S. agencies were borrowing. Apart from their substantial presence in London, and largely for taxation reasons, American banks increasingly undertook their international activities through off-shore banking centres. To a large extent the Bahamas and the Cayman Islands developed as off-shore booking centres for deals done from New York and elsewhere.[54] Statistics for the Eurocurrency market in Nassau from the Federal Reserve Board show that interbank deposits due to banks abroad accounted for 75 per cent of deposits in Nassau in 1978.[55]

Against these liabilities, the FRBNY's report estimates that total combined assets of U.S. agencies of Mexican banks aggregated US$ 2.9 billion by end-June 1982. Total loans accounted for US$ 1,885 million or 65 per cent of the agencies' assets. Of this amount, US$ 1,407 million (74 per cent) were commercial and industrial loans to private or public corporations outside the U.S, while the remaining US$ 203.4 and US$ 178 consisted of loans to other banks in foreign countries and to foreign governments and official institutions respectively. The second largest asset of the agencies was net transfer claims of approximately US$ 348 million due by their head offices. Federal Funds sold represented US$ 260.6 million or 10 per cent of total combined assets, of which approximately 95 per cent was to U.S. commercial banks. Overall, of the US$ 2.9 billion in U.S. assets of these agencies, an estimated 80-90 percent represented loans to Mexican borrowers, and about 60 percent represented loans to the Mexican Government or the public sector.

The assets and liabilities composition described above makes clear the agencies' business model: borrow from commercial banks in the U.S. interbank money market and then lend the money on to Mexican borrowers. As a matter of fact, foreign agencies acted as an extension of their parent banks and increasingly served as channels through which U.S. money was sent home. In other words, they assumed the role of managing the liquid dollar assets of their parent bank networks. As stated by Clifton Hudgins, the Banamex's agent in New York, while one of the reasons for establishing a presence in New York was to open a dollar-based funding channel, "it [was] important to be in the money market on both sides, as we are."[56] The absence of limits on the amount of loans and credits in New York regulation led the Mexican agencies to finance the need of their large costumers in Mexico without restrictions. For Wellons, "the government of both countries rely, although to widely varying extents, on domestic financial institutions to raise foreign funds and to lend them locally without the detailed review they normally give foreign loans."[57]

In addition to the branches and agencies, Mexico's two largest banks owned two Californian commercial banks. In 1980, Banamex bought the Community Bank of San José and the Mexican-American Bank of San Diego, merging them into the California Commerce Bank, which had seven branches in total. In the spring of 1982, Bancomer purchased the Grossmont Bank of San Diego, with five branches. As of June 30, 1982, California Commerce had total assets of US$ 307 million and the Grossmont Bank, US$ 141 million, which represented approximately 30 and 10 per cent of the total

[54] Lomax and Gutmann (1981), p. 33-35.
[55] The Banker, January 1979, p. 71.
[56] "Biting into the Big Apple," Euromoney, June 1978, p. 53.
[57] Wellons, 1977, p. 52.

consolidated assets of Banamex and Bancomer in the U.S. respectively.[58] In both cases, however, they were smaller in size than the U.S. agencies of their parent banks, especially in the case of Bancomer and the Grossmont Bank.

The reasons why Banamex and Bancomer acquired these banks seemed to be different from those motivating the establishment of their own foreign branches and agencies. It might appear that these banks could have served as instruments for raising additional money to support new lending to Mexico. After all they were the only two Mexican banking subsidiaries in the U.S., with full retail banking service capacities, including the acceptance of deposits, a funding source ruled out for banking agencies. Another possible reason might seem to have been the interest of Banamex and Bancomer in participating in the financing of the rapid growth of United States-Mexican trade.[59] However, a close look to the balance sheet structures of these banks casts doubts on these hypothesis.

Although both banks seemed to have strongly relied on public deposits to fund themselves,[60] their asset structure looks highly local and shows no evidence of significant financing of Mexican borrowers. In both cases, loans accounted for 60 per cent of the bank's total assets with the bulk of the funding granted to real estate, domestic commercial and industrial corporations and to individuals. The only way Mexican borrowers might have benefited from financing by these subsidiaries would have been through interbank credit lines granted to the respective Mexican banking group's foreign agencies and from them to home country final users. However, for California Commerce only 17% of the loans went to financial institutions and the Grossmont Bank was not engaged at all in lending to other financial institutions. That evidence, plus the fact that they were relatively small banks, makes it hard to believe that they could have been significant for financing Mexicans. However, as I will argue later in the text, the fragility of these institutions after the outbreak of the crisis would prove very damaging for the Mexican banking system.

3. The fragility of Mexico's domestic banking

Between 1977 and 1982, as domestic financial institutions increased their international businesses, the Mexican commercial banking system went through major transformations and reforms. Up to 1977, Mexican banking was divided into three different types of institutions, consisting of mortgage banks, *financieras*, and deposit and saving banks. Although usually owned by the same financial conglomerates or groups,[61] these institutions worked within a banking system based on the principle of financial specialization. The Multiple Bank reform of 1976, which changed the paradigm towards financial integration, allowed the banks to legally merge the three activities into one single institution. In addition, as previously mentioned, these reforms also stimulated the setting up of bank branches and agencies abroad. The result was a drastic reduction in the number of banks in

[58] Data from FRBNY archive, Files "C261 - Mexican Government 1917-1984"
[59] "World Push by Mexican Banks Irks Rivals," The New York Times, April 18, 1981.
[60] In the case of California Commerce, deposits represented as of 93 per cent of the bank's total liabilities.
[61] See del Angel, 2002, pp. 97-103.

Mexico and the increasing concentration of the banking industry, a process that was vigorously encouraged by the Bank of Mexico.[62]

Along with the Multiple Bank legislation, Mexican financial authorities undertook a number of additional reforms designed to deregulate the banking system and enhance its financial intermediation operations. Among these measures, there was a reduction and unification of the reserve requirement for commercial banks, direct controls of the central bank over interest rates were relaxed, and the limits on dollar borrowing and lending operations increased. Moreover, in 1979 the central bank enacted a series of provisions attempting to restructure banks' operations by allowing greater flexibility in a system that previously pushed banks to "directly match the lines of the banks' assets and liabilities according to their maturity."[63] In short, as was also the case in many other Latin American countries, the Mexican banking system went throughout a process of progressive deregulation and financial liberalization during the 1970s.[64]

Within this context of free international banking, Mexican developing and commercial banks raised their foreign exposure by running a risky business model. They both increased their dollar liabilities abroad while continuing to concentrate their lending activities in Mexico. The accumulation of cross-border currency mismatches would prove to be a major problem when the prospect of devaluation loomed. In the case of commercial banks, through the operation of their foreign branches and agencies, they also incurred two additional serious imbalances. On the one hand, by borrowing short-term in the international interbank markets, and lending longer term in Mexico, they incurred cross-border maturity mismatches. On the other hand, since they borrowed at floating rates while lending was made at predetermined fixed rates, they also created interest rate mismatches. With the rise of international financial stability from the late 1970s and the outbreak of Mexico's debt crisis in 1982, banks' financial imbalances would eventually lead the entire Mexican banking system to the brink of disaster.

3.1. The exposures of development banks

In the period from the early seventies to the outbreak of the debt crisis, the Mexican development banks accumulated a series of important imbalances on their financial accounts. Their deep involvement in international borrowing have led them to operate in foreign currencies, with the dollar becoming the main currency in their balance sheet operations. As of June 1982, development banks' liabilities denominated in foreign currency reached US$ 31,148 million, an amount accounting for 70 per cent of their total obligations. However, on the asset side, dollar claims were of US$ 24,971 million, representing 56.1 per cent of the bank's total assets. As a result, these banks had on average US$ 0.80 in their asset portfolio for every dollar owed. They were actually borrowing in dollars while lending relatively more in pesos and therefore failing to properly match their assets to the currencies in which their debt was denominated (currency mismatches).

Indeed, an even more striking fact about development banks' balance sheets is the extent to which dollar liabilities consisted mostly of foreign obligations while dollar denominated claims were

[62] Ibid, pp. 104-108.
[63] See Banco de Mexico's 1979 Anual Report, p. 64.
[64] See Diaz-Alejandro (1985) for the financial liberalization of Latin American and Southern Cone countries.

domestic assets. Up to 76.8 per cent of dollar liabilities were due to international creditors while all of their dollar claims were from national agents. This means that banks' dollar payment obligations to foreign creditors relied heavily on the reimbursement of dollar domestic claims, held by agents that operated mainly in local currency and with only limited genuine capacity to provide themselves with foreign currency. The Mexican public sector was the sector's main debtor, holding 89.5 per cent of development banks' dollar claims. Indeed, by the end of June 1982, just one month away from the beginning of the debt crisis, the Mexican government was struggling to find the foreign exchange it needed to pay its dollar debt obligations.[65]

Development banks' cumbersome involvement in financing Mexico's government and public companies was not surprising. After all, they were government-owned financial institutions and their principal task was financing public works and development projects. As Jorge Espinosa de los Reyes, former director-general of Nafinsa, the largest Mexican development bank, put it: "Nacional Financiera serve[d] as an instrument of the Mexican government to channel both domestic and foreign resources towards financing infrastructure projects."[66] Back then, such projects were mainly undertaken by the Mexican government directly or through other public companies or agencies such as Pemex, Comisión Federal de Electricidad, among others, of which Nafinsa was usually a minority or majority shareholder. Besides, official banks were not subject to the portfolio requirements set by the Bank of Mexico, which could have played a role in restricting the concentration of financing in the public sector.

Their funding activities also conformed to the overall governmental external borrowing program at the time. With 55 per cent of their total liabilities due to the foreign sector in June 1982, the development banking system's resources strongly relied on fundraising from foreign creditors on the international capital markets. Among the domestic funding sources, checking and saving deposits accounted for 11 per cent of their liabilities. General saving instruments had only a limited capacity to provide development banks with funds since they did not usually operate at a retail level and some of the institutions were not actually authorized to receive deposits. As far as government and public non-banking sector contributions are concerned, which were a crucial source of funds during the initial stages of the evolution of development banks, they represented only 7,6 per cent of the sector total liabilities by that time. In the case of Nafinsa, foreign resources outweighed domestic funds as the main financing source during the early 1960s,[67] accelerating even more its recourse to foreign finance during the seventies.

These development banks' imbalances put the entire Mexican banking system under pressure. Although few in terms of numbers (only seven in 1982), development banks played an important role in the Mexican banking system. As of the end of June 1982, their total assets reached US$ 44,419 million, which was only 25.7 per cent lower than commercial banks' assets which amounted to US$ 59,870 million.[68] At a consolidated level, development banks' assets represented as much as 44.7 per cent of the Mexican banking system's total assets. Besides, since development and commercial banks were linked in a number of ways, difficulties in the developing banking sector

[65] See Kraft (1984) and GAO (1997) for a description of the emergency overnight swap arrangements with the Federal Reserve to meet Mexico's foreign reserves requirements.
[66] "Espinosa: setting Nafinsa's priorities," Euromoney, April 1978, p. 20
[67] See Lopez, 2009, Cuadro 3, p. 12.
[68] Data from Banco de Mexico's 1983 Anual Report.

could quickly spread to other financial institutions and thereby compromise the stability of the entire banking system.

The first observation to be made about financial ties between development and commercial banks has to do with international financing. As previously mentioned, development banks were important recipients of syndicated Euroloans during this period and an important share of them came from Mexican commercial and consortium banks. The examples of Intermex and the Libra Bank illustrate the pattern. Of the 24 eurocredits granted by Intermex to Mexico between 1974 and 1982, 14 went to government owned development banks. Moreover, 12 of the 17 eurocredits accorded by the Libra Bank went to state financial institutions. Given this situation, any failure by development banks to pay their external debt obligations would inevitably affect the financial position of the Mexican consortium banks, of which they were important debtors.

Indeed, state development banks were also directly financed by Mexican commercial banks through the Euromarkets. In April 1971, for example, Bancomer and Banamex led, along with N.M. Rothschild & Sons and Rothschild Intercontinental Bank, a syndicated loan of US$ 100 million to Nafinsa and Banobras. According to Negrete (1999)'s Table B.14, in the period from 1973 to 1982 Banamex participated in 14 eurocredits to Mexico, with 2 of them going to government development banks. Even more striking is the case of the Bancomer, whose Mexican international loan portfolio was highly centralized on financial institutions, with 6 of the 9 eurocredits having been granted to state development banks. These figures shows the extent to which the Mexican eurocredit portfolio of Bancomer and Banamex, who represented half of the commercial banking market share in Mexico, was exposed to development banks. With respect to Banca Serfin and Multibanco Comemex, the other two Mexican commercial banks involved in eurolending, the 4 international loans granted during went to Mexico's non-banking public sector.

The aggregated data on the balance sheet of the development and commercial banking sectors published by Banco de Mexico is consistent with these assessments. As of June 1982, development banks total liabilities to commercial banks reached US$ 2,275 million, which is exactly the same amount reported by commercial banks as credit claims on development banks. On the asset side, development banks reported credit claims on commercial banks of US$ 935 million, which shows that development banks were net borrowers from commercial banks in the interbank credit market. Finally, the fact that 87.5 per cent of commercial banks' credit claims on development banks was denominated in dollars (only one quarter for development banks credit claims on commercial banks) suggests that commercial bank dollar lending relied on dollars raised on the international capital markets. This means that even this domestic source of funding though commercial banks ultimately relied also on foreign borrowing.

By the end, development banks' exposure to the non-bank public sector made the reimbursement of their dollar debt obligations conditioned on Mexican government payments. This transferred to commercial banks, whose payments of their dollar obligations on the international capital markets ultimately relied on the payments of development banks as well as domestic non-banking public borrowers. Therefore, the whole Mexican banking system suffered from the currency domestic and cross-border mismatches that development banks' exhibited.

3.2. The risks behind commercial banks' foreign business

Two important differences come up when comparing the commercial banking sector with the balance sheet imbalances of development banks analysed in the previous section. First, at an aggregate level, commercial banks were not only less involved in dollar operations but their balance sheet structures also show a better matching of their assets to the currencies in which their debt was denominated. At the end of June 1982, 40.2 and 41 per cent respectively of the commercial banking sector’s total assets and obligations were denominated in foreign currencies. Secondly, foreign liabilities represented a much lower share of the sector's dollar obligations and of their total liabilities: 42.5 and 18 per cent respectively. That means that, while also incurring cross-border mismatches between domestic dollar claims and foreign dollar obligations, their implications affected a smaller part of the sector's activities compared with development banks. Contrary to what these figures might suggest, however, the commercial banking sector also suffered from serious imbalances regarding their foreign activities, in particular through the financial situation of their overseas agencies.

Banks' foreign branches and agencies became a fundamental part of Mexican commercial banks’ funding strategies. Although smaller in number, foreign agencies of Mexican commercial banks proved to be an excellent instrument for gathering funds, much more powerful that the bank's vast domestic agency network. Data from the Banco de Mexico's 1983 Annual Report shows that the 21 Mexican agencies oversees generated US$ 6,182 million or 17.8 per cent of the total funds accumulated by commercial banks at the end of December of 1983. On average, therefore, each foreign branch had raised total funds of US$ 395,2 millions, mostly in dollars, while each of the 4,512 commercial banks' domestic branches contributing only US$ 0.5 million either in pesos or dollars. Although important, external borrowing was limited solely to a few institutions, since there were only 6 Mexican commercial banks, which were actually the largest 6, to have branch offices abroad.

As already mentioned in previous sections, interbank credit lines were the main fundraising instrument used by Mexican overseas agencies. Foreign banks' loans accounted for 94.6 per cent of Mexican foreign agencies' funding liabilities with the remainder consisting of foreign time deposits and checking and saving accounts. Although foreign interbank credit lines were used to finance Mexican commercial banks' offices in Mexico, the bulk was granted to their New York and London branches. Fully 70 per cent of commercial bank loans with foreign banks was held by Mexican foreign agencies, while the remaining 30 per cent was in the hands of national branch offices, notably those in Mexico City. Therefore, it was mainly through these foreign agencies that commercial banks channeled external finance back to Mexico. At an aggregate level, foreign bank loans accounted for almost one quarter of commercial banking system funding in the early 1980s.

In their role as intermediaries between foreign finance and local final users, the foreign agencies of Mexican commercial banks incurred serious balance sheet imbalances. The FRBNY report’s data on the U.S. Mexican agencies and branches' dollar debts and claims at the end of June 1982 shows that there were significant differences in the maturity structure of their assets and liabilities. For instance, US$ 1,027 million or 73 per cent of the commercial and industrial loans granted by the agencies to foreign borrowers were due within one year, while US$ 380 million (the remaining 27 per cent) had a maturity of over one year. These amounts represented as much as 35,4 and 13,1 per cent of the agencies' total combined assets.[69] On the liability side, 85 per cent of agencies' funds borrowed from other banks, which represented 37 per cent of total liabilities, had maturities greater than one day and 15 per cent were due within a day. Moreover, the report estimates that U.S. liabilities of these agencies maturing between late August and end 1982 were around US$ 1.8 billion, an amount representing a bit less than two thirds of their total liabilities. As for the balance of the liabilities, although there is no information in the report, given that they were mainly interbank obligations, which had essentially short-term maturity, they were probably due within six months or a maximum of one year.

Mexican agencies outside the U.S. seem to fit to the same pattern. According to estimates of Mexico's BAG, by the end of August 1982 Mexican foreign agencies as a group "had maturing liabilities of $750 million by 3 September, 1.25 billion by mid-September, and 6-6.5 billion by 31 December."[70] For its part, the FRBNY estimated that Mexican agencies outside the U.S. had dollar liabilities of US$ 4 billion maturing up to end-December which, when added to the approximately US$ 1,8 in U.S. liabilities due over the same period, adds up to US$ 5,8 billion which, as a the FRBNY report put it, "is close to the $6-$6.5 billion estimated by the Advisory Group".[71] About one fourth of this amount was owed to the 14 banks in the Advisory Group and the remaining three quarters to the other banks. The fact that banks were almost the only creditors of Mexican agencies confirms the importance of the interbank market instruments in the financing of the agencies. Agencies' heavy reliance on interbank funding came with a liability structure almost necessarily biased toward very short-term debts. Overall, by borrowing short-term from interbank markets and lending much longer term to Mexican final users, agencies accumulated important maturity mismatches.

Apart from maturity mismatches, agencies also ran the risk of interest rate mismatches in their borrowing and lending activities. At that time, interbank placements or credit lines were typically arranged at LIBOR plus a usually modest premium depending on the risk associated with the borrowing bank. This means that virtually all agencies' debts were contracted at a variable interest rate. In contrast, when we look at agencies' loan portfolios, we see that an important part of the assets were arranged at fix interest rates. Of the US$ 1,027 millions in industrial and commercial loans due within a year, approximately 72 per cent had fixed interest rates and the balance (28 per cent) had floating rates. Similarly, 70 per cent of the US$ 380 million in loans with maturity over a year had fixed interest rates. Overall, industrial and commercial loans granted at fixed interest rates reached approximately US$ 1,005.4 million, an amount accounting for one third of agencies' total assets. Although there is no information on the interest rates for the rest of the agencies' liabilities, this figure provides a minimum threshold of claims with fixed interest rates which contrast with the absence of fixed interest debt on the liability side. These mismatches would eventually have very damaging impacts on the financial situation of the agencies once the short-term interest rate sharply increased during the first half 1981 in the U.S. and other major countries.

Finally, Mexican agencies faced some worrisome cross-border complications. While borrowing abroad in dollars, domestic loans were contracted either in pesos or in dollars but with domestic agents operating largely in pesos. The Mexican public sector, emerged as an important domestic

[69] There is no maturity schedule information about the rest of the assets. However, since they mainly consisted of Federal Funds and net transfers to head offices, they likely had short-term maturities.
[70] FRBNY archive, File "C261 - Mexican Government 1917-1984," Office Memorandum, August 30, 1982.
[71] Ibid.

recipient of commercial bank's external finance intermediation during the 1970s. Toward the end of the decade, the Mexican government as well as their financial and non-financial public companies, increasingly covered their financial needs with domestic indebtedness from commercial banks. Although registered as domestic debt, most of this money was actually coming from outside the country. As of June 30, 1982, the U.S. Mexican bank agencies reported approximately US$ 1,740 million as loans to the Mexican Government or public sector, an amount representing up to 60 per cent of agencies' total combined assets.

Taken as a group, Mexican foreign agencies accounted for over a tenth of commercial banks' total liabilities. As of the end of June 1982, the estimated US$ 5.8-6.5 billions of Mexican foreign agencies' liabilities maturing up to the end of 1982 represented 9.6-10.8 per cent of the commercial banking system's total liabilities. Since there were only 6 Mexican banks operating agencies abroad, this ratio was higher if we consider only the liabilities of their parent commercial banks. At the time, Banamex and Bancomer together held over 50 per cent of the commercial banking market. Adding Banco Serfin, Comermex, Somex and Internacional, which were the other banks running foreign offices, we reach almost three quarters of the market. For these banks, short-term foreign agencies' liabilities represented about 12,9-14,4 per cent of the bank's estimated total liabilities. An important remark to be made here is that the external imbalances of these 6 largest Mexican banks, and their exposure to potential financial problems of their foreign agencies, threatened the entire commercial banking system.

4. Debt crisis and external debt renegotiation

Mexico borrowed from the Eurocurrency credit market until the very last minute. On Friday August 12, 1982, the same day that PEMEX closed a US$ 300 million syndicated loan agreement (the last one to Mexico),[72] the Minister of Finance, Jesús Silva Herzog, flew to Washington to discuss Mexico's inability to service its upcoming debt obligations with the IMF and U.S. government officials. One week later, in a meeting held at the FRBNY with representatives of creditor banks on August 20, Silva Herzog and Gurria officially requested (but de facto imposed) a transitory external debt moratorium on principal payments. It was the beginning of the Mexican debt crisis, which soon spread to many other indebted countries ultimately reaching a global scale and becoming a veritable international debt crisis. Mexico's default put a definitive end to the lending boom to developing countries started in mid-1970s.

The sudden stop in the flow of international credit that followed Mexico's declaration of a debt moratorium affected all Mexican borrowers, including their development and commercial banks. In the eyes of the market, state development banks were sovereign borrowers and, like the rest of the Mexican public sector, which included the Government and non-banking parastatal firms, their default status shut them out of the international capital markets. As for commercial banks, whether private or with participation of the government (mixed), the government default also deprived them of access to international funding. With their balance sheets suffering from serious mismatches, credit retrenchment along with domestic government debt reimbursement difficulties put the banks and the entire Mexican banking system on the brink of bankruptcy and collapse.

[72] Negrete (1999), Table B.14. This loan could actually have been a de facto roll-over.

During the negotiations that followed the outbreak of the crisis, Mexico's development and commercial banks' external debts were managed differently. Development banks' external obligations were naturally declared part of the government debt, and as such they were rolled over and rescheduled according to the restructuring schemes agreed for public sector debt. Interbank borrowing by foreign branches and agencies of Mexican banks were not subject to that process. As for official export credit, international organization credits, bonds and a number of other special facilities that were agreed with the banks, commercial banks' external debt, including both private and majority state-owned banks, they were never restructured. Moreover, amortization and interests on these debts continued to be promptly paid when due even after August 20, 1982. Interbank obligations were a peculiar category of debt that was neither defaulted nor rescheduled.

As for the rest of the Mexican borrowers, foreign agencies in New York and London encountered increasing difficulties in rolling over their outstanding liabilities from mid-1982 on. The interruption in voluntary renewals in interbank deposits and credit lines sharpened the lack of foreign exchange in Mexico and added pressure to the dwindling reserves of the central bank. In a communication to banks on 22 August 1982, "the Mexican authorities requested the banking community to rollover such deposits on interest terms to be agreed upon each renewal; interest would be paid, but branches and agencies were not allowed to effect any capital repayment on such facilities."[73] Deposits were frozen and it was agreed that they should not fall bellow US$ 5.2 billion and they would continue to be rolled over from there on. Such deposits would eventually became the responsibility of the Mexican public sector with the nationalization of commercial banks on September 1982.

4.1. Banks' financing difficulties in the face of the crisis

Like other Mexican borrowers, the banking sector benefited from international financing in the months leading up to the crisis. After all, although aware of the country's increasing financial difficulties, international bankers had not really lost their enthusiasm for Mexico. As *The Banker* reported, in 1981 Mexicans had "tapped the sterling bulldog market, Asian dollars, US commercial paper and sterling acceptances all with success."[74] Indeed, as of February 1982, when asked about Mexico funding prospects on the international capital markets, a British banker stressed that "there [was] no doubt that [Mexican would] be able to raise what they want[ed] (...), but they may have to pay a little more for it."[75] Although at increased costs and shorter maturities, both government-owned development banks and private and mixed commercial banks could continue their usual borrowing activities in London and New York during the first seven months of 1982.

The last borrowing transaction of Mexican development banks on the international capital markets dates from July 1982. It was a US$ 50 million Nafinsa Eurobond issued by Lloyds Bank Int. Previously, on May 7th, 1982, Nafinsa had concluded a jumbo US$ 1.2 billion with a broad syndicate of over 35 banks, with the Mexicans Bancomer, Libra Bank and Banco Internacional among the lead management group. The credit was arranged in 3 tranches of US$ 400 million each with 1, 2, and 3

[73] Gurria, 1988, p. 76.
[74] "Mexico: Lenders Market," The Banker, February 1982, p. 82.
[75] Ibid, p. 81.

year maturities and spreads of 0.5, 0.625 and 0.75 respectively. Together with a 6-month term US$ 70 million loan granted by Intermex to Banrural that same day, these were the last two Eurocredits to Mexican banks. Overall, 4 Euroloans for a total of US$ 1,723.6 million and 5 Eurobonds for US$ 403.8 million were issued to Mexican development banks in 1982 prior to the outbreak of the crisis. With 55 per cent of developing banking system liabilities relying on rolling over loans from Eurocurrency lending, the cut-off of international credit lines put the banks in a delicate financial position.

As commercial banks are concerned, their Mexican agencies' financial activities in London and the United States were also strongly affected by the debt crisis. The international interbank market, which was the center of their funding operations, became highly sensitive about lending to Mexicans. The policy of creditor banks in placing and lending in the interbank market was based on the creditworthiness of the borrowing bank, which mainly relied on a country risk analysis. In estimating this risk, banks looked primarily to the nationality of the ownership but also to the location of the borrowing branch, treating with more caution those located outside major financial centres.[76] Under this policy, as the BIS Reported, "It might be, for example, that the market comes to regard all banks of a certain nationality (e.g. Mexican) with some suspicion, perceiving the interbank operations with them more risky and therefore want to reduce their involvement with them." That is what actually happened to Mexican banking institutions after the government's moratorium declaration. Mexico's default led to plunging confidence in Mexican banks, whether they were private, public or mixed owned, thereby increasing their market risk and damaging their funding lines.

More generally, the participation of foreign banks in the international interbank markets turned upside down with the crisis. Historical data from the U.S. Financial Account report shows that 1982 marked a turning point in the evolution of the liabilities of foreign banks to U.S. commercial banks. From 1977 to 1981, foreign banks increased their interbank obligations to U.S. banks at a growing pace, passing from a US$ 6.2 billion increase in 1977 to US$ 15 and US$ 13.4 billion in 1980 and 1981 respectively. In 1982, foreign banking interbank liabilities due to U.S. banks fell by US$ 4.7 billion and would continue to fall by similar amounts in 1983 and 1984. This means that U.S. commercial banks, which were net lenders in the interbank market, did not place any new interbank funds with foreign banks as a group but also stopped renewing past credit lines and even withdrew deposits with them in their U.S. branches. In fact, this is what happened to the Mexican agencies in the United States.

In this context, it did not take long for Mexican agencies, engaged in maturity transformation in their interbank business, to face acute liquidity problems. In normal times, when interbank deposits came due, Mexican agencies rolled over their debts either by renewing the deposit directly with the creditor bank or by borrowing from some other bank and refunding the first. But, as bad times emerged, banks could only find new interbank credit lines at shorter maturities and higher costs, suffering from eventual creditor banks lending limits and the refusal to roll over deposits as they fell due once the crisis broke up. Having lost access to their single most important source of immediate liquidity, Mexican agencies were forced to look for alternative financial sources to raise funds and meet their liquidity needs. Otherwise, with interbank liabilities falling due more rapidly than they

[76] See BIS (1983) for a review on the interbank lending policies of commercial banks during this period.

had maturing assets available, they would not be able to reimburse their creditors in time and would have to default on their interbank liabilities.

Worried about the liquidity position of the Mexican agencies, FRBNY officials held extensive interviews and conversations with their representatives during August 1982. In all the cases, the institutions reported that they were able to raise money through overnight and term purchases in the Federal funds and through similar arrangements in the Eurodollar markets which remained open to Mexican banks. As a matter of fact, Manuel Farina, senior manager-finance of Bancomer's New York agency, informed FRBNY authorities that his agency had just purchased at market rate US$ 10 million in Eurodollars with a 6-month maturity and that its London office was also able to borrow money. However, despite the optimistic tenor of their reports, agencies' representatives stressed that financial markets were under pressure and that future funding, as a Banco International official put it, looked "awfully shaky."[77] Moreover, they were already taking a number of precautions to avoid liquidity strain.

U.S. Mexican agencies planned to overcome their limited access to money markets by reinforcing alternative sources of funds. In that vein, agencies first tried to obtain the needed funds through their international banks' correspondents. Banamex's New York agency vice president Clifton T. Hudgins, reported that they had confirmed lines of credit of US$ 40 million with Bank of America, Chase, Manufacturers Hanover and Security Pacific during August 1982. In addition to that, Manufacturers Hanover had approved an overdraft line of US$ 120 million. Beyond these credit lines, Banamex had also advance lines with a number of foreign banks that ranged in size from US$ 2 million of US$ 30 million that they had tested by drawing down US$ 10 million for 6 and 7 months. As of Banco Internacional, since the parent banks was the smallest of the six Mexican banks operating in the U.S. and since it is not well known, the agency was unable to raise funds in the money markets directly and it was seeking temporary funds from two correspondents Irving Trust and Bankers Trust. The bank reported that they were counting in drawing upon its correspondents to meet their US$ 450 million payment obligations coming due during September. In the case of Bancomer, Manuel Farina reported that they had stand-by back-up lines with several European banks.[78]

As a second measure to face illiquidity problems, agencies were preparing the necessary documents for accessing the Federal Reserve discount windows should the need arise. As of end-August 1982, only Bancomer and Banamex New York agencies have filled the required documents, and only Bancomer was in a real position to borrow since it was the only having submitted collateral to the FRBNY. As for the other branches and agencies, although none of them had completed the necessary documents they were all acting to make sure they would be able to meet the requirements for accessing the discount windows. However, from the FRBNY's perspective, the use of Federal reserve discount facilities looked unlikely. In their meeting with Mexican agencies representatives, FRBNY officials stressed that Federal Reserve discounting, if available, was very limited in nature and that any use of these facilities would be very carefully studied and that they would need to provide precise information about the matter and its possible dimensions.[79]

[77] FRBNY, File "C261 - Mexican Government 1917-1984," Office Memorandum, August 25, 1982.
[78] Ibid.
[79] Ibid.

Instead, the FRBYN encouraged the Mexicans to consider how best to deal with any problem with their own resources, suggesting they look to their head offices or the Central Bank of Mexico to satisfy their funding requirements. As a matter of fact, Banamex received a shipment of currency from Mexico for US$ 31 million during the last week of August and they were expecting more money to arrive. These shipments represented dollars gathered by the head office through foreign exchange conversions in Mexico. The usual flow of dollars coming from foreign bank agencies to Mexico had now been reversed. But, at a time in which dollars were scarce resource and exchange controls were being set up in Mexico, an outward flow of dollars could not last long. The pressures of withdrawals at times were placing considerable strains on Mexican foreign exchange reserves. After all, Mexican foreign agencies had been working as instruments of their parent banks to raise dollars abroad and it could never work the other way around.

Strictly speaking, therefore, foreign agencies could not hope to find the dollars they needed to reimburse their debt within the international interbank market. Besides, although these agencies could be required to obtain deposit insurance from the Federal Deposit Insurance Corporation (FDIC),[80] none of them was FDIC insured. For these reasons, the contraction in interbank funding not only put them under liquidity pressure but it also raised a more serious concern about their solvency. Aware of the risk, discussions were being held at the FRBNY about how to proceed in the case of default by a New York state licensed agency. Given a failure to repay an agency obligation, the New York Superintendent has the right to revoke the agency's license (in which case it must cease doing business in NY) or to take possession of the agency's business and property and liquidate it. Moreover, the Superintendent could even take possession of an agency if he had reason to doubt its ability or willingness to pay the claims of preferred creditors.[81]

With the market regarding Mexican banks with increasing suspicion, it would not have taken much for an interbank run to occur. Boughton (2001, p. 301) reports that on Tuesday September 7, 1982, a panic broke out in the interbank market and international banks were refusing to roll over lines of credits to Mexican banks on a massive scale, which left the agencies with no choice but to default unless something was done. During that Black Tuesday, officials of the FRBNY and of the Bank of England intervened to calm down the market and called the banks to persuade the banks to maintain the level of interbank credits. By that time, Mexico's creditors, led by the Fed and the U.S. government but also working in collaboration with the IMF, the BIS and other developed countries' governments and central banks, were trying to keep Mexico afloat. Boughton noted that a "substantial portion" of the US$ 1.85 billion BIS bridge-loan approved in August 1982 was parceled out to repay a part of the interbank outstanding claims. By the end of the day, the banks finally agreed to preserve the rest of their interbank lines and no Mexican agency defaulted.

For both creditors and debtors, Mexican agencies' default was not a convenient outcome. For Mexico, a default on commercial banks' foreign agencies threatened the stability of their banking system. The foreign agencies' default would rebound on their parent banks in Mexico through their cross-border obligations. After all, these agencies were the operating arms of Mexican banks overseas and they were necessary to collect the capital and interest payments on the international and syndicated loans they had participated in. Besides, if, for example, it happened that the New

[80] Under IBA state agencies were regarded as branches and they could be required to subscribe for FDIC insurance (IBA $ 5(6)).
[81] FRBNY archive, File "C261 - Mexican Government 1917-1984," Office Memorandum, August 30, 1982.

York agencies were liquidated the money that could be raised would not be enough to reimbursed the loans with which the head office had been assisting them lately, which would transfer the crisis back to Mexico. Since the banks in this situation were the largest ones in Mexico and represented up to 70 per cent of the Mexican commercial banking market, the entire domestic banking system was at risk.

On the creditors' side, although a default could have actually triggered a run against other developing countries' foreign agencies, it seemed unlikely that it would provoke a systemic collapse in the interbank market as suggested by Boughton (2001). Indebted developing countries' foreign banks, which were the ones suspected from insolvency, represented only a very small part of the U.S. banking market. For instance, as already mentioned, total assets of Latin American banks represented less than 7 per cent of total foreign bank assets in the U.S. by 1978, an amount that is even lower when both U.S. foreign and domestic banking are considered. In terms of the interbank market, the bulk of the transactions was held among money center banks of developed countries and only a very small part involved banking institutions from Latin America and other troubled countries. The real risk for creditors seems to have come from the negative effects of defaults on the success of the strategy that creditors were working out to deal with the debt crises. As will be seen in the following section, the success of the debt management strategy relied to a large extent on the maintenance of interbank credit lines.

4.2. Mexican banks' external debt renegotiation

From the outbreak of the debt crisis in 1982 to the launching of the Brady plan in 1989, Mexico went through multiple reschedulings of its external debt. There were four renegotiation rounds in total with each of them leading to a corresponding restructuring agreement between Mexico and its international creditors. The principles and the strategy underlying these agreements essentially consisted of rescheduling the existing debt and extending new lending facilities conditioned on agreement to an IMF adjustment program.[82] A device associating new bank finance, IMF finance, and other government or multilateral finance was established by creditors to cover Mexico's financial needs. The arrangements reached between Mexico and its creditors aimed to conserve the country's much needed foreign exchange and allow the Mexican banks to preserve their funding base.

Mexican banks' external debt, and in particular their interbank obligations, played an important part in the rescheduling approach. Foreign agencies' interbank debt was not only significant when compared to the amount of Mexico's debt being restructured, but it was also essential for the functioning of the debt management strategy. In the eyes of the IMF, international commercial banks' roll-over operations could not be limited to medium and long-term debt but needed to integrate "also the inter-bank element related to the euro-market operations of agency banks, which attract short-term euro-market deposits to re-lend to banks in their own countries at longer

[82] There were in total four renegotiation rounds in 1982-83, 1983-84, 1984-85 and 1986-87. See Cline (1995) for a description of the debt renegotiations process during this period.

maturities."[83] In Jacques de Larosière's words, "It could undermine the rest of the rescheduling operation if the base of the ice-berg (the large inter-bank element) were to dissolve."[84]

From the onset of the crisis, interbank placements were recognized as warranting special treatment and were excluded from the generalized restructuring of Mexico's external debts. In dealing with debtors' external obligations, interbank deposits fall in a particular category of debts that was neither paid nor restructured. While failing to be paid on time because of the borrowers' lack of money, the interbank liabilities were not formally restructured into one agreement binding all depositors or lenders unlike the rest of Mexico's external debt. As Lee Buchheit pointed out, "when the first moratorium telex went out in 1982 and 1983, (...) the interbank creditors, felt themselves especially aggrieved by the prospect of having to restructure short-term deposits that had been placed (probably at the sovereign's urging), only a few hours or days before the release of the moratorium telex."[85] In that context, the problem was that, while foreign agencies' medium and long-term loans were being restructured along with the country's other external liabilities, the interbank deposits, which had been used as the basis for those loans, kept their original short-term maturities. Moreover, "the banks were by then not even willing to re-lend the repayment received in order to maintain the same exposure."[86] This put foreign agencies in a delicate position with long-term restructured assets and very short-term liabilities, thus making the repayment of such deposits at maturity virtually impossible.

To insure that the country's foreign bank agencies did not experience a large scale leakage of funding, the interbank loans outstanding were frozen at the pre-moratorium level of August 1982. As part of the first rescheduling agreement, after implementing the Mexico stabilization program which provided the basis for the IMF Extended Fund Facility and with the finalization of a new money facility for Mexico, "Mexico request[ed] and anticipat[ed] that the banks [would] maintain their existing exposure to the foreign agencies and branches of government owned Mexican banks."[87] On the other hand, Mexico committed to making available to such agencies and branches sufficient funds to process market interest payments on their interbank account. In the end, with the restructuring loan documentation, creditor banks committed to not let deposits fall below US$ 5.2 billion until the end of 1986. In practice the interbank commitment agreements kept deposits rolling over 90 days were renewed and then renewed again, whenever they were about to expire.

Interbank outstandings to Mexican banks were maintained at the US$ 5.2 threshold level for ten years. With the argument that Mexican banks needed the placements as a long term source of funding for their loans to Mexico governed by the restructure agreements, Mexican government officials have asked for an extension on the covenant in all of the public sector restructure and new money agreements on two occasions. With the Financing Packages of 1986/1987 the expiration date was extended to June 1989. At the time of this financing package, though there were no official number reported, interbank placements were believed to be reached US$ 5,180 billion and to broke down as follows: Banco de Comercio, Banco international and Multibanco Comermex accounted for US$ 1.2, 1 and 1.05 billion of the frozen interbank liabilities respectively, while Banamex, Somex and

[83] IMF archive, OMDF Larosière chronological files Sep 82 - Apr 83, Memorandum, February 23, 1983.
[84] Ibid.
[85] Buchheit, 1991, p. 15.
[86] Gurria, 1988, p. 71.
[87] FBRNY, File "BAC 1982," Telex, Dicember 13, 1982.

Serfin for the remaining US$ 800, 580 and 550 million.[88] Two mechanism permitting reductions of the US$ 5.2 billion threshold were included within the Financing Package: a) exchange of interbank liability for restructured or FICORCA facility debt at par, and b) identify interbank liability in credit schedule and bring it under restructure agreement. However, because of the low value in the secondary market of such instruments, these transactions did not really attract the bank creditors.

By the late 1980s Mexican banks and their creditors were trying to work out a long-term solution to the interbank problem. As Buchheit (1991) observed: "In 1988, for example, First Interstate Capital Markets Limited arranged an innovative transaction for Banamex in which US$ 200 millions of short-term interbank deposits of Banamex were transformed into a 20-year subordinated obligation of Banamex, which could, incidentally, be counted as bank capital for Mexican bank regulatory purposes. The transaction became a model for several deals in Mexico and elsewhere. A separate series of transactions involved the exchange of interbank deposits for medium-term floating rate notes that had greater secondary market liquidity."[89] Neither of them reached a significant scale as to provide a solution to frozen interbank liabilities. Moreover, Mexico's 1989-92 Financing Package extended for more three years the special arrangements relating to interbank deposits setting the final expiration date on December 31, 1992. This was the financing package corresponding to the Brady Plan and, although it prove to be successful in providing a definitive solution to Mexico public sector debt, interbank deposits stayed as the only portion of Mexico's external debt that couldn't been dealt with a permanent market-oriented basis.

The final solution to the interbank issue came in the early 1990s. On June 1991, Angel Gurria, Undersecretary of International Affairs of the Mexican Ministry of Finance and Public Credit, released a communication and an invitation for bids from holders of the interbank liabilities of the foreign agencies and branches of Mexican banks. The proposal consisted in exchanging the interbank deposits for a new instrument, Floating Rate Privatization Note. They will be direct obligations of the United Mexican States and will be issued in bearer form to non-U.S. purchasers and in registered, transferable from to U.S. purchasers. The novelty was that this securities could be used to purchase shares of any of the 18 Mexican commercial banks whose privatization the Government has formally initiated intended during the previous years. Privatization Notes were expected to be very ready marketable securities because of their acceptance at full face value, in lieu of cash, in payment of all or any part of the purchase price of the Mexican bank shares being acquired. The notes will be exchanged for existing interbank deposits using an auction mechanism that gave preference to holders accepting the deepest discount on the exchange.

4.3. The nationalization of the banking system

By presidential decree of September 1, 1982, the Mexican executive government "decided to expropriate for causes of public need, the possessions of the private credit institutions."[90] At that moment, the Mexican private banking system consisted of 35 multiple banks, 14 commercial banks,

[88] FRBNY, BOX 108401, United Mexican States Report.
[89] Buchheit, 1991, p. 16.
[90] FRBNY, File "Banco de Mexico 1980-82," Decree nationalizing the banks.

11 *financieras* and one mortgage bank.[91] Ranging from physical installations to financial assets and shares or participations in other enterprises, all the properties of these financial institutions, with the exception of Banco Nacional Obrero's and Citibank N.A.'s, were transferred in favor of the Nation.[92] The nationalization also included the transfer of ownership, control and administration of branches and agencies of Mexican private commercial banks overseas. As a consequence, all their foreign assets and liabilities became now a responsibility of the Mexican public sector.

The official argument behind Lopez Portillo's nationalization decision was the necessity to deal with the drain of capital. In the eyes of the president, a State-controlled banking system would enable the government to stop the outward flight of dollars and the financial speculation for which Mexican private banks were blamed. The concomitant establishment of formal exchange controls was also part of the policy package that Carlos Tello, the architect of the banks' expropriation, considered necessary to control capital flight and successfully implement nationalization.[93] From a political perspective, the nationalization decision was embedded in a context of rising tension and conflicts between bankers and policy makers during the previous decade. As Del Angel, Bazdresch and Suárez Dávila (2005) emphasized, the nationalization of the banking system has been present in left-parties' proposals since the 1960s and it also appeared in the speeches of Presidents Echeverria and Lopez Portillo during the 1970s.

Although classical accounts considered the nationalization as a merely political decision, a number of historians have suggested that it could have actually served to save the banks. Del Angel (2002), for instance, stressed that "the expropriation was a controversial political move, but perhaps a mechanism to bail out a banking system on the edge of collapse."[94] Marichal (2011) also notes that "possibly, the [nationalization] was unavoidable because after the devaluation [of 1982] many Mexican public and private banks have to be rescued."[95] As was seen in the previous sections, with international bank refusing to renew credit lines and a portfolio of delinquent loans, Mexico's domestic banks were in a very delicate financial situation since the onset of the crisis. Angel Gurria himself stressed that, even though it could have been managed differently and that the decision to nationalize might have been taken for the wrong reasons, the nationalization was a way of solving the financial difficulties of banks that would otherwise have had to declare themselves insolvent.[96]

In this vein, archival evidence shows that the fragility of commercial banks and their overseas branches was a major worry for the Mexican financial authorities. For instance, in a telex to Paul Volcker on March 29, 1983, Banco de Mexico's Governor Miguel Mancera Aguayo expressed his deep concern "about the potential damage to the Mexican banking system and to Mexico in the event that class actions presently pending in San Francisco, California against 3 Mexican banks [were] determined against them."[97] At that moment, three separate classes were being sued on behalf of all U.S. depositors seeking return of the full dollar value of the money placed on deposits with Mexican banks. With the devaluations and imposition of exchange controls during the previous

[91] del Angel, 2002, p. 108 based on Marquez (1987).
[92] Decree's article 5ve.
[93] Formal exchange controls were introduced in Mexico by decree that same day of the nationalization.
[94] del Angel, 2002, p. 229
[95] Marichal, 2011, p. 124.
[96] Interview held on July 9, 2013.
[97] FRBNY archive, File "C261 - Banco de Mexico 1980-82," Telex, March 29 1983.

year, their dollar and peso certificates of deposits have suffered from foreign exchange losses. Mancera's immediate concern was for the Mexican banking system, and also about the potential ramification effects, if they were "forced to pay in damages literally hundreds of millions of dollars."[98]

In comparative perspective, the Mexican nationalization does not look so different from the solutions undertaken in other banking-troubled Latin American countries. In Argentina, for instance, "more than 70 institutions (accounting for 16% of commercial bank assets and 35% of finance company assets) were liquidated or subjected to intervention between 1980 and 1982."[99] In the case of Chile, the systemic banking crisis of 1981 led to massive interventions from the government and the central banks to rescue the banking system.[100] In the personal notes to his 1984 paper, Diaz-Alejandro states that "the Mexican bank nationalization [was] not so different from Chilean".[101] He argues that If bankruptcy had been allowed, the domestic financial system would have been dragged down, which would have raised the risk of a takeover and wholesale acquisition of the banks by foreigners.[102] Therefore, in the absence of any other plausible exit option, the expropriation of Mexican banking can actually be thought of as a mechanism to bailout the banks.[103]

Moreover, the nationalization of private banks fit the broader strategy of the Mexican government for dealing with the external liabilities of the Mexican private sector. In addition to the US$ 6,000 million of nationalized interbank debt of Mexican banks' foreign branches and agencies, the SHCP estimated that the Mexican private sector's external debt reached US$ 24,000 million up to December 1982. Of the outstanding amount, approximately US$ 20,000 million was owed by more than 1,200 private enterprises to international commercial banks while the remaining US$ 4,000 million to suppliers.[104] Regarding foreign banks' claims, through a subsidizing foreign exchange program called FICORCA,[105] the Government and the Bank of Mexico assisted the private enterprises with both the pesos and the dollars needed to serve their rescheduled foreign debt. As for the US$ 2,000 million debt with foreign suppliers without official guarantee, the Bank of Mexico created a mechanism by which the firm deposited their payment in pesos and paid off as foreign exchange were available. For the remaining US$ 2,000 million on official export credits, they were restructured by the Mexican government with the Club de Paris in June 1983. As a result, to a large extent the Mexican private sector external debt was partially or completely taken over by the public sector.

[98] Ibid.
[99] Laeven and Valencia, 2008, p. 32.
[100] See Diaz-Alejandro (1985) and Arellano (1983).
[101] See Diaz-Alejandro archives, Box 77, File "BREA 1984."
[102] Diaz-Alejandro (1984), p. XXX and Archives
[103] To additionally support this notion, it is interesting to compare the 1982 expropriation what happened a little more than a decade later. Following a bungled devaluation of the peso in December 1994, amidst a deep recession, three-digit interest rates and a financial meltdown, from 1995 the Mexican government injected massive amounts of capital into commercial banks (privatized only a few years before) to avoid their collapse and a panic, a de facto nationalization (partial or total depending on the specific bank). The government (headed by president Ernesto Zedillo) was ideologically against nationalization, but had no other option. Eventually, starting from the end of the Zedillo administration, the banks would be sold again –mostly to foreigners.
[104] Gurria, 1993, p. 50.
[105] For the Spanish initials of "Trust Fund for Covering Exchange Risks" (Fideicomiso para la Cobertura de Riesgos Cambiarios).

Indeed, in some cases these measures could have been supported or even boosted by international creditors. For instance, Diaz-Alejandro (1984) argues that there was a major change in the rules of the game for public and private external indebtedness with the outbreak of the debt crisis. Quoting a 1980 speech of Walter Robichek, then director of the IMF Western Hemisphere Department, Diaz-Alejandro emphasizes that "the explicit and implicit rules of the game of 1980 were that private agents were on their own when lending or borrowing, unless governments explicitly guaranteed their debt."[106] However, the "violation of the Robichek doctrine and the rules of the game, forc[ed] countries to handle private debt (re: internal and external breakdown, as in Argentina and Chile)."[107] The author mentions that during 1984 international banks were requiring that, along with the green light of the IMF, the Colombian government took up the debt of some Colombia-owned private banks or they wouldn't lend them otherwise.[108] Similar pressures seemed to have been put on the Chilean government by its Bank Advisory Committee to rescheduled private foreign obligations along with public external debt.[109] In the case of Mexico, the possibility of bankruptcies among Mexican companies was also an issue of particular concern for U.S. banks. As of June 1981, "they held almost $10 billion in claims on private nonbank Mexican borrowers, or more than half the total, whereas their claims on the public sector were less than 30 percent of the total."[110]

In the case of exchange control policies set up in some countries as measures to deal with the crisis, Diaz-Alejandro raises the question whether they could have been even "urged from abroad." He argues that "when foreign banks have an interest in collecting debt, then they want LDCs to get the hands on foreign exchange and make it available - cheaply - to indebted locals."[111] And also those who wants to make remittances abroad, such as their own branches and agencies in debtor countries. In the case of Mexico, external debt payment of both public and private agents benefited from the official preferential exchange rate.

5. Conclusion

The conclusions I draw from my analysis of Mexican international banking between 1977 and 1989 suggest further avenues of research that go beyond the case of Mexico. The fact that large domestic banks were heavily engaged in external borrowing, and that they played a significant role in intermediating foreign finance for local, final, users are revealing findings. They suggest that further work still needs to be done by economic historians to understand the links between the growing external indebtedness of Latin American countries and their domestic economies in the period leading to the international debt crisis of the 1980s.

Both development and commercial banks became highly exposed to, and dependent on, foreign capital during this period. State development banks were large international borrowers and major recipients of the syndicated Eurocredits granted to Mexico. In fact, over half of the development banking sector's lending capacity relied on money raised on the international capital markets. As for

[106] Diaz-Alejandro, 1984, p. 10.
[107] Diaz-Alejandro archives, Box 77, File "BREA 1984."
[108] Ibid.
[109] Diaz-Alejandro, 1985, p. 12.
[110] FRBNY archives, C261 Mexico 1980-1982, The Mexican Financial Situation, March 29, 1982.
[111] Diaz-Alejandro archives, Box 77, File "BREA 1984."

private and mixed commercial banks, they also increased their recourse to foreign finance. Through their overseas branches and associated banks in London and New York, Mexican commercial banks borrowed on the international interbank market to lend the money back home. On the eve of the debt crisis, therefore, Mexican banks were heavily involved in international finance and their foreign obligations accounted for up to a third of Mexico's external debt.

Another major finding is that Mexican banks developed important imbalances as a result of their international businesses. Although borrowing abroad in dollars, both development and commercial banks conducted their lending primarily in Mexico, creating cross-border currency mismatches on their balance sheets. Additionally, through the operation of their foreign branches and agencies, commercial banks incurred maturity and interest rate mismatches. On the one hand, although many of their liabilities consisted of very short-term interbank deposits, the bulk of their claims in Mexico had maturities of more than a year. On the other hand, while these interbank credit lines had been set at floating rates (LIBOR plus a fixed premium), their loans were arranged at predetermined fixed rates. Under these conditions, the increase in international interest rates from the late 1970s, the devaluations of the Mexican peso in 1982, as well as the curtailment of interbank credit lines once the crisis broke out, threatened the banks with bankruptcy and the entire Mexican banking system with collapse.

Finally, this paper suggests the importance of looking at Mexico's external debt renegotiation policy as imbedded in the problems of its banking sector. I argue that a possible reason for Mexico's weak bargaining position when renegotiating its external debt with international creditors stemmed from the government's commitment to avoiding a systemic banking crisis. The nationalization of private banks can also be considered as a measure to deal with insolvent banks and to save the banking system from collapse. However, given the high dependence of Mexican banks on foreign financing and the diminished foreign reserves of the Bank of Mexico, the continuation of foreign financial flows may have proved necessary for this purpose. The withdrawal by international banks of their interbank deposits with Mexican banks would have forced these banks into bankruptcy. The maintenance of such deposits and credit lines at levels needed to keep the banks operating would never have been possible without the Mexican government's commitment to the creditors' debt management strategy.

References

Aggarwal, V. K. (1991). Interpreting the History of Mexico's External Debt Crises. In B. Eichengreen & P. Lindert (Eds.), *International Debt in Historical Perspective* (pp. 140–188). Cambridge, MA.: The MIT Press.

Aggarwal, V. K. (1996). *Debt games: strategic interaction in international debt rescheduling* (p. 634). Cambridge, UK: Cambridge University Press.

Altimir, O., & Devlin, R. (Eds.). (1994). *Moratoria de la deuda en América Latina*. Fondo de Cultura Económica de Argentina.

Arellano, J. P. (1983). De la liberalización a la intervención: El mercado de capitales en Chile: 1974-1983. *Estudios CIEPLAN*, *11*(74), 5–49.

Bértola, L., & Ocampo, J. A. (2012). *The Economic Development of Latin America Since Independence*. London: Oxford University Press.

BIS. (1983). The International Interbank Market: A Descriptive Study. Basle, Switzerland.

Boughton, J. M. (2001). *Silent revolution: the International Monetary Fund, 1979-1989* (p. 1156). Washington D.C: International Monetary Fund.

Buccheit, L. C. (1991). But what do we do about all those interbank lines? *International Financial Law Review*, 15–16.

Cline, W. R. (1984). *International Debt: Systemic Risk and Policy Response* (p. 317). Washington, D.C.: Institute for International Economics.

Cline, W. R. (1995). *International Debt Reexamined* (p. 535). Washington, D.C.: Institute for International Economics.

Cohen, B. J. (1986). *In Whose Interest?: International Banking and American Foreign Policy* (p. 347). New Haven: Yale University Press.

Comptroller General of the United States. (1979). *Considerable Increase in Foreign Banking in the United States since 1972*. Washington, D.C.

Dale, R. S., & Mattione, R. P. (1983). *Managing Global Debt*. Washington, D.C.: Brookings Institution Press.

Davis, S. I. (1980). *The Euro-Bank: Its Origins, Management and Outlook*. New York: John Wiley and Sons.

Del Angel-Mobarak, G. A. (2002). *Paradoxes of financial development: the construction of the Mexican banking system. 1941-1982* (p. 678). Stanford University.

Del Angel-Mobarak, G. A. (2006). The Corporate Governance of the Mexican Banking System. A historical perspective. 1940-2000. Mexico D.F.

Del Angel-Mobarak, G. A. (n.d.). La paradoja del desarrollo financiero. In S. K. Ficker (Ed.), *Historia económica general de México: De la Colonia a nuestros días*. El Colegio de México.

Del Angel-Mobarak, G. A., Bazdresch Parada, C., & Suárez Dávila, F. (Eds.). (2005). *Cuando el Estado se hizo banquero: consecuencias de la nacionalizacion bancaria En Mexico*. Mexico D.F.: Fondo de Cultura Económica.

Devlin, R. (1989). *Debt and Crisis in Latin America: The Supply Side of the Story* (p. 320). Princeton: Princeton University Press.

Diaz-Alejandro, C. F. (1984). Latin American Debt: I Don't Think We Are in Kansas Anymore. *Brookings Papers on Economic Activity*, *15*(2), 335–403.

Diaz-Alejandro, C. F. (1985). Good-bye financial repression, hello financial crash. *Journal of Development Economics*, *19*, 1–24.

Dufey, G., & Giddy, I. H. (1994). *The International Money Market*. Englewood Cliffs, NJ.: Prentice Hall.

Friedman, I. S. (1983). *The World Debt Dilemma: Managing Country Risk*. Washington (D. C.) : Philadelphia (Pa.): Council for International Banking Studies ; R. Morris.

Green, R. (1988). *La deuda externa de México, 1973-1987: de la abundancia a la escasez de créditos* (p. 440). Mexico, D.F.: Editorial Nueva Imagen.

Green, R. (1998). *Lecciones de la deuda externa de México, de 1973 a 1997 : de abundancias y escaseces*. México, D.F.: Fondo de Cultura Económica.

Gurría, J. A. (1988). Debt Restructuring: Mexico as a Case Study. In S. Griffith-Jones (Ed.), *Managing World Debt* (pp. 64–112). New York: St. Martin's Press.

Gurría, J. A. (1993). *La política de la deuda externa*. México, D.F.: Fondo de Cultura Económica.

Helleiner, E. (1996). *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (p. 256). Ithaca, NY: Cornell University Press.

James, H. (1996). *International monetary cooperation since Bretton Woods* (p. 782). Washington D.C.: International Monetary Fund.

Kraft, J. (1984). *The Mexican Rescue* (p. 80). New York: Group of Thirty.

Laeven, L., & Valencia, F. V. (2008). Systemic Banking Crises: A New Database. *IMF Working Paper,* 08/224.

Lipson, C. (1981). The International Organization of Third World Debt. *International Organization*, *35*(4), 603–631.

Lissakers, K. (1991). *Banks, borrowers, and the establishment: a revisionist account of the international debt crisis* (p. 328). BasicBooks.

Lomax, D. F. (1987). *The Developing Country Debt Crisis* (p. 352). London: The Macmillan Press LTD.

Lomax, D. F., & Gutmann, P. T. G. (1981). *The Euromarkets and International Financial Policies*. New York: John Wiley and Sons.

López, P. J. (2009). Los bancos de desarrollo en América Latina: la experiencia de Nacional Financiera durante la industrialización vía sustitución de importaciones mexicana (1940-1970).

Marichal, C. (2000). Deuda externa y política en México, 1946-2000. In I. Bizberg & L. Meyer (Eds.), *México al filo del siglo XXI: cambio y resistencia*. Mexico, D.F.: Océano.

Marichal, C. (2011). Crisis de deudas soberanas en México: empresas estatales, bancos y relaciones internacionales, 1970-1990. *Historia y Política*, (26), 111–133.

Negrete Cárdenas, S. (1999). *Mexican Debt Crises: A New Approach to Their Genesis and Resolution*. University of Essex.

Sachs, J. D. (Ed.). (1989). *Developing Country Debt and the World Economy*. *NBER Working Paper Series*. Chicago: University of Chicago Press.

Sachs, J. D., & Huizinga, H. (1987). U.S. Commercial Banks and the Developing Country Debt Crisis. *Brookings Papers on Economic Activity*, *1987*(2), 555–606.

Sachs, J. D., & Williamson, J. (1986). Managing the LDC Debt Crisis. *Brookings Papers on Economic Activity*, *1986*(2), 397–440.

Smith, G. W., & Cuddinton, J. T. (1987). *International Debt and the Developing Countries*. Washington D.C: World Bank.

Solís, L., & Zedillo, E. (1985). The Foreign Debt of Mexico. In G. W. Smith & J. T. Cuddington (Eds.), *International Debt and the Developing Countries* (pp. 258–288). Washington, D.C.: The World Bank.

United States General Accounting Office. (1997). *Financial Crisis Management: Four Financial Crises in the 1980s*. Washington, D.C.

Volcker, P. A., & Gyohten, T. (1992). *Changing Fortunes: The World's Money and the Threat to American Leadership*. New York: Times Books.

Wellons, P. A. (1977). *Borrowing by developing countries on the Euro-currency market*. Paris: OECD.

Wellons, P. A. (1987). *Passing the Buck: Banks, Governments, and Third World Debt* (p. 342). Boston, MA.: Harvard Business School Press.

Wood, P. R. (2010). Essay: Sovereign Syndicated Bank Credits in the 1970s. *Law and Contemporary Problems*, *73*(7), 8–28.

Zedillo, E. (1981). *External public indebtedness in Mexico: Recent history and future, oil bounded optimal growth*. Yale University.

Zedillo, E. (1985). The Mexican external debt : the last decade. In M. S. Wionczek & L. Tomassini (Eds.), *Politics and economics of external debt crisis : the Latin American experience*. Boulder: Westview Press.

The European Association for Banking and Financial History (EABH) e.V.

www.eabh.info

info@eabh.info

The ***EABH* Working Papers Series** (***eabh Papers***), launched in 2014, gives scholars in banking, financial, business, and economic history and related fields the opportunity to distribute their research-in-progress. Making these findings available to a wider audience, even at an early stage, supports authors' search for qualified feedback, makes their work visible to international audiences, and increases their research's impact. These are important steps towards publication in a top-ranking scientific journal.

EABH offers

- 'Light-touch editing': ensuring that basic scholarly standards are met. Papers may be sent to outside experts for advice.
- Language editing (papers must be submitted in English): ensuring that a basic English language level is met.
- Copyediting in line with the RePEc standards.
- Promotion through our international network and listing of papers in relevant on-line databases.

Submission

Submissions should go to Ms Carmen Hofmann: c.hofmann@bankinghistory.de

Series Co-Editors

Dr Chris Colvin, Queen's University Belfast: c.colvin@bankinghistory.de

Dr Nathan Marcus, The Hebrew University of Jerusalem: n.marcus@bankinghistory.de

Further information

Submission guidelines and a full list of *eabh Papers* are available at the *EABH* website:

http://www.eabh.info/publications/eabh-papers/