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Privitization of the Mexican Banking System: Quetzalcoatl and the Bankers.

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PRIVATIZATION OF THE MEXICAN BANKING SYSTEM: QUETZALCÓATL AND THE BANKERS

JOHN P. COGAN, JR.*

> I come for you. My people claim you as the plumed serpent. They say that the earth and the heavens love you.[1]

On a ridge high above the west side of town, in palatial if somewhat isolated surroundings, there lives a retired law professor. He is the former President of a great nation. He is also a poet. His name is José López Portillo y Pacheco.

On September 1, 1982, during his last state of the union address, President López Portillo, close to tears, dramatically announced the nationalization of the Mexican banking system.[2]

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1. J. LÓPEZ-PORTILLO, QUETZALCÓATL 17 (5th ed. 1980) (quotation translated by the author).

2. Decreto Que Establece la Nacionalización de la Banca Privada, D.O., Sept. 1, 1982 [*hereinafter* Naturalization Decree] (Decree Which Establishes the Nationalization of Private

"We have broken the taboos," he said. "The revolution is freeing itself from fears and speeding up its pace. . . . Mexico's private banking system has postponed the nation's interest, and it has promoted, propitiated, and even instrumented speculation and capital flight. . . . It is now or never," he cried. "They have already plundered us. . . . They will never plunder us again."[3]This surprise announcement during President López Portillo's waning days of office was prompted by Mexico's serious and rapidly worsening economic plight. The privately owned banking system was the natural target for a quick fix.

Three months later, Miguel de la Madrid Hurtado became President and inherited the newly nationalized banking system. Even though many observers felt that the new president opposed the bank nationalization, he declined to restore the banks to their previous status. On the contrary, he announced that the privatization of the Mexican banking system was "irreversible."[4] After a time, however, President de la Madrid did sell off substantial portions of the banks' industrial holdings and he authorized the sale of up to thirty-four percent of each bank's equity in the form of non-voting certificates.[5] While these actions were major developments, the true counter-revolution awaited the next administration.

Today, in the poet's place as chief of state, there sits an economist, a technocrat. He is not a poet; to his credit he is not even a lawyer. He is privatizing the banking system. His name is Carlos Salinas de Gortari.

In mid-1990, President Salinas announced the privatization of the banking system in a move as surprising, if not as dramatic, as President López Portillo's nationalization announcement less than eight years earlier.[6] By the time of this writing at the end of 1991, the government had sold, or announced the sale, of nine of the eighteen government-owned commercial banks. This paper will examine the

Banks). At the same time, draconian exchange controls were enacted. Decreto Que Establece el Control Generalizado de Cambios, D.O., Sept. 1, 1982 (Decree which Establishes the Generalized Control of Exchange).

3. Sergio Sarmiento, *Mexico's President Bucks the Banking Taboo*, WALL ST. J., May 4, 1990, at A11.

4. *Id.*

5. Shepard Barbash, *Sale of Mexico's Bank Shares Successful, But Controversial*, AMERICAN BANKER, April 13, 1987, at 2.

6. Iniciativa Presidencial, D.O., June 27, 1990; William Branigin, *Mexico to Repeal 82 Bank Takeovers*, THE WASHINGTON POST, May 3, 1990, at A33-34.

above-described events and the processes involved from the perspective of a United States lawyer.

I. THE PROLOGUE

Both Anglo and Latin Americans enjoy a good tale. The tale of *Quetzalcóatl* is one of them. It began with the ancient Toltecs and has played a significant role in Mexican history at various times since then, especially during times of intense rivalries between tribes and when invasions were imminent (like the rivalry between the Aztecs and the Texcocans, followed by the arrival of the Conquistadors).[7] It is ironic that President López Portillo would have been the author of a latter day version of the Quetzalcóatl legend not too long before the rivalry between the bureaucrats and the private sector, and the invasion of the foreign bankers broke out afresh in the last part of the twentieth century.

A more gringo-like tale is *The Pardoner's Tale* of Chaucer. It is far less reverent but has a moral tone as well. Medieval pardoners traveled as agents of the Pope who were empowered to forgive sins in exchange for contributions to worthy causes. Some pardoners fulfilled their responsibilities by turning over their contributions to the designated cause, keeping only an agreed upon percentage for their efforts. Unfortunately, many more kept everything for themselves.[8] In either event, during their travels the medieval pardoners frequently confronted the sins of gluttony, gambling, profanity, and greed. So too, in modern Mexico the bankers and their host, the Mexican government, confront similar sins in the travels of the Mexican banking system. This then is *The Bankers' Tale.*

II. PERIOD LEADING UP TO THE NATIONALIZATION: A TIME OF GLUTTONY OR WISE CONSUMPTION?

The economic miracle which Mexico had experienced from the 1940s to the 1960s began to turn sour by the late 1960s. Many of the economy's basic problems were, however, hidden by the oil boom of the 1970s. Political unrest and the oil boom encouraged Presidents Echeverría and López Portillo to take populist approaches in eco-

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7. JONATHAN KANDELL, LA CAPITAL 66-75 (1988).

8. 1 THE NORTON ANTHOLOGY OF ENGLISH LITERATURE 124 (M. H. Abrams ed., 1962).

nomic policymaking. They focused on the inequitable distribution of wealth and the country's perceived dependency on foreign capital in ways which, it turned out, only exacerbated the problem.

In the 1970s, restrictive laws on foreign investment and technology were implemented; existing restrictions on the importation of foreign-made goods were retained. Protectionism reigned supreme. Public spending both on social infrastructure as well as on projects of industrial aggrandizement was massively increased. Inflation, which had been negligible since 1950, took off. The deficit in the country's external account tripled during President Echeverría's administration, driving him ultimately to devalue the rate of the peso to the dollar from one which had remained constant since the early 1950s.[9]

If outside observers thought President Echeverría's actions were excessive and ruinous for his country, they had yet to examine the major league profligacy of President López Portillo. He will be remembered as the president who squandered the opportunities presented by the great oil boom and who created the environment for an unusually high degree of corruption by a relatively few but highly placed government officials, *paraestatal* executives and union leaders.

Much of the money was coming from bankers, both foreign and domestic. One must ask why they discarded their normal credit standards in dealing with Mexican borrowers (and with other even less promising third world borrowers as well). The oil was there but Pemex had an abysmal reputation for inefficiency (including an abnormally high cost for finding and producing oil) which was camouflaged only as long as the price of oil remained at stratospheric heights. Some of the funds were being used for worthwhile purposes, but what were to be the sources of repayment if the oil price fell?

The private sector joined the public sector in the spending binge. During President López Portillo's term, Mexico's public and private sector together borrowed sixty billion dollars abroad. Towards the end, the borrowings did little more than cover up the eroding value of the peso. An artificially propped-up peso and a declining faith in

9. Law to Promote Mexican Investment and to Regulate Foreign Investment, D.O., Mar. 9, 1973; Law on the Registration of the Transfer of Technology and the Use and Exploitation of Patents and Trademarks, D.O., Dec. 30, 1972; JONATHAN KANDELL, LA CAPITAL 541 (1988); Ewell E. Murphy, Jr., *The Echeverrían Wall: Two Perspectives on Foreign Investment and Licensing in Mexico*, 17 TEX. INT'L L.J. 135, 142-44 (1982); *Mexico Survey*, THE ECONOMIST, Sept. 5, 1987.

Mexico's institutions prompted a massive outflow of Mexican capital to banks, stock brokers, and condominium developers north of the Rio Bravo.

Many officials were trying valiantly to stem the tide by aiming at the causes of the problem.[10] However, too little was done too late. Oil prices collapsed in 1981. The government could no longer maintain the value of the peso. In spite of López Portillo's February 5, 1982 protestations that he would "defend the peso like a dog," the Central Bank allowed the peso to float beginning on February 17, 1982.[11] The free market rate for the peso dropped from 25.66 pesos to the dollar on February 17, 1982 to 150 pesos to the dollar in December of the same year.[12]

When construction of López Portillo's palace complex became known to the general public, it was christened *la colina del perro* (Dog Hill), in honor of the President's hollow promise to adopt canine behavior in defending the peso. Dog Hill also became a symbol of the corruption and waste which plagued López Portillo's regime.

III. The Nationalization: A Gamble or the Only Wise Course of Action?

Banking has suffered a checkered history throughout the world, especially in capital poor areas. One of the early disagreements between Federalists and Jeffersonian Democrats in the capital poor United States of the early 1800s was whether, and to what extent, the federal government should be involved in banking.[13] In chronically poor Texas, the state constitution expressly prohibited the chartering of

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10. For example, in April of 1982, Lic. Miguel Mancera Aguayo, Director General of *Banco de México* (the Central Bank), published an impressive monograph explaining why exchange controls don't work. Banco de México, S.A., Inconveniencia del Control de Cambios (1982). Less than six months later, exchange controls were in effect and the Mexican banks were nationalized; Lic. Mancera had resigned and he had been replaced by the mastermind behind those cataclysmic events, Carlos Tello Macias, a Marxist economist who advocated pre-Perestroika Eastern European-type policies for Mexico.

11. Ewell E. Murphy, Jr., *Expropriation and Aftermath: The Prospects for Foreign Enterprise in the Mexico of Miguel de la Madrid*, 18 TEX. INT'L L.J. 431, 437 (1983); *Peso Under Pressure; Trade Surplus, Reserves Dwindle*, LATIN AMERICA WEEKLY REPORT, Aug. 4, 1988, at 7.

12. Stephen Zamora, *Peso-Dollar Economics and the Imposition of Foreign Exchange Controls in Mexico*, 32 AM. J. COMP. L. 99, 102-04 (1984).

13. First Nat'l Bank v. Walker Bank, 385 U.S. 252, 256 (1966). *See generally* McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

banks until 1904. Even today the Texas Constitution prohibits foreign corporations from carrying on a banking business in the state.[14]

Similarly, in Mexico, a capital poor part of the world after its independence from Spain, laws discouraged bankers but did not necessarily deter money lenders. In fact, the Church became an important source of loans for agricultural development at favorable interest rates. Also merchants and factors took up the slack when "bankers," per se, were not available.[15] The same thing happened after the 1982 nationalization of the banks as the government soaked up all available bank credit for its own purposes and a "parallel" banking system emerged.[16]

Yet, banks are more often needed in bad times than in good times if they are adequately capitalized, sufficiently responsible, and not unduly restrained. Unfortunately for the banker, his tale of woe is that when he is most needed, he is most maligned. He was needed in 1982 in Mexico but he was a perfect scapegoat for the problems of the era. Of course, some of López Portillo's wrath was deserved, but the bankers were a product of the system and the system was brought down as much by the López Portillo and Echeverría administrations (*la docena trgica*) as by the banks themselves. If they had been properly regulated and encouraged, the evils which López Portillo sought to eradicate could have been removed without the disastrous side effects of nationalization (or, as many would call it, confiscation).

According to President López Portillo, the purpose behind nationalizing the banks was to prevent the continued flight of capital from Mexico. Proponents claimed that nationalization was necessary because the pleas of the president to the dollar-drainers (the *sacadólares*) to stop transferring their wealth abroad had been ignored and the private banking system was the *sacadólares'* tool. In announcing the nationalization, the president claimed that he had "a little list" of the dollar-drainers who were weakening the Mexican economy but he refused to read the list to the public. He could not have read a complete list in any event because it would have been too long and it would have included members of his own administration.[17]

14. TEX. CONST. art. XVI, § 16; see Cogan & Nunes, *Texas as an International Banking Centre*, in EUROMONEY, INTERNATIONAL BANKING CENTRES 264 (B. Brown ed., 1982).

15. JONATHAN KANDELL, LA CAPITAL 311, 329 (1988).

16. Sergio Sarmiento, *México's Phantom Bankers Come Out of the Shadows*, WALL ST. J., Aug. 7, 1987, at 21.

17. Robert E. Norton & Teresa Carson, *Mexico Nationalizes Its Bank; U.S. Branches*

In fact, the nationalization and the correlative exchange controls just made matters worse. Chaos reigned in Mexico and recession came to those parts of the United States most closely linked to the Mexican economy, such as San Antonio and the Galleria in Houston. As is so often the case, the politicians aimed at the symptoms rather than the causes.

The business community of Mexico was stunned by President López Portillo's announcement of nationalization. Mexicans lost total confidence in their system and a hemorrhage took place. At banks and foreign exchange houses all over Texas, well-heeled Mexicans with shopping bags full of pesos were forming long lines to get as many dollars as they could for their increasingly worthless pesos. The bankers and businessmen of Mexico claimed that the nationalization was "socialistic" and "totalitarian" in nature. As one prominent Mexico City businessman bemoaningly put it to the author shortly after the September 1 nationalization, "On August 31, I went to bed a free man; on September 1, I went to bed enslaved in a kind of totalitarian regime I thought would be impossible in my country." Of course, supporters of the nationalization might have observed that at least he still had a comfortable place to go to bed, which many of his fellow countrymen did not.

It did not help matters that the outraged former shareholders considered the compensation for their shares in the banks, when it came, to be grossly inadequate. It came in the form of government "indemnity bonds" patterned after the bonds used by the French government to compensate former shareholders of the nationalized French banks. The trouble was that the Mexican bond was considered by many to be worth less than twenty-five percent of the true value of the banks.[18]

The former owners of the banks sought relief from the alleged injustices by turning to the Mexican courts. The bankers hoped that the judiciary would enjoin the government from nationalizing the banks. This hope dissolved when the Mexican Supreme Court voted 15-2 against enjoining the nationalization of the banking system.[19]

There Left Untouched, AMERICAN BANKER, Sept. 2, 1982, at 1; Cedric Belfrage, *Man Bites Dog*, THE NATION, Oct. 2, 1982, at 293; JONATHAN KANDELL, LA CAPITAL 544 (1988). The capital that had already "flown the coop" was estimated at nearly $50 billion. Cedric Belfrage, *Man Bites Dog*, THE NATION, Oct. 2, 1982, at 293.

18. *International News-Mexico*, UPI, Aug. 28, 1983, *available in* Westlaw, UPI Database.

19. *International News-Mexbriefs*, UPI, Nov. 23, 1983, *available in* Westlaw, UPI Database.

It is ironic that López Portillo's nationalization was justified by playing on the twin fears of capital flight and foreign control of the economy when the nationalization decree conspicuously omitted Citibank (the only foreign bank allowed to maintain a branch in Mexico), Banco Obrero (a union controlled bank—and unions were notorious *sacadólares* at the time) and the numerous foreign bank representative offices (which were not allowed to take deposits or to handle funds but some of which, nonetheless, were known on occasion to assist in establishing deposits by Mexicans with the home office.)[20]

A further irony of the nationalization was that the debts owed to the foreign banks by the Mexican banks (approximately ten billion dollars) were now guaranteed by the Mexican government.[21] This was undoubtedly one reason why the foreign banking community did not protest the nationalization. The foreign bankers and the government were also concerned that, without the government takeover, there would quite likely have been some major failures and insolvencies in the banking system. In that case, the only alternative to a takeover would have been a massive bailout (a sort of forewarning of the United States savings and loan bailout a few years later), which quite possibly would have been more expensive and even less politically acceptable.[22]

President López Portillo put an even more xenophobic gloss to the situation himself when, as he departed from office, he sought to justify his actions by saying,

> I took the decision to launch Mexico into action in order to escape a trap permanently laid by a hostile world, organized by the powerful nations for their own benefit, to ensnare the developing countries. . . . We had to seize the right moment, a brief opening, to lunge forward and escalate the trap. . . . It was a question of transforming a nonrenewable resource into permanent sources of employment and production.[23]

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20. Decree which establishes the Nationalization of Private Banks ("Nationalization Decree"), D.O., Sept. 1, 1982.

21. *Id.*

22. Robert E. Norton & Teresa Carson, *Mexico Nationalizes Its Banks: U.S. Branches There Left Untouched*, AMERICAN BANKER, Sept. 2, 1982, at 1.

23. Ewell E. Murphy, Jr., *Expropriation and Aftermath: The Prospects for Foreign Enterprise in the Mexico of Miguel de la Madrid*, 18 TEX. INT'L L.J. 431, 436 (1983) (quoting from farewell address); *see also* López Portillo's subsequent reflections on the fiscal crisis of his administration in a 1989 interview with Cuauhtemoc Anda Gutiérrez in C. ANDA-GUTIÉRREZ, NACIMOS ENDEUDADOS 205-27 (1989).

IV. The Privatization: Profanity or Wise Counter-Revolution?

The privatization did not happen all at once. It came piecemeal.

A. *The Sale of Non-Banking Assets*

Because Mexican banks, like many continental European banks, had over time acquired substantial shareholdings in industrial enterprises, the nationalization of the banking system brought the Mexican government not only control of the banks, but also, when combined with the government's existing holdings, control over approximately sixty percent of the entire Mexican economy.[24] Soon after President de la Madrid took office, he came under pressure to sell shares of the industrial and commercial enterprises owned by the banks to the private sector. By March of 1984, the Mexican government had decided to sell share holdings worth four hundred, seventy million dollars in over seventy percent of the companies it had acquired in the 1982 bank nationalization.[25]

B. *The Sale of Minority Interests in the Banks*

By 1987, President de la Madrid had begun a partial privatization by selling up to thirty-four percent of the banks' equity by way of non-voting interests (Certificados de Aportación patrimonial or CAPs) to the private sector.[26] The reasoning behind these sales was to raise capital, to discourage continued capital flight, and to build investor confidence generally. The sales were actually units consisting of CAPs and debentures convertible into CAPs over a five-year period. The sale of these units to the investing public constituted the largest placement on the Mexico City Bolsa up to that time.[27]

C. *The Sale of Control of the Banks*

These chinks in the armor of state ownership were encouraging to

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24. *International News—Mexico Economy*, UPI, July 21, 1983, *available in* Westlaw, UPI Database.

25. *International News—Mexico*, UPI, Mar. 10, 1984, *available in* Westlaw, UPI Database.

26. Shepard Barbash, *Sale of Mexico's State Bank Shares Successful, But Controversial*, American Banker, Apr. 13, 1987, at 2.

27. William Branigin, *Mexico to Repeal '82 Bank Takeovers; Salinas Submits Plan to End 'Paternalism'*, Washington Post, May 2, 1990, at A33-34.

the economy. By 1990, the need for foreign and domestic private investment in Mexico was so acute that President Salinas felt it was a national priority to undo the nationalization of the Mexican banking system, the "irreversible" act that had occurred only eight years before.[28] The need to uphold private sector confidence which had been building with the foreign debt restructuring and privatization moves in the industrial sector became paramount, totally reversing the politics of *la docena trágica*. The Prague pedants were replaced by the Chicago boys and their colleagues from Harvard and M.I.T.

Announcing the first sale of controlling interest in a bank back to the private sector, a headline in *El Financiero* read "And then there were 17 . . ."[29] With this announcement, the Mexican government began its great sell-off of its eighteen state-controlled commercial banks. President Salinas said, "the necessities of the population are so great that to maintain a major part of public resources tied to the banks . . . would be to distract the state from its social obligations."[30] To diffuse opposition, Salinas noted that he was doing nothing more than what had already been done in countries with socialist governments like France and Portugal and what was being planned in Eastern Europe and the Soviet Union. In any event, the privatization of the banking system was necessary to keep the private sector assured of continuing reforms in the structure of the Mexican economy.

Surprisingly, the Multibanco Mercantil auction brought a price 2.66 times book value. This result was at first considered an aberration due to its relatively small size and large number of bidders. "There is no way people are going to pay that kind of a premium for a bank the size of Bancomer [one of the largest banks]," said one Mexican investment banker.[31] Yet, when the sale of Bancomer was announced the price was even higher, 2.99 times book value, earning for the government a tidy $2.54 billion for fifty-one percent of the shares and establishing a favorable price for the remaining shares to be sold.[32]

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28. Jane Bussey, *Mexico Moves to Free Its Banks*, U.S. NEWS & WORLD REPORT, June 18, 1990, at 44.

29. Mike Zellner, *And Then There Were 17. . .*, EL FINANCIERO INTERNATIONAL, June 24, 1991, at 3.

30. William Branigin, *Mexico to Repeal '82 Bank Takeovers; Salinas Submits Plan to End 'Paternalism'*, WASHINGTON POST, May 2, 1990, at A33-34.

31. *Id.*

32. EL FINANCIERO INTERNATIONAL, Nov. 11, 1991, at 3.

The chart in Appendix A shows the incredibly high multiples that have been accepted for the banks auctioned through the end of 1991. This is a far cry from the bleak days just before nationalization when bank stocks were trading on the bolsa at a mere thirty-seven percent of book value. Before the sales began, Solomon Brothers predicted the government might receive six billion dollars for the banks. Now they estimate the figure could go as high as ten billion.[33] And these numbers do not reflect the proceeds from earlier years of the CAPs sales and the sell-offs of the banks' industrial holdings—quite a profit when one recalls that all the government paid for its investment was government bonds having a face value of seven hundred, sixty million dollars.[34] Although some restructuring of the banks designed to increase value has been undertaken in anticipation of the sales, the high multiples are difficult for many outsiders to justify.

While government officials are ecstatic about the prices, one fear is that the banks will be forced into risky loans in order to obtain the returns necessary to justify the high purchase prices.[35] This again raises the specter of the savings and loan debacle in the United States, and concern over the extreme cost of a bailout if that becomes necessary.

Some observers feel that the prices were based on a variety of unsound, speculative factors. These factors include a projected growth rate double the current growth rate, a halt to the daily devaluation of the peso, and a boom in the credit business. On the other hand, many argue that the price for certain banks, even though two to four times book value, is a shrewd investment because of the potential synergies created between the other operations of each purchasing group and its new bank.[36] No Glass-Steagall concerns here.

Although there is some talk of changing the limits, foreigners may currently own no more than thirty percent of a Mexican bank. As a result, there has been only minimal interest by foreign investors in the

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33. Mike Zellner, *Hernandez & Harp—The Hottest Financial Team in Mexico*, EL FINANCIERO INTERNATIONAL, Sept. 9, 1991, at 8.

34. Jane Bussey, *Mexico Moves to Free Its Banks*, U.S. NEWS & WORLD REPORT, June 18, 1990, at 44.

35. Rueben Migueles, et. al., *Salinas Details Modernization and Growth*, EL FINANCIERO INTERNATIONAL, Nov. 11, 1991, at 27.

36. Exhibit A includes a brief description of the bank privatizations at the time of writing (9 out of the 18).

privatization process.[37] Presently a Spanish bank, Banco Nacional Español de Credito, is the only foreign bank to have participated. It has purchased a ten percent interest in Banco de Oriente.[38]

One reason for the lack of interest by foreign investors (particularly United States and Canadian bankers) in Mexican banks is that the North American Free Trade Agreement might possibly allow member nations' banks to operate without restrictions in Mexico.[39] The dilemma of foreign bank participation in the Mexican banking system is similar to the dilemma which was faced by the Texas banking system in the mid-1980s with Texas' restrictions on United States "money center" banks as well as on purely foreign banks. Unfortunately for Texas, its provincialism in this regard also had the practical effect of limiting significant expansion by its own banks into out-of-state markets. The Texas example has not, so far, been a particularly enviable one.

While United States' banks have shown no interest in directly investing in Mexican banks by purchasing a piece of a Mexican bank, they have been willing to participate in the process by financing Mexican investors. For example, in late 1991, J. P. Morgan announced that it had syndicated a "billion-dollar bridge loan for one year to support" the Valores Monterrey (VAMSA) group's bid for Bancomer. In addition, Morgan loaned 120 million dollars in equity to one of VAMSA's group members.[40] Aside from acquiring shares in Mexican banks directly or simply financing Mexican investors, foreign banks might look for opportunities for participation in the Mexican financial sector by means other than conventional "commercial" banking.

For example, foreign banks have a great deal to offer to Mexican banks in the way of technical and management services and franchising. With the repeal of the foreign technology transfer restrictions in 1991, there should be some great opportunities to participate in Mexican banking through the provision of such services in return for a commercially appropriate royalty or other type of return.[41] As the

37. Mike Zellner, *Hernadez & Harp—The Hottest Financial Team in Mexico*, EL FINANCIERO INTERNATIONAL, Sept. 9, 1991, at 8.

38. EL FINANCIERO INTERNATIONAL, Nov. 11, 1991, at 3.

39. EL FINANCIERO INTERNATIONAL, Nov. 11, 1991, at 3.

40. *Id.*

41. La Ley de Fometo y Protección de la Propiedad Industrial, pt. II, D.O., June 27, 1991, abrogated the previously restrictive law which discouraged the use of foreign technology in Mexico.

Mexican foreign investment restrictions are increasingly eased, many creative opportunities for active participation in the non-bank financial sector should present themselves.

V. RULES

How does the privatization work, legally? Shortly after the nationalization decree was issued in 1982, the Constitution was amended to reserve banking and credit operations exclusively to institutions of the state.[42] Thus, a constitutional amendment was required for privatization. As a result of President Salinas' initiative on May 2, 1990, the Constitution was amended to abrogate paragraph 5 of article 28 (the existing impediment) and to transfer bank employees from their status as employees of public institutions to private institutions.[43] Then a new law of credit institutions and companion laws, decrees, and regulations were promulgated to replace much of the prior legislation regulating banks and credit institutions.[44]

These new pieces of legislation set out the procedures for privatizing the banks. They also regulate the operations and ownership of a wide range of credit institutions, including financial groups. Essentially, a Bank Privatization Committee (*Comite de Desincorporación Bancaria*) was established within the Ministry of Finance. Interested persons are required to register with the committee. Foreigners are not allowed to acquire more than thirty percent of the capital.

With certain exceptions, no individual or legal entity may acquire more than five percent of the capital of a bank. One exception to this limit is that qualified holding companies (*sociedades controladoras*) may acquire up to one hundred percent of the capital of a bank. However, with certain limited exceptions, no individual or legal entity can own, directly or indirectly, more than five percent of a qualified

42. CONST. art. 28, para. 5 (Mexico 1984).

43. Decreto Que Deroga al Párrafo Quinto del Artículo, D.O., June 27, 1990 (decree which deletes the fifth paragraph of Art. 28).

44. This package includes the new Ley de Instituciones de Crédito, D.O., July 18, 1990; Ley para Regular las Agrupaciones Financieras, D.O., July 18, 1990 (Law to Regulate Financial Groups); Acuerdo Que Establece los Principios y Bases del Proceso de Desincorporación de las Sociedades Nacionales de Crédito, D.O., Sept. 5, 1990; Bases Generales del Proceso de Desincorporacíon, D.O., Sept. 25, 1990; Procedimiento de Registro y Autorización de Interesados en Adquirir Títulos [de las Instituciones de Banca Múltiple], D.O., Sept. 25, 1990 (Privatization Procedure); and Reglas Generales Para la Constitución y Funcionamiento de Grupos Financieros, D.O., Jan. 23, 1991.

holding company.[45]

Pursuant to the foregoing legislative package, each bank is converted by decree from a national credit company (SNC) to a joint stock company (S.A.), ready to be sold to the private sector in the auction process.[46] Every effort has been made in the legislation and the regulations to avoid corruption and insider deals.[47] So far, the system seems to be working.

VI. The Effects of Privatization: Greed or a Step Towards a More Vibrant Economy?

Critics of the 1982 bank nationalization claim it created a crisis[48] in the Mexican banking sector and the crisis promoted inefficiency and corruption and had to be undone before the economy could fully recover.

Before addressing the effects of bank privatization on Mexico, one must examine the status of the Mexican economy at the time. Inflation had dropped from one hundred, fifty-nine percent in 1988 to between fourteen and fifteen percent per year by mid 1991, representing the lowest yearly inflation rate since 1976. Interest rates had dropped substantially as well. Investor confidence had increased and the Mexico City Stock Exchange took off. In the first six months of 1991, average prices increased by more than sixty percent after inflation.[49] One economic indicator that is not positive is that overdue loans in the first half of 1991 increased by 135.6 percent over the same period in 1990.[50]

This may not bode well for the banks' new owners. On the other hand, capital ratios, a measure of banks' financial strength, average more than six percent. This is double what it is for the United States banking system; and demand for credit will be exceedingly strong. With only eighteen or twenty institutions (down from one hudnred,

45. Privatization Procedure, Item 2; Law to Regulate Financial Groups, art. 20; Atlantico, Aspectos Principales de las Reformas Constitucionales y Promulgación de Nuevas Leyes Relacionadas con el Sistema Financiero (1990).

46. See, for example, the Decree Transforming Banco Nacional de México, S.N.C. into Banco Nacional de México, S.A. (Banamex), D.O., Aug. 16, 1991.

47. Economist, Mar. 9, 1991, at 81.

48. Herb Vest, *The Fast Pace of Bank Privatization*, El Financiero International, Sept. 9, 1991, at 8.

49. *Id.*

50. El Financiero International, Oct. 21, 1991, at 3.

twenty in 1981, thanks to a post-nationalization consolidation) serving the domestic banking needs of over eighty million people in Mexico (compared to some fourteen thousand banks in the United States), the banks can afford to be highly selective in going forward with building their loan portfolios. They also can now be more creative in the services they offer and in pricing. Of course, the oligopolistic structure could change if the government were to grant new banking concessions but this is not likely to happen any time soon. Also, opening the economy to greater participation by foreign banks as discussed below will have a significant impact on the newly privatized banks' well being.

In any event, an immediate result of privatization is the new, much more competitive environment in which the banks will operate. In order to compete, banks will be forced to cut costs even further. The Mexican government, in its final days as a bank owner, had made some cuts in order to increase the value of banks. For example, the staff of Bancomer had been reduced twenty percent "by 'voluntary retirement' and liquidation of 7,370 employees."[51] Now, the new owners will need to reduce staff even more. Banamex has already announced a post-privatization personnel cut of at least thirty percent nationwide. Even though officials of Banamex claim that the measure is strictly voluntary, bank officials are offering incentives to more than thirty-four thousand less experienced employees to quit.[52] With steep cuts like these in Mexico's largest two banks, it is very likely that the remaining banks will also have to make steep cuts in order to remain competitive.

In addition to cost cutting, massive new investments will be needed to upgrade systems and to increase the size and ability of credit analysis departments. This is particularly true if the banks are going to reduce the risk of further bad loans. Because of the high book value paid for the banks and the increased competition, the pressure to increase revenue by making risky loans may increase.[53]

While President López Portillo's nationalization of the banks in 1982 was done ostensibly to prevent the flow of capital out of Mexico, the privatization of the banks by President Salinas was done with the

51. $HORT TAKE$, EL FINANCIERO INTERNATIONAL, Oct. 28, 1991, at 3.

52. *Corporate News Reports*, EL FINANCIERO INTERNATIONAL, Oct. 7, 1991, at 6.

53. Mike Zellner, *Banamex's Success Not Automatic*, EL FINANCIERO INTERNATIONAL, Sept. 9, 1991, at 7-8.

goal of attracting more capital to Mexico.[54] In spite of apparent initial interest in the Mexican banks by at least some United States bankers, President Salinas' goal of substantial direct foreign investment in Mexican banks simply has not occurred (except for the relatively modest Spanish investment in Banco de Oriente).[55]

Foreign bankers are obviously disappointed about the limitation of foreign ownership to only thirty percent of any bank and the uncertain financial condition of many Mexican banks. But there is more to it than that. For instance, banks traditionally prefer to operate through branches rather than subsidiaries for economic reasons; further, they are concerned about whimsical regulation which might dry up credit or send costs skyrocketing; and, for U.S. and Canadian banks, at least they might get a better deal if they wait for the North American Free Trade Agreement. With respect to inopportune regulation, the August 1991 reserve requirement regulations imposed by Central Bank Director General Miguel Mancera Aguayo (the same man who criticized regulatory tampering with foreign exchange in 1982 before resigning) caused a temporary credit crunch and substantial losses to the commercial banks.

VII. THE FUTURE

The factor that could have the greatest impact on not only the future of the privatized Mexican banks (and on whether the book value paid for the banks will be determined to have been unreasonably high) will be the terms of the North American Free Trade Agreement currently under negotiation. Mexican financiers meeting in October of 1991 in Acapulco argued that, because of their small size and lack of modernization compared to banks north of the border, United States and Canadian banks should be denied access to the Mexican financial market for five to ten years.[56] While Mexican bankers are urging the Mexican trade negotiators to continue restrictions imposed against foreign banks, banks north of the border led by Citicorp and Bank of America are urging the United States Trade Representative (USTR) to call for immediate access for United States banks in Mexico. In

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54. Christopher Whalen, *Mexico Needs Privatization, But Proposal May Be a Ruse*, AMERICAN BANKER, May 24, 1990, at 7 (very critical of Mexican policies).

55. John Evans & James R. Kraus, *Mexico's Privatization Plan Wins Praise*, AMERICAN BANKER, May 7, 1990, at 14; EL FINANCIERO INTERNATIONAL, Nov. 11, 1991, at 3.

56. EL FINANCIERO INTERNATIONAL, Oct. 7, 1991, at 15.

fact, Jorge Escobar, Vice President of Bank of America's trade and investment department, asked the USTR to demand that U.S. banks have:

1) The right to establish branches in Mexico immediately, and, once a free-trade agreement is signed, full ownership of Mexican banks;
2) Full national treatment by the Mexican government, allowing nationwide branches with peso deposit gathering and lending powers, on an equal footing with Mexican banks;
3) Full participation of foreign banks in the development of Mexican capital markets, and authorization to underwrite and trade government and corporate securities; and
4) The right to own leasing and finance company subsidiaries or otherwise engage in these activities, and to compete with financial groups that have already acquired Mexican banks.[57]

It is a broadly held belief that Mexican banks cannot currently compete against United States banks.[58] As a result, if banks in the United States are given immediate access to Mexico as they desire, the price paid in excess of book value for the already purchased Mexican banks might prove to be a bad investment, especially since many of the purchasers of Mexican banks to date have based their purchase price on the assumption that Mexican banks would remain protected for five years from competition from banks in the United States.[59] On the other hand, if foreign banks are given the opportunity to acquire one-hundred percent of the equity of a Mexican bank, the price per share may actually increase; or at the very least, some foreign banks might decide to help the government bail out a bank in trouble.

Mexican trade negotiators will be under great pressure from their constituents to insure the largest protection period possible for Mexico's newly privatized banks. Mexican bankers claim that to allow the United States banks immediate access to the Mexican banking market risks the very financial soundness and security of the newly privatized banks.

Even though Mexican banks are urging that banks from the United States should remain prevented from immediately being allowed to open branches of United States banks in Mexico under the free trade

57. EL FINANCIERO INTERNATIONAL, Sept. 16, 1991, at 4.

58. Gregory D. Cancelada, *Banking Competitiveness in Question*, EL FINANCIERO INTERNATIONAL, Oct. 14, 1991, at 4.

59. *Mexico: Government to Reveal Winner of Bank Bidding*, LOS ANGELES TIMES, Aug. 26, 1991, at 4.

agreement, the Mexican bankers want to preserve their access to the United States, especially to the large Hispanic population in the southwestern United States. In fact, Mexican banks have had a presence in the United States since 1978. In 1978, Banamex purchased California Commerce Bank and in 1982, Bancomer purchased Grossmont Bank in San Diego.[60]

VIII. THE EPILOGUE

As noted in the Prologue, since the time of the Toltecs, the people who inhabit Mexico have been searching for Quetzalcóatl, the plumed serpent god of civilization, or his descendants to return and rid them of their troubles.[61] So far, they have been disappointed. Perhaps they have been expecting too much; or, perhaps, the private bankers are the returning descendants of the plumed serpent god. The real question is twofold. First, will the bankers be like honest pardoners (and perhaps like descendants of Quetzalcóatl) who work for the just cause of building the Mexican economy, taking only their fair entitlement (rather than everything) for themselves? Second, will the Mexican government as the bankers' host know the difference? The tale is not over. Let's hope for a happy ending!

Now, Master Pardoner, perk up, look cheerily!
And you, Sir Host, whom I esteem so dearly,
I beg of you to kiss the Pardoner.
"Come, Pardoner, draw nearer, my dear sir.
Let's laugh again and keep the ball in play."
They kissed, and we continued on our way.[62]

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60. EL FINANCIERO INTERNATIONAL, Oct. 7, 1991, at 15.

61. JONATHAN KANDELL, LA CAPITAL 66-75; Ewell E. Murphy, Jr., *The Echeverrían Wall: Two Perspectives on Foreign Investment and Licensing in Mexico*, 17 TEX INT'L L.J. 135, 135 (1982).

62. CHAUCER, THE CANTERBURY TALES 274 (Penguin Classics ed. 1952).

APPENDIX A
MEXICAN BANKS FOR WHICH BUYERS WERE ANNOUNCED IN 1991

Bank	Controlling Buyer	Purchase Price (In U.S. Dollars)	Controlling Buyer's Other Investments	Multiple of Book Value
Multibanco Mercantil de Mexico	Probursa	204 million	Brokerage, leasing, bonding, accounts receivable financing, warehouse	2.66
Banpais	Mexival	181 million**	Brokerage, insurance, leasing	3.02
Cremi	Multivalo res	249 million	Brokerage, foreign exchange house	3.40
Confia	Abaco	297 million	Brokerage, leasing, insurance, accounts receivable financing	3.73
Oriente	Puebla area merchants	75 million	Pharmaceuticals, trade, cattle ranching, leasing insurance, accounts receivable financing	4.00
Bancrecer	Alcantara Rojas Group	125 million**	Shoes, transportation, construction, farming insurance, exchange house	2.53
Banamex	Accival	3.2 billion	Brokerage	2.62
Bancomer	Valores Monterrey	2.54 billion	Beer Brewer	2.99
BCH	The Cabal Group	285 million**	Argiculture	2.67

* Compiled by the author from the authorities cited above.
** 100% of stock. In other cases, the percentage varies but always constitutes at least a controlling interest.