THE MEXICAN PESO BAILOUT

JOINT HEARING

BEFORE THE

SUBCOMMITTEES ON
INTERNATIONAL ECONOMIC POLICY AND TRADE

AND

THE WESTERN HEMISPHERE

OF THE

COMMITTEE ON
INTERNATIONAL RELATIONS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

FEBRUARY 22, 1995

Printed for the use of the Committee on International Relations

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ISSUES ON THE MEXICAN PESO BAILOUT

WEDNESDAY, FEBRUARY 22, 1995

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON THE WESTERN HEMISPHERE, AND SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE, COMMITTEE ON INTERNATIONAL RELATIONS,

Washington, DC.

The subcommittees met jointly, pursuant to call, at 1:07 p.m., in room 2172, Rayburn House Office Building, Hon. Dan Burton and Hon. Toby Roth (chairmen of the subcommittees) presiding.

Mr. BURTON. We will call this hearing together. This is a joint hearing between the Western Hemisphere Subcommittee and the International Economic Policy and Trade Subcommittee chaired by my good colleague and friend, Mr. Toby Roth.

We will start off today with Representative Kaptur and Mr. Buchanan. Before that we will have our opening remarks. We will then have questions for those two, and then we will have as the next panel, Jeffrey R. Shafer, Assistant Secretary for International Affairs for the Department of Treasury, Fred Bergsten, Director of the Institute for International Economics, and John Sweeney, the policy analyst for the Trade and Inter-American Affairs, at the Heritage Foundation and Christopher Whalen, chief financial officer of Legal Research International, Inc. at the same time. That way we can get to them with our questions at the same time.

Marcy, after you finish your testimony and answer questions, if you would like to join us up here on the panel because I know of your interest in this, we would love to have you, but we will leave that up to you.

On January 31, 1995, President Bill Clinton announced that he was abandoning his proposal to provide Mexico $40 billion in loan guarantees to stabilize the peso.

Faced with unwavering public and congressional opposition to this plan, the President announced his intention to bypass Congress and instead, loan $20 billion directly to Mexico.

The money to provide these new loans would come from the Treasury Department's 60-year-old exchange stabilization fund which was established under the Gold Reserve Act of 1934 and was intended to protect and defend the U.S. dollar against international currency fluctuations.

Many people question whether stabilizing the peso with this money will not eventually destabilize the dollar, or at least cause some severe problems.

While the President's new loan package was welcomed by most in the international community, it, like the previous loan guarantee package, seems to have little support here in the United States of America.

In the case of the loan guarantee package, the American public and Congress were provided an opportunity to review the specifics of his proposal. Unfortunately, no similar opportunity was provided to review the loans agreed to just yesterday between the United States and Mexico.

And I might add at this point that I was one of the five people who worked on the original legislation, and we had provisions in there that dealt with not allowing Mexico to give assistance directly or indirectly to Cuba. That was not in the package yesterday.

We also dealt with the drug problem and illegal immigration problems, and those were not illuminated or addressed in the agreement yesterday.

Regrettably, the President's loan package now appears to be a done deal. Nevertheless, myself, and the chairman of the subcommittee on international economic policy, Mr. Roth, believe that our subcommittees still have an obligation to the American people to carefully review every detail of this package.

We also want to provide concerned Americans and Members of Congress with an opportunity to express their concerns. The sad fact is that Americans have many unanswered questions about the loan package.

What did the Clinton administration know about the impending Mexican economic crisis? Why did President Clinton praise Mexico at the Summit of the Americas as a case study of successful economic development 10 days before its economy collapsed?

How will the United States replenish our exchange stabilization fund after our loans are granted? What happens if the price of oil, which is being used to guarantee our loans, goes down?

These are just a few of the many legitimate questions which my office is receiving every single day. It is my hope that the administration can provide the answers to some of these questions today.

I yield to Representative Roth, the chairman of the Subcommittee on International Economic Policy and Trade, for his opening remarks.

Mr. LANTOS. Mr. Chairman?

Mr. BURTON. Yes, sir.

Mr. LANTOS. Will you give the courtesy to the minority to make an opening statement?

Mr. BURTON. I will, I will.

Mr. LANTOS. I want to thank the Chair. Mr. Chairman, I was——

Mr. BURTON. Well, we are not finished yet.

Mr. LANTOS. I am very sorry.

Mr. BURTON. Let me finish my comment. Today we will hear testimony, as I said, from Marcy Kaptur, the Congresswoman from the Ninth District of Ohio, Jeffrey Shafer, the Assistant Secretary for International Affairs with the Department of the Treasury, Patrick Buchanan, syndicated columnist, Mr. John Sweeney, a political analyst with the Heritage Foundation, Mr. Christopher Whalen, the chief financial officer with Legal Research International, and Dr. Fred Bergsten, the director of the Institute for International Economics.

And I want to thank all of you for being here. I hope that you will as much as possible confine your remarks to a 5-minute opening statement, because we do have a lot of questions we would like to ask.

And with that, I will yield to my distinguished colleague for his opening comments, and then I will yield to Mr. Roth.

Mr. LANTOS. I want to thank you, Mr. Chairman, for giving me an opportunity to make an opening comment, and with all due respect, some aspects of your opening statement I will take the liberty of correcting for the record.

I think it is important to realize, and I believe I am quoting you, Mr. Chairman, that you are referring to this package as the President's package which has faced unwavering congressional opposition.

Nothing could be further from the truth. The distinguished leader of the U.S. Senate on the Republican side, Mr. Dole, and the distinguished Speaker of the House, Mr. Gingrich, when this proposal was initially floated, expressed strong support for bailing out Mexico.

I think it does not serve historical truth, Mr. Chairman, one iota, to cast this as a partisan issue, so let me review in the brief moment I have what, in fact, is the history of this bailout.

The history of this bailout goes back to NAFTA, during the course of which, the administration and the majority of Republicans in both Houses, mistakenly supported NAFTA, which was predicated on phoney euphoria concerning Mexico's economic conditions.

With respect to this particular bailout, in its initial congressional form, and now in its administration form, it was opposed by many Democrats, including myself, and I think it is very important to set the record straight, and not try in an inaccurate and historically false manner, to draw this issue as a Republican/Democratic issue.

It is not. There were Democrats who supported NAFTA, but the majority of Republicans supported NAFTA. There are Democrats who are supporting this bailout, both in its congressional and administration version, but there are other Democrats like our distinguished visitor, my good friend, Congresswoman Kaptur and myself, who are opposed to this.

So I think it is important as we begin this very important hearing to stick to the historical record. This is not a Democratic proposal opposed by, as you put it, our unwavering congressional phalanx. That is not true.

The majority of people on your side of the aisle voted for NAFTA. The Speaker of this House, Mr. Gingrich, supported the proposal. Bob Dole supported the proposal, and there were plenty of us on this side, and I am glad to include my friend, Pat Buchanan on this side, who opposed it.

So I think it is a bipartisan issue, and it is important the hearing begin on that note. I want to thank the Chair.

Mr. BURTON. I thank the gentleman for his comments. Before I yield to Mr. Roth, let me just say briefly that it is obvious there is bipartisan opposition to the Mexican bailout agreement; and there was bipartisan opposition to the NAFTA agreement.

My statement did not say anything about Democrats and Republicans in the Congress. What we did say was that the President unilaterally made this decision because he did not get the votes in Congress, and could not get the votes in Congress.

The problem is, and you know it and I know it, and everybody in the Congress knows it, the President and some of our leadership was twisting arms and doing everything they could to get the votes for the Mexican bailout proposal. Even though there were compromises made, and I alluded to some of those in my opening remarks, they could not get the votes.

And so when they couldn't, they gave up and unilaterally they took the action that they did. So I am not blaming Democrats and Republicans in the Congress, but I am saying the responsibility for this program now rests with the President because he did it unilaterally without any action of Congress.

I now yield to my colleague, Mr. Roth.

Mr. ROTH. Thank you. As chairman of the Economic Policy and Trade Subcommittee, I am delighted that we are having this hearing today.

With yesterday's agreement, the champagne corks are popping all over Wall Street, but most Americans think that the United States has been taken for a $20 billion bungie jump with Mexico. [Laughter.]

Mr. ROTH. That is what concerns me, and that is what worries most Americans. I doubt if any Member of Congress has had any citizen come up to them in their town hall meeting, saying boy, am I glad we bailed out Mexico.

This deal is not popular with Mexico either. This is not helping the people of Mexico. Take a look at what's happening in this morning's newspaper. This deal that we just signed, it is bailing out the Mexican banks, and look what the Mexican banks are charging their people.

Mexico lifts key rates to 50 percent. We used to have usury laws in our country. Fifty percent? The loan sharks are jealous of this deal. We cannot ignore the rising chorus of criticism in Mexico that their government has compromised their sovereignty.

The people of Mexico and the American taxpayers are going to be paying huge amounts of money for this bailout, and is it going to turn Mexico against us? That is what concerns me.

The people in Mexico, how are they going to respond? What are they going to say? Are they going to hold their government responsible, or are they going to hold our Government responsible?

And what infuriates me is that they did not come up before Congress. Congress did not put its fingerprints on this bailout, the President of the United States did it, but not Congress.

It is precisely because he could not get it through Congress, that it did not come before Congress.

Now, the financial experts keep saying this is only a liquidity problem, that Mexico has assets that cover the debts, but not enough cash in hand.

Do you think for 1 minute that if things really get bad in Mexico, that we could go down and get our billions back? No way. This money is gone, and it is gone for good.

What I think the American people, what they said on November 8 and what they are still saying today is that they want some truth out of our Government, and they want the politicians to square with them.

Look, this is the agreement. We just got it. I got it in the last 2 minutes. This is the agreement. Let me just quote you how it starts out.

"Whereas Mexico has achieved a remarkable economic transformation over the last several years on the basis of an effective stabilization program and far-reaching structural reforms"—nothing could be further from the truth.

That is precisely why they are in this pickle, and this is how this agreement starts out. No wonder the American people are upset. No wonder the American people have lost their trust and confidence.

No, we want to have this hearing because we want the American people to hear both sides, all sides, because we owe that to our people, and we owe it to the people of Mexico. This is a bad deal for our people and for their people.

Thank you, Mr. Chairman.

Mr. BURTON. Thank you, Mr. Chairman. We want to keep our opening remarks short, if we could, so let me yield to the gentleman from California.

Mr. ROHRABACHER. Well, this will only be one minute. We are watching a betrayal of the American people, a rip-off of billions of dollars that were set aside for the security of our currency. President Clinton is putting our peoples' financial security at risk in order to enrich a corrupt Mexican elite, and Wall Street speculators.

The President has bypassed the Congress when it was clear that there was no support in the Congress for this action, thus the President is not only betraying the interests of our people, but he is betraying democracy by bypassing Congress as well.

That is all I have to say. I am mad as hell. There are a lot of people in Congress who are mad as hell about this. We are not going to see our people ripped off. We are trying to be diligent up here. We are trying to cut down the budget deficit because that is the way we ensure a better future for our children, and then we give away billions of dollars to Wall Street speculators and foreigners? No way.

Mr. BURTON. I thank the gentleman for his comments. Let me just say to my colleagues that some of the panelists are under severe time constraints, so if we can keep our comments short.

The gentleman from Ohio, do you have comment?

Mr. CHABOT. Yes, but I will be even briefer. The Mexican bailout stinks, it is a bad deal for Americans, and it is a bad deal for Mexicans, and in my opinion, it rewards bad behavior. We should not reward bad behavior.

Mr. BURTON. I thank the gentleman. The gentlelady from Florida?

Ms. ROS-LEHTINEN. Thank you so much, Mr. Chairman. Many of us in Congress, not the party leaders but us, the rabble, the rank and file, wanted to at the very least condition the aid to Mexico on true market reforms, on real political openness which has been one party control for so many decades, and many other conditions that we wanted to at least place on this bailout package.

Some of us worked on this package to get Mexico to stop financing the Cuban regime through investments in Cuba's infrastructure at the expense of the Cuban people, and to use a special fund which was established to help stabilize the United States dollar, not the Mexican peso, is unforgivable, so shame on the President and shame on both of our parties' leaders for letting this happen. We wanted to vote on this.

Mr. BURTON. Any others that have a compelling desire to have an opening remark?

If not, we wish you would submit them for the record, and we will now recognize our lovely friend from Ohio, Representative Kaptur.

STATEMENT OF HON. MARCY KAPTUR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Ms. KAPTUR. I thank you, Chairman Burton and Chairman Roth, for the opportunity to testify at this joint hearing. I feel privileged to be here, and I would like to say to my friends and colleagues, Mr. Lantos, Mr. Torricelli, and Mr. Menendez, and Mr. Rohrabacher, I will be quoting many of you I guess in the testimony I give, so thank you so very much for allowing us to spend some time with you today.

Let me just summarize for the record, maybe ask unanimous consent that my full statement be placed in the record.

Mr. LANTOS. Mr. Chairman, we can not hear the witness. If she would be kind enough——

Mr. BURTON. Oh, fine. Would you pull the microphone a little closer?

Ms. KAPTUR. All right. I hope this is on.

Mr. BURTON. And without objection, we will. It is. We will put your remarks in the record.

Ms. KAPTUR. Thank you. What I would like to do is just summarize three recommendations first which are listed on pages 8 and 9 of the testimony, and then walk through the earlier parts with you, pointing out some of the key features so that we use the time well.

If I were to offer the committee recommendations, it would be that No. 1, the subcommittee and full committees of jurisdiction pass an authorizing bill strictly defining the use of the exchange stabilization fund, and narrowly prescribing the authority of the executive branch over the fund so that it will no longer be able to use the fund as a form of backdoor foreign aid, and perhaps that vehicle should be the main vehicle on the floor when we consider this issue in the days ahead.

Second, my recommendation would be that when the use of the fund goes beyond the strict principles of foreign exchange, an appropriation by Congress should be required. It is amazing that we have to appropriate dollars for emergency disaster relief in the United States, but we do not have to appropriate dollars when this sort of guarantee program is put in place, and there is not an offset in the budget.

And finally, we all know that Mexico's problem is not merely a crisis of currency. It is in the middle of a full-blown social, economic and political crisis, and their future defies a simple banking solution.

Over the weekend, Robert Novak observed in a column in the Washington Post, and I quote, "If all sides in Washington view this as essentially a financial crisis, there is nobody in Mexico City who views it that way. After years of denial by Mexico's rulers and their U.S. counterparts, this country's political system is sick unto death."

The well-informed patriotic Mexicans Mr. Novak met while there, feel the United States Government has done them no favors by turning its back on continued corruption, the tightened link between drug cartels and the government, and the absence of real political dialogue.

And so my third recommendation would be, and I hope the executive branch is listening as well, that in order to reach a long-term stabilization plan for Mexico, I recommend that the committee authorize the United States to initiate and participate in a hemisphere commission, and appoint a special Ambassador to this purpose.

The most basic function of that commission, in addition to the long-term stabilization of Mexico would be the creation of a common rule of law, sustainable economic growth policies, and the fostering of multiparty functioning democracies among our trading partners in this hemisphere as conditions of market entry.

And as Mr. Rohrabacher has often said, after all, free trade can only exist among free people.

Now, if I might just, those would be in the form of recommendations, and if I might just go back and explain some of the materials we have supplied for the record.

The use of the exchange stabilization fund by the U.S. Treasury is absolutely unprecedented, in both magnitude and duration, and in my judgment, is illegal.

When I questioned Secretary Rubin a week ago at one of our appropriations hearings, he reluctantly confirmed to me that there is no precedent for this administration's action. The United States has never extended loans to a foreign country on a medium- or long-term basis on such a huge scale, and we have attached a table 1 to the formal submission that was done by CRS which essentially documents back to 1982 how the stabilization fund was used, by which countries, and in which amounts.

The recent action by the executive branch is 20 times as large as any previous use of the fund, and has been structured for different purposes which I will outline in just a second.

But I think it is also important to state for the record, if you look at the report by CRS in the last column where they talk about certain bills being repaid to the Treasury, I think there will be those economic experts that will disagree regarding Mexico's repayment.

They will say it was not a repayment, it was a refinancing. In other words, the principal is not paid back, the debt just gets bigger, and that is part of the overall problem.

I do not believe it has ever been the will of Congress to provide the executive branch with unlimited authority of this sort as a function of the fund. This situation goes well beyond a short-term liquidity crisis, or a need to defend the dollar, our dollar, in foreign markets.

This is an aggressive, foreign aid authorization to Mexico to prop up a failing economy that has its roots in deep-seated political corruption, the lack of a rule of law, and a mismanaged economic program built on debt.

Now, I would like to call your attention, and we have provided the full record as a part of the testimony, hearings that were held before your very committee on October 10, 1989, and it is extremely applicable to what we are discussing today, and the testimony came from officials at the Treasury Department, and the State Department who were being questioned by Congressman Gilman in a proposed economic aid package for Poland.

And, Mr. Chairman, if you could just bear with me for a second here, some of these statements are incredible. Mr. Gilman asked, "there has been a great deal of discussion about the possible utilization of a loan from the Treasury's exchange stabilization fund to help stabilize the zloty as Poland tries to attack its inflationary problem."

And he asked, "Does the Treasury Department have the authority to loan to Poland under this program?" Mr. Barreda, the deputy assistant secretary for trade and investment policy at Treasury replies, "We think the appropriate way to do that is through an appropriation by Congress. We think the exchange stabilization funds' purpose and use quite different. We have used the fund for intervention exchange markets and for very short-term loans, usually bridged to guaranteed repayment in a hard currency. The proposal to provide exchange stabilization funds to Poland on a longer term basis is a totally different use of the funds. That is much closer to foreign aid, Mr. Congressman. We think, therefore, it should be appropriated."

Representative Hamilton then asked, "Let me ask some questions about the fund. You said it was used only for short-term loans. Is that correct?"

Mr. Barreda from Treasury replies, "That is right, sir."

And Representative Hamilton asks, "By which you meant what?"

And Mr. Barreda says, "We have two uses of the exchange stabilization fund now, Mr. Chairman. One, we use it for activity in the foreign exchange markets where we are exchanging dollars for yen or deutschmarks or vice versa. We also do it for some short-term bridging. In that case, we make available the dollars for exchange for an assured repayment in hard currency, and we lock in the exchange rate."

And Representative Hamilton says, "And short-term, in that context, means what?"

Mr. Barreda says, "It is less than 6 months, according to the statute, unless approved by the President to be longer."

And Representative Hamilton says, "You have made longer loans than 6 months, have you not?"

And Mr. Barreda says, "I am not aware of any, sir. I have been discussing with your staff a Mexico loan, and I would like to look into that and get back to you."

And Representative Hamilton, referring to the CRS chart, says, "Six hundred million dollars for 12 months to Mexico in 1982."

And Mr. Barreda says, "That is the one I want to—" and Representative Hamilton says, "Are you not aware of that?"

Mr. Barreda says, "I was not until now and I am going to look into it and get back to you"

And Representative Hamilton says, "Now, of course, you could use this money as a bridging loan to Poland, could you not? That is, you could extend a loan to Poland under the exchange stabilization fund and then when the IMF loan kicks in, it could take over the loan, I mean, that is a possibility, isn't it?"

And Mr. Barreda says, "If there's an assurance of an IMF agreement and it is short-term, we would certainly consider that, as I said in my testimony. What we want to be sure of is repayment in a hard currency being short-term."

And Representative Solarz says, "You are saying, I gather, that we cannot—that if we were to use the exchange stabilization fund without an assured mechanism of repayment that that would be an illegal use of the fund, given the criteria that have been built into it, or would it be a breach of the fiduciary responsibility of the Secretary of the Treasury."

Mr. Kamman from the Department of State says, "We think it would be an improper use of the fund, Mr. Congressman."

Representative Solarz, and I will end here, says, "Would it be an illegal use of the fund?"

And Mr. Barreda says, "It is an improper use of the fund. If there is going to be a chance of loss, we think it should be an appropriation."

Mr. BURTON. Representative Kaptur, for the benefit of the committee, I wish you would give us copies of that, in addition to submitting it for the record, because, and I am sure Toby as well, would like to have our staffs look into that, and check that out.

Ms. KAPTUR. All right, to our testimony, Mr. Chairman, we have attached the respective pages from that hearing held before the committee, and we have the full report.

Mr. BURTON. We would like to duplicate those in addition to putting them in the record. I would like to have copies of them.

Ms. KAPTUR. All right.

[The prepared statement and attached information of Ms. Kaptur appear in the appendix.]

Mr. BURTON. Mr. Buchanan.

STATEMENT OF PAT BUCHANAN, SYNDICATED COLUMNIST

Mr. BUCHANAN. Thank you very much, Mr. Chairman. It is good to see you up there. Many, many—several guests I should say on Crossfire, most of whom have been sitting on my side, but a couple who were on the other side, it is good to see you, gentlemen. Thanks for the invitation.

You know, when I read about this agreement, a phrase from Orwell's 1984 came to mind. In the early pages, he described an individual that worked in the ministry of truth as a man of "almost paralyzing stupidity."

Mr. Chairman, I cannot believe that the Government of the United States is proceeding with this decision which is going to return not to the benefit of this country, but to the damage of her national interests.

First, we are violating Mexican sovereignty. We are interfering in the internal affairs of a neighboring country. If we remember the reaction of Americans to the Stamp Act some 200 years ago, you can imagine the reaction of Mexican patriots to what we are doing to them.

I will talk about that in a minute. First, who benefits? Cui bono? The Wall Street banks who made the loans, the bad loans that have gone sour get 100 cents on the dollar. They benefit.

The Mexican regime which devalued the peso, swindled American investors, and depleted the income of Mexican workers to the point where it is now down below, in real terms, what it was in 1980, the Mexican regime benefits.

Now we hear that the Mexican banks and their depositors, especially wealthy Mexicans and Americans will benefit.

Who pays? The U.S. taxpayers, $20 billion. That will be gone. We can kiss these loans goodbye. The Mexican people will pay in another way. We are imposing, or the Mexican regime at our behest is imposing a regime of austerity which will induce a recession and possibly a depression in Mexico.

Who do we think the Mexican people are going to blame for this? Let me suggest that the Zedillo government, within a matter of months, will be urging the Mexican people to blame the United States for their hardship, for their misery, for their problems which are certain to occur.

As a consequence of this, I think we are going to earn decades of enmity and hostility from the Mexican people who are our friends and neighbors. I do not think an enemy could have dreamed up an arrangement that is going to be more damaging to America's interests.

Finally, this is not going to work. You do not help a bankrupt government which is drowning in debt by placing it $53 billion deeper in debt.

Mr. Lincoln said they have a right to criticize who have a heart to help. Now, what should, in my judgment, this Congress do? I do not believe this is necessarily a done deal.

First, I think there really ought to be a congressional investigation. We have been told our country was on the edge of an abyss, and this bailout is vital, but if we are on the edge of an abyss, who exactly brought us here? Who lead us here?

The Secretary of the Treasury, Mr. Rubin, was at Goldman Sachs when they lead the investors into these Third World investments. He was the chairman of the Economic Security Council which was supposed to watch over NAFTA, and watch over the capacity of the Mexican Government to repay its debts, and to live up to NAFTA.

He is also the individual who has put together the great bailout.

Second, I would recommend a congressional resolution which condemns this usurpation of congressional power. The founding fathers and the constitution gave to Congress the power of the purse, not to the President of the United States. This bailout, the $20 billion aspect of it alone, is almost 50 percent more than the entire foreign aid bill, annual bill for 1 year, and it is being done by Executive order.

I do not believe this was authorized by the Congress, and we know that before the bailout was announced, it was against the will of the American people, 80 percent of whom opposed it.

So there is a secondary issue that may even be primary here, and that is—Is this Congress relevant? We are fighting in the House under the leadership of Mr. Gingrich over funding for PBS and NPR and CPB. I believe that funding is about $350 million which means this bailout, if my arithmetic is correct, is 150 times as large as the NPR, CPB, PBS funding, and there is no resistance here, although there is a tremendous battle over public broadcasting.

I have spent 8 years working in the White House under Presidents Nixon, Ford, and Ronald Reagan, and I believe had they done something like this on their own authority, the charges of an imperial presidency would have been made and there would have indeed have been occasional impeachment resolutions put into the House judiciary.

Now, what should be done? I still believe that Wall Street has got to be required to take the hit for its mistakes. They made the loans, they got the benefits, and they ought to take the losses.

Second, Mr. Zedillo should face the music of what he and his predecessor have done, but third, we ought to stand by to help our friends, and our friends are not the Government of Mexico, or Mr. Salinas or Mr. Zedillo. They are the people of Mexico who work as hard as Americans do, and who have now seen their real income reduced to something like one-tenth of what Americans earn, and below what it was in 1980.

Finally, because of what I think is going to happen in the next several months, and what has happened already out in Negales and in California, I do believe the United States ought to consider moving immediately to build a security fence along its border and to move some National Guard troops there if necessary, because I think what you are going to see, as spring and summer comes, is a great invasion of America by people who have been robbed of their earnings and income, and are seeking a chance to earn just a minimum wage in the United States.

Mr. Chairman, NAFTA was a swindle. The giant sucking sound is not only jobs heading south, but $50 billion heading south. In return, we are going to earn the enmity, resentment and even the hatred of our friends, the Mexican people.

Thank you.

Mr. BURTON. Thank you, Mr. Buchanan. We will now have a few questions from the members of the committee. I will ask this of both of you, and Marcy. Representative Kaptur, I know you have been working on this area for a long time.

One of the big arguments that has been made, and I think you both alluded to it, was that if there is a complete economic collapse in Mexico, we are going to have a flood of illegal aliens. We are already getting 1 to 2 million a year, but it will be increased dramatically, and it will have a tremendous adverse impact on the economy of the United States.

In your opinions, how real is this threat, and is this approach that President Clinton has decided to use, the right approach in dealing with that problem?

Marcy?

Ms. KAPTUR. Well, let me say, first of all, I think that already at our borders it has been proven that hungry people run to aid, and we are seeing a greater flow across our borders at different checkpoints. This has already occurred.

The President has dispatched some additional border security down there, and I think we are going to see that continue because I think the situation in Mexico with interest rates being what they are, and with wages what they are, the situation will exacerbate.

One of my big concerns coming from the Midwest, and we are far from southern California, Arizona, New Mexico, but I will tell you, the largest drug transit route to Toledo, OH is from Mexico.

We have literally had kidnappings in our community related to that drug trade, and I serve on the Agriculture Committee, so I know this, we only check 1 of every 600 trucks that is coming over that border legally, legal crossings of the border points that are open.

I am very, very worried that we are not securing our borders properly, and taking a look at what is coming into this country, so I would urge the committee, and I know the Chairman has been a real leader on this, on this drug situation.

I had one person say to me, Marcy, when you need quick money, what do you do? You sell assets. Well, what could they possibly sell in Mexico? They could sell airports and ports, and who's got the money to buy it in the Mexican situation? You do not have to be a mathematical giant to figure out who's got ready cash down there.

So I guess I would just say I agree with Mr. Buchanan in terms of border security, but not just in terms of people. I think we have to look at goods, and we have to check those vehicles coming over the border.

Mr. BURTON. I want to make this question very clear. Do you think that the action taken by the President will, in a positive or a negative way, or in no way, affect the mass of illegal aliens coming across that border?

Ms. KAPTUR. In my own judgment, it is very small compared to the need, but I will let Mr. Buchanan comment.

Mr. BURTON. Well, the illegal aliens have already doubled, I understand then since I was in Mexico at Nogales a year ago. I think much of the damage has already been done in Mexico.

I think you are going to get a dramatic increase in California and Arizona and Texas. Americans, our first obligation is to protect our own borders. As Ronald Reagan said, a country that can not protect its own borders is not really a country anymore.

But I think, Mr. Chairman, that the bailout is not going to help this situation. If we did not do the bailout, what would happen is the Wall Street banks would have to roll over the loans themselves.

The Mexican Government to find funds to even repay that, would have to behave in a way that would be conducive to the Mexican economy. They would have to start selling off their own assets, Pemex and all the rest, to get funds.

That would rebound to their benefit. By getting the United States in there, we are simply enabling the Mexican Government to continue doing what it has been doing, and relieving them of the pressure to do the right thing.

Thank you. I am not going to use all my time because we do have time constraints. Let me yield to Mr. Lantos for his question.

Mr. LANTOS. I want to thank both witnesses, and I would like to ask each of them the same basic question. NAFTA was sold to the American people by a bipartisan coalition basically on the strength of the notion that with some reductions in Mexican tariff barriers, the United States would be able to sell vast quantities of goods to Mexico.

Now the peso has been devalued by over 40 percent. Is it not true that this makes American products in Mexico dramatically more expensive, and whatever minor benefits could have accrued as a result of tariff reductions, are swamped by the devaluation of the Mexican peso, so the underlying assumption of NAFTA that lower tariff barriers, this would be a tremendous boost to American exports has been completely wiped out?

I would like first, Congresswoman Kaptur, to comment.

Ms. KAPTUR. Congressman Lantos, you are absolutely correct, and what is interesting, if you check the trade figures with Mexico for the past 15 years, and you look at each Presidential election in Mexico—1982, 1988, 1994—you will see that there is a false manipulation of the market that occurs around the value of the peso that effects our trade policy.

If you look at last year, right after NAFTA passed, and you see right before the Presidential election in August what is happening with two-way trade with Mexico, it was about one-fifth of what it used to be 5 years ago. We had over a $5 billion surplus. It was cut down to about a $1.8 billion, and then it began moving down, but they pumped it up just a little bit before the August election, and then the minute the election happened, the numbers head south like this.

Until October, we moved into deficit with Mexico. In November, we had accrued over $370 million deficit. In December it was even larger, and then with the peso devaluation, we are now going to be facing continuing and enlarging trade deficits with Mexico.

I might say that the only goods that are going, largely the goods that are going down there are U-turn goods that are going from companies that used to manufacture in Ohio and Indiana and our parts of the country, going down there, they are put in an Escort, let us say, and then that is sent back over the line to be sold in the United States.

So even the trade that is going down, there is a false export market.

Mr. LANTOS. Thank you. Mr. Buchanan?

Mr. BUCHANAN. Congressman, I believe you are exactly right. The NAFTA deal was sold at a peso to the dollar ratio of about 3+ to 1. It is now much closer to 6 to 1.

I believe the devaluation was deliberate, and it was an effort to, in effect, adopt a beggar thy neighbor policy at the expense of the United States, and to the benefit of the Mexican Government.

There is no doubt that the $5 billion surplus that was talked about in 1992 had been cut by two-thirds to over $1 billion I believe in 1993, and 1994. That surplus is going to vanish, if it has not already vanished this month. We are going to face a horrendous trade deficit with Mexico. I think it is undeniable.

I think the anecdotal evidence from the stores and shops and things along the border, the Mexican folks are not coming across, and I think the inducement of American corporations, now that they have suddenly seen the Mexican workers get a 40-percent pay cut in real terms, to move their plants and expand their plants down to Mexico is going to be obvious. We are going to face a large and growing trade deficit with Mexico this year.

Mr. LANTOS. If I may pursue one more item, last year when NAFTA was under discussion, the subcommittee I chaired, the Subcommittee on Human Rights revealed in testimony appalling violations of human rights, civic rights, labor rights, and child rights throughout Mexico.

The "Country Reports on Human Rights Practices" just published by our own Department of State a few weeks ago says the following things about Mexico.

"Major human rights abuses in Mexico included the violence and killings in Chiapas, as well as extrajudicial killings by the police, torture, and illegal arrests. Other abuses included glaring prison deficiencies, discrimination and violence against women, and extensive illegal child labor."

Now, this is not the kind of a government that we should be bailing out to a tune which is literally astronomical. I think we are facing an horrendous foreign policy mistake, supported by the Republican leader in the Senate, supported by the Republican Speaker of this House, and unfortunately, supported by the administration.

Thank you, Mr. Chairman.

Mr. BUCHANAN. Mr. Chairman, if I could comment on that very briefly, I agree with you, and I said at the time of the NAFTA debate that this Government was not a worthy partner for the United States of America. Its record did not indicate it was a worthy partner, and we are now not only facing a $53 billion bailout, I think the situation is going to be a good deal worse than that.

I will tell you, when my old friend Henry Kissinger testified or wrote just before NAFTA, he said "I know of no more competent Government anywhere than the Mexican Government," I think it was part of an establishment of both parties which badly mislead the Congress, and badly mislead the American people.

Ms. KAPTUR. Mr. Chairman, if I might just say 15 seconds here, for the record, we have attached a memo paid for by Chase Manhattan Bank released January 13 of this year that indicates it is not just the Government of Mexico that has trouble understanding the meaning of human rights, but some of their creditors that include major United States institutions like the Chase Manhattan Bank.

And if you read the memo carefully, you will see statements in there such as Chase Manhattan Bank basically says that the Zedillo administration will need to consider carefully whether or not to allow opposition victories, even if fairly won, at the ballot box, and they also encourage suppression of popular uprisings in Mexico where people are basically demonstrating so they can eat something, and hold on to the little plot of land that they have.

We have submitted that for the record.

Mr. BURTON. Thank you, Ms. Kaptur. I want to apologize to my colleague, cochairman of this meeting, Mr. Roth. I should have recognized him earlier. Mr. Roth.

Mr. ROTH. I just wanted to say that we have heard excellent testimony here this morning from these two witnesses. Congresswoman Kaptur, you have done an excellent job. I must say I am very impressed with your detailed presentation here this morning.

Ms. KAPTUR Thank you.

Mr. BURTON. And Mr. Buchanan, that was a powerful statement.

Mr. BUCHANAN. Well, thank you.

Mr. BURTON. But before I ask a question, I want to say something here.

Mr. BUCHANAN. Sure.

Mr. ROTH. That concerns me. Pat Buchanan, a man I admire very much, you have this love-in with Mr. Lantos. I would not see a Buchanan/Lantos——

[Laughter.]

Mr. BUCHANAN. I will get you some tapes from Crossfire which show some differences of opinion.

Mr. ROTH. Mr. Buchanan, let me ask you this question, because you made a powerful statement here. If I interpret you correctly, you said that, you made the point that we are causing a recession in Mexico, and just so that we can bail out Wall Street and the Mexican ruling class.

I note that they have 37 billionaires in Mexico, the highest per capita of billionaires anywhere in the world are in Mexico, but they have all their money up here.

Mr. BUCHANAN. Uh-huh.

Mr. ROTH. Now, is that the essence of your statement basically?

Mr. BUCHANAN. That is certainly a part of it, Congressman. Historically, the IMF comes in and imposes conditionality upon governments in exchange for the funds it gives, and in many cases, they impose tax increases and devaluations, and in many countries, the IMF has become a despised and hated institution because it enables the host country to blame the IMF, and those who are outside for all the pain and suffering and hardship through which the people have to go.

In this arrangement, the United States is playing the role of the IMF, and all that resentment and anger and rage is going to be directed, and partly by the Government of Mexico itself, right at the United States of America.

The Mexican regime will say do not blame us, they made us do it, and this is why it is a disaster for America.

Now, let me add one point. There is no doubt, however, that given the blunders and failings of the Mexican regime, the devaluation, the loss of income and of wealth by the Mexican people, they are going to go through hard times anyhow, but it is vitally important that the United States not be blamed for this, that we stand aside and let the full responsibility fall upon the Mexican regime, the Salinas/Zedillo regime which is responsible.

And then if the Mexican people need help because they are our friends, and they are good people who have gone through a hard time because of their Government, we ought to be there to help them.

We ought not to be playing the miserly banker which tells them what they ought to do, and puts them through this kind of hardship.

Mr. ROTH. I want to ask two quick questions. The other one deals with Congress. We respect your opinions here, but did you say that Congress, that this is an executive order, but if Congress lets this Executive order stand, Congress will be derelict in its duty?

Mr. BUCHANAN. Mr. Congressman, I do not mean—if I were you, I would take the issue to court, but I would certainly pass a resolution condemning this, saying that the Congress does not support what is being done, and get the whole Congress on record.

If you read the Constitution, the first branch of Government is sitting right up here. It is not down the street where Congressman Rohrabacher and I used to work. Congress is the first branch of Government. You have the power of the purse, and you are arguing over, and I think you ought to, PBS, CPB, and NPR, as I mentioned, $350 million. This is a $53 billion bailout over which you have no say whatsoever.

I think you really ought to re-assert your authority, sir.

Mr. ROTH. One of the things that we were told here is that this thing in Mexico was dragged out and got worse because Salinas had to keep a strong economy so he could be appointed as head of the World Trade Organization.

Mr. BUCHANAN. Right.

Mr. ROTH. Now Mr. Clinton is very much in Salinas' corner to have him have that position. How do you feel about that?

Mr. BUCHANAN. I do not think that is the candidacy that is going to make it. I think Mr. Salinas is not going to make it at all, but I agree with you in terms of what he did.

I understand, and I may be mistaken, but I believe I heard he is now a board member of Dow Jones, which owns and operates the Wall Street Journal, but I do not think anyone is going to advance Mr. Salinas' candidacy for the World Trade Organization.

Mr. ROTH. Just one or two more questions.

Ms. KAPTUR. Mr. Chairman, if I might just inject there. A seat on the Dow Jones board pays a minimum of $1 million, and I might also mention that the Prime Minister, former Prime Minister of Canada, Mr. Mulroney, shortly after NAFTA was signed, was appointed to the board of Archer, Daniel, Midland and Co., where a board seat, minimal payment for that is over $100,000 a year.

Mr. ROTH. Let me just ask one more question because I think this is a thing that we really have to be concerned about.

The Russians have now come and said to us hey, you bailed out Mexico, we want some help from you other countries. I see in the New York Times this morning, or the Wall Street Journal, I am sorry, the Wall Street Journal, the very paper you mentioned, said that Italy is in a chaos, that the lira is going down like a rock.

It talks about what is taking place in that country, what the people are going through. Pat Buchanan, you are President, 1997, the Italians come to us and say hey, you have got to bail us out. What is your response?

Mr. BUCHANAN. Arreviderci. [Laughter.]

Mr. ROTH. Thank you very much.

Mr. BURTON. My good friend, Mr. Torricelli, the ranking Democrat on the Western Hemisphere Subcommittee.

Mr. TORRICELLI. Thank you very much after that unfortunate series of comments. [Laughter.]

Mr. TORRICELLI. I will remind my colleagues that the Italians have a higher savings rate than the United States, and a faster growing economy.

I would like to compliment you both on your statements. Marcy, as usual, it was a very thoughtful statement, and Pat as well, you have made a real contribution to the committee.

Mr. BUCHANAN. Thank you.

Mr. TORRICELLI. Political theorists have always argued that there is a point at which left meets right on the political spectrum. We may have found it on this occasion.

I remember 2 days before the NAFTA vote when I announced my own decision to vote against NAFTA, the next day in the Washington Post, there was an editorial that in a bizarre twist of the NAFTA vote, a member raised foreign policy concerns for being against NAFTA.

It does not look so bizarre anymore. A nation ties itself to the economic future of another people at great peril. It is to be done extremely carefully. Combining the economic futures of the United States and Mexico, absent similar political systems, economic decisions, was always a questionable proposition. What no one would have predicted is that it would have been clear quite so fast.

Pat, I strongly agree with several of your comments in that in the natural course of the political life of Mexico, when the current situation worsens, and there is pain to be shared, there is only one appropriate people to be blamed for their circumstances, and the Mexican political leadership is going to blame the United States for whatever prescriptions there must be to change their economic circumstances.

It is an unfortunate and a cruel irony that the world's oldest revolutionary government, the United States of America, becomes the defender of the status quo. If this means anything, these loan guarantees, it is ultimately the United States defending the economic elite, and the one-party Government of Mexico. We have become the ultimate defenders of the status quo, postponing the inevitable political change away from one-party government, and the complete modernization of their economy away from a oligarchy.

We are the defenders of that old order, and that is only the beginning of my fears. I also fear that what is happening in Chiapas, the loss of life, the potential spread of that rebellion, the Mexican Government is going to argue that the human rights abuses and the internal strife of its people is under the commands of the U.S. Government, and necessary because of conditions that were made for these loan guarantees.

We are potentially at a point where generations of Mexicans are going to look to this date, and these circumstances, and hold us inappropriately responsible for what has happened in their own country. We have interfered with the natural political process of modernization, and the change of leadership, and we do so at considerable, considerable peril.

Finally, I want to say as well, that in the natural process of our own Government, this Congress was guaranteeing the security of the U.S. Government funds by asking for legitimate conditions.

I do not believe that the Pemex assurances on oil revenues are real guarantees. There is no one who can argue that if there is a Mexican Government default, and the Mexican people are headed for political chaos and economic crisis, that the United States is going to actually divert and hold the entire export earnings of Mexico.

Everyone here knows, the administration will return to Capitol Hill and argue we have the legal right to hold the revenues, but it would be against our political interests and the economic interests of Mexico, therefore we are not going to do so.

No one can believe that that would not happen. Therefore we are extending these billions of dollars worth of guarantees, and in fact, holding no real guarantees.

Second, I want to argue that however unfortunate this crisis may be for the Mexican people, the administration has argued that it was necessary to prevent financial disorder from spreading to the United States, but in fact, this program may guarantee that that financial chaos spreads to the United States.

After the guarantees were signed, a run began on the dollar because now we have tied the fate of the dollar to that of the peso, and the markets know that there is no real guarantee for these loan guarantees. They can see through the Pemex guarantees.

The United States in this fund has $25 billion to defend the dollar, and $20 billion of it was just used to defend the peso. By some grade school mathematics, that would lead one to conclude that there is precious little left for the dollar.

Finally, I want to argue that this Congress had a right to ask the Mexican Government that if they were going to receive U.S. Government guarantees, that they cease subsidized investments in Cuba. The end of a totalitarian government in Cuba is a legitimate foreign policy objective of the United States.

We have placed conditions of political pluralism and foreign policy on Russia to receive United States assistance, but we are told that it would be inappropriate to do so with Mexico.

I would like somebody to explain to me the difference. If the United States wants to see a foreign aid program go to Cuba, it is much more efficient to do so directly. We do not have to run the money through Mexico City, and in fact, that is exactly, exactly what has happened.

And Ms. Kaptur, if you want to add to your repertoire of the former President of Mexico's activities, I would remind you that he personally negotiated the Mexican investments in Cuba of the Mexican phone company, and he was also an investor and sits on the board which is now, of course, which indirectly get guarantees.

You may not have seen a question in there. I can come up with many, but in my enthusiasm to respond to your comments, I think I have consumed my time.

Ms. KAPTUR. If the gentleman would give me 5 seconds to respond to you, Mr. Chairman, I just wanted to point out after those eloquent remarks, on page 7 of our testimony, as well as in the attachments, we have tried to tell you who the fellow travelers are with Mexico in the deal that was just struck, and we list mutual funds such as Scutter, Merrill Lynch, Fidelity, Solomon Brothers.

We certainly mentioned Goldman Sachs, Chemical Bank, Chase Manhattan, Morgan—these are all from news articles that have been published in the United States.

And if I could just say, Mr. Chairman, I have this dream, maybe not as big as Martin Luther King had, but I would love to take the CEO's of all these companies, dress them in fatigues, put them on an airplane, take them down to Chiapas, and we are going to spend 2 weeks, and we are going to live like the people there live, and they are going to eat tortillas and they are going to understand, and especially the head of Chase Manhattan who did that memo, and have them understand what those people are facing down there.

Wouldn't that be a diplomatic mission?

Mr. BURTON. I thank the gentlelady for her comments. Pat, do you have a brief comment?

Mr. BUCHANAN. Yes, I would. There is no doubt through NAFTA, it was something of a shotgun marriage to an unpopular, corrupt, deceitful regime that is undemocratic, and now we are aligned with that regime in Mexico, I think against the interests of the Mexican people.

What is going to happen, if I can make a prediction, is that you are going to see anti-American demonstrations as conditions get worse. There may even be anti-American riots down there as a consequence of which, Congressman Torricelli is correct, we are not going to grab the revenues from Pemex, the Mexican Government is going to come to us, and we are going to take a look at this situation down there, and we are going to agree to let the Mexican Government relieve the austerity rules and all the rest of it that has been imposed because they are doing so much damage to America's national interest.

I also agree with Congressman Torricelli, Cuba is a valid foreign policy interest of this country, and that is a legitimate demand to make upon the Mexican Government.

Mr. BURTON. I thank the gentleman for his remarks, and I would just like to say to Congressman Torricelli, he is right on the money once again. We had in the legislation that was going to be proposed, three things that were not in the agreement the President signed yesterday.

First, there were not going to be any funds directly or indirectly going from Mexico to Cuba.

Second, there was going to be money placed in an escrow account, or negotiable securities from the Mexican Government, placed in an escrow account to guarantee $3 billion or $4 billion of the first tranche of the loan, which meant that the U.S. taxpayer probably would not lose any money if that deal had gone through with that in there.

Third, we were going to do something about the illegal alien problem on the border.

None of those things were in the agreement that was signed yesterday, and I thank the gentleman for pointing those things out.

I would be happy to yield now to my colleague from California, a former colleague of yours at the White House.

Mr. ROHRABACHER. Well, it seems I am always the skunk at the lawn party, so I might as well continue being the skunk at the lawn party in terms of NAFTA discussion today.

I do not believe that it is intellectually defensible to suggest that what we are facing now is a direct result of anything to do with NAFTA whatsoever, and I would like you to tie that together for me, because my feeling is that if NAFTA never would have passed, and Mexico would still be in the same spot that it is today, would we be bailing out Mexico? Would this administration be proposing the same bailout?

The answer is yes, and if this is a response to the Mexican elite in a too close relationship with decisionmakers in Washington who think of themselves as part of the world's elite, rather than as part of the American people, whether or not this is the Washington decisionmakers too close to speculators in other countries, there is nothing to do with NAFTA at all.

I supported NAFTA and I continue to support NAFTA because a way that people can improve their lot by trading with the United States is the way to go. You know, telling people, whether it is in Mexico or anywhere else, that if you want to improve yourself, you have got to have an economy that works, and you have got to be able to ship goods to the United States and sell back and forth to us, that is something far different than suggesting we should be giving tens of billions of dollars in a loan that will never, in a loan guarantee that will never be repaid, two totally different issues.

One is a betrayal of the American people. The other one is simply trying to promote trade, and perhaps giving them an option on correcting their situation.

I will, through hard work, I will let you answer that one, and then I have got one other question to go through. Would you like to take a shot at that, both of you?

Ms. KAPTUR. Well, in terms of two-way trade, the gentleman is right, the debt pyramid in Mexico preceding NAFTA, but was exacerbated by NAFTA, simply because the Mexican Government and some of our own United States interests encouraged people to purchase consumer goods.

There was a pile-up of more consumer debt, and part of Mexico's difficulty was actually monetizing those purchases where they were getting goods from Asia and every place else.

Mr. ROHRABACHER. We have actually done this before. This is not the first bailout, and we never had NAFTA before.

Ms. KAPTUR. Right.

Mr. ROHRABACHER. The other bailouts happened——

Ms. KAPTUR. But by any geometric measurement——

Mr. ROHRABACHER. This is the largest.

Ms. KAPTUR. It is much larger than any——

Mr. ROHRABACHER. It is about three times larger than the last bailout proposal.

Ms. KAPTUR. Correct, correct, so I think in that sense there is a connection.

Mr. ROHRABACHER. Right. And in terms of the corrupt PRI, we know that the PRI is a corrupt institution, and certainly those of us in California know that, and we know that is probably at the heart of most of Mexico's problems which is what your testimony was all about.

But there is also, at the time that we did pass NAFTA, there were signs that this PRI control was in some way beginning to crumble, and that good people in Mexico were stepping forward, out of their anti–American stance for the first time in my lifetime, and reaching for it to have a better relation with the United States.

The Pan party, the Pan party who had just won its elections in Jalisco, that is a wonderful sign for the future in Mexico. The Pan party is probably going to be the one saving grace for that country, and while I agree with you about the corruption of the PRI, I do not think that we can write off Mexico.

The idea of writing Mexico off and saying we are not going to deal and have any business relationships with Mexico, we are not going to give them a trading relationship with the United States, that is the wrong approach.

Bailing them out is also the wrong approach. Trying to treat people as adults and responsible neighbors, that is the right approach, and putting our own country at risk because of the irresponsibility of our neighbors is also not only the wrong approach, but is a betrayal of our own people which is, I believe, a great sin that is being committed as we speak against our own people.

And Pat?

Mr. BUCHANAN. You know, we could go back and do the NAFTA debate again, but let me say, Congressman, my opposition to NAFTA was for a variety of reasons. One was the surrender of American sovereignty when you had these tri-national commissions brought into the United States and put on American soil, I did not like to see that, and I even more did not like to see what happened in GATT.

Second, I do not think the government with which we became a partner, the Mexican Government, was a worthy partner of the United States in any way, not only economically, but along the lines suggested by Congressman Lantos.

But third, Congressman——

Mr. ROHRABACHER. But that is the government.

Mr. BUCHANAN. One economic point, if I may. American corporations have, by virtue of decisions taken in this Congress, they paid Social Security taxes 7½ percent of payroll, they are under EPA, they are under OSHA, they have to contribute to their local community.

There are all manner of laws, rules and regulations you put upon American companies, that many have argued about them and disagreed about them, but when they are passed into law, you put them on American companies, and then when you tell that company, listen, if you simply take your plan across the border, you can pay the workers there 10 percent of what you pay them in the United States, do not worry about any other rules and regulations, and now bring your products into the United States, I think what you are doing, Congressman, is first you are creating an enterprise zone in Mexico where American companies are going. They are building hundreds of thousands of cars.

Second, when those products come back into the United States, they undercut the American companies and their workers who remain here, but that is the economic——

Mr. ROHRABACHER. You are taking out the risk factor there, Pat, and the bottom line is if we bail out, one of the reasons why this bailout proposal is a sin against our own people and does not make any economic sense is because we have eliminated the risk factor for people who invest in a foreign country.

Mr. BUCHANAN. Right.

Mr. ROHRABACHER. To the degree that if people in our country have capital and want to invest in another country, and are willing to take the chance, that is an appropriate way for other countries to buildup their standard of living.

But eliminating the risk by bailing out speculators who say hey, I can make 20 percent down there, and then there is no risk because our Government will bail them out, that is what throws the economic equation haywire.

So while I agree with you on some things, I certainly do not agree that trying to cut Mexico off from trade——

Mr. BUCHANAN. I would not cut them off. I have got a plan.

Mr. ROHRABACHER. Is not the appropriate way.

Mr. BUCHANAN. I agree with you. You cannot cutoff Mexico. They are—I mean, our destinies are going to be intertwined, but I do think that at a border like you have between the United States with its wage levels, and with all the social legislation imposed upon American companies, and you cannot—I mean, if you took Missouri, Congressman, and said that any company that moved into Missouri did not have to pay the minimum wage, did not have to follow EPA or OSHA, did not have to follow any rules and regulations and could pay its workers 10 percent of what they make in the United States, all the plants in America would move into Missouri.

Mr. ROHRABACHER. Not if they find out that there is a major economic upheaval right around the corner that they will have to risk being part of.

Thank you very much. We agree on most things, so thank you.

Mr. BURTON. All right, Congressman Menendez.

Mr. MENENDEZ. Thank you, Mr. Chairman. I want to also commend the panel. I have three questions that I would like to lay out and then listen to your responses.

One is for those of us who did oppose NAFTA, and who believe that we had an opportunity to enter a new generation of treatises instead of an old generation of treatises, I recently was on a program with the counsel general of Mexico, and based upon questions, he said that in fact, Mexico could not foresee its liquidity crisis, and that in fact, it could not foresee the current state of events that it has, which of course, I strongly doubt.

I would like to hear your views of that. I do not know how you take down the amount of reserve, the Mexican reserve from I think it was $20-some odd billion down to $6 billion, and not foresee what you are doing.

Mr. BUCHANAN. Right.

Mr. MENENDEZ. And the consequences thereof. I know that was part of the NAFTA debate.

Second, with reference—so I would like to hear your view of the foreseeability and also our foreseeability of that—second, I agree with much of what you have said, and I am also concerned, and would like to hear your views about an aspect that does not often get talked about, and that is that we are creating a speculative environment which has a consequence to middle class investors, mom and pop investors who get their investments through mutual funds and pension funds, who have been going to places like Mexico, emerging markets which have high yield, but also have high risk.

And what is our obligation to middle America in the context of creating the speculative environment, participating in the speculative environment that puts a good deal of their investments at risk.

And last, based upon Mr. Torricelli's comments and your response thereof, about Pemex, the United States not looking to Pemex, and not looking to ensure the austerity efforts because of the consequences they may derive in Mexico, do you foresee a request for debt forgiveness at some point of the amount that the United States has offered?

Mr. BUCHANAN. Let me start from the reverse. Look, the Mexican government, depending on which way you look at the debt, some have put it at $160 billion foreign debt. I think they owe $28 billion in Tesobonos this year.

As you indicated their reserves I think were down to $2 or $3 billion. We are putting them $53 billion deeper in debt now. Look, we are never going to see this money again. What is going to happen is the loans are going to come due, and they are going to be rolled over and over and over and one day they are going to be slid over on to the national debt of the United States.

We are never going to see the money again.

On the liquidity crisis, Congressman, I have got to agree with you. In Mexico, when they see the reserves go from $30 billion, almost $30 billion down to about $15 billion I believe around December 20, and then go down to $6 billion, they know what is coming, and I believe that we ought to investigate what the American Government knew.

We have an economic security council, and they are supposed to watch this. If suddenly we woke up and found that there were two divisions of Russian troops in Canada, someone would say where is the National Security Council.

I think we have got to ask exactly what was the economic Security Council doing, if not watching this.

Also you have a gentleman on the panel here, Chris Whalen, and you also have Ross Perot, both of whom said publicly, and Chris Whalen said it on my program several times, the peso is overvalued. This was during the NAFTA debate.

And they said it is overvalued by 25 percent. They told the country the truth, but folks were not listening, so that would be my view.

With regard to regulations, I go back on my conservative credentials there. I am not a great believer in regulation, but I do think that there is no question that many of these Third World investments are far higher risk than many of the investors were told.

As someone said, the newly emerging markets have become the newly submerging markets, but I do not know about regulation in that regard. I would leave that up to you folks.

Ms. KAPTUR. Let me just say, Mr. Menendez, that the whole question of Pemex and its ability to repay, based on the information that we have, at best, they can generate revenues of about $7 billion a year, and it is an open question as to how much that entire operation is really worth, and how many barrels of oil are really in the ground.

They have been producing less and less because of capital difficulties, labor difficulties. In fact, Oil and Gas Magazine anticipates that they will be a net importer by the end of this decade, and those Pemex revenues constitute a minimum of one-third of their Treasury revenues.

They also owe, according to Moody's Manual, those Pemex revenues are pledged to other debts that are owed in the Eurobond market, and some of that is a matter of public record, so I very much doubt the ability of our Government to call first using those Pemex revenues.

Let me also say that I agree with Mr. Buchanan on the need for this Congress to investigate openly who is benefiting from this. We have not been able to get from the administration a list of the creditors.

You asked about individual Americans who have money in uninsured mutual funds. What portion of what was lent down in Mexico actually are those kinds of people? I do not really feel we should bail them out. Those are speculative investments, but we have a right to know.

We have submitted in our testimony some of the firms that we believe did very unwise investment in Mexico, but let me just end with this, because I served on the banking committee for 8 years, and I am really disgusted with the private financial system of this country.

Who loves debt the most? Who benefits from debt the most? Who benefits from creating money the most? It is not you and me, it is the largest financial institutions in this country, and we have a multitrillion dollar debt that is now owed cumulative by the people of the United States.

Wall Street could not be happier. They could not be happier. The Fed works the 20 bond houses up there. You try to buy a savings bond. Go over there. They have taken the floor out from underneath it. They do not want ordinary people to be involved in the financial affairs of this country.

Consumer loans up to the hilt with debt, right? Credit cards—when do your kids ever get an application in the mail to open a savings account. All you get are 300 applications for $3,000 worth of credit, and you are not even graduated from college yet.

Who benefits from that? When I served on the banking committee, you cannot even define what a bank is anymore, and I am really resentful, and now we have moved into the foreign realm, again with the largest multinational lending institutions in this country wanting the taxpayers to bail them out.

There is something fundamentally wrong with the heart and the values of the banking system of this country, and they've got us all on the edge and the abyss that you talked about.

Mr. BURTON. Thank you, Mr. Menendez. Pat, thank you very much.

Mr. BUCHANAN. Thank you.

Mr. BURTON. Thank you for coming.

Mr. BUCHANAN. Thank you, Congressman.

Mr. BURTON. It is good seeing you again. Marcy, if you would like to join the panel up here for further questioning.

Mr. ROHRABACHER. Mr. Chairman, can I add one amendment to what Marcy just said, and just 1 second, and that is every time the Government guarantees a loan, all they are doing is guaranteeing a profit to the people in the financial industry. That is all we are doing, and if we are going to help somebody, we might as well just allocate the money from the Federal treasury, because you guarantee loans, no matter what they are, no matter who they are to, we are just making the guy in-between, we are giving him a guaranteed profit.

Your comments were right on target, thank you.

Ms. KAPTUR. They have too much call on the U.S. Treasury, and they are not operating in the way that I view private sector should operate. I think they have forgotten who they are. They have lost the theology of what it means to be a bank.

Mr. BURTON. We are going to put some of your questions to the U.S. Treasury in just a minute, and thank you both for being here. We really appreciate it.

Our next panel is from the Department of Treasury, Assistant Secretary for International Affairs, Jeffrey Shafer; Dr. Fred Bergsten, director for the Institute for International Economics; Mr. John Sweeney, policy analyst for the Trade and Inter-American Affairs at the Heritage Foundation; and Christopher Whalen, late of Crossfire, chief financial officer for Legal Research International, Inc.

So could we get you all up there together with the Secretary. I hope he does not mind the company. That way we can speed things up here a little bit, and we apologize for the delay.

We would like all four of you up there. Can we bring one more chair in? You can scoot in there together.

[Pause.]

Mr. SHAFER. Forgive me, Mr. Secretary, for the inconvenience. I was just doing this for the economy of time. I know that tradition is that the executive branch testifies alone.

We will let you testify alone, if you like, but in the spirit of time, we thought we would try this.

Mr. SHAFER. Whatever you wish, Mr. Chairman.

Mr. BURTON. Mr. Secretary.

STATEMENT OF JEFFREY R. SHAFER, ASSISTANT SECRETARY, INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. SHAFER. But if I may, I will go first. I will ask if my—I will abbreviate my remarks and ask that my full remarks be inserted in the record.

Mr. BURTON. Without objection.

Mr. SHAFER. Mr. Chairman, members of the subcommittee, I appreciate this opportunity to discuss the United States response to Mexico's financial situation.

It was on January 31 that President Clinton, with support from the four congressional leaders, announced his decision to proceed with a $20 billion U.S. support program for Mexico.

It was yesterday that my boss, Secretary of the Treasury, Robert Rubin, and his Mexican counterpart, Guillermo Ortiz, and other officials, signed four agreements, all carefully negotiated, to implement this program.

In doing so, they set in place a package to avert the threat to the United States jobs, standards of living, immigration concerns, and our security interests that are posed by Mexico's economic difficulties.

I want to take this opportunity to review briefly the events that lead up to our adoption of these agreements. I also want to go over some of the details of the package which I understand that you chairmen have received recently. The ink is finally dry, and we were able to get it to you just before this meeting.

And I would like to explain how it will work to protect American interests in the short-term, and in the long-term.

It has been nearly 2 months since Mexico first encountered a liquidity crisis. It was brought on by a loss of investor confidence. Almost immediately, the President and the congressional leadership realized that Mexico's problems were not that country's alone, and a Mexican economic collapse would have severe consequences for the United States.

The President emphasized the strong economic stake that we have in Mexico. Right now, we have more than 700,000 jobs in the United States that depend on sales to Mexico. Mexico is our third largest export market.

The President recognized the important effects that a Mexican economic collapse could have on illegal immigration to this country, as it did when Mexico collapsed in 1982–83. At that time, illegal immigration increased by a third as measured by apprehensions.

The President further recognized that Mexico's collapse could set us back years, if not more, in our efforts to promote reform not only in Mexico, not only in Latin America, but around the world.

These important interests called for the United States to be a leader in the effort, to restore market confidence, to help America avert an economic disaster. The President and the congressional leadership saw this. Together they announced the original proposal to offer up to $40 billion in financial guarantees.

We at the Treasury as well as other members of the administration worked hard with congressional leadership, and especially with banking committee chairman Leach, and also with other Members of Congress, seeking to ensure passage of legislation that would implement financial guarantees.

Unfortunately, the international financial markets did not stand still. By the end of January, it became apparent that Mexico was approaching the brink of a financial precipice, and it is for this reason that on January 31, President Clinton, and again the congressional leadership, announced a new approach.

He said that we would move forward with a $20 billion support package for Mexico which would draw on the Department of the Treasury's exchange stabilization fund, ESF, and with the participation of the Federal Reserve.

The leadership all joined in a statement that day declaring their full support for their program, and recognizing the President's and Secretary of the Treasury's full legal authority to implement this using ESF resources.

And Mr. Chairman, taking an aside from my prepared text here, to answer a question that I know will come up after listening to Congresswoman Kaptur's testimony, we do believe we have the full legal authority for this program, and you should have received an opinion of our general counsel setting forth the arguments for this.

We have also had an oral opinion from the Justice Department which we expect to be confirmed soon in writing endorsing that view.

Congresswoman Kaptur read from the transcript of testimony by a Treasury official in 1989 with respect to a program in Poland. As I listened to your reading of that transcript, DAS Barreda who is a career Treasury official, and is still at Treasury, although he was asked on several occasions, he never said that it was illegal to use ESF in the way that Members of the Congress at that time were proposing, for an exchange stabilization package for Poland that would have been medium term.

And in fact, he made the point that clearly it was a policy call at that time, that that was not something that they felt was proper for that case, and later in the Congressional Record, a full transcript of that hearing, additional information was inserted in which Mr. Barreda said it would not be improper or illegal to extend a bridge loan if the Secretary of the Treasury concluded that such a loan would be consistent with U.S. obligations in the IMF, and was necessary.

He went on to say that in the case of Poland, it is highly unlikely that such a conclusion could be justified. There had been much discussion about the adequacy of an assured means of repayment in that case, but nonetheless, that is a policy call about that specific case, and it is quite clear from the transcript that they were talking about this on a case-by-case basis.

With that clarification, I would like to pick up again, and say that the specifics of any large financial agreement need to be worked out with care. We were, I think, painstaking in drawing up the agreements with the Mexicans. The agreements that we signed satisfy all our concerns.

Throughout the negotiations, we remained confident that swapping short-term debt for medium to long-term obligations is an indispensable part of the solution for Mexico's problems.

Looking beyond the current crisis, Mexico's prospects are good, and Mexico is well up to meeting all of its debt obligations. There are many indicators that point to fundamental improvements over the next 6 years, over the past 6 years, excuse me.

The underpinning of market-based reforms coupled with new commitments embodied in the agreement should help put Mexico firmly back on the road to economic growth.

Now let me turn and talk about the agreements and how the package will work.

There were four agreements signed. First, a framework agreement that covers the entire support package. Two, an annex to that agreement that sets out how Mexico's obligations to us will be backed through oil proceeds.

Third, an agreement covering medium-term swaps, and fourth, an agreement setting out the terms under which we will guarantee Mexican security issues.

Through these agreements, we will make available up to $20 billion of support over the next year, or at most, 18 months.

Mexico has agreed to follow a financial plan showing how it will use this support to restructure or refinance short-term obligations that fall due over that period. The plan actually calls for using about half of the $20 billion in resources, holding the other half as a contingency.

This will make Mexico less vulnerable to swings in investor confidence, avert the present liquidity crisis, restore financial stability, and facilitate the return to financial health.

The support will come in short-term swaps which we now have in place, borrow dollars for up to 1 year, medium-term swaps, up to 5 years, and guarantees of up to 10 years.

Let me be very clear on one point. The package does not provide Mexico with cheap support. We will charge an interest rate for any swaps, and a fee for any securities that we guarantee that is sufficient to cover the risk that we bear, and to induce Mexico to repay this as soon as they have good access to markets again.

I want to emphasize two other points, and in fact, they were our guiding principles during the negotiations. One is that Mexico's return to economic stability depends first and foremost on Mexico's pursuing the right economic policies.

And second, that we were unwilling to extend any support to Mexico without assurances that we would be repaid.

As to the financial, economic issues, our agreements with Mexico take as their basis the economic stabilization program that Mexico has already agreed with the IMF. Under that program, Mexico will pursue restrictive fiscal and monetary policies in order to strengthen the peso, to bring inflation down to low levels.

This is the top objective because it is the only sure way to bring about a resumption of normal capital flows and a sustained period of growth. There is just no other way.

There are strict conditionality in the form of performance targets. These oblige Mexico to cut government spending, generate a budget surplus, restrict credit to a degree that would bring about a large decline in the real stock of money, base money, and cut back on development bank lending.

They are going to accelerate structural reforms in transportation, telecommunications, and continue privatization reforms.

And to back this up, we have the financial plan which I referred to earlier which will govern how Mexico uses the resources. For example, it intends to retire up to $16 billion of tesobonos. These are the short-term dollar index obligations that are falling due. They intend to do that over the next year, in part drawing on our resources, but also on other forms of support.

How are we going to assure performance to these commitments? The agreements are very strong on this. We made provision of support contingent on their living up to important transparency and reporting requirements. This will help not only us, but the markets to judge more clearly what Mexico's actual financial and economic situation is.

In addition, they will provide us with any additional information that we need to do our job here.

Second, we are disbursing our support in stages, or tranches, showing the French influence on international financial lingo. Each disbursement will be contingent on our being satisfied that Mexico is making progress, that it is meeting the terms of the agreements.

They will have to provide a complete explanation of how it plans to use any disbursement before we agree to that. If we are not satisfied, we can veto it.

Other controls are built in. For example, in a number of cases, we can accelerate Mexico's obligations to us if they do not comply with key terms and conditions.

All of these safeguards help ensure that Mexico will use the resources as agreed, they will stabilize the economy, and that our interests will be protected. The agreements were carefully constructed and meticulously negotiated.

Before concluding, I would like to emphasize that the administration intends to keep Congress fully informed of our progress as we implement these agreements. We plan to update Congress on a regular basis about the details of disbursements to Mexico, how the proceeds are being used, and any developments related to compliance with our agreed terms and conditions.

Finally, Mr. Chairman, let me reiterate what President Clinton and the congressional leadership stated on January 31. They said we must act now in order to protect American jobs, prevent an increased flow of illegal immigrants across our borders, ensure stability in this hemisphere, and encourage reform in emerging markets around the world.

We are fully confident that the agreements that have just been signed with Mexico will accomplish these objectives by setting the stage for Mexico's rapid return to stability.

Thank you.

[The prepared statement of Mr. Shafer appears in the appendix.]

Mr. BURTON. Thank you, Mr. Secretary. Before we turn to Dr. Bergsten, let me say that one of the things that concerned me, and I think the majority of the members of both the House and the Senate was that we were involved at the take-off, but we were not involved in the landing.

I served with a number of others on a committee to try to come up with a piece of legislation that could pass the Congress and that met a lot of our concerns like Cuba, as Mr. Torricelli talked about, and like putting money in a reserve fund up here to guarantee against loss.

And when it became apparent and the White House did not work as hard as they could have to try to hammer out an agreement, that you did not have the votes, unilaterally, you went around Congress. I think that has not set well, even though we do know that

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on the 31st, Speaker Gingrich and Majority Leader Dole did sign on to this.

I think that they have met with a bit of criticism from some of their colleagues because they did that without consultation with the rest of the Congress.

Mr. Bergsten.

Mr. TORRICELLI. Mr. Chairman, could you yield to me for a moment?

Mr. BURTON. I would be happy to yield.

Mr. TORRICELLI. Mr. Chairman, I just want to inquire of my friend just a concern that Secretary Shafer is here representing the executive branch.

My concern simply is I know the pressure of time, and I know you are concerned in getting everyone to testify. It would just be the precedent of having the executive branch both testify and answer questions with people outside of the Government not representative of the administration.

If the Secretary is going to do that, that is fine. I just, it is so unusual I just think, giving the precedent of it, I wanted to put something on the record that I hope we were not establishing something for the committee since——

Mr. BURTON. I certainly do not want to break precedence. I do not want to take advantage of the other members of the panel. If you would like to question——

Mr. ROTH. Mr. Chairman, if I could—why don't we just ask Secretary Shafer the questions first, and then we will question the other panel members.

Mr. BURTON. Well, why don't we do this? Why don't we limit the questions to 3 minutes for each member? Then we can——

Mr. TORRICELLI. I think that is fine, and I did not want to interfere with the running of the committee, Mr. Chairman.

Mr. BURTON. That is all right.

Mr. TORRICELLI. I just think that it is enough of a break. I am just concerned about what it signals.

Mr. BURTON. Well, with the understanding of the other panelists, we will proceed in that manner; and I will yield to my colleague, Mr. Roth, for three minutes.

Mr. ROTH. Mr. Chairman, before we brought up this issue of who is going to benefit, Secretary Shafer, why don't you tell us who is going to benefit from this bailout?

Mr. SHAFER. I think both the Mexican and American people, workers, people who earn incomes are going to be the beneficiaries of a program that precludes a financial crisis from turning into a deep recession. This is an income-destroying risk. It is not a zero-sum gain for us to provide financial support, financial backing to restore confidence, and it is financial backing that I am completely confident will be fully repaid, and at the same time.

Mr. ROTH. OK.

Mr. SHAFER. I do not want to claim that there won't be any strains in Mexico this year. They have been through enough, and they will be through it in time, but it would be a lot worse, and is to avert that damage to Mexicans and Americans.

Mr. ROTH. Seeing that we have only 3 minutes, it is interesting this morning that people were just baffled that this money is going to go to bailout the banks in Mexico. When the people in the Senate were told about it, they said they were baffled. They had no idea this was going to happen so——

Mr. SHAFER. It is not going to go to bail out the banks in Mexico. Some of it may as a part of resolving the liquidity problems in Mexico, be used to meet dollar liquidity needs of some banks in particular circumstances. We will be very careful about that, and it is certainly not going to support the claims of the bank stockholders.

Mr. ROTH. Well, my dear Mr. Secretary, if this is only a liquidity problem, like you said, what is going to happen when Mexico goes into this deep recession, because they are going to, because yesterday Secretary Rubin said that Mexico must take tougher steps, basically slow down their growth rate.

Now, if that does not mean a recession, I do not know what does.

Mr. SHAFER. I do not believe he said to slow down their economic growth rate, although their economic prospects have been hurt by this event already, but certainly they have to slow down their money growth rate, and that is a part of mastering the inflation problem that they have.

Mr. ROTH. Well, thank you, Mr. Chairman.

Mr. BURTON. Mr. Torricelli.

Mr. TORRICELLI. Thank you, Mr. Chairman.

Mr. BURTON. I will reserve my questions to the end. Mr. Torricelli.

Mr. TORRICELLI. Mr. Secretary, who declares that a default has occurred and therefore the agreements on the collateral have come due?

Mr. SHAFER. If we are not paid, we can make that declaration.

Mr. TORRICELLI. Who makes that judgment in the U.S. Government?

Mr. SHAFER. The U.S. Treasury announces that that fact exists, that we have not been paid, and I should say that under this arrangement that we put in place, beginning before the disbursements of this money, the Mexican petroleum proceeds will flow through the Federal Reserve Bank of New York.

Mr. TORRICELLI. I understand the agreement. Since the Secretary of the Treasury will be reaching this judgment, are you prepared to say on behalf of the Secretary of the Treasury that there are not, that there are no circumstances due to the economic situations in Mexico, or political difficulties in Mexico, in which you will announce to the American people, return to this Congress and claim that we are not exercising our rights to collateral?

Are you prepared to claim that we will exercise our rights regardless of those circumstances, and therefore the Government of the United States is protected?

Mr. SHAFER. I believe the Secretary has said in testimony in front of another committee that the money is ours, and we would exercise our rights to take that, and what we do then is specifically——

Mr. TORRICELLI. Without reservation, unequivocally, we are going to exercise our rights.

Mr. SHAFER. That is his statement.

Mr. TORRICELLI. Would you share my judgment that if during these circumstances under which the United States is providing these guarantees, if the Mexican Government through a corporation in which there is public involvement, make an investment, loan, or other purchase in Cuba, that it would be disingenuous and contrary to Mexican interests and the security interests of the United States?

Mr. SHAFER. I would have to look at a specific set of facts, if there sounded like facts that would give me some concern.

Mr. TORRICELLI. If it is Pemex, or the Mexican phone company, any corporation in Mexico in which there is public involvement making an investment in Cuba, which given Cuban economic circumstances, certainly would not be of an economic nature or they would not be made, wouldn't you consider that disingenuous?

Mr. SHAFER. That would be something that we would have to look at very carefully.

Mr. TORRICELLI. Finally, Mr. Chairman, were you surprised by the fact that the international markets began to lose some confidence in the dollar, and the dollar lost value after this, and could you describe the resources available to defend the dollar, given the use of this fund for Mexican guarantees?

Mr. SHAFER. Yes. I do want to make clear that the issuance of these guarantees, or the extension of swap loans in no way reduces our capacity to use our foreign exchange reserves to defend the dollar.

We have, I think, something in excess of $20 billion worth of marks and yen in the exchange stabilization fund now. We can through an arrangement with the Federal Reserve, place those with the Federal Reserve and receive dollars, if we need to have them to carry out our obligations under our agreements with Mexico.

At any time we need those dollars, we can get them back from the Fed and make the Fed whole from the proceeds of selling—excuse me, get back those marks and yen, not the dollars, and recover the dollars by selling the marks and yen in the market, and make the fed whole.

So those reserves remain fully available, and fully usable to us throughout the period in which we have this agreement with Mexico in force.

Mr. BURTON. Mr. Rohrabacher.

Mr. ROHRABACHER. It seems to me that you are trying to tell us that we are getting something for nothing there. We can provide this stability for Mexican currency, but this in no way is going to reduce our ability to defend our own currency in case there is some attack on it. How is that possible?

Mr. SHAFER. That is correct, and the reason is because what we do in defending our currency is not to use up money. We often say we are spending money in the market. We are not. We are changing. We are changing marks and yen for dollars, and when we do that, we still have the same amount of wealth there.

All we have done is shifted its composition, and we can, through the assistance of the Federal Reserve, have them hold our marks and yen for us when we do not need them, get them back from them when we do need them, and make them whole in terms of the dollars that we get when we sell them.

So in fact our intervention support operations do not use up our money.

Mr. ROHRABACHER. There is no cost at all. Everything is cool. Why is everybody upset? We are not at risk at all. In fact, it has not cost us a cent. It is going to work out just fine.

I do not believe a word that you just said. [Laughter.]

Mr. BERGSTEN. In fact, we will even make money.

Mr. SHAFER. We will make money.

Mr. ROHRABACHER. In fact, we are even going to make money.

Mr. BERGSTEN. It is better than you just said.

Mr. ROHRABACHER. It is even better than that. I am going to be anxious for your testimony, Doctor. I just do not believe it. I mean, I just do not believe it, and if somebody does believe it, I hope they will come to California. We have got some good business deals in Orange County bonds for them.

It seems to me that what we have done, and although the scenario that you have just put forward to me is that I am wrong in that our currency is somewhat more at risk in our attempt to lessen the risk on the Mexican currency, I do not believe you can get something for nothing in this world, and I believe what you just outlined for us, with all the money flying in the air and going between accounts, I do not believe that works.

You are the expert, and the Doctor over here is the expert. It does not make any sense to this Congressman, and my personal feeling is that what we have here is a snow job, and I am trying to make my way through this snow, and I will have to admit to you, I do not understand all the details, but I do not think the American people, if they could, would voluntarily sign the check.

That is the bottom line. The President of the United States did not come to us, and have us, the representatives of the American people, sign the check, and we are very upset about it.

Thank you very much, Mr. Secretary.

Mr. BURTON. Mr. Secretary, I will save the very best for last. You said in your testimony that this agreement met all our concerns. I do not know who all is, but it certainly was not the Congress.

It might have met all the concerns of that small circle of people that hammered out this agreement down at the White House, but it certainly did not meet all the concerns of the Congress of the United States. It just did not. Otherwise, you would have been able to get the votes necessary to pass it, and you would not have had to do this unilaterally.

So I think you ought to rephrase that, the next time you give testimony, because it did not meet all the concerns of the people who represent the people.

And you said that there was going to be an interest rate charged that was going to make this beneficial to the United States of America, and that we were going to make money. I do not understand that.

They are giving 50 percent interest rates down there now for money. Maybe you can explain that a little bit. I would also like to follow up on the issue of Cuba and other issues that we talked about earlier, Representative Torricelli and I.

When we worked on this agreement, and a number of us worked on it for quite a period of time, we had in there provisions that we thought were going to be palatable to the American people and to Congress.

What we got back from the administration was that this would not fly with the Mexican Government, and that it might cause them some political heartburn. I just do not understand that. It is our money, and we are the one that is coming to the rescue like the 7th Cavalry, and yet we have to be concerned about their feelings when we loan them our money.

You know, we did not want them to give any more direct or indirect support to Castro's Cuba. That was not in the agreement that was signed yesterday.

We wanted some money in escrow or some negotiable securities in escrow besides just a promise from the oil company down there, so that if there was a default, that at least the taxpayers would get a large part of their money back.

We wanted some agreements on prisoners in our prisons. We have got 250,000 prisoners, many of them are from Mexico, that are costing $30,000 to $35,000 a year to taxpayers. We wanted to have them go back for execution of sentence, or at least some kind of an agreement.

We wanted to patrol our borders on both sides, and have the Mexican Government work with us on that. There was nothing in the agreement about that that I know of.

And we wanted to talk about the drug issues.

Those were all legitimate concerns of the Congress, and if we were going to negotiate this kind of an agreement, and put American taxpayers' money at risk, we felt they were legitimate issues to be incorporated into this agreement.

None of these things were put in there that I know of, and yet you say it met all our concerns.

Now, in the brief time that you have left, would you explain that to me?

Mr. SHAFER. Mr. Chairman, it has met our concerns for a commercial financial agreement.

Mr. BURTON. Whose concerns?

Mr. SHAFER. The concerns of the administration, I think the concerns of Congress about the commercial and financial agreement that in fact——

Mr. BURTON. I do not think you can speak for the Congress.

Mr. SHAFER. Would benefit the American people.

Mr. BURTON. You can not speak for the Congress. Pardon me, Mr. Secretary. You can not speak for the Congress because it did not mean the concerns of the majority, and I think you know that, but go ahead.

Mr. SHAFER. May I go on? That we have, that we realize the benefits to America from the stabilization of Mexico, and that means that Mexico, in fact, takes the kinds of actions that they have to do to make this work, and that we have an assured means of repayment.

This is a commercial agreement that was undertaken very quickly when it was clear we ran out of time with the market to work our legislative solution to this. It has been taken in the context of our broader bilateral relationship with Mexico which we believe will be furthered by this kind of support.

The efforts continue with the State Department, with the law enforcement agencies to engage intensively with the Mexican Government on discussions of improving cooperation and getting responses in the areas that we did discuss in the legislative area.

I know that there was a meeting last week, for example, of law enforcement officials on both sides. I am told that there was substantial and useful progress made in that meeting, but I am not somebody whose expertise is in immigration and drugs and so forth, and I think it would be useful to hear from those who are about the details of that, but we do feel in the administration that this broader agenda is being pursued, and that we are meeting with success.

Mr. BURTON. Well, I want to thank you very much on behalf of the committee for coming and testifying. You have had a tough job to do, to defend this to the Congress; but I think you have done it about as well as could be done. We want to thank you very much for your participation.

I understand, Dr. Bergsten, you have an associate with you, Dr. Cline, I did not recognize you earlier so I apologize for that. I assume you are going to work together. Is that correct?

OK, we will now recognize first Dr. Fred Bergsten, the director for the Institute for International Economics.

STATEMENT OF FRED BERGSTEN, DIRECTOR, THE INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Thank you, Mr. Chairman, and the other Mr. Chairman. It is a pleasure to be back before you today. I was here 3 weeks ago today, so you know my basic view. I had a detailed statement at that time that Dr. Cline helped me prepare.

I promised you at the time that we were about to release a big study on this. We have now done so. At a minimum, I can tell you we have very heavy background for what we say.

It is a thorough study of the debt crisis of the 1980's. The London based Economist magazine took the rather unusual step in its issue last weekend of publicizing it on its front cover, with the title Bill Cline on Debt, a short summary that he wrote for them of the book.

This, I think is a rather impressive testimony to the kind of work my colleague has done and that we have drawn on in the hearings.

You know my view that, whereas I do have some problems with the specifics of the new program, and I would be glad to share those with you, basically it is a good idea. I think it is in the U.S. interest, and I think the Congress should support it.

However, rather than reiterating my basic view of that, let me start by going to some of the concerns that have been raised today, try to respond to them directly, and maybe help with some of these issues.

First, since it is most recent, Mr. Rohrabacher said "This sounds like such a good deal, how can it possibly be true? How is it that there cannot be a loss?"

First of all, the ESF, like lots of other operations of this type, are literally revolving funds, meaning, as Secretary Shafer said, you take one asset out, you put another in, and vice versa.

That is why the Congress, for example, in its budget scoring of the U.S. contributions to the IMF, does not require appropriation and does not count it toward the budget outlay. It is not such an outlay.

We put in dollars. We get the right to draw marks and yen to intervene to defend our currency, so the ESF is a revolving fund in that sense.

But, Mr. Rohrabacher says, "What do you mean? There cannot possibly be a loss". Of course, there could be a loss. There are two ways in which a loss could occur. The first would happen if somebody violated a guaranteed commitment and did not repay the loan.

If the Mexicans do not repay, there could be a loss. The administration has obviously tried to cover that by getting absolutely rock solid collateral—the Pemex oil revenues.

I am told that Ross Perot told another of the committees up here that this was an absolutely impregnable device. If Ross Perot says it, it must be right?

That is the way they have tried to ensure repayment, by getting rock solid collateral. The question is whether, when the evil day came if it ever did, which I doubt, would the U.S. Government back away?

My answer is no. They have got a legal requirement. They could be taken to court for failing to fulfill a legal commitment to recoup moneys for the United States. You would not let them do it politically.

So I frankly do not worry about that one very much at all.

The second way you can lose money is if you guess wrong on the exchange rates. Suppose they buy marks and yen at one price, and when they have to convert back into the revolving fund, the price has moved against them.

My understanding, though you will have to ask them, is that they have covered that one too. What I used to do, when Treasury intervened to defend the dollar with marks and yen, is to always get an agreement with the other country to essentially cover the exchange risk.

In other words, if we defaulted on the dollar when the German Central Bank was holding dollars, we had to make it up, and vice versa.

There were some comments when I testified last to you, Mr. Chairman, about some of the difficulties in economic policy we had during the Carter administration, and you were quite right. We did, if you remember, have a big dollar support program in 1978—a $30 billion program to defend the U.S. dollar.

As part of that, we borrowed marks and yen, the so-called Carter bonds, to defend the dollar in the exchange markets. But we were smart. We borrowed marks and yen when the dollar was at its floor.

When the dollar subsequently strengthened, in part because of our operation, we bought the marks and yen back at a much cheaper price, and we made well over $1 billion for the Treasury.

So it can cut either way. Historically the Exchange Stabilization Fund has made money. You can inspect their books. I believe they submit them to you regularly. They publish their bottom lines quarterly in the Treasury Bulletin. It has basically been a money maker over time, but it is true, they could guess wrong. They could fail to get cover. They could lose.

Those are the two tracks that you would have to pursue on that particular question.

A second issue that has come up, and you have raised it, Mr. Chairman, as did Mr. Torricelli and Pat Buchanan: What about the conditions that the United States has levied on Mexico?

Are we going to be buying a new enemy next door by levying all these conditions? My answer to that is that the United States is taking a risk in this operation. The United States Treasury has now taken on a large measure of responsibility for the Mexican economy.

This is a major departure from traditional policy. Traditional policy, for exactly the reason you are suggesting, is to rely on the international institutions to levy and implement conditionality, primarily through the International Monetary Fund.

The IMF is at the center of this, but the Treasury has tried to go further, and has clearly stated that it is going to implement the conditions. That raises the risk you suggest.

Frankly, it would have been better to stick with the traditional method of relying on the IMF: requiring IMF approval for the United States to make the actual transfers of the moneys and requiring the IMF to monitor the policies in Mexico.

I suspect the Treasury did it the other way because of you in the Congress, because you were putting so much pressure on them to make sure that the deal was going to restore Mexican stability and to make sure that the United States interests were promoted. The Treasury felt it had to do it.

But that does then raise this question of risk in our relations with Mexico, and I think it is a serious one. But then you raised what I regard as a contradiction.

Both Pat Buchanan and Mr. Torricelli, and now you, Mr. Chairman, have asked why we didn't put more conditions on the loans. Why didn't we hit them on their immigration policy? Why didn't we hit them on credits to Cuba?

You answered the question yourself. If you had required yet additional conditions on top of the economic and financial conditions the Treasury did require, you would have further increased the chance of a nationalist, populist backlash in Mexico that would have turned this into a foreign policy disaster.

You cannot have it both ways.

My preference would have been, A, the Treasury was right to limit the conditions to the economic and financial issues, but, B, it should have stuck with the traditional approach of lending and monitoring through the IMF rather than from the U.S. Treasury itself.

I have answers to the other points raised. If you want to come back to me later, I would be happy to do that.

Mr. BURTON. We will be happy to do that. We appreciate your comments, although we may not agree with all of them.

Mr. Sweeney.

STATEMENT OF JOHN SWEENEY, POLICY ANALYST, TRADE AND INTER-AMERICAN AFFAIRS, THE HERITAGE FOUNDATION

Mr. SWEENEY. Thank you very much. I have submitted a prepared statement. I am just going to limit myself to making a few remarks because much of what I would have said has been stated previously.

First, I want to clarify that I do not believe that NAFTA was a swindle. I want to start at that point. Free trade under fair rules is not bad for America, and it is not bad for any country that participates in that game.

But what do we mean by fair rules? An open market? A democracy? Rule of law? Trade liberalization? All of these things in Mexico, NAFTA will with time push Mexico toward the needed political reforms that will open up the Mexican economy and make it more democratic.

My second point is that the problem in Mexico is fundamentally political. It has been treated until now, or people have sought to treat it as if it was just some kind of market phenomenon.

It is an economic crisis, but it is also a political crisis. The economy is not free enough. The system is still too undemocratic in Mexico.

I do believe, I do agree with comments made earlier that the use of the exchange stabilization fund under these circumstances is unprecedented. I believe it is questionable. I believe the exchange stabilization fund needs to be amended so that its use is confined to transactions in gold and hard currencies, and Presidential discretion to use the DSF is also narrowed.

I suspect that the administration fears that the agreement itself will not work. To me, at least, the tough conditionality of the agreement indicates this. It is put together in such a way that at any moment, President Clinton can bail out of his bailout to Mexico. Therefore there must be some doubts about that in the administration.

You cannot divorce the politics from the economic issues in Mexico. The agreement as structured will not work because what we are having in Mexico is a political and economic crisis which is, each crisis is feeding on the other.

As the political crisis grows, the economic crisis grows worse. As the economic crisis grows worse, the political crisis increases. This is the crux of the problem in Mexico, and this agreement is not going to solve it.

I fear that over the next year in particular we are going to see a substantial increase in political violence in Mexico. I do not believe that the assassinations of Colosio and Ruiz Massieu last year were isolated or coincidental events. I think they are very much a part of the situation that is going on in Mexico today.

And what is happening in Mexico? We are seeing a difficult, dangerous, volatile, slow process of transition from a status corportus centralized one-party society, toward a more democratic and freer society.

You do not achieve this overnight. You do not do it easily. You do not do it without pitfalls, and trying to paint this crisis, what we have seen in the last 2 months, simply as an economic phenomenon, ignores the reality of the transition problem that Mexico is experiencing today, and which should be of concern to the American people.

I fear literally that President Zedillo's life is very much at risk in this process. This has to be taken into account. He is sitting on a bomb in Mexico.

Now, why won't the agreement work? I want to refer here to a point in the testimony that I submitted. President Clinton said yesterday that his administration has "done the right thing by the American taxpayers and the American people."

My rejoinder to the administration is a phrase originally attributed to Mexican President Lopez Portillo. Lopez Portillo said Mexico is not an oil well, and yet this ill-conceived United States-Mexico framework agreement assumes that Mexico is indeed an oil well, because the collateral is nothing less than Mexico's oil export revenues which henceforth, according to the administration's own announcement yesterday, are to be deposited in a special account at a U.S. bank—my question is which bank?—with irrevocable instructions. From who? To transfer funds to a Banco de Mexico account at the Federal Reserve Bank of New York.

OK, now I believe that Mexico's economy is weaker than its trade statistics suggest, and I believe that its dependence on oil is much greater.

Now, I am going to refer here to work that is done by George Baker, a leading United States expert on Mexico, and director of Mexico Energy Intelligence in Oakland.

Mr. Baker believes that oil does not account for 15 percent of Mexico's total exports, as is commonly announced by Mexican and United States officials of trade statistics, but rather that oil really accounts for up to 40 percent of Mexico's real net exports.

What Mr. Baker does is that he desegregates Mexico's merchandise exports, separating out those exported goods made in Mexico by foreign, mainly United States subsidiaries. Mr. Baker maintains that if such products associated with cross-border intra-firm trading are deleted from the merchandise export account, that Mexico's net manufactured exports in 1993 actually fall to an estimated $15 billion from an official $42 billion.

Now, if Mr. Baker's calculations are correct, and I believe at least that they are very accurate, the idea of collateralizing a U.S. emergency loan package with Pemex export receipts is impractical and dangerous.

Mexico's oil exports in 1993 were the equivalent of some 40 percent of manufactured exports if mining and agriculture exports are added to net merchandise exports.

Now, since Mexico's constitution and its energy regulations prevent private investment in oil production, or its refining and distribution infrastructure, then Pemex needs a free hand to negotiate access to capital markets.

About 40 percent of the Pemex budget is in U.S. dollars. If dollar expenditures are included for current operational expenditure such as maintenance, services which are mostly imported from Texas, then Pemex has to make dollar expenditures of $1.7 to $2 billion each year just to maintain production capacity and expand its activities and generate the dollar revenues needed to repay this emergency loan package.

With oil receipts tied up in the Federal Reserve Bank of New York, what will happen when Pemex goes to the market to borrow $1 billion a year? The bankers Pemex approaches are going to ask how is Pemex going to pay, and every prospectus that is issued by Pemex is going to carry a very important caveat. It is going to say investors and lenders should be aware that the oil receipts offered as collateral in this prospectus have been previously collateralized to an emergency loan agreement between the Governments of the United States and Mexico.

This agreement jeopardizes the credit lines of Pemex, and therefore undermines its ability to maintain Mexico's oil exports. Moreover, by tying up 40 percent of Mexico's net merchandise exports, this agreement eliminates the freedom of maneuver Mexico needs to buy United States goods and services.

The U.S. Treasury Department is now at the head of the line. Private U.S. business has been cut out of the picture. Overnight Mexico has been transformed from the diversified economy held by Presidents Salines, Zedillo, and Clinton, into an oil well, once again.

Thank you.

[The prepared statement of Mr. Sweeney appears in the appendix.]

Mr. BURTON. Thank you, Mr. Sweeney. I have some questions for you and we will get to those in just a moment. Mr. Whalen.

STATEMENT OF CHRISTOPHER WHALEN, CHIEF FINANCIAL OFFICER, LEGAL RESEARCH INTERNATIONAL, INC.

Mr. WHALEN. Thank you, Mr. Chairman. I have, of course, a written statement that has been submitted for the record.

Since a lot of the basic nuts and bolts that I would have discussed today on financial and debt issues have been mentioned, I just would like to go through some bullet points and thoughts and reflections on what has been said here today.

First off, as a former employee of the Federal Reserve System, and someone who has written about the exchange stabilization fund, and the related accounts at both the Fed and the Treasury, let me say that neither is this operation profitable, nor is it transparent.

In contradiction to what Dr. Bergsten has said, if you take the year-end figures that are published in the Board of Governors annual report, and the report that is issued by the Federal Reserve Bank of New York which is custodian for those funds, the marks and the yen he referred to, and then if you take the quarterly Cross report, the foreign exchange report that is published by the Fed, you will find that the numbers do not reconcile.

You will also find that the Fed often will take gains and losses on currency when they have not actually sold any assets. They play this little accounting ledgerdemain so that they can maintain their admittance to the Treasury without taking a loss or a gain on a security.

Now this is a fraud, of course, but since ESF——

Mr. BURTON. Could you move the mike a little closer?

Mr. WHALEN. Yes, I do not know what is wrong with it. Since ESF is not subject to annual review, since it is not audited by the

General Accounting Office as I believe former Chairman, Henry Gonzalez valiantly strove for over the last few years. You might look at the hearings that the House Banking Committee held in the previous session in this regard.

We have a problem with ESF.

Let me just speak briefly to what is going to happen in Mexico in the next 6 to 12 months which is my business. I am in the consulting and due diligence business in Mexico. We track down peoples' assets. We examine prospective investments. I think we are pretty much the best at what we do.

The banking system in Mexico, apart from what has been discussed here today, apart from what is in this package, is really going to go the way of Venezuela. You are going to see very large percentage losses on loan portfolios. You are seeing waves of defaults in Mexico.

It has even gotten to the point where on a social basis, whole groups of people—farmers, credit card holders, you name it—are petitioning the President for moratoriums on their debt, and restructuring. It is to the point now where the banks are just inundated.

No bank can survive in the kind of interest rate environment that you have alluded to, Mr. Chairman. And let me say that that 50-percent interest rate is the rate paid on Mexican T-bills. That is not what consumers pay.

Consumers in Mexico are going to pay well over 100 percent for credit card debts. They are going to pay well over 100 percent for their mortgage payments because interest rates all float over the official Government T-bill rate.

So this is a nightmare, and it is very much like Venezuela. If you look at what happened in Venezuela over the last year, and my friend Jack Sweeney is an expert on Venezuela, it is exactly the same scenario, but with some differences.

The inflation rate in Mexico, if we are lucky, is going to be under 100 percent this year. My guess is that it will be higher. What I am telling my clients, and what we are basically saying in our private written material is that if the peso is closer to 10 than it is to 5 by the end of the year, we would not be surprised.

The reason for this is very fundamental. Analysts often focus on the Mexican money supply, the numbers from the Bank of Mexico, the rate of money supply growth in Mexico.

I would hold that these things are completely irrelevant. The only thing that matters in Mexico is the dollar, and there are only two figures or two indicators that really should be of concern to serious analysts—one is the current exchange rate, and the other is their balance of trade.

Until Mexico starts living within its means, and by that I mean we cut off further lending from the World Bank and the IMF to get them off of this addiction to debt that we have actually encouraged over the last 10, 12 years, Mexico is not going to grow and it is not going to recover.

A good friend of mine, Eduardo Valle, who was an official in the Mexican Justice Ministry and was responsible for antidrug activities in northern Mexico, said to me the other day at lunch that there are three economies in Mexico—the productive economy, the speculative economy, and the criminal economy.

Now, for the last 5 years in Mexico, the speculators and the criminals have been running that country, and the productive economy, business people, you know, the vast majority of the Mexican people are literally hostage in their own country.

Now, I will tell you an interesting anecdote, just because we have so much serious material here today. During the negotiations with our Government for this rescue package, there were two gentlemen representing the Government of Mexico traveling around Washington.

One of them was a fellow named Luis Tellez who is head of the Office of the President. The second was his predecessor, Jose Cordoba Montoya who was head of the Office of the President for Mr. Salinas, really the No. 2 man in the country.

Now, Mr. Cordoba Montoya has met with senior officials of this Government. He may have even met with President Clinton, I do not know, but I am sure he has met with everyone in the Treasury on a number of occasions over the last 2 months.

This man has been repeatedly denounced in Mexico for ties to the Matamoras cocaine cartel. He had an affair with a woman who was the chief lieutenant in that organization.

Do you think that Secretary Rubin knows this? You know, I really worry that we are dealing with people in Mexico who are not only unfit counterparties for a commercial transaction, but who are really beyond the pale. I think that this administration, leaving politics aside, has made a gruesome political mistake by embracing this bailout, by embracing this Government in Mexico, both with NAFTA and now with these new series of transactions.

You know, no amount of paper, no amount of transactions, or agreement with a government that is illegitimate is going to make those agreements real. These things are a fraud. When you enter into any contract where the counterparty on the other side is acting in bad faith, you have committed a fraud.

I cannot imagine what circumstances or leverage is going to really enable the United States to make the Mexican Government do what we want them to do. It is an absurdity.

Let me just conclude by saying that I totally agree with what Mr. Sweeney said about political change, but there is a silver lining here. The silver lining in Mexico is that my friends on the left—I was an adviser to Cuauhtemoc Cardenas last year—are in total disarray. The left is breaking up into two or three different pieces in Mexico right now.

And we have just seen a wonderful victory for the center right Partido Accion Nacional [PAN] in the State of Jalisco. I dare to say that if the United States had the courage to really take its hands off Mexico and allow political opening to occur, that it would be the right, ironically enough, that would end up picking up the pieces when the current government falls apart.

One of my dear friends in the PAN is a guy named Vicente Fox who is going to run for Governor in Guanajuato I believe next year in a special election, and then he will probably stay in for President for the PAN in the year 2000 if we do not have an election before that.

My guess is that we have a wonderful opportunity here to support people who are pro-democracy, pro-business, friendly to the United States, and yet my fear is that the State Department and Treasury's fixation with supporting the very people who have created this disaster, and who are now expected to create the solution, is just blinding us to fighting the old battles time and again.

Let me end it there, Mr. Chairman.

[The prepared statement of Mr. Whalen appears in the appendix.]

Mr. BURTON. Your testimony is very interesting. Would you mind waiting? We are going to run over and vote and we will be back in about 5 minutes.

[A recess was taken.]

Mr. BURTON. The other members will be back shortly. I want to thank you very much for your tolerance and for waiting.

I will start off the questioning since the others are not yet back. Mr. Whalen, the last part of your testimony raised the hair on the back of some of our necks. You said that an official of the Mexican Government, and I do not recall the gentleman's name——

Mr. WHALEN. A former official.

Mr. BURTON. Former official who was instrumental in negotiating this agreement?

Mr. WHALEN. Yes.

Mr. BURTON. Is a member of a drug cartel?

Mr. WHALEN. Well, what happened was this. The man's name is Jose Cordoba Montoya.

Mr. BURTON. Hold that mike real close to you so we can hear.

Mr. WHALEN. His name is Jose Cordoba Montoya. He was head of the Office of the President under Mr. Salinas. His protege, Luis Tellez, now holds that position, but more importantly——

Mr. BURTON. His protege is also involved, I presume.

Mr. WHALEN. Well, no, no. Really the protege is a young man. He has not had time to really mature in that corrupt sort of way that one matures in Mexico, but what I can tell you is there were several people in the Salinas Cabinet who I think were very deliberately targeted and infiltrated, if you will, by the Matamoros cocaine organization. They are very good. They are extremely good, at corrupting government officials.

And by the way, the article that you are going to get an English translation of that I published in Colombia tried to talk about how the Mexican narcotics structure is really the top dog in the cocaine industry.

You know, we hear constantly about Colombia, but the Colombians, in my opinion, are not making most of the money, and they are not nearly as influential and as powerful as the Matamoros group which is, of course, right across the border from Brownsville, TX.

Now, there was a gentleman named Emilio Gamboa who was the Secretary of Communications and Transport in the Salinas administration. He was their first target. The Matamoros Group basically turned him. He was not a particular outstanding example of corruption, per se. He was from a wealthy family and a product of a good education, but he became friendly with a woman named

Marcel Bodenstock, who he in turn introduced to Mr. Cordoba. They start having this wonderful affair.

They go to the bullfights together, and it became quite an item because Mr. Cordoba was not known as a social butterfly in Mexico City, so this was unusual. And what I can tell you is that through investment relationships, through other financial transactions, a number of journalists in Mexico have been able to build a pretty good case that Mr. Cordoba and other officials in the Salinas government have direct and continuing contacts and indeed, or an integrated part of the cocaine trafficking organizations in Mexico.

So when this man is written up last week in a couple of big Mexican magazines who are bragging about the fact that he was roaming around Washington meeting all of these big and important American officials, I just could not help but be struck by that.

Because as I said to you at the opening part of my remarks, our firm is about knowing these Mexicans very well, knowing who they are, who they do business with, where they keep their assets, are they clean, are they dirty, and so forth.

Mr. BURTON. I would like to have any documentation you have, articles or anything else.

Mr. WHALEN. I would be happy to give it to you, Mr. Chairman.

Mr. BURTON. I think that is very, very important not only for this hearing, but for the Congress.

Mr. WHALEN. That is why I say it. I do not make these allegations lightly, but this is—if you talked to anyone in the Customs Service or any of the organizations that are really trying to combat the drug trade, you will find that they look upon the Mexican Government at best as being complicit, and at worst, as being actively involved.

Mr. BURTON. Let me ask you this, and Mr. Bergsten might want to comment as well. You indicated in your testimony that the Federal Reserve and some other major financial institutes juggled figures with various currencies in order to cook the book, so-to-speak; so that it appears as though nobody can lose any money, and they won't lose any money because of these financial transactions.

I would like for you to elaborate on that a little bit, and I would like Mr. Bergsten to comment on that because he indicated that there was no real risk of loss with the Mexican agreement.

Mr. WHALEN. Well, let me start by saying that I worked for almost 3 years in the Foreign Department of the Federal Reserve Bank in New York, and I have a continuing relationship with people in that area of the bank, and other areas of the bank.

The ESF portion that is directly attributable to the Federal Reserve is audited annually by the bank's own accountants. They will not answer questions about it. They will not work through the figures with you and help reconcile them. They consider it off limits, completely beyond question, if you will, from the public. They Fed basically hides behind the skirts of the Treasury and the Gold Act for this. They claim that the discretion given to the Secretary over the exchange stabilization fund in the Gold Reserve Act, I believe it is called, allows them not to answer questions about it.

My observation——

Mr. BURTON. The language in there does pretty much give him carte blanche as I read it.

Mr. WHALEN. Yes.

Mr. BURTON. Yeah.

Mr. WHALEN. Now, my own investigations, just looking at the published numbers, the year-end numbers versus the numbers that they use in the quarterly report of exchange activity in the ESF, intervention activity, and so forth do not reconcile.

Just take the numbers and put them side by side in the spreadsheet, and I defy anyone to figure out what their true profit and loss is.

Now, I can also testify from personal direct experience, having worked in currency intervention operations in New York, that the accounting is haphazard at best. We used to, for example, engage in secret intervention activities in futures contracts which were essentially undocumented. There is no paper on that for the period that I was at the bank.

I can also tell you that in terms of their investments of funds that are both in the Feds account and the Treasury account, it is essentially a situation where they will value a given bond, or other instrument in a way that is really not market related.

So when you talk about profits and losses, I guess what I would say is until such time as we have an outside audit by the GAO or someone else who does not have a vested interest in maintaining the secrecy and the lack of transparency that we have seen in this area of the Fed and Treasury, I do not believe any numbers.

Let's drag this thing into the light of day, subject it to an annual audit, and then we can discuss intelligently, but right now, the way it is run is so obscure that I do not think we could argue about it one way or another.

Mr. BURTON. If you have any documentation on that, I would like to see it.

Mr. WHALEN. I have some, and I will be happy to introduce you to other people who can discuss this more.

Mr. BURTON. Mr. Bergsten, do you want to comment?

Mr. BERGSTEN. Yes, I hope the committee will treat this undocumented gossip for what it is. If you get some documentation, look at it seriously.

If you want to ask the Treasury or the Fed or the New York Federal Reserve——

Mr. WHALEN. Well, ask them, Fred.

Mr. BERGSTEN. To explain to you the numbers in the published data on the Exchange Stabilization Fund——

Mr. WHALEN. Oh.

Mr. BERGSTEN. I have no doubt they will do it for you.

Mr. WHALEN. Fred, that is totally untrue. You call Ted Truman, you call up Joe Coin at the Board of Governors, and you ask them to walk through the year-end data.

Mr. BERGSTEN. I did not say they would take the time to tell you all the data.

Mr. WHALEN. Come on.

Mr. BERGSTEN. I told the committee if they want to go through the data, I am sure that any of those officials will be only too happy to do it.

Mr. WHALEN. Well, look, the——

Mr. BERGSTEN. The published data show——

Mr. BURTON. Let me ask a question.

Mr. BERGSTEN. The published data show the balance sheet. They show profits of $2 billion over the last year.

Mr. WHALEN. No.

Mr. BERGSTEN. It is going to take a lot of jiggering to get from that to this undocumented gossip.

Mr. BURTON. Let me ask one question, Mr. Bergsten. Do you think that they would submit to a GAO audit?

Mr. BERGSTEN. I do not know if they would submit to a GAO audit.

Mr. BURTON. Should they?

Mr. BERGSTEN. If I were still there running that fund, I would have no objection to it.

Mr. WHALEN. Good.

Mr. BERGSTEN. The operations of the ESF have to remain in some cases confidential, as may any market transactions the Government does. But valuing the outcome is now, as I understand it, subject to normal FASB-type rules. So if you ask them to explain to you how they do that, they will do it.

I am sure they would be glad to debate Mr. Whalen in front of you or any committee of this Congress.

Mr. WHALEN. Let me say this, Mr. Chairman. According to the Fed, or according to Mr. Fisher who is now running the Foreign Department of the Fed, there were no loans to Mexico during December.

Now, if you all on this committee believe that, and this is right in their published report, if you believe that, then we might as well close this hearing now.

Mr. BERGSTEN. Why is it you think they would lie?

Mr. WHALEN. I think they have other purposes, Fred.

Mr. BERGSTEN. I think all your gossip is just that, and I think the committee ought to know that.

Mr. WHALEN. Well, I disagree with you.

Mr. BURTON. Let me, let me——

Mr. WHALEN. I think that reasonable intelligent people are able to look at the facts and look at the marketplace, and the fact is the Bank of Mexico had run out of money, so you explain to me how they got through the month of December.

Mr. BERGSTEN. You are telling us the Federal Reserve in its report, which I happen to have read as well——

Mr. WHALEN. Right.

Mr. BERGSTEN. Concerning its exchange market operations of the second half of 1994, is lying.

Mr. WHALEN. Yes. That is my allegation.

Mr. BERGSTEN. Well, that is a very serious charge, and I think they might even take you to court for libel.

Mr. WHALEN. Oh, oh, I hope they do.

Mr. BERGSTEN. I think that they should.

Mr. WHALEN. I hope they do, but let me just point out that the——

Mr. BERGSTEN. I hope they do too.

Mr. WHALEN. That during the hearings held by Chairman Gonzalez in the 101st Congress, these same issues were raised in the same dimension, and the same basic issues of transparency and honesty were raised at that time, so go back and look at that report, and then you will see that we are not talking about anything new.

Mr. BERGSTEN. And there was a groundswell of opinion in response, including from the rest of the Congress, that something had to be done about it? You do not remember that.

Mr. BURTON. Let me, first let me ask this question. When did I lose control of the hearing? And then I would like to yield to Mr. Roth.

Mr. ROTH. Mr. Bergsten, I do remember sitting on the Banking Committee and asking the Fed about hey, let's have an audit. Oh, we are audited. We are audited annually. Oh, you are? Oh yes, but it is an internal audit, it is not GAO and so on.

So that is why we asked the Fed hey, how about a GAO audit? No, we are not in favor of that, so I think that the Congress has—you know, let's be frank about this—Congress is looking at 10 different things, like we are running back and forth for voting and so on, and so the Fed comes in and says OK, I mean, they can bamboozle us, they can bamboozle the CPA's. Why wouldn't they, some Congressmen who are, you know, is generalist.

Mr. BERGSTEN. Could I just make one comment. Everybody including the Secretary of the Treasury, has acknowledged that this transaction with Mexico is a departure for the Exchange Stabilization Fund.

Mr. ROTH. Right.

Mr. BERGSTEN. I said it in my testimony 2 or 3 weeks ago. It is the first time. That does, I think, put a different light on the operation.

Mr. ROTH. You know, Doctor——

Mr. BERGSTEN. If you were to ask the GAO to do it, I find it very doubtful that the Treasury would oppose that.

Mr. ROTH. The reason I am somewhat dubious, I do respect you and I like you personally but it just rubs me a little the wrong way when you come and hey, no problem. We are going to make money, no risk.

Come on, the first graders would not believe that. I was offended by that.

Mr. BERGSTEN. Now wait a minute.

Mr. ROTH. Yes, I remember that, you saying that. Now let me ask you something, because you know, people come before our committee, and they can get by with murder. They say one thing one week, and another week they say something else, and no one ever holds them down and says hey, I want to take a look at this.

Now because I do admire you, I want to ask you something. I want you to be perfectly frank with me. Are we heading to trouble in Mexico, or aren't we? I want—Ed, where is our staffer?—I want you to take this down because I remember this when you come back.

Are we heading to trouble in Mexico?

Mr. BERGSTEN. The Mexican situation is a very difficult one with major implications for the United States. We face the choice of how we should respond.

While I think it is right to respond in the way that has been done, I told you last time that I preferred the previous package.

Mr. BURTON. Are we heading for a recession in Mexico?

Mr. BERGSTEN. Mexico will of course have a slow-down in the economy, maybe zero growth, and it could have a recession. The question is, is it a worse recession with worse effects on our economy with or without this financial package? I do not call this financial support package a bailout.

I think that with this package there will be a much less deep recession, with fewer repercussions for other countries and for the whole model of open economics and deregulation that we like.

There is indeed trouble in Mexico: They made a huge policy error. They let their trade deficit get out of hand. They let their currency get overvalued.

Four of my colleagues at my institute, going back 2 years, predicted that there would be a devaluation there. So there is no surprise there, but the question is, how do you make it least bad?

Mr. BURTON. Yes, OK.

Mr. BERGSTEN. That is the issue.

Mr. BURTON. Mr. Sweeney.

Mr. SWEENEY. I would like to make a comment by way of comparison with Venezuela which is what Chris mentioned earlier.

When Venezuela floated to believe, or when the administration of President Carlos Sandres Perez floated the Bolivar in early 1989, the result that year was a contraction of nearly 10 percent of GDP, and inflation accelerated to over 81 percent.

In Venezuela's case, when the economic reform programs were put into effect and gasoline prices were increased, riots ensued at the beginning of the administration, and several hundred people got killed, and thousands more were injured.

Now, I am not saying that there are going to be riots in Mexico. It is a different situation, but I do think that this year we are going to see more than a slow down or a mild recession. I think Mexico is going to contract by several points the economy, and I think inflation is going to go up.

Substantially there is going to be banking difficulties which are going to aggravate the situation, and the political turmoil in Mexico is going to feed upon the economic crisis and aggravate that crisis.

I think this is something that Congress should be aware of. It is something that should be watched closely.

Mr. ROTH. Well, we have only so much time, and I do not want to take too much time away from my colleague, but I want to ask this question. Pat Buchanan said this morning: "Hey Congress, get a Border Patrol, and get our military to patrol our border, our 2,000 mile border with Mexico."

Are we on that type of, facing that type of a problem with Mexico?

Mr. SWEENEY. My personal opinion is that there is going to be a substantial increase in illegal migration to the United States. I think it is difficult, very difficult to quantify how much that is going to be.

I think the notion of putting some kind of wall or fence between the United States-Mexican border, and putting National Guard units, as Mr. Buchanan suggested down there, is frankly, in my opinion, quite ridiculous.

I think the costs would be huge and I do not think it is going to address the fundamental problem.

Mr. WHALEN. They will stand in the desert.

Mr. BURTON. Mr. Rohrabacher.

Mr. ROHRABACHER. Earlier I said almost in jest if anyone believes this, they should buy, they should come to California so they can buy some Orange County bonds.

Let me just note that when I thought about that, and I thought about Dr. Bergsten, or administration official came here today and said I honestly believe that this is equivalent to what was going on in Orange County in the sense that people were being sold a bill of goods that there was almost no risk, and that they were going to receive a value at almost no risk, and a higher value than they would otherwise.

Dr. Bergsten, you said basically the only risks would be is if we have rock-solid collateral and there is no problem with that, but there could be if something happens to that, and if we guess wrong on the value of foreign currency.

Those are the only two ways that there would be some kind of a problem that would cost us, meaning if something goes wrong with the collateral, or if we guess wrong with foreign currency.

We have just heard the testimony from two gentlemen who see— now, I admit, I am an expert in international affairs. These two gentlemen seem to have some credentials and that.

I take it that you two gentlemen disagree with Dr. Bergsten's analysis about how much we are taking with this financial for the United States of America, is that correct?

Mr. WHALEN. Well, let me just briefly say this. The risk is based on whether or not the Mexican recovers. That is to say their ability to pay.

Mr. ROHRABACHER. Right.

Mr. WHALEN. OK. I would argue that the productive economy in Mexico—remember I divided it up in three sectors—has been shrinking for a number of years.

Let me give you an example, on the front page of a big Mexico daily last week, the heads of the three largest chambers of commerce in the country said that two-thirds of their membership are on the verge of bankruptcy.

Mr. ROHRABACHER. So if the productive part of the economy continues to go down, we are risk.

Mr. WHALEN. Exactly.

Mr. ROHRABACHER. Mr. Sweeney.

Mr. SWEENEY. I would concur with Mr. Whalen's remarks. I really have nothing to add to that.

Mr. ROHRABACHER. I want to ask one more question and that is can you please spell the name of the man, the individual that you are saying that has these connection to the——

Mr. WHALEN. Well, the article has been copied, and you will have a copy of it.

Mr. ROHRABACHER. Could you please pronounce for us slowly.

Mr. WHALEN. It is Jose Cordoba Montoya.

Mr. ROHRABACHER. And spell his name for us?

Mr. WHALEN. It is Jose, J-O-S-E.

Mr. ROHRABACHER. OK.

Mr. WHALEN. Cordoba is C-O-R-D-O-B-A, and Montoya is M-O-N-T-O-Y-A, yes.

Mr. ROHRABACHER. What position did he hold?

Mr. WHALEN. He was head of the Office of the Presidency in Mexico.

Mr. ROHRABACHER. But you are saying that he has had meetings in the last 3 months.

Mr. WHALEN. Yes, he apparently still has some sort of quasi-official role.

Mr. ROHRABACHER. Is it your testimony that he has had a meeting with the Secretary of the Treasury?

Mr. WHALEN. I do not know that precisely. I do know that he attended a number of the organizing——

Mr. ROHRABACHER. I believe that from your testimony earlier you indicated that.

Mr. WHALEN. Well, it has been written up in the press that way. In other words, the Mexican press follows this inch by inch, and they have alleged that Tellez and Cordoba together were going to a number of meetings with the Treasury.

Mr. ROHRABACHER. OK, we will ask.

Mr. WHALEN. Well, this is why I am mentioning it. You should ask, is what I am saying.

Mr. ROHRABACHER. I will, but I will let you know that if he has not had a meeting with the Secretary of the Treasury, it really casts a lot of doubt on your credibility.

Mr. WHALEN. I hope he has not, quite frankly.

Mr. ROHRABACHER. OK. Well——

Mr. WHALEN. But the point is if he is even going around with a current member of the Mexican Government——

Mr. ROHRABACHER. Well, we are going to find out who he has had meetings with, and if he has not had the high-level meetings that you are talking about, and if there is not some more verification, we will ask the DEA if he is on their drug enforcement list.

Mr. WHALEN. Please do.

Mr. ROHRABACHER. If he is not——

Mr. WHALEN. You can talk to the people——

Mr. ROHRABACHER. I just have to tell you, Dr. Bergsten is right.

Mr. WHALEN. Uh-huh.

Mr. ROHRABACHER. In that your credibility has been shot with this committee.

Mr. WHALEN. I understand that, and I stand by my statement.

Mr. ROHRABACHER. But if you are correct, if you are correct, and Dr. Bergsten, is it your position that this administration has not met with this man?

Mr. BERGSTEN. I have no idea.

Mr. ROHRABACHER. You have no idea.

Mr. BERGSTEN. I just said it was unsubstantiated.

Mr. ROHRABACHER. OK, I will just say this, that if you are correct, you have—this is really a chilling testimony, and we will take that very seriously.

Mr. WHALEN. May I just say one thing? What I am reflecting to you is based on my own reading of the daily and periodical press in Mexico, my discussions with people in the Mexican Government, people in journalism in Mexico.

Mr. ROHRABACHER. I understand that, but the point is this——

Mr. WHALEN. And that is why I make the statements.

Mr. ROHRABACHER. You say you are giving us an educated opinion.

Mr. WHALEN. That is right.

Mr. ROHRABACHER. If your educated opinion is wrong in something to this degree——

Mr. WHALEN. No, I stand by it, quite frankly.

Mr. ROHRABACHER. To this degree——

Mr. WHALEN. I stand by it.

Mr. ROHRABACHER. OK.

Mr. WHALEN. What I am saying——

Mr. ROHRABACHER. I just wanted to let you know that. Thank you very much.

Mr. BURTON. I would like to have for the committee, and for myself, any documentation you have now or in the future.

Mr. WHALEN. I will get it together for you this afternoon.

Mr. BURTON. Let me just thank all three of you for being here. We have got to run and vote. Thank you very much for your patience.

The committee stands adjourned.

[Whereupon, at 3:52 p.m., the subcommittees were adjourned to reconvene at the call of the chair.]

APPENDIX

TESTIMONY OF CONGRESSWOMAN MARCY KAPTUR (D-OH)

HOUSE SUBCOMMITTEES ON WESTERN HEMISPHERE AFFAIRS

INTERNATIONAL ECONOMIC POLICY AND TRADE

February 22, 1995

I would like to thank the distinguished chairmen of the Subcommittee on Western Hemisphere Affairs, Congressman Burton, and the Subcommittee on Economic Policy, Trade and Environment, Congressman Roth, for holding this hearing today on the $47.5 billion bailout of Mexico.

The Administration's use of public money in such a manner, and specifically, the use of the Exchange Stabilization Fund by the U.S. Treasury, is absolutely unprecedented in both magnitude and duration -- and is, in my judgment, illegal. When I questioned Secretary Rubin on February 14, 1995 at the annual Appropriations Committee Budget Overview Hearing, he reluctantly confirmed to me that there is no precedent for the Administration's action. The United States has never extended loans to a foreign country on a medium- or long-term basis on such a huge scale (see attached chart). This unilateral action by the Executive Branch is 20 times as large as any previous use of this Fund and has been structured for different purposes, as I will elaborate.

Moreover, never has it been the will of Congress to provide the Executive Branch with unlimited authority of this sort as a function of the Exchange Stabilization Fund. As many observers have commented, this situation goes well beyond a short-term liquidity crisis in Mexico or a need to defend the dollar in foreign markets. This is an aggressive foreign aid authorization to Mexico to prop up a failing economy that has its roots in deep-seated political corruption, the lack of a rule of law, and a mismanaged economic program.

I would like to call your attention to some testimony that this very Committee heard on October 10, 1989, which I believe is extremely applicable to what we are discussing today, and excerpts from which I have attached to my own written remarks. The testimony came from officials at the Treasury Department and the State Department who were being questioned by Congressman Gilman in connection with a proposed economic aid package for Poland.

Rep. Gilman: I'd like to ask our distinguished panelists -- there's been a great deal of discussion about the possible utilization of a loan from the Treasury's Exchange Stabilization Fund to help stabilize the zloty as Poland tries to attack its inflationary problem. And I know our good chairman, the gentleman from Indiana, Mr. Hamilton, has raised that issue. Can you tell us, has serious consideration been given to that, and is that possibility presently under review? And does the Treasury Department have the authority to loan to Poland under this program?

Mr. Barreda: Mr. Congressman, the administration has decided to support a Polish fund for stabilization. We think the appropriate way to do that is through an appropriation by Congress. We think the Exchange

Stabilization Fund's purpose and use is quite different. We've used the Fund for intervention exchange markets and for very short-term loans, usually bridged to a guaranteed repayment in a hard currency. The proposal to provide Exchange Stabilization funds to Poland on a longer-term basis is a totally different use of the funds. That is much closer to foreign aid, Mr. Congressman. We think, therefore, it should be appropriated.

* * *

Rep. Hamilton: Now, let me ask some questions about the exchange stabilization fund. I'm not sure that I understood the testimony correctly early on. But . . . you said it was used only for short-term loans. Is that correct?

Mr. Barreda: That's right, sir.

Rep Hamilton: By which you meant what?

Mr. Barreda: We have two uses of [the] exchange stabilization fund right now, Mr. Chairman. One, we use it for activity in the foreign exchange markets where we're exchanging dollars for yen or Deutschmarks or vice versa. We also do it for some short-term bridging. In that case, we make available the dollars in exchange for an assured repayment in hard currency, and we lock in the exchange rate.

Rep. Hamilton: And short-term, in that context, means what?

Mr. Barreda: It's less than six months, according to the statute, unless approved by the President to be longer.

Rep. Hamilton: You have made longer loans than six months, have you not?

Mr. Barreda: I'm not aware of any, sir. I have been discussing with your staff a Mexico loan, and I would like to look into that and get back.

Rep. Hamilton: $600 million for 12 months to Mexico in 1982.

Mr. Barreda: That's the one I want to --

Rep. Hamilton: Are you not aware of that?

Mr. Barreda: I wasn't until now and I'm going to look into it and get back to you.

Rep. Hamilton: Now, of course, you could use this money as a bridging loan to Poland, could you not? That is, you could extend a loan to Poland under the exchange stabilization fund, and then, when the IMF loan kicks in, it could take over the loan. I mean, that's a possibility, isn't it?

Mr. Barreda: If there's an assurance of an IMF agreement and it's short-term, we would certainly consider that, as I said in my testimony. What we want to be sure of is repayment in a hard currency and in short-term --

Rep. Solarz: Will the gentleman yield?

Rep. Hamilton: Mr. Solarz.

Rep. Solarz: Thank you very much, Mr. Chairman. . . .

* * *

Rep. Solarz: . . . . You're saying, I gather, that we cannot -- that if we were to use the exchange stabilization fund without an assured mechanism of repayment that that would be an illegal use of the fund, given the criteria that have been built into it, or would it be a breach of the fiduciary responsibility of the Secretary of the Treasury --

Mr. Kamman: We think it would be an improper use of the fund, Mr. Congressman.

Rep. Solarz: Would it be an illegal use of the fund? Something can be improper without being illegal, and I'm not suggesting that we do something improper, but I just want to know where we stand.

Mr. Barreda:	We can try to give you an opinion on that. As --
Rep. Solarz:	Can you --
Mr. Barreda:	It's an improper use of the fund. We don't think it should be used that way. If there is going to be a chance of loss, we think it should be an appropriation.

Well, in short, I could not agree more. I, too, think the Exchange Stabilization Fund's purpose and past use are quite different from the way it is being used by the Administration in ccnnection with Mexico now. In the past, we have used the Fund for intervention in exchange markets and for very short-term loans, usually bridged to a guaranteed repayment in a hard currency. Providing Exchange Stabilization Fund monies to Mexico on a longer-term basis is a totally different use of the Fund, closer to foreign aid. Moreover, there is a huge risk of loss, exacerbated by the internal banking and financial problems facing Mexico's private lending institutions and businesses. For those reasons, the use of the Fund in this manner without an authorization and appropriation is improper and, again, totally unprecedented.

In the Wall Street Journal on February 1, 1995 there was an article entitled "U.S. Securities Firms and Mutual Funds Have Big Bucks Riding On Mexico Rescue." The article pointed out that U.S. securities firms earned $133 million in annual underwriting fees for Mexican securities, U.S. mutual funds owned $17.1 billion in Latin American assets, and U.S. banks were owed $15.9 billion in loans to Mexico and $41 billion in loans to Latin America. Led by their desire to cash in on returns of 66% on emerging markets, U.S. financial institutions gambled by pouring "hot money" into Mexico's public sector offerings without fully considering the risks involved. Proper collateralization for private sector loans was the exception rather than the rule. When the peso began to fall, these same U.S. financial institutions saw declines in their share prices of more than a dollar and faced potentially huge losses in the value of their peso-denominated, speculative investments.

It is no coincidence that as of last week, Mexico had already drawn at least $2 billion dollars from the U.S. loans in order to pay $1.3 billion to U.S. banks. Its IMF drawdowns were even greater. The government of Mexico, in fact, owes the world a minimum of $140 billion dollars (some say as much as $200 billion), and about $58 billion of that amount falls due this year, mostly to U.S. financial institutions. Furthermore, Mexico owes U.S. banks alone $18.3 billion this year. As Walker Todd points out in the February 13, 1995 issue of The Nation, "With the peso down in value by forty percent and Mexico's dollar reserves dwindling, it is clear that only a mammoth infusion of funds or forgiveness of its debts can prevent the country from defaulting."

What is interesting to note is that U.S. banks and other financial institutions have balked at helping themselves through this crisis, especially as the federal government became involved. As a recent Wall Street Journal article reported, "Bank executives said the loan's urgency has been diminished by the $50 billion White House rescue package for Mexico. With a sum that large in the pipeline, they said they might as well take their time considering terms of any new loans they make to Mexico." Most banks will not even consider loaning $200 million dollars to Mexico. Yet Wall Street expects the U.S. taxpayers to shoulder a burden of $20 billion from the U.S. Treasury. And there is no certainty that amount will even begin to cover what is owed.

We have been told that our U.S. Treasury can supply no record of which investors U.S. taxpayers are bailing out. Given that the CIA can help Mexico track down Subcommandante Marcos and a few peasants in Chiapas, as reported by the New York Times, I find it impossible to believe that the Administration does not know who Mexico's creditors are, especially its U.S. creditors. Today, let me give you an idea of who has directly benefitted from the Mexico bailout.

After the announcement of the bailout by the Administration, the performance rating of mutual funds jumped from negative 6 percent to a positive 7 percent. These mutual funds include Scudder, Merrill Lynch, Fidelity, Salomon Brothers and other major Wall Street firms. U.S. banks had an equally large stake in the bailout. Citicorp is owed approximately $2.9 billion by Mexico. Goldman Sachs underwrote no less than $5.7 billion of Mexican securities from 1992 until the crisis. Chase Manhattan, J.P. Morgan and Chemical Banking Corporation are all heavily invested in the Mexican market. U.S.

banks are so eager to get their investments back that they are willing to start a civil war in Mexico if that is what it takes to bring "financial stability." A Chase Manhattan memo blatantly stated that "the [Mexican] government will need to eliminate the Zapatistas to demonstrate their effective control of the national territory and of security policy" and further that "the Zedillo administration will need to consider carefully whether or not to allow opposition victories if fairly won at the ballot box."

In conclusion, I recommend that this Committee pass an authorization bill strictly defining the use of the Exchange Stabilization Fund and narrowly prescribing the authority of the Executive Branch over the Fund, so that it will no longer be able to use the Fund as a form of back door foreign aid. Second, when the use of the Fund goes beyond the strict principles of foreign exchange, an Appropriation by Congress should be required.

Finally, we all know Mexico's problem is not merely a crisis of currency. Mexico has been building a house of debt. Mexico is in the middle of a full-blown social, economic and political crisis. More broadly, Mexico faces manifold challenges which defy simple banking solutions. As Robert Novak observed in his February 20, 1995 column in the Washington Post,

> If all sides in Washington view this as essentially a financial crisis, there is nobody in Mexico City who does. After years of denial by Mexico's rulers and their U.S. counterparts, this country's political system is sick unto death. The well-informed, patriotic Mexicans I saw here

> feel the U.S. government has done them no favors by turning its back on continued corruption, the tightened link between drug cartels and the government and the absence of real political dialogue.

Corruption and human rights abuses in Mexico are rampant. Mexico's closed political system has permitted one political party, the PRI, to hold power since the 1920s through fraud, intimidation and outright murder. The questions now being raised in relation to Mexico go to the heart of how the United States responds to a crisis on our southern border -- how we stand up for the best values in us. In order to reach a long-term stabilization plan for Mexico, I also recommend that this Committee authorize the U.S. to initiate and participate in a Hemispheric Commission and appoint a Special Ambassador to this purpose. It should carry as its most basic tenets -- in addition to the long-term stabilization of Mexico -- the creation of a common rule of law, sustainable economic growth policies, and the fostering of multi-party functioning democracies among our trading partners in this hemisphere as conditions of market entry.

After all, free trade can exist only among free people.

TABLE 1. Exchange Stabilization Fund Financing Agreements, 1980-6/94

Country	Year	Amount Agreed ($ mil.)	Drew: Amount ($ mil.)	Drew: Date(s)	Repaid in Full by
Mexico	1982	1,000.0	825.0	8/14/82	8/24/82
Mexico	1982	600.0	600.0	9/82-2/83	8/23/83
Mexico	1986	273.0	273.0	8/86-12/86	2/13/87
Mexico	1988	300.0	300.0	8/1/88	9/15/88
Mexico	1989	425.0	384.1	9/25/89	2/15/90
Mexico	1990	600.0	600.0	3/28/90	7/90
Brazil	1982	500.0	500.0	10/82-11/82	12/28/82
Brazil	1982	280.0	280.0	11/82	2/1/83
Brazil	1982	450.0	450.0	11/82	3/3/83
Brazil	1982	250.0	250.0	12/82	1/83
Brazil	1983	200.0	200.0	2/28/83	3/11/83
Brazil	1983	200.0	200.0	3/3/83	3/11/83
Brazil	1988	250.0	232.5	7/29/88	8/26/88
Argentina	1984	300.0	0.0		
Argentina	1984	500.0	500.0	12/28/84	1/15/85
Argentina	1985	150.0	143.0	6/85	9/30/85
Argentina	1987	225.0	225.0	3/9/87	7/15/87
Argentina	1987	200.0	190.0	11/12/87	12/30/87
Argentina	1988	550.0	550.0	2/88-3/88	5/31/88
Argentina	1988	265.0	79.5	11/22/88	2/28/89
Jamaica	1984	50.0	10.0	12/29/84	3/2/85
Philippines	1984	45.0	45.0	11/7/84	12/28/84
Ecuador	1986	150.0	75.0	5/16/86	8/14/86
Ecuador	1987	31.0	31.0	12/4/87	1/26/88
Nigeria	1986	37.0	22.2	10/31/86	12/10/86
Yugoslavia	1988	50.0	50.0	6/15/88	9/30/88
Venezuela	1989	450.0	450.0	3/15/89	4/3/89
Venezuela	1990	104.0	25.0	3/30/90	4/30/90
Bolivia	1986	100.0	0.0		
Bolivia	1989	100.0	100.0	7/89	9/15/89
Bolivia	1989	100.0	75.0	9/22/89	12/29/89
Bolivia	1989	75.0	75.0	12/29/89	1/2/90
Poland	1989	200.0	86.0	12/28/89	2/9/90
Guyana	1990	31.8	31.8	6/20/90	9/90
Honduras	1990	82.3	82.3	6/28/90	11/20/90
Hungary	1990	20.0	20.0	6/90-7/90	9/5/90
Costa Rica	1990	27.5	27.5	5/21/90	5/21/90
Romania	1991	40.0	40.0	3/7/91	3/21/91
Panama	1992	143.0	143.0	1/31/92	3/92
Peru	1993	470.0	470.0	3/18/93	3/18/93

Testimony by
Jeffrey Shafer
Assistant Secretary of the Treasury
for International Affairs
before the House Subcommittee on Western Hemisphere
and the House Subcommittee on
International Economic Policy and Trade of the
Committee on International Relations

February 22, 1995

Introduction

Mr. Chairman and Members of the Subcommittees, I appreciate the opportunity to appear before you today to discuss the United States response to Mexico's financial situation.

On January 31 President Clinton, with support from all four congressional leaders, announced his decision to proceed with a $20 billion United States support program for Mexico. Yesterday, Secretary of the Treasury Robert Rubin, Mexican Minister of Finance Guillermo Ortiz, and other Mexican and United States officials signed four carefully-negotiated agreements implementing the U.S. program. In so doing, they set in place a package to avert the threat to United States jobs, standards of living, immigration concerns, and security interests posed by Mexico's economic difficulties.

I would like to use this opportunity today to review briefly with you the events leading up to our adoption of these agreements. I would also like to go over some details of the package, and how it will work to protect American interests in the short-term and in the long run.

It has been nearly two months since Mexico first encountered a liquidity crisis brought on by a loss of investor confidence. Almost immediately, the President and congressional leadership realized that Mexico's problems were not that country's alone -- that a Mexican economic collapse would have severe consequences in the United States.

The President emphasized early on the strong economic stake we have in Mexico -- the more than 700,000 United States jobs that depend on sales to Mexico, our third largest export market. He recognized the important effects a Mexican economic collapse could have on illegal immigration, as it did when Mexico collapsed in 1982 and 1983. Then, the apprehension of illegal immigrants along our southern border rose by nearly 30 percent.

Perhaps most importantly, the President recognized that a Mexican crisis could threaten one of the most promising economic developments in the world today, the advance of emerging market nations. These have been the fastest growing markets for our exports. Mexico's collapse could knock off course economic progress built on opening markets and freeing up the private sector. That could set us back years, if not decades in our efforts to promote reform around the world. Much of the economic and strategic benefits such reforms offer to Americans would be deferred. America's hopes for increased demand in emerging markets for U.S. products and the good jobs this would bring would also be disappointed.

These important American interests called for the United States to take the lead in organizing an international effort to restore market confidence, and help Mexico avert economic disaster. The President and congressional leadership saw this. Together, they announced the Administration's original proposal to offer Mexico up to $40 billion in financial guarantees. Such guarantees were intended to help Mexico raise funds needed to pay off short-term obligations coming due, and restore financial stability and confidence in Mexico.

Treasury officials as well as members of the Administration worked diligently with the congressional leadership, Banking Committee Chairman Leach, and other Members of Congress, seeking to assure passage of implementing legislation needed for the financial guarantees. Unfortunately, international financial markets did not stand still. Mexico's financial situation began to deteriorate sharply. Mexican and other financial markets sank to new lows, and the spillover to other markets was visible. By the end of January it became apparent that Mexico was approaching the brink of a financial precipice. There was no time left to wait for congressional action if we were to avert a preventable Mexican collapse and safeguard US interests.

That is why on January 31, President Clinton announced a new approach. He said that we would move forward with a $20 billion support package for Mexico which would draw on the Department of the Treasury's Exchange Stabilization Fund or ESF, with participation by the Federal Reserve. The ESF resources are in place -- the Fund was established by Congress in 1934. The ESF authorizes the Secretary of the Treasury to extend loans and credits to foreign governments, which meant the new package could be implemented without delay. Speaker Gingrich, Minority Leader Gephardt, Majority Leader Dole, and Minority Leader Daschle all joined in a statement that day declaring their full support for the program, and recognizing the President's and Secretary of the Treasury's full legal authority to implement it by using ESF resources.

We were not the only ones that day to recognize the need for rapid action. Also on January 31, at the urging of President Clinton and after close discussion with Treasury officials, the management of the International Monetary Fund announced that it was prepared to propose a $17.8 billion support package for Mexico, expanding on an earlier $7.8 billion offer. The first amount was already the largest program in the history of the IMF. The central banks of a number of major industrial countries also said they would consider providing $10 billion in financial assistance through the Bank for International Settlements, $5 billion more than the support package that was originally to be offered through the Bank. I should note, however, that the BIS commitment is for short-term financing.

The international support for Mexico is impressive. Nonetheless, the United States component is rightly seen as the key that will enable Mexico to face up to the market. That is why Treasury, the Federal Reserve, and other United States officials have worked over the past several weeks to complete the agreements necessary to implement the President's proposal as quickly as possible.

The specifics of any large financial agreement need to be worked out with care. We were, I think, painstaking in drawing up the agreements with the Mexicans. We wanted to be absolutely sure that our requirement that United States interests be safeguarded was met, with assured sources of repayment for all Mexican obligations. We insisted, too, that Mexico follow a course that will help assure success -- that Mexico follow the rigorous monetary, fiscal, and structural policies necessary to stabilize its economy. And we insisted that the agreements be structured to provide us with all the information necessary to determine whether Mexico is following through. Nothing less, we believed, would accomplish our goal of stabilizing Mexico's economy, and protecting the U.S. financial, economic and security interests that hinge on Mexico's success.

There were difficult moments. Towards the end of last week markets grew impatient and began to sink, warning us that confidence in our ability to conclude a successful program was waning. In the end, however, our persistence paid off. The agreements we signed with the Mexicans satisfy <u>all</u> our concerns. And they offer Mexico the best route for emerging rapidly from its liquidity crisis, restoring confidence, so that Mexico can quickly regain the path to economic growth, thus safeguarding U.S. interests.

Throughout the negotiations, we also remained confident that swapping short-term debt for medium to long term obligations is an indispensable part of the solution for Mexico's problems. Looking beyond the current crisis, Mexico's prospects are good and Mexico is well up to meeting all of its debt obligations. Many indicators point to fundamental improvement over the past six years or so:

- inflation declined from over 150 percent in 1987 to 7 percent last year. The runaway depreciation of the peso has boosted inflation temporarily, but Mexico knows what it must do to bring it back under control.

- almost 400 state enterprises were privatized, greatly reducing government involvement in the economy and bolstering the private sector;

- tariffs and import restrictions were cut sharply, opening Mexico to foreign trade and investment;

- government spending was drastically reduced, with the budget moving from a deficit that stood at 13 percent of GDP in 1987 to a balanced budget last year; and

- public debt as a proportion of GDP fell from 75 percent in 1986 to 45 percent last year, a level below the average for OECD countries.

This underpinning of market-based reforms coupled with new commitments embodied in the agreements should help put Mexico firmly back on the road to economic growth.

Let me now take a few minutes to discuss the agreements in a bit more detail, and explain to you more fully how our support package will work.

The Agreements

Secretary Rubin, Finance Minister Ortiz, and other officials signed four documents -- a framework agreement that covers the entire support package, an annex to that agreement setting out how Mexico's obligations to us will we backed through oil proceeds, an agreement covering medium-term swaps and an agreement setting out the terms under which we will guarantee Mexican securities. Through these agreements we will make available to Mexico up to $20 billion in support over the next year, or, at most, a year and a half.

Mexico has agreed to follow a financial plan showing how it will use this support to restructure or refinance short-term obligations falling due over that period, switching its debt portfolio to longer-term, less volatile forms of finance. This plan calls for using about half the resources, holding the other half as a contingency. This will make Mexico less vulnerable to swings in investor confidence, averting the present liquidity crisis, restoring financial stability, and facilitating Mexico's return to economic health.

Forms of Support

We will make our support available to Mexico in three forms: short-term swaps which will allow Mexico to borrow dollars for up to one year, medium-term swaps which will extend dollars to Mexico for up to five years, and securities guarantees. Under these guarantees, the United States will back Mexico's obligations on government securities that have maturities of up to 10 years. Our backing should encourage investors to lend money to Mexico for longer terms at lower interest rates. That will further ease Mexico's ability to refinance the short-term obligations falling due.

Let me be very clear on one point. This package does not provide Mexico cheap support. We will charge Mexico an interest rate for any swaps, and a fee for any securities guaranteed, that is sufficient to cover the risks we will bear. Moreover, the more support we disburse, the higher will be the fees and interest rates -- starting at 2 1/4 percent over Treasury interest rates and going up to a premium of 3 3/4. That will encourage Mexico to turn to regular private market sources for capital as quickly as possible, rather than relying on us. And if Mexico doesn't respond to that incentive when their market access is restored, we can require it to go to the market for funds to repay us.

Two Guiding Principles

Two other points should be emphasized -- indeed, they were our guiding principles during the negotiations. One, Mexico's return to economic stability depends first and foremost on Mexico's pursuing the right economic policies. We cannot do this for Mexico, it must make the choice, and it has. The agreements we signed condition all our help on Mexico's implementing the rigorous economic policies that it has announced. The Mexican authorities have given us an economic memorandum spelling out what they intend to do on monetary policy, on exchange rate policy, on their budget, on privatization and so forth.

Two, we were unwilling to extend any support to Mexico without assurances that we would be repaid. That is why we structured the agreements as we did -- with strict controls on how our money would be used, strong provisions allowing us to monitor Mexico's compliance, and assured backing for any support we extend.

Let me say a few more words about both of these concerns -- the economic and financial conditionality, and the safeguards that will help assure Mexico's repayment of its obligations.

Economic and Financial Conditionality

To begin with, our agreements with Mexico take as their basis the economic stabilization program that Mexico has agreed upon with the International Monetary Fund. Under that program, Mexico will pursue restrictive fiscal and monetary policies in order to strengthen the peso and bring inflation down to low levels. Stabilization is the top objective because it is the only sure way to bring about a resumption of normal, spontaneous capital flows and a sustained period of growth.

The IMF program contains strict conditionality in the form of performance targets. Those oblige Mexico to cut government spending and generate a budget surplus, restrict credit to a degree that would bring about a large decline in the real stock of base money, and sharply cut back development bank lending. Moreover, Mexico has committed to accelerate structural reforms in the transportation, telecommunications and banking sectors and continue privatization reforms. The accords we have signed condition support on additional economic steps by Mexico to improve the prospects for a successful stabilization of the economy.

Second, our agreements with Mexico refer to a financial plan which will govern how Mexico uses our resources to restructure and refinance its obligations. For example, Mexico should retire up to $16 billion of Tesobonos -- short-term, dollar-indexed obligations falling due -- over the rest of the year, in part by drawing on $10 billion in United States support. We reached agreement on this financial plan only after careful analysis and study of Mexico's economy and financial profile. We are convinced that the plan is realistic and represents the most effective use of our support.

Assuring Performance

How will we assure performance by Mexico of these commitments? The agreements are very strong on that score.

First, we made provision of support contingent on Mexico living up to important transparency and reporting requirements. This will be a big step forward for Mexico's financial authorities in their dealings with the public and the markets. The agreement also ensures that Mexico will provide us with all the information we need to determine how Mexico's economy is doing, and whether Mexico is living up to its obligations. Mexico will provide us with any additional information we need to do our job here.

Second, we are disbursing our support in stages, or tranches. Each disbursement will be contingent on our being satisfied that Mexico is making progress and meeting all the terms of the agreements. Mexico will have to provide a complete explanation of how it plans to use any disbursement, before we agree to the disbursement request. If we are not satisfied we can veto the request.

Other controls have been built into the agreements. For example, in a number of cases, we can accelerate Mexico's obligations to us if we determine that they are not complying with key terms and conditions. All of these safeguards help ensure that Mexico will use our resources as agreed, to stabilize its economy, and protect our interests.

Backing for United States Support: the Oil Mechanism

I mentioned backing for our support as a second key concern. Repayment by the Mexicans is backed by the revenues from the export of crude oil and petroleum products. Under the Oil Proceeds Facility Agreement, Mexico's state-owned oil company, PEMEX, will instruct its foreign customers to make payments for oil and petroleum products into an account at a bank in the United States. The agreement contains irrevocable instructions to that bank to transfer funds to a Bank of Mexico account at the Federal Reserve Bank of New York. These same instructions ensure that if Mexico fails to meet its obligations the funds will be set off against Mexico's obligations and transferred to a U.S. government account at the Federal Reserve.

These agreements were carefully constructed and meticulously negotiated. They protect our interests, and should accomplish our goal of returning Mexico to economic stability as quickly as possible, preventing the severe consequences we would suffer if Mexico were to default on its obligations and suffer a protracted crisis.

Before concluding, I would like to emphasize that the Administration intends to keep Congress fully informed of our progress as we implement the agreements. We plan to update Congress, on a regular basis, about the details on disbursements to Mexico, how the proceeds are being used, and any developments related to compliance with our agreed terms and conditions.

Conclusion

Finally, let me reiterate what President Clinton and the congressional leadership stated on January 31. They said: "We must act now in order to protect American jobs, prevent an increased flow of illegal immigrants across our borders, ensure stability in this hemisphere and encourage reform in emerging markets around the world." We are fully confident that the agreements that have just been signed with Mexico will accomplish these objectives by setting the stage for Mexico's rapid return to stability. Thank you.

The Mexican Peso Bail-out
Testimony Before
the Joint Sub-Committee Hearings
of the
House Sub-Committee on Western Hemisphere Affairs
and the
Senate Sub-Committee on International Economic Policy and Trade
February 24, 1995
by John Sweeney
Latin American Affairs Policy Analyst
The Heritage Foundation

The U.S.-Mexico Framework Agreement announced on Tuesday, February 21, 1995, establishes the amounts, terms and conditions under which Mexico shall have access to $20 billion from the U.S. Federal Reserve, through the Treasury Department's Exchange Stabilization Fund.

This agreement covers only the ESF portion of President Clinton's $50 billion scheme to bail out Mexico's government and U.S. mutual funds, such as Fidelity of Boston, with billions of dollars at risk in Mexico and other emerging markets around the world. It does not include any additional conditions imposed by the IMF for the $17.8 billion in stand/by assistance pledged to Mexico, nor a further $10 billion from the Bank for International Settlements (BIS).

This ill-conceived agreement is not viable or credible. I suspect that it is the brainchild of panic-stricken politicians and bankers in the White House, Treasury Department, and the Government of Mexico who desperately hope that foreign investors, Congress and the American people can be fooled into believing that the Mexican crisis is a temporary inconvenience that will end shortly.

President Clinton's bail-out of Mexico will not work. Since the Mexican peso was first devalued on December 20, 1994, The Heritage Foundation has argued insistently that the Mexican crisis is not a transitory shortage of liquidity, but rather a major debt payments crisis, as well as a systemic political crisis which is going to continue for the foreseeable future.

The signs of panic are everywhere in this agreement:

• The legality of the president's use of his executive power to bail-out Mexico's government with the Exchange Stabilization Fund is highly questionable. If the first $20 billion is not enough, will President Clinton increase Mexico's draw at the ESF?

In hearings before the House International Relations Committee on February 1, 1995, Fred Bergsten of the Institute for International Economics said that President Clinton could, potentially, disburse billions more to Mexico, through the ESF, and without Congressional approval, by making use of international swap arrangements with other central banks.

If the Mexican crisis continues, the giant sucking sound American taxpayers may hear is the loss of many billions of U.S. tax dollars. That is why the U.S.-Mexico

Framework Agreement comes with so many conditions attached: Clearly, even the Administration has doubts about the viability of this bail-out scheme.

• The Administration's agreeement seems to show less concern for American taxpayers than for the impact of the Mexican crisis on the U.S. mutual funds that today are the largest source of portfolio investment in the world's emerging markets. A single mutual fund, Fidelity of Boston, has invested over $8.5 billion in Mexico and other emerging markets around the world. Many other mutual funds have similarly large exposures at stake in these international emerging markets, which for the most part are second-rate countries ruled by third-rate bureaucrats. The view on Wall Street is that Mexico is the bellwether for these emerging markets, and that if Mexico collapses, the other emerging markets will fall as well.

• In Mexico City, President Ernesto Zedillo is rightly concerned about the economic, political and social repercussions of a crisis that was caused by the Salinas Administration's bad policy decision to manipulate monetary and exchange policy to aid Zedillo's electoral prospects. Zedillo won in what was hailed as the cleanest elections in Mexico's long history of corrupt statism and one-party rule, but the cost was steep: a current account deficit of nearly $30 billion and the expenditure of more than $20 billion in foreign exchange reserves at Mexico's central bank, the Banco de Mexico.

The peso's devaluation is a major watershed in Mexican history, because it accelerated the collapse of the ruling Partido Institucional de la Revolucion, or PRI, which has monopolized Mexico's corrupt and undemocratic political system for more than 65 years. Throughout Mexico this year, local state elections for governors and other public positions will be hotly contested and, probably, increasingly violent elections. The conservative PAN party is expected to score big gains in northern and central Mexico, while the PRD may do well in some southern states. Regional and local PRI factions may not accept orders from the top to respect the results in any elections they lose, and it's a given that the PRD will protests all elections it loses, because they always respect democracy when they win elections, but cry fraud when they lose.

Mexico is making a difficult and dangerous transition from a one-party, corporatist state towards a democracy. It can be argued that Mexico is suffering two parallel crises. One is political, and the other economic, and both crises are growing by feeding on each other. The political crisis fuels the economic crisis because the foreign investors on which Mexico depends (more than any other country in Latin America) are scared away. As Mexico's economic crisis deepens, however, the political crisis also grows. Yet another factor contributing to the Mexican crisis is President Zedillo himself. Zedillo is perceived as a weak and ineffectual leader. The peso's devaluation was badly managed. Zedillo's decision to suspend the offensive againts Chiapas rebels that he had ordered only a few days earlier was perceived as a sign of weakness.

The extent of Zedillo's desperation is revealed by his acceptance of U.S.-imposed conditions that effectively make Mexico the ward of the U.S. Treasury and Federal reserve, and which therefore are politically unacceptable in Mexico. President Zedillo's life, quite literally, may be at risk. In my opinion, the assassinations of Luis Donaldo Colosio in March 1994, and of the PRI's secretary general, Ruiz Massieu, later that year, were not isolated or coincidental events.

The U.S.-Mexico Framework Agreement does not "(bring) this crisis to a close," as Secretary of State Warren Christopher mistakenly stated yesterday.

Since Mr. Christopher is obviously not trying to deceive Congress and the American people, then he must not understand the systemic nature of the Mexican crisis in its full economic, political and social dimensions.

President Clinton said yesterday that, with this framework agreement, his administration has "done the right thing by the American taxpayers and the American people as well."

My rejoinder to President Clinton is a phrase originally attributed to former Mexican President Lopez Portillo.

Mexico, said Lopez Portillo, is not an oil well.

Yet, this ill-conceived U.S.-Mexico Framework Agreement assumes that Mexico is, indeed, an oil well, because the "collateral" is nothing less than Mexico's oil export revenues, which henceforth are to be deposited in a special account at a U.S. bank (which bank? Citbank? J.P. Morgan?), with "irrevocable instructions" (from who?) to transfer funds to a Banco de Mexico account at the Federal Reserve Bank of New York. The Administration's official announcement of the deal reads as follows: "As long as Mexico meets its obligations, these funds will be freely available for use by the Banco de Mexico. If for any reason Mexico should fail to repay the U.S. under any of the financing agreements, the U.S. treasury, through the Federal Reserve Bank of New York, would be entitled to set off its claims against the Banco de Mexico account."

But Mexico's economy is even weaker than its trade statistics suggest, and its dependence on oil is much greater. Official Mexican and U.S. trade statistics estimate that oil exports comprise 15 percent of Mexico's total exports. However, George Baker, a leading U.S. expert on Mexico and Director of Mexico Energy Intelligence in Oakland, California, believe that oil actuall accounts for up to 40 percent of Mexico's real net exports. Mr. Baker disaggregates Mexico's merchandise exports, separating out those exported goods made in Mexico by foreign (mainly U.S.) subsidiaries. Mr. Baker maintains that if such products associated with cross-border, intra-firm trading are deleted from the merchandise export account, Mexico's net manufactured exports in 1993 fall to an estimated $15 billion, from an official $42 billion.

If Mr. Baker's calculations are correct, and I believe that they are indeed accurate, the idea of collateralizing a U.S. emergency loan package with Pemex export receipts is impractical and dangerous. Mexico's oil exports in 1993 were the equivalent of some 50 percent of Mexican manufactured exports, and 40 percent if mining and agriculture exports are added to net merchandise exports. Since Mexico's Constitution and energy regulations preclude private investment in oil production, or its refining and distribution infrastructure, Pemex needs a free hand to negotiate access to capital markets.

About 40 percent of the Pemex budget is in dollars. If dollar expenditures are included for current operational expenditures such as maintenance services which are mostly imported from Texas, Pemex has to make dollar expenditures of $1.7 billion to $2 billion each year in order to maintain production capacity, expand its activities and generate the dollar revenues needed to repay this emergency loan package under the ridiculous conditions imposed by the Clinton Administration. With its oil receipts tied up in the Federal Reserve Bank of New York, what will happen when Pemex goes to the market to borrow $1 billion a year. The bankers Pemex approaches will ask how Pemex will pay. Every prospectus issued by Pemex will contain an important caveat: "Investors/Lenders should be aware that the oil receipts offered as collateral in this prospectus have been previously collateralized to an emergency loan agreement between the Governments of the United States and Mexico."

This agreement jeopardizes the credit lines of Pemex, and therefore undermines its ability to maintain Mexico's oil exports. Moreover, by tying up 40 percent of Mexico's net merchandise exports, this agreement eliminates the freedom of maneuver Mexico needs to buy U.S. goods and services. The U.S. Treasury Department is not at the head of the line. Private U.S. business has been cut out of the picture. Overnight, Mexico has been transformed from the diversified economy hailed by Presidents Salinas, Zedillo and Clinton, into an oil well again.

What happened to NAFTA and the Partnership for Prosperity signed by the U.S., Mexico and 32 other democratic nations of the Americas in Miami on December 11, 1994, only nine days before the Mexican peso collapsed? Mexico is our NAFTA partner, yet we are taking 40 percent of our partner's merchandise exports and tying them up in a U.S. bank. What kind of partnership is that?

President Clinton and his Treasury Secretary, Robert Rubin, claim that this agreement will restore investor confidence in Mexico. This is a fallacious claim; 1995 is a lost year for Mexico. One has only to look at the Venezuelan experience in 1989 to draw an image of what may happen this year in Mexico. When Venezuela's government allowed the bolivar's exchange rate to float in 1989, inflation exceeded 80 percent and the economy contracted nearly 10 percent that year. The Zedillo Administration projects economic grow of about one percent this year for Mexico, and inflation of 19 percent with the peso stabilizing at 4.5 to the U.S. dollar. I believe the Mexican economy will contract, and that inflation could easily reach 50 percent in 1995 because the peso may continue to weaken.

Who will invest in Mexico this year under these circumstances? One has to make distinctions between portfolio investment, or what Wall Street calls "mad money," and direct foreign investment in plants and equipment. Portfolio investors will look either at equity or debt investments in Mexico this year, and the debt investments, mainly in Cetes, are going to win out because interest yileds will be much higher than for equity investments, assuming a stable exchange rate. Equity is investment in the future, and right now Mexico's future is very undertain. Under current conditions, equity investment only makes sense unless assets are incredibly cheap, and unless these assets have a substantial potential to generate foreign exchange by exporting. However, the hot money inflows won't be as great as in 1993 or early 1994.

As for direct foreign investment by private companies (mainly American), there will be a general reassessment of the current economic situation in Mexico. The economy will contract this year and inflation will rise substantially. Mexican consumers will be buying fewer products. Foreign investors in the maquiladora industry will increase their investments to take advantage of cheaper Mexican labor costs, and there will be maintenance investments of existing foreign operations in Mexico, but new foreign investments are likely to be postponed until Mexico manages to get its nose above the water again. This will take at least a year, presupposing that President Zedillo gets his act together, but right now foreign investors are not convinced that Zedillo can do this.

In conclusion, I believe that it is important that the appropriate committees in the House of Representatives and Senate hold extensive oversight investigations and hearings into the causes and consequences of the Mexican crisis. The crisis is not over yet, and the Clinton Administration's legally precarious decision to invoke his executive powers to bail out Mexico should be opposed by Congress. Many doubts and questions need to be clarified. Who in the Clinton administration knew of this impending crisis, and when did they know? Who negotiated this agreement? Which private U.S. bank will receive the oil revenues of Pemex for transfer to the Federal Reserve Bank of New York? What are the Administration's fallback options if the agreement does not work? What conditions will the IMF impose on Mexico, and how will the $17.8 billion be disbursed? Where will the IMF obtain the resources it needs? What are the terms for the BIS credit? Will the U.S. be the guarantor of the BIS credit as well? Is the president's use of the Exchange Stabilization Fund legal? In the opinion of many legal experts, the use of the ESF to support the Mexican peso is not legal, and the 1934 Gold Standard Act which created the ESF should be amended so that it can only trade in gold or hard currencies such as the U.S. dollar.

Statement by Mr. Christopher Whalen
Chief Financial Officer
Legal Research International
February 21, 1995
House Committee on International Relations
Subcommittee of Western Hemisphere

Proposed $51 Billion Mexico Bailout
A Fraud on American Taxpayers

The over $50 billion in new foreign loans for Mexico proposed by the Clinton Administration is a bad idea both politically and financially. The loans support the larger national interests of neither Mexico nor the United States, and are a transparent subsidy for private speculators. Moreover, the Clinton White House is deliberately misrepresenting both the purpose of the loans and the impact this rescue package will have on the very real economic crisis now unfolding inside Mexico.

Congress should enact legislation to block this taxpayer-financed bailout for private speculators and instead demand that the Treasury help to fashion a private sector solution to the financial problems in Mexico. So far, the U.S. Treasury and Federal Reserve System have disbursed over $5 billion since December, including $2.1 billion between December 22 and January 31, 1995; $2 billion from the Federal Reserve and Treasury on or about February 2, 1995; and $1 billion from the Fed and Treasury on February 13, 1995. There are unconfirmed reports that an additional $4 billion of Federal Reserve-Treasury money was released to the Mexican government during the week following February 13, 1995, bringing the total direct U.S. assistance so far to between $12.9 billion and $16.9 billion.

Here are several summary points that members of Congress need to know about the proposed rescue package:

1. The $50 billion will go almost entirely to foreign investors and Mexico's corrupt elite. Little if any of the funds made available under these loans will ever help the people of Mexico, who are the biggest losers in the current financial turmoil. Moreover, the serious financial contraction now underway in Mexico will continue in any event, with or without the U.S. aid package.

2. The $20 billion in U.S. loans and billions more in loans from the World Bank and IMF will never be repaid. Contrary to the optimistic statements made by the Clinton White House regarding the likelihood of repayment, Mexico is already heavily burdened by over $160 billion in foreign

debt and cannot possible repay these additional loans.[1] More than new loans co-signed by the U.S. taxpayer, Mexico needs to restructure its existing foreign debts on a private basis and embrace further free-market reforms in order to prevent a reoccurrence of the type of financial crisis seen since December 21, 1994.

3. There are no free Mexican oil revenues available as collateral on the $40 billion in loan guarantees. Mexico currently earns roughly $6-7 billion annually on oil exports, but most of these dollar revenues are already pledged to pay the country's $80 plus billion in public sector debt and meet other fiscal demands on the Mexican government. Treasury Secretary Robert Rubin and Under Secretary Lawrence Summers are mistaken when they asserts that there is any excess dollar revenues available from Mexican oil exports to serve as collateral on these loans.

Mexico's earnings of dollars from oil exports were approximately $6.17 billion in 1994, down from as much as $15 billion in 1984.[2] Moreover, declining exports and rising internal demand for energy make it clear that the U.S. Congress cannot rely on oil revenues for security on the proposed loans.[3] By the end of the decade, Mexico's oil exports probably will disappear and the country will become a net-importer of oil and refined energy products.[4]

The bottom line: The Clinton Administration is trying to sneak a costly, counter-productive taxpayer bailout for Mexico past the Congress by making all sorts of hysterical claims about the dire consequences of inaction. In fact, the U.S. should do nothing directly about the Mexican financial crisis. Instead, the U.S Treasury should urge private banks and investors to develop a private sector solution to the crisis in Mexico and thereby help that country to move forward toward economic opening and free-market reforms.

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[1] According to *El Financiero* (January 9, 1995, Page 4), Mexico's total foreign debt public and private reached $146 billion at year-end 1994. When foreign holdings of Mexico's internal debt and dollar deposits in Mexican banks are added to the equation, the country's external debt easily exceeds $160 billion. The Institute for International Finance in Washington has estimated Mexico's total foreign debt at year-end 1994 to be $166 billion. See also *El Financiero* (December 12, 1994, Pages 4-5; December 30, 1994, Page 3A).

[2] See *La Jornada* (October 17, 1994, Page 1). Because of a lack of capital investment, Mexico's state oil company, Pemex, is not able to meet demands for energy and replace proven oil reserves. Moreover, Pemex itself has foreign debts of $7.6 billion. See also *El Financiero* (October 27, 1994, Page 8)

[3] See *El Financiero* (December 29, 1994, Page 11). Mexico has already announced plans to reduce oil exports by 3.7 percent during the first half of 1995 because of rising internal demand. Internal demand for crude will rise to 52 percent of total output in 1995 compared with 49 percent in 1994.

[4] See Zaracostas, John, "Study: Mexico on the Road to Becoming New Oil Importer by End of Decade," *Journal of Commerce*, December 21, 1994, Page 6B.

The Clinton Administration claims that without the $40 billion aid package now before Congress, Mexico will experience further financial upheaval, leading to social ills such a greater illegal immigration and poverty. But the truth is that the inconsistent economic model of former President Carlos Salinas has already built these and other problems into the mix. These difficulties will likely grow much worse, thus Bill Clinton would have American taxpayers rescue the Mexican architects of the current disaster.

Contrary to White House claims that the bailout benefits Mexico, in fact the loans will be used to allow foreign investors an opportunity to escape peso investments at a lower penalty, leaving the U.S. Treasury with a potentially open-ended commitment to further subsidize the shaky Mexican economy. Both the Clinton and Bush Administrations made claims of job growth and bigger U.S. exports to Mexico during the NAFTA debate, but these promises lie in ruins. Incredibly, the President now asks you to believe that these new loans "will not cost the United States government anything," in the words of Treasury Secretary Robert Rubin.[5]

History and the disingenuous statements made by officials of the Mexican government argue strongly in favor of caution. The fact is that not one penny of the aid package proposed by President Clinton and apparently endorsed by the Republicans in Congress will ever reach the millions of people in Mexico who really do need help. The proposed $40 billion rescue package announced on January 12 actually is a hidden subsidy for Wall Street and Mexico's elite, not a helpful hand as the Clinton Administration now claims.

While the Treasury remains blind to the true scope of the Mexican debt crisis, officials inside the central bank are alarmed by recent developments. In a confidential presentation in early January to the board of directors at one Federal Reserve Bank, a direct comparison was made between the situation facing Mexico's financial system and the asset price deflation that has crippled Venezuela's economy since the start of 1994. The Fed presentation concluded that Mexico's government will be forced to print money in order to refund deposits in bankrupt commercial banks or face civil unrest.

Mexico faces further peso devaluation as and when commercial banks collapse under the sheer weight of bad loans, this on top of the effective 30-40 percent peso collapse since December 21st. Compared to the paltry $40 billion now on the table to rescue Wall Street punters, Mexico faces a domestic asset meltdown that could total in the hundreds of billions of dollars.

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[5] It is interesting to note that the U.S. was recently forced to redeem $400 million in loan guarantees for Iraq.

As the internal economy in Mexico shrinks. its swollen, $160 plus billion foreign debt will grow ever larger and force another debt default. initially time involving private rather than public sector borrowers. The process driving the gradual collapse of the Mexican banking system and commercial companies with large dollar debts is a still concealed financial catastrophe that seems inevitable, but should come as no surprise in Washington or on Wall Street. Mexico's ingenious peso Ponzi scheme has. after all, collapsed several times before over the past 170 years. Rather than asking Congress to forgive their gambling debts, holders of Mexican debt should consult a priest or bartender

A Free Market Solution

Mexican President Ernesto Zedillo confronts an enormous national crisis not of his making but which is now his sole responsibility. Millions of Mexicans and many others outside the country are looking to him for a solution to the economic chaos caused by the more than 40 percent devaluation of the peso against the dollar over the past week.

The good news is that the hardest part. namely the long-delayed adjustment of the bloated Mexican currency. is now largely complete. While the peso may continue to fall against the dollar over the next several weeks and months. the process of restoring genuine stability to the financial markets has already advanced a long way and can be completed as soon as Zedillo presents a credible economic strategy based on continued market liberalization. Unfortunately, it seems that Mexico, with the assistance of Washington and Wall Street. is preparing to repeat the very mistakes that caused the Mexican economic crisis in the first instance.

The January 31 decision by the Clinton Administration to make $20 billion available to Mexico convinced many in Washington that the peso crisis of 1995 is resolved. The Mexican currency had fallen over 40 percent since December 21 and almost 50 percent since January of 1994. Yet while the U.S. bailout reassured Wall Street banks and their clients. this unprecedented public subsidy for private offshore debts had little effect on the brutal economic contraction now underway south of the Rio Grande.

Restoring confidence to foreigners who choose to speculate in short-term Mexican debt is not the same as providing meaningful assistance to the Mexican economy. In particular. the proposed aid package will have little or no effect on the deteriorating situation inside the Mexican banking and financial system. Growing numbers of credit analysts acknowledge that many Mexican commercial banks and finance companies are insolvent and in imminent danger of failure because of defaults on peso loans by Mexican citizens.

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Any viable program to revive Mexico's economy must begin with a complete repudiation of the key flaw in the economic policy of the previous government, namely pegging the peso to the dollar. Experience teaches us that a pegged currency implies a future devaluation. From the very outset, Mexico's new government must publicly admit that in the future the Banco de Mexico (Banxico) will target internal price stability rather than a fixed exchange rate as part of a new program for stable economic growth and investment within the North American Free Trade Agreement.

Banxico must eliminate future risk of sudden currency shocks. The central bank should publicly declare that it will end open-market intervention to support the peso and allow the currency to float until it reaches a "natural" level supported by the country's commercial and investment flows. Once the peso reaches a truly free rate against the dollar and the threat of a future maxi-devaluation is eliminated, interest rates in Mexico will fall and economic growth will return to a country where many once strong export industries are on the verge of collapse.

As former Finance Minister Jaime Sera Puche correctly told the leaders of the G-7 nations several years ago during the EC's currency crisis, foreign exchange market intervention is an exercise in futility. To further bolster the sagging peso, the Zedillo government must end interventionist restrictions on currency trading and allow speculative short-selling of pesos and other domestic financial instruments in order to help expand and strengthen the domestic capital market inside Mexico.

Moreover, by liberalizing the currency market banks and companies will be able to avoid the type of huge financial losses that discourage investment and now threaten Mexico's basic financial stability. With over $160 billion in total foreign debt and an economy now over 40 percent smaller in dollar terms than at the start of 1994, Mexico now is on the verge of a new debt crisis. Only through prompt action to reassure domestic and foreign investors by continuing to open the economy can Zedillo avoid a complete catastrophe.

Next, Banxico and the Zedillo government must reject the misguided and self serving advice now coming from the U.S. Treasury to respond to the crisis by either throttling internal growth or using new foreign loans to temporarily restore liquidity to the peso. By rejecting austerity and increased foreign debt, Mexico can permanently solve the current short-term volatility of the peso and build a firm foundation for fostering new job creation and higher real wages -- two important aspects that were noticeably absent from the economic program of the previous government. The self-serving bankers on Wall Street will argue for more debt and economic discipline, but Mexico's people need growth and jobs.

Consistent with the ending of foreign exchange market intervention and lifting controls on short-sales of the peso, the Mexican government should quickly end its socialist system of wage and price controls. Just as the peso needs to find a natural and sustainable level against the dollar, Mexican wages and prices must also be allowed to float freely to let the Mexican economy to find competitive "parity" vs. the U.S. and Canada. After an immediate, one-time upward price adjustment to accommodate the recent devaluation, wages and prices should stabilize and track Mexico's long-term rate of inflation.

Before rushing forward with new privatization schemes recommended by the same avaricious Wall Street banks that engineered the present crisis, the Zedillo administration should devise a new approach to selling part or all of the remaining state-run companies in order to maintain government revenues while encouraging private initiative in the economy. Simply selling state-owned assets to finance an unsustainable foreign exchange rate, current account deficit or income redistribution program is a mistaken policy of the previous government that a successful Zedillo administration must abandon forever.

Finally, President Zedillo must tell the Mexican people that while political tensions in Chiapas may have started the run on the peso, the true cause of Mexico's worst financial crisis since 1981 came from an unsustainable economic program that emphasized foreign borrowing in dollars rather than real growth in domestic peso terms. In order to regain badly needed political credibility, Zedillo must assure Mexicans and foreign investors that the priority for the future will be jobs and exports, not new foreign debt and artificial "stability" built on fickle short-term investment flows.

Amidst all of the recent bad news about Mexico, the Christmas crisis of 1994 presents an exciting chance to change many aspects of the old economic formula, a contradictory mixture of corporate statism and free market ideas that hurt Mexico's newly opened economy, destroyed millions of jobs and created the conditions leading to the current crisis. By rejecting discredited expedients such as more foreign debt, currency market intervention and wage/price controls, Ernesto Zedillo could turn the present crisis into an opportunity and complete the free market opening in Mexico that his successor only just began.

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In addition to his duties as an officer of LRI, Whalen edits *The Mexico Report,* a fortnightly review of political and economic affairs in Mexico that combines news, independent analysis, interviews, and commentaries by observers in Mexico. In addition, he publishes a fortnightly fax newsletter on U.S. business and political developments, known as *Washington & Wall Street*, which provides analysis and commentary on political developments in Washington affecting the Federal Reserve, trade policy and the U.S. economy

Whalen was born on January 6, 1959 and graduated from Villanova University with a degree in History in 1981. From 1981 through the end of 1982, he worked as a staff writer for the House Republican Conference Committee, which was then chaired by Rep. Jack Kemp (R-NY). In March of 1983, he accepted a position with the Federal Reserve Bank of New York, where he worked as a financial analyst in both the Bank Supervision and Foreign Departments.

At the start of 1986, Whalen joined Bear, Stearns & Co., working as a bond dealer in the London branch of this respected Wall Street firm. He had specific responsibility for establishing new business relationships with financial institutions from Japan. Whalen has experience in trading both fixed income and derivative products such as futures, options and other types of derivative financial instruments

In 1988, Whalen was appointed a director of The Whalen Company, an international consulting and public relations company founded in 1969 by Richard J. Whalen. Between 1988 and 1995, he served as lobbyist and/or foreign agent for the government of Chile under President Augusto Pinochet and Pakistan under President Zia al Haq and worked as public affairs counsel for a variety of domestic and foreign companies. In 1994, Whalen served as an adviser to the presidential campaign of Cuauhtemoc Cardenas Solorzano in Mexico. He was a principal of The Whalen Co. through December 1994 and remains a director and member of the board. Whalen does not presently serve as lobbyist or foreign agent.

Whalen is the co-editor of the 1990 book Trade Warriors: The Guide to the Politics of Trade and Foreign Investment. He has testified before Congress on issues including the Federal Reserve System and the Mexican business environment. He has contributed articles and commentaries on finance and political themes to publications including: *The American Banker, Barron's, The Christian Science Monitor, Dinero* (Colombia), *Este Pais* (Mexico) *The Freeman, Human Events, The Journal of Commerce, Reforma/El Norte* (Mexico), *Proceso* (Mexico), *The Nation, The New York Times, The Wall Street Journal* and *The Washington Post.* Whalen is co-founder and acting secretary of the Herbert Gold Society, an informal organization of current and former officials of the Federal Reserve, Treasury Department and the Congress who enjoy arguing about matters affecting the political economy.

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HEADLINE: RESUMPTION OF HOUSE FOREIGN AFFAIRS COMMITTEE WITH WITNESS KAMMAN. THE LAST SEND WAS PAGE RESUME ON PAGE RESUMPTION*** HSE FOR. AFFAIRS CMTE KAMMAN ET AL-10/04/89

BODY:
(RESUMPTION OF STORY PREVIOUSLY SENT)
REP. HAMILTON: Mr. Bereuter?
REP. BEREUTER: Mr. Chairman, I am still catching up here. May I defer to Mr. Smith first?
REP. HAMILTON: Mr. Smith?
REP. SMITH: Thank you, Mr. Chairman. Mr. Kamman, since Poland owes approximately $39 billion in foreign debt, what do you see as the applicability of the Brady Plan to Poland? And if you could, how does that $39 billion break down to, say 1990's service payments? How much do they owe for that year?
MR. KAMMAN: Well, I think the expert on debt would be Mr. Barreda, but one thing about Poland, most of the debt is official and not private bank, and the Brady Plan is essentially for private bank debt.
(To Mr. Barreda) Bill, would you want to add something to that?
MR. BARREDA: That's right, the Brady Plan is for private debt and that's about $9 billion for Poland. Any country is eligible for the Brady Plan, the conditions are an IMF program, World Bank programs, and domestic policies that encourgae private investment, including foreign countries.
Subject to those conditions, I think we certainly could consider the application of the Brady Plan. The Brady Plan's benefits are that it opens various options, market determined, to either reduce the total outstanding debt, such as buying back the debt, or reducing the interest rate through one method or another. As I said, if those conditions were met, we certainly would consider it for Poland.
REP. SMITH: What is the anticipated service payments in fiscal year 1994 for servicing that debt?
MR. BARREDA: Estimates -- we're working with the Poles right now, but estimates are on the order of $ ($$)3 to $4 billion.
REP. SMITH: Could you tell me, Mr. Barreda, what the status of the Paris Club rate restructuring negotiations are?
MR. BARREDA: We have been consulting with our allies in the Paris Club and with Polish authorities on the best way to proceed, and we're looking at options now and seeing what the Poles would prefer. The US position isn't very strong, although we favor prompt and generous action of the Paris Club, and that's what we're pushing for.
REP. SMITH: In addition to the $100 million in food assistance and the $140 [million] from the EC, what do you see as the impact of this food aid on the domestic producers in terms of their price, in terms of productivity? Is there any fear that this could have a negative impact?
MR. GOLDTHWAIT: I believe that one reason we are moving very deliberately with

MR KAMMAN: Mr. Congressman, we are doing a trade and development program, a half million dollar project in Hungary already. It has been agreed upon and is being implemented. And that was mentioned, I think, during the President's visit there. There is interest, I know, in Poland. It's not quite as far along, but I think it would be appropriate to consider doing similar things in Poland.

REP. ENGEL: Has any thought been given to setting up a quasi-governmental agency, such as an Eastern European Development Foundation, to coordinate the long-term efforts of both the public and private sectors, as we assist the economic revitalization of Poland, Hungry and hopefully other East Bloc nations along the line? Any thoughts on that?

MR. KAMMAN: Certainly there's been a lot of debate about what is the most efficient to put together, as you say, the private and the public sector here. For the moment, that is not something that we intend to do, although it is certainly the purpose of the President's mission, that he's announced today, to go to Eastern Europe, to Poland, and possibly also a mission that would visit Hungary, to look into the structural requirements of those economies. And that would be a combination of both public and private expertise.

Whether we need to set up a different institutional framework is something I think we'd want to leave open until we see the progress of the structural reforms.

REP. ENGEL: Okay. Thank you, Mr. Chairman.

REP. HAMILTON: Mr. Gilman.

REP. GILMAN: Thank you, Mr. Chairman.

Mr. Chairman, I want to commend you for holding the hearing in a timely fashion. We've just received the bill. I'm pleased to be co-sponsoring it. I think the Polish government certainly needs help and needs it promptly, and we're certainly at a turning point in history, and it's up to our nation to help bolster this new democratic initiative.

I'd like to ask our distinguished panelists -- there's been a great deal of discussion about the possible utilization of a loan from the Treasury's Exchange Stabilization Fund to help stabilize the zloty as Poland tries to attack its inflationary problem. And I know our good chairman, the gentleman from Indiana, Mr. Hamilton, has raised that issue.

Can you tell us, has serious consideration been given to that, and is that possibility presently under review? And does the Treasury Department have the authority to loan to Poland under this program?

MR. BARREDA: Mr. Congressman, the administration has decided to support a Polish fund for stabilization. We think the appropriate way to do that is through an appropriation by Congress. We think the Exchange Stabilization Fund's purpose and use is quite different. We've used the Fund for intervention exchange markets and for very short-term loans, usually bridged to a guaranteed repayment in a hard currency.

The proposal to provide Exchange Stabilization funds to Poland on a longer-term basis is a totally different use of the funds. That is much closer to foreign aid, Mr. Congressman. We think, therefore, it should be appropriated.

REP. GILMAN: Let me --

MR. BARREDA: The other concern --

REP. GILMAN: -- pursue that a moment with you. Is our assistance to Poland going to be based on an IMF loan?

MR. BARREDA: We have said that the use of this $200 million that we are asking for and that we would try to leverage with the assistance of other countries, would be conditional on an IMF program.

said it was used only for short-term loans. Is that correct?
MR. BARREDA: That's right, sir.
REP. HAMILTON: By which you meant what?
MR. BARREDA: The use -- we have two uses of exchange stabilization fund right now, Mr. Chairman. One, we use it for activity in the foreign exchange markets where we're exchanging dollars for yen or Deutschmarks or vice versa. We also do it for some short-term bridging. In that case, we make available the dollars in exchange for an assured repayment in hard currency, and we lock in the exchange rate.
REP. HAMILTON: And short-term, in that context, means what?
MR. BARREDA: It's less than six months, according to the statute, unless approved by the President to be longer.
REP. HAMILTON: You have made longer loans than six months, have you not?
MR. BARREDA: I'm not aware of any, sir. I have been discussing with your staff a Mexico loan, and I would like to look into that and get back.
REP. HAMILTON: $600 million for 12 months to Mexico in 1982.
MR. BARREDA: That's the one I want to --
REP. HAMILTON: Are you not aware of that?
MR. BARREDA: I wasn't until now and I'm going to look into it and get back to you.
REP. HAMILTON: Now, of course, you could use this money as a bridging loan to Poland, could you not? That is, you could extend a loan to Poland under the exchange stabilization fund, and then, when the IMF loan kicks in, it could take over the loan. I mean, that's a possibility, isn't it?
MR. BARREDA: If there's an assurance of an IMF agreement and it's short-term, we would certainly consider that, as I said in my testimony. What we want to be sure of is repayment in a hard currency and in short-term.
REP. SOLARZ: Will the gentleman yield?
REP. HAMILTON: Mr. Solarz.
REP. SOLARZ: Thank you very much, Mr. Chairman.
What would you -- on a scale of zero to ten, with ten being a certainty that there'll be an IMF agreement and zero being a certainty there won't be, where would you put it?
MR. BARREDA: I can't answer that, Mr. Congressman.
REP. SOLARZ: Well, Mr. Kamman, do you want to try?
MR. KAMMAN: Well, those loans are essentially a Treasury decision. They want to be sure --
REP. SOLARZ: I'm asking you for a judgment about the likelihood of an IMF agreement with Poland.
MR. KAMMAN: I'm sorry. I thought you indicated the likelihood that we would extend a loan.
REP. SOLARZ: No. The likelihood that there'll be an IMF agreement, on the scale of zero to --
MR. KAMMAN: Well, since they're in a -- since they're in a very early stage, it's hard to make that judgment. I think it's highly likely. I'm not going to put it on the scale, but it's highly likely.
REP. SOLARZ: Say eight or nine?
MR. KAMMAN: Well, I would say highly likely.
REP. SOLARZ: Well, if it's highly likely that there will be an IMF loan and if the Poles also know that their ability to get the $1 billion stabilization loan depends on their getting an IMF agreement, would the Treasury object to using the Exchange Stabilization Fund for a loan right now to be repaid by Poland when it gets its IMF agreement, so that they get the short-term funds?
MR. BARREDA: I think the Treasury would object, sir, because there is

to get an IMF agreement, then?
MR. KAMMAN: I think they would welcome it either as a bridge loan or as a grant. Whether in some other form it would be useful, I don't think we've had that much discussion with them yet.
REP. SOLARZ: Right. And you're saying, I gather, that we cannot -- that if we were to use the exchange stabilization fund without an assured mechanism of repayment that that would be an illegal use of the fund, given the criteria that have been built into it, or would it be a breach of the fidiciary responsibility of the Secretary of the Treasury --
MR. KAMMAN: We think it would be an improper use of the fund, Mr. Congressman.
REP. SOLARZ: Would it be an illegal use of the fund? Something can be improper without being illegal, and I'm not suggesting that we do something improper, but I just want to know where we stand.
MR. BARREDA: We can try to give you an opinion on that. As --
REP. SOLARZ: Can you --
MR. BARREDA: -- it's an improper use of the fund. We don't think it should be used that way. If there is going to be a chance of loss, we think it should be an appropriation. X
REP. SOLARZ: Right. But, can you let us know whether it is illegal as well as improper?
MR. BARREDA: Uhhh.
REP. SOLARZ: Yes?
MR. BARREDA: Certainly.
REP. SOLARZ: Finally, there's been some talk about the possibility of having Mr. Walesa, when he comes here, address a joint session of Congress. Mr. Kamman (misprounouces) -- Kamman -- does the administration have a view on this? Would it support such a request? Would it oppose it?
MR. KAMMAN: The administration has always regarded the issue of who addresses the Congress to be in the prerogative of the Legislative Branch. And I have mentioned today -- I think you were here at the time -- that the President today announced that he would be inviting President Jaruzelski and Prime Minister Mazowiecki in the coming year. And certainly when Walesa is here, which I understand will be November, we expect that he will receive much attention and many honors. But I think the form of that is really up to the Congress.
REP. SOLARZ: But you would have no objection to his being invited to address a joint session?
MR. KAMMAN: I think it's completely in the real of the congressional prerogative.
REP. SOLARZ: Oh, I would have hoped you could have done a little bit better than that. I mean, this man is one of the extraordinary figures of our century.
MR. KAMMAN: We very much admire Mr. Walesa. But I think it's not right for the Executive Branch to make a judgment about how he's treated at the --
REP. SOLARZ: Well that's simply false and untrue because we frequently receive requests from the administration to invite various people to address a joint session. So it's not as if the administration takes the position that it never speaks out on this question. It --
MR. KAMMAN: Yeah.
REP. SOLARZ: -- very often -- I mean in the past when we've had people who are invited to address a joint session, it is always accompanied by a request from the President to the leadership of the Congress urging that such an invitation be extended. So in light of that fact, do you want to let us know whether the administration would like such an invitation to be extended?
MR. KAMMAN: I think the administration judges that the Congress knows its own mind on the issue, and we will let the Congress be the judge.

2B · MONDAY, JANUARY 23, 1995 · USA TODAY

Although the Dow Jones industrial average rose only a modest 39% the first half of the '90s, many stocks and stock mutual funds delivered huge gains. This page offers a rundown of the top stocks and stock mutual funds for 1990-94 and a look at how various stock industry groups fared.

How fund categories fared

GENERAL FUNDS

Objective	No. of funds	Total return 1994	Total return '90-'94
SG Small-co. growth	283	–0.7%	78.8%
MC Midcap	99	–2.1%	78.1%
CA Capital appreciation	155	–3.4%	54.6%
G Growth	564	–2.2%	53.0%
GI Growth & income	412	–0.9%	49.8%
EI Equity-income	121	–2.5%	42.5%
Avg. general fund	—	–1.7%	55.5%
S&P 500-stock index	—	1.3%	51.6%
SPECIALIZED FUNDS			
TK Science & technology	37	10.6%	123.5%
FS Financial services	16	–2.8%	110.2%
H Health/biotechnology	18	4.3%	98.6%
EM Emerging markets	47	–9.6%	68.2%
CV Convertible bonds	31	–3.8%	57.1%
FX Flexible portfolio	149	–2.7%	49.2%
GS Global small-co.	23	–3.0%	44.9%
RE Real estate	21	–3.1%	41.5%
PC Pacific	69	–12.5%	40.6%
UT Utilities	86	–9.0%	37.5%
GL Global	123	–3.0%	34.2%
IF International	223	–0.7%	31.1%
EU Europe	47	1.2%	22.8%
IS Internat'l small-co.	11	–4.1%	22.5%
NR Natural resources	38	–4.1%	15.9%
EN Environmental	6	–10.5%	6.8%
CN Canada	2	–12.9%	5.9%
AU Gold	38	–12.2%	1.3%
LT Latin America	19	–14.2%	new
JA Japanese	12	15.4%	–19.4%

Source: Lipper Analytical Services

The Wall Street Journal, Feb. 13, 1995

Prospects Dim For Bank Loan To Mexico

By Timothy L. O'Brien
Staff Reporter of The Wall Street Journal

Prospects for a possible $3 billion private-sector bank loan to the Mexico government appear to be fading, even though a much larger rescue plan by the Clinton administration has already calmed Mexican financial markets.

Some banks being asked to participate in the new bank loan are voicing objections

Zedillo's Risky Strategy

By trying to snuff out an insurrection in the southern state of Chiapas, Mexico's president may rally his political opponents. Article on page A10. Meanwhile, Mexico's currency crisis might end up creating investment opportunities, C1.

to its liberal terms and the approach taken by the lead banks, Citicorp and J.P. Morgan & Co.

People close to Citicorp and Morgan maintain the loan is moving forward and may be completed by next week, but the banks declined to comment officially. But executives at several other banks said just the opposite. "It appears to be stuck," said one. "Who volunteered the commercial banks anyway? Not all of the banks have the same interest in or exposure to Mexico as Citicorp and Morgan have."

Senior executives of other large banks have been troubled or angered by the manner in which the loan was proposed, which they call reminiscent of a bygone era when a few senior bankers would get on the phone and solve international financial crises together. Stung too often by foreign debt woes, they said rescue packages can no longer be pieced together so easily.

The bank executives said the loan's urgency appears to have been diminished by the $50 billion White House rescue package for Mexico. With a sum that large already in the pipeline, they said they might as well take their time considering terms of any new loans they make to Mexico.

After the value of the Mexican peso plummeted late last year, Citicorp and Morgan began rounding up partners to help support the beleaguered currency. During the first week of January, the two banks approached several other banks seeking $200 million from each of them for a $3 billion package.

"We were told [by Citicorp and Morgan] that this was important for the United States," said one banker. "But this isn't old boys making calls and getting things done anymore—times have changed."

According to an individual familiar with the loan, most banks balked at committing $200 million. So far, only BankAmerica Corp., Chemical Banking Corp., Chase Manhattan Corp., Bankers Trust New York Corp., Banco Latinoamericano de Exportaciones, and Bank of Nova Scotia have tentatively joined Citicorp and Morgan at that level. Others, including Bank of Tokyo, NationsBank and First Chicago Corp., have agreed to smaller amounts.

Some bankers said they are unwilling to commit formally to a package unless the loans are collateralized, which they currently aren't, and only if the interest rates are more attractive. One person familiar with the loans said they are currently structured at 1.5 percentage points above Libor, a floating-rate bank index, for the first six months after they are made. Some bankers are asking for two percentage points above Libor.

While loan syndications can often be rocky affairs, bankers are typically tight-lipped about such negotiations. But more than haggling over terms appears to be at work here.

The executives who voiced their objections said that even though this loan may no longer be necessary, they believe Citicorp and Morgan are pushing for it, as one banker put it, because they "want to prove to everyone that they support Mexico."

Some of the bankers are reluctant to lend to the Mexican government after the loan debacles they experienced in the 1980s. They said they would prefer to continue lending to their own clients in Mexico's private sector, or commit to purchasing Mexican debt for resale at a weekly auction. "That would be far more appropriate than being at the tail end of a major rescue package," said one banker.

The Nation, 2/13/95

MEXICAN HANDOUT

Bailing Out the Creditor Class

WALKER F. TODD

One of the most preposterous financial crimes of the century, the official management of the 1980s developing-countries debt crisis, is being repeated before our very eyes, and by many of the original perpetrators to boot. As this is written, the Clinton Administration is pushing, and Congress seems poised to approve, a loan guarantee package for Mexico of up to $40 billion. This is on top of hastily arranged international credit lines worth $18 billion, most of them guaranteed directly or indirectly by the United States and cobbled up since Christmas.

Mexico owes the world about $120 billion (more than $160 billion by some estimates), and about $58 billion of that amount falls due this year. Hence the need for a total aid package of about $58 billion, although it is not yet certain that most or all of that aid will be drawn upon. One must be exacting and clear about who the principal beneficiaries of a U.S. guarantee of Mexico's foreign debts would be: Mexico owes foreign—primarily U.S.—investors in stock shares and bonds about $60 billion. Also, about $18.3 billion of the $120 billion total is owed to U.S. banks, led by Citicorp with about $2.9 billion. With the peso down in value by one-third and Mexico's dollar reserves dwindling, it is clear that only a mammoth infusion of funds or forgiveness of its debts can prevent the country from defaulting.

The original crime, now being repeated, was the profligate lending of billions of dollars from the U.S. banking system between 1974 and 1982 to as gaudy a band of tinpot military dictators, kleptocratic presidents and bon vivant finance ministers as ever graced a Connecticut Avenue diplomatic reception, followed in August 1982 by the discovery that the borrowers either could not or would not repay the money. But it was not practical politics to recognize the stupidity of the situation and call the lenders into account. No, orthodoxy and good form required the ongoing pretense that the loans were still good, with a host of jerry-built solutions from the Treasury, the Federal Reserve, the International Monetary Fund and the World Bank. So, as an African economist once told me, "One class of people borrowed the money, and a different class of people had to pay it back."

The I.M.F.-policed austerity regimes that were used to keep the loan money flowing (usually only enough to pay the interest; the principal was rarely reduced) became legendary in developing countries during the 1980s. What did governing elites or international financial diplomats care if the vanishing middle classes and teeming poor of the Third World paid the price of "adjustment" while the lifestyles of the rich changed not at all?

In 1982 Mexico owed U.S. banks about $25 billion. The dirty secret of Debt Crisis I was that foreign banks had deposits of flight capital from rich residents of the debtor nations that would have covered much (and in some cases all) of the banks' claims on the debtor countries. But despite the price paid for "adjustment" by the middle classes and the poor of the developing countries, not to mention the price paid in lost export sales to those countries by U.S. manufacturers and farmers in the heartland, the names of the thieves and the amounts they stole were never disclosed.

The governing elites in both countries who caused this mess expect to escape censure.

Now, by devaluing the peso, Mexico has again committed moral (if not technical) default on its dollar-denominated obligations. This is the principal legacy of the administration of former President Carlos Salinas de Gortari and his supporters in the U.S. establishment. It is doubtful that Mexico can meet its external obligations during 1995 without either debt relief (always the right answer in international lending problems involving developing countries) or new loans from First World governments and banks (the Establishment's preferred solution). After the lost decade of the 1980s, relieved only briefly in the early 1990s by the North American Free Trade Agreement financial bubble, the Mexican people find themselves once more confronting official demands for renewed austerity, quiet acceptance of further reduced wages (now approximately 60 percent below 1980 levels in inflation-adjusted peso terms), reduced possibilities for immigration to the United States to escape poverty, and diminished prospects for renewed growth of the Mexican economy for the foreseeable future.

But here is where the truly intolerable part begins again: The governing elites in both countries who caused, exacerbated or covered up this mess expect to escape censure, just as happened in 1982.

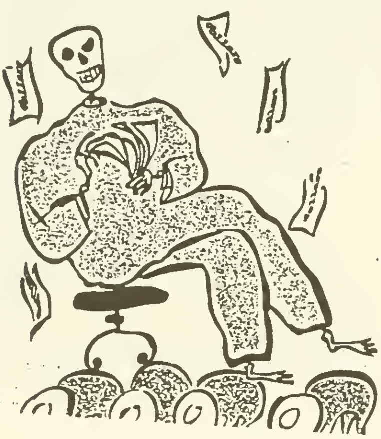
Secret credit lines for Mexico from the United States, Japan and European governments amounting to as much as $12 billion were negotiated twice in the past fifteen months or so, ostensibly to defend the peso, but it is now clear that the only possible use of those lines would have been to finance the flight from the peso of Mexico's governing elites and their compatriots in the international financial system. Amusingly, through a tripartite credit line involving Canada as well as Mexico, which was announced publicly in April 1994, the United States essentially has agreed to lend Canada dollars that Can-

Walker F. Todd, of counsel to the Cleveland law firm of Buckingham Doolittle & Burroughs, was formerly assistant general counsel and research officer at the Cleveland Federal Reserve.

ada can then lend to Mexico, which further weakens the U.S. dollar. Our own creditors now understand that we have underwritten the foreign debts of our two neighbors. Federal Reserve Chairman Alan Greenspan was an active promoter of those credit lines, as well as the current bailout effort.

The principal purpose to be served by the new Mexican bailout package is to prevent a loss of confidence of foreign investors in a host of other developing nations, like Argentina. But this is a silly exercise, a true confidence game, because now no rational investor could have faith in Mexico's governing Institutional Revolutionary Party (PRI), which has enjoyed so much official U.S. support in recent decades. The Banco de Mexico, the country's central bank, was still intervening in the Mexico City stock exchange and rigging tesobono (treasury bill) auctions in the same week that the bailout package was presented to Congress, a clear indication that stability has not returned to the country's shaky financial markets. Also, if other countries have mismanaged their financial affairs and are courting disaster for their currencies, there is not much that a bailout of Mexico can do to restore investor confidence. Besides, the prospects for repayment from future Mexican oil receipts, for example, are somewhat limited: At current oil production and price levels, the gross export receipts for Pemex, the national petroleum company, are only about $8.5 billion per year, and most of that has already been pledged to other purposes. The time is long since past in Washington for a repetition of the Paul Volcker–directed "lend new money to meet the interest payments and pretend that it is all still good debt" strategy of the 1980s.

Dissent has broken out in both the Republican and Democratic parties over various aspects of the bailout. A variety of extraneous conditions are being proposed to sweeten the



ATIONS BY LISA BLACKSHEAR

deal: demands that Mexico loosen its ties to Cuba and crack down on illegal immigrants to the United States (red meat for the right), and calls for stronger enforcement of labor and environmental protections (for the liberal left). But at bottom what is needed is a prompt and full disclosure of what the $40 billion will be used for. The names and amounts paid for each disbursement under the credit line should be published. If there are Charles Keatings, Ferdinand Marcoses and M. Danny Walls lurking, the public is entitled to know who they are and what they intend to do with the money they receive at our expense. And if the names disclosed prove to be those of prominent Mexicans and U.S. banks, securities firms, mutual funds and pension fund managers, then we should know that, too. Who knows, with enough disclosure, maybe no one would step forward to claim the money. But don't count on it.

Unfortunately, no new U.S. loan guarantees administered by the existing PRI government can foster real stability in Mexico. And support for the side agreements to NAFTA misses the point entirely. Dissenters in Congress should insist on complete institutional and financial reform of the Mexican government, which might then do more to address labor and environmental concerns from an authentic Mexican perspective, not merely as a PRI concession to the United States. The PRI has forfeited all moral authority to govern. President Ernesto Zedillo Ponce de León should invite the two main opposition parties to join his Cabinet on a full power-sharing basis, with all the important Cabinet ministries going to the opposition. The PRI itself should be dissolved.

To combat the PRI's almost unnatural hold on the affections of many of Mexico's uneducated poor, truth commissions independent of the PRI, like those used in Chile after Pinochet, should be established to investigate matters like the use of foreign credit lines by the Banco de Mexico, the massacre of student demonstrators in Mexico City in 1968, the manipulation of the 1988 election results, the responsibility for the assassinations of Luis Donaldo Colosio (first presidential candidate of the PRI) and José Francisco Ruiz Massieu (second-ranking PRI official) in 1994, and the murders of journalists and opposition activists under Salinas. Also, a separate inquiry should be mounted into the influence of drug runners and money launderers in Mexican public life, as well as their connections to foreign intelligence services.

As for Washington's pending actions: It once was a federal felony under the Johnson Act for any person subject to U.S. jurisdiction to lend money to a foreign government in default on its loans from the United States. After 1945, however, the act was amended to accommodate the formation of the Bretton Woods institutions. Only international financial "outlaws" like the former Soviet Union and China were excluded. Then in 1992, during the euphoria over market openings in Russia, the Johnson Act was quietly amended further to exempt from its prohibitions former Soviet-bloc countries that were not yet members of the I.M.F. and World Bank, establishing the principle that even outlaws may now borrow money in international financial markets. This is too bad, for as the crimes of 1982 are repeated, this time we lack a good felony statute with which to punish the miscreants.

LRI

Legal Research International, Inc.

March 1, 1995

The Honorable
Dan Burton
Chairman
Subcommittee on Western Hemisphere
House Foreign Affairs Committee
2170 RHOB
Washington DC 20515

Dear Mr. Chairman:

Thank you for asking meet to testify before your panel last week during your hearings on the $20 billion bailout for Mexico. The hearing was of necessity abbreviated and I am happy to comply with your request for further information, which I provide below in two sections:

Jose Cordoba Montoya

During yesterday's hearing, I stated that **Jose Maria Cordoba Montoya**, who was formerly head of the office of the presidency under President **Carlos Salinas de Gortari** and is now Mexico's representative here in Washington to the Inter-American Development Bank (IDB), apparently was closely involved with the negotiations for the $20 billion loan package for Mexico. I stated that along with his protégé and successor, **Luis Tellez**, who is currently head of the office of the presidency in Mexico, press reports in Mexico indicate that Cordoba had served a key role in brokering the loan deal, even though he does not have any direct role in the Zedillo government.

I also stated at the February 22 hearing that Mr. Cordoba has in the past year been linked with the Matamoros Cartel, Mexico's biggest and arguably one of the world's largest and most powerful cocaine trafficking organizations. Perhaps the single best citation on this subject from the press was the September 1994 column by **Raymundo Riva Palacio** in the daily *Reforma*, which contained specific allegations of an ongoing affair between Cordoba and a woman named **Marcela Rosaura Bodenstedt**, who is the wife of and is also herself a chief operative of **Juan Garcia Abrego**, the head of the **Matamoros Cartel.**[1] **Bodenstock**, a former

[1] A former Mexican official in charge of anti-narcotics activity, **Eduardo Valle**, testified at the Mexican le hant consulate in Washington on August 25, 1994 about the connection between Marcela Bodenstedt and the office of Jose Cordoba in Mexico City. In the documents he submitted to the Mexican attorney general's

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official in the Mexican federal judicial police, also has a close relationship with **Emilo Gamboa Patron**, the former head of the Ministry of Communications and Transport in the Salinas government. Incredibly, Gamboa was named head of the National Lottery by President Zedillo late in 1994. [2]

The Riva Palacio column and other published reports were significant for several reasons: (1) the first mention of the relationship between Cordoba and the Matamoros Cartel appeared in the nominally pro-government daily *Reforma*; (2) the allegations, made by one of Mexico's leading commentators and other reporters, went unchallenged and unanswered; and (3) there was no attempt by the Mexican government to discredit the reports in subsequent news coverage. Moreover, the fact of this relationship is common knowledge among my sources in the Mexico political and business communities, as well as among U.S. law enforcement and foreign service personnel, indicates that there is good reason to believe Riva Palacio's account. [3]

In addition, the close ties between Cordoba and members of the Clinton and Bush Administrations are well-documented in the Mexican press. Perhaps the best example is the term coined by *El Financiero* columnist **Carlos Ramirez**, who for several years has repeatedly refereed to the NAFTA agreement, which in Spanish is known as the *Tratado de Libre Comercio* (TLC), as the *Tratado Cordoba Lake*, because of the personal and professional ties between Cordoba and National Security **Adviser Anthony Lake**.

Ramirez and other reputable commentators in the Mexican daily and periodical press have written volumes about the close collaboration between Lake and Cordoba, both during the effort to push NAFTA through Congress and thereafter. A cursory examination of the index for the dailies *El Financiero*, *La Jornada* and *Reforma* for the 1990-1994 period, as well as the extensive coverage in the weekly *Proceso* for the same period, provides ample documentation for the existence of a close working relationship between Lake and Cordoba.

During the entire Salinas *sexenio*, Cordoba has been the main intermediary between Mexico City and Washington, and reportedly has met with and interacted personally with a number of members of the Clinton and Bush Cabinets. In specific reference to the role of Cordoba in the recent negotiations for the $20 billion U.S. loan to Mexico, I refer to the January 30, 1995 article in the weekly *Proceso* written by former Washington correspondent **Carlos Puig**. The gist of the article is that "the team of Salinas and Cordoba, and Cordoba alone, are involved in the talks for the

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office were phone records showing calls between members of the Matamoros Cartel and the office of the presidency in Mexico City. Valle has sought political asylum in the U.S. and now lives in Washington.

[2] See Riva Palacio, Raymundo, "Relaciones Peligrosas," *Reforma*, August 29, 1994. See also the several articles in the weekly magazine *Proceso*, September 5, 1994, pp. 30-37, and Golden, Tim, "Mexico's Drug Fight Lagging, With Graft Given as a Cause," *New York Times*, August 7, 1994.

[3] Usually, when the Mexican government attempts to discredit a critic, they employ hysterical, very loud protests and personal attacks through government controlled print and broadcast outlets. In the case of allegations of corruption, however, the usual approach is to avoid mention of the case when the allegations come too close to the mark.

$40 billion air package." The article details how Cordoba, rather than the new Mexican ambassador, **Jesus Silva Herzog**, conducted the negotiations on behalf of Mexico and, in general, has been directing Mexico's foreign affairs in Washington.

In a February 8,1995 article in *El Financiero*, Washington correspondent **Dolia Estevez** highlights the previous relationship between Cordoba and former Mexican ambassador to Washington **Jorge Montaño**. Among other things, the article confirms that in November 1992, Cordoba personally called to advise the Clinton White House of the appointment of Montaño. As the article reports: "This was tantamount to his being named ambassador of Cordoba."

Exchange Stabilization Fund

The second major issue raised during the hearings was with respect to the transparency of and the accounting procedures used by the Exchange Stabilization Fund of the Federal Reserve and Treasury.[4] During the hearing, I stated, based upon my personal experience and upon my conversations with former and current employees, that the Federal Reserve Bank of New York (FRBNY) used peculiar and apparently inconsistent methods for reporting profits and losses from the ESF. I also stated categorically that the FRBNY had in the past taken gains and losses without actually selling any foreign currency; that is, the FRBNY apparently marked its portfolio to market at a given date but did not actually realize a gain or loss by purchasing dollars, contrary to the publicly available information released by the Federal Reserve Board (FRB).

Perhaps the biggest and most important piece of evidence available to the public with regard to the accounting practices of the ESF come from the publications of the Federal Reserve Board (FRB). The two most important documents are periodic "Treasury and Federal Reserve Foreign Exchange Operations" and the annual report of the FRB. The most recent data available for the Fed/ESF foreign exchange operations are year-end 1993. According to **Joseph Coyne**, head of public affairs at the FRB, the year-end data for 1994 should be available by mid-April.

The table on the next page shows the year-end profits and losses reported by the FRB (first column), compared with the periodic reports of realized profits and losses reported for the Federal Reserve and Treasury(second and third columns). A cursory glance at the figures show that the amounts do not match and, moreover, that the trends in terms of gains and losses also appear to be at variance. All amounts are in millions of dollars.

[4] The ESF is managed and administered by the Foreign Department of the Federal Reserve Bank of New York. For further background, see Todd, Walker, "Disorderly Markets: The Law, History, and Economics of the Exchange Stabilization Fund and U.S. Foreign Exchange Market Intervention," Research in Financial Services, Vol. 4, pp. 111-179, 1992, JAI Press Inc., ISBN 0-55938-481-6.

Fed/Treasury Foreign Exchange Operations
(millions of dollars)

	FRB		Fed	Treasury
1993	0.18	Jan-93	109.50	25.1
		Apr-93	22.00	22
		Jul-93	128.00	127.7
		Oct-93	22.10	22.1
1992	(2,003.418)	Jan-92	75.00	3.9
		Apr-92	0.00	0
		Jul-92	336.20	114.4
		Oct-92	358.10	119.9
1991	366.40	Jan-91	0.00	0
		Apr-91	179.40	146.9
		Jul-91	147.50	60.3
		Oct-91	105.10	9.4
Total	**366.58**		**1,482.90**	**651.7**

Because the Fed has not in the past been willing to discuss the accounting procedures used to assemble these figures, I cannot say whether the numbers are or are not accurate. What can be said, however, is that there appears to be no connection between the gains and losses reported at year-end by the FRB and the transactions executed for the Fed and Treasury as reported in the periodic reports of Treasury and Federal Reserve Foreign Exchange Operations. At the very least, this subject requires greater attention from the Congress, starting with legislation to authorize annual audits by the General Accounting Office of the Fed/Treasury ESF function.

Please let me know if I can be of any further assistance to you or other member of the Committee.

Yours sincerely,

Christopher Whalen
Chief Financial Officer

Mexico: The Narco System
By Christopher Whalen
Dinero (Colombia)
November 1994, Pages 162-176
[English translation]

The September 28, 1994 assassination of the secretary-general of Mexico's ruling party, **Francisco Ruiz Massieu**, is the second major political killing in that country this year. The attack is also one of literally thousands of kidnappings, murders and other violent incidents directed against members of the country's business and political elite, as well as the political opposition, by the bosses of Mexico's thriving underworld. In the most simplistic sense, the murder of Ruiz is a challenge by the leading drug lords in Guadalajara, Tijuana and Matamoros to the existing political order. But the daylight execution of Ruiz, the former governor of the state of Guerrero, also represents a feud among familiars; a fratricidal rivalry whereby politicians aligned with one *narco* gang are being hit by other rival groups that make up the Mexican drug Mafia.

For example, most foreigners do not know that Ruiz's family is deeply involved in the Acapulco, Guerrero, business community, which in turn is dominated by the local drug lords. Just two weeks before the former governor of Guerrero was gunned down, police directed by his brother, **Mario Ruiz Massieu**, who is the official in the Mexican Attorney General's office responsible for combating drug activities, closed a number of nightclubs owned by various drug *capos* (bosses) in the seaside resort city. One local observer says that some of the managers of these clubs were "set up;" police planted cocaine in their offices and arrested them on trumped-up drug charges. According to the source, the closures were the last straw in a running feud between Ruiz and the local drug *capos*, and provoked this act of retaliation against the number two man in Mexico's ruling party.

Foreign observers, particularly the expatriate press, naively attribute the rising levels of violence in Mexico to political motives, but such easy explanations ignore the significant new factor that has entered that country's politics over the past decade: cocaine. Whereas in the past, members of the ruling party and their friends, relatives and allies in the criminal world settled disputes behind closed doors, today the fighting is being done in public, in front of hotels and in poor *barrios*. The head of the railway workers union was also killed in front of a Mexico City hotel in 1993, and dozens of other police officials, journalists and opposition members have died violently over the past five years.

The uprising in Chiapas and the murder of presidential candidate **Luis Donaldo Colosio** on March 23, 1994, in a poor neighborhood in Tijuana are only the most extreme examples of how Mexico's social and civic institutions are crumbling under the pressure of drug-related lawlessness and corruption, factors that are making Mexico a very dangerous place even for members of the ruling elite. Indeed, the same environment of lawlessness and impunity that has allowed Mexico's ruling party, known as the PRI, to govern for over 65 years is now aiding the expansion of the influence of the narcotics trade.

There are 19 distinct drug cartels in Mexico and four dominant groups, the largest of which is the Gulf or Matamoros group. It is widely assumed by savvy observers that the *Grupo del Gulfo* led by **Juan Garcia Abrego**, engineered this latest assassination. As with the Colosio case, a man who is said to be the actual perpetrator of the Ruiz assassination was apprehended almost immediately, but the real, intellectual authors of the crime will probably never see justice. Notably, in this latest assault Mexican officials did not even try to pretend, as they did with the Colosio slaying, that this gangland hit was a random act, a senseless display of violence. Most Mexicans know otherwise.

Federico Reyes Heroles, editor of the monthly magazine *Este Pais*, says bluntly that the killing of Ruiz was a deliberate hit by Mexico's powerful drug lords. News reports in the days following the killing included numerous off-the-record comments by government officials confirming the suspicion that the killing was a hit organized and paid for by drug traffickers.

Another prominent Mexico City editor, speaking off-the record, goes even further, saying that the killing of Ruiz, a close associate of President Carlos Salinas and other powerful figures in and out of the Mexican government, particularly Agriculture Minister **Carlos Hank Gonzalez**, was part of a continuing political dispute between Mexico's biggest drug cartels and their partners in the Salinas government. "Carlos Hank is the biggest money launderer in Mexico," says the veteran journalist. "This killing was a reprisal for the murder of Colosio, a tragic event which many people believe was engineered by Hank and other officials around Salinas." He goes on to say that as in Colombia, Mexican politicians are being killed off because of a power struggle related to money and drugs, not over questions such as democracy and human rights. Beyond the death of Colosio, however, another explanation exists: the need to maintain the appearance of "fighting drugs" to placate Washington.

In Mexico and other parts of Latin America, the term *lavadolares* means money launderers or those "who wash money." Just two weeks before the killing of Ruiz, Treasury Secretary **Lloyd Bentsen** told an audience in Mexico City that the U.S. currently has no less than 12 separate investigations underway concerning money laundering operations based in Mexico. He said the governments of Mexico and the U.S. have recently intensified efforts to exchange information on illicit drug and cash laundering operations in an attempt to clamp down on the growing business. This announcement shocked Mexicans generally and sent a wave of fear over the country's drug lords, who rightly fear that the new Zedillo government will launch an anti-drug, anti-corruption campaign early in 1995 in order to repair Mexico's image and persuade the U.S. government that Zedillo is serious about fighting drugs. In this scenario, the Ruiz killing is a direct warning to Zedillo and his backers, particularly *dinosaurio* Carlos Hank, from the drug trade. The message: Don't even think of arresting a member of the cartel or their people inside the Salinas government to appease the Clinton Administration.

Of course, most Americans are shocked and appalled by the suggestion that officials of Mexico's reformist, Harvard-educated government would actually plan to murder members of their own party or have direct business relationships with Mexico's cocaine lords. The fact is, however, that the violence linked to the drug trade in Mexico is less a civil war than a family squabble; a form of vicious attrition that hurts Mexico's dearly purchased image as a leader among the "emerging markets" around the world.

In a recent interview, President Salinas himself admitted that the annual flow of cocaine and other illicit drugs through Mexico totals some $100 billion annually. The Drug Enforcement Agency (DEA) and local sources in Mexico, such as the opposition daily *La Jornada*, estimate that the profits from this flow of drugs (90 percent of which comes from cocaine) amount to some $25-30 billion a year. In other words, the *profits* from drugs moving through Mexico into the U.S. every year are more than twice the total *revenues* of Mexico's petroleum industry and will roughly equal the cost of servicing Mexico's total, $160 billion-plus foreign debt for 1994.

The rise of the drug lords as sources of political power in Mexico is a relatively recent development, but one that was helped and assisted by the fact that the country's political system was already hopelessly corrupt. For decades members of the PRI have enriched themselves through corruption and dirty dealing at home, while borrowing from foreign banks and secreting the dollar proceeds into offshore bank accounts. Now, with the passage of the North American Free Trade Agreement (NAFTA), the door has been opened for a vast expansion of the drug trade into the United States.

"The NAFTA is now openly referred to as the 'North American Drug Agreement' by U.S. Customs and Drug Enforcement Agency personnel," wrote former Customs chief **William von Raab** last year. "This overt skepticism reflects discontent over the fact that national security concerns have been neglected in the NAFTA negotiations . . . Nothing we [see leads] us to believe that Mexico has tackled 'hard enforcement,' i.e. arresting significant drug figures, cracking down on money laundering or disrupting drug enterprises. Without a real hard-enforcement anti-drug effort by the Mexicans, NAFTA will hurt [the U.S.]."

Fraud on route to and at the ballot box has been used to preserve the very profitable political status quo, creating a poisonous political situation tailor made for the drug traffickers, who have been able to assimilate themselves easily into the existing power structure. "It has become fashionable to speak of the 'Colombianization' of Mexico due to narcotics because of the recent wave of assassinations in the last month that included two former state attorney generals, a judge, and which culminated in the March 1993 assassination of Cardinal **Juan Jesus Posadas** in Guadalajara," wrote **Alicia Ely Yamin**, a lawyer who spent several years in rural Mexico working as a human rights advocate among the poor. "But the problem of drugs has its own dynamic in Mexico and has existed for a long time. The endemic corruption in the Mexican government, the incredible sums of money to be made in the drug trade and political pressure from the United States have combined to make the drug war a lethal cancer that is quickly spreading throughout Mexican society... Two days after the murder of Posadas, a high official in the Attorney General's Office admitted to me: You can't speak of infiltration in Mexico. Here the authorities and the drug traffickers are the same people. Permeation, but not infiltration."

De la Madrid's Faustian Bargain

The *de facto* alliance between the Mexican political system and the leaders of the drug trade dates back more than a decade to a time before the advent of cocaine as the major commodity, when marijuana and heroin were the primary drugs coming into the U.S. from Mexico. In the old days, the police and army sold a little bit of marijuana and later heroin, according to one former police official, but it was relatively small compared with other parts of the economy. Today, the cocaine money is so big that *narcotraficantes* are actually challenging the existing leadership of the PRI for national control.

On June 11, 1993, a lawyer and writer named **Luis Javier Garrido** published a stunning article in *La Jornada* called simply "The Narco System." This courageous overview of the historical and political roots of government cooperation and backing of drug production and transshipment in and through Mexico was translated by the CIA and circulated among U.S. governmental agencies, but received little attention in the craven foreign press. Both Garrido and other observers in Mexico say that during the depths of the 1980s debt crisis, when Mexico's rulers were cut off from foreign credit, the de la Madrid government arranged a secret concordat with the drug lords. The deal: In return for keeping their billions of illicit dollars in the country's nationalized commercial banks, the drug lords would be left unmolested.

The go-between between the drug trade and the de la Madrid government allegedly was **Manuel Bartlett Diaz**, the former head of the Interior Ministry who is now governor of Puebla. Along with **Enrique Alvarez del Castillo**, the Former Attorney General, and **Juan Arevalo Gardoqui**, the Former Secretary of Defense, Bartlett Diaz has been accused of being involved with the torture and murder of DEA agent Enrique Camarena. In her 1988 book "Desperadoes," *Time* correspondent **Elaine Shannon** tells the story of how Camarena traced the connection between the drug lords and their patrons in the Mexican political system, and died a martyr's death as a result.

Bartlett, Alvarez and Gardoqui are said to have acted as some of the de la Madrid government's chief intermediaries with the drug trade throughout the 1980s, right up to the start of the Salinas presidency. For his part, the former Interior Minister declares his innocence and says that "there is no concrete evidence" to connect him with the Camarena slaying. But Bartlett also avoids visits to the U.S., where it is unclear whether or not he might be subject to detention or arrest. "The charges," says Bartlett, "are made with falsehoods, calumnies and without fundamental facts, just like all of the accusations made during these flawed proceedings."

Despite such denials, however, it is clear that the Mexican government is very concerned about any allegation of connection between Bartlett and the *narcos*. When journalist **Zachary Margoulis** of the English-language Mexico City daily, *The News*, wrote a report of the charges against Bartlett, the order immediately went out from the office of the President that the writer be terminated -- an edict that was followed almost immediately by the owner of *The News*.

Indeed, when Bartlett took office as governor of Puebla in 1993, President Salinas himself attended the swearing-in ceremony and, in an extraordinary display of official insecurity, personally attested to the "honesty" of the man who had helped him obtain and hold onto power through the fraud-tainted 1988 elections. Those attending included outgoing U.S. Ambassador **John D. Negroponte** and Canadian envoy **David Winfield**, Papal nuncio **Geronimo Prigione**, and national and state level PRI and business leaders. Salinas made attendance at the ceremony mandatory for members of the PRI, a test of loyalty to the government.

Such exaggerated displays of support are necessary because rumors continue to implicate Bartlett in the murder of journalist **Manuel Buendia** as well as DEA agent Enrique Camarena. The respected Monterrey daily *El Norte* reported in January 1993: "With his image clouded by the shadow of drug trafficking, the DEA's threat to bring him before a U.S. grand jury on a charge of drug trafficking and complicity in the torture-murder of Camarena hangs over Bartlett. Significantly, insurgent, anti-government political groups in the state of Puebla have circulated a 'black book' with newspaper clippings describing Bartlett's connection with drugs and these other alleged crimes."

According to *El Norte*, the "black book" was compiled by former Interior Minister **Fernando Gutierrez Barrios**, a veteran Mexican warlord and long-time familiar of the CIA who succeeded Bartlett in that key position in late 1988. Some believed that Bartlett would remain governor in Puebla for a year or so to save face, and then resign. But he has not done so, in part because of Salinas' political debt to the man who fixed the 1988 election and in part because Bartlett is part of former President Miguel de la Madrid's political circle. "This group has some very powerful members," notes one press report, "including [former] Interior Secretary **Patrocinio Gonzalez Garrido** (1992-1993) and current Transport Minister **Emilio Gamboa Patron**, another man who has had a meteoric political career."

"The production and sale of narcotics has been, as we know and as many studies have shown, a 'lifesaver' for the Mexican economy," wrote Garrido last year. "As a result, the most recent governments have tolerated and even sponsored it, thus turning it into a major political factor. Relations between the United States and Mexico thus became marked by fundamental disagreements not only over the growing immigration of Mexicans seeking jobs on the other side of the border but also over the production and export of narcotics, particularly because the Mexican authorities regard these two things as essential elements of their economic policy. Hence the fears that under a North American FTA the drug trade will intensify, not diminish. Given the shortcomings of the Mexican economy, drugs have furthered the agenda of the [PRI] technocrats by creating jobs, raising the income and living standards of poor peasants, contributing to local causes among low-income earners, building schools, clinics, or roads, and thus gaining the support of entire communities."

Garrido and others now argue that successive Mexican governments have encouraged an increasingly close relationship with the drug traffickers, for one purpose: the PRI "system" needed them and their dirty money during the 1980s. Better to ally with the boys in Guadalajara and Tijuana, de la Madrid and his cronies reasoned, and use their money to maintain one-party rule. A key player in making this decision was the then-personal secretary to de la Madrid, Emilio Gamboa Patron, who controlled the flow of information in and out of the President's office, and thereby became a prime target for subversion by the drug cartels.

In the years since the 1984 deal was struck with the drug lords by Manuel Bartlett, various agencies of Mexico's federal and state governments were gradually infiltrated and the line between them and the network of drug traffickers became blurred. Interior Minister **Jorge Carpizo MacGregor** and Finance Minister Pedro Aspe, two of the most respected members of the Mexican government, have explicitly confirmed this frightening analysis in public remarks. In his previous position as Attorney General, Carpizo explicitly stated numerous times in the Mexican press that he and his trusted aides were "surrounded by traitors" inside the Attorney General's office who are allied with the drug cartels .

Ricardo Pascoe, a senior official in the center-left Party of the Democratic Revolution, says the ties between the government and the drug trade are not an isolated situation. "This is no sub-Mafia, no renegade operation," says the well-known political activist. "The connections between the drug trade and the Mexican government represent a deliberate decision by Miguel de la Madrid to seek an alliance with the drug barons in order to raise money. Salinas has continued this relationship. The state has made a decision that the way to stay in power is to get access to money. Without foreign money, the PRI structure would crumble overnight."

He continues: The assassination of Cardinal Posadas in Guadalajara has to do with this very question of money and power... The Posadas murder was related to the financial situation because of the common link to drugs. The story in Guadalajara is that the Cardinal had evidence of the government's relationship with the drug trade and was getting ready to give the information to the head of the church. He was killed in the midst of all the confusion by a highly skilled, well-trained operative sent to get him. Remember, like the drug lords, the government must also maintain physical control over certain parts of the underworld. There is always the problem of enforcement in the bottomless pit of the drug trade, and the government must constantly enforce on the enforcers, in effect, to keep the system under control."

Andrew Reding, Director of the North America Project of the World Policy Institute, believes that the killing of Cardinal Posadas was deliberate; a direct challenge to the ruling elite in Mexico. "Posadas was the only major authority figure in Guadalajara not owned by the narcotics traffickers," notes Reding. "The drug barons killed him to send a message to the government. Posadas was an outspoken critic of drugs and guns. They actually opened the doors of the car in order to murder him. The Mexican government does not want it to become known that the drug traffickers have such influence. What we have seen here is a very scary demonstration of the drug cartel's growing strength and power." Even today, the Salinas government's propaganda machine continues to maintain that daylight shooting was accidental, but few Mexicans believe this version of events.

The Salinas Gang

Even with a flood of new foreign investment coming into Mexico under the Salinas Administration, there is no indication that the influence of the drug lords has been diminished. Quite the contrary, recent revelations indicate that the cartels have established working relationships with several members of the Salinas inner circle and have provided financing for a number of privatization deals.

Eduardo Valle, former aide to Interior Minister Jorge Carpizo, has given to the Mexican government documents and testimony allegedly linking government officials and drug traffickers to the assassination of presidential candidate Luis Donaldo Colosio. The former official, who is known as "the owl" (*el Buho*), worked as a senior official directing Mexico's anti-drug efforts. He says that Colosio was murdered March 23 in Tijuana by members of the *Grupo del Gulfo* cocaine cartel, with the involvement of Colosio campaign officials close to Communications and Transportation Minister Emilio Gamboa. Included with the documents provided by Valle during testimony given on August 25 at the Mexican consulate in Washington was a DEA report about telephone calls last December by cartel members to the offices of the presidency.

Valle fled to the United States in August, 1994, saying he feared reprisals and wanted to protect important documents. He continues to accuse Gamboa and other officials of maintaining direct connections with the so-called Gulf Cartel in Mexico. But Valle is not the only Mexican making such allegations. In a recent column in the daily *Reforma*, **Raymundo Riva Palacio** asked with his usual puckish humor: "Why is [Transport Minister Emilio] Gamboa Patron so nervous?"

"In good order he must explain his relationship with **Marcela Bodenstock Perlick**, whose dealings and relationships offer some of the more picturesque episodes in recent political life," he explained. "More than anything else, the interest in Mrs. Bodenstock comes because she works for the *Cartel del Golfo*, headed by Juan Garcia Abrego and allied with the Cali cartel, the narcotics organization based in Colombia."

Riva Palacio reminded readers that Eduardo Valle has described the role played by Bodenstock in the largest single cocaine organization south of the border. "Marcela is an ex-police official and the woman of **Marcelino Guerrero**, the former agent in the federal judicial police who works under one of the chief lieutenants of Garcia Abrego, **Oscar Malherve**," Valle told the influential weekly *Proceso*.

Riva Palacio's revelations show just how close the drug lords have come to the very top of the PRI power structure: "The reconstruction of the relationship between Gamboa and Bodenstock, which now touches the highest levels of the government, begins in the late 1980s when the current transport minister was a high official of **Televisa**. Marcela Bodenstock Perlick also had excellent relations with the Executive Branch and, apparently, was well known by the [U.S.] drug enforcement agency, known as the DEA."

"None of this seemed to bother Gamboa. On the contrary, according to the version of events now circulating at the highest levels of the government, Gamboa introduced her to the former head of the Office of the President, **Jose Cordoba Montoya**. This first introduction was not the last. In the middle of 1990, Jose Cordoba was attending a bull fight, which he follows with great enthusiasm. Gamboa also attended and was accompanied by Marcela Bodenstock, who immediately became close to the adviser to the president. The relationship flourished and over a long period of time they were seen together in society, particularly at parties in Mexico City and elsewhere. There is no precise date for the end of the relationship, but sources remember them being together all of last year."

These revelations are not the first nor the most troubling indication of official complicity in the drug trade in Mexico. In the state of Vera Cruz in November of 1991, two years after Carlos Salinas had taken power and two years before the NAFTA vote, Mexican soldiers captured and executed over a dozen U.S. trained Mexican drug agents at a remote airstrip. When the *federales* landed to arrest the occupants of the drug ferrying aircraft that they had been following, Mexican Army regulars, who were apparently waiting to refuel the drug-carrying plane, bound the hands of their fellow citizens and executed them at close range. Many of the dead were found to have powder burns on their palates. The *Washington Post* reported that a U.S. Customs Service plane had trailed the first two aircraft, filmed the incident and was subsequently hit by ground fire, but returned safely to the U.S. The mysterious video tape capturing these crimes has never been released.

Aside from the alarming facts of this case, consider the issue raised by the simple act of refueling the drug-carrying plane. Legally there are only two outlets for aviation fuel in Mexico, the state airport monopoly and the military. Since drug traffickers apparently have no problem refueling literally hundreds of aircraft annually for trips between Mexico and Colombia to deliver product to the Mexican cartels, one must assume that they obtain the fuel with official acquiescence. Overall, illegal air traffic in Mexico increased by 55 percent in 1992, according to a report prepared for the Mexican government. The report, entitled *Evaluacion y seguimiento sobre el control de drogas en Mexico*, says officials confiscated 40 tons of cocaine during 1992, but admitted that the total amount flowing through the country has mushroomed.

Indeed, Eduardo Valle says that during 1988-1989, the peak years of the *Grupo del Golfo*, three planes, each loaded with 6 tons of cocaine, were landing weekly in Matamoros in order to transship the drugs into the United States. He explains why no action was taken to stop this huge cocaine operation by then-Attorney General Enrique Alvarez del Castillo. Valle calls the former Attorney General "a scoundrel" whose appointment "was a mockery to the country" because he shielded the cocaine traffickers from prosecution.

The vast amount of money generated by the drug trade must be legitimized or laundered, and the recent privatization process has provided the perfect mechanism to handle the billions of dollars in profits that flow from illegal narcotics. A practice used by the drug trade during the Salinas *sexenio* has been to buy the equity and debt issued to finance the sale of former state-run enterprises, particularly the commercial banks and large commercial enterprises such as **Telmex**. Another favorite avenue for laundering drug money is real estate.

Businessmen who did not have much money a decade ago, many of whom helped to finance the PRI presidential campaign in 1988, are now among the wealthiest people in the world, with no apparent reason for or legitimate sources of their new wealth. The collapse in early September 1994 of the Cremi Union financial group illustrates one such situation. **Carlos Cabal Peniche** was a businessman of little apparent wealth or influence until the beginning of the six-year term or *sexenio* of Carlos Salinas. In a matter of months, he amassed sufficient financing to acquire several banks as well as a large part of the operations of the U.S. agribusiness **Del Monte** in Mexico and Central America. Fraudulent business practices and insider loans eventually caused his bank tofail, but the episode still leaves unexplained how this obscure individual came to be considered one of Mexico's leading business men with a reported net worth over $1 billion.

Today, Cabal Peniche is a fugitive from justice and his financial empire lies in ruins with hundreds of millions of dollars in losses for the government and investors. Officials in the Mexican Attorney General's office are investigating a suspected connection between Cabal Peniche and money laundering, according to *La Jornada*. An wise veteran observer of the Mexican business scene alleges that most of the money behind the purchase of Del Monte came from illicit sources. "We don't ask any questions in Mexico," he confides. "You could walk into a bank with millions in cash and, in most cases, nobody would say a word."

Cabal's apparent connection with drugs and money laundering is reinforced by his relationship with Emilio Gamboa. Mexican Federal Deputy **Alejandro Encinas**, who sits on the commission investigating the Colosio assassination, says: "In Mafia terms, Gamboa Patron was Cabal Peniche's 'godfather.' This relationship, first personal, then political, allowed the emergence overnight of a very strong economic group that bought the

Cremi and Union Banks and established a new financial consortium in southeastern Mexico." The PRD official alleges that "although Gamboa now denies it, his relationship with Carlos Cabal Peniche has long been in evidence, ever since the days when Carlos worked in the Presidency when Emilio Gamboa was private secretary to former President Miguel de la Madrid Hurtado."

The fact is that there are literally dozens of business people and government officials in Mexico whose apparent wealth vastly exceeds any possible legal sources and, in fact, arises from their political relationships. An alliance of convenience has been forged between drug traffickers and technocrats, with the additional upshot that Mexico's financial institutions would lose a great deal if money laundering were halted. Former Transport Minister **Andres Caso Lombardo**, who has never held a significant private sector job, owns ranches, commercial properties, homes and aircraft valued in the many millions of dollars. But perhaps the most notable example currently in the Salinas Cabinet is Agriculture Minister Carlos Hank, a career civil servant with only modest business experience whose apparent personal fortune now totals in the *billions* of dollars. Though his name does not appear among the *Forbes* list of 24 Mexican billionaires, he is without question one of the most powerful men in the country.

Carlos Hank Gonzalez has visible ties to the Gulf Cartel through Marcelino Guerrero. Eduardo Valle describes Guerrero as one of Mexico's biggest money launderers and says the drug trafficker is involved in development projects all over Mexico, including resorts in Cancun "which are tied to investments by **Jorge Hank Rhon**," the son of Hank Gonzalez. In addition, Valle has provided telephone records showing that an associate of Guerrero "makes and receives calls from people in the office of the President, among them **Arturo Salgado Cordero**, coordinator of *giras presidenciales*, and the former head of the Office of the Presidency, Jose Cordoba.

The "Grupo Hank" has vast business interests in Tijuana and all along the U.S.-Mexico border. Another son of Hank Gonzalez, **Carlos Hank Rhon**, recently purchased control of the parent of **Laredo National Bank** in Texas. Over a year ago, Hank sold his interest in **Taesa**, Mexico's third largest airline, but news reports continue to question whether he still controls the highly profitable and surprisingly liquid airline. A recent report in *El Norte* asks "who is the real owner of Taesa" in direct reference to Hank Gonzalez and notes that the DEA has focused a great deal of attention on searching the company's planes for contraband.

Hank, however, is only one of many members of the political-business elite who works in apparent cooperation with the drug traffickers. Earlier this year, the daily *Excelsior* carried the following report by **Cesar A. Renteria**: "Mayor **Victor Perez Ruiz** declared today that the tourist development area of Nuevo Vallarta in the municipality of *Bahia de*

Banderas has become a 'money-laundering' center, created by the drug traffic operating on the state of Nayarit's southern coast and in some of the country's other states. He claimed that sums of money in the millions from drug producing and distribution rings have been invested in industries such as hotel and restaurant businesses in the aforementioned tourist complex, the largest in the state."

"Victor Perez Ruiz stressed that one of the leading 'entrepreneurs' is the notorious drug trafficker **Joaquin 'El Chapo' Guzman**, the 'lord and master' of the entire municipality of *Bahia de Banderas*. His power embraced the entire *Vallejo* sierra and lowlands, where *El Chapo* owns large expanses of land planted with marijuana. The mayor asserted that the newly opened five-star Hotel Paraiso **Radisson** was built with money contributed by *El Chapo*, through a front man, noting that he is the main stockholder of the property, located in the Nuevo Vallarta complex. He added that other drug traffickers hold shares in the Puerta del Sol Hotel and other large establishments in the municipality of *Bahia de Banderas*. He considered it incongruous that this application of funds, 'backed and promoted by **Celso Humberto Delgado's** administration,' should have become a 'money laundering' operation involving the proceeds of drug dealing and sales. "Perez Ruiz concluded by stating that this [money laundering] might be the reason that Nuevo Vallarta is a leading resort on the national level, offering tourists comforts and luxuries similar to those found in Acapulco, Cancun and Puerto Escondido."

In a related story, the regional daily *El Mañana* of the state of Tamaulipas puts the case very bluntly: "The infiltration of *narcotrafico* in political, public and private institutions represents a deadly threat to democracy in Mexico. As a consequence, it is necessary to change the laws to target the [financial] resources of the drug trade that are interfering with the productive activities of the country. The problem is to establish a culture of drug prevention while at the same time dealing with those already caught up in addiction or trafficking. The drug organizations have the ability to marshal enormous financial resources, behind which can come repressive actions."

Over There, Over Here

Most Americans, while conceding the obvious peril from drugs, still prefer to think of Mexico's problem with narcotics as a distant concern that does not threaten them directly. Think again. The vast money flowing from the drug trade through Mexico is not only destroying that country's civic and legal institutions, corrupting its leaders and blocking the transition to democracy, but is rapidly moving to acquire influence north of the border.

In the recent elections in Mexico, the ruling PRI spent $72 for every vote officially cast in its favor, a level that will be rivaled in the U.S. only by the fierce California Senate race between Democrat **Diane Finestein** and millionaire GOP challenger **Michael Huffington**. The ruling party's presidential effort cost 36 times more than that of the center-right PAN, and over 300 times more than that spent on the election effort of **Cuauhtemoc Cardenas** and the center-left PRD. The PRI's expenditure for the election was gigantic by any measure, but keep in mind that the $250 million figure represents only direct, officially reported spending and does not include the *billions* of dollars directed by Salinas through government agencies such as *Pronasol* and business groups aligned with the PRI.

In state and local races, opposition parties on the left and the right have alleged that drug money was also used to buy or intimidate voters, a troubling twist in a system many already call a "narco democracy." But don't believe that the Mexican drug lords limit their influence to Mexico or mere local officials. From San Diego to Washington, huge investments can be found in American banks, companies and real estate that are secretly tied to Mexico's drug groups. One need only take the trouble to look for the telltale flow of dirty money.

The *Wall Street Journal* reports that U.S. authorities are investigating several Wall Street investment houses for links with money laundering, including **Dean Witter**, **Prudential Securities**, **Paine Webber**, and **Bear, Stearns & Co**. Code named "El Dorado," the investigation is part of a larger effort that includes the prosecution of two officers of **American Express Bank**, who were recently convicted for helping members of the Gulf Cartel move money through U.S. banks. Officials at the Treasury say that the U.S. is planning raids on a number of banks operating along the border in an operation code named "Condor."

In testimony in Brownsville, Texas, in May of this year, **Francisco Perez Monroy** alleged that his cousin and business partner, Juan Garcia Abrego, paid "millions of dollars" to **Javier Coello Trejo** and other senior officials of Mexico's justice apparatus to allow free shipment of cocaine through the Gulf Cartel in Northern Mexico into the U.S. Not only does Perez Monroy's sworn testimony confirm the allegations made by Eduardo Valle about official complicity in drug trafficking, but sheds new light on a scheme to launder $25 million in Gulf Cartel drug money through **Bankers Trust** and American Express Bank.

Bankers, however, are not policemen, nor are the problems of drugs and money are limited to Wall Street. Consider the example of the **Gangster Disciples**, a Chicago street gang that was virtually unknown 18 months ago but which now controls the vast cocaine trade in South Chicago. The Gangster Disciples recently established a political action committee, "21st Century Vote," which is under investigation by the FBI. The leader of the organization, **Larry Hoover**, who operates from a prison cell (like some of his counterparts in Mexico) says that he plans to use his group's political power to win several seats on the city council.

The Gangster Disciples, which boasts an estimated 30,000 members in the Chicago area alone, is just one of dozens of groups around the U.S. that derive their power from the torrents of money generated by the cocaine trade. The *Chicago Tribune* reports that "a variety of politicians -- black and white, liberal and conservative -- has courted the PAC's influence, confident that the group can register voters, raise money and elect mayoral and aldermanic candidates." Sound familiar?

Other than the difference in location and language, there is no fundamental difference between the way the drug trade has perverted Mexico's political system and the erosion now visible inside nearly every major American city -- and in Washington itself. The fact is that many of the policies and decisions taken in Washington over the past decade, from supporting single-party rule in Mexico to ignoring the exploding drug trade, have directly contributed to the growth of the "narco system." As was the case with the American Mafia during the Prohibition years, short of full legalization, no form of government action seems to be effective in controlling the financial and political power of these modern-day outlaws.

"After 1968 the Mexican police were selling marijuana to the middle classes," Eduardo Valle comments. "That is just for starters. Now, what happened when the Vietnam war people, who were directing strategies in Southeast Asia, took control of the narcotics bureaus in New York and other cities after the Kennedy assassination? What happened after the CIA started using drugs to finance the counterrevolutionary movements in Latin America? There you have a long story of perversion. The United States has an enormous responsibility in all of this [drug business]."

Christopher Whalen writes from Washington, where he publishes ***The Mexico Report****, a fortnightly newsletter on Mexico and serves as Treasurer of* ***Legal Research International****, a firm that provides litigation management, cross-border due diligence and communications strategy with respect to Mexico and other emerging markets.*

The Mexico Report, April 10, 1995, by Chris Whalen

◆ There is continuing speculation that Jose Cordoba is going to be *sacrificado* to satisfy public anger at and foreign curiosity in the murder of Luis Donaldo Colosio. This will be an unpleasant surprise to *Pepe* Cordoba's many friends in Washington, including National Security Adviser **Anthony Lake** and his deputy, **Samuel Berger**. Former Under Secretary of State Bernard Aronson recently confirmed in an interview that "for [the Bush Administration], to talk to Cordoba was almost the same as talking to Salinas." Aronson could not specifically recall how many times he met with Cordoba during his tenure as the chief State Department official in charge of U.S. relations with Latin America, but said that "he met with me many times." Aronson also told Pascal Beltran de Rio of *Proceso* that Cordoba maintained close ties and met frequently with Bush National Security Adviser Brent Scowcroft, former USTR Carla Hills, Under Secretary of State Robert Zoellick, and former Secretary of State James Baker III. When asked if he knew anything of the personal connection between Cordoba and Marcela Bodenstedt Perlick, the former newscaster for Televisa and now lieutenant in the Gulf Cartel, Mexico's biggest cocaine trafficking organization, Aronson replied: "I know nothing." South Carolina Senator Ernest F. Hollings has denounced the relationship between Cordoba and various U.S. officials. Senate Banking Committee Chairman Alfonse D'Amato (R-NY) has also raised questions about drug connections in the Mexican government.

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