Financialization and credit in Latin America: the diverging experiences of Mexico and Brazil

Eugenia Correa[1]
Wesley Marshall[2]
Gregorio Vidal[3]

With the finance dominated capital accumulation regime reaching its limits of expansion in early 2007, the possibilities of sustained economic growth have dimmed in many parts of the world. Economies that became dependent on international market based financing - and therefore on the few global banks that have served as drivers of this financial model-, will need to fundamentally transform their financial structures if they are to meet their financial needs. As the pendulum inexorably swings away from global financialization and towards regionalization and growth led by domestic credit, some countries find themselves more adequately prepared for a return to domestic financial intermediation than others. Within this context, in this paper we analyze the diverging paths ahead for Mexico and Brazil. Apart from being the two largest Latin American economies, the two countries have adopted opposite strategies regarding the profound changes in international financial structures. We will argue that Mexico has adopted a position of hopeless defense for a crumbling system that never benefited the vast majority of its citizens, while Brazil has opted for a stance that more accurately accommodates the country's economic future to currently observable global trends.

Our argument will be made in several stages. First, we will set the stage with Brazil and Mexico's common recent history of Washington Consensus public policy. Subsequently, we will present the differing responses of Mexico and Brazil to the international financial / economic crisis, highlighting Mexico's insistence on supporting a regime of market based global finance and Brazil's efforts to isolate itself from this

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[1] Postgraduate Department. Economics Faculty. Universidad Nacional Autónoma de México.
[2] Department of Economics. Universidad Autónoma Metropolitana – Iztapalapa.
[3] Department of Economics. Universidad Autónoma Metropolitana – Iztapalapa.

business model. We will focus our attention on private and public sector financing and investment in separate sections. In regards to the private sector, we will emphasize the measures taken by Mexican authorities that guarantee creditor’s positions while at the same time weaken the long and medium term perspectives of the financial positions of the country’s’ private firms. In our analysis of public finances, we will focus on the differing management of fiscal deficit financing between the two countries. We will round out our analysis with an examination of current trends in Foreign Direct Investment (FDI) and privatizations, emphasizing the different routes being taken by Brazil and Mexico.

The Washington Consensus and Structural Change

Since the end of the eighties, the economic policies employed in Latin American have sought to establish fiscal balance in the context of what was considered the region’s principle problem: inflation. Within this context, fiscal adjustments were rolled out in accordance with the IMF’s economic agenda and under the supervision of the World Bank. These policies, along with the concept of structural change, were later systematized into what became the overarching project of structural reform.

Going forward, widespread liberalization of foreign trade was added to the fiscal adjustment. This included the elimination of import tariffs and other related restrictions. Limits on the inflow of foreign investment, including the possibility of unrestricted holdings of government debt in national currency by foreign actors were also gradually removed, until the capital account of the balance of payments became fully liberalized. Central bank reserve requirements, interest rate limits, and credit requirements were all liberalized. State owned companies were privatized, including those in areas of telephony, generation, transportation and distribution of energy, water services, banking and the exploration and exploitation of petroleum.

The Washington Consensus agenda includes other considerations, but the mentioned measures are particularly noteworthy, given their close relationship with the advance of the financialization process in the region. As Samuel Lichtensztejn points out, the so called debt crisis of 1982 produced foreign debt dynamics in Latin America that have reached far beyond their original arenas of finance and external trade. The management of external public debt, beginning in the eighties, has expressed itself in "orientations of political policy that, in the immediate and formal sense, appear to be tied to the control of inflation and the balance of payments, but in their essence and in the longer term, respond to the need for a greater internationalization of the region's patterns of development" (Lichtensztejn, 1990: 175). The passive and orderly internationalization of the economies of the region has been organized from beyond its borders.

From this perspective, the implementation of the Washington Consensus policies implies a greater articulation of the economies of the region to the processes of profit realization for a small group of large corporations, banks and financial conglomerates with headquarters in the United States and European countries. These earning are founded upon financial domination, which Epstein defines as "…the growing role of financial motivations, financial markets, financial actors and financial institutions in the operations of internal and international economies." (Epstein, 2005:3), or as Vidal puts it: the management of investment decisions, the search for the conversion of illiquid assets into liquid financial resources at the disposal of large corporations, as well as the general advance of financial motivations in transnational corporations, large banks and financial institutions (Vidal, 2009a).

For decades, fiscal expenditures have served as a profit realization space for national and international rent seekers. In particular, public debt payments have become a principle support for the international banking community and for local banks. This second consideration has obviously not held true for the last decade in Mexico, as domestic banks have been reduced greatly in their market presence, but has continued to be very relevant for the brazilin domestic banking sector, which has for decades seen the unrelentingly high interest rates in Brazil, which simultaneously slow economic activity and offer an important support for the profits of local banks. During the first decade of the twenty first century, Brazil has been the region's largest generator of capital outflows, averaging 21 billion dollars. These figures accelerated towards the end of the decade, amounting to 29 billion dollars in 2007, 40 in 2008, and 31 in 2009. These numbers represent around 2 percent of GDP, a number similar to that of Mexico (Eclac 2009 and 2010b).

This profit realization space of national and international banks has been held sacred for decades of Washington Consensus inspired policy. The transfer of public funds to international banks via the servicing of external public debts, which became unpayable at the beginning of the 1980s and have since ensnared the majority of the region in a debt trap, have come to simultaneously represent an important source of profit for local and global banks and one of the principle obstacles to Latin American development. Given the profitability of debt payment by Latin American governments, it is no accident that maintaining a primary fiscal surplus is the first point of the Washington consensus. Yet at the same time, even Williamson admitted that the continual servicing of foreign debts contradicted what he saw was as the Washington Consensus' objective of serving the economic interests of the United States through improving economic conditions in Latin America (Williamson, 1990).

Seen in either light, the maintenance of a primary fiscal surplus, the clearest sign of a government's willingness and /or ability to meet its external obligations, has stood as a condition rarely broken in Latin America, until the outbreak of the us financial crisis, that is.

In the many moments of financial uncertainty and turbulence in Latin America during the last decades, the IMF unwaveringly imposed conditions of market based interest rates and the maintenance of primary fiscal surpluses in return for relatively short term loans used to pay off foreign and domestic creditors. Although such conditions invariably deepened crises, particularly as otherwise solvent debtors can rarely keep current on loans when interest rates breach 100% annual rates, as happened in Mexico in 1995, they were usually said to be needed in order to restore the confidence of the investment community. In order to keep the country attractive to foreign capital, ie., global banks, concerns regarding the well being of domestic economic actors have typically been brushed aside.

Yet in some cases, the weakening or destruction of local firms was not merely an afterthought for global banks. As a direct result of the Mexican banking crisis of 1994-1995 and the inadequate resolution policies that followed, expansionary foreign banks were able to take over close to 85% of the banking system. Likewise, the less severe banking crises in Venezuela in 1994, in Argentina in 1995, and in Brazil in 1998 all led in some form or another to an increase in the participation of global banks in local banking systems. Therefore, market determined interest rates and fiscal restraint in times of financial turbulence and crises not only allowed global banks to safeguard their investment in Latin American public debt, in many cases also dramatically increasing returns on government bonds, but these conditions also greatly weakened the positions of domestic banks, both publicly and privately owned, often leading to their sale to global banks such as Citigroup, BBVA, Santander, Scotiabank and HSBC.

However, when it became apparent that Citigroup had become technically insolvent in 2007, the lofty rhetoric surrounding the need to assure the confidence of the markets and the corresponding public policy measures quickly disappeared. Washington based international financial institutions such as the IMF and the World Bank quickly embraced the new reality. As Galbraith stated in 1970, "then as still, what is called sound economics is very often what mirrors the needs of the respectably affluent" (Galbraith, 2001). In more recent times, we could say that what is called sound economics is almost always what reflects the needs of the largest us and European banks.

As such, in the wake of the collapse of Lehman Brothers, both Mexico and Brazil were permitted to use deficit spending in response to the global crises. Yet the management of public finances has reflected profound differences in economic strategy between the two countries. While Mexico has imposed internally deflationary policies in order to bail out foreign creditors, Brazil has employed internally expansionary and counter cyclical responses and has not offered any measures directed aimed at strengthening the position of foreign creditors.

Perhaps most illustrative of the different paths chosen by Brazil and Mexico has been the role of the public banks during the crisis. Brazil is noteworthy within Latin America for having retained its two largest public banks, Banco do Brasil, a commercial bank, and Banco Nacional de Desenvolvimento Economico e Social (BNDES), a development bank. Entering into the sharpest moment of the crisis (to date) in 2008, publicly owned banks accounted for 35% of total assets in the banking sector. Mexico's situation has been quite different. After three decades of the continual marginalization of publicly owned banks in the banking sector, their assets accounted for only 12% of banking sector assets in 2008.

In Brazil, these banks led counter cyclical credit policies, issuing greater amounts of credit directly to borrowers, as well as serving as agents of stabilization in the system, therefore encouraging lending from private sector banks as well. According to the ECLAC, in June of 2008, total loans from publicly owned banks were at 12.8% of GDP, rising 18.5% in September of 2009, while at the same time total credit issuing jumped from 38.7% to 45.7% of GDP. According to the same source, the rate of growth in credit issuance breaks down as following: 7% growth for domestic private banks, 2,4% for foreign owned private banks, and 38,8% for publicly owned banks (ECLAC, 2009, p. 85).

The credit panorama in Mexico has offered a stark contrast. Instead of credit growth led by public banks that practice traditional financial intermediation, the national public banks Nafin and Bancomext have acted as a key support for global banks, extended a credit line of 50 billion dollars to guarantee external debt payments of eight of Mexico's largest privately owned companies (El Economista, 2009). Companies such as Cemex, Vitro, Comercial Mexicana, Gruma, and Soriana (among others) without a doubt benefitted from such programs, yet in the face of a protracted and deep crisis, the true beneficiaries of the bailout will be international creditors, not the large Mexican companies, and much less the overall Mexican economy. Although granted a temporary reprieve, large Mexican companies are still far from guaranteed stable financing from abroad, and domestic credit is still largely unavailable.

Unlike Brazil, bank financing has contracted during the crisis, registering a year on year fall of over 6% after Lehman's bankruptcy (SHCP, 2009). Also unlike Brazil, Mexico remains well below Latin American standards in bank financing. Even before September of 2008, credit had consistently diminished. In the fourth quarter of 1994, Mexican banks allotted 19.66% of GDP to commercial and industrial activities, while by the fourth quarter of 2008, this figure had shrunk to 8.93% of GDP (CNBV, 1994, 2008).

While in Mexico infrastructure and agriculture have been starved of financing for decades, the BNDES and Banco do Brasil have provided the lion's share of credit to these two sectors, respectively. The fact that Mexico has in recent years lost both its food and energy independence, while Brazil generates every greater capacity surplus in these areas, is a testament to the greatly different credit strategies employed in the two countries.

The dominance of foreign owned banks in the oligopolic market has not fulfilled the financial requirements of the Mexican economy, yet local subsidiaries in Mexico have, since their existence, provided an important source of revenue for headquarter banks, both in the moments of financial stability that predominated until 2007, and after the fall of Lehman. In these moments of crisis, the accelerated repatriated earnings of local subsidiaries have offered an even more fundamental support to global banks in dire straits. The simultaneous deepening of credit restriction in the local market and increased repatriated earnings in moments of crisis offers a very clear panorama of how the Mexican financial sector is actively supporting the principle architects of the system of global financialization.

This support has been facilitated by Mexico's central bank, which auctioned off around 35 billion dollars in reserves to foreign banks in the year following Lehaman's bankruptcy. In turn, the IMF backstopped the central bank with the authorization of a $47 billion dollar credit line in April of 2009. Unlike Mexico's central bank, Brazil's is not "independent" and during the crisis did not have to seek an IMF bailout, and was able to enact a levy on inflows of speculative capital.

As mentioned, the support given to global financial concerns by the State and by foreign bank subsidiaries has been offset by internal deflationary policies. In this sense, Mexico has witnessed a classic, although surreptitious, IMF conditioned bailout. The government is cutting spending on infrastructure projects, education, health, poverty alleviation and a range of other activities, all of which are already being felt in the national economy. In addition, an across the board consumer tax hike has been enacted, while key energy prices, determined in large part by the government, have continued to rise throughout the crisis.

Brazil's government has done the very opposite. In addition to the mentioned tax imposed on speculative inflows, a temporary tax reduction (March to September of 2009) was provided for industrialized products, cars, appliances and construction material. Income taxes were lowered for middle income families, and the state and federal government extended the dates for tax collection (ECLAC, 2009). At the same time, the government has pursued a policy and investment, increasing energy and infrastructure projects, while widening a program of incentives and subsidies for residential construction. The private sector has also reaped great benefits from the financing issued from public sources such as the BNDES.

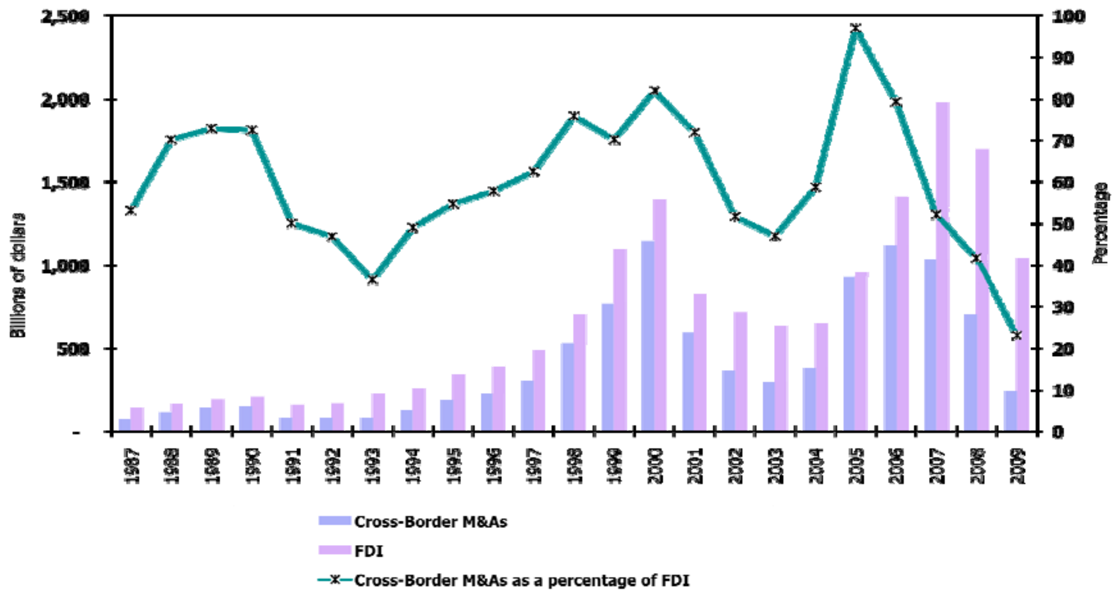
Yet there are still further differences between the Brazilian and Mexican responses to the crisis. Aside from cutting spending on programs that target large portions of the economy and increasing revenues that are extracted from the same portions, the Mexican government has also undertaken another classic IMF condition: further privatization. The most dramatic application of such policies was the shuttering of the state owned electricity company Luz y Fuerza by federal military police on October 10th, directly eliminating approximately 44,000 jobs, yet opening a large electrical grid to voice, video and data transmission for private exploitation. Yet also of great importance has been the increased private particupation in Pemex's operations, as well as those of the Comisión Federal de Electricidad.

FDI and privatizations

As shown, both public and private finance have evolved in opposing directions in recent years in Brazil and Mexico. Yet this bifurcation of strategies is also clearly represented in the productive sector of the two countries. The growth in recent years of the flows of foreign investment, including FDI, is a part of the process of financialization. Among the characteristics of this increase is the notable weight of cross border mergers and acquisitions. As can be observed in Figure 1, the increase of the flows of FDI has closely corresponded with the increase of cross border mergers and acquisitions. This means that a large part of cross-border transfers are used to acquire companies that are already in existence, often for many years and with a great importance to the respective national economy

Figure 1

FDI and Cross-Border M&As (Latin America), 1987-2009

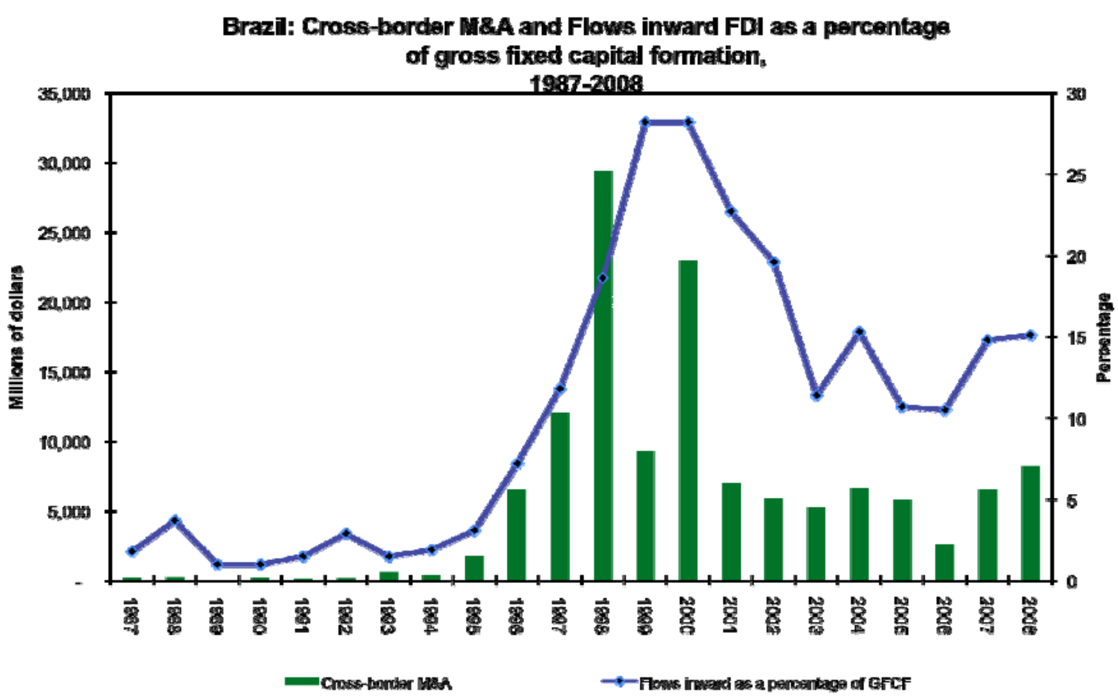


Source:UNCTAD, World Investment Report y Thomson Financial, Mergers & Adquisitions, on line information, www.unctad.org y www.thomson.com, May 2010.

Acquired assets or even whole companies that have been purchased are typically reorganized; some plants may be closed, others have their capacities reduced or reoriented. In many plants, new equipment, including information technology, robots, etc, has been incorporated. These investments do not necessarily offer an increase in production capacity, even when they can reduce unit production costs for many goods, allowing for the firms that are in the best conditions to face competition in an environment of contracting demand and the disappearance of restrictions on operations in diverse global markets to remain profitable. Therefore, the increase in FDI during the second half of the nineties and the proliferation of cross border operations are an aspect of the domination of investment geared towards the rationalization or modernization of production, obeying the logic of reducing the costs of each unit produced or service provided. This has been the route for growth for the firms involved in new economic activities, such as telecommunications, which are constructed upon the public investments of formerly state owned companies.

In Latin American countries that receive the greatest quantities of FDI, these inflows are frequently directed to the acquisition of existing companies. This dynamic is particularly notable in Argentina, where the processes of privatization gained steam towards the end of the eighties. In Brazil and Mexico, the purchase of companies by foreign firms is greatest during 1995-2001. The privatization process of fixed line telephony and cellular phone concession in 1997 and 1998 in Brazil alone accounted for 18 billion dollars, mostly coming from foreign firms. In Mexico, the most important acquisitions during most of the nineties did not operate under the logic of the privatization of state companies. For instance, when banks were privatized during the beginning of the decade, they were sold to domestic capital. However, in later years the sale of companies to foreign corporations multiplied, particularly in the financial sector, which came under the control of consortia from Spain, the United States, Holland and England. In 2001, the sale of Banamex to Citi involved 12,5000 dollars, with the FDI for the year totaling around 16 billion dollars.

Figure 2

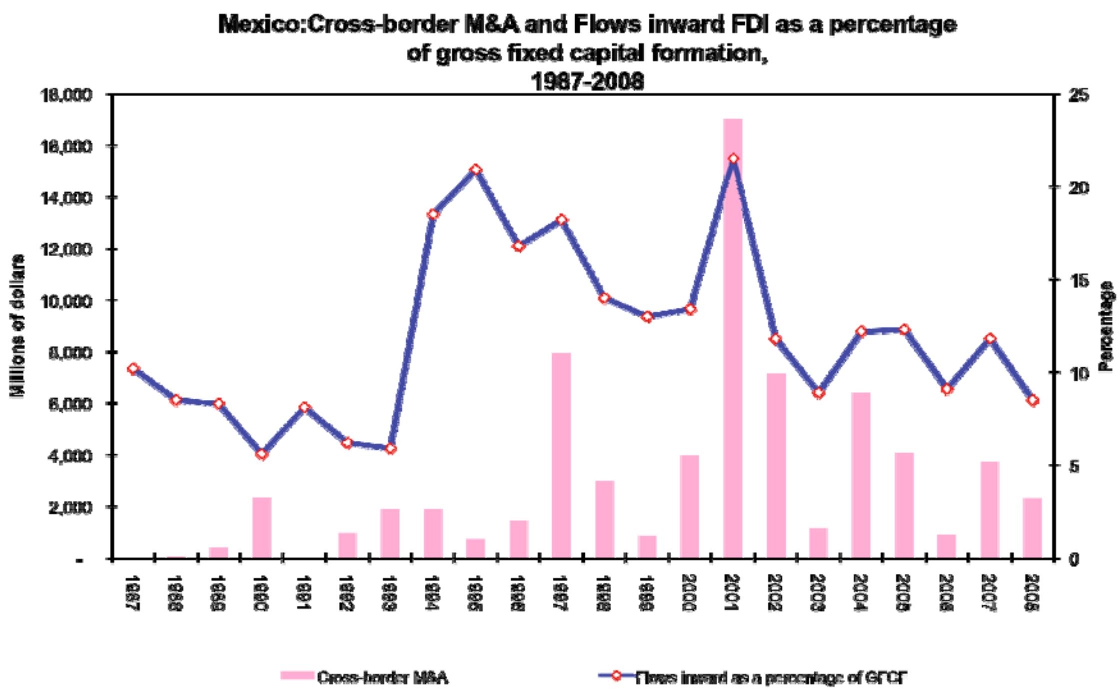


Source: UNCTAD, Statistics, FDI database, on line information, www.unctad.org , October 2004. World Investment Report 2005-2009, Annex table B.3., on line information, www.unctad.org, May 2010.

As can be seen in Figure 2, there is not a close, consistent and ascending relationship between the weight of FDI on gross fixed capital formation (GFCF) and the increase in M&A activity of foreign firms, as many who argued for greater finance and trade liberation had argued. In the second half of the nineties, these processes become associated with privatizations. Changes of ownership among private companies have gained steam in later years. Within this context, it is particularly noteworthy that since the beginning of Lula's government, privatization processes have ceased. During these years, State participation in the generation of electricity has increased, as it has in the support of the development of Petrobras, accentuating the role of the State in its management, particularly in relationship to the discovery of large new oil fields.

A clear relationship between the increase in foreign firms' M&A activity and greater FDI activity is also visible in Mexico (Figure 3). In 2001, when FDI reaches its highest percentage of GFCF, the highest level of M&A by foreign firms also presents itself. However, unlike Brazil and other Latin American countries, Mexico has maintained, and even increased, its privatization policies, as will be further explored.

Figure 3



Source: UNCTAD, Statistics, FDI database, on line information, www.unctad.org , October 2004. World Investment Report 2005-2009, Annex table B.3., on line information, www.unctad.org, May 2010.

As the first decade of the twenty first century began to come to a close, the differences between the economic trajectories of Brazil and Mexico became increasingly notable. In 2008, with the global financial/economic crisis fully in bloom, the Brazilian economy continued to grow vigorously while the Mexican economy began to falter. Brazilian GDP grew by 5.1 in Brazil, while Mexican GDP grew by 1.3. Measured per capita, there is no growth in Mexico, whereas in Brazil it is 4 percent. In 2009, the contrast grew further, with Brazil's GDP growing by 0.6% and the per capita GDP falling only 0.3%, while in Mexico GDP shrunk by 6.7% and per capita GDP by 7.7% (ECLAC, 2009: 116-117).

For Mexico, this contraction is the largest since the 1930s, and it is accompanied by other economic indicators that reflect the severe crisis, including decreases in exports, worker remittances, tourist dollars, fiscal receipts and bank credit, from its already low levels. Also noteworthy is a significant increase –taking into account the form in which official statistics are generated in Mexico- of unemployment and informal employment.

The direness of the crisis in Mexico is a result of the structural conditions of its economy, which has transitioned from weak economic growth in years past to an unusually deep crisis. While the implementation of an export led growth model has increased manufactured exports, these are still concentrated in only a few products, including cars and car parts and electronic goods. The principle market for this type of production is the United States, with intrafirm transactions dominating exchanges, normally between *maquilas* and companies headquartered in the United States. These intra-firm transactions are characterized by a high level of import content. As has been argued (Vidal, 2008), this model of growth based on exports with high import contents, is incapable of generated conditions that would allow for economic growth to improve the distribution of wealth or the means through which the country's inhabitants can fin steady and formal employment.

En Brazil, the experience has been different in these terms. Brazil's principle manufactured exports include: airplanes, petroleum based products, and steel based products, including automobile engines. However, unlike Mexico, these products are produced and exported by companies headquartered in the country, including: Embraer, Petrobras, Gerdau, Votorantim, Vale, Usiminas, Marco Polo, WEG, Sabo. Several of these businesses have significant investments or contracts in foreign countries. The following companies also fall into this category: Odebrecht, Camargo Corrêa, Grupo JBS, Sadia, Andrade Gutierrez.

Conclusion

While the composition of Brazil's imports and exports has undergone a period of diversification for many years, it is noteworthy that in both its productive and financial sectors, Brazil never accepted Washington Consensus ideals of export led growth and trade and financial liberalization to the extent that Mexico has. In addition to maintaining control of its national industry, Brazil has also held intact many (those very notably not all) of its publicly owned banks. The moderation of Brazil in both of these aspects have left the country in better position to face the current crisis, which centers around the United States' economy.

However, as we have attempted to show, equally, if not more important, have been the diametrically opposite actions taken by the governments of Brazil and Mexico in reaction to the crisis. While the first country is actively applying counter cyclical policies and increasing its financial and productive capacities, Mexico is acting as a bulwark (although faulty and small) for the crumbling structures of international financialization. While Mexico by itself can never hope to resuscitate the global financial conglomerates most affected by the breakdown of the very business model that they protected, they have far greater chances of success at severely depressing local economic activity, which is the inevitable cost to be paid for this deeply flawed strategy. In other words, while Mexico has decided to go down with the ship of financialization, although it never acted in any capacity that could even remotely equate it to its captain, Brazil has looked to tried and true alternatives to financialization: domestic financial intermediation based in local currency, and the promotion of national firms operating in domestic spheres of industry and mining and agriculture.

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