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Lessons from Mexico

The lessons from our Mexican neighbor for handling a financial crisis.

BY DEBORAH RINER AND JERRY HAAR

ADDRESSED THE REAL CAUSES: Mexican President Ernesto Zedillo dealt with the underlying causes of the crisis, the authors argue. (Photo: Mexican President's Office)

Nearly a decade and half ago, Mexico faced a financial crisis eerily similar to our own. As we seek a way out of this morass, what lessons might be learned from Mexico's devastating 1995 economic meltdown and bank rescue that cost Mexican taxpayers 19.3 percent of GDP?

When Mexico's banks first started to founder, the government used *Fobaproa*, the obscure government agency that insured deposits, to ride to the rescue. *Fobaproa* funded banks that couldn't secure funding in the markets by taking loans from the banks' portfolios as collateral for bonds issued by Fobaproa. The Mexican banking rescue abandoned its initial case-by-case approach and formalized criteria for *Fobaproa* to purchase distressed assets and, ultimately, recapitalized the banking system by allowing foreigners to buy majority ownership in the country's three largest banks.

DO'S AND DON'TS

The do's and don'ts from the Mexican experience are ones that Congress and the Administration would do well to heed:

1. Address the real causes of the crisis. Mexican President Ernesto Zedillo dealt with the underlying causes of the crisis which were macroeconomic — an unsustainable deficit, resulting in a massive devaluation of the peso. The Mexican response –- an austerity program, the adoption of a floating exchange rate, freeing interest rates, and a stiff 6.2 percent contraction of the economy -– was painful but appropriate. In the U.S. case, the search for scapegoats should take a back seat to sensible regulation, responsible monetary policy, and improved vigilance of mortgage lending, hedge funds, and derivatives.

2. Use great care in the purchase of troubled assets. Mexico's experience teaches that purchasing assets alone won't solve the crisis. The criteria for asset selection, purchasing and pricing must be transparent. Like Mexico, the U.S. Treasury first proposed buying distressed assets from financial institutions under TARP (Troubled Assets Relief Program) and, like Fobaproa, the $700 billion plan purchases these assets from financial institutions. Government purchased assets should hold the promise of appreciation and liquidity at a future date.

3. Ensure the sound recapitalization of banks. In the end, Mexico recapitalized its banks. This was achieved by opening up ownership of the banks to foreigners since there simply wasn't enough Mexican capital interested in recapitalizing the banking system. The U.S.

Treasury department must ensure that the amount of funds for recapitalization and the coverage (i.e., not just the big banks) are adequate to motivate banks to increase lending —especially to small business—and insist they do so.

4. Better regulation, not more or less regulation, should be the goal. The Mexican government moved towards more effective regulation, strengthening the National Banking and Securities Commission and, effectively, adopting international standards, including strengthening capital adequacy. Regulations are only as good as the supervision and implementation that accompany them; and as Sarbanes-Oxley with its mark-to-market rule clearly demonstrate, excessive regulations can produce costly and unfair reporting burdens on enterprises of all sizes and create inaccurate and prejudicial accounting statements, as well.

5. Help "Main Street" and "share the upside." Help for the little guy makes rescuing banks less unpalatable to the public. Along with Fobaproa, the Zedillo Government introduced a program to help people stay in their homes when the value of their mortgages exceeded home value. Since financial crises invariably cost more than originally estimated, it is wise to offer taxpayers a share in the upside. That didn't happen with Fobaproa, exacerbating social tensions and undercutting the legitimacy of the system. The Obama economic plan helps homeowners avoid foreclosure; and the Treasury plan to purchase bank shares that yield dividends could produce a net financial gain for the government in the long term.

6. Guarantee accountability. The rescue designed by Mexico's technocrats wasn't heavy on either transparency or responsibility, and the country is still paying the price. It accentuated Mexicans' distrust of government and the political system, promoted cynicism and undermined confidence in the market system. Embedded in the mantra of "change," that swept Barack Obama and his fellow Democrats to victory at the polls, is accountability. The public expects it and demands it — from their elected leaders, the bureaucracy, banks and corporations. If those just voted into office do not deliver; those just voted out will be voted back in.

ROBUST RECOVERY

What can we learn from Mexico's experience? Transparency, accountability, clear rules, and oversight are crucial. Programs should offer taxpayers a share of the upside, be built on consensus, incorporate effective regulation, re-capitalize the banks, and deal with the underlying causes of the crisis. If done right, this could result in a shorter recession, a more robust recovery and a stronger financial system in the long run — an outcome all Americans, regardless of party affiliation, can celebrate.

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