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Mexico

UPDATED TO JANUARY 1988

1.0 Introduction

1.1 Political assessment. Mexico continues to enjoy a high measure of political stability. The Institutional Revolutionary Party (PRI), which has been in office for the last 58 years, maintains a firm grip on political power despite growing discontent over the country's prolonged austerity program. Declining consumer purchasing power and a stagnant economy are likely to cost PRI presidential candidate Carlos Salinas de Gortari a certain amount of popular support in the July 1988 elections, but this will be expressed mainly in absenteeism, since there is no serious threat from the opposition parties. It is a foregone conclusion that Carlos Salinas de Gortari will win the 1988 presidential election and that the PRI will retain control of the legislature and all governorships.

Opposition parties, especially the conservative National Action Party (PAN), have had some limited success in winning electoral victories in the north owing to the growing disenchantment of the middle class, whose fortunes fell drastically when the boom years ended. Discontent among the middle class has also given rise to independent grass roots organizations in the ecology movement and in the reconstruction efforts following the September 1985 earthquakes. Independent leftist unions have also been gaining influence on the periphery of the official labor sector and represent the only left-wing force with any power base.

However, leftist parties still lack the unity necessary to present a serious challenge to the PRI. Political infighting prevented the left from unifying behind PRI dissident Cuahtemoc Cardenas, the son of Lazaro Cardenas, the most popular Mexican president in this century, when he left the PRI to become an opposition presidential candidate.

With the growing uncertainty following the Mexican Stock Exchange's crash, the primary goal of the outgoing administration of Miguel de la Madrid is to restore confidence so as to allow for the election of Mr. Salinas in an atmosphere of relative calm.

To achieve this, the administration needs to regain control over inflation, which has gone unchecked for the past two years. But despite recent efforts, especially the Pact of Economic Solidarity, which included a 21.9% currency devaluation along with an 85% price increase in many public goods and services and a reduced budget in 1988, it seems unlikely that the government will succeed. The budget needs to be drastically cut—a tall order in an election year on account of the implied lower growth and higher unemployment.

The public has already suffered through prolonged recession since 1982; labor accepted a 38% accumulated wage increase in late 1987 (well below inflation) in return for the administration's promise to index wages on a monthly basis in March 1988.

1.2 Economic environment. Mexico is struggling to restore confidence following the Mexican Stock Market crash. The government has raised interest rates and devalued the free market exchange rate to stem capital flight, returning to the tight credit and high interest rate policies that averted a major economic crisis in 1986 and early 1987.

These measures, however, will push up inflation—which could reach as high as 200% by the end of 1988—and unemployment levels while putting a brake on already sluggish growth. GDP growth for 1987 was only 1%, while the budget deficit hit 18.5% of GDP, with inflation at 158.9%.

The de la Madrid administration will complete its term with one of the lowest average GDP growth rates in modern Mexican history, at a time of massive growth in the labor market. As a

Important Financial Events

- Government promises wage indexation in March (1.1)
- Government launches fight against high inflation (1.1)
- Mexico launches debt restructuring scheme to reduce debt servicing burden (1.2)
- The world's fastest growing stock market becomes the world's fastest falling (8.1)
- Tax reform package knocks tax incentive scheme (9.3)

In the process of updating this chapter of FFO, some financial conditions may have changed. For the most current interest and foreign exchange rates, please refer to the FFO Interest Rate & Forex Updaters, which are sent once a month to subscribers.

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Mexico Data Bank

	1987	1988	1989
GDP (% real growth)	1.0	3.9	2.0
Current account (US$ billions)	2.35	-2.25	-2.55
Trade account (US$ billions)	7.4	5.6	5.3
Inflation (% change)	127.0	165.0	120.0
Exchange rate (P:$1, year-end)			
controlled	2,193	5,600	8,100
free	2,250	5,700	8,300
Prime rate (%)	190.0	230.0	120.0

result, the pressure for stimulative policies will be intense and growth will continue to be a priority concern of the next administration. Foreign creditor nations should take heed of Mexico's contention that it must be allowed to grow in order to pay its debt service.

Mexico's new debt restructuring scheme will reduce the burden of its foreign debt payments. Under the new scheme, Mexico will trade 20-year dollar-denominated bonds effectively backed by the US government for Mexican debt with creditor banks. The Mexican bonds will pay interest of LIBOR plus 1.625 points on a semiannual basis and will be backed by $20 billion dollars worth of 20-year "zero coupon" US bonds that the Mexican government will purchase at 10% of their face value.

Mexico's savings on interest payments will depend upon how much creditor banks discount Mexican debt when trading it in for the new Mexican bonds. Banks are expected to trade the debt at between $0.60 and $0.70 of its face value, which would save Mexico some $18 billion in interest payments over the next 20 years, or about $900 million annually. This combined with $12 billion dollars in new money over 1987 and 1988 should provide a window for balance-of-payments stability through the 1988 presidential election period.

While Mexico has approximately $11 billion in foreign reserves, major external downside risks in 1988 include a continued fall of oil prices and a possible rise in US interest rates.

The delay in receiving credits from abroad—some $3 billion was originally to have been disbursed in 1986—dampened economic growth in 1987 and made it impossible for the government to reduce significantly its domestic borrowing requirement, which reached 18.5% of the country's approximately P190 trillion GDP at end-1987. Soaring interest rates have made the domestic debt service an obstacle to revival of the economy, and fears that increased government spending would stimulate hyperinflation have forced the Mexican cabinet to reconsider its highly inflationary budget for 1988.

The government is scheduled to cut the 1988 budget from P235 trillion to P208 trillion, thus reducing the government deficit by 1.5% to 17% of GDP, but this will allow for little or no economic growth. Moreover, since these cuts will not be enough to offset the inflationary pressure of the March wage indexation, inflation will remain in the three-digit range through the end of 1988.

The crucial period for balance-of-payments sensitivity will be between April 1988, when the agreement with foreign creditors expires, and December 1988, when the new president takes office. Capital flight will increase during this period as part of the historic election year cycle.

1.3 Financial conditions. Liquidity has been tight since July 1985, when Banco de Mexico (the central bank) significantly tightened restrictions on the amount of new bank funds available for lending to the private sector. The move was originally billed as a temporary three-month measure, but is still in force. While the arrival of new credits in mid-1987 brought temporary increased liquidity, this quickly disappeared following the Mexican Stock Market crash.

When mandatory reserves and specially earmarked funds are taken into account, some 90% of all bank resources are controlled by the government. Through the first 11 months of 1987, financing to the private sector totaled approximately P21 trillion—10% of GDP, roughly the same level as in 1986.

Inflationary expectations will strongly affect the government's ability to provide more credit to the private sector in 1988. The $13 billion in foreign reserves at end-1987 will allow the government to service its international obligations, but soaring domestic interest rates based on inflationary expectations are making the internal debt increasingly difficult to service. Despite the increased revenues expected from Mexico's 1987 income tax reform, any credit opening will hinge on the government's ability to restrain interest rates.

The average cost of funds has struggled to keep pace with inflation, with prime rates rising from 90.30% in October 1987 to 104.29% in December. Moreover, credit availability is very low.

The de la Madrid administration's attempt to reduce interest rates in the first week of December was thwarted when investors opted to sell almost P4 trillion in government Treasury bonds, known as *Cetes*, rather than accept interest rates of 114% for 28-day bonds and 123% for 91-day bonds. The following week the government was forced to issue *Cetes* at rates of 120.30% for 28-day bonds and 129.99% for 91-day bonds—rates 20 points higher than those offered in the second week of November.

Subsequently, the government issued P2 trillion in short-term *Cetes* in the last week of December 1987 at rates of 120.70% for eight-day bonds and 121.64% for 15-day bonds to try to slow the growth of interest rates. This action was coupled with a forced 85-day loan by domestic banks to the central bank of P100 billion to reduce market liquidity. The government has managed to keep real returns on these investments positive, but inflationary expectations and tight monetary policy are exerting considerable upward pressure on interest rates.

Real borrowing costs will remain in the 180% range for bank loans to prime customers, with poor credit availability continuing throughout the first half of 1988. For this reason, the *extrabursatil* (parallel) market will continue to be a mainstay for rapid short-term borrowing.

1.4. Discrimination against foreigners. With limited credit availability, it has become increasingly difficult for foreign companies to borrow locally, even within the commercial banks' guidelines. However, the larger banks generally make an effort to provide credits to their most valued customers, many of which are multinational companies. Typically, banks restrict the

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amount of funds an MNC can obtain, but continue to offer low, even below market rates.

Access to special funds available through government agencies can be difficult for majority foreign-owned firms, but the full deductibility of these loans under the new tax system will make the effort increasingly worthwhile as the new tax system becomes fully operational. Fomex continues to provide preexport and export credits to majority foreign owned-firms based on local content levels. Interest charges climbed in early 1987 as a result of moves to eliminate trade subsidies prohibited by GATT and the US agreement on countervailing duties. Fomex is also less willing to grant foreign-majority companies peso preexport credit.

MNCs with easily identifiable alternative sources of financing may have trouble obtaining approvals for loans from these funds, but export-oriented projects and those involving relocations to a priority zone stand a better chance. A 50/50-owned foreign firm recently won Foreign Investment Commission (FIC) approval to be considered Mexicanized for purposes of receiving Fonei equipment financing. In general, the government prefers that majority foreign-owned firms bring in capital and not rely on the shallow local financial market.

The situation eased in early 1987, however, when the National Securities Commission (CNV) allowed foreign-owned firms to resume issuing variable rate bonds (*obligaciones*) following a freeze in 1986—but the high rates on such issues at the moment (144-146% p.a.) make them relatively unattractive.

Nearly all types of local borrowing, by either local or foreign firms, require guarantees, but since November 1985, foreign representative banks have been forbidden to directly guarantee peso loans. Indirectly many have continued to do so, however, using local banks as intermediaries or through the use of offshore credit lines and insurance schemes. A number of *casas de bolsa* (brokerage houses) also continue to accept direct foreign letters of credit, listing them as unguaranteed loans in reports to the CNV, as there has been no real enforcement of the restriction.

The 1983 banking law prevents foreigners from acquiring equity in financial institutions in Mexico. The only foreign and privately owned bank operating in Mexico is Citibank, which was established before restrictive legislation went into effect in 1966. Citibank was also exempted from the 1982 nationalization decree, but has not been allowed to expand its branch network. Also in 1982, Mexico published the rules under which foreign financial institutions may open offshore banking offices in the country—rules offering no tax breaks or access to the domestic market. It is therefore not surprising that no offshore branches have yet been established.

The chief form of discrimination against foreign lending to Mexico has been a 15% withholding tax that non-Mexican banks must pay on gross-interest receipts from Mexican sources. The tax is a highly contentious issue, and Mexico's treasury secretary has promised to abolish it. Five years ago most banks absorbed the it, but few do so now because they are not able to apply foreign tax credits against foreign income, which has dropped substantially over the last several years. Virtually all restructuring contracts stipulate that the client must absorb the 15% tax. Lending institutions of foreign governments, including banks with state participation, also pay a withholding tax of 15%, and interest on loans from nonregistered financial institutions (e.g. parent company loans) is taxed at 42%. As a result, most parent company loans are routed through banks in the form of back-to-backs.

A 21% withholding tax applies to interest on loans from foreign suppliers of machinery and equipment for industries "of public interest." The same rate is charged on loans from nonfinancial institutions (i.e. parent companies) if the loan is in the public interest. Otherwise, the rate is 42%—which tends to discourage intercorporate lending. Mexico can view interest payments on such loans as dividends, subject to a prior payment of a 10% on pretax profits, a 42% corporate income tax and a 50% dividend tax if they are deemed concealed dividends.

1.5 Corporate financial strategies. The return to credit scarcity following the temporary liquidity in mid-1987 is forcing international companies to fall back on the wide range of borrowing sources developed during the 1986 credit squeeze, when companies diversified sources and built new relationships with both lenders and brokers. Perhaps the most important financial strategy, however—given the cost of money and continued high foreign exchange risks—was a reduction of the need to borrow by an improvement of cash management.

For many companies, tighter management of receivables and payables is the key to improved liquidity. Chronic slow payment by government offices and state firms in recent years has resulted in many companies' putting a percentage cap on sales to the public sector whenever possible. Banks discount receivables of chronic late payers such Pemex and Conasupo and then rediscount them with the Fogain industrial development fund, but up-front discounts can run over 100%, currently making such financing unrealistic.

Companies that are able to borrow from cash-rich sister subsidiaries will be able to weather the credit crunch particularly well. In most cases, such peso pooling arrangements represent about the cheapest form of financing available. Also, deals can be executed rather quickly with proper coordination among the companies involved.

The sharp downturn in the supply of bank funds available for lending has limited the ability to draw down large amounts of bank financing quickly, although the large banks have tried to help prime customers with small amounts of exceedingly cheap credit.

Competition from the parallel market—chiefly from *casas de bolsa*—is leading to a gradual elimination of compensating balance requirements and interest up-front-payments for prime customers. Such charges were often unavoidable in the past, but now the large Mexican banks are often willing to forego them—though the small banks still tend to demand them.

Companies continue to view the parallel or *extrabursatil* financial market as a permanent second source of short-term financing. The parallel market offers the advantages of speed and creativity for foreign companies with good credit ratings. MNCs continue to closely cultivate their banking relationships, however, and bank credit, when available, remains cheaper. In 1987, the *extrabursatil* market accounted for approximately 50% of total domestic market resources.

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In some cases, parallel market operations consist of straightforward deals between corporate treasurers. This helps to save on brokerage fees, which can run between 1% and 3% depending on the amount being borrowed. More frequently, brokers are involved in matching lenders with borrowers.

While nominal rates may appear reasonable, the real cost of borrowing on the parallel market can be quite high when brokerage costs, higher fee structures and guarantees are all factored in. First-time participants in the market often have to put up a foreign letter of credit backed by a parent guarantee. Some prime firms have been able to get *casas de bolsa* to accept straight parent guarantees, however, thereby cutting the cost.

Most MNCs in Mexico tend to stay away from the *bolsa* (stock market) as a source of capital, since issuance of commercial paper has become exceedingly expensive because of the need to keep pace with ever-rising *Cetes* rates. Also, many firms are discouraged from issuing paper by the extensive disclosure requirements. Rates paid on *extrabursatil* paper are only a point or two higher than what would be paid on regular *bolsa*-issued commercial paper, and the transactions can be executed much more rapidly. In the last year, the *extrabursatil* commercial paper market grew from P82.2 billion in December 1986 to P466.4 billion in December 1987.

Long-term capital is practically nonexistent, but some MNCs launched bond issues in 1987 following the lifting of restrictions on this type of operation imposed a year earlier by the CNV (7.3). However, the authorities still consider that foreign firms should bring in their own funds and leave local resources for local firms.

The credit crunch will force some foreign firms to obtain parent company funding, although there is no evidence that this has taken place on a widespread basis. Most companies have in fact tried to wipe out their parent company loans, even when doing so meant borrowing heavily in the local market at extremely high rates. As Mexico's new tax system is phased in—penalizing heavy indebtedness—companies may have to utilize retained earnings and equity investment to substitute for heavy peso borrowing. Such borrowing will still be advantageous from a tax standpoint in 1988, however, since companies will be operating 60% on the old tax system.

Uncertainty will continue to mark borrowing conditions. Nevertheless, new instruments and options will emerge to meet the demands of the marketplace. The parallel market is certain to expand, although the government will increasingly try to control it. Fideicomiso para la Cobertura de Riesgos Cambiaros (Ficorca—Mexico's private debt coverage scheme) sales should be an important technique for financial restructuring and expansion in 1988. By the first quarter of 1988, companies should be able to tap into the foreign bank peso onlending program expected to be initiated by the government. A private debt swap program using these peso onlending funds is also expected to emerge eventually.

Changes in the regulations governing venture capital funds have sparked interest from several foreign banks in investing in the operating companies of the funds. This has the potential to strengthen the traditionally shallow local market and provide a source of investment capital for companies in the future.

2.0 Currency Considerations

2.1 General. Mexico has a two-tier exchange system composed of a controlled and a free rate. The former is used to convert all exports, imports, public and private foreign-debt payments (except for debts registered under the Ficorca program's preferential rate), royalty payments, in-bond expenses, and foreign currency payments incurred before Dec. 20, 1982, and payable within Mexico. The free rate applies to all other foreign exchange operations and is market-sensitive but not immune to central bank intervention. The dual exchange rate system is Mexico's most effective exchange control, and as long as the risk of capital flight looms the two-tier system will be maintained.

The controlled rate accounts for about 75% of all foreign exchange transactions. When the two rates are close, many companies circumvent the government through free market operations. Free market transactions provide rapid access to funds and allow exporters to avoid the obligation to return the funds to Mexico within 90 days. The controlled rate will be maintained, however, and the spread between it and the free rate is sensitive to capital flight, as was demonstrated in the aftermath of the Mexican Stock Market crash.

In 1985, the system of regular daily minidevaluations was replaced by one in which peso slippage takes place via a "rational float," that is, on an unscheduled but fairly predictable basis. In setting the rate, Banco de Mexico takes into consideration balance-of-payments factors and short-term supply-and-demand trends reported by banks. The official controlled rate for a given day is formally known as the *tipo de cambio de equilibrio* and is determined at daily meetings between Banco de Mexico and commercial banks. Since fall 1986, the rate announced in the *Diario Official* each day has been the rate for the following day. The system has given the foreign exchange system an important measure of stability, since the pace of slippage generally does not change much from day to day. Most important, the system allows the government to keep the peso realistically valued.

There are now two free rates: the official government free rate and the exchange-house rate. The difference between the two is currently less than 1%. At the end of 1987, the official free stood at P2,260.8:$1, vs P2,278:$1 for the average exchange-house rate.

During the first ten months of 1987—until the stock market crash—de facto government policy was to keep the differential between the controlled and free exchange rates small—2% or lower—with Banco de Mexico selling dollars on the exchange market to narrow the differential and to maintain stability and confidence. The action was effective primarily because of tight credit conditions and depressed demand for foreign exchange.

This slight difference between the rates prevailed despite a slowdown of the controlled devaluation rate as a measure to combat inflation. The measure did not succeed in slowing inflation and as a result contributed to the peso's becoming less undervalued.

In the midst of growing pressure for more rapid devaluation, the Mexican Stock Market crashed, and Banco de Mexico not

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only had to make up for lost ground but also had to stem growing capital flight. The central bank proceeded to make a series of moves to control the situation.

First, it moved to stop capital flight by withdrawing from the free market on November 18, causing a 41% devaluation—the free market dollar rose from P1,714.9 to P2,433. This relieved capital flight pressure on the free market dollar, and the gap between the free market and controlled rates narrowed from the 42% registered after the crash to 25% by mid-December.

Banco de Mexico's next move was to speed up the controlled rate devaluation against the dollar from P2 per day to P3 per day. However, this did not prevent the controlled exchange rate from falling behind inflation, since interest rates also had to be raised nearly 30% to keep capital from fleeing the country.

Finally, on Dec. 14, the government devalued the controlled rate by 22% reducing the gap between the controlled and free rates to 3.6%. Since the controlled rate devaluation, the gap between the two rates has stayed below 2%, primarily because the central bank is supporting the free market rate.

2.2 Currency behavior and forecast. Despite $13 billion in foreign reserves as of end-1987, the peso will continue to weaken because of lack of confidence, and Mexico appears to be headed toward balance-of-payment problems. On the international front, falling oil prices and a possible hike in the US prime rate are two major factors that could force Mexico back to the bargaining table with its international creditors.

Mexico remains heavily dependent on oil exports, so that a continued downward trend in oil prices would place a great strain on foreign reserves. Meanwhile, since some 56% of the P208 trillion government budget has been set aside to service the foreign and domestic debt, a rise in international interest rates would strain government finances considerably. The $900 million annual savings generated from Mexico's new debt restructuring scheme will relieve some of the pressure of foreign debt servicing, but how long it takes to get on line and the amount that creditor banks discount the Mexican debt will determine just how much relief this measure will provide.

The de la Madrid administration's recently announced Pact of Economic Solidarity to combat inflation is being viewed with skepticism. The policy requires a temporary freezing of the controlled rate to check the inflationary pressures of gradual devaluation, but attempts to slow the devaluation rate in early 1987 were unsuccessful in containing inflation. Nevertheless, the controlled rate peso is likely to remain frozen at its end-1987 level of P2,204:$1 until at least mid-March 1988, when a devaluation of up to 15% is expected to bring the controlled rate more in line with the free rate.

As of mid-January 1988, the free rate was P2,260:$1, shored up by central bank intervention. The anticipated devaluation is likely to precede the introduction of the new inflation index intended as the trigger mechanism for the wage indexation promised in the 1987 labor negotiations.

Controlled rate and free rate parities are expected to be P5,000:$1 and P5,100:$1 respectively by the end of 1988.

2.3 How the spot market works. While use of the free market has been high on account of the de facto unification of the two rates, some 75% of all foreign exchange transactions are still carried out at the controlled rate, with the balance conducted at the free rate. The government is the only seller in the market for controlled-rate dollars. All applications for controlled-rate dollars must be made through the firm's commercial bank; the bank then turns over the application to Banco de Mexico, which processes the forms and releases the dollars. Dollar availability was good throughout 1987; if a crunch is to come, it should hit before the end of the first half of 1988.

Commercial banks and exchange houses deal in free-rate dollars. Although rules have been in force recently that have limited the amounts of dollar purchases per transaction ($10,000 for companies; $500 for individuals), these limits have not been consistently enforced.

2.4 Taxation of forex gains and losses. When the new tax system is completely operational in 1991 (it is being phased in over four years), deduction of foreign exchange losses will be limited to the real component. Under the law, exchange losses are treated as interest and firms can generate "an inflationary profit," which can increase monthly tax payments. The new tax law is expected to bring about a change in the current corporate strategy of maximizing exchange losses.

In 1988, existing strategies will still be advantageous because firms will be operating 60% on the old tax system. Foreign exchange losses are fully deductible under the old system but only deductible in real terms under the new system. The loss is calculated by using the difference between the exchange rate in effect when the foreign currency liability was incurred and the rate in effect when payments are due.

In 1983, officials ruled that if companies renegotiated their foreign credits on longer terms, they could take the full deduction for exchange losses at the controlled rate in force on Dec. 31, 1983 (P96:$1), even if they were unable to make the payments. The deduction for exchange losses can still be taken when a payment is due, even though it is not actually made. The debtor no longer has to assume the exchange loss. Additional losses suffered when payment is made may also be deducted; they are calculated as the difference between the exchange rate at the due date and the rate at which payment is made. If a company has to purchase foreign currency at the free market rate to comply with its obligations, it may deduct the difference between the controlled and free rates set at Banco de Mexico on the day of operation. Companies cannot deduct the difference between Banco de Mexico's free rate and a higher rate at which they might have purchased foreign currency.

There are three alternatives for tax deduction of exchange losses on debt enrolled in the private debt coverage scheme known as Ficorca. The deduction can be taken (1) in one sum during the year the loss is suffered; (2) in equal shares over four years, beginning when payment would have been due under the original loan terms; or (3) when payment is actually made under the program. Foreign exchange gains are taxable in the fiscal year when the claim or the debt becomes due according to the original terms of the debt. Any additional exchange gains between the due date and payment date are taxable in the fiscal year payment is made.

Firms must include bank and supplier debts, foreign exchange credits, cash, and accounts receivable and payable in their

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obligatory foreign exchange disclosure statement (register). This register, which must be certified by the secretariat of the treasury, will enable officials to monitor exchange gains and losses.

2.5 Forward contracts and other hedging techniques. Mexico has moved to provide several types of forward protection to replace the loss of such coverage with the shutdown of the offshore forward market in late 1985. It has made legal dollar accounts for firms operating within 20 kms of the border. In 1986 it also launched a dollar indexed treasury bond called the *Pagafe* (*Pagare de la Tesoria de la Federacion*). *Pagafes* are sold in pesos and bought in pesos at the controlled rate but valued in $1,000 dollar denominations. There has been little enthusiasm for the bonds despite rates as high as 15%.

In January 1987, Mexico launched a forward market which is also a controlled peso mechanism, with coverage available up to six months out. However, the high interest rates and steep premiums charged by participating banks have caused corporations to shy away from the mechanism. Some corporate treasurers also report they sometimes have trouble getting home-office approval to use peso mechanisms as hedges since the practice does not guarantee access to dollars. Participation in the instruments could increase in 1988, however, if peso volatility increases as expected.

A traditional peso hedge has been petrobonds, which have a strong secondary market. While the change from quarterly to monthly interest payments and the pegging of interest to Libor plus four made the first 1987 issue more attractive, the fact that the second 1987 issue is not backed by a guaranteed price per barrel of oil has made this instrument more risky.

Mexican government officials do not want to see a return to offshore peso trading because of the pressure it places on the currency. However, Citibank has created an informal forward market to help companies protect against devaluation. The scheme works in the following manner:

- **Day 1.** Company A invests some P2.276 billion in Citibank at a set interest rate for 30 days. Citibank takes the money and changes it into $1 million (P2,276:$1) and invests it for 30 days.

Meanwhile, Citibank locates company B, which is interested in purchasing dollars at a fixed exchange rate in 30 days.

- **Day 30.** Citibank takes the $1 million plus the interest earned over the 30-day period, say $100,000, and buys pesos at the guaranteed rate from Company B. Citibank then uses these pesos to pay Company A its principal investment plus interest.

Firms in Mexico also enjoy a hedgelike option when they purchase controlled-rate dollars. Since mid-1985 (when Banco de Mexico established a new policy for setting the controlled exchange rate—the "rational float" system—see 2.1), firms have had two choices for purchasing controlled rate dollars: a "firm" operation or a "conditional" one. Under the former, the company agrees to buy or sell dollars at the rate in effect on a specified date. The latter allows the firm to set a limit within a certain time period and to trade only if the peso reaches that limit. The minimum for conditional operations is $50,000.

Applications for controlled dollars at the equilibrium rate (the official posted rate) must be made at least two days before the daily session that sets the rate for firm transactions or marks the beginning of the option period. For a firm operation, the transaction must take place within two days after the session. If an importer has to pay for a shipment in one week, there will not be time to arrange a conditional operation. If, however, it can anticipate dollar needs—and has quick access to cash—the importer might find it worthwhile to speculate by using the conditional arrangement. The transaction must be carried out within two days of the session in which the specified exchange rate was reached.

Companies that need to buy or sell dollars in less than a week may trade directly with the banks at what is known as the *tipo de cambio de ventanilla*; they may have to pay a bit more for their hurry, but they take no risk. The bank sets this rate to cover possible fluctuations in the equilibrium rate; the margin between buying and selling can be wide.

Another hedgelike option is prepayment of imports, for which controlled-rate dollars are available. In March 1986, officials sweetened this option by ruling that exporters and their affiliates could use up to 100% of their export earnings to prepay imports. This tends to reduce a firm's liquidity, however, and government authorities introduced the forward market in part to allow exporters to cover the exchange rate risk of tapping low-cost export bank credits available from many nations.

Mexico has two commodity-based investment instruments, petrobonds and silver bonds. Petrobonds are dollar-linked, payable in controlled-rate pesos, but the second 1987 issue has eliminated the fixed percentage of Isthmus crude at a guaranteed minimum price. Silver bonds (*Ceplatas*) are issued in 100-troy-ounce denominations and are dollar-linked, payable in controlled-rate pesos, but have no guaranteed price.

3.0 Foreign Exchange Regulations

3.1 General. Since the relaxation of exchange controls at the end of 1982, there have no longer been any restrictions (other than currency availability) on the remittance of interest, dividends or capital abroad by either nationals or foreigners.

The de la Madrid administration (especially Banco de Mexico head Miguel Mancera) has consistently opposed formal exchange controls. In fact, officials have eased access to hard currency, especially for exporters and their affiliates. Bureaucratic footdragging is not as prevalent as it was in the past, and this general policy trend is likely to continue as long as Mancera heads the central bank, but it could be altered if at some point balance-of-payments conditions once again grow acute.

While there is a theoretical limit of $10,000 per transaction on free market purchases by companies, the cap had not been enforced until the final day of trading of 1987. Banco de Mexico had to enforce the cap then because of excess demand for controlled-rate dollars. Theoretically, large foreign exchange transactions must be reported before they are executed. Regulations governing technology-transfer payments empower a government agency to reject licensing contracts if it deems the royalty payments excessive. Royalty payments are set on a case-by-case basis, and no single limit applies. Officials have traditionally cited 3% sales as the medium, but they have recently been reported to go as high as 10% if the technology contributes

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to development and especially to export goals.

Disclosure requirements. Since January 1984, companies have been required to keep a certified register of all their foreign currency transactions. These include bank and supplier debts, foreign exchange credits, accounts receivable and payable, and cash operations. Incorrect invoicing (e.g. underinvoicing of exports and overinvoicing of imports) and other violations of foreign exchange regulations are heavily penalized, and violators may be kept from exporting or purchasing foreign currency for import purposes if such infractions occur.

3.2 Incoming direct investment. Majority Mexican control of equity and management is required for companies operating in Mexico, and foreign investment must complement, rather than displace, local investment and contribute to development goals. In most industries, foreigners may hold up to 49% of the capital of new ventures.

The secondary segments of the petrochemical and auto parts industries come under separate legislation, which decrees a minimum of 60% Mexican ownership. (Officials are reportedly in the process of drafting legislation to allow majority foreign capital in these sectors.) In the mining sector, there is a strict maximum of 40% foreign equity, except in the case of special mineral concessions, for which the foreign maximum is 34%. The provisions of the foreign investment law do not apply to the in-bond industry (*maquiladora*—light-assembly operations that are given tax and other benefits), in which facilities may be 100% foreign-owned.

Majority foreign-owned companies already operating in Mexico when the foreign investment law was passed in 1973 must obtain Foreign Investment Commission (FIC) approval for foreign participation above 25% of total equity, expansions, introduction of new product lines and other changes in their operations. In the past, approaching the FIC often triggered a demand that the company Mexicanize. Now a slightly different attitude prevails.

If a company is operating in a priority industrial sector, such as consumer basics, capital goods or heavy industry, and is prepared to increase exports, increase the use of local inputs, decentralize or create jobs, the government frequently permits expansion without Mexicanization. Foreign investment officials maintain they approved 90% of requests for increases in foreign-owned capital from minority to foreign majority ownership during 1987. For the remainder of the de la Madrid administration, Mexicanization will be a low priority with the FIC.

Two resolutions were introduced in Sept. 2, 1986, to make investment easier. Resolution 14 declares investment by multilateral organizations and government development banks to be neutral for purposes of the foreign investment law. Resolution 15 streamlines investment procedures for small and medium-sized businesses seeking to invest in Mexico. Such firms, defined as companies whose parent has no more than 500 employees and no more than $8 million in sales, can make majority investments, relocate establishments or engage in new lines of activity within Mexico without prior FIC approval. Each Mexican-based subsidiary of such small firms must operate in manufacturing, employ no more than 250 people and have net annual sales of no more than the indexed equivalent of P1.1 billion. The size restrictions on the parent company have come under fire as being too restrictive to attract much foreign investment, and there is some speculation that they might be liberalized.

These reforms should not be viewed as backtracking on the foreign investment law; selectivity will remain the basic theme of foreign investment policy, with emphasis shifting within the framework of the law as government priorities change. If sufficient development benefits can be obtained, Mexican officials see them as more in the national interest than a forced 51/49 equity split.

3.3 Portfolio investment. No particular rules deal with a foreign acquisition of an interest in a local, publicly held enterprise. However, the 1973 foreign investment law holds that foreign companies must obtain authorization from the government before acquiring more than 25% of the equity or more than 49% of the fixed assets in established ventures. FIC authorization is necessary for the acquisition of any number of shares of a company when such a purchase results in the total foreign investment's exceeding 25% (or if 25% or more of the capital stock of the company is already foreign-owned).

The 1983 banking law prevents foreigners from acquiring equity in financial institutions in Mexico. The only foreign and privately owned bank is Citibank, which was established before restrictive legislation went into effect in 1966 and which was exempted from the September 1982 nationalization decree. Minority foreign participation is allowed in brokerage houses, which have become among the most creative and fastest-growing forces in the financial market. Foreign ownership of venture capital and stock mutual fund operating companies has also been made easier.

In early 1987, new government regulations allowed mutual fund operators to own more than 49% of the companies in which they invest. Furthermore, mutual fund operators do not have to pay tax on profits until the profits are distributed as dividends. While the Mutual Funds Law includes a 10% foreign-participation limitation, it also allows for exceptions where projects are deemed particularly beneficial to the economy. In practice, the authorities want to negotiate deals individually, and they have indicated a willingness to grant foreign ownership levels substantially above 10%. With special FIC and Treasury Secretariat approval, a foreign investor can theoretically own a majority stake in such an operating company.

Foreigners cannot hold *Cetes* treasury certificates directly but can invest in a *bolsa* fund that includes *Cetes*, or in a similar bank fund. Typically, a treasurer will invest through a *casa de bolsa* or a bank fund consisting of *Cetes*, commercial paper, banker's acceptances and perhaps petrobonds over a set period of days at a set interest rate. These transactions are known as *reportos*. The purchase of shares listed on the exchange is restricted by corporate bylaws.

3.4 Borrowing from abroad by residents. There are no restrictions on Mexicans borrowing abroad. A loan must be registered with the Treasury Department (Registrar of Debt) and on the company's debt register. If the loan is not registered, the company will be barred from obtaining access to controlled-rate dollars at time of repayment. Unless they are strong exporters, few Mexican firms can obtain foreign credit at present. There is a

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15% withholding tax on interest paid on foreign bank loans.

Public sector firms, including mixed-capital companies with minority government equity, are subject to tight controls on foreign borrowings. Supervision has become even more rigorous since the introduction of the Public Sector Debt Law, which requires that quarterly statements of the public sector debt position be submitted for congressional review. This watchdog mechanism is also meant to curb wasteful spending, since the purpose of proposed borrowings must be justified.

3.5 Borrowing from abroad by nonresidents. The regulations regarding external borrowing apply equally to domestic and to foreign firms (see 3.4).

3.6 Local borrowing by nonresidents. Theoretically, foreign companies and local firms have equal access to local bank credit. In practice, however, banks do sometimes discriminate against foreign companies in favor of local firms. This tendency is partially offset by the superior credit ratings enjoyed by MNCs.

3.7 Restrictions on export proceeds. Exporters must fill out a foreign exchange sales pledge (CVD) obliging them to sell receipts from foreign sales to their local commercial banks within 90 days. Related imports, suppliers credits and export expenses may be deducted. Secofi has streamlined the process for obtaining approval for deductions of such related expenses. If the original authorization for related expenses was based on 100% of f.o.b., a firm may exceed the authorized amount by $500 dollars without seeking further approval. If the authorized amount was based on 50% of f.o.b., the firm may exceed it by $1,000 without further approval. Documentation proving the additional expenses were incurred must be presented to the bank handling the controlled dollar transaction. Officials apply steep penalities for infringements—up to three times the amount of illegally handled dollar funds. The same penalties apply to underinvoicing of exports and overinvoicing of imports.

3.8 Restrictions on import payments. Some 90% of all imports can be brought into Mexico without a license. All imports are eligible for controlled-rate dollars, and availability is currently unimpeded. But this could well change by mid-1988 with the increasing pressure on the peso.

Specific export requirements exist for certain industries. For example, the automotive sector must balance their hard currency expenditures on imports with exports. On a less rigid basis, foreign companies operating in the computer sector are expected to be able to cover their foreign exchange needs with exports. There is increasing pressure from the United States for Mexico to drop these export requirements. Mexico's entry into the General Agreement on Tariffs and Trade (GATT) also requires it to phase out discriminatory practices by 1990, which is likely to lead to changes in this area.

3.9 Repatriation of capital. Since exchange controls were relaxed there have been no legal restrictions on the repatriation of capital. Massive capital flight, however, would probably spark renewed control.

3.10 Remittance of dividends and profits. Profits are freely remittable, provided a company is registered with the National Registry of Foreign Investment and meets legal reserve requirements and tax obligations. By law, firms must distribute 10% of their pretax profits to employees and allocate 5% of net profits to the legal reserve until 20% of stated capital has been set aside.

A 1987 tax change lowered the withholding tax on dividends from 55% to 50% (except for dividends reinvested within 30 days) but made the dividend paid deductible from taxable income. A 1984 amendment of the tax law stipulates that dividends paid out of one fiscal year's earnings may not be deducted from that same fiscal year's taxable earnings. (In other words, the dividend is still deductible, but not until the next fiscal year.) A planned moved to a creditable dividend was to have been implemented as of Jan. 1, 1986, but Mexico's recent tax reforms halted the planned change and the dividends remain deductible.

As of Jan. 1, 1985, firms have not been permitted to deduct dividends generated by gains resulting from a revaluation of assets. Companies that register losses while paying out dividends must adjust their final results by the amount of the payout. Taxes due on dividends must be withheld by the payor, including payments to individuals. Earnings from dividends are included in a company's taxable income. Dividends may be paid out of current profits plus retained earnings. If a company has accrued losses, dividends may be paid out of current profits alone.

3.11 Remittance of interest and principal on foreign loans. Foreign exchange is available in the controlled market for repayment (including interest, principal and related charges) on foreign currency loans incurred after Dec. 20, 1982, and for repayment of pre-Dec. 20, 1982, debt that has been properly registered with the Secretariat of the Treasury and the Department of Commerce and Industrial Development (Secofi).

Exporters may use their export proceeds to offset past-due supplier debt. They may also use export revenues to make principal and interest payments on registered foreign currency bank debt, payable abroad and incurred after Dec. 20, 1982, provided these obligations are not enrolled in the Ficorca private debt coverage program. Interest payments on registered bank debt incurred before Dec. 20, 1982, may also be made with export revenues as long as the payments are not covered in the Ficorca scheme. If Ficorca covers only part of the interest, exporters may use their proceeds to pay the remainder up to the interest rate stated in the debt register.

Firms may also purchase controlled dollars for import credits incurred after Dec. 20, 1982, or deduct these payments from their export revenues. However, payment of short-term import credits cannot be made until 90 days after the shipment covered by the credit arrives. A 10% advance payment may be made at the controlled rate.

The average amortization period of a long-term credit must be at least 12 months. An advance payment of 20% is allowed. Importers can purchase controlled dollars for interest payments on these credits up to the maximum yield of three-month deposits in the corresponding foreign currency on the date interest is due; the remainder must be covered with free-rate dollars.

Two payment mechanisms exist for supplier credits incurred before Dec. 20, 1982, that are secured by the US Eximbank. In both programs, debtors purchase dollars at the controlled rate for the full amount of their obligation; companies then lend

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these dollars to the credit institution that will make payments directly to Eximbank according to the amortization schedule.

The first program mainly covers long-term credits originally due after Dec. 31, 1983, and follows the pattern of the debt repayment/forward coverage scheme tied to a peso credit of the 1983 Ficorca program. The other program is administered by Nafinsa, the government's development bank, and Bancomext, which assume the credit risk. For this program, peso credits are available as well and amortization payments fall due between Dec. 31, 1984, and June 30, 1989, depending on the original term of the loan. Eximbank decides which of the two schemes may be used by the debtor company.

Ficorca continues to accept enrollments of new debt at the Ficorca peso exchange rate at the time of approval of the transaction. With Ficorca approval companies can transfer their Ficorca coverage to another company as well. Negotiations on restructuring of the $11.2 billion private debt coverage mechanism were completed in July 1987. Bankers rescheduled the debt along the same terms Mexico received on its public debt (20 years with seven years grace and an interest rate 13/16 of a percentage point above LIBOR.) Also included in the agreement was a revolving fund system under which banks will be able to relend peso payments in the domestic market. The amount and rates to be charged on the relending will be controlled by Banco de Mexico.

Bankers expect the peso onlending program to be operational by the first quarter of 1988. They also predict that the government will introduce a debt swap investment mechanism whereby companies will be able to buy a bank's rights to the pesos it receives through Ficorca at a discount in return for investment. Priority would probably be given to export projects, relocations to priority zones and import-substitution.

However, the restructuring agreement of July 1987 means that companies enrolled in Ficorca, except those under the supplier credits program, will have to restructure their debt or prepay their Ficorca obligations. Under the new scheme, debtors choosing from eight-year terms with four years grace up to 12-year terms with six years grace will pay the same interest rate as specified in the original April 1983 agreement. This rate equals the average of three- and six-month certificates of deposit.

However, repayment will be based on the exchange rate on the day the new contract is signed. Those entering into a contract for more than the 12-year term will be allowed to choose between these rescheduling terms, and maintaining the 1983 exchange rate with an interest rate equal to 110% of CPP (the average monthly interest rate offered by banks on all accounts except savings).

3.12 Remittance of royalties and fees. Payment of royalties and fees covered by contracts that are approved and registered can be made at the controlled exchange rate in force on the day of the dollar purchase, provided that the contract under which the fees are to be paid is duly registered with the National Registry of Technology Transfer. However, the free rate is used to calculate the dollar equivalent of peso amounts. To buy controlled dollars, firms must obtain a permit from the Secretariat of Commerce General Office of Technology Transfer.

Companies are not allowed to use their export revenues to cover royalties payments. The Secretariat of Commerce may establish a payment schedule if none is stipulated in the contract. Until recently, 3% of net sales was generally considered the maximum royalty fee. However, the National Registry no longer has firm guidelines on accepted royalty rates, and authorities have permitted rates as high as 10% in certain instances.

3.13 Hold accounts.

Foreign currency held locally by residents. Resident companies may hold foreign-currency accounts in Mexico. The minimum deposit is $5,000 and the dollars must come from abroad. Payments from these accounts can only be made abroad.

Foreign currency held locally by nonresidents. These accounts are generally not permitted, except for diplomatic missions and foreign correspondents, whose dollars must come from abroad. Withdrawal can be made in pesos or US dollars.

Local currency held locally by nonresidents. Interest-bearing time deposit and non-interest-bearing demand-deposit accounts are allowed, but central bank permission is necessary for larger accounts. Nonresident accounts may not be debited directly for transfers abroad.

Foreign currency held abroad by residents. As of Sept. 1, 1982, residents are prohibited from opening foreign-currency accounts abroad. In October 1987, the government passed leglislation allowing residents living along the Mexican border with the United States to hold dollar accounts in Mexican banks. However, investors are wary since pre-debt crisis dollar accounts held in Mexican banks were redeemed in pesos at less than 50% of their value once the crisis hit in 1982. Meanwhile, the Mexican authorities have urged residents holding outstanding accounts abroad to transfer those funds to Mexico but have not forced them to do so, and many Mexican nationals continue to hold foreign savings and checking accounts.

3.14 Leading and lagging. Although Mexico places no legal restrictions on leading and lagging of exports and imports, exchange controls have effectively done away with these mechanisms. Foreign suppliers require prompt payment on delivery. Import licenses, when required, are valid for six months and can be extended by three months in some cases. There is increasing use of letters of credit.

3.15 Netting. Bilateral or multilateral netting between or within companies is not permitted.

3.16 Other restrictions. N.a.

4.0 The Monetary System

4.1 National monetary institutions. Currency, credit and interest rates are regulated by the Mexican government through Banco de Mexico, the country's central bank and bank of issue. The Mexican banking system is made up of commercial banks and development banks. The latter include special funds and agencies created by the government to finance specific development goals in, for example, agriculture and housing. Nacional Financiera SA, or Nafinsa, is the principal government bank for promoting industry. There are no legal caps on what a bank or

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other lending organization can charge in the way of interest, fees or commission.

Mexico's 1985 banking legislation set in motion a reorganization of the financial sector, leaving room for both the nationalized multiservice banks and the increasingly important parallel banking system. One of the most important pieces of legislation was Banco de Mexico's new charter, which enhanced the central bank's role in setting monetary policy and disciplining government finances. Since early 1985, Banco de Mexico has been empowered to conduct open market operations by, among other things, issuing monetary regulation bonds on terms similar to those of *Cetes* (Treasury bills).

Through its management of Treasury bill yields and deposit rates and its setting of banks' minimum reserve levels and terms for banks' obligatory lending, Banco de Mexico wields enormous power over Mexico's financial markets. That influence extends into the parallel financial market.

4.2 Monetary policy. The Mexican financial authorities rely heavily on obligatory deposits and credit allocations as monetary policy tools. Banco de Mexico controls money supply through the purchase or sale of government securities in the secondary market; deposit and auction facilities for banks' excess liquidity; and changes in the legal reserve requirement. The central bank's new charter allows it to issue monetary-regulation bonds to be purchased by the country's national credit institutions, and these bonds can be traded freely among banks. The new charter also enhances Banco de Mexico's role in setting monetary policies, since its board of directors now sets a yearly peso amount of Banco de Mexico funding to the central government; for additional funds the government must now turn to the open market. The changes in legislation also include the creation of a credit and exchange commission to oversee the central bank's activities and ensure coordination with decisions affecting public finance.

Monetary policy in late 1987 returned to a heavy emphasis on credit restrictions to provide government access to available local funds, and this trend is likely to continue through 1988. In 1986, Mexico was forced to compensate for a 58.4% drop in oil revenues ($8 billion) almost entirely through increased local borrowing. Foreign financing in that year was limited to a $1.1 billion bridge loan granted in August to bolster reserve levels. Despite the influx of $3.5 billion in fresh money in 1987, the government has not been able to reduce its deficit (18.5% of GDP at end-1987) because of rapidly rising interest rates.

In 1986, Banco de Mexico's attempt to hold down the cost of Treasury bills by setting rates unilaterally dampened demand, and it was forced to buy most of each issue. Its attempt to raise funds through bankers acceptances was no more successful: Inducing the banks to issue large amounts of acceptances above 100% of bank capital through a hike in the interbank rate further distorted the market. Therefore, in June 1986, the central bank substantially lowered the interbank rate for acceptances and returned Treasury bills—*Cetes*—to the auction block.

The bank then moved aggressively to raise bank deposit rates and allow *Cetes* to climb to market levels. The result was a dramatic rise in interest rates, especially during the second half of 1986: The CPP (Banco de Mexico's interest charge to banks) climbed from 65.66% in December 1985 to 95.33% in December 1986, and *Cetes* rates rose from 71.77% in January 1986 to 103.6% in December.

The tight credit conditions early in 1986 and high real returns on peso investments attracted a heavy inflow of offshore funds during that year. It is estimated that nearly $2 billion entered the country, providing an important cushion for reserves. Real returns on peso investments went as high 14% in the second half of 1986.

By the end of 1986, however, Banco de Mexico wanted to force interest rates down. It froze bank deposit interest rates at the 95% level for 30- and 60-day deposits in early December and held them steady through February 1987. The CPP peaked at 96.20% in February, held through March, and finally, with the arrival of fresh funding from abroad, began a seven-month decline in April, falling to 90.30% in October. This decline was accompanied by a reduction of the legal reserve requirement in August 1987 from 71% to 51%, which further added to market liquidity.

The stock market crash in October 1987 sucked most of this liquidity out of the system and broke the downward trend in interest rates. Interest rates had to be raised to prevent capital flight; they climbed 24 points and the CPP finished the year at 104.29%.

Banco de Mexico was able to maintain control over the money supply despite the chaotic conditions. During the first 10 months of 1987, the money supply in the narrow measures of M-1 fell by more than one third in real terms; nevertheless, M-5 (the widest measure, which includes *Cetes*) registered a smaller decline of about only 14% in real terms, while rising 110% in nominal terms. *Cetes* in circulation increased by 186% in the first ten months of 1987, with 40% purchased by Banco de Mexico.

The arrival of fresh funds in April 1987 allowed Banco de Mexico to scale back substantially its purchases of *Cetes* and restrain money supply growth somewhat. However, a relaxation of monetary discipline will not be possible in the first half of 1988 with annual inflation running at 159% at the close of 1987 and two-digit inflation expected for January 1988 as a result of the recent 85% price hike in most government services.

Open-market operations are beginning to take on greater sophistication with the use of Treasury bills, although the bills, or *Cetes*, have played a more significant role as a means of financing the government's internal debt. Until *Cetes* were first issued in 1978, the only market-control tool available to officials was coordination of the activities of government-affiliated banks such as Nacional Financiera (Nafinsa).

Cetes are auctioned once a week and sold on a discount basis on the Mexican stock exchange. Their total value in December 1987 was about P14 trillion, compared with P7.5 trillion at end-1986. In the final week of 1987, the government issued for the first time eight-day and 15-day *Cetes* at rates of 120.70% and 121.64% respectively. Yields on 28-day and 90-day treasury certificates stood at 124.84% and 124.32% respectively in December 1987, up from 103.60% and 103.1% in December 1986.

The government also uses petrobonds as a quasi-open-market tool. These are three-year government obligations issued by

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Key Rate Movements in Mexico (December 1986-December 1987)

Month	Cetes*	CPP	Inflation—monthly/compounded
December 1986	103.60	95.30	8.1/105.7
January 1987	106.20	95.80	8.1/8.1
February	104.30	96.20	7.2/15.9
March	103.40	96.20	6.6/23.6
April	100.10	95.70	8.7/34.4
May	98.40	94.70	7.5/44.5
June	91.30	93.70	7.2/54.9
July	97.90	92.90	8.1/67.5
August	96.70	92.20	8.2/81.2
September	95.70	91.00	6.6/92.9
October	95.90	90.30	8.3/108.9
November	99.10	92.37	7.9/125.5
December	124.84	104.29	14.8/158.9

* 28-day certificates.

Nafinsa as fiduciary agent. The government has attempted to revive trading in this instrument, which lost its attraction when it ceased to be backed by a fixed amount of Isthmus crude at a guaranteed price, by changing the interest payment schedule from quarterly to monthly and by linking the interest rate for the first time to LIBOR at LIBOR plus 4%. Nevertheless, petrobond trading fell from 3.2% of all stock market and money market transactions in 1986 to 1% for the first 11 months of 1987.

A major government concern has been to raise the critically low rate of domestic saving, and Banco de Mexico has had some success in raising domestic savings levels with attractive interest rates. These rates are announced weekly for all time deposits. There has been a rapid increase in these rates since the stock market crash, with three-month deposit rates soaring over 30 points from October to December 1987 to keep pace with the benchmark CPP rate. As of Dec. 1987, 30-day fixed deposits yielded 122.85%, 90-days yielded 120.8%, and 180-days, 119.25%. In April 1987, the CPP began to decline with the arrival of new funds from abroad—from 95.7% in April to 90.30% in October, its lowest point in 1987.

The stock market crash reversed this trend: the CPP rose to 92.37% in November and to 104.29% in December. The CPP still does not fully reflect banks' borrowing costs, as credit institutions charge a spread to reflect demand and credit scarcity. The spread charged dropped to as low as CPP plus two points in mid-1987 before soaring to CPP plus 23 points at year-end.

Because of interest rate fluctuations, most banks now review spreads on a monthly basis for 180-day loans and quarterly for medium-term loans. Compensatory balance requirements range from 5% to 20%, depending on the amount of business a firm channels through the lending bank. Interest is paid at the beginning of each month or in arrears; the latter is reflected in a larger spread.

MNCs with top credit ratings are finding they can often negotiate out from under up-front interest and compensating balances if they are already using other bank services such as electronic cash tracking services and concentration accounts. Generally, most firms take a one-month loan and roll it over six times, including interest due at the end of the month as principal for the following month, to calculate effective borrowing costs. Using this method and excluding compensatory balances, the current effective cost of borrowing is now about 180% p.a.

5.0 Sources of Capital

5.1 General. For many years, the government controlled nearly 50% of all banking resources in the country through the central bank; Nafinsa, the state financial company; official financial trust funds; and a number of agricultural, public works and other specialized banks and finance institutions. In some cases, the government picked up equity in private banks to bolster their financial condition. These so-called mixed banks operated more as commercial banking institutions than as official agencies. With the advent of nationalization, both the privately owned banks and the mixed banks were turned into national credit companies and consolidated.

Mexico's banking system is still undergoing major changes. Many of the smaller and weaker institutions have been merged with larger and stronger banks. This trend will probably continue, given the problems the smaller banks will experience in the renewed credit crunch.

Another important trend is the expanded roles played by brokerage houses (*casas de bolsa*) in arranging and coordinating the movement of money in the parallel credit market. A potentially important source of long-term capital is the insurance industry, which is pushing for a change in insurance legislation to allow project financing.

5.2 Domestic commercial banks. Multiservice banks were created in late 1974, when amendments to the banking law allowed financial institutions to combine the four separate banking activities of deposit banks, savings banks, mortgage banks and *financieras* under one roof. This step was taken to strengthen the domestic banking industry and, eventually, to help decentralize the financial sector through increased competition. The move also enhanced the ability of Mexican banks to adapt to changing international money and capital market conditions. Nearly all the leading banks converted to multiservice operations, thereby gaining greater flexibility and the use of a wider range of credit and deposit instruments.

The banks, nationalized in September 1982, carry on the usual range of commercial banking functions. In addition, they underwrite and sell securities of some industries and are involved in trust activities. With credit availability for customers once again in critically short supply, banks are stepping up their brokering *extrabursatil* (parallel market) operations between clients.

The 59 banking institutions that existed at the time of nationalization have now been consolidated into 19 credit companies through mergers or liquidations of the smaller banks, and there will be further mergers. Of the 19 banks currently in existence, six are national, eight are multiregional and five are regional. The multibanks hold more than 90% of the nation's

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bank deposits, and the two largest banks, Banco de Comercio (Bancomer) and Banco Nacional de Mexico (Banamex), hold about 50% of all deposits.

In February 1987, Mexico officially launched a sell-off of 34% of the national bank stock. This stock is nonvoting and no individual or company can own more than 1%. The stock was sold in combinations of stock and convertible bonds, but most of the stock was placed privately to bank employees and prime customers in 1986, with the remaining small amount available only at highly inflated prices. Convertible bonds issued by Banamex carry interest of the higher of *Cetes* or bankers acceptance yields plus 2.5%. Bancomer is offering the higher of 90-day *Cetes* or 28-day *Cetes* plus 5%. The sell-off is primarily a means of raising badly needed capital—not a move toward privatization.

Most companies prefer to deal with several banks, avoiding excessive dependence on the resources of one institution. Relationships are carefully cultivated, since banks tend to give preference to established customers, particularly when credit is tight. Banamex and Bancomer have won the lion's share of local business with their electronic banking systems. While other banks offer this service, these two have the most deposit locations nationwide, allowing immediate account crediting from virtually anywhere in the country. Personal computers placed in company headquarters give access to accounts via a modem hook-up and, in some cases, via a direct line. The terminal gives the company access to information on payables, receivables, interest rates, debt and equity. Moreover, funds can be transferred rapidly from an account in one bank to the account in another.

The banking rules of March 1977 set limits on financing to individuals and companies. These regulations were updated at the beginning of 1985. A bank loan to an individual cannot exceed 10% of the person's net worth or 0.5% of the total net capital of the banking institution, up to a maximum amount of P635 million. Corporate financing may not exceed 30% of the firm's net worth or 2% of the bank's total net capital, up to a maximum amount of P5 billion. Several companies have been able to obtain loans above this amount through a syndicate of banks. As a result of the 1985 bank reforms, the nationalized multiservice banks are prohibited from holding more than 10% of the paid-in capital of other companies. That amount can be increased to 25%, with permission from the treasury secretariat.

5.3 Foreign commercial banks. The only foreign-owned bank operating in Mexico is Citibank, which has five branches in the capital. It alone was unaffected by the 1982 nationalization.

Mexico passed amendments to the banking law in December 1978 that applied to offshore banks. The regulations that come out two years later clarified their tax status and operating constraints, but did not prompt any foreign banks to open offshore units in Mexico. The legislation was more of a boost for the international ambitions of Mexican banks than an invitation to foreign institutions, since it provides a basis for the reciprocity needed by Mexican banks to enter some foreign countries. Bancomer, Banamex and Multibanco Comermex opened branches in various cities in the US, as well as in London.

More than 500 foreign banks are registered for business in Mexico; some 150 are operating actively. Many US, European and Japanese banks have representative offices including Continental Illinois, Chase Manhattan, Security Pacific, Morgan Guaranty, Wells Fargo, Barclays, Bank of London and South America, Sumitomo Bank, Swiss Bank Corp and Associated Banks of European Corporations (ABECOR—a banking consortium).

In the past, much of Mexico's foreign borrowing activity was channeled through these representative offices for purposes of client servicing, credit investigation, negotiation of terms, etc. With new foreign borrowing from Mexico now extremely limited, most representative banks have undergone a significant reduction in size. First Pennsylvania and Toronto Dominion closed their offices during 1986. The activities of the remaining banks are generally limited to securitization, trade finance (a business that has also fallen dramatically) and customer service. Management of debt capitalization deals, in which banks such as Citibank, Continental Illinois, Chase and Morgan Guaranty are already involved, and management of the upcoming peso onlending program promises to grow into another important aspect of foreign bank activity.

5.4 Investment banks or *financieras* were subsumed into the multibanks and thus disappeared as a separate source of medium-term capital, although the central bank still separates *financiera* operations in most of its statistical material, calling them departments of multibanks. The *financiera* departments will continue to handle the medium-range financing operations of the big banks and will also be active in underwriting industrial security issues, discounting some trade paper and issuing time instruments for Mexican savers.

5.5 Development banks. Although Nafinsa is primarily a government development bank, that label understates its immense role in, and power over, the Mexican economy. Today, it is not only the country's largest single source of capital but also the foremost intermediary between foreign and Mexican capital and between the government and foreign lending institutions.

Nafinsa's various activities include the promotion, creation and financing of business enterprises (by both direct investment and long-term loans); mobilization of domestic capital through issues of its own and private companies' securities; and the channeling of foreign loans to both public and private enterprises in Mexico. Nafinsa also acts as the financial agent for the federal and state governments. Its assistance to industry has been important for most large Mexican firms, although it constitutes only a small portion of overall operations. It grants medium- and long-term credits to industrial undertakings and underwrites and purchases bonds and equity. The bank is also actively engaged in priority development projects, particularly in the capital goods sector. It already has a number of partnerships with foreign firms and is scouting around for more, especially in high technology areas. Most firms involved in joint ventures with the agency give it high marks for its businesslike attitude and express satisfaction with the excellent contacts that Nafinsa can bring to its joint-venture operations.

Nafinsa is now empowered to conduct regular commercial banking activities—a development greatly increasing its financial muscle without damaging other commercial banks. It generally renews or restructures loans when a borrower has difficulty meeting its obligations; in certain cases, the government

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assumes direct responsibility. Loans that are not restructured, renewed or assumed by the government are segregated as "nonaccrual" loans, and an appropriate allowance for loss is provided in accordance with Mexican National Banking and Insurance Commission regulations. This allowance is based on evaluations of individual loans, and its amount is equal to the total provided for specific doubtful receivables. There is no general reserve fund used to cover for potential losses on current loans. In recent years, net charge-offs have averaged 0.03% of current loans.

An important part of Nafinsa's business consists of guaranteeing loans incurred by others to advance Mexican economic development. Virtually all such loans are repayable to foreign lenders in foreign currencies, principally US dollars.

Nafinsa is now turning its attention to small and medium-sized industries, particularly those willing to set up operations away from industrially congested zones. It is striving to make its resources more readily available throughout the country to more industries by creating regional branches (29 at last count). In this way it is broadening its scope to become an active partner with the government in fostering more balanced national development. The agency also maintains offices in New York, Washington, Tokyo and London.

5.6 Savings, mortgage and cooperative banks. Savings banks are virtually obsolete in Mexico. Their functions have largely been taken over by the savings departments of the commercial banks. Mortgage banks, like the *financieras* and savings and deposit banks, were merged into the multibank operations. Credit unions exist in Mexico, but have yet to develop into significant sources of financing.

5.7 Private banks. N.a.

5.8 Insurance companies. Insurance company investments are strictly regulated by the government. Portfolio investments are confined to certain gilt-edged and long-traded bonds, stocks and real estate compiled in what's known as List No. 40. By law, insurance companies are required to hold at least 30% of their capital and reserves in government paper and a maximum of 50% in urban real estate. Government efforts to promote the stock market included an increase in the limit for investment in stocks, from 20% of capital to 30%. However, in 1986, insurance companies accounted for only 2% of total stock transactions. Banks are prohibited from holding stock in insurance companies, and a number of the largest insurance firms that held majority bank participation are now totally in private hands. Among the major insurance companies are Monterrey Cias de Seguros, Seguros la Comercial, Seguros America Banames Aseguaradora Mexicana, La Nacional, La Interamerican, Seguros De Mexico and Seguros la Provincial.

With the nationalization of Mexico's banks, several large insurance companies, such as Seguros Bancomer and Seguros America Banamex, fell almost entirely into government hands. The government put these shares on sale and most were purchased by former bankers hoping to build a secondary market to channel funds to the private sector through the financial intermediary institutions.

The insurance industry is pressing for changes in existing legislation that would allow insurance companies to undertake long-term investments. Increasingly, insurance companies will be moving into securities and financial activities—perhaps by affiliating with existing stock brokerage houses. While there are some 42 companies now in operation, a major consolidation trend is under way. The 10 largest insurers control 90% of total premiums.

Insurance companies could eventually develop into an interesting source of investment and venture capital. Premiums issued decreased by almost 37% in real terms in the first nine months of 1986, to P463 billion. The companies invested some P45.3 billion in the *bolsa*.

5.9 Pension funds. Pensions funds operated by most large companies in Mexico are a potentially important source of stock market investment. Pension funds may invest in same instruments and stocks as insurance companies. Prior to bank nationalization, most pension fund management was contracted to the banks. *Casas de bolsa*, arguing that they could achieve a higher return if allowed to manage the funds, convinced some companies to try to withdraw their funds from bank management. The banks, however, anxious to maintain the pension business, countered that if the funds were withdrawn income tax would have to be paid. Legal action has been brought to challenge the bank ruling on the matter, and the action also seeks to expand the list of permissible investments. The issue is a potentially important one: the *casas de bolsa*, many of which have partial foreign ownership, argue that if they can obtain management of significant amounts of Mexican pension funds under more liberalized investment rules, they will then be able to attract investment in the Mexican stock market by offshore pension funds.

5.10 Other sources of capital. The various official financial trust funds used by the government to funnel credit to priority areas have become a vital credit source as the government develops and expands its selective credit system, and the full deductibility of interest on such loans under the new tax system makes them increasingly attractive. The funds, administered by Banco de Mexico, Nafinsa and other official institutions, provide relatively low-interest credit for manufactured exports, food production, housing, equipment purchase, tourism, small and medium-sized business, mining and handicrafts.

Funds come from international sources, official banks and the federal government, with rates depending on the fund and the nature of the recipient's business. Loans can be contracted directly from the funds or negotiated through another bank, which then rediscounts the credit with the financial trust.

Some of the notable official financial trust funds are Fonei (industrial equipment), Fomex (manufactured exports), Fonatur (tourism projects), Fomin (industries), Fovi (housing), Fogain (small and medium-sized industries) and Fira (agriculture and livestock). In 1987, financial trusts administered by Nafinsa had a budget of P9 trillion—an 125% nominal increase over the P4 trillion budget in 1986. Other banks through which the government channels preferential credit to specific areas include Banco Nacional de Obras y Servicios Publicos (Banobras), Banco Nacional de Comercio Exterior (Bancomext—export, import and import-substitution financing), Banca Somex and several rural and agricultural banks.

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MEXICO'S DEVELOPMENT-FUND FINANCING

In the hunt for affordable financing, companies should not overlook Mexico's alphabet soup of special development credits. Funds are surprisingly available, and rates and maturities are much better than those currently quoted on the impossible commercial credit market. Financial managers have an extra benefit to factor in: Interest paid on all government development loans will continue to be fully deductible under Mexico's tax system.

Although Mexico has followed through on a 1985 trade pact with the US and hiked interest rates on its credit programs, terms on these loans are still extremely attractive. MNCs that have recently participated report that approvals are fairly rapid and that actual funding is made available without additional delays. A rundown of the terms for the most important programs follows.

In 1988,* some P10 trillion (P2,260.8:$1) will be available through the export development fund, **Fomex**. For peso financing the formula agreed to with the US was an average of banks' cost of funds (CPP) and the rate on 28-day government paper (*Cetes*). At current market rates, credits go for around 115% p.a. Nominal commercial borrowing rates for prime MNCs, in comparison, would be at least 11 points higher, with effective costs 60 or 65 points higher.

Majority foreign-owned firms still cannot tap Fomex's preexport peso financing. They are, however, eligible for **preexport dollar financing** for imports of needed inputs going into export production. Rates on dollar financing are straight LIBOR (8.7%).

Majority foreign-owned MNCs can also tap Fomex's attractive **buyer's credit program**, which enables exporters to offer a credit package with the sale. Current credit terms on primary goods financed over 90 days are 50% of LIBOR plus two points. Interest is paid up front. Manufactured goods can be financed from 90 days to two years at flat LIBOR. Interest is paid up front on terms of up to one year and in arrears semiannually on longer terms. Financing beyond two years is available at OECD rates.

Nontrade programs

Firms that are made up of majority Mexican capital can tap other special development funds. In the past, some majority foreign-owned MNCs have been able to break the size and ownership barrier in negotiations with officials. The leading programs include the following:

- **Fonei**, which funds industrial equipment production, will make available some P325 billion this year—a 50% increase over 1987. Fonei credits can also cover indirect costs, such as R&D and technical assistance, although there is $3 million cap per project. Equipment and working capital financing are available at CPP plus two points; credits for training and research stand at CPP minus three points.
- **Fogain** provides seed money for new plant construction, as well as working capital financing. It will provide P480 billion in 1988. Like Fonei, preference is given to small and medium-sized firms and to exporters and firms located in Mexico's priority development zones. Terms at flat CPP, for example, are available for medium-sized firms located in top priority zones IA or IB; in other zones they would pay CPP plus five points.
- **Nafinsa**, the state development bank, is providing a $500 million credit line for "industrial reconversion." For upgrading technology, long-term financing (over 13 years) is supplied at CPP plus two points, with three years' grace. Rates for working capital financing (more than three years) are the same as those for long-term financing, but with only one year's grace.

* All 1988 program budgets are currently subject to revision and may be reduced.

6.0 Short-Term Financing Techniques

6.1 General. Multiservice banks have traditionally been the primary source of short-term credit. Such credit—whether in the form of term loans or discounted trade bills—is limited by law to 180 days (except for financing exports of manufactured goods). However, funds are often rolled over within a general line of credit, which is normally reviewed annually. Peso financing is an enormously costly proposition, not only because of high nominal interest rates, but because of stiff borrowing terms that jack up real borrowing costs to over 180% p.a. Compensatory balances are almost always required in credit operations, and they can run as high 30%. Borrowers are frequently required to channel other business (i.e. deposits, collection and checking services) through the lending bank.

A maximum interest rate is set by the government and applies to some loans for priority areas. It does not cover loans made from the free investment portion of a bank's resources, which are much costlier. The differential is enormous in times of high inflation, when it is the free investment portfolio that subsidizes the heavily preferential terms on priority credits. Development funds, for example, are currently available at around CPP, versus CPP plus 20 percentage points for prime borrowers in the regular credit market.

6.2 Overdrafts (*sobregiros*) are a common part of overall credit lines. Firms must observe the usually strict limits that are set down. Interest on overdrafts is usually equivalent to the rate the firm pays on short-term loans. In recent months, however, overdraft lines have become more expensive and the amounts available strictly limited. Such lines, once linked to short-term loan rates, often occur now in greater spreads. Rates are presently running at CPP plus 15–20 percentage points, depending on the client relationship.

6.3 Term loans are limited by law to six months, but they can be rolled over indefinitely for additional six-month periods. Banks charges include the following:

- ***Reciprocity or compensatory balances*** (*Reciprocidad*). Banks generally require companies to keep the equivalent of a certain percentage of the loan's value in the banks. This can run up costs considerably as this charge can go as high as 30%.

Some companies, however, have found that the banks, like Banamex and Bancomer, are willing to forgo this charge depending upon the size of the loan and the importance of the client. Small banks still require compensating balances.

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- ***Up-front interest charge*** (*Prepagos de Interes*). This charge is very similar to reciprocity in the sense that it reduces the actual value of the loan. This payment, however, goes toward paying off the interest on the loan. General firms will receive a lower interest rate for prepaying interest. Usually, the borrower has to pay between 10–25% of the interest up front. Competition from the *casas de bolsa* is, however, making this charge less and less common.
- ***Line of credit establishment charge*** (*Comision de Apertura*). This is a one-time fee charged to companies opening a line of credit. It guarantees a set amount of funds to the company entering the agreement. Banks charge an annual fee of 1% of the total value of the line of credit. A further cost of establishing the line of credit is bank approval time, which takes from two weeks to a month. Banks require a financial status report, the most recent past three audits and financial performance projections. With this information, the banks perform a credit study of the firm that takes two to three weeks and is the basis for approval.
- ***Unused funds charge*** (*Comision de Disponibilidad*). This is the fee that banks charge for funds that are allocated to a firm but that the firm does not use. Banks charge an annual rate of 0.5% on the total amount set aside for the company's use.
- ***Moratory interest charge*** (*Interes Moratorio*). Firms that are late in repaying bank loans are charged an additional CPP plus 1.5% per day on the amount that remains to be paid in addition to regular interest charges. This fee rises to two to three times CPP if the banks finds that the company is using the money for investment purposes.
- ***Loan rollover charge*** (*Renovacion*). At the beginning of 1987, banks were charging 1% of the total value of the loan to renew it. Since then, banks have dropped this charge in order to compete with the *casas de bolsa*.
- ***Comfort letters, standby letters of credit and parent company guarantees*** (*Cartas de Credito y Garantias de la Casa Matriz*). Banks generally require subsidiaries of AAA-credit rating parent companies to submit a comfort letter from the parent company. This involves a telex from the parent company that indicates support for the obligation of its subsidiary, the amount of the operation and its use. However, many MNCs are finding that this is not necessary because of their strong local standing.

Companies with lower credit ratings or that are less well known are required to present a standby letter of credit from the parent company or a bank and pay an additional fee that can go as high as 1% of the total loan. Another form of insuring a loan is a parent company guarantee. In this case, the parent company guarantees the amount and the use of the loan. Many companies are finding that competition between banks and *casas de bolsa* is making it possible to obtain funds without a standby letter of credit or a company guarantee.

Although the 1978 amendments to the banking law removed the obligation to secure lending, term loans must frequently be backed by *pagares* (promissory notes with return payable on maturity), inventory or mortgages on fixed assets. MNCs can often use offshore bank balances and foreign bank guarantees.

Companies can also get short-term 28-day loans through the *Mesas de Dinero* operated by the banks. These are trusts that operate like brokerage houses. Companies with lines of credit can borrow short-term at the bankers acceptance rate plus 2–3%. Companies with strong bank relationships can often put up less than a 100% guarantee in *Cetes*, foreign bank balances or other liquid assets. (*Casas de bolsa,* in contrast, almost always require 100% guarantees.) The brokerage houses are working to have these bank trust operations shut down, arguing that they are infringing on the law banning banks from running *casas de bolsa*.

At the end of 1987, nominal interest rates on new short-term loans ranged were 126–127% p.a. (CPP plus 23%). The effective cost of borrowing depends greatly on the bank-client relationship and currently ranges from 170% to 180% p.a. One US MNC subsidiary got some rare insight into banking relations after it merged with the local subsidiary of another MNC subsidiary. The finance director of the merged companies discovered that the difference in lending rates from the same banks was as much as 10 points. He commented, "One company had a treasurer that reported to the finance department in the US and the other's treasurer was responsible to local management. The treasurer that was reporting to the States was under a lot less pressure to get good rates than the other, who had to report to a finance director that knew something about local rates."

6.4 Discounting of trade bills. Banks discount trade bills as part of an overall credit line. The effective cost and limit for this type of credit depends on the client-bank relationship. Banks discount up to 80% of a trade bill, and terms may be up to 90 days, although 45 days is more common. Interest is frequently discounted in advance, which pushes up the effective cost of the operations. Drafts discounted and not paid by the drawee at first presentation are charged back to the borrower's checking account (which was originally credited), producing considerable unsteadiness in balances and frequent surprises. Protecting such accounts with other borrowing arrangements can minimize the impact on corporate cash positions, but banks usually consider both the standby credit and the discount line against the firm's overall credit limit.

The practice of trade bill discounting has become less com-

Interest Rates (end-year %)

	1986	1987
Short-term bank loans	90.00	127.00
Medium-term bank loans	90.00	114.29
Long-term bank loans	80.00	139.00
Overdrafts	90.00	119.00
Interbank overnight	80.00	129.00
Demand deposits	23.00	23.00
30-day CDs	66.10	120.80
60-day CDs	75.40	119.25
28-day T-bills (*Cetes*)	73.14	126.60
90-day T-bills (*Cetes*)	77.28	137.38
Corporate bond issues	85.00	145.00
Commercial paper	80.00	129.00

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mon in recent months—primarily because of the extremely high rates being charged. Current transactions are being discounted up-front at the bankers acceptance rate, which in December 1987 stood at 119%.

6.5 Commercial paper is denominated in pesos, with terms ranging from 15 to 91 days (28-day placements are most common). It is sold on a discount basis through the stock market in notes of P100,000. The paper is unsecured, but the Comision Nacional de Valores (CNV) requires detailed information before it authorizes a placement. A secondary commercial paper market has not developed, mainly because brokerage houses have lacked the resources to take positions themselves.

The volume of commercial paper traded in the first eleven months of 1987 increased nominally by 136% compared to the amount in the same period of 1986. Peso value in circulation is P1.1 trillion. During the period from January to November there were 551 new issues worth P1.2 trillion—an increase of less than 1% in the number of new issues compared with the same period 1986, but a peso value increase of 67% in real terms. The increase is largely due to the lack of credit availability through the banks following the stock market crash. Rates have risen consistently because of competition with Treasury bills (*Cetes*). Rates for commercial paper, based on a spread over *Cetes*, are generally high owing to the higher risk. In 1987, the spread has been *Cetes* plus 1–2%. However, the fast-climbing rates on *Cetes* in the closing months of 1987 made it hard for this instrument to keep pace. At end-1987, the CP rate was 113.84%, less than a percentage point below *Cetes*, with a return of 9.49% monthly. Brokerage houses charge a 1.75% commission, which is tax deductible.

6.6 Bankers acceptances have been decreasing steadily in importance. In early 1986, the use of the instrument ballooned as Banco de Mexico encouraged banks to issue acceptances above 100% of their capital and deposit them with the central bank by hiking the interbank rate for such deposits. In the second half of the year, the central bank rate was lowered substantially to discourage acceptances. BAs went from 25% of market transactions at the end of 1986 to 7% in November 1987.

This dramatic decline was mainly the result of increased liquidity from January to October 1987. Total values placed in the first eleven months of 1987 reached P17.8 trillion—down 2% in real terms compared to the same period in 1986. In early 1987, BA rates were running at par or slightly below 28-day *Cetes* rates of 95–96%. By end-November 1987, however, BAs were at 125.96%, a point and a half above 28-day *Cetes*.

Unlike US BAs, Mexican BAs do not require any underlying commercial transaction. Banks can issue up to 100% of their capital and do not have to place the credits beforehand. Banks issue acceptances for their own financing purposes and as a means of providing funds to clients when credit is tight.

Acceptance credits are used to cover 30-, 60-, 90-, 120- or 180-day payments by a number of firms (for example, pharmaceutical laboratories) to finance raw material purchases. They are usually in the form of *letras* or *pagares*, discounted at the beneficiary's bank but not traded on the open market.

6.7 Supplier credit. Mexico's acute liquidity squeeze in early 1987 contributed to a significant shortening of supplier credit terms. If a firm's essential creditworthiness is not in question, however, generally adequate credit terms can be arranged—usually between 45 and 60 days. At the same time, firms have dropped late-paying clients altogether or have required strict cash payment terms if credit terms are not respected. Discounts for prompt payment have become more common, as have penalties for late payment (10.2).

6.8 Factoring. In addition to the facilities offered by commercial banks, several companies specialize in accounts receivable financing and factoring. The factoring market (in which the factors buy invoices from firms and take responsibility for collection) continued to grow in 1987, with Factoring Serfin, the largest such institution, handling about P15 billion in receivables as of December 1987, compared with under P8 billion at the beginning of the year. It is the only company in Mexico with US-style factoring operations, and also offers a number of other financial services, such as the discounting of warehouse bills, inventory financing and collection of bills throughout the country.

Serfin usually pays about 70% of the invoice in advance and the remainder when the bill is collected. Terms range from 30 to

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Factoring in Mexico

With acute scarcity of credit in Mexico, more companies are turning to their accounts receivables as a means of raising short-term capital. Several options are now available and, although rates are steep, the practice is expected to become more widespread. Factoring Serfin, the largest of Mexico's factoring institutions, currently handles about P15 billion in receivables, compared with P8 billion at the beginning of 1987, and it expects that amount to double again by year-end.

Under a typical factoring operation, the institution providing the service pays a company a percentage of the total value of its receivables in advance (usually around 70%) and the balance when it completes the collection. Depending upon the agreement, interest can be paid in advance or at maturity. Rates are currently running at 30 points over the 30-day *Cetes* yield.

The factoring institution does the actual collecting, but it has recourse to the company in the case of nonpayment; nonrecourse financing is no longer available. A company must establish a working relationship with a factoring institution. The latter does a thorough credit analysis of the company and its customers and takes only those clients whose customers have excellent track records.

A new twist has brought the brokerage houses into the factoring market. Under a typical arrangement, a company that is not already a client of a factoring service (either because a credit analysis has not been completed or because the company has been turned down) can take its accounts receivable to a brokerage house, which places the paper with a cash-rich company. The operation does not shift collection responsibilities; rather, it is a straight financing mechanism accompanied by a buy-back agreement at maturity. The firm buying the paper requires a guarantee.

Some companies are bypassing both factoring services and brokerage houses altogether by providing loans against other companies' accounts receivable. As with intercompany loans, this type of financing must be backed by a letter of credit or other guarantee.

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INTERCOMPANY BORROWING

With liquidity in Mexico's nationalized banking system nearly shut down, the intercompany (parallel) market is the only source of external financing for an increasing number of firms. But tapping this resource can be expensive for the neophyte, and even some old hands are unaware of the tricks for lowering costs. Some key considerations are outlined below.

As an alternative to bank financing, Mexican treasurers can tap the growing intercompany market. Dealing either directly, or through brokerage houses (*casas de bolsa*), cash-strapped Mexican firms can tie into cash-rich organizations for a mutually satisfying arrangement.

The intercompany market has outgrown its shaky beginnings to become a key source of local financing. Intercompany volume (as measured by *extrabursatil* commercial paper alone) has risen from P82.2 billion at the beginning of 1987 to P466.4 billion by the end of the year.

For those who have never used the intercompany market, cost-cutting means doing things right the first time and developing a good reputation—one that goes beyond attractive financial reports. That means paying careful attention to the details.

When companies are forced to borrow in times of tight liquidity, it may take two or three brokerage houses to raise the funds—raising costs as much as 50%. First-time borrowers will have to provide a letter of credit from a foreign bank (despite rules against this). "You don't want to screw up your LC," stresses one MNC finance director. Any snags or delays can tarnish the name of even the strongest firm and make it difficult to keep costs down.

A solid relationship with *casas de bolsa* can eliminate the added expense of an LC (although most brokers will still insist on one). In place of an LC, bargain hard to get your broker to accept a parent guarantee—usually not too burdensome on the parent since the loans are relatively small. For first-time borrowers, however (and those borrowers that have had problems with paperwork), the LC is probably unavoidable.

Although regulations forbid the use of foreign bank LCs, officials are turning a blind eye. Companies can, of course, skirt all brokerage commissions by doing a direct deal with another firm. Such deals are most often arranged between sister subs or corporations that already have strong global business ties. In these instances, much depends on the industry and the strength of the finance director's or treasurer's contacts (most would be leery of approaching firms where they had no personal contacts). But "if you're only going to be in the market occasionally, it's probably worth the time and trouble saved to pay the 0.5% to the brokerage house," says one manager.

In any case, managers should be aware that the intercompany market is very much a short-term affair. Preferred maturities are 30 days or less—90 days is considered long-term. Some 180-day financing can be had, and even longer-term, company-to-company loans are possible (one year is the absolute maximum). Allow 10 days for deals to go through.

Liquidity for the intercompany market flows primarily from firms enrolled in the Ficorca foreign-debt-payment scheme and from companies concentrated in the food and beverage industry, where business is largely on a cash basis. Mexican companies such as Cydsa and Cifra are major lenders, as are many large MNCs.

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90 days, with rates about CPP plus 50%. Brokerage commissions average around 2%. Paper is normally backed by predetermined amounts of *Cetes* and/or petrobonds, or with a standby letter of credit from a foreign bank.

Factoring Serfin has another service, called reverse factoring, through which it finances supplier bills of its major clients, mainly large firms. Serfin pays the invoice when presented by the supplier, while the client has a 90-day term in which to cover the invoice. MNCs note that Mexican factoring operations tend to be extremely selective in which of the firm's invoices it will finance. A firm often finds that it can only finance invoices of clients that pay quickly anyway.

6.9 Intercompany borrowing. Mexico's parallel financial market has undergone explosive growth in the 1985-87 period. Unless conditions in the mainstream credit market improve significantly, the intercompany market will remain a vital and increasingly important source of credit. One of the best measures of such borrowing is the market for *papel comercial extrabursatil*. This market uses *pagares*, or promissory notes, to meet short-term borrowing needs; alternatively, companies in a strong cash position have found the market an attractive place to invest excess pesos.

Most intercompany deals are arranged by brokerage houses. When the large commercial banks lack funds for important clients, they too will provide brokerage services. Also, the growth of the parallel market has given birth to a wide variety of financial consultants, who are also involved in the *extrabursatil* market. Finally, parallel market transactions can take place directly between corporate treasurers, thereby saving on brokerage costs.

Extrabursatil paper is not traded on the open market, although it can be traded between brokers, eliminating the underwriters fees. There was P466 billion of this paper in circulation at the end of 1987, an increase of 133% in real terms over the amount in circulation at the end of 1986. Fees can range anywhere from 1.5% to as high as 4%, depending on the size of the transaction and the broker. Brokerage houses will charge 2-3%; informal intermediaries (*asesores*) will charge around 1.2-2%. Terms can range anywhere from 28 days to one year, frequently with an option for renewal. Rates vary considerably, too. Most are quoted in reference to prevailing *Cetes* yields or Ficorca costs.

Typical rates for prime clients in late 1987 were *Cetes* plus 11-12%. Interest paid is tax-deductible; a 15% VAT is charged on this interest, to be paid by the borrower; it can be deducted from the borrower's overall VAT payments. Holding companies and other entities which collect no VAT can get around the 15% tax by paying interest discounted up front.

Guarantees are invariably required. Parent company guarantees can be used, but are frequently not considered sufficient security. In the past, foreign representative banks would issue standby letters of credit on behalf of clients issuing *extrabursatil* paper, but since 1985 brokerage houses have been prohibited

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from accepting standby letters of credit issued by foreign banks. Now what most commonly happens is that a foreign bank will issue the letter of credit offshore and the foreign representative office will advise the *casa de bolsa* that the letter has been issued.

Some other approaches have been to secure guarantees from local banks, which are backed in turn by foreign bank letters of credit. Alternatively, some subsidiaries have their parent companies establish special escrow accounts abroad as a guarantee. One US company was looking into the possibility of having its *extrabursatil* paper backed by an insurance policy underwritten by a US insurer.

In February 1987 the CNV suspended an instrument that combines the attributes of *bolsa*-issued commercial paper and those of *extrabursatil* paper. Non-*bolsa*-listed firms issued the *pagare empresarial* by meeting disclosure requirements similar to those for commercial paper. These notes were then placed by *casas de bolsa* in a manner similar to *extrabursatil* paper. Rates tended to be one to two percentages points less than *extrabursatil* paper because of strong disclosure requirements. In the nine months of operation, there were 174 placements, with an overall value of P105.3 billion.

6.10 Other short-term techniques.

Accounts receivable financing. Several companies in Mexico, most notably Factoring Serfin, specialize in accounts receivable financing (6.8). A firm sells its receivables to a factor, which in turn assumes full responsibility for collection. Accounts receivable companies also lend funds to firms against its outstanding receivables. Such credits used to be issued in dollars at 3–4% over the prime rate currency for such dollar debts, payable in Mexico.

One large company with clients throughout the country has put its commercial bank in charge of collecting accounts receivable. The deposits of these invoices provide the bank with a float that is automatically credited toward the firm's compensatory balance requirements, thereby reducing the effective cost of the company's outstanding peso loan by several percentage points. However, factoring services are used primarily by smaller companies, particularly those in the textile, auto parts, chemical, petrochemical, and food and beverage industries, since larger firms generally have a full-time staff that specializes in collecting invoices. This is particularly true in Mexico's present inflationary environment, where fast turnover of accounts receivable has become a major source of cash flow.

Serfin also discounts ***warehouse deposits*** for selected clients up to 50% of the value of the deposit at a cost similar to regular factoring. The invoice serves as collateral, although Serfin will sometimes provide financing before the invoice is issued. In that case, inventory serves as collateral and the cost is the same as regular factoring services. Serfin's financing of accounts due from the government is open-ended because of the long lag in collecting from state agencies.

Warehouse receipts. Legally established auxiliary credit institutions—including Almacenadora SA, Almacenes Nacionales de Deposito SA, Bodegas de Deposito and Almacenadora Monterrey, each with several branches throughout the country—issue warehouse receipts (*certificados de deposito*), which are immediately negotiable and may serve as collateral at any Mexican bank or *financiera* (as well as foreign banks) for up to 70% of their value. Receipts may be endorsed to transfer ownership or as a guarantee for credit, or they may be endorsed in blank, which converts them to a bearer's asset. Loans against warehouse receipts are extended up to a maximum of 90 days, although 30-day loans are more common. Interest rates are based on the CPP and vary according to company-bank relations.

The 1984 financial reforms provided for stock exchange notes to be issued for loans against materials in storage. In addition, overall operations of public warehouses were expanded. They now issue receipts for goods in transit, offer transportation services for goods to be deposited and certify and value these products. The legislation also stipulates that warehouses may issue certificates for a value up to 50 times their paid-in capital plus reserves, an increase from previous rules that limited the amount of warehouse receipts to 20 times capital plus reserves.

Dealer financing is primarily used for automotive and agricultural machinery. Distributors and retail outlets can obtain a short-term credit through which up to 100% of the value of a sales contract is financed for a 30-day period. In other cases, distributors pay half the contract's value when they receive the product and cover the other half 90 days later. Given the slack demand that exists in this industry, financing is generally free of cost for dealers and retailers, with the idea that the discount is passed on to end users. However, charges for late payments currently amount to CPP plus 15–20%.

7.0 Medium- and Long-Term Financing Techniques

7.1 General. Mexico's chronic shortage of long-term credit is largely due to the structural weakness of a banking system funded primarily by short-term peso deposit accounts. Officials claim that they will make more long-term funds available for investment projects, but it is doubtful whether many MNCs will have access to such credits. The prevailing official view is that MNCs should bring in their own capital and allow local companies to have full access to what little credit is available. Even when pesos are available for free lending, banks are reluctant to lend for periods exceeding 180 days.

Most long-term financing is available only for equipment loans, and little change can be expected in the need to continuously roll over short-term loans. Domestic long-term borrowing usually requires a statement specifying the use of the funds, a provision for mortgage collateral and inspection by bank representatives every six months to assure that borrowed funds are being used as intended. In addition, banks ask for annual balance sheets and profit and loss statements for the preceding year or years, depending on the amount to be borrowed. Companies must also provide banks with sales projections, sometimes up to two or three years. However, requirements depend greatly on the client-bank relationship.

Exporters stand the best chance of tapping the paltry amount of longer-term funds that are available locally, especially since Mexico received a $500 million loan from the World Bank for export development. At the same time, Nafinsa is also offering long-term loans for technological reconversion at CPP plus

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2-3%. Mexico has reached its borrowing limit with the InterAmerican Development Bank (IDB), ruling out one important source of official finance.

7.2 Medium- and long-term loans. Multibanks are the main source of long-term loans. The law limits their duration to 15 years, but it is extremely difficult to obtain pesos for more than three to five years. A parent guarantee may be required for foreign affiliates, although some large subsidiaries of multinational firms have secured loans without them. Nominal interest rates for medium-term loans and longer-term lending (over five years) are set according to *costo promedio percentual* (CPP). As with all borrowing, effective costs are substantially higher once guarantees, commissions and interest payment schedules are factored in.

At present, credit institutions revise the spread on medium-term loans quarterly—or in some cases, semiannually. They may hike the premium if CPP does not accurately reflect their actual borrowing cost. Some treasurers are willing to settle for a higher premium if the bank agrees to fix the spread for the entire lending period. They argue that this curbs the wild fluctuations in borrowing costs somewhat, thereby helping the company to project its financial expenditures over the medium term.

Inventory loans (*prestamos de avio*) are available for certain priority sectors, including exporting and agriculture. For the latter, basic crops such as corn and wheat qualify for selective credits. As of 1987, preferential rates offered to low-income farmers have ranged from CPP minus 4-5%. Larger producers must now pay the average of *Cetes* plus CPP. Inventory loans are made for 12 to 24 months and often are renewed automatically. The legal maximum term is three years. Any type of inventory (agricultural crops, industrial raw materials, semifinished or finished goods) may be accepted as collateral, but the loan amount cannot exceed 75% of the value of a firm's normal inventory. Inventory loans for nonpriority sectors, when they are available, cost roughly CPP plus 10%.

7.3 Bond issues. In early 1986, the CNV reinstated a previous ruling against majority foreign-owned companies issuing bonds. However, in early 1987, CNV officials indicated they are once again willing to consider requests by majority foreign-owned firms to make such issues. The type of project to be financed by the issue has some bearing on the approval process. In the first eleven months of 1987, total issues reached P168.8 billion, a nominal decrease of 68% from the P535.1 billion in circulation at the end of 1986. There were 12 new offerings for a total of P132.4 billion. In 1987, MNCs such as Chrysler, Puma and Cannon were among the 24 firms issuing bonds. Chrysler worked hard to secure CNV approval for funds to finance a large-scale plant improvement, and apparently succeeded because of its ambitious export program and the positive employment effects of the investment.

Typical maturities that the CNV will approve are terms of four to seven years. It requires extensive documentation and stipulates that funds must be used for fixed assets only. Regulations issued in 1984 allow firms whose shares are not publicly traded to issue corporate debentures through the stock market. The CNV charges a 3% fee. Coupons have a floating-rate structure, typically linked to *Cetes*—Treasury bills—and bank deposits (whichever is higher). The seven-year, P800 million issue by Nalcomex in June 1986 was set at *Cetes* or CD yields plus five percentage points.

A new source of long-term funding in 1987 was the *Certificado de Participacion Inmobiliaria*. This is a bond which will be used to finance large construction projects such as shopping centers. Aurrera received the go-ahead for the first issue of P1.5 billion pesos which will be managed by Banco Somex.

7.4 Private placement of notes. N.a.

7.5 Leasing. Leasing tends to be one of the cheapest forms of financing available in Mexico and MNCs tap it whenever they can. Leasing companies are charging CPP or Ficorca, whichever is higher, plus 13%. Currently, Ficorca is the higher of the two at 110%, making the interest rate 123% p.a.

Interest is usually payable in arrears. The premium drops a few points if interest is due in advance. Commissions charged by leasing firms are around 1%, with payments spread out over two to five years. Leasing firms usually provide a purchase option, allowing the customer to buy the leased equipment at a cost lower than the market value of the asset at the time of payment. Leasing companies may also extend the contract for another term with smaller rental payments or participate with the lessee in the sale of the asset to a third party.

Only about 15 leasing companies are now operating actively Foreign companies are allowed to hold up to 49% equity in new leasing operations and remain majority owners if they were established before May 1973. Nearly all Mexican leasing companies have foreign equity. Although leasing companies and other auxiliary credit institutions were not nationalized, a large part of their capital fell into government hands on Sept. 1, 1982. These shares were put up for sale and most were purchased by former bank shareholders. Among the larger bank-affiliated leasing companies are Arrendadora Bancomer (a partnership with Manufacturers Hanover Bank), Arrendora Comercial Amex (with American Express as a minority partner) and Arrendadora Somex (a joint venture with Morgan Guarantee Trust).

Leasing contracts with a purchase option, called ***financial leasing*** in Mexico, allow the lessee to depreciate the proportion of the value of the asset that has been covered through interest payments. Leasing companies are now considered auxiliary credit institutions, and as such are subject to strict regulations of the secretariat of the treasury and the National Banking and Insurance Commission (CNBS). However, unlike banks they are required to charge the 15% VAT on the interest portion of contracts.

Under legislation pertaining to auxiliary credit institutions, leasing companies are allowed to make mortgage loans with the assets to be financed serving as collateral. A parent-company guarantee is usually required as well. Terms vary according to the useful life of the item in question. Rates are 8-10% over CPP, and the effective cost is increased by the legal and administrative fees for registering the loan with a notary public.

Leasing firms may also provide short-term loans to clients at rates ranging from 10% to 15% over CPP, and some *arrendadoras* (leasing companies) lend medium-term funds. Rates are usually based on Ficorca plus a spread and an up-front deposit. In late 1987, two-year loans were 125%; three-year, 127%; and

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four-year, 129%.

Interest is due at the end of each month. A 1% commission is charged for short- and medium-term loans. Since these loans do not entail reciprocity, their effective cost is currently below the cost of regular bank peso financing. A number of leasing companies also discount credit titles, promissory notes and accounts receivable at CPP plus five to seven percentage points and a 5-7% commission, all payable in advance.

In some instances, firms have used leasing to get around the obstacles of expanding a joint venture. For example, an expansion of a 50:50 joint venture between US and Mexican interests was held up by the Mexican partner's lack of capital and unwillingness to alter the equity split; entering a leasing contract helped solve the problems and shorten the delay.

Major automobile companies also supply lease-purchasing plans for executives' cars. The automobiles are acquired with a low down payment and a company guarantee, and the balance is paid over one to three years on a lease plan, with an interest rate based on CPP. When the car is completely paid for, it is either retained by the company or sold by the dealer, with 92% of the resale price going to the lessee and the remainder to the leasing company. The payments are charged off against current income; interest charges are tax deductible.

7.6 Mortgage loans. are extended mainly by the mortgage department of multiservice banks and, to a lesser extent, by the banks' savings department. In general, mortgage loans have a legal maximum term of 15 years, but mortgage credits are extended 10 years for most family housing. The legal maximum amount of mortgage loans depends on the value of the unit for which credit is extended. For low-cost housing, banks can lend up to 80% of the value; the maximum for most other categories is 50%. Down payments are quite high, from 25-50% of the value of the property.

7.7 Swap financing techniques. For some firms in Mexico, intercompany peso/dollar swaps (between parent and subsidiaries) have become an attractive way to benefit from dollar interest rates and escape the prohibitively high cost of peso loans. The borrowing firm issues a promissory note to the lender, calling for a sum of pesos to be repaid at a given maturity. The borrower agrees to buy pesos and sell dollars simultaneously at a prefixed exchange rate on the date the loan matures. When the borrowing company repays the pesos to cover the promissory note, it does so by converting the pesos into dollars, which it then pays to the lender. The dollar amount covers the principal of the loan plus dollar-based interest. The operation is recorded as a peso loan on the books, thus avoiding the 42% tax levied on interest payments on dollar intercompany loans. However, officials have indicated that they intend to close all loopholes on the withholding tax.

For some firms, back-to-back loans have been preferable to direct parent company loans. For one, withholding tax is only 15% because the loan is from a bank. Further, if the bank can use the tax credit, it may absorb this amount. By remitting funds via interest payments on the back-to-back loan rather than by dividends, a subsidiary can send dollars home at virtually no withholding cost. Back-to-back loans will eventually be eliminated, however, under the new tax reform program, which will penalize high indebtedness by restricting interest deductions to the real component. But because of the phase-in of the tax plan, back-to-backs will continue to be attractive in 1988.

Debt-equity swaps. Mexico launched a debt capitalization program in 1986. Majority foreign-owned firms committed to capitalizing local operations or needing to pay off local obligations are permitted to buy sovereign or parastate Mexican debt paper (at a heavy discount in the offshore market) and then resell the paper back to the Mexican government. Companies receive generally between 80% and 90% of face value from the government in pesos. Controls are tight to prevent unauthorized use of the funds—e.g. purchase of foreign exchange for remittances.

The scheme was suspended in November 1987 because of its inflationary effect. The program is expected to resume by April 1988, but with modifications that make it considerably less attractive. Debt swaps will face a 20% tax on the gross value of the transaction, or 30% of the gain on the sale of government debt paper. Also, the government is committed to paying less for the paper. One banker commented that, prior to the program's suspension, the government offered his bank only $0.66 on the dollar for debt paper.

Nevertheless, the program was increasingly successful prior to its suspension because of the reduction in bureaucratic delays. As of November 1987, some $1.5 billion worth of paper had been swapped and another $1 billion had been approved. Foreign bankers estimate that there was a further $600 million in the pipeline when the program was suspended.

Although there is some speculation that the government's bond for debt deal (see 1.2) will boost the value of Mexican paper on the secondary market, most foreign bankers believe that it will stay around its present level of $0.50-$0.52 on the dollar until end-1988. The program is unlikely to elicit much enthusiasm unless foreign bankers can win concessions from the Mexican authorities. The government, for its part, has said that it will hold debt-for-equity swaps to $300 million in 1988.

Another private debt swap mechanism, the Ficorca peso onlending program, is due to be implemented in 1988 but has been delayed from its February 5 start-up date.

Tax law changes have also encouraged a number of firms to begin selling their Ficorca contracts. The Mexican Securities Commission is expected to approve a mechanism for trading Ficorca contracts through the stock exchange, making such deals easier and more rapid.

8.0 Equity Financing

8.1 General. Mexico has a single stock exchange, known as the *Bolsa de Valores*. There are 211 stocks registered on the *bolsa*, including 121 industrial companies. Only about 28 stocks are highly liquid and can be easily traded; another 24 have some liquidity but rapid purchase and sale can be a problem. As a result, Mexico's stock market is extremely thin. Adding to the problem is the fact that listed companies seldom allow more than 7% of their stock to be freely traded.

In the first 11 months of 1987, four companies alone—Telefonos Mexicanos, Cifra, Purina and Aviacion Mexicana—accounted for 5% of the total volume traded. Stock trading still ac-

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Up and Down on the Mexican Bolsa: Equity Price Movements in 1987

Month	Index	Monthly change (%)
January 1987	60,281	28.23
February	79,824	31.92
March	98,523	23.43
April	122,302	24.14
May	143,307	17.17
June	161,666	12.81
July	226,988	40.41
August	287,395	26.61
September	343,544	19.54
October	200,017	-41.18
November	113,628	-43.19
December	105,699	-6.98

counts for only 5.6% of total market activity. Moreover, the narrowness of the market makes the it a poor indicator of overall economic performance. Speculative moves against several stocks or government intervention (support of various stocks by Nafinsa for instance) can cause major swings in the index.

1987 was a turbulent year for the stock market, which went from being the world's fastest growing to the world's fastest falling. For the year ending in September 1987, it chalked up a phenomenal 614% increase in real terms and then continued upward, adding 376,000 points to the price index by October 7. But there it peaked and then began a dizzying fall that slashed the price index to 105,670—roughly one third its October value. The uncertainty caused by the crash and poor oil price prospects will prevent any resurgence in the short term, and most investors have moved their money from the stock market to dollars or gold.

Despite the crash, the stock market continues to change in structure, with mutual funds gaining importance. In the first 11 months of 1987, 60.8% of the stock traded was in industrial, commercial and service companies, while that in mutual funds accounted for 30.6% of activity.

New stock issues picked up significantly in 1987, and through November there were 87 new issues, at total value of P280 billion. Most of them were made while the market was rising, so that companies could launch 10% of their total offering at the initial price and allow the market to determine the price for the rest, almost always at a higher rate than that of the first offering. Among the companies taking advantage of this was Inverlat Sociedad de Inversion Comun, which followed an initial issue of P1 billion with a P214 billion floatation on the same day in September.

During the second half of 1987, other important issues were offered: Union Carbide, P100 billion; Acciones Bursatiles, P21 billion; CBI Casa de Bolsa, P30 billion; Negromex, P29 billion; Acciones y Valores de Mexico, P62.5 billion; Tapetes Luxor, P35 billion; Novum, P58 billion; Grupo Empresarial Maya, P50 billion; Accival Mexico Alta Renta, P97.5 billion; Fondo Dinamico de Inversion Bursatil, P418 billion; Banco Atlantico, P100 billion; Interfondo de Capital, P50 billion, and Fondo de Cobertura Finamex, P100 billion.

An important development that contributed to the rise in share issues in the first nine months of 1987 was the change in the regulations governing Mexico's nascent venture capital funds. In January 1987, regulations were published allowing venture capital funds to own up to 100% of the firm in which they invest. Foreign companies are allowed to own up to 49% of a venture capital fund operating company and the law leaves open the possibility for majority foreign ownership if approved by the FIC and the Treasury Secretariat.

Prior to the worldwide market crash, the changes had encouraged foreign banks and brokerage houses to begin talking about joint ventures. Citibank, Morgan Guaranty, Bankers Trust, Chicago First National Bank and Paine Webber were said to have been discussing investment possibilities. If the joint ventures come about, the association of foreign venture capital specialists and the ability of local venture capital funds to control 100% of the company invested in could provide the security and confidence necessary to attract offshore investment into the Mexican financial market and substantially strengthen it.

Among Mexico City's 26 brokerage houses, 11 carry out 80% of the stock trading activity. Based on size of market activity in the first 11 months of 1987, they rank in the following order: Operadora de Bolsa (20.19%), Acciones y Valores de Mexico (13.28%), Casa de Bolsa Inverlat (11.20%), Inversora Bursatil (8.54%), Probursa (6.71%), Invermexico (4.91%), C.B.I. Casa de Bolsa (4.05%), Valores Bursatiles de Mexico (3.61%), Abaco, Casa de Bolsa (2.91%), Casa de Bolsa Arka (2.77%) and Casa de Bolsa Madrazo (2.59%).

However, the order changes if total market activities, including capital, money and metal markets, are considered. Under these criteria, the top ten brokerage houses are Acciones y Valores de Mexico (19%), Casa de Bolsa Inverlat (13%), Probursa (9%), Operadora de Bolsa (7%), Inversora Bursatil (6%), Casa de Bolsa Madrazo (6%), Abaco, Casa de Bolsa (5%), Invermexico (4%) and Valores Finamex (3%).

Smaller brokers have only a limited clientele. Mexican underwriters generally try to maintain a market in the stock they issue for as long as a year, and many will hold some of the issue in portfolio as a means of controlling future trading. However, written agreements for this type of assistance are illegal. Good relations with an underwriter are essential to the success of any equity placements on the Mexican market.

In March 1983, the Comision Nacional de Valores (CNV) authorized a futures stock market in which individuals and companies may buy and sell on a pre-established day. The market was suspended in December 1985 and then revived in July 1986, but trading remains minimal at 0.8% of total market activity. Volume traded in 1986 rose to P114.8 billion—up only 28% in nominal terms.

Fourteen companies and petrobonds can be traded through the futures market. Originally, the guarantee deposit was set at 30% of the minimum amount of operation—P1.5 million—but in view of unenthusiastic trading the CNV recently lowered the margin to 10%.

Among the companies that have been authorized to par-

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ticipate in the futures market are Cifra, Celanese Mexicana, Liverpool, Telefonos Mexicanos, Kimberly-Clark, Union Carbide, Grupo Desc, the Frisco Mining Group and Empresa La Moderna, the cigarette and beverage company.

The CNV is expected to approve short selling of stocks sometime in 1988. Currently, the Mexican *bolsa* is one of the few stock exchanges that does not allow short selling.

One reason individuals invest in the stock market is that capital gains realized on stock transactions are tax-exempt, a concession available only to individual taxpayers. Corporations are liable for tax on any gains they make in the market; thus few companies keep stock portfolios as a means of investing excess cash. Investors are no longer required to apply and pay for official permission and registry if they are buying less than 25% of the total shares of a Mexican firm.

The open books required of public companies still pose a major barrier to many potential issuers, especially companies owned by families or small groups, which tend to minimize profits on the books in order to maximize payments to owners before taxes are computed. Only publicly listed firms in Mexico are subject to financial disclosure requirements. Inflation-adjusted accounting procedures, known as B-10, are now obligatory for firms registered on the stock exchange.

In 1984, Mexico enacted a number of changes in financial legislation intended to bring more orderly competition to the financial market. One of the most important modifications prohibits the nationalized banks from holding stock in brokerage houses. Banks may not channel more than 20% of their business through a single *casa de bolsa*, and the brokerage houses, in turn, may not channel more than 10% of their fixed capital to any single client. Purchase of 10% of the shares of a brokerage house by a single individual or company is subject to Hacienda (treasury department) approval, and no firm or individual may hold more than 15%. Pyramidization through holding companies is prohibited and brokerage houses may not form multiservice operations through association with insurance companies or other financial service companies.

The brokerage houses are now authorized to trade intercompany promissory notes, to administer pension funds and to make fully collateralized loans to their clients for the purchase of securities. Investments handled by the stock exchange amounted to the equivalent of 23% of domestic savings at November 1987, down from 42% in 1986.

Venture capital mutual funds will eventually be traded on the stock exchange. Several of these have already registered but have failed to attract much investor interest. Other new instruments that are in the process of being developed include trade of Ficorca obligations, which will begin by the end of the first quarter of 1988. Some brokerage houses are also considering discounting accounts receivables.

Stock and convertible bonds issued by Mexico's nationalized banks in 1987 are proving popular and a strong secondary market should develop for these securities, known as CAPs. Each bank is offering its own terms on the stock issues, which are part of the sell-off of 34% of the nationalized bank stock. Most of the stock was placed with employees and prime bank clients. Banamex and Bancomer were the first to make formal public issues. The Banamex convertible bonds carry an interest rate of the higher of *Cetes* or bankers' acceptances yields plus 2.5%. Bancomer is offering the higher of 28-day or 90-day *Cetes* plus 5%.

Urban Renovation Bonds issued following the 1985 earthquakes have attracted only slight interest. Some P12.8 billion was traded, the equivalent of 0.04% of total market activity in the first 11 months of 1987.

8.2 Listing procedures. CNV authorization is required for all offerings of shares and bonds to the Mexican public, as is its approval of the prospectus and any promotion for the issues. Traditionally, obtaining CNV approval has been a lengthy process, involving red tape and, sometimes, modifications of the company's charter.

The treasury secretariat, in consultation with the CNV, may determine the extent to which Mexican financial institutions can invest in stock offerings of foreign-owned or controlled companies.

Majority foreign-owned corporations cannot be listed. Paperwork required includes detailed financial analysis of the company and description of technology and employment. Labor union approval is also required. Once the application is put together, the CNV should act on it within 15–20 days. There is now a fixed P500,000 fee to pay for the financial investigation by the CNV as well as a P750,000 registration fee for new issues.

The December 1982 tax reforms did away with bearer shares; now all shares have to be nominative. Previously, only shares sold to foreigners and those of companies in certain sensitive sectors had to be registered. Shares usually have a par value, most frequently P100, and cannot be issued at below-par prices. To comply with Mexicanization requirements, foreign-owned companies issue "A" and "B" shares, the former not transferable to foreigners.

The special requirements of petrochemical and mining legislation have prompted some companies to issue two kinds of series "A" stocks, one for purchase by native Mexican citizens and companies with an exclusive-of-foreigners clause, the other for sale to legal residents and companies with some foreign minority equity. Union Carbide Mexicana and Industrial Minera Mexico have gone that route in the past in order to straighten out their Mexican ownership situations.

Placing an issue. The most serious delay companies encounter when placing stock issues is getting Foreign Investment Commission (FIC) approval for issues by firms with foreign participation.

During the de la Madrid administration, there has been a trend away from Mexicanization toward permission of more majority foreign ownership. Firms that reported pressure in the past now find the government is no longer pushing the issue, and as a result the attitude toward stock market Mexicanization—which increases local equity control but not control over management decisionmaking—has become more accommodating. Teleindustrias Ericsson, for example, used the stock market in 1986 to reduce its majority ownership from 90% to 80%. The move was taken not under pressure but as an internal policy move, since the firm deals heavily with the private sector. Foreign ownership had risen because of an equity injection in the early 1980s, in-

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creasing the mix from 60–40 to 90–10.

The controversy over stock market Mexicanizations came to a head in April 1979, when the FIC blocked the Mexicanizations of the Borden and Pennwalt subsidiaries until higher authorities intervened. Several proposals to guarantee Mexican management control were considered—among them that part of foreign equity be held in a nonvoting trust—but nothing emerged in the way of concrete rules. However, an FIC representative now has a seat on the CNV with a direct role in the authorization process.

With the currently more flexible attitude toward foreign investment, some firms may be authorized to place part of their equity if the remainder of the Mexican share is held by a closed group or identified investors, preferably industrial investors. Moreover, indications are that the foreign shareholder could hold voting rights on only 1% less than the equity held by the closed group. In that case, officials will probably go over the company's corporate charter and bylaws with a fine-tooth comb.

The closed group option provides an alternative to the trust arrangements used in the past. Trusts were set up to forestall Mexicanization, but reforms in the tax law rendered this nonviable since the funds now have to be declared as assets (thus violating the government's domestic ownership rules) or as debt, making them taxable.

Among the companies that have used the stock market to Mexicanize are Kimberly-Clark, Allis-Chalmers, Union Carbide, Celanese, Firestone, Borden and Pennwalt. Other MNCs with partial ownership of the Mexicanized portion of their equity include Monsanto, Spicer, B.F. Goodrich and ITT.

Nafinsa, Mexico's chief development financing fund, also plays a part in the government's supervision of the securities market. It intervenes to support the market for the shares of companies in which it has interests.

Under Mexican law, all ordinary shares must carry full voting rights. Preferred stockholders, who vote only on such questions as mergers or dissolutions, must receive a minimum 5% cumulative dividend. Beyond that, preferred stocks usually offer cumulative or noncumulative additional participation; the total payout is rarely less than 8% and sometimes reaches 10–12%.

Companies that pay out dividends generally do so by spreading out payments over the year in semiannual to quarterly installments. Although companies have to gauge their dividend policy to compete with high-yielding fixed-interest securities and time deposits, many are adopting a combination cash- and stock-dividend policy, which slightly reduces payout. For example, a brokerage house exchanged old shares for new ones with a higher denomination at a ratio of 4:1. A tire manufacturer gave its shareholders the option of a P14 cash dividend or the purchase of new shares at a 4% discount.

A number of companies paid out dividends over the final quarter of 1987, ranging from P4 to P300. Among them were affiliates of multinationals such as Indetel, Kimberly-Clark, John Deere and Celanese.

As of Jan. 1, 1985, companies have not been able to deduct dividends generated by gains resulting from a revaluation of assets.

8.3 Trading procedures. See 8.1.

Protecting Against Takeovers

The Mexicanized affiliates of foreign companies can do little when faced with the threat of a takeover on the local stock market. Mexican law requires that existing shareholders be given the right of first refusal on any stock sale, but the provision applies only to their respective series. Thus, a foreign shareholder would not have first option on a sale of series "A" (Mexican only) shares. Moreover, Mexican companies may not acquire their own shares, so that a firm could not head off a takeover by purchasing blocks of its own stock.

Firms can, however, avoid unpleasant surprises by taking the following steps:

- Deal with an underwriter in whom management has full confidence and keep in close contact with the underwriter for careful monitoring of trading.
- Avoid any large concentrations of stock. A key to the Purina takeover, for example, was the Lance block.
- Prepare contingency plans, including a list of possible "white knights" that would be acceptable shareholders and could finance a purchase.
- Consider heading off a takeover attempt—or interference by the Foreign Investment Commission—by putting together a closed Mexican group and arranging the sale of a major block of stock. Experience in Mexico has shown that it is invariably better to take steps voluntarily rather than waiting for them to be imposed by the government.

8.4 Mergers and acquisitions. See box above.

8.5 Private equity placements. Selling equity on the Mexican market can be time-consuming and expensive. Putting together an issue can take anywhere from six weeks to six months; a market debut will normally take longer than an equity placement by a firm that is already listed. Underwriters' commissions run at about 4.5% of the issue amount.

Underwriters base their pricing recommendations on current performance plus a one-year projection of future earnings (though they naturally require far more detailed financial information) and examine the trading results of comparable firms. A first-time issue normally comes out at a discount from that level, sometimes as much as 10% below the market average. Most companies complain that new equity placements are significantly underpriced.

Not all firms can tap the equity market successfully. Placements by majority foreign-owned companies involve only a small part of total equity, say up to 15%. Companies operating in price-controlled product lines would find it difficult to enter the market, as would those that lack solid reputations.

8.6 Other. The World Bank affiliate International Finance Corp (IFC) is stepping up its loan and equity investment in majority Mexican firms. MNCs involved in 49–51% joint ventures are eligible for IFC participation. IFC investment can be attractive because it is now considered neutral under Mexico's Foreign Investment Law, and thus has no effect for legal purposes on foreign equity composition. The IFC recently subscribed to a stock offering made by Camino Real Ixtapa, investing $1.1 million. Currently, the corporation holds $150

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million in investments in 18 Mexican companies and has announced it will consider participating in company restructurings as well as in infrastructure and export-related projects. The IFC will usually invest no more than 25% of the total project cost. The loan financing that can accompany such participation is usually seven to 12 years at either fixed or variable rates.

9.0 Capital Incentives

9.1 General. Mexico offers a host of special funding programs for priority activities, such as basic high-quality production, local technology development, import substitution, relocation and, of increasing importance, export development. It pays to encourage local staff to keep on top of these programs since they are often changed with little fanfare. Most programs provide preferential financing terms, although for budgetary reasons officials have had to gradually bring rates on preferential credits closer to market rates. Another increasingly important factor is the need to avoid subsidies that contravene the rules of the General Agreement on Tariffs and Trade (GATT), of which Mexico is now a member.

9.2 Incentive grants and loans. Many of Mexico's preferential financing schemes are restricted to majority Mexican firms. Fomex (Fondo Para el Fomento de las Exportaciones de Productos Manufacturados) export credits are about the only preferential fund that majority foreign-owned firms have easy access to. The government will also provide export funds to majority foreign-owned firms that are agricultural and livestock exporters.

Government officials are showing some flexibility in this area, however, and firms carrying out high-priority projects may find they can get special approval. In the past, majority foreign-owned companies have been able to tap Fonep (Fondo Nacional de Estudios y Proyectos), which is supported by funds from the Inter-American Development Bank, for financing of feasibility studies, but this has been now closed to majority foreign-owned firms.

Eligible firms may receive direct financial assistance from these funds, although their low-interest loans are also channeled through banks. Fonep's and Fomex's special programs must be applied for through the regular commercial banks. Firms have traditionally complained of the time-consuming red tape involved in obtaining these preferential credits.

Rates on these credits are based on the bank's cost of lending (CPP) according to (1) the industrial sector, with the lowest rates going to priority industries, (2) size of the company (measured through sales and number of employees) and (3) geographical location of the project. Preference is given to the least industrialized areas, and officials take into account the effect of the project on the nation's priority goals: exports, basic goods production, import substitution and local technology development.

Rates have been climbing steadily since 1985. Credits that were available for as little as 55–65% of CPP now range upward to CPP plus 5%. The new tax system, which allows full deductibility of interest, makes these loans additionally attractive. While Fomex credits will only increase slightly in real terms, major increases were budgeted for most other development loan programs until the 1988 budget austerity measures. Details of the 1988 budget cuts are likely to be announced in the first quarter of the year.

Mexico has a wide range of trust funds managed by development banks such as Nafinsa and Banrural. In line with the National Development Financing Program, these funds will gradually move away from providing working capital and toward supplying risk capital for projects in priority industrial areas and relocations. Their new role includes taking temporary minority stockholding.

The Fondo Nacional del Fomento Industrial (Fomin), operated by Nafinsa, will temporarily take minority equity in new or expanding industries, particularly those established outside industrially congested zones. Fomin usually assists small- and medium-sized companies, and participating firms must be majority Mexican held. Fomin contributes risk capital in return for preferred shares, up to 49% of the capital stock of companies whose activities promote regional development or who use or develop local technology. It also makes loans at CPP plus 1-5% through the acceptance of subordinate convertible paper. The rate depends on the industry priority and priority of the geographical zone. In the original 1988 budget (before cuts were introduced), Fomin had an envelope of P26 billion, the same as for 1987.

The Fondo de Garantia y Fomento a la Industria Mediana y Pequena (Fogain) makes inventory and industrial equipment credits available to majority Mexican-owned small and medium size manufacturing companies. To qualify, firms must not employ more than 250 people or generate more than P4 billion in sales. Inventory loans are available at terms up to three years with rates from 85% of CPP to CPP flat, depending on the size of the firm and geographic location. Credits are available ranging from P45 million for small firms to P2.6 billion for medium-sized companies. Equipment loans can be obtained at similar rates on terms up to 10 years with 18 months grace depending on the size of the firm. These rates also apply to credits made available to companies with liquidity problems; loans are granted up to P50 million each for terms varying from one to seven years.

While a credit application is under review, Fogain may hand out bridge loans up to 25–50% p.a. of the required credit, at terms of up to 90 days. Fogain will finance the construction or purchase of industrial plants up to 2,400 sq m; terms can be as long as 12 years, including three grace years for investments made in industrial parks and up to five years with one year of grace in other areas. Before 1988 budget cuts were introduced, Fogain was allocated P288 billion for inventory finance; P108 billion for equipment credits and financing of construction; and P84 billion for payment of debts.

Fidein, the fund for the development of industrial complexes, supports small- and medium-scale industrial operations by financing industrial park infrastructure and providing long-term credit to small businesses for the purchase of factory buildings, machinery and equipment. In 1988, loans are available up to P500 million with maximum terms of 12 years and a grace period up to the time required for construction, not to exceed 18 months. Rates vary from 75% of CPP to CPP flat, depending on the geographic zone.

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The tourism fund, Fonatur, also falls under Nafinsa's jurisdiction. The fund makes available inventory and industrial equipment credits to majority Mexican-owned firms investing in construction, expansion or remodeling of hotels and other tourism-related projects. Terms range from three to 15 years; up to 60% of the total amount of a given investment can be covered. Rates vary from 72% to 95% of CPP depending on the ranking of the hotel. Rates for time-share condominiums are a bit higher at CPP plus 4%. Fonatur also has a special credit program for repair of earthquake-damaged hotels, with rates running 65% to 88% of CPP. Tourist-related food and beverage facilities can be financed at CPP plus 4% as well. In some cases, a grace period for principal and interest payments is available for the period of construction. Fonatur also makes direct investments in hotel projects, mainly through joint ventures. In 1987, Fonatur provided P181 billion in joint venture funding to projects worth a total of P328 billion. Under study is a new program to finance the setting up of travel agencies, guide offices and car rental agencies.

Fonei, the industrial equipment trust fund operated by Banco de Mexico, provides long-term financing to majority Mexican-owned enterprises for up to 13 years. Financing for individual projects cannot exceed 3% of Fonei's P200 billion lending fund. Fonei also makes financing available for equipment purchase, focusing on industrial reconversion, feasibility studies, R&D, pollution control and working capital. Credit approval is based on project viability and will not exceed 80% of the total cost. The maximum term for working capital loans is seven years; the maximum rate for all loan operations is 95% of CPP.

As of Oct. 23, 1987, Fonei has been authorized to acquire temporarily up to 20% of equity in firms included in the government's industrial reconversion program, in order to assist them with working capital problems. This investment will be made only if it is complemented by investment from other sources or by the firm itself. Fonei's maximum period of investment in a firm is five years and the maximum interest rate on this type of financing is 1.10 times CPP. Fonei had a 1988 budget (pre-cuts) of P325 billion, approximately 20% for traditional long-term financing and 80% for capital acquisition.

Another attractive source of official financing is the National Fund for Studies and Projects (Fonep), administered by Nafinsa. Its pre-austerity 1988 budget was P21 billion for feasibility and prefeasibility study financing. Interest charged is 70–90% of CPP, plus a 1% commission for inspection and control. Fonep loans range from one to four years with one year's grace. In addition to financing studies, Fonep provides financing to consulting firms. Credits ranging from 70–90% of CPP are available for working capital, acquisition of fixed assets and technological development. Only majority Mexican companies are eligible.

Organizacion Somex is a semiofficial source of both loan and equity capital. Majority-owned by the Mexican government, Somex includes a banking and an industrial division. Banco Mexicano Somex became a national credit company according to the 1982 banking laws. Interest rates follow prevailing levels. In the past, Somex has proved an excellent joint-venture partner for some foreign companies, including Fairbanks, Morse, Nikko, Amoco, Atsurgy Motor Part Co, Colt Industries, ITT and Ciba-Geigy, but the agency has recently begun to reduce its participation in companies. All banks are required to limit their equity participation and not hold a stake in a company for more than five years.

9.3 Tax incentives. As part of the tax reform package that took effect in 1987, the government announced its intention to make the value of fiscal investment and job creation incentives under the *Certificados de Promocion Fiscal* (*Ceprofi*) system taxable at the normal income tax rate of 42%. This change was not applied in the 1987 tax year but will be applied from 1988. (*Ceprofi* are tax credit certificates to be offset against federal taxes.) The new measure applies to existing *ceprofis*; no new ones will be issued. Companies holding current *ceprofis* will continue to receive benefits, but these will be considered as income when filing tax returns. *Ceprofi* benefits must also be included as income in the computation of mandatory profit sharing.

Companies had to be 51% majority Mexican-owned to be eligible for *ceprofis*, which were available for new investments, job creation and purchase of locally made capital equipment. The mechanism was based on Mexico's geographical zone system, which ranks different locations according to their priority in government decentralization programs and a listing of industrial priority classifications. Investment *ceprofis* are valid for five years and employment *ceprofis* for one year. *Ceprofis* could not be combined with other tax incentives, and even before they were made taxable many companies preferred to opt for depreciation allowances rather than investment *ceprofis*.

9.4 Other capital incentives. In addition to the sources discussed above, some of the less-developed Mexican states offer incentives to companies setting up operations in them. San Luis Potosi provides land grants to some types of projects, and Morelos and Queretaro give rebates on state taxes.

10.0 Cash Management

10.1 General. Effective cash management is now probably the most important, as well as demanding, aspect of doing business successfully in Mexico. In the last few years, most well-run companies have devoted enormous energy, for example, to improving receivable and payable terms and minimizing inventories. An important factor in achieving these goals has been in-depth internal reporting. Companies have taken to holding weekly meetings to plan the use of funds for the upcoming two weeks. One finance executive commented, "When short-term means 28 days, a company has to review its financial situation weekly."

Many companies have beefed up their computer systems as the means of providing departmental forecasts and two-week finance plans for the company as a whole. Strengthened internal reporting systems enable companies to check up on the electronic banking systems, which sometimes make serious errors. Daily analysis allows these foul-ups to be caught within 18 hours. One finance director advised, "If you find an error, call the bank immediately and demand compensation. Every day you wait, you lose." His company caught a P1 billion bank error, but the firm's account was credited with the sum immediately following a phone call to the bank.

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Changes in the tax law accentuate the concern for cutting inventories and generating greater cash flow—particularly early in the month. The new tax rules also reinforce the trend to limit borrowing to the bare minimum. Finally, firms have had to carefully monitor Mexico's constantly and rapidly changing financial markets for leads on where to park excess cash. Conventional thinking about investment options is changing—many companies now move funds based among *Cetes* and banker's acceptances, depending on yields. A number of firms are now tapping higher-yielding commercial paper, although technically it is a bit more risky. For cash-rich companies, intercompany lending has provided hefty returns and should continue to do so in 1988 because of the general credit scarcity.

10.2 Credit and sales terms. See 10.3.

10.3 Collection practices. Companies are accelerating collections and raising prices more rapidly to avoid expensive credit. MNCs often speed up collection times by tracking client payment performance more carefully and offering incentives for early and on-time payment. This is being carried out through a number of measures.

Following up on contracts is the most effective way to speed up payment times. Finance directors have taken to holding weekly meetings with collection department personnel to keep abreast of customers that are not paying on time. Moreover, sales departments are being called on increasingly to collect outstanding bills. MNCs are further hammering the point home to sales personnel by measuring their performance on completed transactions rather than contracts signed.

One US computer manufacturer has shifted its measurement of sales personnel performance from sales arranged to paid contracts in order to encourage personnel to follow up sales. To help sales staff increase collections, the firm allows them to offer an additional 5% discount on immediate payments. Using this tactic, the payment times on the firm's $60 million in annual sales have fallen from 90 to 75 days.

Another effective way of following up sales is to use in-house collectors or salesmen, known as *cobradores*. This can reduce extended payment times resulting from poor mail service, which in Mexico can add anywhere from 10 to 14 days to payment time. The *cobrador* delivers the invoice to the customer on a specified day and brings back a receipt from the customer to the supplier's office. When payment is due, the *cobrador* takes the receipt to the customer's office for payment and the check is carried to the supplier or deposited in the nearest bank branch.

When the follow-up approach does not yield results, firms respond by no longer selling to these clients. Careful screening of clients has become much easier with electronic banking services that allow overdue bills to be easily located. Using these services, firms have immediate access via a computer terminal in the main office to outstanding sales and can monitor payments on a daily basis. Companies keep payment performance records which indicate the chronic late-payers, and such clients are dropped whenever possible.

Collective bargaining is becoming more frequent between suppliers and clients that are just too big to let go. In many cases, the problem is not so much late payment but payment times that are too long. Both private and public sector clients can be persuaded to speed up payment if the suppliers offer benefits in return. In the private sector, for example, a number of pharmaceutical companies joined forces to bargain with major distributors for a reduced payment from 45 to 30 days in exchange for 15 days of free sales. The pharmaceuticals producers chose to give the distributors the free sales in order to avoid discount wars between each other.

Parastate companies are notorious for late payments, but, in most cases, firms cannot charge interest on late payments. While parastate payments have improved, they are still slow to compensate for financing costs. For example, the biggest government customer, *Petroleos Mexicanos*, is paying most of its clients in 90 days (see box above). Suppliers had been raising prices to compensate, but now are seeking to improve the situation through collective bargaining, offering lower and more predictable prices in return for faster payment times.

Both public and private sector customers can be enticed into faster payment through early-payment discounts. While tight credit is making financing for this harder to find, some companies are offering reductions of up to 15% for payment within 10 days. A communications MNC, for example, is requiring 50% advance payment in return for a 15% discount for its private sector clients. Since the company is an important supplier for most of its private sector clients, they accept its policy. Using this tactic, the firm keeps payment times at an average of 30 days.

A US consumer products MNC has reduced payment times by

Expediting Parastate Payments

Economic recovery in 1987—primarily increased oil prices—led to improved payment times by parastate companies. However, an important facet of parastate payment times is careful invoicing. One computer manufacturing MNC reported that a P2 billion peso invoice was rejected by a government client because there was a P20 error. The firm's finance executive commented, "You have to be very careful with invoicing government clients because they will use any excuse not to pay."

A BI survey of various parastate suppliers found that the government-owned companies are making payments in the following time periods:

- **Petroleos Mexicanos (Pemex)**, the biggest government buyer, has reduced payment times to within 90 days, with a few exceptions, from more than 200 days in 1986. Chemical products suppliers have seen the greatest improvement, with payments being made as fast as 60 days, in some cases. However, one gas products MNC reported Pemex payments taking up to 150 days.
- **The Federal Electricity Commission (CFE)** is reportedly paying within 90-120 days.
- **Telefonos Mexicanos (Telmex)** and the Mexican Social Security Institute (IMSS) are the most prompt government customers, paying in terms of 25-30 days. In some cases, IMSS payment times have been as short as 20-25 days, according to one MNC.
- **Conasupo** remains a problem customer, with payments arriving within 90-120 days. However, one US health products MNC says that payments from metropolitan locations, such as Mexico City and Guadalajara, are being made in 70-75 days with the help of centralized operations in these areas, but stores in outlying areas still take from 90 to 120 days to pay.

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OVERCOMING PRICE CONTROLS

Interviews both with companies and with Mexican price control officials have yielded the following picture of Mexico's three categories for price supervision.

- Group I (*sistema controlado*) represents strategic industrial inputs and the most sensitive items in the consumer basket. But the roster has been cut back to cover only absolutely vital goods. Price revisions are handed down industrywide, after negotiations between individual industry chambers and Secofi. There is no set timetable. Secofi makes its decision after examining the recent cost increases for a typical company in the industry. In practice, it holds off on authorizing increases as long as it can without jeopardizing supplies.
- For products in Group II (*registro contolado*), Secofi grants regular price increases, based on a set percentage of the official COL. Once the price-hike schedule is set, firms may automatically increase prices. Increases are usually authorized every two to three months, depending on the industry, and price hikes currently average 90% of official inflation. If a company finds that its input prices are outstripping inflation, it can request special increases. This happens most frequently with firms requiring a high percentage of imported inputs.
- Products in Group III (*registro de seguimiento*) are not technically under official control. Prices may be raised as desired. However, producers are required to submit cost records every six months, to help officials track pricing policies. If hikes reported on a given Group III item are deemed excessive, officials may change its designation to Group II, thus bringing it under tighter control. Recently, the pharmaceutical industry won a concession from Secofi allowing nonessential pharmaceutical products, many of which fall between the definitions of drugs and cosmetics, to be reclassified from Group II to Group III on a trial basis.

Corporate strategies

While the government has been slowly liberalizing its price control system since mid-1986, many producers, especially pharmaceutical companies, are still having problems increasing prices to cover rising costs. The important thing to remember is that the price regulation system, like most rules in Mexico, is flexible. A company that bargains well can win concessions that do not appear in the price control list. Executives experienced in dealing with price controls offer the following suggestions on how to handle the problem:

- Don't wait until the new price control regulations are published to start preparing the data requested by the government. Many times companies are caught off guard when a new price control system is announced.
- Develop an ongoing relationship with Secretariat of Commerce and Industrial Development (Secofi) officials to find out beforehand exactly how they want cost and price information presented. These officials receive a great deal of requests from diverse companies, so that if information is not presented according to their format, price increase approvals can be delayed. Therefore, MNCs should find out exactly how Secofi wants the information presented and do it their way.
- Try to get a good price right from the start, because there can be a long gap between the time of presentation and approval, during which costs continue to rise. A pharmaceutical company executive pointed out that Secofi said that price increases for his firm's Group I products would be processed in 30 days. The company found out later that Secofi was referring to 30 business days and not 30 calendar days.
- Be forceful when arguing with price authorities. The key is constant contact with the authorities to keep the pressure on for price increase approval. MNCs should not discard the idea of hiring a person to negotiate with price authorities. As one pharmaceutical executive noted, "Our inability to raise prices as often as we like is cutting into our profits."

Aggressiveness, however, should not be confused with avoiding the law. An MNC that is found to be raising prices without prior Secofi approval will find itself in big trouble. Ciba-Geigy's labs were shut down in 1987, ostensibly for unauthorized price increases. More than being forced to close a part of operations, the company's image could be devastated locally. Local newspapers have given a great deal of coverage to Secofi's crackdown on local retailers selling at prices above controlled prices, but the case of a MNC would probably be front page material.

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about 14 days by offering 8% discounts for cash and rapid payment, depending upon the product line.

An alternative inducement to prompt payment is late-payment interest charges. While these cannot be used on government customers, they can be a very effective way of reducing payment times of private sector clients. However, these must be reviewed weekly to stay in line with the cost of funds.

MNCs have had considerable success with dollar-based pricing. This has been used primarily by capital goods producers. A computer manufacturing executive explained that dollar-based pricing places the pressure on the client to pay on time because the peso price rises each day the client waits as a result of devaluation. Computer manufacturers reported reductions in payment times of five to six days due to dollar-based pricing.

10.4 Payables management. The efforts used to shorten receivables can, in many cases, be reversed to extend a firm's payment times to its suppliers. However, there is a limit to how long companies can suspend payments because they risk driving their suppliers out of business. Companies are using the following strategies to hold off payments:

- ***Make disbursements on one day of the week only.*** A company that pays only on Fridays, for example, can better control supplier payments allowing it to take advantage of an extra day's interest. If the payments are large, this can be quite a substantial sum.
- ***Pay by mail when possible.*** Just as a *cobrador* can cut receivables time, the Mexican postal system can add 10 to 14 days to disbursement time. One US health products MNC has found that some of its clients accept this practice because the company is an important customer.
- ***Monitor supplier check cashing procedures.*** Electronic banking systems allow MNCs to keep track of check-cashing procedures. One US consumer goods company has taken to investing funds that are not claimed right away. The company

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disburses between $600,000 and $1 million weekly, but some 40% of these payments are not collected immediately. In these cases, the company calls its bank and has the funds transferred into an investment account, where the funds earn a rate equal to *Cetes* for one or two days. The company covers this operation with overdraft lines so that suppliers never know the difference if there is any problem.

● ***Take advantage of parent company financing.*** Many subsidiaries that purchase inputs from their parent company use this as a source of 60- to 90-day financing because funds are made available at zero interest rate. One computer company relies on this technique for 50% of its financing needs. As the company's annual sales are about $40 million, this technique represents considerable finance cost savings.

11.0 Short-Term Investment Instruments

11.1 Time deposits. At the end of 1987, rates for fixed-term deposits were 122.85% for 30 days, 120.8% for 90 days and 119.25% for 180 days.

11.2 Certificates of deposit. Banco de Mexico fixes deposit rates on a weekly basis. Rates tend to move in line with *Cetes* (Treasury bills). After a slowdown in the first ten months of 1987, they rose steadily through December—rising 20% during the period. Banco de Mexico was forced to implement this rapid increase in interest rates to stem capital flight following the stock market crash in October. In December 1987, the rates on bank deposits were all above the 104.29% CPP rate (the average monthly interest rate offered by banks on all accounts except savings). Rates will have to stay high if inflation does not let up, and many estimates point to a 1988 inflation rate of 200%.

11.3 Money market. Mexico's money market is primarily composed of Treasury certificates, or *Cetes*, bankers acceptances and commercial paper (see corresponding sections).

11.4 Treasury bills. *Cetes* are traded over the Mexican stock exchange, with a total of P14 trillion in circulation. Overnight investments of *Cetes* can be arranged through brokerage houses. At the end of 1987, they paid 120.70% on eight-day issues, 121.64% on 15-day issues, 126.60% on 28-day issues, and 124.32% on 90-day issues, compared with a 120.80% return on three-month peso deposits and 122.85% on 30-day deposits. Bankers acceptances ranged from 127% to 128% in December, slightly more attractive than 28-day *Cetes*. In July 1986, Mexico decided to return to an auction system for setting *Cetes* rates (which had been abandoned in November 1985). The resulting rise in rates sparked a gradual return of the private sector to the *Cetes* market.

Some brokerage houses offer a *Cetes* loan program, under which the company purchases the Treasury certificates in its name and then lends them to another investor, who cashes them for money. The purchaser of the *Cetes* is paid an additional 0.25–0.5% interest above Cetes. The brokerage firm finds another company that needs funds, and sells it the *Cetes* at a rate below the effective rate offered by the banks. This firm cashes the *Cetes* for the money, repaying the brokerage firm when the term of the *Cetes* has expired or at some fixed date in the future.

Because the brokerage firm handles the entire operation, the company that originally purchased the *Cetes* can pull out at any time, leaving the broker with the exposure risk on the loan to the company, but the broker earns 0.5–1.0% interest on the loan. This type of operation is not expressly allowed by brokerage house operating rules and therefore there is some question as to its legal basis.

In August 1986, Banco de Mexico introduced the *Pagare de La Tersoreria De La Federacion (pagafe)*, a dollar-indexed instrument that is auctioned with *Cetes* each week. The instrument is valued in dollars but bought and paid out in pesos at the controlled rate. The *pagafe* has become almost a moribund instrument, with usage extremely light and little prospect for the development of a secondary market. However, the fixed exchange rate at end-1987 and early 1988 did increase short-term investment in this instrument, and at end-1987 there were P132 billion worth of *pagafes* in circulation.

11.5 Commercial paper. Terms for commercial paper vary from 14 to 91 days. It is not a large market, and because of the growing cost of placing corporate paper, new issues have been sluggish. Yields are averaging three to four percentage points over 28-day *Cetes*.

11.6 Bankers acceptances. The bankers acceptance (BA) market has decreased significantly following the central bank's decision to lower the interbank rate substantially from the second half of 1986 (4.2). The market is in decline despite the opening up of BA trading to the brokerage houses and the increase in the bank issuing limit from 80% to 100% of net capital. In addition, the central bank freed banks from a requirement that they place the credits before issuing BAs. With the severely restricted credit situation at the close of 1987, many banks began to issue more such acceptances. BAs have 30- to 90-day maturity and a nominal value of P100,000. Returns on them are currently in the *Cetes* plus one or two percentage points range.

11.7 Other short-term investment opportunities. Near the end of 1984, Banco de Mexico announced a new peso instrument called *pagares*—promissory notes with return payable on maturity. Interest earned on *pagares* is reinvested directly. Prior to its suspension in March 1987, the instrument was available for one-, three-, six-, nine- and 12-month terms. Yields on 30-, 90-and 180-day notes stood at 93.25%, 94.30% and 95.65%, respectively. Of the peso interest, 12 percentage points are tax exempt; a 21% tax is directly withheld by the banks.

Returns on intercompany loans vary, according to the relationship between borrower and lender. Deals between affiliate subsidiaries will typically be made at the prevailing *Cetes* yield. Loans between nonrelated subsidiaries will typically be based on something over *Cetes* and less than prevailing bank rates. However, firms in a healthy cash position can charge as high as CPP plus 20 percentage points on intercompany loans. Brokers that assist in locating borrowers will charge the lender one to two percentage points for their service.

12.0 Trade Financing and Insurance

12.1 General. Mexico has an insurance program for exporters, and special financing programs are available for companies involved in foreign trade. The Banco de Mexico-operated

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industrial equipment fund (Fonei) finances the production phase of operations. The Fondo para el Fomento de Exportaciones de Productos Manufacturado (Fomex) makes funds available for preexport production, exports and import substitutions. Fomex is operated through the Banco Nacional de Comercio Exterior (Bancomext), which also provides financing for exporters and importers. Insurance against credit risks on foreign sales can be obtained through Cia Mexicana de Seguros de Credito (Comesec). Political risk coverage is provided by Fomex.

Majority foreign-owned companies can tap these programs, although officials clearly prefer to reserve scarce resources for Mexican firms. Access to preexport credit has been the most problematic. One large US-based MNC was told straight out that it would not have access to Bancomext funding for a new project. Another firm operating in the chemical sector was able to secure Fomex credits, but only in limited amounts and at notably less attractive rates than in the past.

12.2 Official export insurance programs. The government requires export-credit insurance for all companies that use the concessionary credit extended by Fomex. The government plans to introduce a single policy covering both commercial and political risk that will be available from Comesec. Currently, Fomex provides political risk insurance up to 90% of export value, while Comesex offers commercial cover for 70–80% of the export value.

Fomex premiums vary according to contract term and export destination. In the past, General Mills has used Fomex insurance to cover exports of polyamide resins to South and Central America. Other regular customers in recent years have been Corning, Union Carbide, Miles Laboratories, Petrocel and TAMSA. Most insurance covers exports to Latin America.

Comesec has a paid-in capital of P100 million and a reserve for damages of P2.269 billion. Rates are based on the company seeking insurance, destination and time of coverage. Ninety day coverage to the US is currently 0.7%; 180-day coverage is 0.9%. Third World shipments are 1.4% for 90 days and 1.9% for 180 days. Rates can range as high as 2.5% for unknown companies shipping to the Third World.

12.3 Official export credit programs. Exporters can obtain preferential financing through their commercial banks or from state institutions, which discount them with Fomex, the export development bank. Fomex offers export as well as preexport financing. In deciding whether to grant credit, Fomex will consider the economic feasibility of a project, the use of human resources—preference given to labor-intensive projects—and the effect on the country's balance of payments. As a result of the US-Mexico agreement of understanding on subsidies and countervailing duties, export financing rates have been increased to the equivalent of *Cetes* plus CPP divided by two for peso financing and US bankers acceptances plus one for dollar financing.

In 1987, Bancomext, which operates Fomex, granted P6.7 trillion worth of peso and dollar credit. In 1988, it is expected to provide about P10 trillion. Export incentives have been improved with additions to the Profiex export development program. Companies that supply exporters, but are not direct exporters, are eligible for preexport benefits including preferential financing rates and a domestic letter of credit. The domestic letter of credit provides for Fomex financing of a supplier's purchase order or the portion of the foreign letter of credit the order is based on.

Under the preexport program, majority Mexican-owned companies manufacturing goods with over 50% local content can obtain financing for 100% of their direct production costs or 70% of the f.o.b. price (85% of f.o.b. price if the firms have a Secofi-registered export program).

Companies producing items with local content between 30% and 50% may receive export financing for 100% of the Mexican part of their direct production cost or double that amount if the company has a Secofi-registered export program. The terms of these loans run from the time raw materials are purchased until the final export. (The rate presently stands at around 95% of CPP.)

Fomex will finance 100% of the invoice value plus interest for exports with more than 50% local content if the term is one year as of the date of the shipment. For one- to two-year terms, companies can finance 85% of the cost of the invoice value and Fomex will provide funds for 85% of the Mexican part of the invoice. For two- to five-year terms, it will finance 85% of the imported part of the invoice. If credit terms exceed five years, Fomex sets the amount it will finance on a case-by-case basis.

Firms that export products with 30–50% local content can apply for 100% financing of the Mexican part of the invoice for terms up to one year, and 85% of the cost of Mexican parts for terms that run from one to five years. Here again, Fomex will set the amount on a case-by-case basis if the term is over five years.

Companies that are foreign-owned can also obtain preferential financing from Bancomext, at the same rates and terms as those available for Mexican exporters, for products with at least 30% local content. These goods must be considered nontraditional exports going to nontraditional export markets, and they must generate net foreign exchange earnings of 30% of the shipment's value. Export credits up to two years carry an interest rate roughly equivalent to the rate of US bankers acceptances plus 1% on six-month operations. Interest must be paid in advance for credits up to 360 days; in other cases, interest is charged on a quarterly basis.

Rates on medium- and long-term export credits depend on the destination of these exports. Rates for goods sent to developing countries range from 9.55% p.a. for two- to five-year terms to 9.8% p.a. for five- to eight-and-a-half-year terms. To countries with an intermediary level of development, the charge is 8.25% p.a. on two- to five-year export credits and 8.75% p.a. for five- to eight-and-a-half-year credits.

Medium- and long-term credits for exports to developing countries carry an interest rate of 7.4%. Bancomext, through Fomex, makes credit available for nontraditional agricultural exports; the export bank took over this function (the Linea 1.6 facility) from the central bank. The central bank finances 100% of the total invoice for a 90-day term at a rate equivalent to 50% of LIBOR plus two percentage points.; 180-day financing for these exports is also available at 75% of LIBOR plus two percentage points. Companies can apply for this credit through their regular commercial bank or through Bancomext.

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When credit is sought before production starts, the prospective exporter must support the application with documents showing a firm order, a commitment to produce, a description of the manufacturing process, and statement of the time required until the shipment is ready. When financing for 70% or more of the sale price is sought, a detailed and certified cost analysis must be submitted. Exporters' experiences with this type of credit have been favorable, especially since applications are made through their regular banks, minimizing red tape.

12.4 Private export financing techniques. Although not widely publicized, individual bank financing for exports is also available; rates are based on the bank-client relationship. One major exporter of chemical products was able to obtain a dollar-denominated loan paid out in pesos at the controlled rate. The dollar rate was 7%, to which cost was added the depreciation of the controlled-rate peso. The company had to show its export invoices in order to guarantee export revenues. With the hike in interest for export credit, the rate of these dollar-denominated loans will also be raised to the level of international market rates.

Banks offer short- and medium-term export and import credits at about the same rates as regular commercial loans. Like all commercial bank credit, availability is severely limited. (Long-term export and import credit is available only through Somex.)

12.5 Import credit. Fomex provides exporters with the foreign currency financing needed for imports. Through its Profide program, credits are granted directly to the foreign supplier up to 100% of the import value. Maximum credit is $15 million or 60% of the firm's annual export plan. Cost is two percentage points over the six-month New York bankers acceptances rate for imports financed up to one year from the US. Two- to three-year financing is pegged at LIBOR plus 0.25 percentage point and five-year financing is LIBOR plus 0.375 percentage point. Rates to other countries depend on the reciprocal trade agreements Mexico has with each country. Agreements are in force with 21 nations. The term extends from the time raw materials are imported until the finished product has been paid for.

Bancomext has opened up $2 billion worth of foreign currency credit lines to finance raw materials, spare parts and machinery imports. In general, up to 85% of imports can be financed through these credits, although funding may be up to 100% in some cases. Companies must be found to be creditworthy by Bancomext, present an annual export plan, and be located in Mexico (no minimum ownership is set). Imports must be used in priority activities. Terms depend on the goods imported and fluctuate between 30 days and one year for raw materials and up to eight and a half years for capital goods. Interest rates are often fixed and can range from as low as 5% to as high as 10.3%, depending upon the term and the import.

Bancomext also manages a trade line with Brazil that provides a revolving credit of $150 million in each direction. Brazilian imports with at least 30% local content—calculated on a direct-cost basis—can be financed through this credit system for a minimuum amount of $1,500. Maturities range from two years to eight years, depending on the goods imported. The interest rate is set at 7.5% p.a.—except for loans to import steel products, for which 9% is charged. Up to 85% of the purchase price can be financed with these credits. All firms, including majority foreign-owned companies, can apply through their regular commercial bank, which charges a 2% commission. Similar agreements are currently being worked out with Colombia, Argentina and Venezuela.

Fomex and Bancomext also make financing available to the in-bond industry, to firms located in the border zone (a 20-km strip along the northern border) and to companies that supply the border zone. To be eligible, firms must manufacture goods with at least 30% of their total sales or avoid outflows of that amount through import substitution. These companies must be established in Mexico. Financing is available for the purchase of machinery and equipment up to 85% of the investment cost in pesos or dollars. Terms and rates are the same as for other exporters: currently 9.5% on two- to five-year credits and 9.8% over five years.

Fomex funds 100% of production cost for goods with at least 60% local content and 100% of the Mexican components for goods with 30–60% local content. The term is from the moment of purchase of raw materials until the goods are sold, and the cost is CPP plus five percentage points, payable semiannually during an amortization period set by Fomex.

Fomex also provides working capital to majority Mexican-owned companies that manufacture capital goods or products with a high value added and contribute to import substitution. Production financing is given for the period covering raw materials purchase to delivery of the final product, of up to 100% of the production cost or 70% of the invoice value. The minimum amount is P10 million, and no ceiling has been set. Interest is CPP plus five percentage points.

The invoice financing program covers up to 85% of the accounts receivable's net value. Here too the minimum amount is P10 million and interest stands at CPP plus two percentage points. Financing terms are up to 180 days. The latter program is available to majority foreign-owned companies as well as Mexican-controlled companies.

A credit facility supplying $100 million has been made available to Mexico's private sector to finance large imports of machinery, equipment and spare parts required for the production of exports and import substitutions. The facility is provided by the International Finance Corp (IFC), Morgan Guaranty Trust and the Bank of America. Each loan from the facility is guaranteed by Banamex and Bancomer. Companies may apply through any of these four banks; they will jointly identify prime borrowers. Credits range from $5 million to $6 million, with a maximum maturity of eight years. Interest rates are payable on a quarterly basis and fluctuate between 1.5–2.5% over LIBOR, depending on the term, amount and the client's credit standing.

12.6 Countertrade. Given Mexico's extreme sensitivity to the views of the IMF and to the policies of its largest trading partner—the US—it is unlikely that the Mexican government will come out with a formal policy endorsing countertrade (CT) any time soon. CT is not practiced on a wide scale, but recent legislation has legitimized barter and countertrade, and an informal infrastructure to facilitate and approve such deals is being developed.

The legal basis for barter trade was set out in the December

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1982 "Exchange Controls Decree," published in the *Federal Official Gazette*. While not endorsing countertrade, the Mexican government has gone even further in allowing barter and CT activities with its Supplementary Exchange Control Rules Applicable to the Use and Transfer of Foreign Exchange Generated by Exports, dated March 4, 1983. In February 1984, the government issued additional guidelines stipulating when and how export proceeds in hard currency can be left abroad for use in advance purchases or other forms of countertrade.

Under the March 1983 rules, CT is permissible if the Mexican party obtains authorization from the Banco de Mexico and the approval of the Ministry of Trade and Industrial Promotion. Also permissible is the transfer by a Mexican exporter to a Mexican importer of the right to foreign exchange at the official rate.

These transfer rights represent an opportunity for Mexican importers, who would not be eligible to buy foreign exchange at the controlled rate, to purchase that right from either a Mexican exporter who does not have use for the foreign exchange or from a third-party broker.

The Supplementary Exchange Control Rules Applicable to the Use and Transfer of Foreign Exchange Generated by Exports, as amended and expanded by the February 1984 guidelines, stipulate the following:

- Local exporters are officially authorized to receive imports as a means of payment for the goods exported.
- A Mexican firm interested in countertrade must receive authorization from the Banco de Mexico and then obtain the approval of the Ministry of Trade and Industrial Promotion.
- If a CT proposal is approved, the Mexican exporter will then receive a permit stating, "Importation is based on interchange or barter at the controlled rate of exchange. Payment shall be charged to the exportation of . . ."
- When Mexican exporters engaged in CT transactions receive cash in partial payment for their exports, the cash can be used legally for four purposes, one of which is to finance the exporter's own imports. Any foreign currency not used for one of these four purposes must be sold for pesos at the controlled rate.
- Exporters who are required to sell their foreign exchange to the government receive foreign exchange receipts called *comprobantes*, which entitle the exporter to acquire foreign exchange at the controlled rate up to the amount he had previously sold to the government. Of importance for CT purposes is the exporter's ability to transfer, in whole or in part, the right to acquire foreign exchange at the controlled rate. Thus, an importer who would otherwise have to purchase foreign exchange at the free market rate can purchase the right to the "cheaper" foreign exchange. To carry out this transfer, the prospective importer must present to the government (i.e. appropriate credit institution) an import permit, the exporter's proof of sale of foreign exchange, and proof of authorization issued by the Ministry of Trade and Industrial Promotion.

In one instance, a US trading company arranged the transfer of a *comprobante* from a Mexican fertilizer exporter to a Mexican importer. The Mexican exporter was entitled to buy foreign exchange for import purposes, but had use for the foreign currency. Acting as broker, the trading company entered into an exclusive agreement with the Mexican exporter. The trading company found an importer in need of foreign exchange at the controlled rate and arranged for approval by the appropriate Mexican authorities.

12.7 Forfait. N.a.

12.8 Other trade financing techniques. N.a.

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