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SOVEREIGN DEBT CYCLES AND CRISIS: MEXICO AND ITS LESSONS FOR THE EURO AREA PERIPHERY

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Sergio Negrete Cárdenas
snegcar@iteso.mx.

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Instituto Tecnológico y de Estudios Superiores de Occidente (ITESO)
Periférico Manuel Gómez Morín 8585
Tlaquepaque, Jalisco, México. CP 45604
www.investigacionpolitica.iteso.mx

Sobre el autor:

Sergio Negrete Cárdenas es doctor en Economía
por la Universidad de Essex, Reino Unido.
Actualmente es profesor-investigador del Departamento de Economía,
Administración y Mercadología del ITESO e Investigador Asociado
del Centro de Estudios Espinosa Yglesias (CEEY).
Trabajó en el Fondo Monetario Internacional entre 2004 y 2009.

Abstract

Sovereign countries are not individuals or businesses and, contrary to widespread notions, their debt cycles many times follow patterns that differ radically from what is the norm for people or companies. Notably, debt is not expected to be paid in a foreseeable future, and debt payments (principal and interest) are many times financed with more debt.

Sovereign debt crisis frequently erupt when economic agents, operating through financial markets, suddenly change their perception on a country's payment capacity. Information, specifically information asymmetries that are typical of international capital markets, plays a fundamental role. That is the case because a government (the borrower) has more information on the amounts actually being borrowed and the country's future financing needs. Any sudden negative surprise for the markets (the lenders) may push them to suddenly close. Information is also fundamental for a country to regain access to the markets. The borrower not only requires in most cases to correct a weak fiscal situation, but to "signal" to the markets that it has been successful doing so.

Mexico has suffered three debt crises in recent years (1976-77, 1982-89, and 1994-95). In the three cases, markets closed abruptly after a burst of over-borrowing that lenders took time to notice, due to information asymmetries. That was also notably the case with Greece in 2009. Mexico has significant insights to offer to countries in the Euro Area periphery, not only when comparing why the crises started but, even more importantly, how they were overcome.

Key words: Sovereign, debt, crisis.

Resumen

Las naciones, como entes soberanos, no son individuos o negocios y, contrario a nociones ampliamente difundidas, sus ciclos de endeudamiento muchas veces siguen patrones que difieren radicalmente de aquello que sería normal para personas o empresas. Destacadamente, no se espera que la deuda sea pagada en un futuro cercano y el servicio de la deuda (principal e intereses) son muchas veces financiados con más deuda.

Las crisis de deuda soberana estallan con frecuencia cuando los agentes económicos, operando a través de los mercados financieros, modifican abruptamente su percepción sobre la capacidad de pago de un país. La información, en específico las asimetrías de información que son típicas de los mercados internacionales de capital, tienen en ello un papel fundamental. Este es así porque un gobierno (el que pide prestado) tiene mayor información sobre los montos que realmente está solicitando y las necesidades del futuro financiamiento del país. Cualquier sorpresa negativa para los mercados (que prestan) puede empujarlos a que se cierren de manera abrupta. La información es también fundamental para que un país pueda acceder de nuevo a los mercados. En la mayoría de los casos el país no sólo necesita corregir una situación fiscal débil, sino el dar una "señal" a los mercados de que ha sido exitoso en dicha corrección.

México ha sufrido tres crisis de deuda en años recientes (en 1976-77, 1982-89 y 1994-95). En los tres casos los mercados se cerraron abruptamente después de un estallido de sobre-endeudamiento que los prestamistas tomaron tiempo en constatar, debido a la información asimétrica. Ese fue también de forma notable el caso de Grecia en 2009. México tiene lecciones importantes para los países de la periferia de la Zona Euro, no sólo con respecto al estallido de la crisis de deuda sino, todavía más importante, cómo pueden sobreponerse.

Palabras clave: *deuda soberana, crisis*

Sergio Negrete Cárdenas

INTRODUCTION: SOVEREIGN DEBT – AS SAFE AS HOUSES [*]

The impression among many economists, both theoretical and practical, is that debt issued by countries (sovereigns) is considerably "safe", with default, rescheduling or a write-down being rare events. That notion is also shared by many active participants in the financial markets. Actually, public debt, particularly the one denominated in the country's own currency, is deemed many times as the "safest" of potential investments, and as such the benchmark that other debts (notably those from private sector companies) are put against. Moreover, it was considered that sovereign debt crises were exclusive territory of poor or emerging economies.

Certainly, sovereign defaults are not everyday occurrences. Nonetheless, the three decades between the announcement of the Mexican debt moratorium in August 1982 and the massive debt "haircut" imposed on holders of Greek bonds in March 2012, with numerous countries suffering from severe debt problems in-between, should disabuse any notion that sovereign debt difficulties are exceptional –or that only emerging/poor countries may suffer them. The expression "biggest sovereign default in history" has been successively applied to Russia (1998), Argentina (2001), and most recently Greece (2012). It seems a fair assumption to consider that Greece will not occupy that unflattering pole position forever. Sovereign debt has proved to be as safe as houses –that is to say, not impregnably safe.

AN OVERVIEW OF A SOVEREIGN'S DEBT CYCLE

Most countries have fiscal deficits, and practically all those countries finance the gap through borrowing. Countries are neither individuals nor businesses, and generally have a lifespan that stretches far beyond that of an average person or a company. The expectation that countries may, or should, behave like individuals many times causes confusions and fallacies on the borrowing cycle by a sovereign, such as:

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- A sovereign will borrow considerably when it is relatively underdeveloped (such as a young person) in order to invest in itself, and pay back when it has reached a certain stage of development (maturity).

- A sovereign will borrow during tough periods of time (such as recessions) and pay back when times are good (strong economic growth).

That is, in both cases, the expectation is that a sovereign should sooner or later liquidate its debts. Public debt is seen as almost a transitory phenomenon that cannot, or should not, last forever.

However, the fact is that developed and wealthy economies such the United States, Japan, and several European nations have quite high public debt levels. Rather, they seem to show, counter-intuitively, that the more advanced development stage, the higher the debt will be. It is also a fact that the public finances of many countries do not move into a surplus, and debt repayment, during an economic boom, while certainly deficits, and greater debt accumulation, are common during recessions.

That a country remains a "permanent" borrower seems so illogical to some that the explanation they offer is that lenders would need to be irrational –as that sovereign would be setting up by a pyramidal (Ponzi) scheme (Eaton, 1992, p.10). Such views seem to follow the rationale that a country has to behave like an individual, and sooner or later pay off its debts. Nonetheless, sovereign debts are common, and borrowing is practically a permanent fixture.

How a country generally finances its debt payments (interest and principal falling due)? With more debt. Why lenders would lend today to a country doing that? Exactly for the same reason that lenders did so in the past: they expect to be paid with the money provided by other (future) lenders. A sovereign does not normally cover its debt service with its own resources (such as tax revenues or hard currency obtained through a surplus in the trade account) but with the resources provided by more debt.

No practitioner of the financial markets can be unaware of this reality. As one of the most prominent bankers of his era put it bluntly three decades ago:

> If we had a truth-in-Government act comparable to the truth-in-advertising law, every note issued by the Treasury would be obliged to include a sentence stating: "This note will be redeemed with the proceeds from an identical note which will be sold to the public when this one comes due." (Wriston, 1982).

However, what is a standard debt cycle for a sovereign is many times ignored in the academic literature. Eaton, Gersovitz, and Stiglitz (1986, pp. 500-501) consider that, since sovereign loans are owed by governments, repayment is not constrained by the net worth of the country, but by the fraction of it that the government can (or is willing to) appropriate. A country's net worth would then be the discounted present value of its trade account, plus the value of those domestic assets that creditors would be willing to accept as payment.

Rather, it would be more plausible to argue that a country's payment capacity would mostly depend on the expected value of its future borrowing. Lenders will keep their purses open to the country while they believe that they will be paid in the future – most probably with the money of other lenders.

That is, an inter-generational chain of trust quite similar to the one presented by money (Samuelson, 1958, pp. 481-482). Trust is essential, and for sovereigns it crystallizes in the form of creditworthiness. Obviously trust is not an element that can be hammered into a loan contract, but rather is a fuzzy, but fundamental, pre-requisite for it to be signed. It is the emergence of trust the one that allows a "first generation" of lenders to start a debt cycle, continued by posterior lenders.[1]

The central role of trust renders mostly irrelevant the theoretical literature on debt thataims to determine the optimal amount of borrowing by a sovereign. Conversely, it also makes irrelevant to try to determine whether a certain amount of debt (for example measured against GDP or exports) is reaching a "dangerous" level. Such search for "triggers" –for example, to argue that a country's debt should not surpass 150% of its GDP or it will face a crisis– is as futile as trying to determine an "optimal" level of borrowing. However, there is an important caveat: a trigger is indeed relevant if it is widely believed by market participants, particularly potential lenders. It may become,

[1] Devlin (1989, pp. 139-154) presents a vivid analysis of the beginning of the debt cycles by two sovereigns, Peru and Bolivia, in the first half of the 1970s.

then, a self-fulfilling prophesy. For example, if many potential and actual lenders do believe that debt reaching the threshold of 150% of GDP indeed is a serious problem, it would indeed become one, as trust will diminish or vanish if reached.

Probably that possibility makes the search for triggers among economic and financial theorists, and naturally also its practitioners, irresistible. In the recent financial turmoil in the Euro Area periphery, following the evolution of country risk indicators became all the rage. An almost natural corollary was the quest for triggers. Among the many examples available recently (italics added):

> (...) The shares that rose last week on hopes there was light at the end of the sovereign debt tunnel fell back again as it became clear that the light was an oncoming train called the Greek referendum express. Markets reacted with horror to the idea that the birthplace of democracy would put the terms of the latest imposed austerity programme to its people.
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> But was not really just about Greece: it was also about Italy, another southern European government with an unstable government, oodles of debt, low growth and – how shall we put this – a relaxed approach to paying tax. *Far more important than the kneejerk response of the equity markets was the sharp increase in Italian 10-year bond yields, a key measure of how expensive it is for the eurozone's third biggest country to finance its debts. Anything above 6% means the amber warning signs are flashing loud and clear; anything above 7% and Italy joins Greece, Ireland and Portugal in the bailout club* (Elliot 2011)**.**

Recent academic studies of the Euro Area debt travails also show an undiminished appetite for debt triggers (see Mody and Sandri, 2011).

WHAT SETS OFF SOVEREIGN DEBT CRISES?

Why sovereign debt crisis should happen at all if a borrower country and its lenders are aware of how the cycle works? Because there is a sudden loss of trust from the later on the former's creditworthiness, that is, its capacity to pay. Whether that loss of trust is, for example, justified by macroeconomic or financial fundamentals is somewhat irrelevant: loss of confidence move lenders to close their purses tight. If a sovereign had been financing at least a significant fraction of its debt service with debt, then it will be unable to continue servicing it, regardless of its actual wealth. It would be like a bank that, in spite of its actual solvency, faces a bankrun: with money flying out, and no new deposits arriving, it would need to close its doors.

What may spark off such a loss of confidence? Leaving aside exogenous events that may damage perceived creditworthiness (such as the plunge in oil prices for a country that relies heavily on it for revenues) the main one is that the sovereign has, with or without the full awareness of lenders, substantially increased its borrowing. That is, the debt dynamics depart their "normal" pace, instead following an "explosive" one. That generally means a greatly increased deficit that is being financed with debt. If *present* lenders fear that such a pace will mean that eventually debt requirements will be such that there will not be sufficient *future* lenders to provide the necessary financing, the former could stop lending immediately.

It is feasible, although arguably not advisable, for a country to substantially increase its deficit as information asymmetries exist in capital markets. The government may, for example, simply present inaccurate information on the deficit's magnitude, or exploit the asymmetries in the credit markets in order to borrow from different sources that are unaware of the aggregated magnitude of their largesse. Or, naturally, it may be fully open about the fact that its borrowing needs are substantially increased with respect to what had been the trend. In any of the three scenarios capital markets will not necessarily freeze as a result, but certainly may.

Additionally, sovereigns may plunge into a debt crisis suffering from a contagion effect. That is, the markets consider, correctly or not, that a country displays similarities to another that is facing difficulties servicing its debts –and also restrict any new lending to it. Thus, several countries may be affected, like falling dominoes, by the collapse of one.

MEXICAN DEBT CRISES[2]

Mexico has the dubious honor of having thoroughly shaken the international financial system twice in recent decades, with public debt as a centerpiece. Counting the 1976

[2] A detailed description and analysis of the overview contained in this section is presented by Negrete Cardenas (2000), particularly Chapters 3 and 5.

crisis, that had no international repercussions, Mexico has experienced three debt crises in a 20-year span. The Mexican case attains even more relevance when it is considered that, as the country that started both the 1982 and 1995 global commotions, there were no contagion effects. Thus, the country provides an outstanding case study to determine not only how a sovereign loses its creditworthiness and falls into a crisis, but also how the creditors' trust is regained. A brief overview of the 1976-77, 1982-89 and 1994-95 debt crises[3]is presented below:

a) A short-lived and unnoticed debt crisis (1976-77)

When Mexico started in 1973 an aggressive borrowing from the Euromarkets, it had several advantages that assured its success, added to the recent enthusiasm of many banks for developing countries and the petro-surpluses that would soon flood the international capital markets (due to the skyrocketing of oil prices in 1973-74): one was the stature of the country, because of its size and economic development. Another was its solid macroeconomic performance since the mid-1950s, combined with its (then) relatively low levels of debt.

Debt accumulation was greatly increased as, radically departing from orthodox economic policies, the Echeverria administration (1970-76) vastly expanded public spending from 1972, fuelling the fiscal deficit and inflation. External debt also financed capital flight, as the peso (that had been kept fixed against the dollar) became increasingly overvalued.

The borrowing spree (see Figure 1) was brought practically to a halt when a balance of payments crisis exploded in August 1976. The peso was allowed to float (plunging in value during the following weeks) and the government had to request a stand-by loan from the International Monetary Fund. The loan's conditionality subjected the government to a three-year economic adjustment, with targets for variables such as the fiscal deficit and external debt accumulation.

The credit largesse ended in a brief and not very noticed bust. Jose Lopez Portillo succeeded Echeverria as President in December 1976, and the complaint is clear: "The

[3]The dates of the crises are given considering when creditworthiness was lost and when it was regained.

banks were not only not lending lo us, but demanding their money back and controlling us. We had to get out of the trap" (1988, p. 480).

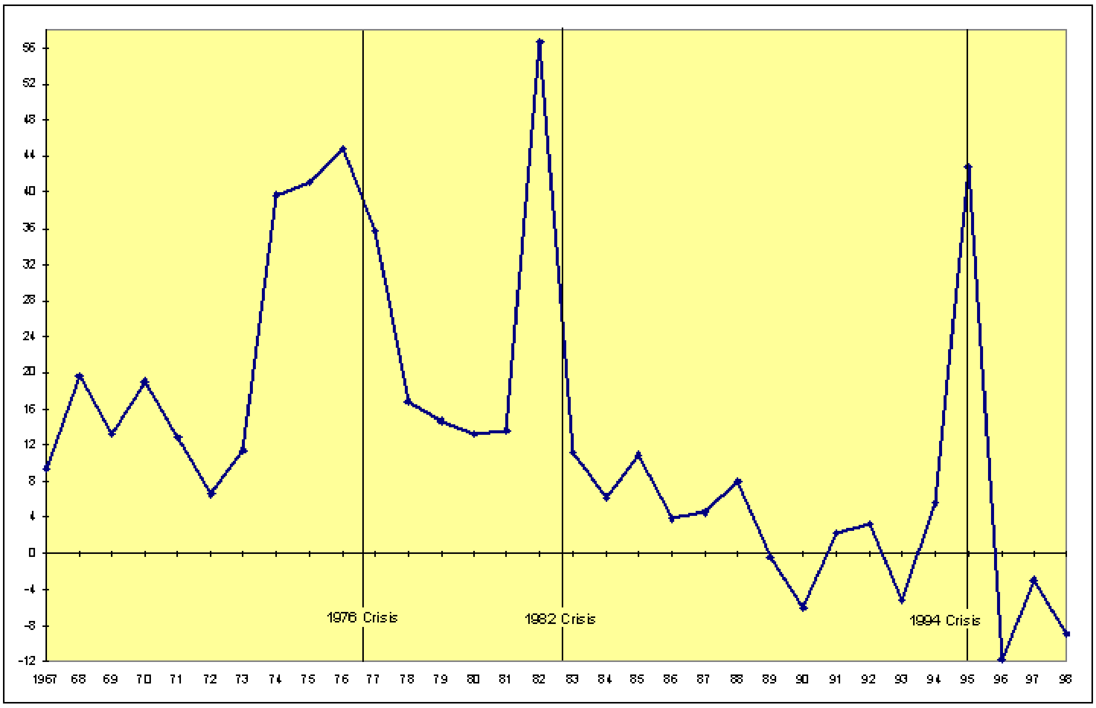
Lopez Portillo was provided with a way to get out of the "trap" by his choice as head of the state-owned oil monopoly (Pemex), Jorge Diaz Serrano. The latter was convinced that Mexico's oil reserves were much higher than officially stated. He contracted the services of the firm De Golyer and MacNaughton (recognized internationally for its expertise in geophysical exploration) to confirm his estimates amidst domestic and international skepticism. A laconic letter from the Texan firm estimated Mexico's oil wealth in 11.2 billion barrels, nearly doubling the previous figure of 6.3 billion (Diaz Serrano, 1988, pp. 64-65).

The unexpected oil ace was quickly shown to all players, including commercial bankers. In Lopez Portillo's words:

> (...) we went out to the world asserting with a very loud voice that we had oil, lots of oil. First to our creditors, so that they would not grow impatient; afterwards to the rest of the world... It worked. The IMF ceased to be irascible, and we could agree more convenient conditions... the creditors not only were tranquillized and renegotiated our debts, but they also offered us new credits (1988, p. 482).

The banks' response was enthusiastic. On March 21, 1977, a $350 million loan, unsurprisingly for Pemex, marked the successful return of Mexico to the Euromarkets. From that moment on, the door to additional credits became wide open. The abundance of private loans allowed Lopez Portillo to pay in advance the loan from the IMF in June 1978, freeing his government from its conditionality (Newell and Rubio, 1984, p. 216).

Figure 1. Increase in Mexico's public external debt, 1967-1998*
(percentages)



* Including the Tesobono debt in 1989-96.
Source: Elaborated with data from the Ministry of Finance and Public Credit.

b) A long and much-noticed debt crisis: 1982-90

Without the IMF's oversight, the government embarked again on a fiscal expansion that mirrored the failed 1973-76 policies. Oil was seen as the difference that would allow the expansionary model to be successful. The second oil shock in late 1979 merely added to the euphoria. Macroeconomic imbalances increased as the boom gathered pace, reflecting the unchecked expansion in aggregate demand led by public expenditure. Yet again, the peso was kept practically fixed while inflation remained well above the US level.

Nonetheless, the banks' vaults remained open for Mexico. José Angel Gurria, responsible for the process of public indebtedness at the Ministry of Finance, describes a panorama that would not be more different from the 1976-77 crisis:

> The banks were hot to get in. AII the banks in the U.S. and Europe and Japan stepped forward. They showed no foresight. They didn't do any credit rating analysis. It was wild. In August 1979, for instance, Bank of America planned a loan of$1 billion. They figured they would put up $350 million themselves, and sell of the rest. As it turned out they only had to put up $100 million themselves. They raised $2.5billion on the loan in total (Quote in Kraft, 1984, pp. 19-20).[4]

With fiscal discipline vanished and an overvalued peso, however, confidence was fragile. A bungled reduction in oil export prices in June 1981, with a loss of $1 billion in exports, was enough to start a huge speculative attack against the peso. With the access to the international capital markets unrestricted, the government increased markedly the pace of borrowing. As traditional sources of loans were unable to provide enough to satisfy the increasing financial needs of the government, huge indebtedness was incurred in short-term loans, that were simple to access, with fast disbursements and minimal documentation (Gurria, 1988, p. 77). A peso devaluation was avoided until mid-February 1982, but only at a cost of massive capital flight, financed through an equally massive borrowing (see Figure 1).

By early 1982 commercial banks, and financial authorities of developed countries, were beginning to realize that serious potential problems were faced by Mexico in the external debt front. The turning point would turn out to be a loan signed on June 30, 1982. Ironically, at $2.5 billion, it was the biggest loan ever received by Mexico until then. Practically after it was signed, the financial well went dry. Less than two months later the Mexican government had no option but to announce a default on payments of principal (while continuing to pay interest) and request banks to negotiate in order to reschedule payments. The government also started negotiations with the IMF in order to obtain financial assistance. Many countries, mostly in Latin America, were to trail a similar path. It would become known as the International Debt Crisis.

President Miguel de la Madrid took office in December 1982. This time there was no oil, or any other, winning card. On the contrary, the accumulated debt was to prove a financial albatross as international interest rates were, and would remain for years, at extremely high levels in real terms, in addition to three-digit inflation and a skyrocketing

[4]That loan was also for Pemex; it was signed in September 1979.

fiscal deficit. Efforts to bring that deficit, and inflation, under control were thwarted by a massive earthquake in September 1985 and the plunge in oil prices the following year.

In December 1987 a radically different stabilization attempt was launched. The Economic Solidarity Pact not only contained all the traditional elements of any orthodox program, including a tough fiscal adjustment, but also selective price freezes to breakdown inertial inflation. By any standard, the program was tremendously successful. Between February 1988 and February 1989, 12-month inflation collapsed from levels of 180 percent to around 20 percent. The fiscal deficit was also brought under control.

Practically simultaneously, particularly during 1988-89, there was an international shift in the balance of international opinion in favour of highly-indebted countries (HICs) and away from commercial banks. The overwhelming priority of protecting the banks from taking massive losses in their loans to HICs, to avoid a collapse of the international financial system, moved under the consideration that several HICs (such as Mexico) had undergone tough adjustments.

Not only the widespread perception was that it was time for the lenders to have their share of sacrifice, but also the theoretical debate on the debt crisis had changed radically (Cline, 1995, Chapter 4). By the late 1980s, the dominant subject of the debt literature was debt forgiveness. Debt reduction became an official international economic policy as it was officially sponsored by the United States, with the announcement of what would be known as the Brady Plan, in March 1989. Under the Brady guidelines, Mexico reached an agreement with commercial banks to reduce its debts in July. The most publicized accord was a reduction of 35% on the debt. As important as debt reduction was the fact that the debt was swapped for 30-year zero coupon bonds (with their principal guaranteed by U.S. Treasury bonds). Thus the payment of principal to the banks in the short and medium terms was considerably reduced.

A few weeks earlier, Mexico had re-entered the international capital markets: on June 16, Bancomext (the Mexican Eximbank) issued $100 million in bonds (Gurria, 1993, p. 170). As in 1977, that loan just marked the beginning of a renewed flow of lending to Mexico.

c) *A short and much-noticed debt crisis: 1994-95*

The December 1994 crisis came as a profound shock because of the economic record that Mexico had registered in recent years. The administration of president Carlos Salinas (1988-94) had been widely praised for its economic management. Privatization slimmed down a bloated public sector and deregulation efforts were successful in many sectors previously untouched by competition. The fiscal deficit actually became a surplus after 1991, even without taking into account one-off privatization revenues. But undoubtedly the enactment of the North American Free Trade Agreement on January 1, 1994 was for many the jewel of the crown. It is not surprising that the crisis that followed left many bewildered not only by its advent, but by its ferocity.

However, yet again the government had tried to keep the exchange rate practically fixed (it floated within a narrow band established in 1991). International reserves reached historical highs during the first quarter of 1994 (nearly $30 billion dollars). However, several economic and political shocks jolted confidence. The U.S. Federal Reserve increased interest rates in February, reducing the attractiveness of emerging markets such as Mexico. Moreover, the Bank of Mexico had to massively sold dollars to keep the peso within the exchange rate band after the presidential candidate of the ruling party, practically assured of winning the August election, was murdered in March.

Uncertainty was unleashed, and the fresh memories of the 1976 and 1982 crises (that had erupted during the last of the six-year presidential period) added fuel to it. Yet again, the greenback became a refuge. Reserves were drained during the following months. The government tried to stop money invested in domestic, peso-denominated Treasury bonds (Cetes) from leaving the country by offering instead dollar-denominated bonds (Tesobonos). The biggest swap of domestic peso debt for dollar-debt in Mexican history took place (see Figure 1). However, Tesobonos were short-term bonds; practically the whole of the Tesobono debt issued in 1994 was due during 1995.

The swap only postponed the devaluation. Just three weeks after taking office as President, Ernesto Zedillo first devalued (December 20) and then floated (December 22) the peso, which next sank. The capital markets fretted with the economic turmoil that followed, as no economic adjustment was announced to accompany the devaluation. Moreover, the Finance minister resigned on December 29, after just four weeks in the post. Fret turned to panic when it became known that the Tesobono debt stood at $29.2 billion dollars, and that practically the whole amount would need to be paid during the following year.

Creditworthiness vanished overnight and uncertainty rapidly spread around the world, hitting hard other emerging economies. It became known as the “Tequila effect”.

An orthodox economic stabilization program was announced on January 2, 1995. An assistance package from developed countries, mainly the U.S., for $27 billion dollars was presented in-tandem (and a swap facility between the Bank of Mexico and the Federal Reserve increased to $9 billion). The amount was seen as insufficient by the markets, and financial meltdown continued. The U.S. government then proposed, on January 11, a package of loan guarantees of $40 billion. After quick negotiations, it was announced that the Mexican government had requested an 18-monlh stand-by arrangement from the IMF, for a total of $7.8 billion.

The loan guarantees proposal became rapidly unpopular among members of Congress. After a few weeks it became clear that it would founder if voted on. Therefore, on January 31, the U.S. government announced a financial rescue package of approximately $50 billion composed loans from the United States ($20 billion in loans and loan guarantees through the Treasury’s Exchange Stabilization Fund), the IMF ($17.8 billion instead of $7.8 billion), the Bank for International Settlements ($10 billion), Canada (C$1 billion), and a group of Latin American countries ($1 billion). The package finally stopped the peso's free fall. The terms of the agreement with the U.S. were formalized on February 21, and a new economic program announced on March 9. The latter had much more realistic macroeconomic targets than its January predecessor.

Such financial support, a credible economic program, *and* public finances that were in surplus allowed confidence to come back. Mexico returned to the international capitalmarkets atthe beginning of May, after just five months of isolation.

MEXICAN LESSONS FOR THE EURO AREA PERIPHERY

Mexico has several lessons to offer to the Euro Area periphery. It is significant to point out that Greece, the country that started the sovereign debt crisis in the region (with others like Spain or Portugal suffering from contagion), followed the Mexican path of markedly accelerating its debt accumulation before the crisis erupted. When George Papandreou took office in October 2009, he was shocked to discover that the previous government had greatly understated the deficit estimate. The capital markets certainly were shocked when he went public with the fact, moreover as the projected fiscal gap kept growing as time went by. The initial forecast for the year was 3.7% of GDP, but the real figure reached nearly four times that level.[5]

Greece lacked the fiscal credibility to convince the markets that it would amend its ways speedily, it already had a quite high debt level (127.1% of GDP in 2009), and its debt lacked the status of safe haven that, notably, that issued by the U.S. government can boast. Unsurprisingly, the credit markets closed. Suffering from a contagion effect, several countries in the Euro Area periphery would follow.

a) Lesson 1 (obvious): Regain fiscal sustainability

The first lesson that Mexico has for Euro Area countries facing a debt crisis is obvious, but that does not make it less relevant: to greatly lower fiscal needs, so borrowing requirements also fall. That is vital if potential lenders are to be convinced *today* that the debt cycle will be sustainable, thus creating firm expectations that there will be lenders *tomorrow* willing to open their wallets (providing money to pay for the debt issued today).

However, according to IMF (2012, p. 8) estimates:

> Greece achieved a cumulative improvement in the primary balance of 8¼ percentage points of GDP between 2009 and 2011 (…). Still, the primary deficit achieved in 2011—2½ percent of GDP—fell short of the initial program target for 2011 by some 1½ percent of GDP. It remains well below the long-run debt stabilizing level of a 1½ percent of GDP primary surplus.[6]

[5]The Greek government had forecasted in February 2009 that the deficit for the whole year would reach 3.7% of GDP. Papandreou initially estimated, in October, that the real figure would be above 10%. A month later it had been increased to 12.7%. It officially closed at 15.5% of GDP.

[6]Moreover, in the specific case of Greece, Blanchard (2012) considers that the reduction of the current account deficit as, or even more, important than the reduction of the fiscal deficit.

Greece's peers in the debt crisis arena probably have less of a fiscal effort in front of them, but it will still be substantial and painful.

b) Lesson 2 (not so obvious): A positive (game changer) shock

The second lesson from Mexico is more subtle. Even if the fiscal situation is fully corrected, potential lenders not only need to be convinced that it is, but also certain that other lenders share that conviction. Lenders move in herds and, moreover, need the security of one to move into uncharted territory –as arguably is a country that had been ostracized by the capital markets for some time.

That is, a radical change in expectations is also required. In the case of the Mexican crisis of 1976-77, it was triggered by oil. A brief letter from a respected firm of geologists proved to be a game changer. The stabilization program, with the IMF's imprimatur, undoubtedly was also relevant, but oil was the magic wand that, at a stroke, turned around expectations. In 1989 and 1995 the fiscal strength was already there, but the Brady Plan negotiations and the massive rescue headed by the U.S. government and the IMF, respectively, also radically altered the sentiment of potential lenders.

Was arguably the Greek debt "haircut" implemented on March 9, 2012, the largest ever negotiated write-down of sovereign debt, a shock with the potential of jolting potential lenders into buying Greek debt again? That is, the equivalent of the Brady Plan for Mexico (and other Latin American countries)? As Ortiz (2011) stresses, the write-down was not intended that way, but to help Greece in its fiscal consolidation efforts.

What could be the event that will represent a positive shock, the game changer? It is futile to try to guess. Moreover, Greece has still has a long (fiscal) way to go before reaching the point where it will require that shock. It is more plausible that other Euro Area members, such as Italy or Spain, will get to that point first. Relevant parties such as the European Central Bank, the European Commission, and the IMF (the so-called "Troika") should ideally be prepared whenever that happens in order to help further that country with a final push (the positive game changer), for a successful re-entry into the capital markets.

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