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FM MEXICO CITY 241800Z DEC 82

TO ROUTINE FCO

TELEGRAM NUMBER 1084 OF 24 DECEMBER

INFO TREASURY, DOT, ECGD, BANK OF ENGLAND, UKDEL IMF/IBRD, WASHINGTON

MEETING WITH MEXICAN MINISTER OF COMMERCE.

1. ON 21 DECEMBER THE COMMUNITY AMBASSADORS ENTERTAINED HECTOR HERNANDEZ, THE NEW MEXICAN MINISTER OF COMMERCE, TO LUNCH, AND HAD A GENERAL DISCUSSION WITH HIM ABOUT THE CURRENT PROBLEMS OF THE MEXICAN ECONOMY.
2. HERNANDEZ EMPHASISED THE DEGREE TO WHICH THE MEXICAN ECONOMY WAS INTERTWINED WITH THAT OF THE UNITED STATES. THIS MEANT THAT MEXICO SUFFERED MORE THAN MOST COUNTRIES FROM THE MEASURES WHICH THE US ADMINISTRATION HAD TO TAKE TO MAINTAIN THE ROLE OF THE DOLLAR AS THE WORLD'S PRINCIPAL RESERVE CURRENCY. AT PRESENT MEXICO SUFFERED NOT ONLY FROM A SEVERE SHORTAGE OF DOLLARS BUT ALSO FROM AN UNEXPECTED OUTFLOW OF PESOS TO THE UNITED STATES. THIS HAD BEEN ONE OF THE RESULTS OF THE PREVIOUS EXCHANGE CONTROL SYSTEM. INDEED THE EFFECT OF THIS HAD BEEN TO PROVIDE ONLY SOME 20% OF THE IMPORTS NEEDED TO KEEP THE MEXICAN ECONOMY TURNING. HE HOPED THAT THE NEW SYSTEM WOULD GRADUALLY PUT THINGS RIGHT.
3. HERNANDEZ EMPHASISED THAT UNDER THE NEW EXCHANGE SYSTEM THERE WOULD BE NO GOVERNMENT SUBSIDY. DOLLARS EARNED BY EXPORTS AND DOLLARS USED FOR IMPORTS WOULD BOTH BE AT THE CONTROLLED RATE, WITH A NEGLIGIBLE DIFFERENCE BETWEEN BUYING AND SELLING RATES. THUS THE RISK OF THE AMERICANS IMPOSING COUNTERVAILING DUTIES HAD BEEN REMOVED. THE GOVERNMENT WOULD BE OBLIGED TO MAINTAIN ITS SEVERE RESTRICTIONS ON IMPORTS. IT COULD NOT AFFORD TO DO OTHERWISE. BUT IMPORTS OF AROUND US DOLLARS 15 BILLION WOULD STILL BE NECESSARY IN 1983. HE MENTIONED THAT SOME US DOLLARS 11 BILLION WOULD BE AVAILABLE FOR USE AT THE CONTROLLED RATE, AND SOME US DOLLARS 3 BILLION AT THE FREE MARKET RATE. HE FEARED THAT THERE WOULD BE A NEGATIVE GROWTH IN GNP IN 1983 BUT WAS SURE THAT THE ECONOMY WOULD RECOVER SOON AFTER.
4. THERE WAS A BRIEF DISCUSSION ABOUT THE POSSIBILITY OF EVENTUAL MEMBERSHIP OF GATT. HERNANDEZ SAID THAT IMMEDIATE ACCESSION WOULD INVOLVE MORE BANKRUPTCIES AND MORE UNEMPLOYMENT IN KEY SECTORS. IN THE LONGER TERM THE GOVERNMENT WOULD ATTEMPT TO REDUCE PROTECTION AND MAKE IT MORE SELECTIVE. HE IMPLIED THAT GATT MEMBERSHIP WAS A DISTINCT POSSIBILITY IN THE FUTURE.

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5. HERNANDEZ SAID THAT THE EUROPEAN COUNTRIES HAD GREATLY IMPROVED THEIR SHARE OF THE MEXICAN MARKET IN THE LAST FEW YEARS, AND HAD GENERALLY DONE PRETTY WELL OUT OF MEXICO. HE WELCOMED THE DEGREE OF DIVERSIFICATION WHICH THIS INVOLVED AND THE CORRESPONDING REDUCTION IN MEXICAN DEPENDENCE ON THE UNITED STATES. BUT IF THE EUROPEANS WISHED TO RETAIN THEIR MARKET SHARE AND SEE THEIR INVESTMENTS PROSPER, THEN THEY HAD TO COME TO THE HELP OF MEXICO IN HER HOUR OF NEED. I POINTED OUT THAT THE EUROPEAN RESPONSE TO MEXICO'S FINANCIAL DIFFICULTIES HAD BEEN EXEMPLARY. HERNANDEZ AGREED, AND PAID PARTICULAR TRIBUTE TO THE ROLE OF THE BANK OF ENGLAND AND THE BRITISH COMMERCIAL BANKS. THE HELP ALREADY GIVEN BY THE EUROPEANS IN AND OUT OF THE FINANCIAL PACKAGES WHICH HAD BEEN PUT TOGETHER WOULD NOT BE FORGOTTEN.

6. HERNANDEZ CONTINUED THAT THE EUROPEANS WOULD NEVERTHELESS HAVE TO THINK HARD ABOUT HOW THEY COULD MAINTAIN THEIR TRADE WITH MEXICO AT A TIME WHEN MEXICO WAS SUFFERING AN ACUTE SHORTAGE OF FOREIGN CURRENCY. PERHAPS UNORTHODOX TRADING METHODS WOULD BE REQUIRED. BY THIS HE DID NOT MEAN TO SAY THAT THE GOVERNMENT WAS CONTEMPLATING USING THE TRADING METHODS OF COMMUNIST COUNTRIES, BUT WE SHOULD LOOK AGAIN AT SYSTEMS OF COMPENSATORY TRADE, AND TRY TO GIVE MORE GENEROUS EXPORT CREDITS. I ASKED IF HE WOULD LIKE TO EXPAND FURTHER ON THIS POINT, BUT HE SAID HE WOULD PREFER TO REFLECT AND DISCUSS IT WITH US ON A FUTURE OCCASION.

7. MY DUTCH COLLEAGUE CHALLENGED HIM ON CURRENT USE OF THE PHRASE THAT THE STATE WAS THE RECTOR OF THE ECONOMY. WHAT DID THIS MEAN? HERNANDEZ SAID THAT EVERY COUNTRY HAD ITS OWN POLITICAL RHETORIC. MORE IMPORTANT FOR US WAS THE PRESIDENT'S PROPOSAL THAT THE CONCEPT OF THE MIXED ECONOMY SHOULD BE WRITTEN INTO THE MEXICAN CONSTITUTION.

8. WHEN ASKED ABOUT THE GOVERNMENT'S ATTITUDE TO FOREIGN INVESTMENT, HERNANDEZ SAID THAT THE GOVERNMENT NATURALLY WISHED TO ENCOURAGE IT, AND HAD ALREADY MADE SIGNALS TO THAT EFFECT. IT WOULD BE EXTREMELY DIFFICULT TO MODIFY THE EXISTING LAW. THIS WOULD ONLY STIR UP A POLITICAL HORNET'S NEST. BUT WAYS AND MEANS COULD BE FOUND TO INTERPRET THE LAW IN A FLEXIBLE WAY. THE GOVERNMENT WAS FULLY CONSCIOUS OF WHAT FOREIGN INVESTMENT COULD DO TO GENERATE JOBS AND INCREASE MEXICAN EXPORTS. THIS WOULD OF COURSE TAKE TIME, AND COULD ONLY FOLLOW RESTORATION OF CONFIDENCE. HERE HE EMPHASISED THE PRIORITY THE GOVERNMENT WOULD GIVE TO HELP SMALL ENTERPRISES PAY COMMERCIAL DEBTS CONTRACTED BEFORE 20 DECEMBER. WHEN IT WAS POINTED OUT THAT ONE OF THE WAYS OF GETTING ROUND THE FOREIGN INVESTMENT LAW HAD BEEN TO ENCOURAGE THE PRIVATE BANKS, NOW NATIONALISED, TO TAKE UP EQUITY IN JOINT ENTERPRISES, HERNANDEZ INDICATED THAT THE GOVERNMENT WOULD SOON BE REORGANISING THE NATIONALISED BANKS AND ALLOWING A PROPORTION OF THEIR EQUITY TO BE HELD BY THE PRIVATE SECTOR.

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9. HERNANDEZ MADE IT CLEAR THAT HE DID NOT FAVOUR THE IDEA OF CURRENCY REFORM. NOTHING THE MEXICANS COULD DO BY CHANGING THE NAME OF THEIR MONEY COULD AFFECT THE REALITIES OF MEXICAN INVOLVEMENT WITH THE UNITED STATES AND THE US DOLLAR.

10 HERNANDEZ SAID THAT THE GOVERNMENT'S POLICIES WERE BOTH ORTHODOX IN ECONOMIC TERMS AND TOUGH IN POLITICAL TERMS. HERE HE EXPRESSED HIS ADMIRATION FOR MRS THATCHER AND WHAT SHE HAD BEEN ABLE TO DO FOR THE BRITISH ECONOMY. BUT WHAT WAS POSSIBLE IN AN INDUSTRIAL COUNTRY WAS NOT NECESSARILY POSSIBLE IN MEXICO. MEXICANS WERE UNDISCIPLINED. MANY SUFFERED FROM DIRE POVERTY. A RIOT ELSEWHERE MIGHT LEAD TO THE BURNING OF A BUILDING OR TWO: BUT IN MEXICO ONCE VIOLENCE GOT OUT OF HAND IT WOULD BE DIFFICULT TO CONTROL. THE GOVERNMENT WAS DETERMINED TO DO WHAT IT BELIEVED WAS RIGHT. BUT IT NEEDED THE HELP, SYMPATHY AND UNDERSTANDING OF ITS FRIENDS.

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