Memorandum

Strictly confidential and not for circulation.

The conversations with the Government during the past months and since devaluation, and particularly the conversation which Mr. Draper and Mr. Maryssael had with Lic. Carrillo Flores last evening, indicate clearly that, while the Government has been ready to face up to the facts of the devaluation with respect to labor and other increased costs due to the devaluation, and adequately, it is not prepared to face up to the situation affecting the electricity companies. This is merely a repetition of previous attitudes of the Government over the years. For purely political reasons or for reasons which the Government for its own purposes considers political, it does not wish to face the electricity situation realistically.

When, almost immediately after the devaluation, the price of medicines into which foreign materials costs enter so materially, was adequately increased, this action of the Government simply was due to the fact that, aside from the few entirely or almost entirely foreign owned pharmaceutical companies in Mexico, there are scores of Mexican pharmaceutical companies and it was because Mexican interests, as well as "fundamental medicines for the public" were involved, that the increase was given so rapidly. This is just one example, but the record shows that practically every item entering into the cost of living, has been increased since devaluation, and in many cases more than proportionate to the increased material cost.

In short, adjustments have been made for practically everybody with the exception of the electricity industry and, I think, also the telephone company.

This simply points up to the fundamental situation which cannot be disregarded, either by the Company with respect to its programs and plans, or by the lending agencies for electricity or other purposes in Mexico or for private investment from abroad. At a time when the Mexican Government needs foreign capital as much, if not more than it has in its history, it is showing the same "political" attitude with regard to the tariffs of the electricity companies as it has continuously done in the past.

When the loans to the Federal Power Commission and to Mexlight were made, there were specific undertakings by the Mexican Government. The Government, among other things, specifically agreed that Mexlight was to be kept in a sound financial condition. There is probably no industry concerning which the Government is better informed so far as the financial aspects are concerned, than the electricity companies, and there is almost certainly no company in Mexico every phase of whose financial position is better known to the Government than that of Mexlight. The Government knows that for years Mexlight has been kept on the brink of impossibility of carrying through the obligations which it has and which it is willing to carry through and which the Government itself says it wants it to carry through. In conversations with the
Mexican Government the Company has from time to time used the expression that we are kept "up to our neck" continuously so far as our financial situation is concerned. Responsible officers in the Government have expressed themselves that the Company has done everything it could to meet its obligations and that it has not been "treated right". In spite of this recognition of the facts of the electricity situation and those concerning Mexlight, the conversation with Lic. Carrillo Flores last night would indicate that the Government is not yet prepared to face up to the facts. Financial, industrial and commercial circles are prepared for any increase in the tariffs of Mexlight which it is necessary to make in order to put the Company into a sound financial condition. If the action of the Government is not adequate, it will cause lack of confidence in the situation which so far is such that no one will go ahead with plans for new production or new plant capacity etc., until they know that they are going to get adequate power. By not attacking this problem adequately at this moment, the Government is going to further decreased confidence on the part of responsible elements in the Mexican economy who have to make the wheels go round. The idea that there should be one increase now and another later in the year is unsound from every point of view, and is so recognized by elements in the Government as well as by the spokesmen from industrial, financial and commercial circles. The increase which is necessary is considerable but it is not as considerable as others which have been put into effect without any difficulty or repercussions and without the Government raising any real objection.

The importance of electricity in the economic structure of the country is so well recognized that there is not any doubt that the responsible elements in the country are prepared to accept any increase which is necessary in Mexlight rates which will make it possible for the Company to function properly and adequately.

So far as the general public is concerned, the increase in the tariffs would affect it little or relatively little as compared to other price increases since devaluation, but so far as the public is concerned, if the Government will make a frank adequate and sufficiently complete statement as to the reasons for the increase in rates, it will be accepted practically without a murmur, even by the public, and so far as responsible elements are concerned on which the Government has to count in the matter of confidence and further initiative, it will be recognized as a move in the right direction and it will go as far to re-establish confidence in the whole economic situation as anything in which the Government can do. Failure to do so will decrease confidence and worsen the general situation. For psychological reasons the full increase should be given now and adequately.

There is at least reason to believe that the Government would find great difficulties in carrying through a second increase later in the year if it is done by steps. The Government may promise formally that it will do this, to the Company and to the lending agencies, but when the time comes to apply the second increase later in the year, its ground will be less firm and its capacity to explain less adequate and the "political" considerations which now determine in giving the full increase
will be even more difficult for them to overcome. The tax subsidy which is proposed to relieve the impact of the rates "temporarily" is unsound from the point of view of the industry, the Government and the public. The Company is unable to refuse it as a "temporary" measure, but this does not change the fact that it is unsound from the point of view of the Government and will greatly increase the difficulties of the Company, particularly with respect to financing, and by the same token it will increase the difficulties of the Government in doing financing abroad which it will definitely need and needs now. In my personal opinion the lending agencies to which the Government will look should refuse to agree to any Mexican exemption measure, even "temporarily", because it is unsound and weakens the whole position of the Government and the capacity to do financing for electricity and other purposes. Experience has shown, not only in Mexico, but in other countries as well, that measures considered as "temporary" inevitably become permanent. The same "political considerations" which impel the granting of a "temporary" tax subsidy, become permanent considerations. It means entering a path which will make the problems of the Company and of the Government far more difficult in the future, and those of the Company have been acute and difficult enough until now.

Even so far as the tariff increase is concerned, it would appear that - from the conversation with Lic. Carrillo Flores last night - that he is thinking only of a return which will give $ 0.25 a share on the common and $ 0.25 for reinvestment. This is an almost incredible position because the Government knows how desirable and necessary it is for the Company to do long-term borrowing and equity financing and has insisted that the Company do equity financing. It is unrealistic to endeavor to delude oneself that a $ 0.25 dividend and $ 0.25 a year for reinvestment open the way towards financing and particularly equity financing on which the Government has obliged the Company to commit itself and which the Company, because of good sound reasons, wishes to do.

The whole attitude of the Government at this moment with regard to the electricity situation is completely disillusioning in view of the full information it has concerning the industry, and particularly our Company, and of its own needs and of the necessity of providing adequate electricity as a basis for not only maintaining but expanding the economy. It is necessary to face the essential facts. The Government believes that, irrespective of what it does in this matter, it will be able to get foreign loans, some of which it is actually seeking today, and in connection with which new promises are being made. It is difficult to conceive that the Government or anyone else will believe that promises for obligations undertaken with regard to new loans will be adequately and promptly met when those with regard to loans already made, are not adequately met.

While personally no one wants to see Mexico to have new investments and credit more than I do, I think every actuation of mine since I came to Mexico in 1942 shows that deep conviction of mine - there are credits which the Government is now actively seeking and others which in my opinion it should have, but it
cannot expect to get them, and no one can give them, unless obligations undertaken with respect to credits already made are punctiliously met. In my opinion the Government must face up to this electricity situation and that of Mexlight adequately and promptly now, or else it must make up its mind to a deterioration of its credit and the impossibility to secure the external loans and credits and investment which it so much needs. Any lack of firmness on the part of the lending agencies will tend inevitably to deteriorate their own lending capacity in the future and their own borrowing capacity for lending purposes, and any lack of firmness is bound to affect the position of the Company to the degree that it will have to give serious consideration as to what it can do in the future.

This is a very inadequate memorandum and hurriedly dictated, but it is prompted by the thought that it is a moment of crisis for the Company as well as for the Government and that at this time both the Government and the Company have to bear in mind the repercussions of the decisions which may be taken in the immediate future by the Government. This may influence definitely the whole economic development of the country and its credits as well as the possibility of the Company to continue as fully as in the past, a long career of usefulness.

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