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CARFAX

Mexican meltdown: states, markets and post-NAFTA financial turmoil

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The devaluation of the Mexican peso in December 1994 triggered a financial panic that required massive intervention by the US government and the International Monetary Fund (IMF) in an effort to prevent a full-scale financial collapse. By the end of January 1995, President Bill Clinton had cobbled together a package of loan guarantees in excess of $50 billion—the largest socialisation of market risk in the history of international finance.[1] Massive state intervention was required to support Mexico in the first year of the North American Free Trade Agreement (NAFTA), the centrepiece of market-led integration in the Western Hemisphere. The paradox recalls Karl Polanyi's celebrated phrase: 'laissez-faire was planned'.[2]

The financial meltdown stimulated a debate over the free market model of development promoted by Washington.[3] Mexico, recently considered the paradigm for countries undergoing market reforms, had again become a pariah. Perhaps, mused some, nation-states have lost too much power and autonomy in this era of global financial deregulation.[4] Of course, the battle between states and markets has been a popular topic for centuries. Whether couched in terms of the role of money lenders to kings, the impact of the Industrial Revolution on labour, the role of international banks, or the pressures of international currency speculators on governments, the question of whether states have lost control has been a central focus in the field of political economy. Despite repeated obituaries for the state, however, nation-states have continued to reassert control. Even the liberal *Economist* recently had a cover story entitled 'The myth of the powerless state'.[5]

Analysts have investigated the relationship between states and markets using variants of three classical theoretical schools: liberalism, structuralism and mercantilism. Each of these approaches has much to say about the types of actors that play a key role in the international political economy, their motivations, and optimal strategies for coping with interdependence in the world economy. What would these schools tell us about the role of financial intermediaries such as mutual funds and investment bankers with respect to the Mexican peso crisis of December 1994? To answer this and related questions, we examine the impact, causes and policy implications of the peso crisis, as well as the reasons for the US-led bail-out package. We then consider the crisis in the light of classical schools of political economy.

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Dimensions of the peso crisis

The impact

Although the overvaluation of the peso was discussed during much of President Carlos Salinas de Gortari's term (1988–1994), the crisis came as a surprise to most policy makers and observers.[6] As Jorge Castañeda noted, 'not even the most acerbic critics of the previous regime and political system could have imagined a nightmare like the one the nation is now living'.[7] Although it is impossible to calculate the exact overall costs of the devaluation, it is easy to get a rough sense of the magnitude of the crisis.

Within a couple of weeks of the peso's collapse, multibillion dollar losses were recorded by foreign investors. Examples of major losers included Merrill Lynch, Fidelity Latin America and Scudder. Canadian investors, such as CI Latin American Fund, the Reichman real estate corporation, Labatt and the Bank of Nova Scotia were also hurt. Mexican firms took an even greater pounding, especially the telephone (TELMEX), cement (CEMEX), and television (TELEVISA) monopolies, as well as other powerful conglomerates like the Monterrey-based Alfa group.[8] US and Canadian investors were forced to defer plans for further projects, while others took losses and fled the market. Retailers were among the hardest hit by plummeting consumer demand; firms like Wal-Mart and Price Club postponed plans for further expansion. Sales of everything from automobiles to kitchen appliances dropped by as much as 50% because of lower incomes and the rising price of consumer credit.

The greatest losses were experienced by ordinary Mexicans. The devaluation, combined with adjustment measures adopted in March 1995, led to a 6.9% contraction in the economy by year end. Over a million Mexicans were left unemployed as a wave of bankruptcies spread across the economy, driving many businesses into the informal sector. With inflation at 52%, and wage settlements kept to a minimum, real earnings were estimated to have fallen by as much as 12% in 1995.[9] As incomes and consumption fell, soaring interest rates placed an additional squeeze on Mexicans with credit card debt, mortgages or bank loans. More than one in every four Mexican borrowers fell seriously delinquent in their debt payments.

Causes of the crisis

The Mexican meltdown prompted a variety of explanations. Central bankers raised questions about the appropriateness of Mexico's exchange rate regime. The peso had been allowed to depreciate gradually within a predetermined band. As Mexico's current account deficit grew, and its foreign reserves dwindled, financial markets lost confidence in the peso. This led to speculation which forced the government to let the peso float. In this view, the underlying problem was the lack of credibility of the exchange rate mechanism. Had Mexico floated the peso earlier in 1994, or perhaps in 1992, the crisis might have been averted.[10]

Others suggested that Salinas relied too heavily on foreign savings to finance growth. Before 1994, 80% of capital flows into Mexico were in the form of portfolio investment—the acquisition of existing assets on the stock market. In

1994, as mutual fund managers and other institutional investors began to detect signs of an impending crisis, that share declined to 50%. Nevertheless, the amount of portfolio investment in Mexico was a far greater share of total capital inflows than in any other country in Latin America, and much of it was encouraged by the prospect that NAFTA would enable Mexico to join the First World.

Between 1984 and 1994 Mexico absorbed more than $94 billion in capital inflows. Meanwhile, domestic savings declined from 22% to 16% of the gross domestic product (GDP) between 1988 and 1994.[11] Worse still, the Mexican economy was virtually stagnant. GDP declined from 4.5% in 1990, to 3.6% in 1992, to 2.8% in 1992, to 0.4% in 1993. Powerful recessionary pressures had begun to manifest themselves during 1993, when per capita income fell for the first time since 1988.[12]

By 1994 Mexico had few options. As US interest rates rose, Mexico found it harder to attract foreign capital. One solution would have been tighter monetary policies to cut imports and improve Mexico's current account balance. However, as Jaime Ros notes, this option would probably have led to a crisis in the banking sector and a recession similar to that of 1995, with one difference: the exchange rate would have remained overvalued.[13]

The other solution would have been to devalue the peso. However, this option was ruled out because of the desire to retain credibility and confidence among investors, especially foreign investors. Thus, when major institutional investors like Fidelity Latin America began to refuse to buy peso-denominated Federal Treasury Certificates, or Cetes, Mexico relied on dollar-denominated Treasury Bonds (Tesobonos), and less on Cetes. This turned out to be a crucial policy error.

The over-reliance on Tesobonos increased the risk that the government shouldered relative to foreign investors in its effort to maintain Mexico's attractiveness as a place to invest. Whereas the value of Cetes issued by Mexico decreased from $26.1 billion in 1993 to $7.5 billion in 1994, the value of Tesobonos increased from $1.2 billion in 1993 to 17.8 billion in 1994.[14] The combination of growing Tesobono obligations and declining international reserves was a major cause of the loss of investor confidence.

The decline of hard currency reserves in the Bank of Mexico was closely linked to the sequence of political and economic shocks that culminated in the devaluation. On 1 January 1994 the Bank of Mexico held nearly $25 billion in reserves. The uprising in Chiapas on that day did not force the Bank to intervene in the market; in fact, Mexico's reserves grew to nearly $30 billion in February. However, the Bank intervened repeatedly in the month following the 23 March assassination of Colosio, leaving Mexico with just $17.5 billion by the end of April. After that, there was little central bank intervention in the market until after the August elections. However, a new round of attacks on the peso occurred in mid-November, following renewed infighting within the ruling Partido Revolucionario Institucional (PRI) over the investigation into the assassination of its Secretary General, José Francisco Ruiz Massieu. This lowered Mexican reserves from $17 billion at the beginning of November, to $12.5 billion at the end of that month. The most devastating attack on the peso occurred on 21 December, when

the central bank spent $4.5 billion in a single day in a futile defence of the peso.[15]

The role of policy error

The deftness with which the attack on the peso in March 1994 was managed contrasts with bungling and incompetence in December later that year. By comparing how these two crises were handled, it is possible to get a sense of the importance of policy error in the peso crisis. It should be remembered, nonetheless, that Mexico experienced considerable capital flight following the assassination, and the expected increase in capital inflows following the presidential election in August failed to materialise. The December attack on the peso was the last in a series of political and economic crises during 1994, and it came at an especially vulnerable moment in the transition from the Salinas to the Ernesto Zedillo government.

In March 1994, when presidential candidate Luis Donaldo Colosio was shot on the hustings in Tijuana, a major financial crisis was averted by timely and effective policy management. The crisis was managed by officials from Hacienda (the finance ministry), in particular José Angel Gurria. Gurria was an experienced negotiator who had participated in Mexico's debt negotiations, as well as in the financial services negotiations in the NAFTA. In March 1994 he was the head of Nacional Financiera, one of Mexico's powerful development banks.

In an effort to head off a speculative attack, officials at Hacienda activated (but did not actually use) a $6 billion swap facility that had been negotiated between Hacienda and the US Treasury (the leading Mexican official responsible was Guillermo Ortiz, later to become Secretary of Hacienda). Although negotiated 'secretly' around the time of the debate between US Vice President Al Gore and NAFTA-critic H Ross Perot, the swap facility had been known to insiders for months.

To gain time in order to get approval from the US government to activate this fund, Mexican officials, with the authorisation of the President, decided to shut down the Mexican stock market (or Bolsa de Valores) for a day. Ortiz called Lawrence Summers, Undersecretary for International Affairs at the US Treasury, who activated the Exchange Swap Fund. Then the Mexican finance officials 'began trying to win back investor confidence by calling everyone they could think of around the world from traders to chief executives'. 'The performance was magnificent', according to one portfolio manager. 'Almost every investment bank and every investor in the US was on the phones from 8 to 9 in the morning and had it all laid out for them by the Mexicans.'[16] Salinas also played a key role: he met business and labour leaders to re-sign the corporatist 'pacto económico'.

The management of the crisis caused by the assassination of Colosio demonstrated how growing economic integration required the construction and maintenance of increasingly complex domestic and international coalitions. However, it did not address the balance of payments problems, which continued to grow. In particular, it did not reduce the government's imprudent reliance on foreign savings. The growing strength of foreign investors was demonstrated in the

aftermath of the Colosio assassination, when a group of mutual funds sent the Mexican government a list of suggestions to bolster the currency. According to the *Wall Street Journal*, 'To lend weight to their advice, the funds said they were willing to pour an additional $17 billion into Mexico this year if the government enacted reforms'.[17]

Eight months after the assassination of Colosio, the final assault on the peso began. On 20 November 1994, President-elect Ernesto Zedillo met with President Salinas in the presence of the Secretary of Hacienda, Pedro Aspe. With the transfer of government less than two weeks away, the assembled officials planned their response to the latest round of capital flight. Aspe opposed devaluing the peso, in spite of declining reserves, and Zedillo and Salinas agreed.[18] Aspe's main concern was that a devaluation would lead to a loss of credibility and confidence in the markets, and he argued that it would have to be accompanied by a host of complementary policies that an outgoing government could not announce at the very end of its mandate.

Once in office, Zedillo appeared to ignore the growing clamour over the current account deficit. When the new Secretary of Hacienda, Jaime Serra, publicly outlined his 'Economic Criteria for 1995' on 8 December he announced neither adjustment measures to reduce the deficit nor modification of the exchange rate regime. For this reason his speech, prepared in consultation with members of the outgoing administration (including Aspe, Salinas, and Ortiz), was judged by business analysts to be insufficient. Luis Germán Carcoba of the Business Coordinating Council called for a meeting with Serra, which was scheduled for mid-December. Although capital flight had already begun and the peso had risen to the top of the band (3.46 pesos to the dollar), Serra remained optimistic.

After his speech, Serra gave an interview to the *Wall Street Journal* in which he denied the possibility of a devaluation. The following Monday the peso broke through the official band and the stock market fell by 4%. In the evening an emergency meeting was held between Serra, Miguel Mancera (of the Bank of Mexico) and members of Mexico's business elite. Although it was agreed to widen the band rather than let the peso float, comments by Mancera hinted that Mexico did not have the reserves to defend the peso against another serious attack. The meeting gave the bankers the opportunity to buy dollars before Serra's announcement of the devaluation, and billions of dollars fled the country in a matter of hours. 'It's the first time in history that a devaluation was consulted on', commented former finance official Jesús Silva Herzog.[19]

Assembling a rescue package for Mexico

It might be argued that the Mexican financial crisis threatened the stability of the global economy, especially emerging markets. However, the threat of a generalised systemic collapse was less significant than during the debt crisis of 1982. In spite of this, a far more costly bail-out of the Mexican economy was engineered by the international financial community, led by the USA. The reason lies in the crucial importance of Mexico to the USA in the context of NAFTA, and the extent to which US business interests were affected by the devaluation.[20]

The bail-out revealed cracks in the international financial system: six European members of the IMF—Britain, Germany, Denmark, the Netherlands, Belgium and Switzerland—abstained on the vote to provide $17 billion in loans to Mexico. They said the plan was pushed through too hastily (documents were received only an hour before the meeting to vote on the package), and without regard for the IMF's other obligations or problems of moral hazard.[21] US officials noted that the speed of the markets had outstripped the ability of bureaucratic agencies like the IMF to respond.

The emergency bail-out, combined with Mexico's domestic adjustment measures, only addressed part of the problem. Under the terms of the bail-out package assembled by the USA, Mexico received $20 billion in loans with up to 10-year maturities through the Treasury's Exchange Stabilization Fund. The Federal Reserve agreed to provide short-term bridge financing of up to $6 billion. The other industrialised nations would provide an additional $10 billion in credit through the Bank for International Settlements (BIS).

President Clinton's pressure on the BIS to contribute to the Mexican bail-out was not openly resisted, but the enthusiasm of European central bankers was minimal. The International Monetary Fund extended $17.8 billion in credit; $7.8 billion (300% of Mexico's IMF quota) were made immediately available. The remaining $10 billion were set aside to be provided to the extent that the government central banks in the BIS fell short of their $10 billion target. Overall, the IMF provided 688% of the quota for which Mexico was eligible, the largest financing package ever approved by the Fund.[22] In fact, the total bail-out package included money that was far from secure. Most of the real, hard money came from the USA, which therefore set the lending conditions. It is unlikely that any further money could come from outside the NAFTA partners.[23]

Clinton's bail-out was unpopular domestically and could not pass opposition in Congress, where some representatives wondered why similar steps were not taken to bail-out Orange County or US workers in distress. The measure had to be taken using executive powers to spend through the exchange stabilisation funds of the US Treasury, and by strong-arming the IMF. Clinton was able to achieve this by linking the crisis to US security and leadership in the global economy.

The bail-out package imposed strict conditionality measures on monetary and fiscal policy and foreign borrowing. Loan guarantees were backed by oil revenues held as collateral by the Federal Reserve Bank of New York. Mexico has to buy back the pesos it had exchanged for dollars with the USA at 2.25% or more over Treasury bill rates of varying maturities.[24] The terms included the unusual accounting practice that every withdrawal of funds had to be approved in advance by the US Treasury, which oversees how all the money is spent. The Mexican government also set up a fund, backed by the World Bank, to ensure that local banks met the minimum capitalisation levels required by regulators—again, a form of socialised risk.

Although it is still too early to assess the success or failure of the bail-out package, by mid-1996 a number of indicators provided room for modest optimism. By January 1996 Mexico had paid off its outstanding Tesobono obligations, and the bail-out allowed the central bank to stabilise reserves at

around $15 billion. Mexico began to borrow in private financial markets within months of the crisis; indeed, development banks were borrowing as early as mid-1995. The government then issued floating-rate notes in an effort to finance advance payment of $4.7 billion owed to the USA under the bail-out package, which, in turn, had been used to cancel the Tesobono debt. As a result of rolling-over these debts, Mexico was able to reduce its short-term obligations and financing costs. By mid-1996 interest rates on Cetes declined to between 25% and 30%, the lowest levels since the crisis began.

Most importantly, 7.2% economic growth in the second quarter of 1996 was unexpectedly high, and was driven largely by manufacturing industry. The stabilisation of the peso at around 7.5 pesos to the dollar from the end of December 1995 until the second quarter of 1996 helped account for this growth. A more competitive exchange rate encouraged the growth of manufacturing exports, a development that promised the creation of new jobs.[25]

Perspectives on the peso crisis

Three classical schools of international political economy suggest different lessons to be drawn from the peso crisis. What would each have to say about the attempts by financial intermediaries such as mutual funds and investment bankers to influence Mexican policy? What explains the US government bailout of Mexico? What regulatory mechanisms are necessary to cope with future Mexican-type crises?

Liberalism

In a purely liberal system, interdependence yields economic benefits for all actors involved. Among liberals, however, there are variants with different stripes. When faced with possible problems of externalities and public goods in the international system, purely classical liberals often find some way of privatising the goods involved or allowing some type of bargaining among actors to internalise externalities. Barring such 'market solutions', however, others of a liberal stripe have suggested solutions including international organisations, integration, or international regimes as mechanisms for coping with potential problems in the operation of the international economic system. Many labels have been attached to the proponents of such mechanisms, with 'neoliberal institutionalists' being preferred for those who favour the development of international regimes.[26] While placing those who would propose economic integration with proponents of privatisation as a solution to possible problems generated by the global economy in the category of 'liberal' seems fallacious, the tie that binds these diverse groups is a conviction that an open world economy provides the maximum benefits to actors in the system.

Pure liberals were opposed to the bail-out because it sent the wrong signal to private markets and developing countries. The irony of offering public money to promote what was supposed to be a market-based 'miracle' was not lost on Wall Street. As the *Wall Street Journal* noted:

> Mr Camdessus argues that the intervention has been required to underpin the credibility of the market-oriented approach to development. What it does is undermine it. It does so by substituting official for private capital, by offering implicit insurance to private capital flows, by making unsound private finance more probable and, most important, by indicating a lack of confidence in the self correcting capacity of financial markets.[27]

Liberals worried that the peso bail-out created a problem of moral hazard that might discourage responsible fiscal management in other countries like Russia.

Some liberals believed that the Mexican crisis was caused not by excessive influence by foreign capital, pointing out that 'Mexican, not foreign, investors triggered the initial outflow of capital in November and early December 1994'.[28] Rather, the crisis was caused by Mexican policy errors, especially the inconsistency between exchange rate and monetary policy. However, neither foreign investors nor US policy makers detected these errors or considered them serious enough in 1994 to anticipate the looming crisis.[29] There was no consensus on the need to devalue the currency in policy-making circles, and explicit hostility to the idea on Wall Street.

For neoliberal institutionalists, the solution to problems of market failure and lack of policy coordination is to strengthen regimes. A major purpose of regimes is to ensure that both costs and benefits are distributed in such a way as to ensure the stability of international economic interactions. In this view, the peso crisis suggested the need for an expanded role for the IMF, and better coordination of policy between the USA and its NAFTA partners. Yet it is striking that the USA directly imposed the terms of the bail-out on Mexico rather than the more conventional practice of using the IMF to negotiate a conditionality agreement. As a result, the USA was drawn deeply into Mexican domestic policy making in ways that suggested a loss of sovereignty comparable to US–Mexican relations from an earlier historical epoch.[30]

Mercantilism

The descendants of mercantilist thinking are much less sanguine about the benefits of the global economy. Analysts in this camp give pride of place to states and their competitive and security concerns. They worry that excessive interdependence will lead to conflict, and propose more limited interaction among states, possibly through regional blocs or other arrangements, as a solution to achieving competitiveness and, preferably, a trade surplus. For these observers, states must either maintain control of their interactions with the international economy or face domestic political and economic disruption. The East Asian newly industrialising countries (NICs) provide examples of neomercantilistic states that have promoted their own export competitiveness while protecting the domestic economy.

If the December 1994 devaluation demonstrated the vulnerability of small nation-states that rely heavily on foreign savings, then the January 1995 bail-out demonstrated the power of the larger players in the global economy to act in response to perceived threats to the national interest. It also demonstrated that one of the primary benefits of the NAFTA for Mexico was the greater commitment

of the USA to ensuring the success of the North American integration process. It is unlikely that the USA would have acted as vigorously in defence of any non-NAFTA partner.

In defence of the bail-out, US officials emphasised less the liberal value of free markets and more the mercantilistic fear that a Mexican collapse would threaten US interests.[31] Yet few mercantilists would be pleased with the results of the peso crisis. In addition to the direct cost of assistance to Mexico, the USA is indirectly subsidising the recovery of the Mexican economy by allowing Mexico to reverse its trade deficit with the USA.

In Mexico, the crisis provided a pointed reminder that the debate on development models is not over. Mexico in the 1990s pursued a development strategy that contrasted sharply with the neomercantilist strategy of the East Asian NICs. The East Asian NICs achieved extraordinarily high rates of domestic savings and investment, relied relatively little on foreign investment, guided markets (including financial markets), provided subsidised, directed credit to targeted sectors, protected agriculture, ensured a relatively equitable distribution of the benefits of growth, and developed close ties between the public and private sectors without losing state autonomy.[32] Mexico negotiated liberalisation of trade and investment, reformed intellectual property legislation, privatised state-owned enterprises, reprivatised its banks, and sought to attract foreign capital as the cornerstone of its economic programme.

Critics were quick to link the peso crisis to the free market model's 'complete irrelevance to a country like Mexico', and it is possible that the crisis will encourage a new look at the East Asian model. Castañeda argued that Mexican policy makers should not have sought to solve the problem of debt by 'attracting resources by other means and leaving the deficit to the market's free play', but rather should have attempted to 'straighten out the trade account by reversing liberalisation, allowing the currency to slide more quickly, and adopting a policy to promote exports through subsidies, selective protection, incentives, identification of market niches, and so on—in a nutshell, a long-term, Asian-style policy'.[33]

Structuralism

Structuralists emphasise the social costs of adjustment and conditionality, and are sceptical of the ability of the laissez-faire approach to address underlying distributional problems or induce shared and sustainable development. NAFTA, in this view, represents an effort to engineer Mexico's entry into the North American market on an unequal footing with the USA, providing the USA with a low-wage region for the reduction of the costs of transnational firms and the articulation of these firms with domestic capitalist conglomerates in Mexico. The bail-out was driven by a concern to protect the returns of these foreign and domestic investors and restore confidence in Mexico; to safeguard the stability of an inequitable international economic order; to guarantee the continuation of the process of hemispheric integration based on competition for foreign capital; and to assure the stability of the Mexican political system and the restructuring of its economy in line with the interests of Washington.

Structuralists call attention to the role of transnational class alliances in shaping policy. The Mexican state worked in alliance with the World Bank and private capital in Mexico to impose the terms of a restructuring of non-performing domestic debts. A debtors' cartel was formed in 1993, called the Barzón, whose members refused to pay the banks, or paid only part of their debts and placed the rest in escrow accounts. Some of the debtors argued that plans proposed by the banks and government represented mechanisms to enforce compliance with illegal debts that were negotiated without the participation of the debtors, and they proposed a restructuring of debt that would place most of the burden on the banks and the government, while providing substantial relief to farmers and other producers. They disputed the total amount of debt, refusing to accept bank practices like charging penalties on late payments, and then adding the penalties to the principal and charging interest on both.

Structuralists emphasised links between the financial and political crises in Mexico.[34] The rebellion in Chiapas by the Zapatista Army for National Liberation represented the kind of revolutionary political response to the crisis that would be anticipated by structuralists. The rebellion sought to mobilise land-hungry peasants in an alliance with other popular organisations (including opposition political parties and civic groups) in an anti-imperialist and nationalist movement against market reforms, including the reform of the traditional land tenure (*ejido*) system.

Above all, structuralists would point to the growing gap between rich and poor under the Salinas administration,[35] and note that the measures implemented by Zedillo were likely to further increase inequality. The crisis depressed real wages, and the adjustment measures adopted in March 1995 included an increased reliance on regressive taxes and cuts in social spending. Furthermore, high interest rates placed a squeeze on the middle class, and forced small businesses into bankruptcy. Finally, as the rebellion in Chiapas indicates, the free trade model is likely to exacerbate regional disparities.

Conclusion

Deregulated financial flows can destabilise regional economies in the process of integration. A number of domestic policy errors and external shocks contributed to the crisis of confidence that led to the collapse of the peso, but the most important mistake was excessive reliance on highly liquid sources of foreign savings to finance long-term development. Mexico made itself vulnerable to external shocks by pinning its economic strategy on the signalling effect of NAFTA and other market reforms on foreign investors. A case can be made that foreign investment stimulates development, but excessive reliance on portfolio capital—to the point that key economic policies such as exchange rates become hostages to myopic, ill-informed and highly mobile investors—is not part of that case.

While pure liberals raised legitimate concerns, their faith in the self-correcting capacity of markets is at odds with the unstable nature of today's financial markets. Pure liberalism offers a poor guide to policy makers facing political realities outside the scope of perfectly competitive markets. The limitation of the

pure liberal view highlights the advantages of the emphasis on regimes placed by neoliberal institutionalists. Yet it is not clear that regimes have kept pace with changes in technology and national regulations that have made possible a global economy in which financial flows dwarf trade and investment.

There is a world of difference between financial markets in 1944, when the IMF was conceived, and 1994. Over US$1 trillion is traded every day in currency markets.[36] The volume and speed of financial transactions has outstripped the capacity of national government regulators and international financial institutions to act in a timely and effective way to avert panics and crashes. The destabilising effects of international capital flows have been recognised, belatedly, by international financial institutions as a potential threat to confidence in 'emerging' markets that could have a ripple effect globally. The new reality was recognised, in a limited way, by the G-7 in Halifax later in 1994, when the IMF was asked to create an 'Emergency Financing Mechanism' for countries facing capital flight.

The bail-out itself did not address the vulnerability of Mexico to financial speculation and reliance on portfolio investment, nor create better institutionalised consultative mechanisms between the NAFTA partners, especially Mexico and the USA. In short, whether the crisis is examined from the point of view of distribution and class alliances (structuralism), state capacity and the national interest (mercantilists), or market interdependence and regimes (liberals), the countries of North America were clearly unprepared to deal with the domestic and international forces flowing from closer integration. The battle between states and markets will continue to attract the interest of scholars for some time to come.

Notes

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[1] W Glasgall, 'Welcome to the new world order of finance', *Business Week*, 13 February 1995, p 38.

According to *The Economist*, $40 billion amounts to 10% of Mexican GDP, and twice what the USA spends on foreign aid every year. 'Rescuing the sombrero', *The Economist*, 21 January 1995, p 18.

[2] K Polanyi, *The Great Transformation*, Boston, MA: Beacon, 1944, p 141.

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[4] R Boyer & D Drache, eds, *States Against Markets: The limits of globalization*, London: Routledge, 1996, pp 15–16.

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[6] Warning signs were detected by R Dornbusch & A Werner, 'Mexico: stabilization and no growth', *Brookings Papers on Economic Activity*, No 1, 1994, pp 253–315. For historical examples of similar speculative bubbles, see C Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises*, New York: Basic Books, 1989.

[7] J Castañeda, 'The devaluation: a political reflection', *Current History*, Vol 94, No 590, 1995, p 117.

[8] For details of corporate losses, see *Financial Post*, 5 January 1995, p 6; *New York Times*, 11 January 1995; Rudy Luukko, 'Lessons of the Mexico massacre', *Financial Times of Canada*, 7–13 January 1995, p 8; 'Power to the plutocrats', *Institutional Investor*, February 1995; and A Willis, 'Pounded by the peso's fall', *Maclean's*, 3 April 1995, p 38.

[9] N Lustig, 'Mexico: the slippery road to stability', *Brookings Review*, Spring 1996, pp 4–9. All other figures from Instituto Nacional de Estadistica, Geografía e Informática (INEGI), 'Producto interno bruto real 1991–1996', and Banco de México y Secretaría de Hacienda, 'Mexico: principales indicadores económicos 1996'. Available on Internet: http:www.quicklink.com/Mexico/tablasec.

[10] These observations are based on interviews with a senior official of the Bank of Canada, 17 May 1995 and 28 February 1995.

[11] According to the Federal Reserve Bank of the United States, Mexican investors increased their deposits in US banks from $12.6 billion to 16.8 billion in 1994—in spite of a massive withdrawal of over $6 billion from US institutions by the Bank of Mexico. See 'Fuga de 4 200 mdd a EU en enero–fedrero', *La Jornada*, 11 July 1995. Figures on savings from President Zedillo's 1995 address to the nation, reported in 'La ciudadanía, motor del avance político: Zedillo', *La Jornada*, 2 September 1995. All other figures are from the Department of Finance (Canada) 'Canada–Mexico finance executive seminar', *Summary Notes*, Ottawa: National Arts Centre, 1995.

[12] N Lustig, 'La crisis del peso: lo previsible y la sorpresa', *Comercio Exterior*, May 1995, p 375.

[13] J Ros, 'La crisis mexicana: causas, perspectivas, lecciones', *Nexos*, May 1995, p 46.

[14] J Sachs *et al*, 'The collapse of the peso: what have we learned?', *Working Paper Series*, The Center for International Affairs, Harvard University, 1995, Table 9.

[15] Banco de México, *The Mexican Economy (Annual Report) 1995*, Mexico, DF, June 1995, pp 222–223.

[16] These quotes are from Craig Torres, 'How Mexico's behind-the-scenes tactic and a secret pact averted market panic', *Wall Street Journal*, 28 March 1994, p A6.

[17] Craig Torres, 'Some mutual funds wield growing clout in developing nations: as investments abroad rise managers take on role similar to banks, IMF', *Wall Street Journal*, 14 June 1994, p 1.

[18] 'Se defiende Aspe de quienes lo acusan de no haber querido devaluar', *El Economista*, 14 July 1995, p 26. A similar meeting had been held in September 1994, in which Guillermo Ortiz had favoured a devaluation, and no action was taken.

[19] A Oppenheimer, *Bordering on Chaos: Guerrillas, Stockbrokers, Politicians, and Mexico's Road to Prosperity*, Boston, MA: Little, Brown, 1996, p 219. For a detailed account, see MA Cameron, 'Crisis or crises in Mexico?', *Third World Resurgence*, No 57, May 1995.

[20] An official in the Mexican Ministry of Foreign Affairs suggested that the generousness of the bail-out sent out a signal that the crisis was more serious than it really was. Mexico City, March 1995.

[21] N Nash, 'Western allies rebuff Clinton in Mexico vote: 6 Europeans abstain on support at IMF', *New York Times*, 3 February 1995, p A1,A6.

[22] See IMF, 'IMF approves US $17.8 billion stand-by credit for Mexico', press release No 95–10, 1 February 1995.
[23] We are grateful to Lawrence Whitehead for these observations.
[24] 'Band-aid', *The Economist*, 25 February 1995, p 79.
[25] Figures from Banco de México and INEGI.
[26] R Keohane, 'Neoliberal institutionalism: a perspective on world politics', in Keohane, *International Institutions and State Power*, Boulder, CO: Westview, 1989, pp 1–20.
[27] Cited in MI Asaria, 'Mexico: panacea in peril', *Third World Resurgence*, No 55, March 1995, p 15.
[28] This point is made in Report of an Independent Task Force, *Lessons of the Mexican Peso Crisis*, New York: Council on Foreign Relations, 1996. The members of the Task Force mainly represented Wall Street firms.
[29] General Accounting Office, *Mexico's Financial Crisis: Origins, Awareness, and Initial Efforts to Recover*, Washington, DC: Government Printing Office, 1996. According to the report, although officials at the Federal Reserve and the Treasury expressed concerns about Mexico's exchange rate management, neither anticipated a crisis of the magnitude that occurred.
[30] On the history of US–Mexican debt negotiations, see VK Aggarwal, *Debt Games: Strategic Interaction in International Debt Rescheduling*, New York: Cambridge University Press, 1996.
[31] US Congress, House Committee on Banking and Financial Services, *US and international response to the Mexican financial crisis*, Washington, DC: Government Printing Office, 1995. See, for example, comments by Secretary of the Treasury Robert Rubin and Secretary of State Warren Christopher, pp 10, 13.
[32] P Evans, 'The state as problem and solution', in S Haggard & R Kaufman (eds), *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts, and the State*, Princeton, NJ: Princeton University Press, 1992.
[33] J Castañeda, *The Mexican Shock: Its Meaning for the US*, New York: The New Press, 1995, pp 179, 183–84.
[34] A Alvarez Béjar, 'Mexico 1995: Entre los desequilibrios macroeconomicos y la crisis política', *Investigación Económica*, No 212, 1995, pp 197–219. On 'neostructuralism', see D Green, 'Latin America: neoliberal failure and the search for alternatives', *Third World Quarterly*, Vol 17, No 1, 1996, pp 109–122.
[35] On income distribution, see J López, 'El derrumbe de una ficción. Evolución reciente, crisis y perspectivas de la economia mexicana', *Investigación Económica*, No 212, 1995, p 11; and M Pastor Jr & C Wise, 'Western hemispheric integration: free trade is not enough', *SAIS Review*, Summer–Fall 1995.
[36] This is related to an explosion of borrowing associated with the emergence of a deregulated system of globalised finance. The OECD estimates that 'gross borrowing increased in 1994 to US$955 billion, more than twice the level in 1990'. See the Report of the House of Commons Standing Committee on Foreign Affairs and International Trade on the Issues of International Financial Institutions Reforms for the Agenda of the June 1995 G-7 Halifax Summit, *From Bretton Woods to Halifax and Beyond: Towards a 21st Summit for the 21st Century Challenge*, Ottawa: House of Commons, Canada, 1995, p 46.