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BOOK REVIEW

How — and Why — the U.S. Saved the Peso in '94

One of Mexico's most prominent political scientists examines the bailout

THE MEXICAN SHOCK
Its Meaning for the U.S.
By Jorge G. Castañeda
New Press; 265 Pages; $23

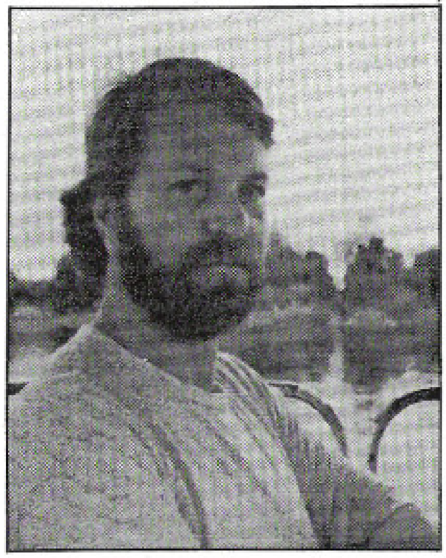
REVIEWED BY MARY D'AMBROSIO

On December 19, 1994, as Wall Street traders were winding up their books for the year, they saw a disturbing trend. The Mexican peso was sinking.

Rumors began to fly: There was a run on the peso. The next day, unable to support its currency, the Mexican government halved the value of the peso, instantly devaluing hundreds of millions of dollars' worth of stocks and bonds. The result was a windfall for Americans planning winter holidays in Cancun, but a disaster for nearly everyone else with Mexico ties. Mexicans saw their buying power plummet and faced unpayable debts. The 20-day-old government of Mexican President Ernesto Zedillo fell under siege.

For President Clinton, already struggling with an isolationist Congress, the occasion was a major embarrassment. Not only had the president recently signed, at considerable political cost, the North American Free Trade Agreement, but a few days earlier he had hosted a celebratory Latin American presidential summit that envisioned extending NAFTA, within the decade, to the rest of Latin America.

The crisis ended, of course, with a colossal $50 billion bailout for Mexico from the pockets of U.S. taxpayers and the coffers of the International Monetary Fund, without which Mexico would have almost certainly defaulted on its foreign debt. Plans for extending NAFTA further into the Americas were quietly shelved. Mexico, which had just joined the Organization for Economic Cooperation and Development and had been promoting itself as a new arrival in the first world, fell with a thud



back into the category of developing countries.

What happened? Pundits have been advancing theories for more than a year, but "The Mexican Shock" is the first book to address the issue. Jorge Castañeda, one of Mexico's most prominent political scientists and government critics, has made an important contribution to the debate. His book is a persuasive, provocative — though by no means definitive — effort to put recent events into the context of Mexican political and economic development over the past 15 years.

Castañeda argues that the financial crisis was a legacy of Mexico's insular, elitist and corrupt political system. With too little attention paid to redistribution of wealth, a small band of leaders is governing without real consensus, and thus arrogantly errs.

Castañeda calls for better checks and balances on executive power: wider participation in Mexican politics through opposi-

> ***Casteñeda believes opening the border under NAFTA terms he considers extremely disadvantageous to Mexico, appreciating the peso and paying too much money to service foreign debt set the scene for disaster***

tion-party representation in the cabinet; the encouragement of an independent labor movement; and creation of an independent and credible judicial system. "Only a step of this magnitude would pave the way for the great democratic reform the country requires," he writes.

However worthy his political thesis, Castañeda's linkage of Mexican political aspirations with the economic crisis is a bigger stretch. Under then-president Carlos Salinas de Gortari, the country began paying its bills with some $30 billion in securities sold to foreigners, and used the proceeds to fund a large trade deficit. With the Chiapas uprising in early 1994 and the subsequent assassination of both ruling party presidential candidate Luis Donaldo Colosio and the leader of the ruling party, PRI, nervous foreign investors began pulling out their cash.

The deficit grew. As it was an election year, the Mexican government refused to stop spending. Eventually, Mexico simply ran out of cash. Other choices could have been made: a more export-focused industrial policy, gradual peso devaluation, or better public information, more quickly provided, about the dire state of Mexico's dwindling foreign reserves.

Of course it's debatable — keeping our own budget debacle in mind — whether any government runs its economic policy better for running it democratically.

However, Castañeda argues that Mexico has been following misguided, makeshift economic policies since 1981, just before the country was forced to default on its debts to foreign commercial banks. He thinks the neoliberal economic model sweeping the Americas today is the true culprit for the Mexican chaos, and that it ignores many public needs.

That is an out-of-favor view, as Latin governments that feature Ivy League-educated economists are applying free market theories with scholarly zeal, with full U.S. government approval. Opening the border under NAFTA terms he considered extremely disadvantageous to Mexico, appreciating the peso in the first place, and paying too much money to service foreign debt set the scene for disaster, Casteñeda believes.

He also considers the bailout the wrong solution: "The American investors made the mistake," he writes. "Mexicans are left to pay, becoming more indebted and dooming our economy and that of our children to indefinite stagnation."

Because parts of this book were published previously as essays, not all of it is cohesive. The first chapter on Mexican immigration to the United States seems tacked on, and the chapter on NAFTA was substantially written before the fact. But it's a thoughtful, eye-opening exposition by one of Mexico's best-informed academics. ■

Mary D'Ambrosio is the editor of Emerging Markets Debt Report, a weekly publication that covers Third World economics.