CHAPTER 7

Ambiguous Threat, Ambivalent Response

The 1993 Mexican Central Bank Reform

The 1988 national elections demonstrated the extent of dissatisfaction with Mexico's ruling party and its neoliberal reform agenda. In particular, they pointed to the rise of a center-left movement with the potential to threaten the electoral hegemony of the PRI. As with Chile, we appeared to be witnessing the prelude to a decisive insulation response.

But while up to here the Mexican and Chilean cases look more or less similar, this is the crucial point where they part company. For while both authoritarian governments faced a threat of regime change, in Chile that threat was imminent, whereas in Mexico it was considerably more distant.

This chapter explores the implications of this difference for the amount of autonomy afforded the Mexican central bank. In brief, I argue that because pressures for democratization were still in their incipient stages, Mexico's authoritarians lacked the incentives to make the central bank fully autonomous. Rather, knowing that they were likely to remain in office for the next several years, they were careful to design an institution that would not overly restrict their own margin of maneuver within the foreseeable future.

The chapter unfolds as follows. In the first section, "The 1993 Mexican Central Bank Reform: An Overview," I demonstrate the key differences between the Mexican and Chilean reforms on the dependent variable. In addition to noting the considerably slower pace at which the Mexican reform evolved, I highlight those specific aspects of the legislation—looser constraints on lending to the executive branch and weaker policy-making tools—that rendered the resulting institution less autonomous than Chile's. In the second section, "Assessing the Degree of Threat: Mexico 1988–93," I then proceed to locate the source of this difference in the independent variable: the degree of threat. I show that while the Mexican government had a number of reasons to fear a leftward rotation of power in the future, a full-fledged transition was not yet under way. Though the ruling party did face growing internal tensions and mounting political competition, the most likely outcome in the short run still seemed to be one of regime continuity.

The third section, "Splitting the Difference: The Logic of Partial Insulation," links this diminished threat of democratization to the correspondingly weaker degree of autonomy observed. On the one hand, there was enough possibility of political change to prompt the authoritarians to use autonomy as an insulation tactic. On the other hand, knowing that they—and not their adversaries—were likely to retain power in the near future, they deliberately loosened the legislation to manipulate monetary policy when needed.

The chapter concludes with a postscript examining the central bank's role in the peso crisis. While some have argued that the lax monetary policy pursued by the Bank of Mexico in 1994 casts doubt on the significance of the autonomy initiative, I offer a variety of different types of evidence to suggest that the reform did, in fact, matter. More important, I also note that as pressures for democratization increased in Mexico, so too did efforts to enhance the autonomy legislation, thus reinforcing the central argument offered in this book about the relationship between democratization and institutional change.

The 1993 Mexican Central Bank Reform: An Overview

Reform Process: The Build-up to the 1993 Reform

The first contrast that emerges when comparing the central bank reforms of Chile (1989) and Mexico (1993) is the pace of the reform once the threat of democracy was on the table. Rather than being executed in a relatively short period of time, as had been the case in Chile, the Mexican reform instead incubated over a period of five years. Right off the bat, this difference signals a lack of urgency on the part of Mexico's incumbent authoritarian regime.

The idea for a central bank reform in Mexico surfaced early on in the Salinas sexenio. While individuals closely involved with the reform were not specific about its exact timing, most dated the initial discussions to shortly after Salinas took office.[1] All concurred that the idea was the brainchild of Finance Minister Pedro Aspe. In his own words, "the idea was in my mind since the beginning of the sexenio . . . as a way to 'lock in' our package of [fiscal] reforms so that Mexico would not revert to inflationary financing in the future."[2] After discussing the idea with the president of the central bank, Miguel Mancera, Aspe went to Salinas in order to bring the president on board.

1. Based on a series of tape-recorded interviews by the author with government officials closely involved with the central bank reform in Mexico City, Mexico, during November 1994–February 1995. Because of the sensitive nature of some of the material included in this chapter, all names of interviewees have been concealed, except where otherwise noted.

2. Pedro Aspe, Mexican finance minister (1988–94), interview by the author, tape recording, Mexico City, Mexico, January 30, 1995.

But while the initial idea for a central bank reform thus coincided closely with the onset of the democratic threat, the authoritarians did not move immediately to put it into practice. Rather, they proceeded to turn the notion over in their heads for the next three to four years. As one central bank economist closely involved with the initiative commented, "the idea would come up from time to time ever since the sexenio began."[3] Indeed, central bank autonomy was just one of several different commitment strategies being considered as a means of locking in tight monetary policy. In the early years of the Salinas administration, the economic team was also pondering at least two other candidates: "dollarizing" the economy by establishing a one-to-one parity between the Mexican peso and the U.S. dollar; or forming a western hemispheric currency zone akin to the European Monetary System.[4] Both options were ultimately discarded on the grounds that they would render Mexico too vulnerable to economic decisions made in other countries.[5]

The decision to get serious about central bank reform did not occur until 1992. At an annual meeting of the economic cabinet early that year, Aspe announced that it was time to go ahead with the initiative. Aspe and Mancera established two study teams to work on the central bank reform—one in the Ministry of Finance and the other in the central bank, although the bulk of the legwork took place in the latter. Over the course of the year that followed, these teams studied various models of autonomy from other countries in order to come up with a set of guidelines for the Mexican law. Of particular note, they consulted with the former president of the Central Bank of Chile, Andrés Bianchi, who spent two months in Mexico as an informal adviser to the government.[6]

It was not until May 1993 that Aspe finally announced the initiative to the public. One week later, it was submitted to both chambers of the Mexican legislature, where a proposal to pass a constitutional amendment for central bank reform was approved by a wide majority.[7] As was typical in Mexico, this was a very top down reform, designed by a handful of high-ranking economic advisers without widespread public debate or dissemination. As one top

3. Confidential interview by the author, Mexico City, Mexico, January 30, 1995.

4. As noted by Patricia Armendariz, former Finance Ministry official, interview by author, tape recording, Mexico City, Mexico, July 23, 1993.

5. Augustín Carstens, former director of research at the Bank of Mexico and principal author of the 1993 reform, interview by the author, Mexico City, Mexico, July 30, 1993.

6. Based on tape-recorded interviews by the author with several senior officials involved in the autonomy initiative, Mexico City, Mexico, November 1994–February 1995. This was confirmed by Andrés Bianchi, interview by the author, tape recording, Santiago, Chile, June 5, 1995.

7. The decision to amend the Constitution passed with 385–17 in favor within the Chamber of Deputies and 62–2 in favor within the Senate. The actual amendment was approved and went into effect in August 1993.

official in the Salinas administration put it, "like many major legislative initiatives enacted by the technocrats, the process was basically one of first making the decision and then figuring out who would write up the press release."[8]

But even after the proposal for a constitutional amendment had been unveiled, the reform was still far from complete. While the proposed amendment noted the bare bones of autonomy, that is, "that the central bank would be autonomous in nature . . . with the primary goal of price stability. . . . no authority will be able to order the bank to give it financing," the specifics behind such mandates still needed elaboration (Ortiz 1994). While this vote thus permitted the government to annul the previous central bank law that had been in operation since 1985, the government still needed to draft a new law to establish the effective means through which the central bank's new authority would be carried out. As a result, a series of much more intense negotiations ensued between the study teams at the central bank and the Finance Ministry over the summer of 1993. It was in these negotiations where the nitty-gritty behind such delicate issues as exchange rate policy and interest rate policy would be hammered out (see the third section of the chapter, "Splitting the Difference: The Logic of Partial Insulation"), which would subsequently assume such importance in the wake of the peso crisis that ensued.

The reform's elaboration culminated with its legislation in the Mexican Congress in December 1993. As a result of the quite extensive preparation noted previously, the new central bank law was largely a fait accompli by the time it reached the legislature. While some changes were proposed and incorporated into the legislation, the autonomy initiative sailed through both chambers without major alterations. This was largely due to the PRI's impressive comeback in the 1991 midterm elections (see the second section of the chapter, "Assessing the Degree of Threat: Mexico 1988–93"), which furnished the government with a sufficient majority to guarantee the reform's passage. In addition, the initiative also won the support of the right-wing PAN, which had long championed the idea of an autonomous central bank (Calderón

8. Manuel Camacho, former mayor of Mexico City, interview by the author, tape recording, Mexico City, Mexico, August 19, 1997. Given the esoteric nature of central bank reform, however, the administration did make more of an effort to discuss it with select public audiences than was the norm. For example, once the basic ideas had been established, the government made a point of vetting the initiative before the economic cabinet, the members of the Pact (peak business and labor organizations), and the chairman of the Chamber of Deputies. The president himself ran the idea past the elite CMHN, and it was also discussed with various individuals in the financial community (see "Crecerá la Influencia del Consejo Mexicano de Hombres de Negocios, Afirma el Politólogo Roderic Camp," *El Financiero,* January 19, 1993). The ruling party would also subsequently organize a congressional delegation to other countries with autonomous central banks to expose PRI legislators to various models of autonomy in practice (Angel Aceves, former chairman of the Mexican Chamber of Deputies, interview by the author, tape recording, Mexico City, Mexico, January 23, 1995).

Hinojosa 1993). Though the reform did inspire vociferous criticism on the part of the left-wing political parties, this was not sufficient to overturn the bill or even to make major alterations. In light of such strong bipartisan support, the legislation passed with a 92 percent approval rating.[9]

In sum, while the Chilean central bank reform was also "in the wings" for many years, once the democratic threat became apparent, its timetable accelerated dramatically. The Mexican case, in contrast, exhibited a much more protracted reform process. While the idea for autonomy initially surfaced early on in the Salinas administration, it was bandied about within the administration for several years and evolved gradually over the period 1988 to 1993. Although the Mexican government seemed intent upon enacting the reform within the Salinas sexenio, it also seemed to be in much less of a rush. To be sure, this delay had something to do with the nature of the Mexican electoral calendar (see the third section of the chapter, "Splitting the Difference: The Logic of Partial Insulation"). But the drawn-out nature of the reform process in Mexico also suggests that, unlike in Chile, Mexico's authoritarians perceived themselves to be under less pressure.

Reform Outcome: Evaluating the 1993 Reform

If the prolonged nature of the Mexican reform process indicated a more diffuse democratic threat, the resulting legislation certainly reinforced this interpretation. Unlike in Chile, where the central bank was granted full autonomy, in Mexico the autonomy afforded the central bank was only partial.

The partial nature of Mexico's central bank autonomy was most evident in two key dimensions of the reform. The first entailed those rules governing central bank lending to the executive. While under previous (1985) central bank legislation, all central bank financing of the executive had taken place at the behest of the Finance Ministry itself, the Constitution now clearly stated that "no authority may order the Bank of Mexico to grant financing, by credit of any sort or through the acquisition of assets" (Constitución de la Estados Unidos Mexicanos, art. 28). Despite this effort to strengthen the Bank of Mexico's hand, however, the new law continued to allow the central bank to finance the executive via both direct and indirect means (Banco de México 1993, art. 11).

That the 1993 law permitted indirect financing of the government was not so unusual. As indicated in chapter 3, most central banks (with Chile as the noted exception) are allowed to acquire government paper in the course

9. In the Chamber of Deputies, the vote was 238–11 in favor, with 22 abstentions, while in the Senate, it passed by a vote of 61–3. In addition to the PRD, the Socialist Party also voted against the legislation.

of their open market operations. The fact that such purchases had to take place at market interest rates was also a step in favor of autonomy (Banco de México 1993, art. 12). That said, the terms surrounding the bank's direct lending to the executive were suspect on a number of grounds.

In those countries where direct lending to the executive is permitted, it is ordinarily highly restricted. In Germany, for example, this amount is stipulated as a strict cash limit (Swinburne and Castello-Branco 1991, 425). In the Mexican case, in contrast, the stated limit on central bank financing was expressed as "1.5% of government expenditures" (Banco de México 1993, art. 12). One and a half percent may appear a rather modest sum. From a technical standpoint, however, any limit set in relation to government expenditures is generally thought to be accommodative to government spending proclivities (Cukierman 1992, 377). Were a populist government to come to power with a lavish expenditure program, the central bank would be legally justified in increasing its lending to the government proportionately. Ironically, in this regard the new law was actually a step backward from the 1985 legislation, which had set the limit on government lending at 1 percent of government revenues (Banco de México 1990, art. 9).

It is true that the law included a countervailing mechanism in the event that this limit was exceeded. If the debtor balance of the government were to exceed 1.5 percent of government expenditures, the central bank was authorized to issue debt on the government's current account to avoid a monetization of its deficit. But the legislation also allowed this provision to be waived under "extraordinary circumstances" (Banco de México 1993, art. 12), providing yet another avenue through which the government might ably finance its spending needs. More to the point, such limitations on central bank lending to the executive were not to go into effect until April 1997. Until that time, the central bank was still legally obligated to cover any checks written by the government, and the government could withdraw money from its account at the central bank without prior notice (Banco de México 1993, transitory art. 4).

A second area where the autonomy of the Mexican central bank also fell short of Chile's concerned its policy-making powers. To be sure, these constituted a significant improvement over the status quo. While under the 1985 legislation the central bank was obliged to act "in accordance with the directives of credit and monetary policy indicated by the Minister of Finance" (Banco de México 1990, art. 2), the new law rendered the central bank "an institution within the state with an autonomous character" (Banco de México 1993, art. 1). Moreover, as in Chile, while the finance minister was permitted to attend central bank board meetings, he or she was given no voting privileges.

But while the central banks of both countries thus benefited from nom-

inal autonomy over monetary policy formulation, in Chile, this authority was buttressed by a series of additional powers that were largely absent in Mexico. For example, while the Chilean central bank played a role in external debt management, exchange rate policy, and various foreign trade and investment policies, in Mexico all such policy-making powers continued to reside with the Ministry of Finance. The extensive policy-making instruments afforded the Chilean central bank were further reinforced through a series of explicit conflict resolution mechanisms that enabled the central bank board to override the finance minister where it saw fit. The Mexican law contained no such provisions. By failing to stipulate how disputes between these two agencies would be resolved, the 1993 legislation left the door open for backdoor influence from the executive. In a country where the Finance Ministry and central bank were "for all intents and purposes, Siamese twins,"[10] a clear-cut division of labor would have seemed all the more warranted.

Indeed, the only area of policy-making where the relative weights of the two institutions were spelled out at all explicitly was exchange rate policy. The 1993 law established a "foreign exchange commission," in which exchange rate policy would be shared between the two agencies on a three-to-three basis (Banco de México 1993, art. 21). But even there, the Ministry of Finance had the last word. All resolutions passed by this body required at least one favorable vote from the Ministry of Finance, and in the event of stalemate between the two agencies, the finance minister had the decisive vote. It is certainly true that, with the notable exception of Chile, most countries leave exchange rate policy in the hands of the Treasury. But most such arrangements presuppose a floating exchange rate. At the time that the autonomy legislation was enacted, Mexico was operating under a crawling peg system, in which government intervention was used to keep the exchange rate pegged to the dollar within a narrow target band. For practical purposes, this was tantamount to having a fixed exchange rate system, as it was really the exchange rate—and not the domestic currency—that served as the anchor for price stability in the economy.[11] By depriving the central bank of control of exchange rate policy, then, the government was limiting the central bank's ability to determine interest rates as it saw fit, at least as long as the crawling peg remained in effect.

In fairness, the law was considerably stronger on the other two dimensions of autonomy—central bank objectives and the rules governing the cen-

10. As characterized by Mike Zellner, financial reporter for *America Economía,* during an interview with the author, Mexico City, Mexico, July 26, 1993.

11. Under a fixed exchange rate, any increase (decrease) in the domestic money supply has to be offset by a corresponding decline (increase) in the country's foreign reserves to keep the exchange rate in equilibrium.

tral bank board, although even these were not without their weaknesses. Under its 1985 charter, the central bank was authorized to obtain "the purchasing power of the peso, the development of the financial system, and the generally healthy growth of the national economy" (Banco de México 1990, art. 1). As in Chile, the new law sought to enhance autonomy by narrowing the focus of these objectives to give more weight to price stability. It constrained the central bank to pursuing the "primary goal of obtaining price stability" along with the secondary objectives of "facilitating the sound development of the financial system and the orderly operation of the payments system" (Banco de México 1993, art. 2).

While this change certainly went a long way toward enhancing the autonomy of the central bank along this dimension, three caveats are in order. First, by including the stability of the financial system as an objective, the law opened up the possibility that price stability might at some point be compromised to protect the health of the banking sector, a caveat not without relevance to the events of 1994 (see the chapter postscript). Second, the new legislation also put an end to the Bank of Mexico's prior practice of setting quantitative monetary stock targets—a projected amount of internal credit that it expected to circulate each year, commonly thought to facilitate a commitment to price stability (Cukierman 1992, 388). Finally, the fact that the Bank of Mexico's annual economic report followed—rather than preceded—that of the government served as an implicit constraint on the Bank of Mexico's ability to determine monetary policy free of executive branch influence.[12]

Accountability measures to ensure compliance with these new objectives were predictably weak (Banco de México 1993, arts. 51, 52). The 1993 law did establish certain basic oversight provisions. Like the U.S. Federal Reserve and the German Bundesbank, the Mexican central bank was obliged to produce three reports annually on the state of monetary policy, and both chambers of the legislature were afforded the right to regularly summon the central bank governor. Following a motion by the PAN during the December congressional hearings, a clause was also added stipulating that all central bank governors could be brought to trial (Banco de México 1993, art. 61). However, the central bank was also given considerable leeway in its reporting duties. Unlike in the United States or Germany, where the central bank was required either to publish its monetary targets or to make public the minutes of its meetings, in Mexico there were no such stipulations. And while the legislature was given veto power over the annual selection of an external auditor for

12. Among other things, the government's annual economic report also included a statement of projected inflation rates.

the central bank, the Congress could only review the final results of such an audit and lacked the authority to take actions based on those results.[13]

The 1993 law probably went furthest in enhancing the autonomy of the Bank of Mexico in its fourth and final dimension: those rules pertaining to the central bank board. Under prior legislation, the central bank board had been made up of eleven individuals drawn from a variety of executive branch agencies, as well as three "independent" representatives from various social sectors (Banco de México 1990, art. 23). These individuals were all presidential appointees with indefinite term lengths, all of whom could be removed at the executive's discretion. The board met on an irregular basis, and all of its members held other professional positions. The largely cosmetic nature of the former central bank board was reflected in the fact that many of its members were not even aware that an autonomy initiative was in the offing. As one former member of this board quipped, "I found out through the press that there was to be a constitutional amendment to modify the statute of the central bank!"[14]

The new legislation enacted an organizational structure much more conducive to autonomy (Banco de México 1993, arts. 38, 40). To begin with, it established a governing board of five members (one governor, four vice-governors) who would be named by the president of the republic, with confirmation either by both houses of the Congress or by a permanent congressional commission.[15] While not quite as lengthy as Chile's ten-year terms, board member terms did compare favorably with those of the German Bundesbank (six years for the governor and eight years for vice-governors) and were staggered to avoid undue politicization. As the argument presented in chapter 3 would predict, Salinas used this opportunity to appoint a central bank board entirely congruent with his own policy preferences.[16] And because the legislation allowed for renewable terms, it enhanced the probability that this conservative bias would be maintained in the future.

13. The PRD did attempt to introduce a number of measures to augment the accountability of the central bank, including a mechanism whereby, within forty-five days of the release of the Bank of Mexico's annual report, the Congress would have the ability to review, revise, and even veto projected monetary policy for the upcoming year. These measures were roundly defeated.

14. Urquidi, interview.

15. This was not an explicit feature of the 1993 law but was automatically guaranteed by Mexican law, which requires congressional approval for all presidential nominees to federal government ministries and agencies.

16. They included the following: Miguel Mancera (governor of the central bank since 1982), Francisco Gíl Díaz (former undersecretary of finance in charge of revenues under Salinas), Jesús Marcos Yacamán (former director of economic research at the Bank of Mexico), Ariel Buira (former director of international organizations and agreements at the Bank of Mexico), and Guillermo Prieto Fortún (former president of the government's chief regulatory body for the private banking sector, the National Banking Commission).

As in Germany, the new law stipulated largely technical criteria for board member dismissal, and, as in Chile, such dismissals also required Senate approval (Banco de México 1993, art. 43). But there was one notable exception. In a clause buried deep within Article 43 that does not even bear a number, the law stated that the central bank governor could be removed for failing to comply with the decisions of the exchange rate commission (Banco de México 1993, art. 43).[17] Such a clause posed a serious impediment to autonomy, as it effectively rendered the governor beholden to the views of the executive branch on a crucially important policy issue.

As in Chile, the Mexican government solidified its commitment to an autonomous central bank over the long haul by enshrining it in a constitutional amendment. Because a constitutional amendment requires a two-thirds majority in both chambers of the legislature in order to be overturned, this arguably constitutes an important piece of evidence for the "tying successors' hands" thesis advanced in this book. Unlike in Chile, however, where the entire central bank legislation formed part of an organic constitutional law, in Mexico it was only the three sentences in Article 78 that fell into this category. What this meant in practice was that the basic principles underlying central bank autonomy in Mexico—that is, a commitment to price stability and the inability to force the central bank to lend to the federal government—would be very difficult to reverse. In contrast, the actual central bank law—that is, all of the supporting details discussed in this section—could be overturned by a simple majority. As we will see, this point is of considerable significance for understanding the likely course of Mexico's central bank legislation in the future.

In short, Mexico's authoritarian leaders designed a central bank reform that can best be termed as partial. On the one hand, there is no question that it constituted a significant improvement over the status quo. Particularly in those rules pertaining to its governing board and statutory objectives, but also in what concerned its limitations on lending and policy-making powers, there were clear advances over what had existed previously. On the other hand, despite the fanfare surrounding its creation, the Mexican central bank was granted considerably less autonomy than its Chilean counterpart. Such

17. I am grateful to Isaac Katz, professor of economics, Autonomous Technological Institute of Mexico (ITAM), for pointing this out. Isaac Katz, interview by the author, tape recording, Mexico City, Mexico, August 12, 1997. The fact that this clause is not even numbered would suggest that it was either an error or was inserted into the reform at the very last minute. In light of its obvious import, as well as the technical competence of those writing the reform, I would tend to doubt that it was a mistake. Rather, I would include it among the numerous inconsistencies and ambiguities that characterized the final version of the legislation as its contents were battled out between the central bank and the Finance Ministry (see the third section of the chapter, "Splitting the Difference").

an outcome might appear curious to the casual observer. After all, the Mexican government openly acknowledged that the Chilean central bank reform had served as one of its models in drafting its own central bank legislation. The authoritarians had even gone so far as to request that senior officials in the Chilean central bank come to Mexico in order to brief them on the Chilean experience. We must, therefore, ask ourselves why Mexico's central bank reform did not end up looking more like Chile's. The next section will begin to shed light on why this was the case.

Assessing the Degree of Threat: Mexico 1988–93

This section offers a plausible hypothesis for the observed disparity between the Chilean and Mexican reforms. In brief, I attribute it to a qualitative difference in their domestic political environments. Whereas the 1988 plebiscite in Chile meant that the onset of democracy was a "scheduled event," in Mexico the shape and speed of the democratization process were a moving target that would ebb and flow over the course of the next several years. While incumbent fears of a populist future were thus palpable in both countries, in Mexico, the incentives to fully insulate the central bank were simply not as clear cut.

The Intensity of Threat: The Sources of Populist Pressures

In the years following 1988, populist pressures in Mexico emanated from three main sources. While it was unclear at the time which—if any—of these potential threats would ultimately prevail, their combined magnitude placed enough uncertainty on the table to call the longevity of the Salinas economic model into question.

External Threat: The Cárdenista Alternative

The first threat to the longevity of the economic model lay in the left-wing Party of the Democratic Revolution (Partido Revolucionario Democrático [PRD]) and, in particular, its leader Cuauhtémoc Cárdenas.[18] Recall that as of 1988, the regime faced a divided opposition, in which the most powerful contenders were the right-wing PAN and what would shortly become the left-

18. In 1989, Cárdenas converted his left-wing movement into a full-fledged political party—the Party of the Democratic Revolution. Although he invited his former FDN coalition partners to merge with this new political party, only the Mexican Socialist Party (Partido Mexicano Socialista [PMS]) chose to join.

wing PRD. From a strictly economic perspective, the PAN did not pose a threat to the ruling clique's vital interests.[19] Combining a mixture of classic liberalism with Christian social doctrine, the PAN had long fought to reduce the influence of the state in all aspects of political and economic life (Partido Acción Nacional 1994). In contrast, the PRD's avowedly anti-neoliberal platform was clearly at odds with the technocratic dogma (Cárdenas 1993).[20] While based on an objective assessment of electoral performance, the PAN would appear to have been much more of a rival to continued PRI dominance (see the discussion that follows), from a subjective standpoint, the PRD constituted a much larger threat to interests of the outgoing regime and, in particular, to Salinas himself.

Cárdenas's threat potential had a variety of origins. To begin with, he had a tremendous amount of public visibility. His symbolic role as the legitimate victor of the 1988 elections continued to afford him an impressive public following and a certain moral authority within the electorate (Cothran 1994, 183; Dresser 1994b, 64). In an opinion poll conducted in May 1993, Cárdenas continued to be mentioned as the most prominent opposition candidate in the 1994 presidential elections—with approximately 80 percent name recognition.[21] Indeed, prior to the presidential debate of May 1994, Cárdenas was in second place (Domínguez and McCann 1996, 190). Because of such demonstrated renown, it was impossible for the ruling party to dismiss him as a real electoral threat. As one Mexican intellectual noted at the time, "regardless of what you think of Cuauhtémoc Cárdenas and his allies, you cannot deny his mobilizing draw. . . . everything seems to indicate that the PRD campaign will reconstitute itself as a fundamental reference point in the federal elections of 1994."[22]

A second set of factors rendering Cárdenas a live concern for the ruling party was, ironically, his credential as an "ex-Príista" (i.e., a former member of the PRI). On the one hand, his "revolutionary" origins as the descendant of the Cárdenas legacy enabled him to go after the PRI's traditional support base

19. The PAN did have a more populist faction as well, embodied in the 1988 presidential candidate, Manuel Clouthier. Throughout the Salinas sexenio, however, this wing was clearly subordinate to the "Neopanista" leadership that was firmly in the neoliberal camp. See Stansfield 1996, 132–33; Crespo 1995, 62.

20. There are those who emphasize a subtle transition in the Cardenista rhetoric, claiming that his anti-neoliberal message mellowed over time, most notably in his eventual acceptance of NAFTA (Dresser 1994b, 64–65; Domínguez and McCann 1996, 186–87). But if such a transition did, in fact, take place over the course of the sexenio, it was most likely for pragmatic reasons and certainly only mild at best.

21. See "Durante su Sexenio, Carlos Salinas Vivió Obsesionado por su Propia Imagen en Comparación con la de Cuauhtémoc," *Proceso* 1080 (July 13, 1994): 23.

22. Luis Sálazar C., "Rumbo a las Elecciones de 1994: El Retorno del Cardenismo," *Cuadernos de Nexos,* November 1993, v.

and appeal to its traditional symbols (Bruhn 1996, 24). On the other hand, precisely because he and other PRD leaders had such a long history in the party, they brought with them a tremendous amount of political experience and knowledge of the political system, much more than what an ordinary opposition party—such as the PAN—could muster (Crespo 1995, 54–56). On both counts, the ruling party needed to worry about Cárdenas's potential to lure away disgruntled Príistas (see "Internal Threat: The PRI Old Guard," which follows).

Above all, however, Cárdenas also clearly posed an ideological or policy-based threat to the Salinas clique. For while a vote for the PAN was not essentially different—in policy terms—than a vote for the PRI, a vote for the PRD was tantamount to a rejection of Salinismo, liberalization, and the entire economic model itself (Regalado 1996, 161–62). As one Mexican journalist astutely observed, "the most threatening thing about Cárdenas is that he is outside the system. More so than the PAN, he is the real threat because he is potentially a 'loose cannon.'"[23] This outsider status was particularly dangerous for the PRI in the poorer southern regions of the country as well as in its industrial heartland, where regional voting patterns suggested a growing frustration with the prevailing economic model and willingness to support a "kinder, gentler alternative" embodied in the PRD (see the section of this chapter titled "The Proximity of Threat"). To the extent that the PRI and the PRD were increasingly competing for the same vote share, there was good reason for the authoritarians to be concerned about stopping the PRD's advance at all costs. After all, a PRD victory only increased this party's credibility among the PRI's own electoral bases at a time when the main determinant of defection from the ruling party was the sense that another party could win in the next presidential elections (Domínguez and McCann 1996, 187).

There were several signs that the Salinas administration viewed the left as a powerful policy threat over the course of its term in office. The aggressive manner in which the PRI fought to win back the states of Michoacán and México in the state elections of 1989 and 1990, respectively—states in which the Cárdenista block had won twenty-nine electoral seats in 1988—betrayed its underlying paranoia about losing to a party on the left (Klesner 1994, 178). This fear was again underscored by the government's willingness to concede defeat to the PAN in the gubernatorial elections in Baja California in 1989 and Chihuahua in 1992 but not to the PRD in the municipal elections in Michoacán in 1989 and 1992.[24] The government's overt embrace of several

23. Carlos Ramirez, columnist, *El Financiero,* interview by the author, tape recording, Mexico City, Mexico, December 12, 1994.

24. The government was ultimately forced to reverse the 1992 decision in favor of the PRD candidate but only after a great deal of postelectoral conflict.

long-championed PAN reform initiatives across the sexenio was also interpreted as indicating a systematic effort to marginalize the PRD (Crespo 1995, 58–65; Bruhn 1996, 240–47; Reding 1989, 689–701). This was equally true of an electoral law prohibiting different political parties from endorsing the same candidate, which many saw as an attempt to prevent the smaller left-wing parties that had supported Cárdenas in 1988 from institutionalizing this electoral union in the future (Morris 1992, 39). Finally, the government also used its control over the media to launch a negative image campaign against the PRD by portraying it as violent, dangerous, and communistic (Morris 1995, 100).

It was clear that through all of these measures the ruling party was employing a strategy of "selective repression" on the electoral front to divide and weaken the left (Reding 1989; Morris 1995, 98–100).[25] Nowhere was such a strategy more evident than in the case of the National Solidarity Program (Programa Nacional de Solidaridad [Pronasol]), a massive social program unveiled in 1989 to deliver a wide range of public works to poor districts throughout the country. Funded through sales resulting from the privatization of major public enterprises, Solidarity encouraged citizens to design and implement community development programs with financial assistance from the government (Cornelius, Craig, and Fox 1994). After but two short years, Solidarity enjoyed an annual budget of U.S.$5.1 billion and accounted for 60 percent of all federal investment (Morris 1992, 32). In addition to whatever economic motivations it may have had, many have argued that the Solidarity program was largely an effort to buy back support for the PRI by strategically channeling funds to Cárdenista strongholds while simultaneously rewarding PRI loyalists (Dresser 1991; Molinar Horcasitas and Weldon 1994; Bruhn 1996, 260–70).[26]

But by far the most important indicator of the left's threat potential was the subjective fear of Cárdenas by Salinas himself. A set of public opinion polls conducted by the office of the presidency during the Salinas years revealed what one journalist called a veritable "obsession" with Cárdenas on the part of the president.[27] On nearly every poll that went out of his office

25. At times, this campaign also included real repression against the left, entailing arrests and intimidation tactics. The PRD also maintains that over the course of the sexenio, 250 of its militants were killed (Morris 1995, 100).

26. Morris (1995, 97) documents, for example, how the first full-fledged Solidarity experiment in January 1989 targeted Cárdenas's home state of Michoacán. Similarly, in Morelos—another state that Cárdenas won in 1988—public investments increased by 93 percent from 1988 to 1989. Molinar and Weldon's study provides more systematic empirical support for the claim that the assignment of Pronasol resources did not correspond to the distribution that would have occurred if poverty had been the sole criterion.

27. See "Durante su Sexenio," 20–26.

from the very beginning of the sexenio all the way to its end, there was always at least one question that asked, "If the 1988 elections were repeated tomorrow, who would you vote for?"[28] And once Cárdenas's candidacy for the 1994 presidential elections had been announced in early 1993, his campaign was followed with scrupulous detail through a series of polls that sought constantly to evaluate his popularity, his policy positions, his actions, even how he dressed. If, in fact, it were true—as some might wish to argue—that the PRD's electoral decline in these years removed Cárdenas as an objective policy threat to the regime, then there would have been no reason to have followed his campaign with such minute attention to detail. The explanation for such "obsessive" behavior can only be that Salinas greatly feared Cárdenas's continuing appeal. In the words of one of the president's closest friends and confidantes, Manuel Camacho, "my impression is that the President never stopped worrying about the possibility that Cárdenas' popularity might grow and that he might win in 1994. . . . this was true even after 1991 and continued right until the very end."[29]

For all of these reasons, it was Cárdenas—more than any other political leader or party—who was seen as the regime's key opponent throughout the sexenio (Domínguez and McCann 1996, 188). As one scholar of the Mexican left noted, "the PRD . . . differed from other opposition parties in one important respect: the special PRI hostility it attracted as a left party that criticized the Salinas project and competed with the PRI for a similar constituency" (Bruhn 1996, 241).

Internal Threat: The PRI Old Guard

The second source of policy uncertainty for the authoritarians lay within the PRI itself. Recall from chapter 6 that the corporatist sectors of the ruling party were deeply dissatisfied with its leadership's embrace of neoliberalism in the early 1980s. Of these groups, the labor sector had been particularly hard hit. On the one hand, the official labor movement's economic power had been declining steadily over the 1980s, as real wages plummeted, massive employment cuts took hold, and social spending dropped precipitously (de la Garza Toledo 1994; Middlebrook 1995, 255–87; Teichman 1995, 159–93). On the other hand, labor also saw a corresponding decline in its political influence within the ruling party. As the CTM failed increasingly to deliver winning candidates in national elections, the party responded by allotting it fewer and

28. Ibid, 22. This was confirmed during a confidential interview by the author with two individuals who worked on Salinas's polling team, tape recording, Mexico City, Mexico, August 20, 1997.

29. Camacho, interview.

fewer seats (Baer 1993, 59; de Remes la Brely 1993). As an expression of their discontent at what was perceived as a twin assault on the PRI's historically most influential corporate sector, many labor union officials took out their frustration at the polls, throwing their support to Cuauhtémoc Cárdenas in the 1988 elections (Teichman 1995, 175; Middlebrook 1995, 293–94).

The existence of such malaise within the party's traditional sectors was dangerous for Salinas on two fronts. To begin with, even as corporatist interest groups constituted an obstacle to economic reform, the ruling elite still needed to rely on them as a fundamental instrument of political control (Craske 1996). Because these more traditional sectors controlled the party machinery, they had the ability to withhold support for the president's pet initiatives in the legislature. Particularly in a setting where the ruling party had lost its two-thirds majority in the Chamber of Deputies, party discipline and party loyalty had become more important than ever (Weldon 1997, 247). They were also crucially important for ensuring the viability of the presidential succession mechanism (Middlebrook 1995, 301).

More important, however, the real secret weapon held by the traditional groups was their ability to defect from the ruling party. In the words of one presidential pollster, "what 1988 showed us was the real inexistence of the corporatist vote. . . . even after 1991, the competitive nature of the electoral system convinced us that there was no 'hard vote' (voto duro) guaranteed."[30] And the government knew that the party that stood to benefit from such defections was not the right-wing PAN but the left-leaning PRD.[31] While the leftward "brain drain" had slowed considerably after the major 1987 party split, there continued to be a few high-visibility defections during the first years of the Salinas administration (Cothran 1994, 184; Morris 1992, 41), and the ever feisty oil workers maintained their ties to the Cárdenas camp (Teichman 1996, 159). To be sure, the possibility of an all-out split from the PRI by its leftist faction seemed unlikely. But it was not difficult to imagine a scenario whereby a severe economic downturn might induce a sufficient number of PRI activists to defect to the Cárdenista camp (Coppedge 1993, 135; Teichman 1996, 164). In a country where economic performance has historically been the main determinant of whether or not voters will vote for the left in Mexico (Brophy-Baermann 1994), this was not a scenario to be dismissed lightly.[32]

30. Ulíses Beltrán, chief pollster for President Salinas, interview by author, tape recording, Mexico City, Mexico, August 15, 1997.

31. This point was strongly emphasized during my interview with Manuel Camacho.

32. Note that as the decade wore on and the economic situation in Mexico deteriorated, local party bosses did begin increasingly to leave the PRI because of unhappiness with the national direction of the party, enabling the PRD to inherit entire *charros* (local political machines) at a time from the ruling party (Klesner 1997, 8).

The party hierarchy was well aware that much of the party machinery was unhappy and that recovering the lost PRI vote had to be a priority during the first half of the sexenio.[33] Awareness of this "internal threat" manifested itself in two ways. In the short run, Salinas sought to smooth over tensions with the old guard by offering them a number of important political positions, including cabinet posts, governorships, and a role in the national assembly (Morris 1995, 93). Much more so than De la Madrid, Salinas sought to balance the increasingly technocratic nature of decision making in Mexico with a role for the more statist sectors in the party. As Centeno and Maxfield so eloquently phrased it, "this was a techno-authoritarian cabinet that consisted of planners and policemen; the former determined policy and the latter ensured that it was carried out" (Centeno and Maxfield 1992, 72). In turn, perhaps the most important indirect measure taken to preempt defection from the labor camp was a steady increase in average real manufacturing wages throughout the first half of the sexenio (Magaloni 1998, 6–9).

In the long run, however, it was clear that Salinas saw traditional party interests as an obstacle to his programmatic agenda that needed to be removed. In this regard, a much more important signal about the threat posed by entrenched party leaders was a series of measures designed to bring the country's political institutions more directly into the service of Salinas's long-term neoliberal economic agenda. First, he sought to disempower traditional labor leaders and rebuild a new pact with labor outside the confines of the official labor movement. During his first year in office, Salinas led a highly public campaign against corruption within the PRI, in which he arrested the leader of the powerful oil workers' union and forced the head of the corrupt teachers' union into early retirement (Morris 1995, 85). Few doubted that this was a measure intended to punish the "turncoats" who had voted for Cárdenas in 1988 (Cothran 1994, 179), while at the same time eliminating some of the major enemies of his neoliberal reform agenda (Middlebrook 1995, 195; Grindle 1996, 93). This was complemented by a series of measures to deprive traditional labor unions of control over policy and, most notably, over the government-subsidized worker-housing fund (Middlebrook 1995, 296–97). But perhaps this strategy was most evident in the onset of the so-called New Syndicalism, through which Salinas sought to cultivate and institutionalize relations with labor unions much more favorable to his neoliberal program of economic restructuring (Morris 1995, 84–88).

The same could be said for Salinas's attempts to reconfigure the structure of the ruling party itself. For example, under the guise of "democratizing" candidate selection in the PRI by promoting local primaries and party

33. Beltrán, interview.

conventions, Salinas in fact pursued a variety of tactics to build a ruling coalition centered around the "Salinas family." By reducing the number of traditional sector nominations for public office, he made way for an increase in the number of candidates from the popular sector, particularly those in the federal and state governments tied to the Salinas team and members of the local business community (Craig and Cornelius 1995, 282–83; Morris 1995, 93).[34] A series of reforms to recast mass-actor incorporation into the PRI along more territorial lines was similarly viewed by many as an effort to remold the party in his own image by promoting new ties to grassroots movements heretofore unconnected to the governing elite (Craske 1996; Grindle 1996; Dresser 1994a).[35] This would certainly seem to have been the guiding logic behind Solidarity, where its organizational structure outside the confines of the ruling party ensured that its beneficiaries would have allegiance not to the party but, rather, directly to the president himself (Morris 1995, 85–86; Grindle 1996, 94).

Through all of these measures, Salinas appeared to be attempting to keep the label "PRI" but to shift its coalitional base to create a new support base for neoliberal reforms. The tremendous energy that Salinas poured into reshaping Mexico's political institutions over the six years he was in power would thus seem proof of the enormous threat that traditional vested interests posed to the sustained viability of his economic model. In the words of one Mexican political analyst, "his goal was to dismantle political constraints and construct bases of consensus that would allow for the continuation and deepening of this economic restructuring program" (Dresser 1997, 63).

Societal Threat: Small and Medium-Sized Businesses

A third and final member of the populist coalition threatening the future of the technocrats' economic project was those portions of the industrial sector that had failed to reorient their production in the wake of Mexico's economic

34. Indeed, despite the rhetoric surrounding the reforms to promote local primaries for candidate selection, the reality is that only 4.3 percent of the PRI's 1991 candidates for the Chamber of Deputies and none of its candidates for the Senate were chosen through party primaries or nominating conventions (Domínguez and McCann 1996, 120). The remainder were handpicked by the PRI leadership and government officials close to the president by virtue of a "unanimity rule" that allowed waiving a nominating convention in the event that only one candidate came forward for a given office.

35. During the fourteenth assembly of the PRI in 1990, the party approved a reform package proposed by Salinas in which the PRI's sectoral structure was retained but that also added opportunities for individuals and groups not affiliated with any sectoral organization to join. This was followed in 1992 by a call for a "refoundation" of the party in which the labor, peasant, and popular sectors would be replaced by four new "support branches" that were much more community and territory based.

restructuring. As noted in the previous chapter, these were generally the small and medium-sized businesses in traditional industries that continued to produce for the internal market and, as a result, were largely left out of the process of economic opening (Alba Vega 1993b; Puga 1992). During the Salinas sexenio, their situation continued to deteriorate. Not only did the number of smaller and medium-sized firms registered in the manufacturing sector fall from 871 in 1988 to 401 in 1993—amounting to a loss of some forty-three thousand jobs (Pastor and Wise 1997, 432)—but even among those firms that did manage to stay afloat, manufacturing output and wages stagnated (Pastor and Wise 1997, 435; Dussell Peters 1996, 70).[36] To obtain some idea of the magnitude of this situation, note that in the manufacturing sector, only 1.3 percent of all firms accounted for 71.8 percent of aggregate value in 1990, while microenterprises—which accounted for 86.9 percent of all manufacturing entities—provided only 4.6 percent of its aggregate value (Puga 1992, 20). As one author put it, small and medium-sized enterprises had become one of the "social escape valves" for unemployment and the contraction of salaries during the process of neoliberal reform (Puga 1993a, 44).

But while these firms were not among the most economically powerful in the country, they were the most numerous. As such, even though their economic weight deprived them of much clout within the structure of organized business, they did have one enormously powerful weapon: their vote. As one analyst of Mexican politics noted at the time, "it is difficult to imagine that many groups that have been affected by the economic policies of the regime and whose lives will be disrupted by NAFTA will remain disorganized and divided" (Centeno 1994, 242).

And, indeed, the progressive marginalization of smaller and medium-sized enterprises from the outward-oriented development model did lead to their gradual political mobilization (Luna 1994). Toward the end of the 1980s, for example, large groups of small and medium-sized producers challenged the great concentration of power within the CCE in the hands of financial and industrial groups (Luna and Tirado 1992, 83). When a separate organization was subsequently created to represent business interests in NAFTA, smaller firms accused this institution of a similar bias toward the interests of large firms (Puga 1993b, 66–68).[37] By the end of the Salinas sexe-

36. It is true that average wages in the manufacturing sector had been steadily increasing. But because the manufacturing sector's growth was steadily shrinking over this period, wages were accruing to an increasingly smaller group of workers, largely found in the more competitive manufacturing branches where small and medium-sized firms were not dominant (Pastor and Wise 1997, 432–35).

37. I refer here to the Business Council for Foreign Trade (Coordinadora Empresarial para el Comercio Exterior [COECE]), which was established in 1990 in the wake of the NAFTA negotiations between Mexico and the United States.

nio, such criticisms translated directly into policy demands. Small and medium-sized firms began to call actively for an industrial policy to meet the needs of those firms not able to manage the transition to internationalization, lobbying for increased credit support and an economic strategy more concerned with domestic markets (Teichman 1995, 189; Luna 1995, 87–92; Shadlen 2000, 89–93). Were their dissatisfaction with the neoliberal economic model to continue, it was entirely conceivable that their preferred form of protest might escalate from benign calls for industrial policy to the choice to vote for an opposition party more sympathetic to their protectionist leanings (Serrano 1996, 15). Indeed, by the early 1990s there was already evidence of a deliberate strategy on the part of the PRD to court these small businesses who were openly disaffected from the neoliberal model (Shadlen 2000, 96–97).

Once again, there is strong evidence that Salinas was not only aware of the mounting grievances expressed by small and medium-sized enterprises but was also intent on fixing them. A former economic aide went so far as to describe the president as "obsessed" with their predicament.[38] Beginning in 1990, and with a dramatic acceleration in 1993 and 1994, Salinas launched a quiet campaign to pump money into the small and medium-sized businesses via the government development banks. From 1992 to 1993 alone, so-called second tier (discount) lending rose by 78.5 percent (Nacional Financiera 1993, 29). It was most egregious where nonbank financial intermediaries such as credit unions were concerned, which grew in number from 55 in December 1989 to 539 in May 1994 (Werner 1995, 22), an increase on the order of 1,000 percent.[39] While fancy accounting techniques enabled government officials to mask the mounting fiscal deficit produced by such official credit expansion, as one Finance Ministry official put it, "the growth was simply savage."[40]

To be sure, one could plausibly attribute Salinas's "obsession" with the

38. Confidential interview by the author, tape recording, Mexico City, Mexico, August 22, 1997.

39. Under regulations that were revised in the early 1990s, development banks could no longer lend directly to creditors but rather had to do so via an intermediate source, whether a commercial bank or a "nonbank" entity such as a credit union or a factoring company. See Werner 1995 for a description of these changes.

40. Francisco Meré, director of Development Banks in the Ministry of Finance under the Zedillo administration, interview by the author, tape recording, Mexico City, Mexico, August 22, 1997. In 1993, the Mexican government changed the way in which public finances were counted by eliminating the "financial deficit"—or the financial intermediation activities of state development banks—from its recording of the federal budget deficit. The government justified this decision on technical grounds, arguing that because development banks were no longer operating outside the market, there was no need to include this deficit in the formal accounting system. That said, the removal of the financial deficit was perceived by many as an effort to hide the government's efforts to stimulate the economy. See "Replanteará Zedillo la Estrategia Económica," *El Financiero,* December 24, 1995; "El Déficit en Cuestión," *Reforma,* February 15, 1995.

fate of small and medium-sized businesses purely to economic strategy. After all, small enterprises did frequently fail to qualify for the high interest rates charged on commercial bank loans and as a result often faced serious obstacles to obtaining financing.[41] There was also strong evidence from the East Asian experience that effective competition required a mix of large and small firms (Fishlow 1994), and the president was well aware of such debates. But the irresponsible nature in which such loans were carried out—in terms of both their magnitude and the corresponding lack of supervision—would suggest that the president was overwhelmingly guided by the imperative of securing electoral victory for the PRI in 1994 (Morris 1995, 82; Luna 1994, 209).[42] Such an interpretation seems borne out by the periodic public gatherings the president would hold during these years with as many as 8,000 people at a time, at which he would personally hand out credit to small businesses with but 2–10 employees.[43] As one senior member of the PAN leadership colorfully phrased it, "the 'fat' of the pork was transferred through the development banks."[44]

Salinas's extreme efforts to direct finance toward small and medium-sized businesses during his tenure in office suggests that he saw them, first and foremost, as an electoral liability whose sympathies he needed to win over, whatever the price. While such policies were sharply at odds with his otherwise technocratic image, they were also a realistic reflection of the broad divide that existed between the winners and losers in the neoliberal development model and of the president's perceived need to accommodate them politically if he were to preserve it (Dresser 1997, 59–61).[45]

In brief, policy-based threats to the long-term potential of the Salinas

41. See "Small Businesses in a Big Time Economy," *Business Mexico,* March 1993, 4–7.

42. And few in the current Zedillo administration would deny this. Who exactly is to blame for this exorbitant lending spree on the part of the credit unions has been the source of much discussion in Mexico in the wake of the peso crisis. In part, it can be attributed to the inexperience of the National Banking Commission, which had only recently gained its independence from the Finance Ministry as an autonomous oversight body. It was also clearly the product of irresponsible conduct by the officials at the state development bank Nafinsa (Nacional Financiera), who actively exhorted—over and above the protests of other government agencies—the widespread formation of credit unions, even when it was clear that such loans had no chance of being paid back. At the end of the day, however, the board of directors of Nafinsa responded to the orders of the finance minister, Pedro Aspe, who himself served as the president's financial agent (Federico Patiño, adjunct director of financing, Nafinsa, under the Zedillo administration, tape recording, Mexico City, Mexico, August 20, 1997).

43. One Mexican journalist referred to such gatherings as a "heroic feat." Alberto Barranca, columnist, *Reforma,* interview by author, tape recording, Mexico City, Mexico, August 13, 1997.

44. Augustín Navarro, director of public relations, National Action Party, interview by author, tape recording, Mexico City, Mexico, August 20, 1997.

45. Kessler (1998) offers a different assessment of the political power of small and medium-sized businesses during the Salinas era.

economic model stemmed as much from inside the authoritarian regime as from the nature of its political competition. While the nature of this populist coalition was much more diffuse than had been the case in Chile, any one of its three components—and certainly their combination—was sufficient to jeopardize the prevailing economic model. Moreover, as the evidence presented previously suggests, there was no question that these were all a source of concern to incumbent authoritarian elites. The relevant question, therefore, is not whether these different threats constituted a source of alarm—clearly, they did—but whether they were of a significant magnitude to warrant taking some form of institutional action. I argue that they were but that how much insulation would be required to fend off this threat would be dictated by how soon it was likely to materialize.

The Proximity of Threat: Mexico's Liberalizing Authoritarian Regime

If we accept that uncertainty over the future course of policy in Mexico emanated from a variety of sources over the course of the Salinas sexenio, the key question was how soon—if at all—any of this was likely to come to a head. Here is where we begin to see particularly marked changes with respect to the Chilean case. For unlike in Chile, where a changing of the guard was imminent, in Mexico there were mixed signals as to the longevity of authoritarian rule. While an eventual transition seemed likely, it still looked a good way off.

The ruling party vastly improved its fortunes in the 1991 midterm elections, claiming over 60 percent of the national vote. With this apparent about-face in voter sentiment, PRI hegemony was restored in the Chamber of Deputies, and the ruling party even gained back one of the Senate seats it had lost in 1988. In contrast, support for the right-wing PAN held steady at around 18 percent of the national vote, while support for the left-wing PRD plummeted from over 30 percent to a mere 8 percent. While a variety of factors contributed to the PRI's revitalization at the polls, two major determinants were presidential popularity and the country's economic recovery during the first half of the Salinas sexenio (Domínguez and McCann 1996, 126–36; Buendía 1996; Kaufman and Zuckerman 1998). By the end of his first three years in office, Salinas could point to an economy experiencing low but steady growth, a dramatic decline in inflation, and a steady rise in average real wages. As two analysts of Mexican politics noted at the time, "if the national elections of August, 1991 are a reasonably accurate reflection of popular sentiment, Mexico's economic policy is restoring confidence in the management of the economy by the PRI government" (Weintraub and Baer 1992, 200).

But despite its strong showing in 1991, it was also clear that the PRI would not continue to dominate the electoral sphere indefinitely. The PRI's overall vote share had been declining steadily over the past thirty years, with the proportion of electoral districts dominated by the PRI dropping from over 84.5 percent in 1964 to 37.7 percent in 1991 (see table 7.1). While this was partly due to demographic changes, these figures also reflected the growing number of independents in the Mexican electorate, particularly after 1988 (Basañez 1991; Klesner 1994; Magaloni 1998). As a result of this trend, midway through the Salinas sexenio "the Mexican political electorate was less securely under the PRI's control than it had ever been" (Klesner 1994, 189). As one scholar characterized the situation: "[there were] . . . risk and uncertainty with just enough opportunity to create unpredictable patterns; so much so that in only three years, it has inspired both the shock of 1988 and the counter-shock of 1991" (Morris 1992, 46). For practical purposes, such volatility meant that, were the electorate to determine that the ruling party was not capable of making national policy, PRI supporters in 1991 might just as easily take their business elsewhere (Domínguez and McCann 1996, 78).

Such electoral dealignment was particularly dangerous for the govern-

TABLE 7.1. Mexico: Electoral Competition in National Elections, 1964–94 (% of 300 federal electoral districts)

		Type of Competition[a]				
Election Year	PRI Monopoly	Strong PRI Hegemony	Weak PRI Hegemony	Two-Party Competition	Multiparty Competition	Opposition Victory
1964	28.1	52.2	4.5	14.0	—	1.1
1967	24.2	61.2	3.6	9.7	—	1.2
1970	27.0	53.9	1.7	17.4	—	—
1973	18.7	51.3	4.1	21.8	1.0	3.1
1976	35.8	44.6	6.7	11.9	0.5	0.5
1979	9.4	48.0	12.3	6.3	22.7	1.3
1982	1.3	51.7	6.3	26.1	14.0	0.3
1985	3.3	41.7	9.0	21.0	21.3	3.7
1988[b]	1.0	19.0	15.0	8.3	34.0	22.7
1991	—	21.7	16.0	18.0	41.0	3.3
1994	—	2.3	8.3	26.0	55.4	8.0

Source: Cornelius 1996, 65.

[a]PRI monopoly = PRI vote > 95%; strong PRI hegemony = PRI vote < 95% but > 70; weak PRI hegemony = PRI vote < 70%, but the difference between PRI and second party in district is > 40 percentage points; two-party competition = PRI vote < 70%, difference between PRI and second party is < 40 percentage points, second party vote > 25%, and third party vote < 10%; multiparty competition = PRI vote < 70%, difference between PRI and second party is < 40 percentage points, and second party vote < 25%, or third-party vote > 10%; opposition victory = any party's vote > PRI vote.

[b]For 1988, opposition victories include those won by the Cardenista.

ment in light of the inordinate degree of importance it had placed on NAFTA as the key to solving Mexico's economic problems. In effect, such a strategy intimately linked the electoral fate of the ruling party to the fate of the free trade agreement and the continued performance of the economy more generally (Basañez 1993, 110; Baer 1993, 62). And unlike in previous sexenios, where the ruling party had a variety of political tools at its disposal with which to manage an economic downturn, now such a crisis would be taking place amid an increasingly competitive political environment. One analyst appropriately referred to economic growth as Mexico's "Containment Policy" for the 1990s, in that the government's ability to forestall the onslaught of the opposition hinged on its maintaining positive economic results (Dresser 1994a, 141).

Indicators of internal party cohesion during this period offered a similarly mixed picture of ruling party strength. In light of his early efforts to oust recalcitrant labor leaders and personally influence candidate selection in the PRI, Salinas had largely succeeded in biasing the ruling party in favor of his interests. In turn, his attempts to co-opt the PRI's more intransigent old-style politicians into his cabinet also served to quell internal restiveness (Centeno 1994, 142–43). Perhaps Salinas's ability to manage internal party divides was best demonstrated by the fact that he was still able to impose unilaterally his choice for the PRI presidential candidate in late 1993.

That said, this marriage of convenience was also only a short-term strategy at best. For while Salinas could still rely on the traditional sectors of the party to marshal their bases in support for his economic program, the cost of co-optation had risen. First, it required increasing concessions that undermined the very set of neoliberal policies Salinas sought to promote. The fact that Salinas never acted on the pledge to enact a labor reform, for example, was widely perceived as the price of keeping powerful labor union leaders on board (Middlebrook 1995, 298). Second, furnishing old guard elements with a voice in the regime also enabled them to criticize—if not resist—Salinas's political reform agenda. There is some evidence, for example, to suggest that the PRI was engaging in "conditional party loyalty" during the first half of the Salinas sexenio, withholding its support for the president on key legislative initiatives (Diaz and Magaloni 1997; Weldon 1997, 245). Efforts to replace the three corporate entities of the PRI with more direct citizen-based organizations were also successfully defeated by the old guard, who managed by the end of the sexenio to virtually undo Salinas's internal restructuring effort (Morris 1995, 93–95; Craske 1996). Finally, dissatisfaction with the president's candidate selection process also provoked a good deal of internal party protest at the local and regional levels, even leading to the occasional defection to the opposition (Crespo 1995, 109; Morris 1995, 94–96). By keeping the statist elements of the party alive, Salinas thus placed himself in a double bind. While he him-

self might not be faced with reconciling this contradiction, there was no question that he was keeping a lid on a precarious situation.

A similarly murky image emerges if we consider our final indicator of the proximity of threat: the power of the regime's political opposition. Unlike in Chile, where the outgoing authoritarians faced a well-organized and ideologically united opposition front, the Mexican political opposition was divided throughout the period in question. The opposition parties of the right and left had put aside their ideological differences in 1988 to unite around the common goal of democratization. But immediately after the 1988 elections, the nature of interparty relations began to change (Bruhn 1996, 240–47; Crespo 1995, 58–84). Beginning with a constitutional reform on electoral procedures and later expanding to a series of economic and social policy initiatives, the right-wing PAN began to distance itself from the left-wing PRD and to ally itself instead with the government.[46] Over time, the PAN came to assume an unofficial role as a "junior partner" of the government, while the PRD was increasingly cast in the role of outsider (Alcocer V. 1994, 151–53). As long as the opposition remained so divided, this helped to contain the political threat to the regime.

In addition to the lack of unity between the two principal opposition parties, each suffered from internal weaknesses. To begin with, neither party had a national vote share that came anywhere near rivaling that of the PRI. Despite a number of significant gubernatorial victories by the PAN and its demonstrated skill as a negotiator (Stansfield 1996), this party controlled only 18 percent of the electorate, while the PRD held a paltry 8 percent. In part, this reflected their identities as largely regional parties, with the PAN based predominantly in the northern states, while the PRD's support was concentrated in Mexico City, Cárdenas's home state of Michoacán, and the rural south. Both parties also suffered from internal divides between those who favored negotiating with the PRI and those who favored isolationism (Cornelius 1996, 67–75; Crespo 1995, 62; Castañeda 1993, 184–94; Bruhn 1996, 169–84). Finally, each party was also handicapped by its own idiosyncratic deficiencies. In the case of the PAN, this party lacked a charismatic candidate with which to vie for the presidency throughout most of the sexenio.[47] The

46. Among others, these included the 1989–90 electoral reforms (see the following discussion), the agricultural reform of the ejido system, the privatization of the banks, and the central bank reform itself.

47. This changed in 1994 when the PAN named Diego Fernandez de Cevallos as its candidate for the upcoming presidential elections. While prior to the presidential debate in May 1994, Cevallos had very little national political exposure, he performed so well in a set of televised presidential debates in May of that year that he catapulted overnight into first place. Shortly after this victory, however, he virtually disappeared from the public eye, leading many to suspect that he was either "bought out" by the PRI or simply lost his nerve. See Crespo 1995, 79–280, for details.

PRD, for its part, was also hurt by the public perception that it lacked a rigorous alternative program of governance, not to mention the negative portrait that the government had succeeded in painting of it since its inception (Bruhn 1996, 208–49).

But even while the country's major opposition parties continued to be divided, Mexico was gradually demonstrating a more competitive political environment in which elections and party politics assumed heightened importance. While the ruling party had regained its hegemony within the electoral system at the national level in 1991, the situation was quite different at the state and local levels (Rodríguez and Ward 1995; Pacheco Mendez 1997). In 1989, the PRI's sixty-year monopoly on state governorships was finally broken with the officially recognized victory of a PAN candidate in Baja California. The persistent strength of the opposition was also reflected in a series of highly publicized and embarrassing incidents in which the PRI was forced to reverse officially declared gubernatorial victories and concede these to the opposition (Crespo 1995, 169–96. In turn, the PRI continued to lose ground to the opposition in medium-sized and large cities, such that by 1994, nearly 15 million Mexicans (almost one-fourth of the population) lived under municipal governments led by opposition parties (Cornelius 1994, 56) and more than three-quarters of all municipalities nationally exhibited high rates of electoral volatility (Pacheco Méndez 1997, 345).

Perhaps the most ominous development for the shape of the competition to come was the growing regionalization of the vote in Mexico (Klesner 1998; Magaloni 1998). By the mid-1990s, a clearly discernible trend had emerged whereby the PRI and the PAN appeared to be competing for the north and west zones of the country, while the PRI and the PRD vied for the south and central zones (see table 7.2). Klesner (1998) attributes such "bipartisan" voting patterns to the way in which the process of regional economic integration affected different areas of the country. Simply put, those regions with a strong manufacturing base and better educated labor forces were more favorably predisposed toward the two parties that wanted economic integration (PRI and PAN), while those regions that were either adversely affected by or excluded from integration seemed torn between their traditional allegiance to the ruling party and the more protectionist policies of the PRD. The emergence of a more divided Mexico was alarming news for the ruling party, as it suggested that in the future the PRI would be highly vulnerable both to the right and to the left as it sought to maintain its hegemony.

A variety of different indicators suggest that the ruling party perceived itself as on increasingly shaky ground vis-à-vis its competitors. In this regard, one can interpret the extensive use of polling, younger and more professional candidates, and widespread "get out the vote" campaigns in the 1991 elec-

TABLE 7.2. Mexico: Federal Deputy Election Results by State, 1991–97 (% of voter share)

	PAN			PRI			PRD		
State	1991	1994	1997	1991	1994	1997	1991	1994	1997
North									
Baja California	44.7	36.7	43.4	45.7	50.6	35.2	2.8	7.8	13.7
BC Sur	24.5	33.3	20.9	66.4	57.2	48.4	1.5	5.4	13.3
Chihuahua	32.3	28.4	41.5	58.4	59.6	41.4	2.2	5.8	10.5
Coahuila	21.1	29.3	30.7	63.0	51.0	47.3	7.2	11.4	14.8
Durango	16.5	25.2	25.4	62.1	51.7	38.3	5.8	9.0	10.7
Nuevo León	25.9	41.5	49.5	68.5	49.2	39.3	1.2	2.3	2.8
Sinaloa	25.4	28.9	30.5	65.5	54.5	41.8	4.8	13.2	22.9
Sonora	24.2	32.8	32.8	68.6	48.3	38.9	3.3	13.5	26.9
Tamaulipas	14.7	23.5	19.6	63.3	50.9	47.3	3.7	15.3	26.9
Zacatecas	9.0	21.9	26.1	75.7	61.4	49.7	7.1	9.6	14.3
Bajio									
Aguascalientes	19.6	35.9	36.8	66.4	48.0	41.1	2.6	8.7	13.4
Colima	14.2	25.9	38.1	66.5	55.3	36.6	8.6	12.6	20.9
Guanajuato	33.4	30.5	44.0	53.4	54.7	33.0	4.7	8.6	13.1
Jalisco	23.7	41.8	44.9	63.1	44.6	35.4	2.7	7.7	11.7
Michoacán	8.7	15.2	18.3	53.9	44.9	35.4	31.2	35.4	40.1
Nayarit	4.1	16.3	23.8	70.5	59.4	50.4	12.9	16.5	20.8
Queretaro	21.0	30.1	45.6	69.9	59.1	38.5	2.4	5.0	9.3
San Luís Potosí	30.3	25.1	39.1	63.9	61.1	42.5	1.3	8.8	11.1
Center									
Hidalgo	7.5	16.6	16.3	72.7	62.4	49.3	8.5	14.9	27.1
Morelos	7.5	20.6	17.5	65.8	52.4	34.2	12.3	19.4	39.8
Puebla	14.9	27.0	25.8	69.5	52.5	48.4	4.6	14.0	18.4
Tlaxcala	8.5	22.6	19.2	74.2	55.2	44.3	6.2	14.6	23.7
Metro									
DF	19.9	27.3	18.1	46.3	40.6	23.2	12.0	21.4	45.5
Mexico	16.7	25.9	20.0	53.4	46.6	34.6	10.3	18.5	34.4
South									
Campeche	3.4	16.4	8.3	78.6	56.0	46.4	4.2	21.3	36.9
Chiapas	6.2	10.9	13.3	76.3	49.6	50.3	5.9	33.2	29.9
Guerrero	2.9	9.5	8.0	63.0	49.8	45.8	24.7	34.3	42.3
Oaxaca	5.3	12.6	12.9	73.5	53.5	49.5	9.5	27.3	31.1
Quintana Roo	11.7	27.3	23.9	76.2	55.6	45.9	5.8	12.2	23.9
Tabasco	2.4	5.7	4.9	72.6	59.6	51.3	18.9	33.0	40.7
Veracruz	5.0	15.2	21.6	75.3	54.4	43.1	6.0	23.3	27.3
Yucatan	36.0	40.9	38.5	61.8	54.3	50.7	0.2	2.7	7.6
Total	17.7	25.8		61.5	50		8.3	17	

Source: Klesner 1998, table 1. Reprinted with permission.

tions as proof of the ruling party's awareness of this new atmosphere of heightened competitiveness and the need to address it (Baer 1993, 60). The government also saw the need to undertake a series of electoral reforms during this period that marginally increased the space for opposition participation (Gomez Tagle 1993; Molinar Horcasitas 1996).[48] Finally, the fact that charges of electoral fraud were still widespread at the state and local levels even as late as 1993 also reflected the PRI's continuing uncertainty about its own ability to win elections honestly and make the victories stick (Morris 1995, 97; Bruhn 1996, 274–84; Cornelius 1994, 58–59).

When all is said and done, however, the question on the table is how this atmosphere of political threat measured up when compared to the Chilean case. Perhaps the best way to sum up the distinction between these two cases is that while Chile's authoritarian regime found itself in the midst of a transition to democracy in 1988–89, Mexico was still best characterized during 1988–93 as a liberalizing authoritarian regime—that is, one that had extended certain freedoms to the populace without relinquishing control over the process of change (Loeza 1994; Whitehead 1994). To be sure, the Mexican political environment did embody some aspects of a transition, including a pervasive environment of uncertainty, divisions within the elite, and a persistent challenge to the rules of the game (O'Donnell and Schmitter 1986). It was also clear that the apparent recovery of Mexico's economic health in the first half of the Salinas sexenio had not reversed the decline of hegemonic one-party rule. In spite of the PRI's remarkable political recovery in the 1991 midterm elections, "the anti-incumbent sentiment of the 1980s would translate into continued pressure for a democratic transition in Mexico in the 1990s" (Weintraub and Baer 1992, 191).

But while serving to expedite the transitional process, this liberalizing climate was not yet sufficient to trigger a full-fledged change of regime. And

48. The Salinas administration enacted three electoral reforms during its six years in office. The 1989–90 reform entailed a series of changes to make it more difficult for the PRI and government officials to commit electoral fraud (i.e., photographed voting credentials, same-day announcement of voting results, etc.). A second series of electoral reforms in 1993 served to double the Senate's size from 64 to 128 members, while guaranteeing that opposition parties would control at least one-quarter of the total seats, as compared with 5 percent during 1988–93. The final set of reforms, enacted in early 1994, included an external audit of voter registration lists, the creation of a special prosecutor for electoral crimes, a lower ceiling on party campaign financing, and fairer political party access to the media. It also set up an independent body—the Federal Electoral Institute (Instituto Federal de Elecciones [IFE])—to oversee elections. Many analysts have argued that the PRI has used such piecemeal changes in the electoral code over time in order to distract the public from reforming the core elements of Mexican authoritarianism (Reding 1991; Lujambio 1993; Loeza 1994). Be that as it may, there is no question that such changes moved Mexico in the direction of a more pluralistic political system, particularly after 1994 (Domínguez and McCann 1996, 193–97; Serrano 1996).

because of the in-between stage in which Mexico's rulers found themselves, the incentives for the incumbent authoritarian regime to fully insulate were less compelling than they had been in Chile.

Splitting the Difference: The Logic of Partial Insulation

In the wake of the ambiguous nature of the democratic threat that surfaced in Mexico over the course of 1988–93, Salinas responded in kind. On the one hand, since simply handpicking his own successor might no longer be enough to guarantee the longevity of his preferred policies, some kind of institutional response was in order. On the other hand, it was also incumbent upon him to choose these rules carefully. Since he and his cohort were likely to be those affected in the immediate future, it was important that their control over the economy not be unduly restricted.

Taking out Insurance: The Drive to Insulate

I argue that the Mexican government, in choosing to enact the central bank reform when it did, was motivated primarily by the need to take out some sort of "institutional insurance" on its economic program in the wake of an uncertain future. For while the magnitude of the threat facing Mexico's authoritarian government was lower than that in Chile, it was far from absent. Rather, there was enough uncertainty surrounding both the short-term outcome of the 1994 presidential elections and the long-term course of political change to warrant some degree of insulation.

The 1994 presidential elections marked a turning point in the time-honored Mexican tradition of the dedazo. For the first time in history, the designation of the PRI presidential candidate coincided with increasing signs of democratic political competition. While it was clear that "presidential control over the process of transition of the change of command will try to be as iron-clad as ever, . . . the weight of the unforeseen . . . internal and external factors that are no longer in control of the president [is] much greater than before."[49] As one noted Mexican intellectual commented in late 1993, "until 1988 the central characteristic of the Mexican political system was the predictability of the electoral process for the change of command—today that is no longer the case. . . . in the mechanics of the end of the sexenio something new has been introduced: uncertainty."[50] As a result of this climate of

49. Lorenzo Meyer, "Mexico 1994 o el Difícil Camino de Un Cambio Sin Reglas," *Nexos,* August 1993, 53.

50. Ibid, 50.

increased uncertainty, "midway through the sexenio, when normally the most dangerous ghosts of our political authoritarianism tend to flourish . . . the government continues without being able to normalize the extraordinary situation that emerged with the celebrated elections of 1988."[51] As one of Mexico's leading political analysts succinctly summed this up, "without being democratic, the Mexican successor tradition was operating in a democratizing context."[52]

While Salinas could thus be reasonably confidant that his handpicked successor would emerge victorious in the presidential elections of 1994, he could not be absolutely sure. Indeed, by late 1993, "it was neither an exaggeration nor out of context to contemplate a PRI defeat and government by one or more parties" (Regalado 1996, 157). Several PRI officials admitted as much, confessing that while the party had done much better than had ever been imagined in 1991, "we knew that we might not win in 1994 and that . . . we could no longer take anything for granted."[53] As evidence of such fear, note that the government front-loaded the federal budget considerably in late 1993, loosening spending controls and stimulating demand in classic political business-style fashion (Ramírez de la O 1994, 4; Leiderman and Thorne 1996, 6–12).[54] Particularly noteworthy in this regard was the launching in late 1993 of Procampo—a rural relief effort modeled on Solidarity—precisely at a time when, as we have seen, rural groups seemed increasingly favorably disposed to the left-leaning PRD (Ramírez de la O 1996, 53). Certainly, the rampant and unsupervised lending via the public sector development banks described earlier could have no other reading than an electoral one. The fact that all such measures were planned for and programmed into the budget even before the tumultuous events of 1994 suggests that despite its seemingly comfortable position vis-à-vis its competitors, the ruling elite was actually quite insecure about its own ability to win the upcoming elections.

Because of this uncertainty over whether or not he faced a change within regime (to a continuation of authoritarian rule under a new leader) or a change of regime (to democracy and, if so, what sort), Salinas could not afford to take any risks. To be sure, the worst case scenario from the government's standpoint was a populist future centered on a revived left-wing alternative. But even if the PAN were to prevail in 1994, it was impossible to predict what might happen down the road. In the words of one analyst of Mexican politics,

51. Luis Sálazar C., "La Gran Asignatura Pendiente: Democracia y Legaldad," *Cuadernos de Nexos* 53 (November 1992): vi.

52. Hector Aguilar Camín, "La Pieza Perdida y El Paisaje en Tres Tiempos," *Nexos,* August 1993, 68.

53. Beltrán, interview.

54. Ministerio de Hacienda, *Informe Hacendario* 1, no. 3 (July–September 1993): 24–28.

"even if the victory went to a pragmatic Cárdenas or a dogmatically liberal Panista [member of the PAN], no one in the government believed that any group could manage the economy as competently as Salinas" (Coppedge 1993, 132). In order to grapple effectively with these multiple layers of uncertainty, Salinas would need to shift from merely pursuing policies as his predecessors had done to protecting them in an institutional form.

The 1993 central bank reform reflected precisely such a strategy. As one Mexican political scientist phrased it, "all reforms, such as central bank autonomy, NAFTA, etc. were done as if the government were preparing for a disaster. . . . in effect, it had to ask itself 'what if'?"[55] In this way, Mexico's 1993 central bank reform formed part of a larger set of institutional reforms that one Mexican journalist aptly termed the "trans-sexenial project" of the Salinas administration.[56] Through such reforms, Salinas sought to maintain influence over policy under future governments through a strategy of "imposed continuity." For example, Mexico's entry into NAFTA in November 1993 was arguably an effort to lock in the country's trade and investment policies with its largest trading partner for the next fifteen years (Basañez 1993, 98). The creation of an autonomous antitrust commission in December 1992 could likewise be interpreted as an attempt to make sure that the administration's emphasis on competition and free markets would be respected by future administrations.[57] As one journalist noted when observing this pattern of institutional change, "It seems obvious that these reforms condition—if not limit—the range of options for any party other than the PRI that accedes to the government in 1994."[58]

This more strategic interpretation of the central bank reform's timing was reflected in the criticism put forth by the left-wing opposition when the initiative was first announced. According to the PRD, the government was trying "to perpetuate, at least through the next sexenio, an economic and monetary policy focus . . . so that the group presently in power can continue to direct economic policy tomorrow from today."[59] PRD legislators considered the reform a clear attempt to "maintain control despite the next change

55. Juan Molinar, political scientist, El Colegio de México, interview by the author, tape recording, Mexico City, Mexico, December 15, 1994.

56. See, for example, Carlos Ramírez, "Indicador Político," *El Financiero,* August 16, 1993.

57. I refer here to the federal Law on Economic Competition, which set up an independent commission to police anticompetitive practices in the public and private sectors. This commission was governed by five commissioners, appointed by the president for ten-year renewable terms.

58. José Galindo López, "El Capital Político y los Plazos Largos: El Congreso del PRD," *Cuadernos de Nexos* (July 1993): xii.

59. "Frentes Políticos," *El Excelsior,* May 25, 1993.

of federal government,"[60] accusing the Salinas administration of trying to convert the Bank of Mexico into a "technocratic-financial nucleus, without social, legislative, or executive control."[61] In the words of the party's president, "there is no re-election, but there is continuity of the same economic policy, through mechanisms that exclude the fundamental decisions from popular sovereignty and even the organizations of political representation."[62] The net effect of such a strategy was that "while the Bank of Mexico would gain autonomy in relation to the next president, it would become dependent on the present head of the executive."[63]

Suggestive evidence for how the threat of political change might have influenced the reform's timing was also evident in select comments made by various government officials both during and after its legislation. Aspe himself hinted at such a motive when he unveiled the reform, noting that "for the first time ever, there will be no uncertainty regarding a possible change in the economic course of the country associated with a sexenial change of government."[64] A political motive was explicitly invoked by one central bank economist involved in drafting the reform who noted, "if with a non-autonomous central bank one already has fiscal balance and inflation under control, then there are no immediate incentives to authorize autonomy. *The only reason for autonomy under such circumstances might be to eliminate any future temptation to adopt expansionary polices*" (Roubli-Kaiser 1996, 13) (italics added).

Others corroborated this version of events. In the words of one of the president's leading political advisers, "The process of modernization that had begun in the sexenio allowed us to see an alternation in power in the future . . . and this was new as of this sexenio. In part this contributed to the timing of this reform."[65] Manuel Camacho also agreed that political variables had entered into Salinas's decision-making calculus. In his words, "the president . . . thought of everything in terms of the victory of the PRI, his own personal victories, and the competence of the presidential succession. . . . all of this intervened in even the most minuscule of decisions. So this reform was a way not to eliminate such uncertainty, but, yes, to reduce it."[66] It is possible that even Colosio himself was viewed as a potential risk for the policy preferences

60. "Respalda PAN la Iniciativa; La Oposición de Izquierda Pide Investigación Previa," *El Sol de México,* May 25, 1993.

61. "Frentes Políticos."

62. Porfirio Muñoz Ledo, president and senator of the PRD, *Statement to El Senado de México, June 22, 1993, Diario de Los Debates* 20, 12.

63. "Opinión de Partidos," *El Economista,* May 25, 1993.

64. "Frentes Políticos."

65. Confidential interview by the author, tape recording, Mexico City, Mexico, August 15, 1997.

66. Camacho, interview.

of the outgoing regime. As one member of Aspe's team in the Finance Ministry confessed, "we saw political changes coming—not just alterations between political parties but also within the ruling party itself. . . . I wasn't very sure that Colosio himself—who was not a very orthodox person when it came to the economy—would support an anti-inflationary policy with sufficient vehemence."[67]

But even if it is true that political considerations served as the underlying inducement for the central bank reform, we still need to understand its precise evolution and timing. Recall that while the idea initially surfaced at the beginning of the Salinas administration, it was not actually set into motion until early 1992. Why did the president wait three full years before beginning to work on this reform in earnest? Here, a variety of factors come into play. To begin with, there was a simple question of votes. Given the results of the 1988 elections—and, in particular, the lack of a PRI majority in the Chamber of Deputies—it was not wise to push ahead with a major reform initiative until the regime was on more solid footing politically.[68] The president thus made a calculated decision that it was more important to consolidate the ruling party's electoral base in the first half of the sexenio and wait until the second half of the administration to institutionalize its pet legislative initiatives.

More generally, the six-year calendar that characterizes presidential elections in Mexico is also relevant in explaining the reform's timing. One can imagine, for example, that had this been a parliamentary system, in which the legislature is effectively free to "fire" the prime minister at a moment's notice, Salinas might have tried to insulate the central bank right off the bat (see chap. 8). But because he knew that he had six years until he would have to step down from power, he chose instead to bide his time. On the one hand, and consistent with the logic of insulation outlined in chapter 3, it was only natural that he would put off as long as possible a reform that would limit his

67. Confidential interview by the author with former member of Finance Ministry, tape recording, Mexico City, Mexico, August 22, 1997. Some of those individuals interviewed for this study argued that it was, in fact, the "Colosio threat" that was driving the central bank reform. According to this logic, the reason the central bank reform surfaced in mid-1992 had less to do with an electoral logic (see the following discussion) than with the fact that by mid-1992, everyone was fairly certain that Colosio would become the next PRI presidential candidate. This argument is somewhat persuasive in that Colosio was certainly far less economically orthodox than his fellow presidential contender, Pedro Aspe. That said, he also had a very clear reputation as Salinas's "good son" and someone unlikely to deviate from the script (see, e.g., "Perspective on Mexico: Salinas Bets All on the 'Good Son,' " *Los Angeles Times,* November 30, 1993, p. B7). Thus, unlike Manuel Camacho—the third competitor for the throne—who, by his own admission, really was viewed by the technocrats as a "closet populist," Colosio was much less likely to "rock the boat" (Camacho, interview). Perhaps the biggest proof of Colosio's willingness to continue the economic model was his naming of Ernesto Zedillo—a tried and true technocrat—as his campaign manager.

68. Interviews, Beltrán; Camacho.

own discretion. On the other hand, and consistent with the story outlined earlier in this chapter, he also wanted to wait and see how the threat evolved before deciding exactly how much flexibility he would be willing to yield. The Mexican electoral cycle thus not only affected the timing of the reform but its shape as well (see the next subsection, "Autonomy 'A Medias': Retaining Executive Controls").

Rather than waiting until the very end of his term, however, Salinas had a strong incentive to have the central bank reform in place before the end of 1993. During the sixth and final year of his term, the government's priorities would shift toward ensuring the electoral victory of his successor. If Salinas were to avoid this "lame duck" scenario, he would need to complete all major institutional reforms before the electoral cycle resumed in 1994.[69] And because, as noted in chapter 3, central bank reforms take some time to mount and implement when they are done "from scratch," he would have needed to have begun working on the legislation as early as 1992 in order to have it ready by this date. However one chooses to interpret the precise timing of the initiative, it is clear that it was important that it take place before Salinas left power. According to one aide, he charged his staff to "guarantee me this before I go. . . . don't leave it undone for the next president."[70]

Mexican presidents have always tried to exert influence beyond their own sexenio by handpicking their successors. But this particular conjuncture was different: the dominance of a particular set of interests in power (embodied in Salinas) had also coincided with increasing signs that political change was on the horizon. Mere continuity in personnel would no longer be sufficient for protecting the president's preferred policies. Rather, it would also require institutional reform.

Autonomy "A Medias": Retaining Executive Controls

But while there was thus enough uncertainty about the future course of events to warrant some degree of insulation in late 1993, the question was how much policy-making authority the incumbent government should yield to this independent agency. An earlier section of this chapter ("Reform Outcome: Evaluating the 1993 Reform") detailed the myriad ways in which the 1993 reform failed to result in a fully autonomous central bank. This section links such partial autonomy to the more ambiguous political threat confronting incumbent authoritarian elites. For unlike in Chile, where an imme-

69. I am grateful to Enrique Quintana, columnist, *Reforma,* for this point. Enrique Quintana, interview by the author, tape recording, Mexico City, Mexico, December 10, 1994.

70. Former Aspe aide, confidential interview by the author, tape recording, Mexico City, Mexico, August 22, 1997.

diate challenge to the regime's power met with a fully insulating response, in Mexico there was not enough risk of imminent democratization to warrant the complete abdication of executive control. Because of this cloudier overall picture, the resultant autonomy afforded the institution was watered down accordingly.

Exchange rate policy is particularly instructive in this regard. The question of which agency would control the exchange rate was one of the most contentious of those debated between the Finance Ministry and the central bank in the wake of their summer 1993 negotiations over the central bank law. Noting the quasi-fixed exchange rate regime that prevailed in Mexico at the time, many individuals within the central bank argued that exchange rate policy and monetary policy were effectively "two sides of the same coin." Accordingly, they argued in favor of the Chilean model, whereby the central bank would set exchange rate policy.[71] But despite their protestations to the contrary, the exchange rate policy dispute was ultimately decided in favor of the executive in the form of an exchange rate commission with the deciding vote for the finance minister. And the central bank, for its part, would supervise the country's reserves.

While the government justified its decision on two grounds—Chilean exceptionalism and unresolved theoretical debates (Roubli-Kaiser 1996, 17–21)—there was good reason to suspect that the actual motivation might have had much more to do with political calculations. For one thing, in addition to its purely monetary effects on the financial stability of the currency, the exchange rate is a price that affects the real component of the economy through its impact on the volume of trade. To the extent that the government was concerned with controlling policy instruments that would enable it to generate employment and, hence, votes, it was only logical that it would not wish to yield exchange rate policy to the central bank, particularly during an upcoming election year.[72] Also, because cyclical devaluations in Mexico had become such a politically charged issue (Frieden 1998; Kessler 1998), this was all the more reason for the government to be reluctant to yield control over this crucial element of policy. Were a devaluation to become necessary in the future, the government wanted to make sure that it—and not the central bank—would be in charge of determining its timing.

71. This view was expressed repeatedly to the author in the course of meetings with various officials at all levels at the central bank, Mexico City, Mexico, November 1994–February 1995. It was also shared by many in the academic community. See, for example, Katz 1993; Trigueros 1993.

72. I am grateful to Luis Alberto Giorgio for this point. Luis Alberto Giorgio, assistant director, Center for Latin American Monetary Studies (Centro de Estudios Monetarios Latinoamericanos [CEMLA]), interview by the author, tape recording, Mexico City, Mexico, December 8, 1994.

In short, given that certain individuals in the current Salinas administration expected to play an important role in the next administration's Finance Ministry, there was a short-term personal incentive to retain as many policy-making instruments as possible for this ministry. It was no secret, for example, that Salinas's chief of staff, José Córdoba, was hoping to capitalize upon his close ties to Colosio as a means of maintaining policy influence in the next sexenio (Centeno 1994, 170). Not surprisingly, a "strong form" of autonomy for the Bank of Mexico—including relinquishing control over exchange rate policy—had always been resisted by the members of the Córdoba camarilla within Salinas's economic cabinet.[73]

However one chooses to interpret the exchange rate policy decision, what is clear is that the executive branch was not yet ready to cede control over a policy instrument that would tilt the institutional balance of power in favor of the central bank. This was not only true of exchange rate policy but also of other areas of the law where the rules came up short. A faction within the central bank that had fought to impede any sort of lending whatsoever to the executive branch was also roundly defeated.[74] And while the idea of having the annual economic forecasts of both institutions emerge contemporaneously was also discussed, this idea was also rejected by the Finance Ministry in favor of having the government's projections come out first.[75] As noted earlier, this decision only increased the likelihood of executive branch influence over central bank policy decisions.

A positive spin on what took place in the course of these negotiations was that the executive had simply tried to "maintain a balance" between the powers of the two agencies.[76] With hindsight, however, a more accurate description would seem to be that autonomy "had been diluted" between May and December, as the Finance Ministry fought to keep control over a

73. Individual closely involved in the autonomy initiative, confidential interview by the author, tape recording, Mexico City, Mexico, August 22, 1997. While Córdoba himself was barred from running for president due to his French citizenship, his team included Undersecretary of Finance Guillermo Ortiz and Secretary of Trade and Development Jaime Serra. Both men had good reason to suspect that they would be given important positions in the next cabinet. In fact, Serra was the first finance minister named under the Zedillo administration, though he ultimately resigned in the wake of the peso crisis, only to be replaced by Ortiz. Of the two, Ortiz was very involved in the May–December negotiations over the precise content of the central bank law and was rumored to have been a key figure in retaining a variety of privileges for the executive branch.

74. Central bank official, confidential interview by the author, tape recording, Mexico City, Mexico, January 26, 1995.

75. Individual closely involved in the reform's negotiation, confidential interview by the author, tape recording, Mexico City, Mexico, January 31, 1995.

76. This opinion was expressed by one central bank official. Confidential interview by the author, tape recording, Mexico City, Mexico, January 23, 1995.

variety of policy arenas.[77] The desire to keep the central bank's power in check was reflected in the comments of several individuals closely involved in the reform. Salinas himself was said to have made it known that while he wanted it to be "a good reform . . . I don't want the government to wash its hands entirely."[78] Aspe also admitted that "the central bank was already getting a lot anyway. The pragmatic thing was not to give them everything at once, but rather, to wait and see how they handled this [degree of autonomy] first."[79] As one member of the central bank team cynically characterized the attitude of the Finance Ministry during the negotiations, "It was as if they said, sure, run . . . but we will cut off your legs."[80] Perhaps the best evidence that the reform's bark was worse than its bite was that even the reform's most vocal left-wing critics confided that "it was not as bad as they expected" when they saw the final product.[81]

In addition to reducing the central bank's discretionary powers, the law was also noteworthy for its manifest ambiguity. Consider the clause governing central bank lending to the executive. Whereas in most instances such a clause would be worded in its simplest form—that is, "the central bank cannot lend to the executive"—here the wording was much more convoluted: while the finance minister could no longer instruct the central bank to provide the federal government with a loan, the bank was perfectly free to do so of its own volition. A similar vagueness characterized those rules governing the lender of last resort function, which states that the central bank cannot lend to the banking system "except for purposes of monetary regulation" (Banco de México 1993, art. 14). In practice, it is quite difficult to interpret what, exactly, constitutes "monetary regulation," thus affording the Bank of Mexico a fair amount of discretion in this arena. Finally, there was even some confusion in the bill's language as to the precise nature of the central bank's jurisdiction over exchange rate policy. For example, Article 3 stated that the central bank would, among other things, regulate "foreign exchange." But this can be interpreted either as the power to regulate international reserves or to regulate the country's exchange rate policy more broadly. In light of the Finance Ministry's predominant role on the Foreign Exchange Commission, it is highly unlikely that the authorities intended the latter, but using this ter-

77. Former central bank official, confidential interview by the author, tape recording, Mexico City, Mexico, January 9, 1995.

78. Aspe, interview.

79. Ibid.

80. Confidential interview by the author, tape recording, Mexico City, Mexico, January 30, 1995.

81. Senior economic adviser to the PRD, confidential interview by the author, tape recording, Mexico City, Mexico, December 6, 1994.

minology—as opposed to simply stating "international reserves"—does leave this clause open to some speculation.

Many of those interviewed regarding the precise wording of the law concurred that the principal explanation for its apparent vagueness was that it had been written by a mix of lawyers (representing the Finance Ministry's/presidency's interests) and economists (representing the Bank of Mexico's interests). As one newspaper put it, "Definitively, the December 1993 reform, far from providing a solid, efficient and effective central bank, translated instead into a mumbo-jumbo elaborated by economists mixed in with lawyers and lawyers mixed in with economists."[82] As one Mexican economist quipped, "I have no doubt that if Gíl Díaz and Carstens had written this law themselves, [the Bank of Mexico] would have ended up much more autonomous both politically and economically."[83] But one also has to wonder whether such nebulous language was not, in fact, intentional. After all, Mexico adheres to a system of Roman law, in which—unlike in the common law system of the United States—there is no interpretation of the law by the courts. The government is thus obliged to interpret all laws exactly as they are written down. In light of the strong incentives that such a legal system provides to be precise, it seems difficult to interpret the manifold ambiguities within the central bank law as an accident.

To the contrary, much like the overt limitations on central bank discretion noted earlier, the imprecise nature of the legislation's language would seem to point to what one administration official aptly described as a deliberate effort by the Salinas administration to construct a series of "escape valves."[84] According to a variety of officials close to the Salinas cabinet, all laws written during the Salinas sexenio were designed to maintain some margin of security for the president.[85] Since all legislation inevitably made its way through José Córdoba's office upon completion, if these pockets of protection had not already been built in at the ministerial stage, they were guaranteed to be added in Córdoba's office, before the final product emerged.[86]

82. "Autonomía del Banco de México?" *Reforma,* February 15, 1995.

83. Katz, interview. Gíl Díaz and Carstens are both University of Chicago–trained technocrats in the central bank who were deeply involved in the drafting of the final legislation.

84. High-ranking official in the Ministry of Finance, confidential interview by the author, tape recording, Mexico City, Mexico, August 22, 1997.

85. Former political adviser to Salinas, confidential interview by the author, tape recording, Mexico City, Mexico, August 15, 1997.

86. Former political adviser to the president, confidential interview by the author, tape recording, Mexico City, Mexico, August 22, 1997. To be sure, one might interpret the reform's partial nature as an effort to send a cosmetic signal of credibility to the international community, all the while designing an institution that might allow the authoritarians to continue to win elections handily. But as I showed in chapter 6, the Mexican government did not really need to demonstrate its credibility to the international economic community in the

To be sure, in designing an institution that was only partially autonomous, the authoritarians were pursuing a strategy that posed both opportunities and risks. On the one hand, it would permit them to have an institution that was up and running in anticipation of an eventual turnover of power. This institutional "shell" could then be fine-tuned and strengthened over time should a more forceful democratic threat materialize. In the meantime, it would also permit them some room to manipulate policies to their advantage until complete delegation became absolutely necessary. On the other hand, if they lost the 1994 elections, they would also be "stuck" with a central bank that was not fully autonomous. And even if they did manage to stay in power, they would from here on out be at least partially constrained in their own policy-making abilities.

The reform that was ultimately crafted reflected the Mexican government's probabilistic assessment of its odds of staying in power as it approached the end of the Salinas sexenio. In proceeding as it did, the government must have reasoned that it was not only likely to win in 1994 but that it could always come back and fine-tune this reform later. The 1993 Mexican central bank reform thus effectively amounted to the first round of a long-term investment, one that would gain force over time. In the meantime, the important thing was to leave this institution "fertilized with [the government's] own people."[87]

As Mexico's authoritarians sat around debating the finer points of the central bank legislation in mid-1993, they had no idea what awaited them around the corner. As history would have it, political change came much sooner than the government had anticipated. These events would prove to have both short- and long-term ramifications for the Bank of Mexico's incipient autonomy.

POSTSCRIPT: AUTONOMY TESTED—THE PESO CRISIS IN RETROSPECT

Over the course of 1994, the Mexican government witnessed a series of political and economic shocks that seriously jeopardized the ruling party's

latter half of the Salinas sexenio. This sort of argument also presumes that markets are easily fooled by a cosmetic reform, an observation that would seem to be out of sync with the savvy, well-informed nature of the international financial community. Finally, if the reform were designed purely for window-dressing purposes, implying that its rules were actually meaningless, then one also has to wonder why the authoritarians would not have gone ahead and designed a fully autonomous institution? I return to this latter issue in the chapter postscript.

87. Juan Molinar, Instituto Federal de Elecciones, interview by the author, tape recording, Mexico City, Mexico, August 15, 1997.

prospects in the upcoming presidential elections. In the wake of this challenge to the government's continued hold on power, the newfound autonomy of the Mexican central bank was quickly put to test. Exactly what triggered the cataclysmic denouement to the fabled "Mexican miracle" has been the subject of ongoing debate within academic and policy-making circles alike. Whichever hypothesis one chooses to privilege, however, one irrefutable feature of government policy in 1994 was an expansionary monetary policy by the central bank and a corresponding inability to defend the level of its international reserves. While some have interpreted this evidence as raising doubts about how much the reform really mattered in the first place, I argue that there are several reasons to believe that in fact it did and that its importance will be increasingly evident as Mexico moves toward democracy.

The Threat Intensifies: Mexico, 1994

Throughout 1994, Mexico was rocked by a series of political and economic events that would place the incumbent party on increasingly unsure footing (Castañeda 1994; Edwards and Naím 1997). The "year of living dangerously" began on January 1, 1994, with the outbreak of an armed indigenous rebellion in the southwestern state of Chiapas that would continue throughout the year. Calling for an end to neoliberal economic reforms and political rights for indigenous peoples, the so-called Zapatistas' pleas for greater democratization and social services for the poor generated an outpouring of domestic and international support. In a country known for its political stability above all else, the Zapatista revolt was a clear and unequivocal sign that the social peace on which the Mexican revolution had long prided itself was beginning to show severe signs of strain (Crespo 1995, 197–239). More to the point, it raised the possibility that disgruntled voters in the south—already hostile to the neoliberal economic model—might seize upon the conflict as a justification for supporting a left-wing alternative in the upcoming elections (Klesner 1995, 147).

Close on the heels of the Chiapas revolt came a series of political murders that undermined the ruling party's unity in new and unprecedented ways (Smith 1997, 35–38). In March 1994, the PRI presidential candidate—Luis Donaldo Colosio—was abruptly assassinated while on the campaign trail. Five months later, a senior official in the ruling party followed suit.[88] In both cases, the targets of the murders had spoken of the need for further

88. I refer here to José Francisco Ruiz-Massieu, who was slated to become the head of the PRI delegation in the Chamber of Deputies.

democratic reform, particularly within the ruling party itself (Shultz and Wilson 1995, 13–20). And in both cases, rumors surfaced that important elements of the PRI leadership might have been involved (Cornelius 1996, 3). The sudden reappearance of political assassinations in Mexico—a phenomenon not exhibited since the prerevolutionary power struggles in the early part of the century—was yet another ominous sign that the country's much-vaunted stability was unraveling. The subsequent imposition of the staunchly technocratic Ernesto Zedillo as Colosio's replacement only served to lend fuel to the fire, generating considerable resistance from within the party's old guard and raising doubts about his ability to appeal to the masses (Smith 1997, 38).

Alongside its internal feuds, the ruling party was also confronting unexpected external competition that called into question its ability to win the presidential elections of August 1994. In February of that year, rumors began to surface that former mayor of Mexico City and one-time presidential contender Manuel Camacho might announce an independent bid for election.[89] Camacho had recently been appointed as commissioner for peace in the Chiapas conflict, following which he emerged as one of the most popular—and highly visible—politicians in the country (Domínguez and McCann 1996, 182). In addition to the symbolic importance of a Camacho candidacy as an unprecedented break with the dedazo tradition, it was also dangerous in that it had the ability to divide the party into two camps (Whitehead 1994, 337; Morris 1995, 106–7). Many feared that Camacho might find support not only among those in the PRI who had originally backed him as a candidate for the presidency but also among the opposition—and, in particular, the PRD.[90]

But no sooner had the "Camacho factor" receded as a principal source of alarm for the ruling party than a second external threat presented itself, this time from the right. In May 1994, a nationally televised presidential debate was held in which the unequivocal winner was the Panista candidate, Diego Fernandez de Cevallos. Cevallos's impressive performance in the debate underscored the weaknesses of the "official" candidate, Ernesto Zedillo, and the two men subsequently entered into a dead heat for the next several weeks (Domínguez and McCann 1996, 189–91). While Cevallos subsequently all but disappeared from the public eye, the ruling party could only assume at the time that it would need to battle it out with Cevallos until the bitter end.

89. See "Unintended Revolution in Chiapas: Passed over by Salinas, Camacho Is Tempted to Ride His New Image into an Independent Run for the Presidency," *Los Angeles Times,* March 2, 1994.

90. While Camacho eventually removed himself from the race, he did manage to pose a major threat to the security of the ruling elite for the better part of four months. See "Durante su Sexenio," 26.

Ongoing political instability was accompanied by economic chaos. There was a massive outflow of foreign capital over the course of the year, as the country's foreign reserves plummeted from almost U.S.$30 billion in January to just over U.S.$6 billion in December (Banco de México 1995, 41). By the end of the year, the combined effect of these multiple political and economic shocks was simply too much for the government to handle. On December 19, 1994, the newly elected government of Ernesto Zedillo was forced to devalue the Mexican peso by 19 percent, under a "managed float" system. One day later, after an additional $4 million left the country, the government announced that it would go to a free float. As the world watched in shock, Mexico plunged into a major financial crisis.

Any one of these events might have been potentially lethal in an election year. But to experience them all at once was beyond the pale. In the wake of this unprecedented political and economic threat to the sitting government, it was unclear if the PRI would weather the storm. Such conditions posed a clear test for Mexico's central bank: could it maintain its autonomy when the government needed it now more than ever?

The Central Bank Responds: Assessing the Evidence

In the years since 1994, a veritable cottage industry has emerged around delineating the exact causes of the peso crisis.[91] For the present purposes, however, we are less concerned with the sequence of events culminating in the December 1994 devaluation per se than with the extent to which the Bank of Mexico's behavior in the wake of this crisis was consistent with that of an autonomous central bank.

Over the course of 1994, the Bank of Mexico pursued a monetary policy that can only be termed "expansionary." While in 1993 the monetary base grew at an average nominal rate of 7.3 percent, this figure rose to 20.6 percent in 1993, representing an increase of more than 200 percent (Banco de México 1994, 302). This was reflected in an unprecedented expansion of credit to the financial system, which grew at a rate of 41 percent in real terms over the

91. Among those explanations most commonly advanced are an overvalued exchange rate (Dornbusch and Werner 1994); improper fiscal and monetary policy (Krugman 1995; Lustig 1995; Sachs, Tornell, and Velasco 1995; Leiderman and Thorne 1996); failure to relay information in a timely and transparent manner (International Monetary Fund 1995); the vulnerability of the banking system (Calvo and Mendoza 1995); and a politically triggered speculative attack (Gíl Díaz and Carstens 1997). Others attribute it to underlying weaknesses in the Mexican economy, including low growth, a declining savings/investment ratio, and a large and growing current account deficit, which were only exacerbated by the events and policies of 1994 (Ramírez de la O 1996; Edwards 1997).

course of the year (Giorgio 1996, 11). Of particular note, net credit creation by public sector development banks increased by 35 percent between mid-1993 and mid-1994, equivalent to an increase of 3 percent of GDP (Leiderman and Thorne 1996, 11).[92] And while interest rates on three-month treasury bills did spike following the murder of Colosio, rising from around 10 percent in February to 18 percent in March, this differential showed a declining trend, due partly to hikes in corresponding U.S. rates (Sachs, Tornell, and Velasco 1995, table 3).

The government justified this injection of liquidity into the economy as a means of counteracting the pronounced drop in foreign reserves that took place over 1994.[93] According to this logic, they were not pursuing an "expansionary" policy so much as a "compensatory" one (Gíl Díaz and Carstens 1997, 178–80). Moreover, given the fixed exchange rate regime that was in place at the time, any rise in interest rates would have necessarily entailed forcing the exchange rate to the floor. And because all political and economic shocks were thought to be transitory, there was consequently no need to raise interest rates and/or risk a devaluation (Buira 1996, 316). Once Zedillo got elected, the situation was expected to normalize, and foreign capital would return to Mexico of its own volition.[94]

Nearly any economics textbook would argue, however, that in the wake of falling investor confidence, the appropriate policy to pursue in order to prevent capital from fleeing one's borders is to raise interest rates, even if this means weakening the domestic currency (Edwards 1995, 298). This was all the more true following the rise in U.S. interest rates in February 1994, mak-

92. This was in no small part the result of the deliberate expansion of lending to small and medium-sized producers that began in 1992 noted in the previous chapter. It should be noted that the central bank did repeatedly warn the Finance Ministry about the dangers of such lending practices, particularly those channeled through the credit unions (confidential interviews by the author with a variety of central bank officials, tape recordings, Mexico City, Mexico, August 1997). But despite its dissatisfaction with such lending, it is not clear that there was really much the central bank could do to stop it. Even if central bank officials had raised interest rates in an attempt to offset them, it was not clear that this measure would have had the desired effect, whether because the development banks had their own (subsidized) interest rates or because the loans simply had no chance of being repaid. Ultimately, the problem was one of supervision, and these powers did not reside with the Bank of Mexico but, rather, with the Finance Ministry itself. And as one central bank official observed matter-of-factly, "the development banks have always been 'off limits'" (central bank official, confidential interview by the author, tape recording, Mexico City, Mexico, August 7, 1997).

93. See, for example, Miguel Mancera's op-ed, "La Política Monetaria de México en 1994," *Reforma,* January 31, 1995.

94. Interviews by the author, tape recordings, Mexico City, Mexico, with central bank vice-governors Jesús Yacamán, August 12, 1997; José Sidaui, August 14, 1997; and Francisco Gíl Díaz, August 18, 1997.

ing investment in U.S. treasury bills even more attractive. Throughout the course of the year, there were several additional telltale signs that investors were increasingly nervous about the government's ability to stave off a devaluation. Between December 1993 and December 1994, foreign investors switched from peso-denominated bonds (*cetes*) to dollar-denominated bonds (*tesobonos*) almost in full, suggesting that they did not trust the stability of the exchange rate and predicted a run on the peso (Lustig 1995, 13; Edwards 1997, 113). A variety of other economic indicators—including the weekly foreign exchange risk, the weekly country (default) risk, and the daily position of the exchange rate relative to the ceiling of the exchange rate band—also suggested that the markets perceived Colosio's death as a permanent shock (Leiderman and Thorne 1996, 23–26). Finally, given that there were no reserve requirements in Mexico, the relatively high ratio of M2 to reserves at the end of 1993 meant that a bank run could easily have translated into a currency run (Sachs, Tornell, and Velasco 1995, table 8).

In subsequent years, a number of hypotheses have been put forth to explain the government's dogged refusal to raise interest rates. One such concern was the health of the banking system (Gruben and Welch 1996; Kildegaard 1997). Several officials interviewed for this study confessed that they deliberately eschewed an interest rate hike on the grounds that it might seriously endanger Mexico's commercial banks, which were already in bad shape due to overdue loans (see fig. A7.1).[95] Between 1987 and 1994, outstanding bank credit for consumption (credit cards and durable consumer goods) had grown in real terms by 457.7 percent, while credit for housing had increased by 966.4 percent (Ramírez de la O 1996, 53). By November 1994, overdue loans already comprised an estimated 96 percent of the total capital of the banking industry (Kildegaard 1997, 959). In light of the dire nature of the situation in the banking sector, protecting the banks from a solvency crisis was a top priority throughout 1994 (Calvo and Mendoza 1996).

There was also some speculation that Salinas's judgment—and, hence, the central bank's policy—was clouded by his own postelectoral ambitions, whether a short-term desire to head the World Trade Organization (Smith 1997, 39–43) or the longer-term ambition of one day ruling Mexico once again.[96] Because the credibility of the government's economic program was

95. Confidential interviews by the author with high-ranking central bank officials, tape recordings, Mexico City, Mexico, August 12, 1997.

96. Jorge Castañeda, political commentarist and professor of political science, Universidad Nacional Autónoma de Mexico (UNAM), interview by the author, Mexico City, Mexico, tape recording, August 11, 1997. Salinas did little to hide his ambition of one day returning to office and, indeed, even attempted to propose an amendment to the Constitution to allow for this, although such a measure was defeated by the old guard of his party (Centeno 1994, 1).

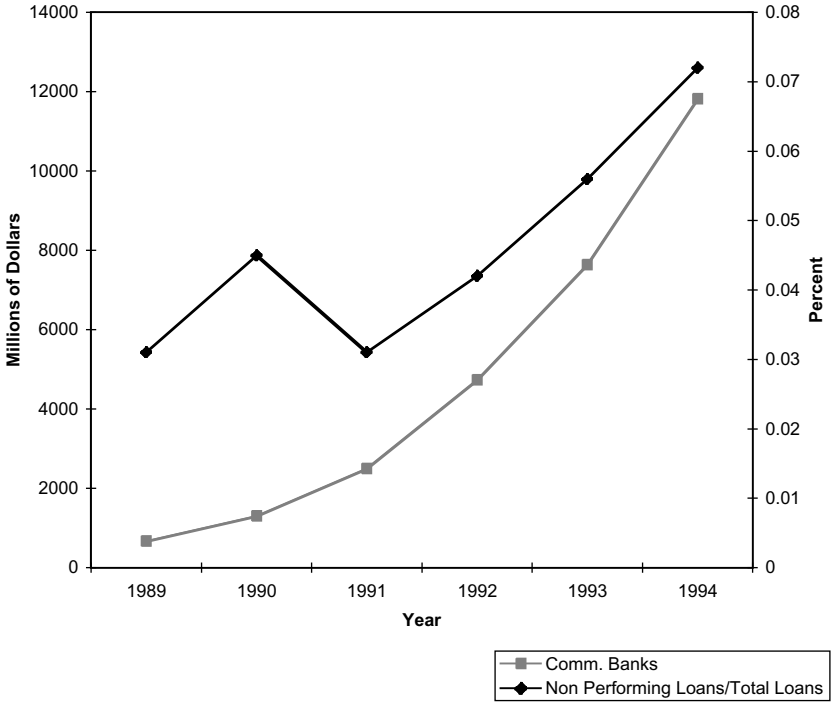

Fig. A7.1. Mexico: Nonperforming loans, 1989–94. (From Sachs, Tornell, and Velasco 1995, table 10a.)

intimately tied to adhering to the preannounced exchange rate, any tampering with existing macroeconomic variables was thus deemed out of bounds insofar as it might blemish his reputation at home and abroad (Sachs, Tornell, and Velasco 1995, 19–20). Indeed, Salinas appears to have faced some explicit pressure from one group of foreign investors to take all measures possible to manage the crisis, short of altering the exchange rate itself (Smith 1997, 41; Naím 1997, 305).

Finally, electoral motives were also almost assuredly at play. By ensuring ample credit to the private sector, the government sought to avoid an explosion of interest rates that might have contributed to the demise of PRI candidate Ernesto Zedillo in the 1994 presidential elections (Sachs, Tornell, and Velasco 1995, 21; González Gómez 1998, 48–49; Lustig 1995, 14–15). In the words of one expert on central banking in Latin America, "the central bank judged that it was better to have Zedillo than Cárdenas or Cevallos and

adopted a monetary policy accordingly."[97] For while the ruling party would arguably have an incentive to make credit abundant in any electoral year, in 1994 these incentives were particularly acute for all of the reasons outlined earlier. According to one analysis, had the central bank not modified its orthodox monetary policy as it did, the electoral results in the presidential race would have been much closer.[98] The remarkable 4.7 percent average growth rate observed in the months leading up to the elections (see fig. A7.2)—not to mention the fiscal expansion due to development bank lending noted earlier— would certainly seem to corroborate a "political business cycle" reading of events. Perhaps these electoral pressures were best summed up by a former member of the Bank of Mexico's board of governors, who said,

> We were making decisions during a . . . politically difficult year in which the party that had been in power for so many years was beginning to question whether it would remain in power. So this meant that some decisions were made with fear, because no one wanted to alter any variable that might increase this fear or affect the outcome of the elections.[99]

None of this is to suggest, of course, that the central bank's failure to raise interest rates caused the peso crisis. It certainly played a role, although how much—and exactly why—is disputed by the experts.[100] Nor does it mean that had the central bank chosen to raise interest rates as early as March, the entire crisis could have been averted. Finally, given the fixed exchange rate that was in place at the time, it is difficult to separate the decision not to raise interest rates from the decision not to devalue. And because of the institutional rules governing the makeup of the Foreign Exchange Committee, it was the Finance Ministry—and not the central bank—that was ultimately responsible for exchange rate policy. Rather, the point I wish to underscore here is merely that in not raising interest rates, the central bank failed to comply with a fundamental element of its autonomy: the ability to preside over a pool of international reserves that can guarantee—over all other objectives—the stability of the currency (Banco de México 1993, art. 18).

97. Confidential interview by the author, tape recording, Mexico City, Mexico, August 15, 1997.

98. See "Relajar la Política Monetaria: Origen de la Crisis Financiera," *El Financiero,* January 25, 1995.

99. Confidential interview by the author, tape recording, Mexico City, Mexico, August 11, 1997.

100. See, for example, Krugman 1994; Sachs, Tornell, and Velasco 1995; Calvo and Mendoza 1996.

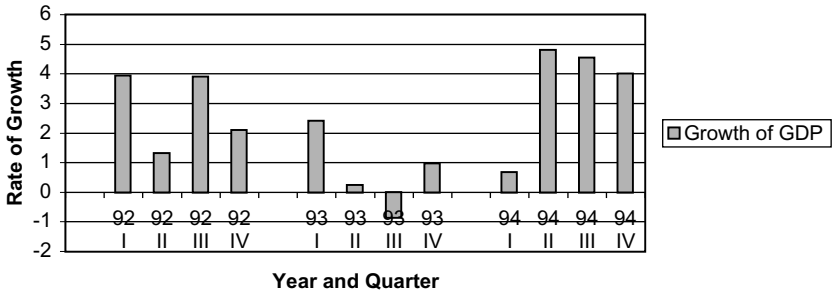

Fig A7.2. Mexico: Quarterly growth of GDP, 1992–94. (From Gíl Díaz and Carstens 1998, 183.)

Revisiting the Rules: Does Autonomy Matter?

In the aftermath of the peso crisis, the Bank of Mexico came under heavy criticism for having failed to act in an autonomous fashion. As one editorial declared harshly, "the devaluation showed that autonomy was merely a formality . . . that the 'independence' of the central bank functioned exactly like the 'independence' of the Chamber of Deputies: servile, surreal and very Mexican."[101] The image of the central bank's president, Miguel Mancera, was particularly damaged by the events surrounding the peso crisis. As one newspaper noted when reporting the reactions of a group of Mexican entrepreneurs, "What hurt them most was to have been betrayed by Miguel Mancera, whom only 12 years earlier they had applauded for not collaborating with the president who . . . nationalized the banks. They could not conceive of how . . . [Mancera] could now buckle in front of Salinas . . . and Aspe."[102] Perhaps this general disillusion was best captured in the words of one of Mexico's most prominent businessmen, who commented, "we just assumed that if you created an autonomous organization, it would behave as such. . . . now we are very disappointed."[103]

What such comments collectively underscore is that the public viewed the peso crisis as definitive proof that the central bank's autonomy was meaningless. But was it? There is no question that—by virtue of their very flexibility—the rules themselves governing autonomy partly facilitated the irresponsible policy-making decisions that came to characterize 1994. For example, by

101. "Balance de Un Año Negro," *El Economista,* December 29, 1994.

102. "Asunto: Aplausos, Silbidos," *El Heraldo de México,* February 2, 1995.

103. Ernesto Rubio del Cuento, president, Cementos Mexicanos (CEMEX), interview by author, telephone, Mexico City, Mexico, January 20, 1995.

obliging the central bank to take the financial sector's "sound development" into account as one of its primary objectives, there was arguably some legal justification for the central bank's decided unwillingness to raise interest rates in 1994. Similarly, because some central bank lending to the executive was permitted, the Finance Ministry continued to have some latitude with which to intervene in interest rate policy.[104]

But are we to conclude that the rather fluid nature of the Bank of Mexico's autonomy throughout 1994 invalidates the reform effort entirely? In other words, if the central bank failed to constrain adequately an expansionary monetary policy during the first year of its existence, should we continue to expect this sort of behavior in the future? While it is easy to see how one might arrive at the conclusion that the law did not really matter, I would challenge such a line of reasoning from a variety of angles.

To begin with, if the autonomy legislation were entirely without basis, why did the authoritarians go to so much trouble to create the law in the first place? The fact that the central bank's autonomy was enshrined in the Constitution suggests that the government was intent on giving this law a certain pride of place. The vast majority of financial legislation in Mexico was traditionally done through bylaws, which are much easier to overturn should the circumstances warrant it. While it is true that the central bank law itself fell under such a statute, the basic commitment to price stability was permanently enshrined in the Constitution. If nothing else, the constitutional entrenchment of this fundamental objective suggests that the authoritarians had a long-term lock-in strategy in mind.

A second and related reason to believe that the rules mattered was, ironically, their partial nature itself. If the rules governing autonomy had not mattered, then it would have been far easier for the Salinas government simply to have created a fully autonomous institution and then proceed to violate it as it saw fit. It was, after all, an authoritarian government, and "in a country where personalities count more than institutions, laws are not enough" (Naím 1997, 297). But the interesting aspect of the Mexican case was not the

104. Technically speaking, the law granted the central bank complete freedom to decide the amount and terms of its internal credit. In reality, however, because the central bank acted as financial agent for the government in the weekly auction of its public debt, the Finance Ministry reserved the right to decide whether or not to participate in such an auction and on what terms. And, at times, rather than letting the market freely determine the price at which these bonds would be purchased, the government would set a limit above which it was not willing to sell them. The Bank of Mexico would then use this as a benchmark in the course of carrying out its open market operations. In colloquial terms, this strategy is known as *tirar la rayita* (line-drawing). Over the course of 1994, the Finance Ministry used this technique to impose an informal interest rate ceiling. This was acknowledged in a series of confidential tape-recorded interviews by the author with former and current central bank officials, Mexico City, Mexico, November 1994–February 1995.

out-and-out violation of an otherwise strong set of rules, as Naím suggests, but, rather—as I have demonstrated in detail in the preceding chapters—the deliberate creation of an autonomous institution that was only partial to begin with. This does not negate the fact that the authoritarian political context in which this legislation was born invariably made these already porous rules all the easier to penetrate. But the great deal of time and energy that the technocrats poured into carefully crafting the precise wording of this legislation to increase its autonomy in some respects and diminish it in others suggests that the rules did, in fact, matter a great deal and that the authoritarians were acutely aware of this.

But even if we do believe that the rules did matter in some broader sense, we must still come to terms with the fact that they proved to be quite malleable in 1994. Here I would raise a number of considerations. To begin with, 1994 was a truly exceptional year. None of the bizarre events that characterized 1994—from the Chiapas rebellion on the very first day, to the political assassinations, to the U.S. interest rate hike—could have been anticipated by the authorities and certainly not in conjunction with one another. In some sense, then, it may not be fair to judge Mexico's central bank autonomy by what was by all accounts an extraordinary year. As Lohmann (1992) has forcefully argued, we should not expect central banks to pursue price stability at all costs in the wake of unforeseen external shocks. Even if Mexico's central bank had looked exactly like Chile's on paper, then, it is not at all clear that it would have responded differently to the events of 1994.

A second reason to believe that the reform should work better post-1994 is that some of the very rules that rendered certain aspects of the original legislation weak have subsequently changed. Take exchange rate policy. At the time the reform was begun, the country was still operating under a fixed exchange rate system. In some sense, 1994 ultimately came down to weighing the trade-off between allowing interest rates to rise to whatever level was deemed appropriate and abandoning this key component of the government's economic program. And it is arguably the case that this was not—in the final analysis—the central bank's decision to make. But with the devaluation of December 1994, a floating exchange rate regime was put into place. As long as this system remains in effect, it grants the central bank complete freedom to determine interest rates as it sees fit, independent of the desires of the executive branch. In similar fashion, the three-year period of exception exempting the federal government from any limitations on lending by the central bank expired in April 1997. As a result of such changes, the government can no longer borrow from the central bank free of charge.

At times, there has also been open conflict between the central bank and the Finance Ministry on a given policy issue. On at least two important occa-

sions in late 1994, for example, Mancera did choose to challenge the executive branch over exchange rate policy. First, in a highly secretive meeting on November 30, 1994, between important figures in the outgoing Salinas and incoming Zedillo administrations, Mancera purportedly threatened to resign if international reserves were to fall below 10 million dollars without an accompanying "free float."[105] Second, in the famous meeting to decide the fate of the peso on December 19, Mancera advocated going directly to a free float rather than widening the band but was overruled by then finance minister Jaime Serra.[106] To be sure, such actions arguably came late in the game, and because exchange rate policy ultimately fell under the purview of the Finance Ministry, there was not much that Mancera could do. But if the central bank proved capable of asserting whatever autonomy it had at what was arguably the country's most delicate moment, we can only surmise that it has been all the more able to do so in the years that followed.

And, indeed, in the ensuing years since the peso crisis, there have been other instances of conflict between the two ministries, again serving as indirect proof that the autonomy legislation was not entirely trivial. On a number of instances, for example, and particularly when Mancera was still in charge of the central bank, the two ministries clashed privately over interest rate policy, and the central bank won out.[107] They also disagreed publicly over the appropriate level of central bank intervention in the exchange rate market, with the administration favoring a gradual devaluation of the exchange rate and the Bank of Mexico fighting successfully to maintain the float, arguing that a weak peso would merely generate inflation.[108]

But perhaps the best evidence of the ongoing significance of the autonomy legislation was the outcome of the explosive controversy that erupted in Mexico in 1998 regarding the creation of a $61 billion government-sponsored stabilization fund (Bank Fund for Savings Protection [Fobaproa]) for the financial sector. The new fund was to be operated by the Bank of Mexico and thus fell under the jurisdiction of its newly appointed governor, Guillermo Ortiz, who had also supervised the initial privatization of the banks as an undersecretary of finance under Salinas. But because both the PAN and the PRD viewed Ortiz as partly responsible for the banking crisis, they refused to approve the authorization of Fobaproa unless Ortiz were to

105. See "La Historia Secreta," *Reforma,* March 17, 1995.

106. See "Línea Financiera," *Uno Más Uno,* December 22, 1994. This was also confirmed in a series of confidential interviews by the author.

107. Private e-mail communication by the author with central bank official in the operations department, December 2, 1998. Mancera stepped down in December 1997 and was replaced by then finance minister Guillermo Ortiz.

108. See "Peso Debate Flares up, but Zedillo Not Likely to Devalue Currency," *Lagniappe Letter,* October 11, 1996.

step down.[109] Even as the controversy raged on for months, the government remained firm in its defense of Ortiz, asserting that "Ortiz' continued presence in the Bank of Mexico is not a subject of negotiation" and underscoring that the autonomy of the institution made such a move impossible.[110] Given that the dismissal of a central bank governor can only be realized for technical reasons, Ortiz's premature removal from office for political reasons would have constituted a grave blow to autonomy. The government's intransigence in this regard thus served as concrete proof of its willingness to uphold the central bank's autonomy at all costs.[111]

In short, it is true that as they were initially crafted, the rules governing autonomy in Mexico were not nearly as strong as they might have been. By the same token, however, nor were they entirely meaningless. Not only will incoming governments face a central bank board entirely of Salinas's choosing, but they will also be constitutionally obliged to privilege price stability above all else, face real limits on their ability to borrow from the central bank, and confront a system in which interest rates are not subject to the vicissitudes of exchange rate policy. In short, incoming democratic governments will still be more constrained than they would otherwise have been had the law never been created in the first place.

Conclusion

In closing, it is worth speculating about what, if anything, the hypothesized link between democratization and institutional change put forth in this book can tell us about the subsequent course of central bank reform in Mexico. The logic of the analysis suggests that as the democratic threat in Mexico intensified, there should have been a strong incentive for the authoritarian government to attempt to strengthen the existing autonomy legislation where it was weak.

In the years following the peso crisis, there is no question that such conditions began to emerge, as social unrest, elite divides, and electoral challenges from the opposition escalated (Kaufmann Purcell and Rubio 1998). In

109. See "Exige PRD Juicio Político Contra Ortiz, Gurria y Mancera," *La Jornada,* October 27, 1998; "Ortiz y Fernández Fuera o No Hay Fobaproa," *El Economista,* November 11, 1998.

110. "Labastida: La Renuncia de Ortiz, Tema Excluido de Toda Negociación," *La Jornada,* December 8, 1998.

111. The stalemate was ultimately resolved in an eleventh-hour deal brokered between the Zedillo administration and the right-wing PAN , in which Ortiz's role as head of the central bank went unaffected. See "In Mexico, Rival Parties Pass Accord on Bank Aid," *New York Times,* December 13, 1998.

particular, Cuauhtémoc Cárdenas's victory in the 1997 Mexico City mayoral elections and the corresponding loss of the PRI majority in both chambers of the legislature demonstrated in bold relief that pressures for democracy were only likely to intensify (Klesner 1997). What Cárdenas's victory made exceedingly clear is that more than ever before, there was a real possibility that Mexico might be ruled in the future by a group of individuals with a very different economic ideology than the technocrats that had been in power since 1982.

It is perhaps not surprising, then, that following on the heels of the Cárdenas victory in July 1997 rumors began to surface of a possible additional reform to the existing central bank law. While not proposing a radical overhaul of existing legislation, a number of individuals in the current government did express an interest in tying up a number of its loose ends.[112] This idea was subsequently formalized in a proposal submitted by President Zedillo to the Congress in 1998, in which the central bank would assume not only exclusive control over exchange rate policy but also oversight of the banking system (Starr 1998, 43).

Such a step was deemed important, as one senior government official put it, "not because Cárdenas will win in 2000, but because it is now a real possibility."[113] As one prominent member of the banking community phrased it, "the government needs to be very careful, precisely because it might find itself before an executive branch that . . . might try to prevent the central bank from bringing about an orthodox monetary policy."[114] This sentiment was echoed in somewhat starker terms by a high-ranking member of the central bank itself, who warned somewhat ominously, "In light of the changing political situation, we cannot afford to think in the short term any more."[115] The appointment of fiscal conservative Guillermo Ortiz as the governor of the Bank of Mexico in December 1997 would certainly seem to underscore this new line of thinking.[116]

Ultimately, it became clear that an additional central bank reform was not politically feasible in Mexico's new electoral environment. To the contrary, it would appear that Mexico's authoritarian elites misjudged the

112. Confidential interviews by the author with a number of central bank officials, August 1997, Mexico City, Mexico. Recall that autonomy was based on two legal frameworks: a constitutional amendment and the accompanying central bank law, and that it was the latter where all of the loopholes lay.

113. Confidential interview by the author, tape recording, Mexico City, Mexico, August 15, 1997.

114. José Madariaga, president, Probursa, interview by the author, tape recording, Mexico City, Mexico, August 8, 1997.

115. Confidential interview by the author, tape recording, August 18, 1997, Mexico City, Mexico.

116. See "Mexico's Budget: A Vote for Stability," *New York Times,* December 16, 1997.

timetable of political change in their country and missed their golden opportunity to strengthen this legislation once and for all. But had such a measure eventually come to pass, it would have been entirely consistent with the basic thrust of the argument advanced in this book. As pressures for democratization assumed a heightened importance, the authoritarians were forced to reevaluate how much longer they could safely expect to remain in power. They were forced to realize that if they did not act quickly to make their monetary policy truly insulated, they might lose this opportunity for good. Were the Zedillo administration to have enacted a central bank reform before leaving power, it thus would have been because now, as never before, it knew that its back was truly against the wall.