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A LOOK BACK AT MEXICO: WAS THE BAILOUT NECESSARY?

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1. The devaluation

- current account deficit was so large, and projected to be so large for 1996, that devaluation was needed (Selected Economic Indicators; the December 9 1994 Mexican government economic forecast);
- monetary policy in late 1994 was not consistent with the maintenance of the exchange rate peg (behavior of reserves, other monetary indicators);
- the devaluation was badly planned and executed;
- the structure of government liabilities exacerbated the situation enormously (changing structure of debt during 1994), as did, though less immediately, the weakness of the banking system;
- the extent of the devaluation needed to reach a current account deficit of 2-3 percent of GDP was about 25-30 percent.

2. The immediate aftermath of the devaluation

- events of December 20-22, including activation of swap lines with U.S. and Canada; (time line)
- within a week the Mexicans had developed a program consistent with a current account deficit of about 3 percent of GDP, which they presented to U.S. and IMF;
- initial view was that this was a devaluation similar to the U.K. or Italian devaluations;
- complete collapse of investor confidence, and the growing realization that if could be self-fulfilling;
- the $40 billion U.S. announcement;
- the IMF drama and the January 31 $50 billion package;
- the March Mexican policy package.

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[1] International Monetary Fund, on leave from MIT. This is the outline of comments prepared for presentation at a meeting of the Group of Thirty in Buenos Aires, March 22-23 1996. The views expressed are those of the author, and not necessarily of the IMF.

3. Why the Fund acted

Considerations relating to Mexico

- the alternative was default, which we feared would lead to a prolonged period in which Mexico would have no access to outside capital, and would go through a major and prolonged depression;
- was restructuring a viable option? - not a risk worth taking, not for Mexico, nor for other countries.

Contagion effects

- loss of confidence in countries that markets might view as being in a similar situation;
- loss of confidence in emerging markets more generally;
- NB: these contagion effects were visible immediately after the devaluation and in January 1995;
- concerns over the market model, of which Mexico had been held up as an exemplar.

4. Were we right?

- despite the deep crisis through which it is moving, Mexico quickly regained access to international capital markets;
- private capital flows to developing countries, including Latin America, are higher than pre-Mexico; (capital flows data)
- the market model is flourishing;
- cost-benefit analysis: moral hazard (for policymakers, for investors), costs of using public money (what were they?) vs benefits.

5. Lessons

- preventing crises: information, surveillance;
- responding to crises: EFM, strengthening Fund's resources, workout procedures;
- no to regionalism;
- policy lessons for individual countries: exchange rate system, banking systems, capital controls.