The Mexican 1994 Crisis

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Abstract:

The Mexican 1994 crisis is also known as the Mexican pesos crisis, is the first global economic crisis in XX century. The crisis started at 1994 and affected whole world, especially Latin America. The crisis started with the sudden devaluation of the Mexican peso. But the root of the crisis runs deeper: it started a few decades earlier. At the beginning of the decade of 1930 after Mexican Revolution and a few years of instability, Mexico entered in political stability and the result of that was an economic growth. Through the years Mexico became more and more a developed country. Until 1968 Mexico had been living what is known as the Mexican miracle. After this year economic and political crisis started. A few years during the late 1970s oil boom created a feeling of economic stabilization, but that was just a mirage. Many wrong decisions in the economic and political aspect destroyed the achieved progress. With not enough preparation, Mexico entered in organizations like the General Agreement on Tariffs and Trade (GATT) and the North American Free Trade Agreement (NAFTA), the latter was a ruinous move for a closed economy. The result of those policies was the 1994 crisis and the so called Tequila Effect. This paper explores the historical background of the Mexican 1994 crisis with the purpose of having a better understanding of the reasons and factors leading to such crisis.

Key words: Mexico; United States of America; economical policies; Institutional Revolutionary Party; Mexican miracle; oil boom; NAFTA; economical crisis

Mexico and United States

By the beginning of 1990, United States consolidated as the major trade partner of Mexico: 75% of Mexico’s exportations were destined to the United States and 2/3 parts of Mexico’s importations came from the United States (Cánovas 1994). At the same time, Mexico became the second market for United States imports, just behind Canada. Moreover, a lot of industries in the United States benefitted from Mexican laborers. With all these factors it was no surprise that Mexico wanted to negotiate a free trade agreement with the United States. As Cánovas stated, there were more integration between Mexico and United States than in the European Union at that time.

It was during 1990 that the Mexican government manifested the intention of a free trade agreement with the United States and Canada. As Alba (1997) had traced, there were also another reasons behind the Mexican proposal: the Soviet Union fall with the economic rise of all of the Eastern European countries (they could be potential economic competitors to Mexico), the free trade agreement between Canada and the United States of 1988 (it could weaken the trade relation between Mexico and its main commercial partner) and as the Cold War ended, Latin America strategic importance to the United States reduced substantially.

The Mexican government needed more support to its free trade strategy, so the government sought the support of the private sector’s segment that had strongest ties with the United States. It is important to note that this segment was formed by Mexican firms located in northern states and Mexican subsidiaries of multinational corporations. Again, exclusion inside the private sector appeared. Mexico’s government took the PSE as a model to private sector and government cooperation and urged the private sector elite to create a formal consultation mechanism. The Coordinating Council of Foreign Trade Business Organizations (COECE, Coordinadora de Organismos Empresariales de Comercio Exterior in Spanish). SECOFI officially invited the COECE to the NAFTA negotiations in the spring of 1990.
COECE did an extensive research on the status and perspectives of different sectors\(^1\); it was the first time that both sectors, public and private, had such a broad compendium of Mexico’s economy (Alba 1997). But the private sector role in the NAFTA negotiation would be more active.

**COECE’s Role During The Negotiations**

COECE not only did a research on Mexico’s economic sector, it also took a very active role since the beginning of the negotiations in June 1991.

Basically, COECE made a mirror organization of the Mexican negotiation team and this mirrored organization meet with its official peer in Mexico prior to a negotiating round (Thacker 1999). They did a kind of training for the negotiating round because they discussed specific issues and strategies.

COECE and SECOFI did a double check on the texts: while COECE checked the technical aspects, SECOFI worked with the legal aspects. To do that, COECE established what is known as the “room next door” (“el cuarto de junto” in Spanish).

The “room next door”\(^2\)” was a place where the private sector representatives meet with SECOFI negotiators before and after the official meeting with the representatives of the United States and Canada’s government. The number of businessmen serving as consultors in this “room next door” depended on the negotiating round importance\(^3\).

According to interviews made by Thacker (1999), the contact between COECE and government negotiators was intense before, during and after the negotiations rounds. There are testimonies of these post-negotiation meetings being held very late at night.

Private sector elite and Mexican government cooperation had its peak during the negotiations rounds when 3, 056 meetings took place according to COECE. But why all of these meetings? As Thacker had stated there were two main reasons: the lack of experience of SECOFI’s negotiators and consolidated the coalition supporting NAFTA.

In order to participate in the “room next door”, COECE’s representatives had to pay the trips by themselves as most of their members were ad honorem members. That is to say, only the private sector elite had the resources to do that, therefore small and medium sized firms were excluded.\(^4\) The only way these small and medium-sized firms could participated was through a business association called National Chamber of Industries (CANACINTRA, Cámara Nacional de la Industria de la Transformación in Spanish). The CANACINTRA representatives were concerned and suspicious about COECE participation as they were not represented by the private sector elite.

The relation between the private sector elite and the government was better than ever. As an example, when the negotiations were over SECOFI gave COECE a copy of the NAFTA draft and asked for a revision of it.

**The fall down**

The private elite sector and the government alliance played a key role in the 1994 crisis. This alliance brought economic benefits on the short term but in the long term, it embodied chaos. After signing the NAFTA, COECE reduced its activities. However, their cooperation with the government showed its result. Mexico’s 1994 crisis factors had two different nature: economic and political factors.

One of the biggest NAFTA’s result was to restore the trust of the investors in Mexico, both foreign and local. The Mexican private sector elite and a lot of foreign firms involved heavily in financial speculation activities. As a consequence, new capital started to flow. This was perfect for Mexican government’s plan: maintain social peace and continue with PRI political and electoral

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1. Automobiles, textiles, beer, aluminium, among others (Thacker 1999)
2. They were in hotels as close as possible to the official meeting venue. So, COECE actually went to the geographic region where the negotiating rounds were held.
3. Alba (1997) states that in February of 1992 in Texas, there were 250 businessmen as consultors in the “room next door”
4. These small and medium-sized firms are normally constituted by a family structure. There were two main reasons why they did not participated in the “room next door”: they did not have enough international trade experience and they could not afford sending a representative to a negotiating meeting.
hegemony (Luztig 1996; Dresser 1997, 1991: Kaufman and Trejo 1997 in Thacker 1999). With this capital flow and the revenues from privatization the Mexican government could control the inflation and create social programs. A lot of people saw in this that Mexico was leaving behind economic instability and how Mexico was entering the First World. But all of those beliefs were torn apart when the EZLN uprising on January 1, 1994.

EZLN and Zapatismo

In 1994, there was a military uprising in the South of Mexico. They were an Indigenous movement claiming for autonomy called Zapatismo. Before anything else, I need to explain what is called Zapatismo. This explanation will be short, but my intention is just to highlight some crucial moments and characteristics of the movement. There exists rich academic literature about this topic worth reading.

Geographic, social and political background of the uprising

Zapatismo emerged in a southern state of Mexico called Chiapas. Chiapas has always have a lot of tensioning relations all through it history. Chiapas is home of a lot of different Indigenous communities: Tzotzil, Tzetzal, Tojolabal, Lancerdon, Maya, just to name a few. Each community has its own culture, traditions and language, making Chiapas a cultural problematic state (Pérez Herrero, 2006).

At the beginning of the 90’s, Chiapas produced 1/5 parts of the oil of Mexico, ¼ of gas and ½ of all Mexico´s hydroelectric power. Chiapas was also the first producer of coffee and corn in Mexico (Pérez Herrero, 2006). But Chiapas was also the poorest state in Mexico: non-existent industry, no services, no communications, no educative activity, no drinking water, starvation, illiteracy and terrible hygiene conditions were normal at that time.

There were a lot of different reason that created a very complex and desperate situation that culminate with the military uprising. I will enlist the most important.

- Poverty and unequal income distribution had augmented
- Mexico’s government retired a lot of subsidies so a lot of agricultural workers of Chiapas were defenseless
- Mexico’s economic opening (culminated when NAFTA came into force in January 1, 1994) created a lot of tension between Chiapas’ different Indigenous communities
- Corruption was common in every level of the government
- The rise in the international prize of coffee forced the landowners to use communities’ lands to avoid financial loses
- There was an immigration from Central America due to guerrillas warfare that caused an overpopulation and not enough jobs opportunities
- Catholic church lost influence in the zone due to Evangelists and Protestants missionaries

All those factors created an explosive cocktail that ended in the military uprising in January 1, 1994.

The military uprising

What was needed was for someone to give a lesson in dignity, and this fell to the most ancient inhabitants of this country that is now called Mexico, but when they were here it did not had a name, that name. It fell to the lowest citizens of this country to raise their heads, with dignity. And this should be a lesson for all. We cannot let ourselves be treated this way, and we have to construct a better world, a world truly for everyone, and not only a few, as the current regime does. This is what we want. We do not want to monopolize the vanguard or say that we are the light, the only alternative, or stingily claim the qualification of revolutionary for one or another current. We say, look at what
happened. That is what we had to do. We have dignity, patriotism and we are demonstrating it. You should do the same, within your ideology, within your means, within your beliefs, and make your human condition count.

-Subcomandante Insurgente Marcos, San Cristóbal de las Casas, Chiapas, 1 January 1994 (Marcos 2002, 211-212)

The military uprising began with the capture of 3 towns by the Ejército Zapatista de Liberación Nacional (Zapatista National Liberation Army, EZLN), some skirmishes with the Mexican Army, extrajudicial executions and civilians murders by the Mexican Army. Some of this Indigenous insurgents have guns, but a lot more only had sticks. (Khasnabish, 2013)

The EZLN had been preparing everything for the uprising since 10 years before, so when they finally emerged, they stated they had emerged from 500 years of oppression, colonialism and imperialism.

The EZLN (formed by around 2,000 volunteers) confronted the Mexican Army (formed by 24,000 soldiers, far better equipped) for a few days and as a result between 200 and 1000 people were killed, thousands of wounded and about 60,000 peasants had to flee from their land (Pérez Herrero, 2006).

Even though the EZLN declared war on Mexico’s federal executive power and the Mexican Army, they did not intend a drastic or radical change in Mexico’s structure as a State. They just wanted to “smash a corrupt, violent, and illegitimate system so that Mexicans could freely and democratically govern themselves”. It is stated in Mexico’s Federal Constitution, in its 39th article that: “National sovereignty resides essential and originally in the People. Every public power arises from the People and it is established for the People’s own good. The People has in every moment the inalienable right to alter and to modify the government”.

The EZLN saw NAFTA as a mortal threat for Indigenous communities in Mexico, and of course has a fundamental rejection of neoliberal capitalism, but their claims were in terms of justice and dignity. All that they wanted was “work, land, roof, food, health care, education, independence, freedom, democracy, justice and peace”.

Along with the EZLN uprising, there were two major incidents that created a political turmoil. In March 1994, PRI presidential candidate, Luis Donaldo Colosio, was killed. The PRI secretary general José Francisco Ruiz Massieu was shot dead in September 1994.

These two assassinations created a deep crisis inside the PRI, the ruling political party. A lot of prominent PRI militants left the PRI and entered the left-winged party: Democratic Revolutionary Party (PRD, Partido de la Revolución Democrática in Spanish).

On the Economic side, there were some factors that contributed to the crisis. Despite having an alliance between the private sector elite and the government, the economic benefits had a very short duration.

The capital flow not only helped the economic growth and contained inflation, it also overvalued the peso. Raising the real price of the peso caused the exports to be more expensive and the imports cheaper, creating a loss making balance of trade. Moreover, the foreign investment were concentrated in the stock and money markets causing Mexico’s productive capacity not to grow and creating no employments. In addition, the limited growth was not shared evenly. According to Thacker (1999): “The Gini coefficient […] increased for Mexico from 0.46 in 1984 to 0.49 in 1989 and finally

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Khasnabish, Alex (2013). Tracing the Zapatista Rhizome, or, the Ethnography of a Transnationalized Political Imagination. In Juris, Jeffrey; Khasnabish, Alex (Eds.), Insurgent encounters. U.S.A.: Duke University Press. p.67


And an economic crisis too. Before Colosio’s assassination federal reserves were estimated in nearly $30 billion and they fall down to $5 billion after the assassination (De Long, Robinson 1996)

The Gini coefficient measures the income distribution being 0 perfect equality and 1 perfect inequality.
to 0.51 in 1994. The proportion of total income earned by the top 10 percent of households increased from 34.6 percent in 1984 to 38.97 in 1989 and to 41.24 percent in 1994. In addition to these unequal distribution, the political turmoil, especially after Colosio’s assassination, created a panic atmosphere among the investors. The situation was politically and economically out of control and the government was having a desperate situation in an election year. There was a capital flight and the government tried to stop it issuing “Tesobonos” which were dollar-indexed debt credits that provided the investors with protection. In order to avoid a devaluation, the central bank spent almost all of its international reserves (Springer and Molina in Thacker 1999). The situation was under control for just a few months.

On December 20, 1994, Ernesto Zedillo’s administration had to announce the peso devaluation. The peso lost more than half of its value, investors withdrew $13.9 billion and inflation raised to almost 52% (Thacker 1999). Panic reigned among the investors. In 1996, the United States, the International Monetary Fund and the Bank for International Settlements gave a lending pack to Mexico in order to recover from the crisis.

Conclusion

It is important to know the Mexican economic and political background in order to understand how the traditional alliance between the government and the private sector shifted from a protectionist economy to a free trade economy. Mexico’s protectionism was not viable anymore so in order to maintain political hegemony, the government decided to open the markets. But the economy was not prepared: Mexico did not have a developed industry nor infrastructure. Also the different alliance created political crisis.

The 1994 Mexico crisis and the Tequila Effect is said to be the first global crisis because it happened at a time when most of the international investors saw Latin America as a new promise land. Just as President Bill Clinton said in a hemispheric presidential summit in early December 1994: “The so called lost decade in Latin America is a fading memory” (Naím 1995). But all the euphoric atmosphere faded away on December 20, 1994 when the Mexican government announced the devaluation of the peso.

The Mexican crash created economic instability, affecting Latin America of course. There were a general fear that the next countries to face such a disastrous crisis were Argentina and Brazil. This created chaos around all the international investors. If Mexico that applied correctly the neoliberal reforms, even signed a free trade treaty with the United States, had a crisis, what will happen to rest of the region? This uncertainty after the Mexican crash is known as the Tequila Effect. The Tequila effect showed how the economies from different countries are more and more intertwined, creating more complex networks and interdependence.

From a domestic point of view, the 1994 crisis was the beginning of the end of an era, the PRI era. Political policies were intertwined with the government economic strategy. That is the reason why for the Mexican government was extremely important to create an alliance with the private sector elite: they needed support to change the country’s economy from a protectionist scheme to an open one.

Despite an economic short term success, the alliance with the private sector elite left out a lot of the traditional PRI supporters: medium-sized firms and labor unions. Not only were them unhappy with the way that the government faced the crisis; the middle class, the popular sector, the peasants and the urban poor showed their discontent. That discontentment was shown via elections: the PRI lost the hegemony it had had: in 1997 the PRI lost the majority in the Chamber of Deputies and in 2000 lost the Presidency.

9 From 3.4 pesos per dollar in September 1994 to almost 7 pesos per dollar in March 1995 (Bailey, Chan and Chung 2000)
10 The United States was the most interested party in this recovery plan because Mexico had just signed a free trade treatment with them. If one of his trade partners suffered a crisis, the United States would suffer the consequences too.
11 It should be taken into account the Latin American efforts, economic policies and economic reforms of the decade. Basically, Latin America relied on portfolio investments at the time thus creating economic instability (Naím 1995)