market economic system and open trade were crucial to solving Mexico's problems.

De la Madrid's policies closely matched the IMF's "structural adjustment" program. De la Madrid kept the peso's exchange rate low to promote exports and discourage imports, cut government spending, raised interest rates to control inflation, and held down wages. In 1986, Mexico took a major step toward opening its economy by joining the General Agreement on Tariffs and Trade (GATT). Membership in GATT required Mexico to lower its trade barriers and reinforced the country's commitment to free-market economic principles.

The economic reforms were generally supported by Mexico's business owners and members of the middle class. Many of them had lost confidence in their government after Lopez Portillo nationalized Mexico's banks and froze foreign currency accounts in 1982.

U.S. leaders also applauded the policies of the de la Madrid administration and lobbied on Mexico's behalf in international financial circles. In turn, the IMF and Mexico's other creditors gave Mexico more time to pay back its debt, granted the country new loans, and eventually forgave a portion of the overall debt. By the late 1980s, Mexico's debt crisis had eased.

What role did Carlos Salinas play in accelerating economic reform?

President Carlos Salinas accelerated the pace of economic reform when he came to power in 1988. With a doctorate in economics from Harvard University and experience as the minister of programming and budget under de la Madrid, Salinas was determined to lead Mexico into the global marketplace.

Salinas vigorously pursued the goals of privatization and free trade. He sold off many of the most prominent state-owned firms, including the country's telephone company, airlines, and a large steel mill. The number of companies under government control dropped from 1,555 in 1982 to 217 in 1992. More than $20 billion was raised in the privatization program, helping Salinas to eliminate Mexico's budget deficit.

Mexico's import tariffs, once among the world's highest, continued to fall under Salinas. From 1985 to 1992, the average tariff on Mexican consumer goods fell from 60 percent to less than 20 percent. Salinas' most dramatic move was to open negotiations with the United States in 1990 on forming a regional trade bloc.

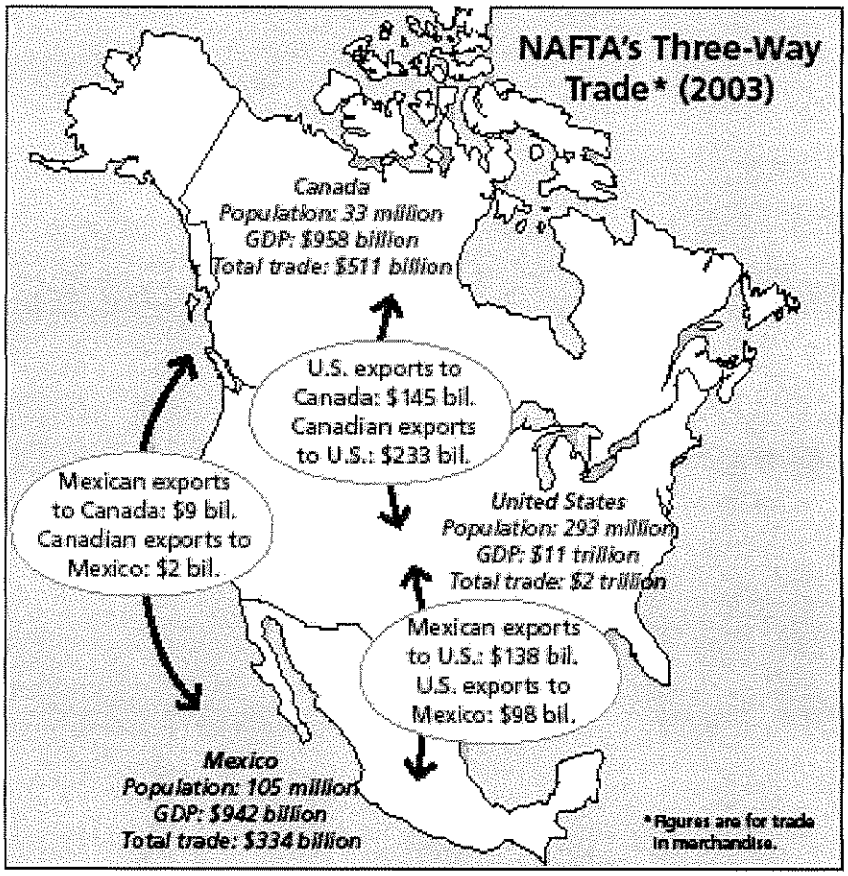
What role did Salinas hope NAFTA would play in the Mexican economy?

Years of Mexican-U.S. talks eventually produced the North American Free Trade Agreement (NAFTA), which took effect in 1994. NAFTA represented Salinas' crowning achievement. The Mexican president succeeded in linking his country to the United States and Canada to form the largest consumer market in the world. Before NAFTA, 14 percent of Mexico's exports to the United States were allowed to cross the border free of tariffs. With NAFTA's enactment, over two-thirds of Mexico's exports were permitted to enter tariff-free, and by 2009 all tariffs are scheduled to be lifted.

Equally important for Salinas was NAFTA's anticipated impact on Mexico's economic outlook. Salinas felt that NAFTA would make his economic reforms irreversible. According to his projections, millions of new jobs would be created as factories and farms increased exports to the North American market. The breakdown in trade barriers would spur modernization and innovation throughout the Mexican economy. Within a few years, Salinas believed, a solid majority of Mexicans would identify free trade with their own economic interests.

Why did NAFTA attract foreign investors to Mexico?

Internationally, Salinas' reforms made Mexico a hot spot for investors. Progress in the NAFTA negotiations, the United States' strong commitment to Mexico's transformation, and Salinas' success in lowering inflation



Source: Statistics Canada and The World Factbook.

and the budget deficit created the impression that Mexico was poised for an economic take-off. Many economists predicted that Mexico would follow the path toward prosperity set by the rapidly developing countries of East Asia or Chile.

From 1990 to 1993, Mexico attracted more foreign investment ($53 billion) than any other developing country. Mexico's exports boomed, thanks largely to growth in manufacturing. General Motors became Mexico's largest private employer, with forty plants and a work force of forty thousand. Oil, which had once been Mexico's main source of foreign revenue, accounted for less than one-fifth of the country's exports. After a prolonged economic slump, Mexico's economy grew at over 3 percent annually.

How did the increase in imports put pressure on the Mexican economy?

Even as Mexicans looked forward to a brighter future, signs of economic trouble began to surface. The lowering of trade barriers allowed Mexican consumers to go on a spending spree. From 1988 to 1994, imports rose about 25 percent annually, much faster than the increase in exports. By 1992, Mexico's trade deficit had widened to $20 billion. (The U.S. trade deficit that year totaled $84.5 billion.)

The trade deficit affirmed that Mexicans were not saving enough of their earnings to lay the groundwork for long-term economic growth. Foreign investment provided part of the answer to Mexico's need for capital. However, most of the foreign investment in the 1990s was placed in Mexico's surging stock and bond markets, where it could be quickly withdrawn. Only a small portion went toward direct investment in factories, farms, and other productive enterprises.

Even foreign investment in Mexico's manufacturing sector often produced disappointing results. The most notable examples were the more than two thousand assembly plants, or *maquiladoras,* in northern Mexico that put together electronic goods, auto parts, and other items for shipment across the U.S. border. Although the *maquiladora* belt accounted for a large share of Mexico's export growth and featured top U.S. and Japanese companies, the more than six hundred thousand Mexican workers employed there made on average only about $5 a day. Moreover, the *maquiladoras* did little to contribute to the growth of Mexican manufacturing. Less than 2 percent of the supplies consumed by the plants each year came from Mexican producers. Mexico's bureaucracy, banking system, and poor transportation network remained obstacles to new businesses.

Much of Salinas' privatization program also failed to address the need for long-term economic growth. In many cases, state-run monopolies were sold to private buyers with political connections. The buyer of Mexico's telephone company became one of the world's richest men largely because he faced no competition on international calls until 1997 and was able to charge customers high rates. Under Salinas, the number of billionaires in Mexico rose from two to twenty-four. Only the United States, Germany, and Japan were better represented than Mexico on a list of the world's wealthiest individuals in 1994.

Politics and Economics Collide

Through 1993 and much of 1994, praise for Mexico's economic reforms overshadowed warnings about underlying problems. At the international level, leaders in the United States and other developed nations contended that Mexico was safely on the road to free-market prosperity, democracy, and stability. President Bill Clinton's support for Salinas was critical to the ratification of NAFTA in the U.S. Congress in the fall of 1993. Clinton overcame fierce opposition to the agreement in the United States by claiming that the Mexican market offered tremendous opportunities for North American exporters.

In Mexico itself, the run-up to the 1994 presidential elections gave the Salinas administration reason to downplay economic problems. Salinas had come to office in 1988 in one of the most hard-fought elections in Mexican history. His main opponent had been Cuauhtemoc Cardenas, the son of the widely revered former president Lazaro Cardenas. Cardenas had left the PRI to form a new political party, charging that the PRI was turning its back on Mexico's poor. The enthusiasm Cardenas generated among voters had not been seen in Mexico since the days of his father. Officially, Salinas won the presidency with 49 percent of the vote to 30 percent for Cardenas. Evidence of massive fraud, however, convinced millions of Mexicans that the PRI had stolen the election.

How did Salinas hold onto power for the PRI?

Salinas was determined to help the PRI hold onto power in the 1994 elections. The situation, however, demanded that the PRI win fairly. NAFTA and economic reform had brought worldwide attention to Mexico. For the first time, international observers would be on hand to monitor the elections in 1994. The political landscape in Mexico had changed too. Opponents of the PRI were becoming increasingly outspoken and more likely to protest election fraud.

To maintain the PRI's appeal to the poor, especially in the countryside, Salinas spent more than $12 billion during his administration on self-help programs to raise living standards. Communities that had supported Cardenas in 1988 received top priority.

More significant was Salinas' fiscal policy. Mexico's rising trade deficit was worrisome to economic analysts both within Mexico and abroad. The gap between imports and exports suggested that the value of the peso was too high relative to the U.S. dollar. By 1994, foreign investment in Mexico had begun to slow, forcing Salinas to draw on his country's reserve of dollars and other foreign currencies to finance economic development.

Why did Salinas postpone devaluing the peso?

Salinas' training as an economist told him that the peso needed to be devalued to make Mexico's exports more competitive and to raise the price of imports. Salinas' political role, however, overruled economic logic. Salinas refused to devalue the peso in 1993 for fear that a rise in Mexican exports to the United States would lead the U.S. Congress to reject NAFTA. As the Mexican elections approached, Salinas believed that a strong peso was critical to the PRI's success. He was especially concerned with holding onto the support of Mexico's middle class, which had