

The Greek and Mexican Financial crises: The role of national and supranational actors

EDGAR J. SAUCEDO-ACOSTA* Y SAMANTHA RULLAN*

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This paper examines the similarities and differences between the Greek (2009-...) and the Mexican (1994-1995) crisis. Both of them had regional impacts, in Europe in the first case and in South America in the second case. After the crisis, important decisions that were taken changed the way economic policy is made in both countries. Measures taken to resolve the crises involved several key players, both at the national and the supranational level. In both crises, Greece and Mexico received a number of recommendations to be applied in their economic policies. The aim of this paper is to analyze the impact and role of national and supranational key players involved in the resolution of both crises.

Key words: Crisis, Greece, Mexico, economic governance, and key actors.

En este trabajo se examinarán las similitudes y diferencias entre las crisis económicas griega (2009 -) y mexicana (1994 - 1995). Ambas ocasionaron un impacto regional, en el primer caso, en Europa y en el segundo, en Sudamérica. Después de la crisis, las decisiones importantes que se tomaron cambiaron la forma de hacer política económica en ambos países. Las medidas que se tomaron para resolver las crisis involucraron varios actores clave tanto a nivel nacional como a nivel supranacional. Durante ambas crisis, Grecia y México recibieron una cantidad de recomendaciones para aplicar en sus políticas económicas. El propósito de este trabajo es analizar el impacto y el papel de los jugadores clave, nacionales y supranacionales, que actuaron en la solución de ambas crisis.

Palabras clave: Crisis, Grecia, México, gobernanza económica y actores clave.

* Universidad Veracruzana, Xalapa, México.

INTRODUCTION

Latin America is a well-acquainted region to economic, fiscal, and political crisis. Indeed, the region's public and private sector has a broad experience navigating through the different types of crisis at different times in history. Economic and political institutions have been subjected to economic shocks that have forced them to implement painful austerity measures and structural adjustments—in many cases encouraged by external actors such as multilateral organizations. Europe has a different history regarding economic crisis, especially after the introduction of the European Monetary Union (EMU) and the euro. The region generally enjoys economic and political stability with some exceptions. However, the Greek sovereign debt crisis has revealed the main weaknesses of the European system and institutions to effectively and swiftly respond to the challenge. The spillover effects of both crises in their respective regions are significant but a thorough analysis of their impact is beyond the scope of this paper.

In Mexico, on the day the North American Free Trade Agreement (NAFTA) came into force, the Chiapas conflict erupted with the declaration of the Zapatista Army of National Liberation. A few months later, with the assassination of Luis Donaldo Colosio Murrieta (presidential candidate for the Partido Revolucionario Institucional) on March 1994, and the murder, on September 1994, of José Francisco Ruíz Massieu (President of the Partido Revolucionario Institucional) investors reacted with fear to the political turmoil. In consequence, uncertainty increased and the stock exchange prices fell. In Greece, the Prime Minister at the time, Yorgos Papandreou, announced his government's decision, on October 2011, to hold a referendum for the acceptance of the terms of an EU bailout deal. The internal and external reaction to the announcement was immediate and generated panic in the markets and anger among its European partners forcing Papandreou's resignation. Subsequently, the Greek elections took place in the midst of austerity measures and were closely followed by national, international and supranational actors.

Also, international organizations such as the International Monetary Fund (IMF) intervened during both crises. Strategic partners such as the United States (U.S.) led the international efforts to support Mexico during the peso crisis. France and Germany played a different but no less important role in the Greek crisis. These countries actively participated in the search for a solution to the economic problems of their respective neighbors. Coordinated international and national efforts are necessary to successfully implement the required measures to help the country overcome the crisis. On the one hand, an ambiguous response from the key players may send a negative signal to the markets and can trigger negative consequences that might deepen the crisis. On the other hand,

suitable actions from national and international actors can contribute to reassure to the markets that the situation is under control and that a viable solution will soon be implemented, thus sending a positive signal.

There are many factors and players present in the Mexican (1994-1995) and Greek (2009-...) crises that had different effects. A comparison between both crises is relevant to understand the mechanisms that were setup in each case—the role of internal and external institutions and the outcomes. First, an overview of the Greek economic and financial crisis is presented, followed by a synopsis of the Mexican peso crisis. Then, the key players are identified and their role in the different crisis is briefly described to demonstrate their impact. Finally, the different concerning the problems these countries faced and the different solutions they employed are presented.

This paper concludes that both crises could have been foreseen if the appropriate institutions would have fulfilled their respective responsibilities and acted accordingly. The price to pay for lack of timely and effective response is too high. Speedy reaction, prompt intervention and appropriate means of communication with the markets are essential. More efficient economic governance is needed at all levels: regional, national, international, and supranational. Institutions play an important role and if they are provided with the necessary instruments, autonomy, and competence they can react and take the required measures to withstand any turbulence.

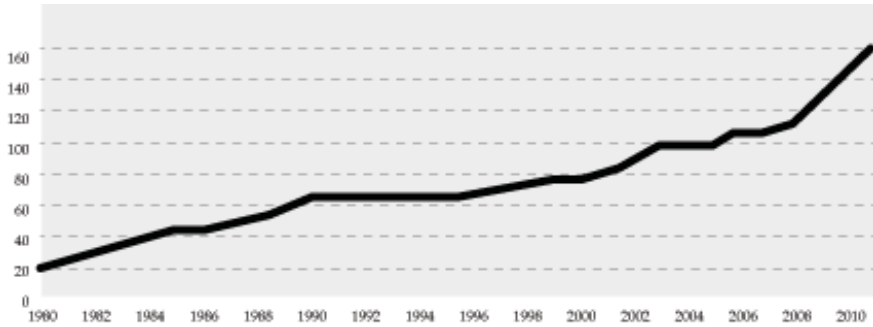
GREEK ECONOMIC AND FINANCIAL CRISIS

The current economic crisis is not only due to the financial crisis that began in the U.S., but also by the weakness of the Greek public finances. Greek governments have been increasing their debt since 1980, following an increase in government spending that was not offset by an increase in government revenue. Akram et al. (2011) show that a significant part of the Greek budget is military spending, which in most cases does not contribute to economic growth. With the accession of Greece to the Eurozone, government debt was stabilized (relative to Gross Domestic Product (GDP)). Figure 1 shows an increase in the Greek public debt (% GDP) from 1980 to the early 1990s, after the debt is stabilized in the nineties, while in the 2000s the debt increases again.

The Greek political system was weakened by the power of political parties and trade unions, so that the conditions were not generated in the 1980s and 1990s for structural reforms to be undertaken in order to have balanced public finances. Featherstone (2011) shows the weakness of the Greek public administration and the failure of the Greek government

before the crisis to take appropriate measures to increase the country's competitiveness, without incurring excessive deficits. Katsimi and Moutos (2010) point out that the weakness of the Greek public administration is due to the fact that Greek political parties were increasingly influential:

FIGURE 1. GREEK GOVERNMENT GENERAL NET DEBT (%GDP) 1980-2011



Source: Authors with data from the International Monetary Fund, World Economic Outlook Database, April 2012.

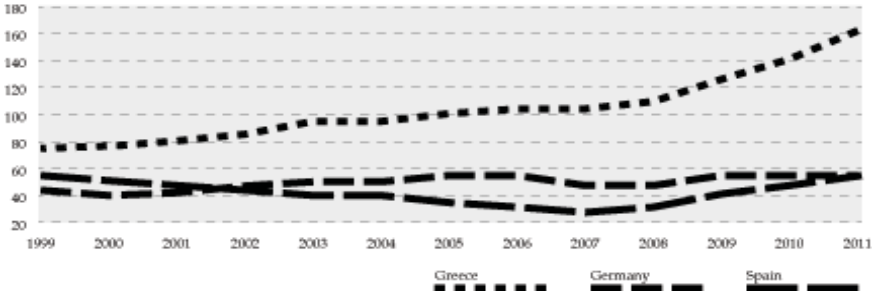
The capture of the public administration by the political parties was cemented by the fragmentation of the unions representing public-sector workers along party-political lines, and by their overwhelming influence on personnel choice and promotion to potentially lucrative posts. In effect, this meant that able civil servants had to “take sides” and “declare their allegiance” with a particular political party if they wanted to avoid being left behind in their careers or to avoid punishment for any unlawful acts they may commit. As a result, many civil servants used great discretion in applying the rule of law: “politically-connected” citizens received favorable treatment (Katsimi & Moutos 2010: p. 6).

As a result of the weak public administration, the budget was used for other purposes than those that would have contributed towards an efficient government, and that expenditure increased significantly, so that the public debt reached unmanageable levels. Kouretas and Vlamis (2010) identified three “key players” of the Greek crisis: First, the Greek government was weak to labor unions and political parties, which allowed the public debt to grow to unmanageable levels. Second, the credit agencies did not realize the weakness of Greek public finances in the years previous to the crisis, and when the crisis started, they overreacted. Third, the European Central Bank (ECB) and Eurozone authorities reacted too slowly.

Figure 2 shows a comparison of the public debt of Greece, Spain, and Germany since the euro was launched. Greece has had a public debt (% GDP) much higher than Germany and even Spain. Weak public finances

of Greece come from its entry to the Eurozone, but once inside the debt increased even more, showing that the Stability and Growth Pact (SGP) did not prevent Eurozone countries from overspending.

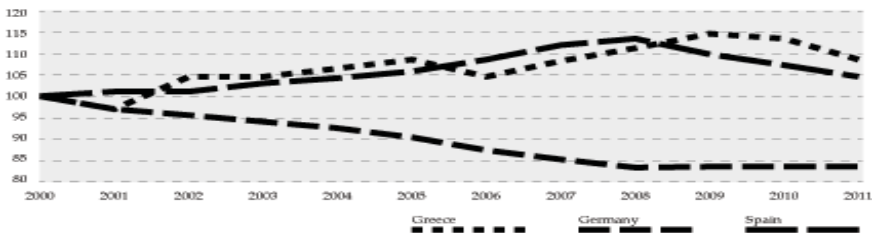
FIGURE 2. GENERAL GREEK, GERMAN AND SPANISH
GOVERNMENT NET DEBT (% GDP) 1990-2011



Source: Authors with data from the International Monetary Fund, World Economic Outlook Database, April 2012.

Once inside the Eurozone, the Greek government benefited from cheap credit, the same interest rate of Germany and France. This situation has arisen because international investors gave the same risk to bonds of member countries of the Eurozone (Akram et al., 2001). However, in terms of competitiveness, Greece is far from its partners. Featherstone (2011) shows that the Greek sovereign debt crisis is due to the failure of previous Greek governments to address the structural problems to the Greek economy. Figure 3 illustrates that while Germany has reduced its Unit Labor Costs (ULC) in the past decade, Greece and Spain have increased their ULC. Increased ULC has made Greece less competitive with respect to other European countries and the rest of the world. Greece was ranked 36th in the Global Competitiveness Index of the World Economic Forum in 2001, in 2012 it was ranked 96th.

FIGURE 3. NOMINAL UNIT LABOR COSTS IN GERMANY,
GREECE AND SPAIN: TOTAL ECONOMY



Source: Authors with data from AMECO, European Commission.

In 2008 the credit in the world declined, and in 2009 Europe showed problems related to the decrease in aggregate demand. The ECB as well as the Federal Reserve and other central banks injected liquidity in the world markets with the aim of reducing the decline in GDP. The risk premium of Greek government bonds was not high in the middle of 2009. On October 4, 2009, Yorgos Panandreu of PASOK (Panhellenic Socialist Movement) won the parliamentary elections and became Prime Minister by absolute majority; his party won 160 seats out of 300. A few days after, the Prime Minister announced that the government deficit in 2009 would be 12.7% and the public debt of 113.4%, above that estimated by the previous government. It was not the first time that the Greek government announced incorrect data, as it had already occurred when they entered the Eurozone.

Skilas and Galatsidas (2012) show that the current Greek crisis is not a result of the financial crisis that began in the U.S. in 2008, but neither is the mismanagement of economic policy of the right government of pre-crisis period (2004 -2009). The authors attribute the Greek crisis to poor macroeconomic policies taken by the governments of the past three decades, making the Greek economy weak and vulnerable. Based on the above, Greece should not have joined the Eurozone, because it did not meet the requirements set by the Maastricht criteria. Much of the economic crisis affecting Europe is due to the facility with which Greece joined the Eurozone, without having fulfilled the convergence criteria and then to have incurred in over-indebtedness. Lane (2012) points out that the problem of the Greek crisis is the set up of a European Monetary Union (Eurozone), with no Fiscal and Bank Union. Greece continued using its fiscal policy and shared a currency with countries with more stable public finances, generating incentives to over-borrowing in the international market.

The SGP did not help Greece to stabilize its public finances, because that country failed and was not punished, but quite the contrary; in the period 2003-2007 there was a great expansion of credit in Europe that affected Greece. Furthermore, the clause “no bailout” created uncertainty among the markets about whether the European Union (EU) would intervene during the lack of liquidity of the Greek government in early 2010. There is a problem of economic governance in the EU because it created incentives for countries to acquire debt, and then as the crisis deepened, markets interpreted that countries would not be easily rescued.

After the announcement of the Greek President in October 2009, Greece faced a steady increase in the price of its bonds, which caused the risk premium systematically increased in the following months. The credit rating agencies started to decrease the rating of Greek bonds, becoming regarded as “junk”. The maturity of Greek bonds was short term, so it created the conditions for the Greek government, which was nearly bankrupt. In this situation the Greek authorities requested a bailout to the EU and the IMF. The Greek government

required a low interest loan to pay the maturities of their bonds and got two bailouts, which temporarily decreased financial pressures.

In Greece there have been a series of reforms that included the reduction of public expenditure by reducing salaries, pensions, and subsidies. On the side of revenues both direct and indirect taxes have increased. These measures have led to a series of protests by trade unions and social organizations. Today, Greece is in the process of privatization of public enterprises that will generate additional revenue to the government.

With the increase in the risk premium on Greek bonds, European authorities were concerned mainly by the “contagion” to its European neighbors. The European authorities estimated again the public debt of Greece and it was higher, prompting more concern. There was a discussion about whether the EU could rescue their partners, because in the EU Treaty was forbidden to rescue European partners by European institutions in order to avoid moral hazard problems. Investors were left with the perception that the EU did not have a lender of last resort, so the price of the bonds in the secondary market rose in countries like Greece, Spain, Portugal, and Ireland. De Grauwe (2010) has pointed out that even if the Treaty forbids bailouts by European authorities, it does not forbid bailouts that may occur among partners. The European authorities (the Council of Ministers of the EU and the ECB) did not act in time (Featherstone, 2011), which generated more uncertainty among investors about whether Greece could be rescued or not. The first rescue was an IMF loan of €30 billion and €80 billion from the Eurozone members over a period of three years, on the condition that the Greek government had to undertake structural reforms in order to reduce its deficit and debt. The approval of the first rescue occurred in May 2010, while in July 2011 it was given a second bailout amounting to almost €110 billion, with contributions from the EU and the IMF; in addition €50 billion were voluntary contributions from banks. For the rescue of Greece, then for other countries, the European Financial Stability Fund (EFSF) was created and later became the European Stability Mechanism (ESM).

To sustain the austerity policies of the Greek government, conditioned by the bailouts, the troika was formed (the ECB, the IMF, and the European Commission) with the aim of monitoring the Greek austerity plan. The ECB bought Greek bonds on the secondary market to reduce pressure on the Greek risk premium. The “contagion” of the Greek crisis spread to Ireland and Spain, because their banking systems were rescued as well, while Portugal was rescued for the lack of liquidity for the payment of short-term bonds. Frankel (2011) mentions three mistakes of European authorities in the sovereign debt crisis: The first is having allowed Greece to enter the Eurozone, where Greece did not fulfill the Maastricht criteria; the second was to allow the interest rates gap between Germany and Greece which was virtually zero, when fundamental between those countries

were completely different; third, the European authorities should have advised Greece to be rescued by the IMF (in January 2010), due to the non-rescue of the EU Treaty in the market, it generated ambiguity about whether the EU would be able to rescue Greece, raising the risk premium. Katsimi and Moutos (2010) suggest that the GSP does not take into account the current account deficits of the member states of the Eurozone, which has a long-term impact on the public deficit and public debt. Furthermore, these authors note that while much of the Greek crisis is due to the Greek government, it was the design and operation of the Eurozone what led Greece further into debt.

The outlook for the Greek economy is not encouraging, because it is in a recession with a fall in GDP, which in the best case will grow but at a very low rate, because its potential output has fallen significantly. Moreover, the austerity measures implemented have had a negative impact on economic growth. One of the fundamental problems of the Greek economy is its low competitiveness, because their products are not competitive with those of its European neighbors. To improve the competitiveness of the Greek government requires the approval of structural reforms.

Elections in July of 2012 were won by Andonis Samaras (New Democracy), who is ruling with PASOK, after the administration by the government of former Prime Minister Lukas Papademos. The last three governments have had a series of general strikes, hampering governance, because on the one hand the government is seeking the confidence of international investors and the troika, through the implementation of the austerity plan; on the other hand, the implementation of the plan has generated much anger among the population because of the application of cutbacks. Thus, the current Greek government has to implement unpopular measures in times when the economy slows down and unemployment is at the highest levels in recent decades, which leaves very little room to the government.

De Grauwe (2011) shows that the formation of the monetary union in the EU generates an internal dynamic that fosters the crisis, because member states issue debt in a currency that is not their own, so that incentives are generated in markets to cause peripheral countries falling into insolvency. The author criticizes the ESM, because this mechanism will provide loans to high interest rates, which will increase the public deficit and risk premiums will rise. The underlying problem for Greece is that the EU has not solved its problems of economic governance, preventing that in the short and medium term financial crisis is resolved. Garcia and Ghezzi (2011) find that even after the bailouts and austerity plans in Greece, not entirely sure that this country can solve its public finances and competitiveness. The solution of the Greek problem is to foster a more competitive economy; otherwise the austerity plans will generate only a temporary improvement.

MEXICAN ECONOMIC AND FINANCIAL CRISIS

The Mexican economy in the 1980s had a low economic growth, because the Mexican government implemented measures to reduce public spending to pay the foreign debt to international lenders. In 1989 the debt was renegotiated and Mexico began to show signs of economic growth. Banks at the time were part of the state, because in 1982 the ex-president Lopez Portillo had nationalized the banks. According to Cypher (1996) the economic policies implemented in Mexico after 1982 were based on recommendations from the World Bank and IMF. These institutions played an important role in this period, because the Mexican government was renegotiating debt with creditors, and one of the conditions for the re-negotiation was that the government followed the approach of the World Bank and IMF to consolidate their public finances. According to Cypher (1996), the 1994 Mexican financial crisis has its origins in the free market policies implemented in Mexico from 1983 to 1994, specifically the liberalization of the banking system. In the period of ex-president Salinas de Gortari (1988-1994) several public enterprises were privatized, including banks, and started to liberalize the entry of foreign capital. Also it deregulated financial activity and continued the release trade coming from the period of ex-president De la Madrid (1982-1988).

The exchange rate regime in Mexico in the early nineties was crawling peg, that is to say, there was a band in which the peso was floating, and that the band was moving every day. Monetary policy was aimed at having the exchange rate within established levels. The real exchange rate of the peso was appreciating every day, because inflation in Mexico was higher than in the U. S. that resulted in deficit of current account. The goal of an overvalued exchange rate was to keep inflation low, because it went from double-digit inflation to single-digit inflation.

Once the government of Mexico renegotiated its debt in 1989, the international financing for the country began through bonds, denominated Treasury Certificates (CETES). While international reserves were high, international actors were confident that the Mexican government could maintain the exchange rate within the bands set. The Mexican economy was very vulnerable in late 1993, because it had overvalued exchange rates the financial sector was deregulated rapidly, generating an increase in unpaid debts to banks. The government sold more CETES at very short term (one month) and the buyers were mostly foreigners. In these conditions of vulnerability, the Mexican government entered into a tough year because it was scheduled to hold elections for President.

Gil-Díaz (1998) believes that one of the causes of the financial crisis of 1994 was the execution of the privatization of public enterprises and the deregulation of the banking sector in Mexico. In this sense, the

expropriation of the banking sector in 1982, and its subsequent privatization in 1991-1992, is the origin of the Mexican financial crisis. Deregulation of the banking sector was made quickly, without the necessary caution to avoid the increase in unpaid debts to banks. Structural conditions of vulnerability were given in late 1993 (Cypher, 1996), so that economic decisions taken by the Mexican government in 1994 were only the trigger. According to González-Hermosillo, Pazarbasioglu and Billins (1996), while macroeconomic factors explain the moment of the Mexican financial crisis, the fragility of the banking system in late 1993 was the determining factor in the crisis. In this sense, these authors agree with Cypher (1996), that the deregulation of the banking system was inadequate.

Griffith-Jones (1997) identifies three important causes of the Mexican financial crisis. First, in late 1993 Mexico had a high current account deficit that had been growing for several years. Second, it is attributed to a large part of the Mexican government bonds issued to foreigners with short-term maturities. Third, the Mexican peso was overvalued from three years before 1994. Another additional explanation is that monetary policy was not adequate (Whitt, 1996), because while the Federal Reserve was raising interest rates in 1994, the Bank of Mexico (Banxico) did not increase them, diminishing the interest rate gap, which generated incentives for investors to leave Mexico.

Mishkin (1999) points out that some factors that triggered the 1994 Mexican financial crisis had not affected the industrialized countries, because emerging countries are more vulnerable to this type of crisis. An exchange rate crisis is a decisive factor for a financial crisis in an emerging country like Mexico, while in an industrialized country like the U.S. this situation is unlikely to arise because the country has no problem supporting their currency (dollars). On the other hand, it is very common in emerging countries that governments sell short-term bonds, while industrialized countries sell long-term bonds. This situation contributes to the vulnerability of emerging countries, as Mexico in 1994.

For Musacchio (2012) there were two factors that triggered the Mexican financial crisis of 1994. First, the excessive enthusiasm of international investors in the Mexican economy was not supported in macroeconomic fundamentals, therefore, when investors lost confidence, there was an overreaction. Second, political events that occurred in 1994 generated mistrust among investors. At the beginning of 1994, several political events and foreign investors started to get nervous. The first was the launch of the Zapatista Army of National Liberation on January the 1st, 1994, coinciding with the entry into force of the North American Free Trade Agreement (NAFTA), while the second was the murder of the Institutional Revolutionary Party (PRI) presidential candidate, Luis Donaldo Colosio. Both events led to a considerable amount of capital leaving the country,

and international reserves decreased. The Mexican government created the Bonds Federal Treasury (TESOBONOS), bonds that were indexed in dollars, as a measure to give certainty to international investors against possible devaluation. In mid-1994, most of the Mexican government bonds were TESOBONOS and to a lesser extent in CETES also that the maturities of the bonds were short term.

On December 20, 1994, the Mexican government devalued the peso by 15%, which caused international reserves to reduce significantly, because investors pulled their dollars out of the country. Two days later, the Mexican government changed to a flexible exchange rate regime, because it no longer had sufficient reserves. Moreover, the banking system was already in trouble before the devaluation, because unpaid debts to the banks had grown considerably. However, banking system collapsed with the devaluation of the Mexican peso, because interest rates rose and many of the debts became unpayable. After the devaluation, the Mexican economy was in bankruptcy, because the Mexican government did not have enough dollars to pay the maturity of TESOBONOS also with the credit crunch, was predicted a fall in GDP in 1995 and inflation increased due to the exchange rate.

The Mexican crisis had regional effects, through a “contagion” in different markets (Calvo and Reinhart, 1996), called the “Tequila effect”, mainly in South America (Brazil and Argentina) and Asia (Philippines, Malaysia, and Thailand), through the stock market and the foreign exchange market and in some cases expanded to the real economy. Specifically in Argentina, the authorities had to take action to contain the “Tequila effect” due to the vulnerability of their exchange rate regime “Currency Board”. Frankel and Schmukler (1998) show how the Mexican crisis affected several countries, these authors conclude that countries least affected by the “Tequila effect” were those that had strong economic fundamentals, while countries like Philippines were more vulnerable because of their bad economic fundamentals.

The Mexican government requested a loan from the U.S. government, because they did not have enough dollars to pay its short-term debts in dollars. Finally, the support came from the Treasury Department of the U.S. (\$20 billion), the IMF (\$18 billion), the Bank for International Settlements (\$10 billion) and some other private banks, making a total of \$50 billion (Musacchio, 2012). The Mexican government used only \$13 billion, which paid before the agreed time. However, the rescue drew criticism, because many authorities (some European) considered that there could be a moral hazard (Musacchio, 2012).

In 1995, the Mexican government implemented a severe adjustment program consisting of public spending cuts, an increase in the rate of value added tax from 10% to 15%, and an increase in prices of public goods and

services. The result of the program and the crisis itself was that Mexican GDP fell 6.5% and inflation increased 50%, while the banking system collapsed and had to be rescued with public funds. Mexico switched to a flexible exchange rate combined with a central bank focused on inflation, later changed to the scheme of inflation targets. Years later, a law that restricted the Mexican government spending was approved because the budget deficit should have been zero. In the years following the devaluation, the Mexican GDP grew at rates of 5% due to an increase in Mexican exports to the U.S. However, after 2000 the Mexican economy had stagnated. Inflation has been controlled after 1995 due to the independence of Banxico, and the scheme of inflation targets reached levels close to those of the U.S. since 2003.

The government of Mexico bailed out its banking system through the Banking Fund for the Protection of Savings (FOBAPROA), and later that government sold the Mexican banks to international financial groups. Nowadays, only one Mexican bank remains and foreign investors own the rest. Moreover, given the experience of the crisis, the government began to regulate the banking system. In the current financial crisis, there were no bailouts in the Mexican Banking system, in part due to the experience gained from the Mexican crisis of 1994.

KEY PLAYERS IN BOTH CRISES

Important actors that had a bearing on the Mexican and Greek crisis can be identified. Their actions or indecisions have an impact on the markets. In a study that documented financial market responses to the unfolding Mexican peso, the results suggested that the equity markets responded positively to remedial actions taken by governmental authorities, especially to the Clinton bailout plan (Wilson et al, 2000). Key players can reassure or send an alarm signal to the markets. In the Greek crisis, the slow actions taken by the European institutions, the different points of view of the Member States concerning the bailouts, and the citizen's reaction to the austerity measures implemented by the Government sent a negative signal to their creditors. Governments and international institutions play an important role to prevent and curtail economic and fiscal crisis.

The North American response to the Mexican crisis: the U.S. and Canada

Mexico has a unique relationship with the United States: it is a big and important neighbor. The U.S. is Mexico's largest trading partner with close economic and demographical ties (i.e. Mexican immigrants in the U.S.). Their complex relationship stems from a shared history (i.e.

Texas Revolution, Mexican-American War, the Gadsen Purchase) and common challenges that have a bearing on their national and international agendas (i.e. illegal immigrants and drug trafficking, among others). The North American Free Trade Agreement (NAFTA) is perhaps the most comprehensive agreement that generated important ties between them and established mechanisms for trade disputes. One year after the agreement entered into force, the Mexican peso crisis broke out.

According to Truman (1996), the international financial community led by the U.S. authorities has assisted Mexico in various occasions since 1976. There is an economic synchronization between both countries and the Mexican exports are highly dependent on the U.S. internal market, but the effect is north south and not vice versa. In February 1994, the Federal Reserve increased the interest rate in the U.S., which had a negative effect in Mexico and exerted pressure in its interest rate. But the U.S. growth was a key factor to achieve the recovery of the Mexican economy.

A prompt and unique response to the Mexican crisis by the U.S. President William Clinton was followed by a proposal to support the Mexican currency (peso) with almost \$20 billion of US dollars from the US Exchange Stabilization Fund. In a study about Mexico's 1994 peso crisis, Wilson et al (2000) concluded that there was a strong positive market's reaction to remedial actions taken by Clinton.

Canada, Mexico, and the U.S. negotiated the North American Framework Agreement (NAFA); this agreement included a swap arrangement that involved the U.S. Treasury and Federal Reserve, the Bank of Canada and the Central Bank of Mexico (Pastor, 2001). This agreement had to be renewed every year and the amount totaled \$6.8 billion. The funds were insufficient when the Mexican crisis broke and the U.S. had to assemble a rescue package. In response to the crisis, the Canadian government fulfilled its obligations within NAFA, the Bank of Canada extended Mexico a \$1.5 billion line of credit.

The Mexican Institutions' response to the crisis

When the crisis erupted, the Mexican government acknowledged the situation and scope that required financial support and adjustment measures. The Mexican government negotiated an emergency financial package to avoid suspending payments. Several actors in the Mexican economic and financial system swiftly reacted with actions and measures to control and reduce the impact of the speculative attack against the currency and the loss of reserves. However, at the time, the Mexican bank regulator, the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) was underdeveloped. The Mexican financial market had been recently liberalized and the banking system lacked managerial

and financial strength. The ineffective monitoring and poor banking standards made it hard to calculate risks in the Mexican banking system. This weakness led to the inadequate supervision and regulation.

Banxico immediately intervened to protect the peso-dollar parity that resulted in a substantial loss of the Mexican international reserves. According to Ángeles-Castro (2010) they fell from 20 billion dollars to 5 billion dollars from January 1994 to 1995. The Mexican government announced an austerity program and the Mexican Congress approved a tax increase. Mexican authorities implemented a recovery program steadfastly and consistently that yielded good results and the country headed towards recovery.

The IMF response to the Mexican crisis

Generally, the loans from international financial institutions are awarded upon the agreement of certain terms and conditions. As mentioned before, after the 1982 debt crisis, the IMF, World Bank, and the U.S. Treasury Department encouraged the Mexican government to embark in a reform path accentuated by trade liberalization and privatization. Among the recommendations were fiscal policy discipline, tax reforms, trade liberalization, privatization of state-owned enterprises, and deregulation. Thus the Mexican banks, among others, were privatized.

The IMF responded to the Mexican peso crisis with assistance from the U.S. Treasury to protect foreign banks and financial institutions, and approved a stand-by credit of almost \$18 billion in support of Mexico's program. In the extensive economic reform package negotiated with the IMF, Mexico agreed to reduce government expenditures, increase interest rates and further privatize state-owned industries. The support by the IMF and the U.S. was crucial. At the time, there was a risk of systemic repercussions and the U.S., IMF and the Bank of International Settlements were in a position to provide financial assistance that was crucial to Mexico without delay.

The EU institutions and the troika

Member states had been reluctant to coordinate supervision and regulation of financial markets, until the Greek crisis. The failure of the EU institutions to identify, alert and act in the early stages of the crisis was in many ways disappointing. When the Greek crisis erupted, both the Council of the EU and the ECB failed to provide a suitable and efficient response. They had not anticipated a bailout for a Eurozone country and they were ill equipped to deal with the crisis. According to Featherstone (2011), the indecision and delay in the response by the Council of Economic

and Financial Affairs (Ecofin) and the European Council increased the cost of intervention (of the bailout loan for Greece and the rescue mechanism for the Eurozone) as the price to convince markets increased over time.

The initial response to the Greek crisis by the EU institutions and leaders of Member States was mainly based on the risk of moral hazard. Most of them believed that any debt relief would pose a moral hazard problem to other debtor Member States. There was an underlying risk that Eurozone countries would infringe the Stability and Growth Pact and expect their debts would be erased. The German Chancellor, Angela Merkel, was a staunch believer of this principle and on implementing severe austerity measures in Greece. Other leaders, such as the President of France, Francois Holland, contend that through growth the Greece economy would improve. Since then, the EU's position has interestingly shifted and the new proposal includes private creditors. Basically, the strategy consists in that all owners of Greek bonds should "voluntarily" accept a 50% reduction of their bonds.

The troika, composed by the European Commission (EC), the IMF and the European Central Bank (ECB) was invested with the responsibility of monitoring the economic adjustment program approved by the Greek parliament, the IMF, and the European leaders. The first rescue package was a response to the request made by Greece for official financial assistance. The second rescue package was necessary since the first one proved insufficient.

The Eurozone Member States, based on the decision of the Ecofin Council, created a temporary rescue mechanism, the European Financial Stability Facility (EFSF), in 2010. The aim was to preserve financial stability in Europe. In 2012, a permanent rescue mechanism, the European Stability Mechanism (ESM) entered into force and is the main instrument to finance new programs.

The Greek response to the crisis

The low credibility of the Greek government and the data they provide were important factors considered to assess the ability to borrow by the international financial markets. In a press release by Eurostat (2009) a reservation on reported data by Greece stated as follows: "Eurostat has expressed a reservation on the data reported by Greece due to significant uncertainties over the figures notified by the Greek statistical authorities". Plus the political turmoil and social unrest added stress to the severe economic problems. The Greek government requested financial assistance from European countries and the IMF, as well as, adopted important austerity measures, wide-ranging reforms to the healthcare and pension systems and public administration to confront the crisis.

From February 2010 to 2012, the Greek government implemented strict austerity packages. They included a freeze in government employees' salaries, cut in bonuses, cut in the salaries of private and public employees, a rise on VAT and tax petrol, among others. These measures have encountered strong opposition by Greek citizens.

In sum, if we compare the action and efforts of the United States (Clinton bailout plan) and international authorities (IMF) to resolve the Mexican crisis, in contrast with the response by the EU institutions and Member States Greek crisis, we find that the response by EU actors was far from forceful and the efforts lacked coordination among the most important players. As a result, the situation has aggravated and what initially was an economic crunch has developed into a larger problem that comprises political and social instability.

DIFFERENT PROBLEMS AND DIFFERENT SOLUTIONS

Crawling peg versus Monetary Union: different exchange rate regimes

Greece had entered the Eurosystem in 2001, while Mexico had a crawling peg exchange rate regime (1991-1994). In both cases, monetary policy was not independent, because while in the case of Greece it did not have its monetary policy when it entered to the EMU, monetary policy was run from Frankfurt. In the case of Mexico, its policy currency was anchored to maintain the exchange rate within the band. Although Mexico had more independence in managing its monetary policy, in practice the degrees of freedom of Banxico were subject to the demand for dollars in the market and the interest rate of the Federal Reserve. Both countries had, before the crisis, large current account deficits. In the case of Mexico, the deficit was due to the overvaluation of the peso against the dollar for several years. The value of the peso against the dollar did not reflect the fundamentals of the Mexican economy, that is to say, the inflation differential between Mexico and the U.S. did not correspond to the exchange rate of the currencies of both countries. In the case of Greece, the current account deficit was due to their low competitiveness with its trading partners, due to the increase of ULC.

In Mexico, former President Salinas had remained anchored monetary policy to the exchange rate in order to reduce inflation, due to previous experiences of Mexican crises, when there was a sharp devaluation; it was transferred immediately to inflation. When Greece entered the EMU it was searching price stability through a fixed exchange rate, because in previous years, devaluations had been transferred to prices.

TESOBONOS and Greek bonds

The markets did not anticipate the Mexican and Greek crises because months before the rating agencies did not provide sovereign debt ratings consistent with the credit risk of both countries. Moreover, at the time of the crisis, the markets overreacted causing the crisis to further exacerbate. In Mexico, the government tried to create certainty among investors through a fixed exchange rate policy, as well as in the years before the crisis held sufficient reserves to justify the choice of exchange rate regime. With the issuance of the TESOBONOS, the Mexican government reinforced certainty among investors. However, the fundamentals of the Mexican economy were not good, due to a very large deficit in the current account, the overvalued peso, and a very vulnerable banking system. In the Greek case, his entry into the EMU generated certainty, because the country shared the euro with countries with a very low risk, such as Germany. Years before the crisis, Greece had access to credit at very low interest rates that led to economic growth in the period 2003-2007. The Greek economy was poorly based, like the Mexican, it had an excessive deficit in the current account, a debt that was becoming increasingly unsustainable and a low level of competitiveness, but that fact was not shown by the rating agencies in their reports on sovereign debt risk.

In both crises, investors were buying debt denominated in currencies that countries could not be issued, in the case of Mexico the TESOBONOS were indexed in the U.S. dollar, and the euro for Greece. Neither could issue Banxico dollars nor the Central Bank of Greece could issue Euros, which made the issue of these bonds very risky; however, most of the debt was short term. The role played by rating agencies was critical because it somehow delayed the onset of both crises, making them deeper.

Bailouts

Bailouts occurred in both countries, where supranational actors were involved and conditioned the economic policies of Greece and Mexico in the years after the crisis. The IMF intervened in both cases, the Treasury Department of the U.S. in the case of Mexico, and the EFSF (which later became ESM) in the case of Greece, where capital contributions are headed by Germany (27%), France (20%), and Italy (18%), and other Eurozone countries contribute 35%. Governments involved in the bailouts were the U.S., in the case of Europe; Germany was the protagonist because it was the country that gave more money to the rescue and because there was internal resistance to rescue Greece. In the Mexican crisis, the Treasury Department and the IMF were responsible for ensuring that the Mexican government continued the austerity policies required, while in the case of

Greece, the troika has followed. The ECB also intervened by buying Greek sovereign debt on the secondary market.

Although both countries were rescued, the timing and shape were different. In the case of Mexico, the crisis began on December 22, 1994 and the rescue was granted by the U.S. on March 2, 1995, without going through the U.S. Congress, through a Stabilization Fund that had been created earlier, while in the case of Greece, the crisis began days after former Greek President Papandreou announced that the deficit would be higher than expected (mid October 2009) and the rescue occurred in early May 2010, after several meetings of heads of state and government of the Eurozone, which increased doubts on whether Greece would be rescued or not. The loan terms were different in both cases; the loan to the Mexican government was primarily through short-term swaps (exchanging dollars for pesos), which generated certainty among investors about the solvency of Mexico, while the loan to Greece was for a period of three years without possibility to exchange their national currency into euro. In both rescues there was criticism: in the case of Mexico, several U.S. congressmen who were previously against NAFTA agreed to the rescue, but the rescue did not have to go through the Congress, because the U.S. Congress had approved the Stabilization Fund since 1934. The case of Greece was different: the rescue was delayed a few months, by the refusal of some heads of state and government to grant the rescue, due to global financial crisis.

Different Solutions

The Mexican government took the decision to move from a fixed exchange rate regime to a flexible one in December 1994. The result was that in 1995 the peso depreciated by almost 100% against the dollar and inflation reached 50%, while Mexican GDP dropped 6.5%. However from 1996 to 2000, inflation declined, GDP increased and the overall economy recovered quickly without excessive deficits. In the case of Greece, after the fall of GDP in 2010, the economy has been worse, because unemployment has risen, while the economy has fallen back in 2011 and it appears will happen again in 2012 and 2013. The difference between the two economies is the use of the exchange rate, devaluation allowed at least temporarily to Mexico to be more competitive and the result was that exports to the U.S. increased, while in the case of Greece, this situation was not possible because it belongs to EMU which prevents the use of monetary and exchange rate policies (the option is internal devaluation through fiscal consolidation), so that competitiveness is achieved partly through reducing public wages, but the result has been an economic downturn.

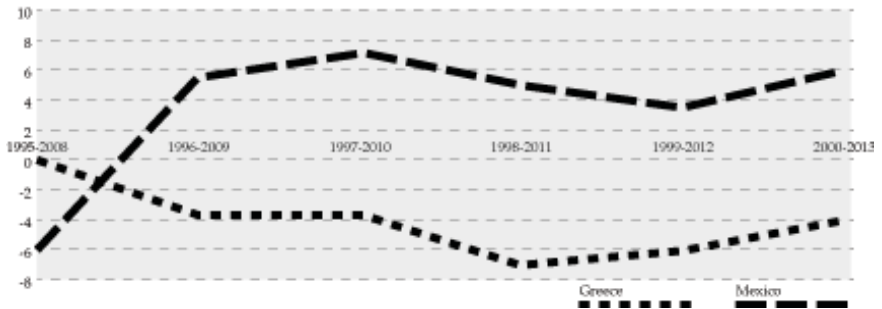
The Greek government imported the credibility of the ECB, while the Mexican government after the crisis was increasingly granting de facto

independence to Banxico and the result was that inflation has been close to 4% in the last almost 10 years. Regarding fiscal policy, the Mexican government has kept a low public deficit, thanks in part to the law which prevents excessive government deficit, while in the case of Greece, the pressures of the troika and the signing of the International Treaty of austerity have generated pressure for deficit reduction.

Using the exchange rate as a tool to grow in the short term should not be underestimated, because it allows an increase in exports that can generate economic growth. Obviously in the long term cannot be systematically used because it generates negative effects, but in the short term and in the middle of an economic crisis, devaluation could help economic recovery.

Figure 4 shows that the performance of the Mexican economy after the crisis was better than the Greek economy has had after 2008, but we have to consider that in that period 1995-2000 there was not a global crisis. The growth rates of the Greek economy have been negative since 2009 and forecasts for 2012 and 2013 remain negative, while the Mexican economy grew at 5% (average) in 1996-2000.

FIGURE 4. GDP GROWTH (%), 5 YEARS AFTER THE CRISIS, MÉXICO (1995) AND GREECE (2008)



Source: Authors with data from the International Monetary Fund, World Economic Outlook Database, October 2012.

For the Greek case, the option of using the exchange rate has not been raised by his government due to the costs that such action would bring. However, the current scenario is not the best, because it is in a recession. Furthermore, although the main mistake of the Greek crisis has been the mismanagement of public finances of the Greek government, poor European economic governance has deepened the crisis. The text is not suggesting that Greece must stop using the euro, but it rather states that there were three conditions that allowed a quick exit of the crisis of the Mexican economy: First, the quick and decisive support of the U.S. government that prevented the crisis from further deterioration. Second, the use of exchange rate policy as an element to gain competitiveness

that increased exports and generated economic growth. And third, a high global economic growth during 1995-2000.

Although the Mexican economy has not had a high economic growth after 2000, the deficit and public debt have remained stable, and that inflation remains around 4%. The keys to stability have been the law that does not allow an excessive government deficit and the autonomy granted to Banxico. Greece has to gain competitiveness through structural policies that make this economy more competitive, since it cannot use the exchange rate tool. Furthermore, it should generate better economic governance within the Eurozone to avoid the vulnerability that has been exposed to Greece, but at the same time should not create incentives for more bailouts. The International Treaty on Austerity that takes effect in 2013 will be an important element to improve the economic governance of the EMU, however it needs to be further advanced.

Many alternatives have been proposed to avoid another crisis such as the Greek, including greater political integration, the creation of European bonds, and the European Monetary Fund, but what we can extract from the Mexican crisis is that to exit a crisis of this magnitude it is necessary to grow, because focusing only in austerity does not solve the underlying problem.

FINAL REMARKS

As presented in this paper, there are many differences between the Mexican and the Greek crisis and solutions and the responses of national, international and supranational institutions are dissimilar. Both crises had not only economic but also political factors that had a negative impact on their economies, they also had, before the crisis, large current account deficits, and the risk of a spillover effect in their respective regions was justified. In the case of Mexico, the US-led action was swift and timely to avoid spillover effects and rescue an important trade partner. For Greece, the slow reaction of the EU supranational institutions hindered a prompt solution and amplified the costs associated with the crisis. It is important to highlight that in the case of Greece there was a global economic crisis, whereas during the Mexican crisis there was a high global economic growth.

Economic governance with suitable monitoring mechanisms is essential to prevent this type of crisis. Coordinated efforts should be taken and institutionalized at all levels (regional, national, international and supranational) to respond promptly in order to take remedial actions that may prevent and curtail any crisis. The EU and, especially, the Eurozone should strengthen and deepen their economic and monetary policies

taking into consideration lessons learned from this and other crises to pursue an effective strategy to prevent and manage crisis.

Considering the globalization process and technological advances, more research should be done on how the institutions can improve their communication skills to interact among them and with the international markets. Also, a study on the spillover or domino effects of the Greek crisis at all levels could yield proposals and measures that could limit the negative effects in other countries. An analysis of the economic interdependence of the European Member States and the future of the Euro should focus on solutions to advance the EU's Economic and Monetary Union and consolidate the European governance to avert threats and make the most of opportunities.

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