The routes to the autonomy:
The forging of the independent central bank in Mexico

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Abstract

The idea of autonomy for central banks has achieved such quality in contemporary life that it is almost taken for granted. Theory claims that autonomy helps to insulate central banks from the direct influence of elected officials and therefore isolates them from political cycles. Nevertheless, the theoretical foundations in which autonomous central banks have expanded have grown in a rather rigid way. Politics centred approaches are usually scarce and the role of political struggles in shaping central bank autonomy is often unseen. Then, this article tackles how institutions and political struggles affected the forging of an independent central bank in a single case study: Mexico. The narrative of this article illustrates the role of epistemic communities, international organisations, and political and economic actors during several reforms throughout the 1990s.

Introduction

The idea of autonomy for central banks has achieved an authority in contemporary life which is almost taken for granted. The creation of autonomous central banks appears as the most prominent example of the practice of delegation to non-majoritarian institutions. Most scholars claim that independent central banks provide a satisfactory protection from politicians' temptation to manipulate monetary policies for their own short-term gains (*i.e.* votes), disregarding the long-term cost that this decision might have (*i.e.* inflation). Politicians have therefore decided to give up control of monetary policy to provide more politically neutral policy solutions, answers that are not easy to accomplish in the context of partisan politics. Autonomy thus helps to insulate them from the direct influence of elected officials and keep them away from political cycles. These ideas have produced an increase in the autonomy of central banks over a wide swath of nations.

Central bank autonomy,[1] however, has been a constant theme since the Second World War, when a large number of countries started granting them more autonomy. Concerns about central bank autonomy reached new heights during the nineties.[2] As a result, there has been an increasing interest in these autonomous institutions, and a considerable—and growing—literature studying central banks, especially in advanced democracies. This literature is rather extensive.

Studies in developing countries, on the other hand, are rather scarce. It is usually taken for granted that the creation of autonomous central banks in developing countries occurred either as an adoption of standardised forms of economic governance after economic reforms or owing to the diffusion of organisational models. Technical approaches to delegation claim that the design of central banks, like other government agencies, occurs as a straightforward process where principal preferences are implemented by the relevant bureaucrats accordingly. Other explanations emphasised that international organisations, investors and epistemic

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[1] In the specialised literature, *autonomy* is sometimes preferred to the frequently used term *independence*, as autonomy entails operational freedom, while independence indicates lack of institutional constraints.

[2] Between 1990 and 1995, thirty-five countries legislated to increase the autonomy of their central banks, representing the highest rate in fifty years (Maxfield 1997). In Latin America alone, six countries contemplated new legislation to increase the autonomy of their central banks.

communities pressure governments to offer some guarantee of the apolitical operation of the monetary and exchange rates.

I devote myself to exploring a competing hypothesis. Political approaches are usually scarce and the role of political struggles in shaping central bank autonomy is often unseen. [3] This article thus stresses, through a careful case study, that the creation of autonomous central banks might be driven by political motivations, rather than for economic or technical reasons.

The case of Mexico provides a particularly good example for study in this regard. Scholars were quick to point out that the creation of the central bank was an action to show creditworthiness as a means to attracting and retaining capital during structural adjustment during the nineties. Nevertheless, the case of Mexico helps to prove that, even with apparent favourable conditions, the level of autonomy has to do more with political struggles than to impartial technical decisions.

The theoretical implications are vast and go beyond a case study. An analysis based upon this method offers a better grasp for the understanding of how regulatory agencies have acquired their current features, and anticipate how they are likely to evolve in the future. Secondly, the narrative of this chapter shows that the control of the process does not necessarily confer the control of the outcomes. Thirdly, it is possible to make some relatively secure predictions about the problems that will emerge in other countries that face similar circumstances.

The approach suggests a realistic way of thinking about the possibility of reform and illustrates that ambitious plans are always liable to be "frustrated by circumstances”, especially nowadays, that regulatory institutions have been put into a question. Both side of the Atlantic have undertaken a vast project to improve regulatory and finance governance. These projects have absorbed billions of dollars and the attention of thousands of reformers. Yet, some recent literature has recognised that both agency design and policy implementation is a complex, multi-directional, fragmented and unpredictable process that need innovative approaches (Odugbemi and Jacobson 2008; World Bank 2008). Then this approach then might help to improve regulatory governance in both first and third worlds.

The article is organised as follows: first, it reviews different approaches to central banks. Secondly, analyses the institutional and historical background to the creation of the central bank in Mexico. Thirdly, it will show how political motivations and political struggles between different bureaucratic coalitions have shaped the level of independence of the Mexican central bank. Fourthly, it highlights how struggles for the control of the monetary policy between opposite bureaucratic coalitions resulted in the 1994 peso crisis and a further reform for the central bank. The article concludes with final comments that summarise the theoretical implication of this case of study.

1. Approaches to central bank independence

Independent central banks have largely been associated with low inflation and an overall economic health. These ideas were confirmed by numerous quantitative studies that showed an inverse relationship between central banks’ independence

[3] Previously, none of the major studies consider such issues, especially for the developing world. Elgie (1998) and Emerson et al (1992) say that they do, but when scrutinised, no such data comes to light.

and inflation.[4] Complementary studies showed that economies with independent central banks were less prone to political cycles (Clark 2003; Clark and Hallerberg 2000; Clark, Reichert, Lomas and Parker 1998). Hence, scholars produced a large literature attempting to prove how some institutional characteristics, such as fragmented, multi-party systems or parliamentary factions, assist in the development of independent, autonomous banks (Alesina 1988; Alesina and Gatti 1995; Alesina and Summers 1993; Cukierman 1992; Cukierman, Webb and Neyapti 1992; Goodman 1991).

Nevertheless, recent studies found no evidence of political manipulation of monetary instruments leading to economic cycles of growth and unemployment (Alesina and Summers 1993). Haggard and Kaufman (1992) argue that, sometimes, these polities also facilitate the creation of blocking coalitions that obstruct the necessary consensus for policy stability and for the reform of independent institutions, such as central banks.

Aware of political differences among parties, another set of literature argues that, constant, unmanageable conflict will lead political actors to grant a central body autonomy to regulate the monetary policy under technical criteria (Alesina 1988; Alesina and Gatti 1995). However, this argument is not persuasive unless it tackles the question of how politicians, who differ ideologically engaging in a pre-electoral bargain, would agree to forgo their partisan objectives and install an independent central bank.

Similar studies established that, despite the empirical association between central bank independence and low inflation, there is no clear evidence of how autonomy affects other real outcomes, such as growth, deficits, and unemployment (Eijffinger and De Haan 1996). Indeed, some studies suggest that central bank autonomy may actually increase the short-term trade-off between output and inflation (Debelle and Fischer 1994; McNamara 2002; Walsh 1995).

Critiques of the duality of institutions in charge of the economic instruments are well known. The basic argument claims that the creation of central banks could lead to sub-optimal performance of the economy, as fiscal policy could act for anticipated monetary policy and vice versa. Co-ordination among instruments could become problematic as two powerful but disconnected players act upon different criteria. Some authors have used an illustrative analogy, for example, portraying this situation as a car with two drivers (Grieder 1987).

Alternatively, the quest for international credibility in the use of monetary policy for non-political reasons has been the main line of analysis for other sets of studies trying to find the sources for the creation of central banks (Downes and Vaez-Zadeh 1991). Autonomous central banks seem to allow politicians to create credible commitments and horizons for macroeconomic policy. According to this approach, politicians decide to create independent central banks because they attempt to signal creditworthiness and attract and retain capital (Maxfield 1990, 1993, 1997; Maxfield and Schneider 1997). Nevertheless, this approach assumes that international

[4] Early studies on central banks focused on the relationship between independence and economic performance. See, mainly, Barro and Gordon (1983a; 1983b), Cukierman (1992), Grilli, Masciandaro, *et al.* (1991), Kydland and Prescott (1977), Rogoff (1985), Wooley (1984). More recently, some studies have tried to confirm these assumption comparing not only developed countries but also emerging economies (Arnone, Laurens and Segalotto 2006) or questioned the idea that central banks' independence provides a reliable and universal remedy for all monetary ills (Kishor Kulkarni 2004; Sola and Whitehead 2006).

investors should be willing to invest in those countries using just the central bank independence as a guarantee, rather than investing in a country that offers a higher return after discounting the risk.[5]

In sum, evidence support the argument that central bank independence guarantees low inflation, more investment and, consequently, high growth is decidedly rather mixed.[6] Corroboration of the correlation between independence and low inflation and high growth is not significant, and it is blindly assumed that this is empirically proven. Economic studies have failed to prove the reasons behind the creation of independent central banks, as they are often based on certain benefits that are not necessarily tangible and subject to different interpretations. Other factors have come into place in the process of spreading out the benefit of central bank independence around the world

1.1 The proliferation of central banks

Two elements need to be considered in understanding the increase in the number of independent central around the world. First, central bank independence came into fashion in the early nineties. In that time, foreign portfolio investors dominated financial flows. Investors and global asset management companies, rather than politicians and finance ministers, became obsessed with credit ratings. Based on the apparent correlation among low inflation and independent central banks, investors started demanding for this kind of institutions, as a guarantee for their investments. Central banks played a key role in financial integration.

Secondly, epistemic communities encouraging these institutions have played a critical role. Proponents are often central bankers themselves. Economists and central bankers have propagated the idea that autonomous central banks are crucial to healthy economies (Maxfield 1997; Santiso 2004; Santiso 2003; Wood 2005). Two authors support this argument. Both Kishor Kulkarni (2004) and McNamara (2002) argue that governments opt for an independent central bank because it has important legitimising and symbolic properties which render it attractive. In some cases, politicians still maintain the basic legal prerogatives both to control monetary policy and to monitor the central bank action, according to politicians' preferences (Kishor Kulkarni 2004). although central bank independence ends up being empty in practice, politicians use this organisational form for symbolic purposes, (McNamara 2002: 60).

In addition, theories of institutional isomorphism (coercive and voluntary), or the copying of organisational models, provide an alternative sociological explanation for why people borrow models from other settings, even when materially inappropriate to local needs (McNamara 2002).[7] Put simply, the view that such delegation is rational, efficient and acceptable in a democratic society may owe more to power and ideational factors than to the functional requirements of economic management. Central bank independence is viewed by political, business, and most academic elites as a highly desirable and legitimate policy, which accounts for its spread as an organisational form.

[5] China is a good counter-example.

[6] Woolley (1994) has observed that autonomy measures do not provide data whether the 'independent' central banks ever actually act contrary to the wishes of the elected government –whether policy is ever different from what it otherwise would be because of the status of the central bank. In addition to the methodological limitations of the approach, numerous doubts have been raised about the accuracy of the data in the various studies, for example, by, Jenkins (1996) and Prast (1996). In a similar vein, Forder (1998; 1999; 2000a; 2000b) has highlighted that measures of central banks' independence provide no guidance for the assessment of central bank real performance.

[7] For different studies on isomorphism see Jordana (2003; 2002; 2004) and Levi-Faur (2003).

2. The Mexican case

With few exceptions, studies trying to identify the sources of central bank independence are scarce in the developing world.[8] Early studies initially tried to replicate methodologies to prove or dismiss the correlation between independence and low inflation. Other studies have analysed how independent central banks could have also been set up through normative or coercive processes of institutional isomorphism. The role of international organisations, such the OECD, the World bank and the IMF, have contributed to the spread of these institutions (Williamson and Haggard 1994). The role of these organisations in “suggesting” such institutions when negotiating loans is well documented (Naution and Griffith-Jones 1998; Santiso 2004; Santiso 2003; Williamson 1994; Wood 2005).

There are only two extended studies on the insulation of the Mexican central bank.[9] On the one hand, Boylan (2001; 2004) provides a comparative analysis of the creation of the central banks in Chile and Mexico. For the Mexican case, she argues that the electoral threat appeared as the main reason for politicians to grant autonomy to the central bank. Nevertheless, she fails in providing solid evidence that Mexican politicians were concerned about electoral turnover as the threat seemed inexistent at the moment of creation. She also fails to explain why, if politicians were concerned for the electoral threat, they decided to go just for a partial autonomy instead of a full autonomy; this would have helped the argument to remain logically sound.

On the other hand, Maxfield (1990; 1993; 1997) offers a useful introduction to the political economy of central banking in developing countries. Her central argument is based on two key analytical elements. First, she argues that politicians in developing countries want to remain in power –yet the longer they stay in power, the worse the balance of payments problem and the scarcer the investment in the country. Secondly, she claims that foreign investors demand proof that politicians will not use exchange rates and monetary policy for political purposes. Politicians will therefore create independent central banks in order to signal increased creditworthiness to potential foreign investors.

Although interesting, both arguments prove insufficient to explain the Mexican case, Boylan’s argument appears incomplete, omitting an analysis of the further evolution of the central bank. On the other hand, Maxfield’s arguments appear as necessary, but not sufficient. She does not explain why politicians decide to increase the independence of the central bank, as politicians will covet maintenance of the central bank under their control despite its formal independence. I developed next a competing politics-centred analysis.

2.1 The historic subordination of the central bank to the Ministry of Finance

The Mexican central bank—the Bank of Mexico or *Banco de Mexico*—came into existence in 1925, once the Mexican Revolution had finished and once order was re-established. The post-revolutionary government found itself close to bankruptcy, and the capitalistic structure of Mexico at that time was quite embryonic.

[8] Exceptions are Boylan (2001; 2004), Maxfield (1997) and Sola and Whitehead (2006).

[9] Both studies are comparative, rather than single, analyses and only examine the creation of the central bank in 1993, and not the further evolution of this story in 1997.

Mexico's leaders thus conceived a network of economic institutions was necessary for development (Krauze 1977). The economic structure for development was itself an objective of public policy (Glade and Anderson 1963). The central bank would play an essential role in it, especially through the relation with the banks and in providing credit for development.

Nevertheless, the Bank of Mexico (*Banco de Mexico*) played not only a typical role in the political system. The central bank was a mechanism designed to be reciprocally beneficial to the development of the economy, the achievement of the revolutionary reforms and the furtherance of political objectives. For instance, credit was one of many powers used by the government as political sanctions. [10] More broadly, the central bank would play the role of the basic creditor for the development plan for the incumbent governing coalition of the moment. As correctly stressed by Glade and Anderson (1963) the evolution of the Bank of Mexico corresponds not to any plan for economic development, but to the necessities of the political system

The history of the Mexican central bank shows the ways in which presidents and finance ministers shaped the central bank's capacities (Turrent Díaz 1982). Hence, the Bank of Mexico was reformed six times (1934, 1954, 1972, 1983, 1993 and 1997), each time being associated with the national and political priorities of the moment (Maxfield 1990, 1997; Turrent Díaz 1982). The central bank's function had to be adapted to the interests of the incumbent president or the finance minister in turn. They strengthened and weakened its capacities according to the political priorities of the moment. This shaped the relationship between the Ministry of Finance and the central bank.

Since the early fifties, the Ministry of Finance had consolidated itself as a multi-functional institution. [11] Most of the credit and monetary functions were the responsibility of the finance ministry, both by law and in practice. This guaranteed that the monetary policy would be under the control of the president and the finance minister, while also guaranteeing the flow of money to the government. [12] Control of revenues and expenditures could be translated into political power, inasmuch as the ministry had the faculty to facilitate or block any state agency actions. During the time of the *Desarrollo Estabilizador*, a period of remarkable growth known as the "Mexican miracle", the relationship between both bodies grew under compelled co-operation.[13]

On the institutional side, the model proved to be fruitful for both bodies, as it also helped to shape their respective authorities. On the one hand, the finance ministry could consolidate its enormous institutional and bureaucratic authority over the rest of the government as the body in charge of not only the country's finances, but also as the institution with control of the nation's economic destiny in relative independence, from the rest of the central government (Chávez 2001).[14] On the other

[10] A good analysis of the use of credit as a political mechanism can be found in Anderson (1968).

[11] The formal name of the Ministry of Finance is Ministry of Treasury and Public Credit (*Secretaría de Hacienda y Crédito Público*). It was responsible for finance, credit and monetary policies. For a critical analysis, see Cardenas (1994).

[12] The most comprehensive work on monetary policy is the Annual reports edited by the Bank of Mexico. See also Cavazos Lerma (1976) and Fernandez Hurtado (1976).

[13] A good recount of the *Desarrollo Estabilizador* model could be found at Ortiz Mena (Ortiz Mena 1970, 1998). A critical approach could be found in Cardenas (1996).

[14] Some authors, in their analysis of the fiscal and economic policy of Mexico, have also emphasized how the role of the central bank has fundamentally been subordinated to the finance ministry, and that the role of the central bank role of the central bank relied on the government being adequately financed (Brothers and Solís 1967; Cavazos Lerma 1976; Chávez 2001; Cortés Conde 2006; Fernández Hurtado 1976). For this reason, the Bank of Mexico never fulfilled the classic function of a central bank.

hand, given the technical character of its activities, the central bank developed a certain degree of independence in training its own personnel.[15] In many cases, the excellence of its personnel was used to breed up bureaucrats at the Ministry of Finance.[16] While tacitly accepted by both partners, this relationship was not totally assumed by the bureaucrats in the central bank. Officials in the central bank were, in a certain manner, seen as subordinate to those in the finance ministry (interview with former SHCP official, August 2005).

With the global financial crisis at the beginning of the seventies, it was necessary to fine-tune the workings of the central bank and consequently the role of the central bank, such that it was reformed again in 1972. The public disputes over the control of the economy during Lopez Portillo's presidency (1976 – 1982) had led the relationship between these two bodies to new heights.[17] Central bankers developed an idea that they need to constrain the incompetence of the rest of Mexico's State agencies (interview with former SHCP official, August 2005).[18]

In the same vein, the 1985 modification concentrated on "empowering the Ministry of Finance to respond flexibly under inflationary pressures and restricting the central bank to acting in accordance with the decision taken by the directives on credit and monetary policy indicated by the Minister of Finance" (Banco de México 1985 art. 2). This allowed President Miguel de la Madrid's government (1982 – 1988) to respond to the constant monetary shocks that characterised the 1980s. He appointed Miguel Mancera Aguayo, a renowned Yale-educated economist who was trained in the ranks of the central bank, as director of the Bank of Mexico.

With the 1985 reform, the central bank's role was severely constrained. The nationalisation of the banks in 1982, by leaving President Lopez Portillo, was not part of Miguel de la Madrid's strategy and it brought more problems than solutions. The administration of the banks was utilising many of its organisational resources and created more tension between both agencies. As a matter of fact, the director of the central bank, Miguel Mancera Aguayo, publicly agreed to restraining the role of the central bank in this matter, in order to focus on monetary policy.[19]

Roughly eight years after the Mexican banks were nationalised, Carlos Salinas (1988 – 1994) submitted to Congress on 2nd May, 1990 a constitutional amendment to re-privatise commercial banks as part of a broad program of privatisation of state-run enterprises.[20] The purpose of this privatisation program was more than merely fiscal;

[15] Although part of the same sector of government, central bankers and officials at the finance ministry presented different profiles and careers. In their analyses of the Mexican bureaucrats, Ballinas (1998, 2001) and Hernandez (1984, 1993) show that, although they present similar educational backgrounds, the patterns of the careers of the central bankers and the bureaucrats in the finance sector vary. Central bankers presented more stable careers, a lower turnover and longer careers than those in the finance ministry. The Ministry of Finance was accustomed to controlling the recruitment of its personnel. See also Centeno (1995).

[16] As was the case with Guillermo Ortiz, current governor of the central bank (2004 – 2010).

[17] For an analysis of this see Cordera and Tello (1981), and Tello (1980; 2005)

[18] It could be said that the central bank accumulated resentment towards the bureaucrats in the ministry (interview with a former Banxico official, September 2006). For an analysis of attitudes of Mexican bureaucrats towards politics and economic decision, see Morales Camarena (1994).

[19] Central bank autonomy was a powerful argument for diminishing the responsibilities of banking supervision. See Mancera Aguayo's speech at the IMF Conference on the role of the central bank (Volcker, Mancera and Godeaux 1990).

[20] As a matter of fact, privatisation started almost immediately after the nationalisation. In 1984, the de la Madrid administration began to sell off the brokerage houses, insurance companies, and other bank operations that did not take deposits or make loans.

it was also political.[21] With the privatisation of the banks in 1992, a fair equilibrium between the Ministry of Finance and the Bank of Mexico was also re-established.

3. Economic reforms and creditworthiness

For many scholars, credibility to economic reform seemed to play a critical role in the decision to create an independent central bank. The evidence displayed here suggests that other factors, mainly political, played a decisive role on the initial thinking behind the decision to create an autonomous central bank. I review this argument here.

The two priorities for Carlos Salinas' team in the macroeconomic arena have largely been documented as being the reduction of Mexico's foreign debt and reducing inflation (Aspe 1992, 1993; Salinas de Gortari 2001; Serra Puche 1992). Just between 1976 and 1982, the debt rose from US$19.6bn. to US$58.8bn (Gurría 1994: Appendix 1). To achieve the macroeconomic goal of stability, inflation had to be controlled. Having reached a high of 159 percent, it was still near 100 percent at the time Salinas took office (Strother 1992). The first set of actions in Salinas's term concentrated on facing both issues.

Salinas, from the beginning of his administration, decided to renegotiate the debt (Gurría 1994; Salinas de Gortari 2001: 15). Mexico managed to negotiate a flow of resources from the United States, the so called "Brady plan," and a couple of loans provided by the World Bank and the Inter-American Development Bank. By July 1989, Mexico had persuaded creditor banks to agree to a direct debt reduction of around US$7,000m., which meant a saving equivalent to 5% of the GDP (Gurría 1994).

Alongside these negotiations, inflation was contained through different "economic pacts" throughout Salinas's term. Cyclical devaluations and end-of-presidency devaluation, an event that had been "traditional" event since 1976, in Mexico made monetary policy a politically charged issue (Frieden 1991, 2006; Frieden, Pastor and Tomz 2000; Kessler 1998, 1999; Zedillo Ponce de Leon 2008). At the same time, the Ministry of Finance and the central bank focused on increasing the slope of the exchange rate flotation band, to avoid a sudden liberalisation. This would also avoid market shocks and would allow a consistent strategy over the presidential term, important in building up credibility on an international level.

Economists agreed that the North American Free Trade Agreement (NAFTA), signed in 1992 and came into force in 1994, would also stimulate investment in Mexico and would increase foreign financial inflows to Mexico providing a boost to the economy. The NAFTA was then complemented by the Foreign Investment Law, which aimed to provide security and assurances for long-term foreign investors.

Nevertheless, it was expected that there would be a flow of capital to emerging economies. During the late eighties and early nineties, a change in the composition of international financial resources occurred. Financing the world market no longer depended on commercial banks and international investor began looking for a higher return, as the interest rate in the United States was very low. Latin American thus

[21] Although it is beyond to the objectives of this thesis to analyse the reasons and consequences of the nationalisation of the banks, this also contextualises the process of creation of the central bank. For testimonies of the people involve see, Cardenas and Espinosa Rugarcia (2007) For a analysis of the privatisation of the bank, see Elizondo (1993), Mancera (1998) and Ortiz (1994).

became very attractive for investors, especially after successful macroeconomic reforms. According to the IMF, in 1992 alone investment increased from US$29bn. to US$123bn. (International Monetary Fund 1998).

For some analysts, the Mexican government needed to create a positive reputation in order to attract a flow of capital. An autonomous central bank would have helped to it. Nonetheless, credibility was not a major concern in Salinas's inner circle. In 1993, Mexico was accepted into the OECD, and the economic indicator of the Salinas *sexenio* showed that Mexico was not necessarily vulnerable to external economic pressures. Mexico's economy gained incredible prestige credibility with the international community (Gil Díaz and Carstens 1996, 1998).[22] The creation of the central bank was then no a priority. Yet an autonomous central bank was created.

Other approaches suggest that Mexican politicians were motivated primarily by the need to take out some sort of "institutional insurance" on their economic programme in the face of an uncertain future. For many analysts, the central bank was reconfirmed as a technocratic-financial nucleus, without social, legislative, or executive control, that could guarantee the continuity of liberal policies even if an opposition party arrived to the presidency.[23]

Nevertheless, this was not the case—after the mid-term elections in 1991, the *PRI* recovered a large majority in the House and the Senate, and electoral preference polls showed that the *PRI* could win the next presidential elections (see also Salinas de Gortari 2001).[24] In addition, in the opinion of some scholars, a transition to democracy was not yet underway in 1993 (Whitehead 1994). Moreover, electoral prospects may have been improved by tightening control of the monetary variables in 1994.[25] Creditworthiness was then not a concern for Mexican reformers.

4. The role of international organisations

The market, contrary to the liberal theory, it is not guided by an invisible hand, but by the unceasing interactions of economic actors. Behind the power of the market is hidden a multitude of actors, analysts, strategists, economists and portfolio managers, who constitute a veritable epistemic community with its own dynamic of opportunity and constraint. These actors decide the trends and the way things are done.

The logic behind the concept of epistemic communities and cognitive institutions is seductively simple. An epistemic community is a network of professionals with recognised expertise and competences in a particular domain, having an authoritative claim to policy-relevant knowledge within an issue area (Haas 1992).[26]

[22] Furthermore, a decade had passed before the central bank needed to cope with an estimated $17.7bn. worth of capital fled Mexican borders. This actually happened once the financial constituency benefited from the autonomy was already secured (Garrido 1993).

[23] Some analyst have even suggest that the reform team were creating an institutional shield, almost as though they were preparing for a disaster (Molinar Horcasitas 1993; Molinar Horcasitas and Weldon 2001).

[24] Cuauhtémoc Cardenas's (the potential PRD presidential candidate) popularity was rising, though he was still in second place in the polls (Crespo 1995; Domínguez and McCann 1996: 190)

[25] A key electoral claim was that the opposition could manage the economy, but PRI could not (Centeno 1996).

[26] Epistemic communities share a set of normative beliefs, which provides a value-based rationale for social action. They also share a causal belief, served for a similar analytical process, and a notion of validity internally defined and which could be subjective. Finally they also share common practices

With growing internationalisation, experts are coloured by the views of their colleagues at different levels. The role of epistemic communities is crucial in explaining international co-operation and institutions for development.

The roles of epistemic communities and international organisations in shaping economic policies in Mexico and Latin America has been widely analysed (Centeno 1994, 1996; Centeno and Maxfield 1992; Domínguez 1997; Haggard and Kaufman 1992; Haggard, Lee and Maxfield 1993; Haggard and Webb 1994; Naim 1995a, 1995b; Santiso 2004; Santiso 2003; Wood 2005). These studies have shown how Washington-based organisations, played a pivotal role at critical junctures, during the liberalisation processes of the 1980s and 1990s. International organisations provided information, advice and practical knowledge, as well as promoting best-practice institutions. These institutions served as arenas of interaction between 'experts' and 'decision makers,' who contributed to the dissemination of ideas. These institutions made a key contribution by formulating proposals, stimulating debates and, when academics entered the government arena, promoting implementation.

Mexican reformers were part of those epistemic communities. For instance, the members of Salinas's inner circle, comprising Pedro Aspe, Manuel Camacho, Jose Angel Gurria, Jaime Serra, Miguel Mancera Aguayo and Guillermo Ortiz, were educated in the educational centres that have traditionally provided the 'umbrella' under which various cognitive institutions operate. They worked and taught in the different think-tanks and research institutions that played a critical role in disseminating this paradigm in Mexico.

As a matter of fact, the rise to power of economically- trained technocrats produced strong repercussions throughout these epistemic communities. Actually, this phenomenon could be described as having had a double effect: the increased importance of economic problems stimulated an influx of very able new recruits, attracted by the extremely favourable career prospects associated with the possession of this economic expertise.[27] At the same time, the importance of these epistemic communities and cognitive institutions was extended when economists arrived in the top ranks of the government (Centeno 1994, 1996; Santiso 2004; Santiso 2003; Santiso and Whitehead 2006; Wood 2005).[28]

It is not surprising, then, that these communities played a pivotal role in suggesting the creation of an independent bank. It cannot be denied that the pressure of international forces and epistemic communities was influential. It is true that economic reforms were carefully attuned to the doctrines and suggestions of international economic forces, but assuming that governing coalitions accepted all the recommendations coming from these epistemic communities is taking the argument too far. Other analysts, like Kugelmas (2006), have also criticised the one-sidedness of some efforts to explain how international ideas shape domestic politics.

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associated with a set of problems. On the other hand, cognitive institutions are institutions with technical and policy-oriented capacities that serve as spaces of deliberation and arenas of interaction and articulation between members of the epistemic community and the policy-making process (Santiso and Whitehead 2006).

[27] Ballinas (1998; 2001) argues that the rise of the so-called technocrats followed different patterns and reason in different countries across Latin America. In some point the debate about of technocrats was mislead by the fact of the onset of economist to the presidency and cabinets in few countries.

[28] Whitehead (2000) claims that the role of epistemic communities shaping policies is not new in Latin America and not narrowed confined to economic forms of expertise. Particular type of expertise may therefore enjoy brief period of concentrated power. He claims that an apparent triumph of technocratic ideas may so often prove ephemeral.

Although part of these communities, the Mexican reformers did not implement all the policies they suggested, and those that were adopted were not implemented blindly.[29] Domestic actors had some discretion in the implementation of suggested policies as they face institutional restrictions and social opposition that might have made some reforms difficult to implement. Mexican officials showed, especially during the Salinas administration, sufficient political autonomy and independent capacity to generate their own counter-proposal, or to modify and adapt the suggestions of the international organisations and forces, even if this implied go against the desire of their own epistemic communities (MacLeod 2004; Teichman 1995, 2001).

During the Salinas term, different episodes generated tensions with both the international and also the domestic economic community.[30] Tension with international commercial banks would suggest that they would not follow the communities' suggestions indiscriminately. Then, it would thus be conceivable that the creation of the central bank's autonomy could merely have been designed purely for window-dressing purposes or cosmetic signal of credibility to the international community. Mexico could not have simply imported financial stability by creating an independent central bank. More importantly, no matter how committed and indoctrinated government officials are to market principles, politics comes first.

Two authors support this argument. Firstly, Dresser (1998) affirms that Salinas' administration presented two contrasting identities to the world. On the one hand, Salinas was rather successful with marketing Mexico's economic and political reform to external audiences and Washington's international bureaucracy. On the other hand, Salinas was skilful enough to use the instruments of the regime in seeking political support such as patronage, compensation of interest groups and discretionary intervention that would allow him to extend his political control over key policy decisions. In a complementary approach, Smith (1998) argues that the struggle over the control of monetary policy increased as the political and economic reform started to shatter the basic pillars of the regime. Consequently, the governing coalition around the Party and the bureaucratic groups started to fragment, to disperse and to act for their own political survival. Thirdly, the evidence showed latter proves that the first version of an independent central bank, was just partially insulated while the Ministry of Finance retained the most of the power. This is analysed next.

5. The political character of the 1993 reform

The Salinas administration, did not conceive the central bank reform as a key element in the economic reform (interview with former SHCP official, August 2005). Economically, the reform's objective was less one of establishing credibility than of legitimating the stabilisation program; [31] the autonomy of the central bank thus had to wait until the government had succeeded in attaining single-digit inflation and a budgetary surplus (interview with a former Banxico official, September 2006).

[29] Carlos Salinas and his cabinet have made public this in different published works (Aspe 1992, 1993; Gurría 1994; Ortiz 1994; Salinas de Gortari 2001).

[30] Tension with international commercial banks, the Paris club and the American government were not uncommon during Salinas's term. A description of this episode can be found on Salinas (2001), chapters 1 and 2.

[31] In his memoirs, Salinas stresses that the structural reform would need that the State would not help itself to unlimited financing from the central bank, as occurred before. "This was going to require one of the deepest reforms of my administration: to provide the central bank with autonomy through constitutional mandate" (Salinas de Gortari 2001: 449).

Furthermore, an autonomous central bank would only be possible once there had been fiscal reform.[32]

Prior to 1993, the Salinas reform group had no intention of granting autonomy to the central bank (interview with a former SHCP-Banxico official, January 2007). On the contrary, Salinas's economic team believed that control of monetary policy should be retained by the finance ministry for as long as was possible. An autonomous central bank would have limited the political control of key economic instruments at a sensitive point of the reform.

Two pieces of evidence support this argument. On the one hand, if Mexican reformers had wanted to create a totally independent central bank, they had all the political elements to concrete the reform, such as a highly prepared and motivated cabinet, the control of the House and the Senate and, more importantly, the support of the international community.

The Mexican reformers were careful in designing rules which afforded them some margin of manoeuvre as long as they remained in office.[33] Put simply, Salinas and his inner circle did not trust the central bank to be a co-operative actor once independence was granted. On the other hand, when conceiving conceding more independence to the central bank, the reform team faced the dilemma of granting the control of key economic instruments to a body that was not part of the cabinet or part of Salinas's inner circle. Therefore, the proposal to grant autonomy to the central bank came as a surprise.

When Salinas released the proposal in May of 1993, the idea of granting more autonomy to the central bank was presented as the most important monetary decision in decades, a permanent renunciation of the inflationary past and the crowning measure of a decade-long effort to control public finances (Ortiz 1994; Secretaría de Hacienda 1993). The 1993 proposal presented the central bank for first time in Mexican history as "an institution within the state with an autonomous character" (Banco de México 1993 Article 1). The proposal represented a "huge step towards equipping the central bank with more policy-making capabilities". On 18th May, the proposed central bank statute was readily approved by the House, with the symbolic modification of one word.

Despite the modification of the character of the central bank, the intention of the reform groups was to maintain control of monetary policy. This can be shown through further analysis of the faculties granted to the central bank. The 1993 reform was based on two main objectives. First, the new law granted the bank a legal mandate to achieve price stability above all else (Banco de México 1993 Article 1). This mandate was complemented by the legal duty of "facilitating the sound development of the financial system" (Banco de México 1993 Article 2). Although this brought the reformed Mexican central bank into line with practice around the world, it was not backed up by explicit rules to resolve disputes between the central bank and the executive branch that characterised other countries' laws governing central banks.

[32] Additionally, the driving force behind Salinas's economic programme upon his assumption of power in 1988 was a small nucleus of agents of holders of highly mobile capital drawn from the brokerage houses and newly privatised banks, the large export firms, and an ever deepening foreign capital base (Alba Vega 1993; Elizondo 1993; Garrido 1993, 1994; Mansell Carstens 1994). This "technocratic faction" enjoyed disproportionate formal influence in Mexico's peak business organisation, and they did not want to lose this unless absolutely necessary. Granting autonomy to the central bank would be a stepping-stone to ensuring that they did not (Gil Díaz and Carstens 1996, 1998).

[33] Especially considering the painful episode of the nationalisation of the banks in 1982 (Elizondo 1993; Garrido 1994; Heredia 2002; Teichman 1995, 2001; Valdés Ugalde 1994, 1996).

As a matter of fact, the finance ministry retained decisive control and voting power over a wide range of policies, including exchange-rate policy (Ballinas 2009; Boylan 2001, 2004). The central bank's ability to determine interest rates independently of executive branch policy was seriously and deliberately constrained.

The composition of the bank's governing board was also substantially changed. Under the 1985 statutes, the board had a cosmetic nature, being composed of officials from various government agencies and social sectors, who met on an irregular basis and could be removed from their indefinite appointments at the president's discretion. In contrast, under the new law, there were only six board members (called governors), appointed for fixed terms (six years), with staggered renewals, and congressional approval for both appointments and dismissals. More importantly, a governor could be removed on grounds of "grave fault" or for failing to comply with the decisions of the exchange rate commission (Banco de México 1990).

This is actually a weakly worded provision that limited enormously the independence of the central bank –the Ministry of Finance/president were still in charge of monetary policy. These clauses were intended to protect intervention of the central bank in the monetary policy (interview with a former Banxico official, September 2006). In many ways, the central bank was legally constrained to increasing its lending to the executive as *per* the reform team's will. But it was also legally constrained as regards appointments, removals and its two basic mandates (*cfr*. Banco de Mexico, 1990).

Miguel Mancera, president of the bank since 1982, was appointed as governor of the newly created *Banco de Mexico*. The rest of the vice-governors comprised a group of officials coming from the finance sector of central government, such as Francisco Gil Diaz (former Under-Secretary of Finance) and Guillermo Prieto (Chief of Regulation, National Banking Commission) or from the central bank itself, such as Marcos Yacaman (former Chief of Research), and Ariel Buira (Director of International Organisation).

The decision to include people from the finance ministry, even when the central bank was full of with personnel with proven capacity for the task, shows the intentions to control the decisions of the central bank. The possibility to remove the central governor for failing to comply with the decisions makes evident the political character of the reform.[34] Salinas's inner circle had serious intentions on maintaining policy influence over the central bank.

Given a sufficiently threatening political environment, it was quite easy for the Salinas group to use a partially autonomous central bank as a means to achieving its political ends, while preserving the control of the monetary policy (Dresser 1998). While the partial isolation strategy allowed the Ministry of Finance to maintain a "back-door influence" on the central bank, the latter sought to assert its independence by claiming the right to control monetary policy (interview with a former Banxico official, September 2006).

This was not entirely new in Mexico's history. Mexican presidents decided consistently to restrain the central bank and its directors' role *vis-à-vis* the finance minister and the president (Maxfield, 1998: 106). The central bank was in charge not of the monetary policy, but of supplying the necessary information to the finance ministry for decision-making; yet the central bank was granted a permanent, constant

[34] The last clause in article 43 states that the governor could be removed by failing to comply with the decision of the exchange commissions. The reason that this clause is unnumbered suggests that it was a decision taken without consultation with the people in the central bank.

structure and an extensive institutional supervising authority. Rather than create an independent central bank the reform wanted instead to return a fair equilibrium to the relationship between the Ministry of Finance and Banxico and amend some problem that came as a result of the 1982 nationalisation of banks. This new institutional arrangement bears direct relevance to how we interpret the dramatic events surrounding the peso crisis of 1994–95.

Although it is beyond the scope of the aims of this article to explain such a complex phenomenon as the 1994 peso crisis, it still can be illustrated how political struggles among bureaucratic groups for controlling the monetary policy contributed to this. The new legal provision empowered the bureaucrats at the central bank who grew a felling of protection of the monetary decisions from politicians in the central government (interview with a former SHCP-Banxico official, January 2007). The 1993 reform created an opportunity for central bankers to reclaim their exclusive authority over monetary policy. Therefore, during the whole electoral year of 1994, took this as par of their persona; agenda. On the other hand, bureaucrats at the finance ministry tried to maintain their authority over the monetary policy.

6. Declaration of Independence.

Even before the ink was dry on the new legislation that granted independence to the central bank, the political game put the newly created autonomous body to the test. The unceasing political instability that characterised the presidential election year of 1994 also fuelled economic chaos. The rise of the guerrilla *Zapatista*, together with a series of high-level political assassinations and an open battle with former President Salinas, impacted directly on the embryonic economic reforms and NAFTA. In that year alone, the country's foreign reserves plummeted—from almost US$30bn. in January to just over US$6bn. in December—making necessary a massive devaluation of the currency (Banco de Mexico, 1995).[35]

It could be argued that with the reform to the central bank an appropriate set of policies to preserve investor confidence were not undertaken as actor were struggling over the control of the monetary policy.[36] More importantly, a series of contradictory decisions, taken as a consequence of the lack of co-ordination between the different teams at both the newly created central bank and the finance ministry, resulted in unexpected, catastrophic consequences.

Contrary to any orthodox expectations, the new central bank decided to pursue an expansionist policy (Edwards and Naim 1997). Throughout the whole year, the central bank hesitated to raise the interest rate, fearing a weakening of the Mexican peso and the incipient banking system, instead of injecting large amounts of liquidity into the economy.[37] According to many decision-makers at that time, the decision was justifiable as a means of counteracting the drop in foreign reserves that took place after the guerrilla uprising and following the murder of the *PRI*'s presidential candidate in March (Gil Díaz and Carstens 1996, 1998). In the opinion of former

[35] According to the US International Trade Commission, Mexico direct investment rose to US$3,327bn. (US Trade Commission, 1997).

[36] An excellent book analysing a different aspect of the 1994 peso crisis is the one edited by Edwards and Naim (1997). See also Santiso (2003). A competing argument can be found in Gil Diaz and Carsten, (1996; 1998).

[37] Whereas the monetary base grew at an average nominal rate of 7.3% in 1993, this figure rose to 20.6% in 1994, representing an increase of more than 200%. At the same time, whereas interest rates rose from around 10% in February to 18% in March, they subsequently levelled off at this plateau until the December before the crisis (Banco de México 1994).

governors and deputy governors of the central bank, since “the government’s policy was one of maintaining exchange rate parity at all costs in the hope of riding out the storm, any rise in interest rates was deemed unacceptable” (Boylan 2001: 21; see also Gil Díaz and Carstens 1996).

Throughout 1994, the central bank and the Ministry of Finance publicly disagreed over monetary policy, and interest and exchange rates (Boylan 2001; Gil Díaz and Carstens 1996, 1998). These facts reflect an unintended consequence of the partial isolation strategy of the Salinas reform group. The finance ministry and the central bank also disagreed publicly over exchange rate policy at several points in the following years, again reflecting the unresolved battle over both the central bank’s ability to act independently of the executive and its control over monetary policy, a consequence of the central bank’s new status.

Whatever the reason and the causes, the net result was that the central bank failed to uphold a key element of its mandate: a pool of international reserves that could guarantee the stability of the currency above all else. The 1994 peso crisis posed a major challenge to the reputation of the recently created central bank. Below a certain level of crisis, the newfound autonomy of the Mexican central bank appeared to be meaningless and useless as regards the needed credibility. As a matter of fact, the partial autonomy of the bank in some way or another contributed to the crisis (Edwards and Naim 1997). The new institutional framework, once set, created two conflicting groups in the arena of monetary policy and interest rates.

Wanting to recover the credibility on the monetary policy, Ernesto Zedillo (1994 – 2000) granted Ortiz *carte blanche* to reform the central bank. After the Contrary to Salinas, the cabinet shake-up in late 1994 during the peso crisis, Zedillo appointed Guillermo Ortiz as Finance Minister after a brief stop in the Ministry of Communication. Coming from the ranks of the central bank, Ortiz had a completely different perspective about the scope of the autonomy of the bank. He more than anyone knew that the Salinas’ team had sacrificed central bank autonomy rather than relinquishing control to it over the interest rate and credit in the 1994 electoral year, hurting the bank’s reputation and creating a problem that would turn into a cause of the crisis (Dresser 1998; Sachs, Tornell and Velasco 1995). More importantly, it had provoked a critical situation when it failed to secure key elements of the bank’s mandate in the 1994 crisis, a mistake that Ortiz was determined to amend (interview with a former Banxico official, September 2006).

In the 1997 reform, with the blessing of the president, the monetary faculties were conferred completely to the central bank, together with a new legal status that granted total autonomy (Article 1). In this sense, the bank was not only in charge of monetary policy, but it also acquired the executive and legal faculties to do it. The staffing of the board was changed and the clause previously hanging over the president of the bank was removed. The head of the board was renamed as governor. Complementing the staffing capacities which limited the institutions from renovating its staff, a closed civil service within the central bank was created. All these amendments enhanced the previously merely imitated capacities of the central bank.

Final remarks

This article has covered several critical points for a better understanding of the process of creation of autonomous central banks in the developing world. First, this article showed how the mushrooming of central banks around the world has been strongly related to a reigniting paradigm disseminated both by epistemic communities and cognitive institutions. International organisations played a critical role in pushing this element forward in the reform agenda of different developing countries. In the case of Mexico, as with other Latin American countries undergoing profound reforms, economic policies were shaped hand-in-hand with the interaction of international forces. Nevertheless, this reform, endorsed by powerful epistemic communities, faced the discretion of domestic policymakers.

What is argued here is that the creation of the independent central bank in Mexico did not spring automatically from ideological or technical reasons, but rather from bureaucratic politics and the historical use of the central bank for political purposes. Incentives to create central banks in emerging markets might stem from the same basic forces as in established economies, but they are of considerably different character and magnitude, as political groups see institutional building as a way to gain more power and defeat rival political and bureaucratic groups.

The history of the Mexican central bank shows the ways in which the president shaped its capacities according to the development and political necessities of the moment. The 1993 reforms show how politicians wanted, on the one hand, to please all the international forces and the international communities they were also part of, while, on the other, maintaining some degree of control over central bank decisions. A set of contradictory and erratic decisions resulted in a gradualist approach that, under the new political and institutional scenario, faced the groups in the central bank and the finance ministry with regards to the control of monetary policy. As a consequence of the political events and the 1994 peso crisis, a new generation of reformer started a second stage of reform to the central bank. The current governor of the central bank took this as a personal crusade to provide the central bank with further autonomous character.

This article also showed how autonomy is a dynamic but still a political process. The idea of cumulative incremental reform, in which achievable initial measures generate more favourable conditions, is not necessarily a sign of successful reform. The evolution of the Mexican central bank was incremental, mainly driven by internal bureaucratic interests. This case showed how the creation of an independent central bank envisaged mounting distortion and rent-seeking along the way.

In sum, in a country where both the Ministry of Finance and the central bank were characterised for a symbiotic relationship—almost as identical twins—, the spirit of corps of the smaller brother thrived over the big one. This highlights the political character of autonomy that could trigger political conflict between bureaucratic groups who look to gain more power as a way of political survival.

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