To Insulate the Peso, Adopt a Watchdog With Teeth

Mexico: An independent federal reserve board might prevent the political tinkering that brings fiscal chaos

By Andrew Reding

Mexico’s peso crisis is but the surface eruption of chronic problems with deep political roots. The country’s excessive borrowing, the printing of money to pay debts and the drawing down of foreign reserves to artificially elevate the peso have all had one primary objective: maintaining the Institutional Revolutionary Party (PRI) in power. Which is why the only cure for the country’s economic ailment is to insulate its currency from partisan politics. There are two ways this can be achieved, both involving drastic change. Mexico can either follow Panama’s example of adopting the dollar as legal tender or relinquish one-party rule.

Though it has been the genius of Mexican authoritarianism to rely on elections for legitimacy, that strategy has placed excessive strain on the federal budget. To buy the votes of the poor, Mexican presidents have squandered public funds on politically motivated subsidies and grants. To buy peace with the middle class, successive administrations have sworn to defend the peso—and its ability to purchase imported goods—even if that meant draining the country’s dollar reserves.

This year, as partnership in the North American Free Trade Agreement subjected Mexico to unprecedented outside scrutiny, the old shell game collapsed. Outgoing President Carlos Salinas de Gortari was expected to do what many presidents have done for the sake of the party: clear the slate for his successor before inauguration day—in this case, by devaluing the peso—and take the blame. But Salinas, hoping to become the first president of the World Trade Organization, held off devaluation, forcing the problem on his successor. Unfortunately for President Ernesto Zedillo, this time the game is up.

That brings up the options, both of which involve depoliticizing the currency. The first option, relinquishing control to the U.S. Federal Reserve, is the only way to have a stable currency while maintaining one-party rule. Call this the Panamanian model. With the greenback as legal tender, Gen. Omar Torrijos and Gen. Manuel Noriega had no trouble sustaining the reign of the Revolutionary Democratic Party until U.S. troops intervened.
Mexico need not fear invasion; its principal concern is loss of national identity to a much larger and wealthier neighbor.

That concern could perhaps be alleviated by borrowing another Panamanian innovation. As a pecuniary fig leaf, Panama mints the balboa, which is pegged at par to the dollar and is available only in denominations suitable to purchases customarily paid in cash. Mexico could follow suit with, say, the juarez, named after the revered 19th Century president who bequeathed to Mexico a constitution modeled (in principle) on that of the United States. Mexico could even be offered a seat or two on the U.S. Federal Reserve Board.

Alternatively, Mexico could seek to insulate its currency from electoral politics by establishing its own federal reserve bank. That would not be easy. Since formation of the PRI in 1929, the country has never seen a truly independent agency in the federal government. Even today, with a much stronger opposition, the PRI holds, in addition to the presidency, 60% of the Chamber of Deputies, 74% of the Senate and 100% of the Supreme Court. This is the reality that led Zedillo to select a leader of the opposition National Action Party (PAN) to be attorney general, in the hope he would be independent enough to tackle corruption.

To have any chance of success, a Mexican federal reserve would have to be run by economic professionals whose careers and personal interests were not bound to government employment or relationships with the nominally private oligopolies that thrive on cozy government ties. To terminate the timely tips and handsome gratuities that are the stock in trade of Mexican business, Zedillo would have to again turn to the opposition in search of consensus on truly independent appointments, then hope that they are not corrupted by the temptations of office.

The success of such an initiative would hasten the end of one-party rule. The example of a genuinely independent federal reserve board would soon bring demands for comparably independent electoral commissions and labor boards. That would level the democratic playing field just when the PRI, stripped of its ability to manipulate the exchange rate to cover deficient economic policies, would have to face the judgment of the voters.

Andrew A. Reding directs the Americas Project of the World Policy Institute of the New School for Social Research.